



House of Commons
Public Administration
Select Committee

**Tax Credits: putting
things right:
Government Response
to the Committee's
Second Report**

**Fourth Special Report of Session
2005–06**

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The Public Administration Select Committee

The Public Administration Select Committee is appointed by the House of Commons to examine the reports of the Parliamentary Commissioner for Administration, of the Health Service Commissioners for England, Scotland and Wales and of the Parliamentary Ombudsman for Northern Ireland, which are laid before this House, and matters in connection therewith and to consider matters relating to the quality and standards of administration provided by civil service departments, and other matters relating to the civil service.

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The following Member was also a member of the Committee for part of this inquiry: Julia Goldsworthy MP (Liberal Democrats, Falmouth and Cambourne)

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Publications

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Committee staff

The current staff of the Committee are Eve Samson (Clerk), Clive Porro (Second Clerk), Lucinda Maer (Committee Specialist), Phil Jones (Committee Assistant), Sue Holt (Secretary) and Louise Glen (Senior Office Clerk).

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Fourth Special Report

The Public Administration Select Committee reported to the House on *Tax Credits: putting things right* in its Second Report of Session 2005–06, published on 29 January 2006 as HC 577. The Government's Response to the Report was received on 30 March 2006. On 20 March 2006 we also received a letter from Sir David Varney, Chairman of HM Revenue & Customs responding to some additional queries from Dr Tony Wright MP, following the evidence session on the Ombudsman's Report into Tax Credits on 20 October 2005. These documents are appended to this report.

Appendix 1

Tax Credits: putting things right: Government Response to the Committee's Second Report of Session 2005–06

We welcome the Revenue's willingness to look at the Ombudsman's recommendation to introduce a pause before starting recovery of overpayments. However, we are concerned that, not for the first time, a government department is presuming to define what constitutes maladministration. Moreover the Revenue seems to suggest that protection of the public purse overrides other considerations, including fairness. Public services cannot be designed or delivered without regard to costs but an unfair system, while it may well be cost-effective, cannot be said to constitute good public administration. (Paragraph 19)

The department believes that automatic recovery represents the only practical and efficient way to administer a system of this size and, given that the vast majority of overpayments are properly recoverable, believes that the practice is fair. It has sought to address concerns by introducing new procedures that enable it to stop recovering an overpayment if a claimant lodges a dispute. In such cases it will not recommence recovery until it has made a decision based on the facts of the particular case. It is also improving the quality of the information given to claimants to explain the circumstances in which recovery of overpayments may be waived.

The department has agreed to look at the proposal for a pause. However, introducing it would mean a major structural change to the operation of the tax credits computer system and the department is examining whether it can be done without jeopardising the stability of the system.

We are concerned that the IT system which is supposed to enable an efficient delivery of the scheme has in fact been a root cause, first of creating some of the problems which have led to the criticism and complaints about the scheme and then of acting as a barrier to resolving them quickly. Careful consideration needs to be given to the design of future government IT-enabled schemes so that it is the needs of the customer rather than the limitations of the technology which are paramount. (Paragraph 22)

There were some well-publicised problems following the introduction of new tax credits when the IT system did not perform as required or expected. Since that time the

department has contracted a new IT supplier and significant progress been made dealing with past problems and stabilising the IT system. Looking ahead the department is planning further improvements to the IT system. However, having established the system's integrity and significantly improved its performance, the priority is to ensure that progress takes place in a measured and orderly way.

The Office of Government Commerce works with the public sector to achieve efficiency, value for money and effective delivery of Government projects. This includes identifying and addressing systemic issues that occur in the acquisition and implementation of Government IT-enabled projects and promoting best practice.

We are concerned that the consolidation of the tax and benefits systems represented by the tax credit scheme and the consequent transfer of functions from DWP does not appear to have resulted in any assessment on the part of the Revenue about the nature, and the needs, of this particularly vulnerable group among tax credit recipients for whom regular and reliable payment is not a desirable budgeting convenience but a real necessity. (Paragraph 27)

Many of the Department for Work and Pensions staff involved in the delivery of the Working Families and Disabled Persons Tax Credits transferred to Inland Revenue and the government was able to build on their experience, consulting with voluntary groups, to help it understand the needs of more vulnerable claimants. However, in line with its commitment when tax credits were announced in 2002, the Government has sought to learn from the early operation of the system and will continue to do so.

The package of administrative measures set out in the Paymaster General's written statement of 25 May 2005 and the subsequent package of measures announced in the 2005 Pre-Budget Report are based on HMRC's experience of the first two years of operating the system.

