



House of Commons
Committee of Public Accounts

**Inland Revenue: Tax
Credits**

**Fourteenth Report of
Session 2003–04**

*Report, together with formal minutes,
oral and written evidence*

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The Committee of Public Accounts

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The following was also a member of the Committee during the period of this inquiry.

Mr Nick Gibb MP (*Conservative, Bognor Regis and Littlehampton*)

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Summary

The Working Families' and Disabled Person's Tax Credit schemes administered by the Inland Revenue (the Department), ran from 1999 to 6 April 2003 distributing some £6.4 billion in 2003–03 and £17.8 billion in all.¹ The Government replaced these schemes with new tax credits from April 2003 which are estimated to cost about £16 billion in 2003–04. The introduction of the new scheme has brought a number of problems for several hundred thousand claimants who were not paid on time, for employers who made some of the payments and for the Inland Revenue. The problems were due in large part to deficiencies in IT systems.

The Department examined samples of 2000–01 tax credit applications and estimated the level of overpayments at between 10% and 14% by value, equivalent to between £510 and £710 million for a full year. The Department did not disclose these results until August 2003. As the procedures were not changed significantly in subsequent years, it is reasonable to assume overpayments continued on broadly the same scale.²

On the basis of a Report by the Comptroller and Auditor General we examined the Department on responsibilities for the problems with the new tax credit system and lessons to be learned; errors and overpayments of tax credits; and compensation for claimants and recovery of overpayments of tax credits.

1 C&AG's Standard Report on the Accounts of the Inland Revenue 2002–03 (HC 1072, Session 2002–03) para 9

2 *ibid*, paras 6, 8

Conclusions and recommendations

- 1. The Department should have been more cautious and realistic in fixing the timetable and assessing the resources needed for setting up and testing New Tax Credit assessment and payment procedures and checking claims.** Their failure to do so has had serious financial consequences for many thousands of citizens and caused disruption for other areas of work for the Department. To the extent that these large complex systems were intrinsically not capable of testing sufficiently to eliminate such problems, the Department should have devised more comprehensive contingency arrangements.
- 2. New Tax Credits is one of a series of major IT systems that have caused serious problems, other notable cases being the National Insurance Recording System (NIRS2) and the Passport Office system.** Since the Committee's hearing, the Office of Government Commerce have updated their Gateway review guidelines. The Office of Government Commerce should analyse the weaknesses of IT partnering arrangements that have run into problems and draw together experience, best practice and guidance with the aim of helping departments to understand better how to manage the problems inherent in such partnering relationships.
- 3. The level of errors in tax credit payments is unacceptable at 10% to 14% by value.** The Department said that they expected an immediate halving of error rates with the introduction of New Tax Credits. They should take all necessary steps to achieve this predicted reduction, including comprehensive cross checking to other departmental information sources, set quantified targets and timescales for further reductions and report their performance against these targets.
- 4. The Department preferred not to launch a campaign to draw attention to compensation available for claimants who suffered as a result of the system problems.** They saw their compensation arrangements for claimants as being voluntary and spontaneous. The Department should monitor the effectiveness of their arrangements and, if the number being compensated in this way is unrealistically low, target such a campaign at those likely to have been most disadvantaged.
- 5. The Inland Revenue should explain to those affected how recovery and non-recovery of overpayments of tax credits will take account of implications for other benefits.** They should clarify the main interdependencies of tax credits and other benefits, such as Housing Benefit, which are the responsibility of the Department for Work and Pensions. Both Departments should operate to a coherent and consistent policy that is equitable for those who were affected by New Tax Credit delays and errors in 2003 and those who are affected in the future.

1 Problems with the new Tax Credit system

1. The Government introduced Child Tax Credit and Working Tax Credit for payment from April 2003 and received some 4.5 million applications by the end of June 2003. These two tax credits are expected to cost some £16 billion per year. The Department's IT service provider, EDS, created a new IT system for processing the new tax credits. It links to other Inland Revenue databases and exchanges data electronically with the Department for Work and Pensions to help check tax credit claim forms.³

2. The Office of Government Commerce have a government-wide role for advising Departments on IT projects and they conduct Gateway reviews during major IT system developments. In December 2002, the Gateway 4 review, "Readiness for Service" described the new tax credit programme as "an exemplar of good programme management", while noting that a large amount of work remained against a tight schedule. The implementation of new tax credits was overseen by a Programme Board, chaired by the Inland Revenue, with senior representation from the Department for Work and Pensions and EDS. The Board received regular progress reports from Inland Revenue and EDS teams and monitored progress in implementing the projects.⁴

3. When the new tax credits schemes went live for payment in April 2003, problems with the IT systems resulted in several hundred thousand claimants receiving payments after they fell due, while the Department were unable to reconcile payments made with amounts authorised.⁵

4. Analysis of the technical problems by EDS and "tuning" the system to perform more reliably took several weeks. EDS did not achieve a stable system until after 10 weeks of live operations.⁶ In July 2003 the Department engaged consultants to conduct a review to provide independent assurance about the analysis of the technical problems and the action being taken to address them. The Department's consideration with EDS of the underlying technical problems had to have regard to the discussions between them about compensation for the unsatisfactory performance of the system and the possibility of legal action. For the past two years, EDS have also been re-competing for the Department's overall IT service provision, in a project called ASPIRE.⁷ The Department announced on 11 December 2003 that Cap Gemini Ernst & Young (CGEY) had been selected as the Department's preferred supplier for the ASPIRE Contract, rather than the consortium that included EDS.

5. The C&AG's Report recorded the view of the Department and EDS about the testing of the new tax credits systems in the following terms: — *They had worked together with other parties involved, on testing to make sure that key functions needed for April were*

3 C&AG's Report, paras 3.1, 3.7

4 *ibid*, paras 3.8–3.9

5 *ibid*, para 3.21

6 Q 74

7 C&AG's Report, paras 3.11–3.12

*ready. This was a complex task. To ensure robust IT functions were available at the time they were needed, the testing strategy was to prioritise the functionality needed first, and to delay less urgent testing. The period of instability in the early months of the live service was caused by queues building up in the channels between system components. The causes of these queues were not detected during testing. The nature of the particular testing regime meant that the underlying technical faults could not have been discovered and corrected in testing although more testing might have reduced the effects of some of the problems.*⁸

6. The Department and EDS had not foreseen that the new tax credit systems would prove unstable and not fit for purpose. EDS recognised the disruption that was caused within the Department and the pain in the country at large, and they deeply regretted the consequences of the system instability. They prioritised the testing to make sure that they could get tax credit payments to people and the testing that was undertaken did not identify the problems that eventually resulted.⁹

7. The Department relied on advice from EDS as to what was feasible. EDS gave the best advice they had at the time, but it proved to be wrong and they accept responsibility for their advice and for the IT systems being unstable. EDS accepted that the instability contributed to the overall New Tax Credit problems and that they shared some responsibility with the Department.¹⁰

8. EDS emphasised that the project was one of the most challenging the Government had ever undertaken and that the timetable had been compressed. There was a six week delay while the rules for calculating tax credits were finalised. The 19 week system testing window had been cut significantly. In particular the volume testing timetable was cut from 12 to 4 weeks because EDS had to solve problems with National Insurance numbers. Both EDS and the Department considered that the compressed timetable had adverse consequences for the project.¹¹

9. EDS said that if they had been aware during the testing period that they would have the problems which eventually resulted, they would have advised the Project Board not to go ahead with the system. Likewise if the Department had had any indication that the system would not be fit for purpose they would have advised Ministers to invoke the contingency arrangements.¹²

10. In their partnership with EDS, the Department had been concerned not to duplicate the functions of EDS. With the benefit of hindsight, they have looked at what went wrong with the New Tax Credits systems. For the forthcoming tax credit system extension they have retained Deloitte and Touche to work for the Department to make them a more intelligent customer.¹³ The Department and EDS are also considering what

8 C&AG's Report, para 3.13

9 Qq 2, 15, 22

10 Qq 24, 65, 175

11 Qq 74, 19, 42

12 Qq 152–154, 88

13 Q 45

lessons can be learned about technical system design and testing strategy, including the effects of a compressed testing timetable.¹⁴

11. This Committee and our predecessor Committees have criticised on several occasions major IT systems and developments, including the National Insurance Recording System (NIRS2) and the Passport Office system, both of which involved partnerships with IT suppliers. The problems with NIRS2 showed the dangers of setting too tight a deadline for implementing the Pensions Act 1995 and not properly assessing the effect on NIRS2 of changes to pensions and national insurance legislation.¹⁵ The Passport Agency were far too optimistic in assuming that their new system, involving substantial changes in working methods, could be implemented over a few months without detriment to services.¹⁶

12. The Department transferred many staff from other work to deal with the problems with new tax credits. They subsequently revised their business plans and made arrangements to catch up on the backlogs where possible. They have not quantified the overall cost of what went wrong or the opportunity cost, but consideration of those matters will inform their negotiations with EDS over the scale of compensation. The Department believe that their contract was robust and they hope to negotiate a reasonable level of compensation without litigation.¹⁷ For their part EDS acknowledge that they have some responsibility for the problems that were caused when new tax credits went live. Discussions on compensation were continuing at the time of the Committee's hearing in December 2003.

14 C&AG's Report, para 3.13

15 38th Report from the Committee of Public Accounts, *NIRS 2: Contract Extension* (HC 423, Session 2001–02)

16 24th Report from the Committee of Public Accounts, *The Passport Delays of Summer 1999* (HC 208, Session 1999–2000)

17 C&AG's Report, para 3.14; Qq 83, 121

2 Errors and overpayments of tax credits

13. The C&AG's Report on the Inland Revenue accounts for the financial year 2000–01, described the operation of Working Families' and Disabled Person's Tax Credits. The report explained the steps the Department had taken to improve their intelligence on the likely level and types of non-compliance amongst applicants for those tax credits. The Department had examined a representative sample of applications made between August 2000 and August 2001 but they were unable to provide the results of the exercise when the C&AG finalised his report for that year. The results were made available to him in August 2003 and placed in the Library of the House in November 2003.¹⁸ At this Committee's hearing in June 2003 on the C&AG's report on "*External Fraud against the Inland Revenue*", the Department said that they had incorporated the lessons learned into their design of the New Tax Credits.

14. Both the former and the new tax credits carry the risk of fraud through claimants providing false information. The most common frauds have been understated or undeclared income or capital, undeclared or fictitious employment, overstated working hours, undeclared or fictitious partners, fictitious children and misrepresented child care. Collusion between employers and employees has also been a risk but the Department have found few examples.¹⁹

15. The Committee's report on the June 2003 hearing said that the Department would need to demonstrate that the more sophisticated risk management structures for the New Tax Credit systems were more effective in minimising the errors and fraud than those for earlier comparable benefit schemes.²⁰ The Department have yet to demonstrate any reduction in error or fraud.

16. The Department do not have a target error rate for New Tax Credits. They recognise that they will never get error rates down to zero as error and fraud are endemic in benefits. But they expect an immediate halving of error rates with the introduction of New Tax Credits and a constant improvement thereafter as they improve their risk analysis.²¹

17. If the Department for Work and Pensions paid out benefits corresponding to tax credits in the traditional way they would have to seek Parliamentary approval for overpayments of £500 to £700 million a year. As these tax credit overpayments are netted off against tax collected within the Inland Revenue's accounts they are not subject to the same reporting and accountability to Parliament as voted funds.

