
Department for Work and Pensions Resource Accounts 2004-05

Report by the Comptroller and Auditor General

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DEPARTMENT FOR WORK AND PENSIONS RESOURCE ACCOUNTS 2004-05

Report by the Comptroller and Auditor General

Introduction

1. In its consolidated resource accounts, the Department for Work and Pensions accounts for expenditure of £118.7 billion on a wide range of benefits, employment programmes and the associated administration costs, together with its assets and liabilities at the year-end.
2. In 2004-05, I began the rollout of an enhanced financial audit strategy for the audit of the Department's financial statements. My main motivation in doing this was to assist the Department in addressing some of the long standing problems which have led to qualification and to improve the scoping and disclosure within the published accounts so as to focus attention on the barriers to long term improvement. The audit strategy also aims to assist the Department in achieving common goals, for example faster closing and the identification of efficiency savings.
3. I am pleased that the Department has already achieved some positive results including the resolution of the underlying problems which had led to last year's qualification for missing Incapacity Benefit case files, and accelerated audit and accounts clearance processes across the consolidated group of accounts. I also welcome the Department's improved payment accuracy disclosures, which should serve to enhance the transparency of the problem areas underlying the longstanding qualification.

Audit Opinion

4. I have, nonetheless, qualified my opinion on the accounts on four specific issues:
 - i. Substantial levels of estimated losses from fraud and error in benefit expenditure recorded in the operating cost statement. I provide full details, including commentary on the Department's enhanced payment accuracy disclosure in paragraphs 7 to 27.
 - ii. Material uncertainties over contributory and non-contributory benefit customer overpayment debtors. Details are discussed in paragraphs 28 to 32.

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- iii. A significant limitation in the evidence made available to the National Audit Office during the audit of other Social Fund debtors. Details are discussed in paragraphs 33 to 35.
 - iv. An Excess Vote within the Request for Resources 2 – Working Age. This results in a breach of regularity qualification on the accounts, as this expenditure did not have Parliamentary authority. Details are provided in paragraphs 36 to 45.
5. The remaining section of my report, in paragraphs 46 to 50, discusses an exercise undertaken by the Department to assess the level of missing cases across all benefits in 2004-05. I have as a result of my review of this exercise been able to remove the previous 2003-04 qualification in respect of missing Incapacity Benefit cases.
 6. I have however still qualified my opinion on the Social Fund White Paper Account for 2004-05 on the grounds that the levels of missing cases in respect of certain grants and loans, were significant enough to warrant a limitation on the scope. This account, together with my certificate and report, was laid before Parliament on 29 November 2005 (HC ref.724). Whilst the amounts concerned are not material to the expenditure of the Resource Accounts they did, in the case of loans, prove material to the balance sheet of the Resource Accounts, resulting in the qualification in respect of other Social Fund debtors as noted above.

Estimated fraud and error in benefit expenditure (Schedule 2 and note 44 of the accounts)

7. The National Audit Office, based on information provided by the Department and its own independent testing, has concluded that an estimated £2.6 billion may have been lost from benefit payments because of fraud and error. A further estimated £0.7 billion was paid to customers in respect of Disability Living Allowance (DLA) and related premiums, which would not have been paid if these customers' case details had been reviewed earlier.

The estimation methodology

8. The Department's evidence supporting the combined fraud and error estimate is based on a range of exercises, which cover all significant benefit types on a cyclical basis. The frequency and detail of the work undertaken is proportionate to the value of expenditure and the assessed likelihood of fraud and error occurring in each benefit type. I provide further details on the
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individual exercises later in my report, but in broad summary they can be grouped into three categories:

- Continuously Measured Benefits (for example, Income Support, Jobseeker's Allowance, Pension Credit and Housing Benefit), which are subject to a continuous rolling programme of checking, validation and fraud and error evaluation;
- National Benefit Reviews (for example, of Disability Living Allowance, Incapacity Benefit and Retirement Pensions), which periodically consider individual benefits and provide a snapshot assessment of fraud and error not otherwise measured. The annual estimates for Incapacity Benefit and Retirement Pensions benefits are further supported by an annual review that rolls forward and reassesses the error assessment made at the time of their last full review;
- Annual statistical assessments of fraud and error based largely on historic data and covering benefits with lower levels expenditure and lower risks of fraud and error occurrence.

The resulting estimate focuses on overpayments that result from fraud and error, but also generates estimates of underpayments particularly in relation to the continuously measured benefits.

