National Audit Office

Report
by the Comptroller
and Auditor General

Cross-government

Managing debt owed to central government

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Key facts

£22bn	£41bn	£6bn
estimated total overdue debt owed to government at 31 March 2013	estimated cash collected against overdue debt in 2012-13	losses to government in 2012-13 from debt being written off or not pursued on value-for-money grounds ('remitted')

68 per cent of total government debt is owed to HMRC

87 per cent of overdue cash collected was collected by HMRC

61 per cent of HMRC debt is older than 180 days

81 per cent of DWP benefit overpayment debt is older than 180 days

66 per cent of DWP debtors receive benefits

£675 million of additional debt is expected to be recovered by HMRC and DWP as a result of new measures announced in the Chancellor's December 2013 Autumn Statement

Summary

Background and scope

1 Individuals and businesses owe debt to government for overdue tax liabilities, benefit or tax credit overpayments, and for other reasons including outstanding fines and court confiscation orders. There is no official figure for the total owed to central government that is overdue. However, our data suggest that debt identified by government was at least £22 billion at March 2013, against total collected revenue of over £600 billion. HM Revenue & Customs (HMRC) was owed the majority of this debt (£15.1 billion), while the Department for Work & Pensions (DWP) and Ministry of Justice (MOJ) were owed nearly all the remainder.

2 Managing debtors is a normal part of most businesses. Debt is an asset, but if it is not managed well it can fall in value and not generate the income expected. Government has a duty to manage its debtors effectively as part of good financial management, and optimise value for the taxpayer.

3 Since 2011 the Fraud, Error and Debt Taskforce, an expert panel chaired by the Minister for the Cabinet Office, has been developing a cross-government view of debt management. The Cabinet Office's Efficiency and Reform Group has set out an ambition for government to save £10 billion by 2014-15 from initiatives on fraud, error and debt combined.

4 This report sets out the landscape of debt owed to government, the strategic challenges, and the approach the centre of government (Cabinet Office and HM Treasury) has taken. We do not consider debt owed to local government, or debts that one part of government owes to another.

Key findings

Understanding debt

5 **Government does not publish definitive figures on the total amount of overdue debt it is owed, which the data suggest was at least £22 billion in March 2013.** Establishing the level of overdue debt is important because it provides the basis for government to manage that debt effectively. We based our £22 billion estimate on unpublished data from the Cabinet Office's surveys of departments, and information from our audit work. While information on debt owed to HMRC is available in the Comptroller and Auditor General's report on its annual accounts, most departments' statutory accounts do not require reporting of debt, only 'receivables' (which refers to all amounts receivable, including those not overdue).

6 **The overall debt balance has reduced in recent years but could rise again in the short term; government has no overall forecasts.** The total has reduced by around £5.5 billion in the last four years, largely because HMRC has reduced debt through a combination of write-offs and remissions, and collection efficiencies. DWP's balance has increased and is likely to increase further in the short term. In future, overall debt owed to government could be affected by economic factors, behaviour of citizens and businesses, departmental efficiency, or new policies. Government needs to take an overall view of the likely impact of such factors, including for example, introducing Universal Credit, continued accumulation of tax credits debt, and revisions to the estimated recoverability of student loans.

7 **The actual amount of working capital tied up across the whole collections process is not a figure captured or managed by government.** Because of factors including differences in processes and definitions, and historic problems with data systems, neither the centre's debt surveys nor information in accounts fully capture the amount of government's working capital tied up in collections processes. Over £1 billion of mainly small balances are treated as uncollectable and not captured in cross-government debt surveys, and around £400 million is lost from collections processes because of difficulties reconciling legacy data systems. There are larger balances held earlier in the government's revenue collection cycle before they become defined as debt or even receivables. Understanding the challenges across collections better would help government manage working capital.

Managing debt

8 **Government has not published an overall strategy for its debt management or clearly articulated its appetite for holding debt.** In 2012, the Fraud, Error and Debt Taskforce explained its broad priorities for tackling debt, but did not set out clear future actions, objectives and targets for the whole of government. There are elements of a strategic joined-up approach to debt, particularly in the Cabinet Office's proposal to create a single point of access to private sector debt management services for all government departments and bodies. However, without a cross-government debt strategy with clear shared objectives, it is difficult to see what government is aiming to achieve and what level of debt it considers optimal.