18 C&AG's Report, para 2.5

19 1st Report from the Committee of Public Accounts, *Tackling Fraud against the Inland Revenue*, (HC 62, Session 2003–04) para 20

20 29th Report from the Committee of Public Accounts, *Inland Revenue: Tax Credits and tax debt management* (HC 332, Session 2002–03)

21 Qq 12–13

3 Compensation for claimants and recovery of overpayments of tax credits

18. Problems caused by the new tax credit system resulted in hundreds of thousands of the most vulnerable people in society being put to inconvenience and not receiving the tax credits to which they were entitled and which they needed. Members of Parliament were inundated with constituents' complaints and the Department's helpline had to be changed because it was overwhelmed. The problems were extremely time-consuming and frustrating for many people. The Department have compensated about 1,600 people who could demonstrate that they incurred expenses as a result of delays and to recognise worry and distress.²²

19. The Department referred to their compensation arrangements for claimants as being voluntary and spontaneous. But they have not run a campaign to draw attention to the availability of compensation for people who felt that they had suffered from not receiving what they were due. The Department consider that a specific campaign would be counterproductive and involve huge expense sorting out the resulting bona-fide claims from the others. They are relying instead on arrangements set out in their booklet "*How to complain about the Inland Revenue*".²³ In addition, the training of officials dealing with tax credit cases will cover their duty to draw the attention of colleagues to cases where individuals may be entitled to compensation. The Department have undertaken to reinforce that message.²⁴

20. The Department have procedures designed to recover overpayments of tax credits. But they recognise that individuals having to repay significant sums each week should not be left destitute. They will not therefore recover overpayments if it would involve hardship and they have published a code of practice entitled "*What happens if we have paid you too much tax credit?*"²⁵

21. From April 2004 the Department will adjust tax credit awards for the past year and make new awards for the next year which will take account of changes in claimants' circumstances. The process will probably bring to light further overpayments which the Department will seek to recover.²⁶

22. Some recipients of tax credits realised that they were being overpaid and tried to repay the money. But the Department declined the offer and told them that the family would need to repay next year. The Department have since recognised that such people should not be left to worry about a bill in the future and that if they want to repay they should be allowed to.²⁷

22 Qq 22, 27, 61

23 Qq 109–110, 112, 114

24 Q 115

25 Qq 131, 63–64

26 Q 135

27 Qq 28–30, 135

23. Tax credit payments can have implications for individuals' entitlement to Income Support, Housing Benefit and Council Tax Benefit. In some cases substantial overpayment of tax credits has resulted in a level of income which has led the Department for Work and Pensions to cancel other benefits. Recipients then face the prospect of the Inland Revenue recovering the tax credit overpayment in the next tax year, potentially leaving them out of pocket.²⁸

Formal minutes

Monday 8 March 2004

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Allan
Jon Cruddas
Mr Ian Davidson

Mr Gerry Steinberg
Jon Trickett

The Committee deliberated.

Draft Report (Inland Revenue: Tax Credits), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 23 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Fourteenth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

Adjourned until Wednesday 10 March at 3.30 pm

Witnesses

Wednesday 3 December 2003

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Sir Nicholas Montagu KCB, Mr David Hartnett CB, Mr Nicholas Lodge, Inland Revenue, **Mr Bill Thomas**, and **Mr Craig Wilson**, Electronic Data Services

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The reference number of the Treasury Minute to each Report will be printed in brackets after the HC printing number

Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 3 December 2003

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Allan
Mr Richard Bacon
Jon Cruddas
Mr Ian Davidson
Mr Frank Field

Mr Brian Jenkins
Gerry Steinberg
Jon Trickett
Mr Alan Williams

Sir John Bourn KCB, Comptroller and Auditor General, further examined.

Mr Brian Glicksman, Treasury Officer of Accounts, HM Treasury, further examined.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL:

Tax Credits

Witnesses: **Sir Nicholas Montagu KCB**, Chairman, **Mr David Hartnett CB**, Deputy Chairman, **Mr Nicholas Lodge**, Programme Director, Tax Credits, Inland Revenue, **Mr Bill Thomas**, President, EDS Europe, Middle East and Asia, and **Mr Craig Wilson**, EDS Enterprise Client Executive for Inland Revenue, Electronic Data Systems Corporation, examined.

Q1 Chairman: May I start by welcoming you to the Committee of Public Accounts. May I start by welcoming the Chairman and members of the Committee for Economic and Budgetary Affairs of the National Assembly of Vietnam. We are grateful for their presence. Our hearing today of course concerns the Comptroller & Auditor General's Report on the Inland Revenue, particularly tax credits. We welcome Sir Nicholas Montagu back to our Committee and Mr Bill Thomas, Chairman of EDS Europe, Middle East and Asia. Sir Nicholas, would you like to introduce your colleagues?

Sir Nicholas Montagu: Thank you very much, Chairman. Your colleagues will be familiar with that hardy perennial on my immediate left, Dave Hartnett, who is a member of my Board and Deputy Chairman dealing with Policy and Technical matters, and beyond him is Nick Lodge, who is the Project Director for Tax Credits. On Bill's right is Craig Wilson, who is the EDS account executive for the Inland Revenue.

Q2 Chairman: I will start the questioning. Why did you and EDS introduce a system for Tax Credits which did not work properly?

Sir Nicholas Montagu: That is a simple question with a long answer, I fear, Chairman. The simple answer is that it was a system that we had every reason to believe would perform properly. It was one on which we had been working together, obviously, in the months leading up to the implementation of Tax Credits, and the Comptroller & Auditor General's Report mentions the Office of Government Commerce report, which essentially described our project management in the months running up to the

release which failed, which is known as Release 2, as exemplary. I can honestly say that it came as an equal shock to EDS and ourselves that a system which we had every reason to believe would perform to standard turned out, when it came to live running, to be unstable and not fit for purpose.

Q3 Chairman: Was there something wrong with the testing regime? Had it been adequately gone through beforehand?

Sir Nicholas Montagu: We had a testing regime in the months leading up to the day of going live, and the system was tested on what is called a clone, which cannot fully replicate live running, but which, again, gave no indication that there would be problems.

Q4 Chairman: This testing regime had obviously not been gone through enough; otherwise you would not have had all these problems, would you?

Sir Nicholas Montagu: I do not know that that is an entirely fair inference. The plain fact is, as all organisations find, it is very difficult to be absolutely sure that a system is foolproof. What we did was the testing that we, working with our partners EDS, regarded as necessary to give the appropriate assurance and, as I say, with all of that, nevertheless, we had the unpleasant shock of its not being fit for purpose on the day.

Q5 Chairman: Very unpleasant, and very unpleasant for hundreds of thousands of people. When will you be able to complete the checks that show that individuals have been paid the proper amounts?

 Inland Revenue and Electronic Data Systems Corporation

Sir Nicholas Montagu: After the end of the year, because new Tax Credits, unlike the Working Families Tax Credit, are based on a year and not on a snapshot, so it will be after the end of the year that we will be able to reconcile things.

Q6 Chairman: Let me go to the old Tax Credits. You came in front of us in June. You recall that session?
Sir Nicholas Montagu: Very clearly.

Q7 Chairman: In August you told the Comptroller & Auditor General that you had overpaid £500–700 million a year on the old scheme. Why did you not give us any warning of that when you came in front of us in June?

Sir Nicholas Montagu: Because at that stage we did not have sufficient information to validate the results of the review. This is a subject where the Committee and I have had several discussions. The Committee will remember that, essentially, the exercise that indicated the size of the overpayments was undertaken primarily to learn about the types of non-compliance and error in Working Families' and Disabled Persons' Tax Credits in order to inform our systems for new Tax Credits. But when it started coming up with the results which indicated that there was some cause for concern, I talked to my Director of Analysis.

Q8 Chairman: When was this?

Sir Nicholas Montagu: The results started coming through in 2002, but I talked at that point to my Director of Analysis and Research, and he advised me that further work was needed in order to validate the results. We did not get that further work completed until after my last appearance, and that is why I did not mention it on my previous visit.

Q9 Chairman: You told us in that hearing, did you not, that there were nine main categories of error? So you had done a fair amount of work. It is hard for me to believe, frankly, that you came forward with this analysis, but you could not give us any kind of figure, and so it was a total shock in August when we discovered there had been this massive overpayment.

Sir Nicholas Montagu: At the stage when I came before you, I mentioned the main categories of error—and those remain the main categories of error—because it was quite clear from the review at that point that those were indeed the main errors. What was not clear until we had done the validating work, which included additional field work, was exactly what the scale of overpayments might be.

Q10 Chairman: You appreciate, do you not, that £500-700 million wasted in overpayment is a serious breach of parliamentary control?

Sir Nicholas Montagu: I understand that entirely, Chairman. Perhaps I could say this: I take absolutely no pleasure at all in having Sir John qualify our accounts, but I can understand why he has done so. We need to go back to a point which I have made at previous discussions with your Committee, and it is this: Working Families' and Disabled Persons' Tax

Credits were always going to be an interim system. They bridged the gap between Family Credit and the new Tax Credits, and in many ways they have far more in common with Family Credit, the benefit which preceded them, than they do with new Tax Credits.

Q11 Chairman: If these were benefits paid out through the Department for Work and Pensions, and you were over-spending by £500–700 million a year, you would have to get authority from Parliament, would you not, but under the new system you do not?

Sir Nicholas Montagu: I am not clear what the position is.

Q12 Chairman: I put it to you that if you were the Department for Work and Pensions, and you were spending this amount of money, you would have to get parliamentary authority, but under this new system you do not.

Sir Nicholas Montagu: The point I must make here, Chairman, is that, as this Committee well knows from its examination of Accounting Officers from the Department of Social Security and its successor department, unfortunately, error and fraud to a certain degree are endemic in benefits. I think I can fairly point out that the Department of Social Security and its successor department were qualified by the Comptroller & Auditor General in every year since Family Credit was introduced, and I can also point out, I think fairly, that although I deeply regret the level of error that the review indicates, it is of the same order but slightly lower than the error rate which sampling with Family Credit revealed. My point is that I believe there will be a real step change with new Tax Credits, and one could not reasonably have expected an overnight drop of any great magnitude during what was essentially an interim scheme.

Q13 Chairman: You have an error rate of 10–14%. To what level do you plan to reduce the overpayments and by what date?

Sir Nicholas Montagu: We do not have a target error rate as such, but perhaps I might put it this way. The review indicated that some 23% of claims for those two Tax Credits were erroneous, compared with a figure of 26% for Family Credit. Under the new Tax Credits scheme things will be very different. There will be a stringent 100% check within our computer systems that will cross-match claims against our own extensive databases and those of the Department for Work and Pensions. Again, you will never get error rates down to zero, but I would be very disappointed if one did not see an immediate halving of error rates with new Tax Credits, and a constant improvement as we improve our understanding and as we improve our risk analysis.

Q14 Chairman: May I ask Mr Thomas this: were you unrealistic in accepting from the Department a contract which clearly you could not deliver at the time?

Inland Revenue and Electronic Data Systems Corporation

Mr Thomas: No, I would say we were not unrealistic in accepting this contract. When, together with the Inland Revenue, we planned the implementation of new Tax Credits, we did have an extremely challenging and complex project that lay ahead of us. The new Tax Credits system we were implementing has around 10 million lines of computer code and would represent the largest IT challenge that has been undertaken by the Inland Revenue. Having said that, when we committed together to implement this new IT system and change the business process, we had a very challenging programme, but a programme that was capable of being implemented.

Q15 Chairman: What went wrong with your relationship with the Inland Revenue, do you think?

Mr Thomas: Our relationship with the Inland Revenue has not gone wrong, but we certainly had a dreadful problem with the going live of Release 2 of Tax Credits, and we understand quite clearly the complication, the disruption and the pain that that caused, both within the Inland Revenue and in the country at large. Our experience of the run-up to going live in April of this year was that we had to make a judgment together whether or not this system was in a suitable condition to go live in April. It is the nature of very large IT systems that when you go live, you cannot be certain that there are not faults within the system, because you cannot test it with exactly the same data it will encounter when it goes live.

Q16 Chairman: Can I stop you there? If you look at paragraph 3.13 of the Report of the Comptroller & Auditor General, which you will find on page 83, it says: "The Department and the EDS are considering what lessons can be learned about technical system design and testing strategy, including effects of a compressed testing timetable." What was the timetable that you wanted for testing, and what were you finally given by the Department?

Mr Thomas: The timetable that we both wanted, the timetable that the programme wanted, was that we would have a 19-week period of testing.

Q17 Chairman: That was what you wanted. How much were you in fact given?

Mr Thomas: Testing divides into two main sections: systems testing and volume testing.

Q18 Chairman: How many weeks were you given?

Mr Thomas: The volume testing element of the programme was planned to be 12 weeks, and we accepted compression of that testing window to four weeks.

Q19 Chairman: This is really the nub of the problem, is it not? You were mucked around by the Department; you were promised originally 19 weeks and you got four weeks. Is that correct?

