



NATIONAL AUDIT OFFICE

# Report by the Comptroller and Auditor General

Department of Health and Social Security:  
Statutory Sick Pay Scheme

*Ordered by the House of Commons to be printed  
19 November 1984*

LONDON  
HER MAJESTY'S STATIONERY OFFICE  
£2.60 net

This report is presented to the House of Commons in accordance with Section 9 of the National Audit Act, 1983.

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National Audit Office  
16 November 1984

# Contents

## **Department of Health and Social Security: Statutory Sick Pay Scheme**

	<i>Pages</i>
<b>Summary and conclusions</b>	1–2
<b>Report</b>	
Part 1: The 1980 Green Paper Proposals	3
Part 2: Outline of Scheme	4
Part 3: Financial Effect of Scheme on Public Funds, National Insurance Fund and Employers	5–6
Part 4: Checks on Employers' Records	7–8

# **Department of Health and Social Security: Statutory Sick Pay Scheme**

## **Summary and conclusions**

1. This Report records the results of an initial examination by the National Audit Office (NAO) of the operation of the Statutory Sick Pay (SSP) scheme which employers were required to operate under the Social Security and Housing Benefits Act 1982 with effect from April 1983. The examination showed that the Department of Health and Social Security (DHSS) had been able to make substantial staff savings as a result of the introduction of the scheme, that overall the Exchequer was expected to benefit financially and employers were expected not to lose, but that DHSS inspection of the early operation of the scheme had fallen short of planned coverage and had shown that significant numbers of relatively minor mistakes had been made by employers in assessing entitlement to SSP.
2. In 1980, following a review of the National Insurance sickness benefit scheme, the Government proposed that employers should take over from DHSS responsibility for providing sick pay for employees in the initial weeks of incapacity. Following discussion of the proposals, the Government introduced legislation to give effect to them.
3. Under the Social Security and Housing Benefits Act 1982 employers in Great Britain became responsible from 6 April 1983 for paying SSP to their employees for up to eight weeks of incapacity for work due to sickness in any tax year. SSP replaced most employees' short-term entitlement to sickness benefit and, unlike that benefit, it is subject to income tax and National Insurance contributions. Each month employers may recover in full from National Insurance contributions due for payment over to the Inland Revenue Department (IRD) any payments of SSP they have properly made.
4. DHSS estimated that in 1983-84 terms employers' expenditure on SSP in a full year would amount to £615 million and that National Insurance sickness benefit paid by the Department to those ineligible for SSP, and to longer-term claimants, would total £255 million. They also estimated that the introduction of SSP, together with an associated change in National Insurance contributions and extra tax revenue, would result in a net gain to the Exchequer of £90 million.
5. As employers are permitted to recover SSP paid to employees out of National Insurance contributions DHSS considered it necessary to undertake a complete survey of the operation of the scheme by visiting all known employers (originally estimated at over one million). They allocated 1,600 staff to this task.
6. This report records the preliminary findings of the NAO examination and covers the period up to the end of August 1984. At that time full information was

not available about the operation of the scheme in 1983-84, and DHSS had not completed their survey of employers. I intend to report again when more information is available. (Similar arrangements applied in Northern Ireland from 6 April 1983 and were administered by the Northern Ireland Department of Health and Social Services; they were therefore outside the scope of NAO examination).

7. The main findings in the following Report are summarised below.

(a) Whilst the decision to allocate staff to survey employers' operation of SSP meant that a lower target had to be set for DHSS manpower savings, significant savings have in fact been made and the lower target has been exceeded (paragraph 3.3).

(b) The Government Actuary expects SSP payments in 1983-84 to be some 10 per cent lower than his earlier estimate and this is likely to reduce the estimated gains to public funds (paragraph 3.5).

(c) Employers as a whole were expected to have benefited by an estimated £90 million in 1983-84, because they are permitted to offset SSP against contractual payments due for the same day. This amount should cover any extra administrative and indirect costs incurred by employers in operating the scheme (paragraph 3.8).

(d) About one third of DHSS's 1,600 strong SSP inspection staff have full powers to investigate all aspects of employers' operation of the scheme. The remainder were not appointed as Inspectors and are dependent on the goodwill of employers in order to perform their duties (paragraphs 4.4 — 4.7).

