



National Audit Office

**HM REVENUE & CUSTOMS**  
**Accuracy in processing Income Tax**

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# SUMMARY

**1** HM Revenue & Customs collected £149 billion in Income Tax in 2006-07<sup>1</sup>, dealing with the tax affairs of around 36 million taxpayers. £125 billion was collected via employers through the Pay As You Earn (PAYE) scheme. £24 billion was collected directly from self employed people and others who have additional income, through the Income Tax Self Assessment (Self Assessment) system. The Department spends in total around £1.7 billion<sup>2</sup> a year on administering Income Tax. The cost of processing Self Assessment and PAYE tax returns and other information provided by taxpayers was £378 million in 2006-07, and involved around 15,900 full-time staff.

**2** Ensuring that people pay the right amount of tax depends on them correctly declaring all their income and on the Department correctly processing the information they provide. Income Tax processing work has traditionally been carried out, alongside tax compliance work, at each of the Department's 300 offices across the UK. Since HM Revenue & Customs was set up in 2005, it has undergone significant organisational change aimed at improving taxpayer compliance and customer service and achieving efficiency savings. The Department expects progressive restructuring and streamlining of Income Tax processing work, together with increased levels of online filing of tax returns, to make a significant contribution to achieving these aims.

<sup>1</sup> Latest estimate for 2006-07.

<sup>2</sup> 2005-06 cost figure.

## Summary text continued

**3** This report examines the Department's accuracy in processing Self Assessment and PAYE. It covers:

- the levels of accuracy achieved in processing Income Tax and the impact of errors both for the Department and for the taxpayer (Part 1);
- the causes of error (Part 2);
- changes underway to improve the accuracy of Income Tax processing (Part 3).

**4** My report on HM Revenue & Customs' Accounts 2005-06 examined controls over the collection of Income Tax through PAYE, including challenges faced by the Department in securing taxpayer compliance and administering the system effectively. The results of further work on controls over the collection of Income Tax through PAYE and Self Assessment will be published in my report on the 2006-07 Accounts later in July 2007. My report on "Helping Individuals understand and complete their tax forms", published in April 2007 covers how the Department provides information and deals with enquiries from individual taxpayers. Appendix A provides details of our methodology.

## Conclusions

**5** The Department accurately calculates the right amount of tax in 95.4 per cent of Income Tax cases. It has improved its accuracy in processing Self Assessment cases since 2001-02, achieving 96.5 per cent in 2006-07, slightly missing its target of 97 per cent. Over this period, accuracy in processing PAYE cases fell slightly although it improved to 95.1 per cent during 2006-07. The accuracy rates achieved for certain categories of cases are however lower. Around 25 per cent of PAYE cases are more complex and require processing by hand which is more prone to error, resulting in an accuracy rate of 82.1 per cent in 2006-07. There are other errors on Self Assessment that could affect the tax payable such as coding errors but the Department corrects them in an annual reconciliation exercise before they affect the tax paid. The accuracy rate for Self Assessment including these cases was 78.1 per cent in 2006-07.

**6** The Department estimates its accuracy rates and the effect of errors through its quality monitoring, whereby it checks a sample of around 40,000 cases a year across all processing offices and extrapolates the results to produce a national estimate. In November 2005 it introduced monthly, rather than annual, monitoring which enables it to better track performance in real time both nationally and by area. It has also introduced in-flight checks on cases as they are processed to gauge quality, rectify any mistakes identified immediately and help staff learn and improve.

**7** The Department estimates that inaccurate processing led to 3.6 million errors on Self Assessment and 2.8 million errors on PAYE in 2006-07. Some other errors result in mistakes in taxpayers' records, such as incorrectly logging address or personal details, which do not directly affect the tax payable. However if they remain uncorrected they could in time affect the tax payable. Coding errors in Self Assessment also do not affect the tax payable as the Department conducts an exercise each year to correct them. The Department also corrects other errors it can identify and those which taxpayers bring to its attention. Taking into account these changes, processing errors affected the tax payable of just over one million taxpayers in 2006-07, resulting in £125 million in underpayments of tax and £157 million in overpayments.

**8** Errors in processing have a wider impact for the Department and taxpayers. The Department does not assess the likely costs involved in reworking of cases to correct errors, but this and dealing with customers affected by errors add to the pressure on staff. For the taxpayer, the average underpayment and overpayment of tax is around £250 and £290 respectively, although some errors can involve unexpected repayments of much larger sums. Processing errors are more likely to affect certain groups of taxpayers whose income tax affairs are more complicated, such as people on pensions, agency workers, those with several jobs or sources of income and those who receive benefits in kind. It is difficult to determine the additional cost to the taxpayer of getting an error corrected but the National Audit Office's tax agents' survey and taxpayer case examples show that the process can sometimes cause anxiety and require significant time and effort.

**9** Wider demographic changes have increased the complexity of processing Income Tax, for example by increasing the caseload involving pensioners, and the volume of changes required to PAYE records as people change jobs more frequently. The most frequent type of error is in the Department's calculation of tax codes, which are used by employers to calculate deductions of income tax from employees' pay. In 2006-07 63 per cent of all errors in PAYE affecting the tax payable related to tax codes. The Department's projects to automate further the clerical checks and calculations involved in coding and other parts of processing have significantly reduced the associated levels of error.

