

15 July 2011

Department for Work and Pensions: 2010-11 Accounts

**Report by the Comptroller and Auditor
General**

Introduction

Fraud and error in benefit expenditure

1. The accounts of the Department for Work and Pensions (the Department) disclose net expenditure of £160.3 billion on benefits, employment programmes and their related administration costs in 2010-11, together with the assets and liabilities as at 31 March 2011.
2. Under the Government Resources and Accounts Act 2000, I am required to give an opinion on whether, in all material respects:
 - i) the financial statements give a true and fair view of the state of the Department's affairs as at 31 March 2011 and of its net cash requirement, net resource outturn and net operating cost for the year then ended; and
 - ii) the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions issued thereunder.
3. In addition, I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income reported in the financial statements have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them (my regularity opinion).
4. In respect of the Department's 2010-11 accounts I have qualified the regularity aspect of my audit opinion due to the material level of fraud and error in benefit expenditure, other than State Pension where the level of fraud and error is lower. The Department's accounts, and those of predecessor Departments administering this expenditure, have received similar qualified audit opinions since 1988-89.
5. Legislation specifies entitlement criteria for each benefit and the method to be used to calculate the amount of benefit to be paid. Where fraud and error result in over or underpayment of benefit to an individual who is either not entitled to that benefit, or is paid at a rate which differs from that specified in the legislation, the transaction is not in conformity with the governing legislation and is irregular.
6. Note 43 to the Department's accounts discloses the Department's best estimate of all such fraud and error within the benefits system. As shown in Note 43, the Department estimates total overpayments due to fraud and error in 2010-11 are £3.3 billion (2009-10 – £3.1 billion), which equates to 2.1% of total benefit expenditure of

£153.6 billion (2009-10 – 2.1% on expenditure of £148.0 billion), representing an increase in the amount of benefits being overpaid, although the percentage overpaid against total expenditure remains flat. The Department estimates total underpayments in 2010-11 at £1.3 billion (2009-10 – £1.3 billion), which equates to 0.8% of total benefit expenditure (2009-10 – 0.9%).

7. Within those figures, the Department estimates that in 2010-11 fraud and error within State Pension resulted in overpayments of £0.1 billion (2009-10 – £0.09 billion), 0.1% of related expenditure (2009-10 – 0.1%) and underpayments of £0.1 billion (2009-10 – £0.11 billion), 0.1% of related expenditure (2009-10 – 0.2%).

8. I have therefore qualified my audit opinion on the regularity of the Department's benefit expenditure, other than State Pension, because of the level of overpayments attributable to fraud and error which do not conform to Parliament's intention; and because of the levels of under and overpayments in such benefit expenditure which are not in conformity with the relevant authorities. This report sets out the reasons and context for my qualified audit opinion by commenting on the key causes of fraud and error in the benefits system and the actions the Department is taking to try to reduce it.

9. The report also demonstrates the significant challenge that the Department faces in administering a complex benefits system to a high degree of accuracy in a cost effective way. Some benefits, mainly those with means tested entitlement, are more inherently susceptible to error due to their complexity, the difficulties in obtaining reliable information to support the claim and the problem of capturing changes in a customer's circumstances. These more complex to administer benefits tend to be the ones exhibiting the highest estimated fraud and error rates.

10. In February 2011, the Government introduced the "Welfare Reform Bill 2011" to Parliament. One of the main elements of the Bill is the introduction of a new Universal Credit to replace many of the current working age benefits with a single means tested payment. The primary aim of Universal Credit is to create a single streamlined working age benefit, with tapered payments that are structured to encourage customers to return to work. It is also intended that this streamlining of benefit will reduce or remove some of the current complexities around benefit entitlement, verification of customer circumstances and administrative burden that can increase the opportunities for fraud and error. In combination with that restructuring, the Welfare Reform Bill also includes proposals to apply further penalties in respect of customer fraud to bolster the Department's tools to further reduce fraud and error in benefit payments.

