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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National Audit Office

Department for Work & Pensions and
HM Revenue & Customs

Fraud and error stocktake

Report by the Comptroller and Auditor General

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National Audit Office

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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.

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Contents

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Key facts

£193bn
spending in 2013-14 on benefits and tax credits

£4.6bn
overall fraud and error overpayments on benefits and tax credits, 2013-14

£1.6bn
overall underpayments on benefits and tax credits, 2013-14

	Department for Work & Pensions	HM Revenue & Customs
Spending on benefits and tax credits, 2013-14	£164 billion	£29 billion
Total overpayments due to fraud and error, 2013-14	£3.3 billion 2.0%	£1.3 billion 4.4%
Total underpayments due to fraud and error, 2013-14	£1.4 billion 0.9%	£0.2 billion 0.6%
Target for overpayments due to fraud and error in March 2015	1.7%	5.5%
Latest fraud and error rate	1.9% (preliminary figures, 2014-15)	4.4% (2013-14)

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.

Part One

Systemic issues

1.1 The Department for Work & Pensions (DWP) and HM Revenue & Customs (HMRC) are responsible for administering a complicated system of benefits and tax credits. HMRC paid out £29 billion in tax credits to 4.7 million claimants in 2013-14. DWP administers most remaining benefits and paid out £164 billion in 2013-14 to 18 million claimants. Departments have to balance several objectives with the need to manage costs and reduce fraud and error.

1.2 The level of fraud and error in benefits and tax credits is a long-standing problem. Over the past 25 years we have examined fraud and error as part of our annual audits of government accounts and value-for-money reports. In this Part we draw on our previous work to identify systemic issues in the way departments have managed fraud and error. We acknowledge that in many cases departments have responded to our earlier recommendations, and we discuss their recent fraud and error initiatives in Part Three.

A significant and long-standing problem

1.3 Fraud and error has various causes, including: the difficulty of administering means-tested benefits; and the complexity of benefits, which can cause confusion and genuine error. Fraud and error can occur when a claimant submits a new claim or, more often, when they delay or fail to report changes to their circumstances.

1.4 In 2013-14, DWP and HMRC overpaid claimants by £4.6 billion because of fraud and error, and underpaid claimants by £1.6 billion. Overpayments increase costs to taxpayers, because departments need to recover debts, and reduce government's resources available for other purposes. Underpayments mean households are not getting the support they are entitled to.

1.5 In March 2015 government restated that levels of fraud, error and debt in the benefits and tax credits system are unacceptably high.[2] The Comptroller and Auditor General has issued 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. The Committee of Public Accounts has repeatedly called for DWP and HMRC to tackle fraud and error more effectively. It has highlighted the losses that government could otherwise have spent on other objectives.

2 HM Government, *Tackling Fraud, Error and Debt in the benefits and tax credits system*, March 2015.

1.6 Our previous work has highlighted four systemic issues in managing fraud and error: establishing clear strategies and governance; designing controls into the way departments work; implementing controls and interventions effectively; and measuring and evaluating performance.

Establishing clear strategies and governance

1.7 Fraud and error can affect all benefits, and arise at many different stages of a claim. Overpayments arise if departments get initial eligibility assessments wrong or are unaware of changes in claimants' circumstances. So departments need to have a strategy to manage individual benefits, address risks, prioritise interventions and identify ways to make long-term improvements.

1.8 Departments have struggled to set out comprehensive responses to fraud and error and align interventions to major areas of risk. For example, our 2011 report *Reducing losses in the benefits system caused by customers' mistakes* found that DWP had shown less commitment to tackling claimant error than official error, despite claimant error accounting for a much larger share of losses.[3] Our 2013 report *Tackling tax credits error and fraud* found HMRC had made progress in some areas to reduce losses but not in two risk categories, which accounted for £1 billion.[4]

1.9 There are barriers that departments face in setting out more targeted approaches. These include not understanding changes in the causes of losses and – in some cases – not adapting their interventions accordingly. Another barrier is unclear governance and responsibilities. Our 2014 report on *Housing Benefit fraud and error* concluded that DWP had not established sufficiently clear responsibilities for tackling fraud and error.[5]

Designing controls into the way departments work

1.10 Departments need to balance a range of competing objectives when designing benefits and administrative processes. They should identify and resolve trade-offs with other objectives, and build controls against fraud and error into the way processes and rules are designed.

3 Comptroller and Auditor General, *Reducing losses in the benefits system caused by customers' mistakes*, Session 2010-11, HC 704, National Audit Office, January 2011.
4 Comptroller and Auditor General, *Tackling tax credits error and fraud*, Session 2012-13, HC 891, National Audit Office, February 2013.
5 Comptroller and Auditor General, *Housing Benefit fraud and error*, Session 2014-15, HC 720, National Audit Office, October 2014.

1.11 In practice, departments sometimes failed to identify fraud and error risks. The introduction of tax credits in 2003 is a clear example of how the design of a scheme can lead to unanticipated outcomes, and build in a long-term problem for managing fraud and error. HMRC initially adopted a 'pay now, check later' approach which, coupled with a low volume of post-payment compliance checks, meant there was a misalignment between controls and risks. And our 2014 report on *Housing Benefit fraud and error* recommended that DWP should improve incentives for local authorities to prevent and identify fraud and error, and align these incentives with its own aims.[6]

1.12 Departments will understandably concentrate on core policy objectives when introducing new schemes, as these often present complex legislative and operational challenges. In order to ensure that fraud and error is not an afterthought, it is important that departments consider how scheme rules affect fraud and error, that trade-offs are assessed explicitly and controls are designed into schemes from the start.

Implementing controls and interventions effectively

1.13 Even after benefits have been implemented, departments have considerable scope to improve (or weaken) controls against fraud and error. The administration of benefits and tax credits involves complicated processes and front-line staff are under competing pressures to process claims quickly as well as accurately. The detailed steps for making and updating claims – and the quality of advice available – can also affect how well claimants understand requirements.

1.14 A risk in managing fraud and error is that incentives to process claims quickly and efficiently can outweigh incentives to improve accuracy. For example, in our financial audit of DWP's benefits we raised concerns that managers in local processing offices gave greater weight to productivity targets than accuracy targets, and that compliance with accuracy checks can be weak.

1.15 Because information about processing times and efficiency is often more timely, and more easily monitored, departments need to pay particular care to ensuring that steps to improve accuracy are actually observed in practice.

Measuring and evaluating performance

1.16 Over time, departments have improved their measurement and reporting of fraud and error. This has helped to identify long-term trends in performance and emerging risks. In order to tackle fraud and error effectively departments must continue to identify root causes (as well as the effects) of fraud and error, and track the impact of interventions. This includes a disaggregated view of risks and why claimants make mistakes, and an assessment of the effectiveness of processing controls and initiatives for each risk type.

6 See footnote 5.

1.17 In the past, departments have struggled to assess the impacts of initiatives to reduce fraud and error. Our report on tax credits showed that HMRC overestimated the impact of its initiatives to reduce losses and did not have a clear understanding of the relationship with the overall level of fraud and error.[7] Our report also recommended that HMRC strengthen its assessments of different causes of fraud and error. Our recent work with DWP on individual benefits also highlighted the need to assess the strength of departmental controls and initiatives by each risk type.

Main steps in managing fraud and error

1.18 Based on these systemic issues we have identified a series of critical factors for departments in managing fraud and error (**Figure 1**). Part Three looks ahead at how departments are addressing these issues.

