



ENTRUST Compliance Inspection Risk Model

October 2017

1. Introduction

- 1.1 This report details the outcome of our consultation exercise on the operation of ENTRUST's compliance risk model.
- 1.2 This consultation sought stakeholders' views upon:
 - Our overall approach to the compliance risk model;
 - Individual indicators used in the compliance risk model; and
 - Opportunities for change and improvement.
- 1.3 We consulted on the operation of our compliance risk model between May 2017 and July 2017.
- 1.4 As part of the consultation exercise we ran a sounding board event on 23 May 2017 attended by eight EBs and a member of the ENTRUST board. Further meetings were held with EBs who were unable to attend the sounding board event.

2. Background

- 2.1 ENTRUST has a statutory responsibility to ensure LCF monies are spent compliantly under the Terms of Approval with HMRC and the Landfill Tax Regulations (1996) (Regulations). To achieve this objective we operate a 'cradle to grave' regulatory framework, which includes a risk-based approach to compliance.
- 2.2 The compliance risk model is reviewed and updated on a regular basis in response to stakeholder feedback, current or emerging issues raised by HMRC and our experience of compliance reviews. Feedback in 2017 highlighted a concern among EBs about the operation of the model and in particular the need to carry out annual compliance visits.
- 2.3 In response to stakeholder feedback the 2017-2020 corporate plan incorporated a plan to review the risk model:

"Following feedback from stakeholders in 2016/2017, during 2017/2018, we plan to consult with stakeholders on the operation of our compliance risk model to ensure that it continues to provide sufficient and accurate information to allocate our limited resources to the delivery of our statutory assurance role."

3. Summary of feedback

- 3.1 The following feedback regarding the risk model was received during the sounding board event and meetings held with other EBs:
 - Overall annual compliance visits were not considered to be unnecessarily onerous however a small number of larger EBs did question whether they should receive annual compliance visits despite having previously had no non-compliant findings.

- The transparent explanation of the basis and detail of the risk model used by ENTRUST was welcomed. The sharing of the risk model and profile of risk scores was welcomed and this should continue to be available.
- The current risk indicators used were appropriate in determining the risk to EB compliance with the Regulations, and it was noted that the focus was on the Regulations and addressing non-compliance and breaches and that ongoing review and improvement was in place.
- Specifically in relation to indicators the following points were made:
 - Indicators now acknowledge where an EB has improved over time;
 - Number of non-compliant recommendations which remain unaddressed should be taken into account;
 - The indicators should, where appropriate, be based on percentages rather than actual figures (e.g. administration costs);
 - The indicator for uncommitted funds should be weighted more highly; and
 - Additional indicators concerning the level of unspent funds and value of project expenditure should be considered.
- A self-assessment approach for larger EBs or funding EBs might contribute to the overall EB risk assessment and reduce the need for compliance reviews.

3.2 Further to feedback on the risk model suggestions were also made for the improvement of the compliance inspection process:

- The way in which compliance reviews are carried out could be reconsidered to take advantage of many larger EBs now holding more data electronically. Access to these systems remotely by the inspector could reduce the need for site visits.
- EBs would welcome more detail, when being notified of a visit and in compliance reports, on the focus and priorities of the review, why the review was carried out and their risk score/profile.
- Benchmarking data that is being developed for the sector by ENTRUST to cover levels of unspent/uncommitted funds, administration costs and LOs' requirements for Contributing Third Parties (CTPs) are welcomed. It was further suggested that use of quartiles as well as percentage of EBs would be a useful presentation of the benchmarking data and as part of inspection. Further benchmarks were suggested for consideration:
 - Risk scores;
 - Number of non-compliant findings; and
 - Level of contributions/income.