9. In each of the years 2001-02 to 2003-04 the methodology for estimating fraud and error overpayments remained much the same and the reported estimated value was constant at around £3 billion. For 2004-05 the estimation methodology changed from that used in previous years in two significant ways.
 10. Firstly, the rounding and overall accuracy levels used throughout the estimation process were tightened and the resulting details disclosed in the payment accuracy note made much more transparent. The fraud and error estimate which was previously reported as an overall total and rounded to the nearest £0.5 billion is now reported in tabular format that reflects the more extensive details from the underlying estimation work and is rounded to the tighter amount of £0.1 billion. Furthermore, the overall degree of tolerance in the total estimate, which provides a good measure of accuracy, has also improved to +/-£0.3 billion. I understand this to have previously been nearer +/-£0.5 billion.
 11. The second change in methodology, which I discuss in more detail at paragraphs 17 to 21, came about through a National Benefit Review of Disability Living Allowance (DLA). This identified for the first time a specific
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group of cases associated with DLA (and related premiums on other benefits) where payments were correctly made based on the case information available at the time, but where a case review would be expected to lead to a reduction in payment. In past Resource Accounts such cases were treated as overpayment errors or fraud, so their reclassification does result in significant sums being removed from the previously reported estimate.

12. Whilst I welcome the improved disclosure and accuracy brought about by these changes the effect of their combined adoption in 2004-05 makes it difficult to draw any firm conclusions as to the success of the Department in tackling the problem of fraud and error. The Department has recognised this fact by re-stating 2003-04 comparative figures using the revised methodology, but it nonetheless remains difficult to track the full impact of the change in methodology. For example, of the £3 billion fraud and error reported in 2003-04, £2 billion was attributed to fraud. The equivalent figure for fraud overpayments in 2003-04 as re-stated in the 2004-05 accounts is only £1 billion. The £1 billion decrease results from a combination of the overall improved accuracy of the estimates and the reclassification of fraud estimates relating to DLA. Neither represents a real improvement in tackling fraud, or conversely, a diminution in the level of error that a simple consideration of the comparatives might suggest, although they generate a more accurate measure of the value of fraud in the system.
13. The value of the improved methodology will become evident in future years when the need to restate and, moreover, explain the restatement has passed and the focus can instead be on comparatives using the now more accurate and more comprehensive note of payment accuracy.

Continuously Measured Benefits: Income Support, Jobseeker's Allowance and Pensions Credit

14. Income Support, Jobseeker's Allowance and Pensions Credit are, with Housing Benefit, the benefits considered to face the highest risk of fraud and error and as such are subjected to a continuous rolling programme of checks by the Department. These checks seek to evaluate the extent of fraud and error, as well as provide valuable information on control compliance and operations effectiveness for management. This checking process is itself subject to an internal validation procedure, which in turn is scrutinised by the National Audit Office.
15. The published fraud and error overpayment estimates for Income Support (£560 million), Jobseekers Allowance (£180 million) and Pensions Credit (£290 million) that are disclosed in the accounts are based on error rates relating to the period 1 October 2003 to 30 September 2004 applied against
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2004-05 expenditure. These figures suggest that in percentage terms the Department is reducing the overall reported levels of fraud and error across all these continuously measured benefits. This said, and contrary to the general trend, official error rates (one aspect of the overall total) for Pension Credit do appear to be rising. It is my understanding that more up to date analysis covering the full year period 2004-05 will be available in the near future.

Other Continuously Measured Benefits: Housing Benefit

16. The equivalent continuous review for Housing Benefit indicates that an estimated £640 million was overpaid, which in percentage terms is in line with the equivalent estimate reported last year (similarly to the benefit discussed in paragraph 15, this figure is based on error rates relating to the period 1 October 2003 to 30 September 2004 applied against 2004-05 expenditure, but also includes small adjustments to published National Statistics for the purposes of estimating this global figure). Housing Benefit is paid by local authorities and subsidised by the Department and as a result the methodology for estimating fraud and error differs from that used for the other continuously measured benefits. The statistical uncertainties relating to this methodology are greater than those relating to other continuously measured benefits, due to the relatively smaller sample size used, but this does not undermine the overall conclusion that the levels of fraud and error remain broadly stable.

