National Audit Office

Report
by the National Audit Office

Department for Work & Pensions and HM Revenue & Customs

Understanding fraud and error in benefits and tax credits: a primer

JULY 2015

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Contents

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Introduction

1 The level of fraud and error is a persistent concern in benefits and tax credits. In March 2015 the government stated that the level of fraud and error was unacceptably high.[1] In the 10 years up to 2013-14, fraud and error overpayments were around 3% of total benefit and tax credit spending, while 1% of expenditure was underpaid. The Committee of Public Accounts has raised repeated concerns about how departments manage fraud and error, and the opportunities for spending money better.[2]

2 Fraud and error is a complicated subject. HM Revenue & Customs (HMRC) and the Department for Work & Pensions (DWP) measure fraud and error differently. They use several technical concepts to define and analyse fraud and error, which means that it can be difficult to understand what is really happening to public spending.

3 In this primer we explain the main concepts and definitions of fraud and error in benefits and tax credits. We want to help people to understand official statistics, departmental accounts and related publications. We are publishing this primer with our *Fraud and error stocktake*, which covers departments' progress and plans to reduce fraud and error.[3]

4 The primer covers how departments:

- define fraud and error (Part One);
- measure fraud and error (Part Two); and
- manage fraud and error (Part Three).

5 We summarise the main concepts in a quick reference guide.

1 HM Government, *Tackling Fraud, Error and Debt in the benefits and tax credits system*, March 2015.
2 HC Committee of Public Accounts, *Housing Benefit fraud and error*, Twenty-seventh Report of Session 2014-15, HC 706, January 2015.
3 Comptroller and Auditor Genera, *Fraud and error stocktake*, Session 2015-16, HC 267, National Audit Office, July 2015.

Quick reference guide

Defining fraud and error

Term	Description	Further explanation
Monetary value of fraud and error (MVFE)	MVFE is an estimate of the total value of fraud and error over and underpayments. DWP and HMRC publish MVFE estimates. HMRC's exercise to measure the value of fraud and error is called the Error and Fraud Analytical Programme.	Paragraphs 1.2 to 1.3
Over- and underpayments	Departments sometimes overpay or underpay claimants. This occurs when the actual payment differs from the claimant's entitlement to a benefit.	Paragraphs 1.4 to 1.7
Official error, claimant error and fraud	Departments commonly distinguish between official error (mistakes departments make), claimant error (genuine mistakes by claimants), and fraud (people intending to mislead).	Paragraphs 1.8 to 1.10
Gross and net overpayments	Fraud and error can be measured in 'gross' terms (the value of overpayments) or 'net' terms (after money has been recovered). Published statistics and accounts usually quote gross figures and money recovered separately.	Paragraphs 1.11 to 1.15
Other overpayments of tax credits	Some overpayments in tax credits are not counted as error or fraud. Entitlements are estimated at the start of the year, and adjusted when the award is finalised at the year-end.	Paragraphs 1.16 to 1.17
Periods and disregards	Some changes in income are ignored as departments may set minimum thresholds for changing entitlement to benefits or tax credits. There are also different rules about time periods people must report changes in.	Paragraphs 1.18 to 1.19

Measuring fraud and error

Departmental estimation processes	Departments estimate the level of fraud and error by taking samples of live claims and checking whether they are correct. The overall estimates of fraud and error over- and underpayments are based on an extrapolation of samples.	Paragraphs 2.2 to 2.4
Confidence levels and significance	All estimates are subject to uncertainty. Reported levels of fraud and error are usually central estimates but departments also disclose the range within which the true value lies. Apparent changes in fraud and error between years need to be interpreted with care.	Paragraphs 2.5 to 2.7
Time lags	Measurement of fraud and error often lags behind data on spending and claims, as it takes time to perform sampling checks to determine whether claims are accurate.	Paragraphs 2.8 to 2.10
Frequency of measurement	Some benefits are continuously sampled to estimate the level of fraud and error. Other benefits are measured periodically or not at all.	Paragraphs 2.11 to 2.12
Classifying causes of fraud and error	Departments classify the causes of fraud and error (for example, because of incorrect declarations of income or capital). Some claims may have multiple causes of fraud and error.	Paragraphs 2.13 to 2.17
Auditing fraud and error	Departments include estimates of fraud and error in their accounts. We qualified DWP and HMRC accounts because of levels of fraud and error overpayments.	Paragraphs 2.18 to 2.20

