

DEBT MANAGEMENT AND BANKING
ADDING CAPACITY & CAPABILITY PILOT

FINAL EVALUATION

APRIL 2010

DMB Adding Capacity & Capability Pilot

Final Evaluation – April 2010

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Executive Summary

Context

1. In 2008, as part of its debt management strategy, HMRC started to investigate the potential to use private sector debt collection agencies (DCAs) to collect some of its debts. At the same time, the National Audit Office (NAO) published its latest report on HMRC's management of its debts¹ and as part of this also recommended that the department should explore using the private sector to collect some of its debts.
2. The department's initial investigations suggested both private and public sector bodies had gained benefits from using DCAs to collect debts. Consequently, following the agreement of the Financial Secretary to the Treasury (FST), HMRC launched a small scale pilot in May 2009. This report sets out the final evaluation of the pilot, using data and experience up to January 2010.
3. The agreed objective of the pilot was "to establish urgently the feasibility and impact of using private sector debt collection agencies (DCAs)."
4. Within this objective, three high level aims were identified.
 - a). Proof of concept. To establish whether DCAs and HMRC have the operational capability to work together to ensure a viable use of DCAs in the collection of HMRC debts within its legal and administrative framework that does not compromise departmental standards.
 - b). Benefits and costs. To evaluate the benefits that using DCAs to collect HMRC debts can yield, and the costs attached to this - assessing both the financial and customer impacts. As part of this identify where possible any types of debt where DCAs have particular collection expertise that HMRC could not cost effectively or practically build up in-house.
 - c). Adopting best practice. To develop an understanding of the skills and tools DCAs employ, how these contribute to the DCAs' performance in collecting tax debt, and to what extent these could

¹ "HMRC Management of Tax Debts", NAO, 20 November 2008 (HC 1152 Session 2007-2008)

be employed by HMRC to aid wider HMRC debt recovery. This was a key element of the pilot, as the expected benefits in this regard were ones that could not be achieved without using a mix of in-house and contracted out debt collection.

5. The debts chosen for the pilot were selected from those lower value debts for which staff interventions had been limited² – this was also the size of debts that DCAs were most used to handling. Within this, a range of debts were included, covering different values, ages, Heads of Duty, and customer types. At 8 January 2010, almost 16,500 debtors, with initial debts totalling over £16½ million, had been included in the DCA process. While all debts included in the pilot were referred to the DCAs by December 2009, those debts that have not been resolved are to remain with the DCAs until at least the end of March 2010. Those debts secured in payment arrangements with the DCAs will remain with the DCAs until each arrangement concludes.

6. The trials run as part of the pilot and used to measure performance featured:

- Self Assessment (SA) debts – trials featuring both old (older than six months) and new (no older than six months) debts, with values up to £10,000;
- Pay as you Earn (PAYE) – a trial of debts from before 2007/08, with values up to £500;
- Class 2 National Insurance debts (NIC2), at least six months old, up to £700 in value; and
- Class 2 National Insurance Late Registration Penalties (NIC2 Penalties) – at least six months old, £100 in value.

7. In addition to these, trials were run of Value Added Tax (VAT) debts and post County Court Judgement debts (which included customers that had a mix of two or more different Heads of Duty debts). However the DCAs only started to work the debts in these trials in December 2009 – so while these trials provided useful information on the operational impact of referring such debts to DCAs, there was not a sufficient span of data to assess collection

² Subsequent to the design of the pilot, DMB launched further initiatives that changed the way it prioritises debts – in particular the introduction of a Campaigns based approach which led to some lower value debts being pursued more actively than before.

performance for these trials. Preliminary (“Control Go Live”) trials, featuring old SA debts, were run before the main evaluation trials to check the operational systems were working as intended. Further details of the trials can be found in annex A.

8. For the pilot, HMRC was able to engage suppliers used by DWP under an existing government framework contract, without needing to run a full tender process. Two DCAs were used - iQor Recovery Services Ltd and Fairfax Solicitors Ltd.³ Payment for both DCAs was by results only, with a percentage commission paid on successful recoveries. Before the debts were referred to a DCA, HMRC issued a letter, informing the debtor their debt(s) was/were about to be referred to a DCA unless the debtor contacted HMRC and made satisfactory arrangements to deal with the debt. No payment was made to the DCAs for any debt paid as a result of the HMRC letter.

Analysis

Proof of concept

9. The evidence from the pilot evaluation period is as follows.

- a). **The DCAs have the necessary capabilities to collect HMRC debts.** The DCAs demonstrated that they could correctly interpret HMRC’s IT, Finance and Accounting requirements, which were fully validated and approved by HMRC in advance of any proactive recovery work commencing. The debts passed to the DCAs during the pilot were all worked to the agreed strategies, using lettering, telephone and SMS text messaging to contact debtors. From the training provided by HMRC, the DCAs’ front line staff quickly understood the necessary information about the types of debt referred to them. The DCAs also demonstrated that they could work to HMRC’s required standards, most importantly in relation to the use, storage and transmission of data, and customer contact.
- b). **HMRC has the necessary capabilities to use DCAs to collect some of its debts.** The pilot demonstrated that HMRC can provide DCAs with debts prepared to the necessary standard for referral to a DCA, as well as correctly allocating payments made

³Eversheds Solicitors were initially engaged but the functions (and staff) were transferred to Fairfax Solicitors Ltd in late September 2009 following the decision of Eversheds Solicitors to de-merge this part of their business.

via DCAs. While the pilot flushed out issues with the verification of management information, the department was able to monitor and understand DCA performance during the course of the pilot. HMRC established and maintained a collaborative approach with the DCAs.

- c). **All the risks identified with the use of DCAs can be managed to prevent the occurrence of unacceptable outcomes.** Ahead of the start of the pilot, there were concerns that engagement of DCAs could damage HMRC's reputation in a number of ways – not only through the risks associated with customer data being transferred outside the department, but also through the risk of DCAs failing to adhere to HMRC customer standards, particularly given the widespread negative perceptions of private sector debt collection agencies. Briefing was provided to allay these concerns, including active engagement with key customer representative groups ahead of the launch of the pilot. In addition, adherence to standards by the DCAs was monitored during the pilot. As a result there was no evidence that HMRC's reputation suffered any damage as a result of the pilot.

Benefits and costs

10. The evidence from the pilot evaluation period is as follows.
 - a). **DCAs can recover a significant level of debts that would not otherwise be recovered across a range of Heads of Duty.** Recovery rates were significant, and shown to be above recovery rates seen from debts that were not actively pursued.
 - b). **The financial benefits in terms of additional revenues collected by using DCAs can exceed the operational costs.** In all trials measured in the pilot, additional recoveries exceeded costs, markedly so in some cases.
 - c). **Contacting customers as part of this process can also flush out a significant proportion of debts that can be discharged, giving a further reduction in the debt balance.**
 - d). **Using DCAs to pursue debts does not appear to cause any significant additional costs for customers.** The level of

complaints received during the pilot did not give any cause for concern. Nor did taxpayer representative groups raise any general concerns about the operation of the pilot.

- e). **Comparisons of DCA and HMRC performance are not readily available.** The very limited data from the pilot, which relates to new SA debt only, does not provide evidence that DCAs can work these types of debts more cost effectively – however, this cannot be used to draw any wider conclusions.

Adoption of best practice

11. Following work to establish what best practice could be learnt from the DCAs, the project team made a number of recommendations to the Debt Management and Banking (DMB) Management Board. The recommendations related to a variety of areas, including the structure and tone of calls, the approach to payment arrangements once established, telephone centre capacity, and the combined use of communication channels as part of the campaigns approach.

12. While the recommendations flowed from the key differences observed between the DCAs' and DMB's working methods, it should be noted that there was much common ground between the two. The recommendations did not therefore propose any fundamental revision of DMB's methods of operation, but rather supplemented the evolution of working practices that were already in train.

13. Most of the ideas in the recommendations are being taken forward in some form. Given the recommendations were made at the end of 2009, and were still being implemented at the time of writing, it is not yet possible to say what impact the changes will have or to quantify the benefits.

14. It is also difficult to provide a definite answer on the issue of whether using DCAs allows HMRC to identify techniques which allow it to develop its in-house capabilities more quickly than would otherwise be possible. It seems clear there are benefits to be gained in this way, but even if these can be quantified, it is very difficult to determine to what extent these are triggered by the department directly using DCAs.