Where do the errors occur?

Overview

11. The Department's total expenditure on benefits in 2010-11 was some £153.6¹ billion, of which £127.0 billion was in respect of benefits paid directly by the Department and £26.6 billion in respect of benefits paid on the Department's behalf by Local Authorities, mainly Housing Benefit and Council Tax Benefit. Note 43 to the Department's accounts sets out expenditure by benefit type and the Department's estimate of the extent of fraud and error in each type. The Note also explains the extent of statistical uncertainty inherent in these estimates and the difficulty in identifying certain types of complex error and well concealed frauds, and that therefore some caution must be exercised when examining the estimates for trends. The estimate of fraud and error disclosed in the accounts is nevertheless the best measure currently available.

12. The estimates separate the reported incorrect payments into three categories, which the Department defines as follows:

- Official error arises when a benefit is paid incorrectly due to inaction, delay or a mistaken assessment by the Department, a Local Authority or Her Majesty's Revenue and Customs (HMRC);
- Customer error occurs when customers make inadvertent mistakes with no fraudulent intent; and
- Fraud arises when customers deliberately seek to mislead the Department and local Authorities who administer benefits on the Department's behalf to claim money to which they are not entitled.

13. The following paragraphs further analyse the types of fraud and error which commonly arise within the Department's three main error categories of official error, customer error and fraud. For the purposes of this report, we have primarily focussed on the benefits administered directly by the Department and have discussed the different characteristics of Housing Benefit and Council Tax Benefit, which are administered by Local Authorities on the Department's behalf, separately in paragraphs 2.14 to 2.18.

¹ Sourced from Note 43

Official Error

14. The Department's 2010-11 estimate of official error (defined in paragraph 2.2 above) is broken down in Figure 1 below.

Figure 1

Estimated official error

| Benefits | 2010-11 | 2010-11 | 2010-11 | 2009-10 | 2009-10 |
|--|----------------------------------|--|---|--|---|
| | Total expenditure £ million * | Official error overpayments £ million * (% of related expenditure) | Official error underpayments £ million * (% of related expenditure) | Official error overpayments £ million * (% of related expenditure) | Official error underpayments £ million * (% of related expenditure) |
| Benefits administered directly by the Department | 127,000 | 700 (0.6) | 300 (0.3) | 800 (0.6) | 400 (0.3) |
| Housing related benefits administered by Local Authorities | 26,600 | 100 (0.5) | 100 (0.3) | 300 (1.2) | 100 (0.4) |
| All DWP benefits | 153,600 | 800 (0.5) | 400 (0.3) | 1,100 (0.7) | 500 (0.3) |

NOTES

Figure Source: Department for Work and Pensions Accounts, Fraud and Error in the Benefit System October 2008 to September 2009 (for the 2009-10 estimates), First Release; Fraud and Error in the Benefit System: Preliminary 2010/11 Estimates (for the 2010-11 estimates).

Rounded to the nearest £100 million.

15. Official errors can cause hardship to customers who are underpaid and unfairly reward others who are overpaid at an additional cost to the taxpayer. They can take time to identify and correct and as a result their cumulative impact on resource and efficiency can be considerable. The overall rate of official error for overpayments and underpayments shown in Figure 1 represents an average across all benefits. In the benefits administered directly by the Department, the costs of administrative errors are proportionately higher in means tested or disability related benefits, where entitlement depends on the Department collating and assessing a wide range of information. In

general, the greater the data requirements required to establish entitlement to a benefit, the more complex it is to administer and therefore the higher the inherent risk of an official error being made. For example, there is a relatively low rate of error in State Retirement Pension, whereas State Pension Credit, which is more complex to administer due to its means tested nature, has an error rate of 6.0% in overpayments and 2.1% in underpayment (2009-10 – overpayments 4.4%; underpayments 1.9%).²

16. My Value for Money report, 'Minimising the costs of administrative error in the benefit system', published in November 2010, reported that the most common types of official error relate to the Department incorrectly recording the level of a customer's income, incorrectly applying complex additional premiums, or making errors in establishing the customer's status (such as their fitness for work, single status etc). These factors can also be subject to frequent change over the course of a claim, which can increase the propensity for overpayments. My findings confirmed that the majority of official errors resulting in overpayments arise when adjustments are made to existing claims, rather than when processing a new claim.

