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Tackling tax credits error and fraud

Summary

1 Working tax credits and child tax credits (tax credits) are government payments to support low-income workers and those responsible for children and young people. In 2011-12, HM Revenue & Customs (HMRC) paid around £30 billion in tax credits to just under six million families and individuals, supporting around nine million children.

2 The tax credits scheme is complex. The eligibility of claimants and the value of their awards is based on a range of criteria including: hours worked (working tax credits) and children (child tax credits), disability, childcare costs and household income. The scheme is designed to react to changes in claimants' circumstances. However, claimants do not always fully understand when they should tell HMRC of changes to their circumstances. In 2010-11, HMRC estimated that one-fifth of awards contained error or fraud, which resulted in claimants receiving more money than they were entitled to. HMRC works to identify and correct error and fraud, such as through in-depth information checks and providing support to claimants. HMRC refers to these activities as interventions.

3 In July 2008, HMRC announced a target to reduce personal tax credits losses due to error and fraud to no more than 5 per cent of the value of finalised entitlement by March 2011. As HMRC can only produce its estimate of error and fraud for any year once the awards for that year are finalised, there is a significant time lag between reporting and the period to which the estimates refer. In June 2012, HMRC published the error and fraud results for 2010-11 and announced that it had missed this target. It estimated the overall level of error and fraud as 8.1 per cent, some £2.3 billion. The Comptroller and Auditor General reported on this in the HMRC 2011-12 Resource Accounts and qualified his regularity audit opinion because of the level of error and fraud in the payment of tax credits.

4 In October 2010, the government announced that it intended to introduce a new Universal Credit, which will replace many of the current working-age benefits, including tax credits, with a single means-tested payment. Universal Credit will go live in April 2013, starting with a limited number of local authority areas. Tax credit claimants, where eligible, will transfer to the new benefit by 2017.

Scope of report

5 In November 2012, the Committee of Public Accounts took evidence on HMRC's 2011-12 accounts. There had been no significant reduction in the overall level of tax credits error and fraud. It concluded that HMRC was unable to get a grip on tax credits error and fraud.[1] This report examines HMRC's progress in tackling tax credits error and fraud since 2009 and assesses why it did not achieve the target.

1 HC Committee of Public Accounts, *HM Revenue and Customs: Annual Report and Accounts 2011-12*, Nineteenth Report of Session 2012-13, HC 716, December 2012.

Key findings

HMRC's approach to tackling error and fraud since 2009

6 **The introduction of a target to reduce error and fraud led HMRC to reassess its approach.** HMRC recognised that a fresh approach to tackling error and fraud was required if it was to meet its target. From April 2009, it increased the number of error and fraud checks on claims; targeted the claims at greatest risk of containing error and fraud; and checked claims earlier in the tax credits cycle. It also increased the number of front-line staff involved in claims checking from 1,100 to 1,500. HMRC only had, however, two years to reduce the level of error and fraud from 9 per cent to 5 per cent by 2010-11 (paragraphs 2.2 to 2.5).

7 **HMRC has been innovative in how it tackles error and fraud.** It analysed error and fraud data to improve its understanding of losses and target its resources. Since introducing its new approach, HMRC has developed around 40 different interventions to tackle specific risk types. For example, it introduced a new automated approach to screen applications, which allows HMRC to check claims at risk of containing error and fraud before they enter the tax credits system. HMRC also introduced new approaches to data matching. This includes using Department for Work and Pensions data to reduce error and fraud relating to disability from £145 million to £40 million. HMRC monitors interventions to confirm they provide expected returns and stops those that do not (paragraphs 2.11 to 2.17).

8 **HMRC has increased the impact of its interventions on error and fraud.** It has assessed that the error and fraud prevented as a result of its interventions increased from £253 million in 2008-09 to £480 million in 2010-11. It delivered this uplift by increasing the number of error and fraud interventions from 123,000 in 2008-09 to nearly two million in 2010-11. HMRC achieved this by changing how it intervened, shifting the focus away from full compliance enquiries towards conducting checks targeted at specific risks on a larger number of claims (paragraphs 2.8 to 2.10).

