

Report by the Comptroller and Auditor General to the House of Commons

Introduction

The statutory child maintenance schemes in Great Britain are delivered by the Department for Work and Pensions (DWP), which is leading the schemes through a period of major reform. For the first time since 2003, a new scheme has been introduced (the '2012 scheme') which is intended to eventually process all child maintenance cases in Great Britain. At present the Department is running the older 'legacy' schemes concurrently with the new '2012 Scheme', while it begins to transfer cases from one to the other.

The Client Funds Account records the receipts of child maintenance from non-resident parents; payments to parents with care and the Secretary of State; and a statement of cash balances held at the year end; this being the value of maintenance received which has not yet been paid out. I have issued an unqualified audit opinion on whether these receipts and payments are properly presented, and a qualified audit opinion on regularity. Further details of my reasons for the qualification are set out below.

The Account also includes an arrears balance (Note 6), which is the amount of child maintenance outstanding and owed by non-resident parents to either parents with care or to the Secretary of State. Note 6 also includes an analysis of the collectability of the outstanding arrears. I have concluded that this note does not give a true and fair view of the arrears outstanding, or its collectability, as at 31 March 2014 for the reasons set out below.

These modifications to my audit opinions are longstanding and reflect significant and ongoing problems in the accurate calculation of maintenance and with the underlying IT systems since statutory child maintenance schemes were first introduced. I have reported on these issues previously.

Irregular Receipts and Payments

Audit Opinion

As the independent external auditor, I am required to give an opinion on whether, in all material respects, the Client Funds Account properly presents the receipts and payments for the year ended 31 March 2014 and whether these transactions have been applied to the purposes intended by Parliament and conform to the authorities which govern them (the 'regularity' opinion).

The Department is required to adhere to specific legislative requirements when determining maintenance assessments and has no authority to exercise latitude. When an assessment is made

that is not in accordance with these legislative requirements, the receipt and associated payment are incorrect and not in accordance with legislation. Whilst the account properly presents the amounts of child maintenance received and paid in year, I have qualified my regularity audit opinion on the grounds of material errors in the calculations of maintenance assessments; these assessments are not in accordance with the legislation and therefore are not in line with the purposes intended by Parliament.

In 2013-14, the Department received £851.7 million in respect of child maintenance from non-resident parents. As a result of errors in the calculations of maintenance assessments, I have estimated that, within this amount, a proportion of non-resident parents have made overpayments of child maintenance amounting to £7.3 million (0.9% of receipts), while others have made underpayments totalling £6.9 million (0.8% of receipts). The cases affected by overpayments are unconnected to the cases affected by underpayments, and consequently I have had to consider the gross error figures. I have therefore qualified my regularity audit opinion on the basis of the gross value of irregular receipts and payments.

My estimate for the level of over and underpayments remains unadjusted within the reported receipts and payments figures in the Account. An adjustment cannot be made to the figures because the value of over and underpayments is an accumulation of a significant number of individual incorrect maintenance assessments. To correct these errors, every decision on each of the affected cases would need to be reassessed from the inception of the case to the present day. Since each case can have a large number of reassessments over its lifetime to account for changes in circumstance, this would represent a significant piece of work.

Incorrect maintenance assessments

There are currently three statutory maintenance schemes in operation, and the basis for the maintenance assessments under each scheme is set out in the relevant legislation introduced in 1993, 2003 and 2012. The legislation determines the value of the maintenance assessment and the date from which the assessment is effective.

Transactions passing through the 2012 Scheme during 2013-14 form approximately 0.5% of receipts. Therefore, the primary driver of irregularity within the 2013-14 Account remains error within the legacy schemes, and this is discussed further below. More detail on the 2012 Scheme is included under the heading '2012 Scheme'.

The original 1993 legislation required up to 148 different pieces of information to calculate a maintenance assessment. An error in any element of the assessment will impact the regularity of the child maintenance ultimately received from the non-resident parent. Ordinarily there are multiple assessments throughout the lifetime of a case to reflect changes in circumstance. Where such reassessments occur, the likelihood of error increases.

The 2003 legislation sought to simplify the assessment process and significantly reduce the amount of information required to make an assessment. Despite this simplification, the Department has determined the error rate for cases assessed under these rules to be higher than those assessed under the 1993 legislation. This suggests that caseworker error and system problems, rather than complexity of legislation, are the primary causes of incorrect maintenance assessments.

The Department's Client and Process Assurance Team (C&PA) carries out extensive checking of maintenance assessments each year. These checks cover both new applications for child maintenance and cases where there has been a recalculation owing to a change in circumstance. C&PA reported that for the legacy schemes the Department achieved a cash value accuracy¹ of 98.0% in 2013-14 (98.3% in 2012-13). Table 1, below, shows the percentage of maintenance assessments that C&PA found to be accurate has remained consistent over the past four years.

