

Department for Work and Pensions Resource
Accounts 2006-07

Report by the Comptroller and Auditor General

DEPARTMENT FOR WORK AND PENSIONS RESOURCE ACCOUNT 2006-07

Report by the Comptroller and Auditor General

Introduction

1. In its consolidated resource account, the Department for Work and Pensions accounts for expenditure of £128 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 2006-07 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 my opinion on the accounts and to 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 issues I reported on last 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 18th successive year in which I have qualified the Department's accounts. I am pleased to report, however, that this year has seen further real progress towards removing or tackling these long-standing qualifications, building on initiatives put in train last year. The Department's staff have continued to demonstrate real determination to resolve the underlying causes of these qualifications. Indeed I have been able to remove two aspects of the long-standing limitation of scope qualification on customer overpayment debt balances, which is a tribute to the clear leadership evident within the Department in tackling these issues.

Audit Opinion

5. In 2005-06 I qualified my opinion on two specific issues. In 2006-07, although real progress has been made in tackling the underlying causes, I am again qualifying my opinion on the same two issues. These are:
 - Substantial levels of estimated losses from fraud and error in benefit expenditure recorded in the operating cost statement. I provide full details in paragraphs 6 to 25.
 - Material uncertainties over the completeness of customer overpayment debtors. Details are provided in paragraphs 26 to 30.

Substantial levels of estimated irregular payments resulting from fraud and error in benefit expenditure

6. Based on information provided by the Department and my own independent testing I estimate that £2.5 billion may have been lost in 2006-07 compared to £2.7 billion in 2005-06. This £0.2 billion improvement when expressed as a percentage of benefit expenditure represents a 0.2 per cent fall to 2.1 per cent compared to 2.3 per cent in 2005-06.
7. The Department estimates underpayments of benefit in 2006-07 of £1 billion, of which £0.4 billion was due to official error. Nonetheless, where comparisons are feasible, for certain continuously monitored benefits upon which the Department's efforts have focussed, the Department is again showing a trend of reducing error.

The estimation methodology

8. 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. In 2006-07 the Department has continued to build on that positive endorsement by continuing to enhance and better focus its measurement processes. For example, the Department has included details of underpayments and refined the estimates for smaller value benefit streams not ordinarily subjected to detailed fraud and error measurement.
9. The Department's evidence supporting the fraud and error estimate is based on a range of exercises which are intended to reflect fraud and error risks associated with individual benefits. More regular review is applied to those benefits which are considered to be more susceptible to fraud and error. The estimated error arising from each of the exercises is set out in Note 44 to the Account along with an explanation of what each exercise involves. In summary, the percentage of benefits expenditure in 2006-07 covered by continuous assessment was 27 per cent, the percentage based on periodic National Benefit Reviews was 59 per cent and the percentage based on assumptions of comparability with other benefits was 14 per cent.
10. As part of my audit of these accounts, including the Department's estimate of fraud and error, the NAO reviewed the Department's approach to sampling and the methodology applied in checking, including re-performance of a sample of items. The National Audit Office also reviewed the processes for interpreting the data and generating estimates of error and fraud. As a result, I am satisfied that the figures reported by the Department are the best estimates available. In making this statement the National Audit Office has specifically obtained assurances around the estimation of error in unreviewed benefits and in the confidence intervals used in the Department's analysis.

Confidence Intervals

11. The estimates of fraud and error are based on analysis of samples of benefit payments and are subject to a degree of statistical uncertainty. This is quantified in the form of confidence intervals and expressed as a percentage expectation that the true value of the estimated error lies within a particular range. The Department applies confidence intervals of 95 per cent in accordance with the standards applicable to generating National Statistics.
12. The Department has estimated that, whilst the best estimate of overpayments is £2.5 billion, to achieve 95 per cent confidence of the actual levels of overpayment

the range of the estimate is from £2.1 billion to £2.8 billion. For underpayments, the equivalent figures are an estimate of £1 billion within a range of £0.8 billion to £1.2 billion. These estimates have been subject to rigorous statistical analysis and I am satisfied that the assumptions underpinning these estimates are sufficiently robust.