Mr Thomas: That is not correct. We had a 19-week window for testing the system. Testing the system has two primary parts: testing the end-to-end functionality of the system, and then volume testing,

when we put lots and lots of data through the system. We did have compression of the systems testing part of our programme, because we had a six-week delay while we finalised the rules for calculating Tax Credits. That was the first part of the testing. The part that was volume testing—and it was volume testing where we had our problem—was meant to be 12 weeks originally and was compressed to four weeks, because we took the decision, in partnership with the Inland Revenue, to divert both our people and the infrastructure that we were using to carry out testing to solve a different kind of problem.

Q20 Chairman: What profit have you made from this contract?

Mr Thomas: Our overall profit on the Inland Revenue contract will be approximately 10% corporate margin over the life of the contract.

Q21 Chairman: What profit have you made from this contract in monetary terms?

Mr Thomas: On Tax Credits, our profit margin would be 7% and the revenues for Tax Credits at completion would be £168 million.

Q22 Chairman: I put it to you that hundreds of thousands of the most vulnerable people in society have been put not just to mere inconvenience, but have not received Tax Credits on which they have to live, and they have been put to this inconvenience because you were incompetent, or connived with the Department, or both, in not having a proper testing regime. You were quite prepared to unleash this system upon the most vulnerable people in society without having done your homework properly, and you have still made a fat profit out of it. Are you pleased with yourself and your company?

Mr Thomas: We deeply regret the impact that this instability had on the country. The testing that we did was prioritised to make sure we could get people into payment, and so that was what we used our four weeks predominantly to address, and when we did go live, we did get people into payment, with some 5% payments being two or three days late. So we did diligent testing against the highest risk activity that lay ahead of us. The other thing I would say is that when we advised the Department that we had no material reason that would say we should not go live, and they concurred with that advice, we did not have evidence in front of us that would lead us to believe that the problem that did fall out was there waiting for us.

Sir Nicholas Montagu: Chairman, may I take issue with the use of the word "connived with the Department." If I may say so, that was an unfortunate word to use.

Q23 Chairman: What went wrong then? Public confidence in the Inland Revenue has been severely dented, Sir Nicholas. How are you going to put this right?

Sir Nicholas Montagu: I accept that public confidence has been severely dented and, like Bill, I deeply regret the fact that a lot of people who should

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have been paid on time were not, that people had to queue up for interim payments in our local offices and so on. Equally, I think it is important to make the point that the majority of people did get paid correctly and on time: 1 million in the first week, and 2 million four-weekly claimants. What I think we need to do to restore confidence—and we have to some extent already done this—is to make sure that we give a good service to our clients. Although I very much regret what went wrong, I am also extremely proud of the way that my people across the country—and I suspect all members of the Committee will have heard this from their constituents—responded to what was needed once the systems did fail. We switched people across to new Tax Credits work on our helplines—and, again, I regret the delays that people found there. We moved them across to Tax Credits work in our local offices. Our people paid out 375,000 interim payments to people who qualified, who needed the payments, but who, because of the system's difficulties, had not received them.¹ As I say, I am in no way complacent about what happened, but I am immensely proud of the way my people responded. The manager of my Dunoon office told me when I was up in Glasgow in the summer that they had never had such appreciation from customers over any other issue.

Q24 Chairman: You heard the question I put to Mr Thomas. He originally wanted 19 weeks to test the system, and we have had some confusion about the exact amount of time he had, but it could be as little as four weeks. It is your fault, is it not? You failed to come to a decision, and you put him in a difficult position, did you not?

Sir Nicholas Montagu: No, I do not think that is entirely fair, Chairman. Bill has generously accepted that EDS, as our partners, were at fault over this. We have to rely on their advice as to what is feasible, and I have to say that at no time during this compressed period of testing was there any suggestion that as a result of that compression the system would not work.

Q25 Chairman: No suggestion from him to you? This Committee wants to find out who is to blame. We do not want each of you passing the buck.

Sir Nicholas Montagu: I do not think there is going to be any question of that, Chairman. If I may say so, I am not here to deal with who was to blame. That may be your task; it is not mine. I am here to give the Committee facts. It is a fact that at no stage during the testing programme was I told or were any of my people told by EDS that there was any reason to suppose that compressed testing would lead to a failure of the system or that there was a danger that as a result of compressed testing we would not have a system that was fit for purpose.

Q26 Chairman: It was not fit for purpose, so it was their fault because they did not advise you properly.

¹ *Note by witness:* The number of interim payments made was, in fact, 330,000 not 375,000.

Sir Nicholas Montagu: I have given you the facts, Chairman. I have also said I am not here to apportion blame. That may be for the Committee.

Chairman: I think the Committee can draw its own conclusions.

Q27 Mr Bacon: I would like to ask you about compensation. I have a case here of a Rashib Patel, who wants to know if you are going to compensate those people who have been facing delays because of the Inland Revenue's incompetence.

Sir Nicholas Montagu: We judge every case on its merits, but what I can say is this. We have already compensated a number of people. Indeed, I wrote to Mr Steinberg recently about a case where I had asked for compensation to be paid to a constituent. We will compensate people on two bases. If they can demonstrate that they incurred expenses as a result of our delays, we will reimburse those expenses. We will also recognise worry and distress, and we have so far paid out something of the order of 1,600 compensation payments. That is a figure to the end of September.

Q28 Mr Bacon: I also have a case here of a Fahana Daiwood, who was overpaid. When the family phoned to try and pay back the money, they were told nothing could be done and that the family would need to repay next year. How can you refuse to accept payments of money? Do they have to get in touch with you?

Sir Nicholas Montagu: I think I am right in saying that if somebody identifies an overpayment and offers to pay, we would certainly accept a payment. It may have been that the person that you mention –

Q29 Mr Field: I have a constituent in exactly this position.

Sir Nicholas Montagu: What I have to say, Messrs Field and Bacon, is this: we will take payments in year, but what I suspect the people involved may have been told is that we will normally make adjustments at the end of the year.

Q30 Mr Bacon: You refused to accept the payments, and these people are now worried that they will have to face a bill in the future. Surely you could just accept the money and pay it into a consolidated fund and keep a record.

Sir Nicholas Montagu: If people want to make payments, they should be allowed to. If they are refused, I can only apologise.

Q31 Mr Bacon: Is that a guarantee?

Sir Nicholas Montagu: That is an absolute guarantee.

Q32 Mr Bacon: Can I ask you about the testing process? You said the Gateway review gave the Tax Credits a green light, and the testing process the Chairman has already alluded to. Why was it cut short?

Mr Hartnett: There are two principal issues, Mr Bacon. The first was this: there was some mismatching of claims to claimants on the system.

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Q33 Mr Bacon: National Insurance numbers?

Mr Hartnett: That sort of thing, which had to be put right. We discussed this with Bill and his colleagues, and formed the view that the best way to do this was to use the clone, the testing environment, to do some of it.

Q34 Mr Bacon: Who made the decision to stop testing, or to compress the testing?

Mr Hartnett: I am not sure there was an active decision.

Q35 Mr Bacon: There was a passive decision, was there?

Mr Hartnett: No. If I can just finish, I am not sure it was an active decision to stop testing. It was important for us to sort out these mismatches so that people could get their money.

Q36 Mr Bacon: Mr Thomas, you said the 12 weeks for volume testing was compressed into four. Was that 12 out of the total of 19?

Mr Thomas: Yes, that is correct.

Q37 Mr Bacon: So there were seven weeks for testing the end-to-end functionality.

Mr Thomas: They overlapped.

Q38 Mr Bacon: How many weeks were there altogether?

Mr Thomas: Nineteen, and we lost six.

Q39 Mr Bacon: When you say they overlapped, if you took the start date and the finish date that were planned, how many weeks were there? Presumably not 19.

Mr Thomas: There were 19 planned.

Q40 Mr Bacon: Yes, but if they overlapped—I am talking about calendar weeks—how many weeks, in total time, were there for the testing?

Mr Thomas: Thirteen.

Q41 Mr Bacon: Was the 13 compressed into four?

Mr Thomas: No.

Q42 Mr Bacon: So how many were allowed for end to end functionality?

Mr Thomas: Four. We had a 19-week testing plan, and six weeks were cut off the front of it whilst we defined the rules that had to be used. There are two kinds of testing that overlapped. One is functional testing, and that is where the six weeks came off. That was the longest part. The 12 weeks, which is the critical part, was volume testing. We advised our client that it was in the best interests of the programme that we sacrifice two-thirds of that volume testing because we had to fix this National Insurance problem.

Q43 Mr Bacon: You said there was a total of 13 actual weeks, if you include the actual time from the beginning to the end planned, and that total of 13 weeks was cut to what? To four?

Mr Thomas: No. I am sorry. I have misled you. There were 19 weeks planned and it was cut to 13.

Q44 Mr Bacon: What was the start date and what was the finish date?

Mr Thomas: The intention was that we started system testing on 25 November, and that date was delayed by six weeks.

Q45 Mr Bacon: Sir Nicholas, do you think the Inland Revenue has lost its intelligent customer function?

Sir Nicholas Montagu: I think that is an extraordinarily difficult question to answer. I will try to do so. Over the previous nine years of the partnership with EDS I think it is fair to say that the partnership had worked well and we had some very significant successes together. The complex releases at the start of self-assessment were a good, publicised example, and in my time over the last six years there have been a lot of less publicised ones. We have been concerned not to keep a dog and bark ourselves, but that said, we have obviously looked back with all the benefit of hindsight at what went wrong with the New Tax Credits. What I am not saying with any degree of certainty is that, had we had consultancy help to make us an even more intelligent customer, we could have avoided the problems, but we have certainly concluded that, and for the forthcoming and very important release due in March, we have retained Deloitte and Touche to work with us and EDS to make us a more intelligent customer.

Q46 Mr Bacon: Are you familiar with the August 1994 Cabinet Office report for government's use of external consultants?

Sir Nicholas Montagu: I probably was at the time, Mr Bacon, but old men forget.

Q47 Mr Bacon: It says right at the beginning, "It is difficult to do good consultancy for a bad client and difficult to do bad consultancy for a good client." I am suggesting you were a bad client.

Sir Nicholas Montagu: I do not think that is a fair suggestion at all. As I say, we have had a successful nine-year partnership with EDS. We inherited a partnership that was an unsuccessful one with what was then Andersen Consulting, and we have turned it into a successful one. The plain fact is, with the best will in the world, some systems fail, both in the public and in the private sector.

Q48 Mr Bacon: Mr Hartnett, is it correct you have 112 sub-systems?

Mr Hartnett: We have a number of sub-systems. I do not know that it is 112. It is a large number.

Q49 Mr Bacon: If you have that many sub-systems, who is there in the Inland Revenue who understands them, or has that expertise been transferred over to EDS? If you were to give the contract to somebody else, how would you get the expertise back?

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Mr Hartnett: I do not think there is any single person in the Inland Revenue who understands 112 systems, if that is the right number. Nick's Programmes team have the greatest insight into those systems, but no-one else.

Q50 Mr Bacon: Sir Nicholas, have you read this book by Tony Collins: "*Crash: Ten Easy Ways to Avoid a Computer Disaster*"?

Sir Nicholas Montagu: No, I have not. Maybe it would be a good use of my forthcoming retirement.

Q51 Mr Bacon: My next question is about one of your earlier jobs. Have you read the *Tractatus Logico-Philosophicus*?

Sir Nicholas Montagu: No. I hate to say this, but it was not my period.

Q52 Mr Bacon: You have a CV here for all the people on the Inland Revenue side. Mr Hartnett, you are called the Director General, but you do not have an IT or technical background, do you?

Mr Hartnett: No. I have been involved in a lot of IT projects.

Q53 Mr Bacon: Mr Lodge, you are the Programme Director for Tax Credits. You were in retail banking. Are you an IT specialist or a banker by background?

Mr Lodge: I have experience of running and delivering IT projects but I am not an IT expert.

Q54 Mr Bacon: So none of the witnesses here today from the Inland Revenue is an IT expert.

Sir Nicholas Montagu: That is correct, Mr Bacon.

Q55 Mr Bacon: That rather bears out my point, does it not? You have lost the skill as an intelligent customer.