9 **Departments are developing their own debt management strategies, with HMRC's the most advanced.** HMRC set out a debt management strategy in 2009, in part as a response to our work, and has implemented and updated it since. DWP revised its approach in 2013 and has made debt management more clearly part of its strategic finance function. Other departments are still developing strategies, and all are proposing to make greater use of the private sector for analytical and recovery expertise.

10 **Some £6 billion was lost in 2012-13 from debt written off as irrecoverable, or 'remitted'[1] as not value for money to pursue, and government accounts show losses of over £32 billion since 2008-09.** Some losses are difficult for government to control, given the need to weigh up complex objectives and protect the vulnerable – nearly 70 per cent are due to insolvencies. In addition, the way the tax credits system works has created overpayments, of which a significant proportion turn into debts that cannot be collected. Government is now working to get this under control and learn lessons to "design out" debt in future systems. However, in general government's approach to write-offs and remissions has tended to be 'lumpy' and reactive, with departments periodically writing off or remitting large amounts of debt. The centre of government needs to have a greater ongoing awareness of expected losses to manage the corporate position.

11 **Government allows too much overdue debt to age, which can lead to erosion in its value.** Many businesses do not hold debt for longer than six months, but aim to promptly collect, sell or write it off, because older debt is usually harder to collect. However, a large proportion of government debt has been allowed to become 'aged', because of lack of resources or capability, or legal limits on how fast it can be recovered from debtors on benefit. Some 61 per cent of debt owed to HMRC was over 180 days old; for DWP, 81 per cent of benefit overpayment debt was more than 180 days old. Both HMRC and DWP are seeking to reduce old debt through better risk profiling and segmentation of their debtors. A 2011 pilot study on aged fines debt in HM Courts & Tribunals Service suggested that pursuing older debt more actively could generate a 49 per cent increase in expected total revenue, which we estimate could increase collections of fines from £156 million to £233 million.

1 Debt 'remission' (a concept unique to government) is where a department decides not to pursue a debt primarily on the grounds of value for money, i.e. the cost of pursuing it would be greater than the benefit, or it is not the most efficient use of limited resources, compared with other priorities.

12 **A lack of good quality, shared data on debtors undermines government's ability to manage debt effectively.** Legacy IT systems were often not designed to capture the key data needed for debt management. For example, HM Courts & Tribunals Service found more than 96 per cent of records, on debtors with aged debts, were missing one or more key data fields (such as telephone number). Departments are working on improving both data and analytical capability. HMRC has, since 2009, invested in IT and expertise to capture and analyse data on tax debtors from its numerous systems, and has seen benefits from tailoring its approaches to recovery for specific groups of debtors. A DWP pilot study that drew on external credit reference agency data achieved a 90 per cent increase in recoveries within the sample group. But there is much further to go – for example, it is not possible to determine how much an individual debtor owes to government as a whole. HMRC has the capability to produce a 'single debtor view' across its own business, but cannot yet do so as a matter of course. DWP can provide a holistic debtor position for benefit and Social Fund debtors, and is working to include child maintenance.

13 **Departments do not produce consistent performance data on debt management that can be monitored effectively by the centre or compared across government.** Departmental data returns to the Cabinet Office have been inconsistent and incomplete. The two leading debt-owners, HMRC and DWP, are in discussion with the Cabinet Office to agree a set of performance indicators for tax credits and benefit debt.

14 **Suitable data with which to benchmark costs of debt management and collection across government do not yet exist.** Consequently it is difficult for the centre to identify where exactly to target scarce resources to get the most benefit from improved debt management, and for departments to raise their performance by benchmarking themselves against others. For example, in examining the management of confiscation orders we found limited information on costs across the bodies involved, but estimated that it cost £102 million across the whole justice system to recover £133 million a year. HMRC, DWP and to a lesser extent other departments, have begun to get a better understanding of the cost of elements of their debt recovery work, and will be using new framework contracts with private sector recovery agencies to benchmark their cost-effectiveness.

The role of the strategic centre

15 **Against this background of poor information and inconsistent processes, the centre of government has more to do, to establish its authority over debt management.** The cross-government Fraud, Error and Debt Taskforce has galvanised greater cross-government action to address barriers to good debt management, where there was previously little or no coordinated activity. This has enabled the Cabinet Office, HM Treasury and departments to start making progress on some key issues, and some new funding incentives for increased recovery work have been announced, but there is still a long way to go. Closer working between the Cabinet Office and HM Treasury would help establish the centre's authority over debt management. However, the centre has not yet articulated a clear vision for how it will work with departments to promote better debt management.