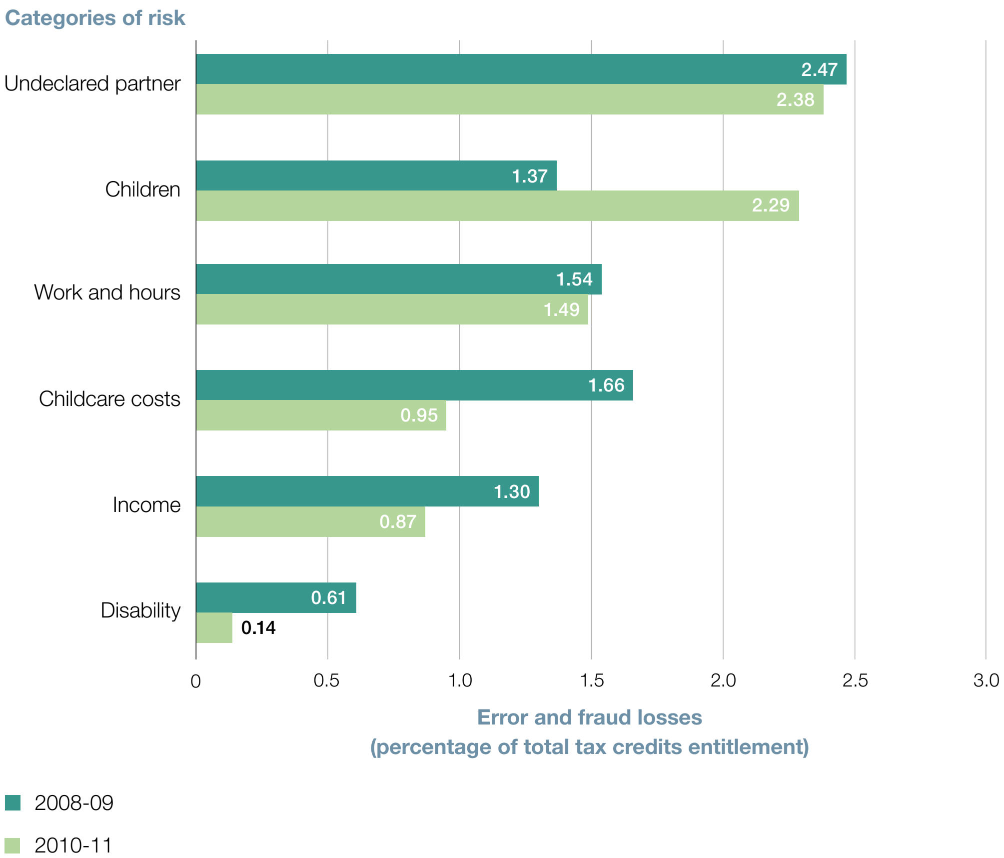
Performance in reducing error and fraud at March 2011

9 **HMRC significantly overestimated the impact of its interventions on the level of error and fraud.** HMRC had calculated that error and fraud would reduce to 5 per cent by March 2011 based on its original assumptions in support of its losses-prevented measure. HMRC originally estimated that its interventions would reduce error and fraud by £1.4 billion in 2010-11. It has subsequently analysed the relationship between the losses-prevented measure and the error and fraud results and revised the estimate downwards to £480 million. HMRC overestimated the wider impact of correcting claimants' awards, such as changes to customer behaviours and the broader deterrent effect (paragraphs 3.3 to 3.10).

10 HMRC has achieved notable reductions in the level of error and fraud in three of six risk categories. HMRC has different approaches to tackling error and fraud across its six risk categories, which correspond to the main elements of tax credits awards. HMRC has made progress in reducing error and fraud in the 'childcare' and 'income' categories and has made a significant reduction in the 'disability' category (**Figure 1**) (paragraph 3.14).

Figure 1
Error and fraud losses by risk category, as a percentage of tax credits entitlement

HMRC's performance has varied across the six risk categories[1]



NOTE

1 The values are HMRC's best estimate of the primary reason for an adjustment to awards. HMRC does not publish confidence intervals for these estimates. Does not sum to total error and fraud due to rounding.

Source: National Audit Office analysis of HM Revenue & Customs error and fraud statistics

11 HMRC has made little progress in two categories – 'undeclared partner' and 'work and hours'. These accounted for losses of over £1 billion in 2010-11. HMRC has found the undeclared partner risk particularly difficult to tackle as it holds limited data to establish claimants' living arrangements and financial relationships. Similarly, it does not hold the data to readily verify information on claimants' work and hours. Since publication of the 2010-11 error and fraud results HMRC has sought to improve its response in these areas, but the results to assess its performance are not yet available (paragraphs 3.20 to 3.21).

12 Error and fraud relating to children being incorrectly included in awards doubled to £640 million between 2008-09 and 2010-11. HMRC did not anticipate this increase and has not yet fully established the causes. It believes that around 80 per cent of the £640 million error and fraud in 2010-11 related to children incorrectly declared as being in full-time education or training. In these cases, claimants failed to notify HMRC of a change in their circumstances and continued to receive a higher value of award. Since publication of the results HMRC has increased checks in this area (paragraphs 3.18 to 3.19).

13 HMRC had not fully analysed the amount of error and fraud entering at each point in the tax credits system until late 2011. The value of tax credits awards varies as claimants' circumstances change and HMRC may pay claimants the wrong amount if these are not reflected in the award. HMRC estimates that around 80 per cent of error and fraud occurs after application. This analysis was not available to inform the design of interventions in 2009-10 and 2010-11 (paragraphs 3.22 to 3.23).

14 Despite the significant increase in interventions, around 1.4 million awards (20 per cent) remained incorrect. There still remains a substantial number of claims containing error and fraud after HMRC's interventions. With the existing level of resources, HMRC has prioritised its interventions and focused on higher value claims at greatest risk of being incorrect. Although HMRC corrected approximately one quarter of the claims that it checked, there remained a significant level of undetected error and fraud in the tax credits system (paragraph 3.26).