To further improve its understanding of the needs of claimants HMRC seeks to access the insights and customer focus of the voluntary and community sector to help improve its understanding of customers' needs, particularly the most vulnerable. HMRC is also developing plans with the Citizens Advice Bureau to run a series of pilots to test how it can support these claimants better.

It is deeply worrying that a scheme such as this one has such unsophisticated means for reconstructing individuals' records. It is essential that any public service scheme which involves a history of transactions between individuals and a department should have at its base adequate case-handling capacity, whatever technology it uses. (Paragraph 30)

We have put in place a system for enabling our staff to have easy access to recordings of telephone conversations between claimants and our help-line staff. This is helping them to assemble more quickly the case history and reach decisions. In the longer term, we are looking to improve our technology to provide better summary screens for our staff to show them what has happened with each case more easily.

We welcome the Revenue's review of the reasonableness test and support the need for a solution modelled on the well-established social security benefits. (Paragraph 34)

In the tax and tax credits system, like the social security system, there is a statutory right of appeal against decisions on entitlement which turn on matters of fact, but no appeal against the use of discretion. HMRC and DWP have almost identical policies on recovering overpayments caused by official error, although DWP have recently applied the “reasonableness test” differently.

A new version of HMRC's Code of Practice 26 “What happens if we have paid you too much tax credit?” will be published in April 2006. This will clarify the reasonableness test, providing a clear statement of what a claimant is expected to check on their Award Notice. To supplement the revised code and help build confidence in decision making, HMRC is considering with the adjudicator whether it would be possible to provide a fast-track, independent review of decisions to recover overpayments in disputed cases.

Appendix 2

Letter to Dr Tony Wright MP, Chairman of the Public Administration Select Committee, from Sir David Varney, Chairman of HM Revenue & Customs, dated 20 March 2006

You wrote to me on the 8th December raising some additional queries following the PASC hearing into The Ombudsman's Report into Tax Credits on the 20th October, 2005. Please accept my apologies for the delay in replying.

For clarity, I have listed the questions in order, followed by my response.

At Q173 you were asked “Can you tell us the number of overpayments resulting from Revenue errors?” You referred the Committee to the Standard Report on the Accounts. The Committee would like to know whether there is now any further information about the proportion of errors caused by a) Revenue staff error, b) software errors and c) customer error and omissions respectively and their respective financial quanta? If not, what steps are being taken to gather and report such information?

It is difficult to ascribe every error to the particular categories mentioned. In some cases—for example where there has been a particular computer problem—we can assess the size of the error and ascribe it to a particular cause. The following details provide an overview:

- (a) The accuracy of the Department's processing of tax credit awards was 96.5% in 2004-05 (78.6% in 2003-04) against a Public Service Agreement target of 90%.
- (b) The Comptroller & Auditor General's reports on the Inland Revenue accounts for 2003-04 and 2004-05 provide details of software errors. These gave rise to write-offs made centrally of £37m in 2003-04 and £1.85m in 2004-05. In addition, where software errors which resulted in overpayments were corrected, some further write-offs will be authorised in instances where it was not reasonable for claimants to have detected the error. More recently, the Department was able to quantify accurately the impact of three other software errors that had led to overpayments mainly relating to 2003-04. As a result write-off of a further £44.85m has been authorised. This write-off will be included in HMRC's 2005-06 accounts. The

Department has ongoing processes in place to detect and, where necessary, quantify the financial impact of software errors.

- (c) To produce a reliable estimate of the level of claimant error and fraud the Department is examining approximately 4,700 randomly-selected 2003-04 awards to determine whether any non-compliance has occurred and whether this non-compliance was deliberate or resulted from simple negligence. This approach is in line with that used by DWP for benefits and by the IRS in the US for their Earned Income Tax Credit (EITC). Progress on this exercise will be reported when final results from it are available.

You say in your statement that the £71.25 million settlement is “commensurate” with EDS’s responsibility for the IT problems surrounding the launch of the Tax Credit System. But the report to which you referred the Committee suggests that software errors resulted in overpayments of £94m in 2003-04 and £7.9m in 2004-05, in addition to “various other incorrect payments” and, presumably, to the cost of a far more extensive customer support operation than originally planned. Some press reports state that EDS was paid £168m for the project. Is this correct? If so, is it reasonable to assume that software failure and inadequacy accounted for nearly half the difficulties in the tax credit system?

After many months of detailed legal and forensic accounting analysis, we were able to identify a loss legally attributable to EDS failures of £104 million after taking account of overpayments being recovered from claimants and other acts of mitigation.