(e) After the first complete round of surveys of employers' operation of SSP, DHSS intend to concentrate on those employers identified as more likely to make mistakes or abuse the scheme; they do not intend that inspection staff should check a random sample of employers (paragraph 4.10).

(f) It is doubtful whether the current checks are entirely adequate and, as anticipated from the outset, not all employers were visited by the target date of July 1984 (paragraphs 4.9 — 4.13).

(g) DHSS inspections have shown a significant number of relatively minor mistakes by employers in operating the SSP scheme. An abuse of the rules has come to notice and steps have been taken to close the loophole in the law which allows it (paragraphs 4.14 — 4.15).

8. DHSS have informed me that the scheme was launched with remarkably little difficulty and is running quite smoothly (paragraph 2.10).

# **Department of Health and Social Security: Statutory Sick Pay Scheme**

## **Report**

### **Part 1: 1980 Green Paper Proposals**

1.1 In April 1980 the Government published a Green Paper "Income During Initial Sickness: A New Strategy" (Cmnd. 7864) drawing attention to the diminution in the importance of National Insurance sickness benefit because of the large percentage of employees covered by occupational sick pay schemes. Administrative machinery was duplicated because DHSS were still having to devote considerable resources each year to processing 10 million claims for sickness benefit, most of which were for short periods of incapacity. The Government thought it right to review the role of the National Insurance scheme in the belief that the State should wherever possible disengage itself from activities which firms and individuals could perform perfectly well for themselves. Payment by employers during the early weeks of sickness was also found to be a common practice abroad. It was therefore proposed to use employers' sick-pay arrangements as a basis for a new scheme under which all National Insurance contributors would be guaranteed sick pay from their employers during the initial weeks of incapacity.

1.2 The Government explained that a consequence of the duplicate administrative arrangements was that it had

proved difficult to bring sickness benefit into tax and there was no early prospect of doing so. Many employees were financially better off when sick rather than in good health and the Government suggested that payments under the new arrangements should be treated as wages and made subject to tax and contribution liability.

1.3 The Government proposed to compensate employers as a whole for extra costs arising under the scheme on a broad basis, largely through a once-for-all reduction in their National Insurance contribution liability. Some employers would be better and some worse off depending upon such factors as the incidence of sickness of their employees and whether or not they had previously had a sick-pay scheme. However after considering comments on the proposals from employers and others, the Government conceded that compensation should take the form of full recovery of SSP payments made by employers.

1.4 As regards administration of the scheme, DHSS recognised that there would be additional administrative costs for some employers but they considered that such costs were likely to be small. The new scheme would however achieve a reduction in civil service work and staff numbers.

## Part 2: Outline of Scheme

2.1 The Social Security and Housing Benefits Act 1982 places a statutory duty on employers to pay SSP to their employees who are unable to work because of sickness. These payments replace an employee's entitlement to National Insurance sickness benefit which may be claimed only when SSP is not payable or is exhausted. SSP is not payable for example to employees who are over minimum State pension age, those taken on for a specified period of no more than 3 months, and those who have average weekly earnings less than the lower weekly earnings limit for National Insurance contribution liability. These employees, along with the self-employed and unemployed who are also excluded from the new scheme, continue to receive sickness benefit for all eligible periods of incapacity.

2.2 To qualify for SSP an employee has to meet three conditions. First, there must be a day of incapacity for work which forms part of a period of incapacity for work (PIW) of four or more consecutive days. Second, the day of incapacity must be part of a period of entitlement for SSP and, third, the day of incapacity must be a qualifying day. Qualifying days are agreed between the employer and employee and although they are usually the employees' normal working days, or days chosen to reflect the normal pattern of working, the rules allow great flexibility in the way they are determined.

2.3 No SSP is payable for the first three qualifying days in a PIW (waiting days). An employer's maximum liability in respect of an employee is to pay eight times the appropriate weekly rate of SSP in any one tax year, or PIW if it runs from one tax year to another. Unlike National Insurance sickness benefit which is at a basic rate for the claimant — from November 1983 £25.95 per week for those under retirement age, with additions of £16.00 per week for a dependant spouse and 15p for each child — SSP is paid at one of three flat rates based on normal earnings with no additions for dependants. The 1983–84 rates of SSP applied from April 1983 and were £27.20 for those whose average weekly earnings ranged from £32.50 to £48.49, £33.75 for those with earnings ranging from £48.50 to £64.99, and £40.25 for those with higher earnings. There is a statutory obligation on the Secretary of State to review the rates and earnings bands annually having regard to the movement in prices and to lay before Parliament either an order to increase them appropriately or a report explaining the reasons for not so doing.