16 The Cabinet Office has focused its efforts on aggregating debt management across departments and making better use of the private sector, but agreeing a scheme with departments has been difficult and complex. Ministers agreed in February 2012 to consider bringing together debt management across government and to find ways of capitalising on collective buying power. However, conflicting priorities, poor data and uncertainties over departmental take-up of the scheme have led to delays in agreeing how to take this forward. A business case is now being considered by the Treasury to create a debt 'market integrator' – a single point of access for departments to purchase debt collection, analytics and enforcement services. There are still significant hurdles to negotiate, such as the commercial model to be used and issues around data sharing, but integration is planned to begin gradually from October 2014.

17 The Treasury has begun to take a closer interest in monitoring debt, and recognises it needs to strengthen its central role. The Treasury has increased its monitoring of HMRC's write-offs and remissions and involved the Cabinet Office. There is scope to extend this approach to other departments. The creation of a new Director General role, to oversee financial management and reporting across all departments and monitor performance, also offers the opportunity to take a strategic, cross-government approach to debt management for the first time.

Conclusion

18 The centre of government has not yet fully gripped debt management, although the Cabinet Office has raised awareness of the issue and HM Treasury has agreed new financial incentives. There is no overall view of government's objectives for managing debt, the total current and future financial risk to government, or its appetite for that risk. Performance in managing debt cannot be compared or benchmarked across government, and information on the cost and efficiency of collecting debts is particularly poor. There are pockets of expertise and innovation, but poor quality data on debtors is a significant problem and government lacks the analytical sophistication it needs. The result is inconsistency and inefficient use of resources, with government unable to judge accurately the scale of taxpayer value being lost.

19 Lack of attention to debt means that government's working capital is larger than necessary, and government has to borrow more. Departments with the biggest debt balances are recognising the need to improve, and there are strong arguments for a much more integrated approach. The climate is now right for the Cabinet Office and HM Treasury to accelerate their joint work with departments, to better understand the corporate debt position, set out shared goals and take forward a clear strategy.

Recommendations

20 The strategic centre of government (Cabinet Office and HM Treasury) should set out a clear overall strategy and target for debt owed to government, supported by:

a **Monitoring accurately the overall level of working capital tied up in collections processes, supported by:**

- clear and consistent definitions of debt;
- working with departments to identify all relevant balances.

b **Clearly setting out government's objectives for debt management, its appetite for risk as regards debt and how this applies to departments.**

c **Agreeing with all departments a minimum set of debt performance indicators, which could be based on those set out in this report.** The centre should ensure these are incorporated into good practice in board reporting and use these indicators in its discussions with departments.

21 The Treasury should put in place arrangements that support and provide incentives for good debt management, including:

d **Monitoring the position across government on debt write-offs and remissions, extending its monitoring approach beyond HMRC to other departments.**

e **Reviewing the scope for further funding mechanisms that better incentivise departments to recover debt. This could include building on its work with HMRC and DWP.**

f **Promoting best practice on reporting of debt in accounts where it is material, which might include:**

- reconciliation of debt with receivables;
- age analysis of debts; and
- provisions for bad debts based on forecast collectability.

22 Departments should ensure they have a clear understanding of future risks and how well they manage debt, including:

- g **Ensuring that debt management is part of their overall plans for improving departmental financial management, and a key responsibility of the finance director.**
- h **Adopting the minimum set of performance data and making it available to boards and the centre of government.**
- i **Identifying what further data they need, to understand their debt and target their debt recovery resources effectively, whether by buying, borrowing or building debt management capability.**
- j **Monitoring the causes of debt to understand the potential effect on their future exposure to debt.** Departments should build forecasting capability around debt and ensure they consider the effects on debt when creating or changing policy and designing IT systems.

23 The centre and departments, working together, should agree on an integrated approach to debt and break down barriers to making that happen, including:

- k **Pursuing intelligent, coherent engagement with the market that makes best use of government's buying power for both small and large departments while preserving clear accountability for debt.**
- l **Building on the experience of the Fraud, Error and Debt Taskforce, to share debt management expertise more effectively across government.**
- m **Each department agreeing a goal of developing a 'single debtor view', as a step towards achieving this across government.**