National Audit Office
Report of the Comptroller and Auditor General

National Insurance Fund Account 1998-99

Confidential

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Contents

Executive summary

1 The National Insurance Fund was established in 1948 to pay Social Security benefits to individuals who had paid qualifying National Insurance contributions. In 1998-99 the National Insurance Fund received £48,831 million in contributions from employers, employed earners and the self-employed. The main benefits paid out of the Fund in 1998-99 were:

	£ million
■ Retirement pension	**35,575**
■ Incapacity benefit	**7,251**
■ Widow's benefit	**974**
■ Jobseeker's allowance	**474**

2 Section 161 of the Social Security Administration Act 1992 requires me to examine and certify the National Insurance Fund Account and this report records the results of my examination of the 1998-99 account.

3 My examination includes work to confirm that National Insurance contributions received have been properly brought to account in accordance with Parliament's intentions. As I have no rights of access to records maintained by employers and the self-employed, my audit is limited to reviewing the measures taken by the former Contributions Agency and the Inland Revenue to monitor and enforce compliance with contributions law.

4 The Contributions Agency, formerly part of the Department of Social Security, merged with the Inland Revenue in April 1999.

Main findings and conclusions

(a) Progress on implementing the new national insurance recording system

5 The Inland Revenue and the former Contributions Agency have made significant progress through a Stabilisation and Recovery Programme in addressing the ongoing problems with the full implementation of the new National Insurance Recording System (NIRS2). Processing of individual contribution details is on target and contribution based benefits are being processed using up to date information. Backlogs of interim and emergency claims have been mostly cleared.

The resolution of problems has improved recently but a number remain and there are areas of the business still awaiting full implementation. (paragraphs 1.8 to 1.24)

6 An independent technical review of the system concluded that the system was capable of providing a robust and reliable platform to meet the future business needs of the Inland Revenue. I am, however, concerned that the system has not yet reached this state and given the history of the system it is unlikely to achieve an acceptable level of robustness before March 2000 at the earliest. (paragraphs 1.25 to 1.31)

(b) Benefit fraud and error in Jobseeker's allowance

7 One of the Benefits Agency's main priorities is to tackle fraud and inaccuracy. I support the action taken by the Agency to combat benefit fraud and my report sets out some of the measures the Agency is taking to reduce fraud in benefits paid from the National Insurance Fund. (paragraph 2.2)

8 However, because of the estimated loss to the Fund arising from the fraudulent encashment of girocheques and order books (which could be as much as £56.6 million) and the level of confirmed or high suspicion of fraud in contribution based jobseeker's allowance totalling £46.9 million, I have no alternative but to qualify my opinion on this account. (paragraphs 2.8 to 2.9)

9 My report also records errors of some £44.9 million, of which £35.6 million were overpayments and £9.3 million underpayments, in awards of contribution based jobseeker's allowance. The Employment Service and the Benefits Agency jointly administer jobseeker's allowance, and the Benefits Agency are responsible for payment. I have reported on this benefit on the Class XII Vote 1 Appropriation Account for 1998-99 (HC 11 – XII 1999-2000). In that report I set out the action proposed by the Benefits Agency and the Employment Service to make improvements in the future. (paragraph 2.11)

(c) Measures to collect National Insurance contributions

10 My report sets out the measures taken by the former Contributions Agency and the Inland Revenue to secure the timeous collection of national insurance contributions by identifying underpayments by employers. Agency inspectors identified underpayments of some £188 million in 1998-99 during visits to employers. In October 1997 the Agency introduced a new system to confirm that employers have settled the arrears, relating to previous years, identified during inspection visits. The system can track the progress of individual debts but it is unable to confirm that all arrears have been collected promptly. (paragraphs 3.5 to 3.9)

11 The former Contributions Agency conducted annual survey visits to a random selection of employers. In 1998-99, these found that there has been an improvement in compliance but some employers are continuing to experience difficulties in calculating their liabilities for Class 1 and Class 1A National Insurance contributions. The surveys estimated that errors in Class 1 contributions were some £130 million together with £26.4 million in respect of Class 1A. (paragraphs 3.10 to 3.11 and 3.16 to 3.18)

12 The former Contributions Agency and Inland Revenue inspectors made over 11,000 visits in 1998-99 to contractors in the construction industry, and part of those visits involved checking whether they had properly categorised their workers as employed or self employed. The outcome of each visit is individually recorded, and the information is collated nationally. It shows the number of visits to contractors in which employment status was raised as an issue. However, information is not, at present, available to estimate the number of workers whose status has changed as a result of compliance visits but should be available from 2000-2001. (paragraphs 3.12 to 3.14)

13 The Inland Revenue are in the process of unifying former Contributions Agency and Inland Revenue debt management activities but in the meantime they are continuing to experience difficulties in processing Class 2 national insurance contributions debt, and this has resulted in a failure to maximise the yield to the National Insurance Fund. An accurate estimate of the level of outstanding Class 2 contribution debt can not be established and this continues to be a cause for concern. (paragraphs 4.8 to 4.13)