Figure 1

Tackling fraud and error – critical factors

Establishing clear strategies and governance	**a** Set out long-term performance aspirations, supported by appropriate operational targets and ongoing review of the environment. **b** Develop clear strategies and target interventions at major areas of loss based on an assessment of the causes of losses and the impact of different activities to prevent, detect or disrupt fraud and error. **c** Establish governance arrangements within and across departments for managing fraud and error.
Designing controls into the way departments work	**d** Design scheme rules and information requirements giving full consideration to fraud and error risks, and the trade-offs with other departmental priorities. **e** Build preventative controls in operational processes and systems.
Implementing controls and interventions effectively	**f** Operate controls and interventions effectively. **g** Refine controls and interventions in response to improving information about risks and impact.
Measuring and evaluating performance	**h** Continuously monitor performance in reducing fraud and error and the impact of interventions, considering the need to refresh strategies. **i** Set clear baselines and benchmarks for evaluating performance and the impact of interventions on fraud and error. **j** Establish robust external reporting and audit arrangements.

Source: National Audit Office

7 See footnote 4.

Part Two

Progress in reducing fraud and error

2.1 During the last five years both the Department for Work & Pensions (DWP) and HM Revenue & Customs (HMRC) have introduced many initiatives to reduce fraud and error. In this Part we review departments' performance in reducing fraud and error, based on published statistics and their estimates of savings from these activities.

Starting to integrate strategies

2.2 In October 2010 DWP and HMRC published a joint strategy to reduce fraud and error.[8] The strategy set out actions in each department to reduce overpayments, as well as joint initiatives such as the single fraud investigation service project. Both departments drew on existing and new initiatives to design a range of fraud and error activities.

2.3 The joint strategy set a target to reduce overpayments by £1.4 billion by 2014-15, a reduction of around one-quarter. To help achieve this, government planned to invest an extra £425 million over the period.[9] The strategy identified a further £400 million in possible annual savings from HMRC introducing real-time information for claimants who are paid through pay-as-you-earn tax schemes (**Figure 2** overleaf).

2.4 Departments set targets to reduce fraud and error and reassessed whether these were achievable:

- In 2010 DWP set a target to reduce fraud and error overpayments to 1.7% of benefit expenditure by 2014-15. In 2012 and 2013 it reassessed and reaffirmed the target.
- In 2008 HMRC had set a target to reduce tax credits fraud and error overpayments from 8.9% to 5% by March 2011. It estimated that this would achieve the £600 million annual saving in 2014-15, as set in the 2010 strategy. In June 2012 HMRC's performance measurement indicated it had not hit the 5% target. The following year it reassessed what was achievable, and replaced its target with an aim to reduce fraud and error overpayments towards 5.5% by the end of 2014-15.

2.5 The departments did not set targets for reducing underpayments.

8 Department for Work & Pensions and HM Revenue & Customs, *Tackling fraud and error in the benefit and tax credits systems*, October 2010.

9 HMRC was not able to draw on this additional funding. Figure 5 on page 21 shows that DWP invested £273million of the available funding over the period.

Figure 2

Joint fraud and error strategy, October 2010

DWP and HMRC aimed to reduce fraud and error overpayments by £1.4 billion

	DWP (£m)	HMRC (£m)	Total (£m)
Annual saving by 2014-15	800	600	1,400
Further potential annual saving from real-time information	100	300	400

Notes

1 Department for Work & Pensions savings by 2014-15 include £200 million from Universal Credit.

2 Further savings from real-time information depended on successful implementation.

Source: Department for Work & Pensions and HM Revenue & Customs, *Tackling fraud and error in the benefit and tax credits systems*, October 2010

Recent reductions in headline rates of fraud and error

2.6 Recent progress in reducing fraud and error is mixed (**Figure 3**). HMRC reduced tax credits fraud and error overpayments from 8.1% in 2010-11 to 4.4% in 2013-14. It has achieved a statistically significant reduction over this period. Underpayments declined from 0.8% to 0.6% over the same period.

2.7 Overpayments in DWP benefits have not decreased significantly, but fell from 2.1% in 2010-11 to 1.9% in preliminary figures for 2014-15. Underpayments rose slightly from 0.7% to 0.9%. The overall fraud and error rate masks significant changes in individual benefits. For example, overpayments of Jobseeker's Allowance fell from 6.1% to 4.8% between 2010-11 and 2014-15. Overpayments of Housing Benefit rose from 4.2% to 5.7% over the same period.[10]

2.8 Within headline rates, there have been individual examples of success in reducing fraud and error. For example, in 2008 the Comptroller and Auditor General removed the qualification on the regularity of state pension expenditure, and he decided not to issue a qualified opinion on the regularity of the 2012-13 Social Fund account after DWP made sustained reductions in the level of error.

HMRC's recent estimates show significant reductions

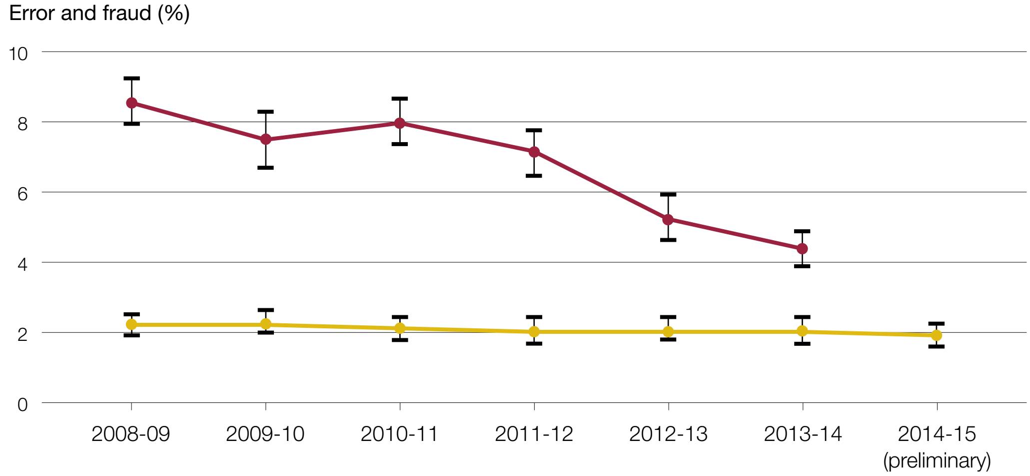
2.9 Until recently HMRC expected fraud and error to remain stable compared to 2011-12. It originally estimated that fraud and error overpayments for 2012-13 were 7.0%, and expected a small increase in 2013-14 due to changes in tax credit rules.[11]

10 In 2014-15 DWP introduced changes to the way it measured Housing Benefit fraud and error. Using the previous method, overpayments rose from 4.6% in 2010-11 to 6.1% in 2014-15.

11 HMRC reduced the amount by which a claimant's income could increase before the level of tax credits paid was affected. It assumed that this would reduce overall spending on tax credits, but may also increase fraud and error.

Figure 3
Fraud and error overpayments

HMRC's fraud and error rate has fallen significantly



	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15 (preliminary)
DWP benefits							
Overpayment (£bn)	2.9	3.3	3.1	3.2	3.4	3.3	3.2
Total expenditure (£bn)	135.7	148.0	153.4	159.2	166.6	164.0	168.1
Overpayment (%)	2.2	2.2	2.1	2.0	2.0	2.0	1.9
Tax credits							
Overpayment (£bn)	2.1	2.1	2.3	2.1	1.5	1.3	Data not available
Total expenditure (£bn)	24.7	27.5	28.5	29.2	29.1	28.8	Data not available
Overpayment (%)	8.9	7.8	8.1	7.3	5.3	4.4	Data not available
Total							
Overpayment (£bn)	5.0	5.4	5.5	5.5	4.9	4.6	Data not available
Total expenditure (£bn)	160.4	175.5	181.9	188.4	195.7	192.8	Data not available
Overpayment (%)	3.1	3.1	3.0	2.9	2.5	2.4	Data not available

● HMRC ● DWP

Notes

1 Excluding State Pension fraud and error overpayments are:
DWP: 2008-09 – 3.9%; 2009-10 – 4.0%; 2010-11 – 3.7%; 2011-12 – 3.7%; 2012-13 – 3.8%; 2013-14 – 3.9%; 2014-15 – 3.7%.
Aggregate: 2008-09 – 5.0%; 2009-10 – 4.9%; 2010-11 – 4.7%; 2011-12 – 4.5%; 2012-13 – 4.2%; 2013-14 – 4.1%.

