National Audit Office

Report
by the Comptroller
and Auditor General

Department for Work & Pensions and
HM Revenue & Customs

Fraud and error stocktake

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Summary

1 Benefits and tax credits support about 20 million households across the UK. In 2013-14 government departments paid out £193 billion to support a wide range of claimants including pensioners, working people, jobseekers and disabled people. Almost everyone in the UK gets a state pension, benefit or tax credit at some point in their lives.

2 HM Revenue & Customs (HMRC) manages tax credits. The Department for Work & Pensions (DWP) manages most remaining benefits and state pensions. Local authorities are also responsible for the day-to-day administration of Housing Benefit. DWP is replacing tax credits and four working-age benefits with Universal Credit.

3 The level of fraud and error is a persistent concern in benefits and tax credits. The Committee of Public Accounts has repeatedly called for departments to tackle fraud and error more effectively, and to target initiatives at the biggest sources of loss. It has highlighted the scale of losses that could otherwise have been spent on other government objectives. Overpayments increase costs to taxpayers and reduce public resources available for other purposes. Underpayments mean households are not getting the support they are entitled to.

4 This report provides an overview of progress in reducing fraud and error in benefits and tax credits, and how departments are responding to emerging opportunities.[1] We draw on our extensive work with departments in annual audits of their accounts and value-for-money reports, which examine individual benefits in more detail. We consider:

- systemic issues in how departments manage fraud and error (Part One);
- progress in reducing fraud and error since 2010 (Part Two); and
- shaping the future to tackle fraud and error (Part Three).

Fraud and error can be reduced by more efficient administration, reframing the rules with a view to 'designing out' the circumstances when it can arise, or obtaining better information on claimants' circumstances in order to prevent overpayments from occurring. We examine progress in this area in our section on 'shaping the future'.

1 Our assessment of HMRC excludes its management of Child Benefit.

Defining fraud and error – a note on presentation

5 Departments define and measure fraud and error differently. These technical differences can be confusing. In this report we try to avoid excessive terminology. For example, we cite departments' central estimates of fraud and error rather than the ranges in published statistics. For readers who require more detail, we are publishing a companion report, *A primer on fraud and error*, which describes how departments define and measure fraud and error.

6 In this report we refer to gross fraud and error, which government has used to monitor departments' performance. This does not account for subsequent recoveries, for example when departments get back overpayments made to claimants. DWP has started to publish overpayments net of recoveries as a measure of overall losses to taxpayers. In our *Primer on fraud and error* we consider the different ways net overpayments can be measured.

Key findings

Systemic issues

7 **Fraud and error in benefits and tax credits is a significant and long-standing problem.** The Comptroller & Auditor General has given qualified opinions on DWP's accounts since 1988-89 and on HMRC's accounts since 2003-04 because of the levels of fraud and error in benefits and tax credits. In 2013-14, DWP and HMRC overpaid claimants by £4.6 billion because of fraud and error, and underpaid claimants by £1.6 billion. In March 2015 the government restated that the level of fraud and error in the benefits and tax credits system remains unacceptably high (paragraphs 1.3 to 1.5).

8 **We have identified four systemic issues which departments need to continue to address.** These are: establishing clear strategies and governance; designing controls into the way departments work; implementing controls and interventions effectively; and measuring and evaluating performance (paragraphs 1.6 to 1.17).

Recent progress

9 **DWP and HMRC set out a joint approach to reducing fraud and error.** In October 2010 the departments published a joint strategy to tackle fraud and error in benefits and tax credits, which set out to build upon previous initiatives. Government planned to reduce annual overpayments by one-quarter by March 2015, or around £1.4 billion. In some cases, the departments identified a common approach and overlapping areas of work, such as the introduction of a single fraud investigation service. The departments have otherwise pursued their own programmes and targets to reduce fraud and error (paragraphs 2.2 to 2.5).

10 **The departments have made progress in reducing headline rates of fraud and error, particularly in tax credits.** HMRC reduced fraud and error overpayments in tax credits from 8.1% in 2010-11 to 4.4% in 2013-14. Overpayments of DWP benefits fell from 2.1% to 2.0% between 2010-11 and 2013-14. Preliminary estimates for 2014-15 show a rate of 1.9% (paragraphs 2.6 to 2.8).