Social Fund

13. On page 61 the financial statements show payments of £2.481 billion to the Social Fund to allow awards to qualifying customers, including around £830 million on discretionary awards. The Department's estimation methodology for fraud and error includes an element for Social Fund awards based on comparability with other benefits. My separate audit of the Social Fund White Paper Account for 2006-07 noted irregular payments of discretionary awards totalling around £31 million and as a result I qualified my audit opinion on that Account (HC977/06-07). Upon consolidation into the Resource Account, however, the same amounts are not in themselves considered material to my opinion. Nonetheless I understand that the Department is assessing the scope for alternative mechanisms to estimate the value of monetary losses each year in Social Fund payments.

Developments in the measurement methodology

14. As described in my Report on the 2005-06 accounts, the Department has committed to further improving the measurement of fraud and error and tackling the underlying causes. During 2006-07, the Department has enhanced the way fraud and error will be measured and reported in future. Further enhancements will be developed to improve the efficiency and effectiveness of the measurement regime. Enhancements will include:
- The use of more in-year transaction testing results to derive the reported estimates. At present much of the estimation process is driven by transactions tested in the previous reporting year or before;
 - Modification to the sampling approach and testing programme of continuously measured benefits to improve the efficiency with which data is collected and thereby make the estimate more representative; and
 - The introduction of more robust quality control procedures, which should further improve the accuracy of the reported results.
15. The Department is also currently reviewing the performance measurement work already being carried out within each of the Agencies responsible for the calculation and payment of benefits. This review will assess the potential to align Agency-led work with Department-wide work and thereby establish a much more holistic approach to the measurement of both fraud and error.
16. I welcome these enhancements and will continue to monitor developments in this area, providing an update in my future reports.

The Department's Strategy to reduce fraud and error

17. In 2005 the Department demonstrated its commitment to tackling fraud in publishing '*Reducing Fraud in the Benefit System – Achievements and Ambitions*'. This highlighted key initiatives supporting the Department's approach to Fraud

prevention. In January 2007 the Department also published '*Getting welfare right – Tackling error in the benefits system*', highlighting the various strategies and initiatives being taken or planned.

18. These initiatives include an anti-fraud advertising campaign, legislative reform to support fraud investigations and sanctions, increased use of risk-profiling to target investigations towards high risk individuals, development of new technologies to identify fraud at the point of claim and advanced data-matching, comparing data from a number of sources including the Department, other Government departments and external sources. There are plans to further develop data-matching using advanced IT systems which will allow more timely identification of fraud and error and, in particular, help to target organised fraud rings.
19. With the publication of its error strategy, this year has seen an increased focus on tackling customer error while continuing to address official error by building on last years Official Error Task Force. Customer error 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 affect the level of benefit paid. Official error can arise from a number of reasons, the most common of which are – the complex nature of rules governing the benefits system, IT systems not as integrated as they could be, poor business process design and human fallibility. The strategy, consistent with previous Departmental initiatives, places the emphasis on preventing new error from entering the system, improving compliance by reminding staff and customers of their responsibilities and identifying and correcting error already in the benefits system. Specific new initiatives to counter customer error include:
 - influencing customer behaviour – a campaign to increase public awareness of the need to inform the Department of lifestyle changes;
 - introducing targeted reviews – where the case has not been reviewed for a period of time, asking customers to confirm whether or not the entitlement details held continue to be correct; and
 - making it easier for customers to report changes in their circumstances via the telephone and, in time, over the internet.
20. I am currently carrying out a review of the impact of the Department's activity to counter fraud. This will provide an update on my Report '*Tackling Benefit Fraud*' (HC392 2002-03) by examining in detail six of the Department's counter-fraud initiatives: the advertising campaign, fraud investigation procedures, customer compliance, data-matching, the national benefit fraud hotline and prosecutions. I will report my findings separately during 2007-08. In 2008-09 I intend to supplement my review of counter-fraud initiatives with a review of progress in tackling error and complexity in the benefits system. These reviews are part of a substantial programme of NAO work designed to support the Department in its attempts to address the root causes of the qualification on my opinion on the accounts.

