National Audit Office

Report
by the Comptroller
and Auditor General

Cross-government

Managing debt owed to central government

HC 967 SESSION 2013-14 14 FEBRUARY 2014

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Managing debt owed to central government

Report by the Comptroller and Auditor General

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Comptroller and Auditor General
National Audit Office

10 February 2014

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This study examines how well government understands and manages debt owed to it across various departments and bodies, to determine whether it has a good strategic grip of debt management as part of wider financial management.

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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/2014-debt-to-government

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Key facts

£22bn

estimated total overdue debt owed to government at 31 March 2013

£41bn

estimated cash collected against overdue debt in 2012-13

£6bn

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.**

Part One

Understanding debt

1.1 A debt in everyday terms is an obligation owed to another individual or organisation, captured as part of 'receivables' in departmental accounts. Organisations need to decide what level of debt they can manage effectively and how much working capital they are willing to have tied up in debt, as part of overall financial strategy. In this report we focus on overdue debt, which is money owed that is in arrears and legally collectable.

1.2 We have reported previously that government's approach to financial management tends to focus too little on management of the financial position and maintaining long-term value.[2] We have also reported, through our work on accounts, on the financial risks from tax and benefit debt.[3] In 2011 the Cabinet Office added debt to the remit of the expert Fraud, Error and Debt Taskforce, which is chaired by the Minister for the Cabinet Office, and takes a cross-government view of these three related issues. This part sets out the available data on debt overdue to government, and examines how well government understands the whole picture.

Understanding the scale and sources of overdue debt

1.3 Debt owed to government departments and bodies includes, for example, individuals owing debt from benefit or tax credits overpayments, and businesses with overdue tax liabilities (**Figure 1**).

1.4 There is no definitive figure for the total amount of overdue debt owed to central government, largely because it is not an item reported separately in all departments' accounts. Based on non-published data from the Cabinet Office's surveys of departments and information from our audit work, we estimate the total at £22 billion on 31 March 2013 (**Figure 2** on page 14), compared to a total revenue collected of over £600 billion. Most of this (68 per cent) is debt owed to HM Revenue & Customs (HMRC), who also collect some 77 per cent of government revenues. The figures do not include local government debt (mainly council tax and business rates arrears), or debts owed by one part of government, central or local, to another.

2 Comptroller and Auditor General, *Financial management in government*, Session 2013-14, HC 131, National Audit Office, June 2013.

3 Comptroller and Auditor General, *HM Revenue & Customs annual report and accounts*, Session 2012-13, HC 10, June 2013; Comptroller and Auditor General, *HM Revenue & Customs annual report and accounts*, Session 2011-12, HC 38, June 2012; and Comptroller and Auditor General, *Department for Work & Pensions annual report and accounts 2012-13*, Session 2012-13, HC 20, December 2013.

Figure 1
Sources of debt owed to government

Debt source	Examples
Unpaid taxes and fees	Income tax (self-assessed and PAYE), VAT, corporation tax, driver licensing fees
Ineligible benefits or grants	Benefit and tax credits overpayments, Common Agricultural Policy support payments
Unpaid fines and court orders	Court fines, confiscation orders
Loans not repaid	Social Fund loans, student loans
Operations-related debt	Supplier overpayments, payroll debt

Source: National Audit Office

1.5 A complete understanding of an organisation's debt management requires not just the debt balance, which is a snapshot of an organisation's debt 'stock' at a particular point and depends heavily on the nature and size of the business. It also requires data on the 'flow' of debt over time, for example new debt created over a year. **Figure 3** on page 15 charts movements of government debt stocks and flows for 2012-13.

Understanding and planning for changes in debt levels

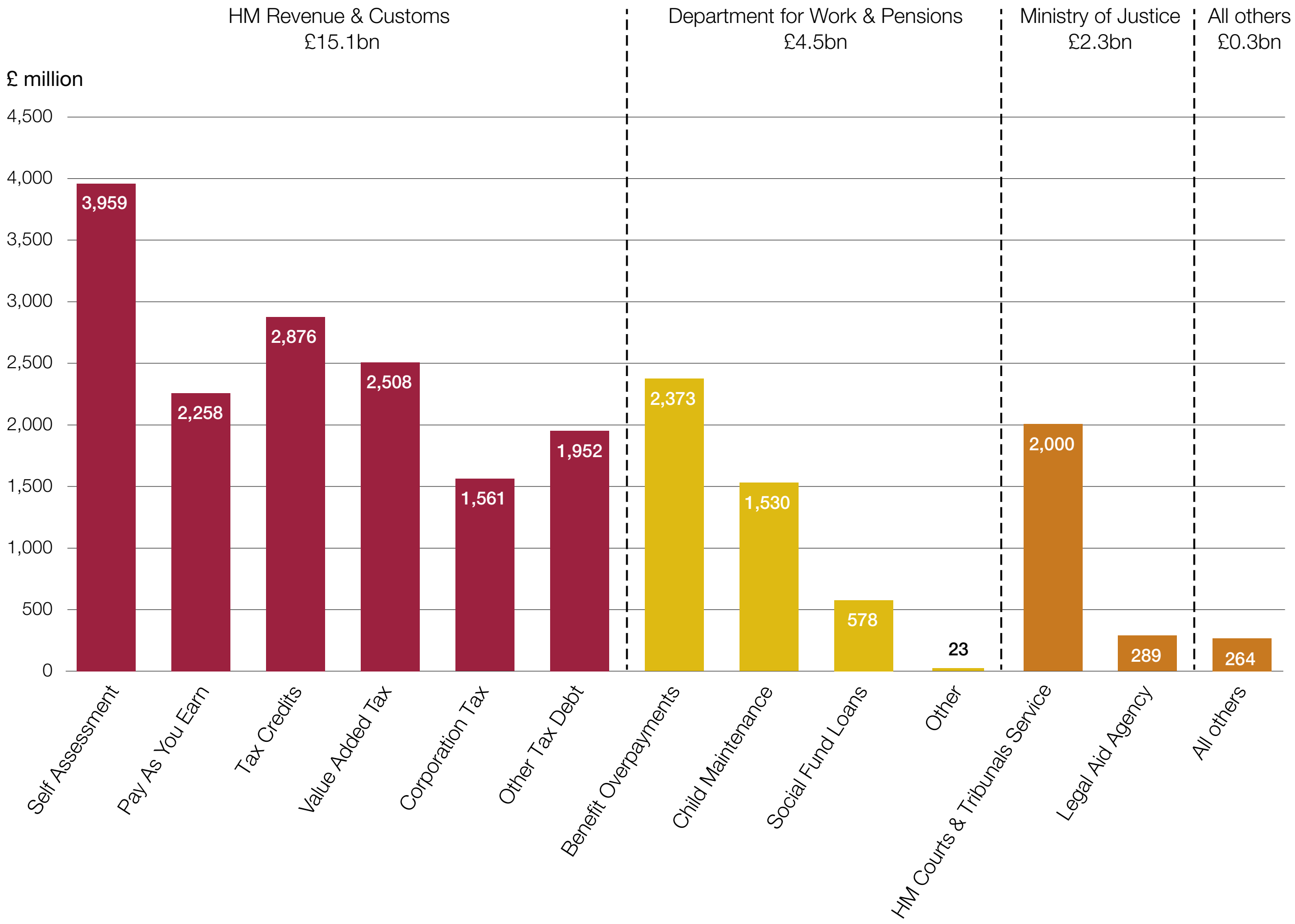
1.6 Total government debt balances have declined from £26 billion in 2007-08 to £22 billion in 2012-13 (**Figure 4** on page 16). Of the three departments with the largest debt balances, only HMRC's has reduced over the last six years, by £6.4 billion, through improvements in recoveries and cleaning up the debt book by remitting some £3.5 billion in tax credits and reclassifying some debts as uncollectable. The Department for Work & Pensions' (DWP) and Ministry of Justice's (MOJ) debt balances have both risen during the same period, including an increase of £0.8 billion in debts owed to DWP.

1.7 There are no overall cross-government forecasts of future debt to government. A cross-government view on likely changes in overall debt is complex and requires good data. While HMRC and DWP are both improving their forecasting capability, a Cabinet Office survey of departments found that other departments do not currently forecast their future debt balances, stocks or flows. We also reported in November 2013 on the need to improve forecasting of the recoverability of student loans.[4]

4 Comptroller and Auditor General, *Student loan repayments*, Session 2013-14, HC 818, National Audit Office, November 2013.