Customer Error

17. The Department's estimate of customer error, as defined in paragraph 2.2, is shown in Figure 2 below.

Figure 2

Estimated customer error

| Benefits | 2010-11 | 2010-11 | 2010-11 | 2009-10 | 2009-10 |
|--|----------------------------------|--|---|--|---|
| | Total expenditure £ million * | Customer error overpayments £ million * (% of related expenditure) | Customer error underpayments £ million * (% of related expenditure) | Customer error overpayments £ million * (% of related expenditure) | Customer error underpayments £ million * (% of related expenditure) |
| Benefits administered directly by the Department | 127,000 | 500 (0.4) | 600 (0.5) | 600 (0.5) | 500 (0.4) |
| Housing related benefits administered | 26,600 | 700 (2.5) | 300 (1.1) | 500 (2.0) | 300 (1.2) |

² Minimising the costs of administrative errors in the benefit system, HC 569, 25 November 2010

by Local
Authorities

| | | | | | |
|---------------------|---------|-------------|-----------|-------------|-----------|
| All DWP benefits | 153,600 | 1,200 (0.8) | 900 (0.6) | 1,100 (0.7) | 800 (0.5) |
|---------------------|---------|-------------|-----------|-------------|-----------|

NOTES

Figure Source: Department for Work and Pensions Accounts, Fraud and Error in the Benefit System October 2008 to September 2009 (for the 2009-10 estimates), First Release; Fraud and Error in the Benefit System: Preliminary 2010/11 Estimates (for the 2010-11 estimates).

Rounded to the nearest £100 million.

18. Customer error accounts for around one third of the total cost of the Department's overpayments and around two thirds of the total cost of underpayments, although there are substantial differences in customer error rates between benefits. As with official error, those with the highest customer error rates are means tested benefits, such as State Pension Credit and Income Support, which have entitlement conditions that relate to the level of income and/or savings of customers. Mistakes can arise here as a result of the customer failing to provide accurate or complete information to the Department, or having failed to report a change in their circumstances, which leads to an incorrect assessment being made.

19. My January 2011 Value for Money report into customer error³ found that there were three main issues underpinning customer error. Firstly, the benefits system is complex for customers to navigate. The Department's research found that customers are generally unaware of rules on capital, investments or redundancy payments and do not easily understand deductions for non-dependants. Nor do customers readily recognise that they have to report any changes in their circumstances. A significant proportion of customers (70% of those asked) thought that they did not have to report short term changes, and (40%) had little or no knowledge of their reporting obligations. Thirdly, many customers incorrectly believe that reporting changes once to a local or central government body will lead to all government bodies updating their records for that individual.

20. Customers have a responsibility, as a condition of receiving benefit, to provide the Department with accurate and complete information and to tell the Department promptly about any changes in their personal circumstances that might affect the amount of benefit to which they are entitled. The Department has adopted this approach, which relies on customers being pro-active in notifying changes, because it does not have routine access to verifiable third party sources of information, or such information may not exist, which would allow them to track those changes. However, the Department and Her Majesty's Revenue and Customs' joint strategy 'Tackling fraud and error in the benefits and tax credits systems' (published in October 2010)

³ Reducing losses in the benefits system caused by customers' mistakes, HC 704, 21 January 2011

acknowledges that the Department has historically been too passive in its approach to ensuring that customers report changes in circumstances.