2 DWP figures for 2014-15 are based on *Fraud and error in the benefit system: preliminary 2014/15 estimates first release*, 14 May 2015 (www.gov.uk/government/statistics/fraud-and-error-in-the-benefit-system-financial-year-201415-preliminary-estimates). It expects to publish final estimates for 2014-15 in November 2015.

3 In 2014-15 DWP changed the way it measured Housing Benefit fraud and error to bring it in line with other benefits. DWP has recalculated prior years' figures from 2010-11 onwards. The change means that each year the level of overpayments is slightly lower, although this is not always apparent because of rounding. The overpayment figures using the original method are: 2010-11 – £3.2 billion (2.1%); 2011-12 – £3.4 billion (2.1%); 2012-13 – £3.5 billion (2.1%); 2013-14 – £3.4 billion (2.1%); 2014-15 – £3.3 billion (1.9%). Figures for 2008-09 and 2009-10 use the old method for calculating Housing Benefit fraud and error.

4 When comparing DWP's performance against its 1.7% target, it is more appropriate to use the original method for calculating overpayments so that performance is assessed on a like-for-like basis.

5 For a description of the methods used by DWP and HMRC to estimate the value of fraud and error, see National Audit Office, *Understanding fraud and error in benefits and tax credits: a primer*, July 2015.

6 The range bars show the confidence intervals for each year's estimate.

7 Figures do not sum due to rounding.

Source: National Audit Office analysis of National Statistics

2.10 In June 2015 HMRC released estimates showing a significant decline in fraud and error. It revised the 2012-13 estimates from 7.0% to 5.3%, a reduction of £490 million. It also released 2013-14 estimates, showing the fraud and error rate had continued to fall to 4.4%, which is the lowest level since tax credits were introduced.

2.11 HMRC has not yet had time to assess the reasons for the reductions more fully and is planning to conduct further detailed analysis. Based on its initial examination:

- HMRC believes that the increasing number of compliance checks over this period, particularly in its work with credit reference agencies to tackle undeclared partner risk, have helped to reduce fraud and error. It plans to do more analysis to better understand the link between initiatives and outcomes;
- HMRC assesses that around half of its revision of 2012-13 estimates was because losses for undeclared partners had previously been overstated. Some awards that HMRC initially assessed as incorrect were overturned or amended on appeal; and
- HMRC understands the reasons for the revision of losses for the income risk which was partly caused by its misclassification of losses between years. It has not established a full understanding of the reasons for the remainder of the revision by risk type, including a £90 million reduction in losses due to work and hours.

Composition effects helped to reduce headline rates in DWP

2.12 There are several wider factors that are likely to have affected fraud and error, such as:

- **Delays to the roll-out of Universal Credit.** The 2010 joint strategy estimated that Universal Credit would reduce overpayments of DWP benefits by £200 million by 2014-15. Delays to roll-out could have hindered DWP from meeting its fraud and error target, although the impact is uncertain because DWP introduced additional initiatives into legacy benefits it had not initially planned.
- **Reduced income disregards for tax credits.** In 2013-14, the government reduced income disregards, increasing the likelihood of claimants being overpaid because of unreported changes in income.[12] Changing the level of the disregard may reduce overall spending on benefits while increasing fraud and error.
- **Changing claimant types.** In our report on Housing Benefit fraud and error we noted that the increase in in-work claimants – with more variable incomes – might have contributed to increases in claimant error.[13]

12 The income disregard is the amount a claimant's income can increase during the course of the year without affecting their tax credit entitlement. The disregard was reduced from £10,000 to £5,000 from April 2013.

13 Comptroller and Auditor General, *Housing Benefit fraud and error*, Session 2014-15, HC 720, National Audit Office, October 2014.

2.13 DWP's headline rates of fraud and error have benefited from changes in the composition of benefits. DWP's fraud and error rate includes the State Pension, which has a low rate of overpayments (0.2%). Over the past five years the share of benefit spending on State Pension has increased relative to working-age benefits, rising from 46% (£70 billion) of spending in 2010-11 to 51% (£87 billion) in 2014-15. This effect has pulled down the overall rate of overpayments by around 0.2% in 2014-15.

2.14 Other changes in the composition of benefits have also reduced fraud and error. Government abolished Council Tax Benefit in March 2013. In 2012-13, overpayments on Council Tax Benefit were £230 million (4.6% of spending). Abolishing Council Tax Benefit helped DWP reduce overall overpayments by around £100 million in 2013-14, even though overpayments for other benefits had risen by £130 million (**Figure 4**).

2.15 Appendix Three summarises some of the main factors that may have affected fraud and error in recent years. The overall impact of these changes is uncertain. But, in our view, the combined effect has probably been broadly neutral or favourable for DWP, and marginally unfavourable for HMRC, in achieving their targets.

Figure 4

DWP fraud and error overpayments, separating out Council Tax Benefit

Excluding Council Tax Benefit, total DWP overpayments increased in 2013-14

Source: Overpayments figures derived from Department for Work & Pensions fraud and error publications 2009-10 to 2014-15

Mixed performance against 2010 Spending Review commitments

2.16 HMRC has already reduced fraud and error below its aim to reduce losses towards 5.5% by the end of 2014-15. It estimates that fraud and error overpayments were 5.3% in 2012-13 and fell further to 4.4% in 2013-14. If HMRC sustains the fraud and error rate at current levels it will meet its target. Due to the lag in measuring fraud and error, the final results for 2014-15 will be available in June 2016.

2.17 DWP will publish final results for 2014-15 in November 2015. Its preliminary estimates show that overpayments were 1.9% compared with its target of 1.7%. Given the uncertainty in estimates and its recent initiatives to reduce fraud and error, it is possible that estimates for 2014-15 will fall further. However, based on its preliminary results, DWP is not on track to meet its target. In DWP's view, it is not possible to know whether or not it is on track.[14]

Reliance on correction rather than prevention and design

2.18 The 2010 joint strategy set out to better prevent fraud and error, as well as improve detection, correction and punishment.[15] The departments developed initiatives to identify higher-risk claims before paying claimants, and to use data better in getting claims right. For example, each year HMRC targets around 140,000 high-risk tax credits claims when it is renewing them.

2.19 Sometimes the departments have redesigned benefit rules or processes to control fraud and error. HMRC redesigned Child Tax Credit rules to require claimants to provide more information to confirm their entitlement; for example, claimants now need to confirm each year whether children aged over 16 remain in full-time education.

2.20 But DWP has shifted substantially away from the original 2010 strategy due to limited progress in delivering initiatives to prevent fraud and error. Most benefits of DWP's fraud, error and debt programme to 2014-15 came from corrective work, such as 'case cleanse' work to target errors from altered claimant circumstances (**Figure 5**). DWP estimates that corrective activities saved £1,454 million (71% of total savings) by March 2015. It is unclear whether this approach will deliver long-term reductions in the level of fraud and error.

