



Accounts of the Public Services 2009

Central Government and Revenue

Report of the Comptroller and Auditor General
Volume 1

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

September 2010

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.

Tá leagan Gaeilge den tuarascáil seo ar fáil freisin A10/1219.

Report of the Comptroller and Auditor General on the Accounts of the Public Services – 2009

I am required under Article 33 of the Constitution to report to Dáil Éireann at stated periods as determined by law.

Pursuant to that constitutional provision, I am required under Section 3 of the Comptroller and Auditor General (Amendment) Act, 1993 to report to Dáil Éireann on my audit of the Appropriation Accounts of Departments and Offices and the Account 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 have certified each Appropriation Account for the year ended 31 December 2009 and submitted those accounts together with my audit certificates to Dáil Éireann.

Separately, I report on matters arising out of my audit of the accounts of the public services. My report which is in two volumes is set out beneath.

- Volume 1 deals with matters arising out of the audit of Central Government, Revenue and the National Debt.
- Volume 2 outlines some matters that arose out of the audit of funds charged to particular Appropriation Accounts.

I hereby present both volumes of my Report for the year ended 31 December 2009 in accordance with Section 3 of the aforementioned Act.

A handwritten signature in black ink, appearing to read 'John Buckley', with a stylized flourish at the end.

John Buckley
Comptroller and Auditor General

10 September 2010

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Chapter 1

Central Government Financial Outturn for 2009

Financial Outturn

1.1 Receipts into the Central Fund in 2009 totalled €34.8 billion. This represented an 18% decrease relative to the 2008 receipts of €42.5 billion, and a cumulative 29% decrease from 2007 receipts level.

1.2 Exchequer expenditure in 2009 was €59.4 billion, up 7.5% on the 2008 level. Expenditure related to servicing the national debt increased by 64%¹. The 2009 outturn also included

- exceptional expenditure of €4 billion used to provide equity in the State owned Anglo Irish Bank and
- an accelerated Exchequer contribution to the National Pension Reserve Fund in 2009, in effect an advance of €1.4 billion on the 2010 contribution².

1.3 Central Fund receipts and payments each year from 2007 to 2009 are summarised in Figure 1.

Figure 1 Central Fund Receipts and Payments, 2007 to 2009

	2007	2008	2009
	€m	€m	€m
Receipts			
Tax revenue	47,249	40,777	33,043
Other current revenues	638	847	838
Loan repayments	747	749	750
Other capital receipts	196	161	140
Total Exchequer receipts	48,830	42,534	34,771
Payments			
Issues for voted expenditure	44,609	49,313	47,163
Share capital acquired in Anglo Irish Bank	—	—	4,000
Service of National Debt	1,676	1,611	2,641
National Pensions Reserve Fund contribution	1,616	1,690	3,000
Contribution to EU Budget	1,572	1,587	1,486
Loans issued	740	741	790
Other payments	236	306	332
Total Exchequer payments	50,449	55,248	59,412
Deficit for the year	1,619	12,714	24,641

Source: Finance Accounts 2008 and 2009

¹ This represents the service cost excluding sinking fund payments.

² This was provided for under the Investment of the National Pension Reserve Fund and Miscellaneous Provisions Act 2009. See Chapter 4.

Comparative Performance

- 1.4 The State deficit increased by almost €2 billion in 2009. This increase is attributable to
- a decline in tax revenue of €7.7 billion (see Chapter 12)
 - an increase of €1 billion in the cost of debt servicing (see Chapter 2)
 - additional Exchequer payments totalling €5.4 billion to meet some of the costs of banking stabilisation measures (see Chapter 6).

The impact of these factors was partially offset by a reduced Exchequer outlay of €2.1 billion in respect of voted expenditure.

- 1.5 Overall Exchequer receipts in 2009 were €24.6 billion less than the expenditure incurred. This was substantially in excess of the deficit in 2008, which amounted to €12.7 billion.

Audit of Finance Accounts

The summary in Figure 1 is drawn from an account of the Exchequer — the Finance Accounts — that, *inter alia*, show the payments into and out of the Central Fund. The 2009 Finance Accounts have been audited by me and are due to be presented to Dáil Éireann by 30 September 2010.

Movement in Exchequer Balances

- 1.6 Because of a pre-funding policy, the Exchequer opened the year with surplus liquid resources of €1.8 billion. This liquidity buffer was retained through borrowing in the year equivalent to the 2009 deficit.

- 1.7 The movements in the Exchequer balances associated with the financial outturn are set out in Figure 2.

Figure 2 Movements in Exchequer Balances, 2007 to 2009^a

	2007	2008	2009
	€m	€m	€m
Exchequer balance at 1 January			
Central Bank Exchequer Account	3,587	3,996	21,269
Commercial deposits	—	490	790
Total opening balance	3,587	4,486	22,059
Movement in year			
Net Exchequer borrowing in year	2,518	30,287	24,397
Surplus/(deficit) of receipts over expenditure	(1,619)	(12,714)	(24,641)
Net movement	899	17,573	(244)
Exchequer balance at 31 December			
Central Bank Exchequer Account	3,996	21,269	21,025
Commercial deposits	490	790	790
Closing balance	4,486	22,059	21,815

Source: Finance Accounts 2008 and 2009

Note:

a Excludes small balances in the Capital Services Redemption Account: €842,000 (end 2007); €434,000 (end 2008) and €452,000 (end 2009).

Major Exchequer Liabilities and Assets

1.8 The State had certain long-term financial liabilities and assets at 31 December 2009 which are reported on in other chapters in this report. The summary position in relation to key liabilities and assets is outlined below.

National Debt

1.9 The gross National Debt at end December 2009 was €97 billion (at redeemable par values). Taking account of liquid assets of €21.8 billion (as outlined in Figure 2 above), the net National Debt at that date was €75.2 billion. This compares to a net National Debt amount of €50.4 billion at end December 2008. (See Chapter 2)

Financial Commitments Under PPP Contracts

1.10 Central Government departments and agencies have entered into long-term public private partnership (PPP) deals for the provision of a range of services and infrastructure. These include commitments to future payments over the lives of the contracts.

1.11 The total value of the future commitments to be met in respect of contracts in place at the end of 2009 is estimated at €4.1 billion (€4.27 billion at the end of 2008). Further PPP projects are in the course of development or procurement, but financial commitments in respect of these projects will not arise until they reach formal contract stage (See Chapter 5). Part of this commitment represents the rolled up cost of future operation and maintenance which in comparable projects or services effected through public provision is met on a 'pay as you go' basis.

Public Service Pension Liabilities

1.12 At end December 2009, a total of €16 billion had accrued in respect of occupational pensions payable to public servants. The total amount accrued at the end of 2008 was €108 billion. A critical factor in determining the present value of the projected future cash flows for pensions earned up to 31 December 2009 is the discount rate. Much of the increase is due to a change in that rate. (See Chapter 3)

Pension Reserves

1.13 The value of the National Pension Reserve Fund stood at €22.3 billion at end December 2009. This compares to a total of €16.1 billion at the end of 2008. The end 2009 balance was composed of discretionary investments with a market value of €15.3 billion, and directed investments totalling €7 billion. (See Chapter 4)

Major State Contingency

1.14 As outlined in Chapter 6, the State has guaranteed the liabilities of certain Irish credit institutions. The cumulative value of the bank liabilities guaranteed at the end of December 2009 was of the order of €281 billion³.

1.15 Income in the nature of premia from financial institutions for the guarantee by the State had amounted to €548 million by 31 December 2009.

³ Deposits (up to a maximum of €100,000 per depositor per institution) are covered separately by a Deposit Guarantee Scheme. At the end of December 2009, such deposits with the same credit institutions had a combined value of a further €77 billion.

Chapter 2

Central Government

National Debt

National Debt

2.1 The Net National Debt of Ireland at redeemable par values amounted to €75.2 billion at 31 December 2009. This liability is reported after taking account of liquid assets. Figure 3 sets out the composition of the National Debt in gross and net values over the past three years.

Figure 3 National Debt of Ireland 2007 – 2009^a

Year	2007	2008	2009
	€m	€m	€m
Gross National Debt	42,047	72,457	96,968
Liquid Assets	(4,487)	(22,059)	(21,816)
Net National Debt	37,560	50,398	75,152

Note:

a The National Debt is stated at redeemable par values (nominal values). The net present value of the Net National Debt at the end of 2009 was €78.4 billion (€52.5 billion at the end of 2008). The present value of the debt reflects the total of all future cash flows (both interest and principal) discounted using the appropriate market rates at the end of the year.

2.2 The Net National Debt increased by €24.7 billion between 2008 and 2009 of which €24.6 billion was applied towards funding the Exchequer deficit for the year⁴.

General Government Debt

2.3 In addition to borrowings reported in the financial statements of the National Treasury Management Agency (the Agency), further debt liabilities arise on foot of other borrowing activity. The relationship between the Gross National Debt and the General Government Debt⁵ (GGD) is set out in Figure 4.

Figure 4 Gross Government Debt 2007 – 2009

Year	2007	2008	2009
	€m	€m	€m
Gross National Debt	42,047	72,457	96,968
Other Debt Liabilities ^a	5,363	7,402	7,700
General Government Debt	47,410	79,859	104,668

Note:

a Other debt liabilities are derived mainly from the preliminary return to the EU made in March 2010 under the single currency rules.

⁴ The remaining €0.1 billion mainly relates to the effects of issuing bonds at a discount to the nominal value and foreign exchange rate movements.

⁵ The General Government Debt is the standardised measure of indebtedness of EU governments taking account of all liabilities included in the National Debt, without any offsetting of liquid assets, together with the liabilities of non-commercial State agencies and local authorities. In addition, it includes the build-up of accrued interest on certain government borrowings, in particular on the Government Savings Schemes.

2.4 Other Debt Liabilities comprise a range of borrowings by State bodies and local government, related assets, as well as financial obligations of the State. They are summarised in Figure 5 for the past three years.

Figure 5 Other Debt Liabilities^a 2007 – 2009

Year End	2007 €m	2008 €m	2009 €m
Non-commercial State Bodies (including Housing Finance Agency)	4,929	5,914	5,895
Intra Government Balances and Deposits	(2,840)	(3,116)	(2,084)
Post Office Bank Fund Deposits (excluding government bonds)	1,205	1,616	1,580
Local Government Debt (excluding debt due to central government)	564	613	754
Coinage	653	697	674
Accrued Interest on Savings Schemes	780	653	341
Westlink Buy-out	—	532	482
Adjustment to nominal value of debt ^a	23	489	55
Miscellaneous	49	4	3
Total	5,363	7,402	7,700

Source: Department of Finance and NTMA.

Note:

- a General Government Debt reported to the EU is stated at nominal values. Where certain debt, such as Commercial Paper, is issued at a discount to its nominal value the General Government Debt figures must be adjusted to the nominal value.

2.5 As a percentage of Gross Domestic Product (GDP)⁶ the General Government Debt (GGD) was 66% at the end of 2009. In addition to funding Exchequer deficits, the accumulation of liquid resources equivalent to 14% of GDP at 31 December 2009 contributed to the increase in debt over this period. The Agency continued to maintain the large liquidity buffer it built up in 2008 which amounted to €21.8 billion at the end of 2009 (€22 billion: 2008). These funds are placed mainly on deposit with the Central Bank.

⁶ The ratio of General Government Debt (GGD) to Gross Domestic Product (GDP) is a standard measure applied for the purposes of the single currency.

Borrowings by the Agency

2.6 Net borrowings⁷ by the Agency in 2009 amounted to €24.5 billion (€30.4 billion: 2008). These were raised mainly through the issue of medium/long-term debt by means of auction and syndication. The National Debt is composed of a variety of borrowing elements with differing maturity profiles. Figure 6 sets out the break down of the debt by its major component types.

Figure 6 Composition of the Gross National Debt (in nominal terms)

At End of	2008 €m	2009 €m	June 2010 €m
Government Bonds – maturity more than one year	41,863	70,858	84,747
Other Medium/Long-Term Debt – maturity more than one year	483	670	900
Short-Term Debt – maturity less than one year	21,783	16,261	7,932
Borrowings from the Minister for Finance ^a	2,605	1,783	2,160
Government Savings Schemes – maturity of up to 5½ years	5,723	7,396	8,785
Gross National Debt	72,457	96,968	104,524

Note:

a The main element of this borrowing relates to the Post Office Savings Bank Fund.

2.7 Most of the medium and long-term debt is borrowed in the form of government bonds which have differing maturities, the longest of which at the end of 2009 was fifteen years. Figure 7 compares the maturity profile of government bonds at the end of 2008, 2009 and at the end of June 2010.

Figure 7 Maturity Profile of Government Bonds

Duration	2008 €m	2009 €m	June 2010 €m
Under 5 years	15,931	25,687	26,849
5 to 10 years	11,857	29,296	32,009
Over 10 years	14,075	15,875	25,889
Total	41,863	70,858	84,747

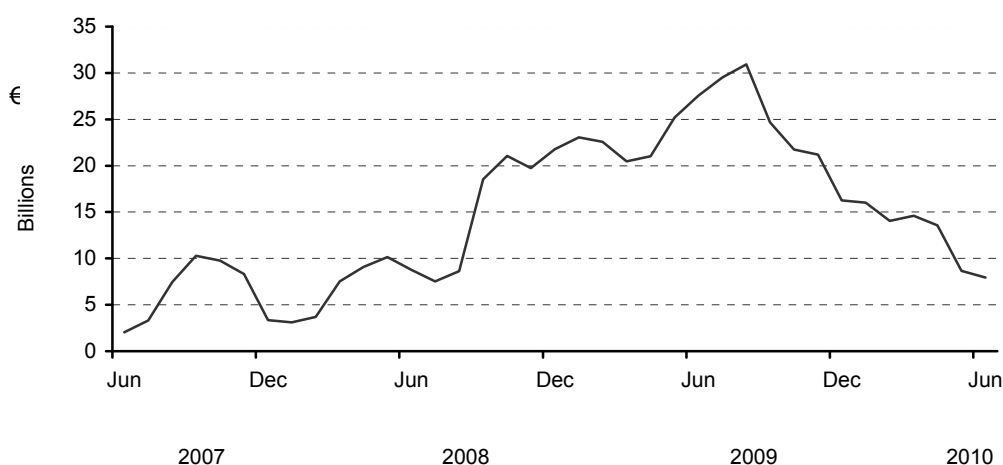
2.8 Short-term debt which is debt with a maturity of less than one year, is comprised mainly of borrowings under the Agency's European Commercial Paper Programme, as well as Treasury Bills and US Commercial Paper Programmes introduced in 2009. Figure 8 sets out the maturity profile of short-term debt.

⁷ Net borrowings represent the movement in the Gross National Debt.

Figure 8 Maturity Profile of Short-Term Debt

Duration	2008 €m	2009 €m	June 2010 €m
Less than one month	3,880	4,561	3,827
One to three months	5,518	8,628	2,548
Three to six months	5,803	2,913	716
Over six months	6,582	159	841
Total	21,783	16,261	7,932

2.9 Short-term borrowings had increased in the period since 2007 and had been mainly used to build up the liquidity buffer during 2008 and 2009. At the end of 2009 short-term debt accounted for 17% of the Gross National Debt compared with 30% at the end of 2008. This had dropped to 7.6% by mid-2010. By the end of 2009 borrowings raised through the issue of government bonds constituted part of the liquidity buffer of €21.8 billion. Figure 9 tracks the level of short-term funding included in the debt portfolio from mid-2007 to mid-2010.

Figure 9 Level of Short-Term Borrowings in the period 2007 to June 2010

Debt Service Costs

2.10 The debt service cost disclosed in the Agency's accounts for 2009 amounts to €3.2 billion (2008: €2.1 billion) when measured on a cash basis. However, this includes a transfer of €573 million (2008: €488 million) from current funds to a sinking fund to repay debt bringing the current servicing cost to €2.6 billion (2008: €1.6 billion).

2.11 Measurement of debt service costs on a cash basis masks the effect of servicing obligations which had accrued by year end but remained to be discharged. When the debt service cost is measured on an accruals basis⁸, the servicing cost for 2009 amounted to €3.2 billion (2008: €1.9

⁸ The accruals basis recognises the costs incurred rather than those paid and does not take account of sinking fund movements.

billion). The bond yield spreads⁹ on Irish debt compared to Germany, which had started to grow in recent times most significantly from September 2008 onwards, widened further in 2009. The increase of €1.3 billion in interest payable arises from a combination of the increase in borrowings in 2009 and from the increase in costs of issuing new debt. There was also an increase in fees on borrowings, which rose by €36 million due to an increase of €8 million in fees payable on saving schemes in line with the level of deposits in the schemes, and €28 million increase mainly relating to bond syndication fees due to the extra volume of issuance and higher fee rates.

Conclusion

The General Government Debt had increased to €104.7 billion at the end of 2009 with the Gross National Debt accounting for nearly €97 billion of that liability. When account is taken of €21.8 billion in liquid assets which was held as a liquidity buffer for the Exchequer, the Net National Debt amounted to €75.2 billion at 31 December 2009.

The increase of €24.5 billion in the Gross National Debt in 2009 was mainly due to the funding of the Exchequer deficit for 2009.

In the 18 months to June 2010 the structure of the debt, in terms of duration, has altered significantly. The proportion of the Gross National Debt made up of short-term borrowings had decreased from 30% at the end of 2008 to 7.6% at the end of June 2010.

Debt service costs when measured on an accruals basis increased by €1.3 billion in 2009 (or 68%).

⁹ Yield spread is the difference between the quoted rate of return on different investments.

Chapter 3

Central Government

Public Service Pensions

Public Service Pensions

3.1 Special Report 68 – Public Service Pensions¹⁰ put the accrued liability for public service pensions at an estimated €108 billion as at 31 December 2008. This cost related to occupational pension schemes only and did not take into account the net cost of State pensions which for persons who joined the public service after 6 April 1995 are integrated with their occupational entitlements.

3.2 In February 2009, the Government introduced a pension-related deduction (PRD) for staff in the public service under the Financial Emergency Measures in the Public Interest Act 2009. While the PRD does not affect the value of the liabilities for pensions that has already accrued because since those liabilities are based on service to date and the PRD is not a pension contribution for purposes of the Pensions Act 1990 – it has, however, been taken into account for the purpose of this report in estimating the annual cost of future pensions.

Chapter Focus

This chapter updates the financial liability that has accrued for public service pensions to 31 December 2009. It also makes an estimate of the additional accrued cost of the State pension.

While the liability for State pension could be regarded as accruing to all pensioners as a result of general social welfare entitlements, it is presented here in order to give as complete an estimate as possible of the extent of future funding that will be necessary in respect of those citizens that are in public employment.

In addition, the chapter outlines the impact on the Exchequer pay bill of the pension-related deduction for public servants introduced in 2009.

3.3 The methodology for this examination was broadly in line with that employed for Special Report 68. Annex A sets out the key underlying methodologies and assumptions. The report is based on the results of a pension consultant's analysis.

Accrued Liability for Pensions

3.4 Before taking account of the liability that has accrued in respect of State pensions for those public servants whose occupational and State pensions are integrated, the accrued liability for occupational pensions of public servants was of the order of €16 billion at the end of 2009.

3.5 Figure 10 sets out the present value of expected future pension payments to public service staff and their dependents in respect of service to date, along with an estimate of the present value of future payments to current pensioners and their dependents and to former employees with preserved pensions. The aggregate pension payments arising from the liabilities will be spread over 60 or more years into the future.

¹⁰ The report was presented to Dáil Éireann on 22 October 2009.

Figure 10 Accrued Occupational Pension Liabilities at 31 December 2009

Sector	Gross Liability
	€m
Civil Service	14,257
Health	24,352
Gardaí	8,954
Prison Officers	1,323
Defence Forces	8,895
Teachers ^a	30,923
Vocational Education Committees and Institutes of Technology	6,691
Universities	5,281
Non Commercial State Sponsored Bodies	7,605
Constitutional, Ministerial and Judicial Office-Holders	769
Local Authorities ^b	7,387
Total Liability	116,438

Notes:

- a Includes primary teachers, post-primary teachers, special needs assistants and non-teaching staff in schools.
- b The estimate for local authorities was a limited exercise based on relativities derived from the Report of the Commission on Public Service Pensions (2000).

3.6 State-owned assets are available to offset the total pension liability shown in Figure 10. One-third of the value of the National Pension Reserve Fund (NPRF) has been notionally allocated towards the cost of Public Service pensions and two-thirds towards the cost of the State pension. Taking account of the value of the NPRF (€22.3 billion at 31 December 2009) and the subsequent transfer of €1.07 billion in assets of pension schemes¹¹ to it in the course of 2010 the net occupational pensions liability may be of the order of €108.6 billion at the end of 2009.

3.7 The gross accrued liability has increased by 7.4%. The main items that have increased the accrued liability over the 2008 estimate include

- The change in the discount rate assumption from 3.3% to 3.0%¹² increased the liability by 5.4%.
- The reduction in the number of serving staff and the increase in the number of pensioners since 31 December 2008 resulted in a 3.8% higher liability. Staff and pensioner numbers are shown in Annex B.
- The impact of pay cuts for active members has reduced the accrued liability by 1.8%.

¹¹ €88 million remain in these schemes to be used to defray gross pension costs in the State bodies to which they relate.

¹² The lower the discount rate, the higher will be the present value of future entitlements.

Impact of State Pension on Liabilities and Costs

3.8 The integration of post April 1995 State pensions with occupational pensions needs to be taken into account in estimating overall State liabilities and costs for citizens employed in the public service. The total financial entitlements of public service pensioners do not change due to integration so that the same overall level of financial benefit accrues to recipients of integrated and pre-integrated pensions. However, as more staff are recruited under integrated arrangements the proportion of the total entitlement accounted for by pure occupational pension diminishes and there is a correspondingly greater cost of the State pension¹³ element.

Impact of State Pension

3.9 It is estimated that, in addition to the State's liability for occupational pensions, there would be a further liability in the order of 11% of the accrued value of occupational liabilities at 31 December 2009 were the impact of the State pension to be taken into account.

3.10 It is estimated that the accrued liability in respect of State pension arising from the entitlements of public servants who pay full rate PRSI was €12.7 billion at 31 December 2009. (€11.8 billion at 31 December 2008). The present value of pension liabilities at 31 December 2009, taking account of both occupational and State pension elements is outlined in Figure 11.

Figure 11 Present Value of all Pension Liabilities at 31 December 2009

	€ billion
Occupational Pension Entitlements	116.4
State Pension	12.7
Accrued Pension Entitlements of State Employees^a	129.1

Note:

a This is stated gross and does not take account of any contribution from the NPRF.

Annual Pension Costs

3.11 The ongoing annual costs of pensions can be represented using two measures

- the cost of one year's additional service – which is the change in the accrued liability for active members expressed as a percentage of pensionable remuneration
- the effective contribution rate for a new entrant starting after 1 April 2004.

3.12 Both measures are useful but answer two different questions. The cost of one year's additional service is largely an accounting representation of the extra pension earned in any one year expressed as a percentage of pay. It answers the question 'if this scheme was already fully funded how much extra would need to be set aside in the current year to keep it so'. By contrast, the effective contribution rate expresses the net present value of the estimated aggregate pension costs as a proportion of the present value of pensionable salaries over an officer's whole working life. It therefore gives an estimate of the proportion of ongoing salary that would have to be set aside from all sources to meet pension benefits based on retirement levels of pay. The key difference between the two measures derives from the fact that the cost of one year's service is an

¹³ Up to the limit of the State pension in individual cases.

aggregation of the costs in relation to whole cohorts of staff. It takes account of the mix of employees, their stage in the 'work life cycle' and their current earnings¹⁴. By comparison, the effective contribution rates are based on representative new entrants in various classes of employment.

Cost of One Year's Service

3.13 The net cost of pension entitlements in terms of annual remuneration is estimated at 15.1% for the average civil servant. Figure 12 outlines this average cost showing its component elements. The base year used was 2008 but the impact is unlikely to vary to any material extent.

Figure 12 Cost of One Year's Additional Service of Civil Servants^a at 31 December 2008

Pension Element	Gross Pension Cost as a Percentage of Pensionable Remuneration	Employee Contribution	PRD	Net Pension Cost as a Percentage of Pensionable Remuneration
	%	%	%	%
Occupational Pension Cost	22.3	(2.2)	(7.1)	13.0
State Pension Cost	3.5	(1.4)	-	2.1
Total Pension Cost	25.8	(3.6)	(7.1)	15.1

Note:

- a The cost of one year's service is calculated by reference to the change in the accrued pension liability over one year (expressed as a percentage of remuneration) for the existing cohort of staff in a category.

New Entrant Contribution Rates

3.14 A further measure of annual pension cost is the additional contribution rate required to fund future pension benefits to a new entrant. By way of example, Figure 13 sets out the new entrant contribution rates for a (male) established civil servant at the end of 2008.

Figure 13 New Entrant Contribution Rate at 31 December 2008

	Gross Pension Cost as a Percentage of Pensionable Remuneration	Employee Contribution	PRD	Net Pension Cost as a Percentage of Pensionable Remuneration
	%	%	%	%
Cost of Occupational Pension	24.6	(4.6)	(8.1)	11.9
State Pension Cost	10.2	(2.6)	-	7.6
Total	34.8	(7.2)	(8.1)	19.5

¹⁴ Many factors impinge on an explanation of the difference between the two rates. Apart from the fact that the 'populations' are different they would be expected to diverge because the one year cost does not accrue equally over an employee's work life and, since the actual distribution of staff shows higher proportions in the categories with lower annual costs, the one year rate is relatively lower.

PRSI Contribution Assumption

3.15 The net State pension costs were computed on the basis that the percentage of employee PRSI contributions that is used to finance pensions is 85%. This is based on previous work that estimated that pension expenditure as a proportion of total social insurance has been projected to reach 85% by 2056¹⁵. Accordingly, a working assumption was made that this percentage of employee social insurance contribution would be allocated to finance pensions. No element of the Employer PRSI contribution is reckoned in calculating annual pension costs since the purpose of the calculation is to determine the residual element of contribution that must be made by the State out of general taxation. In reality, it is impossible to predict the future level and distribution of social insurance contributions and benefits¹⁶. The potential impact of reducing this level to 50%, 25% and zero is outlined in Figure 14.

Figure 14 Impact of Variations in Employee Contribution Rates on Net Pension Costs

PRSI Proportion	0%	25%	50%	85%
Annual Pension Cost Measure^a	%	%	%	%
One Year Cost	16.4	16.0	15.6	15.1
New Entrant Cost	22.1	21.3	20.6	19.5

Note:

a As a percentage of remuneration.

3.16 Annex C sets out the detail for the various sectors of public sector employment for both the cost of one year's service and the new entrant contribution rate.

Pension-Related Deduction for Public Servants

3.17 A pension-related deduction from the remuneration of public servants was introduced in February 2009. This was part of a wider set of measures provided for in the Financial Emergency Measures in the Public Interest Act 2009, designed to assist in achieving stability in the public finances.

3.18 The deduction was applied to income earned from 1 March 2009. The rate of deduction was based on a graduated scale and applied to all elements of pay of public servants, including non-pensionable payments such as overtime and certain allowances.¹⁷ The application of the deduction was expected to achieve a reduction in the pay bill across all sectors totalling €1,160 million in 2009, and €1,350 million in a full year.

3.19 Subsequent to the commencement of the scheme, a number of changes were made in the deduction rates and related income bands, with effect from 1 May 2009. The changes were intended to reduce the impact of the deduction on lower paid public servants and increase the rate of deduction for those on higher earnings. The net impact of the changes was estimated to reduce the projected 2009 saving by €100 million and the full year saving by €150 million.

¹⁵ The National Pensions Review Report – Appendix 6, 2006.

¹⁶ The last actuarial review of the Social Insurance Fund was completed in 2007. The Social Welfare (Consolidation) Act 2005 provides that the next review should be completed in 2012.

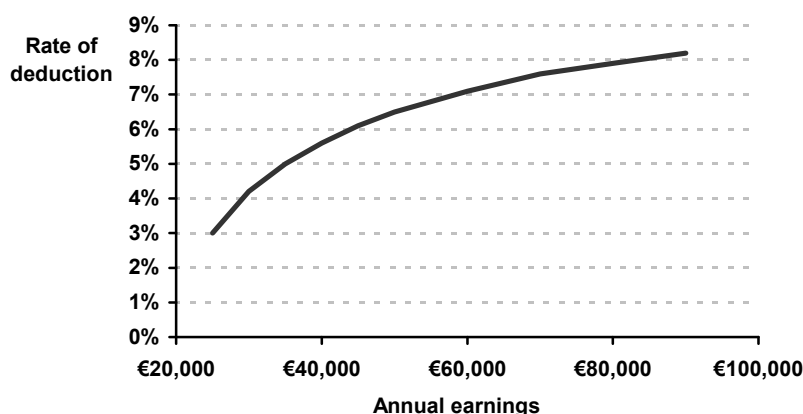
¹⁷ Excludes employers' Pay Related Social Insurance contributions.

3.20 The deduction rates and bands that currently apply are

- the first €15,000 of earnings are exempt
- a deduction of 5% is applied on earnings between €15,001 and €20,000
- a deduction of 10% is applied on earnings between €20,001 and €60,000
- a deduction of 10.5% is applied on all earnings over €60,000.

3.21 Figure 15 indicates the effective rates of deduction that apply for annual earnings in the range €25,000 to €90,000. The rates increase from 3% at the lower earnings level to over 8% at the upper earnings level.

Figure 15 Rates of Pension-Related Deduction with effect from 1 May 2009



Impact on Exchequer Pay Bill

3.22 The Revised Estimates Volume 2009 included estimates of the value of the deductions under each Vote. The projected total value of the deductions was just over €56 million. This included deductions in respect of public sector employees paid directly from each Vote, including civil servants, teachers and others employed in the education sector, health service workers, Gardaí, prison officers and Defence Force personnel. Deductions in respect of local authority employees¹⁸, and public servants paid directly from the Central Fund are not included.

3.23 The total amount of pension-related deductions collected under Votes in 2009 was €37 million i.e. 98% of the projected amount. The highest yields were in respect of the Health Service Executive Vote (€32 million) and the Education and Science Vote (€304 million).

3.24 The amount collected under the deduction scheme in 2009 represents about 5.1% of the total Exchequer pay bill of €6.5 billion. Because the deduction was only applied from 1 March 2009, the percentage impact in a full year will be higher.

¹⁸ The Exchequer pay bill does not include the pay costs of local authority staff because those costs are not directly funded by the Exchequer and the Local Government Fund does not include an identifiable pay element. See Department of Finance, Analysis of the Exchequer Pay and Pensions Bill, 2005-2010 (June 2010).

Conclusion

The accrued liability for occupational pensions of public servants at 31 December 2009 is estimated at €16.4 billion.

It is estimated that the value of the additional accrued liabilities arising from integration of the State pension into overall pension benefits is €12.7 billion as at 31 December 2009. This would bring the total cost of funding accrued pension benefits to citizens currently employed in the public service to €29 billion.

Net new entrant contribution rates – the proportion of pay needed to fund retirement benefits for a typical civil servant would cost 11.9% of pensionable remuneration for occupational pension entitlements and a further 7.6% to fund State Pension.

The pension-related deduction which came into effect in March 2009 reduced voted expenditure by €37 million in that year.

Annex A Methodology and Assumptions

This annex outlines the calculation methodology used and the key assumptions made in the course of estimation. Special Report 68 outlines the methodology in greater depth for the occupational pension element.

Accrued Liability

The accrued liability represents the present value of the future pension benefits that had accrued to the employee or pensioner as at the valuation date. This method sees each period of service as giving rise to an additional proportion of benefit. The methodology used to calculate the accrued liability was covered in Special Report 68. This section sets out the methodology used to estimate the impact of including the State pension in the accrued liability.

Active Members

For members currently in employment, the accrued liability was calculated as the present value of the expected benefits at retirement, based on the service completed as at the valuation date.

The following calculation was performed for each member in order to add the State pension to the accrued liability

- the amount of the State pension was projected to age 65
- the present value of the State pension was then calculated by discounting the value of the State pension at age 65 to the valuation date
- the capital value of the State pension was then calculated by applying an annuity factor to the present value of the accrued State pension. This was added to the accrued value of the occupational pension.

Pensioners

For pensioners the value of the State pension was calculated for each pensioner by applying an annuity factor to the current State pension amount.

Preserved Pensioners

The value of these benefits was calculated in a similar manner to that for active members.

Update of Accrued Liability

This section sets out the methodology used to update the accrued liability to the position as at 31 December 2009. A full review was done for 2008. The impact of the following items was estimated in order to arrive at an approximate accrued liability one year later i.e. as at 31 December 2009.

- The accrued liability for active members was rolled forward to allow for an increase of one year in age and service. This was adopted on the basis that there was low recruitment in 2009 so there was unlikely to be younger new entrants offsetting the increase in age and service of existing active members. Promotional salary increases for active members were also applied.
- The pay cuts applied in 2009 were allowed for.

- The accrued liability for each sector was adjusted for the numbers of serving staff and pensioners as at 31 December 2009 compared with 31 December 2008. Annex B sets out the details of the numbers assumed.
- The early retirement enhancements taken by civil service employees during 2009 were allowed for. This increased the civil service pensioners accrued liability.
- The discount rate was updated from that applying at 31 December 2008 (3.3%) to that applying at 31 December 2009 (3.0%).

Cost of Public Service Pensions

Cost of One Year's Service

The cost that arises from one year's additional service was determined. The cost is equal to the change in the accrued liability for active members and is then expressed as a percentage of Pensionable Remuneration (salary plus pensionable allowances).

The process involved re-running the updated accrued liability model as described above, adjusting the data for one year's age, service and salary increases (including scale and promotional increases) to calculate the cost of one year's additional service.

New Entrant Contribution Rate

Under this method the effective contribution rate that would be required to fund future pension benefits for a new entrant was determined. The effective contribution rate is the proportion of Pensionable Remuneration that would have to be contributed for each year of service in order to provide the benefit accrued at retirement.

The following calculation was performed for each new entrant in order to include the State pension cost in the new entrant cost

- the State pension was projected to age 65
- the present value of the State pension was then calculated by discounting the value of the Pension at age 65 to the valuation date
- the capital value of the State pension was then calculated by applying an annuity factor to the present value of the accrued State pension. This was added to the capital value of the occupational pension benefits
- the equivalent annual contribution rate was calculated as a percentage of Pensionable Remuneration that would be required over the working life of the employee so that the accumulated value of the contributions made is equal to the capital value required at retirement
- the employee pension and PRSI contributions were deducted to arrive at a net required employer contribution.

Key Assumptions – Inclusion of the State Pension

The assumptions outlined in Special Report 68 continue to pertain. This section sets out the additional assumptions required to include the State pension in the figures.

- An assumption was made that the percentage of employee PRSI contributions that is used to finance pensions is 85%, as per the National Pensions Review in 2006. This was used to determine the employee PRSI contributions in the calculation of the cost of Public Service pensions. It does not impact the accrued liability. The impact of varying this percentage is set out in the foregoing chapter.
- The 2008 PRSI contribution rates and State pension amounts were used. It was assumed that the PRSI pay bands will increase in line with salary inflation.
- Health contributions were excluded from the PRSI contributions.
- It was assumed that no spouse or dependant's PRSI benefits apply.
- It was assumed that the State pension is payable from age 65. For employees that will retire before age 65 that are also integrated (the pre-2004 and post-1995 cohort) an extra cost for the "bridging pension" that is likely to be paid by the pension scheme was included.
- It was assumed that the State pension is accrued at the same rate as the occupational pension, for the purposes of calculating the accrued liability for active members and preserved pensioners. This was also assumed for calculating the new entrant cost. In reality, individuals qualify for the State pension if they have paid enough PRSI contributions (between 3-10 years worth is required depending on the date that pension age is reached). However, using this approach would give rise to irregular results so a more smoothed approach of accruing a portion over each year of working life was used.
- In order to update the accrued liability for pensioners it was assumed that any current pensioner that is a member of an integrated pension scheme, will receive the full pension amount from age 65. Non-established civil servants and persons who are not officers in terms of the Local Government Superannuation Scheme were integrated pre-1995 so pensioners in those schemes have been updated to include the cost of the State pension.

Annex B Employee Numbers

Data on serving staff numbers and pensioners at 31 December 2008 underpinned the findings reached in Special Report 68. These data sets have been used in this chapter for consistency. In the case of the staff and pensioner numbers at 31 December 2009, data were sourced, insofar as possible, from the Analysis of Exchequer Pay and Pensions Bill 2005-2010. Some estimates have been made in relation to pensioner numbers at 31 December 2009 where information was lacking for some public sector groups.

Figure 16 Size of the Public Service by Sector

Sector	Number of Serving Staff		Number of Pensioners	
	31 December 2008	31 December 2009	31 December 2008	31 December 2009
Health	112,500	109,100	29,549	31,385
Education	92,480	93,706	22,415	26,355
Civil Service	38,572	37,381	15,660	17,594
Security Services	26,202	25,583	19,495	21,056
Non Commercial State Sponsored Bodies	12,175	11,834	3,728	4,840
Constitutional, Ministerial and Judicial Office-Holders	419	404	603	598
Local Authorities	34,926	32,200	21,934	22,126
Total	317,274	310,208	113,384	123,954

Annex C Pension Costs

One measure of the cost of public service pensions is the cost of one year's additional service. The cost is equal to the change in the accrued liability for active members expressed as a percentage of pensionable remuneration. It is the cost for all serving staff and so includes members with pre-1995, post-1995 and post-2004 pension terms.

Figure 17 Cost of One Year's Additional Service of Public Servants including State Pension, at 31 December 2008^a

Sector	Gross Pension Cost as a Percentage of Pensionable Remuneration	Employee Contribution	PRD	Net Pension Cost as a Percentage of Pensionable Remuneration
	%	%	%	%
Civil Service	25.8	(3.6)	(7.1)	15.1
Health	21.7	(6.8)	(7.1)	7.8
Gardaí	31.0	(5.7)	(7.9)	17.4
Prison Officers	33.9	(4.3)	(7.0)	22.6
Defence Forces	30.6	(2.8)	(7.0)	20.8
Teachers ^b	25.7	(6.9)	(7.5)	11.3
VECs and ITs	24.5	(7.0)	(7.5)	10.0
Universities	22.6	(5.3)	(7.8)	9.5
Non-Commercial State Sponsored Bodies	24.1	(4.4)	(7.8)	11.9
Constitutional, Ministerial and Judicial Office-Holders	70.0	(0.3)	(8.9)	61.8
Average Public Service Cost of Occupational Pensions (excluding local authorities)	24.4	(6.0)	(7.3)	11.1

Notes:

- a The cost of one year's service is calculated by reference to the change in the accrued pension liability over one year (expressed as a percentage of remuneration) for the existing cohort of staff in a category.
- b Includes primary teachers, post-primary teachers, special needs assistants and non-teaching staff in schools.

Another measure of the cost of public service pensions is the effective contribution rate for a new entrant starting after 2004. This cost represents the notional contribution rate that would have to be contributed for each year of service in order to provide the benefit accrued at retirement. The new entrant contribution rates are based on the pension scheme terms that apply to employees joining from 1 April 2004, so employees were assumed to be integrated.

Figure 18 New Entrant Contribution Rates including State Pension - Males^a

Category of Employment	As a percentage of Pensionable Remuneration			
	Total Cost	Employee Contribution	PRD	Net Cost
	%	%	%	%
Civil Service				
Established	34.8	(7.2)	(8.1)	19.5
Non-Established	25.9	(2.9)	(7.0)	16.0
Education				
Primary Teacher	28.5	(7.4)	(8.4)	12.7
Post-Primary Teacher	31.6	(7.4)	(8.4)	15.8
Security				
Garda	40.8	(7.6)	(8.5)	24.7
Prison Officer	44.2	(7.3)	(7.7)	29.2
Commissioned Officer	53.7	(7.2)	(8.1)	38.4
Enlisted Personnel	41.5	(3.1)	(7.2)	31.2
Health				
Consultant	29.2	(6.9)	(9.5)	12.8
Nurse (General)	27.8	(7.5)	(8.0)	12.3
State Sponsored Bodies				
Established Officer	31.2	(7.4)	(8.5)	15.3

Note:

a The female new entrant contribution rates are very similar to the rates for males.

Chapter 4

Central Government

National Pensions Reserve Fund

National Pensions Reserve Fund

4.1 The National Pensions Reserve Fund (NPRF) was established in 2001 with the objective of providing a fund of money to meet the future costs of social welfare and public service pensions. An independent Commission (the National Pensions Reserve Fund Commission) was established to control and manage the Fund.

4.2 The Minister for Finance (the Minister) is required¹⁹ to make a contribution each year equivalent to 1% of GNP to the NPRF. This contribution amounted to €1.6 billion for 2009.

4.3 In implementing its investment strategy the Commission seeks to maximise returns within acceptable risk levels with a focus on the long-term, taking account of the fact that the NPRF is expected to contribute to the financing of pension costs from 2025 until 2055.

Directed Investments

4.4 In 2009, legislation²⁰ was enacted which permitted the Minister to direct the Commission to invest in listed financial institutions or to underwrite share issues in such institutions where such a direction is in the public interest. The Act also provided that the Minister can direct the Commission with regard to the management and disposal of any such investments.

4.5 In March 2009, the Commission was directed by the Minister to invest €3.5 billion in Preference Shares of Bank of Ireland and in May 2009 to invest €3.5 billion in Preference Shares of Allied Irish Banks. In each case, the investment consisted of

- Perpetual non-cumulative preference shares which pay an annual non-cumulative fixed dividend of 8% at the bank's discretion. If the dividend is not paid in cash, the NPRF receives its value in Ordinary Shares. The Preference Shares can be repurchased by the bank at par value (€1 each) within the first five years and thereafter at €1.25 each.
- Warrants attach to the Preference Shares giving an option to subscribe²¹ for ordinary share capital in the bank. The warrants are exercisable any time between the fifth and tenth anniversary of the date of the issue of the preference stock or in the event of an offer for the bank or other change of control, whichever is earlier.

Rights Attaching to Preference Shares

Preference shares are a type of share capital which confers particular rights, including priority payment of any dividend. The directed investments in Bank of Ireland and Allied Irish Banks Preference Shares rank *pari passu*²² with Ordinary Shares in any liquidation and the annual dividend ranks *pari passu* with dividend claims of other Preference Shares and ahead of ordinary share dividends. In addition, on foot of the investment, the Minister can appoint 25% of the directors to each bank and the NPRF receives 25% of total ordinary voting rights in respect of change of control and board appointments.

¹⁹ In accordance with the National Pensions Reserve Fund Act 2000.

²⁰ Investment of the National Pensions Reserve Fund and Miscellaneous Provisions Act 2009.

²¹ The exercise price for the Bank of Ireland warrants was set at €0.52 for 177,213,784 shares and €0.20 for 157,523,364 shares. The exercise price of Allied Irish Banks warrants is €0.975 for 155,780,375 shares and €0.375 for 138,471,444 shares.

²² Generally defined as having equal rights in terms of payment or level of seniority.

Additional Contributions

4.6 A further €1.4 billion was paid²³ from the Exchequer to the NPRF in 2009 to contribute towards funding the directed investments in the two banks.

4.7 Under the Financial Measures (Miscellaneous Provisions) Act 2009 the assets of the pension funds of eight non-commercial State bodies and universities were transferred to the NPRF on 31 December 2009. The Commission determined in consultation with the Minister that the value of the assets transferred was €993 million. The assets transferred are set out in Figure 19. The pension schemes associated with those funds continue in force for existing members with no impact on benefits or associated provisions for members. All future pension costs will be paid, in the first instance, by the relevant State body or university and, thereafter, will be met by way of Oireachtas grant in lieu of amounts which would have been payable by the pension funds.

4.8 The assets of pension funds of a further six non-commercial State bodies and universities were transferred to the Commission in 2010. The estimated value of post-2009 transfers is of the order of €1 billion.

Figure 19 Pension Assets Transferred to the NPRF on 31 December 2009

Responsible State Body / University	Value €m
Arts Council	2.5
Bord Bia	15.7
National Tourism Development Authority	32.9
FÁS	364.6
Forfás	186.3
Shannon Development	52.3
National University of Ireland Maynooth	58.5
Trinity College Dublin	280.5
	993.3

Value of the NPRF

4.9 The value of the NPRF stood at €22.3 billion at 31 December 2009 (2008: €16.1 billion) composed of discretionary investments with a market value of €15.3 billion and directed investments of €7 billion which were valued at cost under a direction of the Minister. Figure 20 sets out the movement in the NPRF for the year ended 31 December 2009.

²³ In accordance with the Investment of the National Pensions Reserve Fund and Miscellaneous Provisions Act 2009.

Figure 20 Movement in the NPRF Value for 2009

	€m		
Value of NPRF at 1 January 2009			16,142
Increase in Value of NPRF (including asset transfers)			
Contributions			
<i>Exchequer Contribution</i>			
Statutory annual contribution	1,584		
Additional contribution	1,416		
Assets transferred from pension schemes	<u>993</u>	3,993	
Net Income			
Net Discretionary Investment Income (less expenses)	386		
Net Directed Investment Income (less expenses)	56		
Increase in Value of Discretionary Investments	<u>1,758</u>	2,200	6,193
Value of NPRF at 31 December 2009			22,335
The assets of the NPRF are composed of			
Discretionary Investments		15,335	
Directed Investments		7,000	22,335

Developments Since Year End

Payment of Preference Share Dividend

4.10 On 19 February 2010, Bank of Ireland paid the dividend then due of €250 million. On 13 May 2010, Allied Irish Banks paid the dividend due of €280 million on its Preference Shares. In each case, the payment was made in the form of Ordinary Shares in lieu of a cash payment.

4.11 The reason for the payment by way of Ordinary Shares was because the European Commission had requested that discretionary²⁴ coupon payments on Tier 1 and Upper Tier 2²⁵ capital instruments in Bank of Ireland and Allied Irish Banks not be paid while it considered each bank's restructuring plan. The number of shares issued in lieu of cash dividends was calculated by reference to the amount of the Preference Share dividend divided by the average share price in the 30 trading days prior to the date on which the dividend payment was due. Following the issue of these shares the NPRF (including small shareholdings already held in its indexed portfolio within the Discretionary Investment portfolio) held 15.7% of the issued Ordinary Shares of Bank of Ireland and 18.6% of the Ordinary Shares of Allied Irish Banks.

²⁴ The payment of a cash dividend on preference shares is subject to Board approval. If the dividend is not paid in cash the fund will receive the value of the dividend in ordinary shares.

²⁵ Tier 1 capital instruments refer to paid up share capital and common stock. Upper Tier 2 capital refers to certain subordinated debts including the preference shares held in the two banks.

Conversion of Investment to Ordinary Shares

4.12 On 30 March 2010 the Minister announced details of the capital determined by the Financial Regulator to be necessary for the banks to meet his requirement of a Tier 1 capital ratio of 8%, of which 7% must be equity. In the case of Bank of Ireland this translated into an additional equity requirement of €2.7 billion and in the case of Allied Irish Banks into an additional equity requirement of at least €7.4 billion. In his statement, the Minister said the State would support both banks in their capital raising to meet these new capital standards.

- In the case of Bank of Ireland this support would be provided through the conversion of part of the NPRF's Preference Shares into Ordinary Shares.
- In the case of Allied Irish Banks it would be provided through commitment to convert part or all of the NPRF's Preference Shares as required into ordinary equity. If additional capital was required it would be provided through investment in Ordinary Shares by the Commission.

4.13 In April 2010, Bank of Ireland announced a plan to raise €3.4 billion equity capital through a share placement and rights issue. The Commission was directed by the Minister in accordance with enabling legislation²⁶ to participate in the share placement and rights issue in accordance with the terms of a Transaction Agreement with Bank of Ireland. Under the terms of the Agreement

- The Commission agreed to subscribe for 576 million units of Ordinary Stock at a price of €1.80 per unit, through the conversion of the Preference Shares into Ordinary Stock at a price of €1 per unit.
- Bank of Ireland re-purchased, in their entirety, the warrants issued in conjunction with the Preference Stock for €491 million in cash.
- The Commission agreed to participate in the Bank of Ireland rights issue, taking up the full allocation to which it was entitled, based on its holding of Ordinary Stock after the share placement. The consideration for the shares purchased under the rights issue was met through the conversion of 627 million Preference Shares based on a price of €0.55.
- The coupon on the remaining 1,837,041,304 Preference Shares was increased from 8% to 10.25%.

4.14 Following these transactions, the NPRF's holding in Ordinary Shares of Bank of Ireland is 36%. The NPRF received, in addition to the €491 million in respect of the warrants, €52 million in transaction fees under the Transaction Agreement (a €22 million transaction fee, €10 million in share placement fees, a €19 million underwriting fee and €800,000 incentive fee in respect of the rights issue). The market value of its shareholding at 30 June 2010 was €1.3 billion and the par value of its Preference Shares was €1.8 billion.

Valuation of the Directed Investments

4.15 In its 2009 financial statements the Commission has valued the Preference Shares at cost in accordance with the direction received from the Minister and the equity warrants are valued at zero.

4.16 The Commission considered in preparing the 2009 financial statements whether there was any evidence of impairment of the directed investments which might make it appropriate to

²⁶ Investment of the National Pensions Reserve Fund and Miscellaneous Provisions Act 2009.

recognise a provision for impairment and concluded that, for the reasons set out below, no such provision was appropriate.

4.17 Bank of Ireland successfully completed a share placement and rights issue in 2010. The conversion of €1.7 billion of the NPRF's Preference Shares into Bank of Ireland Ordinary Shares on the basis of exchanging Preference Shares at par for Ordinary Shares at market price at the time of the transaction was evidence that those Preference Shares had not suffered impairment.