Figure 2
Estimated overdue debt balances at 31 March 2013

Debt owed to government as at 31 March 2013, by type of debt



- HM Revenue & Customs
- Department for Work & Pensions
- Rest of government

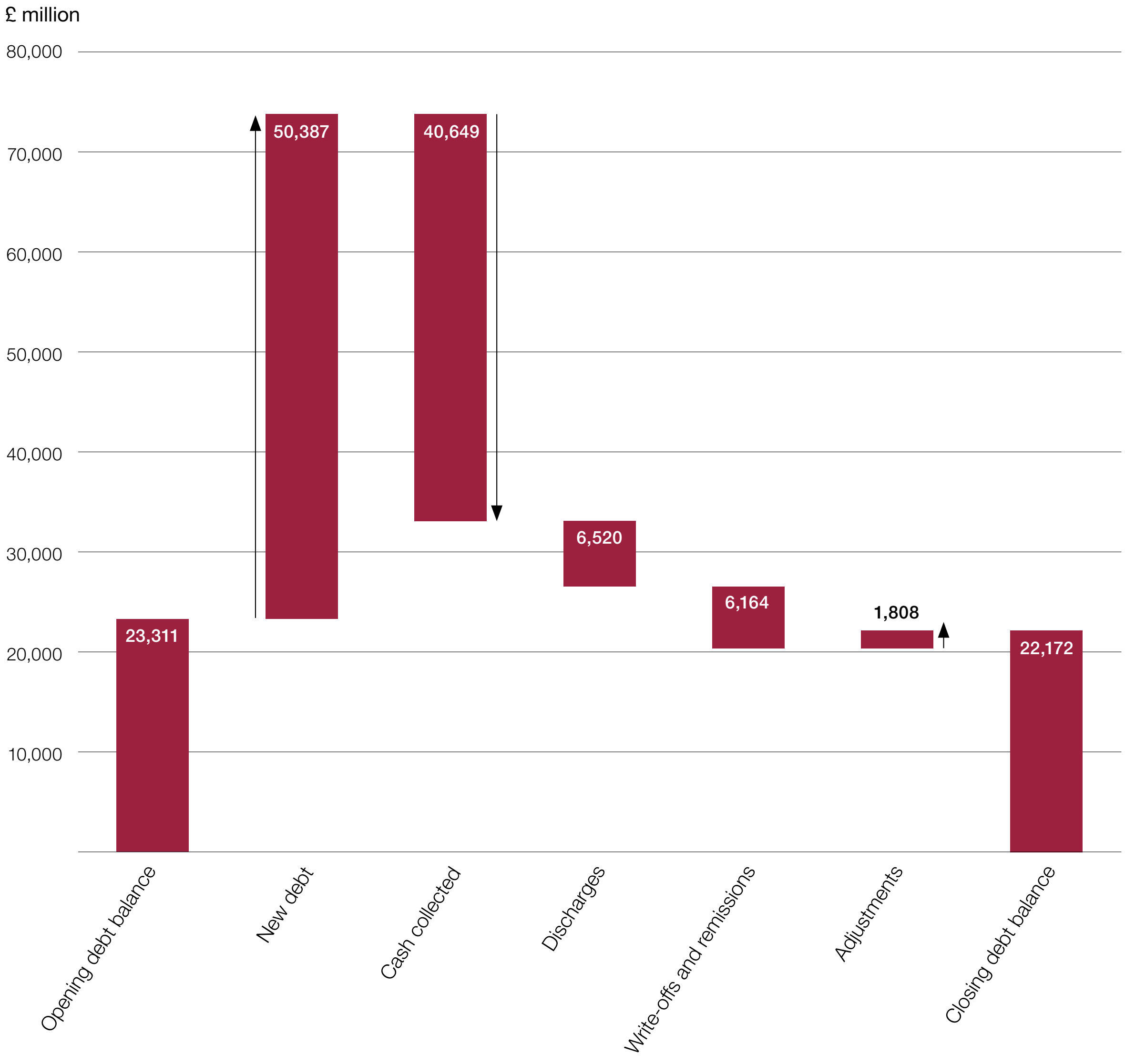
Notes

1. This chart is based on 2013 data from the Cabinet Office's survey of departments. Where debt balances were incomplete or missing entirely, we used 2012-13 financial statements, management accounts and other debt returns submitted to the Cabinet Office.
2. For HM Courts & Tribunals Service, the value of confiscation order debt at 31 March outside the agreed payment terms (overdue) was £1.3 billion. Debt from other financial impositions was £0.7 billion. HM Courts & Tribunals Service are not able to analyse this other debt between balances within and outside payment terms.
3. Student loans are included in 'All others'. Although loans total £46 billion, only a small fraction of this is overdue.

Source: National Audit Office analysis of financial accounts, management accounts and Cabinet Office data

Figure 3
Government debt stocks and flows, 2012-13

Debt movements 2012-13



Notes

1 Debt is written off in situations where there is no practical way to pursue the liability. Some write-offs occur automatically and are outside a department's control such as where the debtor is insolvent.

2 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.

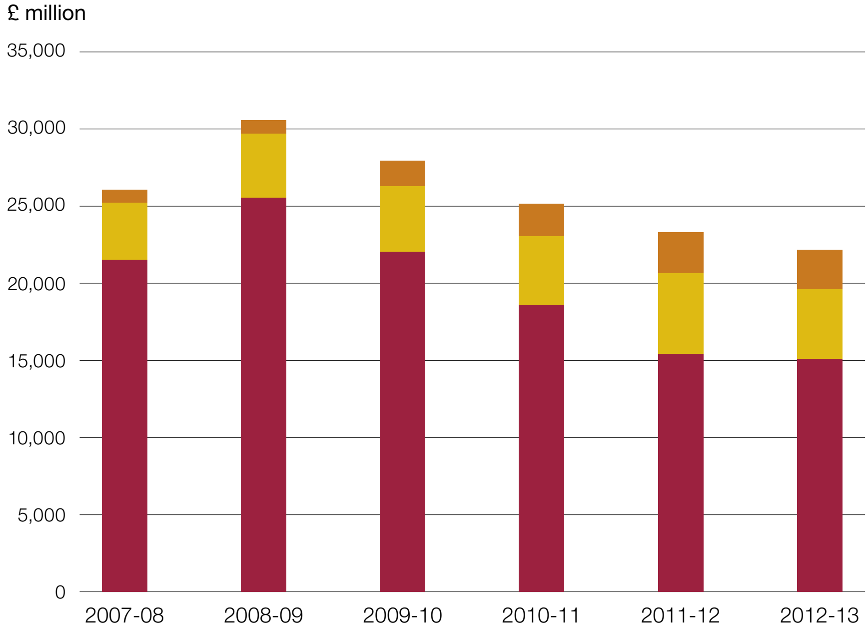
3 Discharged debt is where HMRC amends or cancels a debt as further information is received that determines the taxpayer's final liability as being lower than the originally estimated figure.

4 Adjustments are due to manual adjustments to reconcile between debt balance figures in debt management systems and movements, such as cash collected, in other financial systems.

Source: National Audit Office analysis of financial accounts, management accounts and Cabinet Office data

Figure 4
Government debt balances from 2007-08 to 2012-13

Progression of government debt figure over last six years



	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Rest of government	825	870	1,625	2,072	2,626	2,553
Department for Work & Pensions	3,693	4,121	4,256	4,508	5,240	4,504
HM Revenue & Customs	21,549	25,578	22,494	19,331	15,445	15,114

Notes

1 This chart is based on 2013 consolidated data returns submitted to the Cabinet Office. Where debt balances were incomplete or missing entirely, we used alternative sources, including 2013 debt-type survey, 2012-13 financial statements, and departmental debt management information. Debt balances 2007-08 to 2010-11 taken from 2011 Debt Survey returns.

2 Confiscation orders have been included in the 'rest of government' debt balance from 2009-10.

Source: National Audit Office analysis of financial accounts, management accounts and Cabinet Office data

1.8 Forecasts of future debt levels are important if government is to make informed financial, operational and policy decisions. In the private sector, if overdue debt rises to an unacceptable level, organisations may refuse to do business with certain individuals or companies, or cease to offer a service that is creating debtors. Government may not be able to take such action, and needs to understand the interplay of policy and other factors if it is to manage its level of debt effectively. Changes (some current examples are set out in **Figure 5** overleaf) may arise from:

- the economic environment – individuals and businesses in financial hardship may miss payments to government;
- behavioural factors – people's perception of owing money to government and propensity to repay;
- policy changes – introduction of new regulations, tax rules, benefits or charges; and
- management of debt – changes in a department's processes or resources affecting how fast and effectively it resolves overdue debt.

1.9 Many people owing debt to government are in difficult circumstances, and also owe debt to private sector companies. The Money Advice Service reported that 8.8 million people in the UK are over-indebted, with 48 per cent of those feeling that being in debt prevents them from buying the basics.[5] The Committee of Public Accounts has previously highlighted that having to repay tax credits overpayments has placed 'unacceptable' burdens of debt on people already suffering hardship. The Minister for the Cabinet Office has pledged to ensure that vulnerable individuals and struggling businesses receive appropriate support and guidance, and both HMRC and DWP have a number of measures to provide specific support in hardship cases.

5 Money Advice Service, *Indebted Lives: the complexities of life in debt*, November 2013.

Figure 5

Government actions potentially affecting the level of debt

Tax credits	Tax credits receivables are expected to rise to £5.5 billion by the start of 2014-15, from £4.8 billion at 31 March 2013. Although more tax credits debt is now being collected through 'time to pay' arrangements, HMRC's expected recovery rate is 31.4 per cent.
Universal Credit and other benefit changes	DWP hopes a simpler benefit system under Universal Credit will support debt prevention and recovery, and reduce debt in the long term. However, in the shorter term, DWP's debt levels are likely to rise, because: tax credit debt already in recovery will transfer from HMRC; and changes to regulations mean that all debt is now recoverable, including that caused by official error. Other reforms to housing benefit, council tax and disability benefit could put additional pressure on the finances of existing debtors. We reported in December 2013 that in extending Council Tax liability to more people, some councils had not put in place protection for vulnerable people, other than pensioners.[1]
Student loans	Our 2013 report indicated that the current value of student loans is £46 billion, which will rise to £200 billion by 2042. The Department for Business, Innovation & Skills estimates around half of borrowers with new student loans will not fully repay their loans.[2]
Child maintenance	Our 2012 report on child maintenance concluded that the accumulation of payment arrears due from non-resident parents had not been resolved.[3] Child maintenance debt totalled £3.8 billion in 2012, of which an estimated £1.5 billion is owed to government (with the remainder owed to parents with care).
Immigration fines	Following a consultation the government announced in July 2013 that it would look to double the maximum penalty for employers employing illegal immigrants to £20,000. Some 40 per cent of the £16 million associated debt balance is currently more than one year overdue. The Home Office is looking into the potential financial and behavioural impact of the increased penalties.

Notes

1 Comptroller and Auditor General, *Council tax support*, Session 2013-14, HC 882, National Audit Office, 13 December 2013.

2 Comptroller and Auditor General, *Student loan repayments*, Session 2013-14, HC 818, National Audit Office, 28 November 2013.

3 Comptroller and Auditor General, *Child Maintenance and Enforcement Commission: cost reduction*, Session 2010-12, HC 1793, National Audit Office, 29 February 2012.

Source: National Audit Office analysis

Problems with understanding the level of debt

Absence of shared definitions

1.10 There is no common definition of overdue debt across government, largely because debt (unlike receivables) is not required to be reported externally, and departments deal with different types of debt. Government financial reporting frameworks, the financial reporting manual and *Managing Public Money*, do not require departments to identify debt on a consistent basis, or hold standard management information.[6] Departments have therefore formed their own definitions of overdue debt. This makes comparisons difficult and hinders the centre of government's ability to understand the corporate position.

1.11 In an attempt to gather data on the overall position, the Cabinet Office worked with external experts to produce the following definition for its 2012 departmental debt survey.