The National Benefit Review of Disability Living Allowance

17. In July 2005 the Department concluded a National Benefit Review relating to Disability Living Allowance (DLA), which updated a previous exercise carried out in 1996. The review considered the various categories of possible fraud and customer error that result from inaccurate assessments of customer needs. DLA is paid on the basis of care needs.

18. In particular, the review made a distinction between cases where customers could be reasonably expected to recognise changes in their care needs and cases where the changes in circumstance were so gradual that it would be unreasonable for customers to recognise the potential impact. This distinction was important because it created a new classification of cases where the information from the customer may have differed if their case had been reviewed, but at the time of payment the customer was not deemed at fault in not recognising their change of circumstance. The resulting payments are therefore in excess of entitlement, but nonetheless procedurally correct. For this reason when estimating the overall value the Department concluded that these amounts should be excluded from the global total of fraud and error

overpayment because procedurally the payments remained correct until reviewed and deemed otherwise. This decision effectively introduced a new category which the Department considered as neither fraud nor error, but was nonetheless recognised in the payment accuracy note as money paid out that customers would not have been entitled to if their cases had been re-assessed.

19. The Review estimated the value of such cases to be £580 million and a separate exercise considering the interdependencies between DLA and other benefits suggested a further £120 million of overpayments. The total value of £0.7 billion, which whilst noted in the payment accuracy note to the accounts, is not included in the £2.6 billion global fraud and error estimate. The equivalent estimate for 2003-04 of around £0.6 billion also is not included in the re-stated figures for that year.
20. Considering this change in the wider context of clarifying or removing the longstanding qualification on these accounts I believe the National Benefit Review of DLA illustrates how complexity in some benefit programmes can lead directly to overpayment. I welcome the Department's efforts to clarify and to continue to report such matters in the accounts and thereby focus attention on those aspects of fraud and error that can be reasonably addressed.
21. In this particular instance the critical issue is what is a reasonable interpretation of the Department's duty to reassess DLA entitlement. Regular reviews would undoubtedly reduce the current estimate of payments made in excess of entitlement, but this must be balanced against the cost of undertaking such assessments and the disruption and possible distress to the many DLA clients where no reduction in entitlement would actually result. These are matters I intend to take forward with the Department as part of my on-going rollout of an enhanced financial audit strategy. The transparency of such issues being central to understanding and identifying solutions to those aspects of complexity in the benefit system, which I have long maintained are the main cause of the repeated qualification.

Other National Benefit Reviews and Annual Reviews: Retirement Pension, Incapacity Benefit and Carer's Allowance

22. There were no other National Benefit Reviews concluded in 2004-05, although a pilot review focussing on Retirement Pension is currently in progress. My staff will consider the methodology applied to this review and I will comment on this exercise, as appropriate, in my report to the 2005-06 Resource Accounts.
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23. Previous reviews relating to Retirement Pension, Incapacity Benefit and Carer's Allowance have generated fraud and error figures, which have been re-visited for the 2004-05 estimation exercise. The methodology applied is broadly consistent with previous years, although some statistical enhancement of the originating estimates resulted in a small reduction in the current estimate of fraud for these benefits. Similarly the official error figure relating to Carer's Allowance was also reduced. Both adjustments only have a marginal impact on the overall reported figures for 2004-05.
24. A final element of the fraud estimate that is captured by periodic reviews relates to Instrument of Payment fraud (for example, stolen order books). This has led to a welcome reduction from £70 million to £40 million following changes in working practice that directly reduce, and were intended to reduce, the risk of such frauds. The Department has as a consequence reassessed the methodology applied in determining this figure.

Other Fraud and Error Data

25. Where data is not available through continuous measurement, snapshot reviews or other periodic reviews, assessments are made by statisticians that draw on historic data. For the majority of unreviewed benefit types an assumed fraud and error rate of 2.7% is applied as the best available estimate. Until 2004-05 this category included Council Tax Benefit, but the Department now considers this to be more closely aligned to fraud and error rates for Housing Benefit and on this basis the Housing Benefit fraud and error rates have been applied to Council Tax benefit.

