
Department for Work and Pensions Resource Accounts 2005-06

Report by the Comptroller and Auditor General

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DEPARTMENT FOR WORK AND PENSIONS RESOURCE ACCOUNTS 2005-06

Report by the Comptroller and Auditor General

Introduction

1. In its consolidated resource accounts, the Department for Work and Pensions accounts for expenditure of £124.2 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 which I have continued to progress during my audit of the 2005-06 accounts. My main motivation in doing this was to assist the Department in addressing some of the long standing problems which have led to repeated qualification of the accounts. I am also seeking to improve the reporting of the issues and thereby bring about greater transparency of the barriers to long term improvement that the Department faces.
3. In this report I provide an update on the four qualifying issues I reported last year and explain the reasons for the residual qualifications that I am obliged to report this year. Under each issue I report progress made and the implications for this year's accounts, together with details of initiatives underway to bring about long term improvement.
4. This is the 17th successive year in which I have qualified the Department's accounts. I am pleased to report, however, that this year has seen real progress towards removing or tackling the qualifications which have been made to the Department's accounts in previous years. Two of the four qualifications which I reported last year have not been repeated as a result of improved focus and effort by the Department. I also particularly welcome the establishment of the Official Error Taskforce, established by the Permanent Secretary, to help drive down levels of fraud and error in the Department's payment of benefits. Overall, I have seen and greatly welcome a sense of real determination within the Department - led from the top - to tackle and seek to resolve the causes of the longstanding qualifications on the Department's accounts.

Audit Opinion

5. In 2004/05 I qualified my opinion on four specific issues. In 2005/06 this is reduced to two:
- i. Substantial levels of estimated losses from fraud and error in benefit expenditure recorded in the operating cost statement. I provide full details in paragraphs 7 to 19.
 - ii. Material uncertainties over contributory and non-contributory benefit customer overpayment debtors. Details are discussed in paragraphs 20 to 28.
6. These two are the more long standing and consequently the more difficult to address. The other two of previously reported qualifications:
- iii. a significant limitation in the evidence made available to the National Audit Office during the audit of other Social Fund debtors. Details provided in paragraphs 29 to 33.
 - iv. an excess vote within Request for Resource 2 – Working Age. Details provided in paragraphs 34 to 36.
- have not been repeated.

Substantial levels of estimated losses from fraud and error in benefit expenditure

7. The National Audit Office, based on information provided by the Department and its own independent testing, has concluded that an estimated £2.7 billion may have been lost from benefit payments because of fraud and error in 2005-06. This amount represents some 2.2 per cent of the £124.2 billion of expenditure in the accounts and is in my view a material sum.

The estimation methodology

8. The estimate of £2.7 billion is disclosed by the Department in Note 44 of the accounts entitled Payment Accuracy. The details in this note are supported by extensive work undertaken by the Department to continuously measure fraud and error activity in the benefits system. This work is based on a range of exercises:
- Continuously Measured Benefits (for example, Income Support, Jobseeker's Allowance, State Pension Credit and Housing Benefit) which
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are subject to a continuous rolling programme of checking, validation and fraud and error evaluation;

- National Benefit Reviews which periodically consider individual benefits and provide a snapshot assessment of fraud and error not otherwise measured. The latest review relating to State Pension was undertaken in 2006 – with previous reviews undertaken for Disability Living Allowance (2005), Incapacity Benefit (2001) and Carers Allowance (1996);
- Annual estimates for Official Error in Incapacity Benefit and State Pension and Instrument of Payment fraud; and
- Annual statistical assessments of fraud and error of otherwise un-reviewed benefits based largely on historic data and covering benefits with lower levels expenditure and lower risks of fraud and error occurrence

These measurement exercises produce estimates of overpayments and underpayments although the total estimate of £2.7 billion in the Payment Accuracy note relates only to overpayments.

9. In my report '*International benchmark of fraud and error in social security systems HC1387 2005/06*' I noted that the Department is at the forefront of fraud and error measurement, and compares well with other countries in terms of focus and initiatives to combat the problem. The current estimate of fraud and error disclosed in the accounts is the best measure currently available.
 10. In undertaking the audit of the accounts the National Audit Office consider the work of the Department in producing the estimate of fraud and error, including a review of the Department's methodology, checking procedures and underlying sample work. The National Audit Office also undertake their own work to independently validate the conclusions reported by the Department.
 11. In 2004-05 I acknowledged the significant improvement the Department had made both in the accuracy of the fraud and error estimate and the improved disclosure in the Payment Accuracy note, which for the first time in 2004/05 broke down the estimate by benefit types. In 2005-06 the Department have built on this initiative by retaining the enhanced disclosure, but also now disclosing the period of the exercise upon which each estimate is based and thereby providing greater transparency of the estimates currency at the time of reporting.
 12. The process used to derive the estimate is labour intensive, which at a time when the Department is seeking to make significant efficiency savings must
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demonstrate its value. As a consequence the Department is currently reviewing its fraud and error measurement requirements generally. The review is seeking to determine the optimum use of resources to support the process, while maximising the allocation of those resources to the front line activity of tackling fraud and error. As part of this consideration thought is also being given to the rationalisation of fraud and error reporting with other reporting targets and closer alignment of fraud and error estimation with the period of account. The intention is to provide a more coherent picture of fraud and error across the benefit system. I welcome these initiatives and will report further on their development in subsequent reports.