> '… an obligation or liability owed:
>
> - to central government;
> - by entities/individuals external to government;
> - is in arrears – debt that is overdue after missing one or more required payments from the date that original payment was expected to have been received by;
> - before any fair value or provision adjustment; and
> - is legally collectable.'

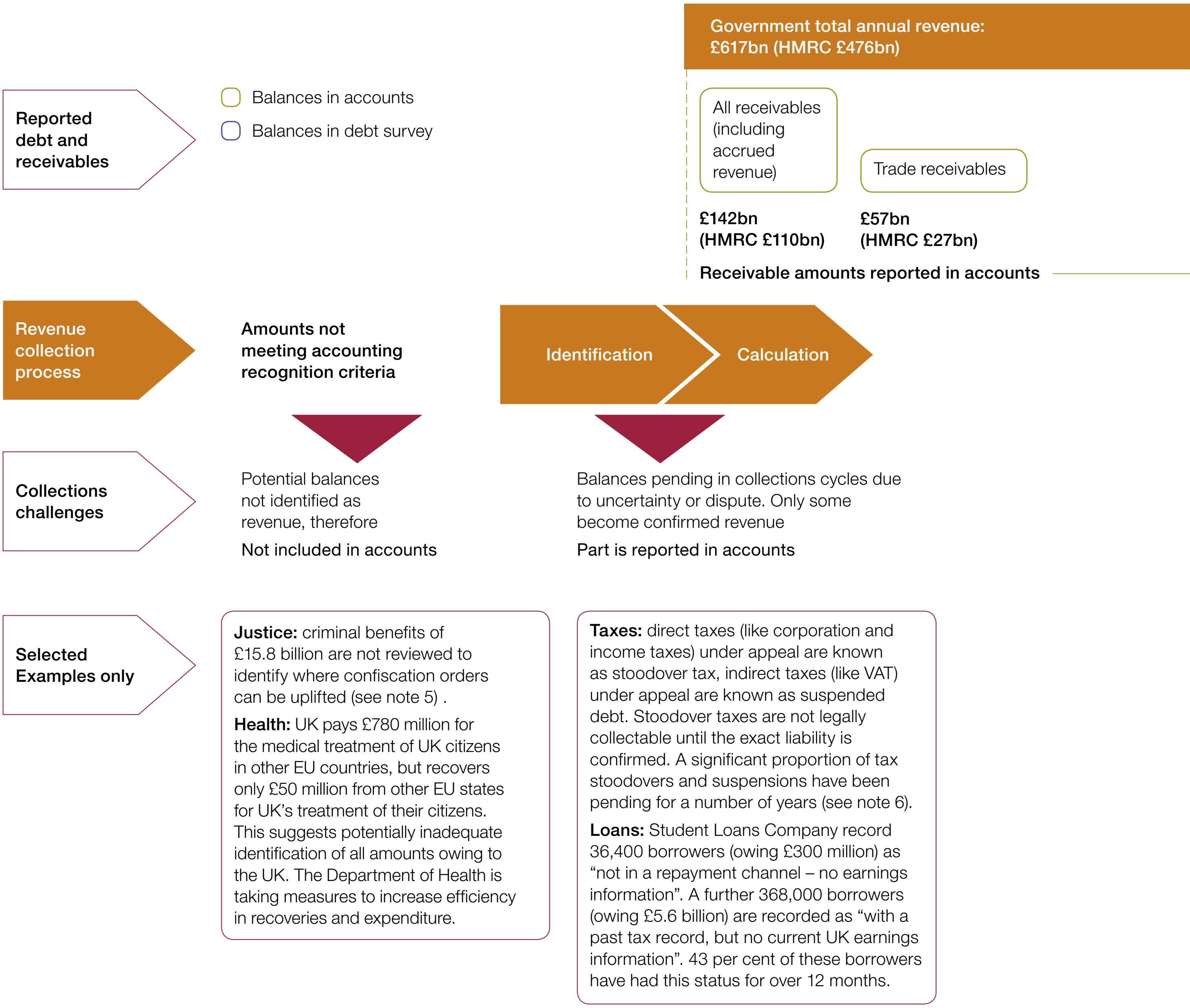
Uncertainties around the overall level of debt identified

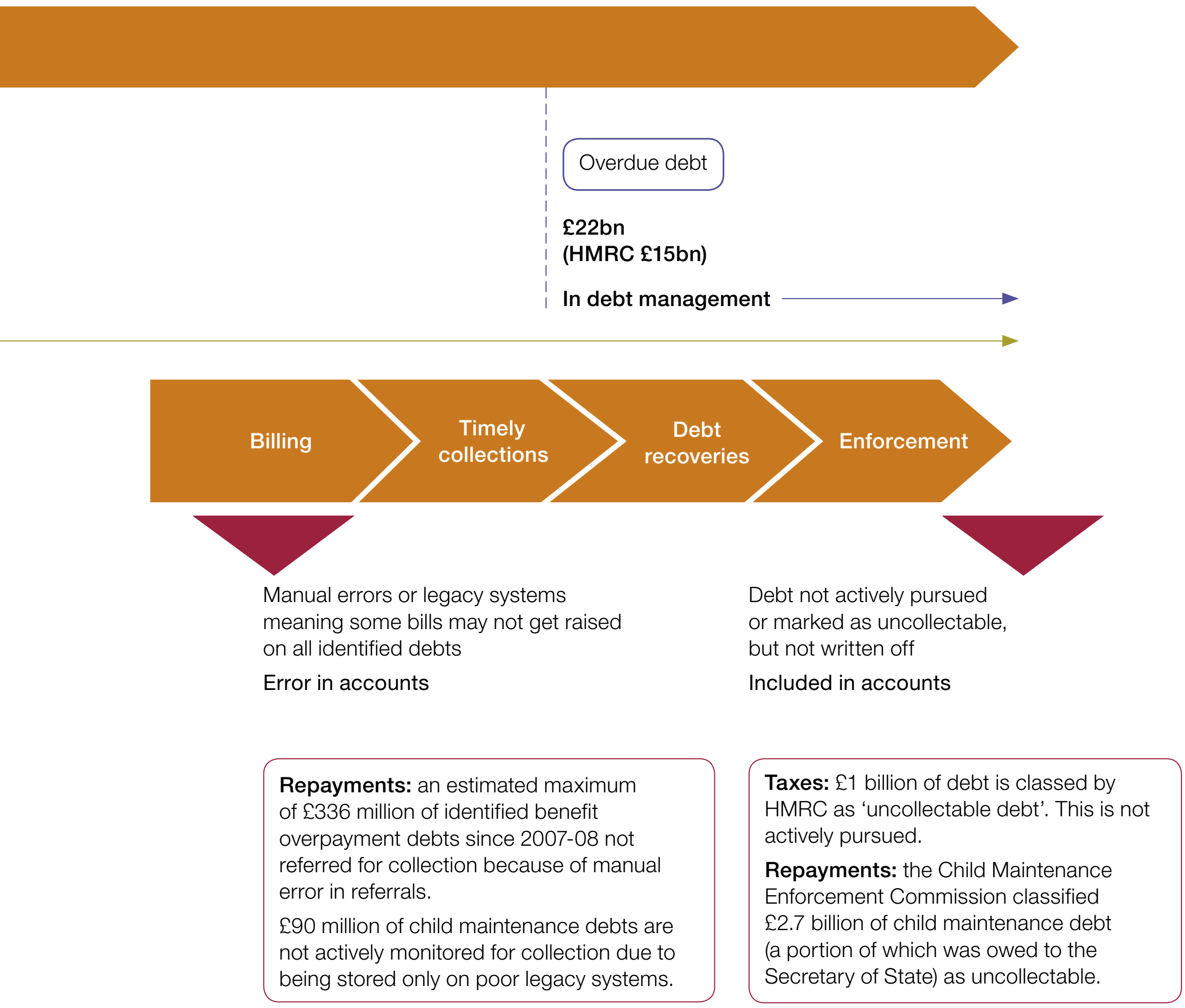
1.12 Departments accurately report receivables in their individual financial statements. However, because of factors including differences in processes and definitions and historic problems with data systems, this does not fully capture the amount of government's working capital tied up in collections processes (**Figure 6** overleaf). To understand where to focus its efforts, government should acknowledge that overdue debt is only part of the challenge for revenue collections.

6 www.gov.uk/government/publications/managing-public-money

Figure 6

Overdue debt is only part of the challenge for government revenue collections





Notes

1. Receivables figures are reported before impairments. Figures for total government revenues taken from most recent Whole of Government Accounts (2011-12). HMRC figures taken from *2012-13 Annual Report and Accounts*.
2. Trade receivables are monies owed to government for which payment is now due.
3. All receivables figures also include accrued government revenues, monies which relate to the financial year but which are not yet due for payment. The majority of these relate to taxes and duties not yet due for collection.
4. Overdue debts are monies owed that are in arrears and legally collectable. Overdue debt figures taken from NAO adjusted Cabinet Office debt survey (see Figure 2).
5. Confiscation orders, containing £15.8 billion of identified criminal proceeds have been imposed since 1986. The outstanding balance of confiscation orders may be understated since the criminal justice system has an inconsistent approach to reviewing cases, and identifying assets where the original order can be uplifted.
6. Stoodover tax (£16.4 billion) comprises direct tax assessments (for example on Corporation Tax and self-assessed Income Tax) under appeal. HMRC cannot legally collect stoodover tax and so does not classify it as receivable until the outcome is virtually certain that it will not be discharged. £0.6 billion of stoodover corporation tax was included in HMRC accrued revenue receivables in the 2012-13 HMRC Trust Statement. Suspended tax is estimated at £0.9 billion and arises when assessments of indirect taxes (for example VAT) are not yet confirmed. It is reported in HMRC's receivables figures. A significant proportion of stoodover tax relates to pre-2010, and some VAT suspensions date back to 2006.

Source: National Audit Office analysis of audit work

Poor quality of data

1.13 The Cabinet Office attempted to gather cross-government debt data through surveying departments in 2011 and 2012, and including debt measures in its central data gathering exercises – the Quarterly Data Summary (QDS) and Consolidated Data Request (CDR). The data requested has evolved to reflect changes in the understanding of debt within departments. However, these changes have made it difficult to track the position over time, and returns from departments have been incomplete and inconsistent (**Figure 7**). The Cabinet Office has been unable to rely on QDS data, because of its poor quality. The Treasury does not use these data to monitor departments' performance, relying instead on information provided directly to its Spending Teams.