4.18 The additional equity share capital generated in the rights issue, both from the market and from the conversion of Preference Shares, significantly improved the position of the remaining Preference Shares which rank ahead of that equity share capital. The valuation of the remaining Preference Shares would also benefit from an increase in the coupon rate from 8.0% to 10.25%.

4.19 In addition, the bank has been recapitalised sufficiently to meet the requirements of the Financial Regulator.

4.20 Allied Irish Banks was planning to raise capital from private sources and through the disposal of certain overseas assets to meet the capital requirements of the Financial Regulator. To the extent that Allied Irish Banks is unable to raise sufficient external capital, the Minister has indicated that he will convert the Preference Shares as required. While there is still uncertainty about the final outcome, the Commission had no evidence that the directed investment, in that bank, is impaired.

4.21 At 30 June 2010, the value of the directed investments was €6.8 billion made up of the market value of Ordinary Shares (€1.5 billion) and the original acquisition cost of Preference Shares (€5.3 billion). This excludes the €0.5 billion in cash which was received by the NPRF in June 2010 following the conversion of the Bank of Ireland investment to Ordinary Shares.

Conclusion

The fund was valued at €22.3 billion at the end of 2009. €7 billion of this value was made up of directed investments. These directed investments continued to be stated at cost at the end of 2009 and the Commission did not consider that their value had been impaired.

Since 31 December 2009, the par value of Bank of Ireland Preference Shares held has reduced to €1.8 billion following conversion of the balance of its original €3.5 billion investment into Ordinary Shares.

Chapter 5

Central Government

Financial Commitments under Public Private Partnerships

Financial Commitments under Public Private Partnerships

5.1 A Public Private Partnership (PPP) is an arrangement between public and private sector partners for the delivery of public infrastructure and/or public services.

5.2 Typically, a PPP project involves a formal contract between a government agency and a private partner, where the latter undertakes to deliver specified facilities and/or services over the life of the contract. This is usually 25 to 30 years, although some contracts in the roads sector may be up to 45 years in duration. Project risks, which are a feature of all long-term projects, are shared between the public and private sector partners, depending on which partner is in the best position to manage them. Under the PPP process, the State retains ownership of the assets throughout the contract period. At the end of the contract period, the sponsoring Government agency assumes responsibility for the ongoing maintenance and operation of the assets.

5.3 The structure put in place to compensate the private sector partner for developing the assets and delivering the required services varies, with different implications in terms of the financial commitments involved for the sponsoring public bodies (see Figure 21). In many cases, the public sponsors of the project take on contractual commitments to make regular payments to the private sector partner over the life of the project. In other cases, projects are designed on a concession basis, whereby the private sector partner receives some or all of the compensation in the form of charges imposed on the users of the service.

Figure 21 Financial Nature of PPP Arrangements

Unitary payment projects

This is where the sponsoring public agency makes regular payments (monthly, quarterly or annually) over the term of the contract to the private sector partner, subject to satisfactory performance in providing agreed facilities to the required standard. Typically, part of this unitary (or all-in) payment amount is fixed over the life of the contract, with the remainder varying in line with price fluctuations (usually the Consumer Price Index). The split between the fixed and variable elements varies from project to project.

Up-front capital payment projects

In the water and wastewater sector, many PPP projects are procured on a design, build, operate and maintain (DBOM) basis. In these cases, the Exchequer provides up-front capital funding (as with traditional procurement), so there are no capital or financing costs to be paid back over the life of the project. Annual operating costs (paid by the relevant local authorities) are based on the volume of water/wastewater arriving for treatment.

Concession projects

In concession projects, the users of the service pay fees to the private sector partner e.g. motorists using toll roads. The State may pay a contribution towards the capital costs of providing the infrastructure, and may also pay operating subventions during the contract period. Where user payments exceed projected levels, there may be scope for the additional income to be shared between the public and private sector partners.

Asset-based schemes

In this kind of project, the public sector contribution to the project includes provision of an asset (usually land), with the private partner developing the asset e.g. social/affordable/private housing projects. Ultimately, much of the funding for this kind of project depends on sales or rentals on the open property market, and the ongoing difficulties in the property market have made many proposed developments unviable. Such projects are usually of shorter duration (five to seven years) than concession or unitary payment projects.

Chapter Focus

This chapter has been compiled to provide information about the financial commitments entered into by central Government departments and agencies under PPP contracts.

Summary of Expenditure and Commitments

5.4 Annex A lists the major²⁷ PPP projects, as at the end of December 2009, in respect of which central Government departments and agencies had entered contracts as the sponsoring agency, or had otherwise made financial commitments to the projects.

5.5 Up to the end of 2009, the total expenditure incurred by central government departments and agencies under PPP contracts was just over €1.5 billion (see Figure 22). Expenditure in the year under contracts amounted to €321 million²⁸.

Figure 22 Expenditure and Commitments under PPP contracts in place at end December 2009, by department/agency

Department/agency	Number of projects contracted	Expenditure		Outstanding commitment ^a
		prior to 2009	in 2009	
		€m	€m	€m
Education and Skills ^b	3	139	29	525
Courts Service	1	—	—	634
Tourism, Culture and Sport/Office of Public Works	1	—	—	754
National Roads Authority	10	614	230	2,116
Environment, Heritage and Local Government ^c	18	460	62	68
Total	33	1,213	321	4,097

Source: Annex A

Notes:

a Assumes inflation will average 2% a year over the remaining lives of the contracts.

b Excludes a new schools bundle project contracted in 2009 and due to commence service in September 2010. The Department of Education and Skills is not yet publicly disclosing the commitment figure in relation to that project for commercial reasons.

c Amounts shown in relation to projects sanctioned by the Department of the Environment, Heritage and Local Government are the contributions by the Department towards the capital cost of local authority PPP projects. They do not include expenditure under the contracts by the relevant local authorities, or the outstanding commitments that will have to be met by the local authorities from

²⁷ Projects where the capital cost of asset creation was less than €20 million are not included.

²⁸ There was additional expenditure by departments and agencies in 2009 in relation to the development of PPP projects, but this did not form part of the contract with the private sector partner. For example, the Department of Education and Skills spent €11.7 million in 2009 on PPP-project related costs such as site acquisitions, technical and legal advisors, etc.

their own future budgets.

5.6 The total outstanding commitments of central Government departments and agencies in respect of contracted PPP projects at end 2009 is estimated at €4.1 billion. This excludes the commitment incurred by the Department of Education and Skills under a March 2009 PPP contract for provision of a bundle of four second level schools which are due to come into service in September 2010 (see below).

5.7 Based on expenditure incurred to end 2009 and the estimated outstanding commitments, the aggregate Exchequer expenditure in respect of the currently contracted PPP projects is projected to be €5.6 billion.

Potential Future Commitments

5.8 A further significant number of PPP projects were in development at the end of 2009 but had not yet reached contract stage²⁹. A contract has since been agreed for a further schools project. The financial commitments under the PPP programme are expected to increase as more projects reach contract stage.

5.9 Given the complexities involved in the PPP process and payment mechanisms, it is difficult to estimate potential future commitments of projects that are still in planning. The cost of a project depends on a range of factors, including the project specification, perspectives on risk pricing and the cost of borrowing in the project finance market. These are not finally settled until projects reach contract stage.

5.10 The Department of Finance has projected the State's likely costs for PPP projects, based on the assumption that they will progress as scheduled at July 2010. While stressing the inherent uncertainty around such projections, it estimates that the potential total expenditure on currently contracted projects and projects expected to commence construction by 2016 will be approximately €24 billion over the period 2010 to 2053. Expenditure is projected to average €730 million a year over the 30-year period from 2010 to 2040³⁰.

PPP Contracts in 2009

5.11 Two PPP projects reached contract stage in the course of 2009. These were

- a bundle of four second level schools
- a contract for the development and operation of motorway service facilities.

First Schools Bundle Project

5.12 In September 2005, the Minister for Education and Science announced a plan to provide 27 new schools by means of PPP projects — 23 post primary and 4 primary schools in 22 locations (the Schools PPP Programme). The stated aim of the Schools Programme is to deliver new schools in rapidly developing areas, to replace existing schools with new accommodation and to provide new accommodation for schools that are an amalgamation of existing schools.

²⁹ The Department of Finance maintains and publishes a project tracker database, listing all PPP projects with an estimated capital value of over €20 million each. The tracker includes projects where a contract is in place, and those for which project advisors have been appointed. The information on each project is provided by the relevant sponsoring authorities. See www.ppp.gov.ie

³⁰ These projections do not include payments in respect of water/wastewater projects, or the costs associated with the operate-only LUAS contracts.

5.13 The first bundle of schools identified for procurement via PPP comprises four post-primary schools on three sites in Ferbane, Banagher and Portlaoise (two schools) catering for a total of 2,700 pupils. The scope of the project is similar to that of the pilot schools PPP project (2001) i.e. design, build, operate, and maintain the schools, and finance the project over its lifetime.

5.14 A notice was published in the Official Journal of the European Union seeking expressions of interest for the first bundle of schools on 27 September 2006. Following a competitive tendering process, Macquarie Partnerships for Ireland (MPFI) were awarded the contract for the project on 6 March 2009. Construction of all four schools is due to be completed by September 2010. The contract runs for 25 years from the date the schools open.

5.15 A second schools bundle project, involving five second level and one first level school, and also with MPFI as the private sector partner, reached contract stage in June 2010.

Motorway Services Project

5.16 In 2005, the National Roads Authority (NRA) was asked by the Minister for Transport to undertake a review of policy with regard to the provision of service areas on motorways and on high quality dual carriageways of the national roads network. Arising from the review, the Authority announced a strategy to provide service areas at intervals of approximately 50 to 60 kms, where feasible, through a combination of facilities located on-line and off-line (i.e. at or close to interchanges). In September 2006, the Authority announced that it would become directly involved in developing on-line service area facilities as PPP projects.

5.17 The first project under the programme encompasses the design, construction, operation and financing of three motorway service areas: two on the M1 motorway and one on the M4 motorway. Each of the locations is to be served by facilities on both sides of the motorway, or provide access from both sides of the motorway. The facilities will include extensive parking, restaurant/food outlet, fuel station, toilet facilities, and Garda enforcement area. The private partner will earn revenues from the operation of the various retail services offered and the NRA will receive a share of those revenues.

5.18 A contract notice for the first service area project was placed in the Official Journal of the European Union on 1 May 2007. In October 2009, the NRA awarded the PPP contract to the Superstop Consortium, which is currently developing the facilities at Castlebellingham and at Lusk (on the M1) and at Enfield on the M4. Service provision is expected to commence in late 2010.

5.19 The NRA has confirmed that the total public financial commitment under the contract will amount to €47 million by way of a capital contribution following completion of construction. No unitary payments are envisaged, and the NRA will receive an ongoing share of the overall revenues.

Financing of PPP Projects

5.20 The National Development Finance Agency (NDFA) was established in 2003 to advise State authorities on the optimal financing of large scale public capital investment projects³¹. In 2007, the remit of the Agency was widened, mandating it to undertake the procurement and delivery of PPP projects in all sectors, apart from transport and local government. The NDFA operates under the aegis of the National Treasury Management Agency.

Impact of Financial Crisis on PPP Projects

5.21 Prior to the financial crisis, the arrangements for all PPP competitions required each of the consortiums bidding for the deal to submit committed funding terms at the time of the tender. Bank support letters were submitted with tenders, confirming the proposed banking terms and the banks' satisfaction with the legal documentation and all technical aspects of the project. These banking terms were then normally held until financial close — an undefined period, but generally six to twelve months³². As banks normally operated exclusively to support the bids submitted by each consortium, the number of banks involved in each competition could be significant. This approach to funding provision was in line with international market practice.

5.22 The ongoing global financial crisis has adversely impacted the funding for all investments, and has led to a significant decrease in the number of banks willing to provide long-term funding for all projects. Banks are now generally unwilling to hold terms for longer than two to three months at most, if at all, and the amounts on offer for participation in individual projects are generally lower than in the past. This results in more banks being needed to draw together the required funding. Additionally, syndication arrangements where one or more banks underwrite the debt are now no longer available, and all participating banks negotiate funding terms and conditions individually in so-called club deals. Consequently, prospective tenderers have generally been unable to provide fully committed funding terms at the time of tenders.

5.23 The NDFA has stated that, in order to address this liquidity problem, it has introduced a 'preferred tenderer funding competition' arrangement in more recently procured PPP projects, in keeping with current practice in other jurisdictions competing for limited PPP private funding. This involves postponing the requirement for committed funding terms until after the appointment of the preferred bidder, based on evaluation of tenders. This approach serves to reduce the length of time banking terms have to be held, and the number of banks from whom commitments have to be raised. The NDFA considers that this is particularly applicable where there may be planning obstacles for the PPP company.

5.24 The preferred tenderer funding competition approach may prolong the timeframe to reach final contract agreement. It also carries a risk that the preferred tenderer's proposal at tender stage may require renegotiation following bank due diligence examinations when compared to the option of seeking committed funding at tender stage. In the latter case, project amendments required by the bank(s) would already have been incorporated into the proposal at tender stage.

³¹ The scale of projects within the remit of the NDFA was originally defined as those with an expected capital value of €20 million or more. This was subsequently amended to those with an expected capital value of €30 million or more.

³² The proposed terms normally allowed fluctuations in market interest rates between the date of tender submission and financial close. Consequently, the sponsoring agency carried interest rate risk until the contract was signed.

Pension Fund Investment in PPPs

5.25 The National Pension Reserve Fund (NPRF) was established with the objective of meeting as much as possible of the costs to the Exchequer of social welfare and public service pensions to be paid from 2025 to at least 2055. The National Pension Reserve Fund Commission is responsible for the investment of the NPRF in accordance with its statutory investment policy of seeking the optimal financial returns. As a long-term investment, infrastructure is a natural asset class for the NPRF, and it is keen to access PPP investment opportunities where the risk/return characteristics satisfy its statutory commercial investment mandate. The use of preferred tenderer funding competitions offers the NPRF a market entry opportunity.

5.26 Both the NDFA and the NPRF operate under the aegis of the National Treasury Management Agency. However, NDFA and NPRF are separate bodies, with their own boards, legal remits and decision-making processes. In any discussions between the two bodies, especially in relation to PPP funding competitions, there is a strict obligation to ensure that the NPRF does not become privy to any information that would give it an advantage over other potential providers of finance.

5.27 A potential funding opportunity for the NPRF is not expected to arise until at least late 2010.

Conclusion

The total outstanding commitments of central Government departments and agencies in respect of contracted PPP projects at end 2009 is estimated at €4.1 billion. A further significant number of PPP projects were in development at the end of 2009 but had not yet reached contract stage.

Based on the assumption that the projects will progress as scheduled at July 2010, the Department of Finance has estimated that the potential total expenditure on currently contracted projects and projects expected to commence construction by 2016 will be approximately €24 billion over the period 2010 to 2053. Expenditure is projected to average €730 million a year over the 30-year period from 2010 to 2040.

Annex A Expenditure up to end 2009 and outstanding commitments on large PPP project contracts, by public sector agency and by project

The table lists the individual projects reported by the respective departments/ agency. Only commitments/expenditure in relation to projects which have an estimated capital development value of €20 million or more are included.

A summary outline of the individual projects contracted up to the end of 2008 was included in the Comptroller and Auditor General's Annual Report 2008 (pages 29 to 34).

Inflation

The commitment amounts are projected based on the assumption that inflation will average 2% a year over the remaining life of each project. All amounts include VAT (unless otherwise stated)

Scope of PPP projects

The elements within the scope of the project (indicated on the table) may include some or all of the following

- D design** of service/infrastructure
- B build/construct/extend/renovate** capital assets
- F provide **finance**** (e.g. provide/secure private equity and borrowing; collect user charges)
- O operate** assets (e.g. facilities management; employment of services staff)
- M maintain** assets over contract life.

Sponsoring authority/project name	Scope of project	Key project dates			Expenditure			
		Contract signed	Service commencement	Contract end	Pre 2009	2009	Future commitment	Projected total expenditure
					€m	€m	€m	€m
Department of Education and Science								
Pilot PPP schools bundle	DBOFM	November 2001	2003	2027	74.3	11.7	197.0	283.0
Maritime College	DBOFM	February 2003	2004	2029	45.6	8.7	137.4	191.7
Cork School of Music	DBOFM	September 2005	2007	2032	19.3	9.0	190.7	219.0
First bundle PPP schools ^a	DBOFM	March 2009	2010	2035	—	—	Withheld	Withheld
Second bundle PPP schools	DBOFM	June 2010	2011	2036	—	—	Withheld	Withheld
Courts Service								
The Criminal Courts of Justice	DBOFM	April 2007	2009	2035	—	—	634.1	634.1
Department of Tourism, Culture and Sport/Office of Public Works								
National Conference Centre	DBOFM	April 2007	2010	2035	—	—	754.0	754.0
National Roads Authority ^b								
Kilcock/Kinnegad	Concession	March 2003	2005	2033	168.4	0.9	7.9	177.2
Dundalk Western Bypass	Concession	February 2004	2005	2034	0.2	2.0	4.3	6.5
Rathcormac/Fermoy	Concession	June 2004	2006	2034	90.9	7.0	52.7	150.6
Waterford City Bypass	Concession	April 2006	2009	2036	94.5	12.5	95.5	202.5
Limerick Tunnel	Concession	August 2006	2010	2041	115.6	44.9	88.7	249.2
Clonee/Kells	Concession	April 2007	2010	2052	111.2	124.1	479.7	715.0
Galway/Ballinasloe	Concession	April 2007	2009	2037	18.5	25.3	319.4	363.2
Portlaoise/Cullahill	Concession	June 2007	2010	2037	15.0	12.9	58.9	86.8

Sponsoring authority/project name	Scope of project	Key project dates			Expenditure			
		Contract signed	Service commencement	Contract end	Pre 2009	2009	Future commitment	Projected total expenditure
					€m	€m	€m	€m
M50 upgrade	DBFOM	September 2007	2007	2042	—	—	961.5	961.5 ^c
Motorway Service Areas	Concession	October 2009	2010	2034	—	—	47.0	47.0
Department of the Environment, Heritage and Local Government^d								
<i>Sewage treatment projects</i>								
Dublin Bay treatment plant	DBM	March 2001	2003	2024	194.8	6.4	15.5	216.7
Wexford treatment plant	DBOM	July 1999	2004	2026	18.3	—	—	18.3
Cork treatment plant	DBOM	December 2001	2004	2027	65.2	—	—	65.2
Balbriggan/Skerries treatment plant	DBOM	September 2004	2006	2028	23.8	—	—	23.8
South Tipperary treatment plant group	DBOM	March 2003	2007	2029	11.9	1.3	0.4	13.6
Dungarvan treatment plant	DBOM	April 2004	2007	2029	11.5	—	2.2	13.7
Sligo treatment plant	DBOM	September 2006	2008	2030	18.0	—	—	18.0
Donegal (A) treatment plant group	DBOM	June 2006	2008	2030	22.8	—	1.3	24.1

Sponsoring authority/project name	Scope of project	Key project dates			Expenditure			
		Contract signed	Service commencement	Contract end	Pre 2009	2009	Future commitment	Projected total expenditure
					€m	€m	€m	€m
Waterford treatment plant	DBOM	September 2006	2010	2033	18.0	1.1	13.6	32.7
Portlaoise treatment plant	DBOM	December 2006	2009	2031	16.0	2.1	1.5	19.6
Meath villages treatment plant group	DBOM	October 2007	2010	2032	12.3	9.0	0.3	21.6
Mullingar treatment plant	DBOM	April 2008	2010	2032	6.4	9.7	—	16.1
Castlebar treatment plant	DBOM	September 2008	2010	2032	0.6	4.8	6.0	11.4
Shanganagh treatment plant	DBOM	September 2008	2010	2034	6.7	19.9	25.5	52.1
Wicklow treatment plant	DBOM	September 2007	2009	2031	10.9	7.3	1.2	19.4
Water treatment scheme								
Clareville water treatment project	DBOM	December 2006	2010	2030	22.5	—	—	22.5
Area development projects								
Fatima Mansions redevelopment	DBF	June 2004	2006	2009	—	—	—	—
Greystones harbour development	DBOF	December 2007	2012	2042	—	—	—	—

Notes:

- a The Department of Education and Skills is not yet publicly disclosing information on the projected financial commitments under these contracts for commercial reasons.
- b In the case of NRA concession contracts, the Projected Total Contract Value represents the total payments expected to be made to the PPP companies concerned over the life of the contract. The PPP companies also benefit from user charges which contribute to their capital and operational costs. The contracts incorporate a revenue sharing mechanism whereby the NRA receives a portion of toll revenue.
- c Excludes VAT.
- d Expenditure/commitments data excludes those of local authorities.

Chapter 6

Central Government

Banking Stabilisation Measures

Banking Stabilisation Measures

6.1 The ongoing crisis in global financial markets and the structural weaknesses it exposed in the Irish banking sector continue to require concerted policy, regulatory and public finance responses. The initial responses to the crisis — in late 2008 and early 2009 — focused on containment of the problem, primarily through liquidity support and guarantees for bank liabilities. Since then, policy responses have focused more on resolution of underlying systemic problems, through a range of measures to restructure banks and encourage bank lending, including purchase of distressed loans, ongoing guarantees of banking liabilities and injections of capital. Measures have also been taken to address the failures in regulation and in oversight of the financial sector that contributed to the severity of the impact in Ireland of the global financial crisis.

6.2 Some of the banking stabilisation measures that were implemented have resulted in expenditure of substantial public funds, or the taking on of commitments to future expenditure. Other measures give rise to significant contingent liabilities.

Chapter Focus

The measures implemented have involved action by the Department of Finance, the Central Bank, the Financial Regulator, the National Treasury Management Agency and the National Pension Reserve Fund. The financial transactions involved and commitments entered into are (or will be) accounted for in a variety of ways. This chapter has been compiled to present an overview of the main measures implemented, and of the financial impacts to date, including financial commitments and contingent liabilities.

Importance of Banking Stability

6.3 Banks are vital to the functioning of the economy. The deposits they hold are a key part of the payment mechanism for households and businesses, and by allocating savings to borrowers, they promote economic growth. The failure of a major bank has the potential to leave individuals and businesses unable to access savings, raise finance or meet ongoing payments. System wide failures in the banking sector cannot but cause very significant negative effects on the wider economy.

6.4 Banks are vulnerable in two main ways

- a combination of short-term (liquid) liabilities and longer term (illiquid) assets creates a risk of liquidity shortage
- a decline in the value of their assets can have a disproportionately large effect on a bank's capital (since impairments can only be met out of accumulated reserves).

6.5 When such liquidity or solvency issues arise, governments and/or central banks acting as guardians of the public interest, need to intervene in order to protect the stability of the whole financial system and at the same time try to avoid major negative repercussions for the real economy. This intervention can take various forms ranging from deposit insurance schemes and the function of the lender of last resort undertaken by the central bank in order to address liquidity as well as State sponsored purchases of distressed assets and outright capital injections to address solvency issues.

Liquidity Support Measures

6.6 The main State mechanisms for provision of liquidity support to banks have been schemes guaranteeing certain classes of banking liabilities. In addition, the Central Bank has extended collateral-based credit to Irish banks under European Central Bank Eurosystem rules.

Guarantees of Banking Liabilities

6.7 State backed guarantees over banking liabilities have been put in place under three main schemes. These were

- extension of the existing Deposit Guarantee Scheme, announced on 20 September 2008, to address apparent consumer concerns about the security of their deposits in credit institutions
- provision of a two-year State guarantee in respect of a wide range of bank liabilities, announced on 30 September 2008 (the CIFS Bank Guarantee scheme)
- a State guarantee scheme put in place on 9 December 2009, providing for cover for a narrower range of banking liabilities but with maturities of up to five years, mirroring schemes put in place by other European states and approved under EU State aid rules (the Eligible Liabilities Guarantee scheme).

Deposit Guarantee Scheme

6.8 All credit institutions licensed to receive deposits in Ireland are required to participate in the Deposit Guarantee Scheme. As a means of enhancing the security of deposits and encouraging consumers to retain funds in Irish institutions, the compensation limit under the scheme was increased in September 2008 from €20,000 to €100,000 per eligible depositor per institution³³.

6.9 Credit institutions subject to the provisions of the scheme are required to deposit funds in a Deposit Protection Account administered by the Central Bank. The required deposit is 0.2% of the total value of current customer deposits with the institution — not just of the value of deposits guaranteed. In the event of the liquidation of a credit institution, claims by depositors would be met in the first instance by the Central Bank, using the resources of the Deposit Protection Account. Any shortfall would be met from the Central Fund of the Exchequer, which would be recouped in due course from the banking sector. No claims have been made under the scheme since its inception.

6.10 At end 2009, around 50 credit institutions were subject to the provisions of the scheme. The balance in the Deposit Protection Account was €608 million (by comparison with €526 million at the end of 2007 and €669 million at the end of 2008).

6.11 Up to September 2008, credit unions had not been covered by the scheme. The extension of the scheme included a provision that credit union deposits would subsequently be covered, and the legislation provided for this. However, an order has not yet been made requiring credit unions to hold funds in the Deposit Protection Account. Discussion is still ongoing about the level of funding that credit unions will be required to hold in the account.

³³ The legal basis for the change was provided through the Financial Services (Deposit Guarantee Scheme) Act 2009.

CIFS Bank Guarantee Scheme

6.12 The Credit Institutions (Financial Support) Scheme (referred to as the CIFS Bank Guarantee scheme) was announced on 30 September 2008³⁴. Participation in the scheme was voluntary (subject to certain terms and conditions), and seven credit institutions (including certain subsidiaries) opted to avail of it³⁵.

6.13 The scheme provided a temporary State guarantee — until 29 September 2010 — for a broad range of liabilities of the covered institutions at 30 September 2008, or incurred by them during the guarantee period. These include

- all deposits with the covered institutions, to the extent that they are not covered by the Deposit Guarantee Scheme
- senior unsecured debt
- asset-covered securities and
- dated subordinated debt.

Asset-covered securities and dated subordinated debt issued after the credit institutions concerned joined the Eligible Liabilities Guarantee scheme are not covered by the CIFS scheme.

6.14 Institutions participating in the scheme are required to make quarterly payments to compensate the State for the impact of the scheme on the cost of State borrowing.

6.15 The overall sum to be recovered through the payments is based on the estimated increased cost of funding Government debt as a result of the provision of the CIFS guarantee. In practice, it is not readily possible to separate the impact of the guarantee on Government funding costs from the impact of other factors. In arriving at the sum, account was also taken of the combined capacity of the covered institutions to pay the charges, given the circumstances that gave rise to the need to introduce the guarantee. Based on the advice of the National Treasury Management Agency, the Department of Finance concluded the cost of funding Government debt increased by between 0.15% and 0.3% as a result of the guarantee. On that basis, the Department determined that the sum to be collected from the covered institutions should be €1 billion over two years.

6.16 The model used for calculating the distribution of the charge between the institutions covered by the guarantee was based on long-term credit ratings as indicators of the risk profiles of the individual institutions. Each institution is required to calculate the amount to be paid each quarter, and to have the amount verified by the institutions' external auditors.

6.17 A special account was set up at the Central Bank into which payments by the covered institutions under the CIFS scheme are lodged. This balance is being held as a reserve for any payments to be made under the scheme. Any balance remaining at the expiry of the scheme will be paid to the Exchequer.

³⁴ The legal basis for the scheme was provided through the Credit Institutions (Financial Support) Act 2008, which was signed into law on 2 October 2008.

³⁵ AIB, Bank of Ireland, Anglo Irish Bank, Irish Life and Permanent, Irish Nationwide Building Society, Educational Building Society, and PostBank.

6.18 Figure 23 indicates the amount paid into the CIFS scheme account since the inception of the scheme. Up to the end of July 2010, a total of €730 million had been received.

Figure 23 Payments by covered institutions under the CIFS Banking Guarantee Scheme, for Quarter 4 2008 to Quarter 2 2010

	Payments €m
Quarter 4 2008	110
Quarter 1 2009	115
Quarter 2 2009	70
Quarter 3 2009	76
Quarter 4 2009	177
Quarter 1 2010	170
Quarter 2 2010	12
	730

Source: Department of Finance

6.19 The CIFS scheme provides for the Minister for Finance, at his discretion, to review the charges levied on covered institutions. In light of the amounts paid in respect of the period to June 2009 (a total of €295 million), the charges were reviewed and adjusted upwards in September 2009. As a result, the charges in respect of the last quarter of 2009 were more than double the level paid for the quarter ending in September 2009.

6.20 The CIFS payment system was further amended to align the scheme charges with those under the Eligible Liabilities Guarantee scheme. This included moving from payment in advance, based on estimated covered liabilities, to payment in arrears based on actual covered liabilities. This, coupled with a substantial movement of covered liabilities to the Eligible Liabilities Guarantee scheme, resulted in a reduced payment level (€12 million) for Quarter 2 2010.

Eligible Liabilities Guarantee

6.21 The Eligible Liabilities Guarantee scheme was introduced in December 2009. It is designed to provide a longer term guarantee of certain banking liabilities, and to bring the Irish bank guarantee structure more into line with guarantees in other EU member states.

6.22 The scheme is being administered by the National Treasury Management Agency, on behalf of the Minister. The Agency has approved the participation of six of the credit institutions covered under the CIFS Banking Guarantee Scheme (and certain of their subsidiaries) in the new scheme. In joining it, the participating credit institutions effectively relinquished the right to issue or incur new liabilities under the CIFS scheme.

6.23 Following approval under EU State aid rules, the Eligible Liabilities Guarantee scheme initially provided for participating credit institutions, in the period up to the end of June 2010, to issue eligible debt securities and to take deposits with a maturity of up to five years, on either a guaranteed or non-guaranteed basis. New dated subordinated debt and asset-covered securities issued after a participating institution joined the scheme are not eligible for guarantee cover.

6.24 On 29 June 2010, the EU Commission approved a prolongation of the period during which liabilities could receive cover. As a result, participating credit institutions can apply for and receive guarantee cover

- until 29 September 2010, for new corporate deposits and new debt liabilities with maturities up to three months
- until 31 December 2010, for other new eligible liabilities with maturities up to five years.

6.25 The institutions participating in the Eligible Liabilities Guarantee scheme pay a fee for the cover they receive, but at a higher level than provided for under the CIFS scheme. The pricing is designed to encourage the institutions to reduce their reliance on State support over time.

6.26 The payment level for liabilities depends on factors such as the maturity profile and amount of the liabilities, and is based on European Central Bank recommendations on pricing government guarantees of banking liabilities. For instance, an annualised fee of 0.5% applies to short-term debt (i.e. with a maturity up to one year). For longer-maturity debts, an additional fee (based on the credit default swap rating of the institution prior to the banking crisis) is also applied. Since 1 July 2010, further additional fees of between 0.2% and 0.4% (depending on the credit rating of the institution) apply on all covered liabilities.

6.27 Up to the end of July 2010, a total of €296 million had been collected from institutions for participation in the scheme. Payments accrue to the Exchequer on an ongoing basis and will not be held in a reserve.

Aggregate Value of Covered Liabilities

6.28 The three guarantee schemes operate in parallel for the covered institutions. Figure 24 indicates the estimated total value of the liabilities covered by the schemes at the end of each quarter from December 2008 to March 2010.

Figure 24 Estimated value of guaranteed liabilities of covered credit institutions, December 2008 to March 2010

	Banking liabilities covered by			Total value of guaranteed liabilities € billion
	Deposit Guarantee ^a	CIFS Bank Guarantee	Eligible Liabilities Guarantee	
	€ billion	€ billion		
End Quarter 4 2008	82	346	—	428
End Quarter 1 2009	79	293	—	372
End Quarter 2 2009	79	276	—	355
End Quarter 3 2009	78	287	—	365
End Quarter 4 2009	77	281	—	359
End Quarter 1 2010	77	130	139	346
End Quarter 2 2010	78	103	153	334

Source: Department of Finance

Note:

a Relates only to eligible deposits in the institutions covered by the CIFS Bank Guarantee Scheme.

Central Bank Liquidity Support

6.29 The Central Bank, through its participation in Eurosystem monetary policy operations, has provided substantial funding to support the liquidity of the banking sector, in the form of advances to credit institutions based in Ireland (including credit institutions based in the Irish Financial Services Centre). All the advances are secured by collateral approved by the Eurosystem, which broadened the type of assets acceptable as collateral in 2008. Key ECB interest rates were reduced between October 2008 and June 2009. In practice, the Central Bank/Eurosystem has, since October 2008, provided as much liquidity as banks sought³⁶.

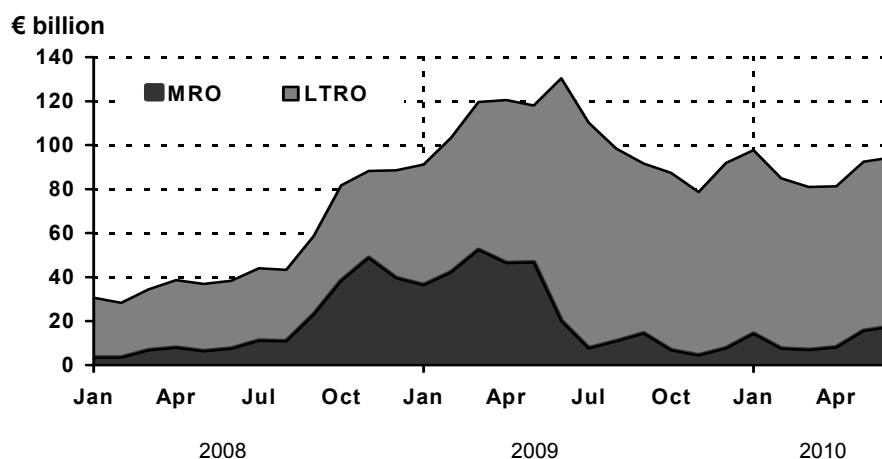
6.30 Advances under the Eurosystem fall into two broad categories

- The Main Refinancing Operations (MRO) comprise weekly offers of loans with a maturity of one week and (since October 2008) at fixed interest rates
- The Long Term Refinancing Operations (LTRO) comprise mainly monthly offers of loans with a maturity of three months and (since October 2008) also at fixed interest rates.

6.31 In 2008, LTRO loans with a maturity of six months were added as a temporary measure. In 2009, LTRO loans with a maturity of twelve months were added. The extended maturity LTRO loans issued in December 2009 (one-year maturity) and March 2010 (six-month maturity) were scheduled to be the last such facilities.

6.32 As Figure 25 indicates, Central Bank Eurosystem lending to credit institutions increased significantly from €38 billion at the end of June 2008, to a peak of around €130 billion at the end of June 2009. Since then, the level of liquidity support provided has fallen, fluctuating in the range €80 billion to €100 billion since August 2009.

Figure 25 Central Bank/Eurosystem Lending to Credit Institutions, January 2008 to June 2010



Source: Central Bank Monthly Statistics Bulletins

6.33 Both retail and international banks avail of Eurosystem liquidity. The Central Bank has reported that over 65% of the lending at end March 2010 was to banks with an important retail

³⁶ The level of Eurosystem lending is limited, however, by the amount of available eligible collateral held by banks.

presence in Ireland and undertaking significant business with households and non-financial corporate customers.

Special Liquidity Facilities

6.34 In addition to liquidity provision within the Eurosystem operations, the Central Bank also provides special liquidity facilities where required. At end 2009, the Central Bank's balance sheet reported 'other assets' totalling €12.8 billion, up from €729 million at the end of 2008. The increase primarily reflected the provision of special liquidity facilities.

6.35 On 30 September 2008, the Minister for Finance issued a letter of comfort in support of Anglo Irish Bank's borrowings from the Central Bank under special liquidity arrangements.

Restructuring of Banks

6.36 A range of State-funded or promoted initiatives have been implemented to restructure banks with the aim of restoring confidence in their ability to operate as going concerns, and to resume normal lending. A key focus has been to achieve market-acceptable capital levels in the banks, in particular following the recognition by them of enormous losses incurred on their development and property loan portfolios on the transfer of these impaired assets to the National Asset Management Agency (NAMA).

6.37 As part of the EU State aid review process, the credit institutions being recapitalised by the State were required to draw up and submit restructuring plans to the European Commission. The plans must identify why the institutions ran into difficulty, and present a viability plan, a programme of burden sharing measures, and a programme of measures to limit distortion of competition. The recapitalised institutions submitted their plans on various dates between September 2009 and June 2010. A decision was received in respect of the Bank of Ireland plan on 15 July 2010. Dialogue with the EU is continuing in respect of the other plans.

Assessment of Capital Requirements

6.38 In early 2010, the Central Bank and Financial Regulator carried out reviews of the capital requirements of three credit institutions — Bank of Ireland, AIB and the Educational Building Society (EBS) — for the three years until 2012. Based on the results of the reviews (referred to as Prudential Capital Assessment Reviews) new capital levels were set for the institutions. The capital was set at levels designed to ensure that they can withstand future losses, even under very stressed conditions. The institutions were required to prepare recapitalisation plans to meet the capital levels by end 2010.

6.39 In order to calculate the capital requirements of individual institutions, the Financial Regulator specified a core tier 1 capital requirement of 8% of total assets to be attained by the end of 2010. This level of capital must be met after taking account of all future losses, from both NAMA and non-NAMA portfolios. This capital must be principally in the form of equity — a 7% equity requirement. Furthermore, banks could not go below a level of 4% core tier 1 capital even in a severely stressed scenario.

6.40 The capital assessment process was not completed for the other institutions participating in the State guarantee schemes. In two cases — Anglo Irish Bank and Irish Nationwide Building Society (INBS) — levels of capital needed to allow the institutions to meet the current minimum capital requirements were identified. In a statement on the results of this exercise, the Minister for Finance indicated that Anglo Irish Bank would require further capital to cover future losses.

6.41 Irish Life and Permanent was not included in the first round of capital assessments because it has not received a government capital injection and is not taking part in NAMA.

6.42 The identified additional capital requirements for individual credit institutions are summarised in Figure 26.

Figure 26 Summary of additional equity capital required, March 2010

Credit institution (State guaranteed)	Minimum equity capital requirement by end 2010
	€ billion
Bank of Ireland	2.7
AIB	7.4
Educational Building Society (EBS)	0.875
Anglo Irish Bank	18.3 ^a
Irish Nationwide Building Society (INBS)	2.6

Source: Financial Regulator

Note:

a Comprises €8.3 billion to meet capital requirements at end March 2010, and an estimated €10 billion to cover subsequent losses.

Purchase of Impaired Bank Assets

6.43 NAMA was established in December 2009. Its purpose is to acquire impaired property-related loans from banks (bank assets). The overall objective is to bring stability to the banking system by removing those loans from the balance sheets of banks.

6.44 The National Asset Management Agency Act 2009 (the Act) and associated regulations made by the Minister for Finance prescribe the types of bank assets that NAMA may acquire and how they are to be valued. Five financial institutions — those shown in Figure 26 above — applied to take part in the scheme, and all were designated as participating banks by the Minister.

6.45 Based on the Minister's direction, NAMA is purchasing eligible bank assets from participating banks at their long-term economic value. The purchase scheme required the approval of the EU Commission because it includes the provision of State aid to the participating banks. The Commission gave its approval for the establishment of NAMA on 26 February 2010. It has stated that it will reassess the aid granted in light of the adequacy of the actual notified asset transfers and restructuring plans which the banks are required to submit to the Commission. It must be notified of the transfer prices of the bank assets on an ongoing basis.

6.46 NAMA's business plan, published in June 2010, indicates that the Agency anticipates it will ultimately acquire about 15,000 loans made by banks to 1,500 borrowers, with an aggregate book value (including accrued interest) of around €81 billion. Figure 27 gives a breakdown of the target assets by participating credit institution, to be acquired in tranches. NAMA aims to transfer all the target assets by February 2011.

Figure 27 Estimated value of eligible assets for purchase by NAMA, by credit institution

Credit institution	Value of eligible assets € billion
Anglo Irish Bank	36
AIB	23
Bank of Ireland	12
Irish Nationwide Building Society	9
Educational Building Society	1
Total	81

Source: NAMA Business Plan, June 2010, page 20

6.47 The purchase of the first tranche of bank assets — loans to ten of the borrowers with the highest debt — was completed in May 2010. The cumulative value of the debts of these borrowers to the participating credit institutions was €15.3 billion (just under 19% of the target total). NAMA paid €7.7 billion for the loans — around 50% of the book value. For individual credit institutions, the amount paid represented discounts on the book value of the loans ranging from 35% to 58%. The amount paid for individual loans ranged from 0-100% of the book value.

6.48 The property associated with the acquired bank assets was valued at around €7.5 billion, which was uplifted by 11% to €8.3 billion after adjustment for long-term economic value.

6.49 The loans are acquired by a NAMA group entity, a majority privately owned special purpose vehicle called NAMA Asset Management Ltd. This entity issues debt to fund the consideration payable. Debt issued to pay for the first tranche of loans comprised

- €7.3 billion (95% of the total) in securities guaranteed by the Minister for Finance
- €0.4 billion in subordinated debt.
- The guaranteed securities pay interest at a variable rate, which is reset twice annually. The rate in the period to 1 September 2010 was just under 1%. The subordinated debt carries an interest rate linked to the yield on 10-year Irish Government bonds. Payment of interest on the subordinated debt and its ultimate redemption are dependent upon NAMA's financial performance.

6.50 A report on the acquisition of the first tranche of impaired bank assets by NAMA is in preparation. This will be published in Special Report number 76 of the Comptroller and Auditor General.

State Investment in Credit Institutions

6.51 Under legislative provisions in early 2009, the Minister for Finance directed the National Pension Reserve Fund Commission to invest €3.5 billion in preference shares of both Bank of Ireland and of AIB. In each case, the investment consisted of

- Perpetual non-cumulative preference shares³⁷ that pay a non-cumulative fixed dividend of 8%, payable at the respective banks' discretion in cash or with the equivalent value in ordinary shares. The preference shares can be repurchased by the bank at par value (€1 each) within the first five years and thereafter at €1.25 each.
- Warrants attach to the preference shares giving the Fund an option to subscribe³⁸ for ordinary share capital in the bank. The warrants are exercisable on the earlier of (i) anytime between the fifth and tenth anniversary of the date of the issue of the preference stock and (ii) in the event of an offer for the bank or other change of control.

6.52 In addition, on foot of the investment, the Minister can appoint 25% of the directors to each bank and the Fund receives 25% of total ordinary voting rights in respect of change of control and board appointments.

6.53 On 19 February 2010, Bank of Ireland paid a dividend of €250 million due on preference shares, in the form of ordinary shares in the bank. On 13 May 2010, AIB paid a dividend of €280 million due on its preference shares, in the form of ordinary shares of the bank.

6.54 In both cases, the payment was made in the form of ordinary shares because the European Commission had requested that discretionary coupon payments on tier 1 and upper tier 2 capital instruments³⁹ in Bank of Ireland and AIB not be paid while it considered each bank's restructuring plan. Following the issue of the shares, the Fund held 15.7% of the ordinary shares of Bank of Ireland and 18.6% of the ordinary shares of AIB⁴⁰.

6.55 In order to assist the two banks to meet the regulatory capital requirements identified by the Financial Regulator in the March 2010 recapitalisation exercise, the Minister for Finance announced that the State would support them in their capital raising.

- In the case of Bank of Ireland, this support would be provided through the conversion of part of the Fund's preference shares into ordinary shares.
- In the case of AIB, it would be provided by conversion of part or all of the Fund's preference shares (as required) into ordinary equity. If additional capital was required, it would be provided through investment in ordinary shares by the Commission.

³⁷ Preference shares are a type of share capital which confers particular rights, including priority payment of any dividend. The directed investments in Bank of Ireland and AIB preference shares rank *pari passu* (i.e. with equal rights) with ordinary shares in any liquidation, and the annual dividend ranks *pari passu* with dividend claims of other preference shares and ahead of ordinary share dividends.

³⁸ The exercise price for the Bank of Ireland warrants was set at €0.52 for 177,213,784 shares and €0.20 for 157,523,364 shares. The exercise price of AIB warrants is €0.975 for 155,780,375 shares and €0.375 for 138,471,444 shares.

³⁹ Tier 1 capital instruments refer to paid up share capital and common stock. Upper Tier 2 capital refers to certain subordinated debts including the preference shares held in the two banks.

⁴⁰ This includes small shareholdings already held in within the Funds discretionary investment portfolio.

6.56 In April 2010, Bank of Ireland announced a plan to raise €3.4 billion equity capital through a share placement and rights issue. The Commission was directed by the Minister to participate in the issue in accordance with the terms of a transaction agreement with Bank of Ireland. The financial impacts for the Fund arising from the deal are

- the Fund's ordinary shareholding in Bank of Ireland now stands at 36%, the market value of which at 30 June 2010 was €1.3 billion
- the par value of its remaining preference shares was €1.8 billion
- the Fund received €491 million in respect of the warrants issued in conjunction with the preference shares
- the Fund received €52 million in transaction fees.

6.57 AIB is continuing with its capital raising programme. No further financial outlays have been incurred by the Fund in respect of AIB to date.

Financial Support for Nationalised Credit Institutions

6.58 Since the emergence of the financial crisis in September 2008, three credit institutions — Anglo Irish Bank, INBS and EBS — have been taken into full State ownership. Substantial State expenditure has been incurred or committed in acquiring and supporting the continued operation of the three institutions.

Nationalisation of Anglo Irish Bank

6.59 The evident absence of market confidence in Anglo Irish Bank and growing concerns about the bank's governance resulted in a Government decision on 15 January 2009 to take the bank into State ownership.

6.60 The nationalisation was given effect through the Anglo Irish Bank Corporation Act 2009, which was signed into law on 21 January 2009. Since then, the bank has operated as a commercial semi-State body. It remains subject to regulation by the Financial Regulator and also remains a 'covered institution' under the terms of the guarantee scheme.

6.61 A detailed internal assessment of the Anglo Irish Bank loan book was carried out for the period leading up to the end of March 2009, and was reviewed independently by PricewaterhouseCoopers. As a result, it was recognised that there was very substantial impairment of certain loans, resulting in the bank's half year accounts published at the end of May 2009 showing pre-tax losses of €4.1 billion.

6.62 In the light of the losses, the Minister announced that, subject to EU approval, he would provide up to €4 billion of capital for the bank. Part of the injection of capital was to be used by the bank to buy back certain outstanding subordinated loans from bondholders at a significant discount on their par value. EU approval for the Government's capital injection was received on 26 June 2009.

6.63 During 2009, the Government provided the capital to the bank through the purchase of ordinary shares in the bank. The sum of €4 billion was paid out of the Central Fund, under Section 6 (9) of the Credit Institutions (Financial Support) Act 2008.

6.64 The subsequent recognition of further losses on the bank's lending portfolio during 2009 and in 2010 resulted in a requirement for the State to provide additional financial support to keep the bank in business. The provisional estimate at end March 2010 of the further capital required by the bank was €18.3 billion.

6.65 In order to provide the capital support, the Minister for Finance issued a promissory note to Anglo Irish Bank in March 2010 with a value of €8.3 billion. In May 2010, the value of the note was increased by €2 billion (to a total value of €10.3 billion). This mechanism will spread the payment out over a number of years. The Minister has indicated that any further capital support for the bank will be provided by the same mechanism.

6.66 At the end of June 2010, a proposal for the provision of a further capital injection of €8.58 billion into Anglo Irish Bank was notified to the EU Commission. This is intended to meet the capital needs of the bank from the end of June to allow it to meet its minimum core tier 1 capital requirements. The capital injection may be increased to a total of €10.05 billion, depending on the accounting treatment of the NAMA bonds in Anglo Irish Bank's accounts. The EU Commission announced temporary authorisation under EU State aid rules for this capital injection on 10 August 2010, pending a final decision on a restructuring plan for the bank.

Acquisition of Building Societies

6.67 Traditionally, Irish building societies concentrated their business focus on providing residential mortgages for customers in Ireland. More recently, INBS in particular (and EBS to a more limited extent) became involved in non-residential lending. In the case of INBS, such lending became its primary focus comprising approximately 80% of its lending business. As a result, they incurred significant losses on speculative lending for land and development and commercial investment loans. In the case of INBS, loan assets with an original value of €9 billion will transfer to NAMA while in the case of EBS, assets with an original value of approximately €1 billion will transfer.

6.68 The estimate at end March 2010 was that INBS required further capital of €2.6 billion to address capital losses arising from the transfer of the first tranche of its property loans to NAMA. The Prudential Capital Assessment Review identified a requirement for the EBS to raise additional equity capital of €875 million.

6.69 In order to avail of State capital support, both building societies passed resolutions allowing them to issue new Special Investment Shares to the State, which paid €200 million from the Exchequer to acquire the shares. As a result of the investment, the State acquired economic ownership of the two societies, and now controls them. The Minister for Finance issued a promissory note to INBS on 31 March 2010, to the value of €2.6 billion.

6.70 Following the planned transfer of assets with an original value of €9 billion to NAMA, INBS will have a small, mainly residential loan book valued at about €2 billion. The Minister announced in his Banking Statement at the end of March 2010 that, in the circumstances, the INBS does not have a future as an independent stand-alone entity. The Government has stated its aim is to secure a swift sale of INBS or its integration with another entity

6.71 The Minister for Finance issued a promissory note to the value of €250 million in respect of the EBS on 17 June 2010. The building society raised a further €8 million through a liability management exercise. Together with the special investment share of €100 million, this contributed a total of €438 million towards meeting the capital requirement of €875 million. The society is currently exploring the availability of private market capital. To the extent that private capital is not forthcoming, the remaining capital requirement will be met either partly or fully through the issue of a further promissory note by the State to the institution.

Delegation of Banking Functions

6.72 In March 2010, the Government delegated a number of banking system functions of the Minister for Finance to the NTMA, to be carried out in accordance with directions issued by the Minister. This delegation related in particular to management of the State's interests in the credit institutions covered by the banking guarantees, negotiation of capital support to those institutions and sustainable development of the banking sector.