Sir Nicholas Montagu: No, I really do not think that is right, Mr Bacon. What you have here is a team from the Inland Revenue whom we judged best able to answer your questions, because we did not expect the Committee to delve into fine technicalities. It is the essential feature of a successful IT partnership that there is a sensible division of roles. I have people who are IT experts who are involved with day-to-day discussions with Bill's people, but what we do not do is to duplicate the expertise that EDS, as our main IT partner and supplier, have. I have to say this: even had we been a more intelligent customer, given the nature of the fault that caused the difficulties, I think that we and EDS are clear that it would not have enabled that fault to have been identified in advance.

Q56 Mr Bacon: You said both you and EDS were surprised by the scale of the problems. In this book they refer to what is called a "rare success", Abbey National and share registration after it demutualised. There were millions of different cases and different documents to deal with. It was a great success, not least because "Abbey understood what

the suppliers were capable of delivering." You did not understand what EDS were and were not capable of delivering, did you?

Sir Nicholas Montagu: On the contrary, we understood well what EDS were and were not capable of delivering. Bill will confirm that what took us completely by surprise is that there is no doubt that they were able to deliver it, but that the system failed. I have to point out here that this is not unique to the public sector. It is well known that the most successful private sector food retailer on line had to junk its entire system before re-starting. One cannot absolutely guarantee success.

Q57 Mr Steinberg: You were a collector of taxes, doing a very good job, and now, with benefits, you appear not to be doing such a very good job. Are you comfortable with the situation now?

Sir Nicholas Montagu: I am very happy with the functions that the Chancellor has given us, Mr Steinberg. I would, as you might expect, take issue with the last remark. I have readily admitted to the Chairman that I greatly regret the effects that our systems failure had, but I also have to point out that now, just under 6 million families are benefiting from new Tax Credits. This represents a 98% take-up of those who were expected to benefit and I regard this as a vindication, if I may say so, of the Chancellor's decision to give the administration to my Department. I also come back to the point that I made earlier, that I am extremely proud of my people's response to the considerable difficulties earlier this year.

Q58 Mr Steinberg: That is all well and good. I know it might be painful, but have you ever had your accounts qualified before?

Sir Nicholas Montagu: No, and as I said, it gives me no pleasure at all that Sir John felt constrained to do so, but equally I have to say that it does not altogether surprise me, given that he qualified them in respect of what was in its essential form still an old-style benefit, which had been run by a Department whose accounts had been qualified for every year since it had first been introduced.

Q59 Mr Steinberg: That is the whole point. I was trying to be helpful. I was trying to make the point that here you were, a successful Department, collecting taxes in, enabling the Health Service and the Education Service to function, and then suddenly, here you are, a doler out of dole, and everything goes wrong.

Sir Nicholas Montagu: No. One thing went wrong. What went wrong was the failure of the IT systems. As I have indicated, given that it went wrong, I think my people coped well. It is now going right. I come back to that figure: just under 6 million households are benefiting.

Q60 Mr Steinberg: They were benefiting before, under the old system—not so many, but they were benefiting before—and now people who were OK under the old system suddenly found themselves in some cases without any money at all. As a

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conscientious constituency MP, and I am sure all my colleagues are the same, I would say that the fiasco of the Tax Credits was the biggest postbag we had in years, apart from fox hunting, which we will put right anyway, I understand.

Sir Nicholas Montagu: I have to be thankful for small mercies, Mr Steinberg. Fox hunting is not a subject about which you write to me. If I might make the point, I do think that the new Tax Credits are very different from Family Credit in every way. They go to far more households, they are at a higher rate, and they are calculated on a different basis.

Q61 Mr Steinberg: The fact is that, in terms of the Tax Credits, I am not arguing against the system at all. All I am saying is that at the end of the day, I, and I suspect other Members, were inundated with complaints. I have two secretaries working full-time in my office and they spent all day for about a fortnight or longer dealing with nothing but Tax Credits, having to ring up your Department, having to ring up the helpline, which eventually had to be changed because it was inundated, to get people enough money to last the week on. That cannot be condoned at all.

Sir Nicholas Montagu: I would not attempt to condone it, Mr Steinberg. Indeed, I have said I deeply regret it, but that is why we paid out the interim payments through our local enquiry offices to people who needed them. That is why we extended the helpline, and that is why we set up the MPs' helpline. My point is this. We were fire-fighting. I would much rather that there had been no fire, but I believe we now have a stable system, working well, and working in the way that Parliament intended when it passed the legislation with 98% of those predicted to benefit doing so.

Q62 Mr Steinberg: I am not criticising your Department at all, but is the ethos of a tax collector the same as the ethos of a benefits distributor?

Sir Nicholas Montagu: I do not see any contradiction between them, in this sense: that obviously there are some people whose job will be mainly on what you call the benefits distribution side, and there will be some, for example, in my Special Compliance Office, who are dealing with the hard end of enforcement. But essentially, what all my people are trying to do, regardless of which bit of the business they work in, is to make it as easy as possible for people to understand what they owe us or what they are due from us, and to pay it or to get it. That is the common theme. We want to help customers—and, as you know, I use that term unapologetically—to get it right first time.

Q63 Mr Steinberg: I very rarely do this, but I actually wrote to the Accounting Officer—I have only done this once before, to another Accounting Officer—and I must say you were very helpful, and I thank you very much, because by writing to you, we sorted one problem out in four weeks, which we could not sort out at all. I have had a letter today,

for example, from a welfare rights worker in Ripon Citizens Advice Bureau giving an example of a case similar to the one I had.²

Sir Nicholas Montagu: If any member of the Committee wants to write to me about that case, I will, of course, look into it.³

Q64 Mr Steinberg: In the case that I wrote to you about, somebody was overpaid in their Tax Credits, and it was not their fault at all. They had received interim awards, and this had not been taken into consideration, and they were paid too much. Then you came along as a Department and demanded that money back immediately. That to me is very unsympathetic. If people are on Tax Credits, they are very poor in terms of the vast majority of people in our society. To expect them to come along and pay back, without any compassion at all, is just not on, frankly. You put that right for me, and that person will have to pay it back eventually, but they will pay it back next year. But the case I have here today is where somebody on Tax Credits is now having to pay back over £38 a week. They have written to the Inland Revenue and they cannot get any satisfaction at all. What worries me is that the ordinary punter who does not have an MP breathing down the neck of the Accounting Officer does not get the help they need, whereas we do. That is what we are there for, but everybody should be treated the same. How can we guarantee that, and that nobody will be left destitute?

Sir Nicholas Montagu: You are absolutely right to raise that, if I may say so, Mr Steinberg. The plain answer again is that if the case you mention was handled in that way, I can only apologise. Basically, we think we are getting the overwhelming majority of cases right, but if you are paying out Tax Credits on the scale that we are, there will be some slip-ups. Where we identify an overpayment, unless it results from our error and was on a scale where the person could reasonably have supposed it to be correct, we do, obviously, owe it to the public purse to recover it, but we will do so in a number of ways. We will never do so if it involves hardship. We will do so at different rates for people, let us say, on the full rate of the tax credit and on the standard rate, and we recently published on our website a code of practice about overpayments which emphasises that we want to be flexible and sympathetic, and that will be appearing in paper form very shortly.

Q65 Mr Steinberg: I will hand this over to you so you can get that one sorted out. It is not my constituent. Mr Thomas, whenever there is a problem with a system, invariably we discover it is the IT that has gone wrong. I do not know how many times we have sat here and that has been the case, and of course, this fiasco in April was no exception. How much of the blame do you accept?

Mr Thomas: First of all, I do not think there are any IT projects; I think they are business projects. We accept responsibility for giving the best advice we knew at the time to the Inland Revenue. That advice

² Ev 19

³ Ev 19

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proved to be wrong, but we think that, based on the data we had at the time, it was the right decision to make. It proved to be wrong and I have to take responsibility.

Q66 Mr Steinberg: How many other contracts do you have with government?

Mr Thomas: I do not know the precise number. We have a number of very large relationships with government.

Q67 Mr Steinberg: How many have gone wrong?

Mr Thomas: At various times we have had various problems on our contracts. We have a challenging situation with the Child Support Agency at the moment and we are talking to DWP. We also have some very successful projects with DWP.

Q68 Mr Steinberg: I am not interested in them. I am only interested in what has gone wrong. It is nasty, but that is the fact. Can you tell us how many contracts you have and how many of those contracts have gone wrong during the lifetime of those contracts? Finally, do you agree that you will expect to pay compensation?

Mr Thomas: We agree that we bear some responsibility for the problems that were caused in the country when this went live, and we are very open to a constructive conversation about compensation.

Q69 Mr Steinberg: You will pay some compensation out of the £12 million profit you have made.

Sir Nicholas Montagu: Chairman, could I possibly ask for a degree of protection here? We are discussing compensation with EDS at the moment, and the Committee will understand that this is a commercially quite sensitive issue.

Q70 Mr Field: Why is it?

Sir Nicholas Montagu: The discussions between us and EDS over how much is due, within the terms of the contract, are covered by normal terms of commercial confidentiality that extend to negotiations between partners.

Mr Field: I think that is just crap.

Q71 Mr Jenkins: If I am building a house and I do not understand all the different crafts involved, I would employ an architect. You have brought in a consultant to have a look at this job, to oversee what EDS has done and to assist them. What has your consultant told you?

Sir Nicholas Montagu: It is quite a complex and technical Report, but the sort of headline conclusions are: that the system was not fully documented, that component parts of the overall IT system were not always linked in the best way, and that the way transactions were managed within the system created additional performance problems.

Q72 Mr Jenkins: Would you think that is a very critical Report of the way the project was set up by EDS?

Sir Nicholas Montagu: It is difficult for me to answer, Mr Jenkins because, again, it is a technical Report. What it clearly does, and, one must allow, with the benefit of hindsight, is to come in and look at a project or a system that failed in the sense of not being stable and fit for purpose when it was required, and to diagnose what went wrong.

Q73 Mr Jenkins: So the OGC, EDS and the Programme Board, and probably others, completely missed the imperfections in this system before it was up and running.

Sir Nicholas Montagu: Yes, that is right, and again, Bill will be able to explain the technicalities to you, which I certainly cannot. I think what he will be saying to you is that EDS followed accepted best practice in the profession in the way they approached what was a project of exceptional complexity, that it was tested on this so-called clone—because obviously you cannot test it on the full thing—and that the clone itself could not have been expected in its running to reveal the faults, which took some months after they manifested themselves to track down. If you want the technicalities, ask Bill.

Q74 Mr Jenkins: I will ask Bill the next question. The testing arrangements might have had a smoother start. You are a big company. These are not stand-alone projects. Your experience is passed from project to project, and hopefully you will learn from each one. What have you learned from this, and what will you do differently next time round?

Mr Thomas: We have one of the most challenging projects the British Government has ever undertaken. This was a massive programme. The programme had become compressed. We produced Release 2 in about a year around the original plan of two years. So we had a massive compression. The problem, I would suggest, is not that there were errors in the system, because there are errors when you go live with a computer system. The problem was that we did not find this error and we did not fix this error before it caused the problems that it did out in the country. That was the first thing. What have we learned from this? We look at Tax Credits and we look at Release Zero, which went successfully. Release 1 went successfully, and Release 2 we had dreadful problems with. We lost eight weeks of our testing period. After some ten weeks of live operation we restored stability, but it was too late because we were live in the country. We have now released Release 3 of Tax Credits in the last month. That was another 193 man years of work, and it has been very successful. So it is a huge and complex programme. We have learned, and we are working together with our colleagues on Release 3 and on Release 4, and we are being extra zealous over change management when approaching the testing period. So we are being very aggressive on keeping down change, and we are being very aggressive on ensuring that we have an adequate testing period. We currently have 15 weeks planned of elapsed time for volume testing for Release 4,

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which comes next April, and we are jealously guarding that and will not compromise on that 15 weeks.

Q75 Mr Jenkins: Would it be possible to pass any of this over to the CSA project, which crashed on the day it was intended to start and has apparently crashed again? That is a large and complicated project, no doubt.

Mr Thomas: It is an extremely large project.

Q76 Mr Jenkins: It is an extremely large government project. You are supposed to be an expert in large and extremely complex projects. I thought that is what your company did.

Mr Thomas: They do, and I have lots of colleagues who are expert in that.

Q77 Mr Jenkins: Was any of the information passed over?