Actions taken since 2010-11

15 HMRC has strengthened its approach since 2011, although the impact on overall levels of error and fraud will not be available until summer 2013. HMRC estimates that it stopped £620 million of error and fraud in 2011-12, up from £480 million in the previous year. HMRC achieved this impact through the better targeting of risks, while also reducing the number of interventions to 1.6 million, from around 2 million in 2010-11 (paragraphs 4.2 to 4.3).

16 In 2011-12, HMRC has increased the impact of interventions which correct awards already in the tax credits system. HMRC's estimate of the impact of activities to correct error and fraud from existing claims increased from £190 million to £370 million from 2009-10 to 2011-12. HMRC has improved productivity, with a threefold increase in the error and fraud prevented from each intervention from £215 to £630. It has also made better use of data analysis to target claims during the annual renewals process. This achieved better results than its previous approach which targeted claims with a larger award value (paragraphs 4.5 to 4.6).

17 HMRC has strengthened its response to the undeclared partner risk by using new methods of data analysis and risk profiling, in partnership with a private sector firm. In 2011, it began work with a credit reference agency to cross-check the information that claimants provide on households against other sources. HMRC improved its initial identification of risky claims by using its CONNECT system, which can uncover hidden relationships between people, including shared addresses and financial transactions (paragraph 4.7).

18 HMRC has not yet developed a detailed picture of how claimants behave. HMRC has focused on identifying areas of risk and how error and fraud enters the system. It has begun to draw together this data analysis with its research on claimant behaviour to develop new insights, but this work is at an early stage. It has not built analysis to help it predict when claims are likely to go wrong so it can intervene to keep them correct (paragraphs 4.9 to 4.10).

19 HMRC will not now achieve its target to deliver £8 billion in error and fraud savings over the period 2011-12 to 2014-15. HMRC agreed this target with HM Treasury based on the original assumptions supporting the calculation of losses prevented. It will not achieve the target due to the reassessment of the actual impact of its interventions on error and fraud (paragraph 3.11).

Conclusion on value for money

20 In June 2012, HMRC estimated that tax credit error and fraud in 2010-11 was around 8.1 per cent, which meant it had missed its target to reduce error and fraud to 5 per cent of finalised payments by 2010-11. It has improved its understanding of risk to strengthen its operational response, piloting different approaches to tackle risks. This has led to a year-on-year improvement in the estimated amount of error and fraud prevented through interventions from HMRC's front-line staff. However, HMRC can only demonstrate that its actions have been effective in reducing error and fraud in three of its six areas of risk. In addition, it has not yet developed an effective response to stopping error and fraud reoccurring on claims in the system due to changes in claimants' circumstances. Overall, despite improvements in the impact of its interventions, HMRC's approach has not yet achieved a sustainable reduction in the level of error and fraud, and it has yet to deliver value for money.

21 HMRC needs to build on the positive actions it has taken since its error and fraud target was introduced. To deliver value for money, HMRC needs to enhance its understanding of risks and customer behaviours, make better use of data to target risks in the largest loss areas, and ensure that changes to customers' circumstances are promptly and accurately captured.

Recommendations

22 HMRC has not yet delivered lasting reductions in the overall level of error and fraud or sustained changes in customer behaviours. We support how HMRC is seeking new ways of working, but have also identified a number of areas where it could strengthen its response.

On managing its error and fraud response

a **HMRC should establish an error and fraud reduction plan for each of its six categories of risk and use this to evaluate its performance.** Evaluation at this level will help ensure that HMRC's focus is on reducing loss for each category of risk to the lowest possible amount.

b **HMRC needs to review and update annually the assumptions used to support its calculation of losses-prevented.** HMRC has found the losses-prevented measurement important for monitoring performance in real-time. However, the original assumptions used by HMRC did not accurately reflect the impact of interventions on error and fraud in 2010-11.

On data and analysis

c **HMRC needs to improve its data analysis to support the development of responses that will deliver sustainable reductions in error and fraud.** HMRC has little analysis on what happens to claimants following an intervention or what circumstances indicate when a claimant is likely to make a mistake.

d **HMRC should assess how it can make better use of available data and analytical techniques.** HMRC has successfully used CONNECT to help identify additional information about tax credits claimants, but its use has been limited to identifying undeclared partners. HMRC should use CONNECT more widely in profiling tax credit awards for intervention.

e **HMRC needs to assess how it can develop a more effective response to tackle error and fraud resulting from changes in claimants' circumstances.** Eighty per cent of error and fraud occurs after the point of application. HMRC needs to extend its use of data analytics to target and engage with claimant groups whose awards are more likely to contain inaccurate details or who need support with their claim.

On expanding the number and quality of interventions

f **HMRC should evaluate ways to improve the quality and volume of interventions through the use of third parties.** HMRC's initial use of third-party data on a payment-by-results model has proved a cost-effective way of obtaining appropriate evidence to correct awards. HMRC should consider how it could expand this model to cover a wider range of risks beyond that of undeclared partners.