6.73 The main functions delegated to the NTMA and the parameters set out in directions of the Minister are

- to lead discussions in consultation with the Department of Finance and the Central Bank and Financial Regulator with the covered credit institutions to determine their likely capital requirements
- to negotiate with the covered institutions the terms and conditions on which any capital support provided by the State will be invested
- to manage any Ministerial shareholdings or other ownership interest in these institutions
- to carry out all of the roles required by the Minister in respect of any relationship framework with any credit institution required under statute
- to lead discussions in consultation with the Department of Finance, with all interested parties on the ultimate shape of the 'third force' and any other restructuring of the financial system
- to conduct on behalf of the Minister any discussions with other players in the market, both national and international, as necessary
- to advise the Minister in relation to his consultations with the Financial Regulator under the Credit Institutions (Financial Support) Scheme and Eligible Liabilities Guarantee Scheme
- to report to the Minister and seek approval and direction prior to making any irrevocable commitment and
- to provide any information required by the Department of Finance in relation to any of the above issues, particularly in the context of discussions with the European Commission on State aid to the banking sector.

6.74 The NTMA has stated that its initial work in the banking area has focused on the analysis of the financial condition of Bank of Ireland and AIB, and the provision of advice to the Department of Finance on specific banking related issues. It has also stated that it negotiated, in consultation with the Department of Finance, with Bank of Ireland and AIB ahead of the Minister's banking statement to the Dáil of 30 March 2010 in which he set out the equity capital requirements of individual institutions and what State support might be provided.

Central Bank Reform

6.75 At the request of the Minister for Finance, the Governor of the Central Bank carried out an examination of the root causes of the systemic failures that led to the need for the extraordinary State support for the Irish banking sector, and of the respective statutory powers, roles and responsibilities of the Central Bank and Financial Regulator in that context. In his report published in May 2010, he identified three primary factors that appeared to have contributed to the problems

- a regulatory approach that was and was perceived to be excessively deferential and accommodating, insufficiently challenging and not persistent enough
- an under-resourced approach to banking supervision that, by relying on governance and risk-management procedures in the regulated institutions, neglected quantitative assessment and the need to ensure sufficient capital to absorb the growing property-related risks
- an unwillingness by the Central Bank and Financial Regulator to sufficiently take on board the real risk of a looming problem and to act with sufficient decision and force to head it off in time.

6.76 The Central Bank Reform Act 2010 was signed into law on 17 July 2010. This provides for a fully-integrated structure — the Central Bank of Ireland — to replace the existing dual-structured Central Bank and Financial Services Authority of Ireland. The Bank will have a unitary Board, ‘the Central Bank Commission’, which will be chaired by the Governor, with a specific focus on regulatory performance, including the development of performance benchmarks. The Bank will be responsible for maintaining the stability of the financial system, the effective regulation of financial institutions and markets and safeguarding the interests of consumers and investors. It will relinquish the current statutory function of promoting the development within the State of the financial services industry.

6.77 The Central Bank Reform Act 2010 includes provisions that will give the Bank specific powers to ensure the fitness and probity of nominees to key positions within financial institutions. It also provides for mechanisms to enhance the accountability of the Bank and oversight by the Oireachtas of its regulatory performance, including

- preparation by the Bank of an annual performance statement in relation to its regulatory functions, to be presented to the Minister and laid before the Houses of the Oireachtas
- international peer reviews of regulatory performance prepared at least every four years (incorporated in the annual performance report of the relevant year)
- provision for a committee of the Oireachtas to call the Governor and/or the Heads of Regulation and of Central Banking to be examined on the annual performance report.

6.78 A further Bill is to be published in the autumn which will set out enhanced regulatory powers and functions for the restructured Central Bank. A third Bill will consolidate all existing statutory provisions.

Administrative Costs of Banking Initiatives

6.79 In the course of developing and implementing the wide range of measures aimed at stabilising the banking sector, there has necessarily been very significant recourse to the services of legal, financial and economic advisors by the Department of Finance, the National Treasury Management Agency and the Central Bank. This was required because of the highly technical issues that have arisen, and because of the frequent need to complete the work within a very short timeframe. The nature and urgency of the work also necessarily resulted in the procurement of some services without recourse to competitive processes. Significant internal costs in relation to staff engaged in the design and implementation of the stabilisation measures have also been incurred.

6.80 The main consultancy contracts entered into by State bodies in relation to banking stabilisation measures are

- **Department of Finance** — contracts with Arthur Cox Solicitors for legal advice and with PricewaterhouseCoopers for accounting advice
- **National Treasury Management Agency (NTMA)** — contracts with Merrill Lynch and Rothschild for advice on financial market issues
- **National Pension Reserve Fund Commission (NPRFC)** — contracts with Arthur Cox Solicitors and PricewaterhouseCoopers for assistance with legal and financial due diligence processes in relation to investment in Bank of Ireland and AIB, and with Sir Andrew Large⁴¹ who was engaged as a ‘trusted advisor’ to assist in overseeing that process
- **Central Bank and Financial Regulator** — commissioned a range of financial consultancy services in relation to the Banking Guarantee Scheme from KPMG, PricewaterhouseCoopers, Jones Lang LaSalle, Deloitte and Ernst & Young.

6.81 Expenditure by the various agencies on consultancy services up to the end of July 2010 amounted to €33.76 million (see Figure 28). It should be noted that this expenditure excludes the costs of consultancy services commissioned by financial institutions at the direction of the Department and/or the Central Bank and Financial Regulator under provisions of the Banking Guarantee Scheme. In those cases, the consultancy costs were paid by the credit institutions themselves.

⁴¹ Sir Andrew Large is a former Deputy Governor of the Bank of England and a former Chairman of the UK Financial Services Authority.

Figure 28 Cumulative expenditure by State agencies on consultancy services for banking stabilisation measures, to end July 2010^a

Commissioning Agency	Consultancy provider	Expenditure to 31 July 2010	
		€m	€m
Department of Finance	Arthur Cox Solicitors	9.66	
	PricewaterhouseCoopers	0.12	9.78
NTMA	Merrill Lynch	7.33	
	Rothschild	4.54	11.87
NPRFC ^b	Arthur Cox Solicitors	1.95	
	PricewaterhouseCoopers	1.58	
	Sir Andrew Large	0.12	3.65
Central Bank/Financial Regulator	PricewaterhouseCoopers	4.95	
	KPMG	2.01	
	Jones Lang LaSalle	0.84	
	Deloitte	0.42	
	Ernst and Young	0.24	8.46
Total for all consultancies			33.76

Source: Department of Finance

Notes:

a Consultants hired in relation to NAMA are dealt with in Special Report 76.

b NPRFC expenditure is to end December 2009.

6.82 Of the consultancy services listed in Figure , three were procured without competitive tender in 2009 by the NTMA as part of the due diligence exercise for the directed investment by the NPRFC in Bank of Ireland and AIB, namely PricewaterhouseCoopers, Arthur Cox and Sir Andrew Large. Furthermore, as these contracts and the contracts for banking advice for Merrill Lynch and Rothschilds were fixed fee arrangements, there was no detailed vouching relating the charges to specific activities. In response to my queries, the Accounting Officer of the NTMA explained that time was of the essence with regard to the due diligence exercise and, given the urgency of the situation, did not allow the Agency to go through the standard public procurement procedures in awarding the contracts.

- PricewaterhouseCoopers and Arthur Cox were engaged to carry out the due diligence as these firms had already been engaged by the Financial Regulator to carry out in depth studies of the banks' asset book in the context of the government guarantee scheme. To have engaged alternative firms would have involved significant delays in order to gather this information once again.
- Sir Andrew Large was engaged as a 'trusted advisor' on certain aspects of the due diligence process including the judgments to be made in light of the final reports because of his specialist expertise in the banking area.

Recovery of Administrative Costs

6.83 To date, the Department has received payments amounting to around €3.3 million from the credit institutions covered by the original Banking Guarantee Scheme in respect of recoupable costs. This total includes €1.7 million in respect of the associated legal expenses. The Central Bank/Financial Regulator also levied fees totalling €6.8 million on the relevant institutions up to the end of December 2009.

Conclusion

Up to the end of July 2010, the State had spent or committed a total of €24.35 billion on the direct provision of financial support to credit institutions. This comprises

- €7 billion invested by the National Pension Reserve Fund in AIB and Bank of Ireland, in return for which it has become a substantial shareholder
- €4.2 billion spent supporting Anglo Irish Bank and taking the INBS and the EBS into State ownership
- the issuing of promissory notes to the value of €10.3 billion to Anglo Irish Bank, €2.6 billion to the INBS and €250 million to the EBS — this mechanism will spread the Exchequer cash payments over a number of years into the future.
- In addition, the Minister for Finance has indicated an intention to provide up to €10 billion in further support for Anglo Irish Bank and up to €37 million for the EBS, if required.

Apart from the capital injections for individual financial institutions, the State has provided substantial guarantees in respect of banking liabilities. At end June 2010, the extent of the credit institutions liabilities covered by such schemes was estimated to be €34 billion. This included €8 billion covered under the Deposit Guarantee Scheme.

The State has received some funding in return for the guarantees it has provided in respect of bank liabilities. By end July 2010, it had collected guarantee fee payments totalling €1,026 million. A small amount of the costs of developing and administering banking stabilisation measures has also been recovered from the institutions availing of the guarantee cover. In addition, substantial balances were held in the Deposit Guarantee Account in the Central Bank (€608 million at the end of 2009).

Administrative costs incurred by State agencies in relation to banking stabilisation measures have been substantial in absolute terms, but are small relative to the scale of the costs, financial commitments and risks associated with the banking stabilisation measures. Access to timely and professional advice is a vital input to decision making in this context. At the same time, it is important to ensure that sound procurement and contracting practices are followed to ensure that the expenses being incurred are no more than is warranted in the circumstances.

Chapter 7

Central Government

European Union – Financial Transactions 2009

European Union – Financial Transactions 2009

7.1 The budget of the European Union (EU) is financed by own resources and some additional receipts. Own resources comprise

- the proceeds of customs duties and sugar levies (also referred to as traditional own resources) less a retention of 25% for collection costs (13% of total EU revenue)
- a VAT-based own resource under which an annually agreed percentage is levied on the VAT base of all member states (12% of total revenue)
- an own resource based on Gross National Income (GNI) under which the same percentage is levied on each member state's GNI in accordance with EU rules (73% of total revenue).

7.2 The additional receipts into the EU budget include interest, refunds and any surplus carried over from the previous year (2% of total revenue).

7.3 Ireland is a net beneficiary of EU funding and receipts from and payments to the EU budget over the past five years are set out in Figure 29.

Figure 29 Ireland's Receipts from and Payments to the EU Budget 2005 - 2009

Year	Annual Receipts € billion	Annual Payment € billion	Surplus/ (Deficit) € billion
2005	2.4	1.5	0.9
2006	2.2	1.5	0.7
2007	2.1	1.6	0.5
2008	2.1	1.6	0.5
2009	1.8	1.5	0.3
Total	10.6	7.7	2.9

Source: Department of Finance

Chapter Focus

This chapter has been compiled to present an overview of the financial transactions between Ireland and the European Union, the procedures for the allocation of EU funds and the various audit arrangements relating to those funds.

Contribution to EU Budget

7.4 The Irish contribution to the EU budget for 2009 was €1.5 billion. The component elements of this total are shown in Figure 30.

Figure 30 Ireland's Contribution to EU Budget 2009

Contribution Element	2009 Determination Base ^a	Amount €000
Traditional Own Resources	75% of total received into Exchequer	176,598
VAT-based Contribution	0.3278% of established VAT base	163,005
GNI-based Contribution	0.5847% of established GNI	1,000,612
UK Correction Mechanism ^b		114,884
NL/SE GNI Reduction ^c		31,209
Total		1,486,308

Source: Department of Finance

Notes:

- a The rates presented for the VAT and GNI based contributions are those agreed at the beginning of the budget year. These can alter during the year as amending budgets are agreed.
- b Since 1985, the UK has received a partial refund of its EU budget contributions. The refund is financed by contributions from all other member states in proportion to their national percentage of EU GNI.
- c For the period 2007-13, the Netherlands and Sweden benefit from a gross reduction in their annual GNI contribution of €605 million and €150 million, respectively, over the period. The refund is financed by contributions from all other member states in proportion to their national percentage of EU GNI.

Receipts from EU Budget Funds

7.5 Receipts of €1.8 billion from the EU in 2009 were sourced from particular EU Funds and Programmes. The 2009 receipts were applied by Ireland as amounts voted by Dáil Éireann of €384 million, Central Fund Payments of over €82 million and amounts paid directly to Implementation Agencies and Beneficiaries amounting to €1.3 billion as specified in Figure 31.

Figure 31 Ireland's 2009 Receipts by Source

Source of EU Receipts	Amount	Application of EU Funds		
		Votes	Central Fund	Direct ^a
	€000	€000	€000	€000
<i>Agriculture and Rural Development</i>				
European Agricultural Guarantee Fund (EAGF) ^b	1,318,985	-	-	1,318,985
European Agricultural Fund for Rural Development (EAFRD)	329,171	329,171	-	-
European Agricultural Guidance and Guarantee Fund ^c	744	744	-	-
<i>Structural Funds^d</i>				
European Regional Development Fund (ERDF) ^e	57,713 ^f	-	57,156	557
European Social Fund (ESF)	42,810	42,810	-	-
Cohesion Fund	22,930	-	10,700	12,230
<i>Other Funds/Receipts</i>				
Other Receipts	38,398	11,673	14,730	11,995
Total	1,810,751	384,398	82,586	1,343,767

Source: Department of Finance

Notes:

- a These receipts are held separately from State or Voted funds and paid to recipients on behalf of the EU.
- b The principal component consists of Single Farm Payments amounting to almost €1.3 billion.
- c From 2007, the European Agricultural Guidance and Guarantee Fund was replaced by the EAGF and EAFRD.
- d The Structural Funds consists of the ERDF, which provides financial support for the development and structural adjustment of regional economies, the ESF, which provides for education, training and employment supports and Cohesion Funding for environmental and transport infrastructural projects. Ireland is no longer eligible for Cohesion Funding support from the end of 2003 and receipts recorded relate to claims prior to this date.
- e Includes receipts from the Programme for Peace and Reconciliation of €4.9 million.
- f This figure includes an amount of €9.3 million in respect of advances, which are retained in a suspense account and are used in pre-financing of projects approved for EU funding.

7.6 The €38.4 million in Other EU Receipts set out in Figure 31 is comprised of the funds detailed in Figure 32.

Figure 32 Estimated EU Receipts from Other Sources^a

Source of Other EU Receipts	Amount	Application of EU Funds		
		Votes	Central Fund	Direct
	€000	€000	€000	€000
Financial Instrument for Fisheries Guidance	2,526	2,526	-	-
Fisheries Protection/ EAGF Fish Markets and Conservation and Management of Fisheries	617	617	-	-
European Fisheries Fund ^b	2,959	-	2,959	-
Veterinary Fund	6,424	6,424	-	-
Education Programmes	11,858	-	-	11,858
EEA/TENs/Other ^c	11,771	-	11,771	-
European Refugee/Integration/Return Funds ^d	2,106	2,106	-	-
CSO – Eurostat Receipts	137	-	-	137
Total	38,398	11,673	14,730	11,995

Source: Department of Finance

Notes:

- a Some EU Funds from other sources may be paid by the EU Commission directly to private firms or individuals e.g. research grants and therefore the term estimated is used.
- b Advances from this fund are retained in a suspense account and used in pre-financing of projects approved for EU funding.
- c These receipts relate principally to transport, energy and telecommunication projects.
- d These receipts consist of €1.5 million in respect of the European Refugee Fund and the Integration Fund for Third Country Nationals with the balance being receipts for the European Return Fund.

Allocation of EU Funds

7.7 EU budget policy is implemented on the basis of multi-annual financial programming periods. The current programme period is 2007-13 and the financial framework for this period was agreed between the European Parliament, EU Council and the European Commission (the Commission) under an Inter Institutional Agreement adopted in May 2006. The general and detailed rules for the implementation of the EU policy objectives are laid down in EU Council and Commission Regulations. An annual EU budget of expenditure and receipts is then agreed.

7.8 The annual EU budget is decided by the EU Council and the European Parliament on the basis of a budget proposal from the Commission, which is also responsible for implementing it. Across all EU member states, the largest single element of EU spending has been related to agriculture and rural development – principally in the form of payments to farmers – which accounted for 45% of the budget in 2009. Cohesion Funding accounted for almost 40% of the budget.

7.9 The main sources of EU funding to Ireland are Agricultural and Rural Development funds and Structural Funds. Ireland's share of Structural Funds has been decreasing over the years. Each component fund is governed by its own rules for financial management, control and accountability. A principal difference is that independently certified annual accounts of expenditure must be submitted each year for the Agriculture Guarantee and Rural Development funds, whereas for Structural Funds certified accounts must be submitted at the end of the programme period.

Agriculture Funds

7.10 EU expenditure on Agriculture and Rural Development is financed out of two funds

- the European Agricultural Guarantee Fund (EAGF), which, with a few exceptions, fully funds direct aid payments to farmers as well as a range of market support measures
- the European Agricultural Fund for Rural Development (EAFRD), which came into operation in 2007 and is used for co-financing measures implemented under Ireland's Rural Development Programme 2007-2013.

7.11 EAGF and EAFRD expenditure is paid by accredited paying agencies⁴² in member states. In Ireland, the Department of Agriculture, Fisheries and Food is the sole accredited paying agency and managing authority⁴³ for the EAGF and the EAFRD. The authority to make rural development payments in respect of specific measures of the EAFRD relating to LEADER⁴⁴ is delegated to the Department of Community, Equality and Gaeltacht Affairs.

7.12 EAGF expenditure is recouped on a monthly basis from the EU while EAFRD expenditure is recouped quarterly. At year-end, independently certified annual accounts of EAGF and EAFRD expenditure must be submitted to the Commission. The Secretary General of the Department of Agriculture, Fisheries and Food is required to provide annually a statement of assurance regarding the EAGF and EAFRD accounts and control systems. In the case of EAFRD, the Department submit an annual report on its implementation.

7.13 The Commission clears both of the annual accounts in two stages - by an annual clearance decision based on the independent certification of the annual accounts and by ad-hoc clearance decisions arising from follow up audit work by the Commission. The Commission undertakes an annual programme of audits on specific schemes and areas following certification of the annual accounts and conducted five audit missions in Ireland in 2009.

Structural Funds

7.14 The Regulations governing the Structural Funds require member states, in conjunction with the Commission, to prepare and agree Operational Programmes to implement strategic priorities and impose financial management and control requirements relating to the implementation of Structural Fund co-funded assistance.

7.15 Each member state is required under the Regulations to designate a Managing Authority for each Operational Programme. The member state must also designate an Audit Authority and a Certifying Authority for each fund. The functions and responsibilities of these bodies include the following

- The Managing Authority is responsible for managing and implementing the operational programme in accordance with the principles of sound financial management and for ensuring that activities selected for funding match the Operational Programme criteria. It is also responsible for verifying that co-financed projects are delivered, that expenditure declared by the beneficiaries has actually been incurred and complies with EU and national rules and that an adequate audit trail exists.

⁴² Paying agencies are accredited by member states if they comply with specific requirements on financial control and accountability over EU expenditure as set out in Community legislation (EU Reg. 885/2006).

⁴³ The Managing Authority is responsible for managing and implementing the programme in an efficient, effective and correct way.

⁴⁴ The LEADER initiative is designed to aid the development of sustainable rural communities.

- The Certifying Authority is responsible for drawing up and submitting certified statements of expenditure and applications for payment. It is responsible for ensuring the accuracy and probity of these statements of expenditure.
- The Audit Authority functions include ensuring that audits are carried out to verify the effective functioning of the management and control system of the Operational Programmes. It must present an audit strategy to the Commission and submit an Annual Control Report setting out the findings of audits carried out and provide an annual audit opinion as to whether the management and control systems function effectively.

7.16 The Department of Finance has overall policy responsibility for the Structural Funds and is also the Certifying Authority for the ERDF. There are two Managing Authorities for the ERDF in the 2007-13 programming period - the Regional Assembly for the Border, Midlands and Western region and the Regional Assembly for the Southern and Eastern region. The Department of Education and Skills⁴⁵, as Managing Authority and Certifying Authority, has primary responsibility for the ESF.

7.17 The Secretary General of each department involved in the implementation of co-financed projects is required to sign a declaration annually and submit it to the Department of Finance to confirm compliance with all applicable EU regulations. An Implementation Report is submitted annually to the Commission by each Managing Authority which sets out the financial implementation of the operational programmes in terms of targets and outturns and outlines the monitoring and evaluation procedures in place.

Audit of EU Funds

7.18 The audit arrangements in place within each of the relevant departments in relation to EU funds are outlined below together with an outline of the roles of my Office, the EU Commission and the European Court of Auditors (ECA).

Audit Authorities

Agriculture and Rural Development

7.19 The Department of Agriculture, Fisheries and Food appoint a firm of commercial auditors to provide an independent annual certificate and report on internal controls to the Commission. In addition, the Department's Internal Audit Unit finalised and issued seven system audit reports on the EAGF and EAFRD funded schemes in 2009.

⁴⁵ Responsibility for ESF policy and operations transferred from the Department of Enterprise, Trade and Innovation to the Department of Education and Skills on 1 May 2010.

Structural Funds

7.20 Audit Authorities known as Financial Control Units have been established in the Department of Finance, ERDF Financial Control Unit and the Department of Education and Skills ESF Financial Control Unit. The Control Units were required to perform annual minimum 5% verification checks⁴⁶ on total eligible expenditure within managing authorities, intermediate bodies and beneficiaries in operational programmes in the 2000-06 programming period.

7.21 In 2009, the ERDF Control Unit carried out audits in 34 organisations and in the course of these audits it verified expenditure to the value of €88 million in respect of the 2000-06 programming period. As at 31 December 2009, the Unit has verified expenditure of €441 million or 12% of the cumulative expenditure of €3.7 billion declared to the Commission. In 2009, the Unit verified Cohesion Fund⁴⁷ expenditure to the value of €2 million and to the end of 2009 the Unit had verified expenditure of €319 million out of the total of €777 million declared to the Commission.

7.22 As at 31 December 2009, the ESF Control Unit had verified cumulative expenditure in respect of the 2000-06 programming period of €222 million or 11% of the total of €1.9 billion declared to the Commission. In 2009, in respect of the 2007-13 programming period, it performed verification audits on 39 operations which included expenditure claims totalling €43 million. This represented 25% of the total claimed expenditure in 2007 and 2008 of €175 million.

7.23 System-based audits are also performed at each level to verify the effectiveness of the management and control systems in place and both of the Control Units coordinate an annual plan of systems-based audits to be completed by Internal Audit Units in bodies involved in the management and administration of the Operational Programmes. In addition, a series of system checks and compliance checks from the Managing Authority level down to the final beneficiary level is carried out in accordance with EU regulations⁴⁸.

Audit by the Comptroller and Auditor General

7.24 Where a Department or State Body audited by me is in receipt of EU funds, the receipt and application of the funds are audited in like manner to national funds and to all other transactions by that body. Audit planning has regard to the audit tasks undertaken by others including the ECA, the Financial Control Units and the independent external Certification Body for agricultural supports. Audit work includes testing of compliance with national rules that have been transposed from EU Directives and Regulations. However, the transposition process is outside the remit of the audit.

7.25 Inspection arrangements put in place by the Department of Agriculture, Fisheries and Food to confirm farmer eligibility for Single Payment Scheme entitlements and cross-compliance with regard to farm management, environmental, health and welfare conditions are examined in Chapter 27 of this Report.

⁴⁶ The requirement for 5% verification checks was changed for the 2007-13 programming period. EU Regulations now require that the sample of operations to be audited each year is based on a random statistical sampling method. A non-statistical method may be used where the number of operations is insufficient to allow the use of a statistical sampling method.

⁴⁷ The ERDF Financial Control Unit is also responsible for performing annual minimum 15% verification on eligible expenditure in respect of Cohesion Funding.

⁴⁸ Article 60 of General Regulation 1083/2006.

7.26 The administration of the aid payable under the Sugar Restructuring Scheme was examined by my Office during the course of the year. A summary of the findings of this examination are outlined in Annex A.

Audits by EU Commission

7.27 Audit services from the Commission carry out a number of audits annually in member states and have the right to carry out on-the-spot audits or may request a member state to audit specific programmes or projects.

European Court of Auditors

7.28 Ireland contributed almost €1.5 billion in 2009 towards the total EU budget of approximately €120 billion which amounted to about 1% of the Gross National Income of its 27 member states. Because Ireland's financial contribution is pooled with that of other member states it shares an interest that the common funds are managed to good effect. At EU level this assurance is provided by the ECA.

7.29 The ECA is required to give an annual Statement of Assurance (an audit opinion) on the reliability of the Accounts of the European Union and of the legality and regularity of the transactions underlying those accounts. In carrying out these functions, ECA staff visit member states to review management structures, test systems of control and to examine in detail a sample of applications submitted in support of payments to final beneficiaries. When selecting audits, the ECA aims to identify audit subjects that are likely to yield high impact in terms of identifying potential improvements in the economy, efficiency and effectiveness of EU spending.

7.30 Liaison arrangements provide for ECA visits to Ireland to be organised by my Office and all correspondence including the ECA audit findings and management responses are addressed to my Office for transmission to the audited body. Four such visits were carried out in 2009. Following consultation with the certifying authority, the findings are incorporated into the annual report of the ECA.

7.31 For the second consecutive year the ECA gave a positive Statement of Assurance, without qualification, on the reliability of the 2008 accounts⁴⁹. However, for the fifteenth successive year, the ECA did not give a positive Statement of Assurance on the legality and regularity of most categories of EU expenditure. It reported a material level of error⁵⁰ among member states for EU spending categories comprising 53% of expenditure, including the Cohesion and Rural Development categories.

7.32 However, the overall results on the legality and regularity of transactions reflected a detectable improvement in the management of the budget in recent years particularly in the largest policy group, Agriculture and Natural Resources. The ECA concluded that, except for Rural Development, payments in this policy group were in all material respects legal and regular and for the first time it gave a qualified opinion⁵¹ rather than an adverse⁵² one.

⁴⁹ The audit of the 2009 accounts is not yet completed.

⁵⁰ The ECA treats as material an error in excess of 2% of total expenditure in a policy group.

⁵¹ A qualified opinion is given when an unqualified opinion cannot be expressed but the effect of any disagreement or limitation on scope is not so material or pervasive as to require an adverse opinion or a disclaimer of opinion.

⁵² An adverse opinion is given when the level of error in the underlying transactions is material and pervasive, or the accounts are not reliable.

7.33 Overall, the level of irregularity across the EU remains high in some areas and a qualified opinion was given on the policy group, Economic and Financial Affairs, while the ECA gave adverse opinions for three other policy groups which were materially affected by error, although to different levels. One of these was Cohesion Funding which is the second largest policy group and was the area most affected by errors in spending across the EU, with an estimated 11% of claims found to be ineligible.

7.34 The ECA concluded that overall, error rates appear to be decreasing but that the high level of error reported in many situations is a consequence of rules and regulations that are too complex and simplification remains a priority if further significant and sustainable reductions in the level of irregular payments are to be achieved.

Irregularities, Recoveries and Financial Corrections

7.35 Member states are obliged to recover amounts lost as a result of irregularities. Financial corrections⁵³ may be made by the member state based on the nature and gravity of any irregularities discovered and the extent and financial implications of the deficiencies.

7.36 Financial corrections may take the following forms

- Specifically quantified corrections in cases where an irregularity is detected for an individual operation or several individual operations and it is possible to quantify the correction.
- Extrapolated corrections where an irregularity found in a representative sample of transactions can be assumed to have recurred in other operations of the same type.
- Flat rate corrections where individual breaches or systemic irregularities are not in practice quantifiable. Scales of flat rate corrections may vary from 2% to 100% of the assistance depending on the severity of the breach of the regulations.

7.37 Certifying Authorities for the Structural Funds have overall responsibility for processing and reporting financial corrections. Specifically quantified corrections detected by the Audit Authority contribute to Ireland's error rate⁵⁴. The error rate determined by the Audit Authority is set out in its annual control report submitted to the Commission.

7.38 Where any of the above types of financial corrections are made, the Certifying Authority for the Fund may recommend remedial action and the irregularity is reported to the Commission. However, this may not impact on the overall drawdown because a member state can utilise other eligible expenditure. Ineligible expenditure can only be replaced with eligible expenditure before the closure of an Operational Programme⁵⁵ provided there are sufficient excess eligible claims.

7.39 The Department of Agriculture, Fisheries and Food as paying agency for EAGF and EAFRD funds has overall responsibility for processing and reporting financial corrections. As EAGF funding is fully funded by the Commission, amounts recovered as a result of irregularities are paid back to the Commission. The rules on recovery for EAFRD funding concerning the re-use of funds are similar to the treatment of Structural Funds.

⁵³ Articles 98-100 of EU Regulation 1083/2006.

⁵⁴ The error rate is the value of quantified errors detected calculated as a percentage of the transactions sampled as part of the audit.

⁵⁵ Article 98(2) of EU Regulation No. 1083/2006 provides that for the 2007-13 programming period, the resources from funds released as a result of financial corrections may be re-used by the member state until 31 December 2015 for the Operational Programme concerned.

Financial Corrections by the EU Commission

7.40 In the case of Structural Funds, the Commission may make financial corrections⁵⁶ by recovery of amounts paid or by cancelling all or part of the Community contribution where after examination, it concludes that there is a serious deficiency in the management and control system of a programme or ineligible expenditure has been contained in a certified statement of expenditure by the member state and has not been corrected.

7.41 This type of financial correction by the Commission most commonly occurs at the closure process at the end of a programme cycle when the last claims have been submitted by the Certifying Authority at which point it may be difficult to substitute the ineligible expenditure.

7.42 To date, the Commission has made financial corrections totalling €48 million in respect of the Structural Funds. Total Cohesion Funding lost to the Exchequer in the 1994-1999 round of funding amounted to €5.6 million. These corrections occurred in the case of water supply schemes and road projects. In the 2000-2006 round, a further amount of €13.4 million was disallowed⁵⁷.

7.43 The amount lost to Ireland under the 1994-1999 round of funding in respect of the ESF was just over €29 million. €15.6 million of this arose on three programmes – the Human Resource Development Operational Programme, the Tourism Operational Programme and the Industry Operational Programme – as a consequence of a Commission audit decision in 2000, which was confirmed by the European Court of Justice in 2005. In this instance, ESF monies were withheld due to the manner in which Ireland presented ESF claims⁵⁸.

7.44 There have been no financial corrections in respect of ERDF or ESF for the 2000-2006 and the 2007-13 programming periods.

7.45 In the case of Agricultural and Rural Development funds, the Commission takes ad-hoc compliance clearance decisions on the basis of Commission audit findings. The Commission will refuse ineligible expenditure and may apply financial corrections arising from its audit work if it concludes that there are deficiencies in management and control systems.

7.46 Ad-hoc disallowances imposed by the Commission in the period 2000 to 2009 in respect of EAGF expenditure amounted to just under €39 million. The Department of Agriculture, Fisheries and Food received EAGF payments of €16.4 billion in the period. The largest single financial correction related to the year 2000 when just under €20 million was disallowed following two Commission decisions⁵⁹. Based on the Department of Agriculture, Fisheries and Food calculations, Ireland's disallowances in relation to expenditure incurred in the years 1999-2008 inclusive amounted to approximately 0.13% of EU funding. These calculations also indicate a corresponding percentage disallowance of 1.44% for total EU-15 expenditure⁶⁰ over the same period.

⁵⁶ Under Article 99 of EU Regulation 1083/2006.

⁵⁷ This related to disallowances of €8.9 million in respect of works at Heuston Station that were non-Exchequer funded, waste-water treatment in Dublin and the Cloghran-Lissenhall Road Project.

⁵⁸ Due to an assisted non-government organisation that had not declared the total amount of its government funding and to the methodology used by the Department of Enterprise, Trade and Innovation in converting Irish punts to ECUs.

⁵⁹ Commission Decision of 1 March 2000 (2000/216/EC) relating to a correction of €6.4 million for late payments and unsatisfactory control in the Meat Premium sector. A financial correction of €13.4 million was decided on 5 July 2000 (2000/449/EC) in regard to afforestation aid which was not eligible and an insufficient number and quality of on-the-spot checks in the Arable Crop sector.

⁶⁰ EU-15 refers to the 15 member states in the EU prior to the accession of ten candidate countries on 1 May 2004.

Conclusion

Ireland contributed €1.5 billion to the EU budget in 2009 while €1.8 billion was received from EU funds.

The EU Commission has, since 1994, made financial corrections of €48 million to Ireland's ESF and Cohesion Fund receipts. In the case of agricultural and rural development funds, the Department of Agriculture, Fisheries and Food estimate that, between 1999 and 2008, approximately 0.13% of EU funding received by Ireland has been disallowed while the average disallowance across EU-15 was 1.44%.

Ireland, like other member states, has an interest in how the EU budget is used. While the European Court of Auditors noted an improvement in the management of the budget across the EU, they were unable to give positive assurance on the legality and regularity of most elements of EU expenditure. However, the Court has acknowledged that in many instances the errors are as a result of the complexity of the rules.

Annex A Restructuring of the EU Sugar Industry

In 2006, the EU established a restructuring fund (funded by the processors staying within the business of sugar processing) to encourage less efficient sugar processors to exit the market. Ireland's sole sugar processor, Irish Sugar Ltd (Greencore), decided to cease production totally.

The total amount of aid available to Ireland was €145.5 million, and an additional €41 million retroactive restructuring aid⁶¹ giving a total of €186.5 million. Payments were made to three types of beneficiary - the processor, beet growers and machinery contractors. The relevant regulation⁶² allowed for at least 10%⁶³ of the aid to be reserved for beet growers and machinery contractors to compensate them for losses. No minimum level was set for processors.

Compensation to Processor

The total amount allocated to Greencore was €127 million. Greencore was required to submit a restructuring plan to the Department of Agriculture, Fisheries and Food (the Department) for approval. To draw down the payments, Greencore was required to lodge a security of 120% of the amount of the payment in accordance with the EU regulations. The security is subsequently released as progress is made in implementing the plan.

The payments and related security are outlined in Figure 33.

Figure 33 Payments and Security - Greencore

Payment Date	Payment €m	Security Lodged €m
June 2007	43.6	52.4
February 2008	83.4	100.0
Total	127.0	152.4

As implementation of the plan progressed, Greencore submitted annual progress reports and the Department verified these by means of site visits and then produced annual inspection reports.

The security for the June 2007 payment was released in full in February 2008 on foot of the Department's first annual inspection report. Partial release of the second security was granted in 2008 and 2009 but the Department is withholding €9.6 million pending satisfactory completion of the restructuring plan.

⁶¹ Council Regulation 1261/2007 provided for additional payments and these were made available retrospectively to growers who exited the market in 2006 and 2007.

⁶² Council Regulation 320/2006.

⁶³ Amended in October 2007, where it set a maximum amount of 10% to be allocated to the growers.

Beet Growers

Growers who had delivered beet to Greencore in any of the three reference years (2001, 2002 and 2004) were eligible for aid. The Department decided to pay all aid to growers on the basis of the contracted amount of sugar beet and not the amount of beet delivered.

The Department, based on information supplied by Greencore, established a database of 3,779 farmers who had held a sugar beet contract with Greencore during at least one of the reference years.

The Department checked the information supplied for accuracy by taking a random sample of 5-7% of contracts in both the Carlow and Mallow plants and checking the information supplied by Greencore against delivery dockets, contracts and weighbridge records⁶⁴. The Department wrote to each beet grower advising of the specified contract tonnage. Growers were requested to contact the Department with any queries or corrections. No responses were received. The payments to each grower were then based on this information. As a result of the Department's examination of the database, 3,515 beet growers were found to be eligible to participate in the scheme.

In order to calculate the amount of aid payable to each grower, the Department divided the total number of tonnes contracted for all growers by the amount of aid available to get a rate per tonne. This rate was then applied to the contract amount for each grower.

Four types of payments were made to beet growers

- restructuring aid – payments to incentivise exit from the industry
- diversification aid under Article 6 of Council Regulation 320/2006 – compensation payable to growers to meet the costs of diversifying
- diversification aid under Article 7 of Council Regulation 320/2006 – additional aid available as the amount of each member state's sugar quota was renounced
- retroactive restructuring aid – additional payments to those growers that ceased production, applied retroactively to growers that exited the industry in 2006 and 2007.

Diversification aid was made available to beet growers as a contribution to the cost of diversifying into other activities. In accordance with the EU regulations, it was paid in two equal instalments - in September 2007 and March 2008. The allocation of the diversification aid was completed in the same manner as the restructuring aid.

Growers who received restructuring aid were eligible and were required to complete a form indicating that they intended to diversify and stating what the diversification entailed. According to the Department's records, 11 of the 3,515 growers did not return the diversification form.

Details of payments to beet growers are set out in Figure 34.

⁶⁴ This was a reasonableness check on the contracted amounts.

Figure 34 Payments of Restructuring Aid to Beet Growers

Payment Type	Budget €m	Spent to Date €m	% Spent
Restructuring Aid	12.35	12.28	99.43%
Diversification Aid (Article 6)	21.82	21.42	98.16%
Diversification Aid (Article 7)	21.82	21.77	99.78%
Retroactive Restructuring Aid	41.33	40.81	98.74%
Total	97.32	96.28	98.93%

Machinery Contractors

As machinery for sugar beet farming is specialised and is not transferable to other areas of farming, €6 million of the restructuring aid was made available to compensate machinery contractors. The EU regulations required that 40% of the aid be paid in June 2007 and the remainder in February 2008.

The Department identified five types of machine that could be classified as specialised beet machinery⁶⁵ and eligible for compensation. Applications were made by the machinery contractors for compensation on standard application forms providing personal information and information about the machine being claimed for. In order to be eligible for aid, all applicants had to have used the specialised beet machinery for beet sowing, cultivation or harvesting work during the beet campaign of 2004.

Field inspections were completed to verify the accuracy of the information provided. 123 of the 384 valid applications were inspected. These resulted in reduced payments in seven cases where incorrect information was provided on the application form or where the machine was disposed of.

A total of €5.9 million was paid to 384 contractors. The average grant paid was €15,384. 70% of the contractors received €15,000 or less. Some 5% of the contractors received €50,000 or more, with seven contractors receiving in excess of €70,000 (€99,966 was the largest amount paid out to any one contractor).

Administrative Matters

Overpayments

Overpayments of €26,454 were made by the Department to machinery contractors. At April 2010, overpayments of €16,223 had been repaid by cheque or recouped by offsetting against other payments due from the Department. The overpayments were as a result of either an administrative error where the Department calculated an incorrect amount of aid or an irregularity, where the applicant gave incorrect information.

There was one overpayment, since recouped, to a grower where the aid was paid on the basis of his unique ID number as opposed to the contracted tonnage. There were also a number of

⁶⁵ Harvester, seeder, inter-row cultivator, cleaner loader and beet basket.

incorrect payments made as a result of merged or inheritance cases as well as cases where duplicate payment forms were sent for processing.

Outstanding Liabilities

All amounts due have not been paid to growers. The maximum residual liability for unpaid amounts is just over €1 million. However, the Department estimates that the final amount payable will only be a fraction of this. As the deadline for funding by the EU was July 2009, any further payments to the growers will have to be met from Exchequer funding.

European Court of Auditors

The European Court of Auditors expect that a report on the Sugar Restructuring Scheme across the EU will be published in November 2010.

Chapter 8

Central Government

Public Procurement

Public Procurement

8.1 Procurement by public bodies of goods, services and construction works is an important element of total public expenditure. Estimates prepared by the Department of Finance in November 2009 indicate that annual public expenditure on procurement of goods and services totalled around €9.3 billion, with a further €7 billion being spent on capital works (see Figure 35).

Figure 35 Estimated annual public procurement expenditure by sector, 2009

Expenditure area	Value € billion
Health sector ^a	4.7
Central government sector ^b	2.0
Local government sector	1.7
Education sector	0.9
All goods and services procurement	9.3
Capital works	7.0
Total public procurement	16.3

Source: Department of Finance analysis (November 2009)

Notes:

a Includes expenditure relating to drugs and medicines and GP and pharmacist fees.

b Government departments and agencies, including Defence Forces and Garda Síochána

8.2 Given the scale of expenditure on public procurement, Government policy is to ensure that the development of organisational structures and systems, and of procedures and skills in public procurement, are consistent with the objective of achieving value for money.

8.3 Procurement of goods and services by public bodies must be conducted in accordance with EU and national regulatory requirements, and within guidance issued from time to time by the Department of Finance. In general, there is an obligation on Government agencies to follow a competitive process, carried out in an open, objective and transparent manner. This is expected to result in best value public procurement.

8.4 The Department of Finance is responsible for developing public procurement policy within the framework of EU law and in the context of Government policy across a number of broad areas, including public expenditure, value for money and enterprise development policy. As part of this role, the Department is responsible for setting a broad strategic direction for procurement implementation. The Department's National Public Procurement Policy Unit (NPPPU), which was established in 2002, has responsibility for national public procurement policy, legislation and construction procurement reform.

8.5 The National Procurement Service (NPS)⁶⁶ was established in March 2009 within the Office of Public Works (OPW), taking over some of the staff and functions of the existing Government Supplies Agency (GSA).⁶⁷

⁶⁶ The NPS was originally titled the National Public Procurement Operations Unit.

⁶⁷ The Election Services and Government Publications Service, formerly part of the GSA, were not taken over by the NPS.

Chapter Focus

This chapter focuses on

- Initiatives being developed by the National Procurement Service (NPS) to provide better value in the procurement of goods and services.
- Expenditure declared to have been undertaken in 2009 on foot of contracts entered into without recourse to competitive procurement processes. It also presents an analysis of the declared reasons why a competitive process was not followed in those cases.

National Procurement Service

8.6 The objectives assigned to the NPS were

- to establish national framework agreements to allow all central Government departments and offices, agencies and non-commercial public bodies to procure commonly-used goods and services more effectively, efficiently and with better value for money
- to provide professional procurement advice to central government and non-commercial public sector bodies
- to develop targeted and accredited procurement training and education measures and
- to further develop web-based e-procurement.

8.7 While it was initially proposed that the remit of the NPS would extend to central Government departments and offices only, the unit was set up with a wider remit covering central government agencies, non-commercial State bodies, health sector bodies, third level education institutions and local government.

8.8 The Government decided that, from the outset, the NPS would have responsibility for managing the purchase of goods and services common to all areas of the public service e.g. office equipment, furniture and fittings, fuel, electricity, natural gas, printing, stationery and office supplies, ICT consumables, uniforms, travel and transport fleets. Procurement of sector-specific items (such as drugs, medical supplies and military equipment) will continue to be managed by the relevant departments and agencies.

8.9 The Department of Finance recognised that use of the GSA's services by bodies within its remit had been inconsistent. It estimated that the aggregate value of procurement in 'common procurement' categories dealt with by the GSA amounted to around €65 million (in 2007). Given the wider remit of the NPS, the Department estimated the total procurement value of the common procurement goods and services at about €300 million a year (based on 2009 figures).

8.10 The NPS planned to build up its staffing level to around 50 staff in the short term, but currently employs 26 staff, made up of former GSA staff and staff redeployed from other Government departments. The Department of Finance has recently sanctioned the filling of 21 additional posts sought by the NPS, and the recruitment process is due to commence shortly. The training needs of NPS staff have been identified and relevant training courses have been tendered for.

8.11 The NPS's budget for non-staff expenditure for 2009 was €228,000, and the outturn was €100,000. The reasons given for the shortfall in expenditure are

- the Service was not fully operational
- there was a delay in a planned upgrade of the eTenders system⁶⁸. Expenditure on this project is anticipated in 2010 and 2011.

8.12 Links have been established between the NPS and the Commercial Contracts Section of the Chief State Solicitors Office (CSSO), which services the needs of central government departments for procurement-related legal advice. The CSSO, in conjunction with the NPS, has developed a suite of standard tender competition and contract documentation, which will be made available in due course to all departments, government offices and agencies. The Department of Finance has approved the recruitment by the CSSO of two solicitors to be seconded to work in the NPS on a full-time basis.

8.13 The NPS has developed a draft strategy statement which focuses on the following three areas

- **strategic sourcing**⁶⁹ to optimise the efficiency of, and the value for money obtainable from, all sourcing activities thus enabling public service clients to gain access to quality goods and services to support their business processes, including supporting and furthering government policies through public procurement.
- **education and guidance** to facilitate the provision of learning, development and guidance opportunities that will assist both procurers and potential suppliers to develop appropriate skills to enable them to operate at optimum capacity in all procurement-related business
- **e-Procurement** goals to ensure the availability of a world-class, e-Procurement platform affording maximum visibility for procurement campaigns.

8.14 The NPS strategy statement will be examined and approved by the NPS Board, which consists of representatives of the relevant stakeholders, including the Department of Finance.

8.15 Two key initiatives progressed by the NPS during 2009 were

- a procurement expenditure reduction initiative
- identification of the top categories of expenditure.

These initiatives were commenced with the objective of achieving 'quick win' savings in 2009 and identifying the procurement areas common to public bodies.

Expenditure Reduction Initiative

8.16 In 2009, the Government sought expenditure reductions of up to 8% on contracts for all goods and services purchased by government departments, agencies, offices, third level institutions and local authorities. The procurement savings were to be achieved by reductions in price and/or in the quantity purchased.

⁶⁸ www.eTenders.gov.ie has been developed as part of the Irish Government's strategy for the implementation of e-Procurement in the Irish public sector. The site is designed to be a central facility for all public sector contracting authorities to advertise procurement opportunities and award notices

⁶⁹ Strategic sourcing is defined as the establishment of systems to enable the identification of major categories of procurement where an intervention has potential to yield value.

8.17 In May 2009, the NPS sent advice to the public bodies within its remit on how to negotiate with suppliers to agree expenditure reductions. In addition, it asked the bodies to return a monthly report listing all contracts for the supply of goods and services with a value over €100,000, beginning in June 2009. The report form included space for reporting of agreed savings on each contract. The initiative excluded expenditure on professional fees⁷⁰ and on construction related activities.

8.18 The initial target set for the savings to be achieved through this initiative was €25 million in 2009. The reports to the NPS indicated that a total of €27.3 million in agreed savings on existing contracts had been achieved by December 2009.

8.19 The NPS considers that in addition to the reported agreed savings on existing contracts, public bodies also achieved significant savings by re-tendering for goods and services, and by entering into new contractual arrangements at lower prices. The NPS has requested that where contracting authorities can do so, they should report these comparative savings to the NPS in 2010 returns.

Top Expenditure Areas

8.20 In conjunction with the expenditure savings initiative, the NPS also undertook a survey of agencies in its remit, asking them to report their respective 'top 30' suppliers of goods and services in 2008, by value of expenditure. The names of the suppliers and the nature of the goods and services supplied by them were also to be provided. Certain categories of goods and services were excluded from the scope of the survey because they are not within its remit i.e. professional fees, construction related activities, costs related to the purchase and rent of property and all payroll costs.

8.21 The NPS targeted 307 public bodies for the survey. By the end of December 2009, a total of 264 bodies (86%) had responded. The NPS is still pursuing the outstanding returns, which are principally small agencies whose annual spend on goods and services is believed to be low.

8.22 Figure 36 shows the categories of expenditure, where the combined reported spend value was €50 million or over.

⁷⁰ A separate Department of Finance initiative sought a reduction of 8% in professional fee levels, including fees paid to health sector professionals.

Figure 36 Top spending areas (€50 million + in 2008) as reported by public bodies within the remit of the NPS

Procurement category	€m
ICT & IT consumables	278
Travel	179
Energy	116
Waste/reuse/recycling/disposal	78
Plant and equipment	70
Water	69
Medical supplies	66
Advertising/marketing /PR/media/photography	65
Transport	64
Telephony	62

Source: National Procurement Service analysis (January 2010)

8.23 A further round of returns about top expenditure areas is currently being sought by the NPS in relation to expenditure in 2009.

Development of Framework Agreements

8.24 The NPS has identified the development of national framework agreements in key areas as a means of achieving an impact on public procurement. Initial categories for framework agreements have now been identified. The NPS plans to advertise tenders in the second half of 2010 with a view to putting in place framework agreements and centralised contracts for the procurement of

- stationery (including paper and ICT consumables)
- electricity
- natural gas
- LPG
- managed print services
- certain categories of motor vehicle.

8.25 The NPS expects use of framework agreements to benefit its clients through the economies of scale that aggregation of demand can deliver and by reducing the administrative burden associated with these categories of procurement. Nevertheless, the NPS recognises that it faces challenges in achieving impacts through the agreements. These include the following

- Public bodies will need time to extract themselves from existing contractual arrangements.
- In many cases, the NPS will be expected to deliver better value than that which can be achieved by individual bodies before they commit to come on board. Even where better value should be achievable given the economies of scale, some bodies may wish to retain control over their procurement activity.
- When savings are available through economies of scale, many organisations will be keen to ensure that they will retain the benefits of those savings.

- Market analysis and the development and application of particular strategies to deal with markets require a significant amount of research. This must be done methodically and accurately in order to avoid distortion of the market, which is a real risk given the size of the public procurement spend in these areas.

Conclusion – Procurement Initiatives

The NPS needs to become fully operational quickly if it is to have a positive impact on the cost of public procurement in the short term.

Analysis is beginning to put the NPS in a position where it can strategically target spend categories for market interventions.

Strategic objectives should be set for the NPS, which should monitor and report publicly on its progress and performance against those objectives. Key performance measures should focus on areas like price and cost reduction, consumption levels, and the extent to which NPS-facilitated procurement is availed of by public bodies within its remit.