Figure 7

Central debt data requests to departments

Metric	Debt Survey: 2011	Debt Survey: 2012	QDS: 2010-11, 2011-12	QDS: 2012-13	QDS: 2013-14	CDR: 2013
Debt and receivables measures						
Debt – value	○	●	○	○	○	○
Debt – volume	○	○				○
Receivables – value		○		○	○	○
Receivables – volume						○
New debt – value	○	○				○
New debt – volume		○				○
Debt balances for past five years	○					
Debt broken down by number and value of individual debts	○	○				
Debt management measures						
Debt written off – value	○	●		○		○
Debt written off – volume		○				○
Receivables collected – value		○				○
Debt collected – value	○	○				○
Debt collected – volume						○
Cure rate (defined as a percentage of debts resolved out of all debts that were attempted to be resolved)		○				
Cost of in-house debt collection	○	●		○	○	

Figure 7 *continued*
Central debt data requests to departments

Metric	**Debt Survey: 2011**	**Debt Survey: 2012**	**QDS: 2010-11, 2011-12**	**QDS: 2012-13**	**QDS: 2013-14**	**CDR: 2013**
Debt management measures *continued*						
Cost of outsourced debt collection	○	○		○	○	
Age of debt	○	○				
Debtor days			○	○		
Roll rate (defined as a percentage debt balance delinquent at 30, 60 and 90 days)		○				
Use of external debt collection agencies	○	○				○
Debt placed with external providers of debt collection services – value						○
Debt placed with external providers of debt collection services – volume						○
Number of employees working on debt collection	○					
Debt collection activity – number of telephone calls and letters		○				

○ Measure included in data request, but full response not received from every department/body

● Measure included in data request, and full response received from every department/body

Notes

1 The table contains selected debt measures from the debt surveys, QDS and CDR.

2 The 2011 debt survey and QDS were sent to all departments. The 2012 debt survey, which contained more detailed measures than the 2011 survey, was sent to six departments owed the majority of government debt. CDR questions on debt were sent to 13 departments.

Source: National Audit Office analysis of returns to Cabinet Office debt surveys, QDS and CDR

Part Two

Managing debt

2.1 Managing debtors is a normal part of most businesses. Debt is an asset that creates income and a source of value, but if it is not managed well, it can decline in value and not generate the income expected. This part looks at how clearly government has set out strategies for managing debt, the evidence available on performance, and the scope for improvement.

Overall indicators and targets for debt recovery do not yet exist

2.2 Government as a whole has not published an overall debt strategy that clearly states its objectives, performance measures and targets for debt management. Elements of a corporate approach to debt can be found: HM Revenue & Customs (HMRC) and the Department for Work & Pensions (DWP) have had a joint strategy since 2010 for tackling fraud and error in benefits and tax credits, which in the longer term contributes to the reduction in debt.[7] The Cabinet Office has set out an ambition for government to save £10 billion by 2014-15 through initiatives on fraud, error and debt combined,[8] although it is not clear how much of this relates specifically to better debt management. A strategic, cross-government approach is also embodied in the Cabinet Office's proposal to create a debt 'market integrator', which would provide a single point of access to private sector debt management services for all government departments and bodies.

2.3 The Fraud, Error and Debt Taskforce's 2012 report *Tackling Debt Owed to Central Government* set out four broad priorities for tackling debt: prevention, fairness, efficiency and effectiveness.[9] However, government has not published a clear statement of the overall outcomes it is seeking to achieve, or how it assesses progress towards them. New commitments totalling £675 million from both HMRC and DWP to increase recoveries were set out in the December 2013 Autumn Statement but an overall debt indicator has yet to be agreed.

7 HMRC and DWP, *Tackling fraud and error in the benefit and tax credits system*, October 2010.
8 Comptroller and Auditor General, *The Efficiency and Reform Group*, Session 2012-13, HC 956, National Audit Office, 17 April 2013.
9 HM Government, *Tackling Debt Owed to Central Government: An Interim Report of the Fraud, Error and Debt Taskforce*, February 2012.

Debt management strategies are emerging across government

2.4 HMRC set out a debt strategy in 2009, in part as a response to our work, which it has since implemented and updated each year. DWP revised its strategic approach to debt in 2013 and made accountability for debt more firmly part of strategic finance. Other departments and bodies have, until recently, not set out strategies and objectives for debt management (**Figure 8** overleaf).

2.5 The absence of joined-up strategies and objectives is reflected in variable use of debt management performance measures. There is no standard set of data captured by all debt-owning departments and information reported at board level varies widely. Based on expert advice, we developed a minimum set of measures that we consider should be captured by any debt-owning organisation monthly (**Figure 9** on page 28). HMRC and DWP capture this information already and are currently working with the Cabinet Office on a set of performance indicators for tax credits and benefit debt.

Assessing the risks to taxpayer value

2.6 Against this background of poor and inconsistent data, and a lack of clear objectives, it is impossible to judge accurately the taxpayer value that is being lost. Our external audit and departments' internal work points to a range of problems in the broad collections process. In 2011-12, eight of the 27 government accounts' qualifications highlighted concerns over management of receivables, erroneous payments or recoveries.[10] We also reviewed all internal audit reports specifically on the management of debt for HMRC, DWP and MoJ since 2011-12 (**Figure 10** on page 29). While the number of reports indicates management is focusing on debt, the level of assurance varies.

2.7 To understand better the fundamental issues in government's debt management we have considered three types of financial risk:

- collectability – debt treated as not collectable, which could in fact be recovered;
- timeliness – debt not collected promptly enough, leading to erosion in its value and/or tying up resources unnecessarily; and
- efficiency – high costs of collection or poor data quality, leading to inefficiency.

This is not a systematic review of all departments, types of debt, or performance issues, owing to the lack of data and performance measures outlined above. We have looked at areas where there are indications of risk, scope to improve and/or action in hand.

10 Including DWP Resource Accounts, HMRC Resource Accounts, HM Courts and Tribunal Service Trust Statement and Rural Payments Agency.

Figure 8

Development of departments' strategies for overdue debt

Debt-owning government body	HMRC	DWP
Organisation and accountability	The Debt Management and Banking (DMB) group reports to the Executive Committee of the Board	The Debt Management Division was reorganised in 2012 to report directly to the Director General for Finance
Status of debt management strategy	Strategy initiated in 2009, and has since been implemented and revised annually	A new strategy was set out in June 2013
Stated objectives	Maximise recoveries, minimise costs, with due regard to hardship, including continuing to utilise fixed term capacity, including private sector, where appropriate and cost effective to assist in-house collection Maximise efficiency of debt recovery through continued use of increasingly sophisticated segmentation, campaigns and analytics Manage age profile of debt Work with colleagues across HMRC to constrain the creation of debt where possible	Minimise debt exposure Deliver a professional, cost-effective and efficient public service, continually improving return on investment Deliver joined-up services to improve the customer journey Support delivery of DWP strategic objectives Maintain accurate debt accounts Partner with government to drive better outcomes for the taxpayer
Future plans	Expand capacity to increase recoveries, through both in-house staffing and use of debt collection agencies Existing framework contract for outsourced services (also used by other departments) expires in October 2014 Use of enhanced in-house analytics to segment debtor population, enabling more targeted collection approaches	Increased use of analytics to inform debtor treatment, including better use of private sector (announced in Autumn Statement 2013) Developing a single view of DWP debtors through improved IT Taking over tax credit debt in recovery from HMRC Use of Direct Earnings Attachment Orders to recover debt from earnings Use of digital self-service channels to expand payment and contact options Developing professional debt qualification and accreditation for staff through the Institute of Credit Management Intention to deliver a cross-government debt recovery service from 2017

HM Courts & Tribunals Service	Legal Aid Agency	Home Office	Student Loans Company
The Service is operationally independent of MOJ, but must work with other parts of the justice system to manage debt	The Agency independently manages its debt. It was created as an executive agency of the Ministry of Justice in 2013 following the abolition of the Legal Services Commission	Most Home Office debt relates to the immigration enforcement activities of the former UK Border Agency (UKBA). In 2013 UKBA was brought into the Home Office	The Company is responsible for administering and collecting debts. The Departments for Business, Innovation & Skills (BIS) owns and sets collection targets
We reported in December 2013 a need for a coherent strategy that joined up the Home Office, Ministry of Justice and Attorney General's Office	A refreshed strategy was agreed by the Agency's Board in July 2013	Following the reintegration of UKBA, a debt management strategy for the whole department is in development	Company has a strategy, but we reported in November 2013 that it should have a joint strategic approach with BIS and HMRC for improving collection performance
No overarching objectives have been set out	Preventing debt arising Efficient administration Increasing recovery	The department is working on clarifying its objectives These include maximising the deterrent effect from enforcing penalties, and value for money of enforcement	Key objective set by BIS is that as many borrowers as possible are in a repayment channel
Plans to outsource enforcement activity in 2014 to the private sector under the *Compliance and Enforcement Services Project*	Migration to a new case and cost management IT system took place in December 2013 Currently exploring alternative debt management models for 2014 onwards, taking account of the development of a cross-government approach	The department is considering how internal processes and systems can be strengthened and how to effectively use outsourcing options to improve collection	Sale of remaining pre-1998 loans was announced in November 2013 For the remaining loan book, BIS aims to have developed an improved forecasting model by spring 2014, with a better reflection of borrowers' earnings histories

Source: National Audit Office analysis of departmental debt strategies

Figure 9

Our suggested minimum performance measures on overdue debt

Type of measure	**Minimum data set which should be available monthly – and underpin reporting to the Board**
Stocks and flows	Opening and closing balances in active recovery, broken down by type of income
	Amounts not in debt management systems
	Inflow and collections total
Compliance – where heightened risk of default	Bad debt provision – impairments
	Value of write-offs and remissions
Age of debt	Age analysis, broken into time intervals, e.g. under one year, one to two years etc.
Efficiency of collection	Cost per £ collected
	Cost per £ collected in debt collection agencies
	Collection rate in debt collection agencies
Customer service	Percentage of call attempts handled
	Level of complaints

Source: National Audit Office minimum set of indicators, based on advice from Deloitte and others

Figure 10

Internal audit assurance on debt management 2011-13 for three departments

Internal audit assurance on debt management	Department for Work & Pensions (DWP)	HM Revenue & Customs (HMRC)	Ministry of Justice (MOJ)
Strong	Review of DWP's customer segmentation pilot	Review of HMRC's use of Debt Collection Agencies Review of HMRC's expansion of use of Debt Collection Agencies Review of lessons learning in Tax Credit Debt Strategy	
Reasonable	Review of DWP's progress and systems for aged debt Review of DWP's cleansing of old e-referrals cases Review of debt referral process across nine benefit streams Review of benefits from DWP's transformation of its debt management		
Limited	Review of DWP's calculation of omitted debt	Review of efficiency of mobile Field Force enforcement staff Review of HMRC's international coordination in Mutual Assistance in the Recovery of Debt	Review of HM Courts & Tribunals Service Fines Collection
Weak		Review of planned benefits from project tackling Contrived Insolvency	

Source: National Audit Office analysis

Collectability: government needs to reduce the level of bad debts

2.8 Some debt owed to government may not be recoverable, in full or in part. Good financial management requires departments to: understand the characteristics of their debt; accurately forecast recoverability and provide for bad debt; write off when debts become clearly irrecoverable; and adjust policy if write-offs become too high. In the five years since 2008-09, over £32 billion of debt owed to government has been written off or remitted[11] by the three largest debt-holding departments (**Figure 11**).