Quick reference guide *continued*

Managing fraud and error

Term	Description	Further explanation
New claims and changes in claimants' circumstances	Fraud and error can occur at the start of claims, or from changes in circumstances which claimants do not report, or report wrongly or late.	Paragraphs 3.2 to 3.3
Data-matching	Departments use their own and each other's data to check information provided by claimants. But data is not always available, or of good quality.	Paragraphs 3.4 to 3.6
Recoveries and penalties	Departments can recover overpayments arising from claimant error and fraud (and are liable to pay back underpaid claimants). Recoveries can take time, so in-year recoveries may relate to past years.	Paragraphs 3.7 to 3.9
Losses prevented and savings	Departments estimate the impact of their fraud and error activities using different methodologies. They do this to monitor progress towards their fraud and error targets and make decisions on how to allocate resources.	Paragraphs 3.10 to 3.12
Housing Benefit subsidy regime	DWP uses a subsidy regime to reimburse local authorities for payments they make to claimants of Housing Benefit. There are sometimes mistakes in the subsidy claims local authorities make, but this is not the same as MVFE in accounts.	Paragraphs 3.13 to 3.15

Part One

Defining fraud and error

1.1 In this Part we explain the main concepts used to describe fraud and error. We explain: how fraud and error is defined; and how it relates to other types of payments.

Monetary value of fraud and error

1.2 To measure fraud and error we can consider the total number of errors, the number of incorrect claims, or the total value of errors. Departments can learn from the profile and trends in the number of errors and incorrect claims. Departments usually define the monetary value of fraud and error as the value of incorrect payments in the benefits and tax credits systems.

1.3 The Department for Work & Pensions (DWP) measures the monetary value of fraud and error (MVFE) in its benefit expenditure. HM Revenue & Customs (HMRC) uses a different term, but its measure of fraud and error is also an estimate of the value of incorrect claims. The monetary value of fraud and error is published by departments each year and forms the basis of the Comptroller and Auditor General's audit opinion on the accounts for benefits and tax credits.

Overpayments and underpayments

1.4 The amount people receive in benefits and tax credits depends on their circumstances and each benefit's entitlement criteria. When mistakes occur, people can receive too much (an overpayment) or too little (an underpayment). In 2013-14 the DWP estimated that it overpaid £3.3 billion and underpaid £1.4 billion.[4] HMRC estimated it overpaid £1.3 billion on tax credits and underpaid £0.2 billion in 2013-14.

1.5 Overpayments and underpayments are undesirable. Overpaying benefits reduces the money available for other government services. Underpaying reduces the amount claimants receive, potentially causing hardship and distress. Fraud and error also creates administrative costs for departments as they try to identify and recover money that should not have been paid out.

1.6 Underpayments exclude some situations where people get less than entitled. If someone does not claim a benefit they are entitled to, this is treated as low take-up rather than an underpayment. The DWP last measured take-up in 2009, when it estimated that this ranged between 50% and 80% depending on the benefit.

4 Department for Work & Pensions, *Fraud and Error in the Benefit System 2014-15 Preliminary Estimates (Great Britain)*, May 2015.

1.7 Departments sometime describe overpayments and underpayments in different ways. For example, HMRC refers to overpayments as *error and fraud favouring the claimant and underpayments as error and fraud favouring HMRC*. When discussing fraud and error, we will use the terms 'overpayments' and 'underpayments'. However, there are some circumstances in which over- and underpayments occur for reasons other than fraud or error.[5]

Official error, claimant error and fraud

1.8 Fraud and error occurs for different reasons. People can mistakenly put the wrong information in a claim (claimant error), or can deliberately put in false information or withhold information (fraud). Departmental staff can make mistakes when checking awards or not respond quickly in processing information (official error).

1.9 The distinctions between claimant error, official error and fraud depend on benefit rules and can involve judgement. For example, defining fraud (as opposed to claimant error) can depend on assessing the claimant's intent and what it is reasonable to expect them to know or do.

1.10 DWP and HMRC use slightly different classifications for fraud and error. For example, HMRC considers that its own mistakes (official error) are very limited. This is because tax credits regulations require claimants to continually check their entitlement and HMRC believes the onus is on claimants to ensure their claims are correct. **Figure 1** compares the definitions between the two departments in more detail. However, definitions have enough common features to allow us to make meaningful comparisons.

Gross and net overpayments

1.11 Gross overpayments and underpayments show how much money is outstanding, at any point in time, due to fraud and error. The National Audit Office has used gross overpayments as the primary measure of departments' performance in tackling fraud and error. In general when we refer to fraud and error, we refer to gross estimates only.

1.12 There are several ways of trying to measure net overpayments, for example considering recoveries or offsetting underpayments. **Figure 2** describes some possible interpretations of net overpayments (or underpayments).

1.13 The most common interpretation of net overpayments is gross overpayments net of recoveries. Departments can recover many overpayments each year from claimants. Estimating overpayments net of recoveries is, however, not straightforward. For example, we could try comparing overpayments in 2012-13 with recoveries in 2012-13 but this may be misleading as recoveries in 2012-13 can relate to overpayments from previous years.

