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COMPTROLLER AND
AUDITOR GENERAL

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HM Revenue & Customs

Tackling tax credits error and fraud

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HM Revenue & Customs

Tackling tax credits error and fraud

Report by the Comptroller and Auditor General

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Amyas Morse
Comptroller and Auditor General
National Audit Office

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This report examines HMRC's progress in tackling tax credits error and fraud since 2009.

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Contents

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This report can be found on the National Audit Office website at www.nao.org.uk/tax-credits-2013

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Key facts

£30bn	8.1%	5%
paid by HMRC on tax credits, 2011-12	losses due to error and fraud in 2010-11	HMRC's target for losses due to error and fraud, March 2011

£2.27 billion	HMRC's estimate of losses due to error and fraud, 2010-11, around £850 million higher than it expected
1,973,000	interventions in 2010-11, up from 123,000 in 2008-09
£1.4 billion	HMRC's initial estimate of the error and fraud its interventions prevented in 2010-11, based on its original assumptions
£480 million	HMRC's revised estimate of the error and fraud its interventions prevented in 2010-11, following a review of its original assumptions

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).

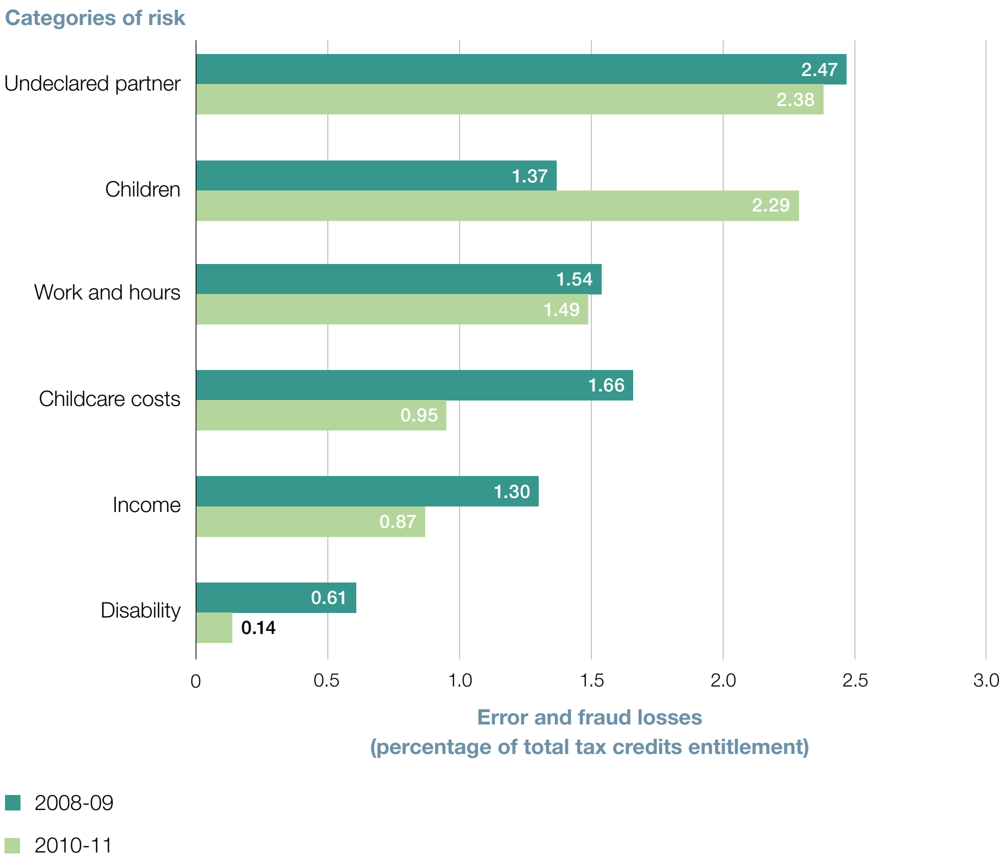
Performance in reducing error and fraud at March 2011

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.

Part One

Overview of tax credits

The purpose and design of tax credits

1.1 HM Revenue & Customs (HMRC) paid £30 billion in tax credits in 2011-12, providing support to just under six million individuals and families, including around nine million children. Tax credits are government payments, introduced in April 2003, with the aim of providing support to families with children; tackling child poverty; and helping to make sure that work pays more than welfare.

1.2 Tax credits are a complex benefit. The award is designed to be flexible and respond quickly to changes in claimants' financial and personal circumstances. Eligibility and the value of awards are based on a range of criteria including: hours worked (working tax credits) and children (child tax credits), disability, childcare costs, and household income (**Figure 2**). Tax credits are means-tested and HMRC reduces the value of awards once household income reaches certain thresholds.

Figure 2
Elements of tax credit awards

There are six key areas of awards which, if incorrect, are likely to lead to error and fraud

Main elements of award	What claimants should report
Income	Estimates of the before tax annual income for the household.
Childcare costs	Average weekly childcare costs, based on an estimate of total childcare costs for the year.
Work and hours	Current employment and hours of work per week.
Household	Claimant must make a joint claim with their partner if they are 'living together as husband and wife'.
Children	Number and age of children, including young persons aged 16 to 19.
Disability	If claimant, partner or children have a qualifying disability, as HMRC defines it.

Source: National Audit Office analysis of HM Revenue & Customs guidance

1.3 Tax credits are an annual award and claimants must provide HMRC with accurate details of their circumstances. The awards are provisional with the final amount calculated at the end of the year once actual household income and circumstances are known. **Figure 3** outlines this annual cycle.

1.4 Claimants are responsible for providing accurate details of their circumstances and notifying HMRC if any changes occur. Claimants do not always fully understand what they need to report to HMRC, leading to inaccurate or non-reporting of their circumstances. For example, HMRC's research shows:

- Claimants struggle to estimate their average annual income where their working patterns change regularly or they have multiple or temporary employments.
- Where household relationships are complex, claimants may not be clear on whether to report a change.
- Claimants do not understand how to calculate average weekly childcare costs.

Figure 3
Tax credits process

An annual award, the tax credit cycle runs for 16 months (start of the tax year to end of the annual renewal period); and claimants must provide HMRC with accurate details of their circumstances

Application and award	Change in circumstances	Annual renewal
Applications can be made at any point in year	**Changes of circumstance should be notified as they occur**	**Renewal period runs from April to July each year**
Claimants apply by post	Majority of claimants notify HMRC of changes through ringing a contact centre. Claimants may also notify in writing	Claimants make renewals by post or by ringing a contact centre
Claimant submits application form, based on current circumstances and estimated income for the year		Claimant provides information on their income and actual circumstances for the year
HMRC verifies the information provided, calculates provisional award and issues award notice to claimant	HMRC verifies the information provided and calculates the revised award	HMRC calculates actual entitlement for the year and issues final award notice to claimant, including details on any over or underpayment
Provisional award goes into payment	Revised award goes into payment	HMRC uses the same information to calculate the provisional award for the following year and issues award notice

Source: National Audit Office analysis

Error and fraud in tax credits

1.5 Error and fraud occurs when a finalised award contains incorrect or incomplete information. Error occurs when claimants do not provide HMRC with accurate information on their circumstances before their award is finalised, provide inaccurate information which they believe to be correct, or when HMRC makes a mistake when processing the claim. Fraud occurs when claimants knowingly provide HMRC with inaccurate information or deliberately conceal information to increase the value of their award.