Mr Thomas: Yes. There are lots of mechanisms within our firm to try and make sure that we share risk management across programmes, and not just within the UK but outside the UK as well. We have peer review teams that would work perhaps on our CSA programme and would also work on our Pension Credit programme, which recently went live for DWP. The same people worked on the modernisation of the employment service, the Job Centre Plus programme. The same people worked on the implementation of 120,000 desktop devices for DWP that went live. So we are in a position to share best practice around. We do have problems on CSA and some of those problems are of our making. I understand that. But we do share practice around those problems.

Q78 Mr Jenkins: When this is finally wrapped up, and you will no doubt be sitting on some beach somewhere enjoying your well-earned retirement, at the end of the day, when we have the final figure, we are going to have to come to some arrangement when we cannot collect these overpayments any more. When do you envisage the total figure being rounded off, and when do you intend to come back to tell Parliament, via the Minister, that we have lost this much money?

Sir Nicholas Montagu: Are you talking about overpayments during the current year or overpayments on Working Families Tax Credits?

Q79 Mr Jenkins: This year.

Sir Nicholas Montagu: For any year, we will be able to tell the National Audit Office the scale of finalised overpayments and underpayments after the year end, when we reconcile claims and payments. As I have indicated, new Tax Credits, unlike Working Families Tax Credit are based on a whole year and not on a snapshot at the time of the claim.

Q80 Mr Jenkins: So at the end of the year you know how much you have got back in, you know how much you have claimed back from overpayment, and would that be paid back in next year?

Sir Nicholas Montagu: That would be the presumption, Mr Jenkins, yes. Again, obviously, if we reconcile at the end of the year and we then identify overpayments, we then go to people and recover overpayments by a reduction in Tax Credits. We are also looking for those people who are taxpayers, to recover in the future by an adjustment to their tax coding. But yes, we get the data out at the end of the year and we follow up in the wake of that.

Q81 Mr Jenkins: On Tax Credits overpayments of £500–700 million, it works out at £500 for every one of the 1.25 million claimants. It obviously does not work out exactly that way; there will be some with a considerable overpayment. Is that going to be reclaimed in a year?

Sir Nicholas Montagu: We are talking here about two separate things. You are talking now about the overpayments which Sir John's Report identifies from the Working Families and Disabled Persons Tax Credits, the ones which, as I have explained, were more akin to benefits paid out under the Family Credit scheme. But remember that these things, again, as the Comptroller & Auditor General makes clear, are an extrapolation. These are not overpayments that we have identified. They are an extrapolation from a sample. From the sample where an overpayment was more than £1, we would recover it. Similarly, we can identify some other overpayments, to, for example, people who were on those Tax Credits, now on new Tax Credits, and where we pick those up we will recover them.

Q82 Mr Jenkins: My understanding is that you have said error and fraud are endemic in benefit pay-outs. Now we have this new system, because it will go through employers, and you will be able to trace the individual, we will have less error and fraud.

Sir Nicholas Montagu: No, it is not because of that at all. Again, perhaps I might just give the Committee one other figure, which I think is illustrative of my point about error levels endemic in the old system. When I was in the United States two months ago, I was talking to Mark Everson, my opposite number, who tells me that error rates in the earned income tax credit are running at around 30%, with an annual loss of around \$9 billion. We, thank goodness, are not quite like that. The reason why I believe the risks to be incomparably lower under new Tax Credits is partly because it is based on a yearly picture rather than a snapshot, but also because all the risk identification is done within the systems. Essentially, with Working Families Tax Credits and Disabled Persons Tax Credits, like Family Credit, the risk was handled clerically. What we can do is cross-check claims within the system against things like addresses, DWP data, earnings data, employment data that we hold, and that will cut the risk right back. That is why, although I very much regret the losses on the scale extrapolated from our sample, we have made sure that we have turned them to good use by taking what that sample showed and using it to refine the risk identifiers within our new Tax Credits systems.

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Q83 Mr Jenkins: What has the cost of the new Tax Credits system been so far? How much extra have you had to pay to get it right, by shifting manpower across, and where is the money going to come from?

Sir Nicholas Montagu: Again, we have not quantified an overall cost of what went wrong, or indeed the opportunity cost. There has been an opportunity cost, and considerations of that sort will again, going back to the point that Mr Field raised with me, inform our negotiations with EDS over the scale of compensation.

Q84 Mr Allan: Sir Nicholas, you have described to us how the Programme Board followed all the rules and was a model of best practice, yet the system did not work when it was delivered. Would you deem that Programme Board to be a success or a failure?

Sir Nicholas Montagu: It would be an extraordinarily complacent thing for me, in the wake of the systems failure, to say it was a stunning success. Obviously, when we have had a failure on this scale, I go back with Dave and Nick and my other colleagues and say, "Could we, should we, have done things differently?" In terms of the running of the programme—and again, obviously this is something we have talked about with the Office of Government Commerce—I cannot see an obvious way in which we could have handled it differently. Where, as I indicated, with the benefit of hindsight, we might have done better is if we had brought in a third party, not to second-guess EDS but to work with EDS and us just as a third brain. Interestingly, the latest Office of Government Commerce report on the new Tax Credits project also gives us a clean bill of health on governance.

Q85 Mr Allan: To follow your analogy, you would have had a dog warden as well as your barking dog.

Sir Nicholas Montagu: Or is it a second dog to do the barking? I am not sure, but essentially, yes.

Q86 Mr Allan: Can I ask any of the Inland Revenue team who had IT qualifications on that Programme Board and what those qualifications were?

Mr Hartnett: Our Director of IT was on the Programme Board; our Director of E-Business was on the Programme Board; and two senior officials from EDS were on the Programme Board.

Q87 Mr Allan: Can I ask about the OGC Gateway review? These issues such as who has the IT qualifications all come out of the work that has been done on field computer projects in the past. This Programme Board was described as late as December 2002 as an exemplar by the OGC stage 4 review, which is the readiness for service review. So four months before something which was clearly not ready for service was delivered, we had the OGC Gateway review saying that. Ought we to be worried that the scheme we put in precisely to avoid these kinds of problems was so spectacularly wrong in its judgment?

Sir Nicholas Montagu: Again, hindsight is a wonderful thing, Mr Allan. What the Gateway reviews do is to look critically at the governance of

different projects right across the piece, the way in which they are organised, the way in which risks are being managed and so on. I think they have been enormously valuable and that Peter Gershon and his team have added terrific value and rigour to the process. What I think you are hearing as a consistent theme from along this table is that we did what we could, and we relied on EDS's advice, and EDS were acting in accordance with what we are told were best industry standards, and yet things went spectacularly wrong.

Q88 Mr Allan: Can I try and get at what may be at the heart of the problem? You had to deliver for April 2003. There was a political imperative to do that. The Programme Board presumably had the twin objectives to deliver a working system on time, and they cut the time and ended up putting the priority on April 2003, when the Chancellor wanted it delivered. When the Programme Board has to make that kind of judgement, do you feel they have sufficient flexibility to say, "We cannot deliver that target"?

Sir Nicholas Montagu: Absolutely no doubt at all. Dave, who chaired the Programme Board, may wish to comment. Ministers will understand this. I think that the timetable was reasonable. The original Tax Credits came in in October 1999. We obviously discussed a realistic timing for the transition to new Tax Credits with Ministers on all the odds. April 2003 was reasonable. Had the Programme Board come up with a show-stopper or any indication that we were likely to have a system that was not fit for purpose, then clearly Dave would have come straight to me and we would have talked to the Paymaster General and the Chancellor about the implications of the timetable.

Mr Hartnett: Two things, Mr Allan. First, we have contingency. We expected to deliver. We have a contingency of being able to run on WFTC for some of the new Tax Credit population and the contingency which we eventually had to invoke, which means the people in our organisation have to do things, effectively, manually if we get into difficulty. But we never expected, even as late as towards the end of March, to invoke either contingency.

Q89 Mr Allan: The best case scenario in this situation would have been that your volume testing had taken place and had identified the problem, and showed that when it went live it was not going to work. That would have been as late as January/February, as I understand it, even on the planned timetable. That is the best case in terms of avoiding unforeseen problems, because clearly, the system itself had a problem that needed to be resolved.

Sir Nicholas Montagu: But I think, again, Mr Allan—I have to come back to this point—there is nothing to suggest that the errors in the system that led to its being unstable would have been revealed by longer testing. Obviously, any statement of this sort is a speculative one, but we have been over the issues exhaustively with our IT partners. What it could conceivably have identified may be some fixes, but

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what longer testing would not have done would have been to identify this problem. The problem, once it manifested itself, took some months to identify, and that is why I think there was no reason for EDS to suggest to us that the testing made the introduction risky.

Q90 Mr Allan: You may not have wanted longer but it seems as though you needed different testing. This may be a question for Bill Thomas. What has been described to us is that it has been tested on a clone of the system. When is a clone not a clone? A clone is not a clone when it is not actually the same as the system which it is supposed to be a clone of.

Mr Thomas: I am not a geneticist. Please understand that this was a massively challenging programme. It had been at a red status from May 2002 at the Programme Board. We knew we were dealing with one of the hardest business and IT change programmes the British Government had ever introduced. The goal, I understand, is a massive goal in terms of moving from welfare to work, and it is a massive undertaking to implement. We knew we had a very high-risk programme. What Sir Nicholas said about could we have precisely identified the third bit on the fourth path from the left that went wrong in the system is absolutely correct. There are billions of paths through any computer system and you cannot exercise them all. We could not have found them. What we would have done by greater volume testing is find bottlenecks in the system, and then tune the system so that the problem would not have had as big an effect. It is of no consolation to anybody here or anybody that is impacted by this in the country, but we cut down volume testing by eight weeks. After eight weeks we got some measure of stability back into the system, although it was still going down for about 15 minutes a day twice a day. After ten weeks we had stabilised the system to meet its service levels, but we still had not fixed the problem. It took us another few weeks to fix the problem. It is a very complex project.

Q91 Mr Allan: When you have had a problem like this, it can strain relationships between customers and suppliers. I am not intending to provoke that strain—EDS employees are constituents in my constituency of Sheffield—but can I be clear which companies are in the running for the Aspire contract, the renewal of the Inland Revenue project for the future at this stage?

Sir Nicholas Montagu: We have announced that two consortia have been short-listed. One is Revenue Professional Services, which is a consortium consisting of EDS and Accenture, and the other consists of Cap Gemini Ernst & Young, partnered with Fujitsu.

Q92 Mr Allan: Is this taking place against a genuine competitive procurement exercise?

Sir Nicholas Montagu: There has been an immensely strong competition, which we launched a couple of years or so ago. We announced early on that we were short-listing three consortia, the two now in the final

stages and a third one consisting of BT with Syntegra, CSC and SchlumbergerSema. We then, in the terrible jargon, down-selected in the summer.

Q93 Mr Allan: Can I clarify as well that these are all or nothing contracts? In other words, you cannot take bits out. There is a £160 million bid of work for this project. Within these contracts you cannot say “This company has not performed so well. We will give that bit away to somebody else.” It is all or nothing, is it?

Sir Nicholas Montagu: Life is not quite as simple as that. It is as you describe it in this sense: that the outcome of the so-called Aspire competition will be the selection of one or other of those two consortia, but Inland Revenue business is very extensive and very diverse, and we have made clear that it will form part of the evaluation that determines our choice that we expect the successful consortium to demonstrate that it has the ability—again, forgive the jargon—to co-partner. That means that although they will be—I see the Chairman wince; I used to wince at that too but I have got to the idea of co-partnering—although one will be the main supplier, they will recognise that there will be other organisations on particular projects on whose expertise they need to call in the way that within the existing contract EDS have been working with a company called EzGov, who complement their excellences.

Q94 Jon Cruddas: Coming at this from a slightly different tack, Sir Nicholas and Mr Hartnett, would you accept that part of the strategy lying behind Working Families Tax Credits and Tax Credits is a massive re-incentivising of take-up of low-paid work?

Sir Nicholas Montagu: Yes. The Chancellor has made clear that that is a major driver behind his policy.

Q95 Jon Cruddas: Would you accept that part of the effect in terms of the government employability agenda is that that will serve as a disincentive to raise wage costs in some of these sectors which are disproportionately recruiting some of these through the system?

Sir Nicholas Montagu: I do not think, if you will forgive me, Mr Cruddas, it is for me to comment on the effects of policy. I can comment on what the Chancellor has publicly said about the aims of the policy.