Table 1: Accuracy of maintenance assessments – legacy systems

	2010-11	2011-12	2012-13	2013-14
<i>Cash Value Accuracy¹</i>	97%	98%	98%	98%
<i>NAO estimated irregular receipts and payments (gross)</i>	3.1%	2.7%	1.7%	1.7%

This table also includes my estimate of the percentage of irregular receipts and payments each year (gross of both under and overpayments). Although I use the cash value accuracy percentage within the calculation of irregular receipts and payments, the two are not directly linked due to the complex calculation methodology.

The C&PA team performs root cause analysis on errors found, to allow focussed training and improvements to processing procedures.

Outstanding Maintenance Arrears

Audit Opinion

Where a non-resident parent does not make payments in accordance with their child maintenance assessment, the Department records any shortfall in the outstanding maintenance arrears balance and reports it in Note 6 of the Client Funds Account. The balance of £3.993 billion as at 31 March

¹ Cash value accuracy is a measure of the value of correct assessment against the value of incorrect assessment. This means that, for an incorrect maintenance assessment calculated at £90 per week which should have been calculated at £100 per week, cash value accuracy would be reported as 90%.

2014 is the cumulative total of outstanding arrears since the Child Support Agency was established in 1993. This balance represents the total amount owed by non-resident parents to either the parent with care or, in some instances, the Secretary of State. Current legislation allows the Department to write off arrears only in very limited circumstances.

I am required to give an opinion on whether the outstanding maintenance arrears balance as at 31 March 2014 is true and fair. In my opinion there is material error in the value of arrears recorded in Note 6 to the account and as a result I have concluded that Note 6 does not give a true and fair view of the maintenance arrears outstanding at 31 March 2014. The misstatement is primarily a result of:

- a) Incorrect maintenance assessments (as outlined above); and
- b) Incorrect adjustments to arrears.

a) Incorrect maintenance assessments

Where the Department has made incorrect maintenance assessments, for the reasons set out above, any arrears accruing will be doing so at an incorrect rate and consequently the value of the accrued outstanding maintenance arrears will be misstated. The Department is unable to estimate the value of this misstatement, but our audit work indicates that the cumulative impact of incorrect maintenance assessments on the value of arrears as at 31 March 2014 is significant.

b) Incorrect adjustments to arrears

Caseworkers administering child maintenance cases are able to adjust the value of arrears on individual cases. This is to allow the Department to take retrospective action when circumstances change which alter the value of maintenance charged. Errors can arise in the calculation of the required adjustment, which can then result in a misstatement in the value of arrears.

Note 6 to the Client Funds Account reports the arrears balance net of any caseworkers' adjustments, which means that any errors made in these adjustments affect the arrears balance reported. I estimate that arrears are overstated by around £15.2 million and understated by around £114.2 million as a result of such errors.

As with the level of irregular receipts and payments, the Department is unable to make a revision to the arrears note in order to correct for these errors, because they are an estimated aggregation of the accumulated over and under-adjustments made to individual cases since the inception of the statutory schemes.

A separate part of the Department's C&PA Team measures the accuracy of adjustments to arrears and undertakes a similar root cause analysis as with the accuracy of maintenance assessments to allow focussed training and improvements to processing procedures.

Table 2, below, shows that in 2013-14 the Department continued to improve the accuracy of adjustments made to arrears. However, the Department has no plans to correct cases where errors

have occurred previously. As the errors that have accumulated over the years remain uncorrected in the arrears balance, we consider a material level of error remains.

Table 2: Accuracy of adjustments to arrears 2010-11 to 2013-14

	2010-11	2011-12	2012-13	2013-14
<i>Percentage of cases with accurate adjustments to arrears</i>	86%	91%	86%	94%

The clerical case database

The two issues described above are the primary causes of the high value of errors in the arrears balance. Further errors arise from weaknesses in the management of clerical cases, but it is not possible to accurately estimate the financial impact.

Where system failures prevent on-line case management, the Department has to manage the affected cases manually on a separate clerical case database. This database was originally set up to manage around 10,000 cases, but there are currently over 107,000 cases managed in this way. There are two specific problems with the clerical case database, which are set out below. The Department is planning to take corrective action on the clerical case database balances from 2014-15 onwards, in readiness for the transition of these cases to the 2012 Scheme.

Incorrect charging status of cases

The clerical case database requires the manual input of customer maintenance schedules. A maintenance schedule which is not correctly maintained can result in cases incorrectly reporting that no maintenance is due, which will understate the arrears balance at the year end. There is no adequate information available from which either the Department or I can provide a reliable estimate of error, but the available evidence indicates that arrears are understated as a result.

Opening balances on the clerical case database

Of the cases that the Department has transferred onto the clerical case database, there are a number which it transferred without arrears balances. The Department had adjusted for this in the account by increasing the arrears balance by the value of the arrears reported on the online systems for the affected cases before they transferred. The Department's two key assumptions underlying this adjustment are that the majority of nil opening balances on the Clerical Case Database are errors and that the closing balance on the 2003 system is the correct opening balance for cases now managed on the clerical case database. However, my testing has confirmed that this is not the case in all instances. While it is clear that the arrears balance is overstated, there is not, however, sufficient information available to make a reliable estimate for the value of this error.