**10** Accuracy rates in processing Income Tax vary significantly across local offices, ranging from 91 to 99 per cent on Self Assessment and from 66 per cent to 93 per cent on PAYE in 2006-07. Higher accuracy rates are associated with experienced, well trained staff, lower staff turnover and workloads that require less processing by hand. Some offices have achieved substantial improvements by targeting workloads more closely to the skills and experience of staff, increasing management focus on accuracy, and promoting the sharing of good practice and new ideas among staff.

**11** Processing work is at the forefront of major changes underway in the Department. These involve strengthening its leadership and management to promote a culture of continuous improvement, modernising its IT systems, re-engineering how processing work is carried out through Lean<sup>3</sup> working, and reducing the number of local processing offices. The Department estimates that implementing Lean will improve accuracy rates and increase productivity in processing by 30-50 per cent. Overall it expects to achieve a reduction of around 6,870 full-time equivalent staff. This amounts to savings of £440 million across the Department's processing of Income Tax, National Insurance, Tax Credits and VAT by 2011. The Department expects that to fully embed and sustain the changes made over the past 18 months will take another three to five years.

**12** The Department's introduction of Lean processing reflects many of the good practices adopted and challenges faced by other organisations in seeking to improve the accuracy and quality of their processing work and implementing change. Our research on practice

in private sector organisations and other tax authorities found examples where substantial improvements and very high accuracy rates had been achieved. Success often depended on rigorous root cause analysis of error rates and redesigning processes end to end from a customer perspective. It is also important to engender a culture of accountability and good communications with staff, and to involve them in designing solutions, and to provide sufficient training and strong project management.

**13** The Department's initial experience of Lean working suggests that significant improvements in the accuracy and efficiency of processing Income Tax are possible. Early results suggest some improvement in the quality and productivity of work, but lead times in completing work have increased. No firm conclusions could be drawn on how Lean working had affected accuracy rates at this stage. Close scrutiny of emerging trends will be important in identifying any unforeseen effects and in assessing action needed to sustain improvements in the longer term. Focus groups with staff have raised questions over whether the way work is now processed in stages may lead in the future to a loss of quality and skills. They have also indicated a need for better communications, management of performance and training.

## Overall Conclusion and Recommendations

**14** The Department processes most Income Tax cases accurately but the sheer scale of this work means that errors have considerable impact on both the Department and individual taxpayers. The full cost of these errors is largely hidden – in reworking cases to correct mistakes and in the time, cost and anxiety for taxpayers in getting errors put right. Such errors also disproportionately affect more vulnerable groups who are probably less able to deal with them. Initiatives to tackle specific types of error have been successful in reducing their number, and by monitoring accuracy rates in real-time, the Department is now managing its performance more effectively. The Department has embarked on a major programme of change designed to achieve further and sustained improvement while also reducing its costs. Our recommendations are designed to help the Department build on the work already in hand to improve its accuracy in processing Income Tax.

<sup>3</sup> Lean working seeks to review processes from the customer perspective to eliminate waste, inconsistency and duplication and to identify and resolve the root cause of problems in performance. The main driver for Lean is to achieve more with less resource, by continuous review and elimination of those activities and processes that do not add value.

**15** To reduce the level of errors in Income Tax payments and taxpayer records, the Department should:

- Continue to use information on identified errors in the quality monitoring sample of cases to identify and correct other similar cases. [paragraph 2.2]
- Facilitate sharing of good practice by analysing area accuracy rates against the various factors that can influence performance to identify the reasons for the success of better performers and to learn more about the effects of the introduction of Lean. [paragraphs 2.7 to 2.10, 3.15]
- By analysing trends in the monthly data, develop an early warning system for emerging problems, which may require adjustments in workload and resourcing or changes in working practice. [paragraph 3.3]
- As it reviews its targets, adjust its monitoring and reporting of accuracy rates to give a clear picture of the rates achieved, for Self Assessment, PAYE and Income Tax as a whole. [paragraphs 1.10 to 1.15]
- Build on the success of recent projects by identifying further opportunities for low-cost quick-win projects to reduce errors. These could include automating specific parts of the process or validating manual checks and calculations. [paragraph 3.9]
- Separate out more complex cases, which generate high levels of error, for processing by specialised teams that have the requisite skills and experience to process them accurately. [paragraphs 1.25, 3.22]

**16** To manage the costs and consequences of errors, the Department should:

- Assess the cost and incidence of reworking to inform its longer-term decisions on achieving incremental reductions in different types of error, and their relative cost-benefit. [paragraph 1.19]
- Develop its customer-focused approach by tracking how error rates affect different taxpayer groups and tailor the way it helps taxpayers to understand and deal with the different types of error that might affect them. [paragraphs 1.25, 2.1]

**17** To build upon its early experience of Lean working in processing, the Department should:

- Reassess the training provided to meet the different needs of staff, taking account of current recruitment patterns and the impact of changes in working practices under Lean. [paragraphs 2.8 to 2.10, 3.17]
- Strengthen communications with staff by seeking feedback on the effect of changes, and involving them in developing proposals for further improvement. [paragraphs 3.17 to 3.18]
- Consider how its new approach to working might be reflected in the performance appraisal systems for staff. [paragraphs 3.14 to 3.18]
- Benchmark its experience with other organisations to identify potential pitfalls and solutions, and further opportunities for improvement. [paragraphs 3.20 to 3.25]