Q96 Jon Cruddas: Presumably, if that is an aim of the policy in terms of this massive injection by the state, that there will be an effect in terms of the tax take to the Revenue over time, in terms of the influx rather than just talking about the relative efficiency of the outflows in terms of the £16 million under the new Tax Credits regime.

Sir Nicholas Montagu: Again, you will forgive my treading carefully. Clearly, as the Chancellor has emphasised, there are a number of aims behind this policy. One is the encouragement of work and the other, obviously, the wider stimulation of the

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economy. A successfully stimulated economy tends to produce beneficial effects in terms of tax raised. I do not think I can go beyond that.

Q97 Jon Cruddas: Presumably in the modelling of the Treasury, when they do this—the Treasury might want to come in on this—if they do anticipate the scale of the redistribution of the effect, if they are seeking to alter labour market behaviour like that, they will assume also that there will be some lesser inflows to the Treasury as a whole because of the relative efficiency of that. We have had the effects of the Working Families Tax Credit for three years now and I am wondering if either in the modelling of the Treasury or in terms of your experience of the system to date there has been any effect in terms of the inflows ascribed to this policy initiative?

Sir Nicholas Montagu: We do not collect data that would give any indications one way or the other.

Q98 Jon Cruddas: I was talking to a union official yesterday actually who represents members in the Revenue as well as other parts of the Civil Service and he said there have been effects in terms of staff morale because of their experience of administering the new system. Would you acknowledge any effects on staff morale?

Sir Nicholas Montagu: Most certainly I would, but, again, as with any big department the effects are variable. The same was true when I was working in the Department of Health and Social Security. What is true undoubtedly is that the fact of the system being not fit for purpose imposed huge and unforeseen pressures on my people across large sections of the department. I have mentioned already that at the height of the difficulties we switched 7,000 people from other duties to help out, very obviously the pressures on the Inland Revenue enquiry centres and on the helplines were acute. To give you an illustration, at the height of the difficulties there were 1.7 million attempts in a single day to get through to our contact centres. It was inevitable, given that, that the kind of queues, which I mentioned and regret, took place. Now, yes, people were tired and they were pressured but certainly I got some e-mails which indicated that the stress that this caused was considerable. Equally I have been around an awful lot of local offices, particularly making a point of calling in on the enquiry centres, to thank them and so on. A lot of them have said that actually, yes, it was absolute hell but paradoxically it was not inevitably bad for morale because people felt that they were all pulling together, that their colleagues from elsewhere in the office were piling in to help, that hierarchical barriers were being broken down and they had the satisfaction of coping with a difficult situation which presented them with huge challenges that they were largely successful in meeting. As I indicated earlier, I think that is an enormous credit to them.

Q99 Jon Cruddas: He did say that the staff adapted extremely well.

Sir Nicholas Montagu: They were superb.

Q100 Jon Cruddas: He did focus in on the qualitative shift of the work they were doing away from tax revenues towards dealing with the administration of these benefits. It was something Mr Steinberg was touching on. He was saying there was a failure, which I think has been recognised within, that they could not really understand the time horizons that some of the claimants were dealing with literally to survive economically from week to week. Is that a problem that you very much recognise compared with the more experienced Benefits Agency in respect of this?

Sir Nicholas Montagu: I think that is an entirely fair point. Some of the behaviours that desperation can cause put additional strains on our people. Of course, we have trained them in differing degrees, depending on whether it was foreseeable that they were engaged on this work. I think, again, with the benefit of hindsight, we have not prepared them sufficiently perhaps for dealing with a different type of customer; again, it is a customer where I am familiar with some behaviours from my time in social security. Certainly it did increase strains for our people in some of the offices where there was customer behaviour which on any analysis was unacceptable but which, given the difficulties the customers were experiencing, was understandable perhaps.

Q101 Jon Cruddas: There has been indicated to me, also, that there is quite a regional variation in terms of the problems associated with the system. Do you detect any regional variation and how do you account for that?

Sir Nicholas Montagu: No.

Q102 Jon Cruddas: Was there a consistency nationally?

Sir Nicholas Montagu: I think there was a consistency. Again, Nick, Bill and Craig will be able to say but I am not aware of significant regional variations with the system.

Mr Thomas: The only comment I would make is that when we were in the thick of the problems then we would get some variation when another problem impinged. If we had perhaps a problem with the server, I seem to remember we had a problem with a server in one of the Scottish offices, that might impinge upon it but the tax credits problem I would have said was quite uniform across the UK.

Q103 Jon Cruddas: I have just had some unscientific evidence from talking to some of my colleagues that some were getting a heavier mailbag on this than others, reflecting possibly a relatively more effective system of managing some of the problems that the system threw out at the high point.

Mr Thomas: From an IT perspective, I would have said the problem was uniform across the UK. I think it is for my colleagues from the Revenue to comment about whether beyond the IT part of the system into

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the network and into the tax credit office and the call centres there was some variance in terms of how they handled that problem.

Sir Nicholas Montagu: Again, I am not aware of differences. Of course there were differences in the pressures. One of the offices which I visited to say thank you was Stratford in East London, and I think that the pressures on their enquiry office were probably the second greatest in the country.

Q104 Jon Cruddas: This is Stratford on Avon?

Sir Nicholas Montagu: Not Stratford on Avon, no.

Q105 Jon Cruddas: I heard a rumour that there was an issue about money being directed to Stratford—which is near my part of the world—which should have been directed to Stratford on Avon.

Sir Nicholas Montagu: I suspect it is an urban myth, Mr Cruddas. I hate to disappoint you.

Q106 Mr Williams: My colleagues have asked virtually every question there is to ask. I have one, Sir Nick, which is are you looking forward to your retirement?

Sir Nicholas Montagu: With mixed feelings, Mr Williams.

Q107 Mr Williams: Are you going to miss us?

Sir Nicholas Montagu: I shall miss the Revenue hugely and of course I will miss your and my regular discussions.

Q108 Mr Williams: I can console you that facing this prospect the Committee has now made the decision—I am sure it will please you enormously—that in future we will call back out of retirement accounting officers who may be appropriate to our inquiry. So we may see quite a lot of you still.

Sir Nicholas Montagu: It will be a pleasure still to feel useful, Mr Williams.

Q109 Mr Williams: I am sure we will both look forward to it. Coming to the question of compensation to the public as opposed to compensation between yourself and the company, I am encouraged by the fact that you have been willing to make compensatory payments but what information is given to the public and how is it given about the fact that compensation may be available?

Sir Nicholas Montagu: This is contained in our so-called Code of Practice (COP) 1 booklet which is widely available. You can get it through our order line, you can get it through our helpline, you can get it in our local offices. It is called something like “*How to complain about the Inland Revenue*” and it gives the full gamut of avenues through MPs to the PCA to the Revenue Adjudicator and so on.

Q110 Mr Williams: In a book can mean different things, it can be highlighted in a book, it can be in the book, at the back of the book. In fact since some people have suffered quite considerably from not receiving what they should receive, do you not think

you owe them some sort of campaign to draw to their attention the fact that compensation is available and on what grounds it is available?

Sir Nicholas Montagu: I think that there are dangers in doing so, if I am honest, Mr Williams.

Q111 Mr Williams: You might have to pay someone.

Sir Nicholas Montagu: As I have said, where there is a case for doing so we will pay compensation.

Q112 Mr Williams: You mean you voluntarily and spontaneously pay?

Sir Nicholas Montagu: Absolutely. If you write to me with a case from a constituent, and obviously it needs to be brought to our attention, I will frequently write back. Indeed I have written to you this week, not on a tax credits case, on a case that we handled extremely badly where I have said that I have asked the Director for Wales to send a compensation payment.

Q113 Mr Williams: I am sure all Members here are flattered by the fact that if we write to you directly the odd constituent might get some compensation. Let me ask my question—

Sir Nicholas Montagu: Let us see if I have got it right.

Q114 Mr Williams: What about the 99% of people in our constituency who do not think or feel it would be appropriate to bring it to their MP? What about those who do not even know compensation is available and do not think to question?

Sir Nicholas Montagu: We will pay it spontaneously, Mr Williams. Let me finish this one because it is quite important. If somebody writes in to complain and we look into it and we find that they were out of pocket and/or they were caused distress and worry, then my complaints people make payments to them. We have taken every opportunity to raise the awareness of compensation but an actual take up campaign saying “Did you know” I really think would be counterproductive. It would involve us in huge expense sorting out the *bona fide* claim from the non *bona fide*. When we get complaints we send people the booklet if we are not compensating them. As I say, in many, many cases we compensate off our own bat.

Q115 Mr Williams: Can you give this Committee an assurance that every one of your officials who is dealing with cases of under payment has in the front of his consciousness the fact that he has a duty to draw to the attention of his colleagues in the Department that that individual may be entitled to compensation?

Sir Nicholas Montagu: Our training would certainly cover that and I am very happy in the light of this hearing to give an undertaking to reinforce the message it should certainly be in the forefront of their mind. If I may say so, I have a cast iron opportunity because tomorrow night I am going to be in Blackpool for the annual so-called Complaints Conference and this is a big conference of our key

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frontline people who deal with customer service and complaints. I will take the opportunity there to follow this up with a reinforcement of the message.

Q116 Mr Williams: That I find encouraging. Will you put in a note because I saw Mr Hartnett passed you a note which was helpful. Will you give us a note so we can cover it fully in our report of precisely how that system is going to work so we can advise our constituents?

Sir Nicholas Montagu: I am very happy to do so.⁴ If I may say so, it would be extremely useful if you and other Parliamentary colleagues essentially help us raise that awareness.

Q117 Mr Williams: We will make sure your point of view is widely heard. You have said we are not here to decide who is to blame and blame may be the wrong term, we are here to decide who is responsible, are we not?

Sir Nicholas Montagu: Yes.

Q118 Mr Williams: It is the same thing but without the same unpleasant significance. I recognise the fact—I should have declared that EDS operates in my constituency, not in this respect—this was an unusually complex operation. If we do not identify where the responsibility lies, we do not identify (a) who is to put it right and (b) where the cost lies for any damages that arise.

Sir Nicholas Montagu: Yes.

Q119 Mr Williams: Now in the context of following up on that to another of my colleagues you adduced the phrase that you do not keep a dog and bark yourself.

Sir Nicholas Montagu: Yes.

Q120 Mr Williams: That seems to make it pretty clear where you think the responsibility lies. Who is supposed to bark?

Sir Nicholas Montagu: I have to say—and again I think it has been both implicit and explicit in what Bill has said—that I expected EDS as our IT partners to bark. I expected them to provide a system which was stable and fit for purpose. I expected them to alert me if at any stage in the weeks and months leading up to Release 2 there was any reason to suppose that the system would be other than stable and fit for purpose.

Q121 Mr Williams: You are sure your contract is robust enough to enable you to enforce appropriate compensation? Only a couple of weeks ago we had of all departments, the Lord Chancellor's Department sitting there admitting the contract they had drawn up on the PFI case was not strong enough to stand up in court. How robust is your contract?

Sir Nicholas Montagu: We believe that it is very robust, Mr Williams. I should say that, as Bill has done today, his Chairman, Mike Jordan, has assured me that he is convinced that we have a case

for compensation. As I indicated earlier, the quantum of that compensation is obviously for negotiation.

Q122 Mr Williams: We cannot discuss that.

Sir Nicholas Montagu: No but also I do need to say that I hope we will be able to reach agreement on a reasonable level of compensation without litigation.

Q123 Mr Williams: In pursuit of trying to establish where responsibility lies in many IT cases we have had in the past with different organisations one has found there has been a lack of clarity in the definition of a project and the requirements. Has that been a problem as far as this one is concerned, Mr Thomas, or is it just a software problem that emerged after experience?

Mr Thomas: Mr Williams, it is not as simple as a software problem which emerged after experience. There is a need for EDS and our partners in the Inland Revenue to come to an understanding on attribution of responsibility.

Q124 Mr Williams: That is important. If it was not a fault in the software system, what was the fault in?

Mr Thomas: If you will allow me to give you a proper answer to that.

Q125 Mr Williams: Please do.