Fraud

21. The Department's estimate of fraud, as defined in paragraph 2.2, is shown in Figure 3 below.

Figure 3

Estimated fraud

| Benefits | 2010-11 | 2010-11 | 2009-10 |
|--|----------------------------------|--|--|
| | Total expenditure £ million * | Fraud overpayments £ million * <i>(% of related expenditure)</i> | Fraud overpayments £ million * <i>(% of related expenditure)</i> |
| Benefits administered directly by the Department | 127,000 | 900 (0.7) | 700 (0.6) |
| Housing related benefits administered by Local Authorities | 26,600 | 300 (1.3) | 300 (1.2) |
| All DWP benefits | 153,600 | 1,200 (0.8) | 1,000 (0.7) |

NOTES

Figure Source: Department for Work and Pensions Accounts, Fraud and Error in the Benefit System October 2008 to September 2009 (for the 2009-10 estimates), First Release; Fraud and Error in the Benefit System: Preliminary 2010/11 Estimates (for the 2010-11 estimates).

Rounded to the nearest £100 million.

22. Of the benefits administered directly by the Department, it is the means tested benefits, such as State Pension Credit, Jobseeker's Allowance and Income Support, which tend to have the highest rates of fraud as they require the customer to supply complete and accurate information in order to establish entitlement to benefit. Most commonly, fraudulent customer statements relate to the customer's living arrangements where the customer has a partner, but is claiming and receiving benefit as a single person, or falsely stating the level of their earnings, whether those are legitimate earnings or from the grey economy. There are also instances where the customer has provided a false address in order to claim benefit.

23. The Department's research indicates that customer difficulties in reporting changes in their circumstances and concerns about potential changes or disruptions

to benefit payments contribute to the problem⁴. The complex administration of benefits also allows potential fraudsters the opportunity to present themselves differently to different administering agencies, which are not always sufficiently integrated to identify those instances. Because the Department does not have a readily available source of external information against which to verify some aspects of claims, such misrepresentations can result in fraud occurring.

Housing Benefit and Council Tax Benefit

24. As noted in paragraph 2.1, Housing Benefit and Council Tax Benefit are administered by the customer's relevant Local Authority on behalf of the Department. Undetected errors in benefits administered directly by the Department, can, however, also lead to errors on Housing Benefit claims. This is because receipt of income related benefits such as Jobseeker's Allowance or Income Support can be used by a Local Authority as evidence that customers are entitled to Housing Benefit and Council Tax Benefit. Therefore, fraud and error in one claim can be passported into the Local Authority administered benefit. As Housing Benefit and Council Tax Benefit are also means tested, they are subject to similar limitations around evidence that can be gathered as those means tested benefits administered by the Department. Consequently, a number of fraud and error types that are common to the means tested benefits administered by the Department also arise in Housing Benefit and Council Tax Benefit.

25. The Department has a key role in setting the framework within which Local Authorities must manage benefits. For Housing Benefit, the funding arrangement between the Department and Local Authorities contains a formula intended to encourage accurate payments by Authorities by affecting the amounts refunded to them based on accuracy targets. The Department has also established a performance management regime to encourage Local Authorities to adopt best practice in the administration of Housing Benefit, including an output based performance measure which sets each Local Authority a target for identifying reductions in benefits overpaid and to prevent overpayments due to customer error entering the system.

26. Common errors arise from poor or non-timely exchange of information between the Department and the Local Authority with regard to whether a customer is in receipt, or entitled to, a qualifying benefit. In practice, given the lack of integration between the Department's systems and those of all Local Authorities, such errors will be difficult to eliminate.

27. There are additional fraud and error risks which are more specific to Housing Benefit and Council Tax Benefit as the benefit is paid in respect of a specific property. For example, where the customer moves between Local Authority areas they may

⁴ 'Tackling fraud and error in the benefit and tax credits system', October 2010

need to communicate effectively with more than one Local Authority which, again, increases the risk of errors being made or changes in circumstance not being communicated effectively or being fraudulently concealed.