14 DWP said in June 2015: "Achievement of an MVFE level of 1.7% at end 2014-15 remains challenging, but we are conscious that a number of initiatives (notably the RTI bulk match and FERIS) were not implemented until the second half of 2014-15 and therefore have yet to be reflected in the data. This is a statistical estimate and by definition there is inherent uncertainty around the outturn."

15 The strategy focused on preventing fraud and error from entering the welfare system. It can do this in a number of ways: simplifying rules and improving claimants' awareness; increasing the obligation for claimants to report information; changing the frequency of engagement with claimants; and improving access to information at the point of processing claims. Where departments could not stop fraud and error entering the welfare system, they seek to identify and stop overpayments as soon as possible.

Figure 5

DWP fraud, error and debt programme spending and savings to 2014-15

DWP has reduced expected savings over the spending review period and relies heavily on correction

	Original programme		Revised programme		Variance	
Categorisation of projects	Cost (£m)	Saving (£m)	Cost (£m)	Saving (£m)	Cost (£m)	Saving (£m)
Prevention	192	1,120	27	258	-165	-862
Detection	53	131	15	0	-37	-131
Correction	132	1,069	145	1,454	14	385
Punish	27	123	11	8	-16	-115
New projects	–	–	44	315	44	315
Staff costs	20	–	29	–	9	–
Total	**424**	**2,443**	**273**	**2,035**	**-151**	**-409**

Notes

1 Prevention includes IRIS, Credit Reference Agency project, ATLAS and IT Fixes.

2 Detection includes single fraud investigation service and Mobile Regional Taskforce.

3 Correction includes case cleanse, debt management and debt legislation.

4 Punish includes sanctions and penalties.

5 New projects includes social fund recoveries, real-time information and abroad fraud.

6 DWP does not expect to meet commitments to save £2.4 billion over the spending review period. However, it expects to make up this shortfall in 2015-16.

7 Future spending and benefits from those projects that continue beyond 2014-15 are shown in Figure 14.

8 Figures are DWP's estimates, which are used for internal reporting and reporting to external stakeholders.

9 Figures do not sum due to rounding.

Source: Department for Work & Pensions Fraud and Error Programme Overview (February 2012) and Fraud, Error and Debt Programme Business Case (March 2015)

2.21 During the 2010 Spending Review period DWP made little progress developing prevention initiatives to provide better information to process claims. It originally planned to spend £192 million on projects such as IRIS (identifying and preventing high-risk payments) and ATLAS (to improve data-sharing with local authorities), and expected them to save an estimated £1,120 million over the spending review period. In its latest plans, DWP reduced its spending on prevention projects to £27 million, and now expects these will save £258 million in reduced overpayments.

2.22 In particular, DWP originally considered IRIS to be the centrepiece of its programme, on which other projects would rely. Its aim was to analyse available data and intelligence to target high-risk cases. However, in June 2013 DWP closed it, deeming it unaffordable. DWP is now focusing on developing a digital security and counter-fraud system for Universal Credit. It also dropped another preventative initiative, using credit reference agency data, because of its limited success.

2.23 Similarly, HMRC has concentrated its efforts on detecting and correcting fraud and error. In 2014-15 it used 61 activities, of which 44 sought to detect and correct existing overpayments (**Figure 6**). Its detection activities accounted for 59% (1.3 million) of claims examined, and 79% (£370 million) of losses prevented. HMRC has sought to strengthen its prevention activities. Our 2013 report found that it was improving the way it assessed new claims before they enter the tax credits system, identifying claims with a higher risk of error.[16]

Figure 6
HMRC fraud and error interventions during 2014-15

HMRC's activities are mainly focused on detecting fraud and error

	Number of activities	Claims examined	Net losses prevented (£m)
Detect/correct	44	1,254,000	370
Prevent	13	868,000	98
Other	4	7,000	<1
Total	**61**	**2,129,000**	**469**

Note

1 HMRC forecasts that total net losses prevented for 2014-15 will be £715 million. The figure will be finalised in August 2015.

Source: National Audit Office analysis of HMRC activity reports as of March 2015

Reductions in fraud and error do not align with detection of past overpayments

2.24 Both departments have identified large savings (or losses prevented) as a result of individual projects. HMRC identified net losses prevented of £3.2 billion from all its compliance activities between 2010-11 and 2014-15. It uses these measures to monitor its performance in-year. DWP estimates its fraud and error projects saved £2 billion over the same period. DWP does not monitor savings from its wider fraud and error activities, such as processing benefit claims.

2.25 Initiatives have not always reduced estimates of overall fraud and error as expected. There are several possible explanations for this. One possibility is that the underlying risks of fraud and error have changed and that new initiatives have offset an increase that would otherwise have occurred. Another is that initiatives have simply been less effective than expected or may take longer to achieve noticeable reductions.

16 Comptroller and Auditor General, *Tackling tax credits error and fraud*, Session 2012-13, HC 891, National Audit Office, February 2013.

2.26 Departments have not been able to draw clear links between estimated savings (or losses prevented) and rates of fraud and error in order to test the impact of their initiatives. For example, although DWP did not expect that all savings identified from projects would result in a drop in the headline rate of fraud and error, it acknowledges that savings did not correspond with a drop in the rate until the provisional 2014-15 statistics. Given lags in the measurement of fraud and error and a range of external factors, it is inherently difficult to produce accurate estimates of savings.

2.27 Departments have refined their measures of savings in response to recent experience. For example, HMRC removed deterrent effects from its estimates in 2013 after it found that fraud and error was not falling as fast as expected. Nonetheless, departments' estimates of savings (or losses prevented) are not yet a reliable measure of the impact on fraud and error rates. For example, recently HMRC's fraud and error rate has fallen by significantly more than its estimated savings from its activities.

Increasing involvement of the centre of government

2.28 The Fraud Error and Debt Taskforce was established by the coalition government as a strategic decision-making body for all fraud and error, debt and grant efficiency initiatives across government. The Taskforce was chaired by the Minister for Cabinet Office and comprised ministers and senior officials from government departments. It also brought together expertise from the private sector and public sector.

2.29 In July 2013 the centre's Fraud, Error and Debt team carried out an in-depth review of the departments' actions against the strategy, because of government concerns that insufficient progress had been made. The Taskforce assessed the results of this review, and created a sub-group in December 2013 to support departments and scrutinise fraud and error in the benefits and tax credits systems. The Taskforce then held regular meetings with accounting officers to discuss progress. In July 2014 DWP agreed to the Taskforce's request to develop a plan for meeting its 1.7% target.

2.30 In 2015 the Taskforce was replaced by the Fraud, Error and Debt Steering Group, which comprises senior officials from HM Treasury, the Cabinet Office, HMRC and DWP. The Steering Group meets regularly to monitor departments' progress and consider ways to further reduce loss and increase debt recovery.

Part Three

Shaping the future to tackle fraud and error

3.1 Departments manage benefits and tax credits in an evolving environment. In this Part we look ahead at the opportunities over the next five years and challenges that the departments face in establishing a baseline to assess their performance. To understand how departments are preparing for future developments, we also consider their recent initiatives and emerging plans to address the four systemic issues identified in Part One.