5 See our discussion of in-year overpayments of tax credits in paragraphs 1.16 and 1.17.

Figure 1

Definitions of official error, claimant error and fraud

	Department for Work & Pensions	HM Revenue & Customs
Fraud	The following three conditions apply: • the claimant does not meet basic conditions for receipt of the benefit or the rate of benefit; • it is reasonable to expect the claimant to be aware of the effect on their entitlement of providing incomplete or wrong information; and • benefit is stopped or reduced as a result of DWP's review.	Evidence the claimant deliberately set out to misrepresent their circumstances to get money to which they are not entitled.
Claimant error	Claimant has provided inaccurate or incomplete information, or failed to report a change in their circumstances promptly, but DWP assesses the claimant's intent was not fraudulent.	Claimant inadvertently provides HMRC with the wrong information, and there is no evidence that they are deliberately trying to deceive HMRC.
Official error	DWP pays the wrong amount because of a lack of action, delay or a mistaken assessment by DWP or a local authority. Data held in other parts of DWP but not applied to the claim is sometimes classified as 'official error'.	HMRC does not track official error as it believes it to be very limited. Data held by HMRC but not applied to the claim is treated as claimant error.

Source: National Audit Office review of the Department for Work & Pensions and HM Revenue & Customs information

Figure 2

Some different ways to define net overpayments

	Description	Current practice
Overpayments net of recoveries	Overpayments less recoveries of overpaid benefits from claimants. Measures could offset recoveries in the same year, or could try to apportion recoveries to the year overpayments occurred.	Departments have used such measures internally to monitor their performance. DWP has started publishing a measure of overpayments net of estimated recoveries in its 2014-15 preliminary estimates.
Overpayments net of underpayments (by individual case)	Departments can offset some overpayments and underpayments against each other when they apply to a single case.	In its estimates of gross fraud and error, DWP already nets off official error over- and underpayments against each other. It also nets off claimant error and fraud. It does not net off official error against other sources of fraud and error.
Overpayments net of underpayments (total by benefit or department)	Underpayments could be subtracted from overpayments across a department or benefit overall, to understand how fraud and error affects overall spending.	This measure of net overpayments is rarely used.

Source: National Audit Office

1.14 DWP has started disclosing an additional measure of the level of fraud and error net of estimated recoveries in its annual statistics. It believes that this helps to explain the net loss to government. DWP reduces the gross estimate of fraud and error overpayments by its estimate of money it recovers. HMRC currently has no plans to publish net fraud and error statistics.

1.15 We rarely consider total overpayments net of total underpayments. After all, the people that departments overpay are not the same as the people they underpay. One error does not offset another. Departments aim to make sure that each person gets what they should over the life of their claim.

Other overpayments of tax credits

1.16 Not all overpayments and underpayments are classified as fraud or error. The design of tax credits can mean that people can be overpaid or underpaid while still meeting entitlement rules. There are two main ways that this can happen: people can be temporarily overpaid or underpaid because of the timing of assessments and payments; or people can be overpaid or underpaid by small amounts which are disregarded by departments (see paragraphs 1.18-1.19).

1.17 In tax credits, claimants receive a provisional award based on their circumstances at the start of the year. For example, awards are based on estimates of claimants' income for the coming year. During the year, people's income can change substantially. At the year-end, HMRC identifies where it has over- or underpaid and corrects large differences. **Figure 3** gives an example of how this can happen. In 2012-13 HMRC identified £1.6 billion in overpayments of this kind.

Periods and 'disregards'

1.18 Overpayments of tax credits is an example of a more general problem in administering benefits. People's circumstances and incomes change frequently, meaning that it is not always possible to have perfect real-time assessments of their entitlement. Benefit rules allow for lags in reporting changes and adjusting awards and, in some cases, also ignore small changes in income (**Figure 4**).

1.19 Disregarded changes in income do not create fraud and error, but can still lead to an over- or underpayment. There may also be complicated interactions between benefit rules about disregards and managing fraud and error. For example, removing disregards may lead to more errors as claimants and officials struggle to update and correct claims more often.

Figure 3

Example of overpayment of tax credits

Tax credit awards are determined at the start of the year and can create overpayments (which are not fraud or error)

	Claimant circumstances	Outline of claim
Start of year	Claimant earned £10,000 in the previous tax year, and expects to earn the same in the coming tax year.	Award assessed assuming an income in the coming tax year of £10,000. Payments are then made monthly during the year.
During the year	Claimant's income rises and now expects to earn £20,000 over the tax year.	Claimant expected to tell HMRC about changes in income. HMRC only adjust the award at this point if the reported change is above a certain level (see Figure 4).
End of year	Claimant finishes tax year with total income of £20,000.	Claimant tells HMRC of new income and HMRC assesses there has been an overpayment. If the claimant is renewing a claim for tax credits for the following year, HMRC deducts the amount overpaid from future tax credit payments.