4. Recommendations

4.1 After taking into account the feedback received from stakeholders the following recommendations were made to improve the operation and transparency of the risk model:

- We will further review all scores and weightings in light of the reduction in the size of the fund, for example some indicators contain bandings of level of contribution which are now too high;
- The risk model review has in part been initiated in response to larger EBs suggesting that they are not the highest risk and that level of funds received should not be highly weighted, instead we will further review additional indicators for unspent funds held and related project expenditure levels where these indicate that the EB is not distributing funds in a timely manner;
- We will consider whether application of percentages rather than absolutes to risk indicators, e.g. on administration levels can be developed within ENTRUST Online (EOL) or used as a secondary measure at allocation of review stage;
- We will review our approach and focus on Control Framework Inspection (CFI) reviews to consider the implications and impact of:
 - If no non-compliant or guidance findings are raised at a CFI inspection in one year, the CFI inspection will not be repeated in the following year. This means that large EBs may not automatically receive an annual CFI inspection where there are no issues identified so processes will not be repeatedly reviewed. However, project compliance reviews may still be undertaken at any time to ensure that appropriate sampling of the outcome of processes are assessed. This will reduce the time needed at visits to the larger EBs where no issues have been identified with processes and will still ensure effective levels of assurance can be achieved with minimal disruption to the EB; and
 - More reliance is placed on previous compliance work so that if a CFI review is required the following year, then governance questions will be addressed on an exception basis rather than asking the same questions each time, i.e. focus on reviewing what has changed and not re-reviewing what remains in place.
- We will consider how a self assessment process could feed into the Risk Model or compliance inspection process, without placing an onerous administrative burden on EBs and adding to EB running costs. There is potential for a self assessment approach to reduce the frequency of compliance inspection visits, this will need to be balanced by the additional requirement for EBs to complete the assessment and this type of approach has been previously rejected by EBs, following our recommendation as part of our response to HMRC's consultation on reform of the LCF.

5. Outcomes

- 5.1 Following consideration of the feedback received from stakeholders the above recommendations were made to improve the operation and transparency of the risk model. The recommendations were accepted by the ENTRUST Board in July 2017.
- 5.2 The additional risk indicators based on project data have been introduced. These additional indicators had not been fully tested in time for the 2017/2018 Quarter 3 and Quarter 4 allocations. However, the revised risk scores will be reviewed on implementation and any significant changes to an individual EB's risk score arising from the new calculations will be accommodated within the 2017/2018 compliance schedule.
- 5.3 All scores and weightings within the Model have been reviewed in light of the reduction in size of the LCF. Changes to the bandings and scores of four of the risk indicators have been made.
- 5.4 The number of recommendations raised at previous CFI reviews is now considered when planning compliance inspection schedules and was introduced for the allocations for the second half of 2017/2018. This has resulted in five of the larger Distributive Environmental Bodies (DEBs) scheduled for review during Quarters 3 and 4 of 2017/2018 which would previously have been considered for CFI reviews, being allocated for project compliance reviews as no non compliant issues were identified at the previous CFI review.
- 5.5 The use of percentage values within the Model has been considered, however, this would require considerable development to programme EOL to calculate the percentage values and this is not considered to be cost effective.
- 5.6 A self assessment process for EBs has also been considered, however in the current climate it is considered that this would place an onerous additional administrative burden on EBs at a time when they are being asked to reduce running costs. Additionally, this approach was suggested during HMRC's consultation on reform of the LCF during 2015/2016 and rejected by EBs.
- 5.7 Consideration has been given to the amount of risk information which should be publicised to EBs via the ENTRUST website and individual EB compliance reports. It was agreed at the consultation exercise that an individual EB's risk score could be included in the EB's compliance report and has been introduced to all compliance reports issued from October 2017.
- 5.8 The whole Model specification has been published without compromising the integrity of it as the indicators are based on EB activity and even though EBs will be aware of how their risk score is calculated, there is very little scope for EBs to be able to engineer a lower risk score. The definition, banding, score and weighting for each risk indicator within the Model has been published. The current specification is attached at Appendix A.

- 5.9 As part of the proposed wider benchmarking exercise, a review of the EB risk scores as at August 2017 has been carried out. The benchmarking data for risk scores will be based on two criteria:
- Risk score by quartile; and
 - Banding of risk score.
- 5.10 Compliance procedures are reviewed on a regular basis and a number of changes to the Compliance inspection workbook and recommendation database were introduced for 2017/2018, following the reduction in size of the Compliance team. It is planned to carry out an in-year review with the compliance inspectors to assess the impact of these changes. The additional action arising from the Model consultation exercise which was to consider if greater use can be made of information held to reduce the level of documentation requested at CFI reviews will be included in this review.