Procurement without a Competitive Process

8.26 EU directives set out advertising requirements and tendering procedures for contracts above certain value thresholds that must be applied by all public bodies involved in procurement. For contracts or purchases below the threshold values, less formal procedures are allowed. For example

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

Revised guidance issued by the Department of Finance in August 2010 now require all contracts for goods and general services with an expected value of €25,000 or more to be advertised on the eTenders website.⁷¹

8.27 Exceptional arrangements are allowed under national and EU procurement rules in limited circumstances. Department of Finance Circular 40/2002 outlines the course to be followed in those cases where Government departments and offices propose to award contracts without a competitive process.

8.28 Under the Circular 40/2002 procedure, proposed contracts that exceed €25,000 in value (exclusive of VAT) that are not subject to a competitive process are required to be reviewed prior to award by the relevant department's/office's Internal Audit or by an appropriate senior officer who was not part of the procurement process.⁷² The Circular also requires

⁷¹ Department of Finance Circular 10/10: Facilitating SME Participation in Public Procurement (13 Aug 2010).

⁷² The Department of Finance issued a supplement to Circular 40/2002 in July 2003, providing guidance for officers reviewing the case for such proposed contract awards.

- Accounting Officers to complete an annual statement in respect of non-competitive contracts, and to submit it to my Office, with a copy being sent to the Department of Finance, by 31 March of the following year. This return should give details of the subject or purpose of the contract, its value and the reasons for not having a competitive process
- each department/office to maintain an up-to-date central register of non-competitive contracts
- each department/office to designate a Procurement Officer to collate the information on these contracts.

8.29 The Department of Finance has stated that the award of contracts and their related expenditure are the responsibility of the contracting authority and the relevant Accounting Officer (or Accountable Person). The NPPPU examines the Circular 40/2002 returns from departments and agencies with a view to identifying and addressing any systematic deficiencies. Any issues arising in reports of the Comptroller and Auditor General or in the course of Committee of Public accounts examinations, and related recommendations are also addressed. The Department has a general oversight role and, where information about potential problems comes to light, it raises the issue with the department or agency, bringing the requirements of procurement law and best practice to their attention. This can also involve re-examining guidelines and revising them where appropriate.

Health Service Executive Return

8.30 I reported in my 2008 report that the Health Service Executive (HSE), although funded by a vote, was not included within the scope of Circular 40/2002. The Department of Finance stated at that time that it was intended to extend the scope of the Circular to it.

8.31 In May 2009, the Department of Health and Children informed the Department of Finance that the HSE had now put in place procedures that incorporated the provisions of the Circular. A return in respect of 2009 was subsequently received from the HSE in May 2010. In making the return, the HSE emphasised that the return did not extend to voluntary hospitals and other voluntary service providers funded or part funded by it. On examination of the return, it was noted that it listed 26 instances of contracts/purchases, above the threshold, undertaken without a competitive process by the HSE in 2009. These totalled €4.2 million and related to five (out of a total of 32) local health offices and the HSE head office.

8.32 I subsequently wrote to the Accounting Office of the HSE querying the completeness and accuracy of the return. In reply, he informed me that all senior managers in the HSE were requested to submit returns for their areas of responsibility as per the Circular in respect of 2009 contracts and that the schedule submitted by him was a complete and accurate list of the responses received from those managers.

Extent of Non-Competitive Procurement

8.33 The annual 40/2002 returns for 2009 indicate that payments were made under 473 contracts concluded without competition. The total value of the contracts reported in 2009 was €69.1 million. Both the number and value of non-competitive procurement payments reported decreased in 2009 relative to 2008 (522 contracts with a combined value of €79.1 million).

8.34 Figure 37 shows the number of contracts and the total contract expenditure disclosed in the departmental returns.

8.35 The Irish Prison Service (IPS) had the highest reported level of contracts awarded without a competitive process, with expenditure of €22 million on 154 contracts in 2009, and expenditure of

almost €28 million in 2008. The Department of Finance has stated that the position of the IPS is receiving particular attention, and that the NPPPU has engaged with the IPS on this matter. The IPS has indicated that it has put new contracts in place where existing ones had been extended beyond their original term — a particular issue identified by the Service in analysing its purchases. It is expected that the drop in the level of expenditure by the Service under contracts not subject to competitive tender will continue in 2010 and beyond.

Figure 37 Reported contracts awarded without competition, 2009

Department/Office ^a	Number of cases ^b	Total contract expenditure €m
Prison Service	154	22.0
Garda Síochána	62	8.1
Finance	4	6.0
Justice, Equality and Law Reform	44	5.7
Agriculture, Fisheries and Food	10	5.5
Defence	40	4.2
HSE	26	4.2
Courts Service	20	1.9
Communications, Energy and Natural Resources	4	1.6
Education and Science	3	1.2
Arts, Sport and Tourism	9	1.2
Environment, Heritage and Local Government	9	1.2
Community, Rural and Gaeltacht Affairs	5	1.1
Others	83	5.2
Total	473	69.1

Source: Circular 40/02 returns

Notes:

a There were 14 nil returns by departments and offices.

b Includes eight reported contracts with a value under €25,000 (ex VAT).

Reasons for Non-Competitive Procurement

8.36 Figure 38 sets out the main reasons given in the returns by departments and offices explaining why competitive processes were not used in the procurement process.

Figure 38 Reasons cited for non-use of competitive process, 2008 and 2009

Reason	Number of cases		Value of contracts	
	2008	2009	2008 €m	2009 €m
Urgency	21	16	8.7	2.5
Purchase of proprietary goods	128	94	19.4	17.3
Extension/rollover of existing contract	128	109	18.4	16.7
Expert service/recent experience with supplier	53	56	8.3	10.1
Single suitable supplier	89	85	12.8	9.8
Security considerations	11	13	1.6	2.6
Other reasons	92	100	9.9	10.1
Total	522	473	79.1	69.1

Source: Analysis of Circular 40/2002 returns by Office of the Comptroller and Auditor General

8.37 The analysis in Figure 38 shows that, excepting cases involving urgent expenditure (down €6.2 million), which by their nature are unpredictable, the 2009 returns represent only a small decrease relative to the 2008 returns.

Urgency Exception — €2.5 million

8.38 Circumstances can arise from time to time where departments and offices are required to respond urgently to events. The rationale for the exception in these cases is that where there is a requirement to procure goods and services, there may not be time to set up a competitive procurement process. It may also be the case for confidentiality reasons that a public or widespread procurement process may not be consistent with optimum management of the public business involved.

8.39 The most significant recourse to non-competitive procurement under this exception in 2009 was by the Department of Communication, Energy and Natural Resources. Following the unexpected withdrawal of the project consultants from the Silvermines remediation project, the Department deemed it necessary to hire replacement consultants at a cost of €1.5 million due to serious health and safety concerns and a requirement not to disrupt work on site.

Proprietary Goods Exception — €17.3 million

8.40 Generally speaking, non-competitive purchases of proprietary goods relate to branded or named products or exclusive services. In some instances, these procurements include maintenance of previously acquired goods or services, upgrades or additional purchases. 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 or carriage of spares.

8.41 Of the 94 instances of purchasing of proprietary goods contained in the 2009 departmental returns, 27 were in respect of purchases by the IPS to a value of €8.6 million; and 53 were in respect of purchases by the Garda Síochána to a value of €7.2 million. The proprietary goods

purchased, in general, related to information and communications technology or to technical systems.

8.42 Where departments and offices specify proprietary goods, the potential of a competitive procurement process to result in value for money may be lost. The scale of purchasing of proprietary goods also emphasises the importance of considering whole-life costs when planning technical procurements.

8.43 The Department of Finance has stated that a large part of the reported expenditure on propriety goods and services relates to parts and servicing for Garda, IPS, Army, Naval Service and Air Corps equipment. Some of the expenditure relates to payments for ICT annual licences and maintenance, software support, etc. covering a number of years. It is not clear the extent to which such arrangements initially formed part of tendering procedures which were subject to a competitive process. The NPPPU intends to raise this matter directly with the State bodies concerned to identify how they are responding to the matters identified, and will decide how best to address any systemic issues arising.

Extension/Rollover Contracts Exception — €16.7 million

8.44 One hundred and nine cases reported involved the extension or rolling-over of existing contracts for goods and services. Some of the contracts extended or rolled over had been in place for several years.

8.45 Justifications reported by departments and agencies for continuing with existing contractual arrangements included

- the contractor had relevant experience gained from prior involvement with the department
- the contractor was best placed to provide the required goods/services without undue extra cost to the Exchequer
- it was not possible to go to the market due to staffing difficulties.

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

- The extension by the Department of Education and Skills, at a cost of €0.5 million, of a contract for the operation of Irish examinations for primary school teachers who obtained their teaching qualification outside the State.
- The rollover by the Department of Agriculture, Fisheries and Food, with Department of Finance approval, of a contract for the supply of storage facilities for intervention products. The cost was €1.6 million.
- The extension of seven expired contracts, at a cost of €0.6 million, to deliver home care packages in one HSE local health office area.

8.47 The extent to which the contracts being rolled over had originally been subject to competitive processes is not captured in the returns. 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.

8.48 The circumstances of some further cases involving extension of contracts for procurement of goods and services were noted during 2009 Appropriation Account audit work. These are outlined in Annex A.

Expert or Recent Experience Exception — €10.1 million

8.49 Fifty six cases were reported where departments and offices took the view that their interest was best served by entering contracts where they had used the services of individuals or firms in the recent past or had identified, without recourse to competitive processes, persons or firms whose expertise coincides with their requirements. This does not exclude the possibility that there might be other suitable suppliers. Examples include

- The hiring by the Department of Finance, at a cost of €5.9 million in 2009, of legal advisors in relation to banking stabilisation measures. The advisors had been engaged in 2008 in the context of extreme urgency. Their experience from that assignment and acknowledged expertise was considered key to the continuation of the arrangement in 2009.
- The hiring of legal advisors, on behalf of the Department of Tourism, Culture and Sport by the Chief State Solicitor's Office at a cost of €0.3 million.

Single Suitable Supplier Exception — €9.8 million

8.50 This category relates to procurements where departments and offices consider there is only one suitable supplier of the required service. In 2009, expenditure was incurred under 85 single supplier contracts.

8.51 The largest contract of this type in 2009 was the hiring by the Department of Agriculture, Fisheries and Food of a company, at a cost of €2.6 million, to capture TB infected badgers throughout the State. The Department felt that this company was the only provider of this service that met departmental requirements.

8.52 One contract costing €1.2 million was returned by the HSE under this heading. This related to the relocation of clients in alternative nursing home accommodation in one local health office area, on the basis that no alternative service provider was available in the locality.

Security Considerations — €2.6 million

8.53 Competition was limited in the interests of security in 13 instances reported in the returns. The most valuable contract in this category was placed by the Department of Defence to purchase a communications system for the Naval Service at a cost of €1 million.

Other Reasons — €10.1 million

8.54 There were 100 reported instances of contracts being awarded for a variety of other reasons. Of these, 68 contracts were awarded by the IPS, at a total cost of €4.8 million. A large number of these were in respect of the local purchase of various goods and services such as cleaning, catering and transport services as well as the purchase of televisions and electrical equipment.

Conclusion – Exceptions to Competitive Procurement

From a public accountability viewpoint, procurement must meet two criteria

- achieve value for money
- be conducted in an open, transparent and competitive way.

In general, these are mutually supporting in that competition is acknowledged as a primary means of achieving best value. However, in exceptional circumstances, it may be necessary to depart from competitive processes. To ensure that this only occurs in appropriate cases, it is incumbent on purchasers to have processes in place to identify and address their procurement needs in a timely manner. The incidence of cases where existing contracts are extended may represent practical responses to individual circumstances. However, there is a need to formally review such proposed extensions and document the related decisions to ensure that they represent good value, that they do not continue longer than is necessary and that the administrative convenience of such arrangements does not outweigh the commitment to competitive procurement methods.

Over €17 million was reported to have been spent in 2009 on proprietary goods in the absence of competition. It is important that departments and offices avoid identifying their needs by reference to branded products. Specifications should, where possible be described in generic terms so as to encourage real competition. While the results of many procurements may be the purchase of branded products or services, the procurement process should be characterised by efforts to minimise ‘brand capture’ and to ensure that procurement decisions do not result in future streams of payments over which departments and offices have little or no control.

The HSE needs to put additional procedures in place to capture the full extent to which procurement is conducted without competition and implement the full requirements of Department of Finance Circular 40/2002.

Annex A Examples of Procurement based on Extensions of Existing Contracts

Commissioning of a History of the OPW

In January 2002, following a request for proposals from interested persons, the OPW entered into a two-year contract with a professional historian to research and write a text for publication on the history of the OPW from the seventeenth century to 2000. The total fee specified for this commission was €76,184, with a completion date of January 2004.

In January 2004, the OPW agreed a further two-year consultancy contract with the author at a revised fee of €78,470. The deadline for the production of the final text was extended to January 2006. No signed contract beyond this date was entered into.

Up to 31 December 2009, the author has been paid a total of €341,714 (inclusive of withholding tax of €68,172). Two completed chapters of the book have recently been received by the OPW.

The OPW are currently reviewing the terms, conditions and outputs from this commission and consequently are not yet in a position to give a final estimate of the likely total costs involved.

In regard to the management of this commission, the Accounting Officer has stated that, while the history originally envisaged has not yet been completed, the work done on OPW archives has been worthwhile, and would otherwise have required the hiring of professional archivists. This includes the indexation of records, and the photographing and storage of building plans. The historian also provided an occasional archival consultation service to OPW staff working on restoration and conservation projects. Taking on board the value of the work done under this contract to the OPW in the period since 2002, her view is that the commission has been handled in an effective, efficient and economic manner and that, when completed, the product will be a classic work of Irish governmental and administrative history.

An Garda Síochána – Extension of Supply Contracts

Procurement of Tyres for Garda Vehicles

An internal audit of procurement in An Garda Síochána⁷³ noted that there was no contract in place for the purchase of tyres for Garda vehicles at the time of audit. It found that payments totalling €1.58 million had been made for tyres in 2008.

Historically, the Government Supplies Agency conducted the tendering process, and the award of contract, for the supply of tyres to public bodies. An Garda Síochána availed of the terms of these contracts to purchase tyres for the Garda fleet. As the existing contract had expired, the GSA issued a Request for Tender (RFT) for the supply of tyres in 2008. Following the commencement of the process, a number of practical and legal difficulties were encountered and the competition was cancelled by the GSA. This led to the situation where the Garda Síochána continued to purchase tyres under the terms of the expired contract.

In order to comply with both EU and national procurement guidelines and to avoid any further delay, An Garda Síochána took the decision to manage the procurement of tyres in-house. In drawing up the specifications for the RFT, the Finance Directorate took account of the issues that

⁷³ An Garda Síochána is the Irish police service.

arose from the NPS tendering process. This involved research and evaluation of the operational needs of An Garda Síochána. In December 2009, An Garda Síochána published an RFT for the supply of tyres and subsequently awarded the contract to a single supplier.

Procurement of Fuel for Official Vehicles

The internal audit report also found that there was no centralised contract in place at that time for the procurement of fuel for official vehicles. Payments totalling €1.17 million were made to a single supplier for fuel in 2008.

The GSA has also historically conducted the tendering process, and the award of contract, for the supply of fuel to public bodies. In 2008, following discussions with An Garda Síochána, the GSA issued an RTF for the supply of fuel.

An issue arose in defining the contract price review mechanism with the preferred bidder. This resulted in a significant delay in the approval of the contract leading to payments being made outside of the terms of a competitively-procured contract.

The contract was awarded to a single supplier in May 2009 and is now fully operational. It is a variable price contract, with prices reviewed on a weekly basis. An Garda Síochána have reported that the implementation of the contract has led to significant savings for the Garda Vote.

Chapter 9

Central Government

State Body Management

State Body Management

9.1 The OECD⁷⁴ review “*Ireland Towards an Integrated Public Service*” in April 2008 highlighted the need for a better framework of engagement between Government departments and State agencies. In particular, it pointed to the need for formal criteria for establishing reporting relationships. It also drew attention to the need for a new focus on the capacity of departments to discharge their oversight function taking account of the specialist nature of many agencies, how they are resourced and how their performance is measured. Furthermore it drew attention to the need for practical guidance on the winding down of agencies once their objectives have been met.

9.2 State bodies in Ireland fall into two main classes – non-commercial State bodies and commercial State bodies. Commercial State bodies enjoy a greater freedom in the pursuit of their objectives and they are not directly accountable to Dáil Éireann. Non-commercial bodies in the main carry out core functions of the State and together with education institutions and most regulators are audited by the Comptroller and Auditor General. They are accountable to Dáil Éireann through its Committee of Public Accounts for both their financial affairs and the economy and efficiency of their operations.

9.3 There has in recent times been a concern that there is a proliferation of State bodies in the non-commercial sector and that central supervision for all State bodies needed to be strengthened. These concerns have resulted in

- a programme of rationalisation of State bodies and functions
- alterations to the Code of Practice for the Governance of State bodies
- attempts to address performance monitoring using a common framework.

Chapter Focus

While a variety of informal bodies and boards operate under the aegis of departments and a number of State bodies have also established subsidiary companies to carry out related functions, this chapter focuses mainly on those bodies that have been formally constituted either as corporations under specific legislation or have been established by a process of registration under the Companies Acts.

The review examined

- the status of the arrangements to rationalise State bodies and certain other activities
- the progress in establishing enhanced mechanisms to supervise the performance of State bodies and confirm their adherence to governance norms.

In order to inform the examination, key features of oversight as exercised by the Department of Transport over the Córas Iompair Éireann (CIÉ) group of companies and by the Department of Communications, Energy and Natural Resources (DCENR) over the National Oil Reserves Agency (NORA) were examined.

A review of integration and cohesion in local and community development schemes is dealt with in chapter 24. Special Report Number 74 examines, *inter alia*, the integration of the School Completion Programme, the Home School Community Liaison Service and the Visiting Teacher Service for Travellers under the aegis of the National Education Welfare Board.

⁷⁴ Organisation for Economic Co-operation and Development.

Rationalisation of State Bodies and State-sponsored Activity

9.4 In October 2008, the Government agreed to the rationalisation of over 60 State entities or functions by means of amalgamation, abolition or absorption into already established entities or into parent departments. The plan was initially to reduce the number of entities by at least 41 and, thereafter, further work on rationalisation would take place. No public savings target was adopted. Eleven departments were involved in the rationalisation plans and the Department of Finance was to oversee and report on the progress of the overall programme.

9.5 Figure 39 sets out the type of entities and functions targeted in the Government decision of October 2008.

Figure 39 Entities and Functions to be Rationalised by Type

Entity/Function	Number
State Bodies	32
Department Sections	9
Unincorporated Entities	15
Other Functions	5
Total	61

9.6 I asked each department with responsibility for supervising the entities or functions for information on the present position in regard to their rationalisation. Of the 61 entities or functions to be rationalised, implementation had occurred in 33 by June 2010 as set out in Figure 40. In the case of the 33 entities, rationalisation has resulted in the reduction of these entities to six in number. Annex A sets out the status of these completed rationalisations.

Figure 40 Rationalisation Actions Taken^a

Entity/Function	Total	Amalgamation	Abolished	Absorbed
State Bodies	20	12	1	7
Department Sections	3	-	2	1
Unincorporated	7	1	4	2
Transfer of Function	3	2	-	1
Total	33	15	7	11

Note:

a The figure includes three entities in which rationalisation has been implemented administratively but the corresponding legislation is currently with the Oireachtas.

9.7 In response to my enquiries supervising departments identified potential annual savings of €8.97 million in the case of 25 entities. A further €20,000 in once-off savings was identified in one of these entities. Comments received on the remaining cases were

- in 15 cases savings were dependent on what could be achieved under new structures
- in five cases savings were expected but were not quantified
- in five cases savings were not commented on
- in eleven cases, no savings were expected.

9.8 Departments noted 16 instances where material set up costs and restructuring costs accrued. These totalled €4.24 million. In the remaining cases restructuring costs were either not calculated or not identified.

9.9 I sought information on what consideration had been given in the planning and implementation process to the achievement of post-rationalisation efficiencies and asked departments to identify how business processes had been or would be adjusted.

9.10 Generally, departments did not address the form of business re-engineering that would take place on rationalisation. Where measures were indicated these generally dealt with administrative mechanisms such as the proposed management structure, budgets or drawing up of legislation. In some cases departments stated that the substance of the business would be unchanged following the merger.

9.11 The foregoing suggests that departments have not yet identified the fundamental changes in business processes to be delivered following rationalisation. This effort would be needed to bring economy and efficiency gains under the revised structure.

9.12 Figure 41 describes the status of the remaining 28 entities or functions that had not been rationalised by June 2010. Of these, there are no current proposals for rationalisation in ten cases. In the remaining 18, departments expect to have full implementation by end 2011.

Figure 41 Rationalisation to be Completed

Entity/Function	Total	To be Amalgamated	To be Abolished	To be Absorbed	Under Consideration
State Bodies	12	5	-	2	5
Department Sections	6	1	-	-	5
Unincorporated Entities	8	8	-	-	-
Other Functions	2	2	-	-	-
Total	28	16	-	2	10

9.13 Annex B lists the entities and functions that have not yet been rationalised.

Views of the Accounting Officer of the Department of Finance

9.14 The Accounting Officer of the Department of Finance informed me that the agency rationalisation process was a structural reform initiative aimed at streamlining service delivery and promoting efficiency and good governance in the delivery of public services. In adopting the rationalisation process outlined in the 2009 Budget the Government set out a clear set of guiding principles that underpinned the decision-making process. These principles made it clear that rationalisation was not just about the pursuit of a fixed level of savings.

9.15 He stated that classifying and calculating the savings and efficiencies that arise from implemented rationalisations was extremely difficult because of the impact of other savings initiatives in addition to the rationalisation measure. For example, he stated that it was very difficult to disaggregate the savings arising from pay rate reductions, general staff number reductions and cuts in consultancy. One approach was to use a simplified before-and-after approach that compares the full year costs of the Agency for a year before rationalisation with

the ongoing costs of delivering continuing functions, which themselves may have changed, for a period well after the new arrangements had bedded down.

Conclusion – Rationalisation

A considerable element of the rationalisation is still a work-in-progress with nearly half of the projected changes yet to be effected.

Rationalisation offers an opportunity to achieve process efficiencies. While the initial phase may, for practical reasons, involve little more than the bringing together of previously separate functions there is a need for supervising departments to ensure that the new functions have a comprehensive change plan that seeks to identify how the business processes might be reengineered in order to provide joined-up services and achieve maximum synergy through cohesion and integration.

Departments should put monitoring arrangements in place in order to ensure that the desired benefits are realised and that services are being delivered to defined standards and that any surplus assets are identified and used to optimum effect or disposed of.

Supervision of State Bodies

9.16 Excluding minor non-statutory bodies there are approximately 316 non-commercial State bodies and funds in Ireland and a further 17 commercial State-sponsored agencies.⁷⁵ Non-commercial State bodies are classified in Figure 42.

⁷⁵ Second Schedule, Comptroller and Auditor General (Amendment) Act 1993 updated to reflect current status of bodies listed. Since the Act, a number of bodies have been sold, dissolved or liquidated. In three instances, the bodies formerly scheduled are now audited by the Comptroller and Auditor General.

Figure 42 Classification of Non-Commercial State Bodies and Funds^a

Type	Number	Activity ^b €
Regulation and Arbitration	52	613,736,457
Enterprise Development	44	903,618,213
Subsidiary Companies	38	72,505,760
Second Level Education	34	1,367,021,621
Third Level and Further Education	36	4,361,208,000
Cultural and Language	17	313,904,529
Funds	19	26,022,433,957
Hospitals and Health	13	15,846,923,834
Sport and Tourism	10	452,582,000
Research	9	516,323,055
Housing and Welfare	8	104,085,000
Information and Advice	6	46,970,247
Miscellaneous	6	942,200,000
Regeneration	5	13,305,000
Safety Promotion	5	82,588,000
Parliamentary Bodies	4	135,700,000
Promotion	4	140,300,000
Infrastructure Procurement	3	1,766,800,000
Training	3	1,101,600,000
Total	316	54,803,805,673

Notes:

- a The Central Bank and Financial Services Authority of Ireland has not been included in Figure 42 nor have a number of debt management functions administered by the National Treasury Management Agency. Cash flows accounted for by these are in the order of €63 billion.
- b This represents the estimated turnover of the bodies for 2009. In a small number of instances, turnover figures for 2008 are used.

9.17 The benefits of dedicated agencies focused on the delivery of specific services have been well recognised in Ireland. At the same time, due to their proliferation, the appropriate level of direction and supervision has been an issue raised in a number of recent reports.

9.18 In November 2008, the Task Force on the Public Service⁷⁶ (the Task Force) recommended the development of a new governance framework in respect of State agencies, offices and bodies to improve their efficiency and effectiveness while clarifying the respective role and function of departments and agencies in policy making and strategic direction.

⁷⁶ Transforming Public Services: Citizen Centred – Performance Focused.

9.19 Governance concerns of this nature have also been mirrored in the accountability field as demonstrated by the legislative response to identified shortcomings in the arrangements for supervising and governing Foras Áiseanna Saothair (FÁS)⁷⁷. The key legislative changes subsequently implemented are outlined in Figure 43.

Figure 43 New Governance Structure for FÁS

In January 2010, new legislation was enacted^a which provides for a significantly stronger governance and accountability structure at FÁS. Some of the key matters addressed by this legislation are

- a reduction in the size of the Board of FÁS from 17 to 11
- introduction of a rolling system of appointments to the Board
- appointments to the Board following consultation and reflecting particular skill sets
- removal of the automatic right to nominate individuals for appointment to the Board from bodies not directly accountable to the taxpayer
- making the Director General of FÁS accountable to the Oireachtas
- requiring the disclosure of conflicts of interest by Directors and staff at FÁS
- banning directors and staff of FÁS from any involvement on matters where they have a conflict and providing for the removal of directors or termination of staff contracts where there is a breach in this regard
- protection for ‘whistleblower’ members of staff who report serious wrongdoing in the organisation
- allowing directors representing the Minister to report matters arising without breaching fiduciary duties to the Agency.

Note:

a Labour Services (Amendment) Act 2009.

9.20 The Task Force called for a performance framework for agencies that defined the expectations of Government and Ministers. This type of framework should provide for the adoption of both annual and multi-annual targets and the development of performance indicators based on clear outputs including milestones to measure their delivery. A greater use of output and outcome indicators should form the basis for a new performance dialogue between Government departments and State bodies.

9.21 The Task Force recommended that the development of and widespread use of service level agreements should form part of the wider performance management framework for those agencies involved in service provision.

⁷⁷ Special Report Number 10, “*General Matters arising on Audits – Non-commercial State-sponsored Bodies, Health Sector Bodies and Vocational Educational Committees*” (Chapter 2), May 2008, Special Report Number 66, “*Advertising and Promotion in FÁS*”, September 2009 and Special Report Number 73, “*Internal Control and Governance in FÁS*”, Office of the Comptroller and Auditor General, January 2010 and the *Fourth Interim Report on Special Report 10 of the Comptroller and Auditor General and FÁS 2007 Accounts*, Committee of Public Accounts, February 2009.

9.22 It proposed that output and outcome indicators should be regarded as the basis for increased delegation to agencies and for greater operational autonomy and not as an additional form of centralised control. Annual Output Statements should be produced by all non-commercial agencies in line with the new performance framework.

9.23 Overall, the concerns articulated by the Task Force and a range of other reports fall into two main categories

- confirming conformance by State bodies with governance norms
- ensuring that bodies perform their functions and deliver services to the highest standards.

9.24 The Task Force Report envisaged that the Department of Finance would lead the development of models of performance and governance frameworks to be completed within eight to 12 months of the Task Force Report's publication. The Transforming Public Services Steering Group of Secretaries General subsequently asked the Secretary General of the Department of Communications, Energy and Natural Resources to lead a project to develop recommendations in relation to the establishment and governance of State agencies.

Implementation Progress

9.25 A revised Code of Practice for the Governance of State Bodies ('the Code') was published by the Minister for Finance in June 2009 and applied with immediate effect. Progress in addressing performance issues has been slower.

Governance

9.26 The Code has been revised on a number of occasions. While many such codes adopt a 'comply or explain' approach the Irish Code is more prescriptive allowing only a limited margin of flexibility for certain bodies for which compliance with all its requirements would have a disproportionate effect because of the nature and/or scale of their activities. The approach has been to place annual reporting obligations on the Board and the Chairperson. Significant features of the regime include

- the requirement to adopt an annual statement on the system of internal financial control
- the obligation to have functioning internal audit and audit committees
- a system of risk management designed to address strategic, operational, and financial risks.

9.27 The new or revised measures introduced in the 2009 version emphasise

- the key responsibilities of the Board in the areas of strategic planning and the State body's system of internal control and its risk management framework
- additional requirements and clarifications on business conduct including internal audit, Audit Committees, procedures for dealing with conflicts of interest and confidential disclosures
- additional responsibilities for the State body in key operational matters in the areas of procurement, travel, disposal of assets, investment appraisal, legal action, including compliance with tax clearance and public sector contracts regulations
- further reporting requirements for the Chairperson in his annual report to the Minister and additional disclosures to be made in State bodies' annual accounts and reports on the CEO's salary, fees paid to Directors and expenses paid to the Board

- new departmental responsibilities for oversight and Accounting Officers responsibilities to satisfy themselves that the requirements of the Code are being implemented.

An outline of the key changes is set out in Annex C.

9.28 Overall, the changes implemented in the Code imposed significant requirements on Chairpersons and Directors of State bodies. The Code also recommended development of performance frameworks through dialogue between the State body and the Department as recommended by the OECD and mirrored in the Task Force's report. It further recommended that each Department/Office set out in writing the respective role of its Accounting Officer and the Chief Executives of State bodies under its aegis.

Opportunity to Improve Governance Reporting

9.29 As a result of the 2009 revision, considerable progress has been made in addressing the governance aspects of performance by State bodies. This has been built on extending the obligations of boards and confirming compliance in an annual report by the Chairperson to the supervising Minister as well as the existing reporting on control and risk management by way of statements on internal financial control. Going forward, it would be worth considering whether

- the statement of internal financial control could be replaced by a Statement that encompasses all controls and mirrors that applying in large private and public companies and in the UK government sector.
- in order to underpin the annual statements of the boards and Chairperson on governance and control there could be a process of certification, at least in bodies above a defined size, which would lend assurance to board members in issuing the reports required under the Code.

9.30 In March 2010, the National Standards Authority of Ireland (NSAI) and the Institute of Directors in Ireland published a new code of practice for corporate governance assessment for Irish companies and State bodies⁷⁸. The new code provides a best practice standard for an independent evaluation of an organisation's compliance with existing corporate governance codes such as the OECD principles, the Combined Code on Corporate Governance and the Code of Practice for the Governance of State bodies.

9.31 The SWiFT 3000 initiative awards certification to companies and State bodies that meet the required standard following independent assessment.

9.32 A particular concern which hampered the effectiveness of State supervision was the belief that in the case of State nominees directors' fiduciary duty was generally understood as preventing a board member from reporting to the Minister on key issues of governance, regularity, probity and financial performance.

9.33 Bearing in mind the complexity of amending all sectoral legislation and because the objective is of a limited nature, the Department of Finance has, in the first instance, prepared a protocol for civil servants nominated to Boards of non-commercial State bodies to address this issue. The protocol was noted by Government at its meeting of 13 July 2010 and has been promulgated by circular letter to heads of Government Departments and Offices. It will also be included in the Code of Practice for the Governance of State Bodies.

⁷⁸ SWiFT 3000: 2010 Code of Practice for Corporate Governance Assessment in Ireland.

Accounting Matters

9.34 A key part of the discharge of a State board's accountability is evidenced through the production of annual accounts. The vast majority of these accounts are certified as giving a true and fair view using an audit system that complies with international standards of auditing.

9.35 Without qualifying audit opinions, reservations are sometimes included in audit reports. Departments should from time to time review the significance of matters raised in those audit reports. While many of the matters reported are technical in nature and arise out of the strict application of Financial Reporting Standards to State bodies, they often highlight areas for consideration both by central steering departments and supervising departments.

9.36 Reservations have been expressed in the audit reports of a number of State bodies in recent years. The range of issues upon which reservations were expressed in opinions in the period 2006 – 2009 included

- failure to review the effectiveness of internal financial control
- failure to account in accordance with Generally Accepted Accounting Practice (GAAP) in Ireland, for pension costs and pension liabilities
- instances where value was not derived from expenditure including non-effective expenditure, improper expenditure (i.e. expenditure not in compliance with the proper authority) and non-business related expenditure
- deficiencies or uncertainties relating to accounting for depreciation, valuation of investments and disposal of assets
- shortcomings in financial controls including cut-off procedures.

9.37 A summary of the type and extent of reservations raised in each year covering the period 2006 – 2009 is set out in Figure 44.

Figure 44 Reservations in Audit Reports 2006 – 2009^a

	Accounting Year			
	2006	2007	2008	2009 ^b
Failure to Review the Effectiveness of Internal Financial Control	2	14	18	-
Pension-Related Matters	30	31	28	5
Expenditure Related Matters	2	1	6	1
Asset Valuations and Disposals	1	1	2	1
Shortcomings in Financial Controls	1	1	2	-
Other Matters ^c	5	4	9	8
Total	41	52	65	15

Notes:

- a This covers audits reports signed in the period 2007 to 30 June 2010. In general, since 2009, the policy of the Comptroller and Auditor General is not to refer to issues that are self-reported by State bodies either by way of notes to accounts or as part of their Statements on Internal Financial Control unless the matters are judged to be material by amount, nature or context.
- b This covers audit reports signed in the period up to 30 June 2010.
- c These include disclosures regarding litigation, income related matters, going concern issues and divergence of accounting policies from Generally Accepted Accounting Practice.

Conclusion – Governance

The responsibilities of boards for the governance of State bodies could be strengthened further by extending reporting on internal control and having the process supporting the production of a Statement on Internal Control underpinned by certification to NSAI standards.

The protocol for board members drafted by the Department of Finance should help remove any communication barriers between Ministers and civil servants appointed by them to non-commercial State bodies in areas of governance and probity where those barriers relate to their concomitant fiduciary duty to the State body.

State bodies, in general, are given unqualified audit opinions on their accounts. However, audit reports often draw attention to issues of control, management, accounting and governance which come to light in the course of audit. In addition, below a materiality level agencies often self-report shortcomings in control or accounting.

A welcome change in recent years, has been a greater internalisation of accountability – with Boards, through audit committees and internal audit functions, equipping themselves with information, feedback and advice on the management of their programmes. This development which is driven by the Code of Practice has enhanced overall assurance about the management of public programmes.

Performance Management

9.38 While a comprehensive performance management framework would encompass the corporate governance arrangements referred to above, it would also extend to the delivery by the State body of its services.⁷⁹ It is unlikely that a ‘one size fits all’ framework could apply to all State bodies because of the need to acknowledge the differences in function and objectives of purely commercial entities, those commercial entities with social objectives and of agencies with enterprise development, debt management, promotional, service delivery and regulatory functions. However, some common aspects of State supervision are capable of articulation. These might be based around a proposition that if State agency performance is to be managed effectively there needs to be a framework that has the following features

- a clear statement of the agency’s current mission and purpose agreed with the Department
- an annual agreement that converts that mission and purpose into goals and associated outcome targets
- a defined reporting mechanism (set out with that agreement)
- a provision for a formal review of performance on a periodic basis with a focus on whether and to what extent the desired or intended outcomes are being achieved.

⁷⁹

This section focuses on operational performance.

9.39 As an initial step the Accounting Officer of the DCENR has been charged to undertake a study setting out proposals, including frameworks which might inform the establishment, functions, corporate governance⁸⁰ and performance management of agencies. The specific areas of focus include

- principles which might inform policy on the establishment and retention of agencies
- the structure and governance of agencies
- the establishment by Ministers and departments of the tasks and priorities of agencies (including re-mandating and allocation of additional functions)
- implementation of corporate governance arrangements
- departmental oversight of agencies, including corporate governance and related capacity issues
- measurement of performance by agencies, including the use of Service Level Agreements.

9.40 I asked the Accounting Officer for an update on the current status of this work. He informed me that the study has been finalised and submitted to the Secretaries General Sub-Group on Transforming Public Services. He stated that it will be a matter for that sub-group as to how the study should be progressed and subject to this, it is expected that consideration of recommendations in the study will be a matter for Government. He stressed that as set out in the areas of focus above, performance management and evaluation is just one element of the study.

9.41 He stated that one challenge to uniformity of performance monitoring arose from the fact that non-commercial State bodies range very much in size and structure and have varying functions and statutory bases. This, in turn, has implications for the nature of interaction with the supervising Minister and Department and implementation of governance and performance measurement frameworks. He pointed out that in the area of performance measurement his study focused primarily on appropriate general frameworks rather than details of individual performance measurement templates. Existing performance frameworks such as Statements of Strategy, Annual Output Statements and Service Level Agreements should provide an adequate general basis for a robust system of performance measurement. It is key, however, to ensure that these processes enable a transparent performance measurement system by reference to relevant and measurable performance indicators – the quality rather than the quantity of the latter is also crucial. This requires, in turn, appropriate engagement between departments and State bodies on the specifics of a performance measurement system within any general framework.

Funding and Cash Management

9.42 A number of State bodies and institutions who receive substantial State funding report considerable cash balances. A key aspect of monitoring is the funding plan of the agency. It is a principle that there be economy in the management of State funds. Consequently, close monitoring of cash balances and the management of creditor positions consistent with prompt payment obligations should be a feature of department supervision. The necessity for such an approach is highlighted by the instance noted beneath.

⁸⁰ Taking account of existing corporate governance and other relevant operational guidance for State agencies.

Road Safety Authority

At the end of 2009, the Road Safety Authority (the Authority) reported a surplus of €12.87 million for the year and had a bank balance of €12.21 million. Heretofore, the Department of Transport has not requested details of the funds on hands at the time of the Authority's drawdown of State funding. The Accounting Officer has indicated that this requirement, following consultation, may be considered as part of the drawdown process going forward.

He stated that his Department is in frequent communication with the Authority and was formally notified in January 2010 that the Authority was reporting a surplus of €12.87 million for 2009. At a meeting in February, this surplus was explained as arising from the Authority's increased non-Exchequer income (in excess of the amount originally budgeted for). In addition, a third party contract for the supply of High Visibility Material for road safety promotional purposes was terminated due to inability of the provider to deliver, leading to a further reduction in expenditure. Finally, as previously agreed with the Department, the surplus also included €4.2 million to fund a Commercial Vehicle Roadworthiness Reform programme.

He also stated that it had been intended to commence the latter programme during 2009, but due to various difficulties, including obtaining approval for the required staffing resources, it was not expected to commence until this year. The remainder of the surplus had been allocated to other capital projects, including a Digital Tachograph Online System, a Driver Licensing Plastic Card Programme and a Driver Testing Data Capture Programme. Apart from a relatively small amount of funding from the Department, the Authority funds its capital programme mainly from non-Exchequer income. The allocation of the balance of the surplus to these programmes has been the subject of various discussions between his Department and the Authority in 2010.

9.43 Overall, short of reducing the level of grant payments to bring an entity's State funding into line with its cash needs, there may be merit in consolidating balances through more active treasury management.

Day-to-Day Interaction

9.44 A revised performance framework could not rely on formal reporting alone. A comprehensive performance framework would need to address the factors which should give rise to immediate reporting outside the formal process.

9.45 The establishment of a range of such issues and materiality levels might be considered. In order to strike a balance between the responsibility of the board for day-to-day operations and the special considerations that attach to bodies capitalised or funded by the State or whose functions are determined by law the reporting threshold should be set at a reasonably high level. Some key reporting issues that could be considered are

- the emergence of material contingent liabilities
- major litigation claims that could have an effect on the financial position of the body
- working capital deficiency in terms of risk to the body's capacity to meet its obligations for at least the next twelve months
- material fraud or irregularity, or suspected fraud or irregularity, affecting the body
- breach of borrowing limits approved by the Department.

9.46 An example of an event that should have triggered such a report is set out in Figure 45.

Figure 45 Defalcation at CIÉ

In late October 2009, following media reports concerning an investigation into infrastructure procurement and internal controls in Iarnród Éireann by Baker Tilly Ryan Glennon (BTRG), the Minister met with the Chairperson of CIÉ and expressed his concern that the BTRG report had only been mentioned to his Department for the first time in the preceding days and that it had never been specifically mentioned by the Chairperson in his annual statements on compliance with the Code of Practice. The Minister also expressed concern at the number of procurement exceptions in these reports. He indicated that a Chairperson's report to him in November 2009 needed to provide assurances in respect of all procurements being undertaken within Iarnród Éireann.

The Chairperson acknowledged that in retrospect it would have been appropriate to bring the procurement matters to the Minister's attention but that, as the issues arising were being dealt with, he felt that there was no need to make specific mention in that regard. The actual loss was in the region of €2.6 million.

The Accounting Officer of the Department of Transport stated that on being made aware of the existence of the BTRG report on 9 October 2009, the Minister made clear that it should have been brought to the attention of the Department on its completion. He sought a full report from the Board of CIÉ on the circumstances giving rise to the report, the extent to which progress had been made in implementing the recommendations in the report and the measures being taken to ensure adequate controls in expenditure areas not covered by the report. He also discussed the matter with the Chairman of CIÉ on 23 October 2009 and expressed his concern to him on the weaknesses identified and the fact that neither he nor the Department had been informed. The Chairman briefed the Minister on the issues and confirmed that almost all of the recommendations in the report had already been implemented.

Detailed replies from CIÉ were received in January and March 2010 outlining the steps taken in strengthening procurement policy and practice, the extent of implementation of the BTRG recommendations and the Board's satisfaction with the adequacy of the controls in place in expenditure areas not covered by the report.

The Accounting Officer stated that the Department is satisfied that the CIÉ Board has taken the necessary steps to ensure adherence to the procurement requirements detailed in the Code of Practice.

Monitoring Capacity of Supervising Departments

Code of Practice – Requirements^a

The Accounting Officer of the Department under whose aegis a body lies should satisfy him/herself that the requirements of the Code of Governance are being implemented and if reports indicate that problems exist, ensure that appropriate action is taken as soon as possible.

Note:

a This is set out in Section 13.4 of the 2009 Code of Practice for the Governance of State Bodies.

9.47 In discharging their responsibilities, Accounting Officers need to ensure that adequate resources are available to monitor and report on State bodies. In this regard, some of the Department of the Taoiseach's recommendations on regulatory governance are equally pertinent in the case of State body governance capacity, and, in particular, *"If performance indicators and reporting are to be effective, it is important that Departments have the analytical capacity and technical expertise to effectively scrutinise both outputs achieved and proposed targets."*⁸¹

9.48 A review of the implementation of the key provisions of the Code for the 2009 round of reporting for two State bodies — CIÉ and NORA, was undertaken. Both supervising departments have developed internal checklists to determine whether the Chairperson of each body has complied with reporting requirements under the Code. In addition, the Department of Transport has developed a template to promote a more uniform and structured approach to the compilation of Chairpersons' reports which sets out all the necessary components to be included.⁸²

9.49 The audit review identified the following

- DCENR has completed a checklist based on the provisions of the Code. With the exception of a performance framework, the checklist indicates that NORA is compliant with the Code provisions for 2009.
- The Chairperson's Report for CIÉ for 2009 was submitted under the older 2001 Code of Practice. The Department requested that a revised report be submitted. This was received at the end of July 2010.

9.50 While existing reporting requirements regarding the timely submission of accounts for NORA have been adhered to for 2009, this has not been the case for CIÉ

- interim unaudited accounts for the first half of 2009 were not submitted until mid October 2009 (due by the end of August)
- draft unaudited annual accounts were received in early March 2010 (due by the end of February)
- submission to Government of annual report and accounts for 2009 took place in July 2010 (due by end of April 2010).

Observations of Accounting Officers

9.51 The Accounting Officer of the Department of Transport stated that in November 2008, the Minister for Transport put in place enhanced arrangements to strengthen corporate governance within the Transport related agencies. This initiative followed a number of reviews of corporate governance carried out both within the Department of Transport and across the wider system. He stated that the new initiative – A Change in Tone – had established arrangements to improve communications and set the relationship between the Minister/Department and each agency on a more formal footing. Included in the new arrangements is an annual meeting between the Minister and the Board which provides a forum for discussion of any corporate governance issues arising. Less formal meetings between the relevant Assistant Secretaries and the staff of State bodies occur on an ongoing basis. Any

⁸¹ Better Regulation, Department of the Taoiseach, 2009.

⁸² The Department sent this template to the Chairperson of CIÉ in July 2009 requesting that his report for the year be drawn up in accordance with the template.

significant issues of concern that arise are brought to his attention or to the attention of the Management Board.

9.52 DCENR's checklist captures wider compliance with the Code, in that it covers all areas of the Code regarding operational activities within NORA, not only those aspects specifically attested to by the Chairperson in his annual report. Its ability to complete a full checklist of compliance with the detailed Code provisions is aided by the presence of a Departmental official on the Board of NORA.

9.53 The Accounting Officer for DCENR informed me that following the publication of the new Code, his Department revised its checklist to monitor compliance with the Code. When the annual report and accounts of each company/agency are submitted to the Department for approval, they are accompanied by the Chairperson's Statement of Internal Financial Control and statement of compliance with the Code of Practice. As part of the Department's review of the annual report and accounts, the Chairpersons' statements are analysed in detail within the relevant Division and by the Department's financial advisor. The Department also meets with bodies under its aegis for a full briefing on its annual accounts.

9.54 He stated that compliance with individual aspects of the Code is marked on the checklist, which is signed by the relevant Head of Function and submitted to him, along with the annual report and accounts. Where non-compliance is identified, explanations are sought and remedies applied where appropriate. He intends to keep the operation of this process under ongoing review in order to ensure that the obligation placed on him under the Code of Practice is implemented effectively.

Conclusion – Performance Monitoring

Both departments have either direct or indirect access to financial, technical, legal and a broad range of generalist skills for effecting their oversight functions. Evaluation of both CIÉ's and NORA's performance is carried out on a regular basis throughout the year by each department.

Both departments have formal liaison arrangements in place which provide for regular meetings between key officials in the Department (including the Minister) and the State body. Arrangements are also in place for less formal interactions on a day-to-day basis.

The introduction of performance frameworks must await consideration of a report of a sub-group considering that and related matters and the outcome of subsequent government deliberation.

Overall, in the two cases examined, providing due regard is had to the nature of their operations, a performance management framework and the associated process of development could help drive a more outcome-focused delivery of service. There has, as yet, been no movement to introduce output statements in non-commercial State-sponsored bodies.

Audit reviews would suggest that there is scope for reviewing the monitoring arrangements that apply to funding and cash management and considering more active treasury management.

Conclusion

There would be value in compiling practical guidance on the wind down of agencies and functions chosen for rationalisation so that the maximum savings and operational synergies can be targeted.

There is clear consensus based on the OECD Review, and the Task Force Report on the Public Service that a Performance Management Framework for State bodies should be in place.

In general, good progress has been made in creating a regime that gives assurance in regard to State body compliance in the area of governance and its association with the accountability process helps ensure that all conformance matters are on Boards' agendas.

Wider aspects of performance now need to be addressed and a framework developed that balances the operational independence of State bodies with the need for focused delivery. It may be useful to focus attention on achievement of outcomes in formulating this framework.

The nature of the framework to be implemented will need to be adjusted to the circumstances of each State body. Different levels of oversight may need to be considered according, for example, to whether the State body is in the commercial or non-commercial sector, the risk levels associated with the sector, previous experience and whether the body appears before the Committee of Public Accounts in its own right. In addition, independent sectoral regulators have specific features which mean that this recommendation would need to be tailored to their specific circumstances. The recent legislative proposals dealing with financial regulation could provide a framework for greater public scrutiny of such functions including the provision of three-yearly strategic plans and annual regulatory performance statements.

More generally, performance statements should be sufficiently comprehensive to allow the identification of objectives, enable progress tracking to take place through regular reporting and review, and facilitate corrective action where planned progress is not being made.

Departments should consider requiring State bodies under their aegis to apply for and achieve certification under the new NSAI assessment code within a reasonable period of time. This would give assurance to board members that there is a reasonable evidence base to support the assertions set out in annual Statements on Internal Financial Control.

Annex A Schedule of Implemented Rationalisation Decisions

Agency/Initiative	Amalgamation	Abolished	Absorbed
Department of Transport			
Dublin Transportation Office	√		
Department of Social Protection			
Citizens Information Board	√		
Office of Social Inclusion			√
Money Advice and Budgeting Service ^a	√		
Combat Poverty Agency			√
Department of Environment, Heritage and Local Government			
Rent Tribunal ^b	√		
Private Residential Tenancies Board	√		
Department of Education and Skills			
Educational Disadvantage Committee		√	
National Adult Learning		√	
Centre for Early Childhood Development and Education		√	
Department of Health and Children			
National Cancer Screening Board			√
National Council on Ageing and Older People			√
Children Acts Advisory Board			√
Women's Health Council			√
Crisis Pregnancy Agency			√
Postgraduate Medical and Dental Board			√
Department of Defence			
Longford, Lifford and Monaghan Barracks		√	
Rockhill House, Letterkenny		√	
Department of Agriculture, Fisheries and Food			
Council for Forest Research and Development			√
Marketing/Promotion functions from An Bord lascaigh Mhara to An Bord Bia			√
Department of Tourism, Culture and Sport			
Culture Ireland			√
Department of Justice, Equality and Law Reform			
National Crime Council		√	
National Consultative Committee on Racism		√	
Censorship of Publications Office	√		
Censorship of Publications Appeals Board	√		
Department of Communications, Energy and Natural Resources			
Central Fisheries Board	√		
Eastern Fisheries Board	√		
North Western Fisheries Board	√		
Northern Fisheries Board	√		
Shannon Fisheries Board	√		
South Western Fisheries Board	√		
Southern Fisheries Board	√		
Western Fisheries Board	√		
Total	15	7	11

Notes:

a The Money Advice and Budgeting Service has been merged with the Citizens Information Board.

b The Rent Tribunal has merged with the Private Residential Tenancies Board.