1.6 HMRC's error and fraud analysis programme provides an estimate of the overall level of error and fraud in tax credits. HMRC bases this annual estimate on an examination of 4,000 to 5,000 randomly selected finalised awards. Awards for 2010-11 were generally finalised by July 2011. However, for some claimants who pay income tax under self-assessment, the finalisation of their 2010-11 award may not have taken place until January 2012. There is, therefore, a time lag of around 14 months between the end of the award period and HMRC publishing its error and fraud estimate.

1.7 In June 2012, HMRC estimated that error and fraud was around 8.1 per cent of finalised entitlement in 2010-11, against a target of 5 per cent (**Figure 4**). The value of error and fraud losses was around £2.3 billion, £850 million higher than if HMRC had achieved the target. Error and fraud affected 1.4 million awards. Just under half of these awards accounted for almost 90 per cent of the total losses.

1.8 Error by claimants or HMRC may also result in claimants receiving less money than they are entitled to when their award is finalised. These errors, which are not included in HMRC's estimate of the level of error and fraud, fell from 1.9 per cent of the value of finalised awards in 2003-04 to 0.8 per cent in 2010-11. In 2010-11, this level of error amounted to £230 million, across 490,000 awards.

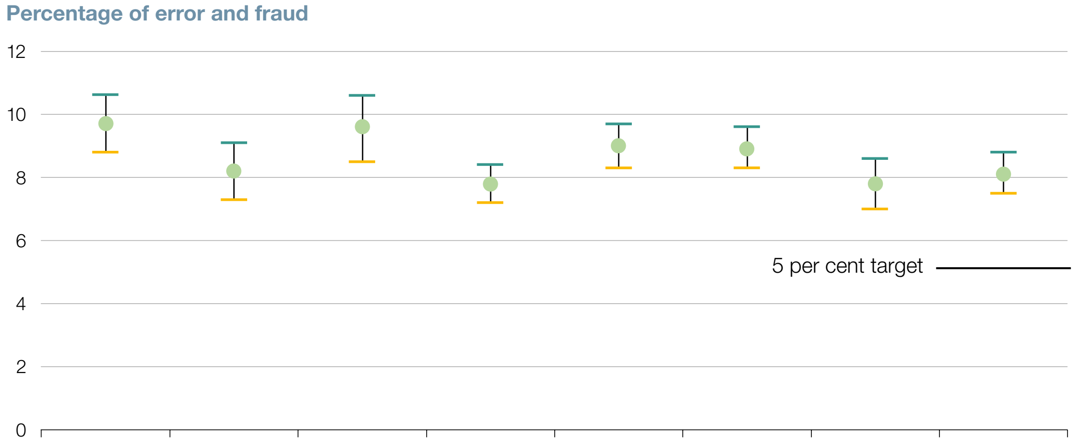
Organised crime

1.9 HMRC has established a separate team to tackle and disrupt organised attacks on the tax credits system. This team seeks to gather intelligence from a range of sources and analyses patterns of behaviour to identify attacks in as close to real time as possible. HMRC investigates these cases and, where appropriate, will seek to use available sanctions to punish and prosecute criminal behaviour.

1.10 The impact of HMRC's organised crime activity are not included in HMRC's overall measure of error and fraud and fall outside of the scope of this study.

Figure 4
HMRC missed its target to reduce tax credits error and fraud

The level of error and fraud in 2010-11 was between 7.5 and 8.8 per cent, which meant HMRC did not achieve its target[1]



	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Upper bound	10.6	9.1	10.6	8.4	9.7	9.6	8.6	8.8
Central estimate	9.7	8.2	9.6	7.8	9.0	8.9	7.8	8.1
Lower bound	8.8	7.3	8.5	7.2	8.3	8.3	7.0	7.5

NOTE

1 HM Revenue & Customs reports error and fraud within a range around a central estimate. The figures referred to within this report are the central estimates. The NAO reviews the methodology for producing this estimate, which meets the national standard for official statistics. It is the best estimate of error and fraud available.

Source: HM Revenue & Customs, Child and Working Tax Credits Error and Fraud Statistics, 2003-04 to 2010-11

Uncertainty in HMRC's estimation of the impact of its interventions

1.11 HMRC recognises the importance of measuring the impact of its work to reduce error and fraud. In addition to the annual estimate of the overall error and fraud in tax credits (paragraph 1.6), HMRC estimates the losses prevented at the point of intervention. HMRC uses the losses-prevented measure as an indicator of the operational performance of its error and fraud response and as a proxy measure of progress towards the 5 per cent target. In reconciling its 2010-11 performance as measured through estimated losses prevented and the overall level of error and fraud, HMRC has re-estimated the total impact of its interventions. We examine this reconciliation in Part Three. We have used HMRC's revised estimate of the aggregate impact of its interventions throughout this report.

1.12 HMRC has not re-estimated the impact of each individual intervention, such as those we examine as case studies. In this report we have used HMRC's original estimate for the impact of individual interventions as it is currently the best available estimate. HMRC recognises that its estimates for individual interventions are overstated and that these overstatements may be significant. HMRC is currently undertaking work to re-evaluate the impact of the different types of intervention.

Part Two

HMRC's approach to tackling error and fraud

2.1 In April 2009, HMRC introduced a new strategy for tackling error and fraud. This part examines the first two years of the strategy to March 2011 and covers:

- the introduction of the new strategy; and
- how HMRC implemented its strategy in the first two years.

HMRC's strategy to tackle error and fraud

A new target to reduce error and fraud

2.2 In July 2008, following criticism from the Committee of Public Accounts, HMRC announced its target to reduce error and fraud to 5 per cent of finalised tax credits entitlement by March 2011.[2] It also reassessed its approach to tackling error and fraud, including the need to ensure that it was undertaking the right interventions in the right quantities to meet the target.

2.3 HMRC launched its revised approach to tackling error and fraud in April 2009, meaning it had only two full tax credit cycles – 2009-10 and 2010-11 – to achieve its 5 per cent target. In addition, HMRC could not assess the outcomes of its approach during this period, as the error and fraud results for 2009-10 would only be available in summer 2011.