Mr Thomas: It is not as simple—in fact, if you will take a slightly frivolous example—as saying that the fly half failed to charge down Jonny Wilkinson's drop goal in the final and that fly half lost the World Cup for Australia, it is not that simple. You have to understand the entire gambit of a very massive complex IT enable business change programme. What I would say—and we are not shirking the fact that we gave the best advice we could to the Inland Revenue and we supported going live with this system—ultimately the people in the country, the staff in the Inland Revenue and my 900 colleagues who worked night and day through the difficulties of this programme, they paid the cost of the fact that with our support we went live with the system where we continued to change it up until we were supposed to be testing the system and we compressed our testing.

Q126 Mr Williams: Who made the decision to compress it? Was that at the insistence of the Revenue or a decision you made yourself?

Mr Thomas: The decisions on the programme are decisions made by the Inland Revenue with our support and advice. We advised the Inland Revenue that given the situation we faced, where we had to fix this National Insurance problem, then it was the right thing to do. It was the right thing to do for us to give up our testing window because there was a bigger problem to be solved. The highest risk element to the programme, which was getting claims into payment, we believed that we could prove that was robust in the four weeks that we had and we think we did prove that was robust and the claims were put into payment, as I said, with about 5% of them being up to three days late.

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Q127 Mr Williams: Since the fault emerge through experience, ie through volume of cases and experience.

Mr Thomas: Yes.

Q128 Mr Williams: The decision to cut back, particularly on the volume testing, if you had not cut back is it not possible you might have discovered this fault in advance?

Mr Thomas: That is a very good question and the truth is the problem was the transaction management system which managed the flow of traffic between all the different subsystems of tax credit, that was the problem. You could not recreate that problem in a test environment. As I tried to explain to one of your colleagues earlier it is not always about solving the problem, if you understand that there are bottlenecks in the system, if you understand there is a build up of traffic then you can tune the system so you avoid the situation arising. Would we have been able to tune the system and not have the dreadful problems that we had going live, I honestly cannot answer that. What I do know is that if we had had three months to test the system and not one month to test the system we would have found bottlenecks, we would have tuned the system. I know, also, that even when we had gone live, after eight weeks we had sufficiently tuned the system that with two downtimes a day of about 15 minutes we could get a level of stability from the system. That I do know but I am not claiming, Mr Williams, that we would have found the problem and fixed it in those three months.

Q129 Mr Williams: That is very helpful and very open. Thank you very much. Sir Nick we look forward to seeing you next time.

Sir Nicholas Montagu: Thank you, Mr Williams.

Q130 Mr Field: Sir Nicholas, in answer to Mr Steinberg you presented this as a success. What would have had to have gone wrong for you to have come and admitted to us there was chaos?

Sir Nicholas Montagu: What I said, Mr Field, was something rather different. What I said was that I very much regret the fact that people did not get payments when they should have done, that they had to queue at my local offices and that they had difficulties in getting through to my contact centres.

Q131 Mr Field: I am anxious to use my ten minutes asking questions. Would it be fair to say that however we regard what has happened that is only part of what is going to happen next April, that many of the consequences of this maladministration will be with our constituents when adjustments are made to their tax credits in April?

Sir Nicholas Montagu: What is true certainly is that if your constituents have been overpaid then yes when we do the end of year reconciliation, subject to the points that I have made, we will seek to recover the overpayments.

Q132 Mr Field: Very good. The point you made to Mr Cruddas earlier that here was the most expensive ambitious government programme to move people from benefit to work could be at risk next April when people find that they have nil tax credits or very small tax credits because they will be repaying an overpayment which was not their fault?

Sir Nicholas Montagu: No. I come back again to what I said earlier. First of all, we will never try to recover an overpayment where it would cause hardship.

Q133 Mr Field: All of our constituents who next April may be thinking of giving up work because of the incompetence of this programme should merely say to your officers "You are wrong, you made the error, I wish to work, write off the debt".

Sir Nicholas Montagu: No, the position is, Mr Field, as I have indicated, where we identify an overpayment unless it is an administrative error in the circumstances I have described, we will recover it. I need to be allowed to finish this point without interruption. We will tailor our recovery according to the needs of your constituent. If they are on the maximum rate under no circumstances would we seek to recover it at a rate of more than 10%.

Q134 Mr Field: 10% over what time?

Sir Nicholas Montagu: Over the period that it takes to recover the overpayment. If they can prove hardship we will not seek to recover the payment. If they are on the standard rate, we will recover it at 50%, and if they are receiving only the child element then, and then only, will we recover at 100% of the child care element.

Q135 Mr Field: Maybe we should have a note on the details of recovery or non-recovery.⁵ Can I come back to the examples which have been raised by other members of people trying to pay back money which they knew they were not eligible for.

Sir Nicholas Montagu: Yes. Before you do so, might I just correct myself. I think I said the rate of deduction for overpayments from people on the standard rate was 50%. I should have said 25%.

Q136 Mr Field: That is one of the reasons why we will be grateful for that note. Let us have a talk about people who have received huge sums of money in their bank accounts and they have not been able to repay them. You are saying anybody who wishes to repay can repay?

Sir Nicholas Montagu: Yes.

Q137 Mr Field: Now how can you help my constituent who was overpaid by you by nearly £2,000 because there is some working between you and the Department of Work and Pensions. The run on period for income support, the run on period for housing benefit and the run on period for council tax benefit was cancelled because DWP said, quite rightly, she has got this money from you, although she was not actually at that point working, she was

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working later. So she now faces the prospect of next April having to repay the £2,000 to you and she has lost almost that sum in income support. She has got a double whammy.

Sir Nicholas Montagu: Yes.

Q138 Mr Field: How do you answer that constituent?

Sir Nicholas Montagu: I think the way I have to answer it is to say that if it is as you described it sounds a fairly deplorable example of official error and, going back to what Mr Williams was asking me, would be a pretty clear case for compensation. Could I ask you to write to me about that case?

Q139 Mr Field: She has written to you, maybe you would like to answer her letter. All this business of shoving it on to us so we have to go round the whole country shouting and screaming that you are prepared to pay compensation, it is your job to do that, not our job.

Sir Nicholas Montagu: And we do it.

Q140 Mr Field: You set up helplines and you think that solves the problem. Why should you shift it on to our shoulders when the service you are providing to our constituents is a disgrace?

Sir Nicholas Montagu: I need to take issue with that last point. What I have accepted, and I repeated it at the beginning of your questioning, is the service that your constituents got at the beginning of the year was a result of systems failures and was—

Q141 Mr Field: They have been worried out of their minds, they are worried sick by your behaviour, they have been ringing the numbers you tell them to ring and they can never get through. You take your salary, a lot of my single mums in Birkenhead who have responded to the Government plea will probably cease working next April because of this chaos, and in the meantime they have been worried out of their minds.

Sir Nicholas Montagu: I understand that, Mr Field, and that is why, as I made clear to Mr Williams, we do not rely on you to publicise the availability of compensation, we volunteer it ourselves. May I finish your question?

Q142 Mr Field: Are you taking some television adverts to actually tell people you will apologise?

Sir Nicholas Montagu: No. I have dealt with that point.

Q143 Mr Field: You have not.

Sir Nicholas Montagu: I have dealt with that point in my reply to Mr Williams about why it would not work, it would not be sensible, to have blanket advertising.

Q144 Mr Field: Most of these people know they have been missing—

Sir Nicholas Montagu: Do you want me to answer your questions?

Q145 Mr Field: That is why I am trying to hone you down to the answers. Most of my constituents who have real troubles know you are at fault. Most of the other constituents would not understand what the advert was about but you will get through to them. Why do you not take the maximum opportunities to tell people how to get compensation?

Sir Nicholas Montagu: Because, Mr Field, I have talked about the criteria for compensation. They do not apply to everybody who was affected by the delays or whatever. You know and I know—you have been a Minister—that if you have a television advertisement of that sort we would be inundated with claims, many of them claims which were not valid. That is why my people across the country—complaints handlers, helplines and so on—make it known to your constituents the availability of compensation. The only point I was making to Mr Williams was that you will be a valuable adjunct. The second point I need to answer is, I dispute very strongly that we are giving a deplorable service. What I have accepted was that your constituents did not get the service they and I would have wished as a result of the failure and that—

Q146 Mr Field: Their lives have been roughed up by your behaviour, and you keep saying, “We have not got quite the service we would like to give them.”

Sir Nicholas Montagu: I have said, they have not had at all the service we would like to give them, and that is why, where people were seriously disadvantaged by the results of computer failure, we made the 370,000 interim payments for periods up to five weeks through our local offices.⁶ Nobody likes what happened to your constituents, I least of all, but I am not seeking to defend that.

Q147 Mr Field: But you are not going to do more than pretend you are running a secret society and ask officers to talk to people; you are not going to go public, we know that. On the issue of compensation, will you be providing information to the Comptroller and Auditor General on the nature of your contract and the settlement you make with EDS?

Sir Nicholas Montagu: Yes, I have absolutely no difficulty in giving that undertaking.

Q148 Mr Field: May I move to EDS please. You are also in charge of the child support programme, are you not?

Mr Thomas: We support the Department of Work and Pensions on child support.

Q149 Mr Field: And you have run that programme into the ground?

Mr Thomas: I would not agree with that.

Q150 Mr Field: They cannot transfer any of the existing cases on to your new computers, the whole thing is a farce. I want to register the point, given you have got two mega projects here from the Government which you have managed to win, do

⁶ *Note by witness:* The number of interim payments made was 330,000 not 370,000.

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you not think when you next apply you ought to have a health warning on your application, that the chances are that EDS will mess up the programme if the Government is foolish enough to give you the programme?

Mr Thomas: Mr Field, I am sure you understand I do not agree with that. What I see is that we do a huge amount of work for the Government, we are in a very privileged position to do that, I have 20,000 colleagues across the UK who work extremely hard to try and deliver the IT-enabled business change which the departments want to implement on behalf of the Government. They work very, very hard to deliver against these programmes, they are very challenging programmes and, yes, sometimes these IT programmes go wrong. If you look at the volume of work we do, we do have two very high profile problems which you have just referred to, but we would also suggest that we run a huge amount of IT for the Government and we deliver good service.

Q151 Mr Field: The good news we have for the taxpayers, Mr Thomas, is that after this meeting we are deciding on next year's work, and I shall be asking we do a special study of the CSA. The good news for Sir Nicholas is, if he wants it in retirement, that as many of these problems will come home to roost after April we might have the pleasure of having him back again then.

Sir Nicholas Montagu: It is always a joy discussing with you and your colleagues, Mr Field, within the conventions.

Chairman: We just have a few supplementary questions, if you do not mind.

Q152 Mr Allan: Mr Thomas, can you give us a categorical assurance that had you been made aware during the testing period immediately prior to going live that you would have had the problems which eventually resulted, your advice to the Project Board would have been, "Don't go ahead"?

Mr Thomas: If we had known we were going to end up where we were, we would have said to David Hartnett, "Do not go ahead with this system." We are still working together, we have 254-man years of work to plug in to get Release 4 of this system working, and we are managing that risk very diligently, and if we thought we had a similar problem we would have spoken up.

Q153 Mr Allan: Mr Hartnett, would you on behalf of the Project Board have said to Sir Nicholas, "We cannot go ahead with this project"?

Mr Hartnett: I would have said to Sir Nicholas, "There is a real problem here, we had better invoke the contingency", just as you said.

Q154 Mr Allan: And, Sir Nicholas, you would have gone to the Chancellor and said, "You cannot have your flagship programme on 3 April"?

Sir Nicholas Montagu: Absolutely, "We must invoke the contingency."

Mr Allan: All of you are clear about that. Thank you.

Q155 Mr Bacon: Sir Nicholas, when the accounts are qualified for a publicly quoted company it is common that there is hell to pay at the annual general meeting, and it is common for directors to resign. Did you think of resigning?

Sir Nicholas Montagu: No, not over this at all, Mr Bacon, I am afraid. The plain fact is that though unwelcome it was not a surprise. I am not aware of this Committee having year after year after year sought the resignation of the Permanent Secretary of the Department for Social Security. We always—

Q156 Mr Bacon: I never failed to ask him about this subject.

Sir Nicholas Montagu: We always knew that there would be a high level of error rate. I refer back to the 26% for Family Credit, 30% for Earned Income Tax Credit. It was never going to change overnight. Against that background, it was not a surprise, although as I say it was unwelcome, that Sir John felt constrained to qualify our accounts.