Conclusion

26. Because of the varying nature and timing of the exercises undertaken to produce the fraud and error estimate it is not possible to consider it as a precise measure, but it is the best estimate available at present. The £2.6 billion estimate of fraud and error that results represents some 2.2 per cent of the £118.7 billion of net expenditure. This in my view is a material sum and I have therefore qualified my audit opinion on the account.
27. I have now qualified the Department's account and those of its predecessors for the past 16 years because of the scale of fraud and error in benefit expenditure. The improved accuracy and enhanced disclosure noted in the 2004-05 accounts represents a positive step in improving the transparency of the underlying problems. This point is well illustrated by the now separate disclosure of DLA and related entitlements which were legitimately paid to customers, but would not have been if their cases had been re-assessed.
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Contributory and Non Contributory Benefit Customer Overpayment Debtors (£1,254 million)

28. Overpayments to customers arise from fraud and error by customers and from errors by officials. These are identified by staff in local offices and referred to Debt Centres for confirmation of the existence of a debt and its valuation and recovery.
29. Debt Centres record overpayments on systems that in the majority of individual cases do not provide a satisfactory audit trail from the original valuation of the debt through subsequent recoveries. Therefore it is not possible to confirm the existence and valuation of a significant number of customer overpayment debts. The Department is currently implementing a new debt management and accounting system which is intended to produce robust audit trails. The Department expects to complete the migration of existing data on debt to the new system by January 2006.
30. As in previous years I have concerns about the completeness of customer overpayment debt. This is because at the year-end not all benefit overpayments have been identified, some overpayments have been identified but not referred to Debt Centres for recovery and others have been referred but await input to the debt recovery systems. This suggests that the figure in the accounts for customer overpayment debtors could be significantly understated.
31. As there remains significant uncertainty over the completeness, existence and accuracy of the £1,254 million recorded in the account for benefit overpayment debtors, I have qualified my audit opinion.
32. Looking forward to 2005-06, my staff are working with the Department on a number of initiatives to assist the Department in its efforts to account for all relevant customer overpayment debts and provide a robust audit trail to individual transactions. This includes joint working with Internal Assurance Services to determine the extent of debt which has been identified but has not been referred to Debt Management for appropriate action as well as a proposed detailed review of the new debt management and accounting system.

Other Social Fund debtors (£625 million)

33. The Department administers Social Fund awards and repayments through its network of Jobcentre Plus offices. These are accounted for separately in the
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Social Fund White Paper Account and are also included in the Department's Resource Account on consolidation.

34. Following certification of the Department's Resource Account in December 2004, evidence came to light which limited the scope of my audit of Social Fund awards and repayments. To this end, I qualified my opinion on the 2003-04 Social Fund White Paper Account in June 2005 because I was unable to confirm that the Department had maintained proper accounting records for certain Social Fund transactions and that I had received all the information and explanations I required for my audit.
35. Whilst this year the Department has been very successful in bringing forward the completion of the Social Fund White Paper Account, so I can consider its audit findings in conjunction with the Resource Account, I have for the same reasons as in 2003-04 qualified my opinion on the 2004-05 Social Fund White Paper Account. Evidence made available by the Department to support amounts recorded in the account for Budgeting Loans (£460 million), and Crisis Loans (£165 million) was limited to a significant degree and as these amounts generate debtor balances significant to the Department's Resource Account I am obliged to qualify my audit opinion on the Departmental Resource Account in this respect. Further details are available on my report on the 2004-05 Social Fund White Paper Account. This account, together with my certificate and report, was laid before Parliament on 29 November 2005 (HC ref.724).

Excess Vote

36. In 2004-05, the Department expended more resources than Parliament had authorised. By doing so, the Department breached Parliament's control of expenditure and incurred what is termed an "excess" for which further parliamentary authority is required. I have qualified my opinion on the Department's 2004-05 Resource Accounts in this regard. The purpose of paragraphs 37 to 45 of the report is to explain the reasons for the qualification and to provide information on the extent and nature of the breach to inform Parliament's further consideration.
37. As part of my audit of the Department's financial statements, I am required to satisfy myself that, in all material respects, the expenditure and income shown in the Resource Accounts have been applied to the purposes intended by Parliament and conform to the authorities which govern them; that is, they are "regular". In doing so, I have had regard to Parliamentary authority and in particular the Supply limits Parliament has set on expenditure. By incurring expenditure that is unauthorised and is thus not regular, the Department have breached Parliament's controls.