The error and fraud strategy

2.4 HMRC's strategy is based on developing a better understanding of tax credits claimants to support a tailored approach to tackling error and fraud risks. The main elements are:

- better support to claimants – to help them get their claims right first time by assisting them through the application and renewals processes, and contacting existing claimants to confirm that the information held is accurate;

2 HC Committee of Public Accounts, *Tax Credits*, Twenty-second Report of Session 2006-07, HC 487, April 2007.

- preventing error and fraud – by increasing HMRC's focus on stopping error and fraud entering the tax credits system at the application, change of circumstance and renewals stages; and
- tackling non-compliance – by continuing to identify claims for compliance enquiries by applying risk-scoring criteria applied when awards are processed.

Another aspect of the strategy is to improve professionalism by ensuring that staff working on tax credits have the right skills to do the job.

2.5 In 2009, HMRC reorganised its tax credits compliance and processing activities under a single management team and increased the resources dedicated to tackling error and fraud. It increased the number of front-line staff on error and fraud checking from 1,100 to 1,500. HMRC plans to retain this number of staff on front-line checks throughout the 2010 spending review period, while reducing its overall headcount in the area of the business responsible for tax credits from 6,000 to 4,500 (25 per cent).

2.6 The full cost of HMRC's error and fraud response on tax credits, including the cost of deploying 1,500 front-line staff on front-line checks and the managerial and analytical support, was around £107 million in 2011-12.[3]

Implementing the strategy

2.7 In implementing its strategy HMRC has worked to provide better support to claimants and, in particular, has increased its efforts in two areas: preventing error and fraud and tackling non-compliance (paragraph 2.4). Its operational response was based on:

- increasing the number of claims checked;
- improving its targeting of higher risk awards;
- making better use of information; and
- performing checks earlier in the tax credits process.

Increasing the number of claims checked

2.8 Since introducing tax credits in April 2003, HMRC has passed claims through automated verification and risk rules in the tax credits computer system before being paid. When claims triggered specified risk rules, they were passed to compliance teams for in-depth checking. This 'one-to-one' approach, involved compliance staff reviewing the entire claim to ensure it was correct. Limitations on resource meant that HMRC only investigated cases assessed as highest risk. Up to 2008-09, HMRC set a simple target for the number of compliance enquiries it planned to complete each year, with no target for the losses prevented from these checks or their wider impact.

3 The full cost consists of around £50 million in direct staff costs, with a further £57 million being a share of overhead costs.

2.9 From 2009, HMRC introduced a wider range of checks designed to target particular aspects of risk in an award, such as errors in income or childcare costs. This 'one-to-many' approach has allowed staff to check a larger number of claims. As these 'single aspect' interventions focus on correcting a specific part of the claim, they are less complex and less time consuming. This has allowed HMRC to make better use of all staff on targeted interventions to tackle error and fraud.

2.10 Following this new approach, HMRC has significantly increased the number of error and fraud interventions from 123,000 in 2008-09 to nearly 2 million in 2010-11 (**Figure 5** overleaf). HMRC estimates that its interventions reduced error and fraud by £253 million in 2008-09, increasing to £480 million in 2010-11 (**Figure 6** overleaf).

2.11 HMRC has been innovative in how it has delivered its interventions. Since April 2009, it has developed around 40 different types of intervention to reduce error and fraud. HMRC has actively managed its error and fraud response by amending its approach or developing new types of intervention to improve results.

2.12 HMRC established monitoring arrangements to ensure it progressed towards its targets. It monitored how successful each type of intervention has been in identifying incorrect claims, the average losses prevented per claim, and the impact of interventions in correcting claims. It used these results to discontinue interventions not delivering the expected returns and moved resources to interventions that generated the largest return.

Improving the targeting of higher risk awards

2.13 HMRC has used its data to improve its targeting of higher risk awards. The published error and fraud estimate splits the total losses across the six main categories of risk, such as childcare costs and income (Figure 2). Since 2009, HMRC has analysed its data by risk category to identify 'disproportionate loss groups' of claimants that have on average a higher risk of error than the wider population.

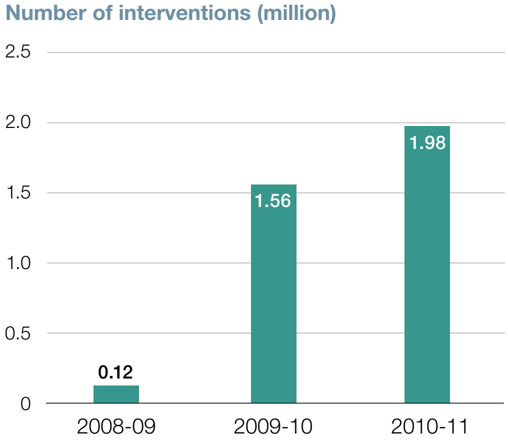
2.14 HMRC has used its analysis of disproportionate loss groups to identify and target interventions on live claims in the tax credits database with the same characteristics. This focus on higher risk awards has helped HMRC increase the estimated impact of its work. Since the introduction of the strategy, HMRC has improved productivity. The average error and fraud prevented per full-time equivalent rose from £240,000 in 2009-10 to £320,000 in 2010-11.

Making better use of information

2.15 HMRC has improved how it uses the information it holds to validate the claimant details in the tax credits system. It has also matched claimant records with data from the Department for Work and Pensions to identify error and fraud in the disability element of awards. It has similar matching checks on new claims to keep error and fraud out of the system.

Figure 5
Number of interventions to reduce error and fraud

HMRC has significantly increased the number of interventions



Source: National Audit Office analysis of HM Revenue & Customs data

Figure 6
Error and fraud prevented by interventions

HMRC estimates that the impact of its interventions to tackle error and fraud have increased year-on-year[1]

NOTE

1 In Autumn 2012, HMRC reassessed the impact of its interventions, based on an analysis of the error and fraud results in 2010-11. HMRC has analysed data from error and fraud testing and compliance cases to produce a better estimate of the impact of interventions in 2010-11. It has also used this analysis to adjust the results in the preceding and succeeding year.

Due to the lack of comparable data we have not re-estimated the impact of interventions in 2008-09. We report HMRC's initial estimate for 2008-09. As such, the figures for 2008-09 and 2009-10 onwards are not directly comparable.

Source: HM Revenue & Customs assessment of the impact of interventions. Figures are presented in cash terms

2.16 As the tax credit system is not integrated with its other systems, HMRC cannot automatically cross-reference claimant details with other sources of data. It has therefore developed other data matching approaches, for example, to identify income discrepancies between tax credits information and data from the Pay As You Earn and self-assessment income tax systems. HMRC estimates that its checks for income discrepancies reduced error and fraud by £55 million in 2010-11.[4]

Performing checks earlier in the tax credits process

2.17 HMRC has also developed new approaches to assess the risk of a claim containing error and fraud before it makes any payments. It has worked with its information system partners to improve how it screens new claims before they enter the tax credits system. HMRC has used tools to analyse new claims to predict how likely they are to contain error or fraud. It uses this analysis to prioritise its verification of claims against other information it holds on earnings and benefits, including child benefit. HMRC estimated its screening of new claims reduced error and fraud by £59 million during 2010-11 (**Figure 7**).