Conclusions

15. The pilot had three key aims and has provided important answers against each of these.
- a). The pilot has clearly established that both DCAs and HMRC have the operational capability to work together to ensure a viable use of DCAs in the collection of HMRC debts within its legal and administrative framework that does not compromise HMRC standards.
 - b). The pilot has also demonstrated that DCAs can recover a significant level of debts across a range of Heads of Duty, and the financial benefits in terms of additional revenues collected by using DCAs can exceed the operational costs. Nor does there appear to be any significant additional costs for customers from using DCAs to pursue their debts.
 - c). In using DCAs, HMRC was able to develop an understanding of the skills, tools and strategies employed, and to identify how elements of these might be employed by HMRC to aid wider debt recovery work..
16. However, it was recognised at the outset that in part such a controlled small scale pilot could not provide evidence on all areas of interest, and consequently there are some areas where the pilot has not provided answers on the use of DCAs.
- a). Given the novelty and small scale nature of the work, the pilot operated within certain parameters, which may have impacted on both costs and recovery rates.
 - b). The pilot only involved a small proportion of HMRC's total debt stock. The pilot did not identify any reasons why both HMRC and DCAs would not be able to manage a much larger volume of HMRC debts through this process. Possible changes to HMRC's systems to better facilitate the referral of larger volumes of debts to DCAs were also identified. However, the small scale nature of the pilot meant the use of DCAs to manage large volumes of HMRC debts could not be tested.

- c). The nature of the debts selected for inclusion in the pilot, coupled with wider difficulties in comparing HMRC and DCAs' performance on a like for like basis, means very limited information about the relative cost effectiveness of DCA and HMRC operations was obtained.
- d). While there was a reduction in the debt balance as a result of reductions in debt liabilities from customers challenging payment demands, further reductions can be expected once DCAs have exhausted their debt collection attempts and cases are returned to HMRC with information to support a recommendation to remit. There will also be other cases returned from the DCAs with a recommendation to enforce collection, which if pursued would be expected to boost recoveries further.
- e). While some practices have been learnt from the DCAs which can be applied to DMB collection activities, most of these have yet to be implemented, and even when they have, it is difficult to quantify how much the use of DCAs contributed to providing these benefits.

Part I: Context

Background

1.1. In 2008, even before the economic downturn, the underlying trend in the overall value of debts owed to HMRC was upwards. While HMRC had contained the rise in the debt balance by focusing its activities on collecting higher value debts, this represented a small minority of the total debt items received. As a consequence, action on many lower value debt items had been deprioritised, leading to a large rise in the number of outstanding debt items, as well as causing a marked increase in the age of the debt book.

1.2. HMRC therefore started to take a number of steps aimed at improving its internal capability to handle debts and perform better against the department's objectives. However, the size of the challenge faced – particularly in relation to the number of smaller value debt items being received – meant internal capability improvements alone were unlikely to be sufficient to close the growing capacity gap.

1.3. The department therefore started to investigate the potential to use private sector debt collection agencies (DCAs) to collect some of its debts. At the same time, the National Audit Office (NAO) published its latest report on HMRC's management of its debts⁴ and as part of this also recommended that the department should explore using the private sector to collect some of its debts.

1.4. The department's initial investigations found that the use of third party capacity was common amongst UK private sector organisations that handle debt, such as financial service and utility companies. While there was limited evidence of external debt collection agencies being used by foreign tax authorities, other UK public sector organisations, such as the Department of Work and Pensions (DWP) were successfully making use of such bodies.

1.5. Moreover, many academic and industry experts considered best practice to be a mix of internal and contracted out debt collection, as it facilitates the use of a diverse range of practices, promoting innovation, shared learning and the improvement of practices across the organisation. There was also evidence that using DCAs enabled the recovery of some debts that would not otherwise be possible. DWP's experience was that the

⁴ "HMRC Management of Tax Debts", NAO, 20 November 2008 (HC 1152 Session 2007-2008)

DCAs could recover a significant proportion of debts they might otherwise write off. Using DCAs also gave greater flexibility than using additional in-house resource, in terms of both scaling up and reducing capacity to match peaks and troughs in workload.

1.6. As a result, although not without risks, there was a strong case for the department to test whether it could gain some of these potential benefits by piloting the use of DCAs to collect some of its debts. Consequently, following the agreement of the Financial Secretary to the Treasury (FST), HMRC launched a small scale pilot in May 2009. This report sets out the full final evaluation of the pilot, using data and experience up to January 2010.

Objective and aims

1.7. The agreed objective of the pilot was “to establish urgently the feasibility and impact of using private sector debt collection agencies (DCAs).”

1.8. Within this objective, three high level aims were identified relating to proof of concept, cost benefit analysis and process understanding.

Proof of concept

1.9. The first aim of the pilot was: “to establish whether both DCAs and HMRC have the operational capability to work together to ensure a viable use of DCAs in the collection of HMRC debts within its legal and administrative framework that does not compromise HMRC standards”. Three broad questions to address in the pilot were identified.

- a). Do DCAs have the necessary skills and tools to collect HMRC debts?
- b). Does HMRC have the operational capability to use DCAs to collect its debts? For example, does HMRC have sufficient capabilities to cleanse and transfer cases, receive payments, and enter payment and other data from DCAs onto the necessary HMRC systems?
- c). Does the use of DCAs create any additional business risks (e.g. to data security or customer service)? The pilot would be used to understand the nature of the potential additional risks and to understand how HMRC might address and manage these.

Benefits and costs

1.10. The second aim was: “to evaluate the benefits that using DCAs to collect HMRC debts can yield, and the costs attached to this. Where possible, this would include identifying any types of debt where DCAs have particular collection expertise that HMRC’s Debt Management and Banking directorate (DMB) could not cost effectively or practically build up in-house”. There were two areas identified for consideration – financial impact and customer experience.

Financial

1.11. The key tests identified in this regard were to assess whether using DCAs leads to:

- the recovery of money (either by payment in full, or in appropriate cases through robust payment arrangements) that would otherwise not be recovered;
- the recovery of money more quickly than would otherwise be possible; or
- a reduction in the HMRC debt balance as a result of remissions or identification of ‘spurious’⁵ debts’; and
- in all cases, the cost effectiveness of this.

Customer experience

1.12. The second cost benefit issue was to assess the impact on customers from having their debts handled by a DCA. Given the context that the customers here are taxpayers who have not taken steps to resolve tax debts, it was recognised that this could be difficult to assess, and it was decided that surveying those dealt with by DCAs would not be appropriate. This analysis would therefore be focused on:

- complaints against DCAs’ conduct; and

⁵ This is ‘false’ debt which is generated by upstream errors, delays or by weaknesses in departmental processes. These can include both HMRC and customer errors and are a common feature of large debt books. It very often only becomes obvious that individual debts are ‘false’ when DMB starts to work them.

- data on the levels of remissions and robustness of time to pay cases set up following DCA actions.

Adopting best practice

1.13. The final aim of the pilot was: “to develop an understanding of the skills, tools and strategies DCAs employ, how these contribute to the DCAs’ performance, and to what extent these could be employed by HMRC to aid wider HMRC debt recovery. In addition, the pilot would also be used to consider how HMRC could drive continuous improvement from using a mix of in-house and contracted out collection of debts as part of business as usual”. There were a number of elements to this.

- a). What are the techniques, systems, and processes employed by DCAs in managing debt items?
- b). Which of these could be employed by HMRC?
- c). Of those that could be used by HMRC, what are the costs attached to this (e.g. IT investment)?
- d). If these techniques were used by HMRC, what would be the expected performance effect?
- e). Does using DCAs to collect some of its debts allow HMRC to identify techniques which allow it to develop its in-house capabilities more quickly than would otherwise be possible?

Operation and scope

Debt collection agencies

1.14. For the pilot, HMRC was able to engage the suppliers DWP uses under an existing government framework contract, without needing to run a full tender process. Two DCAs were used - iQor Recovery Services Ltd and Fairfax Solicitors Ltd.⁶ Both had a proven track record in managing public sector debts. Each debt package for the evaluation was split between these two providers.

⁶ Eversheds Solicitors were initially engaged but the functions (and staff) were transferred to Fairfax Solicitors Ltd in late September 2009 following the decision of Eversheds Solicitors to de-merge this part of their business.

1.15. iQor began working debts in June 2009; Fairfax came on stream later, working debts from August 2009. Ahead of referring the debts to the DCA, HMRC sent a letter to the debtor explaining what was about to happen and giving them an opportunity to pay or reach an agreement direct with HMRC to prevent the debt being referred.

1.16. The debts remained HMRC's and the department was responsible for the collection and management of these debts, including the associated accounting arrangements. The role of the DCAs was to make contact with the debtor and resolve the debt as appropriate – be it payment in full or on a payment arrangement, or a recommendation to HMRC that further action be taken.

1.17. The DCAs were not asked or empowered to do any home or face-to-face visits or litigation work as part of the pilot. While not seen as tasks that the department should never consider asking private sector bodies to undertake, both of these options would have required legislative and data security constraints to be addressed that would have taken time to resolve and delayed the launch of the pilot.

1.18. In setting the scope of the pilot, it was decided not to create structures and incentives to make the DCAs actively compete against one another. The main objective of the pilot was to test the viability of using DCAs and therefore it was seen as important to foster a spirit of cooperation, not only between HMRC and the DCAs, but also between the DCAs themselves. Comparing the DCAs' performance against one another during the course of the pilot would also have added an extra layer of complexity.