2.4 SSP is subject to income tax under PAYE and to National Insurance contribution deductions. The rates of SSP were originally set so that, as a group, employees would be broadly in the same financial position that they would have been had sickness benefit been brought into tax. DHSS estimated that SSP would bring some 90 per cent of payments during short-term sickness into tax. However, National Insurance sickness benefit remains free from income tax and National Insurance contribution deductions although since 1980 it has been set approximately 5 per cent lower than would have been justified by the general level of price increases partly to take account of this fact.

2.5 The Act provides that SSP shall be offset against contractual remuneration and vice versa. Accordingly SSP

counts towards any occupational sick pay paid by the employer to his employee for the same period. The Act does not permit an employee to contribute to his own SSP and where occupational sick pay is paid from a jointly funded scheme the employer can only offset sick pay in the same proportion as the employer's contribution bears to the total contributions to the scheme. An employee who disagrees with his employer about SSP can refer the question to the independent social security and adjudicating authority.

2.6 Regulations made under the Act require employers to take reasonable steps to make known to their employees the procedures for notifying incapacity for work. Employers may also ask for reasonable evidence of an employee's incapacity, for example, by a self-certificate for periods up to 7 days and by a doctor's statement for longer periods. Regulations require employers to record details of employees' periods of incapacity for work and to make the records accessible to inspectors appointed by DHSS.

2.7 Employers are entitled under the Act to recover any payments of SSP from their contributions payments, ie, payments in discharge of any liability in respect of primary (employees') or secondary (employers') Class 1 National Insurance contributions, but not National Insurance surcharge. The Act also provides for reimbursement from the National Insurance Fund of any payments of SSP which employers are unable to recover from contributions.

2.8 The Act extends to SSP provisions in the Social Security Act 1975 which empower the IRD to combine collection of contributions with collection of income tax. Regulations made under the Act require employers to maintain records relating to the deduction of SSP from contributions payments. However employers are not required to notify the amount of such deductions in their monthly returns to the IRD, and the total expenditure on SSP in any year will not be known until employers' end of year returns, which do show total SSP payments, are collated.

2.9 The Act makes provision for regulations to be made to deal with wrong payments of SSP when sickness benefit was due and vice versa, by recovery of the amount overpaid from the payment properly due. However DHSS have not been able to devise workable procedures to be specified in such regulations. Accordingly employers are responsible for recovering from their employees any SSP overprovided, while DHSS apply normal statutory rules for recovery of any State benefit overpaid because SSP was properly due instead.

2.10 The Department informed me in July 1984 that they considered that the scheme had been launched with remarkably little difficulty, that it was running quite smoothly and that very few complaints had been received from employers and employees. They referred me to a recent report of an independent body. This report said that although one employers' organisation considered that the scheme was not working satisfactorily, in general it appeared to be running smoothly and there had been less confusion and fewer problems than expected.

## Part 3: Financial Effect of Scheme on Public Funds, National Insurance Fund and Employers

3.1 The Explanatory and Financial Memorandum to the Social Security and Housing Benefits Bill set out the expected financial implications of the proposed SSP scheme. The main effects in a full year were shown as a reduction in public expenditure by £385 million and a reduction in contribution income to the National Insurance Fund by £565 million. However, acting under the provisions of section 7 of the 1982 Act, the Secretary of State increased the rates of SSP quoted in the Memorandum prior to the scheme coming into operation, thus altering the effect on the Fund.

### Overall effect on public funds

3.2 In February 1983 DHSS prepared the following revised estimate in 1983–84 terms of the effect of the scheme on public funds in the first full year, (ie excluding adjustments for transitional effects and time lags in claiming reimbursement).

Gains	£m	Losses	£m
National Insurance sickness benefit saved	405	Amounts reimbursed to employers	615
DHSS administration cost savings	30		
Extra income tax collected on SSP	135		
Extra National Insurance Contributions collected:			
— employers	40		
— employees (general)	40		
— in respect of married women paying at the lower rate	50		
Extra National Insurance Surcharge	5	Net gain to public funds	90
	705		705

Thus although it was estimated that extra income tax and National Insurance Surcharge would amount to £140 million, as the loss to the National Insurance Fund of £50 million (see paragraph 3.6 below) had to be offset against this the net gain to public funds was expected to be £90 million.