Figure 7
Risk screening of new claims[1]

HMRC receives around 4,000 tax credits applications a day. All claims are passed through the verification and risk-scoring process in the tax credits system. The system lacks flexibility and does not allow claims data to be verified automatically against other HMRC systems.

In 2010, HMRC introduced an additional manual check on new claims before they entered the system. Compliance staff selected around 30 per cent of new claims for examination, based on six criteria, but the prioritisation lacked sophistication.

During 2010, HMRC worked with its IT partner to create an automated screening of claims. Its IT partner developed a tool to screen new applications called FEAST (fraud and error application system tool). This uses previous claims known to contain error or fraud and third-party demographic data to predict the level of risk in a new claim. FEAST risk scores each claim, allowing HMRC to review the riskiest first. HMRC then checks and verifies the information on claims using the information it holds on income, child benefit and social security benefits.

In 2010-11, HMRC estimated that FEAST interventions reduced error and fraud by £59 million. HMRC has been able to generate the same level of error and fraud reduction as the manual processes but from fewer interventions.

NOTE

1 We have used HMRC's figures for the impact of individual interventions as its current best estimate. However, as stated in paragraph 1.11 and 1.12, HMRC recognises that the estimates for individual interventions are overstated.

Source: National Audit Office analysis

4 We have used HMRC's figures for the impact of individual interventions as its current best estimate. However, as stated in paragraph 1.9 and 1.10, HMRC recognises that the estimates for individual interventions are overstated.

2.18 HMRC has been less successful in attempts to improve its approach to checking changes to customer circumstances. It receives around 19,000 telephone calls each day from claimants notifying changes to their circumstances. A new intervention to screen and check higher-risk changes of circumstances fell short of expectations; 15 per cent of checks identified error and fraud rather than the expected hit rate of 25 per cent. HMRC could not check promptly the volume of claims identified as high risk. An internal audit report found that HMRC's design of the risk rules was poor and there had been inadequate testing.

2.19 As the intervention was not effective, HMRC re-prioritised staff to interventions that were achieving better results. It aims to intervene to verify changes on high-risk claims before it applies changes to claimants' awards. HMRC is also developing the automated screening of reported changes of circumstance.

Part Three

Progress towards the 2011 target

3.1 In June 2012, HMRC established that the overall level of error and fraud for 2010-11 was 8.1 per cent of the value of finalised entitlement. In giving evidence to the Committee of Public Accounts in November 2012, HMRC acknowledged that it was disappointing that it had not met its 5 per cent target.

3.2 This part examines the factors which contributed to HMRC not making the progress it expected towards the 5 per cent target. In assessing HMRC's performance we considered:

- its approach to measuring the impact of error and fraud interventions;
- progress against the principal types of error and fraud risk;
- where error and fraud enters the tax credits system; and
- the extent to which HMRC can tackle all error and fraud in the tax credits system.

HMRC's approach to measuring its impact

3.3 Given the time it takes to produce error and fraud estimates, HMRC introduced a new measure, building on existing methods, to monitor the value of error and fraud losses it prevents as a result of its interventions. This measures the 'losses prevented' by each intervention. In amending claims, HMRC identifies the amount of error and fraud it estimates interventions will prevent, and overpayments which it will seek to recover. The estimated impact of error and fraud savings through interventions does not take into account the recoverability of any debt arising from adjustments to awards.

3.4 HMRC set annual targets for the amount of losses it considered it needed to prevent to achieve its target to reduce error and fraud to 5 per cent by 2010-11. HMRC assessed that it needed to substantially increase the levels of error and fraud it prevented each year and set losses-prevented targets. In 2009-10, the target was £750 million and in 2010-11, £1,400 million.

3.5 HMRC achieved the targeted level of losses prevented and expected to come close to achieving the 5 per cent error and fraud target. Achieving the annual losses-prevented targets did not, however, translate into a sustainable reduction of the overall level of error and fraud in the tax credits system (Figure 4).

3.6 Following publication of the 2010-11 results, HMRC's analysts reassessed the relationship between the overall level of error and fraud in the tax credits system and the losses prevented by its 2010-11 interventions. It was concluded that the interventions had a lower than expected impact on the level of error and fraud. HMRC assessed that the actual level of error and fraud prevented in 2010-11 was £480 million, one-third of the £1.4 billion originally claimed (**Figure 8**).

3.7 HMRC did not test the relationship between the losses-prevented measure and its assessment of error and fraud when the results first came available in 2009-10. It believed that its approach was delivering a satisfactory impact as error and fraud stood at 7.4 per cent.[5]

3.8 HMRC's calculation of losses prevented is based primarily on the results of its interventions. The methodology included the value of changes made to claims plus an estimate of how long the claim would have stayed correct following an intervention (the 'preventative' effect). These calculations involved making assumptions about the impact of the interventions on overall levels of error and fraud. HMRC did not, though, test its assumptions by tracking cases post intervention and its recent analysis showed that the assumptions were over-optimistic. It subsequently reduced its estimate of the value of the preventative effect in 2010-11 by £270 million (Figure 8).

3.9 HMRC's methodology also included assumptions on the impact of its interventions in the following tax credits period (the 'carry over' effect) and the wider deterrent effect. HMRC reduced its estimated value of the wider impact of correcting claimants' awards by £300 million (Figure 8).

3.10 Of the revised estimate of £760 million, HMRC believes that £270 million related to mistakes identified during the year which it would have corrected when finalising awards. HMRC now assesses that £480 million of what it originally estimated resulted in a reduction in error and fraud in 2010-11.

2010 spending review commitment

3.11 As part of the 2010 spending review, HMRC has a commitment to deliver £8 billion of tax credit error and fraud savings by 31 March 2015. HMRC agreed this based on its original understanding of the impact of its interventions and its initial assumptions around the losses-prevented measurement. Under its revised understanding of the impact of its interventions and its current approach HMRC will be unable to achieve this target.