Q157 Mr Bacon: Who is responsible for this mess, in your judgment?

Sir Nicholas Montagu: What do you mean by "this mess"?

Q158 Mr Bacon: I know you taught philosophy for eight years, and I thought you said you were not from the analytic Wittgensteinian tradition, but I think I am referring to the mess we have been discussing for the last two and a half hours.

Sir Nicholas Montagu: We have been discussing two distinct things, Mr Bacon.

Q159 Mr Bacon: Two distinct messes.

Sir Nicholas Montagu: The first is the failure of the IT systems adequately to deliver new tax credits. As I have indicated and as I think Bill has accepted, I think the responsibility for the system being unstable and not fit for purpose for delivery in April rests with EDS as our IT partners. So far as the Working Families Tax Credits over-payments are concerned, obviously the formal responsibility rests with me as Accounting Officer. Against that background, I can only repeat, we knew that it was in the nature of what was still an essential form of benefit that there would be over-payments and errors. We thought that what we needed to do in the interim was, as best we could, within the clerical system to apply our own risk indicators. We have got the error rate down by 3%, as compared with the Department of Social Security—our error rate is 7% below those of the Internal Revenue Service—but I do not pretend a situation which leads to the qualification of accounts, even if it stems from the intrinsic nature of family credit, is a situation in which I take satisfaction.

Q160 Mr Bacon: Thank you, Sir Nicholas. My final question is to Mr Thomas. Sir Nicholas did say there was not much point in having a dog and barking oneself. There is a difference between doing that and walking the plank. In your case you said it was a very challenging programme, one of the most challenging

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ever delivered for Government. What I do not understand is knowing it was so challenging and then seeing that the testing period was being ludicrously compressed, why did you not just say “Stop, we cannot do it within this period, it will be dangerous.”? If they are setting off the space shuttle—this happened on a number of occasions—and there needs to be extra testing because of certain things, they delay the launch.

Mr Thomas: Yes, they do.

Q161 Mr Bacon: Why was that not done?

Mr Thomas: Please remember that this system had been live since October.

Mr Wilson: August.

Q162 Mr Bacon: It had not been adequately tested.

Mr Thomas: This system had been live since August 2002.

Q163 Mr Bacon: You do not mean live in terms of volume, do you?

Mr Thomas: No, the infrastructure, Mr Bacon. The infrastructure was live.

Q164 Mr Bacon: There was electricity running through it, it was not processing all the payments, was it?

Mr Thomas: No.

Q165 Mr Bacon: Why, when it did not work, did you go ahead with it?

Mr Thomas: Sorry?

Q166 Mr Bacon: Why, when the system was not working properly, did you go ahead with it?

Mr Thomas: Because we did not know it was not working until we went ahead with it.

Q167 Mr Bacon: Surely a sensible test would tell you that before you went ahead with it?

Mr Thomas: You cannot simulate volume testing.

Q168 Mr Bacon: In that case you said you allowed 12 weeks of volume testing which got compressed to four weeks. If you cannot simulate volume testing why have 12 weeks, have four weeks, why have any weeks if you cannot simulate it?

Mr Thomas: Why do we not have six months which was what we had on pension credit and pension credit has gone very successfully.

Q169 Mr Bacon: That is a good question. Why did you not?

Mr Thomas: Because it is a different programme. It is a different and more challenging programme.

Q170 Mr Bacon: The point is the same one, test it until you get it right and only then once you have got it right go ahead with it, is that not a sensible thing to do?

Mr Thomas: I think the ability to test at full volume before we go live is definitely the right thing to do but unfortunately in the vast majority of complex system cases you simply cannot do that and we could not do it here.

Q171 Mr Bacon: You have been testing on our constituents essentially like laboratory rats and you will make a profit out of it.

Mr Thomas: No, I would not accept that is what we are doing.

Q172 Mr Bacon: You should be ashamed.

Mr Thomas: I would not accept that is what we are doing. I will say I very much regret what happened. I am not ashamed of what my 900 colleagues did on this system, I am not ashamed of that. I do very much regret the problems that this caused but I am not ashamed of the work that my company did on this.

Q173 Chairman: Mr Thomas, Sir Nicholas has generously taken responsibility for the overpayments but in his earlier answer a few minutes ago, he has firmly blamed you for the fiasco of the new tax credits. Are you happy with his answer?

Mr Thomas: I am not sure that is what Sir Nicholas said.

Q174 Chairman: That is exactly—I am sorry, the record will show—he said it was your responsibility.

Mr Thomas: We have to take responsibility that the IT system was unstable.

Q175 Chairman: Exactly. It is your fault is it?

Mr Thomas: Please, Chairman, could I finish. We take responsibility for the IT being unstable. That contributed to an overall programme problem and we share some responsibility for that but just as we have a partnership with the Inland Revenue, we implemented this programme together and the responsibility has to be shared between us.

Q176 Chairman: You delivered an unstable system to the Inland Revenue.

Mr Thomas: Chairman, I do not think that is the case. This is not like Airbus Industries where the wings are made by BAE Systems and the fuselage is made by EADS and they come together and then fly. These programmes are not like that. IT enabled business change in Government is about an incredibly tight working relationship and you cannot see where the requirements stops and the system starts. It is not as simple as saying that end of the rowing boat sank and that one did not.

Chairman: Our constituents sank in the rowing boat in any event. Gentlemen, thank you very much. The meeting is closed.

Letter to the Committee from Ripon and District Citizens Advice Bureau

We are writing to highlight a case at our bureau, which we believe demonstrates one of the serious problems within the tax credits procedures which are undermining people's confidence in the system. Unless this is tackled urgently we believe it will discourage people from working.

A client at this bureau, who was in receipt of Working Tax Credit and Child Tax Credit, had an overpayment when her hours dipped below 16 per week. She is now on Income Support but Inland Revenue is recovering the whole of her Child Tax Credit each week to repay the overpayment of Working Tax Credit. As Income Support takes this into account as income available to her to support her children, having £38 per week less than the relevant applicable amount means that she is living significantly below the agreed minimum level for a single parent in her circumstances.

At the beginning of November, the client asked Inland Revenue for a "top-up" payment so that she could stagger the repayments. We were told that a payment would come through in about 10 days. Since then we have tried repeatedly to get through to Inland Revenue to find out what is happening but the system is totally impenetrable. The people we speak to on the helpline claim to have no access other than emails to the people dealing with overpayments. We have no way of pressing the urgency and the situation drifts on.

The Government wants to encourage lone parents to go out to work but workers often cannot control the hours they work for an employer. There is a real danger that problems such as my client is facing will undo all the good work the tax credit system does.

On Income Support alone the maximum which could be recovered is £8.10 a week, or £10.80 if she had committed fraud. Less might be recovered depending on her circumstances. She is having over £38 a week recovered from the equivalent income.

The cap on the amount of money which can be recovered by Inland Revenue for people on Income Support must be no more than that which can be recovered by Income Support. There needs to be an agreed maximum and this needs to be implemented immediately to prevent similar situations arising. These problems are causing great difficulties for parents and children and are undermining the tax credit system.

Sue Royston
Welfare Rights Worker

1 December 2003

Reply to Ripon and District Citizens Advice Bureau from the Inland Revenue

Thank you for your letter of 1 December to the Committee of Public Accounts about delays in the receipt of "top-up" payments. They asked me to reply to you as the issues you raise are the responsibility of the Department.

I am sorry for any delays which your client experienced in receiving payments, and also for the obvious failings in the service that your client got from our Helpline.

The general position on top-up payments is set out in our Code of Practice 26 *What happens if we have paid you too much tax credit?* This is currently available online at www.inlandrevenue.gov.uk and paper copies will be available shortly. The Code of Practice makes clear that a claimant should contact us if, as a result of their award being adjusted, their tax credits payments are reduced to a level that causes hardship or if they think a possible overpayment should not be recovered. We will then, depending on the size of their award, make additional payments to bring their tax credits payments back to a higher level.

We set those additional payments taking into account the maximum amounts by which we would reduce an award for the following year if we were collecting an overpayment from it. Someone with children who is getting Income Support, or Jobseeker's Allowance (income-based), would qualify for the maximum amount of child tax credit, not just the family element. The Code confirms that where we are approached by a claimant on the maximum award we would reduce their award by no more than 10%.

We are aware of the need to deal urgently with "top-up" requests, and we have procedures in place to provide early payment. Without further details, and possibly in waiver of confidentiality, it is not possible for me to explain what has happened in your client's case. If the request was made in writing, I can say that we aim to deal with such letters as quickly as we can. I have asked the Tax Credits Office and the Contact Centres to review their procedures to see whether they are working as well as they might.

Whatever has happened on this occasion, we would want to advise your client on the best way to resolve the situation. She may like to provide more information to allow us to look into this further, or if time is of the essence, she may prefer to call into her nearest Inland Revenue Enquiry Centre. Staff at the Enquiry Centre will be able to contact the Tax Credits Office with her details, and if they get authorisation for payment they can make an initial four-week giro payment, within one to two hours.

I hope that this letter will be helpful to your client.

Sir Nick Montagu
Chairman

23 December 2003

Supplementary memorandum submitted by the Inland Revenue

Question 116 (Mr Williams): The Committee asked for note on training and procedures for officials dealing with cases where tax credits have been underpaid and where compensation may be due

BACKGROUND

There are a number of situations in which tax credits underpayments or overpayments may arise. In some cases, for example, customers do not report a relevant change of circumstances or a rise or fall in income, or they notify the Revenue some time after the relevant event. In other cases, the underpayment (or overpayment) may have arisen as a result of official error—this may have been through clerical error or as a result of problems with the IT system. Whenever customers feel that there is a problem with their award, whatever the cause, we would expect them to contact us.

Underpayments and overpayments are formally identified when the award is finalised at the end of the year and we check the amount due against the amount paid. But legislation also allows us to adjust an award during the year if we think an overpayment is likely to occur.

In this way, as in others, new tax credits are responsive. Payments are adjusted during the year so that we pay claimants the right amount over the year, based on our most recent information about their entitlement.

DEALING WITH UNDERPAYMENTS

Where an underpayment is identified, we will pay the difference in a lump sum, as well as adjusting the remaining payments due for that award. As Sir Nicholas outlined in his evidence, where cases of underpayment are the result, or partially the result, of official error we have clear procedures for officials to follow to decide whether compensation may also be due. These are set out in our Code of Practice 1 *Putting Things Right*. A copy of this Code of Practice is attached at Annex A.⁷

We treat each case where compensation may be due on its own merits. We provide specialist training on complaints handling and the application of Code of Practice 1 through workshops tailored to the individual requirements of specialist complaints handlers in the Revenue's various business streams, including the Tax Credits Office and the Inland Revenue Contact Centres. Within the last year these workshops have been provided to experienced complaints handlers within all business streams. We regard our complaints handling to be of a very high standard, but will continue to keep our procedures under review.

Question 135 (Mr Field): The Committee asked for information on the procedures for recovering tax credits overpayments

In the interest of fairness to other tax credits customers who do not get extra money, and to taxpayers generally, we expect claimants to repay overpaid tax credits and it is in everyone's interests that we recover the money as quickly as possible.

During the year, tax credit payments are adjusted so as to pay the right amount of tax credit by the end of the year. We aim to pay people their entitlement for the year as evenly as we can, but changes of circumstances or earlier Giro payments to claimants may make the pattern of payment uneven. We recognise, however, that the adjustment of payments can cause difficulties for some claimants. So, to address this, we have put measures in place to make additional payments of tax credit if the adjustment of an award causes hardship. Our approach is set out in our Code of Practice 26 "*What happens if we have paid you too much tax credit?*" A copy of this Code of Practice is attached at Annex B.⁸

The Department will in the future be writing to tax credits customers with more information about the handling of under- and overpayments, the possibility of their receiving temporary additional payments of tax credits, where adjustments to payments have caused hardship, and the potential for them to claim compensation for official error.

15 January 2004

⁷ Not printed. This Code is available over the internet at <http://www.inlandrevenue.gov.uk/pdfs/cop1.pdf>

⁸ Not printed. This Code is available over the internet at <http://www.inlandrevenue.gov.uk/leaflets/cop26.pdf>