3.3 Under the proposals in the Green Paper the Government hoped that DHSS would be able to save 5,000 staff. However, because of the change eventually conceded by the Government in the method of compensating employers it became necessary for DHSS to allocate more staff to the examination of employers' records. Accordingly the Explanatory and Financial Memorandum to the Bill envisaged manpower savings of 3,000 leading to a reduction in administrative costs of £30 million. In December 1983 the Department stated that they had achieved staff savings of 3,342.

3.4 The additional income tax and National Insurance contributions were expected mainly for the reasons

described in paragraph 2.4 above. Married women who have elected to pay reduced rate National Insurance contributions are ineligible for most National Insurance benefits but are entitled to SSP. Their contribution rate has therefore been increased, providing additional income (expected to total £50 million in 1983–84 terms) to finance their new entitlement.

3.5 The Government Actuary provided estimates of amounts recovered by employers in respect of SSP payments in 1983–84 in both his 1982 and 1983 reports on the contribution re-rating orders. These estimates took full account of transitional effects and lags in employers recovering the SSP they had paid. The 1983 estimate was reduced to £488 million, compared with the previous year's estimate of £540 million, as a result of a continuing decline in claims to sickness benefit which he assumed also to be reflected in reduced claims to SSP. Lower SSP payments mean consequential reductions in some of the tax and contribution gains. DHSS informed me that it was not possible to estimate the actual gains because this would depend on how much sickness benefit would have been payable had the system not changed. No data is available on this nor would any data be reliable since the change in the system may itself have affected short-term sickness experience.

### Effect on National Insurance Fund

3.6 As the additional income tax and National Insurance surcharge receipts are not credited to the National Insurance Fund, the introduction of SSP was expected to result in a loss to the Fund of £50 million in 1983–84 terms. [As shown in paragraph 3.2 above, the DHSS administration savings of £30 million together with the increased National Insurance contributions of £130 million would fall £50 million short of the increase of £210 million (£615 less £405 million) in sickness payments to individuals borne on the Fund]. The Treasury agreed that in the first year any actual loss would either be left on the Fund or met from voted funds by increasing the Supplement paid from Class XVIII, Vote 10. It would not be met from increased National Insurance contributions paid by employers and employees. DHSS informed me that in practice the actual extent of this loss was extremely hard to estimate with any precision as April 1983 receded and it became progressively more difficult to say with any certainty what would have happened in the absence of SSP. But in any event they considered that it was not of a size to affect, more than very marginally, the level of contributions needed to keep the Fund in balance year by year.

### Effect on Employers

3.7 Employers recover the full cost of SSP paid to employees but are not directly compensated for their administration and other indirect costs of operating the SSP scheme. Employers have also had to meet the cost of extra employers' National Insurance contributions and National Insurance surcharge. However, because some employers made payments under occupational sick pay schemes, their actual extra costs will be less than the amount of recoverable



SSP paid. For example, employers who prior to the introduction of SSP took no account of National Insurance sickness benefit, and whose employees remained on full pay when sick, will in future have to provide less sick pay from their own resources. On the other hand employers who did not operate any occupational sick pay scheme will now incur additional administrative costs.

3.8 DHSS estimated that under SSP employers as a whole would have extra direct costs of £480 million in sick pay above the payments they would have made through occupational sick pay schemes. With additional National Insurance

contributions and surcharge of £45 million, the total extra costs of £525 million compared with the £615 million which employers would be reimbursed under the SSP scheme. DHSS considered that the difference of £90 million should be sufficient to cover any extra administration and indirect costs which employers might incur as a result of the introduction of SSP. DHSS's calculation was based partly on figures taken from a Survey of Occupational Sick Pay Schemes published in 1977. If, as seems likely, there has been increasing use and improvement of such schemes since 1974 (when the data for the survey was collected) the net benefit to employers would be higher.