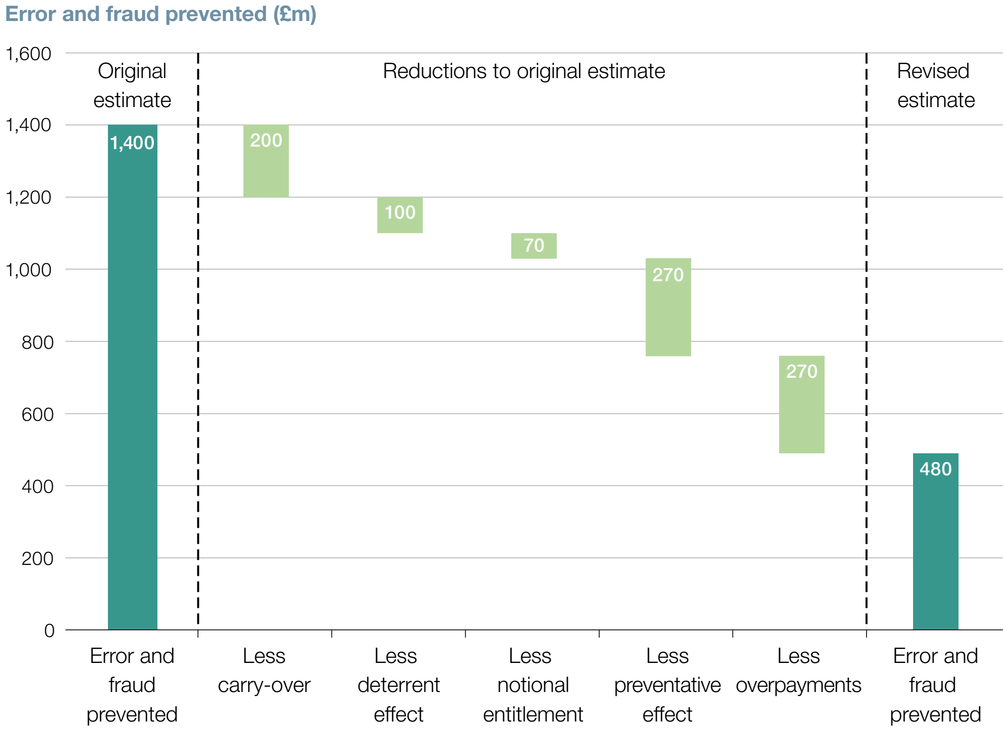
Progress against the principal types of error and fraud risk

3.12 To assess HMRC's progress in reducing the aggregate level of error and fraud it is important to analyse its performance in reducing losses across the principal areas of risk. As part of its analysis of error and fraud results, HMRC undertakes an assessment of what aspect of the tax credit claim was incorrect. There are six risk areas where incorrect information can give rise to incorrect tax credit payments: childcare, children, disability, income, (undeclared) partner and work and hours.

5 This was subsequently revised upwards to 7.8 per cent.

Figure 8
Revisions to HMRC's losses-prevented measure

HMRC has adjusted the estimated impact of interventions in 2010-11 from £1,400 million to £480 million[1]



Reductions to original estimate

The **carry-over** is HMRC's estimate of the impact that correcting a claim will have on the award in the following year, as claimants learn why their claim was wrong. HMRC's original estimate was £250 million which was an overestimate of £200 million.

The **deterrent effect** is the wider impact that HMRC assesses its interventions will have as claimants tell friends and family about changes to their award. There was no evidence available on the size of the deterrent effect so HMRC's analysts excluded all of the £100 million originally claimed.

Notional entitlement: the original measurement did not consider the impact on error and fraud in cases in which HMRC withdrew awards because claimants should have claimed jointly with their partner. These claimants would often be entitled to some tax credits as a couple, an amount known as notional entitlement, resulting in an overestimation of £70 million.

Preventative effect: HMRC overestimated how long claims would remain correct and reduced the estimated impact by £270 million.

NOTE

1 HMRC's analysis is based on a sample of cases tested for error and fraud and a sample of claims corrected following an intervention. While the individual reductions are subject to some uncertainty, the error and fraud prevented is HMRC's best estimate of the impact of its interventions. Amounts do not total due to rounding.

Source: National Audit Office analysis of HM Revenue & Customs data

3.13 We analysed HMRC's estimate for each risk category by comparing the results in 2008-09, the year prior to the introduction of its new approach, to 2010-11, when it aimed to achieve the 5 per cent target (**Figure 9**). Although the analysis is based on a relatively small sample of cases and therefore subject to uncertainty, the analysis represents HMRC's best available information on levels of error and fraud across risk areas.

3.14 Figure 9 shows HMRC's performance across the risk categories has been mixed. Over the period, HMRC has reduced error and fraud in three risk groups, with significant reductions in error and fraud relating to the disability risk. HMRC had made little progress in two risk areas, which together account for over £1 billion in losses – 'work and hours' and 'undeclared partner' – where the level of losses increased in line with tax credits entitlement. However, the value of error and fraud arising from the children element of awards unexpectedly increased from £325 million to £640 million. We have assessed HMRC's approach to tackling error and fraud in each of the risk categories.

Figure 9
Estimated error and fraud losses by risk category

Performance has varied across the risk categories[1]

Risk Group	2008-09 Error and fraud (£m)	Error and fraud as percentage of total tax credit entitlement (%)	2010-11 Error and fraud (£m)	Error and fraud as percentage of total tax credit entitlement (%)
Undeclared partner	580	2.47	665	2.38
Children	325	1.37	640	2.29
Work and hours	365	1.54	415	1.49
Childcare costs	390	1.66	265	0.95
Income	305	1.30	240	0.87
Disability	145	0.61	40	0.14
Total error and fraud	2,110	8.90	2,270	8.10
Total tax credits entitlement	23,600	–	27,900	–

NOTE
1 The values are HMRC's best estimate of the primary reason for an adjustment to awards. HMRC does not calculate confidence intervals for these numbers. Numbers are rounded and may not add to total. All values are presented in cash terms.

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

Categories of risk where performance has improved

Disability

3.15 HMRC has substantially reduced error and fraud from claims incorrectly including the disability element – from an estimated £145 million in 2008-09 to £40 million in 2010-11. As stated in paragraph 2.15, HMRC has achieved this by using data from the Department for Work and Pensions to confirm eligibility.

Income

3.16 Error and fraud relating to incorrect income reduced from an estimated £305 million in 2008-09 to £240 million in 2010-11. The most common reason for error relates to claimants understating their income. HMRC is now using the PAYE system to verify the information in the tax credits system both for new awards and for existing claims. It expects that the introduction of Real Time Information will provide better information to reduce the level of error and fraud.

Childcare

3.17 Error and fraud relating to incorrect childcare costs has reduced from an estimated £390 million in 2008-09 to £265 million in 2010-11. Calculating childcare costs is complicated and the majority of losses relate to claimants claiming incorrect costs. HMRC introduced additional support for claimants by developing a childcare calculator for staff to use when claimants call to notify a change to their childcare circumstances. It also examines high-risk childcare claims during the annual renewals process.

Categories of risk where performance has not improved

Children

3.18 Children being incorrectly included in an award accounted for £640 million of losses in 2010-11, an increase from £325 million in 2008-09. Eighty per cent of error and fraud relates to claimants not telling HMRC about children aged 16–19 who are no longer in full-time education. The remaining error relates to customers claiming for a child or young person who is no longer in the household.