Funding

1.19. The pilot was funded through the Departmental Transformation Programme (DTP), with a budget for 2009-10 of £650,000. This budget covered payments to the DCAs, as well as consultancy and internal IT costs. The staff costs of the project and operations teams were met by DMB.

Timetable

1.20. The pilot evaluation period was set for six months, starting from when the DCAs first began working HMRC debts, so data for the evaluation was taken up to 8 January 2010 (15 January 2010 for the purposes of the DCA - HMRC comparisons exercise discussed in paragraphs (2.85 to 2.91).

However, as envisaged at the outset, the DCAs continued beyond the evaluation period to work the debts referred to them.

Debts

1.21. It was recognised that while it was desirable to include a range of HMRC debts in the pilot, this would need to be balanced against the need to ensure the pilot was managed within operational, financial, legal and time constraints.

1.22. Consequently, at the outset it was recognised that given the novelty of the work, until the pilot had taken place, there would be uncertainty about the exact operational and financial implications of using DCAs. Therefore the project team had to retain flexibility to adjust the volume of work put through the pilot in the light of operational and financial constraints, and to vary the number, size, and timing of the trials through the life of the pilot.

1.23. The debts chosen for the pilot were selected from those lower value debts for which staff interventions had been limited⁷ – this was also the size of debts that DCAs were most used to handling. Within this, a range of debts were included, covering different values, ages, Heads of Duty, and customer types.

1.24. The pre-pilot estimate was that the level of funding would allow 10,000 to 30,000 items to be included in the pilot, with a potential debt value of £15 million to £40 million. Subsequently, the initial recoveries reported (and associated anticipated commission charges) by the DCAs were higher than initially assumed for budget planning purposes, and the value and volume of later packages was trimmed to ensure the pilot did not run over budget.

1.25. At 8 January 2010, almost 16,500 debtors, with initial debts totalling over £16½ million, had been included in the DCA process. While all debts included in the pilot were referred to the DCAs by December 2009, those debts that had not been resolved were to remain with the DCAs until at least the end of March 2010. Those debts secured in payment arrangements with the DCAs will remain with the DCAs until each arrangement concludes. The trials run as part of the pilot and used to measure performance featured:

⁷ Subsequent to the design of the pilot, DMB launched further initiatives that changed the way it prioritises debts – in particular the introduction of a Campaigns based approach which led to some lower value debts being pursued more actively than before.

- Self Assessment (SA) debts – trials featuring both old (older than six months) and new (no older than six months) debts, with values up to £10,000;
- Pay as you Earn (PAYE) – a trial of debts from before 2007/08, with values up to £500;
- Class 2 National Insurance debts (NIC2) - at least six months old, up to £700 in value; and
- Class 2 National Insurance Late Registration Penalties (NIC2 Penalties) – at least six months old, £100 in value.

1.26. In addition to these, trials were run of Value Added Tax (VAT) debts and post County Court Judgement debts (post CCJ - which included customers that had mix of two or more different Heads of Duty debts). However the DCAs only started to work the debts in these trials in December 2009 – so while these trials provided useful information on the operational impact of referring such debts to DCAs, there was not a sufficient span of data to assess collection performance for these trials. Preliminary (“Control Go Live”) trials featuring old SA debts were run before the main evaluation trials to check the operational systems were working as intended. Further details of the trials can be found in annex A.

Other issues

1.27. As well as sending debts to each DCA, control groups of equivalent debts from most trial packages were set up, which were not worked in any way, so that the amount of debt that would be cleared without any active pursuit could be measured – and so to allow an assessment of the additional receipts that could be generated by using DCAs.

1.28. Work was also undertaken to try to compare DCA performance against that achieved in-house by HMRC. However, the purpose of this was to understand how performance compares, not to calculate precisely which type of collection was the most cost effective. As noted in paragraph 1.5, a mix of in-house and outsourced collection is seen as best practice by many through its facilitation of shared learning, and the complementary impact it can have on collection rates. This is explored further in Part II.

1.29. It was also decided not to attempt to measure the wider impact on compliance from using DCAs. It was highly unlikely that any impact on future individual or wider customer behaviour would have been evident within the time span of the pilot. However, this does mean that the measurement of the financial impact of using DCAs is likely to underestimate the true level of benefit to some degree. An assessment of the impact of using DCAs on individuals' compliance could be made by monitoring the long term behaviour of those debtors involved in the pilot against those debtors held in the control groups. However, it is harder to measure the wider impact of using DCAs on the compliance of those debtors who have not been referred to a DCA - but who might improve their compliance in response to the perceived possibility of being referred to a DCA.

Part II: Analysis

2.1. This section sets out analysis of the operation of the pilot, centred around the three high level aims of the pilot: proof of concept; benefits and costs; and adopting best practice.

Methodology

2.2. To address each area of interest, a number of hypotheses were defined under each high level aim (a full list of these is at annex B). The evaluation techniques that would be used to test each hypothesis were also identified, and the necessary procedures for these put in place. The main techniques used to generate the information used to inform this evaluation were as follows.

- a). Collections performance data from both the DCAs and HMRC. As well as data on collections and payment arrangements made by HMRC and the DCAs, data was collected on cases that were not actively worked to allow an assessment of the additional revenues collected as a result of the DCA process.
- b). Audit and assurance reports. While audit and assurance processes were an important part of governance regardless of the evaluation, for the pilot they were used to provide information for the evaluation, particularly regarding the achievement of standards, such as storage and use of taxpayer information by DCAs.
- c). Complaints data. Detailed complaints data was collected from the DCAs and AC&C operations team to allow assessment of both adherence to service standards, as well as broader customer experience.
- d). Stakeholder experience. Qualitative data was drawn from the experience of staff in HMRC (both those directly involved in the pilot and more broadly across the department), the DCAs (including through ad hoc site visits) and also other interested parties such as debtor representative bodies.

Proof of concept

Summary

2.3. The first test of the pilot was to establish whether DCAs and HMRC have the operational capability to work together to ensure a viable use of DCAs in the collection of HMRC debts within its legal and administrative framework that does not compromise departmental standards. There were three aspects to this.

- a). Do the DCAs have the necessary skills and tools to compliantly collect HMRC debts?
- b). Does HMRC have the operational capability to use DCAs to collect its debts?
- c). Does the use of DCAs create any additional business risks?

2.4. The evidence from the pilot evaluation period is that:

- the DCAs have the necessary capabilities to collect HMRC debts;
- HMRC has the necessary capabilities to use DCAs to collect its debts; and
- all the risks identified with the use of DCAs can be managed to prevent the occurrence of unacceptable outcomes.

2.5. A number of constraints were deliberately applied to the pilot, both to allow it to be up and running relatively quickly and also to reduce some of the risks that were identified with such a novel process. It may be operationally possible to ease some of these constraints in any future use of DCAs (and by doing so boost recovery rates and reduce costs of operation). The main areas are:

- investing in IT enhancements to allow more automation of both the debt preparation and payment allocation processes (this should also facilitate the use of DCAs on a large scale);

- addressing potential legislative constraints to allow DCAs more freedom of action (e.g. in making doorstep collections and the way they apply time to pay arrangements);
- including a wider range of both debts (e.g. tax credit debts) and debtors (e.g. those of pension age); and
- where a debtors' existing debts have been referred to a DCA, referring to the DCA any subsequent debts, penalties and/or accumulating interest incurred by that debtor.

Methodology

2.6. The main evaluation techniques used were the findings of audit and assurance work, HMRC operational team and DCA experience, and quantitative and qualitative complaints data.

DCA capabilities

Introduction

2.7. Evidence from the industry prior to the pilot suggested that DCAs were well versed in collecting debts on behalf of their clients, and doing this in a way that met the standards of both regulatory and industry bodies, such as the Office of Fair Trading (OFT) and the clients themselves. This included government bodies such as DWP. However, it was of course a key aim of the pilot to test whether this also held for HMRC – whose debts and debtor relations can have some significant differences to those of other bodies (for example the customer relationship with HMRC is a non-voluntary, usually ongoing, relationship for both sides).

Collection activities

2.8. Prior to receiving HMRC debts, each DCA set out its proposed strategy for working the debts. For each DCA, the strategies included letters, telephone contact and SMS messaging, and the strategies set out when each stage would take place. Fairfax also used postcard contact.⁸

⁸ Given their public nature, postcards were suitably worded to ensure they did not breach taxpayer confidentiality requirements.

2.9. Legislative uncertainties, coupled in some areas with data security constraints, meant that for the pilot DCAs were not asked to carry out the full range of collection activities. For example, DCAs were not permitted to make doorstep visits or to take enforcement action, and payment arrangements with debtors had to be within the same parameters as permitted by HMRC. However, these constraints did not prevent the DCAs from successfully collecting debts.