Significant new opportunities

3.2 Departments' ability to manage fraud and error is likely to be helped significantly by changes to the design of benefits and improved access to data. These include:

- **The introduction of Universal Credit.** The Department for Work & Pensions (DWP) expects that Universal Credit will reduce annual fraud and error overpayments by around £0.5 billion (**Figure 7**). For example, policy changes should design out some current sources of error, such as incorrectly recording the details of other benefits in the calculation of a passported benefit such as Housing Benefit.
- **Changes to the welfare system.** DWP expects that welfare reform will reduce fraud and error. For example, the government is introducing state pension reforms, which will reduce reliance on Pension Credit.
- **Using real-time information beyond Universal Credit.** In 2013-14, DWP and HM Revenue & Customs (HMRC) estimated that £1.4 billion of fraud and error was caused by incorrect assessments of claimants' income. HMRC expects that using real-time information to check claimants' earnings will save £410 million on tax credits over the next two years. DWP expects the use of real-time information will save £356 million between 2015-16 and 2020-21.
- **Improving the use of other sources of data.** Both departments have longer-term plans to improve their use of data. DWP is building an analysis and intelligence hub to improve analytical capability using a wider range of data sources. DWP is building the hub for Universal Credit and is considering how this could be used more widely in legacy benefits. HMRC is increasingly using its tax evasion technology to assess tax credits risks. It is also developing a new enterprise data hub, which will bring its data together to improve analysis and intelligence-sharing.
- **Introducing digital accounts.** Departments also plan to introduce digital accounts on tax credits and Universal Credit, enabling them to interact more frequently with claimants and make their responsibilities clearer.

Figure 7

The impact of Universal Credit on fraud and error

DWP expects Universal Credit to reduce fraud and error overpayments by £0.5 billion each year once fully rolled-out

	Estimated annual savings (£bn)	
Reacting to changes in income	**1.0**	Not classed as affecting fraud and error
Abolishing the 'income changes disregard'	0.9	
No run-ons when people change from out-of-work to in-work	0.1	
Designing out in-year tax credits overpayments	**0.6**	
IT – using RTI to report PAYE earnings	0.4	
More frequent reporting requirements on claimants	0.2	
Designing out fraud and error	**0.8**	Classed as affecting fraud and error
IT – using RTI to report PAYE earnings	0.2	
Policy changes	0.5	
More frequent reporting requirements on claimants	0.1	
Designing in fraud and error	**-0.3**	
Increased errors due to abolishing income changes disregard	-0.1	
Failure of in-work claimants to report capital amounts	-0.2	
Total	**2.1**	

Notes

1 In-year overpayments occur for tax credits as a result of the way entitlements are determined in advance without knowing claimants' income for certain. These overpayments are corrected at the end of the year, and are not counted as fraud and error.

2 Run-ons occur in: tax credits, which HMRC continues to pay for four weeks after a claimant goes out-of-work; and Housing Benefit, where DWP continues to pay out-of-work entitlement for four weeks after a claimant moves into work.

3 Policy changes consist of: no longer paying out in-work benefit based on the number of hours worked; childcare no longer asking for average childcare costs; no disability premiums; different rules for paying back underpayments; and no incorrect amount of one benefit being taken into account in another benefit.

4 More frequent reporting requirements consist of: child-care costs; self-employed earnings; and no more losses due to tax credit 'terminations'.

5 Figures are quoted in 2010-11 prices. They are DWP's estimates which are used for internal reporting and reporting to external stakeholders. Figures are DWP's best estimate as at December 2014. DWP expects to revise the figures as better information becomes available, for example, to reflect HMRC's latest estimates of tax credits fraud and error.

Source: National Audit Office analysis of Department for Work & Pensions assessment of Universal Credit Fraud and Error Savings

3.3 As DWP introduces new processes for administering Universal Credit it will also have opportunities to design in more effective operational controls, tackling any new sources of fraud and error that arise or are identified through better risk analysis. Staff from both DWP and HMRC with knowledge of fraud and error issues have been involved with teams designing new systems for Universal Credit, and have helped develop policy and delivery proposals.

3.4 Although the most significant developments are likely to help in reducing fraud and error, there are some offsetting factors. Increasing the frequency of re-assessing entitlement may reduce government spending overall, but with the effect of reclassifying currently allowed payments as fraud and error. For example, DWP expects that removing the income disregard used in tax credits (for in-year changes in income) will reduce overall spending but also slightly increase opportunities for error.

Challenges establishing baselines during transition

3.5 Departments face a long transition to managing fraud and error in Universal Credit. The migration of claimants is expected to take until at least 2020-21, leaving significant scope for losses in legacy benefits and tax credits in the interim. There will also continue to be several large benefits outside Universal Credit, including Personal Independence Payment, Pension Credit and Child Benefit.

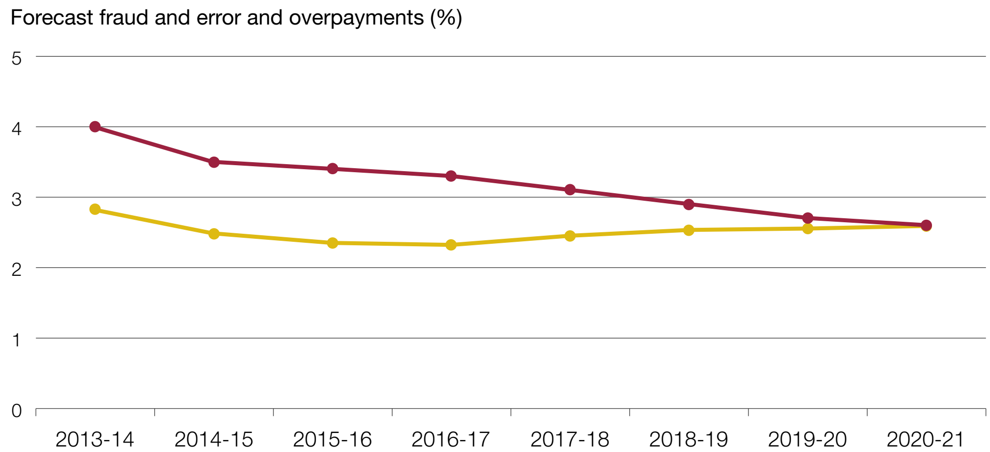
3.6 During the transition period DWP and HMRC will increasingly need to take a cross-departmental view of fraud and error to understand performance. DWP has developed projections of the overall rate of fraud and error across benefits and tax credits. It currently estimates that overall fraud and error will fall from 2.8% of expenditure in 2013-14 to 2.5% in 2020-21 (**Figure 8**).

3.7 One of the challenges for establishing a clear baseline is the treatment of in-year overpayments in tax credits. These in-year overpayments arise from the way tax credits entitlements are set at the beginning of the year and then finalised later, and they do not count as fraud and error. DWP intends to include in-year overpayments in a combined baseline for fraud and error. This shows that the combined total of overpayments and fraud and error will fall from 4% in 2013-14 to 2.6% in 2020-21. Universal Credit will eliminate these in-year overpayments. DWP will need to be clear about how both types of overpayment are performing against forecasts.

3.8 The challenge now for HMRC is to sustain the recent reductions in levels of tax credits fraud and error during the transition to Universal Credit. HMRC believes that the transition may well limit its scope to develop business cases for further investment in significant policy or system changes to reduce fraud and error. It says it will continue to explore options.

Figure 8
Forecast fraud and error, 2013-14 to 2020-21

The removal of tax credits in-year overpayments is the main driver in reducing DWP's definition of fraud and error



	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
● Total DWP and HMRC fraud, error and in-year overpayments	4.0	3.5	3.4	3.3	3.1	2.9	2.7	2.6
● DWP and HMRC fraud and error only	2.8	2.5	2.3	2.3	2.5	2.5	2.6	2.6

Notes

1 This chart is based on estimates that predate the release on 4 June 2015 of HMRC's *Child and Working Tax Credits Fraud and Error Statistics for 2013-14*, and restated statistics for 2012-13.