11 **HMRC's recent reduction in fraud and error is encouraging and it is conducting further analysis to fully understand the reasons for all of the reductions.** In June 2015, HMRC revised its 2012-13 estimate of fraud and error overpayments from 7.0% to 5.3%. HMRC's latest estimate for 2013-14 confirms that the downward trend from 2010-11 has continued. This decline suggests that HMRC's initiatives to tackle specific fraud and error risks have had an impact. For example, it has worked with credit reference agencies to address the 'undeclared partners' risk. HMRC has not yet had time to assess reasons for all of the reductions more fully and is planning to conduct further analysis (paragraphs 2.9 to 2.11).

12 **The composition of DWP benefits has helped to bring down headline rates of fraud and error.** DWP's fraud and error estimates include the State Pension, which is large (£87 billion in 2014-15) and has a low rate of overpayments (at 0.2%). Over the past five years the share of the State Pension has increased from 46% to 51% of benefit spending. This effect – and other changes to the mix of benefits – has helped to bring down the headline rate of DWP overpayments by around 0.2%. In DWP's view, other factors, such as the rising number of in-work claimants, has increased overpayments and made tackling fraud and error more difficult (paragraphs 2.12 to 2.15).

13 **Based on current estimates HMRC will meet its spending review target for fraud and error, while DWP is not on track.** DWP set a target to reduce fraud and error in 2014-15 to 1.7% of benefit spending. HMRC aimed to reduce losses to 5.5% of tax credit spending by March 2015. HMRC has already reduced losses below this level, and will meet its target if it sustains or improves the current rate of fraud and error. The final results will be available in June 2016. DWP's preliminary estimates show that overpayments fell to 1.9% in 2014-15. DWP's final estimates will be published in November 2015, and could show further reductions given the uncertainty in estimates and its recent initiatives. In DWP's view, it is not possible to know whether or not it is on track to meet its target (paragraphs 2.16 and 2.17).

14 **Over the past five years, initiatives to reduce fraud and error have focused primarily on correcting claims rather than preventing errors.** DWP estimates that its projects to identify and correct overpayments have saved £1.5 billion over the 2010 Spending Review period, £0.4 billion more than initially forecast. In contrast, projects to prevent errors will save £0.9 billion less than originally expected. Similarly, HMRC's detect and correct activities accounted for almost 80% of losses prevented in 2014-15. It is unclear whether a continued emphasis on detection will deliver sustainable long-term reductions in fraud and error (paragraphs 2.18 to 2.23).

15 Departments' estimates of savings from their fraud and error activities do not translate directly into sustained reductions in the overall level of fraud and error overpayments. DWP estimates its projects saved £2 billion over the 2010 Spending Review period. HMRC estimates £3.2 billion of losses prevented. In both cases, departments initially assumed that identifying and correcting claims would lead to reductions in the level of fraud and error. But departments' measures of savings from their fraud and error activities do not translate directly in the headline rate of overpayments. This can work both ways: recently HMRC's fraud and error rate has fallen by significantly more than its estimated savings from its activities (paragraphs 2.24 to 2.27).

Shaping the future

16 Departments have implemented some major changes that should help to reduce fraud and error in the future. DWP expects the introduction of Universal Credit to reduce fraud and error by £0.5 billion each year when fully rolled out, by removing some types of overpayments created by existing systems. It also expects wider changes to welfare reform, such as the introduction of state pension reforms to reduce losses. In addition, both departments are refining and extending their approaches to preventing and detecting overpayments in legacy benefits and tax credits:

- DWP has introduced new initiatives which it estimates will save £2.9 billion in fraud and error up to 2021-22 from legacy benefits.
- HMRC has started a project with a private sector partner to increase the number of compliance interventions and made changes to scheme rules to require claimants to provide additional information to support their claim. It expects the project to increase its capacity to save £423 million over the next three years and its policy changes to save £471 million over the next five years. HMRC is also introducing digital accounts to improve its interaction with claimants.
- Both departments have strengthened sanctions for punishing fraudsters. This has been supported by introducing the single fraud investigation service, and communication campaigns to raise claimants' awareness of their obligations and potential sanctions (paragraphs 3.2 and 3.23).