Annex B Schedule of Rationalisation Decisions not yet Implemented

Agency/Initiative	Effective Implementation Target	To be Amalgamated	To be Absorbed/Merged	Under Consideration
Department of Transport				
Commission for Taxi Regulation	End 2010	√		
Bus Route Regulation	Third quarter 2010	√		
Railway Accident Investigation Unit	Third quarter 2010	√		
Air Accident Investigation Unit	Third quarter 2010	√		
Marine Casualty Investigation Board	Third quarter 2010	√		
Department of Environment, Heritage and Local Government				
Local Government Management Services Board	Fourth quarter 2010	√		
Local Government Computer Services Board	Fourth quarter 2010	√		
Department of Education and Skills				
National Qualifications Authority	2011	√		
Higher Education and Training Awards Council	2011	√		
Further Education and Training Awards Council	2011	√		
Department of Health and Children				
Pre-Hospital Emergency Care Council	No Target Date Set			√
Opticians Board	No Target Date Set			√
Food Safety Authority of Ireland	No Target Date Set			√
Office of Tobacco Control	No Target Date Set			√
Irish Medicines Board	No Target Date Set			√
National Social Work Qualifications Board	End 2010	√		
National Council for the Professional Development of Midwifery	No Target Date Set	√		

Agency/Initiative	Effective Implementation Target	To be Amalgamated	To be Absorbed/Merged	Under Consideration
Drug Treatment Centre	September 2010		√	
National Cancer Registry Board	No Target Date Set		√	
Department of Defence				
St. Bricin's Hospital Dublin	No Target Date Set			√
Department of Tourism, Culture and Sport				
Irish Museum of Modern Art	No Target Date Set			√
Crawford Art Gallery	No Target Date Set			√
National Archives	No Target Date Set	√		
Irish Manuscripts Commission	No Target Date Set	√		
Department of Justice, Equality and Law Reform^a				
Equality Authority	Ongoing			√
Human Rights Commission	Ongoing			√
Department of Enterprise, Trade and Innovation				
Competition Authority	2011	√		
National Consumer Agency	2011	√		
Total	28	16	2	10

Note:

a Further progression is a matter for the Department of Community, Equality and Gaeltacht Affairs.

Annex C Additional Obligations under the Code of Practice for the Governance of State Bodies 2009

Clarity on Board Responsibility and Related Matters

Extension of schedule of matters specifically reserved to the Board for decision to include delegated authority levels, treasury and risk management policies, succession planning for the Chief Executive, specific staffing related matters, reporting requirements to the Minister for bodies operating on a commercial basis – i.e. business is a going concern (qualified as necessary).

Responsibility of the Board for the State body's system of internal control. It should review annually its effectiveness, including financial, operational and compliance controls and risk management. Board required to confirm annually to the Minister that the State body has a system of internal financial control in place.

Preparation of strategic plan now a primary responsibility of the Board (formerly the Body's responsibility). Strategic planning requirements now different for commercial and non-commercial State bodies. Draft plans should be sent to the Minister prior to finalisation and his/her views should be considered.

Decisions on major items of expenditure to be aligned with medium/long-term strategies and a performance measurement system put in place to assess effectiveness/outcome of expenditure which should be reported to the Board.

Each State body should develop a Risk Management policy. The Board should approve the risk management framework and monitor its effectiveness. It should also review material risk incidents and note or approve management's actions as appropriate. Key issues of Board's oversight to include - risk management as a standing meeting agenda item, establishment of a risk committee (or inclusion in charter of Audit Committee), inclusion of risk management experience/expertise in competencies of at least one Director or source external advice, appoint a Chief Risk Officer or empower a suitable management alternative, require external review of risk management framework on a periodic basis.

Board should deal with the issue of post resignation/retirement employment, appointment and/or consultancy of Directors/employees by private sector and monitor application of procedure put in place in this regard.

The Board should review its own performance and that of its committees and individual directors.

Business Conduct

Extension of Codes of Business Conduct for Directors to deal with conflict of interest matters and non-retention of documentation obtained during term of office.

Requirements for internal audit function now include provisions for alternative means of accessing the function where the size or risk to the Body does not warrant a separate unit.

Clarification that bodies with 20 employees or more must have an Audit Committee with at least three independent non-executive directors. One member at least to have recent and relevant financial experience. Smaller State bodies permitted to have only two members on the Audit Committee. Audit Committees also mandated to review effectiveness of the State body's internal audit activities and ensure early communication to the Board of matters arising.

The Board should have procedures to monitor and manage potential conflicts of interest of management and Board members. It should also put procedures in place to deal with confidential disclosures.

Extension of issues that new Directors should be briefed on regarding conflict of interests and provision of a listing of statutory requirements relating to the body.

More detailed rules regarding Board Members' ability to obtain fees where there are subsidiary or associated bodies.

Key Operational Matters

State bodies to be clear about their mandates including identification of appropriate structures to deliver them.

Enhanced procurement procedures including set up of a sub-Committee of the Board (or include in Charter of Audit Committee) where there is a significant procurement function, EU Treaty principles to be observed and compliance with EU directives, completion of a Corporate Procurement plan.

State bodies to ensure that they are in compliance with 2006 Tax Clearance requirements and Department of Finance regulations on Public Sector Contracts.

The role of the Chief Executive and the Chairman should not be combined, except with the consent of the Minister.

State bodies also to have regard to appropriate models for investment appraisal and seek to apply best practice in the appraisal and management of all investment proposals. The Department of Finance Value for Money Frameworks to be adhered to in all cases.

Non-commercial State bodies to adopt and comply with Department of Finance regulations on travel and subsistence. Commercial State bodies should also be cognisant of the need to achieve economy and efficiency in expenditure on official travel.

Boards of State bodies that incur significant annual expenditure on foreign travel should put appropriate procedures in place to monitor, report and enforce the relevant rules and requirements. A Framework Travel Policy is also suggested which considers value for money principles.

The threshold for activating procedures regarding disposal of assets increased from €70,000 to €150,000. Directors connected to potential disposals should also absent themselves from Board deliberations.

New responsibilities introduced regarding legal disputes involving other State bodies. Every effort should be made to mediate, arbitrate or otherwise before expensive legal costs are incurred. State bodies should provide a list of legal issues to the Department of Finance together with an estimate of the legal costs incurred up to the date of this information.

Annual Reports and Accounts and Chairperson Reporting Requirements

State bodies should publish in their annual reports details of fees paid to each of their directors, expenses paid to the Board and the salary of the CEO. The attendances of each Board Member at Board meetings to be reported in the Annual Report. Annual reports should be published on the website and online publication considered when this can reduce costs.

Amendment of wording regarding consent of Minister to extend relevant annual report and accounts submission and publication deadlines.

More formalised reporting to the Minister by the Chairperson of instances of non compliance with statutory obligations setting out the consequences of non-compliance and the steps taken or will be taken to rectify the problem. Additional matters to be included in his annual report are - outlining steps to be taken to guard against breaches of internal financial controls (where breaches have occurred). He/she must also certify that Government travel policy requirements are being complied with and affirm that appropriate procedures for travel are being carried out.

Chairperson to specifically confirm in annual report compliance with Department of Finance 2005 guidelines on Capital Investment Appraisal.

Compliance reporting by Chairman in annual report to Minister affirming adherence to the relevant procurement policy and procedures and the development and implementation of a Corporate Procurement Plan (this plan to be completed by all non commercial State bodies).

The Chairpersons of each subsidiary should formally report to the main Board in a similar manner as the main Board Chairperson reports to the Minister. This report should be received prior to the main Board reporting.

Departmental and Accounting Officers' Responsibilities

The Code recommends that each Department/Office set out in writing the respective roles of its Accounting Officer and the Chief Executives of State bodies under its aegis.

The accountability of the Accounting Officer/Accountable person to the Oireachtas must be differentiated from that of the Board's general responsibilities in certain instances.

Responsibility for preparation of Appropriation Accounts and associated public financial procedures are the responsibility of the Accounting Officer not the Board.

The Accounting Officer of the Department should satisfy himself /herself that the requirements of the Code are being implemented and where problems exist ensure that appropriate action is taken as soon as possible.

New departmental oversight provisions are set out in the context of the development of performance frameworks.

Chapter 10

National Treasury Management Agency

Accounts

Accounts of the National Treasury Management Agency

10.1 The National Treasury Management Agency (the Agency) has the following functions

- it borrows moneys on behalf of the Exchequer and manages Ireland's National Debt.
- it acts as the Manager of the National Pensions Reserve Fund
- it manages compensation claims on behalf of State agencies
- it discharges the functions of the National Development Finance Agency
- it purchases carbon credits required to meet Ireland's climate change obligations
- it provides central treasury services for government departments and all non-commercial State bodies.

10.2 During 2009 and 2010 a number of additional functions and services were added to the Agency's remit including the provision of support services for the National Asset Management Agency, the operation of the Eligible Guarantee Scheme and certain banking system functions. These are outlined in Chapter 6.

10.3 Under the provisions 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 under Section 3 of the Comptroller and Auditor General (Amendment) Act 1993 to also make a report to Dáil Éireann on the correctness of the sums brought to account by the Agency in the year.

Conclusion on NTMA Accounts

The Agency's accounts for 2009 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 of them before both Houses of the Oireachtas.

I am satisfied that the accounts properly present the transactions of the Agency for 2009 and its balances at year end.

10.4 Chapter 2 outlines the outcome of the Agency's borrowing activity in 2009 and the amount and composition of Ireland's National Debt at 31 December 2009.

10.5 Chapter 11 presents a review of the Agency's performance in carrying out its borrowing and debt management functions.

Chapter 11

National Treasury Management Agency

Debt Management

Debt Management

11.1 The primary objective of the National Treasury Management Agency (the Agency) as set out in the National Treasury Management Agency Act 1990 (the 1990 Act) is *“to borrow moneys for the Exchequer and to manage the National Debt on behalf of and subject to the control and general superintendence of the Minister for Finance.”*

11.2 The 1990 Act enabled the Government to delegate the borrowing and debt management functions of the Minister for Finance (the Minister) to the Agency. Those functions were to be performed subject to such directions or guidelines as the Minister might give. Ultimately, obligations or liabilities undertaken by the Agency in the performance of its functions have the same force and effect as if undertaken by the Minister.

11.3 Borrowing undertaken by the Agency has increased significantly in recent years in order to meet budget deficits and build in an element of pre-funding to manage liquidity risks. In 2009, the net borrowing by the Agency was in excess of €24 billion, following upon over €30 billion borrowed in 2008. Because of the materiality of the borrowing now being effected by the Agency on behalf of the State, the systems, procedures and practices employed by the Agency were reviewed in the course of audit.

Chapter Focus

The chapter reviews the arrangements in place to ensure that

- the Agency’s borrowing programmes are based on agreed borrowing requirements and long-term debt costs are minimised consistent with the management of liquidity and other risks
- the Agency’s tolerance for risk is identified, monitored and regularly assessed
- an appropriate human resource function is in place that reflects the necessary level of skills in processing, reporting and monitoring activities.

The chapter also reviewed the results of performance monitoring for 2009.

Specification of Borrowing

The level of borrowing to be effected in each year should be formally approved or specified by the Minister.

11.4 In practice, the level of borrowing is not specified in advance by the Minister. The Government has, by order, conferred on the Agency, the function of preparing and submitting to the Minister *as soon as may be in each year a scheme indicating, as respects the moneys proposed to be borrowed by the Agency on behalf of the Minister for the Exchequer in that year, the proportion thereof proposed to be borrowed in the currency of the State, in respect of that year.* With the adoption of the euro, most borrowing is now effected in the currency of the State.

11.5 A borrowing plan is drawn up by the Agency. The primary determinants of the funding proposed are the Exchequer Borrowing Requirement (EBR) which is driven by government decisions and debt refinancing which is monitored and managed by the Agency. More recently, the level of borrowing has also been influenced by the creation of a strategic liquidity buffer. The

plan outlines the anticipated sources of the overall borrowing proposed. While it is submitted to the Minister, its content is not subject to formal Ministerial approval.

11.6 Control and general superintendence of borrowing is exercised through Ministerial Guidelines (the debt management guidelines) that set limits to the exercise of the Agency's responsibilities in respect of day-to-day management of the national debt and the operation of the Central Treasury Service⁸³. An outline of the debt management guidelines is at Annex A.

11.7 The debt management guidelines remain in force until superceded. In a period of volatility, considerable changes can occur in the borrowing requirement throughout a year. In light of the emerging budgetary position in 2008 the guidelines were amended by removing the limit on the cash balance, which could be held by the Agency. Following correspondence this was formally sanctioned by the Minister in December 2008 and had the effect of giving latitude to the Agency to borrow over €20 billion in excess of that required to meet budget deficits⁸⁴.

Conclusion – Borrowing Levels

The statutory provision in relation to borrowing requires the Agency to produce a scheme indicating the proportion of the annual borrowing to be made in the currency of the State. In practice this has been overtaken by events such as the adoption of the euro as the currency of the State, the effecting of virtually all borrowing in that currency and latterly the creation of a strategic liquidity buffer.

While it is accepted that in the execution of its delegated functions the Agency must have commercial freedom to execute borrowings in the market at times and in the amounts it judges most appropriate while taking account of overall market conditions, there would be merit in considering, in the new environment, what might be the most effective means of exercising control and superintendence of the borrowing levels by the Minister for Finance and, in particular, the level of those borrowings.

The Accounting Officer stated that the Minister for Finance had, up to recently, exercised control over the Agency's borrowing levels through guidelines which the Minister issues annually to the Agency under the National Treasury Management Agency Act 1990. These guidelines normally contain an upper limit on the cash balances which the Agency may hold. That limit, combined with the amount of the maturing debt to be refinanced and the Exchequer borrowing requirement as set out in the Minister's annual budgetary statement, represents the approved borrowing level for the year concerned.

However, in the extremely uncertain and volatile conditions prevailing in the capital markets since 2008, the Minister had decided that the Agency should have discretion to determine what level of cash balances is most appropriate and, accordingly, the Minister's guidelines currently do not stipulate a limit on cash balances. The Accounting Officer said that it is envisaged that, as market conditions normalise, the limit on cash balances would be reinstated.

The re-establishment, as part of the Ministerial guidelines, of a cash limit on the size of Exchequer balances would be an effective way of capping the borrowing limit.

⁸³ Central Treasury Service (CTS) takes deposits from and makes advances to Local Authorities, Vocational Education Committees and non-commercial State bodies. The objective of the CTS is to provide these bodies with a competitive alternative to the banking industry for their treasury business and to make savings for the Exchequer.

⁸⁴ The average size of the buffer was €24 billion in 2009. A figure of €20 billion is used throughout the report in order to acknowledge the fact that an Exchequer balance up to €4 billion has traditionally been held.

Management of Liquidity

The State must have sufficient cash to meet all liabilities as they arise. The principle of economy of cash balances would dictate that, other things being equal, the amount of debt should be minimised and a balance struck between the amount of any liquidity buffer and its cost to the taxpayer.

11.8 The Agency has procedures⁸⁵ in place to ensure that it manages the timing and volume of issuance to guarantee sufficient liquidity. The Agency's Risk Unit produces regularly updated funding plans and liquidity risk profiles in response to the emerging Exchequer deficit and the volatility in the markets in order to ensure that adequate balances are maintained and that the Agency complies with debt management guidelines issued by the Minister for Finance. The annual funding plan breaks down the cash target by product. The Agency liaises with both the Department of Finance and the Revenue Commissioners in managing cash balances as part of the European Central Bank operations with the objective of ensuring that they are maintained within certain limits.

11.9 The Agency stated that the stance of the European Central Bank's monetary policy is the backdrop against which borrowing operations are carried out. Since the Agency has no input into policy in this area and no influence on the result it is simply a given, at any time, which it is conscious of in making decisions.

11.10 In view of the instability in financial markets an additional liquidity buffer was built up late in 2008 mainly through short-term debt raised under the Agency's commercial paper programme. The build up of this liquidity buffer contributed to the increase in the Agency's short-term debt costs of €593 million in 2009 (€15 million: 2008). Interest received on the cash held, which was placed mainly in the Central Bank, amounted to €319 million in 2009 (€368 million: 2008).

11.11 The interest costs on this type of debt varies according to the period to maturity and market conditions. The Agency entered 2009 with a large carry-over from 2008 of servicing obligations. Approximately €1.2 billion had been borrowed under the Commercial Paper Programme in the September and October 2008 period when borrowing costs for this type of debt were high following the collapse of Lehman Brothers and the advent of the financial crisis. The interest paid on this borrowing amounted to €323 million.

11.12 When measured on an accruals basis, the Agency estimates⁸⁶ that the net cost of maintaining the elevated cash balances in 2008 and 2009 was approximately €100 million. The Agency stated that it used short-term debt as bridging finance to cover the EBR between bond issues and to build up the liquidity buffer. The Agency also stated that the build up of the buffer not only helped it in the timing of bond issues to avoid the most turbulent conditions in the markets but also gave comfort to investors. It stated that bond issues would have carried significantly higher yields if the buffer had not been in place and that, in its absence, the likely financial impact on the Exchequer position would have far outweighed the cost of the buffer.

⁸⁵ These advert to maturity profiles, Department of Finance expenditure profiles and Revenue profiles which are reviewed monthly during the year and more frequently towards year-end.

⁸⁶ Based on calculating the spread of the weighted average cost of the short-term borrowing over the deposit rate (EONIA) and applying it to the average level of the buffer.

11.13 At the end of 2009, the liquidity buffer of over €21 billion had been built up mainly from

- Treasury Bills (€8 billion)
- US Commercial Paper Programme (€4 billion)
- Euro Commercial Paper Programme (€3 billion)
- Other short-term debt (€1 billion)
- Irish Government Bond issues (€5 billion).

11.14 A subsequent increase in the level of longer term debt effectively increases the cost of the buffer further.

Conclusion - Liquidity

The Agency has managed its borrowing programmes to ensure that the Exchequer has the liquid resources to meet the cash demands that arose in recent years and has in addition, taking account of the altered situation in financial markets pre-funded the State budget by an amount of the order of €20 billion throughout 2009.

The Accounting Officer stated that, in stressed market conditions, one of the objectives of liquidity management is to be able to issue in the markets on an opportunistic basis when conditions allow. The markets and rating agencies have favourably regarded the cash buffer and the Agency has used it to advantage in demonstrating to investors that Ireland has no liquidity problems such as are perceived in relation to other Euro area countries. The discretion that the Agency has in managing the Exchequer's liquidity buffer in a manner which it judges will best guarantee continued market access should not be compromised, and the cost of the buffer is an 'insurance premium' which is well worth paying.

The net cost of maintaining the elevated cash balances in 2008 and 2008 was approximately €100 million. While accepting the prudence of the pre-funding approach in view of market volatility, the associated cost is material. The Agency would, therefore, need to keep the costs and benefits of the buffer under constant review in the light of emerging market conditions.

In addition, given the substantial cost of the liquidity buffer, it should be the subject of a limit set within the Ministerial guidelines. As for borrowing, generally, the most efficient way of achieving this would be to re-establish an Exchequer cash balance limit within the Ministerial guidelines on the lines that operated up to 2008.

Borrowing Activity

Borrowing activity should be carried out on foot of funding plans and using competitive processes.

11.15 In practice, the Agency draws up a funding plan which is revised in line with movements in the EBR. It takes account of refinancing and liquidity targets. It is drawn up by the Agency once the Department of Finance has sent the Agency its provisional EBR usually in June each year. The plan is adjusted as the EBR is revised by the Department. The EBR forms the main basis for the funding plan. This in conjunction with all maturities in the year, which are calculated by the Agency, make up the funding requirement. The Agency then decides on the source of the funding requirement i.e. retail, short-term and long-term debt.

Debt Management Environment

11.16 The Agency informed me that the primary source of the Agency's information comes from its presence in the markets and its regular and frequent discussions with the primary dealer banks and with investors. It also derives information from its attendance at international fora for debt managers and investors held by international organisations such as the OECD, EU, IMF and World Bank.

11.17 It makes itself aware of what is happening in the markets at all times. This enables it to time its interventions in the markets to maximum effect and avoid situations where several issuers might be in the markets for very substantial deals at the same time to the detriment of all. Within the EU group of issuers an informal procedure exists to minimise this risk.

11.18 The Agency maintains ongoing contact with a primary dealer group that includes virtually all the major international investment banks. It informed me that it discusses its funding options with those banks on a continuous basis and, accordingly, is always aware as it formulates its funding strategy of market conditions and the opportunities for funding in its main Euro area bond market and other markets.

11.19 The Agency also has frequent contact with rating agencies, both proactively, in keeping them fully informed on all new developments in the economy and public finances and through arranging detailed discussions between them and key private and public sector entities during their visits to Ireland. Both the EU and the OECD have fora where sovereign debt managers meet regularly to discuss the latest market developments. The EU Member States publish auction schedules on their own websites and an EU website⁸⁷. In addition, the EU members have an informal agreement to notify the EU Commission and each other when they are about to launch a syndicated bond deal.

Borrowing Strategy

11.20 The Agency's main strategy is to borrow through the issue of Euro denominated debt securities in the Euro area market where Ireland represents about 2% of the total market. Transparency and predictability are key features which investors in those markets seek. Accordingly, the Agency informs the market at the beginning of each year of its calendar of bond auctions for that year giving an indication of the size of each auction.

11.21 All auctions are currently executed using the Bloomberg auction system where bids are accepted and allocated electronically based on a best price bid basis. Results are reviewed by the Agency's Funding and Debt Management Unit prior to acceptance of the bids. In addition, a non-competitive auction takes place immediately after the announcement of the results of the competitive auction. Bids are accepted from primary dealers at the weighted average price in the competitive auction and the three primary dealers who are adjudged by the Agency to have best fulfilled their quoting obligations in the previous calendar month are each entitled to a non-competitive auction allocation of 5% of the amount of each bond sold in the competitive auction. A further 15% of the amount of each bond sold in the competitive auction is made available and the entitlement to this divided among primary dealers in proportion to their allocations in the competitive auction.

⁸⁷ Website of Economic and Financial Committee – Sub-Committee on EU Government Bills and Bond Markets http://europa.eu/efc/sub_committee/index_en.htm

11.22 However, in order to raise larger amounts than could be achieved in an auction, especially for the purpose of launching a new bond where initial liquidity (which mainly depends on the size of the bond) is important the Agency from time to time issues bonds through a syndication process when it sees a suitable opportunity in the markets. Issuing bonds through the syndication process involves selecting a lead bank or joint lead banks to seek bids from investors for amounts within a specified yield spread. The Agency ensures that prices remain competitive by approving the yield spread in advance with the lead bank.

11.23 In 2009, €23 billion was raised by way of syndication and almost €1 billion in auctions. Ultimately, the choice of method and the costs are a factor of market conditions at the time. The outturn in 2009 is set out in Figure 46.

Figure 46 Debt Raised in 2009

Method	Nominal Debt €m	Cash Raised €m
Auction	10,763	10,746
Syndication	23,000	22,908

Source: NTMA

11.24 In addition, the Agency issues new products. In 2009, a new long-term bond of 15 years maturity was issued in November, as well as a new Treasury Bill programme begun in March and a new US Dollar Commercial Paper programme introduced in July. These products were designed to attract new investors. In the case of the US Commercial Paper programme, none of the investors would have previously held Irish government debt. The Agency explained that this change was designed to tap additional funding sources identified from market feedback. In these cases, currency risk is minimised through immediate hedging⁸⁸.

Conclusion – Borrowing Activity

The Agency draws up funding plans that take account of the EBR, refinancing requirements and latterly the liquidity buffer.

Competitive procurement of long-term funds through the auction and syndication processes helps ensure cost effective borrowing.

Servicing the National Debt

The cost of servicing should be minimised.

11.25 An annual debt service budget is negotiated with the Department of Finance as part of the Multi-Annual Budget process which begins in June and is generally finalised around November each year. There were three debt service budgets for 2009. The first budget was agreed with the Department for the early budget which was announced in October 2008 where the debt service costs were estimated at €3.9 billion. As a result of an increased EBR and higher interest rates, a revised figure of €4.5 billion was subsequently agreed for the budget addendum which was

⁸⁸ Hedging is the implementation of a set of strategies and processes designed to limit or eliminate, through the use of appropriate instruments, the effects of fluctuations in the price of credit or foreign exchange on the Agency's Debt or investments.

released in January 2009 and the final debt service budget was agreed for the Supplementary Budget which was released in April 2009. This was revised again to €3.9 billion due to savings expected by the Agency.

11.26 At the end of 2009, the actual outturn was €86 million below the agreed budget mainly due to interest rates achieved by the Agency which were lower than those prevailing at the time the Supplementary Budget was agreed and also timing factors relating to the payment of coupons on debt issued in 2009. A rolling forecast is maintained by the Agency's Risk Unit and outturn is reviewed against profile. A monthly analysis of performance against profile with explanation of any differences is provided to the Chief Executive and the Director of Funding and Debt Management.

Conclusion – Servicing the National Debt

The primary indicator of cost minimisation is the extent to which the Agency is successful in raising new debt at rates below the prevailing market rate. In addition, competitive procurement of debt through auctions and syndication should help it to achieve the keenest rates. Budget revisions also help maintain a focus on the outturn target.

The results of benchmarking suggest that the Agency is successful in raising new debt at competitive rates.

Risk Tolerance

There should be a comprehensive framework of goals and risk tolerances for debt and cash management approved by the Minister.

11.27 Apart from the overall imperative to manage liquidity the risks encountered by the Agency can be classified as market risk, counterparty credit risk and operational risk. Risk tolerances are set on the basis of the planned portfolio for the year.

11.28 The overall risk tolerance guidance in the debt management guidelines is

- a net exposure to sterling up to 3%, a net exposure to US Dollar, Swiss Franc and Yen of up to 2% and a net exposure to other currencies of up to 1% but an overall exposure to all foreign currencies of 3%
- a ceiling of 45% on floating interest rate debt
- a limit of 75% of net debt with less than five years to maturity.

11.29 The results achieved for 2009 were

- the Agency had no net exposure to other currencies due to the hedging of all foreign currency borrowings
- the proportion of floating interest rate debt was around 5%
- the proportion of net debt with less than five years to maturity was 44%.

Accordingly, the actual exposures were well within the specified limits in the Guidelines.

Market Risk

11.30 In the case of market risk, the Agency has a set of procedures to gauge the impact of movements in interest rates and foreign exchange rates. These include systems to quantify the sensitivity of budgeted debt service costs, both in the current year and in future years, to movements in market rates.

11.31 Stress tests are used by the Risk Unit to supplement these measures by estimating the possible impact on the debt service budget that may occur under extreme market conditions. A Cost at Risk⁸⁹ model is also used to estimate the risk to the debt service budget under different funding strategies and a range of interest rate scenarios.

11.32 Fiscal limits with regard to exposures to potential movements in interest rates and exchange rates are approved by the Chief Executive annually. The Agency's Risk Unit reports monthly on exposures against the preset limits.

11.33 Since the introduction of the Euro, all of the national debt is now either denominated in, or swapped into Euro. Where deals are initiated in non-Euro currency, e.g. under the commercial paper programmes, the relevant product description provides that the exposure should be hedged immediately. The Agency's Risk Unit monitors compliance and ensures that all foreign borrowing deals have a corresponding foreign exchange hedge in place.

Counterparty Risk

11.34 Counterparty credit exposures, arising from the placing of deposits as well as transactions in derivatives, are monitored daily against approved limits. The Agency has in place a comprehensive system for managing its credit risk with other financial institutions. Exposures are measured on an aggregate basis across the various Agency portfolios by a system⁹⁰ which provides real-time information on limits and their utilisation. Counterparties are constantly monitored for any events that might affect their creditworthiness and all counterparty limits are subject to a daily review process.

11.35 The debt management guidelines set out the minimum requirements for counterparty quality. The Agency has put in place systems and processes to identify, measure, monitor, control and report its direct counterparty credit risk. The objective of this credit risk management framework is firstly to protect cash and investments and, secondly, to facilitate the maximisation of the rate of return on financial market investments.

11.36 The Agency recently established a Counterparty Credit Risk Committee⁹¹ to assist the Agency's Chief Executive, NPRF Commission and the Board of NAMA in the effective discharge of their responsibilities for managing counterparty risks and exposure. Its main objectives are to ensure that

- an appropriate counterparty credit risk management framework is in place
- investment and treasury operations are conducted within the scope of that framework

⁸⁹ Cost at Risk is a measure of the maximum rise in nominal interest costs that can be expected over a nominated time period within a specified level of probability.

⁹⁰ The SPRINT system is an in-house developed treasury system for the collection and reporting of information for the measurement and management of debt activity. It is linked to internal and external information sources that allow the automation of a variety of debt management tasks from routine calculations to transaction initiation and confirmation.

⁹¹ This was implemented in early 2010.

- proper attention is paid to compliance and counterparty risk management issues.

11.37 The management of credit risk is guided by the following general policies

- transactions in financial instruments are conducted and entered into only with approved counterparties after credit limits have been authorised
- all credit limits are now recommended by the Counterparty Credit Committee for approval by the Agency's Chief Executive
- the usage of credit limits is regularly monitored
- all derivative exposures are marked-to-market
- transaction netting takes place in accordance with the terms and conditions of the underlying trading agreements⁹²
- concentration of credit risk is managed by setting credit risk limits at a counterparty-specific level.

11.38 The vast bulk of the Agency's deposit activity is transacted with the Central Bank. The average cash held throughout 2009 was €24.2 billion. Cash deposits held with the Central Bank attract a return based on European Central Bank EONIA rate.

Operational Risk

11.39 Operational risk is controlled by policies and procedures that govern payments and by internal organisation processes such as the separation of duties, in line with best practice in the financial sector. Management of operational risk is the responsibility of all business units and is supplemented by the work of the Agency's Control and Compliance units and the internal auditor.

Derivatives

11.40 Under the Agency's operating policies, interest rate swaps should only be entered into for the purpose of managing the interest rate risk associated with the debt and cross-currency swaps transacted in order to manage the exchange risk associated with the foreign debt portfolio. The Agency hedges any foreign currency exposure in short-term borrowings through the immediate use of forward contracts. The performance of derivative contracts is measured under benchmark rules agreed with the Minister. Value at Risk⁹³ reports are also used to quantify risks under swaps contracts.

11.41 The Debt Service budget includes provisions for payments and receipts under derivatives, itemised by product. The outturn is measured monthly against the budget and any variances are analysed. The market value of interest rate and cross currency swaps is monitored on a monthly basis by the Agency. Overall, reports on compliance with the debt management guidelines are designed to ensure that the derivatives entered into are effective in hedging currency and interest rate risk as required.

⁹² In general, master netting agreements are not used. However the Agency is reviewing whether they would be useful in light of additional operations arising from the establishment of NAMA.

⁹³ Value at Risk is expressed as the worst case loss that could be expected to be incurred from a given portfolio as a result of movements in identified risk parameters, over a nominated time period within a specified level of probability.

Other Risks

11.42 The Agency maintains two risk registers. These comprise a general risk register focusing on information technology and people risks and a funding and debt management risk register. Each risk is described, categorised (financial, operational, reputational and regulatory) and assessed using a three-tier level as to its likelihood and impact. Mitigating controls are identified. The work of both the Agency's control function and internal audit is based on the risks to which the Agency is exposed and both report to the audit committee.

11.43 There are several layers of operational contingency planning and event risk management. The Agency ensures that it has a significant number of primary dealer banks for its long-term and short-term issuance programmes so that the unexpected absence of a number of dealers will not endanger the viability of the programmes. It also maintains several separate borrowing programmes – three main short-term paper programmes⁹⁴ and two long-term issuance programmes. In addition, the Agency maintains bilateral relationships with a large number of banks so as to facilitate private placements of debt instruments if so desired.

Conclusion – Risk Tolerance

Internally the Agency has a well bedded in risk management system.

While the exposure limits were within the levels specified in the Guidelines there could be merit in setting more stretching limits in order to exert tighter control over the nature of debt liabilities. It would be preferable if they were reviewed and agreed half-yearly to take account of market conditions.

The Accounting Officer stated that the purpose of the debt management guidelines is to set broad parameters for the Agency's delegated borrowing and debt management functions. In his view, the annual guidelines are appropriate in that context.

Operational Capacity and Control

The Agency should have the capability in terms of human resources and standard operating procedures to execute its mandate within a controlled operational environment.

11.44 Detailed job specifications are in place for all Agency roles. The Agency informed me that staff members are recruited from a wide variety of disciplines and at the highest levels of professional expertise and commitment in accordance with those specifications. Candidates complete psychometric assessments including aptitude tests, references are checked and educational qualifications examined.

11.45 Management review staffing regularly and any skill gaps are identified. Succession is considered during the performance review cycle and recently action has been taken to supplement the team to ensure succession options are available. Specific project work is given to staff members as opportunities arise to increase their skill-set and provide development opportunities.

⁹⁴

US Commercial Paper, Treasury Bills and Euro Commercial Paper.

11.46 Objectives are in place for all staff with an emphasis on performance feedback, dialogue and development. Training and development programmes are implemented to help staff focus on performance, teamwork and achievement while remaining at the leading edge of their disciplines. Performance is evaluated throughout each year and the evaluation forms part of the annual remuneration review led by the Chairman of the Agency's Advisory Committee.

11.47 The Agency maintains Office Instructions and Product Descriptions that set out the rules for entering, processing and reporting on transactions. Deals are captured in a system which facilitates straight-through processing and the maintenance of a full audit trail. The Agency has in place a comprehensive system of third party confirmations and reconciliations to ensure the integrity of data. The internal control system relies on strict organisational independence of the monitoring and control functions, the segregation of duties and the application of the maker/checker principle to all activities.

11.48 An audit committee operates under a written charter and its main responsibilities include the review and monitoring of risk management arrangements, review and advice on the operation of internal audit and internal controls, assessing the results and implementation of internal audit reviews and reviewing annual financial statements. The committee consists of four members, two of whom are members of the Agency's Advisory Committee, one is a member of the Board of the National Development Finance Agency and one independent external member.

11.49 Compliance with the policies and procedures is monitored by the Agency's Control Unit and by its internal auditor. The audit committee agrees audit plans which are designed to address all material areas of risk.

11.50 Management reports are supplied to senior management daily including funding and liquidity position, cash balances, maturity profile, foreign currency exposures, counterparty credit limits, debt service outturn, EBR versus profile and performance against benchmark. Reports on compliance with debt management guidelines and sensitivity to interest movements are issued to the Chief Executive monthly.

11.51 Three full disaster recovery tests are completed each year at the Agency's business continuity site at Swords Business Campus. Representatives of all Directorates go on-site to test and verify availability of key systems. As part of the testing, the encrypted high-speed link from the Agency's Head Office is shut down to simulate complete loss of the facility. The Control Unit of the Agency is in attendance at all tests to provide a control and audit presence. The Human Resource function also attends. Structured documentation is completed by all testers and retained for audit purposes. The main telephone switchboard is also transferred on one occasion each year to the Swords site as part of the HP/Eircom Suretel service⁹⁵ which can be triggered by authorised personnel within minutes should the Agency suffer a catastrophic loss of the Head Office's functionality. The business continuity plan is continually updated with structured quarterly reviews.

11.52 Management information and internal controls are reviewed by the Control Unit and by the internal auditor. The internal audit function operates in accordance with the Framework Code of Best Practice set out in the Code of Practice for the Governance of State Bodies. The work of internal audit is informed by analysis of the risk to which the Agency is exposed, and annual internal audit plans are based on this analysis. The analysis of risk and the internal audit plans are endorsed by the Chief Executive and Directors and approved by the Audit Committee. At least

⁹⁵ The Eircom Suretel Plan is a facility managed on the Agency's behalf by HP Business Continuity Services which arranges for the transfer of the telephone switchboard to the Agency's business continuity site at HP Swords.

annually, the Internal Auditor provides the management of the Agency and the Audit Committee with a report of internal audit activity including the Internal Auditor's opinion on the adequacy and effectiveness of the system of internal financial control.

11.53 The Accounting Officer, in conjunction with the submission of the Agency's Annual Report and Financial Statements, prepares a Statement on Internal Financial Control which I review in the course of my audit. The Statement outlines the key financial controls in operation which are designed to mitigate risk and confirms that the effectiveness of the system of internal financial control is reviewed annually.

Conclusion – Operational Capacity and Control

The Agency has standardised its operating procedures and its key controls are evaluated in the course of each annual audit. Nothing has come to light in the course of audits that cast doubt on the assertions and assurance provided in the Agency's Statement on Internal Financial Control.

Performance Measurement and Reporting

The Agency's performance in managing debt should be measured and reported against objective standards.

11.54 Under the debt management guidelines, the Agency must provide a quarterly update of its performance as measured by an agreed benchmark to the Minister. The benchmark rules are agreed with the Department of Finance based on debt management parameters set out in the debt management guidelines, the funding requirement as set out in the Budget and prevailing market conditions. The benchmark model is maintained by the Agency's Risk Unit. While reports are run daily, formal reporting to senior management is quarterly. The quarterly update is provided by way of oral briefing to the Minister.

11.55 A firm of accountants is engaged to independently audit the benchmark results. In undertaking their audit they determine that

- the input of actual portfolio transactions during the year is in line with the Agency's records
- the benchmark portfolio transactions are formulated in line with the rules agreed with the Minister for Finance in respect of the relevant funding portfolios and are correctly input into the system
- the valuations of both the benchmark and actual funding portfolios, and the calculation of portfolio fees, are in line with the benchmark rules and appear reasonable.

National Debt Benchmark

The National Debt Benchmark reflects the medium-term debt management objectives of the Exchequer and represents a portfolio with the interest profile, duration and maturity structure which is consistent with guidelines set by the Minister for Finance. The benchmark performance measurement system takes account of both the accumulated cash positions and the net present value of all future cash flows. It calculates the impact of the Agency's actions in the year under review, based on their projected impact over the full life of the debt.

The objective of the performance rules is to measure the value added by the Agency by comparing the cost of funding achieved on a deal-by-deal basis to a market-sourced benchmark price. For example, the cost of funding on government bonds is benchmarked against other Euro sovereigns' government bonds; the cost of commercial paper is compared to Euribor.

I have acceded to the Agency's request not to disclose the details of the performance measurement rules because it might impact on the Agency's bargaining position through disclosure of its pricing targets.

Results of Benchmarking

11.56 Each annual benchmarking round takes account of the economic cost of the Agency's activities, effected in the year, over the full life of those transactions. It then compares the outturn against the cost that would have accrued using the benchmark values. By comparison, the debt service cost reported in the Financial Statements of the Agency measure the cash consequences of transactions in a twelve month period and consequently are subject to variations due to timing factors and the fact that they do not capture the effect of non-cash elements such as discounts. The results of benchmarking are outlined in Figure 47.

Figure 47 Performance against the Benchmark for 2009

Category of Debt	Performance Outturn	
	€m	€m
Short-Term		
Treasury Bills	28.81	
Exchequer Notes	1.42	
Section 69 and Commercial Paper	<u>31.67</u>	61.90
Cash Management and Exchequer Deposit Placements		4.21
Repos		<u>0.05</u>
		66.16
Long and Medium Term		
Auctions	19.40	
Syndications	50.80	
Other	0.08	70.28
Overall		136.44

Conclusion – Benchmarking Performance

For 2009, the results of benchmarking indicate that the Agency outperformed the benchmark in relation to its management of the National Debt. In essence, the funding and debt management activity was conducted at a cost that was €136.44 million less than the cost that would have been incurred using the target rates built into the benchmark.

Conclusion

Borrowing plans are drawn up by the Agency in advance of each year and adjusted in respect of emerging funding requirements and market conditions.

The borrowing environment has altered since the establishment of the Agency especially due to the adoption of the euro and the consequent borrowing of most funds in the currency of the State. In addition, the recent financial market turbulence has led to the Agency borrowing in excess of immediate requirements in order to create a strategic liquidity buffer of over €20 billion.

In the circumstances, there may be merit in reviewing the approval mechanisms that underpin the general superintendence and control of the Minister especially around the formal approval of the borrowing levels and, in particular, the level of any strategic buffer. The re-establishment of a cash limit on Exchequer bank balances as part of Ministerial guidelines would be an effective way of achieving that control. In practice, any limit set would need to be sufficiently tight to establish an effective limit, within the current environment, while allowing the Agency, within that limit, sufficient latitude to carry out its borrowing and debt management functions.

From the viewpoint of internal control and management, the Agency has documented standard operating practices, a well bedded in control system and arrangements for reporting on both conformance and performance.

For 2009, the results of benchmarking indicate that the Agency outperformed the benchmark in relation to its management of the National Debt. In essence, the funding and debt management activity was conducted at a cost that was €136.44 million less than the cost that would have been incurred using the target rates built into the benchmark.

Annex A Debt Management Guidelines

The debt management guidelines comprise both specific and general guidelines.

Specific Guidelines

The specific guidelines pertaining in 2009 are designed to ensure that

- the net exposure to foreign currencies is within prescribed limits
- the debt with floating interest rates as a proportion of net debt is within a prescribed ceiling
- the proportion of net debt maturing within a specified time period is under a prescribed ceiling
- bonds are not issued at a discount greater than a specified percentage
- the Post Office Savings Bank reserve will not go below €5 million
- the year-end balance of the Capital Service Redemption Account is less than €1 million

In light of prevailing market conditions, no formal limit on total cash balances at year-end was set.

General Operating Guidelines

The following requirements are set out under the general operating guidelines

- With the exception of deposits in the Post Office Savings Bank, any proposal for changes in the remuneration terms or investment limits on national savings schemes is subject to the approval of the Minister, as are proposals for changes in other aspects of the schemes which have clear implications for tax receipts and any proposals for new national savings schemes.
- The Agency is required to report to the Minister quarterly about the main borrowing and debt management transactions carried out during the period, an update of the Agency's performance as measured by an agreed benchmark and details of the actual portfolio of debt at the end of the quarter.
- The Agency is required to ensure that its information and control systems are adequate and appropriate to allow it to monitor the level of risk, taking full account of swaps, futures and other derivative products, to which the Exchequer is exposed as a result of the borrowing and debt management operations carried out by the Agency. The Agency is required to monitor the level of risk with the appropriate frequency for each type of risk and follow best industry practice. Derivatives may be used for the better management of the national debt and, without exception, should be based on the underlying debt.

The Agency must have in place a counterparty risk approval and monitoring system. Apart from a very limited number of cases where the Agency is satisfied as to the risk exposure involved, risk exposures in excess of one year should be confined to counterparties with a long-term rating from Moodys of at least Aa3 (or equivalent from Standard and Poor's or Fitch, i.e. AA), while short-term exposures should be confined to counterparties with either a long-term rating from Moodys of at least A3 (or equivalent from Standard and Poor's or Fitch, i.e., A-) or a short-term rating from Moodys of at least Prime 1 (or equivalent from Standard and Poor's or Fitch, i.e., A1/F1).

Chapter 12

Revenue

Revenue Collection

Revenue Collection

12.1 This chapter examines

- Revenue's collection performance in 2009
- the tax outstanding at 31 March 2010
- the amount of tax written off in 2009
- the results of the audit of the Revenue Account.

Revenue Collection and Repayment

12.2 The gross amount collected by Revenue declined from €60.1 billion in 2008 to €50.7 billion in 2009. When the amounts collected on behalf of other Departments and agencies are excluded, €41.3 billion of the 2009 gross collection was attributable to the core revenue of the State (€50.1 billion in 2008).

12.3 €8.1 billion of the gross collection was repaid to taxpayers in 2009 (€9.2 billion in 2008). These repayments represented 20% of gross taxes and duties collected (18% in 2008). Repayments in three taxheads account for 98% of all repayments — VAT, Income Tax and Corporation Tax. Chapter 16 examines repayments.

12.4 The total gross collection, the amounts attributable to other agencies and repayments are summarised in Figure 48.

Figure 48 Collection and Repayment of Revenue

	2008 €m	2008 €m	2009 €m	2009 €m
Gross Collection		60,061		50,744
<i>Less Attributable to other Departments and Agencies</i>				
PRSI ^a	(9,779)		(9,291)	
Tobacco Levy ^b	(168)		(168)	
Environmental Levy	(26)		(24)	
Other	(5)	(9,978)	(3)	(9,486)
Gross Taxes and Duties Collected		50,083		41,258
<i>Less Repayments of Taxes and Duties</i>		(9,178)		(8,148)
Net Taxes and Duties Collected^c		40,905		33,110

Notes:

- a PRSI comprises a social insurance contribution, the National Training Fund levy and the health levy. Residual amounts of the now abolished employment and training levy are also included here. Net receipts were €9,209 million (€9,708 million in 2008) after taking account of repayment of €82 million (€71 million in 2008).
- b Section 3 of the Appropriation Act 1999 (as amended) provides that each year an amount determined by the Minister for Finance shall be paid to the Health Service Executive from the proceeds of tobacco excise. This is known as the Tobacco Levy and the Minister for Finance has determined that the amount payable should be the maximum amount permissible under the Act – €167,605,000.
- c This includes some €114 million collected in 2009 as part of the various special investigations being carried out by Revenue (see Chapter 14).

12.5 The gross collection, repayments and net collection for each taxhead are set out in Figure 49 together with the percentage change in net receipts in 2009. Income Tax receipts in 2009 include an estimated €1.1 billion in respect of the income levy introduced with effect from 1 January 2009⁹⁶. Included in Income Tax repayments is €216 million in respect of an age related health insurance tax credit introduced in 2009⁹⁷. This is partly offset by the introduction of a related levy on health insurance companies, the proceeds of which are included in Stamp Duties⁹⁸ (€197 million). The credit and related levy are temporary measures for the three years to 2011 and are intended to be revenue neutral over that period.

Figure 49 Tax Collected and Repaid by Taxhead

Taxhead	2009 Gross Receipts €m	2009 Repayments €m	2009 Net Receipts €m	2008 Net Receipts €m	Percentage Change
Income Tax ^a	15,068	(3,229)	11,839	13,195	(10%)
Value Added Tax	13,963	(3,325)	10,638	13,432	(21%)
Excise	4,782	(48)	4,734	5,432	(13%)
Corporation Tax	5,335	(1,445)	3,890	5,071	(23%)
Stamp Duties ^b	1,024	(23)	1,001	1,763	(43%)
Custom Duties	212	(4)	208	245	(15%)
Capital Acquisitions Tax	268	(12)	256	343	(25%)
Capital Gains Tax	606	(62)	544	1,424	(62%)
Total	41,258	(8,148)	33,110	40,905	(19%)

Notes:

a PAYE accounts for €8.5 billion of net Income Tax receipts (€10.1 billion in 2008).

b The Finance (No. 2) Act 2008 provided for an incentive scheme to encourage the presentation of instruments for stamping which had not been presented to Revenue within the required time limits. Provided such instruments were presented for stamping and the duty and interest due was paid within 56 days from the passing of the Act, no further penalty was payable. The deadline was 17 February 2009. Under the Scheme a total of 4,036 instruments were presented to Revenue resulting in the collection of €64.9 million (including interest of €12 million), almost all of which was received in 2009.

⁹⁶ Section 2, Finance Act 2009.

⁹⁷ Section 22, Health Insurance (Miscellaneous Provisions) Act 2009.

⁹⁸ Section 26, Health Insurance (Miscellaneous Provisions) Act 2009.

Payover to the Exchequer

12.6 The net proceeds available to the Exchequer for the year was €33.1 billion (€40.9 billion in 2008). €3 billion was paid to the Exchequer⁹⁹ in 2009 a decline of almost €8 billion over 2008 (€40.8 billion).

12.7 Much of this decline was projected with the 2009 Supplementary Budget Exchequer target for tax revenues set at €34.4 billion. In the event, a tax revenue deficit against forecast of €1.4 billion was experienced in the year. The shortfall by individual taxhead is set out in Figure 50. There was a shortfall against forecast of €1,585 million on six taxheads. Income Tax and VAT made up 88% of this shortfall. There was an excess over forecast in the case of Excise (€68 million) and Corporation Tax (€160 million).

Figure 50 2009 Tax Revenue Paid to Exchequer compared to Forecast

Taxhead	Forecast	Payments to Exchequer	Excess/(Shortfall)	
	€m	€m	€m	%
Income Tax	12,475	11,835	(640)	(5%)
Value Added Tax	11,420	10,670	(750)	(7%)
Excise	4,634	4,702	68	1%
Corporation Tax	3,740	3,900	160	4%
Stamp Duties	980	930	(50)	(5%)
Custom Duties	230	209	(21)	(9%)
Capital Acquisitions Tax	295	254	(41)	(14%)
Capital Gains Tax	625	542	(83)	(13%)
Total	34,399	33,042	(1,357)	(4%)

12.8 Tax forecasts are prepared by the Department of Finance with the assistance of Revenue. Each taxhead is forecast separately using estimates of relevant macroeconomic drivers and, where appropriate, elasticity factors. The basic methodology is to estimate the base year outturn for each taxhead, adjust for known one-off factors and apply a forecast of the relevant macroeconomic driver to this adjusted outturn. Macroeconomic drivers include, for example, the projected change in personal consumption in the case of VAT and the projected changes in earnings and employment for PAYE. The forecasts of the relevant macroeconomic drivers used are those produced by the Department of Finance. As a check on the individual taxhead forecasts, the change in aggregate tax is estimated using a one for one relationship with forecasts of the change in the nominal level of Gross Domestic Product.