2 DWP projections exclude the effects of possible increases due to new and uncertain sources such as cyber-fraud.

3 Figures are DWP's estimates, which are used for internal reporting and reporting to external stakeholders. Figures are DWP's best estimate as at April 2015. DWP expects to revise the figures as better information becomes available, for example to reflect HMRC's latest estimates of tax credits fraud and error.

Source: Department for Work & Pensions and HM Revenue & Customs, Long-term forecasting of benefits and credits overpayments, FED Steering Group, April 2015

3.9 During the transition period, departments may struggle to establish baseline levels of performance and distinguish the impact of transition from new interventions. As well as being hard to measure, the actual impact of different interventions could also change. For example, savings from introducing real-time information into tax credits or legacy DWP benefits will increase (and the savings from Universal Credit could correspondingly reduce) if Universal Credit migration takes longer than expected.

3.10 Departments have not yet set formal targets to reduce fraud and error for the next five years. They plan to set out aspirations and the case for investment over the next six months as part of wider departmental planning.

New strategies and strengthened governance

3.11 In the face of an uncertain and evolving environment, the departments will need to exploit emerging opportunities and anticipate risks while also maintaining pressure on existing efforts to reduce fraud and error. The strategies will provide the basis for departments to make informed decisions on the allocation of resources. Where changes have to be made, departments need well-established governance and decision-making arrangements.

3.12 Departments continue to develop strategies for managing fraud and error. DWP is developing an overall fraud and error strategy up to 2020. In March 2015, it approved benefit-specific strategies for Pension Credit and Housing Benefit, and plans new strategies for other legacy benefits by September 2015. The strategies identify major loss areas, recognise the need to prevent overpayments and set out how DWP will coordinate its response across the department. Since 2009 HMRC has had a clear strategy for managing fraud and error, and is continuing to assess its performance against existing plans until it publishes its 2014-15 results in summer 2016.

3.13 Departments have also strengthened governance and responsibilities for fraud and error (**Figure 9**). HMRC has clear lines of accountability for managing its fraud and error activities and a well-established approach to assigning resources to different activities. DWP has reorganised responsibilities over the past two years. This includes creating the new operational service to manage its fraud and error activities, and strengthening the link between policy, strategy, analytical and operational teams. It has also introduced clearer oversight of fraud and error activities in Housing Benefit and Pension Credit.

3.14 In April 2015 DWP estimated that fraud and error overpayments will still be £5.8 billion in 2020-21. As departments develop their strategies they will need to show that they are targeting major areas of loss. Departments are now tackling income-related overpayments using real-time information. They will also need to develop effective approaches in other major risk areas to deliver sustained reductions in fraud and error. For example, £823 million of fraud and error overpayments were due to undeclared partner/living arrangements risks in 2013-14 (**Figure 10** on page 30).

Figure 9
Strategies and governance: current developments

Departments are strengthening strategies and governance

	DWP	HMRC
Set out long-term performance aspirations	Currently assessing opportunity and risk profile for 2015–2020 Establishing baseline fraud and error across benefits	Modelling fraud and error in tax credits as claimants move to Universal Credit Assessing resource implications of the transition to Universal Credit
Develop clear strategies and target interventions	Approved strategies for Pension Credit and Housing Benefit Developing strategies for other benefits and overall 2015–2020 by September 2015 Developing activity plans to support individual strategies by September 2015	Planning to assess performance against 2015 targets in June 2016 Considering investment case as part of departmental planning process
Establish governance arrangements	Assigned clear responsibilities for strategies to senior responsible owner for fraud, error and debt programme Setting up steering groups to oversee progress against Pension Credit and Housing Benefit strategies	Continuing with existing responsibilities for fraud and error

Source: National Audit Office summary of departmental interviews and reports

Figure 10
Overview of major areas of risk in 2013-14

Departments have not developed effective responses for undeclared partners and living together risks

DWP benefits	Fraud and error (£m)	Percentage of total
Income	1,162	46
Living arrangements	393	16
Abroad/untraceable/residency	284	11
Capital	194	8
Control/premiums	117	5
Conditions of entitlement	75	3
Other	300	12
Total	**2,530**	**100**
Tax credits		
Undeclared partner	430	34
Work and hours	290	23
Income	230	18
Childcare costs	135	11
Children	130	10
Disability	50	4
Total	**1,260**	**100**

Notes

1 Department for Work & Pensions is able to assess the causes of overpayments on its continuously measured benefits: Jobseekers Allowance, Pension Credit, Housing Benefit, Income Support and Employment Support Allowance. It cannot undertake this analysis on the remaining £0.9 billion of overpayments.

2 Department for Work & Pensions 2014-15 preliminary fraud and error figures state that fraud and error that year for continuously measured benefits was £2,360 million, broken down as follows: Income – £1,120 million; Living arrangements – £340 million; Abroad/untraceable/residency – £230 million; Capital – £220 million; Control/premiums – £130 million; Conditions of entitlement – £80 million; Other – £240 million.

3 Figures do not sum due to rounding.

Source: National Audit Office analysis of National Statistics and departments' documents

Increasingly aiming for prevention in design

3.15 In Part Two we highlighted the dependence of departments on initiatives to detect and correct fraud and error, rather than preventing overpayments from arising. Detection activities will always play a role, but long-term improvements will only be possible if departments find ways to embed effective responses to fraud and error into the way benefits are designed and administered. Preventing fraud and error from occurring eliminates the problems of managing large levels of debt, reduces the cost and difficulty of recovering overpayments, and lessens claimants' hardship.

3.16 Both departments have recognised the impact that scheme rules can have on fraud and error and, increasingly, are factoring in fraud and error when considering scheme design (**Figure 11** overleaf). In addition to Universal Credit, departments have considered fraud and error in:

- **reporting requirements for tax credits.** HMRC now requires claimants to report whether their children aged between 16 and 19 remain in full-time education, and to provide regular updates if they are reporting high childcare costs. It is also intending to strengthen conditions of entitlement for self-employed claimants, including investigating where it believes there is a risk of fraud, and to change rules to recover more overpayments. In March 2015 HMRC estimated that these changes would save up to £471 million over five years;

- **strengthening conditionality, sanctions and penalties.** While DWP has primarily reformed conditions and sanctions to encourage people into work, it has also identified reductions in fraud and error from having more clearly defined rules. In addition, DWP has strengthened the sanctions it can impose on fraudsters, including raising the levels of penalties and increasing the amount it can take from benefits to recover fraudulent payments. In a complementary measure, it has launched two communication campaigns to raise claimants' awareness of their obligations and of the detection and punishment for fraud; and

- **wider efforts to reduce spending.** In some cases departments have had to consider increases in fraud and error rate as a trade-off for making savings overall. For example, DWP expects the removal of the assessed income period for Pension Credit, and the more frequent re-assessment of claims for Personal Independence Payment, to reduce spending overall. But in both cases fraud and error could increase because fewer changes in circumstances are disregarded.

Figure 11

Designing controls: current developments

Departments are increasingly factoring fraud and error into their scheme design

	DWP	HMRC
Design scheme rules and information requirements	Designing out some types of fraud and error in Universal Credit	Changed reporting requirements for claimants with children in full-time education and with high childcare costs
	Embedding fraud and error experts in policy and delivery design teams for Universal Credit	Introducing new tests for self-employed claimants
Build controls into operational processes	Evaluating impact of communication campaigns	Introduced risk profiling – checking 130,000 claims with a high risk of unreported changes and 140,000 high-risk renewals each year
	Planning to make RTI data available to operators processing new claims, starting with Pension Credit in autumn 2015	Piloting new risk tools for changes reported by claimants

Source: National Audit Office summary of departmental interviews and reports

3.17 In addition to scheme rules, departments need to consider how to build controls into day-to-day processes. In particular, they need to use data effectively to prevent fraud and error occurring – by strengthening decision-making at the point of processing claims and improving their identification of high-risk claims. Real-time information is a valuable tool and departments are exploring new ways to use it effectively in administering new claims.