2.9 Some losses are difficult for government to control. Approximately 95 per cent of HMRC's write-offs (and hence nearly 70 per cent of all government losses) relate to insolvencies. In these cases government has little scope to recover more, and must focus on risk-based approaches to limit its exposure to insolvent companies and individuals. Unlike a private sector company, government must also take into account wider considerations, which constrain the collectability of debt, for example:

- offering 'time-to-pay' agreements to struggling small businesses in order not to precipitate insolvency;
- risks around pursuing debts from vulnerable individuals owing tax credits or long outstanding child maintenance; or conversely
- debts from confiscation orders are never written off as a point of policy.

Figure 11

Write-off and remission of bad debts by HM Revenue & Customs, Department for Work & Pensions and Ministry of Justice

Treatment of bad debts by HMRC, DWP and MOJ	2008-09 (£m)	2009-10 (£m)	2010-11 (£m)	2011-12 (£m)	2012-13 (£m)	Total (£m)
Write-offs	4,658	6,565	5,184	4,751	4,902	**26,061**
Remissions	405	670	1,431	2,583	1,223	**6,312**
Total	**5,063**	**7,235**	**6,616**	**7,334**	**6,125**	**32,373**

Note

1 Remission of debt is used by HMRC and HM Courts & Tribunals (part of MOJ), with HMRC accounting for the overwhelming majority of cases, but not by DWP.

Source: National Audit Office analysis of statutory accounts

11 For definition of remission see footnote to Figure 3.

2.10 A large proportion (51 per cent) of the £6.3 billion remissions between 2008-09 and 2012-13 relate to personal tax credits. The way the tax credits system works has created overpayments and debt. Payments were made to individuals over the course of a year that could potentially exceed their total annual entitlement – of which a significant proportion turn into debts that cannot be collected. Tax credits overpayments are still being created twice as fast as they are being recovered, and this type of debt is difficult and expensive to collect. However, HMRC is focusing on trying to ring-fence and manage tax credits debt as a separate debt portfolio, using 'time to pay' agreements, and is bringing in more private sector resources to help manage it.

2.11 In the Autumn Statement 2013, the government announced that, in future, tax credits payments to an individual would be stopped once they had reached the annual entitlement, to avoid building up overpayments. There is scope for government as a whole to use this experience to ensure that in future it 'designs out' unnecessary debt from new policies. For example government has said it intends that the design of Universal Credit will specifically avoid creating unnecessary debt.

2.12 Departments' powers and policies for writing off debts vary. Court fines and child maintenance are not written off for reasons of principle. In other areas, very small debts can be written off, though departments' minimum thresholds differ: for HMRC, they range from £1 to £32 depending on the tax stream, compared with a standard £65 for DWP.

2.13 Clearing irrecoverable debt from the books by writing off or remitting is a sensible management response. However, trend analysis suggests government's approach to write-offs and remissions has historically been 'lumpy' and reactive. For instance, over half of the £3.2 billion tax credits remissions since 2008-09 was remitted in 2011-12. Similarly, following qualification of its accounts in 2010-11, the Legal Aid Agency carried out an exercise to clear its debt book, writing off £48 million, or nearly a fifth of its gross debt book, in 2012, and a total of £201 million over four years.

2.14 Government accounts include a provision for bad debts or 'impairment of receivables' to reflect the amount of receivables not expected to be recovered. The most recent Whole of Government Accounts show a total provision for bad debt of £17.1 billion (**Figure 12** overleaf). Around half of this (£8.8 billion) related to tax. Provision of £1.7 billion was also made against welfare benefit debts, while most of the remaining provisions related to local government.

2.15 Impairment provisions in the accounts of the main debt-holding departments are higher than whole of government figures, ranging in 2012-13 from 43 per cent of benefit overpayment and social fund receivables, to 65 per cent of legal aid receivables and 79 per cent of court fines receivable. The £4.8 billion of tax credits receivables has an impairment provision of 69 per cent or £3.3 billion. These provisions do not map directly across to overdue debt since they refer to the likely collectability of all receivables, whether overdue yet or not.

Figure 12
Government provision for bad debt

	2009-10 (£bn)	2010-11 (£bn)	2011-12 (£bn)
Trade and other receivables (net)	£139.4	£145.1	£141.9
Provision for doubtful debts	£18.2	£18.2	£17.1
Provision as a percentage of receivables	13.1%	12.5%	12.1%

Notes
1 Whole of Government Accounts refer to government's 'provision for doubtful debts', whereas departmental accounts refer to provisions for the impairment of receivables.
2 Overdue debt makes up a small part of receivables, most of the latter being paid in the short term (paragraph 1.6).

Source: Whole of Government Accounts 2011-12, p. 17

2.16 Accurate impairment assessments help departments understand the quality of their debt book, to inform decision making. However, our work has highlighted impairment provisions that are backward-looking, using historical data on debt recoveries rather than operational forecasts of future recoverability, and compromised either by poor quality historical data, or optimism bias. For instance, child maintenance debt was classified as uncollectable simply if there had been no contact with the debtor for 12 months, rather than based on an assessment of actual circumstances. Conversely, we reported in 2013 that, between 2009-10 and 2011-12, student loan repayments were consistently over-forecast and actual repayments were £378 million or 11 per cent less than forecast.[12]

Timeliness: government could collect debt faster to avoid it losing value

2.17 In the private sector, debt outstanding for more than six years can no longer be collected, under the Limitation Act 1980. Notwithstanding this, many businesses do not hold debt for longer than six months because its collectability and hence value to the business tend to decline rapidly after this time (though it may in some cases improve again as circumstances change). Good financial management practice requires: understanding the age of the debt book and its collectability; understanding the cost of holding and managing large volumes of aged debt; and taking steps to keep the age at an acceptable average.

12 Comptroller and Auditor General, *Student loan repayments*, Session 2013-14, HC 818, National Audit Office, 28 November 2013.

2.18 Although the legal time-bar does not apply to most debt owed to government, allowing debt to age means:

- government has working capital tied up in debt which could be used elsewhere;
- older debt can be more difficult to collect because of difficulties in locating debtors and their lower propensity to pay; and
- by neither pursuing debtors nor writing the debt off, government risks a perception that the debt can be ignored by the citizen.

2.19 A large proportion of overdue government debt is 'aged': 61 per cent of debt owed to HMRC at 31 March 2013 was over 180 days old; for DWP, 88 per cent of benefit overpayment debt was more than 180 days old (**Figure 13**). This debt may still be recovered: aged debt accounted for 45 per cent of DWP's debt management recoveries; and 20 per cent of HMRC aged debt was in a managed payment plan or in enforcement action.

2.20 Legal and other restrictions can limit how government deals with certain types of debt or debtors. Child maintenance or court fines may not be written off no matter how old. As at 31 March 2013, 66 per cent of DWP debtors are in receipt of benefit and recovery of debt through benefit payments can only be collected at a certain rate, leading for instance to almost 90 per cent of DWP's £2.4 billion benefit overpayment debt being reported as receivable in over 12 months' time.

Figure 13
Age of debt

Department	Age of debt at 31 March 2013			Total
	0–6 months (£m)	6–12 months (£m)	1 year+ (£m)	(£m)
HM Revenue & Customs – tax debt	5,538	2,489	4,211	**12,238**
HM Revenue & Customs – tax credits	345	597	1,934	**2,876**
Department for Work & Pensions – Benefits overpayments	290	160	1,920	**2,370**
Total	**6,173**	**3,246**	**8,065**	**17,484**
Percentage total	**35%**	**19%**	**46%**	**100%**

Source: National Audit Office analysis of departmental debt management information

2.21 In tax and benefits, departments are gradually improving their targeting of aged debt. HMRC's analytics system went live in October 2011, allowing them to develop the sophistication of their 'campaigns' targeting groups of debtors. DWP is developing its use of risk scoring to enable a better understanding of debtors' ability to pay, and is increasing recovery of aged debt from people in work through their pay, using direct earnings attachment orders.

2.22 A 2011 pilot on recovery of aged debt by HM Courts & Tribunals Service highlighted the potential benefits of tackling aged court fines (which the report identified as approximately £420 million).[13] Improved enforcement could result in 4 per cent more accounts being cleared with a 49 per cent increase in total revenue: which we estimate could have raised 2011-12 fines collections from £156 million to £233 million. Also an additional estimated 8 per cent increase in revenue could be achieved if HM Courts & Tribunals Service improved management information to the standard reached in the pilot. Our 2013 report on confiscation orders indicated the Service still has progress to make in this area: 43 per cent of debt relating to confiscation orders was over five years old, and the absence of good data and management information undermined the effectiveness of enforcement. From 2012-13, HM Courts & Tribunal Service's published Trust Statement has included an aged debt analysis of confiscation orders to aid understanding.

Efficiency: government could collect debt more efficiently

2.23 The cost of collecting debt depends strongly on the age of debt, sector and approach. The debt management industry tends to have a very detailed understanding of costs, as profit margins are slim. Departments need to understand their costs of collection to judge whether their chosen approaches, including use of private sector collection agencies, are value for money.