2.10. Initial audit visits included a random check of cases and in all instances found cases had been worked in line with the agreed strategy. Both DCAs also agreed to provide data on action history on a case by case basis, to allow HMRC to perform a comprehensive check that all cases had been worked as agreed. While HMRC resources had not been available to undertake all this analysis at the time of the evaluation (see paragraph 2.34) the willingness of DCAs to make this data available for scrutiny gives further assurance that they were confident they had worked the debts as required.

Data

2.11. One of the key operational issues was data - its provision, storage, use and transfer between HMRC and the DCAs. There were no difficulties with the sending, receiving, storage and use of data by DCAs.

2.12. The DCAs were able to successfully use their IT systems to load and manage the cases referred to them. While there were queries on specific cases in all trials, this was entirely within expectations for such a novel process. Similarly, for payment information, audit and assurance checks showed that the DCAs provided correct payment details, including amounts, effective dates of payments, and work item allocation.

2.13. The need to work within the constraints of existing IT systems, combined with departmental data security requirements, meant that for the duration of the evaluation period, taxpayers details had to be passed between HMRC and the DCAs on encrypted CDs by couriers. The DCAs were able to manage the security measures required for such a process and there were no incidents of data loss by the DCAs in this process. Audit and assurance checks also showed that the DCAs had stored and destroyed the discs they received in line with HMRC requirements. The use of the Secure Electronic Transfer (SET) as the medium for transferring data to and from the DCAs was progressed during the pilot, and was put in place for both DCAs in early 2010.

This will reduce HMRC's costs and improve the timeliness and security of data transmission.

2.14. The DCAs both provided performance data and other management information as required by HMRC, and in general no problems were identified with this data (though as discussed in paragraph 2.34, HMRC had not had the resources to verify the DCA reports through analysis of the raw case level data).

2.15. However, in early 2010, HMRC detected that commission charges being made by both DCAs were lower than anticipated from the recoveries data they were submitting. On investigation it was identified that both DCA had separately made errors that had led to them both double counting some payments made directly to HMRC in their performance statistics (but neither had made any error in their commission invoices). As a result, the reported debt collected at the start of January 2010 was around £610,000 higher than it should have been. This problem required the performance data to be re-calculated and verified to ensure there were no further issues.

Customer contact

2.16. The letters used by both DCAs were agreed with HMRC in advance of being used. In addition, training and guidance given to both DCAs included direction on language and assertions that can be made during telephone contact with debtors. HMRC also ensured that both DCAs had clear procedures in place for dealing with any complaints that were made.

2.17. As a result, the contacting of customers by the DCAs worked successfully with no major issues.

- a). From the 16,500 debtors involved in the pilot, 43 complaints were made in total (one quarter of a per cent of the debtors) and 18 of these were upheld. Additionally, towards the end of the evaluation period, key taxpayer representative groups were asked to provide any general concerns they had had about the operation of the pilot – no comments were received.
- b). The audit and assurance visits included listening to a random selection of calls to ensure these were being conducted in line with HMRC requirements and found no major areas of concern.

- c). Debtor representative groups (including Citizens Advice Bureau and TaxAid) were briefed ahead of the pilot and asked to notify the project team of any customer problems they became aware of regarding the operation of the DCAs in the pilot. Additionally, towards the end of the evaluation period, these groups were asked to provide any general concerns they had had about the operation of the pilot – no comments were received.

HMRC capabilities

Introduction

2.18. Before the pilot was undertaken, it was clear that many other organisations, including other public sector bodies, had successfully used DCAs to collect their debts. However, the nature of both HMRC debts (for example the variety and complexity of rules across different head of duties) plus the way in which HMRC manages its debts (for example using multiple IT systems) had the potential to raise some unique challenges for HMRC in its use of DCAs.

Data preparation

2.19. Before the pilot began, a major area of uncertainty was the quality of HMRC data being passed to DCAs (e.g. accuracy of debtor contact details). The DCAs' previous experience with some other organisations was that inadequacies in data (e.g. missing or out of date information) were only exposed when debts were first passed to DCAs. Consequently recoveries for such cases were difficult.

2.20. However, the results from the pilot showed that the HMRC data passed to the DCAs was of good quality. The feedback from both DCAs was that the quality of HMRC data significantly exceeded the quality of data supplied by other organisations and contributed to the high recovery rates seen (discussed further in paragraph 2.56).

2.21. The initial Control Go Live trials used two levels of data cleansing – minimum cleanse (ensuring the debts met the agreed pilot criteria) and maximum data cleanse (doing additional work to provide as much data as possible for the agreed fields for each debt). The additional data preparation involved in the latter trial provided little by way of benefit as it had no significant impact on the cases that were subsequently identified as

unsuitable for DCA action. Consequently, all subsequent trials proceeded on the basis of a minimum data cleanse – this did not trigger a significant number of queries or complaints that could have been avoided by a more thorough data cleanse.

2.22. The experience from the pilot suggests that it may be possible to further reduce the amount – and therefore costs – of data preparation work without excessively impacting on recovery rates or the level of subsequent problems and queries with cases once transferred to the DCAs.

2.23. To minimise costs and avoid the need for long lead in times, the pilot operated within the confines of the existing IT architecture. This was a significant factor in the relatively high level of clerical work within HMRC that was required to prepare the debts before referral to the DCAs. While the department was able to successfully prepare debts using existing IT systems and clerical interventions where necessary, this was within the context of a small scale pilot. It is likely that referring much larger volumes of debts to DCAs would benefit from improved internal IT capabilities. In addition, the amount and ease of data preparation also varied by debt type and therefore while the pilot demonstrated that data could be prepared to the necessary standard across all the trials that were run, there may be cost reasons to not include certain types of debt in future use of DCAs – explored further in the benefits and costs section (paragraph 2.65).

Collection processes

2.24. The main collection activity for HMRC was the issuing of the letter informing each debtor that their debt was about to be referred to a DCA, and the response this generated. This issuing of letters was a relatively straightforward exercise, achieved using pre-existing capability within the department's main debt management system, the Integrated Debt Management System (IDMS).

2.25. The responses received by HMRC to these letters were managed within available resources. The volume of responses (including those contacting HMRC to make payment) was between 25 and 35 per cent of letters issued for most trials; although it was significantly lower (less than 20 per cent) for both trials involving NIC2 related debts and the trial of post County Court Judgment debts. For nearly all the trials, the main channel of response was telephone (over 80 per cent of responses) – the only exception

to this was the post County Court Judgment trial, where one third of responses were made by letter.

2.26. The final area of collection activity undertaken by HMRC was the monitoring of those payment arrangements set up with HMRC. HMRC did not have the resource to monitor these payment arrangements with the same regularity as that performed by the DCAs for the payment arrangements they establish. However, all the payment arrangements established by HMRC as part of the pilot were revisited towards the end of the evaluation period, and only a small minority (in both volume and value terms) had broken down. All those cases that had broken down were revisited, but only in a small proportion of the cases were arrangements re-established. Given the constraints of pilot funding, these cases were not referred to the DCAs.

Data security

2.27. As previously discussed, data security requirements and the constraints of HMRC's IT systems meant that when the pilot started, the only way in which taxpayers details could be passed between HMRC and the DCAs with the required encryption was by CD. Consequently these CDs needed to be couriered between HMRC and DCAs, giving rise to a risk of loss in transit (no such losses occurred), as well as adding costs. In addition, the time HMRC's IT partners require to produce an encrypted CD introduced a significant time lag into the process, with a five day gap between HMRC uploading the data and DCAs receiving it, thus requiring HMRC to provide an additional update file (which could be done via secure email).

2.28. There were clear benefits in terms of security, accuracy, timeliness and cost of moving away from the use of CDs to electronic transmission of data. Even if the department were to make no further use of DCAs, it was advantageous to establish such a link as part of the pilot to allow transmission of data relating to those cases in payment arrangements that the DCAs retained. Consequently work was undertaken during the pilot to progress the use of the Secure Electronic Transfer (SET) as the medium for transferring data to and from the DCAs. While resource constraints meant this was not established as quickly as initially hoped, the use of the Secure Electronic Transfer (SET) as the medium for transferring data to and from the DCAs was put in place for both DCAs in early 2010.

Payments management

2.29. HMRC successfully managed payments and payments data coming in from the DCAs, and the department's Head of Duty systems were successfully updated. Each DCA made a single composite CHAPS⁹ payment each week and provided the details of individual customer payments on a spreadsheet. There was an initial delay in getting the payment update process working while perceived risks to HMRC's wider use of CHAPS were addressed, but this was quickly resolved and did not generate any material problems.

2.30. A more significant longer term issue relates to the processing of payments for NICS contributions. The limitations of existing HMRC IT systems meant clerical intervention was required to process NICS payments. While this operated satisfactorily for the purposes of the pilot, it suggests any longer term use of DCAs to collect significant volumes of NICS debts would benefit from some improvements to manage incoming payments.