ENTRUST
October 2017

EB Risk Model specification – September 2017

Appendix A

Risk Model Indicators	Risk Definition	Interval	Score	Weighting	Max Value
Non-reconciled Annual Returns	Number of Annual Returns at 'non-reconciled' status on EOL for previous 6-years	0	0	100	2000
		1	1	100	
		2	5	100	
		3	10	100	
		4+	20	100	
Non-compliant recommendations	Number of non-compliant recommendations raised at previous compliance review	0	0	100	2000
		1	1	100	
		2	3	100	
		3	5	100	
		4	10	100	
		5+	20	100	
Lateness of Annual Returns	Number of Annual Returns submitted after 28 April during previous 6 years	0	0	60	6000
		1	10	60	
		2	30	60	
		3	50	60	
		4+	100	60	
Lateness of reporting contributions	Number of Form 3s submitted over the 7 day requirement during previous 12 months	0	0	80	8000
		1	10	80	
		2	30	80	
		3	50	80	
		4+	100	80	
Assets purchased	Value spent on assets within previous 12 months	£0 to £10,000	0	50	500
		£10,001 to £100,000	2	50	
		£100,001 to £200,000	5	50	
		£200,001 to £300,000	7	50	
		>£300,000	10	50	

Lateness of reporting EB transfers	Number of Form 7s submitted over the 7 day requirement during previous 12 months	0	0	30	3000
		1	10	30	
		2	30	30	
		3	50	30	
		4+	100	30	
Administration costs	Value of EB administration costs reported on previous Annual Return	<£500	0	80	1600
		£501 to £5,000	1	80	
		£5,001 to £10,000	2	80	
		£10,001 to £20,000	3	80	
		£20,001 to £50,000	5	80	
		£50,001 to £100,000	10	80	
		£100,001 to £500,000	15	80	
		>£500,000	20	80	
Time since previous compliance review	Number of months since previous compliance review	<12	1	100	400
		13 to 24	2	100	
		25 to 36	3	100	
		>37	4	100	
Total funding – contributions received	Value of contributions received during previous 6 years	<£1,000	0	100	5000
		£1,001 to £50,000	2	100	
		£50,001 to £100,000	5	100	
		£100,001 to £500,000	7	100	
		£500,001 to £1m	10	100	
		>£1m to £5m	20	100	
		>£5m to £10m	30	100	
		>£10m to £20m	40	100	
		>£20m	50	100	
Total funding – transfers received	Value of transfers received during previous 6 years	<£1,000	0	100	5000
		£1,001 to £50,000	2	100	
		£50,001 to £100,000	5	100	
		£100,001 to £250,000	7	100	

		£250,001 to £500,000	10	100	
		£500,001 to £1m	20	100	
		>£1m to £3m	30	100	
		>£3m to £5m	40	100	
		>£5m	50	100	
Committed funds	Value of funds committed to projects approved by ENTRUST on previous Annual Return	<£1,000	0	50	500
		£1,001 to £25,000	1	50	
		£25,001 to £50,000	2	50	
		£50,001 to £100,000	3	50	
		£100,001 to £150,000	7	50	
		>£150,000	10	50	
Un-committed funds	Value of funds not committed to projects on previous Annual Return	<£25,000	1	80	4000
		£25,000 to £50,000	3	80	
		£50,001 to £100,000	7	80	
		£100,001 to £250,000	10	80	
		£250,001 to £500,00	20	80	
		£500,001 to £1m	30	80	
		>£1m – £3m	40	80	
		>£3m	50	80	
Completed projects	Number of projects completed within the previous 6 years	1 – 5	20	50	1000
		6 – 20	10	50	
		21 – 100	7	50	
		101 – 300	5	50	
		>300	1	50	
Value of completed projects	Total value of LCF expenditure on projects completed within the previous 6 years	£1 – 10,000	1	40	800
		£10,001 – 50,000	10	40	
		£50,001 – 100,000	20	40	
		£100,001 – 500,000	7	40	
		£500,001+	5	40	