2.24 Departments have made progress in capturing the costs of debt collection, but government still has a very limited understanding. In 2013 we reported that HMRC had improved its understanding of elements of debt management costs since 2008-09, but there was scope to do more.[14] DWP too is now using activity-based costing and beginning to benchmark the cost of its in-house collections against external collection agencies. The Legal Aid Agency estimated an internal cost for every £1 collected and used this to track its own performance over time, though this did not capture full costs.

13 HM Courts & Tribunals Service, *HMCTS Aged Debt Pilot: Final Report*.
14 Comptroller and Auditor General, *HM Revenue & Customs annual report and accounts 2012-13*, HC 10, June 2013.

2.25 However, there is scope to do much more:

- In examining the management of confiscation orders we found limited cost information across the bodies involved, and estimated that the cost of recovering £133 million a year was £102 million across the whole justice system.
- The Cabinet Office's 2011 survey suggested there were 13,000 civil servants working in debt management and collection, with additional capacity provided by private sector credit reference and debt collection agencies, but there is no current, accurate data. This makes it impossible to estimate accurately the total workforce cost, or calculate benchmarks such as amount of debt recovered per employee.

Overall, it has not been possible for the Cabinet Office to collate any suitable costing data on debt management with which to benchmark costs of collection across government or support the case for an integrated approach to contracting out.

2.26 Autumn Statement 2013 announced that HMRC would outsource the first tier (letter and telephone contact) of tax credits debt collection from 2014-15, and redeploy in-house staff from tax credits debt to tax debt recovery. The Department expects this to deliver an additional £530 million to government by 2016-17. At the same time, HMRC is to use in-house staff to pursue debt returned after debt collection agencies have been unable to collect it (with expected benefits of £45 million). It will also maintain increased numbers of debt collection staff that were originally announced in autumn 2012, and should bring £60 million additional revenue.

Efficiency: government needs better data on debtors

2.27 The quality of data on debtors is generally poor across government, owing to legacy IT, poor data input quality and some systems not having been designed to collect the key data. Our report on confiscation orders found enforcement hampered by outdated and slow IT systems, data errors and poor joint working.[15] Pilot work by HM Courts & Tribunals Service illustrated this (**Figure 14** overleaf).

15 Comptroller and Auditor General, *Criminal Justice System: confiscation orders*, Session 2013-14, HC 738, National Audit Office, 17 December 2013.

Figure 14

Data quality issues for HM Courts & Tribunals Service debtors

Percentage of accounts (%)	Data quality issue
96.7	Missing one or more of nine key fields required for tracing: title, forename, surname, address, postcode, telephone number, email, National Insurance number, date of birth.
95	Not contactable by telephone due to missing telephone number.
31.3	Missing date of birth, which is the key field used in verification and data enrichment processes.
7.3	Accounts contactable immediately without some form of data validation and tracing activity taking place.

Source: HM Courts & Tribunals Service pilot study: final report. This data relates to the outstanding debt sent to one of the three providers in the pilot project

2.28 Both HMRC and DWP have worked to improve debtor tracing using Credit Reference Agency data. DWP ran a pilot study from March 2011 to see if using this data to segment and prioritise a sample of 236,990 debtors could enable more efficient collection. They selected two random samples of 384 people from a range of segments. The control group was allowed to go through normal debt collection processes, while the other went through the pilot process. The results were encouraging:

- Between April 2011 and February 2012, £301,871 was collected from the pilot cases, compared to £159,029 from the control group; a 90 per cent increase.
- Following the success of the pilot, DWP contracted for credit reference agency services, which contributed to a rise of £25 million in benefit debt recovered between 2011-12 and 2012-13. The December 2013 Autumn Statement announced an extension of this approach in both scale and sophistication, to allow DWP to understand debtors' ability and propensity to pay, and determine the most appropriate recovery strategy in each case.

2.29 The Public Accounts Committee has urged departments to make greater use of debt industry techniques to understand their debtors. HMRC has been working since 2009 to build up its analytics function and used this to adopt a ‘campaigns’-based approach which tailors recovery efforts to particular groups of tax debtors. It has also shown effective use of behavioural ‘nudges’ in coordination with the Cabinet Office’s Behavioural Insights team to increase recovery.[16] However, in other departments this capability does not exist: their analytical skills are focused on other departmental priorities.

2.30 Experience in Canada demonstrates the potential improvement in performance from both integration and better analytics (**Figure 15**).

Figure 15

Improvement of analytics in the Canada Revenue Agency

Following a critical report by the Canadian Auditor General in 2006, the Canada Revenue Agency (CRA) took steps to improve its performance in collecting tax debts. The CRA’s reforms focused on improving and analysing data to make better use of its resources, including introducing:

- automated systems to risk-rate tax debts. The risk ratings are used to prioritise collection work and allow staff to concentrate on higher risk and higher value accounts.
- an application that brought together all of a client’s debts from different revenue streams (e.g. a business might owe corporation tax, payroll taxes, etc). This enables more efficient collection as multiple debts can be pursued together.
- a national approach to debt collection, so that tax offices could pursue debts in other parts of the country. This allowed for better use of resources as work could be transferred from busy offices to those with spare capacity.

These changes have contributed to an increase in the recovery of tax debts, from $21.5 billion in 2006 to $40 billion in 2012, without any increase in staff numbers.

Source: Office of the Auditor General of Canada, *Report of the Auditor General of Canada – Spring 2013*, April 2013, Chapter 3

16 Cabinet Office, *Applying behavioural insights to reduce fraud, error and debt*, February 2012.

Part Three

Role of the strategic centre of government

3.1 Effective corporate debt management requires the centre of government to identify risks and opportunities for coordinated action to improve taxpayer value. This part examines the role of the Cabinet Office and HM Treasury in managing the corporate position.

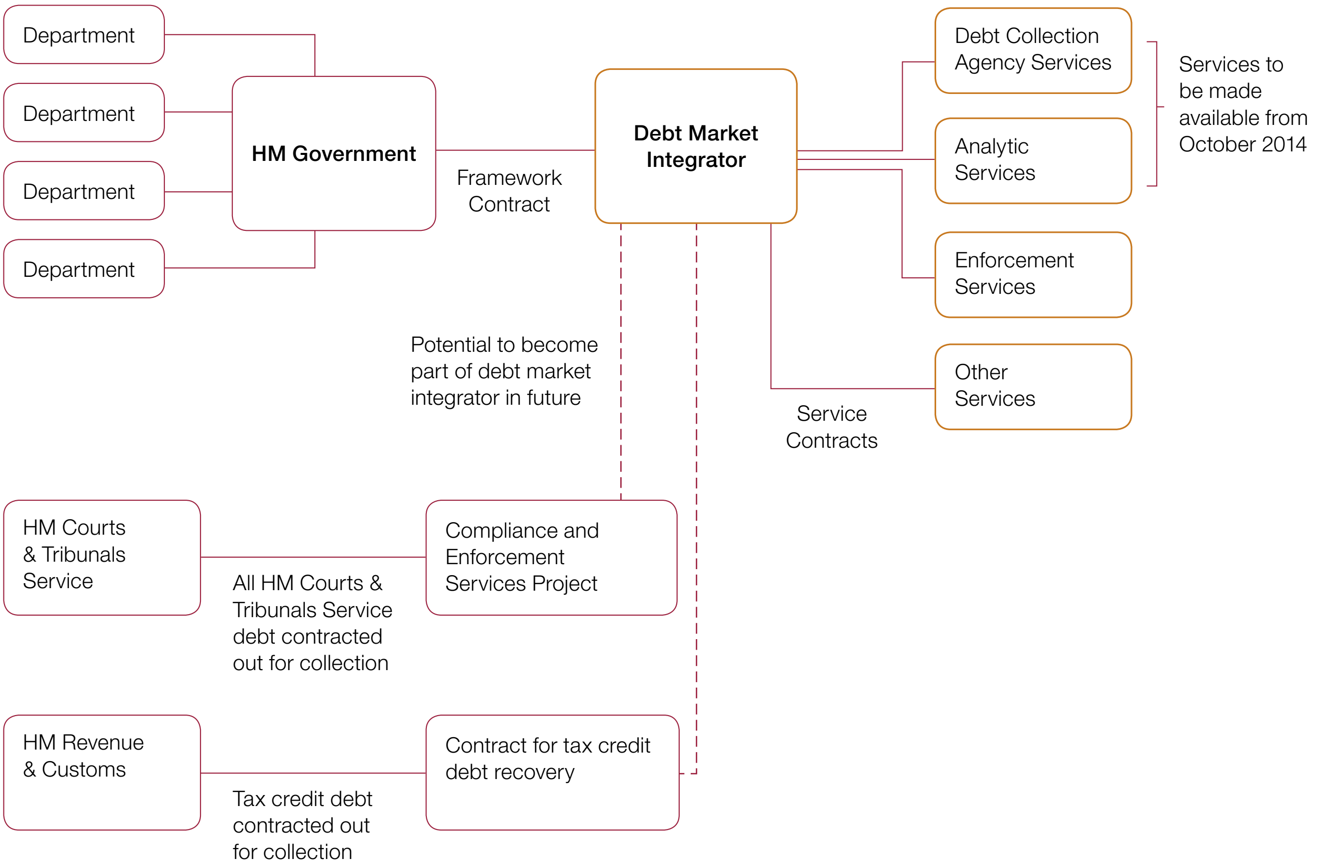
Approach of the Cabinet Office and HM Treasury to strategic debt management

3.2 Government has historically treated debt management as an operational issue for departments rather than a strategic financial issue, which has inhibited a cross-departmental overview. A cross-government approach could potentially provide a fairer and more consistent engagement with citizens and debtors, as well as improving efficiency and effectiveness. Recently, the centre of government has taken a closer interest in debt across government. A sharper corporate focus has been driven by the cross-government Fraud, Error and Debt Taskforce (the Taskforce), which is attended by ministers from six departments.

3.3 Since 2011, the Cabinet Office has attempted to carve out a central role on debt management. A debt programme team was created within the Efficiency and Reform Group to support the work of the Taskforce. This team has focused on identifying how and where government could recover more debt and on developing a proposal for a debt 'market integrator' – a single point through which government departments and bodies can access private sector debt collection, analytics and enforcement services. **Figure 16** sets out a possible model, under which specialist services would be delivered by private sector organisations, while departments would retain the ultimate responsibility for managing their debt and it would remain on their balance sheet.