2.31. IT limitations also meant that for the pilot the DCAs were not asked to calculate or collect accruing interest and penalties once the debts had been referred to them. As new debts were not included in the pilot, any new debts relating to debtors who were already being pursued by DCAs were not referred to the DCAs to be linked to the old debts. These amounts would instead be collected separately by HMRC. There could be benefits for both HMRC and debtors if it were possible to allow DCAs to calculate and collect the full amount outstanding, as well as collect debts that arise subsequent to the debt being referred to the DCA, but both policy and practical implications would need to be resolved.

Supplier management

2.32. Learning from the experience of other public sector bodies, HMRC recognised the need to ensure the department had in place the appropriate skills, systems and resources to manage the relationship with the DCAs and monitor their performance. In addition, the department purchased some consultancy advice from a leading industry broker to provide advice on relationship management and performance analysis.

⁹ CHAPS (Clearing House Automated Payment System) is an electronic bank-to-bank same-day value payment made within the UK in sterling.

2.33. Feedback from both HMRC project staff and the DCAs themselves suggests relationships worked well, and in particular all sides developed and maintained a cooperative approach. The DCAs were also positive about the training and guidance provided by HMRC.

2.34. HMRC was able to monitor DCA performance on an ongoing basis and held regular performance meetings with both DCAs to interrogate their results and understand the reasons for performance in each of the trials. However, pressures on analytical resources during the evaluation period, for example to build the spreadsheets to allow internal management information to be recorded and analysed, meant it was not possible to obtain nor analyse raw case level data from the DCAs during the evaluation period. If such resource had been available, it is likely the performance statistic errors made by the DCAs (see paragraph 2.15) would have been detected sooner. Such analysis would also have given strong additional assurance that the data provided by the DCAs was robust, and that the results were being provided by the two DCAs on the same basis.

2.35. Given that commission costs relating to debts referred to the DCAs manifest themselves over the course of several years while payment arrangements set up by the DCAs are fulfilled, it was necessary to develop a cost profile forecast so that the volume and value of trial packages could be sized appropriately. This was particularly important where the funding has a set monetary ceiling, as was the case for the pilot.

2.36. A costing model was developed by KAI which was able to use data provided by the DCAs about payment arrangements in place and expected break rates of these arrangements to forecast future commission costs. While the mid-pilot forecasts for 2009-10 looked like being higher than actual costs, this is mainly due to the problem with the input data provided by the DCAs (see paragraph 2.15) rather than the subsequent modelling undertaken by HMRC.

2.37. At the time of this evaluation it was not possible to say how accurate the forecasts were for the future years of 2010-11 and 2011-12, though the expected recoveries – and consequent commission costs – for these later years were higher at the end of the evaluation period than had been expected in the early stages of the pilot. This reflected a changing view of the profile of recoveries, with more recoveries occurring later as some payment arrangements broke down but were subsequently re-established.

Business risks

2.38. Ahead of the launch of the pilot, a number of potential risks associated with using DCAs were identified, and appropriate mitigation strategies put in place. During the evaluation period none of these risks were realised as significant problems, nor did any significant unanticipated difficulties arise.

2.39. A key concern was the security of data transmitted to and from and held and used by the DCAs. No problems arose in this regard. Before any data was transmitted to the DCAs, HMRC data security accreditation was obtained. This included checks of the DCAs' premises and systems, plus full documentation of all the data movements that were involved during the pilot processes. As noted in paragraph 2.27, IT constraints and ensuring the necessary security for taxpayer data initially meant transferring this data between HMRC and DCAs by encrypted CD, but Secure Electronic Transfer was subsequently put in place, giving greater levels of protection.

2.40. Another key concern was whether DCAs would adhere to the standards of customer treatment that are required by HMRC - again, the operation of the pilot provided considerable assurance. Even before the pilot started, the DCAs demonstrated during discussions with HMRC that they readily understood the importance of maintaining departmental standards, and could point to a proven track record in this regard in managing DWP debts. To provide safeguards, the contracts agreed with the DCAs for the pilot explicitly set out the need to adhere to HMRC standards, as well as guidelines issued by both the Office of Fair Trading (OFT) and the Credit Services Association (CSA).¹⁰ As set out in paragraph 2.17, there were a limited number of complaints, and audit and assurance visits also provided reassurance that the DCAs met the required standards.

2.41. Audit and assurance visits also verified that the DCAs were meeting HMRC requirements in regard to customer authentication, with the necessary checks taking place before DCA operators requested settlement of the debt. Information was not imparted to persons other than the debtor unless a written authority was held.

¹⁰ "Debt collection guidance-Final guidance on unfair business practices", July 2003 (updated December 2006) OFT

(www.oft.gov.uk/advice_and_resources/publications/guidance/consumer_credit_act/of664) and "Code of Practice", September 2008, Credit Services Association

(www.csa-uk.com/page/codes-and-standards/code-of-practice)

2.42. The referral of cases to DCAs also created the risk that HMRC would work cases which were with a DCA, or a DCA would work cases which had been subsequently suspended or returned to HMRC. During the evaluation period there were no instances of DCAs working cases that had been returned to HMRC. In the early stages of the pilot there were some instances of debtors who had already been referred to a DCA contacting HMRC (specifically Debt Management Telephone Centre and the Business Payment Support Service) and setting up payment arrangements, but guidance was subsequently issued to provide clarity to HMRC staff that such debtors should be advised they need to discuss any payment arrangements with the DCA.

2.43. Ahead of the start of the pilot, there were concerns that engagement of DCAs could damage HMRC's reputation in a number of ways. However, there is no evidence that the image of HMRC suffered from its use of DCAs. This reflects work that was undertaken as part of the pilot to ensure the associated risks were appropriately managed.

- a). The DCAs used were on the existing DWP framework, and had a proven good reputation, including in collecting debts on behalf of DWP. Departmental checks were also undertaken on the DCAs to ensure they had a sound financial record.
- b). Contracts with the DCAs included adherence to both HMRC standards and relevant industry codes and as part of contract discussions, assurance was gained that the DCAs understood the importance of this.
- c). A detailed stakeholder management strategy that was put in place. This included identifying and briefing key debtor representative groups such as Citizens Advice Bureaux, TaxAid and the Low Income Tax Reform Group (LITRG), ensuring these groups correctly understood the nature and purpose of the pilot, and could accordingly brief their wider stakeholders.
- d). The project team also worked closely with HMRC Press Office to identify the likely main areas of interest and produce a clear, correct, and consistent message. While there was some media interest and Parliamentary questions prompted by the start of the pilot, clear pre-planned briefing lines allowed the department to address these and correct initial misconceptions, which mainly

focused on concerns that the pilot would involve inappropriate use of bailiffs and other enforcement action.

- e). Some parameters were placed on the pilot to deliberately reduce the risk of reputational damage – for example both debtors of pensionable age and those claiming benefits were excluded from the pilot. In addition, as part of the data preparation process checks were made to ensure inappropriate cases were not brought into the pilot (e.g. if the debtor was deceased).

2.44. The pilot therefore established that HMRC can manage the risks associated with the use of DCAs, albeit with an associated impact on costs and potential recoveries.

2.45. An equality screening assessment was also undertaken ahead of the launch of the pilot. In most areas no specific issues for particular groups were identified – and no issues for these groups manifested themselves in the pilot. The equality screening assessment identified the need to consider the specific needs of visually and hearing impaired customers, as well as people for whom English was not a first language.¹¹ Audit and assurance checks verified that both DCAs had measures in place to facilitate communication with both hearing and visually impaired customers. Both DCAs also employed a number of agents who could speak a language other than English. Audit and assurance checks did not identify any case where a debtor with special needs was inadequately supported.

¹¹ It was recognised that the needs of Welsh language users would be difficult to accommodate during such a small scale pilot and consequently Welsh language cases were excluded from the pilot.

Benefits and costs

Summary

2.46. The second test of the pilot was to evaluate the benefits that using DCAs to collect HMRC debts can yield and the costs attached to this - assessing both the financial and customer impacts. As part of this, where possible, the pilot would look to identify any types of debt where DCAs have particular collection expertise that HMRC could not cost effectively or practically build up in-house. There were two areas identified for consideration – financial impact and customer experience.

2.47. The key tests identified in regard to financial impact were to assess whether using DCAs leads to:

- the recovery of money (either by payment in full, or in appropriate cases through robust payment arrangements) that would otherwise not be recovered;
- the recovery of money more quickly than would otherwise be possible; or
- a reduction in the HMRC debt balance as a result of remissions or identification of ‘spurious’¹² debts; and
- in all cases, the cost effectiveness of this.