12.9 Information on total losses being carried forward for relief in future years is not readily available (See Chapter 17). The Accounting Officer informed me that if such information were available, it could not be easily or reliably integrated into Budget forecasting methodology to, for example, estimate the likely effect of any losses ‘overhang’ on future tax collection. This is because losses carried forward will be available for future offset over an indeterminate period, where the breakdown between one year and another will be unknown. Furthermore, the base for forecasting the following year’s no-policy-change tax yield (before applying appropriate macro-

⁹⁹ The amount paid to the Exchequer over time takes account of suspense balances in cases where a taxpayer has paid taxes but they are not allocated. The amount prepaid at 31 December 2009 was €132 million (€200 million prepaid at 31 December 2008).

economic predictors and other factors) is the current year's expected outcome, which already reflects losses utilised.

12.10 However, based on information available from Revenue's monitoring of the largest companies, a provision for an expected reduction in Corporation Tax of €500 million each year has been included in the forecasts for 2009 and 2010 due to the losses arising from the 2008 financial crisis or subsequently. An adjustment to provide in the forecasts for a recovery of €50 million of this cost in 2011 and a further €100 million in 2012 has also been included.

12.11 The Accounting Officer stated that the budget forecast anticipated much of the year-on-year reductions that emerged but nevertheless there was a shortfall of €1.4 billion. Where there was a shortfall against forecast for individual taxheads these were due to the following factors, the impact of which was not fully anticipated in framing the forecast

- weak labour market conditions
- low levels of consumer spending
- a further decline in property and share values.

12.12 Payments to the Exchequer exceeded forecast for two taxheads

- Corporation Tax where the excess was mainly due to a large once-off payment, and
- Excise which exceeded target for all duty types with the exception of Vehicle Registration Tax and duty on spirits.

Taxes and PRSI Outstanding

12.13 Figure 51 shows the amount of tax outstanding for each category of tax and summarises the charges raised, the payments made and the amounts written off in the twelve-month period ended on 31 March 2010. Total tax outstanding at the end of March 2010 has increased by €251 million to €2,112 million or 13% over the amount outstanding at March 2009.

Figure 51 Outstanding Taxes and PRSI^a

Balance at 31 March 2009 €m	Tax or Levy	Net Charges Raised ^b €m	Paid €m	Written Off €m	Balance at 31 March 2010 €m	Analysis of Balance at 31 March 2010	
						Under Appeal €m	Available for Collection €m
461	VAT	10,036	9,756	108	633	119	514
150	PAYE	11,644	11,596	25	173	13	160
212	PRSI	9,372	9,292	38	254	3	251
363	Income Tax (excluding PAYE)	2,379	2,304	12	426	139	287
–	DIRT	562	562	–	–	–	–
364	Corporation Tax	4,114	4,158	5	315	247	68
251	Capital Gains Tax	511	515	3	244	140	104
3	Capital Acquisitions Tax	256	256	–	3	–	3
5	Abolished Taxes	–	–	–	5	–	5
52	Relevant Contracts Tax ^c	–	(27)	20	59	8	51
1,861	Total	38,874	38,412	211	2,112	669	1,443
4.2%	Debt as % of net charges raised				5.4%	1.7%	3.7%

Notes:

- a Tax is regarded as outstanding from the date the liability is placed on the taxpayer's record - usually as a result of the receipt of a return or the raising of an estimate.
- b Net charges raised in the year to March 2009 were €44,700 million.
- c Relevant Contracts Tax net charges raised comprises assessments and declarations relating to principal contractors of €367.3 million, less claims of €367.7 million from sub-contractors. The net repayment of €27 million comprises €345.4 million received from principal contractors and €372.6 million repaid to sub-contractors (or offset against other tax liabilities).

12.14 Of the total outstanding, €669 million is the subject of an appeal by the taxpayer and, while the appeals are being disposed of, Revenue is prevented from seeking to collect it. This is an increase of €41 million or 7% over the amount under appeal twelve months previously. The balance of €1,443 million which is available for Revenue to collect, has increased by €210 million or 17% over the March 2009 amount.

12.15 Figure 52 sets out an aged analysis of the balance outstanding at 31 March 2010 and shows that 26% of the amount outstanding related to the most recent tax period (2009). In March 2009, the amount outstanding for the then most recent period (2008) represented 30% of the total outstanding. Some 57% of the amount outstanding relates to tax periods prior to 2008.

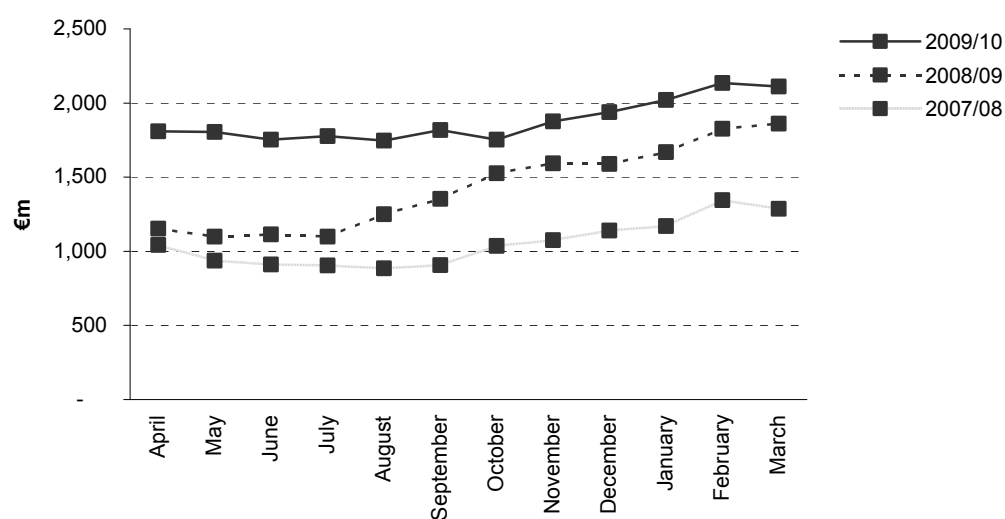
Figure 52 Aged Analysis of Debt at 31 March 2010

Taxhead	Total Tax Outstanding at 31 March 2010	Amounts Outstanding for 2009	Amounts Outstanding for 2008	Due for 2005 to 2007	Due for earlier periods (i.e. > 5years old)
	€m	€m	€m	€m	€m
VAT	633	274	137	121	101
PAYE	173	89	32	32	20
PRSI	254	148	54	37	15
Income Tax	426	3	86	136	201
Corporation Tax	315	23	23	44	225
Capital Gains Tax	244	2	22	77	143
Capital Acquisitions Tax	3	-	-	-	3
Abolished Taxes	5	-	-	-	5
Relevant Contracts Tax	59	11	9	31	8
Total	2,112	550	363	478	721
Comparator ^a	1,861	559	276	531	495

Note:

a These are the corresponding figures for the amount outstanding twelve months previously.

12.16 The total tax outstanding has risen over the period as depicted in Figure 53, which also shows the monthly movement in the twelve-month periods to March 2008 and March 2009.

Figure 53 Monthly Debt Outstanding

12.17 The increase in the amount of tax outstanding in the latter months of each year is largely due to increases in Income Tax and Capital Gains Tax in October and November when returns for both taxes are due. Similarly, the amount of PAYE and PRSI outstanding increases in February when the annual P35 return is due.

12.18 The Accounting Officer stated that the economic and financial environment in which Revenue and its customers operate has been extremely challenging over the last number of years. She said that the 91% increase in the amount of tax outstanding from €1.1 billion in March 2007 to €2.1 billion in March 2010, reflects the financial distress that many businesses are experiencing.

Write-Offs of Tax and PRSI

12.19 In cases where Revenue is unable to collect outstanding tax or where it considers the cost of collection to be disproportionate, the outstanding amounts are written off. From an administrative viewpoint, all outstanding tax remains on the taxpayer's record but a write-off marker is placed on the computer record of the case which has the effect of halting further collection activity. Lists of all cases proposed for write-off are formally submitted to the Revenue Chairman for approval. Should the circumstances in a case change, the write-off marker is removed and collection efforts can re-commence. In 2009, the write-off marker was released for 52 cases in which €1.8 million had previously been written off.

12.20 €22 million of taxes and PRSI was written off during the year ended 31 December 2009, an increase of €3 million over 2008. Increases in the amounts written off for VAT, PAYE and PRSI account for 90% of this. The Accounting Officer stated that the increase in the amount written off reflects a rise in business failures.

12.21 €20 million of the total write-off was assessed on a case-by-case basis. The remaining €2 million, relating to 74,111 cases with balances of less than €1,000 which were considered uneconomic to pursue, was written off on an automated basis. A breakdown by taxhead of the total amount written off is shown in Figure 54. Of the €22 million written off in 2009, €04 million or 92% was in respect of fiduciary taxes¹⁰⁰.

¹⁰⁰ The fiduciary taxes are VAT, PAYE/PRSI and Relevant Contracts Tax and are collected by businesses on behalf of Revenue and held in trust until paid to Revenue.

Figure 54 Taxes Written Off

Taxhead	2008	2009
	€000	€000
Value Added Tax	57,710	101,530
PAYE	19,831	37,145
PRSI	25,438	47,610
Relevant Contracts Tax	12,581	16,617
Income Tax	5,310	10,305
Corporation Tax	3,016	3,889
Capital Gains Tax	985	2,610
Automatic Write-Offs	4,125	1,842
Total	128,996	221,548

12.22 The reason for each write-off is recorded and Figure 55 sets out the number of cases and the amount written off for each category. Approximately 88% (€195 million) of the amount written off arose in cases where businesses had ceased or encountered difficulties. The balance of €27 million relates to cases where the amount outstanding was not collected due to factors such as an inability to locate the taxpayer, a decision by Revenue that the amount outstanding did not warrant committing resources to collecting it and compassionate grounds. Three categories account for 93% of the increase in the amount written off – liquidation/receivership/bankruptcy, ceased trading and uneconomic to pursue.

Figure 55 Reasons for Write-Off

Reason	2008	2008	2009	2009
	Number	Amount	Number	Amount
	of Cases	Written Off	of Cases	Written Off
		€000		€000
Business Cessation/Difficulty				
Liquidation/Receivership/Bankruptcy	728	78,041	1,260	131,876
Ceased trading – no assets	709	26,633	1,000	47,533
Uncollectable due to financial circumstances of taxpayer	134	3,752	233	7,148
Examinership	24	4,839	28	7,497
Deceased and Estate Insolvent	26	355	49	746
Other Reasons				
Cannot be traced/Outside Jurisdiction	199	6,491	209	6,409
Uneconomic to pursue ^a	240,445	7,404	76,067	18,961
Compassionate Grounds	101	1,323	76	1,197
Unfounded Liability	32	158	20	181
Total	242,398	128,996	78,942	221,548

Note:

a Includes 74,111 cases written off automatically (239,909 in 2008).

12.23 The largest single amount written off in 2009 was €3.46 million in respect of VAT and PAYE/PRSI. There were 15 other cases where the amount written off was greater than €1 million.

12.24 The Internal Audit Branch in Revenue undertakes an annual examination of tax write-offs. Its 2009 audit examined a sample of 269 cases, representing 30% (€65 million) of the value of non-automated write-offs (€220 million). Internal Audit were satisfied that all write-offs were in accordance with the criteria prescribed. Internal Audit also examined the results of the automatic write-offs in 2009 and verified that the authorised selection criteria were correctly applied.

Audit of Revenue Account

12.25 Under the Comptroller and Auditor General (Amendment) Act 1993 I am required 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
- examine the account of revenue received and paid over to the Exchequer by the Revenue Commissioners (the Revenue Account) in order to satisfy myself as to its completeness and accuracy and to report to Dáil Éireann on the results of my examination.

12.26 On a cyclical basis I examine Revenue's systems for the assessment and collection of tax.

12.27 I form an opinion on the completeness and accuracy of the Revenue Account on the basis of the examination and testing carried out by my Office on the various receipting, repayment and accounting systems within Revenue. I also take assurance from the systems work referred to above.

Audit Conclusion

The Revenue Account together with my opinion thereon is set out in Annex A. I have given a clear report on that account.

Annex A Account of the Receipt of Revenue of the State collected by the Revenue Commissioners in the year ended 31 December 2009

Statement by Accounting Officer on Internal Financial Controls

Responsibility for system of Internal Financial Control

As Accounting Officer I acknowledge my responsibility for ensuring that an effective system of internal financial control is maintained and operated by the Office. This responsibility is exercised in the context of the resources available to me and my other obligations as Head of Office. Also, any system of internal financial control can provide only reasonable and not absolute assurance that assets are safeguarded, transactions authorised and properly recorded, and that material errors or irregularities are either prevented or would be detected in a timely manner. Maintaining the system of internal financial controls is a continuous process and the system and its effectiveness are kept under ongoing review.

The position in regard to the financial control environment, the framework of administrative procedures, management reporting and internal audit is as follows:

Financial Control Environment

I confirm that a control environment containing the following elements is in place:

- financial responsibilities have been assigned at management level with corresponding accountability
- reporting arrangements have been established at all levels where responsibility for financial management has been assigned
- formal procedures have been established for reporting significant control failures and ensuring appropriate corrective action
- there is an Audit Committee to advise me in discharging my responsibilities for the internal financial control system.

Administrative Controls and Management Reporting

I confirm that a framework of administrative procedures and regular management reporting is in place including segregation of duties and a system of delegation and accountability and, in particular, that

- there are regular reviews by senior management of periodic and annual financial reports which indicate financial performance against forecasts
- a risk management system operates within the Office
- there are systems aimed at ensuring the security of the ICT systems.

Internal Audit

I confirm that the Office has an internal audit function with appropriately trained personnel, which operates in accordance with a written charter which I have approved. Its work is informed by analysis of the financial risks to which the Office is exposed and its annual internal audit plans, approved by me, are based on this analysis. These plans aim to cover the key controls on a rolling basis over a reasonable period. The internal audit function is reviewed periodically by me and the Audit Committee. I have put procedures in place to ensure that the reports of the internal audit function are followed up.

Josephine Feehily
Accounting Officer
Office of the Revenue Commissioners
31 March 2010

Account of the Receipt of Revenue of the State collected by the Revenue Commissioners in the year ended 31 December 2009

Report of the Comptroller and Auditor General

I have examined the financial statements relating to the receipt and disposal of Revenue of the State during the year 2009 collected by the Revenue Commissioners set out on pages 172 to 177 under Section 3(7) of the Comptroller and Auditor General (Amendment) Act 1993.

The financial statements, which have been prepared under the accounting policies therein, comprise the Accounting Policies, the Account of the Receipt of Revenue of the State collected by the Revenue Commissioners and the related notes.

Respective Responsibilities of the Revenue Commissioners and the Comptroller and Auditor General

The Revenue Commissioners are responsible for preparing the financial statements and for ensuring the regularity of transactions.

My responsibility is to examine the financial statements in accordance with the relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

I report my opinion as to whether the financial statements are properly presented in accordance with the Accounting Policies. I also report whether in my opinion proper books of account have been kept. In addition, I state whether the financial statements are in agreement with the books of account.

I report any material instance where the transactions do not conform to the authorities governing them.

I also report if I have not obtained all the information and explanations necessary for the purposes of my examination.

Basis of Opinion

In the exercise of my function as Comptroller and Auditor General, I conducted my examination of the financial statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Audit Practices Board and by reference to the special considerations that attached to State bodies in relation to their management and operation. My examination was conducted on a test basis that reviewed evidence relevant to the amounts and disclosures and regularity of the financial transactions included in the financial statements. It also included an assessment of the significant estimates and judgements made in the preparation of the financial statements, and of whether the accounting policies were appropriate, consistently applied and adequately disclosed.

I planned my examination so as to obtain all the information and explanations that I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In my opinion, the financial statements properly present the receipt and disposal of the revenue collected for the year ended 31 December 2009 and the residual balances at that date.

In my opinion, proper books of account have been kept by the Revenue Commissioners. The financial statements are in agreement with them.

A handwritten signature in black ink, appearing to read 'John Buckley', with a stylized flourish at the end.

John Buckley
Comptroller and Auditor General
10 September 2010

Account of the Receipt of Revenue of the State collected by the Revenue Commissioners in the year ended 31 December 2009

Accounting Policies

1. This Account presents the collection and allocation of taxes and duties by the Revenue Commissioners, and the transfer of the proceeds to the Exchequer. The accounts have been prepared pursuant to Section 3(9) of the Comptroller and Auditor General (Amendment) Act 1993.
2. No charge is included in this Account for the administration or operational costs of the Office of the Revenue Commissioners. Funds for this purpose are voted by the Oireachtas and accounted for in the annual Appropriation Account for Vote 9 - Office of the Revenue Commissioners.
3. Amounts received in respect of penalties and interest imposed by the Revenue Commissioners are brought to account with the related tax and duty settlements. Court fines and penalties are brought to account as Appropriations-in-Aid of Vote 9.
4. This Account also presents the receipts collected by the Revenue Commissioners for other Government departments and agencies as follows
 - Department of Social and Family Affairs (PRSI Contributions).
 - Health Service Executive (Health Levy & Tobacco Levy).
 - Department of Environment, Heritage and Local Government (Environmental Levy on Plastic Bags).
 - Department of Enterprise, Trade and Employment (Employment and Training Levy).
 - Commissioners of Irish Lights (Light Dues).
 - Department of Transport (Marine Fees).
 - Fee Stamps in respect of Registry of Deeds, Arbitration Fees and Fee Stamps in respect of Companies Registration Fees (paid to the Department of Finance as Miscellaneous Revenue).
5. A charge is levied by the Revenue Commissioners for the collection of PRSI Contributions, the Environmental Levy on Plastic Bags and Light Dues. Amounts received in respect of those charges are not included in this Account but are accounted for as Appropriations-in-Aid of Vote 9.
6. The Account has been prepared on a cash basis in accordance with the principles of Government Accounting. Except where described at paragraph 7, the Account shows the actual amounts received and paid in the year. Where further amounts of taxes, duties, etc. are received in subsequent years or where amounts received in the current or earlier years are repaid, such items are recorded in the year of receipt or repayment.
7. Certain customs and excise duties and VAT on imports are accounted for on an accruals basis in that they are recorded as receipts in the year to which they relate even though they are not received until after the year-end. The corresponding asset is included in accrued income in the Statement of Balances.
8. The gross receipts and repayment figures for each taxhead include offsets i.e. cases where the repayment is not directly paid to the taxpayer but offset against other outstanding taxes.

Account of the Receipt of Revenue of the State collected by the Revenue Commissioners in the year ended 31 December 2009

Account of the Receipt and Disposal of Revenue Collected			
	Notes	2009 €000	2008 €000
Gross Receipts			
Taxes and Duties Collected	1	41,425,690	50,251,063
Receipts Collected on Behalf of Other Departments/Agencies	2	9,318,329	9,809,999
Total Gross Receipts of Revenue Collected		50,744,019	60,061,062
Repayments			
Repayment of Taxes and Duties	3	(8,148,354)	(9,177,659)
Repayment of Receipts Collected on behalf of Other Departments/Agencies	6	(82,027)	(71,020)
Total Repayments		(8,230,381)	(9,248,679)
Net Receipts			
Taxes and Duties Collected	4	33,277,336	41,073,404
Receipts Collected on behalf of Other Departments/Agencies	6	9,236,302	9,738,979
Total Net Receipts of Revenue Collected		42,513,638	50,812,383
Disposal of Net Receipts			
Taxes and Duties Transferred to the Exchequer	5	(33,041,960)	(40,776,164)
Transfer of Tobacco Levy to Health Service Executive	5	(167,605)	(167,605)
Transfer of Receipts to Other Departments/Agencies	6	(9,236,044)	(9,741,943)
Total Disposal of Receipts of Revenue Collected		(42,445,609)	(50,685,712)
Net Receipts retained at Year End		68,029	126,671
Opening Balance on the Account of Receipt and Disposal of Revenue at 1 January		(188,287)	(314,958)
Closing Balance on the Account of Receipt and Disposal of Revenue at 31 December		(120,258)	(188,287)

Any apparent discrepancies in totals are due to rounding of constituent figures

The Accounting Policies and Notes 1 to 12 form part of this Account

William Funnell
Accountant General
Office of the Revenue Commissioners

31 March 2010

Josephine Feehily
Accounting Officer
Office of the Revenue Commissioners

31 March 2010

Account of Receipt of Revenue of the State collected by the Revenue Commissioners in the year ended 31 December 2009

Statement of Balances

	Notes	2009 €000	2008 €000
Assets			
Cash at Bank and in Hand	7	161,182	120,200
Accrued Income	8	15,230	14,523
Advances for Revenue Purposes	9	63	82
Amounts due from Government Departments	10	898	3,159
Total Assets		177,373	137,964
Liabilities			
Amounts Awaiting Receipt and Allocation	11	(159,897)	(111,075)
Deposits Held	12	(137,734)	(215,176)
Total Liabilities		(297,631)	(326,251)
Net Liabilities		(120,258)	(188,287)

Represented by:

Closing Balance on the Account of Receipt and Disposal of Revenue

Balance of Taxes and Duties owing from the Exchequer	5	(131,646)	(199,417)
Balance of Receipts Collected and due to other Departments/Agencies	6	11,388	11,130
		(120,258)	(188,287)

Any apparent discrepancies in totals are due to rounding of constituent figures

The Accounting Policies and Notes 1 to 12 form part of this Account

William Funnell

31 March 2010

Accountant General

Office of the Revenue Commissioners

Josephine Feehily

31 March 2010

Accounting Officer

Office of the Revenue Commissioners

Account of the Receipt of Revenue of the State collected by the Revenue Commissioners in the year ended 31 December 2009

Notes to the Account

Note 1. Gross Taxes and Duties Collected

	2009	2008
	€000	€000
Value Added Tax	13,962,910	17,991,949
Income Tax	15,068,374	16,592,722
Corporation Tax	5,335,053	6,046,034
Excise Duty	4,949,536	5,702,770
Stamp Duties	1,023,426	1,812,685
Capital Gains Tax	606,420	1,493,984
Capital Acquisitions Tax	267,996	350,536
Customs Duty	211,975	260,383
	41,425,690	50,251,063

Note 2. Gross Receipts Collected on Behalf of Other Departments/Agencies

	2009	2008
	€000	€000
Department of Social and Family Affairs	9,168,364	9,612,279
Health Service Executive	121,011	166,037
Department of Environment, Heritage and Local Government	24,165	26,287
Commissioner of Irish Lights	3,426	4,306
Department of Enterprise, Trade and Employment	1,280	958
Department of Finance (Miscellaneous Revenue)	82	129
Department of Transport (Marine Fees)	1	3
	9,318,329	9,809,999

Note 3. Repayment of Taxes and Duties

	2009	2008
	€000	€000
Value Added Tax	(3,325,047)	(4,559,883)
Income Tax	(3,229,019)	(3,397,711)
Corporation Tax	(1,445,602)	(974,569)
Excise Duty	(48,192)	(103,206)
Stamp Duties	(22,558)	(49,272)
Capital Gains Tax	(61,754)	(70,052)
Capital Acquisitions Tax	(12,378)	(7,765)
Customs Duty	(3,804)	(15,201)
	(8,148,354)	(9,177,659)

Account of the Receipt of Revenue of the State collected by the Revenue Commissioners in the year ended 31 December 2009

Notes to the Account

Note 4. Net Receipts of Taxes and Duties

	Gross Receipts 2009 €000	Repayments 2009 €000	Net Receipts 2009 €000	Net Receipts 2008 €000
Value Added Tax	13,962,910	(3,325,047)	10,637,863	13,432,066
Income Tax	15,068,374	(3,229,019)	11,839,355	13,195,011
Corporation Tax	5,335,053	(1,445,602)	3,889,451	5,071,465
Excise Duty	4,949,536	(48,192)	4,901,343	5,599,564
Stamp Duties	1,023,426	(22,558)	1,000,869	1,763,414
Capital Gains Tax	606,420	(61,754)	544,666	1,423,932
Capital Acquisitions Tax	267,996	(12,378)	255,618	342,771
Customs Duty	211,975	(3,804)	208,171	245,183
	41,425,690	(8,148,354)	33,277,336	41,073,404

Note 5. Taxes and Duties Transferred to the Exchequer

	Balance at 1 January 2009 €000	Net Receipts €000	Total Transfers €000	Balance at 31 December 2009 €000
Value Added Tax	32,533	10,637,863	(10,669,652)	745
Income Tax	(6,657)	11,839,355	(11,835,235)	(2,537)
Corporation Tax	6,889	3,889,451	(3,900,306)	(3,966)
Excise Duty	(169,225)	4,901,343	(4,870,157) ¹	(138,039)
Stamp Duties	(64,171)	1,000,869	(929,510)	7,187
Capital Gains Tax	(644)	544,666	(541,849)	2,173
Capital Acquisitions Tax	476	255,618	(254,258)	1,836
Customs Duty	1,382	208,171	(208,598)	955
	(199,417)	33,277,336	(33,209,565)	(131,646)

¹ The amount of €4,870,157,000 includes €167,605,000 which was paid from the proceeds of Tobacco Excise Receipts to the Health Service Executive under Section 3 of the Appropriation Act 1999, as amended by the Appropriation Act 2005.

Account of the Receipt of Revenue of the State collected by the Revenue Commissioners in the year ended 31 December 2009

Notes to the Account

Note 6. Transfer of Receipts to Other Departments/Agencies

	Balance at 1 January 2009	Net Receipts	Total Transfers	Balance at 31 December 2009
	€000	€000	€000	€000
Department of Social and Family Affairs	7,012	9,086,416 ¹	(9,085,913)	7,515
Health Service Executive	3,214	121,011	(121,753)	2,471
Department of Environment, Heritage and Local Government	520	24,095 ²	(23,394)	1,220
Commissioner of Irish Lights	239	3,426	(3,589)	77
Department of Enterprise, Trade and Employment	145	1,280	(1,341)	84
Department of Finance (Miscellaneous Revenue)	(2)	72 ³	(50)	20
Department of Transport (Marine Fees)	3	1	(3)	1
	11,130	9,236,301	(9,236,043)	11,388

1 The amount shown of €9,086,416,211 is net of repayments of €81,947,621

2 The amount shown of €24,094,667 is net of repayments of €70,026

3 The amount shown of €72,368 is net of repayments of €9,492

Note 7. Cash at Bank and in Hand

	2009	2008
	€000	€000
Balance in Revenue Accounts at Central Bank	20,837	28,038
Cash in Hand	140,345	92,162
	161,182	120,200

Cash at Bank and in Hand represents amounts held in Revenue bank accounts pending completion of processing through Revenue's accounting systems.

Note 8. Accrued Income

Accrued Income represents amounts due to Revenue which are proper to 2009 for which payment was received after the year end.

Note 9. Advances for Revenue Purposes

Advances for Revenue Purposes arise due to the operation of a local accounting procedure in Districts for Customs and Excise Duties whereby a shortfall in the collection of monies arising from items such as an unpaid cheque is temporarily met through the mechanism of an 'advance' drawn on a Revenue account. These 'advances' are subsequently cleared when payment is received from the trader.

Account of Receipt of Revenue of the State collected by the Revenue Commissioners in the year ended 31 December 2009

Notes to the Account

Note 10. Amounts Due from Government Departments

Where a liability arises as a result of the importation of goods by Government Departments, the goods are released without immediate payment of duties or taxes and the Department is subsequently charged for the amount due.

Note 11. Amounts Awaiting Receipting and Allocation

	2009 €000	2008 €000
Unallocated Tax Deposits	(20,837) ¹	(28,038)
Tax Receipts awaiting Transfer and Allocation	(141,368)	(82,872)
Miscellaneous	2,308 ²	(165)
	(159,897)	(111,075)

1 Unallocated Tax Deposits (UTD) comprise mainly of payments made on account during tax audits and audit settlements for which accounting instructions have not been completed. Consequently, the payments cannot be allocated to the appropriate taxheads and are held by Revenue in a UTD account in the Central Bank.

2 This balance relates mainly to amounts for which the provenance has not yet been established.

Note 12. Deposits Held

	2009 €000	2008 €000
Stamps	(1,311)	(76,032)
C&E Collectors	(7,845)	(6,340)
Automated Entry Processing system (AEP) Deposits	(128,578)	(132,804)
	(137,734)	(215,176)

Deposits held represent amounts paid by taxpayers for transactions not yet processed through Revenue's accounting systems.

Chapter 13

Revenue

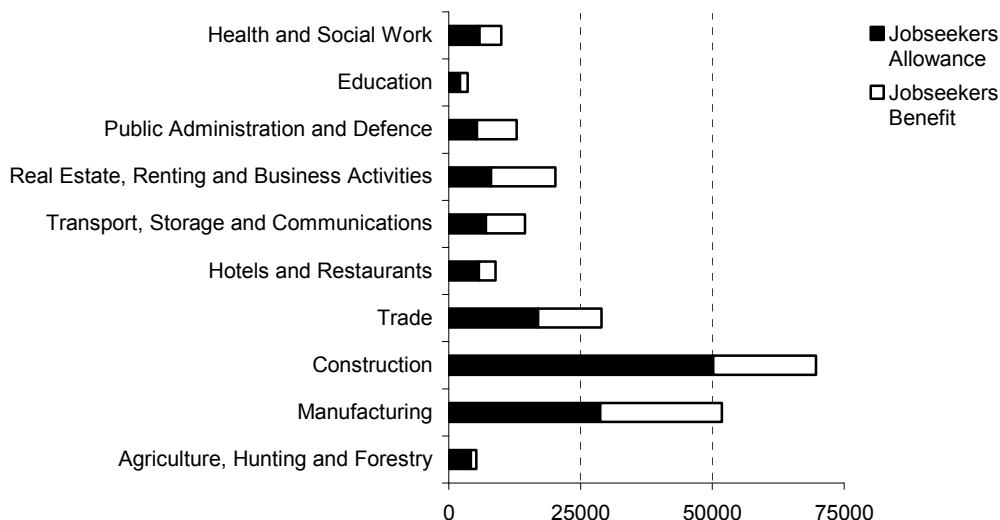
Collection Performance by Sector and Taxhead

Collection Performance by Sector and Taxhead

13.1 The net yield from tax and PRSI in 2009 was €42 billion. This represented a reduction of 25% (€14 billion) over the yield in 2007. A reduction in yield would be expected as a result of the severe contraction in output in the economy and the falls in prices. This is underscored by changes in some key indicators, including Gross National Product (GNP)¹⁰¹, jobseeker claimants, redundancies and energy consumption. GNP at current market prices fell by 18.5% over the period¹⁰².

13.2 The total number of claimants for jobseekers' allowance and jobseekers' benefit increased by 283,753 between 2007 and 2009 (an increase of 164,956 for jobseekers' allowance and 118,797 jobseekers' benefit claimants). The change in the composition of jobseeker claims in each economic sector is shown in Figure 56. This analysis is based on the occupation code assigned to claimants by the Department of Social Protection¹⁰³.

Figure 56 Net Increase in Jobseeker Claimants by Sector in the 24 months to December 2009^a



Note:

- a Because the data is presented on a net basis, it does not capture those claimants who commenced and ceased claiming during the period. In addition, some of the increase in jobseekers' allowance claimants is likely to arise from those who had been claiming jobseekers' benefit.

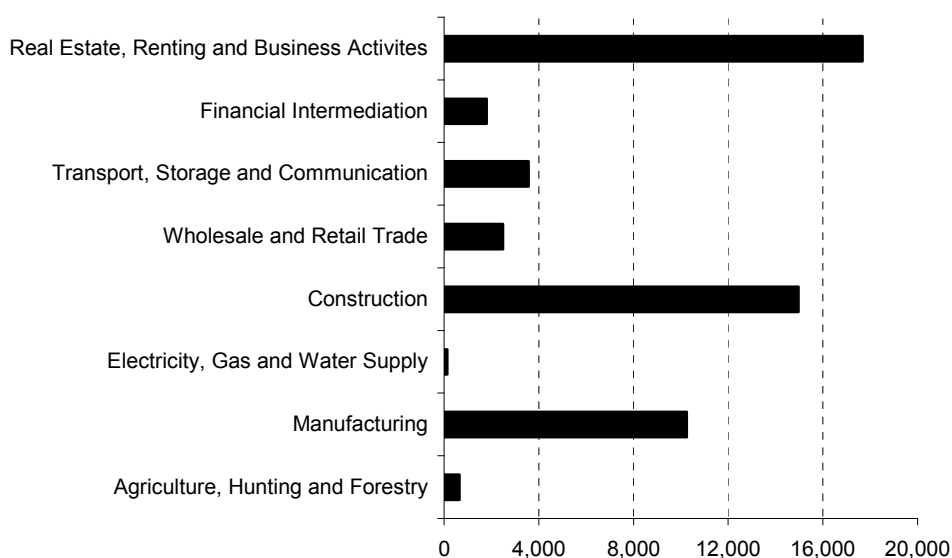
¹⁰¹ Gross National Product is the output produced by the factors of production owned by the residents of a country. It is distinguished from Gross Domestic Product which is the output produced by the factors of production located in a country regardless of the nationality of ownership.

¹⁰² **Quarterly National Accounts, Quarter 4 2009 and Year 2009 (preliminary), March 2010**, Central Statistics Office.

¹⁰³ The code assigned to each claimant is based on their most recent occupation and therefore may not represent that in which they are most skilled or spent most time employed in. The data was analysed and where possible the occupation codes were categorised by economic sector. Over 80% of the claimants were categorised in this way.

13.3 Redundancy claims received by the Department of Enterprise, Trade and Innovation in the same 24 months totalled 117,608¹⁰⁴. Figure 57 depicts changes in redundancies by sector for the three years 2007 to 2009.

Figure 57 Redundancies by Sector 2007 to 2009^a



Note:

- a Data from the Department of Enterprise, Trade and Innovation analyses redundancies by the industrial group of the enterprise where the employees were made redundant. The ten industrial groups have been redefined into eight to coincide with the economic sectors employed in this chapter.

13.4 The contraction in output in the economy was also evident in the reduction in energy consumption in the key productive sectors in 2008 as indicated in Figure 58.

Figure 58 Shares and Growth Rate of Total Final Energy Consumption by Sector, 2008

	Share in 2008	Growth in 2008
Industry	18.6%	– 5.4%
Transport	41.9%	– 1.3%
Residential	23.8%	+ 8.8%
Commercial/Public	13.5%	+ 6.9%
Agriculture	2.2%	– 0.4%
	100%	+ 1.2%

Source: Energy in Ireland 1990 – 2008, 2009 Report, Sustainable Energy Ireland.

13.5 As the figures for jobseeker claimants, redundancies and energy consumption show, the contraction in the economy did not bear equally on all sectors.

¹⁰⁴ Redundancy claims received in 2008 and 2009 include claims in respect of redundancies arising in earlier years. In addition, claims for redundancies arising in 2008 and 2009 may not be received until later years.

Chapter Focus

Based on the foregoing, it would be expected that taxes on business activity, profits and employment would decrease. The audit sought to examine the sectoral impact of the general downturn and in particular

- isolate sectoral performance outcomes
- examine the movements by tax type within sectors.

13.6 €1 billion of the reduction in yield of €4 billion is capable of being analysed on a sectoral basis. The balance is made up of a variety of taxes and levies which are separately reviewed at the end of this chapter.

Receipts 2007 to 2009 by Sector¹⁰⁵

13.7 A breakdown by sector is available for domestic VAT, PAYE, PRSI in respect of employees¹⁰⁶, Self-Assessed Income Tax, Corporation Tax and Capital Gains Tax¹⁰⁷. These accounted for 77% of total receipts of tax and PRSI in both 2007 and 2009. The composition of the tax for which sectoral data is available together with the change between 2007 and 2009 is set out in Figure 59.

Figure 59 Tax Proceeds by Taxhead for which Sectoral Analysis is Available, 2007 to 2009

Taxhead	2007 €m	2009 €m	Change 2007 to 2009 ^a	
			€m	Percentage
Domestic VAT	12,978	9,628	(3,350)	(26%)
PAYE	10,155	8,488	(1,667)	(16%)
PRSI	8,947	8,911	(36)	(0.4%)
Self-Assessed Income Tax	2,309	987	(1,322)	(57%)
Corporation Tax	6,393	3,890	(2,503)	(39%)
Capital Gains Tax	3,097	544	(2,553)	(82%)
Total	43,879	32,448	(11,431)	(26%)

Note:

- a Changes introduced in Budget 2008 in relation to these taxes were estimated at the time of the Budget to have a net cost in 2008 in terms of reduced collection of about €700 million. The net additional yield in 2009 arising from the measures in relation to these taxes introduced in Budget 2009 and Supplementary Budget 2009 was estimated at around €3.5 billion.

¹⁰⁵ The sectoral analysis is an estimate of the yield by sector based on information in relation to the payments by each taxpayer contained in Revenue's Integrated Taxation Processing system.

¹⁰⁶ A breakdown by sector is not available for PRSI paid by self-employed persons.

¹⁰⁷ The income levy paid by PAYE employees and the self-employed, which was introduced from 1 January 2009, has been excluded from the sectoral analysis to provide more meaningful comparisons with collection in 2007 and 2008. The payments received by Revenue in respect of PAYE and self-assessed income tax on which this analysis is based include amounts in respect of the income levy which cannot be separately identified for each sector. Therefore, the levy has been deducted from the amounts allocated to each sector for these taxheads in the same proportion as total receipts for the taxheads, including the levy, are distributed across the sectors.

13.8 Without taking into account the effect of changes in the 2008 and 2009 budgets, there was an overall reduction for this element of tax of €1.4 billion or 26% in the yield in the two years ended on 31 December 2009. This is analysed by sector in Figure 60. Reductions were recorded in most sectors and these ranged from 90% (€739 million) in the case of the agriculture, hunting and forestry sector to 11% (€243 million) in the case of the transport, storage and communications sector.

Figure 60 Sectoral Tax Yield – Change 2007 to 2009^a

Sector	2007	2009	Change 2007 to 2009	
	€m	€m	€m	%
Construction	3,619	1,128	(2,491)	(69%)
Wholesale and Retail Trade	8,870	6,453	(2,417)	(27%)
Real Estate, Renting and Business Activities	7,740	5,503	(2,237)	(29%)
Manufacturing	5,823	4,663	(1,160)	(20%)
Financial Intermediation	4,515	3,525	(990)	(22%)
Agriculture, Hunting and Forestry	817	78	(739)	(90%)
Hotels and Restaurants	1,500	1,190	(310)	(21%)
Transport, Storage and Communications	2,197	1,954	(243)	(11%)
Mining and Quarrying	247	118	(129)	(52%)
Community, Social and Personal Services	1,148	959	(189)	(16%)
Fishing	15	10	(5)	(33%)
Activities of Households	11	7	(4)	(36%)
Extra-Territorial Organisations	4	5	1	25%
Electricity, Gas and Water Supply	541	544	3	1%
Education	587	670	83	14%
Health and Social Work	2,177	2,334	157	7%
Public Administration and Defence	2,632	3,011	379	14%
All Other Sectors/Unknown ^b	1,436	296	(1,140)	(79%)
All Sectors	43,879	32,448	(11,431)	(26%)

Notes:

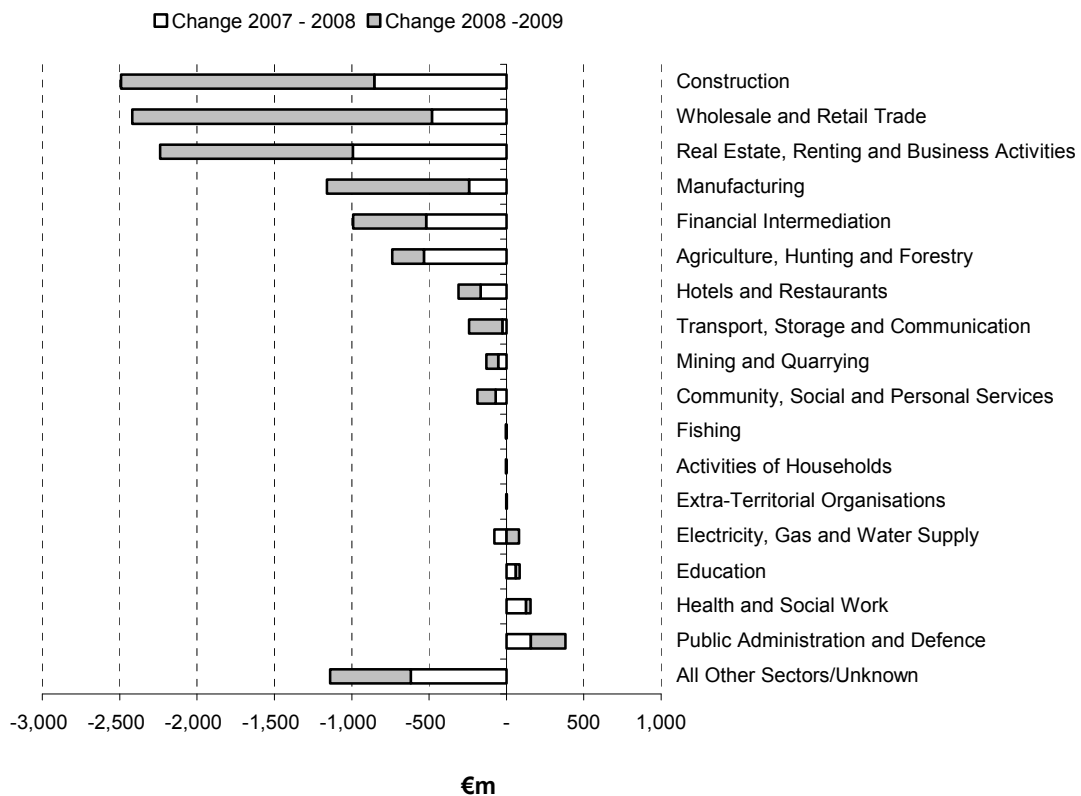
- a The allocation to sectors is based on NACE codes which are used in the European Union to classify economic activities for statistical purposes. The NACE code assigned to each tax registration is based on the primary economic activity undertaken by that registration. Revenue has pointed out that the allocation of NACE codes to taxpayers is not completely precise.
- b A considerable volume of tax collection is not assigned to a sector – the second largest drop in tax take in percentage terms from €1.4 billion in 2007 to €0.3 billion in 2009 was recorded here. The bulk of this drop related to capital gains tax which comprises two thirds of the total tax in this sector. It is likely that the high level of Capital Gains Tax allocated to the other/unknown sector is a result of payments of Capital Gains Tax by those who are not registered for other self-assessed taxes and have therefore not been allocated a sector code.

13.9 In absolute terms €8.3 billion of the total reduction of €11.4 billion is accounted for predominantly by reductions in the following sectors

- construction (€2.5 billion)
- wholesale and retail trade (€2.4 billion)
- real estate, renting and business activities (€2.2 billion)
- manufacturing (€1.2 billion).

13.10 The rate of reduction increased in 2009 with €7.1 billion occurring in that year compared with €4.3 billion in 2008. Figure 61 outlines the extent of change in each of the years 2008 and 2009 by sector. While the yield dropped in both years for most sectors, three sectors showed an increase in each year — public administration and defence, education, and health and social work.

Figure 61 Changes in Tax Receipts by Sector 2007 to 2009



Receipts 2007 to 2009 by Nature of Tax

13.11 When tax is classified by the nature of the activity giving rise to the tax, it gives four main classifications – domestic VAT, employment taxes (PAYE and PRSI), taxes on profits (Self-Assessed Income Tax and Corporation Tax) and Capital Gains Tax. The reduction of €1.4 billion between 2007 and 2009 is not evenly spread between the tax types as shown in Figure 62.

Figure 62 Changes in Receipts by Tax Year 2007 to 2009

Tax Classification	Reduction 2008	Reduction 2009	Total
	€m	€m	€m
Domestic VAT	913	2,437	3,350
Employment Taxes	(267)	1,970	1,703
Taxes on Profits	1,974	1,851	3,825
Capital Gains Tax	1,673	880	2,553
Total	4,293	7,138	11,431

13.12 The movement in receipts between 2007 and 2009 analysed by sector and nature of tax is set out in Figure 63.

Figure 63 Change in 2009 Tax Receipts over 2007 by Tax Type and Sector

Sector	Domestic VAT ^a	Employment Taxes	Taxes on Profits	Capital Gains Tax	Total
	€m	€m	€m	€m	€m
Construction	(933)	(804)	(672)	(82)	(2,491)
Wholesale and Retail Trade	(1,800)	(176)	(281)	(160)	(2,417)
Real Estate, Renting and Business Activities	(170)	(420)	(895)	(752)	(2,237)
Manufacturing	(617)	(266)	(212)	(65)	(1,160)
Financial Intermediation	213	(72)	(1,076)	(55)	(990)
Agriculture, Hunting and Forestry	(164)	(19)	(133)	(423)	(739)
Hotels and Restaurants	(67)	(80)	(87)	(76)	(310)
Transport, Storage and Communications	(41)	(34)	(112)	(56)	(243)
Mining and Quarrying	(38)	(1)	(89)	(1)	(129)
Community, Social and Personal Services	(105)	22	(52)	(54)	(189)
Fishing	(1)	2	(4)	(2)	(5)
Activities of Households	1	1	-	(6)	(4)
Extra-Territorial Organisations	(1)	1	1	-	1
Electricity, Gas and Water Supply	(23)	37	(2)	(9)	3
Education	37	54	(3)	(5)	83
Health and Social Work	46	160	(11)	(38)	157
Public Administration and Defence	359	5	16	(1)	379
All Other Sectors/Unknown	(46)	(113)	(213)	(768)	(1,140)
All Sectors	(3,350)	(1,703)	(3,825)	(2,553)	(11,431)
% Change	(26%)	(9%)	(44%)	(82%)	(26%)

Note:

a VAT is allocated to the sector of the VAT registered business which pays over the VAT collected to Revenue.

13.13 Eight sectors showed a decline across all tax types¹⁰⁸

- construction
- wholesale and retail trade
- real estate, renting and business activities
- manufacturing
- agriculture, hunting and forestry
- hotels and restaurants
- transport storage and communications
- mining and quarrying.

13.14 Total taxes in the financial intermediation sector fell by €90 million with taxes on profits declining by just over €1 billion. This and a fall in employment taxes and Capital Gains Tax in this sector was partly offset by an increase of €13 million in VAT. The fall of €89 million in the community, social and personal services sector arose from decreases in three of the tax types partially offset by an increase of €22 million or 4% in employment taxes.

13.15 Substantial increases in total tax occurred in three sectors

- an increase of €379 million in the public administration and defence sector is largely accounted for by increases in VAT
- increases in employment taxes and VAT in the education sector totalled €1 million and were only partially offset by falls in taxes on profits and CGT
- the increase in the health and social work sector is mainly due to increases in employment taxes.

13.16 Over half of the total reduction in VAT of €3.4 billion is accounted for by a reduction of €1.8 billion in the wholesale and retail trade sector. The construction sector accounted for a further €33 million of the decrease.

13.17 In both absolute and percentage terms, employment taxes were the least affected by the downturn. There was an increase of €67 million in 2008 due to an increase in PRSI, followed by a reduction of €1.97 billion in 2009. Overall, employment tax receipts fell in ten sectors by a total of almost €2 billion. This was partially offset by an aggregate increase of €82 million in eight sectors.

13.18 Taxes on profits recorded the largest reduction (€3.8 billion) over the two years with receipts falling in almost all sectors. The financial intermediation (€1.1 billion), the real estate, renting and business activities sector (€895 million) and the construction sector (€672 million) accounted for most of the decline.

13.19 The fall of €2.5 billion in CGT effected all sectors with 'All other sectors/unknown' falling by €768 million, the real estate, renting and business activities sector by €752 million and the agriculture, hunting and forestry sector by €423 million.

¹⁰⁸

The 'all other sectors/unknown' category also recorded a reduction in all tax types.

Receipts 2007 to 2009 — Other Taxes

13.20 The details of the taxes for which no sectoral analysis is available together with the movement in receipts between 2007 and 2009 is set out in Figure 64.

Figure 64 Tax Proceeds by Taxhead for which no Sectoral Analysis is Available 2007 to 2009

Taxhead	2007	2009	Change 2007 to 2009	
	€m	€m	€m	Percentage
Income Tax – Withholding Tax, Income Levy, etc	1,118	2,364	1,246	111%
VAT on Imports	1,541	1,010	(531)	(34%)
Excise	5,835	4,734	(1,101)	(19%)
Stamp Duties	3,244	1,001	(2,243)	(69%)
Custom Duties	273	208	(65)	(24%)
Capital Acquisitions Tax	391	256	(135)	(35%)
	12,402	9,573	(2,829)	(23%)

13.21 The net reduction of €2.8 billion is largely accounted for by a decline in stamp duties and excise duties. These were partially offset by the proceeds of the income levy introduced in 2009.

Excise Duty

13.22 An analysis of excise duty by type of duty is available and is set out in Figure 65 which shows that Vehicle Registration Tax accounts for €1 billion or 94% of the total fall in receipts of €1.1 billion.

Figure 65 Excise Duty by Type of Duty, 2007 to 2009

Type of Duty	2007	2009	Increase/ (Decrease)	Percentage Increase/ (Decrease)
	€m	€m		
Beer	465	404	(61)	(13%)
Cider and Perry	68	57	(11)	(16%)
Spirits	368	264	(104)	(28%)
Wine	230	243	13	6%
Tobacco ^a	1,024	1,049	25	2%
Hydrocarbon Light Oils	1,051	1,075	24	2%
Hydrocarbon Oils Other	1,153	1,120	(33)	(3%)
Vehicle Registration Tax	1,406	375	(1,031)	(73%)
Other Excise	70	147	77	110%
Total	5,835	4,734	(1,101)	(19%)

Note:

a Excludes Tobacco Levy paid to the Health Service Executive from the proceeds of tobacco excise duty - €168 million in 2007 and 2009.