3.4 The principle behind the integrator is to capitalise on government's combined strength in the debt market by creating a cross-government debt collection facility covering a range of departments and bodies. Smaller government bodies without the capacity for sophisticated debt management would benefit from being part of a larger whole in the skills and services they could access. Examples of this approach exist already: HM Revenue & Customs (HMRC) has a framework contract with 12 debt collection agencies that smaller government bodies can use, due to expire in October 2014; and the Department for Work & Pensions (DWP) has a framework agreement to supply data access, processing and analytics services also used by other bodies.

Figure 16
Proposed structure of the debt 'market integrator'



Source: Adapted from Cabinet Office

3.5 HM Treasury's approach to debt management has developed largely through its spending teams' close relationships with individual departments and there is scope for it to develop a more corporate approach, given its role in overseeing accounting and finance across government. For example, HM Treasury has responsibility for setting delegated authorities for write-offs and remissions. It has started to hold quarterly write-off approval meetings with HMRC that involve the Cabinet Office, but does not yet do so with other departments. HM Treasury could build a government-wide approach to overseeing write-offs, remissions and impairments, which would be consistent with its support for the Taskforce's work on getting cross-government commitment to reduce losses from debt.

Barriers to progress

3.6 The Cabinet Office has identified several barriers to a cross-government approach:

- **'Silo working':** no systematic sharing of debt collection data, tools or systems, and no joined-up communication with the debtor (**Figure 17**).
- **Inconsistent practices and approaches:** debt collection policies and approaches vary, and departments have inconsistent performance measures.[17]
- **Lack of data sharing:** barriers to data sharing include legacy IT, data compatibility and legal restrictions.
- **Not 'core business' for some departments:** lack of priority given to debt management means best practice is not always pursued.
- **Large, dispersed debt workforce:** this makes it difficult to share resources and expertise, and there is no centralised professional development.

3.7 The 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 significant debt management issues – such as: having comparable measures of debt management performance across government; bringing together approaches to purchasing private sector services under one umbrella; and developing accredited training for debt management staff. But there is still a long way to go on many of these issues. **Figure 18** outlines the cross-government initiatives on debt management, and progress to date.

Figure 17
'Overlapping' debtors

Around 10 per cent of government debt is owed by debtors who have amounts outstanding to more than one department. The Fraud, Error and Debt Taskforce initiated a pilot study, which was conducted by HMRC and DWP with the Cabinet Office, to explore how collection activities could be better aligned across departments which are owed debt by the same individuals, and assess whether this would increase recovery rates. This is consistent with debt industry best practice, which emphasises a 'single view of the debtor'.

Most departments do not have a single view of the debtor: DWP is able to provide a holistic debtor position for all benefit and social fund debtors and is working to include child maintenance, while HMRC has the capability to generate the information if required, but cannot yet do so as a matter of course. There are also several practical issues which could prevent a more integrated approach to overlapping debtors, including incompatibility of IT systems, the cost of and legal barriers to data sharing, and disruption to business. Being able to see a full picture of each debtor's position would help inform decision-making about recovery, though amalgamating debts into one large balance does not necessarily improve recovery rates.

Source: National Audit Office

17 As noted in Part Two, different debt recovery approaches and measures may sometimes be justified as they will depend on the nature and size of debt owed to particular departments.

Figure 18
Cross-government initiatives on debt

Data and performance	**To establish a clear data strategy for longer-term monitoring of debt to drive improved performance.** Progress: Departmental debt surveys conducted in 2011 and 2012; debt metrics included in Quarterly Data Summary (QDS) and Consolidated Data Return (CDR).
Customer segmentation	**To better understand the composition and behaviour of government debtors across departments and develop strategies appropriate to each segment.** Progress: DWP undertook a customer segmentation and scoring pilot to use credit reference agency data to increase recoveries, which it is rolling out more widely; HMRC has developed a debt analytics system ('ADEPT') to optimise collection strategies; and the proposed debt market integrator will use analytics to inform collection approaches.
Commercial models	**To establish a new business/commercial model for government's debt operations.** Progress: Debt market integrator proposal is being developed to aggregate debt across departments.
Data sharing	**To explore policy options which would enable better access to debtor data across departments.** Progress: Cabinet Office is looking at a range of policy options (including legislative proposals) to resolve data sharing issues, following DWP mapping of debtor data sharing 'gateways'.
Sanctions and penalties	**To review the enforcement policies in place across government to ensure consistency and value for money in future enforcement strategies.** Progress: Cross-government sanctions and penalties survey conducted in 2012; the findings are informing the development of the debt market integrator.
Overlapping debtors	**To identify the extent of the overlap between central government departments (DWP, HMRC, HM Courts & Tribunals Service) of individuals with overdue debt.** Progress: An overlapping debtors pilot project conducted; the findings are informing the development of the debt market integrator.
Procurement	**To get government the best deal from third party suppliers of debt services, e.g. debt collection agencies and credit reference agencies.** Progress: HMRC negotiated a framework contract with 12 debt collection agencies, which the rest of government is able to use; the Cabinet Office's proposed debt market integrator is intended to increase government's buying power with the debt market.
Professionalism	**To improve the skills and capabilities of those working in the civil service on debt management and collection.** Progress: DWP are developing a professionally accredited debt recovery qualification with the Institute for Credit Management, working with HMRC to determine requirements.
Ability to pay	**To develop a consistent and common approach across departments to the treatment of those individuals and businesses who are unable to pay.** Progress: Cross-government consultation on ability to pay occurred in 2012; departments are now liaising with relevant debt advice organisations on how to embed their services into departmental operations.
Write-offs/Remissions	**To develop a consistent and appropriate approach across departments to the remission and writing off of debts, and policies on provisions for bad debts.** Progress: HM Treasury has developed an approval process for HMRC write-offs and remissions, but this is not a government-wide approach.
Funding models	**To review funding arrangements for debt recovery to provide improved incentives for departments to pursue debt.** Progress: Spending Round 2013 contained two projects to incentivise greater recovery of tax credit and benefit debt.

Source: National Audit Office analysis of Cabinet Office data

3.8 The Cabinet Office believes there are clear areas of debt management which need further reform. One example is financial incentivisation of departments such as DWP and HMRC to recover greater amounts of benefit and tax credits debt. Because benefits and tax credits are paid through departments' Annually Managed Expenditure (AME) budgets, debts relating to benefit and tax credits overpayments accrue through AME. However, departmental administration and staffing costs, including the costs of debt recovery, come out of departments' separate Departmental Expenditure Limit (DEL) budgets. This means that DWP and HMRC need to spend DEL (on debt recovery costs) to reduce AME. Departments may not have adequate incentives to prioritise spending on debt recovery from their tightly-controlled DEL budgets – even if a great deal of AME spend could be recouped.

3.9 Spending Round 2013 announced funding arrangements enabling DWP and HMRC to take forward measures to recover more benefit and tax credits debt. The measures included using debt collection agencies to collect unpaid debts on a payment-by-results basis. HM Treasury also agreed a 'gain-share' funding approach with DWP under which, from 2015-16, DWP can retain a proportion of debt it recovers beyond specified targets – instead of returning it all to the HM Treasury.[18]

Cross-government integration

3.10 A strategic approach to debt across government requires departments to work together, and a degree of coordination from the centre. However, government as a whole is not yet working together effectively to address the cross-cutting issues that debt management raises. The Cabinet Office and HM Treasury have yet to establish a coherent way of working with departments that would enable the centre of government to establish its authority over strategic debt management. This is illustrated by the difficulty the centre has faced in getting departments to supply consistent, comparable data on debt (paragraph 1.13).

18 HM Treasury, *Spending Round 2013*, Cm 8639, June 2013.

3.11 Government collectively has also found it difficult to build a shared consensus to take forward its key proposal, the debt 'market integrator', at the pace originally planned. The idea of aggregating debt across departments and bodies was first outlined publicly by the Taskforce in February 2012, but it was not until 2013 that an outline business case was prepared and it is now being considered by HM Treasury.[19] Services from the proposed market integrator are intended to become available by the end of October 2014. In the meantime, a number of departments are pursuing short term contracts for debt services which are expected to migrate into the market integrator once it is operational:

- The Home Office is seeking to place interim contracts with multiple debt collection agencies for recovery of immigration penalty and other debt.
- The 2013 Autumn Statement announced that HMRC and DWP would increase the use of private sector debt collection services for recovery of benefit and tax credits debts. A contract covering tax credits debt is being put to the market in February 2014, and will be incorporated into the integrator.
- HMRC and DWP also intend to use the market integrator to replace other debt collection agency contracts expiring in October 2014, and April 2015 respectively.[20]

Additionally, HM Courts & Tribunals Service plans to outsource its enforcement activity to the private sector in 2014, under its Compliance and Enforcement Services Project, with the option to fully integrate into the proposed debt market integrator in future.

3.12 We analysed the development of the proposed market integrator against the requirements for successful integration projects we set out in 2013 (**Figure 19** overleaf). Achieving strong buy-in from departments is a key success factor, and the Cabinet Office has engaged closely with departments in developing the debt market integrator proposal. However, progress has been hampered by difficulties in getting good data, persuading some departments of the proposed integrator's benefits, and agreeing with them the details of the scheme's design.

3.13 Because of delays in agreeing the form of the integrator, the timeframe for procuring its services remains optimistic and there are a number of challenges still to be addressed before it can be set up. The centre needs to ensure it fully understands and manages the risks involved in putting more debt out to the market, including effects on citizens and debtors. Practical implementation issues that need to be clarified before the first services can start being delivered in late October 2014 also include data sharing arrangements, IT system compatibility, and staffing.

19 HM Government, *Tackling Debt Owed to Central Government: An Interim Report of the Fraud, Error and Debt Taskforce*, February 2012.
20 HM Treasury, *Autumn Statement 2013*, Cm 8747, December 2013.