## Part 4: Checks on Employers' Records

### Arrangements for checking operation of SSP

4.1 Because they can readily recover SSP from National Insurance contributions employers have little incentive to ensure that all the SSP payments they make are strictly in accordance with the Act and the statutory regulations. As the method of compensation was unlikely to reveal errors and could be abused by unscrupulous employers DHSS recognised at the outset the need for an intensive system of random checks to ensure proper control of public money. The Department's Internal Audit issued a report in February 1983 highlighting the risks of abuse and the need for adequate monitoring arrangements. The Act provides that fraudulent deduction of money from contributions may, on summary conviction, result in financial penalties and/or a term of imprisonment being imposed on the employer, and fines may be imposed for failure to comply with statutory requirements.

4.2 The main control checks included in the SSP system are extensions of the present National Insurance contribution compliance checks undertaken by DHSS local office Inspectors. Visits, known as SSP surveys, are currently being made to all known employers to see that SSP is being dealt with properly, to answer questions, to advise about mistakes and to instigate any appropriate action. In the first round of visits the Department's aim is to educate employers, and legal proceedings will be used sparingly. There had been no prosecutions by August 1984.

4.3 DHSS issued instructions to inspection staff (since modified, see paragraph 4.12 below) detailing the checks necessary to ensure that employers have adequate systems for administering SSP, that these systems operate effectively and that payments made and recoveries from contributions payments are in accordance with statutory regulations. The instructions require inspection staff to examine at each employer up to five individual cases where SSP has been paid or an employee is shown as excluded from the scheme.

4.4 In the past inspection work has been carried out by staff graded at Local Officer I (LOI) level, equivalent to Executive Officer. However, following a special staff inspection exercise DHSS decided that some of the SSP survey work was appropriate to be carried out by staff graded at Local Officer II (LOII) level, equivalent to Clerical Officer. Some 1,600 staff have been allocated for SSP survey work, 620 LOIs and 980 LOIIs.

4.5 Of the 620 LOIs, 160 have supervisory duties. The remaining 460 have been appointed Inspectors with the same powers as regards SSP as they have for dealing with contribution liability under the main Social Security legislation. They are empowered to enter premises, to examine records and to require information from employers and employees in order to confirm compliance with the statutory requirements of the SSP scheme. The Inspectors concentrate on surveys of employers where SSP error is considered most likely to occur and during a visit normally carry out checks of both National Insurance contribution and SSP records.

4.6 The 980 LOIIs have not been appointed as Inspectors and consequently have no entry or inspection rights on employers' premises. They are therefore dependent upon the goodwill of employers in order to perform their duties. During visits they only concern themselves with the SSP scheme and do not become involved in National Insurance contribution matters beyond those necessary to establish whether or not the employer is complying with his SSP responsibilities. If the employer is unco-operative and refuses to allow an LOII to carry out the survey, or is unwilling to correct any SSP irregularities pointed out to him, the case has to be referred to an Inspector for further action.

4.7 One hundred and twenty nine LOI and 773 LOII posts have been withdrawn with effect from August 1984 when the first stage of visiting all known employers was due to be completed.

4.8 In addition to visits to employers by DHSS LOIs and LOIIs Inland Revenue PAYE auditors include records of SSP payments in their inspection of employers' pay records. IRD instructions require the auditors to ensure that proper records are being kept, that payments of SSP to employees are correctly included with gross pay for the assessment of income tax and National Insurance contributions and that the appropriate amount is deducted from the payment made to the collector. As a general rule, PAYE auditors are to refer to DHSS any problem or enquiry relating to any other aspect of the scheme which emerges during a visit to an employer. They did not extend the normal range of their SSP checks when visiting employers during the recently completed combined National Insurance and PAYE survey pilot exercise.

### Frequency of surveys

4.9 DHSS intended to undertake SSP surveys on all employers liable to operate the SSP scheme, and to complete as many as possible in the first 16 months of the scheme's operation, that is by the end of July 1984. Originally there were estimated to be some 1.06 million such employers but DHSS informed me that it now seemed unlikely that the number would exceed 800,000 because they believed that the original total included large numbers of businesses which have ceased trading or which no longer have employees, or which have registered as new businesses but have not yet engaged any employees. They estimate that the number of visits needed is likely to be nearer 700,000 because of the role played by accountants or third parties, eg holding companies, in dealing with the wages/SSP affairs of an estimated 100,000 companies. Once an accountant/third party has been visited and given a clean bill of health over the SSP affairs of one company, he is not normally visited again in connection with other companies for whom he provides a similar service. The Department expected that around one quarter of the employers would be surveyed by Inspectors and the balance by LOIIs.