2.48. The second area was customer impact. Given the context that the customers here are taxpayers who have not taken steps to resolve tax debts, it was recognised that this could be difficult to assess, and it was decided that surveying those dealt with by DCAs would not be appropriate. This analysis would therefore be focused on:

- complaints against DCAs’ conduct compared to those about HMRC conduct; and
- data on the levels of remissions and robustness of time to pay cases set up following DCA actions.

¹² This is “false” debt which is generated by upstream errors, delays or by weaknesses in departmental processes. These can include both HMRC and customer errors and are a common feature of large debt books. It very often only becomes obvious that individual debts are “false” when DMB starts to work them.

2.49. The evidence from the pilot evaluation period is:

- DCAs can recover a significant level of debts that would not otherwise be recovered across a range of Heads of Duty;
- the financial benefits in terms of additional revenues collected by using DCAs can exceed the operational costs;
- contacting customers as part of this process can also flush out a significant proportion of debts that can be discharged, giving a further reduction in the debt balance;
- using DCAs to pursue debts does not appear to cause any significant additional costs for customers; and
- comparisons of DCA and HMRC performance are not readily available – the very limited data from the pilot, which relates to new SA debt only, does not provide evidence that DCAs can work these types of debts more cost effectively – however, this cannot be used to draw any wider conclusions.

Methodology

2.50. The status of each debt included in the pilot was monitored and captured at each stage of the DCA process to build the aggregate picture of the volumes and values of debts recovered, in payment arrangements, cleared, or still unresolved.

2.51. In addition, control groups of equivalent debts from most trial packages were set up, which were not worked in any way, to allow evaluation of the additional receipts generated by using DCAs.

2.52. Some work was also done to gauge how DCA performance compared against that of HMRC, though it should be noted there were considerable limitations around this analysis (set out at paragraph 2.88).

2.53. The costs had a number of different elements. While the direct costs of using the DCAs were captured by the DCAs' commission charges, there were additional costs incurred by HMRC, primarily in staff time, for example from preparing the debts. For the purposes of assessing the costs of using DCAs on an ongoing basis, it was necessary to split out the HMRC costs that

relate to one off project costs (such as pilot design and the collation of the additional management information needed for this evaluation).

Financial impact

2.54. This section looks at the financial impact of using DCAs. It considers: the recovery rates achieved and how these recoveries split between the HMRC pre-referral stage and DCA action itself; the impact of the debtors who would have paid without active intervention; costs, and how these break down between DCA commission costs and HMRC's internal costs; the overall cost effectiveness of the DCA process for each type of debt; and the impact on the debt balance from amendments to debts owed.

Recoveries

2.55. There are three key metrics.

- a). Actual recoveries at 8 January 2010. This includes all money recovered both directly by HMRC and also by the DCAs, the latter including funds which had not yet been transferred to HMRC.
- b). Debts held in payment arrangements at 8 January 2010. That is the value of outstanding debt owed by debtors who had entered into payment arrangements with either HMRC or a DCA - these payments should be made over the course of two years, with the bulk of payments falling in 2010/11.
- c). Projected final recoveries. This is the assumed final recovery rate, calculated by adding actual recoveries as 8 January to that proportion (65 per cent) of payment arrangements at 8 January that are assumed, on the basis of DCAs' previous experience, will be collected. This assumes that no recoveries will be made on debts that were not already in recovery at 8 January – in time this should prove to be cautious, as DCAs continue pursuit of those debtors, and also as some of the debts returned uncollected to HMRC are taken to enforcement.

2.56. Recovery rates at 8 January were significant in all the trials. Further recoveries from debtors who had entered into payment arrangements were projected to boost the final recovery rate by up to 10 percentage points. This suggest DCAs are capable of collecting debts across a range of different

Heads of Duty. There is a considerable range of projected recovery rates across the trials (between one quarter and three quarters of initial debt by value). There are a number of potential factors that explain this.

- a). Recovery rates are lower for higher value debts (this is observed in the results of different value debts in the Self Assessment debt trials).
- b). Recovery rates are higher for new debts than old debts (this is observed by comparing equivalent value debts in the three Self Assessment debt trials). The results of the control groups also show that proportionately more payments are made without any active intervention for newer debts (see paragraph 2.60).
- c). It is harder to assess the extent to which recovery rates vary by Head of Duty, as the different recovery rates shown between the trials may also be a function of differences in the age and value of the debts.

2.57. The HMRC letter informing the debtor that their debt was about to be referred to a DCA prompted a significant proportion of the total debt collected. As DCAs receive no commission for these payments, it was a very cost effective and valuable part of the process. However, with the exception of the new SA trial, the majority of the collections were made by the DCAs themselves. When expressed as a percentage of the debts they were instructed to work, the DCAs had achieved recovery rates of between 20 per cent and 50 per cent by 8 January 2010.

2.58. As set out in paragraph 1.18, in setting the scope of the pilot, it was decided not to create structures and incentives to make the DCAs actively compete against one another.

Additionality

2.59. As noted in paragraph 2.56, recovery rates are likely to be driven in some part by those debtors who would have taken action to clear the debt without active intervention. In order to know how to best deploy DCA resources, it is important to understand the extent to which certain types of debt will clear without active intervention. Therefore, as well as capturing the outcome of each debt included in the DCA process, control groups of equivalent debts from most trial packages were set up, which were not

worked in any way, to allow evaluation of the additional receipts generated by using DCAs.

2.60. While there were relatively few clearances in the control groups for most Heads of Duty, there was a noticeable clearance rate in the control groups containing SA debts (both new and old debts). The results for new SA debts is not surprising as, by definition, this trial included debts that had recently arisen, and therefore would contain debtors who simply had not been organised enough to pay on time as well as those who were deliberately hoping to avoid payment.

2.61. For older SA debts, the reasons for the smaller, but still relatively high rates of clearance in the control groups is less obvious. However, it should be noted that, even where there is no active intervention, SA customers with outstanding balances are automatically sent regular statements of liability – this is likely to prompt some debtors to pay their debts, and so contribute to the seemingly high payment rate for SA debts in the control groups. Unsurprisingly, the results from the control groups also showed that for debts over £2,000, debtors were less likely to take action to resolve it without active intervention.

Costs

2.62. There are two main elements to the costs incurred through the use of DCAs: (i) the direct costs of the DCAs themselves; and (ii) internal costs to HMRC in supporting the DCA process.

2.63. For the pilot, the DCA charges were structured as a straight commission charge on successful recoveries only, meaning there was a direct relationship between the value of recoveries made by the DCAs and the costs of using DCAs. This is a common pricing structure in the industry, though it is possible to vary this to suit individual needs.

2.64. Internal HMRC costs, by contrast were not directly linked to the value of recoveries.¹³ There were three main areas¹⁴ of internal costs:

- data preparation;
- issuance of HMRC letters and managing responses to these;
- DCA liaison, including ensuring processes working as needed, managing queries on individual cases, and monitoring performance.

2.65. The costs incurred by HMRC for each trial can be considered both in terms of (i) each £1000 debt included in the trial, and (ii) each debtor included in the trial. Costs per £1000 debt were highest in the NIC2 penalty debts and the PAYE trials, and lowest in the SA trials. Costs per debtor were markedly higher in the post CCJ trial than any of the other trials, with the lowest costs for those trials featuring old SA debts.

2.66. The difference between these two figures for each trial are a function of the average debt value. For example, for the NIC2 Penalties trial, the average debt value was £100, and so the cost for each £1,000 debt included was simply ten times the cost per debtor. Conversely, for the post CCJ debts trial, the average debt value was £2,200, and so the cost per £1,000 debt included was less than half that of the cost per debtor.

2.67. Data preparation costs were the largest element of HMRC costs, representing about two thirds of total HMRC costs. These costs varied with the volume of debts included in the trial, but were also driven by the ease with which debts could be extracted from HMRC systems. The high costs per debtor for the post CCJ trial reflected the fact that these debts were not easily identifiable on HMRC systems, and consequently a large amount of manual clerical work was required to enable this.

2.68. While the issuance of HMRC letters was a very small element of total HMRC costs, the resources required to manage responses was more significant, representing up to 20 per cent of total HMRC costs. There is

¹³ Costs calculations were based on standard HMRC metrics for staff costs, which include associated overhead costs. As set out in paragraph 2.53, those costs, such as those associated with this evaluation, which relate solely to the pilot and would not be incurred as part of business as usual work, have been excluded for the purposes of this cost analysis.

¹⁴ For the trials involving NIC2 related debts, there were also some minor costs associated with correctly accounting for the payments made to HMRC.

some relationship between these costs and recoveries, as it includes the cost of dealing with those debtors who contacted HMRC to make payment before the debt was referred to a DCA. This contributed to the HMRC costs for the new SA trial being higher than for the old SA trial (with the costs of the trial containing both old and new debts being in between these two).