3.19 HMRC has not fully established the reasons for the increase in losses in this risk category in 2010-11. It believes some of the increase relates to its decision to increase the number of claims automatically renewed. HMRC automatically renews lower-risk claims to reduce the burden on claimants and administrative costs. In 2010-11, it automatically renewed around 1 million awards where claimants received income support or jobseeker's allowance. The automatic renewal process does not remove the need for claimants to report changes, who are responsible for checking the details on which HMRC has based the awards. However, HMRC believes that an unintended consequence of its decision to increase automatic renewals was that claimants failed to report changes that they otherwise would have done and, as a result, continued to claim for children in the 16 to 19 age group who were no longer eligible. HMRC has increased checks in this area since publication of the error and fraud results.

Undeclared partner

3.20 Claimants applying as a single person and not including their partner on the claim remains the largest area of error and fraud, accounting for an estimated £665 million of losses in 2010-11. This is an increase from £580 million in 2008-09 which is in line with the increases to tax credits entitlement. It remains one of the more difficult areas to target and tackle. Since 2011, as explained in paragraph 4.7, HMRC has begun to use third-party data sources to develop its response to tackling this risk type.

Work and hours

3.21 Error and fraud attributable to claimants overstating the hours worked to meet the minimum requirement to claim working tax credits amounted to an estimated £415 million in 2010-11. This is an increase from £365 million in 2008-09, which is also in line with increases to tax credits entitlement. HMRC is undertaking further research to understand the nature of losses and the extent to which they are being driven by claimants' lack of understanding of their obligations or the difficulty of calculating hours where they fluctuate over the year.

Understanding when error and fraud enter the system

3.22 Error and fraud can enter at the point of application, during the life of a claim or during the renewal of an award. Understanding where error and fraud enters the system is important as it may indicate claimants' misunderstanding of their obligations and would enable HMRC to tailor its response accordingly. HMRC did not have this insight available to influence the design of interventions during 2009-10 and 2010-11.

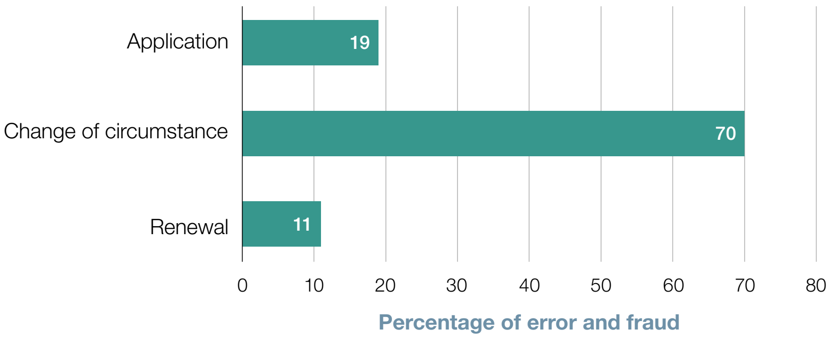
3.23 HMRC first completed its analysis to understand when error and fraud enters the system in late 2011. It has repeated this analysis in November 2012. The most recent analysis shows that 81 per cent of error and fraud occurs after application, mainly due to claimants failing to report or misreporting changes in their circumstances that would affect the value of their award (**Figure 10**). The point at which error and fraud enters the tax credits system differs for each of the six risk groups. The analysis illustrates the importance of HMRC proactively intervening to detect changes in claimants' circumstances.

Reported changes of circumstance

3.24 Claimants incorrectly reporting changes in their circumstance account for around a third of the value of error and fraud at this point of entry. Claimants report almost all of these changes by telephone through contact centres. HMRC has provided support to claimants to help collect the necessary information accurately including, for example, the childcare calculator. HMRC has to manage a trade-off between call centre resources, its targets to handle customer calls, and the contact needed with the claimant to gather information and verify the accuracy of the claim. As stated in paragraph 2.18, interventions designed to target high-risk changes of circumstance have had limited success.

Figure 10
Where error and fraud losses enter the system

The majority of error and fraud occurs through a change of circumstance, which claimants may incorrectly report to HMRC or not report at all



Source: National Audit Office analysis of HM Revenue & Customs data from 2010-11

Non-reported changes of circumstance

3.25 Claimants' failure to report changes in their circumstances – either wilfully or through ignorance of their obligations – presents particular challenges in keeping them on the right award. In the light of its November 2012 analysis, HMRC has a better understanding of the losses arising from non-reported changes and the main areas of risk affected; children and undeclared partner. Although this insight on the point of entry of error and fraud into the system was not available until 2011-12, HMRC is now developing interventions to address potential non-reported changes (paragraph 2.19).

Tackling all error and fraud in the tax credits system

3.26 With current levels of resource and performance there are more claims incorrect in the tax credits system than HMRC can tackle. We estimate that, overall, HMRC identifies error or fraud in around 25 per cent of its interventions. In 2010-11, HMRC intervened on almost 2 million claims, correcting around 450,000. Following these interventions, HMRC's analysis shows that after the finalisation of 2010-11 awards around 1.4 million claims still contained error and fraud.

Part Four

HMRC's actions since 2010-11

4.1 HMRC has continued to develop its approach to reducing error and fraud since 2010-11. This part examines:

- how HMRC has developed its approach since 2011-12; and
- HMRC's latest plans for evolving its approach, including the impact of welfare reform.

4.2 A full assessment of HMRC's performance in reducing error and fraud in 2011-12 will not be possible until its analysis of finalised awards is available in summer 2013. Based on its original assumptions, HMRC initially estimated that it would reduce error and fraud by £1.9 billion in 2011-12. Applying its revised assumptions for the impact of its interventions (paragraphs 3.3 to 3.10) HMRC now estimates it will reduce error and fraud losses by £620 million in 2011-12. We have used HMRC's revised estimate of the impact of its interventions to assess performance.

HMRC's approach since 2010-11

4.3 HMRC has made improvements in the delivery of its strategy since 2010-11. It has introduced nine new interventions and found ways to increase the impact of its existing work. HMRC undertook 1.6 million interventions, 21 per cent fewer than in 2010-11, but improved their effectiveness. In particular, HMRC has sought to achieve this by:

- better targeting of risk, by developing its analysis and using new sources of data; and
- developing its understanding of error and fraud.

Targeting risks

4.4 HMRC's interventions seek to: 'prevent' error and fraud from entering the system; 'cleanse' error and fraud from claims already in the system; or 'maintain' awards as correct following prevent or cleanse activities. Since 2010-11, HMRC has focused on increasing the impact of interventions that correct ('cleanse') awards already in the system.

4.5 HMRC has achieved an uplift in the error and fraud it prevents through increasing both the number and effectiveness of interventions that correct ('cleanse') awards in the system. In 2011-12, five of the nine new interventions were 'cleanse' interventions. It also increased the average impact of each 'cleanse' interventions from £215 in 2009-10 to £630 in 2011-12. These interventions accounted for almost all of the total increase in error and fraud prevention between the two years (**Figure 11**). HMRC's increased focus on 'cleanse' activities aligns with the need to increase interventions that correct error and fraud in the system.