3.18 Both departments have also devoted significant resources to improving their analysis and use of data. HMRC undertakes an annual assessment of where fraud and error enters the tax credits system and what errors customers make in different risk groups. It has introduced annual exercises to check claims with the highest risk of error. DWP has strengthened its fraud and error analytical team after recognising it could make better use of the high-quality analysis the team had been producing. It is also negotiating with data suppliers to acquire access to new data sets.

3.19 Overall, the departments have recognised the value of using data more effectively in designing and administering schemes, but there is still some way to go to exploiting these opportunities fully. Past initiatives to improve the use of data have often achieved more limited benefits than expected and have had to introduce data-sharing around – rather than instead of – existing processes. For example, in our report on *Housing Benefit fraud and error* in 2014 we found that DWP's attempts to improve data-sharing with local authorities were valuable but achieved under half the savings expected.[17]

17 Comptroller and Auditor General, *Housing Benefit fraud and error*, Session 2014-15, HC 720, National Audit Office, October 2014.

Improving incentives but some way to go to embed controls

3.20 One of the systemic challenges for departments is in embedding controls against fraud and error in the way front-line staff process claims (**Figure 12** overleaf). Data and systems can help to some extent but departments continue to rely heavily on people to take calls, process payments and check claimant details. The effectiveness of core operations in managing fraud and error will depend not just on the existence of processes to check accuracy, but also on the incentives people have to adhere to those processes and improve performance.

3.21 The departments have introduced some changes to strengthen incentives to reduce fraud and error, for example:

- **adding positive incentives.** In our report on Housing Benefit fraud and error we identified a misalignment between DWP and local authority incentives to prevent and detect fraud and error. DWP has introduced additional incentive payments, which nearly all authorities have taken up;[18]
- **introducing stronger monitoring of quality.** DWP has introduced a new quality framework for processing claims with dedicated teams assessing performance in individual benefit centres. These teams provide a counter-weight to the strong operational focus on speed of processing; and
- **increasing resources for routine checks.** HMRC has begun a project with a private sector partner, using a payment-by-results contract, to increase its capacity and significantly increase the number of checks. The contract began in autumn 2014 and is due to run until August 2017. It expects the project to cost £56 million and deliver lifetime savings of £423 million.[19]

3.22 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. Accuracy is less straightforward to measure and track, and operational teams are continually striving to improve speed of processing. For example, DWP sets targets to process claims promptly for most benefits and HMRC cancels some additional checks on new claims to meet processing targets. Building upon recent developments, departments need to ensure sufficient attention to quality measures, and resource accuracy teams appropriately.

18 See footnote 17.
19 HMRC originally expected to save £1.1 billion but has revised estimates, partly in response to delays to the start of the programme resulting from problems with the contractor's systems.

Figure 12
Implementation: current developments

Operational incentives to target accuracy continue to be relatively weak

	DWP	HMRC
Operate controls and interventions effectively	Introduced quality assurance framework in 2014 to target broader measures of quality (not just accuracy)	Interactive guidance for call centre operators, although not always used
	Pre-payment risking for small numbers of Pension Credit claims	Use pre-payment risking for new claims; although some checks cancelled to meet processing targets
	Flexible risk-based verification by local authorities for Housing Benefit	
	Call handling and claims processing targets continue to be most visible performance management measures	
Refine controls and interventions	Limited updates to IT systems due to planned introduction of Universal Credit	Limited updates to IT systems due to planned introduction of Universal Credit
	Quality project to improve consistency of scripts in call centres	New project to increase the number of high-risk claims being checked
	Additional incentives for local authorities to detect fraud and error in Housing Benefit	

Source: National Audit Office summary of departmental interviews and reports

Many initiatives but challenges in assessing performance

3.23 Looking ahead, both departments recognise the importance of tackling fraud and error over the next five years. DWP has introduced a number of new initiatives spanning prevention, detection and correction of claims, which will deliver future benefits. Between 2015-16 and 2021-22 DWP plans to invest a further £545 million in projects tackling fraud and error. It estimates that its projects will generate savings of £2,941 million over the same period, including £509 million from ATLAS and £64 million from strengthened sanctions it can impose on fraudsters. **Figure 13** overleaf summarises DWP's major initiatives it will invest in from April 2015 onwards.

3.24 Departments are continuing to improve their understanding of the reasons for fraud and error. They need to develop and embed their assessments of the root causes for different risk types, analysing their performance and establishing what is achievable. Departments should seek to develop a better understanding of residual losses and the barriers to these being reduced.

3.25 Departments will continue to face problems in measuring the impact of their initiatives. It is inherently difficult to ascribe a direct cause and effect of interventions on fraud and error rates, because of the impact of other factors, such as changes in claimants' behaviours and the wider economic situation. Without clear tracking of performance and links to outcomes it will be difficult for them to assess performance robustly. There is a risk that effective measures are not recognised or that ineffective measures are expanded, so increasing costs. In particular, it is difficult to assess the impact of preventative measures unless there are clear baselines against which to assess performance.

3.26 Departments are improving their approaches to measuring performance (**Figure 14** on page 37). To evaluate the impact of more preventative measures, departments will need to use modelling better, and use a set of measures to evaluate effectiveness. Over the longer term, departments must measure the impact of preventative projects against reductions in gross overpayments.

Figure 13

Forecast costs and savings from DWP's fraud, error and debt programme, 2015-16 to 2021-22

DWP forecasts that its fraud, error and debt programme will continue to deliver savings, with increased amounts coming from prevention and detection projects

Categorisation of projects	Projects	Estimated cost (£m)	Estimated saving (£m)
Prevention	**Total**	44	504
	Referral and case management		
	Business Architecture Framework and Services model		
	IT Fixes		
	ATLAS		
Detection	**Total**	317	575
	Single fraud investigation service		
Correction	**Total**	60	909
	Debt Transformation Programme		
	Case cleanse		
Punish	**Total**	40	64
	Sanctions and penalties		
New projects	**Total**	76	888
	Social Fund recoveries		
	Abroad fraud		
	Real-time information		
	Housing Benefit reductions		
Staff costs	**Total**	8	–
Total		545	2,941

Notes

1 Following the introduction of the single fraud investigation service, DWP will reduce the level of grant funding to local authorities by £234 million. As a result, the estimated net cost of detection projects between 2015-16 and 2021-22 is £83 million.

2 Figures are DWP's estimates, which are used for internal reporting and reporting to external stakeholders.

3 Figures do not sum due to rounding.

Source: National Audit Office analysis of departmental papers

Figure 14
Measurement: current developments

Tracking and assessing initiatives will continue to be difficult

	DWP	HMRC
Continuously monitor performance	Developing a new fraud and error dashboard to provide information on performance	Planning to introduce a new framework for measuring performance
Set clear baselines and benchmarks	Adjusted Housing Benefit fraud and error methodology	Reassessing link between losses prevented measure and level of fraud and error
	Developing models to assess impact of interventions on fraud and error	
Establish robust external reporting	Continued reporting to HM Treasury and Cabinet Office through new Fraud Error and Debt Steering Group	Continued reporting to HM Treasury and Cabinet Office through new Fraud Error and Debt Steering Group

Note

1 When comparing DWP's performance against its 1.7% target, it is more appropriate to use the original method for calculating overpayments so that performance is assessed on a like-for-like basis.