17 These new opportunities will make it easier to reduce some types of fraud and error, but significant risks will still remain. In 2013-14, DWP and HMRC estimated that £1.4 billion of fraud and error was caused by incorrect assessments of claimants' income. Departments are now using the real-time information system to detect income changes in existing benefits and will use this in Universal Credit. HMRC expects this to save £410 million over the next two years, and DWP expects it to save £356 million between 2015-16 and 2020-21. Departments will, though, continue to face the risk of significant losses on legacy benefits over the next five years and need to develop their approaches for other major risk areas, such as the 'undeclared partner risk' which was the cause of £823 million of fraud and error in 2013-14 (paragraphs 3.2 to 3.4 and 3.17).

18 For the next five years both departments will have to manage fraud and error in a long and complicated transition period to Universal Credit. Departments will need to manage fraud and error in legacy benefits and tax credits, and develop controls within Universal Credit. DWP and HMRC will find it difficult to assess their performance in reducing fraud and error against a changing baseline for individual benefits and Universal Credit, as claimants transfer between benefits and departments (paragraphs 3.5 to 3.10).

19 Both departments have strengthened governance over fraud and error initiatives. In 2013 we looked at HMRC's management of fraud and error in tax credits and identified clear lines of accountability and an effective process for managing resources. DWP has more recently reorganised its management of fraud and error. In 2014 it brought together fraud and error work that was spread across the department. DWP is now developing a long-term fraud and error strategy, supported by benefit-specific strategies. It is still working on activity plans and new accountability arrangements for each major benefit (paragraphs 3.11 to 3.14).

20 Departments have improved their understanding of the causes of fraud and error and are increasingly aiming for prevention in scheme design. Both departments are seeking to make better use of data to make decisions and increase their focus on preventing overpayments from occurring. They are factoring fraud and error considerations into the design of schemes and processes. Despite these developments, departments still need to manage the tension between fast and efficient processing and accuracy, and to balance these competing demands by creating the right incentives for operational staff (paragraphs 3.15 to 3.22).

21 Departments will need to strengthen how they monitor performance as there will still be significant levels of fraud and error during and after the introduction of Universal Credit. DWP currently estimates there will still be around £5.8 billion fraud and error overpayments across benefits and tax credits in 2020-21. Departments need to assess what is achievable, and the barriers to reducing fraud and error further. They will also need to develop new performance frameworks to monitor their progress, including the impact of initiatives to prevent fraud and error (paragraphs 3.14, 3.23 to 3.26)

Conclusion

22 For more than 25 years we have highlighted concerns about fraud and error, and departments' limited inroads into the problem. The government continues to lose large amounts of money through overpayments, reducing the money available for other purposes. And many vulnerable people get less support than they are entitled to. Until recently, departments had not made significant improvements due to an inconsistent and tactical approach to tackling losses.

23 HMRC's success in reducing fraud and error is encouraging and suggests that its initiatives and a more structured approach are tackling overpayments effectively. But the analysis needed to fully understand all of the changes is not yet complete. Based on its preliminary estimates, DWP has made less progress and is not on track to meet its commitments to reduce fraud and error to target levels for March 2015. Departments will need to show they can track the impact of initiatives through to outcomes if they are to achieve sustained and continuing reductions in fraud and error.

24 There are many reasons to be optimistic about opportunities to reduce fraud and error, in particular through the use of real-time information and introduction of Universal Credit. Real-time information has made it much easier to deal with changes in claimants' earnings. However, the full impact is still uncertain and it will be several years before Universal Credit is fully rolled-out. Departments need to build on recent efforts to develop more integrated and systematic responses to preventing fraud and error.

Recommendations

25 Departments must continue to address the four systemic issues we have identified in past work by continuing to build on and learn from the best practice in each department. To do this, they should:

a **Develop and maintain strategies and activity plans for individual benefits to target major areas of fraud and error.** Departments should disaggregate major risks and show that interventions target the most significant losses and risks for each benefit. They should consider end-to-end processes for benefits, especially Universal Credit, and set out planned improvements over the next five years against clear baselines.

b **Design fraud and error responses into core processes and better use information from across government.** Departments should explicitly consider fraud and error in the design of new benefits and processes, and improve access to data in processes for checking claims.

c **Strengthen controls to prevent fraud and error.** Departments should ensure that operational staff have adequate incentives to improve quality and not only to process claims efficiently. They should strengthen feedback loops between corrective initiatives and day-to-day controls.

d **Improve assessments of root causes and the impact of initiatives.** Departments should extend risk analysis to provide a more granular assessment of root causes and claimant behaviours. They should establish consistent methods for evaluating the impact of new initiatives and improve their understanding of fraud and error in benefits they do not measure or publish each year.