Figure 11
HMRC has focused further on 'cleanse' interventions since 2011

HMRC has increasingly focused on cleansing claims of error and fraud[1]

	2009-10	2010-11	2011-12
Prevent (£m)	110	150	120
Maintain (£m)	40	50	70
Cleanse (£m)	190	230	370
Total (£m)	**350**	**430**	**560**
Carry-over from prior years (£m)	10	50	60
Total error and fraud prevented (£m)	**360**	**480**	**620**

NOTE

1 Numbers are rounded and may not add to total. All values are presented in cash terms. The figures are HMRC's revised estimate of the impact of its interventions, as outlined in note one to Figure 6.

Source: National Audit Office analysis of HM Revenue & Customs data

4.6 HMRC has also extended its data analysis to identify claims at most risk of being incorrect. It has built on its previous analysis (paragraphs 2.13 and 2.14). It has used this analysis to target claims for intervention. In particular, HMRC can target claims during the annual renewal period more effectively (**Figure 12**).

4.7 HMRC has also begun to use new types of analysis and sources of data. In 2011, HMRC began work with credit reference agencies to find a new way to target the undeclared partner risk, the largest single area of error and fraud losses at £665 million. HMRC improved how it initially identifies risky claims through its CONNECT system. Using this method of data analysis and risk profiling with the aid of a credit reference agency, HMRC has significantly increased its ability to identify awards that claimants should have made jointly with their partner (**Figure 13**).

Developing its understanding of error and fraud

4.8 If HMRC is to improve its error and fraud response it needs to make better use of data analysis and improve its understanding of how it can influence claimant behaviour.

4.9 HMRC has continued to develop its analysis of error and fraud data. Its analysis of 2011-12 data contained a more detailed breakdown of risk categories than in the previous year. However, it has taken HMRC almost four years since the target was set to arrive at this level of analysis and there is still progress that it can make:

- HMRC's analytical team is in high demand. This has resulted in them prioritising work, meaning that some analysis has not been undertaken and been unavailable to operational decision-makers or has taken longer to complete.
- HMRC does not track claims following an intervention to identify if, when and how error or fraud reoccurs.
- HMRC's analysis is backwards-looking, identifying claims that have gone wrong. HMRC has done less work to predict which claims are likely to go wrong so it can check them at the most appropriate point, or offer support before error occurs.

4.10 HMRC's claimant research also provides insights that it cannot get by analysing the error and fraud data alone. HMRC is not yet making full use of this. It commissions research on claimants' attitudes, behaviour and experience of tax credits. While HMRC has begun to systematically draw its data analysis together with this research to provide insights into error and fraud, it has only completed this work for two of the six risk categories.

Figure 12
Preventing losses through analytics: high-risk renewals[1]

All tax credits claimants are required to renew their award at the end of each year. HMRC prioritises the claims it selects for checking during the renewal window, with those claims assessed as lower risk automatically renewed.

In 2009-10, HMRC contacted claimants with the highest value awards by letter, requesting they discuss and finalise their award by telephone. While the majority of claimants responded, few of the claims were incorrect. HMRC prevented error and fraud estimated at £29 million.

Subsequent work by HMRC's analysts showed that high-value claims were not necessarily those at greatest risk of error and fraud. HMRC has used this analysis to focus on those categories of claim its analysts assessed as most at risk. In 2012, HMRC estimates it prevented error and fraud of £353 million.

NOTE

1 We have used HMRC's figures for the impact of individual interventions as its current best estimate. However, as stated in paragraph 1.11 and 1.12, HMRC recognises that the estimates for individual interventions are overstated.

Source: National Audit Office analysis of HM Revenue & Customs data

Figure 13
Tackling the undeclared partner risk

Claimants living as 'husband and wife' with their partner must make a joint claim. Claimants who fail to disclose their partner, and therefore their household income, may receive more money than they are entitled to.

HMRC has struggled to develop an effective response to the undeclared partner risk. Undeclared partner interventions typically followed a specific allegation or indication of fraud and were pursued through face-to-face meetings with claimants. These investigations were time intensive.

In 2010-11, HMRC changed its approach. It wrote to 142,000 claimants with a potential undeclared partner asking them to confirm their circumstances. Only a third of claimants responded, and HMRC amended less than 14,000 claims. It estimates it prevented £32 million of error and fraud.

In 2011, HMRC piloted a new approach with a credit reference agency, using a payment-by-results basis, to identify evidence of undeclared partners. This approach involved identifying risky claims using HMRC's CONNECT system, which draws on a wide range of internal data and external information to identify hidden relationships between people. HMRC uses the results of this analysis with credit reference agency data to identify other people at the claimants address with a financial or residency link to the claimant.

HMRC estimates that in 2011-12, this intervention prevented around £158 million in error and fraud where claimants had not declared their partner. It forecasts the intervention will reduce error and fraud by £240 million 2012-13.

NOTE

1 We have used HMRC's figures for the impact of individual interventions as its current best estimate. However, as stated in paragraph 1.11 and 1.12, HMRC recognises that the estimates for individual interventions are overstated.

Source: National Audit Office analysis of HM Revenue & Customs data

HMRC's current plans

4.11 HMRC has continued to learn as it has developed its approach and has identified areas that it can build on. These include the following:

- Collaboration: The work with credit reference agencies to identify undeclared partners highlighted the potential of working with the private sector and HMRC plan to explore options for collaboration to address other areas of risk.
- Data analysis: HMRC has recognised that it can make progress in its use of data analysis. It is planning to review whether it is realising the full potential of the tools and sources available.
- Deterrent: Through its interventions HMRC may establish strong evidence that the claimant has been unwilling to accurately report their circumstances. HMRC plans to influence claimant behaviour by increasing the number of penalties it imposes. HMRC has already increased the number of penalties it imposes each year, from 412 in 2008-09 to 1,932 in 2010-11.

4.12 HMRC is planning to use new sources of data as they become available, including payroll data reported in real time by employers. The availability of Real Time Information from 2013-14, will increase HMRC's ability to ensure, both at the point of renewal and on an ongoing basis, that it calculates tax credit awards on the basis of correct income figures.

4.13 The *Autumn Statement 2012*[6] outlined HMRC's intention to introduce new obligations for claimants. From April 2014, claimants with high childcare costs will be required to provide supporting evidence. Claimants with children aged between 16 and 19 will need to provide evidence each year that they remain in further education or training. HMRC expects these measures to save £585 million in the period 2014-15 to 2016-17.

The impact of welfare reform on tax credits

4.14 In October 2010, the government announced it would introduce a new Universal Credit, which will replace many of the current working-age benefits, including tax credits, with a single means-tested payment. From late 2013, tax credit claimants will begin to have their awards ended and will need to apply for Universal Credit. This will take place over a number of years, although the programme for which claims move, and when, is not fully settled. Tax credits will end by 2017.