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38. Parliament authorises and sets limits on departmental expenditure on two bases – ‘resources’ and ‘cash’. Such amounts are set out in Supply Estimates for which Parliament’s approval and authority is given in annual Appropriation Acts.
39. By this means, Parliament has authorised Requests for Resources for the Department. It thereby authorises amounts for current (rather than capital) expenditure, which are net of forecast income known as operating Appropriations in Aid. Parliament sets limits on the amount of operating Appropriations in Aid that can be applied towards meeting expenditure. The amounts authorised for Requests for Resources and Appropriations in Aid together represent a limit on the gross current expenditure that may be incurred under each Request for Resources.
40. The limits described above for the Department were set out in the Main Supply Estimate for 2004-05 (HC 466), as amended by the Winter and Spring Supplementary Estimates (HC 1234/325). The limit for Request for Resources 2 was set at net expenditure of £34,980,415,000 together with a limit on Appropriations in Aid of £1,564,698,000. These limits were authorised in the Appropriation Acts 2004 and 2005. The breaches reported below are against these limits.
41. Schedule 1 to the accounts shows net expenditure on Request for Resources 2 of £35,168,572,000, which is £188,157,000 (0.54 per cent) in excess of the amount authorised. Operating income authorised to be appropriated in aid of expenditure on this Request for Resources was limited to £1,564,698,000. Income earned and applied fell short of this limit by £146,624,000 and gross expenditure was £41,533,000 greater than authorised, resulting in the excess of £188,157,000. It is proposed to ask Parliament to authorise £188,157,000 as additional use of resources by an Excess Vote.
42. The Excess Vote was primarily due to a shortfall in receipts in respect of Income Support, and an overspend on expenditure within Housing Benefits.
43. The shortfall in Income Support receipts was primarily in respect of an over-estimation of recoveries by the Child Support Agency of maintenance payments from non-resident parents where the parent with care receives their Income Support gross. The estimation of recoveries was based upon expected improvements in processing times and case compliance following the introduction in March 2003 of Child Support Reforms. However, the CSA have continued to face many problems and both the processing times and compliance have not yet improved to the degree anticipated, hence the estimates made in respect of recoveries were too high.
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44. The under-estimate of Housing Benefit expenditure was principally due to an increase of subsidy costs in respect of benefit paid by local authorities to those classified as temporarily homeless (non-HRA Rent Rebate). This was in turn due to an increased use by local authorities of higher rental leased accommodation rather than bed and breakfast accommodation. This resulted in an increase of 60% in this type of expenditure which had not been anticipated by the Department.
45. As the primary factors contributing to the Excess Vote are demand-led, and in the case of Housing Benefits subject to local authority policy, the Department does not consider there to be significant weaknesses in its own internal controls which contributed to the Excess Vote arising. As a result, the Excess Vote has not been referred to by the Accounting Officer in his Statement on Internal Control. However, I believe that there remains some merit in a reassessment of the current control environment, particularly in respect of the inter-relationship between the Department and local authorities, in order that any changes to the design and operation of controls can be implemented as necessary to ensure that the risk of a further occurrence of an excess vote is managed.

Missing Case Papers

46. In order to verify the estimates in the error rates relating to Incapacity Benefit in 2003-04 the National Audit Office sought to examine an independent sample of 800 Incapacity Benefit cases to check that eligibility conditions were met and that accurate payments had been made. The absence of this evidence from 106 cases which could not be located at the time was a significant limitation on the scope of the audit and I qualified my audit opinion to reflect this.
47. In the current year, I have considered the results of an exercise undertaken by the Department which sought to assess the level of missing cases across all benefits in 2004-05, based on the work undertaken by its Performance Measurement Unit. This generated an overall missing case figure of just under 1% of cases selected for review.
48. The National Audit Office confirmed the robustness of the underlying database supporting these figures, and is satisfied that the proportion of missing cases across all significant benefits in 2004-05 is within tolerable levels. Hence, I have been able to remove this qualification in 2004-05.
49. However, in respect of certain grants and loans administered under the Social Fund White Paper and consolidated into the resource account, levels of
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missing cases were significant enough to warrant a limitation on the scope of the separate audit opinion for the Social Fund White Paper Accounts. This account, together with my certificate and report, was laid before Parliament on 29 November 2005 (HC ref.724). Whilst the amounts concerned are not material to the expenditure of the Resource Accounts they do indicate that missing case files remain a significant concern and in the case of loans (see earlier paragraph 33 to 35) they did prove material to the balance sheet of the Resource Accounts.

50. The Department has recognised the weaknesses within the document retrieval process, including the management of the Department's document storage. Work is ongoing to improve these weaknesses including the re-tendering of the contract for the management of the storage facility, consolidating the service into a single store and introducing a standard storage and retrieval process supported by a modern IT system.