28. The Department is implementing an Automated Transfers to Local Authority Systems (ATLAS) project to enable the better transfer of data on benefit entitlement between central government and Local Authorities responsible for Housing Benefit, which it hopes will lead to a significant reduction in fraud and error within Local Authority administered benefits.

Future Plans

29. The Department fully recognises the problems created by the level of fraud and error in benefit payment and has, over the years, made many efforts to reduce it, ranging from introducing data-matching systems, advertising campaigns targeting actual and potential fraudsters and the application of sanctions and prosecutions. Nevertheless, the level of fraud and error within the benefits system remains high.

30. Now, with savings being sought across all levels of government and tough decisions needing to be made about public spending priorities, there is a strong and renewed imperative for the Government to reduce fraud and error. This is evidenced by cross government initiatives such as the Cabinet Office's Counter Fraud Taskforce set up in October 2010, which emphasised the need to aggressively tackle fraud losses in its interim report ('Eliminating Public Sector Fraud' published in June 2011). Alongside these initiatives, the Department has adopted a new four year fraud and error strategy, published in October 2010, which sets out a new approach to tackling fraud and error that intends to deliver significant reductions in the level of both. This includes considering making innovative use of private sector data, interventions targeted on reinforcing customer responsibilities, targeted system improvements and the creation of a single integrated investigation service for welfare fraud.

31. The Government's proposal to introduce a Universal Credit to replace some of the existing working-age benefits, which are the benefits that have historically suffered from the highest rates of fraud and error, also marks an opportunity for the Department to eliminate many of the key contributory factors to the current high level of fraud and error within benefit expenditure. Reducing the complexity of the current welfare system and reducing the number of complex interactions between different benefits should help improve compliance with the rules and reduce fraud and error.

34. Complementing these reforms, Her Majesty's Revenue and Customs plans to introduce a real time information system for Pay As You Earn, which would link the tax and benefits system for the first time. This offers the potential to significantly reduce current issues around verification of entitlement for benefits which have means tested elements to their eligibility criteria.

Conclusion

35. The estimated value of fraud and error overpayments in the benefits system in 2010-11 was £3.3 billion, or 2.1% of expenditure, which represents an increase on 2009-10 on the value and of benefits overpaid, although the percentage of overpayments remained flat (2009-10 – £3.1 billion and 2.1% respectively). Over the period in which fraud and error have been measured by the Department, fraud and error rates have consistently remained at a high level. This has been most notable in means tested benefits, where entitlement can be based on complex, interlinked or subjective evidence and which the Department is either unsuccessful in verifying, or which it simply gets wrong. These observations have led me and my predecessors to qualify the Department's accounts on the grounds of material amounts of fraud and error in the benefits system since 1988-89. I consider that this view is consistent with the views expressed by the Government in the October 2010 DWP/HMRC document "*Tackling Fraud and Error in the Benefit and Tax Credits Systems*" that the level of illegitimate payments in the systems remains unacceptable.

36. However, I recognise that no system can ever be perfect, not least because it is difficult to administer a benefits system of such complexity in a cost effective way and because human error can and does occur even in the best designed systems. Consequently, where the Department needs to gather information to process a claim correctly, it has to strike a balance between the need to provide sufficient scrutiny over claims and do so in a way that is not overly burdensome, otherwise administration of the benefits system would become impractical.

37. We welcome the Department's commitment to tackling these difficult issues, and the refreshed approach that it intends to take in reducing fraud and error, which it sets out in more detail within the Annual Report and in Note 43 to the accounts. The Department has proposed some radical measures to reform the benefits system, which is also, in part, an attempt to drive down incorrect payments. It needs to continue to enhance its understanding of the underlying root causes of fraud and error in the benefits system, in order to develop more effective decision making and more accurate benefit decisions. Only by developing such an evidence based framework will the Department be able to demonstrate that its systems are sufficiently optimised to minimise the gap between what it should achieve and what it does achieve.

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