Note

1 Deductions from future tax credit payments depend on claimant circumstances and are designed to smooth recoveries over time.

Source: National Audit Office

Figure 4

Examples of assessment periods and disregards

	Assessment periods	Disregards
Tax credits	Annual assessment finalises the previous year's entitlement and estimates next year's entitlement.	HMRC ignores changes in income of less than £5,000 when finalising awards.
Pension Credit	Assessed income period lasts for 5 years during which time department does not review benefit claim.[1]	During assessed income period changes in pension income or capital would not trigger a change in the benefit claim.

Note

1 DWP will remove the assessed income period from April 2016.

Source: National Audit Office review of published benefit rules

Part Two

Measuring fraud and error

2.1 In this Part we explain how departments measure fraud and error. We consider the methods they use and what this means for the accuracy, timeliness and scope of fraud and error estimates.

Departments' methods for estimating fraud and error

2.2 The Department for Work & Pensions (DWP) and HM Revenue & Customs (HMRC) have similar but not identical methods of estimating fraud and error. In both cases, the departments test a random sample of claims and extrapolate the results to produce an overall estimate of the value of over- and underpayments due to fraud and error. DWP refers to its methodology as the 'monetary value of fraud and error' (MVFE) process, while HMRC refers to its methodology as the 'error and fraud analytical programme' (EFAP).

2.3 Departments' estimates of fraud and error are based on testing samples of actual benefit and tax credit claims. Reviewers check a sample of awards that DWP and HMRC make during the year. The reviewers check all available information held on the claimant – interviewing if necessary – to decide whether the award continues to meet eligibility criteria and the payment is still correct. **Figure 5** outlines departments' approaches.

2.4 Departments sample about 33,000 cases each year. DWP randomly selects a sample of 29,000 cases. Its internal performance measurement team tests the cases to check whether an over- or underpayment has occurred. HMRC randomly selects around 4,000 tax credit payments for testing. Internal reviewers assess the cases for indicators of risk, before writing to claimants to confirm circumstances that would affect their tax credit claim.

Figure 5

Departments' methods for estimating fraud and error

Steps	Department for Work & Pensions	HM Revenue & Customs
Initial review	• Performance Measurement (PM) review a specific week for each case sampled to determine whether there is any official error. • Heritage Benefit Systems and any information which would have been available to DWP during the review week are examined.	• The Knowledge Analysis and Intelligence (KAI) team select the sample for review. • The risk team looks for the main risks of fraud and error through interrogation of HMRC and DWP system as well as other information available.
Claimant interaction	• PM conduct face-to-face interviews with each of the claimants selected. • The purpose of the interview is to determine whether there is any indication of fraud or claimant error.	• A team in Belfast write out to each customer in the sample and request evidence to support their claim. • All documentation such as bank statements, proof of address, etc. is tested for anomalies.
Secondary review	• The Data Quality Assurance (DQA) team re-perform a sample of 4,000 cases which have been tested by PM. • If DQA do not agree with PM's assessment of error, they will agree this with the PM team and update the results accordingly.	• Quality checks are carried out by managers.
Extrapolation of results	• Fraud Error Measurement Analysis (FEMA) undertake the statistical analysis on the results to produce the fraud and error statistics	The results of the sample are extrapolated by the KAI team, which inform the fraud and error statistics.

Source: National Audit Office review

Confidence levels and significance

2.5 As DWP and HMRC measure fraud and error using a sample of claims, their estimates are uncertain. Sampling uncertainty arises when sample estimates differ from the underlying population of claims. This can happen as departments sample less than 0.1% of actual claims. There are also sampling assumptions where departments have to adjust for incomplete or imperfect data.

2.6 DWP and HMRC publish central estimates for fraud and error alongside 95% confidence intervals. This represents the range within which the true value of fraud and error is most likely to lie. For example, in 2013-14 DWP's central estimate of overpayments was £3.3 billion and the range was between £2.9 billion and £3.9 billion.[6] It is important to bear in mind these confidence intervals when comparing trends in fraud and error. A small change in central estimates may not be significant when compared with large ranges in the estimates.

6 Department for Work & Pensions, *Fraud and Error in the Benefit System 2014-15 Preliminary Estimates (Great Britain)*, May 2015.

2.7 The existence of uncertainty does not, however, mean that central estimates are useless or misleading. Central estimates are the best estimate departments have of fraud and error overpayments. They can be a useful source of information when making decisions, despite uncertainty. In our commentary on departmental accounts and our value-for-money reports we often discuss central estimates to describe levels and trends in fraud and error. For example, in our report on *Housing Benefit fraud and error* in October 2014 we discuss ways to assess how significant changes in central estimates are.[7]

Time lags

2.8 Fraud and error statistics take time to produce. It takes departments time to select and check the sample of benefit claims, as they need to get the information that would have been available when the claim was paid. This creates a time lag between the end of the financial year and publishing fraud and error statistics.