Figure 19

Requirements for successful integration projects

Potential for value from integration

Government is likely to be particularly interested in opportunities to integrate services or programmes that generate significant cost savings

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Commitment to work in an integrated way

Successful integrated working depends on the commitment of all organisations involved to implement it effectively

The commitment to work in an integrated way is likely to be reflected in the following criteria:

- Shared vision and objectives
- Effective leadership and staffing
- Incentives for integrated working

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Implementation capability

Organisations need to have sufficient implementation capability to make integration work. Capability requirements include:

- Programme and risk management
- Information and technology requirements
- Responsibilities and accountability arrangements
- Funding mechanisms
- Communication and knowledge sharing

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Sustained effort to continuously improve

Once integration has been implemented, it needs sustained effort and commitment to maintain the resulting improvements

Continuous improvement will be reflected in process design and management, as integrated working is embedded into working processes

Good monitoring information will be needed to evaluate the impacts of integration

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Successful, high-value integration

Successful, high-value integration can be assessed using two criteria relating to value management:

- Cost efficiency or savings
- Effects on service or programme outcomes

Source: National Audit Office report, *Integration across government*

Future risks and opportunities

3.14 Since the Taskforce began to focus on debt in 2011, government has begun a number of initiatives. However, the centre has not yet published a clear government-wide debt strategy. The Cabinet Office and HM Treasury do not have common objectives for debt, or a shared understanding of the total financial risk to government. This in turn makes it difficult to for them to formulate a coherent approach to departments. We set out our assessment of their approach to strategic debt management, against our expectations of an effective strategic corporate centre in **Figure 20**.

Figure 20

Effectiveness of the strategic centre on debt management

Our criteria for an effective strategic centre	Debt management findings on the strategic centre
Clear articulation of operating model for the centre of government, with clear lines of accountability and defined roles and responsibilities.	Cabinet Office and HM Treasury are developing stronger central roles in debt management, but they need to establish how they can work together coherently as a strategic centre.
Clear vision, strategy and objectives, supported by business plan.	There is no published government-wide strategy for debt management, and consequently no clearly articulated objectives or overall target for reducing government's total debt balance.
Comprehensive view of cross-government picture, informed by reliable management information – able to spot opportunities for integration and innovation.	The centre lacks good data to inform a cross-government view of debt. Departments have submitted poor returns to the Cabinet Office's data gathering exercises, and HM Treasury and Cabinet Office do not use the same data to monitor debt.
Consistent and integrated in engagements with departments.	Cabinet Office and HM Treasury do not engage consistently with departments on debt. Cabinet Office has sought to build a cross-government approach. HM Treasury's approach has developed largely through its spending teams' close relationships with departments.
Credible in engaging departments – understanding of implementation issues, and of departments' own operational environments.	Cabinet Office has had some difficulty building a cross-government consensus on its debt management reforms, especially the proposed debt market integrator. HM Treasury has greater credibility with departments but is still formulating its cross-government role on debt.
Cross-government view of the strategic risks across government, and a process for monitoring and intervening when necessary.	Cabinet Office has identified total debt owed to government as a risk to the public finances and has proposed debt management initiatives to address this risk. However, the centre has not set out an ongoing monitoring role on strategic debt management.
Centre to have identified adequate capacity and capability to deliver its objectives.	The centre has demonstrated leadership through creating the cross-government Fraud, Error and Debt Taskforce and supporting debt programme team, but it is not clear if there is sufficient expertise at the centre to challenge departmental debt management.

Source: National Audit Office analysis

3.15 There is a clear role for the centre to ensure that departments have the right incentives to work together on debt management, and the Cabinet Office and HM Treasury need to define how they will use their complementary roles to drive a strategic approach, long term. This will involve each clarifying its respective responsibilities, and how they work together, so that they approach departments coherently. The central departments also need to ensure they have the capacity to provide a strategic central debt function.

3.16 In December 2013 HM Treasury published its *Review of financial management in government*, announcing the creation of a new Director General role in HM Treasury to oversee financial management and reporting across all departments, and monitor performance.[21] This offers the opportunity to take a strategic approach to debt management, for the first time. We have adapted the HM Treasury's Financial Transformation Programme criteria, providing a vision to aim for (**Figure 21**).

Figure 21
Financial management vision for debt

	Effective leadership	**Cost-conscious culture**	**Professionalism**	**Expert central functions**
People	Ministers, boards and senior civil servants demand the highest standards of financial management of debt.	All staff understand the costs of inadequate debt management and their responsibilities – and are appropriately trained and incentivised.	Debt management professionals have the range of skills and experience needed to support the business.	The centre aligns with departments to provide consistent and coherent messaging on debt.
Process	Finance is an integral part of debt strategy and business planning.	Debt management processes promote a value-for-money and continuous improvement culture.	Debt management processes are economic, efficient and effective.	Central processes support and incentivise good financial management of debt.
Information and technology	Senior management has expertise to use and analyse information on debt effectively.	Systems provide relevant and timely debt-related information that staff need to exercise their responsibilities.	Systems provide access to clear, consistent and well-understood information on debt.	The centre draws on information on debt that is used by and useful to departments.
Structures	The finance director is a key member of the senior leadership team, positioned to influence all material business decisions, with debt management a key responsibility.	Departments' internal structures and governance around debt support and incentivise a cost-conscious and risk-aware culture.	The finance department is structured and resourced to provide the business support for debt management.	There is clarity between the respective roles and responsibilities of the centre and departments.

Source: Adapted from HM Treasury

21 HM Treasury, *Review of financial management in government*, December 2013.

Appendix One

Our audit approach

1 This study examined how well government understands and manages debt owed to it, across its various departments and bodies. We reviewed:

- the Cabinet Office and HM Treasury's understanding of the scale and nature of debt across government, and departments' debt management performance;
- how effectively government is tackling common barriers to good debt management; and
- government's use of new approaches to improve debt management efficiency and effectiveness, such as greater integration and outsourcing of debt management.

2 Our audit approach is summarised in **Figure 22** (overleaf), and our evidence base is set out in Appendix Two.

Figure 22
Our audit approach

The objective of government

The cross-government Fraud, Error and Debt Taskforce's stated debt management objective is to develop a cross-government approach to overdue debt focused on greater collaboration and consistency, that will help to reduce losses over the long term.

Our study

This study examines how well government understands and manages debt owed to it across various departments and bodies, to determine whether it has a good strategic grip of debt management as part of wider financial management.

Our evaluative criteria

How well do the Cabinet Office and HM Treasury understand the scale and nature of debt across the whole of government, and how departments are performing at debt management?

How effectively are the Cabinet Office and HM Treasury identifying and tackling problems or barriers commonly faced by departments managing debt?

Is government exploiting new approaches to make debt management more efficient and effective, such as aggregation and outsourcing of debt to the market?

Our evidence (see Appendix Two for detail)

We assessed government's understanding of debt and departmental debt management performance by:

- analysing **central debt data** from departmental debt surveys, QDS (Quarterly Data Summaries) and CDR (Consolidated Data Return);
- analysing **financial accounts data** and drawing on insight from **financial audit teams**;
- reviewing **departmental debt strategies**, **performance measures** and **performance reporting packs to boards**;
- conducting **interviews** with central and line departments;
- reviewing past **NAO and PAC reports**, and **current NAO work**, on debt;
- reviewing a sample of departments' **internal audit reports** and **governance statements**; and
- examining relevant **private sector and international comparators** to put departmental performance into context.

We examined how well the centre of government is tackling barriers to good debt management by:

- reviewing **internal government minutes and documents**, including reports to the Fraud, Error and Debt Taskforce;
- conducting **interviews** with central and line departments; and
- reviewing **past NAO and PAC reports**, and **current NAO work**, on debt.

We assessed government's adoption of new debt management approaches by:

- reviewing the **Cabinet Office's approach to developing a business case** for its 'debt market integrator' proposal, to provide advice on what we would expect to see in the business case – in particular on:
  - option appraisal;
  - cost–benefit analysis;
  - risk identification;
  - debt forecasting;
  - testing assumptions on use of the debt market;
  - implementation plans; and
- conducting **interviews** with central and line departments.

Our conclusions

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.

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.

Appendix Two

Our evidence base

1 We reached our conclusions on how well government understands and manages debt owed to it using evidence collected between August and December 2013.

2 We analysed **centrally collated data** and **financial accounts data** on debt owed to government departments and bodies, to assess the scale and nature of debt.

- The central data we examined came from the Cabinet Office's debt data gathering exercises: the 2011 and 2012 departmental debt surveys, and data returns on the debt indicators in the Quarterly Data Summaries (QDS) and Consolidated Data Return (CDR).
- We examined financial accounts data from departmental resource accounts and other statutory accounts, including the Whole of Government Accounts (WGA).

3 We drew on the expertise of **NAO financial audit teams** to gain insights into the nature of debt owed to specific departments and bodies, and the challenges facing them. We also reviewed a sample of departments' **internal audit reports** and **governance statements** to understand their management of these risks and challenges.

4 We conducted **interviews** with:

- central departments: Cabinet Office and HM Treasury;
- debt-owning departments and bodies: HMRC, DWP, Home Office, HM Courts & Tribunals Service and Legal Aid Agency;
- Money Advice Service, to provide the debtor's perspective on debt owed to government; and
- private sector debt experts on the Fraud, Debt and Error Taskforce, and debt management firm TDX, to provide private sector perspectives on government debt management.

5 We reviewed departmental **debt strategies**, **performance measures** and **performance reporting packs to boards** to assess whether departments had developed robust plans for their debt management, and if they (and their boards) were able to monitor progress on improving performance.

6 We examined relevant **private sector and international comparators** to put departmental debt management performance into context. We engaged Deloitte to provide advice on debt management practice in the private sector and in other countries.

7 We reviewed **internal government minutes and documents**, including reports to and minutes of the Fraud, Error and Debt Taskforce, to understand government's approach to improving debt management.

8 We reviewed relevant **NAO and PAC** reports on debt management, and on financial management in general, to identify debt management issues that had been highlighted in the past for particular departments. We also drew on **current NAO work** on debt, including the work of the NAO's debt centre of expertise in helping formulate our expectations for good debt management.

9 We reviewed the **Cabinet Office's approach to developing a business case** for its proposed debt 'market integrator', and provided advice on what we would expect to see in the business case. The analytical approaches we used to test the robustness of the business case were:

- option appraisal;
- cost–benefit analysis;
- risk identification;
- forecasting;
- testing assumptions on use of the debt market; and
- assessing implementation plans.

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