Stamp Duty

13.23 An analysis of stamp duties by category of charge is available and is set out in Figure 66. A decline in duty from transactions in land and property accounted for €2 billion or 92% of the total reduction of €2.2 billion.

Figure 66 Stamp Duties by Category of Charge, 2007 to 2009^a

Category of Charge	2007	2009	Increase/ (Decrease)	Percentage Increase/ (Decrease)
	€m	€m	€m	%
Residential Property	1,018	149	(869)	(85%)
Non-Residential Property	1,363	178	(1,185)	(87%)
Shares	609	210	(399)	(66%)
Cheques	19	37	18	95%
Insurance Policies	3	2	(1)	(33%)
General Deeds	18	36	18	100%
Penalties	15	18	3	20%
Credit Cards	72	62	(10)	(14%)
Non-Life Levy	85	86	1	1%
Life Assurance Levy ^b	–	9	9	100%
ATM Cards	18	3	(15)	(83%)
Debit Cards	–	1	1	100%
Combined Cards	24	13	(11)	(46%)
Health Insurance Levy ^c	–	197	197	100%
Total	3,244	1,001	(2,243)	(69%)

Notes:

- a Companies Capital Duty receipts totalled €0.1 million in 2009 and €0.3 million in 2007 and is therefore not shown.
- b Introduced in Supplementary Budget April 2009.
- c Introduced in September 2009 for a three year period.

Conclusion

Leaving aside the impact of budgetary increases, the revenue of the State including PRSI decreased by €15 billion in the 24 months to the end of 2009 before taking account of the proceeds of an income levy which yielded €1 billion in 2009 bringing the net reduction to €14 billion. 79% of this reduction is capable of analysis on a sectoral basis.

All tax types fell significantly over the two year period with the largest reductions occurring in taxes on profits (€3.8 billion) and domestic VAT (€3.3 billion). In percentage terms, Capital Gains Tax was the most affected falling by 82% (€2.5 billion). Employment taxes were least affected falling by €1.7 billion or 9%.

Almost 73% of the reduction can be attributed to four sectors which were among those where receipts fell for all tax types in the period

- construction where yield reduced by almost €2.5 billion
- the wholesale and retail trade sector where the reduction was more than €2.4 billion
- the real estate, renting and business activities sector with a reduction of over €2.2 billion
- manufacturing where the yield fell by over €1 billion.

Chapter 18 examines performance outcomes at organisational level. There would be merit in Revenue exploring whether and to what extent the suggestions for enhancing performance information outlined in that chapter could be applied at sectoral level.

In particular, Revenue should explore whether the accumulated random audit results to date can be exploited to give an indication of sectoral audit gaps¹⁰⁹.

The Accounting Officer stated that Revenue will examine the feasibility of doing so.

¹⁰⁹

Chapter 12 of the Annual Report 2008 examined the random audit results for two sectors and indicated significant differences in the financial impact of non-compliance between sectors.

Chapter 14

Revenue

Revenue Compliance Interventions

Revenue Compliance Interventions

14.1 This chapter examines

- the extent and outcome of Revenue compliance checking including audits
- the extent of deterrence actions arising out of non-compliance
- the extent of publication of defaulter details
- the outcome of special investigations.

Compliance Checks

14.2 Revenue conducts a range of checks to ensure that taxpayers are compliant. These fall into two main categories – audits and assurance checks. The main audit classifications are

- A comprehensive audit is normally a response to an Income Tax or Corporation Tax issue. However, significant risks associated with other taxes are also considered.
- Multi taxhead and single taxhead audits address compliance with one or more tax or duty types and relate in the main to taxes other than Income Tax or Corporation Tax.
- Single issue or transaction audits focus on more specific tax matters including compliance work in relation to a particular tax relief or regime.

14.3 The outcome of the 2009 programme of Revenue audits is summarised in Figure 67.

Figure 67 Revenue Audit Activity

Category	2008		2009	
	Number	Yield ^a	Number	Yield ^a
	Completed	€m	Completed	€m
Comprehensive Audits ^b	3,904	253	4,353	280
Single Tax/Duty Audits	6,082	183	5,053	163
Multi Tax/Duty Audits	2,065	64	1,735	63
Single Issue/Transaction Audits	1,363	58	1,278	97
Total Audits	13,414	558	12,419	603

Notes:

- a Yield in 2008 has been re-stated to exclude the estimated yield of €11 million expected in future years as a result of the restriction of losses carried forward and reliefs overclaimed. The corresponding amount for 2009 was €295 million and has not been included in the yield for that year.
- b Includes the yield from random audits completed in the year. Also includes the yield from audits of special investigation cases of approximately €69 million (€90 million in 2008).

14.4 Although the total number of audits completed fell by 995, there was an increase in the total yield of €45 million. There were 449 more comprehensive audits completed in 2009 than 2008 and the increase in yield was €27 million. While 85 less single issue/transaction audits were completed, the yield increased by €39 million. The largest reduction in audit numbers was in the Single Tax/Duty category where 1,029 less audits were completed compared to 2008.

14.5 Included in the audits completed in Figure 67 are the results of Revenue's examinations of whether employers are operating PAYE/PRSI correctly. The Department of Social Protection also undertakes a programme of employer inspections to ensure the correct operation of PRSI. This programme identified a non-compliance rate of 20% in 2009 (14% in 2008) and these cases are reported to Revenue for follow up action. In the light of the implications for both PAYE and PRSI of this non-compliance rate I sought details of the follow-up action taken by Revenue. The Accounting Officer stated that Revenue does not collate details of the action taken as a result of information reported by the Department of Social Protection. The results of all employer audits are reflected in the general audit statistics.

14.6 The trend in the percentage of yielding audits for 2007, 2008 and 2009 for each audit category is set out in Figure 68.

Figure 68 Percentage of Yielding Audits 2007 to 2009

Audit Category	Percentage of Yielding Audits ^a		
	2007	2008	2009
Comprehensive Audit	67%	63%	68%
Single Tax/Duty Audit	54%	61%	70%
Multi Tax/Duty Audit	57%	64%	67%
Single Issue/Transaction Audits	49%	71%	86%

Note:

- a Figures are based on audit results recorded on Revenue's Audit Case Management System. Not all audits are recorded on that system.

14.7 An analysis of the 2009 audit yield for each audit category is set out in Figure 69. The total audit yield of €603 million is comprised of 76% tax, 17% interest and 7% penalties. The composition of the yield varies between the different categories of audit with tax accounting for 64% of the yield from comprehensive audits rising to 95% for single issue/transaction audits.

Figure 69 Analysis of Audit Yield 2009

Audit Category	Tax	Interest	Penalties	Total
	€m	€m	€m	€m
Comprehensive Audits	180	69	31	280
Single Tax/Duty Audits	135	20	8	163
Multi Tax/Duty Audits	51	7	5	63
Single Issue/Transaction Audits	92	4	1	97
Total	458	100	45	603

14.8 The tax element of the 2009 audit yield (€458 million) is analysed by taxhead and type of audit in Figure 70. VAT accounts for the largest proportion of the total audit yield and the largest proportion for most of the audit categories. The exception is the comprehensive audit category which results in more Income Tax and Corporation Tax being collected.

Figure 70 Analysis of Tax Yield by Taxhead and Type of Audit 2009

Taxhead	Type of Audit				Total €m
	Comprehensive	Single Tax/Duty	Multi Tax/Duty	Single Issue/Transaction	
	€m	€m	€m	€m	
Income Tax	48	2	2	6	58
Corporation Tax	52	8	2	27	89
Relevant Contracts Tax	4	8	12	2	26
VAT	33	76	17	46	172
Employer's PAYE/PRSI	16	10	8	2	36
Other including CGT	17	20	2	8	47
CAT and Stamp Duty	–	4	–	–	4
Miscellaneous ^a	10	7	8	1	26
Total	180	135	51	92	458

Note:

a This element of the yield is referred for enforcement and includes a number of different taxheads.

14.9 The Accounting Officer stated that the increase in total yield despite the reduced number of audits indicates that Revenue's efforts to target the riskiest cases are bearing fruit. The significant reduction in the number of Single Tax/Duty audits is due to a reduction in the number of Stamp Duty and Capital Acquisitions Tax audits which reflects the changed economic circumstances. The decline in Revenue staff from 6,575 to 6,100 over the course of 2009 also had an impact on audit activity. In relation to the percentage of yielding audits, the Accounting Officer stated that the increase in all audit categories showed that Revenue was continuing to lessen the impact of audits on compliant taxpayers.

Comprehensive Audits

14.10 The outcome of the 4,353 comprehensive audits completed in 2009 is further analysed in Figure 71. The yield of €280 million includes interest charges of €69 million and penalties of €31 million. The highest settlements were €4.1 million for Income Tax and €35.43 million for Corporation Tax. Comprehensive audits were completed in 23 bogus non-resident account cases with settlements totalling €1 million, in 191 offshore assets cases with settlements totalling €30 million and in 194 life assurance product cases with settlements of €28 million¹¹⁰.

¹¹⁰

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

Figure 71 Yield from Comprehensive Audits

Agreed Settlements	2008		2009	
	Number	Yield €m	Number	Yield €m
€1 to €30,000	1,480	14	1,842	18
€30,001 to €100,000	516	29	593	33
€100,001 to €500,000	368	80	417	86
€500,001 to €1m	55	36	49	34
Over €1m	36	94	33	109
No additional tax payable	1,449	–	1,419	–
Totals	3,904	253	4,353	280

Risk Evaluation

14.11 Revenue uses a risk evaluation and profiling system (REAP) to help select cases for audit. 71% of the audits actually completed in 2009 which were recorded in Revenue's Audit Case Management (ACM) System¹¹¹ and which were risk ranked¹¹² were in the top 20% of risk. Figure 72 outlines the extent to which each type of audit fell into the higher risk classification.

Figure 72 Percentage of Settled Audits 2009 in Top 20% of Risk

Type of Audit	Number Completed	Number Recorded in ACM	Number Risk Rated	Number in Top 20%	% in Top 20%
Comprehensive Audits	4,353	4,330	3,805	2,444	64%
Single Tax/Duty Audits	5,053	4,297	3,899	2,894	74%
Multi Tax/Duty Audits	1,735	1,734	1,689	1,417	84%
Single Issue/Transaction Audits	1,278	1,278	1,163	744	64%
Total Audits	12,419	11,639	10,556	7,499	71%

14.12 Work has begun on extending the scope of REAP to include risk assessment of PAYE taxpayers. A risk assessment of PAYE taxpayers was carried out in 2009 and units were established in two regions to analyse the results.

14.13 Work is continuing on the development of a model to enable the risk scores from REAP to be used to predict the audit yield. The model has been piloted in one region and a draft of the preliminary results has yet to be considered by senior management in Revenue.

14.14 The Accounting Officer stated that because of quality issues with the classification of audits as REAP or non-REAP selected on Revenue systems, a comparison of the results of audits sourced from REAP with those sourced by other means was not possible. Changes to the ACM

¹¹¹ Not all audits are recorded on the Audit Case Management System.

¹¹² Not all cases are risk ranked, for example, cases that are no longer 'live' are excluded.

System are being introduced to record the risk rules which cause a case to be chosen for audit and track the progress of the audit, identifying the extent to which those risks have been examined on audit.

Assurance Checks

14.15 Assurance checks are initiated with the intention of assuring Revenue, without recourse to a resource intensive audit or enforcement activity, that the customer is broadly compliant in the areas that are the subject of the check. Assurance checks include

- verification of documentation and requests for additional information in relation to Income Tax, Corporation Tax, VAT and capital taxes
- checks of customs documentation
- excise checks including VRT
- checks arising from suspicious transactions reports¹¹³
- eligibility checks arising from special investigation voluntary disclosure schemes
- queries which examine a single aspect of a case for the purpose of testing an apparent risk highlighted by REAP.

14.16 The number of assurance checks reported has grown significantly, from 98,981 in 2005 to 361,480 in 2009. Part of this increase may be due to previous non-recording and an increased awareness in districts of the need to log such checks. An internal Revenue group is examining the current system of assurance checking and reporting, including the definition of what constitutes an assurance check, the overall approach to such checks and the system for recording and reporting assurance checks.

14.17 An analysis of assurance checks in 2009 by type is set out in Figure 73.

¹¹³ Under the Criminal Justice Act 1994 (as amended) designated bodies are required to report to An Garda Síochána and Revenue where they have a suspicion that a money laundering offence may have been committed. These reports are known as Suspicious Transaction Reports.

Figure 73 Assurance Checks 2009

Type of Check	Total Number	Number Compliant	Number Non-Compliant	Number with yield	Yield €m
Document Verification/Requests for Additional Information	176,344	164,641	11,703	7,156	48.8
Customs	97,437	81,029	16,408	10,308	2.3
Excise	53,222	47,844	5,378	4,253	5.3
Suspicious Transaction Reports	9,679	9,243	436	14	0.3
Special Investigations – Eligibility Checks	772	714	58	13	0.8
Specific Risk Inquiries ^a	24,026	22,297	1,729	925	11.0
Total	361,480	325,768	35,712	22,669	68.5

Note:

a These checks examine one of the risks highlighted by REAP in each case.

Random Audits

14.18 Around 400 random audits are selected for completion annually. The results as at 31 March 2010 of the random audit programmes for 2006 to 2009 are shown in Figure 74.

Figure 74 Random Audit Programmes 2006 to 2009

Number of Cases	2006	2007	2008	2009
Sample Selected	402	401	403	400
Completed Cases	387	390	383	276
Dropped Cases	4	2	1	-
Incorrect Period Audited ^a	11	1	-	-
Cases on hand at 31/03/2010	-	8	19	124
Yield	€	€	€	€
Yield for Base Year	1,502,106	793,775	1,145,241	379,659
Yield from other Years	768,020	1,154,803	1,330,128	269,548
Total Yield	2,270,126	1,948,578	2,475,369	649,207
Average Yield for Base Year	3,881	2,035	2,990	1,376
Total Average Yield	5,866	4,996	6,463	2,352
Yielding cases as % of completed cases	31%	33%	30%	29%

Note:

a The yield from the incorrect period audited cases in 2006 amounted to €114,191 and is not included in the total yield figure for 2006.

14.19 The number of yielding cases continues to be around 30% and while there was a fall in the average yield for 2007 cases, this has increased again for the 2008 programme. The average yield for the base year for the 2009 programme is currently €1,376 based on completion of 276 of the scheduled 400 audits. Experience in previous years has shown that this average is likely to increase as more audits are completed.

14.20 The Accounting Officer stated that the results of the random audit programmes in recent years have been reasonably consistent. She noted that the average yield is small and reflects a number of outliers. Over the last four years about 70% of random audits resulted in no yield and a large majority were only marginally yielding.

Non-Compliance – Deterrence Actions

14.21 Revenue's deterrence provisions fall into two main categories – civil penalties and criminal proceedings. In certain cases, it publishes details of persons who have defaulted on their Revenue obligations.

Civil Penalties

14.22 Where incorrect returns are made fraudulently or negligently, penalties are generally imposed. These mainly arise out of Revenue audits. Civil penalties imposed as a result of 2009 audits amounted to €45.3 million (€42.2 million in 2008).

14.23 Revenue can also impose civil penalties for failing to submit returns on time. In 2009, Revenue imposed penalties totalling €1.7 million in 519 cases which did not submit P35 returns on time. Due to a change in legislation which required the issue of an additional letter in all cases, no civil proceedings for non-payment of these fines were taken in 2009.

Criminal Proceedings

14.24 Criminal proceedings arise in relation to the non-filing of returns, summary prosecutions for various other tax and customs and excise offences and prosecutions for serious evasion.

Non-Filing of Returns

14.25 Criminal prosecutions of cases that failed to file VAT returns resulted in 82 cases being heard in Court in 2009 and fines of €702,335 being imposed. There were 1,147 convictions for failure to file Income Tax and Corporation Tax returns with €2.3 million in fines imposed. Failure to pay P35 fines led to criminal prosecutions in 183 cases. In addition, one case was convicted for failing to file Relevant Contract Tax returns and a fine of €1,300 was imposed.

Summary Prosecutions for Customs and Excise Offences

14.26 There were 535 successful summary prosecutions for customs and excise offences in 2009 resulting in fines of €826,894. These included cases of cigarette smuggling, marked oil, excise licence and VRT offences.

Summary Prosecutions for Tax Offences

14.27 There were nine convictions for tax offences other than non-filing of returns, with fines totalling €14,115 imposed. Seven of these cases were for failure to submit a statement of affairs, one for failure to furnish books and records and one for providing a false name to a Revenue Officer.

Prosecutions for Serious Tax Evasion

14.28 107 cases of serious tax evasion were at various stages of the investigation and prosecution process at the end of 2008. In 2009, a further 23 cases were determined to be suitable for investigation with a view to prosecution (36 in 2008). Convictions were obtained in six cases decided in Court in 2009 and details of the six cases are set out in Figure 75. Five of these cases were originally identified as being suitable for investigation with a view to prosecution as a result of Revenue audits and checks. In one of the cases, an individual was released on appeal after serving four months of a 20-month custodial sentence, the remaining 16 months of the sentence being suspended.

Figure 75 Convictions in 2009 for Serious Tax Evasion

Occupation/Activity	Fine	Estimated Tax at Risk	Offence
Property Developer	€2,250	€21,000	Submitting an incorrect CGT return
Builder ^a	-	€500,000	Failure to furnish VAT returns; failing to remit VAT; failure to deliver Income Tax returns; issuing incorrect invoices; failure to keep records
Courier ^b	-	€200,000	Submitting incorrect Income Tax returns; issuing incorrect invoices; falsely claiming VAT repayments
Builder	€3,500	€50,000	Submitting an incorrect Income Tax return; failure to keep records
Construction Sub-Contractor	€500,000	€100,000	Failure to submit VAT returns; failure to remit VAT
Security Guard	€3,700	€150,000	Submitting incorrect Income Tax returns

Notes:

a A 20-month custodial sentence was imposed, 16 months of which was suspended on appeal after serving four months.

b A three year suspended sentence was imposed.

14.29 13 cases were closed during 2009 and therefore 111 cases were at various stages of the investigation and prosecution process at the end of 2009. The status of those cases at the end of April 2010 is shown in Figure 76.

Figure 76 Status of Serious Tax Evasion Cases at April 2010

Status	Number of Cases
Under investigation	50
With the Revenue Solicitor's Office	13
Submitted to the DPP	9
Directions issued by DPP to prosecute	21
Before the court	13
Closed	4
Convictions obtained	1
Total	111

14.30 63% of these cases were identified as being suitable for investigation as a result of Revenue audits and checks, 17% arose from Revenue investigations, 12% were identified from Suspicious Transaction Reports and 8% are based on information provided by other agencies and individuals.

Prosecutions for Serious Customs and Excise Offences

14.31 There were seven convictions for serious Customs and Excise offences in 2009. The offences in six of these cases related to excise duty on tobacco products and the other involved excise duty on alcohol. Fines of €300 and €250 were imposed in two cases. Custodial sentences were imposed in five cases ranging from two years (suspended) to four months.

Publication of Defaulters

14.32 To further deter evasion the details of audit settlements may, in certain circumstances, be published. Cases are not published where

- a 'qualifying disclosure' is accepted
- the settlement is less than €30,000
- the penalty does not exceed 15% of the tax ultimately due.

14.33 In 2009, details of 356 cases of non-compliance were published. The total amount of tax, interest and penalties in published cases settled in 2009 was €96.8 million.

Special Investigations

14.34 A number of special investigations have been carried out by Revenue in the past number of years. The total amount collected on foot of investigations in 2009 was €14 million. Of the €2.6 billion collected to date from all investigations, some €1.4 billion or 54% was collected from the voluntary disclosure schemes which formed part of five of the investigations¹¹⁴.

14.35 Figure 77 sets out the cumulative amounts received to the end of April 2010 as a result of each investigation. Two investigations – Life Assurance Products and Undisclosed Funds in Irish Bank Accounts – were extended in 2009. An investigation into trusts and other offshore structures began in 2009.

Figure 77 Special Investigations – Revenue Collected to 30 April 2010

Investigation	Year Commenced	Number of Cases Involved	Receipts 2009 €m	Receipts to April 2010 €m
DIRT - Look Back Audits (financial institutions)	1999	37	-	225
DIRT Underlying Tax				
<i>Voluntary Disclosure Scheme</i>	2001	3,675	-	227
<i>Post Voluntary Disclosure Investigations</i>	2001	8,500 ^a	7.7	420
NIB – Offshore Investment Schemes	1998	465	0.2	60
Ansbacher-type Schemes	1999	289	3.2	107
Pick Me Up Schemes	1998	71	-	1
Tribunal-related reviews	1998	49	-	41
Offshore Assets	2004	14,867	18.3	957
Undisclosed Funds – Life Assurance Products	2005	5,500	12.0	479
Undisclosed Funds in Irish Bank Accounts	2008	1,232	55.3	77
Trusts and Offshore Structures	2009	103	17.6	21
Total			114.3	2,615

Note:

a This is an estimated figure.

Undisclosed Funds – Life Assurance Products

14.36 This investigation began in 2005 with a voluntary disclosure scheme for persons who invested €20,000 or more of untaxed funds in life assurance investment products. Subsequent to the voluntary disclosure phase, in 2006 Revenue obtained High Court orders requiring policy providers to furnish details of those who invested €50,000 or more in single premium policies between 1990 and 2003.

¹¹⁴ Voluntary disclosure schemes were available for the investigations into DIRT Underlying Tax, Offshore Assets, Life Assurance Products, Undisclosed Funds in Irish Bank Accounts and Trusts and Offshore Structures.

14.37 In 2009, Revenue sought, and was granted, High Court orders in respect of the balance of policies where the sum invested was between €20,000 and €50,000. As most policyholders will have fully met their tax liabilities in relation to these funds, Revenue requested the insurance companies to send a declaration form to the policyholders which would allow a policyholder to declare that they had no outstanding tax obligations. For those with untaxed funds in these policies, Revenue would accept a full and complete disclosure in lieu of initiating a criminal prosecution, provided full declaration and payment was made by 30 November 2009.

Offshore Assets

14.38 The scope of this investigation was broadened in 2009. Revenue obtained four High Court orders requiring Irish clearing banks to disclose the identity of persons who transferred funds to or from financial institutions in the Isle of Man, Jersey, Guernsey, Switzerland and Lichtenstein. Previously in this investigation, details of transfers to and from the Isle of Man, Jersey and Guernsey were obtained but only involving the offshore entities of Irish banks. The latest orders require details of all transfers of more than €5,000.

Trusts and Offshore Structures

14.39 In 2009, Revenue commenced an investigation into the use of trusts and offshore structures. The investigation is concerned with those who have undeclared tax liabilities in relation to trusts and offshore structures. The focus of the investigation is on those who have transferred or settled property, assets or funds to/on trusts or offshore structures. Such persons had until 1 September 2009 to provide a notice of intention to make a disclosure. Full disclosure and payment was required by 31 October 2009. The benefits of making a disclosure were

- details of payments would not be published
- a prosecution would not be initiated
- penalties would be mitigated in accordance with the Code of Practice for Revenue Auditors.

14.40 Persons who were already the subject of a Revenue audit or investigation or who came within the scope of one of the other special investigations were not eligible for the voluntary disclosure scheme. 99 notices of intention to make a disclosure were received and disclosures were received from 94 of these cases who paid a total of €17.6 million. Revenue is examining the disclosures made as well as the cases that submitted notices of intention but did not make a disclosure.

14.41 Reporting requirements introduced in Finance (No. 2) Act 2008 require returns to be made to Revenue by third parties in relation to settlements involving non-resident trustees. The deadline set for returns in respect of settlements between December 2003 and April 2009 was 1 September 2009. Third parties required to make returns include solicitors, accountants, financial institutions, financial intermediaries, financial advisors, tax practitioners, trust service providers and companies. These returns are being examined in the context of this investigation. The investigation includes an examination of the tax returns of the individual transferors and settlors. It is focused on the tax treatment of the underlying funds and the income and gains arising as well as any disbursements made from the trusts and offshore structures. Revenue has the power to issue a notice requiring any person it believes has information relating to a settlement on a trust, to provide that information. Automatic reporting of information under the EU Taxation of Savings Directive and exchange of information under Tax Information Exchange Agreements will also be used in this investigation.

Conclusion

The yield from targeted audits increased in 2009 despite a reduced number of audits. The results of the random audit programmes in recent years indicate that the underlying level of non-compliance is around 30%. However, Revenue does not assess the overall financial impact of that non-compliance by extrapolation of the results.

Now that a critical mass of random audit work had been completed it should be possible to fully realise the potential of that work. This would involve

- using the identified underdeclaration in the course of recent random audit programmes to estimate the gap in tax collection
- identifying the sectors where non-compliance has a material monetary effect
- isolating the trends in taxpayer behaviour that lead to non-compliance.

Chapter 15

Revenue

Counteracting Smuggling of Tobacco Products

Counteracting Smuggling of Tobacco Products

15.1 In 2009, €1.2 billion¹¹⁵ was collected by Revenue in excise duty on tobacco products. 95% of this arose from duty on cigarettes. The duty collected from tobacco products in the period 2004 to 2009 is shown in Figure 78.

Figure 78 Excise Duty on Tobacco Products, 2004 to 2009

	Cigarettes		Other tobacco products ^a		Total
	Quantity 000's ^b	€m	Kgs ^b	€m	€m
2004	5,330,593	1,024	207,270	35	1,059
2005	5,514,228	1,054	183,390	26	1,080
2006	5,604,884	1,071	190,453	32	1,103
2007	5,401,702	1,155	201,858	37	1,192
2008	4,940,567	1,132	198,763	39	1,171
2009	4,607,146	1,155	285,425	61	1,216
	31,399,120	6,591	1,267,159	230	6,821

Notes:

a Other tobacco products include cigars, fine cut tobacco and other types of smoking tobacco.

b Excise duty on cigarettes comprises a rate of duty levied per thousand cigarettes together with a fixed percentage of the retail price at which the cigarettes are sold. All other tobacco products are charged at a rate of duty per kilogram.

15.2 Total excise duty on tobacco products increased by €45 million between 2008 and 2009. While the quantity of cigarettes on which duty was paid fell by 7%, the duty collected increased by 2% or €23 million. This is mainly due to an increase of 4% in the rate of duty in 2009¹¹⁶. There was also an increase in duty collected on other tobacco products of 56% or €22 million.

15.3 In addition to the amounts of excise duty collected, Revenue has received total payments of €2.8 million between 2006 and 2009 from two tobacco manufacturers. These payments are taken to account as appropriations-in-aid in the Vote for the Office of the Revenue Commissioners. The payments arise from legally binding agreements between the European Commission and member states on the one hand and the tobacco manufacturers on the other. The European Commission and member states have been seeking to enter into such agreements with the four major global manufacturers with the objective of instituting formal cooperation arrangements to combat cigarette smuggling.

15.4 Three such agreements have been signed to date – with Philip Morris International (PMI), Japan Tobacco International (JTI) and British American Tobacco (BAT) – and Ireland is party to all three agreements. The agreements include provision for the phased payment of an agreed sum to the members states and the European Commission over the period of the agreements as well as additional payments (known as seizure payments) to member states where genuine branded cigarettes (above a threshold of 50,000 cigarettes) of the relevant manufacturer are seized and

¹¹⁵ €168 million of this, referred to as the tobacco levy, was paid to the Health Service Executive Vote under Section 3 of the Appropriation Act 1999.

¹¹⁶ The new rate became operable on 8 April 2009.

where such cigarettes have not been released for consumption in the EU. The European Commission is actively negotiating an agreement with the other major global manufacturer – Imperial Tobacco Ltd (ITL).

15.5 The agreements commit the manufacturers to ensure that they only sell to legitimate traders, carry out due diligence checks on their customers and that they have in place ‘track and trace’ procedures to enable the source of any smuggled cigarettes to be identified.

Excise Duty Environment

15.6 With the introduction of the Single European Market in 1993, routine controls on imports from other EU member states were removed and an EU-wide control and movement system for excisable products was introduced. Under this system, the excise duty is suspended on goods moving between tax warehouses in different member states.

15.7 At the same time, restrictions on the amount of duty-paid excisable products that a person could bring into Ireland from another EU country no longer applied, provided the products are for the personal use of the person transporting them. Revenue has set indicative quantities¹¹⁷ of tobacco products (currently 800 in the case of cigarettes), which, if not exceeded, will be regarded as for personal use, provided there is no indication or suspicion of commercial activity. This is the lowest indicative level permitted.

15.8 Notwithstanding the EU Treaty provisions on free movement of goods and people, Revenue officials may carry out checks to combat smuggling of prohibited or restricted goods, including tobacco products where there are reasonable grounds for suspecting contravention of national or EU law.

15.9 Persons bringing tobacco products into Ireland from outside the EU are liable to excise duty and VAT on those products unless the quantities are below certain limits (200 in the case of cigarettes) and the products are for personal use.

Chapter Focus

Ireland has the highest rate of tobacco taxation in the EU. This makes Ireland, despite the small size of the market, a target for the smuggling of illegitimate products into the State. Illegal importation of tobacco products represents a loss to the Exchequer and the availability of cheap products undermines health policy which aims to reduce the level of smoking. In order to address smuggling of tobacco effectively, it would be necessary for Revenue to

- ensure that there is a high level of assurance that duty levying arrangements are operated in a controlled manner
- estimate the extent of illicit activity
- target activities within an articulated strategy based on the best analysis of the nature of fraud
- implement an operational response based on such a strategy
- monitor performance.

¹¹⁷

The limits are set in accordance with Council Directive 2008/118/EC.

The audit set out to examine the extent to which each of the elements of such a strategic approach were in place.

Duty Levying – Control

15.10 Excise duty on cigarettes and fine cut tobacco ('roll-your-own') is payable by means of the purchase of security stamps¹¹⁸ which are affixed to the packet beneath the cellophane wrapper. Excise duty on other tobacco products such as cigars and pipe tobacco is payable by reference to the weight of the product.

15.11 While excise duty is payable at the time of importation into Ireland, payment is suspended until the products are released for consumption onto the Irish market. To avail of this duty suspension arrangement, tobacco products imported into Ireland but not released onto the market must be held in a Revenue approved tax warehouse.

15.12 There is a risk that tobacco products on which duty has been suspended because they are held in tax warehouses or are being moved between warehouses will be released onto the market without payment of duty. Revenue controls the duty suspension arrangements by an approval process for warehouses and warehousekeepers, assurance checks of warehouse records including supervisory visits and regular audits. There are five warehouses authorised to hold tobacco products in Ireland.

Conclusion – Duty Levying

Each of the three main companies' warehouses has been audited annually by Revenue since 2005 with no yield arising. About 700 assurance checks annually have also been carried out between 2005 and 2009 with little or no yield arising. This gives reasonable assurance that duty-levying arrangements are operating effectively.

Estimation of the Extent of Illicit Activity

15.13 A study¹¹⁹ commissioned by the EU Commission estimated that, in 2004, untaxed products accounted for approximately 13% of the EU-wide tobacco market. It estimated that this was comprised of 4% to 5% legitimate untaxed and between 8% and 9% of illegitimate untaxed products.

15.14 There is no published official estimate of the extent of evasion of duty on tobacco products in Ireland. Revenue has in recent years, in conjunction with the Office of Tobacco Control, commissioned surveys, based on market research, which attempt to estimate the scale of illicit cigarette consumption and consumption of cigarettes untaxed in Ireland but purchased legitimately abroad. The most recent survey in 2009 estimated that 20% of cigarettes consumed in Ireland were untaxed. The figure for illicit consumption was put at 14% which would equate to a loss to

¹¹⁸ The security features on the stamps, some of which are known only to Revenue control and enforcement staff, are upgraded on a regular basis to reflect current best practice. A reserve stamp is retained in the event of the existing stamp being compromised.

¹¹⁹ KPMG, *Study on the Collection and Interpretation of Data Concerning the Release for Consumption of Cigarettes and Fine-cut Tobacco for Rolling of Cigarettes*, December 2005, Commissioned by the European Commission.

the Exchequer of approximately €200 million. The balance of 6% related to legal untaxed (in Ireland) cigarettes.

15.15 In response to my enquiries, Revenue has stated that it is currently undertaking an analysis of the economics of tobacco with a view to obtaining a better understanding of the market for tobacco in Ireland. One component of this research is to create an econometric model to estimate the demand for tobacco that will identify the key determinants of the market in Ireland. The literature on this topic is well developed and there is a World Bank recommended approach that will be adopted. As part of this project, economic techniques and data from various sources will be assessed for their usefulness in estimating the scale of tobacco smuggling in Ireland.

Conclusion – Estimation of Illicit Activity

Revenue should estimate the level of illicit tobacco importation and report the results in an open, transparent manner. Doing so would help position it to formulate appropriate responses that seek to reduce the level of evasion of duty taking account of the extent and nature of the problem.

The planned research to analyse the economics of the tobacco market in Ireland offers a means of supplementing the current estimate based on market research. The risk presented by other tobacco products, for which there is no estimate of illicit consumption, should be continually reviewed particularly in light of the significant increase in the quantity of these products legally consumed.

Strategic Targeting of Operations

15.16 In order to target Revenue activities designed to combat evasion of duty as well as preparing regular estimates of the extent of the problem there would need to be

- an analysis of the nature of the problem including the sources of supply, the profile of the population that uses the products and the trends over time
- an operational response based on that analysis designed to tackle the problem in an efficient manner
- the establishment, monitoring and regular review of goals and outcomes
- regular review of the control regime employed and applied by Revenue designed to identify gaps that could be exploited
- a performance-reporting regime designed to provide information on the extent of achievement in terms of goals and outcomes.

15.17 Revenue regions and the Investigations and Prosecutions Division (IPD) are responsible for implementing the actions designed to counteract smuggling.

15.18 While Revenue has a strategic aim of minimising the size of the illicit cigarette market, it does not have a high level strategy that targets specific achievements in terms of outcomes. It employs operational strategies that envisage an effective response to cigarette smuggling through targeting distribution outlets and a 50% increase in the seizure of smuggled cigarettes. Revenue also targets improved compliance by applying sanctions for non-compliance and, in particular, increasing the number of prosecutions.

15.19 One of Revenue's key priorities for 2009 sought "to increase the use of intelligence-based operations to combat the smuggling of goods, including drugs and tobacco products". The priorities for 2010 included "tackling the social and fiscal menace of tobacco smuggling to prevent it undermining government finance and public health policy".

15.20 Revenue has stated that organised crime is centrally involved in the illicit cigarette market. Revenue has access to international resources and expertise, including the World Customs Organisation and the European Anti Fraud Agency (OLAF)¹²⁰.

Conclusion – Strategy

While Revenue has set a target for seizures and acknowledging that other factors such as the after-tax price of cigarettes, the general state of the economy and the EU legal framework would have to be taken into account, it has not developed a strategy based on the regular generation of estimates of the size of the problem and which targets the achievement of specified outcomes designed to reduce or contain the problem.

Operational Response

15.21 Revenue's actions to counteract tobacco smuggling fall into a number of categories

- tackling, using a multi-agency approach, large-scale smuggling which usually involves organised criminal gangs. In this regard, Revenue receives assistance and co-operation from OLAF which also plays a role in facilitating follow-up investigations in countries from which seized cigarettes were shipped
- the identification of suspect consignments by means of risk profiling, intelligence gathering, sharing of information with other customs services and, where appropriate, using X-ray scanning technology to detect contraband.

15.22 Certain programmes and operations are coordinated by IPD, particularly multi-agency operations. Other than in the case of these centrally coordinated operations, intelligence sourced by IPD is passed on to the relevant Revenue region for action. A National Freight Intelligence Unit (NFIU), which is part of IPD, profiles and sources intelligence on third country traffic¹²¹. Targeting reports are produced which help operational units identify high risk traffic. Figure 79 sets out details of seizures of tobacco products as a result of reports issued by NFIU to operational units for the period 2007 to 2009.

¹²⁰ OLAF's mission is to protect the financial interests of the European Union and to fight fraud, corruption and any other irregular activity. It promotes cooperation between the Member States in order to coordinate their activities and provides them with the necessary support and technical knowledge to help them in their anti-fraud activities.

¹²¹ Goods imported into Ireland from outside the European Union are known as third country traffic.

Figure 79 Seizures of Tobacco Products arising from NFIU Profiling, 2007 to 2009

	Number of Cigarettes Seized	Quantity of Hand Rolled Tobacco Seized
	m	kg
2007	6.4	1.4
2008	51.7	–
2009	17.9	2.5

Role of Revenue Regions

15.23 Revenue regions participate in national and international coordinated operations and undertake local operations aimed at points of importation and at distribution outlets. ‘Operation Downstream’ is an ongoing operation which targets the sale of illicit products at various retail points including shops and markets and by street traders. Acting on intelligence generated within Revenue and received from industry and other sources this operation has resulted in 424 seizures totalling over 17 million cigarettes between December 2007 and December 2009.

15.24 Revenue also deploys staff on a permanent basis at a number of key locations in each region and operations are conducted in regions based on risk profiling. In addition to the profiling of third country freight provided by the NFIU, regions also profile EU traffic. Because of the free movement of goods provisions within the EU, limited information is available in relation to EU freight and care is applied in detaining any for examination.

15.25 Regions use profiling and a presence on the ‘high street’ to combat sales of illicit tobacco products. Checks on the internet followed by reviews of Revenue information systems are used to profile premises where illicit products are potentially being sold. Revenue officers have a right of entry to commercial premises. A warrant is required for private premises. For example, in the Dublin Region there were a total of 24 such warrants requested in 2009, warrants were granted in all of these cases which resulted in seizures in 13 cases and 13 prosecutions. Test purchases in commercial premises are also used to identify illicit trade and all of these cases are referred for consideration with a view to prosecution.

Scanning of Consignments

15.26 An aid to identification of illicit tobacco products is X-ray scanners. X-ray scanners can identify illicit goods in containers and vehicles. The scanner takes an X-ray image of the container and officers interpret that image based on training and experience. Revenue first acquired a scanner in 2006 and a second one was acquired in late 2009. One scanner operates in and around Dublin Port and the other, while based in Rosslare, is available to other regions as required.

15.27 It is only possible to scan a small percentage of the containers that arrive each week in Dublin Port (approximately 10,000). Revenue requires a significant amount of port space to operate the scanner for both radiological protection reasons and to accommodate freight that is to be scanned. It aims to avoid unduly delaying freight traffic moving through ports while scanners are in operation. Details of seizures of tobacco products which were identified using the X-ray scanner in the period 2007 to 2009 are shown in Figure 80.

Figure 80 Seizures of Tobacco Products from use of X-Ray Scanner 2007 to 2009

Year	Number of cigarettes seized	Quantity of other products seized	Value of tobacco products detected
2007	15 million	–	€6,337,500
2008	13 million	12.5 kgs	€5,492,500
2009	22 million	6,490 kgs	€11,295,000

Conclusion – Operations

Much of Revenue's operations are based on intelligence. Revenue has suggested that it is becoming more difficult to identify suspect consignments because smugglers increasingly use the tax registration details of legitimate traders as a cover.

There has been limited success in using X-ray scanners to detect contraband cigarettes. A comparison of the number of scans and the detection rate per scan with that achieved by tax authorities in other countries would be a useful approach for Revenue to assess the performance of its scanners and whether they could be deployed to better effect. Revenue informed me that it plans to conduct a study in 2011 that will compare the detection rate achieved with that achieved by tax authorities in other countries.

Performance Reporting

15.28 Revenue has not set performance targets in terms of outcomes. Its monitoring is focused on its actions including those designed to

- profile and assess risk
- target outlets that are distributing illicit products
- increase the number of intelligence based operations
- increase seizures
- increase the number of prosecutions.

15.29 Other than the aim in Revenue's Strategy Statement to increase seizures by 50%, quantified targets have not been published for these activities. Regions set targets for the number of seizures and the quantity to be seized as well as the number of cases to be referred for prosecution but these are not published or included in performance reports to the Revenue Board. Details of actual prosecutions and seizures are published in the Revenue Annual Report. Revenue has stated that seizures are analysed as a matter of course.

15.30 Figure 81 sets out the details of all seizures of cigarettes by Revenue in the period 2007 to 2009.

Figure 81 Cigarette Seizures, 2007 to 2009

	2007	2008	2009
Number of Seizures	15,481	10,191	10,610
Number of Cigarettes Seized	74.5m	135.3m	218.5m
Number of Counterfeit Cigarettes Seized	n/a ^a	62m	127.6m
Retail Value of Cigarettes Seized	€25.6m	€54.4m	€92m
Duty and Tax	€20.5m	€39.5m	€73.2m

Note:

a Figure not available.

15.31 While the number of cigarette seizures has fallen by about 30% since 2007, the actual number of cigarettes seized has increased from 74.5 million in 2007 to 218.5 million in 2009. One seizure in 2009 accounted for over 120 million cigarettes. Given the size of this seizure and the brands seized, it is unlikely that these cigarettes were destined for the Irish market.

15.32 Figure 82 sets out details of seizures of other tobacco products for the period 2007 to 2009.

Figure 82 Tobacco Seizures, 2007 to 2009

	2007	2008	2009
Number of Seizures	763	1,100	1,171
Quantity of Tobacco Seized	1,516kgs	3,083kgs	10,451kgs
Retail Value of Tobacco Seized	€0.4m	€1.1m	€3.7m
Duty and Tax	€0.3m	€0.7m	€2.9m

15.33 The number of seizures of other tobacco products increased by over 50% between 2007 and 2009 but there was a seven-fold increase in the quantity seized.

Conclusion – Performance Reporting

There is no performance reporting in terms of outcomes designed to highlight Revenue's impact on the illegal importation problem and performance against operational targets is limited to reporting the level of seizures.

The extent of seizures does not necessarily indicate whether the level of illicit trade is being impacted upon. The success of the measures that Revenue is taking to reduce the level of evasion of excise duty on tobacco products can ultimately only be measured in terms of their effect on reducing the incidence of evasion. This requires estimating the level of evasion over time, analysing the nature of that evasion and targeting actions accordingly. The market research commissioned by Revenue in conjunction with the Office of Tobacco Control is a first step in this regard.

Variations in seizures underline the need for Revenue to identify the factors that give rise to changes in the level and nature of seizures. Isolating the causes of variations would be valuable in determining whether they are as a result of better targeting by Revenue, changes in the nature of smuggling or other factors. Analysis and reporting of seizures in terms of whether the products were destined for the domestic market or for elsewhere would be useful in this regard. A planned review of seizure policies should provide valuable information on the effectiveness of the approach.

Sanctions and Penalties to Deter Smuggling

15.34 Under excise law it is an offence to do anything (hold, remove, transport, deposit or conceal) in relation to excisable products on which duty has not been paid with the intention of defrauding the State of the duty. It is also an offence to be involved in the evasion or attempted evasion of excise duty. The penalties are as follows

- on summary conviction a fine of €5,000 and/or up to 12 months in prison¹²²
- on conviction on indictment a fine not exceeding €126,970 or up to three times the value of the goods where their value is greater than €250,000 and/or up to 5 years imprisonment¹²³.

15.35 Section 125 of the Finance Act 2001 also provides for the forfeiture of the products, any goods packed with or used to conceal them and any conveyance used to transport them. Offences relating to tobacco stamps are set out in Section 78 of the Finance Act 2005. There is also provision for a court fine (€5,000) and forfeiture for failing to comply with the warehousing requirements and the EU control and movement provisions.

¹²² Section 119, Finance Act 2001 (as amended)

¹²³ The penalties on indictment were increased to this level by Section 99, Finance Act 2010. Previously, the fine was the greater of €12,695 or three times the value of the goods (section 119, Finance Act 2001).

15.36 Details of prosecutions by Revenue in relation to tobacco offences for the period 2007 to 2009 are set out in Figure 83.

Figure 83 Prosecutions for Tobacco Offences 2007 to 2009

	2007	2008	2009
Summary Prosecutions			
Number Prosecuted	120	82	159
Number of Convictions	120	82	159
Number where Custodial Sentence Imposed	14	5	28
Number where Fines Imposed	n/a ^a	78	143
Value of Fines Imposed	€43,710	€41,259	€93,510
Prosecutions for Serious Offences			
Number Prosecuted	1	3	6
Number of Convictions	1	3	6
Number where Custodial Sentence Imposed	–	1	5
Value of Fines Imposed	€7,500	–	€300

Note:

a Figure not available.

15.37 Revenue has stated that its policy is to prosecute wherever possible. As prosecution is dependent on the availability of quality admissible evidence, neither minimum nor maximum targets are set. Cases are analysed for their intelligence value and to extract the lessons learned.

15.38 Figure 84 sets out details of other sanctions imposed in relation to tobacco offences in the period 2007 to 2009.

Figure 84 Other Sanctions Imposed for Tobacco Offences 2007 to 2009

	2007	2008	2009
Number of Vehicles Seized	59	110	130
Cash Seized	€7,000	–	€312,338
Ship Seized	–	–	€250,000

Conclusion – Prosecutions

In-depth analysis of the effectiveness of deterrence, in terms of the type of prosecution case taken, the resultant sentences and the other sanctions imposed would be useful to assess its effectiveness as a deterrent.

Recent Developments

15.39 In recent years, Revenue has signed Memoranda of Understanding with two of the main cigarette manufacturers, ITL and JTI, to further cooperation in relation to the illicit tobacco trade. Samples of all major seizures are sent to manufacturers to establish whether the products are genuine or counterfeit. In addition, Revenue meets regularly with the trade association representing the leading tobacco companies as well as the four major global manufacturers to discuss global and national trends, including cigarette consumption figures and penetration of market by illicit product.

15.40 The Accounting Officer informed me that an internal group was established in January 2010 to examine the risks related to tobacco excise. A number of initiatives have already been taken arising from the work of this group. These include

- convening a national profiling conference
- the establishment of a tobacco hotline
- co-ordinating periodical national ‘blitz’ type operations on distribution outlets and at ports and airports to supplement normal activities
- the acquisition of additional hand held scanners and the evaluation of tobacco X-ray and other detection technology
- looking at best practice in other relevant jurisdictions
- the planned research into the market for tobacco in Ireland.

15.41 In addition, the group has initiated a number of projects including

- evaluation of a tobacco dog unit including a cost-benefit analysis
- establishment of a National Profiling Network and reviewing profiling effectiveness
- sourcing further guidance and training internationally
- a report to be prepared on alternative mobile scanning devices.

15.42 The group has also re-emphasised the benefits of enhanced co-operation with the Gardaí, the road haulage industry and the cigarette machine vending industry. It has also requested a review of seizure policies with a view to increasing the impact of Revenue activity against the smuggling of tobacco products.

Conclusion

Revenue needs to measure whether or not its activities are succeeding in reducing the problem of evasion of tobacco duty. The market research carried out gives an indication of the level of the problem and Revenue should use those results to set specific objectives in terms of reducing the illicit market share. To have value, this estimate needs to be updated regularly. Revenue should continue to explore other methodologies for estimating evasion.

Output targets for all key activities should be set and published to enable an assessment to be made of whether the activities are on course to deliver the required outcomes.

Chapter 16

Revenue

Revenue Repayments

Revenue Repayments

16.1 Revenue repayments in 2009 amounted to €8.1 billion. Repayments to Revenue customers represented 20% of the receipts for the year. Over 98% of those repayments related to Income Tax, VAT and Corporation Tax.

16.2 Repayments arise in three main ways and as well as cash repayments (€3.2 billion) and refunds (€4.16 billion) they can also arise by way of offset (€0.78 billion) against liabilities. The nature of repayments is outlined in Figure 85.

Figure 85 Types of Revenue Repayments

Type	Circumstance of Repayments
Repayments	Repayments principally arise in relation to VAT and Relevant Contracts Tax. In the case of VAT they reflect the differences between VAT on purchases and sales.
Repayments in the nature of refunds	Refunds arise in instances where tax has been overpaid and the client is due a refund in circumstances where <ul style="list-style-type: none">the preliminary tax paid exceeds the total tax payablethe taxpayer is entitled to reliefs or allowances not known or not allocated in sufficient time to allow computation and payment of the appropriate tax.
Offsets	Offsets occur where tax overpaid is less than cumulative underpaid tax across a number of years or taxheads. Revenue set these overpayments against other tax liabilities – no cash transfers arise in these cases.

16.3 Entitlement to refund and repayments is statutorily underpinned¹²⁴. Since 2003, repayments are subject to a valid claim being made to Revenue within four years from the end of the period to which the claim relates. This four-year limit replaced previous limits, the longest of which was ten years.

¹²⁴

Section 865 Taxes Consolidation Act 1997.

