

## Due Diligence Processes

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### Who is this for?

This guidance is of immediate concern to members who hold HMRC excise authorisations, such as registered consignee, commercial importer, tax representative, WOWGR, distilling, compounding, rectifying and excise warehousing and wholesaler registration (AWRS).

It is also relevant to those who trade with such businesses, as it illustrates the standards to which excise traders have to work and in turn the standards they will expect of their business partners.

This guidance will be updated periodically.

It is intended to be read in conjunction with a due diligence policy, setting out the business' approach to due diligence and risk. Members are advised to develop a policy setting out the checks they will make and the criteria they will adopt before deciding to do business or continuing to do business with a trading partner.

### Introduction

As part of the Due Diligence (DD) requirement in the various excise regimes (AWRS, WOWGR, excise warehousing), businesses will find it necessary to carry out due diligence checks on existing and proposed customers, suppliers and contractors. This is also important from an anti-money laundering perspective.

Failure to demonstrate due diligence may lead HMRC to conclude that a business poses a risk to the revenue and not "fit and proper" for the purpose of excise legislation, which may lead to restrictions or conditions being imposed and, ultimately, to the withdrawal of authorisations, financial penalties, prosecutions and the seizure of stock.

This guidance considers the checks that parties may wish to carry out before and during their trading relationship, because the full due diligence process will be unique to each business and each transaction. For example, companies will develop their own forms for recording and managing trading partners, for assessing risk and for considering what needs to be assessed for each relationship and/or consignment of goods.

This guidance is intended as an example of what businesses might do on each occasion when conducting checks. It is not, however, exhaustive, as the circumstances of each business relationship and transaction will vary.

HMRC's own due diligence guidance refers to the FITTED process, which for completeness is set out in the Annex to this guidance.

## Detail

The process falls into three parts:

1. Obtaining information directly from the proposed trading partner. This may be face to face, over the telephone, or through submission of a hard or soft copy form. The details of the inquiry will by definition be known to the proposed trading partner.
2. Making independent checks to corroborate or supplement the information provided by the proposed trading partner. Although proposed trading partners may be aware of this in general terms (and may have consented to some checks being made) they will not be aware of the timing of the checks or the responses received. Some checks may be entirely invisible.
3. Analysis of the information provided – this will be invisible to the proposed trading partner and is probably **the most critical part** of the exercise. HMRC are clear that they expect to see businesses appraising the information they receive critically, in order to decide whether a particular trading partner or transaction is suitable.

Similarly, business will readily identify different types of trading partner. This might be expressed as the product of a number of variable factors:

	Length of trading relationship	Length of establishment of trading partner	Corporate stability	Consistency of order	Financial record
<b>High</b>	New and untested	New to the market; limited history; unknown key personnel	Erratic/frequent changes of personnel, business model, ownership or address	Highly volatile	Frequent credit control or solvency worries
<b>Medium</b>	Relatively recent	Relatively recent	Mixed picture, with varying levels of communication of change	Mixed picture, with some variations needing better explanation	Some ups and downs; resolved by discussion
<b>Low</b>	Long and well established	Long and well established Reputable UK business	Stable & predictable – changes well-flagged and explained	Regular and consistent, with fluctuations in volume and products easily explained	Highly reliable, prompt and consistent

## Information that will be sought from a proposed trading partner

This table sets out different categories of information that might be sought. It is not exhaustive and in some cases particular items will not be necessary. That will depend on the assessment of the degree of risk posed by a particular trader or trade.

Category of Information	Particulars	Read-across to FITTED criteria & comment
Particulars of ownership	<ul style="list-style-type: none"> <li>Registered Name</li> <li>Trading Name</li> </ul>	Identity
Registered office	<ul style="list-style-type: none"> <li>Address</li> <li>Company Reg. No.</li> <li>Copy of Certificate of Incorporation required</li> <li>VAT No.</li> <li>Copy of VAT Registration Certificate required</li> </ul>	Identity
Directors	<ul style="list-style-type: none"> <li>Full names of all directors and proof of identity of at least one director</li> </ul>	Identity  Comment: Excise Notice 2002 does not require passport and utility bill checks as a matter of course
Invoice address – (only if different to registered office)	<ul style="list-style-type: none"> <li>Address</li> <li>Email address</li> <li>EDI</li> </ul>	Identity
Accounts payable contact details	<ul style="list-style-type: none"> <li>Contact Name</li> <li>Telephone No.</li> <li>Fax No.</li> <li>Email Address</li> </ul>	Identity and Financial Health
Statement address – (only if different to invoice address)	<ul style="list-style-type: none"> <li>Address</li> <li>Fax Number</li> <li>Email Address</li> </ul>	Identity and Financial Health