6 HM Treasury, *Autumn Statement 2012*, Cm 8480, December 2012.

4.15 HMRC will pay out a significant amount in tax credits until 2017, which in total will exceed £100 billion. HMRC recognises that, although tax credits will end, minimising losses due to error and fraud remains important and it plans to build on and strengthen its response.

4.16 HMRC and the Department for Work and Pensions have a joint strategy for tackling error and fraud in the benefits and tax credits systems. The strategy aims to ensure that work to reduce error and fraud in the entire welfare system is as joined-up as possible. The Cabinet Office, through the Fraud, Error and Debt Taskforce, also plays a role in coordinating action across government and the wider public sector to focus on reducing fraud and error loss in the public sector.

Appendix One

Our audit approach

1 This study examined HM Revenue & Customs' (HMRC) progress in tackling tax credits error and fraud since 2009 and assesses why it did not achieve the target. We examined:

- the approach to tackling tax credits error and fraud;
- progress in reducing error and fraud; and
- areas where HMRC can develop its approach.

The examination of related areas such as tax credits debt, the response to organised crime and customer service are outside of the scope of this study.

2 We applied an evaluative framework to assess HMRC's response to tackling error and fraud. We base our assessment of value for money on an evaluation of the approach HMRC has adopted as well as the outcome of HMRC's activities to reduce error and fraud.

3 Our audit approach is summarised in **Figure 14**. Our evidence base is described in Appendix Two.

Figure 14
Our audit approach

The Department's objective

HMRC has a strategic objective to improve the extent to which individuals receive the tax credits which they are entitled.

How this will be achieved

In July 2008, HMRC announced a target to reduce error and fraud to no more than 5 per cent of the value of finalised tax credits entitlement by 2010-11. HMRC revised its strategy and launched a new approach to tackling error and fraud.

Our study

The study examines whether HMRC's approach to tackling tax credits error and fraud is value for money.

Our evaluative criteria

HMRC has a coherent approach to tackling error and fraud.

HMRC has focused resources on the most appropriate activities.

HMRC has made progress towards reducing fraud and error to target levels.

Our evidence

(see Appendix Two for details)

We examined the approach by:

- review of **HMRC's error and fraud strategy** and planning documents;
- review of the **structure and responsibilities** for delivering the approach; and
- review of **resources** available to deliver the approach.

We **examined HMRC papers:**

- **management information** and HMRC analysis to determine the impact of the approach;
- reviewed methods of **measuring the impact** of interventions; and
- analysis of data including **where error and fraud enters the system**.

We assessed outcomes by examining **progress against targets:**

- Progress against HMRC's error and fraud target and losses-prevented target.

We **assessed performance across the six categories of risk** reported in the error and fraud results.

Evidence covering all criteria

We used the following methods to inform all areas of the study:

- **Interviews with HMRC staff and other stakeholders.**
- **Case studies** of five fraud and error-reduction interventions.
- Analysis of published and unpublished **error and fraud statistics and analysis**.
- Review of **HMRC's research** on tax credits.

Our conclusions

HMRC has not delivered value for money. HMRC missed the 5 per cent target, reporting error and fraud of 8.1 per cent. We have seen evidence of HMRC continuing to improve its approach. HMRC reduced the value of three categories of risk and sought new ways to deliver its error and fraud response.

To achieve value for money HMRC should:

- Enhance its understanding of risks and customer behaviours.
- Make better use of data to target risks in the largest loss areas.
- Ensure that changes to customers' circumstances are promptly and accurately captured.

Appendix Two

Our evidence base

1 We formed our conclusions on whether HM Revenue & Customs (HMRC) is achieving value for money on tackling tax credits error and fraud following analysis of evidence collected between June and December 2012.

2 Section 2 of the Exchequer and Audit Departments Act 1921 requires the Comptroller & Auditor General (C&AG) "to examine the accounts of HM Revenue & Customs to ascertain that adequate regulations and procedure have been framed to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out". The C&AG is also required by that Act to examine the correctness of the sums brought to account and to report the results to the House of Commons. This has included an assessment of the tax credits scheme since it commenced in 2003-04. Our fieldwork builds on the understanding we have developed of tax credits through these annual examinations.

3 We developed an evaluative framework to determine good practice in tackling error and fraud. Our audit approach is at Appendix One.

4 We evaluated HMRC's approach to tackling error and fraud:

- We reviewed **HMRC's error and fraud strategy** and planning documents. This included business plans for the error and fraud response. We examined how the revised approach launched in 2009 differed from HMRC's previous approach and what the new approach has achieved.
- We reviewed HMRC's **management structure and responsibilities** for delivery of error and fraud response. We examined the process for setting annual targets to monitor progress.
- We ascertained the **resources** available to deliver the error and fraud approach.

5 We examined whether HMRC had focused its resources on the most effective error and fraud-reduction activities:

- We analysed **management information** such as the information prepared for HMRC's performance committee, a subcommittee of HMRC's board. This included the monitoring data on individual activities. We also examined how HMRC used this information to deploy resources.

- We examined HMRC's analysis of data, including **where error and fraud enters the tax credits system.** We analysed where HMRC has focused its interventions and matched these to where error and fraud occurs.
- We reviewed the method HMRC has adopted for **measuring the impact** of its interventions. This includes the relationship between this measurement and error and fraud outcomes.

6 We examined the progress HMRC has made in reducing error and fraud:

- We examined HMRC's **progress against its main target** for reducing error and fraud to 5 per cent of tax credits expenditure by 2010-11. We also examined HMRC's progress towards preventing £8 billion in error and fraud losses, over the period 2010-11 to 2014-15. This included examining interventions developed since 2010-11.
- We examined error and fraud results and **assessed performance across six categories of risk** for the period 2008-09 to 2010-11.

7 We used the following methods to support all areas of the study:

- **We interviewed a range of staff.** This included staff responsible for HMRC's operational response to error and fraud. We interviewed the teams responsible for developing and monitoring interventions, to examine the design and amendment of activities. We interviewed the team that provides analytical and research support, to understand what analysis of error and fraud is undertaken and how this informs interventions. We also met with operational staff undertaking interventions.
- We undertook **case studies** of five interventions designed to reduce error and fraud. We selected these to cover interventions made at point of application, during the life of awards, and during the renewal period. We examined the business case, design and monitoring of the interventions. We examined how HMRC had amended these interventions to improve their impact.
- We examined HMRC's published and unpublished **error and fraud statistics and analysis.** We undertook detailed analysis of the error and fraud in the six categories of risk identified by HMRC. We assessed progress against each of these six categories since 2008.
- We reviewed HMRC's published **research reports** which focused on, or covered aspects of, tax credits. The research reports cover areas such as claimant attitudes, understanding and behaviour, as well as error and fraud. We also sent out a call for evidence among the claimant stakeholder groups that HMRC works with on tax credits, to inform our understanding of customer issues.
- We sent out a call for evidence to the customer stakeholder groups that HMRC works with on tax credits.

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