2.9 The rules of different benefits also affect how long it takes to measure fraud and error. DWP produces preliminary estimates in May following the financial year end, based on partial information. It releases final estimates in November. HMRC releases its fraud and error statistics 14 months after the financial year-end for tax credits. HMRC has to finalise tax credit awards at year-end before it can check whether claims are correct. **Figure 6** sets out the timeline for both departments.

2.10 One important consequence of lags in measurement is the difficulty of assessing the impact of initiatives to tackle fraud and error. Departments often rely on proxy measures of impact and these may not reflect lasting improvements in the monetary value of fraud and error.

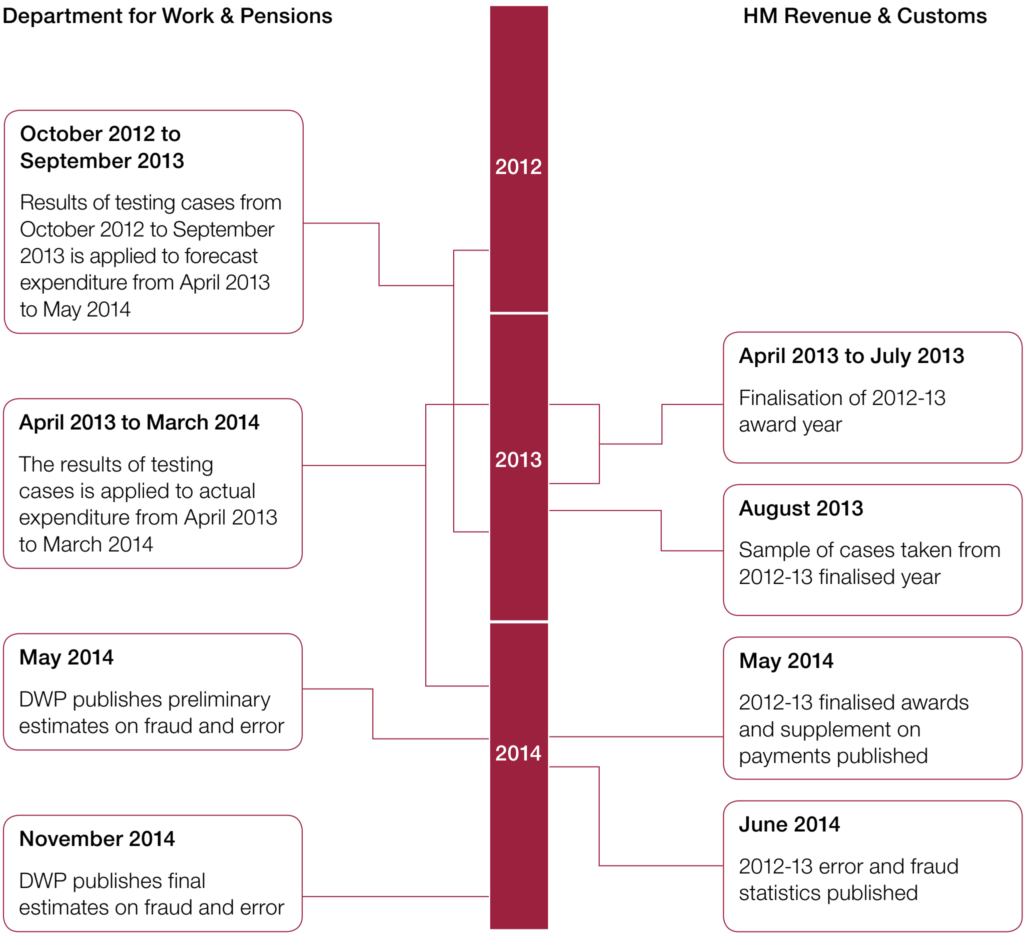
Frequency of measurement

2.11 DWP does not measure fraud and error in every benefit every year. In some cases it estimates fraud and error using occasional samples and assumes how fraud and error changes in intervening years. For example, DWP last measured Disability Living Allowance in 2004-05 and bases current year estimates of fraud and error on this historic result. DWP occasionally estimates the level of claimant error and fraud for about 60% of all its benefit expenditure.

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

Figure 6

Timeline for producing fraud and error statistics



Notes

1 DWP based preliminary estimates, published in May 2014, on testing cases from October 2013 to September 2014. It applies results of testing to forecast expenditure from April 2014 to March 2015. DWP based final estimates, published in November 2014, on testing cases from April 2013 to March 2014. It applies results to actual expenditure from the 2013-14 financial year.

2 HMRC published the final awards and supplement on payments in May 2014, however they are for the 2012-13 award year. These results are for claimant numbers and overpayments, which it does not classify as fraud or error.