2.69. Excluding those trials that the DCAs only began working in December 2009, liaison costs were around 15 per cent of total HMRC costs for most trials. The exception to this was those trials containing old SA debts, where the figure was around 25 per cent. These differences are driven by the number of queries HMRC received from the DCAs. While it is difficult to be certain about the reason for this difference, it should be noted that the old SA trial and the mixed old and new SA trial were the first two evaluation trials worked, and therefore may simply have been reflective of the initial bedding in process. Additionally, the average value of debts was higher in these two trials than the others, and therefore it may also have been reflective of debtors with larger outstanding debts being more likely to question the amount owed.

Overall cost effectiveness

2.70. An assessment of the overall cost effectiveness of the DCA process can be made by combining the effect of the recoveries achieved through the DCA process, the impact of recoveries that would have been made without any active intervention, and the costs of using DCAs.

2.71. It should be remembered that these results are based on collections (and payment arrangements) made up to 8 January 2010. While, for most of these trials, the DCAs are likely to have made the vast majority of such recoveries and payment arrangements by that time, it is likely that further recoveries could be made once cases are returned to HMRC with a recommendation to enforce (which would of course also involve further associated costs).

2.72. There was considerable variation in the cost effectiveness of the various trials, and the cost effectiveness of each trial did not follow the projected additional recovery rates. The additional recoveries associated with the NIC2 penalty debts and PAYE debts trials were marginally higher than the associated collection costs; the additional recoveries associated with the NIC2 trial were comfortably above the associated collection costs; and the additional recoveries associated with the SA trials were substantially above the associated collection costs.

2.73. The SA debt trials were clearly the most cost effective, despite the higher recovery rates seen in other trials. Part of this difference is driven by the lower costs of the SA debt trials. However, there is very limited scope to compare performance between different Heads of Duty. In particular, it seems likely that the differences between trials in cost effectiveness were in part driven by the fact that the average debt value was higher in the SA debt trials than the non SA trials. This is supported by the detailed results from within the old SA debt trial. This shows the amount recovered per £1 spent was almost double for debts between £5,000 and £10,000 in value as for those up to £500 in value – despite recovery rates in the latter group being much higher than in the former group.

2.74. It is extremely likely that any future use of DCAs could be achieved at a much lower cost. For example, some internal IT investment could reduce the amount of clerical activity that was required in the pilot to prepare the debts, and allow larger volumes of debt to be extracted from the debt systems to be worked through the DCA process. The SET system for data exchange (see paragraph 2.28) will also reduce costs.

2.75. It is also clear from discussion with both DCAs that their recovery rates were higher than they had expected ahead of the pilot, reflective of the good quality data (e.g. up to date telephone and address details) supplied with the debts. Costs could therefore be reduced further in two ways.

- a). DCAs could be expected to charge lower commission for working any further debts of a similar quality passed to them by HMRC.
- b). HMRC could trade this off by reducing the amount of quality assurance performed as part of the data preparation. However, it would be necessary to assess the impact of this on customers, HMRC downstream costs (in terms of additional queries from DCAs and also additional complaints from customers), and on recovery rates, in order to gauge where the optimum cost-benefit balance lay.

2.76. Moreover, the low additional recoveries per cost ratios of some debt trials does not by itself mean there is little merit in using DCAs to collect these debts. The pilot results suggest for all the debt types included in the performance analysis, DCAs can be used to collect debts cost effectively.

2.77. In addition, there are likely to be wider compliance benefits from using DCAs. Not only might those debtors referred to a DCA be more likely to improve their future compliance to avoid such experiences in the future, but also wider compliance amongst taxpayers not referred to a DCA could be boosted as the publicity generated and the reputation of DCAs alone may be enough to prompt some customers to pay more promptly. This impact was not measured as part of the pilot study. It was highly unlikely that any impact on future customer behaviour would have been evident within the short time span of the pilot. In addition, it would also have been extremely difficult to disaggregate the effect on the compliance of the wider community from other factors, both in terms of other changes in HMRC's debt collection and enforcement methods and external influences (such as changes in economic conditions). However, this does mean that the measurement of the financial impact of using DCAs is likely to underestimate the true level of benefit to some degree.

Reductions

2.78. In addition to reductions in the debt balance due to the collection of overdue payments, the DCA process also prompted a further reduction in the debt balance of £1 million (over 6 per cent by value of the debt included in the trial) as a result of reductions in debt liabilities from customers contacting HMRC to challenge and correct payment demands. Further reductions can be expected once DCAs have exhausted their debt collection attempts and cases are returned to HMRC with information to support a recommendation to remit.

Customer experience

2.79. As part of the assessment of benefits and costs, the pilot also sought to assess the impact on customers from having their debts handled by a DCA. Given the context that the customers here are taxpayers who have not taken steps to resolve tax debts, it was recognised that this could be difficult to assess, and it was decided that surveying those dealt with by DCAs would not be appropriate. This analysis was therefore focused on complaints against DCAs' conduct.

2.80. The level of complaints received during the pilot does not give any cause for concern. From the 16,500 debtors involved in the pilot, 43 complaints were made in total (one quarter of a per cent of the debtors) and 18 of these were upheld. Additionally, towards the end of the evaluation

period, key taxpayer representative groups were asked to provide any general concerns they had had about the operation of the pilot – no comments were received.

2.81. This low level of customer complaint can be attributed both to the approach of the DCAs and also safeguards put in place by HMRC. The letters used by both DCAs were agreed with HMRC in advance of being used. In addition, training and guidance was given to both DCAs including direction on language and assertions that could be made during telephone contact with debtors. HMRC also ensured that both DCAs had clear procedures in place for dealing promptly with enquiries/disputes and complaints made. All complaints were monitored closely and then reviewed as part of the audit and assurance process to ensure adherence to customer standards.

2.82. The robustness of payment arrangements was also identified as a measure of customer experience – if breakage rates were high then it could indicate that the DCAs were attempting to make debtors pay debts at levels higher than the debtors could afford. Audit and assurance checks of DCA assessments for payment arrangements did not suggest that either DCA had tried to make debtors pay back more than could be afforded.

2.83. Moreover, the approach of both DCAs to payment arrangements – quickly seeking to contact debtors who missed payments and also regularly revisiting those debtors who maintained payment arrangements, can be considered to serve the interests of customers. This both identifies those whose ability to pay may have reduced and allows more suitable payment arrangements to be set up, and also those whose financial circumstances have improved since the payment arrangement was established and so are able to clear their debt quicker than previously supposed.

2.84. The other area of customer experience identified as important was ensuring customers could be confident that contact from a DCA regarding their HMRC debt was genuine – particularly as once referred to a DCA, the debtors made their payment(s) to that DCA, not direct to HMRC. No major issues with customer verification were identified during the evaluation period, reflecting the success of the safeguards put in place in this regard. Not only did the final HMRC letter tell each debtor the name of the DCA that their debt would be referred to, but correspondence sent by the DCAs also

signposted a page on the HMRC website¹⁵ where the DCAs' activity could be verified.

Comparison with HMRC performance

2.85. As part of the benefits and costs aim, it was noted that it would be desirable to know what debts (in terms of e.g. size, type, age, previous actions taken) are best pursued by HMRC and which best referred to a DCA for pursuit. The pilot therefore sought to gain some understanding of the relative performance of DCAs in collecting HMRC debts against that of HMRC itself.

2.86. However, to make the best use of resources, the pilot was deliberately scoped such that the types of debts referred to DCAs were lower value debts for which DMB staff interventions had been limited, and as a consequence there was not a ready evidence base to make a comparison of performance in collecting like for like debts.

2.87. In order to enable the evaluation to include some comparison of relative performance, the trial involving new SA debts was run simultaneously to the separately planned DMB campaign on these types of debts, and a representative sample of debts in this campaign were tracked to allow comparison with the DCA trial.

2.88. While the small scale nature of this trial and limitations in comparable costs data mean the results should be treated with caution, they suggest that – for these types of debt – the recovery rates achieved by DMB and the DCAs are broadly similar. Although the overall costs of using DCAs are somewhat higher, as already discussed in paragraphs 2.74 and 2.75, there are strong reasons to believe these costs could be markedly reduced. In particular, for this type of debt, given the high recovery rates seen, DCAs ought in future to be willing to work similar debts for a much lower commission rate.

2.89. These (limited) results therefore do not provide any evidence that DCAs would provide a more cost effective means of collecting these type of (new SA) debts than existing HMRC capacity. Given the limited nature of the exercise, it is not possible to draw any wider conclusions about which, if any, of HMRC's debts would be best pursued through DCA action.

¹⁵ <http://www.hmrc.gov.uk/payinghmrc/debtcollectors/>

2.90. Looking at other organisations, evidence suggests that debt collection work is rarely either entirely performed in-house or entirely outsourced. There are two identified reasons why organisations use DCAs to collect certain types of debt.