4.10 DHSS intended that during the following two years to July 1986 inspection staff should visit only those employers who ask for a survey or where the Department have evidence which suggests that errors are likely. However, during the

period a number of initial visits will also have to be made (paragraph 4.11 below). PAC have recognised the value of random checks in other fields of social security activity but DHSS believe that once the first round of SSP visits has been completed their task of monitoring employers' administration of the SSP and National Insurance contribution rules will be most effectively achieved by concentrating on employers considered to be "at risk".

4.11 DHSS decided to end the first phase of surveys on employers on 28 August 1984 although by then only 572,870 employers had been visited. The next phase began immediately and will include those employers not yet visited. The Department state that the main reasons for the slippage were:

- (a) a slow start to the survey programme because of the need to train the redeployed staff;
- (b) some offices were delayed by difficulties in arranging effective visiting programmes because numbers of employers were found to have ceased to trade; and
- (c) an underestimate of the incapacity benefit work load that remained in local offices after the introduction of SSP which resulted in some monitoring staff being redeployed to this work for a period.

4.12 During 1983 DHSS had doubts as to whether one of the detailed checks performed by inspectors, designed to identify employers who were over-deducting SSP from their National Insurance contributions payments, was cost effective. It was taking about one-third of LOI inspectors' time at SSP surveys. In order to speed up the visiting programme DHSS replaced the detailed check in December 1983 by a more general scrutiny of one month's payments by employers to the Collector of Taxes to confirm that the amounts recovered in respect of SSP were not clearly inflated.

4.13 In view of the procedures relating to visits to accountants and third parties outlined in paragraph 4.9 and the replacement of the detailed check (paragraph 4.12) I have some doubts as to the adequacy of the checks being carried out.

### **Results of survey**

4.14 DHSS are collating the results of SSP survey visits. For the period from the inception of the scheme to 28 August 1984 they show that 572,870 employers have been visited of whom 11 per cent (mainly employers with less than six staff) were not aware of SSP prior to the visit. Of the total of 320,650 individual cases examined, 32 per cent contained various types of errors of which about half were wrong payments. Eight per cent of cases examined involved over-

payments of SSP to employees, and seven per cent under-payments; these had led to over and under-recoveries by employers from contributions payments. DHSS have found that the most common errors have been forgetting to apply waiting days, using rates of SSP which are out of date, and making individually small arithmetical errors. The financial value of the errors has not been recorded and collated, but DHSS are taking steps to obtain this information in future.

4.15 An abuse of the rules for determining qualifying days has come to DHSS's notice. By avoiding fixed qualifying days and retrospectively varying them to match the employees' days of incapacity for work, employers with occupational sick pay schemes are able to make greater recoveries of SSP from National Insurance contributions than Parliament intended. Normally no additional benefit accrues to the employee. The Health and Social Security Act 1984 now enables the Secretary of State to make regulations to prevent employers continuing to benefit from this abuse.

### **End of year checks**

4.16 At the end of the tax year Inland Revenue reconcile the total amounts of PAYE income tax and National Insurance contributions shown as due in returns submitted by employers with the remittances received. If they doubt the accuracy of any returns they may also check that records in respect of the individual employees support these totals. Although DHSS also have access to the employers' returns they have not been able to reconcile them with the total of National Insurance contributions received from the Inland Revenue Department. DHSS have introduced certain checks of the SSP element of the employers' returns using computerised methods, which include various feasibility and compatibility tests. But these checks will only enable errors to be identified for certain employees who are excluded from the scheme and others to whom the total amount of SSP payable in the tax year has been exceeded. In addition DHSS intend to carry out a small percentage check of employees who are shown as having received SSP. They will be asked to confirm the length of any period of sickness and to produce their end of year P60 for checking against the appropriate deduction card.

### **Accountants' reports on employers' operation of SSP**

4.17 DHSS have suggested to employers that they might like to provide the Department with reports by independent accountants on the employers' operation of the SSP scheme. These could be on a regular annual basis and would be useful in showing that employers were operating SSP properly. This in turn might help to reduce the amount of routine regular checking by DHSS inspection staff. Employers would have to bear the cost of preparing such reports and DHSS do not yet know how many will adopt the arrangements.