Category of Information	Particulars	Read-across to FITTED criteria & comment
Delivery address(es)	<ul style="list-style-type: none"> <li>• Address(es)</li> <li>• Contact Name</li> <li>• Telephone No.</li> <li>• Fax No.</li> <li>• Email Address</li> </ul>	Identity and Terms of Contract
Bank details (all on company headed paper)	<ul style="list-style-type: none"> <li>• Bank Name</li> <li>• Bank Address</li> <li>• Sort Code</li> <li>• Account No</li> <li>• IBAN</li> <li>• Swift</li> <li>• Currency</li> </ul>	Financial Health
References (at least two, one trade and one financial)	<ul style="list-style-type: none"> <li>• Name</li> <li>• Address</li> <li>• Telephone number</li> <li>• Email Address</li> <li>• Length of trading relationship</li> <li>• Detail of comments</li> </ul>	Identity and Financial Health
Excise trader details	<ul style="list-style-type: none"> <li>• Excise/Tax Warehouse No.</li> <li>• WOWGR authorisation</li> <li>• Wholesaler Registration number or confirmation of date of application</li> <li>• AEO/EORI details</li> </ul>	Identity and Financial Health
Warehouse contact details	<ul style="list-style-type: none"> <li>• Contact Name</li> <li>• Telephone Number</li> <li>• Fax Number</li> <li>• Email Address</li> </ul>	Identity and Terms of Contract
Authorised warehouse keeper details	<ul style="list-style-type: none"> <li>• Company Name</li> <li>• Address</li> <li>• Warehouse Keeper Number</li> <li>• Telephone Number</li> <li>• Fax Number</li> <li>• Email Address</li> </ul>	Identity and Financial Health

In addition, members will want reassurance about the terms of the contract, the identity and provenance of the goods and transport/warehousing /3PL arrangements. Again, these will be highly variable from case to case.

Proposed trading partners may also be asked to sign a declaration in the following terms or similar:

I/WE DECLARE THAT:

1. I/we have read and agree to the [ ] Terms & Conditions of Sale.
2. The answers to the above questions are complete, true and accurate in all respects.
3. For goods supplied under bond, I/we undertake to receipt the goods' movements within EMCS system no later than 3 months of despatch to us by [ ], and we hereby indemnify [ ] for i) all and any costs it incurs in relation to excise duty and import VAT assessments raised by HMRC against [ ] for goods not receipted as described in this undertaking and ii) all and any other costs that [ ] may incur that relate to our non-compliance with this undertaking.
4. For goods supplied for export outside the UK, I/we undertake to provide original signed shipping documents (e.g. original Bill of Lading) or transport documents (e.g. signed original CMR) to [ ] within 3 months of despatch to us by [ ], and we agree that a failure by us to comply with this undertaking will result in [ ] issuing VAT invoices for the goods supplied and such invoices shall be paid by us to [ ] in full and in cleared funds within 2 business days of the date of such invoice.
5. The undersigned is duly authorised to sign this Customer Account Application Form and make the above declarations for and on behalf of the Applicant.

## Managing Confidential Information

It may be that some relationships or transactions will depend for their credibility on commercially sensitive information, such as the profit to be expected by the proposed trading partner. It may be unrealistic (and perhaps unlawful in terms of competition law) to expect this information to be shared. There may be a role for third party providers who can be tasked to obtain such information confidentially and report a conclusion to the enquiring partner, without breaching commercial confidentiality.

The WSTA has secured the services of a pool of such providers, with expertise in audit and customs issues and who can offer favourable rates. Members may, of course, prefer to use their usual auditors or third party providers.

## Analysis of responses

This step is probably the most important, as it requires the responses received to be assessed by the business as part of the wider due diligence process. It is likely that

businesses will want to create some internal checks and balances, to ensure that there is a degree of independent scrutiny in each case.

Where information is not provided or is unavailable or it is unrealistic to obtain it, the impact of that absence will form part of the risk analysis for that relationship or transaction. The absence of information, however, is not necessarily fatal to the decision to trade. It may influence the terms of trade or the frequency of review of trading terms, perhaps in relation to volume, credit terms or indemnities.

## Record keeping

As well as having a clearly documented policy and process, businesses should consider having records of:

- Roles and responsibilities for specific staff within the process;
- A record of each due diligence exercise that has been carried out on prospective trading partners and on specific transactions, with a reasoned outcome in each case;
- A review schedule for each trading partner with a rationale for that schedule;
- Lessons learned from specific due diligence appraisals or reviews.