Further Developments

21. As noted above, the Department is devoting significant effort to reducing the incidence of fraud and error and also to improving its approach to measurement to

ensure that the information available is as accurate as possible. I fully support these initiatives and the Department's renewed drive to achieve a position where I am able to remove the long-standing qualification of my opinion on these accounts in this regard.

22. To achieve this, the Department still faces a significant challenge and will need to assess the extent to which fraud and error can continue to be reduced when considered against the cost of the Department's initiatives. To assist in this consideration, and building on my review this year of the Department's counter-fraud initiatives, I plan to carry out further reviews of the value for money of the Department's initiatives. For example, I intend to report during 2008-09 on the Department's work in tackling Official Error. An important factor in the cost effectiveness of error reduction continues to be the complexity of the benefits system as I have already reported, most recently during 2005 in my Report *'Dealing with the Complexity of the Benefit System'* (HC 592 2005-06)
23. The detail provided in paragraphs 6 to 20 above, demonstrates that there is material error arising from overpayments alone. However, as raised during the last Committee of Public Accounts hearing on these issues (HC411 incorporating HC 447-I, Session 2004-05) some members were also concerned about the levels of underpayment of benefits. Consideration of the costs and benefits of reducing errors in benefit payments will therefore need to consider both overpayments and underpayments. I will continue to work with the Department in addressing this important issue.

Conclusions on fraud and error in benefit expenditure

24. The estimate of £2.5 billion overpayments due to fraud and all types of error represents around 2 per cent of the £128 billion of gross expenditure. Although this represents a further reduction of the levels reported in previous years, in my view it is a material sum of expenditure not spent in accordance with Parliament's intentions and I have therefore qualified my audit opinion on the account.
25. I have now qualified the Department's account and those of its predecessors for the past 18 years because of the scale of fraud and error in benefit expenditure. The Department is placing increased focus on both addressing the causes of fraud and error and improved measurement accuracy. My staff will continue to monitor these developments as part of my annual review of the financial statements and also through my Value for Money Reports as noted above.

Material uncertainty over Contributory and Non Contributory Benefit Customer Overpayment Debtors

26. Overpayments to customers arise from fraud and errors by customers and from errors by officials. These are predominantly identified by staff in local offices, although they are also picked up by the extensive testing undertaken to estimate fraud and error. Identified overpayments are referred to Debt Centres for confirmation of the existence of a debt, its valuation and scope for recovery. Once confirmed, the debts are included in the debt balances recorded in the Department's balance sheet.

27. 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. My work in 2006-07 has allowed me to conclude that there is now sufficient evidence that the disclosed debt exists and is accurately valued. I am, however, still unable to determine that all debts that could have been identified and referred to Debt Centres for recovery have in fact been so. I am, therefore, unable to provide an unqualified opinion in respect of the completeness of debt and continue to limit the scope of my audit opinion in this respect.
28. Significant efforts have been made by the Department in recent years in enhancing the identification and management of customer overpayment debt. The introduction of the Debt Manager IT system in 2005 allowed the Department to cleanse data and to put in place processes that reliably support the existence and valuation of overpayment debts recorded in the balance sheet. Work by my staff has confirmed that this has been done well and provides a sound basis for the future. Furthermore, in March 2007, NAO conducted a pioneering stock-take at every Debt Centre to confirm that, unlike the previous year, a material backlog of debt referrals from operational business units had not built up.
29. I am also aware of the steps being taken in Jobcentre Plus and The Pensions Service to develop more streamlined business processes that will allow the prompt identification of overpayments and referral for recovery action. These processes will be crucial to ensuring that future balance sheets record the complete debt position at the end of each financial year. I welcome these initiatives as positive steps to address the current limitation in evidence to support disclosed debt.
30. The Department is considering the criteria for determining the extent to which the identification and recovery of historic benefit overpayments, not previously identified and referred for recovery over many years, may represent value for money to pursue. My staff will continue to monitor these developments as part of my annual review of the financial statements.