- a). Not all debts or debtors are the same and consequently it is likely that some debts (of a certain size, type or age/stage of recovery) are best collected in-house, while others are best referred to a DCA for pursuit. For example, many bodies (including DWP) will pass debts to DCAs only after they have first attempted (and failed) to collect/resolve these using internal means. As HMRC looks to develop its ability to segment its debts so that appropriate recovery actions can be better targeted, it may be better able to identify types of debt that are best referred to DCAs for collection.
- b). There would be additional costs associated with expanding internal capacity (e.g. from training and expanding the departmental estate to house staff). Therefore, where there is a temporary increase in debts owed (e.g. at a particular time of year, or in HMRC's case, due to a deterioration in the economy), DCAs may well provide a better solution, as they could give greater flexibility, both in terms of up scaling and in terms of reducing capacity once the debt balance returns to a steady state level.

2.91. Moreover, there may be gains to organisations from using DCAs over and above any efficiencies the DCAs have in collecting certain sorts of debt.

- a). A mix of in-house and outsourced collection methods are often used as complementary parts of the overall debt collection strategy. The threat of a debt being referred to a DCA at a later stage can prompt greater and earlier compliance. This does not necessarily require DCAs to operate in a fundamentally different way to the internal body – the general reputation of DCAs in many debtors' minds means there is always going to be a perception that the DCAs will be tougher and the experience more unpleasant. Unfortunately it is very difficult to quantify this effect and no attempt to do so was made for the pilot.
- b). Having different organisations approaching collection with different tools, skills, strategies and techniques facilitates a permanent and rich set of "champion challenger" collection approaches, allowing

identification of the most effective and efficient methods that can then be applied more widely. The next section set out the results of the exercise undertaken as part of the pilot to assess what practices HMRC could learn from the DCAs.

Adopting best practice

Summary

2.92. The third aim of the pilot was to develop an understanding of the skills and tools DCAs employ, how these contribute to the DCAs' performance, and to what extent these could be employed by Debt Management & Banking (DMB) to aid wider HMRC debt recovery. This would help determine whether it is possible to drive continuous improvement from using a mix of in-house and contracted out collection of debts as part of business as usual. There were a number of elements to this.

- a). What are the techniques, systems, and processes employed by DCAs in managing debt items?
- b). Which of these could be employed by HMRC?
- c). Of those that could be used by HMRC, what are the costs attached to this (e.g. IT investment)?
- d). If these techniques were used by HMRC, what would be the expected performance effect?
- e). Does using DCAs to collect some of its debts allow HMRC to identify techniques which allow it to develop its in-house capabilities more quickly than would otherwise be possible?

2.93. Following work to establish what best practice could be learnt from the DCAs, the project team made a number of recommendations to the DMB Management Board. The recommendations related to a variety of areas, including the structure and tone of calls, the approach to payment arrangements once established, telephone centre capacity, and the combined use of communication channels as part of the campaigns approach.

Methodology

2.94. The main work undertaken for this strand of activity was undertaken by two experienced managers from DMB Operations. They each visited one of the DCAs to assess how they operate, how this compares with DMB methods, and what they thought could be adopted by HMRC to provide benefits to the way it collects debts in-house. Project team members also

contributed ideas from their own observations of the way the DCAs worked. From this a number of recommendations on changes to DMB ways of working were made to the DMB management board. This work took place in autumn 2009 with the recommendations made to the DMB management board in December 2009.

Impact

2.95. Most of the ideas in the recommendations are being taken forward in some form. Given the recommendations were made at the end of 2009, and were still being implemented at the time of writing, it is not yet possible to say what impact the changes will have or to quantify the benefits.

2.96. It is also difficult to provide a definite answer on the issue of whether using DCAs allows HMRC to identify techniques which allow it to develop its in-house capabilities more quickly than would otherwise be possible. While it seems clear there are benefits to be gained in this way, even if these can be quantified, it is very difficult to determine to what extent these are triggered by the department directly using DCAs.

- a). Some recommendations did represent genuinely new ideas – for example consistently asking debtors for immediate payment upfront in telephone conversations (previously, individual telephone techniques had been less consistent in their approach and had not always emphasised the importance of addressing the debt through the order and tone of the conversation).
- b). While several of the recommendations made already tied into work that was planned within HMRC – for example expanding telephone capacity in evenings and at weekends – being able to draw on DCA experience can still be useful in providing assurance that others have already developed these techniques successfully, understanding how working methods can be implemented in practice, and ways in which methods can be further extended.
- c). Moreover, using DCAs certainly helps to engender a constant culture of looking at wider developments in the debt collection industry to see what techniques can be adapted and adopted. The process of identifying and assimilating best practice is therefore likely to be an ongoing benefit of continued use of DCAs, rather

than limited to the one off capture of best practice achieved as part of the pilot.

Other areas of difference

2.97. Finally, it should be noted that there were some operating practices used by DCAs that were not considered to be appropriate for adoption by DMB. These factors may however contribute to any differences in productivity and performance between DMB and DCAs and therefore should be borne in mind as part of those considerations. The two key areas are set out below.

- a). Performance based pay. While differing in detail, in both DCAs a significant proportion of each member of staff's remuneration is based on the amount of debt they personally secure. In addition, the pay of the team leaders is linked to the overall success of their teams.
- b). Educative role. For the pilot, the deliberate decision was made not to ask the DCAs to undertake any customer education work as part of their customer contact as would be done by DMB staff – e.g. explaining to taxpayers how to ensure future compliance. DCA staff were instead focused on collecting the debt referred to them. It is difficult to gauge what impact this has on future compliance of those individuals, but it is likely to mean DCAs are able to make more, shorter calls to debtors than DMB can achieve.

Conclusions

2.98. The pilot had three key aims and has provided important answers against each of these.

- a). The pilot has clearly established that both DCAs and HMRC have the operational capability to work together to ensure a viable use of DCAs in the collection of HMRC debts within its legal and administrative framework that does not compromise HMRC standards.
- b). The pilot has also demonstrated that DCAs can recover a significant level of debts across a range of Heads of Duty, and the financial benefits in terms of additional revenues collected by using DCAs can exceed the operational costs. Nor does there appear to be any significant additional costs for customers from using DCAs to pursue their debts.
- c). In using DCAs, HMRC was able to develop an understanding of the skills, tools and strategies employed, and to identify how elements of these might be employed by HMRC to aid wider debt recovery work.

2.99. However, it was recognised at the outset that in part such a controlled small scale pilot could not provide evidence on all areas of interest, and consequently there are some areas where the pilot has not provided answers on the use of DCAs.

- a). Given the novelty and small scale nature of the work, the pilot operated within certain parameters, which may have impacted on both costs and recovery rates, for example:
 - i). the DCAs had only recently started working the VAT debt and post CCJ debt trials at the point the data was gathered for this evaluation, and so the performance results from these trials were not available;
 - ii). using the existing DWP framework agreement contract, coupled with no previous knowledge of DCA recovery rates for HMRC debts limited the commission rates the DCAs were able and willing to offer;

- iii). the pilot operated with existing HMRC IT capabilities, meaning a relatively large amount of clerical work was required to prepare the debts ahead of referral to the DCAs;
 - iv). to reduce the risks associated with the initial use of DCAs, certain types of debts and debtors were excluded from the pilot;
 - v). the DCAs were not asked or empowered to do any home or face-to-face visits or litigation work as part of the pilot;
 - vi). the DCAs were not asked to actively compete against one another, nor were their relative performance statistics shared between them to encourage this; and
 - vii). no widespread publicity was given to the use of DCAs, which may have encouraged improved compliance beyond those directly referred to the DCAs.
- b). The pilot only involved a small proportion of HMRC's total debt stock. The pilot did not identify any reasons why both HMRC and DCAs would not be able to manage a much larger volume of HMRC debts through this process. Possible changes to HMRC's systems to better facilitate the referral of larger volumes of debts to DCAs were also identified. However, the small scale nature of the pilot meant the use of DCAs to manage large volumes of HMRC debts could not be tested.
- c). The nature of the debts selected for inclusion in the pilot, coupled with wider difficulties in comparing HMRC and DCAs' performance on a like for like basis, means very limited information about the relative cost effectiveness of DCA and HMRC operations was obtained.
- d). While there was a reduction in the debt balance as a result of reductions in debt liabilities from customers challenging payment demands, further reductions can be expected once DCAs have exhausted their debt collection attempts and cases are returned to HMRC with information to support a recommendation to remit. There will also be other cases returned from the DCAs with a

recommendation to enforce collection, which if pursued would be expected to boost recoveries further.

- e). While some practices have been learnt from the DCAs which can be applied to DMB collection activities, most of these have yet to be implemented, and even when they have, it is difficult to quantify how much the use of DCAs contributed to providing these benefits.

**DMB ADDING CAPACITY & CAPABILITY PROJECT TEAM
APRIL 2010**

List of annexes

Annex A. Details of pilot debt trials

Annex B. Evaluation hypotheses