Collectability analysis

In line with the Accounts Direction, the Department has assessed the collectability of the outstanding maintenance balances and disclosed the results in Note 6 to the Account. The Department has estimated the value of arrears 'likely to be collected' and 'potentially collectable', based on the history of payment from, and payment agreements with, non-resident parents, as well as an estimate of additional recoveries it could secure using existing enforcement powers.

The Department's assumptions are subject to an inherent degree of uncertainty, since a number of external factors (including the economic climate and the resources available to the Department to pursue the enforcement of arrears) influence whether any individual non-resident parent will pay their outstanding arrears. Furthermore, the collectability assessment is applied to information on arrears which is known to contain errors, as described above. As a result the value of arrears existing as at 31 March 2014 which will actually be collected in the future may be significantly different to that reported as 'likely to be collected' within Note 6.

Financial Reporting and IT Systems

Since the inception of the statutory child maintenance schemes there have been significant problems with the legacy IT systems supporting the schemes. Amongst other problems, the IT systems do not have the functionality to fully report arrears for inclusion in the Account. In order to address this, the Department has developed a separate process to scan the underlying systems and produce a suite of reports. The Department use these reports, in addition to the general ledgers, as the basis for preparing Note 6 to the Account.

The Department first used this revised methodology in 2008-09, and the reports generated have increased the visibility of a number of historic problems. In response to this, the Department has made a number of refinements to the reports since 2008-09 to take account of the issues identified in the underlying data.

The efforts of the Department have resulted in the reporting of a more robust arrears position to that reported in the past. However, due to the scale and age of the issues which have accumulated against some of these arrears balances, there remain significant and unresolved inaccuracies, which materially misstate the arrears balance reported in the Account.

2012 Scheme

Since 25 November 2013, all new child maintenance applications are processed by the Department under the 2012 Scheme. By 31 March 2014, the 2012 Scheme caseload was 45,000, and during 2013-14 the Department processed total receipts of £4.7 million relating to the 2012 Scheme. For 2013-14, the transactions passing through the 2012 Scheme form only 0.5% of receipts, and 0.3% of

arrears. However, although the 2012 Scheme has a minimal impact on the 2013-14 Account, that impact will increase in future years.

The Department has also started to close existing cases on legacy systems, and part of the closure process is to give parents the option of starting a new case on the 2012 Scheme. The closure process will take place in segments, with the Department intending to complete the process in 2018.

Incorrect maintenance assessments

Within the 2012 Scheme, I have estimated that for 2013-14, overpayments made by non-resident parents amount to £0.04 million (0.9% of total receipts), while underpayments amount to £0.1 million (2.0% of total receipts). These are included within the total over and underpayments outlined under 'Irregular Receipts and Payments' above. These represent a greater percentage of error than that within the legacy schemes, although they compare favourably with the accuracy of assessments at a similar point in the roll-out of the 2003 Scheme.

As described below, the 2012 Scheme is supported by a new IT system, which interacts directly with HMRC and DWP databases to obtain information necessary to produce maintenance calculations. The Department anticipates that, over time, this will result in quicker, more accurate assessment calculations. In the future, therefore, the Department expects accuracy levels to improve, but at the current early stage of the 2012 Scheme, these expectations are still to be proven.

Arrears

Where the Department closes a case on a legacy system and opens a new case on the 2012 Scheme, any arrears balances will transfer to the new case. The Department currently has no plans to correct cases which have previously been subject to incorrect maintenance assessments or incorrect adjustments to arrears. As such, errors on arrears already in the legacy systems are expected to continue if the cases transfer on to the 2012 Scheme. It is likely, therefore, that a material error on arrears will remain in future years.

Financial Reporting and IT Systems

The Department has developed new IT systems to underpin the 2012 Scheme. Full IT functionality to support both management information for the 2012 Scheme and the latter stages of case closure, is dependent on completion of the data warehouse, which has been substantially delayed. Existing functionality has been sufficient for the current year, given the low volume of receipts and payments relating to the 2012 Scheme, but will become increasingly problematic as the volume of cases on the 2012 Scheme increases.

The new systems, alongside the simplified assessment rules, are designed to reduce manual intervention, and therefore improve the timeliness and accuracy of assessments. In particular, the

systems interface directly with income details held by HMRC, which has resulted in automated income details for 90 per cent of applications. The anticipated increase in volume of cases on the 2012 Scheme in 2014-15 will better test the effectiveness of these changes.

My assessment of the early progress of the 2012 Scheme is covered in more detail in a report published in June 2014: www.nao.org.uk/report/child-maintenance-2012-scheme-early-progress-2/

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