Our assessment of the maximum amount we could recover from EDS had to take into account the “limitation of liability cap” under the contract which limited damages to a maximum of £31 million “per event of default”. The number of events of default would have been the subject of considerable argument in any legal proceedings, with EDS proposing a single event and HMRC arguing for three or more. Even if HMRC had succeeded with its arguments, it was clear that not every event of default would have involved the maximum amount of £31 million.

In considering the settlement offer, HMRC looked for precedents for settlements in software-related cases in the public sector and elsewhere. We could not find any situation in which an IT company had made a compensation payment to a UK government customer of a similar magnitude to that eventually obtained by HMRC from EDS.

Against this background, and given the settlement avoided at least two years litigation, which would have been very costly both in money and senior management time, we believe the settlement of £71.25 million represents a very satisfactory outcome.

How far were the initial problems over the launch of the Tax Credit scheme due to bad systems design? Did this make the problems over the IT system inevitable?

The initial problem with the IT system to support Tax Credits arose from poor system architecture, poor software coding and the use of EDS staff who had not been fully trained.

We have stabilised system availability and performance and we continue to enhance its functionality in periodic software releases. We also continue to look for ways of improving the design of the system through our new IT suppliers, Capgemini.

Did the Revenue work with EDS to design the system, or simply define its requirements at the outset?

The Revenue did not work with EDS to design the system; its role was to define requirements.

What consideration was given to the users and client base of the New Tax Credit system in drawing up the systems design and procurement specification?

The System design was informed by the initial policy consultation. Pilots were also conducted to understand how customers would cope with forms, processes and portal services, which informed the design. Detailed walk through exercises to test customer experience, and revise accordingly, were held at all major stages.

The needs of our system users were established through model office testing, as well as business testing of IT with business processes.

Were there extensive changes in the specifications of this system during the development process?

As is normal with a project of this sort there were changes to the system requirements as the development process progressed. EDS were given the opportunity to object to any requested change on the basis that it was too late or not deliverable.

How long did it take for the IT system to become stable? Was EDS paid to supply the software fixes the revenue found necessary? How many fixes were needed as a result of initial IT faults, and how many changes in Revenue operational requirements?

The IT system was stable and performing to availability and other service levels by autumn 2003. Large numbers of fixes and process workarounds were needed because of IT problems. These were fixed by EDS with no additional payment.

When you gave evidence to us, you told us you would not be able to produce an automatic pause between the recalculation of tax credits and the recovery of overpayments until 2007; Is it usual to have an IT system which is so difficult to adjust?

The department has agreed to look at the proposal for a pause, however, having established the system's integrity and significantly improved its performance, the priority is to ensure that progress takes place in a measured and orderly way. We continue to look for ways of improving the flexibility of the system alongside our new IT suppliers, Capgemini.

What sorts of governance arrangements were put in place to oversee delivery of the new scheme and the associated IT system? Did such arrangements include external or independent assessors?

A full programme structure was put in place in line with best practice and OGC guidance. This included board level involvement and independent reviews undertaken by OGC through their Gate processes. In addition, IR commissioned an external review by Deloitte

in the early months of 2003-04 when the system problems emerged which resulted in an agreed action plan.

How important is it to have an “intelligent customer” capacity when designing and producing new business critical systems? How is this intelligent customer function being discharged at present and how was it discharged at the time of the EDS contract?

It is very important. It is a key plank in the reforms our new CIO is making with the engagement of experts to ensure we can articulate our needs effectively to our new IT supplier, Capgemini, and validate IT changes proposed by them against the latest technology industry standards. We see ourselves as owning the IT strategy for HMRC and not being dependent on the supplier for that.

This differs to the arrangements in place in 2003 when former IR relied heavily on EDS for this role.

Why was not enough time given to testing the new IT system? What measures have been put in place with your current partners to avoid a repetition of these problems?

Testing was undertaken accordingly, to plans put forward by EDS.

With Capgemini, we have a new testing strategy that adheres to latest industry standards. Recent software releases have been implemented successfully.

Reports from the Public Administration Select Committee since 2005

The following reports have been produced during the current session.

Session 2005–06

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|-----------------------|---|---------|
| First Report | A Debt of Honour | HC 735 |
| Second Report | Tax Credits: putting things right | HC 577 |
| Third Report | Legislative and Regulatory Reform Bill | HC 1033 |
| First Special Report | The Attendance of the Prime Minister's Strategy Adviser before the Public Administration Select Committee | HC 690 |
| Second Special Report | Ministerial Accountability and Parliamentary Questions: Government Response to the Committee's Fifth Report | HC 853 |
| Third Special Report | Inquiry into the Scrutiny of Political Honours | HC 1020 |