3 HMRC based its fraud and error statistics, published in June 2014, on the 2012-13 award year. Finalising the award year happens between April and July after it begins point-sampling and testing.

Source: National Audit Office review

2.12 DWP does not conduct an annual review of the level of fraud and error in some benefits that it considers to be lower value or risk. In some instances, it uses a proxy measure to estimate the fraud and error. For example, for Personal Independence Payments, DWP applies the rate of fraud and error for Disability Living Allowance to the current year's expenditure. Unreviewed benefits account for about 10% of overall spending on DWP benefits. **Figure 7** describes how often departments measure fraud and error in different benefits. In determining the method of measurement, the Department makes judgements about how best to focus its measurement resources, also considering changes to the benefit system.

Figure 7

Frequency of measurement

Benefit	Frequency	Last measured	Next measured
Housing Benefit	Annual	2013-14	2014-15
Jobseeker's Allowance	Annual	2013-14	2014-15
Income Support	Annual	2013-14	2014-15
Employment and Support Allowance	Annual	2013-14	2014-15
Pension Credit	Annual	2013-14	2014-15
State Pension (mistakes by departments only)	Annual	2013-14	2014-15
Disability Living Allowance	Occasional	2004-05	n/a
Personal Independence Payment	Unreviewed	n/a	2015-16
Attendance Allowance	Unreviewed	n/a	n/a
Carers Allowance	Occasional	1996-97	n/a
Tax credits	Annual	2013-14	2014-15
Child Benefit	Annual (unpublished)	2013-14	2014-15

Notes

1 DWP expects to publish final 2014-15 results in November 2015. HMRC will publish 2014-15 results in June 2016.

2 Income Support will no longer be measured annually after the 2014-15 preliminary estimates.

Source: Departmental publications

Classifying causes of fraud and error

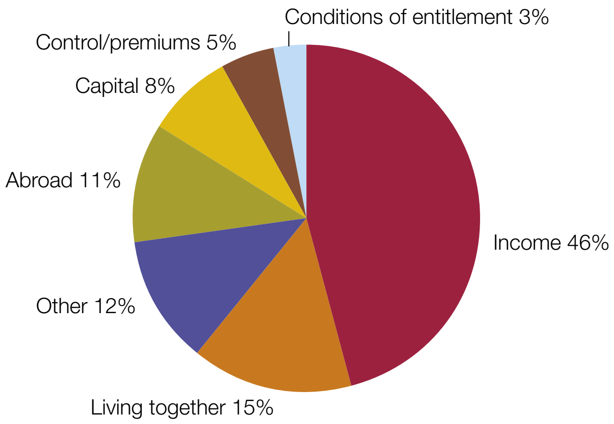
2.13 Fraud and error can be caused by many different things. The departments identify the causes of fraud and error as part of their annual estimation exercises. **Figure 8** shows the main reasons for fraud and error overpayments across benefits and tax credits.

2.14 In tax credits, the biggest cause of claimant error is a person failing to tell HMRC that they have a partner. A person who is cohabiting but claims to be single may understate total household income. This leads to an incorrect assessment of that person's circumstances, and they may get more money than they are entitled to.

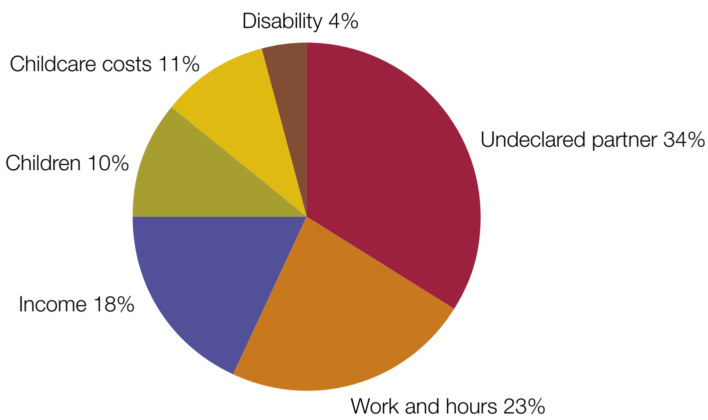
Figure 8

Main causes of fraud and error in benefits and tax credits, 2013-14

Department for Work & Pensions benefits



Tax credits



Source: National Audit Office analysis of departmental information

2.15 Most claimant error in DWP benefits relates to claimants' income. Income comes from many sources: not just salary, but other benefits, pensions or sources such as rental income. If a person fails to declare all income and savings, the department may calculate their award wrongly and pay the claimant more than they are entitled to.

2.16 This information gives an important insight into how fraud and error has occurred. There are, however, some limitations with the data. For example, smaller sample sizes for some type of fraud and error mean that estimates of the reasons for overpayments are subject to greater uncertainty. Some claims may also have multiple causes of overpayments.