The Department's Strategy to reduce Fraud and Error

13. The Department has placed significant emphasis on tackling fraud in recent years. Since the current payment accuracy disclosure was first used the Department estimates reductions in fraud of around £0.2 billion in relation to Income Support, Jobseekers Allowance and Housing Benefit. Key initiatives supporting the Department's approach to fraud prevention continue. These include a targeting fraud campaign, legislative reform to support fraud investigations and data matching client details between accessible systems to spot inconsistency and therefore potentially fraudulent claims. I will monitor progress in these areas and report developments in subsequent reports.
14. In the current year, enhanced focus has been put on Official Error. Official Error arises when the Department incorrectly processes a new claim to benefit or takes incorrect action when processing a change of circumstance notified by a customer. As this is an area widely acknowledged as wholly under Departmental control, an Official Error Task Force has been established to support a demonstrable and measurable reduction in benefit complexity and, by implication, official error rates. Focused initiatives are now directed to the 'top ten' official errors, by monetary value, in Income Support, Jobseekers Allowance, State Pension Credit and Disability Living Allowance, which I understand account for an estimated 60% of the total monetary loss across these benefits. Initiatives include:
 - actions to reduce the stock of error, for example, through data cleansing;
 - enhanced IT solutions;
 - raising the profile of accountability within benefit processing agencies;
 - an improved management checking regime;
 - desk Aids and Refresher Training to support staff; and,
 - focused solutions for specifically identified problem areas.

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15. These initiatives are welcome, but set against a background of significant on-going reform their effectiveness may prove difficult to quantify as like with like comparatives may not continue to exist. Again I anticipate reporting further on such developments in subsequent reports.
 16. The Department also continues to focus on customer error. This arises when customers unintentionally provide incorrect information when making a claim to benefit, or fail to provide timely information on changes in their circumstances which can affect the level of benefit paid. Consistent with previous Departmental initiatives, emphasis is being placed on preventing new error, reminding customers of their responsibilities and identifying and correcting error already in the benefits system.
 17. Key initiatives in tackling customer error focus on the causes of complexity that lead to such error and data cleansing old client information. There are also planned media campaigns that will highlight error, as well as fraud, and thereby encouraging honest customers to assist in getting and keeping their benefits correct.

Conclusion

18. The £2.7 billion estimate of fraud and error represents some 2.2 per cent of the £124.2 billion of expenditure. In percentage terms this represents a continuation of a slow downward trend in the overall volume of fraud and error. It is however still a material sum, which in my view cannot by its very nature have been spent as Parliament intended. I have therefore qualified my audit opinion on the account.
19. I have now qualified the Department's account and those of its predecessors for the past 17 years because of the scale of fraud and error in benefit expenditure. In 2005-06 the Department has demonstrated a clear determination to resolve this long standing position introducing numerous initiatives and actively engaging with stakeholders to identify possible solutions. My staff will continue to monitor developments in these areas including following up on my report on '*Tackling Benefit Fraud HC392 2002-03*'.

Material uncertainty over Contributory and Non Contributory Benefit Customer Overpayment Debtors

20. 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
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valuation and recovery. Once confirmed, the debts are included in the debt balances recorded in the Department's balance sheet.

21. In previous years, I have limited the scope of my audit opinion because the Department has been unable to provide me with all relevant evidence to demonstrate that the customer overpayment debt balance recorded within the Resource Account balance sheet is complete, accurately valued and consistently proven to exist. This position has not changed in 2005/06 in terms of my formal opinion, although significant progress has been made against each of the problems resulting in the limitation of scope.

Completeness

22. Customer overpayment debt arises when the benefit paid to the customer exceeds the amount they are entitled to. Each of the Department's Executive Agencies is responsible for identifying possible overpayments in the benefits they administer and for referring them to Debt Management for action.
23. My work in this area for 2005-06 was carried out jointly with Internal Audit and focused on the timeliness with which debts are referred to Debt Management by Jobcentre Plus. The work concluded that over 4 million income support and jobseekers allowance potential overpayments had still to be referred to Debt Management. The Department is unable to estimate the value of these cases due to the limitations of the underlying heritage benefit systems, although a drive within the Department's business units demonstrates that such amounts are still being pursued. Consequently I conclude that the scope of my audit has been limited and have qualified my opinion on the completeness of debt.
24. In order to strengthen the control environment, the Department has told me that from 2007-08, the Chief Executives of each Agency will be responsible for ensuring the timely referral of potential overpayment cases to Debt Management according to pre determined referral targets which will be monitored and assessed.