Records will need to be kept and scheduled for destruction in accordance with the Data Protection Act 1998 and each business' individual DPA registration.

## Inquiries by proposed trading partners

Businesses with which members deal may be subject to similar processes, or may undertake them for their own purposes. This is to be expected and for a partner to omit to do so might in itself raise concerns about their diligence, competence or probity.

Businesses should expect to be asked similar questions to the ones set out above and may decide to prepare a standard information package that they will provide.

We have already seen instances of a number of businesses asking trading partners to submit due diligence disclosure packages.

## Frequency of Inquiries

It is to be expected that parties entering into a new relationship will wish to carry out a full due diligence exercise.

Where companies have been in a business relationship for some time, the process may need to be refreshed to ensure that the relationship still has all the appropriate

characteristics. It is not unknown for fraudsters to “groom” target businesses and replace honest directors or senior managers with dishonest ones.

It is suggested that all relationships should be reviewed at least annually and on the occurrence of a significant event, such as a takeover or the appointment of new executive directors or senior staff. It is also suggested that members should set a specific review schedule for each company they trade with.

## Conclusion

This topic will continue to develop and evolve. There is a challenging balance between legitimate commercial risk and risky trading. The WSTA would be very interested in hearing from members about how HMRC views due diligence in practice and how it interprets legitimate risk in commercial decisions.

Such feedback will inform future versions of this guidance and discussions with HMRC about how it implements this legislation.

## Annex

### FITTED process, from HMRC due diligence guidance

#### **Financial health of the company you intend trading with**

- There are no, or poor, credit ratings but is still able to finance substantial deals
- There are high levels of debt
- They are buying high value goods on extended credit
- They are a new company with little or no trading history
- There are little or no fixed assets

#### **Identity of the business**

- There is a lack of detail about the business' identity, e.g. no address details, or HMRC approval number
- They do not appear to be on Companies House records as originally described
- They are dealing in high value goods from short term lease accommodation and/or residential addresses
- There is no general visibility of the company you intend trading with for example, they do not appear to advertise or have a website
- They have returned only partly completed application or trading forms
- If you are a warehousekeeper, receiving duty suspension goods on behalf of a third party who is not WOWGR registered where they would otherwise be required to be registered

#### **Terms of contract, payment and credit agreements**

- An insistence on dealing in cash, especially where the deal is a high value one
- Cash payments made using money couriers
- Offers of credit appear to be outside normal business practice. Payment terms are normally 21, 31 or 45 days, high risk transactions may have short payment terms e.g. 48hrs
- You are asked to make payment to an account or person which does not appear to be linked to the seller, or other unusual payment arrangements requested by the seller. The same applies to customers.
- A valid pro-forma or purchase invoice is not/will not be provided
- The circumstances of the trading arrangement seem false or contrived. For example, a supplier provides you with the details of a customer for the goods he is selling to you, or offers you a contract with no financial loss to you.

#### **Transport**

- The goods are to be received from an unusual source or supply route, for example, UK produced goods are sourced from another country and directly compete with those from a more direct supply route

#### **Existence/Provenance of goods**

- The goods are claimed to be duty paid but your supplier (or person on whose behalf you are storing the goods) cannot provide reasonable evidence of duty payment to support the status of the goods. (For further detail about what constitutes evidence of duty payment please refer to our Drawback Notice 207)
- Individuals in the company have little knowledge of your trade sector
- Where samples are provided or the goods have been received,
- for spirits there is no duty stamp in circumstances where there should be one or the duty stamp does not fluoresce on goods received (refer to guidance)
- the goods appear counterfeit, in that, the quality of labels and or packaging is poor when compared to the genuine article
- the supporting paper work seems false
- the goods are older than supporting evidence (such documents demonstrating duty payment) suggest, for example, the best before dates indicate an earlier production date whereas documentation gives the impression you were buying newer stock.
- The company has only been trading for a very short period of time but has managed to achieve a large income in that short period of time

## **Deal**

- Customer demand for specific brands in other countries exceeds expected levels of consumption there
- The goods are to be moved in an unusual supply route that in itself would add significant logistic costs and bring into question the economics of that trade (unless duty was to be evaded)
- Supplies are offered via unsolicited emails/flyers received out of the blue
- Goods are offered at incredibly low prices which seem too good to be true
- Free gifts of similar or other excise goods not fully documented and in themselves would place a question over the deal as a whole
- There are other incentives such as contingency discounts which overall make the deal sound too good to be true