2.17 We have begun to assess how departments are tackling different causes of fraud and error. By knowing the reasons for fraud and error, and the trends, we can assess whether departments are targeting the biggest areas of overpayments. In forming our judgements, we can also consider the relative difficulty of tackling the risk, taking into account the availability of information to confirm claimants' circumstances.

Auditing fraud and error

2.18 The Comptroller and Auditor General (C&AG) issues opinions on departmental accounts. In addition to commenting on whether accounts are 'true and fair', he is required to determine whether spending is in accordance with Parliament's intent. Fraud and error is one reason why departmental spending might not be 'regular' and so affects the C&AG's opinion.

2.19 To support the C&AG's opinions on the accounts, we review the departments' measurement methods and re-perform a smaller sample of benefits and tax credits assessments and calculations. We check we agree with the conclusions reached by each department's own fraud and error measurement teams. We also comment on emerging trends and efforts by the departments to tackle the main causes of overpayments. For example, our 2013 tax credits report found that HMRC had reduced fraud and error in three areas, but made little progress in two others.

2.20 The C&AG has issued qualified opinions on DWP's accounts since 1988-89 and on HMRC's accounts since 2003-04 when the current tax credits scheme began. Besides auditing departmental accounts, we conducted several value-for-money reviews of fraud and error in benefits and tax credits. We also reviewed tax credits fraud and error in our annual *Standard Report* on HMRC's accounts.

Part Three

Managing fraud and error

3.1 In this Part we cover some of the main issues affecting how departments manage fraud and error. We consider: the stages at which fraud and error occurs; the ways departments can use information to identify incorrect claims; and how departments can deter fraud and error and measure the impact of their interventions. We also outline the Housing Benefit subsidy regime and how it affects incentives to manage fraud and error.

When fraud and error occurs – 'new claims' and 'changes in claimants' circumstances'

3.2 Fraud and error can occur at any point during a claim. For example, in a new claim a person may not give the right information on the application form (intentionally or by mistake). Or the department may not process the claim properly. Equally, fraud and error can occur after the department has started paying a claim if the person does not notify their altered circumstances promptly or at all, or the department does not process a reported change properly.

3.3 Complexity in the design of benefits can also lead to fraud and error. People must keep their personal information up to date. Claimants are responsible for notifying departments when their personal circumstances change. Otherwise changes, such as in earnings, can lead to error and fraud. If the departments do not make it clear to claimants their responsibility to do this, genuine errors can occur. But the inconvenience of reporting changes can also lead to fraud.

Data-matching

3.4 Departments ask claimants to provide information to check they are entitled to claim, and to calculate the value of their award. The information needed depends on the scheme rules. Departments check this information against data they already hold on the claimant.

3.5 Departments use their data to check the information provided by claimants in two ways. Departmental staff access the information when checking new claims, information reported by claimants or when renewing claims. Departments can also run exercises to check whether the information they hold on claimants is still accurate. They do this by matching the data they hold on claimants against other information sources.

3.6 Departments are seeking extra sources of data to check what claimants tell them. Other government departments or private sector companies may hold relevant information. This information may be valuable, but there are restrictions and controls in getting and using new sources. For example, data protection and sharing legislation can prevent bodies exchanging personal data, or the data may not be in a format that is readily usable. Poor-quality data can also create unproductive work if departments spend time checking claims that are not wrong.

Recoveries and penalties

3.7 Fraud and error does not necessarily result in a permanent loss to public finances. When a department identifies and stops an overpayment, the person may have to pay it back. Departments seek to recover money that the claimant was not entitled to. They can do this by reducing current benefit payments or seeking to directly recover the overpayment if the claimant is no longer on benefits. **Figure 9** summarises the differences between departments in their recovery of overpayments.

Figure 9

Recoveries and penalties

	Department for Work & Pensions	HM Revenue & Customs
What departments can recover when overpayments occur	Ordinary overpayments: up to £11.10 a week. Fraud overpayments: up to £29.60 a week.	10% to 25% from ongoing tax credits claims, depending on circumstances. Up to 100% is recoverable in some cases.
Penalties available	£50 civil penalty. Administrative penalty of up to £5,000 in fraud cases. Penalties vary by benefit and depend on the offence. Loss of benefit periods range from 4 weeks to 3 years.	Penalty of up to £3,000 in cases of fraud and negligence. Penalty of £300 for failure to comply with some requirements of tax credits scheme rules. Loss of Working Tax Credits periods range from 4 weeks to 3 years
Level of overpayments recovered	£900 million (2014-15).	£967 million (2014-15).

Source: National Audit Office review of departmental information

3.8 In addition to recovering overpayments, Departments can penalise or prosecute claimants who are negligent, knowingly make a false claim or fail to notify a change that they are required to report. In some cases, departments will stop claimants' awards for a period of time, depending on the nature of the offence. The penalties that are applied vary by benefit.