16.4 The repayment under each tax heading over the past five years is set out in Figure 86.

Figure 86 Repayments by Revenue 2005 - 2009

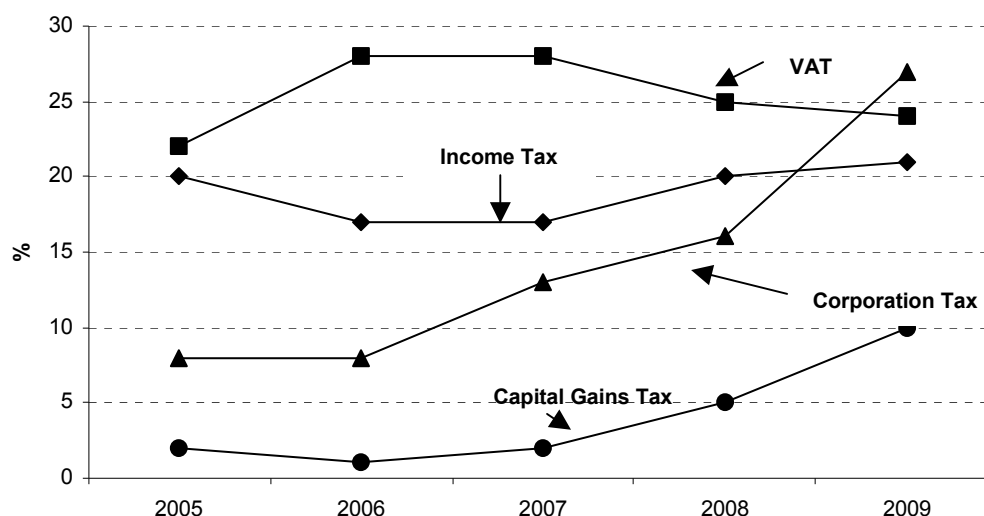
Payments	2005	2006	2007	2008	2009
	€m	€m	€m	€m	€m
Income Tax	2,837	3,075	3,206	3,398	3,229
VAT	3,465	4,358	4,729	4,560	3,325
Corporation Tax	500	586	936	975	1,445
Capital Gains Tax	34	35	64	70	62
Stamp Duties	20	42	65	49	23
Customs Duties	8	6	7	15	4
Capital Acquisitions Tax	12	12	6	8	12
Excise	158	138	124	103	48
Total	7,034	8,252	9,137	9,178	8,148
% of Gross Yield	15%	15%	16%	18%	20%

16.5 Overall, in the last five years, repayments as a percentage of gross yield have shown a steady rise, from 15% in 2005 to 20% in 2009.

Audit Focus – Level of Repayments

In the light of the high level of repayments and the fact that the decline in gross yield in recent years has not been matched by an equivalent reduction in repayments, the audit analysed the factors giving rise to an increase in the level of repayments as a proportion of the gross yield.

16.6 Figure 87 displays the relationship of tax repayments to gross receipts over the period 2005 to 2009 in respect of the taxes where the greatest change in repayment activity occurred.

Figure 87 Tax Repayments as a Proportion of Gross Revenue Receipts 2005 – 2009

16.7 Repayments to customers in 2009 in the case of Income Tax and VAT represented approximately one-fifth and one-quarter respectively of the gross take under those taxheads. A noticeable increase in repayments occurred under two taxheads

- in the case of Corporation Tax where the percentage repaid was the equivalent of 27% of the 2009 gross yield by comparison with levels of 8% to 16% in the previous four years
- in the case of Capital Gains Tax the proportion of the gross receipts repaid has increased by a factor of five from 2005 levels.

16.8 The sectors that account for the Corporation Tax and Capital Gains Tax repayments in 2009 are set out in Figure 88.

Figure 88 Sectoral Repayments, 2009^a

Sector	CT	CGT
	%	%
Real Estate, Renting and Business Activities	18%	40%
Wholesale and Retail Trade	13%	7%
Construction	7%	2%
Financial Intermediation	34%	2%
Manufacturing	22%	-
Agriculture, Hunting and Forestry	-	15%
Other Community, Social and Personal Service Activities	-	1%
Transport, Storage and Communications	2%	1%
Other	4%	32%
Total Value	€1,325m	€54m

Note:

- a The value of repayments treated as offset against other taxheads is not included in this Figure.

16.9 Four sectors accounted for 87% of all Corporation Tax repayments in 2009. These were Manufacturing, Financial Intermediation, Real Estate, Renting and Business Activities and Wholesale and Retail Trade.

16.10 While there is a considerable proportion of Capital Gains Tax repayments that Revenue has categorised under 'Other', it is clear that the Real Estate, Renting and Business Activities sector is the largest source of claims for repayment at 40%. Agricultural based activities account for a further 15% of repayments of Capital Gains Tax.

16.11 I asked the Accounting Officer for her observations on the trend in repayments generally and the particular factors at play in the case of Corporation Tax and Capital Gains Tax.

Views of the Accounting Officer

16.12 The Accounting Officer pointed out that repayments are an integral part of the workings of the tax system. Revenue's success in recent years in raising taxpayer's awareness of entitlements has increased the numbers seeking repayments. Businesses are also claiming repayments as often as they can for cash flow reasons. She said that while VAT and Income Tax account for by far the largest amount of repayments, the strongest driver of the overall increase in repayments as a proportion of gross yield has been the increase in Corporation Tax repayments.

16.13 The Accounting Officer stated that it can reasonably be assumed that overpayments of preliminary tax by companies that did not forecast the extent of the downturn and the pace at which the Irish economy was weakening was a major factor in explaining the high level of Corporation Tax repayments in 2007. The further increase in 2009 is a reflection of the impact of the recession with significant payments arising as a result of companies setting off losses incurred against profits of the previous period. She said that overpayments of preliminary Capital Gains Tax may explain some of the significant growth in repayments as a proportion of gross yield for that taxhead.

Audit Focus – Repayment Controls

Each year my audit of the Revenue Account examines the controls in place in relation to repayments and examines a sample of repayments. For 2009, a computer scan of the major taxheads where repayments occur was conducted and samples of matching records and possible duplicates were examined. While the audit found that a reasonable level of check had been carried out on repayments, it noted a number of overpayments and a decreased level of compliance checks in relation to payments of Tax Relief at Source.

Overpayments

16.14 A computer matching exercise carried out during the audit brought to light 15 cases where taxpayers who had dual registration for Income Tax and PAYE received a repayment for the same tax period under both registrations – a total of 30 payments. The duplicate amounts in question ranged from €1,040 to €7,800 and totalled €53,451.

16.15 The cases identified in the audit were only those that resulted in cash repayments in respect of the same circumstances under two tax headings. Since many computations are likely to be finalised without repayment in cases where the expenses are allowed in the course of computations, there is a risk that a much larger sum has been refunded by Revenue.

16.16 Payment is made automatically to a taxpayer where the amount to be paid falls below a certain limit¹²⁵ ('Autoapproval'). In most cases supporting documentation is only sought if the claim is selected for checking, either due to failing one of the system checks or random selection. Eight of the 30 payments exceeded that limit.

16.17 In one case a VAT registered trader received a repayment. The income from the trade was assessed on the spouse's Income Tax return. At the time of the repayment, there was Income Tax outstanding on the spouse's record.

16.18 As the circumstances underlying these cases suggested weakness in Revenue controls over repayments I sought the views of the Accounting Officer in relation to

- the circumstances giving rise to the repayments
- the controls in place to prevent such overpayments
- the controls in place to prevent repayments to taxpayers who have outstanding tax liabilities
- the extent of overpayments generally.

Views of the Accounting Officer

16.19 The Accounting Officer informed me that system controls ensure that a repayment, other than an unemployment repayment, cannot automatically take place in respect of a PAYE registration if the case is also registered for Income Tax. However, the system does allow automatic repayments to an Income Tax registration even where the case is also registered as a PAYE employee. The circumstances of the duplicate repayments in the 15 cases were

- in eleven of the cases the PAYE repayment took place before the case was registered for Income Tax and the taxpayer did not disclose the details of the repayment when the Income Tax return was filed
- in two cases the Income Tax repayment was made before the PAYE repayment but the system control did not prevent the second repayment as in both cases the Income Tax registration commenced and ceased on the same date
- in one case a PAYE unemployment repayment was made to the taxpayer who did not disclose the details of the repayment when he subsequently filed his Income Tax return
- in a further case the system control was not active because the taxpayer was only assessed for Income Tax periodically¹²⁶.

16.20 The Accounting Officer stated that Revenue is actively considering a development which would automatically record on the Income Tax record that a repayment had been made for the same year on the PAYE registration. This development is currently being costed and a decision on its implementation will be taken shortly. She added that in each of the cases identified, collection activity is underway to recover the amounts incorrectly refunded.

¹²⁵ Different limits exist for PAYE and self - assessed income tax.

¹²⁶ This is a taxpayer from whom an Income Tax return is not expected every year.

Repayments to Taxpayers with Outstanding Liabilities

16.21 The audit also noted six cases¹²⁷ where repayments were made in circumstances where it appeared tax was due to Revenue from the taxpayer but no offset had taken place. The particular circumstances of these cases were

- in four cases there was tax outstanding on the taxpayer's record which had been written off. Revenue write off procedures place a marker on the computer record of the taxpayer that has the effect of preventing further collection efforts. Should the circumstances in the case change, the marker is removed and collection efforts recommence.
- in one case the taxpayer received a refund of Vehicle Registration Tax (VRT) while amounts were outstanding for other taxes
- in the final case a non-resident taxpayer received a refund in December 2009 even though Revenue were aware in November 2009 of a liability in respect of share options.

Views of the Accounting Officer

16.22 In relation to the cases where repayments were made to taxpayers with outstanding tax liabilities, the Accounting Officer informed me that

- in the three cases where tax had been written off, the offset procedure does not take into account tax written off and in such cases manual intervention is required
- in the case involving a repayment of VRT, the regulations do not provide for offset against other tax liabilities in such cases

Extent of Overpayments

16.23 The Accounting Officer said that calculation of a reliable estimate of the extent of overpayments would involve computer analysis and manual checking of cases and work has commenced on this. However, based on an examination of a sample of cases, a rough tentative estimate of such overpayments would be of the order of €1 million each year. This is in the context of annual Income Tax repayments each year of over €3 billion.

Claims for Reliefs

16.24 All Revenue districts carry out assurance checking and verification programmes on claims as well as projects focusing on particular allowances and reliefs. Such claims may result in a repayment of tax or a reduction in the amount of tax payable. It was noted in the course of audit that PAYE reviews in Cork in 2009 found total underpayments of tax of €1.7 million, €0.4 million of this has been repaid with the balance being collected by reducing tax credits in future years. It was also estimated that a further €1.8 million would be recovered in 2010. Most of the cases reviewed related to claims for One Parent Family relief.

16.25 It was also noted that Revenue had investigated certain medical expenses claims in the Waterford District of the East South East Region in 2008. This investigation arose from intelligence that the District received in relation to spurious medical expenses claims by

¹²⁷ Two other cases arose where outstanding tax was under appeal at the time repayments were made. Revenue has stated that there is no basis for offsetting a repayment against tax under appeal until the appeal is determined or the matter is settled by agreement.

employees of some specific businesses. A total of 556 taxpayers were asked to submit supporting documentation¹²⁸ for claims, and 239 or 43% of these were found to have insufficient or invalid supporting documentation. The amount overclaimed was found to be €679,588 and refunds of €188,023 were withdrawn.

16.26 I asked the Accounting Officer for her best estimate of the extent of unwarranted recourse to medical expenses refunds across the country in the light of the findings in the East South East Region and the extent of reviews such as those conducted in Cork together with the results of the review activity.

Views of the Accounting Officer

16.27 The Accounting Officer stated that Revenue systems select cases for manual checking with a focus on higher risk repayments but also with some selected at random. The rules for selecting cases are currently being reviewed to ensure that an appropriate level of checking is in place. Revenue has developed analytical techniques to detect unusual patterns and trends in tax credit claim behaviour.

16.28 She said that it was not possible to make a national estimate based on the results of the project in the East South East Region as that project had a targeted approach. She informed me that an examination of medical expense claims in the South West Region based on a random selection of claims found that the number of invalid claims was 7%. Examination of medical expenses claims in the BMW Region resulted in 3% of claims examined being withdrawn while in the Dublin Region the level was 23%. Similarly, for One Parent Family credit the level of claims withdrawn in cases reviewed ranged from 9% in Dublin to 51% in Waterford. The Accounting Officer pointed out that care was needed in making comparisons between projects as they often have a different focus and some may be more intelligence driven than others. It also should be borne in mind that some taxpayers had their claims withdrawn by Revenue because they failed to respond to queries.

Tax Relief at Source

16.29 Certain expenses are relieved from tax at source and the relief is processed by the institutions to whom the expenses are payable. This principally arises in the case of mortgage interest relief and medical insurance relief. Payments are made each month to mortgage and medical insurance providers who credit each taxpayer's account with the relevant amount of relief. Included in Income Tax repayments in 2009, is €486 million in respect of mortgage interest Tax Relief at Source and €589¹²⁹ million for medical insurance Tax Relief at Source.

16.30 Revenue procedures envisage a programme of compliance visits to mortgage lenders and medical insurers to ensure that they are fully compliant with the terms of the schemes. In 2009, compliance visits were carried out to four of the ten medical insurers, including the three major insurers. Two mortgage providers were visited in 2009 to resolve issues identified through routine monitoring with one of these being visited on four occasions. In 2008, the focus of compliance visits to mortgage providers was on local authorities and minor lenders with six being visited.

¹²⁸ Taxpayers are not required to submit supporting documentation with claims but are required to retain such documentation for six years.

¹²⁹ €216 million of this amount is in respect of age-related health insurance credit.

16.31 I asked the Accounting Officer the reasons why so few visits in relation to mortgage interest relief had been undertaken by Revenue in 2009 and only a limited level completed in 2008. I also asked her, in the light of the limited number of visits undertaken, how she obtained assurances that the institutions concerned were applying the reliefs in a proper manner.

Views of the Accounting Officer

16.32 The Accounting Officer informed me that compliance visits form part of the arrangements for monitoring and ensuring compliance by lenders with the operation of the Tax Relief at Source system. Ongoing monitoring and ensuring compliance with claims procedures is the responsibility of a liaison officer assigned to each lending institution and medical insurer.

16.33 Between 2005 and 2009, 53% of the main lender loan book was the subject of compliance visits. In 2008, it was decided to focus on local authorities and minor lenders, as these had not previously been the subject of specific examination. The 2008 compliance visits covered about 20% of the minor lender loan book.

16.34 The Accounting Officer stated that as a result of the changes to mortgage interest relief introduced in the Supplementary Budget in April 2009, it was necessary to review all 564,000 mortgage accounts to assess eligibility. The compliance assurance from this review together with the limited resources available for compliance work in 2009 meant that the intended programme of compliance visits was not feasible and in fact would not have been an efficient use of scarce resources.

16.35 In 2007, a compliance unit was established to examine the risks associated with mortgage interest relief at the individual mortgage holder level. Up to the end of 2009, just over 17,000 cases had been examined.

16.36 The Accounting Officer said that she was satisfied that in view of the need to implement the changes arising from the Budget and the need to target scarce resources, Revenue had obtained an appropriate level of assurance as regard the correct application of tax reliefs granted at source. She said that this was particularly so in relation to mortgage interest because of the overall coverage of the compliance visit programme between 2005 and 2009 and the checks on all accounts necessitated by the changes in the Supplementary Budget.

Conclusion

The level of repayments as a proportion of gross receipts has increased from 15% in 2005 to 20% in 2009. While some changes in the relationship between repayments and receipts are to be expected in the current economic climate, it is important that Revenue identify the reasons for refunds.

A computer matching exercise identified instances of duplicate repayments. Follow-up work indicated that claims were being made for relief under both the Income Tax and PAYE systems. As the audit sample only extended to cases where identical amounts were paid more than once, the true level of incorrect claims may be higher. Arising from the overpayments identified on audit, Revenue has estimated that the overall level of such overpayments might be of the order of €1 million each year, though it would need to devise an evidence-based estimation method.

There appears to be scope for tightening up on repayments in instances where an existing liability simultaneously exists.

In addition, various Revenue reviews have identified invalid claims for reliefs which may not result in a repayment but in a reduced level of collection.

Chapter 17

Revenue

Loss Reliefs

Loss Reliefs

17.1 In line with practice in other OECD countries, Irish tax legislation makes provision for businesses that incur losses to offset those losses against taxable profits in certain circumstances and subject to certain conditions and restrictions. Provision is also made for certain losses to be carried back against previous year's profits¹³⁰ and carried forward against future profits.

Chapter Focus

The audit set out to establish

- the extent to which the loss relief provisions of tax legislation had been used by companies in recent years
- whether Revenue had identified the level of losses being carried forward and the likely effect of this on future tax collection
- whether there were significant differences between economic sectors in the occurrence of losses and in the extent to which losses are being carried forward.

It focused specifically on Corporation Tax.

Loss Relief Provisions – Corporation Tax

17.2 The figures quoted in the chapter are the amounts of losses claimed or used. The effect of loss relief on a company's tax computation depends on the rate of Corporation Tax applicable to the activities that generate the loss

- The standard rate of Corporation Tax of 12.5% applies to trading profits.
- Relief is available whereby trading profits from certain manufacturing and other activities are effectively taxed at 10%. This relief, commonly known as manufacturing relief, is being phased out and will no longer be available after 31 December 2010.
- Non-trading income is taxed at 25% as is trading income from 'excepted trades', which includes dealing in land and trading income from mining and petroleum operations.

Use of Loss Reliefs

17.3 In general, a company's trading losses can be offset against trading profits of the same accounting period or the preceding accounting period of corresponding length. Trading losses can also be set off against current and previous year profits of activities assessable at the 25% Corporation Tax rate but relief is given on a value basis¹³¹. Any unused losses can be carried forward against future profits of the same trade indefinitely but must be used against the earliest available profits. Group relief also allows one member of a group of companies to surrender its trading loss to another group member but only for the current accounting period i.e. losses carried forward or back cannot be transferred to other group companies. A trading loss incurred in the last

¹³⁰ Carry back of losses is only available to companies chargeable to Corporation Tax. It is not available to sole traders and partnerships where the persons are chargeable to Income Tax.

¹³¹ This ensures that the value of any loss relief allowed remains the same irrespective of the rates of tax that apply to the activities concerned.

twelve months of a discontinued trade may be carried back and set against trading income of the same trade in the three preceding years.

17.4 Losses incurred by a company from the rental of land or property in the State can be carried back for offset against rental income in the preceding accounting period or carried forward for offset against future rental income. Other non-trading losses can be offset against income of the same type in the same period or carried forward against future profits of the same type. Capital losses are not allowable against trading or non-trading income but may be offset against capital gains of the same accounting period or carried forward against capital gains in future accounting periods.

17.5 In order to deter late submission of returns, there are restrictions on the use of a number of reliefs including certain loss reliefs. Where a return is submitted late, the extent to which a loss can be used is restricted so that profits in any period are reduced by no more than 50% of the amount otherwise available, subject to a maximum restriction of €158,715. Where the return is less than two months late, the restriction is reduced to 25% or a maximum of €31,740. There is no restriction on carry forward of losses.

17.6 The transfer of a trade from one company to another constitutes the discontinuance of that trade and means that trading losses are not available for carry forward. However, unused losses of a trade that is transferred from one company to another may be used by that other company where it carries on the trade and an interest in the trade of not less than 75% is held by the same persons before and after the change. Carry forward of losses is disallowed if there is both a change in ownership and a change in the nature or conduct of the trade or if at the time of change of ownership, the trade carried on has become small or negligible. This latter provision is to counter the tax-avoidance device known as 'loss buying'.

Loss Relief Claimed

17.7 Companies are required to make their final Corporation Tax return nine months after the end of their accounting period. It is not until this return is made that information is available to Revenue on the extent to which losses have been incurred. For example, Corporation Tax returns for accounting periods ending December 2008 were required to be submitted by September 2009.

Trading Losses

17.8 Revenue provided details of trading losses included in Corporation Tax returns for accounting periods ending in 2007 and 2008 and these are set out in Figure 89.

Figure 89 Trading Losses – Corporation Tax Returns 2007 and 2008

	Accounting Periods ending in			
	2007		2008	
	€m	€m	€m	€m
Trading Losses in the Period				
Activities taxed at standard rate	13,774		16,500	
Activities eligible for 10% rate	207		882	
		13,981		17,382
Trading Losses Carried Forward from Earlier Periods				
Activities taxed at standard rate	5,433		11,185	
Activities eligible for 10% rate	420		510	
		5,853		11,695

17.9 On an aggregate basis, Revenue's computer systems do not generate data in relation to the amount of losses actually used in any year. Neither is there provision on Revenue's systems for recording details of losses unused and available for carry forward to future years. Therefore, while the amounts in Figure 89 show the trading losses that were included in the Corporation Tax returns in periods ending in a particular year as well as those carried forward from earlier periods, the extent to which relief for these losses has been obtained would not be available without further computer development work.

Trading Losses by Sector

17.10 The trading losses in each period and the amounts carried forward from earlier periods as shown in Figure 89 above are analysed by economic sector in Figure 90, which combines the losses from activities taxed at the standard rate with those taxed at the 10% rate.

Figure 90 Trading Losses by Sector 2007 and 2008

Sector	Accounting Periods ending in			
	2007		2008	
	Losses in Period €m	Losses Forward €m	Losses in Period €m	Losses Forward €m
Agriculture, Hunting and Forestry	102	69	145	64
Fishing	13	22	22	20
Mining and Quarrying	12	13	21	14
Manufacturing	1,569	579	1,465	762
Electricity, Gas and Water Supply	25	114	48	181
Construction	436	358	998	390
Wholesale and Retail Trade	497	596	841	553
Hotels and Restaurants	571	300	160	333
Transport, Storage and Communications	495	318	692	323
Financial Intermediation	8,815	1,546	9,024	5,777
<i>of which</i>				
State Guaranteed Financial Institutions ^a	27	0.5	355	–
Real Estate, Renting and Business Activities	1,120	1,705	3,710	2,992
Public Administration and Defence	16	2	7	1
Education	17	16	16	20
Health and Social Work	49	31	55	36
Community, Social and Personal Services	239	167	176	227
Activities of Households	–	–	–	–
Extra-Territorial Organisations	–	3	–	–
All Other Sectors/Unknown	5	14	2	2
All Sectors	13,981	5,853	17,382	11,695

Note:

- a Included here are institutions covered by the Credit Institutions (Financial Support) Scheme 2008 made pursuant to Section 6(4) of the Credit Institutions (Financial Support) Act 2008 and other companies within their group.

17.11 The impact of trading losses in 2007 and 2008 was greatest in the financial intermediation sector. Of the €8.8 billion trading losses in 2007 in this sector, 85% (€7.5 billion) related to three companies. Just over half of the €9 billion losses in 2008 arose in five companies. 90% of the €5.8 billion losses forward in 2008 refers to one company.

17.12 This sector includes the major financial institutions and included in the 2007 figures is a loss of €26.5 million in respect of one of the seven institutions covered by the bank guarantee scheme (the covered institutions). In 2008, the covered institutions, including companies within their group recorded losses in the period totalling €355 million in their Corporation Tax returns. As the data is for accounting periods ending in 2007 and 2008, it does not include losses incurred for periods ending in 2009 and 2010¹³². Losses in this sector for 2009 and 2010 are likely to be significant due to the impairment charges on loan assets. The losses before tax for the five financial institutions receiving support from the State as shown in each institution's latest available audited accounts are summarised in Figure 91.

Figure 91 State Supported Financial Institutions - Results per Audited Accounts

Financial Institution	Accounting Period	Profit (Loss) Before Tax €m	Prior Year Profit (Loss) €m
AIB Group	31 December 2009	(2,656)	1,034
Anglo Irish Bank Corporation Limited	31 December 2009	(12,829) ^a	784 ^b
Bank of Ireland	31 December 2009	(1,813) ^c	(23)
EBS Building Society	31 December 2009	(99)	(38)
Irish Nationwide Building Society	31 December 2009	(2,478)	(280)

Notes:

- a For 15 months ended 31 December 2009.
- b Prior year is year ended 30 September 2008.
- c For nine months ended 31 December 2009.

17.13 Further losses are likely to be recognised by these institutions in 2010 as loan assets are transferred to the National Asset Management Agency (NAMA) and additional impairment losses are recognised.

17.14 The extent to which these losses can be used to offset any future profits is restricted. The National Asset Management Agency Act 2009 amended the Taxes Consolidation Act 1997 to restrict the use of losses by participating¹³³ institutions in accounting periods commencing after the passing of the NAMA Act. The maximum amount of losses carried forward that can be used in each period is half of the excess of group trading profits over group trading losses for that period, so that a minimum of 50% of group trading profits will remain chargeable to tax in each period. This restriction effectively lengthens the period of time over which loss relief may be used by the participating institutions.

¹³² Corporation Tax returns are due to be submitted nine months after the end of the accounting period.

¹³³ There are five credit institutions participating in the NAMA scheme – three banks and two building societies.

Loss Relief on a Value Basis and Carry Back of Losses

17.15 The Corporation Tax returns also show the extent to which loss relief on a value basis was claimed as well as claims for carry back of losses to earlier accounting periods and group relief. The extent to which these reliefs were claimed for 2007 and 2008 is shown in Figure 92.

Figure 92 Claims for Loss Relief on a Value Basis, Carry Back of Losses and Group Relief for 2007 and 2008

	Accounting Periods ending in			
	2007		2008	
	€m	€m	€m	€m
Loss Relief on a Value Basis^a				
Activities taxed at standard rate	837		1,431	
Activities eligible for 10% rate	49		72	
		886		1,503
Claims for Carry Back of Losses		292		1,573
Claims for Group Relief		3,321		8,357
Total		4,499		11,433

Note:

- a The figures for loss relief on a value basis represent the amount of losses where a value limitation applies, not the total loss relief provided in the period.

17.16 Revenue has indicated that the amounts shown for loss relief in Figure 92 represent loss relief for use in the period. However, as the figures are from the tax returns submitted, they may be subject to change following processing and assessment in Revenue. Therefore, the overall amounts of these losses actually used in the period may be different.

17.17 A sectoral analysis of the loss relief on a value basis and claims for carry back of losses for 2007 and 2008 is set out in Figure 93.

Figure 93 Loss Relief on a Value Basis and Carry Back of Losses 2007 and 2008

Sector	Relief on a Value Basis		Carry Back of Losses	
	2007 €m	2008 €m	2007 €m	2008 €m
Agriculture, Hunting and Forestry	17	22	1	1
Fishing	4	5	–	1
Mining and Quarrying	3	5	–	2
Manufacturing	88	310	24	130
Electricity, Gas and Water Supply	4	12	–	1
Construction	136	313	41	167
Wholesale and Retail Trade	121	179	25	125
Hotels and Restaurants	62	59	2	6
Transport, Storage and Communications	93	96	4	31
Financial Intermediation	26	67	160	929
Real Estate, Renting and Business Activities	290	392	33	167
Public Administration and Defence	9	–	–	1
Education	3	6	–	1
Health and Social Work	4	7	–	1
Community, Social and Personal Services	24	28	2	10
Activities of Households	–	–	–	–
Extra-Territorial Organisations	–	–	–	–
All Other Sectors/Unknown	2	2	–	–
All Sectors	886	1,503	292	1,573

17.18 The use of loss relief on a value basis increased from €886 million in 2007 to €1,503 million in 2008. The sectors which were most affected were manufacturing, construction and the real estate, renting and business activities sector. Claims for offset of losses against earlier accounting periods increased by €1,281 million to €1,573 million between 2007 and 2008. 60% of this increase was in respect of companies in the financial intermediation sector.

Other Losses

17.19 Relief for rental losses can only be carried back or forward against other rental profits. The Corporation Tax return captures details of rental losses carried forward from previous accounting periods and these totalled €14 million in 2007 and €150 million in 2008. The extent to which these amounts have been used is not known.

17.20 Losses on disposals of capital assets in 2008 were €1.8 billion. Capital losses brought forward from previous periods were €1.2 billion and unused losses carried forward to future accounting periods totalled €1.6 billion. Capital losses may only be offset against capital gains.

Capital Allowances

17.21 For Corporation Tax purposes, capital allowances are allowed as a trading expense. A loss created or augmented by capital allowances is treated as a trading loss. Revenue provided data in relation to capital allowances claimed by companies for accounting periods in 2007 and 2008. The data was for companies who had recorded a loss. Details of the capital allowances for those cases are shown in Figure 94.

Figure 94 Capital Allowances for Companies incurring Losses, 2007 and 2008

	Accounting Periods ending in			
	2007		2008	
	€m	€m	€m	€m
Trading Activities Taxed at Standard Rate				
Industrial Buildings	29		43	
Machinery and Plant	501		942	
Miscellaneous	<u>49</u>	579	<u>69</u>	1,054
Trading Activities Taxed at 10% Rate				
Industrial Buildings	4		22	
Machinery and Plant	33		131	
Miscellaneous	<u>1</u>	38	<u>1</u>	154
Total		617		1,208

17.22 As these companies already had a trading loss in the period, the allowances will have the effect of augmenting the trading losses of those companies for the relevant accounting periods. They will increase the amount of losses available for carry forward to future accounting periods, to the extent that the losses are not

- offset against other trading profits, if any, of the same accounting period
- offset on a value basis against other profits of that accounting period
- carried back against profits of the preceding accounting period, or
- surrendered for group relief purposes.

Income Tax Loss Relief

17.23 Total Income Tax trading losses used in 2008 were €535 million. In addition, relief for trading losses of €557 million was not obtained in 2008 and these are available for carry forward to future years. Unused rental losses carried forward to 2008 from earlier periods for those liable to Self-Assessed Income Tax totalled €1.7 billion in 2008.

Views of the Accounting Officer

17.24 Revenue has commenced internal discussions to establish how best their processing systems for Corporation Tax can be adapted to produce aggregate data on the amount of losses used and carried forward by companies. In considering any enhancements, the competing demands for resources for other systems developments have to be borne in mind.

17.25 Revenue pays particular attention to the monitoring of losses in the very largest corporate groups and financial services companies dealt with in their Large Cases Division. Any exceptional potential tax impacts arising from losses in these cases – insofar as they can be determined from all available information, including discussions between Revenue and the groups – are taken into consideration as part of the forecasting process.

Conclusion

In the case of companies, the available figures indicate a growing trend in losses available for carry forward and this is likely to have increased further in 2009. Trading losses alone increased in 2008 by €3 billion to €17 billion and trading losses carried forward from earlier periods increased by €6 billion to €12 billion between 2007 and 2008. Available information for rental losses, losses on disposal of capital assets and unused capital allowances for companies recording a loss suggests that the aggregate amount of these losses being carried forward may exceed €2 billion.

While it is accepted that the impact of the loss overhang on future collection is difficult to forecast, it constitutes a material and growing potential tax offset that calls for further analysis and categorisation designed to model the predicted effect on revenue taking account of the financial positions of the major companies that account for the potential future claims.

In order to do this, Revenue would need to adapt its information systems to identify the losses that are used in a period and the extent to which they are carried forward to offset profits of subsequent periods or lost through non-claiming or discontinuance.

Chapter 18

Revenue

Performance Outcomes in Revenue

Performance Outcomes in Revenue

18.1 The Revenue Commissioners are responsible for having systems, procedures and practices that are adequate to secure an effective check on the assessment, collection and proper allocation of revenue. It is my responsibility to satisfy myself as to whether the manner in which the systems, procedures and practices have been employed and applied is adequate.

18.2 Achieving maximum compliance with tax obligations in a self-assessment system is a shared responsibility where conformance with tax law is a responsibility of the citizen while the tax authority has the responsibility and accountability for encouraging and enforcing compliance. A fundamental mark of the adequacy of Revenue systems is the capacity to evaluate performance through the compilation of relevant measures based on reliable information, especially in relation to tax compliance.

18.3 The key risks to a successful tax administration system are

- that taxable activity is not identified and pursued
- that the full amount of tax is not declared and collected from identified taxable activity.

18.4 In 2009, the net collection represented 20.3% of Gross Domestic Product (GDP) down 2.2% from 2008 levels and 4.7% since 2007. Over that period, tax collection fell by 30% while GDP reduced by 13.8%¹³⁴.

Chapter Focus

While recognising that Revenue produces a set of measures that record its output in terms of the tangible results of its assessment and collection activities the ultimate test of its effectiveness is the level of compliance by the taxpayers. The audit sought to examine the extent to which Revenue monitors those outcomes and publicly reports the results.

Compliance

18.5 Full tax compliance would be achieved if all those liable to tax paid the full amount of tax due on time. There are four basic tax compliance obligations

- to register for the taxes to which liable
- to file tax returns on time
- to correctly report all tax liabilities
- to pay taxes on time.

18.6 Only by measuring the level of compliance and tracking it over time can a judgement be made on whether compliance is improving or not. In doing so, it is desirable to distinguish measures that capture the overall level of compliance and those that relate to each of the basic compliance obligations outlined above.

¹³⁴ Change in GDP at current market prices from Quarterly National Accounts, Quarter 4 2009 and Year 2009 (preliminary) March 2010, Central Statistics Office.

International Comparison

18.7 An OECD Report in 2008¹³⁵, drawing on the experience of a number of tax administrations, examined possible measures and indicators¹³⁶ of compliance. In order to provide a systematic approach to monitoring and measuring compliance, the report encouraged tax administrations to develop a compliance-monitoring framework. The report notes that the different policy and legislative environments that tax administrations operate in should be borne in mind in interpreting the guidance provided.

18.8 A compliance-monitoring framework was defined as a strategy for monitoring compliance and evaluating the impacts of specific compliance improvement activities. A major component is a comprehensive set of compliance measures and indicators, and accompanying measurement methodologies, for each of the key compliance obligations of the major taxes administered by the tax administration. As well as enabling tax administrations account for their performance, such a framework assists in internal planning.

18.9 The OECD report refers to the work of some European countries including the Netherlands, Sweden and the United Kingdom, in developing an approach to monitoring compliance levels and trends. In some cases this includes estimating what is known as the 'tax gap'.

Measuring Tax Gaps

The tax gap is the difference between the amount of tax paid and the amount that would have been paid had all those liable to tax met all their compliance obligations.

Estimates of tax gaps can be based on 'top down' estimates or 'bottom-up' models or a combination of both. 'Top down' estimates use macroeconomic data from national accounts and data on consumption from surveys to estimate the total tax that should be collected. 'Bottom-up' models estimate components of the tax gap using data from internal sources such as surveys and operational data which is then extrapolated across the relevant population.

In countries where tax gap estimates are produced, the 'top down' approach is generally used for indirect taxes and the 'bottom-up' approach for direct taxes. Estimates of tax gaps for direct taxes generally focus on the components of the tax gap, such as type of non-compliance or type of taxpayer, rather than the total taxhead gap.

An example is the 2009 EU Commission report¹³⁷ on the VAT gap in the EU. The report was prepared for the Commission by an economic consultancy company and quantifies and analyses the VAT gap in each member state for the period 2000 to 2006. The study used a 'top-down' approach to calculate the theoretical liability from national accounts data and only used publicly available data. As well as fraud and evasion, the gap calculated includes legitimate tax avoidance measures and VAT not paid due to business insolvencies. The approach used does not allow the tax gap to be characterised in terms of identifying the sector, goods or type of business that are most susceptible to fraud. The VAT gap calculated for Ireland was 5% of the theoretical VAT liability in 2000, increasing to 7% in 2003 and falling each year until 2006 when it was calculated at 2%. The VAT gap for the EU-25 was estimated at 13% in 2000 and 12% in 2006.

¹³⁵ OECD, Forum on Tax Administration Compliance Sub-Group, Final Report, Monitoring Taxpayers' Compliance: A Practical Guide Based on Revenue Body Experience, June 2008.

¹³⁶ The term 'measure' is generally used where quantification of performance is possible. Indicators provide a less direct assessment of performance.

¹³⁷ EU Commission, Study to quantify and analyse the VAT gap in the EU-25 Member States, DG Taxation and Customs Union, September 2009.

Direct Compliance Measures

18.10 The OECD report identified the main measures of compliance used by tax administrations internationally and these are set out in Figure 95. That figure also provides an indication of whether those measures are used in Revenue.

Figure 95 Compliance Measures used Internationally

Compliance Component	Measure	Used by Revenue ^a
Registration	Percentage of businesses registered — number of taxpayers registered compared to independent data on the number of taxpayers from statistical authorities	X
Filing	Percentage of returns filed on time (or within a specified period of the due date) — the number of returns filed compared to the expected number of returns	√ ^b
	Non-filing tax gap — the total liability of late and non-filers minus the amount they pay	X
Correct Declaration	Percentage of overall tax liabilities correctly declared as measured by random audit programmes	X
Payment	Percentage of taxpayers paying on time	√ ^b
	Percentage of tax paid on time — amount of tax paid compared to the amount debited for a given period	√
Composite	Estimates of tax gaps for each tax	X

Notes:

a “√” denotes used in Revenue reporting and “X” denotes not used.

b Revenue do not report these measures separately but if they disaggregated the current timely compliance measure both of these measures would be available.

18.11 Revenue reports a timely compliance rate which is a composite measure that records the extent to which taxpayers submit returns or payments on time i.e. under this measure a taxpayer is considered to be compliant if either a return or payment is received in the due month (‘due month compliance’). Cases are also measured for returns or payments submitted one month after the due month (‘due month +1 compliance’). The rates are calculated by aggregating, within bands based on three case sizes (large, medium and other), the compliance rates for each taxhead on a weighted basis. The weighting is based on the annual yield for each taxhead, so greater importance is attached to compliance in the taxheads with the greatest yield. Rates are reported by case size category and show the ‘due month’ and ‘due month +1’ rates. The target compliance rates to be achieved by the end of 2010 and the actual rates for 2007 to 2009 are shown in Figure 96.

Figure 96 Timely Compliance Rates 2007 to 2009

Case Size	Due Month Compliance				Due Month + 1 Compliance			
	Target	2007 ^a	2008	2009	Target	2007 ^a	2008	2009
Large cases	95%	92%	92%	92%	99%	n/a	97%	96%
Medium cases	90%	86%	86%	85 %	95%	n/a	94%	93%
All Other cases	75%	68%	72%	72 %	85%	n/a	81%	81%

Note:

a The definition of case sizes changed in 2008. The comparative figures for ‘due month compliance’ in 2007 have been restated accordingly. Restated 2007 figures for ‘due month + 1 compliance’ are not available.

18.12 Despite an increase of over €800 million in the amount of tax outstanding between 2007 and 2009¹³⁸, the compliance rates for large and medium cases have remained virtually constant. The compliance rates for the other cases category have also remained constant since an improvement in due month compliance in 2008. This apparent anomaly underlines the risks associated with combining the two aspects of compliance (filing and payments) into one indicator.

Views of the Accounting Officer

18.13 The Accounting Officer informed me that the lack of reliable independent data and the existence of registration thresholds for certain taxes make it difficult to ensure a reliable registration indicator. She also pointed out that Revenue report the percentage of random audits that do not produce a yield.

18.14 In relation to the timely compliance rate, the Accounting Officer stated that, as a result of the economic downturn, the environment in which Revenue operates fundamentally changed in the latter part of 2008. Consequently, Revenue considers that the timely compliance rates currently being achieved, while not reaching target, represent positive outcomes. She also said that this measure is designed to give an overview of returns and payment compliance and therefore is not as sensitive to changes in its component parts as specific measures. Changes in the level of outstanding tax are separately measured by Revenue.

Indicators of Trends in Compliance

18.15 As well as direct measures of compliance, movements in compliance levels can also be monitored through correlation between changes in tax receipts and changes in external statistics. Ascertaining attitudes to compliance is also valuable in analysing compliance levels. The use of indicators by tax administrations internationally was collated in the 2008 OECD Report and the indicators available which might be appropriate in an Irish context are

- the number of companies registered for tax compared with the number registered with a corporate regulatory body
- the income of self-employed taxpayers reported to the tax administration compared with the amounts estimated by the Central Statistics Office
- percentage of net corporate income that was taxable
- the amount of tax payable as a percentage of corporate profits before tax
- the amount of income tax payable as a percentage of net income
- effective tax rates — the average amount of tax raised compared with net business income
- the proportion of returns that are assessed as being ‘at risk’
- ratio of outstanding tax to annual gross or net collection
- survey findings on attitudes to compliance
- growth of net VAT compared to growth of retail sales and personal expenditure.

¹³⁸

Amount of tax outstanding was €1,286 million at 31 March 2008 and €2,112 at 31 March 2010.

18.16 In this context, Revenue use and report on two of these indicators

- The ratio of debt available for collection¹³⁹ to annual gross collection. This ratio has increased from 1.4% in 2007 to 2.8% in 2009. Such an upward trend may indicate a decline in payment compliance and/or reduced efficiency and effectiveness in debt collection.
- Revenue conducts surveys that include questions designed to probe compliance behaviour.

Views of the Accounting Officer

18.17 The Accounting Officer stated that many of these indicators have limitations to which solutions must be found before they can be incorporated into a compliance-measurement framework. These limitations include the lack of reliable independent data sources for the number of tax liable companies. Another limitation which is identified by the OECD is the fact that changes in the relationships between incomes and profits from independent sources and what is reported on tax returns may reflect factors other than changes in taxpayers' compliance. She said that the countries that use many of these indicators operate different compliance regimes and have different revenue requirements to Ireland. Therefore, a study of the effectiveness, validity and robustness of these indicators would be necessary before their inclusion in an Irish compliance measurement framework.

18.18 In relation to the increasing ratio of debt to annual gross collection, the Accounting Officer does not consider that the efficiency or effectiveness of Revenue's compliance programmes has been reduced. She said that Revenue is working with viable businesses that are unable to meet their tax obligations due to the current economic environment. Revenue is fully committed to make the necessary decisions, including closing businesses that are not viable or that seek to deliberately evade the obligation to pay on time.

Opportunities to Improve Compliance Information

18.19 In measuring its performance, Revenue needs to clearly distinguish between the outputs of its activities and the impact of those activities as measured by changes in compliance. Revenue's current measures are predominantly focused on outputs. Revenue needs to develop a comprehensive set of measures and indicators sufficient to demonstrate performance in relation to each compliance obligation. Only by doing so can it demonstrate that to the maximum extent possible all relevant economic activity is captured for tax purposes and that it has discharged its responsibility to evaluate the effectiveness of its operations. Opportunities to improve compliance information are set out below.

¹³⁹

Debt available for collection is the portion of tax outstanding that is not the subject of a taxpayer appeal.

Determine the Audit Gap

18.20 There is an opportunity for Revenue to determine the audit gap¹⁴⁰ using the results of its random audit programme. So far Revenue has not made full use of the data derived from random audits. Currently, the numbers of yielding and non-yielding random audits are reported. While this is indicative of the number of persons who do not comply in all respects with their obligations, it is not useful as a measure of the extent to which tax is underdeclared. It should be relatively simple to develop an indicator of correct declaration by expressing the underdeclaration¹⁴¹ as a percentage of the original declared liability.

Disaggregate Timely Compliance Measure

18.21 Disaggregating filing and payment compliance would give a clearer view of performance for both activities. The timely compliance rate currently measures a case as compliant if either a return or a payment has been submitted. It is noticeable that at a time when many taxpayers are facing financial difficulties, this measure is remaining static while the overall level of tax outstanding is increasing. As an indication of performance this is misleading. Consideration should be given to disaggregating this measure into its component parts i.e. return filing compliance and payment compliance.

Estimate the Tax Gap

18.22 By measuring the tax gap and tracking changes in it, Revenue would be better equipped to assess the level of non-compliance. Thereafter, in order to tailor its responses to the collection challenge it would need to devise relevant reviews and studies designed to identify the underlying factors that contribute to non-compliance.

Indicators of Trends in Compliance

18.23 There is scope to identify changes in compliance through correlation between movement in tax receipts and changes in economic variables. In general, tax collection can be compared with GDP to derive a lead indicator of collection compliance. There are clearly many reasons why the historic relationship between GDP growth and tax receipts could arise, but differences between the two that are not readily explained might at least provide a tentative indicator of changes in collection patterns¹⁴².

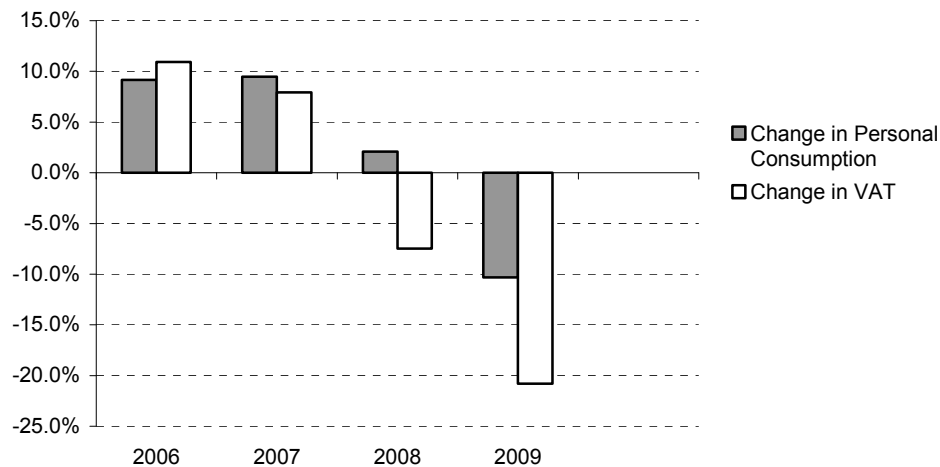
18.24 For instance, as VAT is a tax on consumer spending it would be expected that changes in the amount collected are closely related to changes in personal consumption of goods and services.

18.25 Figure 97 compares the percentage change in personal consumption of goods and services between 2006 and 2009 with the percentage change in net VAT receipts in the same period.

¹⁴⁰ The audit gap is a measure of the extent to which taxpayers have correctly declared their liabilities and is calculated as the difference between the amount of tax that would be collected if all taxpayers were audited by Revenue and the amount currently collected.

¹⁴¹ The amount of the underdeclaration may be different from the actual yield due to the fact that the audit settlement is an amount agreed between Revenue and the taxpayer as well as the fact that the agreed settlement may not be recoverable in all cases due to inability to pay.

¹⁴² While the focus of this chapter is on publicly reported performance information, it is acknowledged that Revenue has begun to include this indicator in its internal performance report.

Figure 97 Percentage Change in Personal Consumption^a and VAT 2006 to 2009

Note:

a Personal consumption of goods and services at current market prices from Quarterly National Accounts Quarter 4 2009 and Year 2009 (preliminary, March 2010, Central Statistics Office).

18.26 VAT as a percentage of personal consumption was 16% in 2006 but this fell to 12.6% in 2009. It would be useful to track changes in such relationships in order to prompt questions about the efficacy of the system in encouraging or enforcing compliance. It is accepted that a recession may lead to a shift in patterns of consumption towards lower rated or zero rated goods and services and as a result the fall in VAT may be greater than the fall in measured consumption. It could be useful to conduct studies into changes in consumption patterns and use the results as an aid to interpreting changes in these relationships.

18.27 A further potentially useful correlation would be between earnings as reported to Revenue¹⁴³ and the total wages and salaries estimated by the Central Statistics Office using its survey methodologies.

Survey Data

18.28 In addition to using compliance indicators, surveys can provide valuable feedback by helping to identify changes and patterns in compliance behaviour as well as the factors that influence behaviour. Revenue has, on a number of occasions in recent years, conducted surveys of taxpayers. In 2008, a survey of Small and Medium Sized Business Customers included questions designed to identify factors that influence compliance for this taxpayer group.

¹⁴³ Details of taxable income of each employee are provided to Revenue by the employer on the annual P35 return.

Conclusion

Revenue has responsibility for evaluating the effectiveness of its operations. This is best judged in terms of outcomes in the form of taxpayer compliance. Revenue does not have a well developed set of outcome focused measures and indicators of compliance.

Opportunities to improve compliance information include

- using the results of a systematic random audit programme conducted on the basis of representative sampling to measure the audit gap
- disaggregating the timely compliance measure to obtain separate measures of filing compliance and payment compliance
- measuring and tracking changes in tax gaps
- correlating movements in tax receipts with changes in relevant economic variables.

In the area of VAT which is directly linked to economic activity, Revenue might explore whether a comparison of trends in VAT collected and trends in measures of relevant economic activity such as consumer spending, could assist in identifying material changes in compliance. It is, of course, accepted that many factors will influence VAT collection such as shifts in patterns of spending and relative price changes across goods and services. However, such a comparison would be useful as an initial step in identifying areas for closer scrutiny using Revenue's compliance and audit powers.

It is recognised that measures and indicators, such as estimates of movements in the tax gap, only provide a starting point for the evaluation of performance and that many factors need to be considered to make the information more explanatory. Nevertheless, only by developing those measures and indicators can a comprehensive compliance measurement framework be put in place.

Observations of the Accounting Officer

18.29 The Accounting Officer stated that the distinction between output, outcome and impact is not always clearcut. She stated that Revenue has an extensive range of measurement systems and compliance evaluation methodologies that enable it to report on progress in improving taxpayer compliance. The measures in place cover a range of areas including collection, compliance, debt, audit and customer service. They provide an important input into the overall evaluation of performance and inform business and resource allocation priorities. She accepts the importance of enhancing Revenue's understanding of taxpayers' behaviour and the need to continue to enhance the measures in place.

18.30 She said that Revenue would consider disaggregating the payment and return compliance measure to determine whether it would deliver enhanced compliance reports. She has some concerns that doing so may not reflect the positive compliance dimension where a taxpayer submits a return and pays as much as possible in a situation where there are cashflow problems. Such problems need to be distinguished from deliberate non-engagement.

18.31 The Accounting Officer considers that although tax gaps can be useful indicators of overall trends, they are not suitable to track or isolate individual factors that give rise to movement in the gap. Measuring tax gaps would require considerable resources. Revenue is, however, exploring other methods of tracking VAT changes over time and against trends in other variables. Ireland is one of the member states that has expressed doubts about the methodology used in the EU study of VAT gaps.

18.32 Revenue has begun to do some research in linking economic variables to changes in tax collection. Preliminary work has been carried out to assess changes in VAT and excise with changes in retail sales data from the Central Statistics Office. The Accounting Officer said that the problem that arises with all such work is that it identifies divergences between tax collection and economic variables but it cannot explain the divergences because they tend to be multifactorial. A comparison of the overall trend in VAT collected and the amount that would be collected if VAT were applied to all consumption (known as the VAT Revenue Ratio) is also being examined.

18.33 The Accounting Officer noted the usefulness of surveys of taxpayers and said that they offered a unique insight into taxpayer behaviour and attitudes not otherwise available.

18.34 The Accounting Officer said that Revenue has measures in place under two of the four compliance components and part of a third one and sees value in developing these further. A project has commenced which seeks to measure changes in overall compliance behaviour based on tracking changes in risk scores. In addition, Revenue is examining models that will map its main inputs and outputs, describe the impact of those outputs and determine intermediate outcomes.