Source: National Audit Office

Appendix One

Our audit approach

1 This report reviewed developments in how the Department for Work & Pensions (DWP) and HM Revenue & Customs (HMRC) have addressed fraud and error in the benefits and tax credit system. We considered systemic issues in the way departments manage fraud and error; reviewed recent progress in addressing these issues; and looked ahead at emerging opportunities and challenges for the two departments. Our audit approach is summarised in **Figure 15**. Our evidence base is described in Appendix Two.

Figure 15
Our audit approach

The objective of government

Government's objective is that the administration of welfare payments is fair and not open to fraud or unnecessary waste.

How this will be achieved

In October 2010 DWP and HMRC published a joint strategy to tackle fraud and error in benefits and tax credits through reducing overpayments by one-quarter (around £1.4 billion) by March 2015. The departments' approach based the strategy around 5 key elements: prevent, detect, correct, punish and deter.

Our study

Our study identified four systemic issues that the departments need to address to tackle fraud and error; reviewed departments progress over the 2010 Spending Review period in addressing these issues; and looked ahead at emerging challenges and opportunities the departments face.

Our evaluative criteria

Departments have a clear strategy and effective governance arrangements.	Departments have considered how to tackle fraud and error in their design of schemes.	Departments have implemented activities to tackle fraud and error effectively.	Departments measure and evaluate their performance.

Our evidence

(see Appendix Two for details)

We assessed the departments' progress in tackling fraud and error by:

- reviewing departmental documents;
- interviewing key staff at the departments and other stakeholders;
- undertaking site visits; and
- reviewing the results of internal and external challenges.

Our conclusions

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. 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. 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.

Appendix Two

Our evidence base

1 We completed our stocktake of how the Department for Work & Pensions (DWP) and HM Revenue & Customs (HMRC) have addressed fraud and error in the benefits and tax credit system after analysing the evidence we collected between February and June 2015.

2 We used an evaluative framework to consider how effective the departments have been in reducing fraud and error. Drawing on our past work, we compared the departments' progress against their respective plans. We reviewed departmental documents and correspondence with central government to assess the cost of work so far, what this spending has produced in terms of savings and its impact on the overall rate of fraud and error.

3 **We identified systemic issues by:**

- using our fraud and error benchmarking model to identify the core elements of an effective control system for managing fraud and error; and
- reviewing our back catalogue of value-for-money, financial audit and fraud and error benchmarking work to identify how the departments have performed against these issues.

4 **We assessed progress over the 2010 Spending Review period by:**

- reviewing departmental documents to understand how they have managed fraud and error over the 2010 Spending Review period, and how this has developed;
- interviewing departmental officials to understand departments' approaches and how this has evolved;
- visiting departments' operational offices to understand how fraud and error initiatives are operating in practice;
- reviewing published fraud and error results to understand the types of errors and risks, when these enter the system, and how this has changed over time;

- reviewing departments' fraud and error analytics to understand the causes of fraud and error and the effectiveness of interventions;
- reviewing a sample of projects, to understand how these have performed compared to departments' expectations;
- reviewing how departments have measured the impact of losses prevented on the rate of fraud and error; and
- interviewing external stakeholders to understand their assessment of the departments' progress in tackling fraud and error.

5 **We identified challenges and opportunities departments need to face by:**

- interviewing senior staff about preparations up to 2020;
- reviewing documents relating to the development of Universal Credit to identify the impact this will have; and
- reviewing documents to establish departments' strategies for managing legacy benefits up to when they are superseded by Universal Credit.

6 Our assessment excludes HMRC's management of Child Benefit. HMRC does not publish the estimated level of fraud and error overpayments. It developed a new methodology for 2014-15 and we will monitor HMRC's performance in tackling fraud and error in future years.

7 In 2014-15 DWP introduced changes to the way it measured Housing Benefit fraud and error, bringing its approach into line with other benefits. We have presented fraud and error figures using the revised methodology, ensuring a consistent basis for comparisons across years. We have also included footnotes to show the fraud and error rates using the previous methodology, to allow the reader to compare back to previous national statistics and National Audit Office publications.

Appendix Three

Factors affecting fraud and error

1 In Part Two we describe the recent progress of the Department for Work & Pensions (DWP) and HM Revenue & Customs (HMRC) in reducing fraud and error. The departments' aggregate performance depends on a wide range of factors beyond the administration of benefits or management of new initiatives. In **Figure 16** we describe in more detail some of the factors that may have affected fraud and error in the past few years.

Figure 16
Factors affecting fraud and error

	Description	Assessing the impact on departments' fraud and error estimates
Benefit composition		
Removal of benefits	Abolition of Council Tax Benefit eliminated a significant source of overspending from DWP's estimates from March 2013. Fraud and error is not measured for local council tax support.	Reduced the overall rate of DWP overpayments by around 0.1% from 2013-14 onwards.
State Pension	Because of demographic trends, working-age benefit changes and the triple lock for the State Pension, the share of DWP spending on the State Pension – with low rates of fraud and error – has increased.	Reduced the overall rate of DWP overpayments by around 0.2% between 2010-11 and 2014-15.
Other mix effects	The share of benefit spending on Housing Benefit (with higher rates) has increased while Jobseeker's Allowance (with lower rates) has decreased.	Increased the overall rate of DWP overpayments by less than 0.1% between 2010-11 and 2014-15.
Overall composition	Combined effect of composition effects taking a like-for-like split of benefit spending and assuming no changes in the claimant mix.	Reduced the overall rate of DWP overpayments by around 0.2% between 2010-11 and 2014-15. Holding the mix of spending constant, the rate of overpayments would have increased from 1.9% to 2.1%.
Claimant mix		
In-work mix	In-work claimants are more likely to incur overpayments due to fluctuating incomes. In some benefits such as Housing Benefit the share of in-work claimants has increased.	Increased the overall rate of DWP overpayments by around 0.1% between 2010-11 and 2014-15, based on estimates from DWP.
In-work claimants complexity	Changing labour market conditions such as the use of zero-hours contracts and self-employment may make it more difficult to track incomes and ensure payments are correct.	Assuming that increases in the error rate of in-work claimants in Housing Benefit is attributable to this effect it would have increased overall overpayments in DWP by less than 0.1%. However, in our view, the effect is not certain, and the reductions in overpayments of tax credits – which should also be affected – suggest it has not prevented reductions in fraud and error.

Figure 16 *Continued*
Factors affecting fraud and error

	Description	Assessing the impact on departments' fraud and error estimates
Programme dependencies		
Universal Credit	DWP expected to roll out Universal Credit by October 2013. Delays to roll-out have delayed expected savings of £200 million in fraud and error overpayments.	Assuming that Universal Credit does reduce overpayments in DWP benefits of £200 million, this would have increased overall overpayments by 0.1% in 2014-15. However, the effect is uncertain.
Policy changes		
Tax credit disregards	HMRC reduced disregards on changes in income in 2013-14. By reducing disregards the level of fraud and error is likely to increase (as more changes in income require changes to entitlement).	This is likely to increase HMRC fraud and error from 2013-14 although the scale of the effect is not known.
Measurement changes		
Housing Benefit	In 2014-15 DWP introduced changes to the way it measured Housing Benefit fraud and error, bringing its approach into line with other benefits.	Reduced the overall rate of overpayments in DWP benefits in 2014-15 by around 0.1% although due to rounding the rate of overpayments was 1.9% under both methods. When comparing with existing targets we use the old methodology in order to ensure a like-for-like basis for comparison.

Source: National Audit Office analysis of published statistics and departments' own analysis

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