3.9 Departments incur administrative costs in seeking to recover overpayments. And not all of the overpayments are recovered. Departments therefore balance efforts to stop overpayments from happening with activities to identify and correct overpayments that have occurred. HMRC and DWP have adopted different approaches.

Estimating losses prevented and savings

3.10 One challenge for departments is in assessing the impact of their initiatives to tackle fraud and error. Because annual measures of fraud and error are imprecise and subject to time lags and a wide range of external factors, it can be difficult for departments to isolate the impact of a specific initiative.

3.11 Departments typically develop proxy estimates, which they call losses prevented or savings (**Figure 10** overleaf). Both departments consider the overpayments identified during an intervention, and then make assumptions about how long claims would have remained incorrect in the absence of the intervention. For example, HMRC might assume that a tax credits claim would remain incorrect until it was renewed at the end of the tax year.

3.12 Estimates of savings and losses prevented are indirect measures of the impact of departments' initiatives on fraud and error. This means that later estimates of fraud and error may contradict early indications of the apparent success of an intervention due to the different methodologies involved. Both HMRC and DWP have continued to develop methodologies for estimating the impact of their initiatives. For example, HMRC has refined its approach to estimating losses prevented in response to later fraud and error estimates.

Figure 10

Methods for estimating losses prevented

	Department for Work & Pensions	HM Revenue & Customs
Estimate	Annually Managed Expenditure savings.	Net losses prevented.
Coverage	Projects included in the fraud, error and debt programme only.	All activities tackling fraud and error.
Description	Estimates additional savings to the public purse delivered by the projects.	Estimates losses prevented in the current year, including fraud and error overpayments which have already occurred in the year.
Basic calculation	**Savings** = future overpayments prevented + past overpayments that are recoverable – overpayments that would have been detected and recovered anyway.	**Gross losses prevented** = total current award year loss x proportion of loss not identified as in-year overpayment at finalisation x proportion of corrected fraud and error claims remaining correct to the end of the award year.
Current assumptions	Average duration of overpayments based on national statistics and debt management data. Detected overpayments assumed to be found, on average, halfway through their lifetime.	Only considers current tax year losses so may underestimate losses prevented.
Attempts to improve calculation	Using debt management data to improve estimates of overpayment durations. Developing ‘stock and flow’ model to assess duration of overpayments.	Removed deterrent effect in 2013. Annual analysis for proportion of losses prevented that claimants would have reported at finalisation. Annual analysis to improve estimate of likelihood of award remaining correct following intervention.

Notes

1 ‘Stock and flow’ model calculates the stock of live overpayments in the system at any point by accounting for the inflows of new overpayments and the off-flows of existing overpayments from one month to the next.

2 DWP uses the methodology described here for most initiatives. Savings that relate to sanctions and penalties that are not annually managed expenditure are calculated using a different methodology.

Source: National Audit Office analysis of departments’ documents

Housing Benefit subsidy regime

3.13 One mechanism that has an indirect effect on fraud and error is the Housing Benefit subsidy regime. The subsidy regime is primarily designed to reimburse local authorities for Housing Benefit payments, but it does have some controls over fraud and error. The interaction between the subsidy regime and fraud and error can be a source of potential confusion.

3.14 Local authorities pay Housing Benefit to claimants. DWP then reimburses them. DWP uses the subsidy process to repay local authorities for paying the correct amount of Housing Benefit to claimants. Local authorities record details of claims in a subsidy form, including whether it has identified overpayments and if they were claimant or official error. This is not a formal measure of fraud and error – as it only tracks fraud and error which local authorities have already identified.

3.15 The aim of the subsidy regime is to repay local authorities for the correct amount of Housing Benefit paid. It was originally introduced as part of a wider regime of incentives to encourage local authorities to manage Housing Benefit correctly. The subsidy process and reimbursement rates create incentives for local authorities to tackle fraud and error. It encourages local authorities to process claims accurately and recover any overpayments. But the subsidy process does not create strong incentives for local authorities to find fraud and claimant error in claims that are in payment.

Appendix One

National Audit Office reports

Figure 11
National Audit Office reports on fraud and error in benefits and tax credits

Report	Date	Reference
Housing Benefit fraud and error	October 2014	HC 720, 2014-15
Tackling tax credits error and fraud	February 2013	HC 891, 2012-13
Reducing losses in the benefits system caused by customers' mistakes	January 2011	HC 704, 2010-11
Minimising the cost of administrative errors in the benefits system	November 2010	HC 569, 2010-11
Progress in tackling benefit fraud	January 2008	HC 102, 2007-08
International benchmark of fraud and error in social security systems	July 2006	HC 1387, 2005-06
Tackling benefit fraud	February 2003	HC 393, 2002-03

Source: All National Audit Office reports are available at www.nao.org

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