Valuation

25. In 2005-06, the Department introduced a new customer overpayment debt management and accounting system known as Debt Manager. As part of the introduction of this system the Department validated the valuation of opening balances transferred from the existing debt systems. Based on the National Audit Office's review I am satisfied that the opening balances in Debt Manager were accurately migrated from heritage systems and that subsequent recoveries arising in 2005-06 were appropriate.
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26. However, the scale and extent of the data migration necessary to implement Debt Manager limited the Department's ability to carry out normal day to day business. As a result, a backlog of cases built up still requiring input into the Debt Manager system. As at 31st March 2006, the Department estimated there were 430,000 debt referrals which required input to Debt Manager, although the Department informs me that this had been reduced to 168,000 cases as at 30 September 2006. The backlog at 31 March 2006 creates a material omission from the customer overpayment debt balance and I have therefore qualified my opinion in this respect.

Existence

27. The number of recorded debts total around 3 million individual items with a significant portion being over 10 years old. Under normal circumstances customer overpayments are rigorously pursued and never written off. All cases are retained on file in case the customer claims benefits again and the debt can be recovered against those payments. Even where this is not the case, most people on attaining the age of 65 will receive a state pension and as a last resort any debts will be recovered against this. While the new Debt Manager system provides an adequate audit trail to new and recent debts previous experience with remote storage retrieval suggests the Department may have difficulty in retrieving system records and paper based documents over periods longer than two years. This would be likely to make it more costly to produce the evidence to support the existence of individual overpayment debt balances if challenged.

28. Once potential debts referred to Debt Management are confirmed a debt notification letter is sent to the customer. As noted in the debt accounting policy on page 51 the Department regards these letters as evidence of the existence of a debt. The letters are also accepted by courts as evidence of existence where enforcement action is taken. It has not yet been possible for me to review the controls around the production, storage and amendment of notification letters in 2005-06 and I have continued to limit the scope of my audit opinion in respect of the existence of customer overpayment debts. As part of my 2006-07 audit, I will review with the Department the extent to which debt notification letters can provide assurance as to the existence of older debts.

Evidence available to support Social Fund debtors

29. The Department administers Social Fund awards and repayments through its network of Jobcentre Plus offices. These are accounted for separately in the Social Fund White Paper Account and are also included in the Department's Resource Account on consolidation.
30. In 2005-06 there were significant improvements in the effectiveness of the Department's document retrieval arrangements. These improvements have allowed me to reduce the extent of my qualification on the 2004-05 Social Fund White Paper accounts, in respect of Budgeting Loans, that arose because the scope of my audit was limited by missing case-papers.
31. Difficulties have remained in finding documentary evidence to support awards of Crisis Loans in the year (£84 million). Accordingly, I have qualified my opinion on the White Paper Account on the basis of limitation of scope on Crisis Loans awards in the year.
32. My review of Crisis Loan awards noted an irregular payment where misrepresentation by the customer was suspected. The Department's procedures for estimating the value of losses from fraud and error in benefit expenditure do not cover payments from the Social Fund, which have been regarded as low risk. This meant that the Department was unable to confirm that the full extent of irregularities on Crisis Loans was at a tolerable level. Checks on a further 53 Crisis Loan awards with similar features to the initial irregular case, identified further irregularities which the Department are continuing to investigate. I will review the outcome of these investigations as part of my 2006-07 audit of the Social Fund White Paper Account. As a result of the irregularities identified I am unable to form an opinion on the accuracy and regularity of Crisis Loan payments in 2005-06 and I have scope limited my opinion in this respect on the White Paper Account (*Social Fund White Paper Account HC1701 2005-06*).
33. Crisis Loans awards when consolidated into the Department's Resource Accounts do generate debtor balances. However, I do not consider these to be of sufficient significance as to generate an equivalent qualification in the Resource Account, particularly when placed in the context of the benefit overpayment debt balances which are already subject to a limitation of scope qualification. Therefore I have not qualified the Resource Account in 2005-06 in respect of balances generated from the Social Fund.

The Department has complied with Parliamentary limits on expenditure

34. In 2004-05, the Department expended more resources in respect of one "Request for Resource" 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 was subsequently required. I qualified my opinion on the Department's 2004-05 Resource Accounts in this regard.
35. The Excess Vote in 2004-05 was primarily due to a shortfall in receipts by the Child Support Agency in respect of recoveries of benefits from non-resident parents; and an overspend on expenditure on Housing Benefits, principally due to an increase of subsidy costs in respect of benefit paid by local authorities to those classified as temporarily homeless.
36. As the primary factors contributing to the Excess Vote in 2004-05 were considered demand-led, and in the case of Housing Benefits subject to local authority policy, the Department did not consider there to be significant weaknesses in its own internal controls which contributed to the Excess Vote arising. Indeed, a non-repetition of the significant demand-led expenditure variances experienced in 2004-05, combined with an increased focus by the Department on its forecasting controls, has resulted in the Department comfortably avoiding an Excess Vote arising in its 2005-06 accounts.