(d) Personal Pensions and State Scheme Premiums

14 The delays in the full implementation of NIRS2 resulted in delays in payment to personal pension providers in respect of individuals contracted out of the State Earnings Related Pension Scheme for the 1997-98 tax year. As a result some £35 million has been paid out to compensate those individuals for the loss of state earnings related benefits foregone. The business areas of the Inland Revenue dealing with personal pensions continue to suffer with the delayed implementation of important parts of the system leading to backlogs of information waiting to be processed. In addition there was a significant shortfall in receipts from state scheme premiums, when they were due, of over £90 million as the system was unable to issue demands for payment during 1998-99. (paragraphs 5.5 to 5.17)

Part 1: The new National Insurance Recording System

Introduction

1.1 This part of my report sets out the progress towards the full implementation of the new National Insurance Recording System, and examines the impact of the delays on the former Contributions Agency and the Benefits Agency. This covers: the background to the system (paragraphs 1.3 to 1.7); the position since 31 March 1999 (paragraphs 1.8 to 1.14); end of year returns (paragraphs 1.15 to 1.17); backlogs, additional costs and compensation (paragraphs 1.18 to 1.24); and the independent review of the system (paragraphs 1.25 to 1.31).

1.2 In April 1999, the Contributions Agency transferred to the Inland Revenue. The Inland Revenue also took on responsibility for managing the contract for the National Insurance Recording System with Andersen Consulting.

Background

1.3 The National Insurance Recording System maintains details on over 65 million National Insurance accounts with approximately 1 million new accounts created each year. It is designed to record contributions, calculate contributory benefits, provide data to other Government Agencies such as the Benefits Agency, and pay age related contribution rebates to occupational and personal pension schemes.

1.4 The former Contributions Agency had recognised for some time that the National Insurance Recording System needed replacing as it was ageing and could not support future business and legislative changes, in particular those associated with the Pensions Reform Act 1995, key parts of which took effect from April 1997. In May 1995, Andersen Consulting were awarded the contract, under the Private Finance Initiative, to develop and operate the new system, known as NIRS2.

1.5 During development Andersen Consulting identified significant risks to the successful delivery of the original implementation plan. Following a full evaluation and assessment of the contractual implications, however, the former Contributions Agency adopted a phased implementation proposed by the contractor. The main release of the system was contracted to take place on 6 April 1998, but this was delayed due to the large number of functional and technical issues outstanding.

Instead, the system was released on a staged basis from July 1998. These delays resulted in a build up of work for both the former Contributions Agency and the Benefits Agency and a significant impact on their customers.

Previous coverage

1.6 In my Memorandum to the Committee of Public Accounts in January 1999 (PAC 98-99/57), I reported the delays in posting the contribution details for 1997-98 to individual accounts and the impact this had on the calculation of contributory benefits. I noted that, despite repeated assurances given by Andersen Consulting, the system had not yet become fully operational across the business. As a result, the Benefits Agency were unable to correctly calculate contributory benefits and many benefit awards were being made on an interim or emergency basis. Customers were severely inconvenienced. The former Contributions Agency were unable to make full payment of national insurance rebates to members of contracted out money purchase and personal pension schemes which led to a potential loss of state earnings pension benefits to the customers of these schemes.

1.7 In July 1999, the Committee of Public Accounts (22nd Session HC 182 1998-99) concluded that as a consequence of the delays to NIRS2, pensioners, widows and benefit claimants had continued to suffer uncertainty and loss of income through the award of interim payments, and that members of contracted out money purchase and personal pension schemes were also losing out through the loss of investment income. The Committee considered that the two key parties to the NIRS2 contract, the former Contributions Agency and Andersen Consulting, had not demonstrated a shared understanding of what was meant by delivery of the NIRS2 system, and about each other's roles in the implementation of the system. The Committee expected the Inland Revenue to resolve the issue of liability for the problems of NIRS2, and where the fault lay with Andersen Consulting to take steps to recover any costs contractually due. Failure to do so would result in the risks purportedly transferred to Andersen Consulting under the PFI contract being transferred back to the public sector.

Position on implementation of NIRS2 since 31 March 1999

1.8 At 31 March 1999, there were 4.5 million contributions still to be posted to the system for 1997-98. NIRS2 was still not fully operational and there were problems in the implementation of the new system. There was, however, an acceptance by both the former Contributions Agency and Andersen Consulting that there had been significant problems in the past with delivery of the new system. Furthermore, there was a recognition that both parties had to work closely together in order to progress towards full implementation of the system.

1.9 Once the former Contributions Agency became aware of the seriousness of the delays to the new system they immediately implemented a stabilisation and recovery programme which sought to address those areas identified as priorities. This programme started in October 1998, and is now in its second phase. The Inland Revenue, the Department of Social Security and Andersen Consulting are working to release more of the system to the business through this and the functionality enablement programme. Progress against the original stabilisation and recovery plan is set out in *Figure 1*.

Figure 1 **Progress against stabilisation and recovery programme**

	Objective	Progress	Achieved
1	Maintain schedule for the collection of Class 2/3 contributions	Direct Debit and Quarterly Billing runs are now stable. £630,240 million billed/collected in 1998/99. Collection figures for 1999-2000 include arrears now being collected.	Yes
2	Maintain schedule of Personal Pension payments including compensation element and maximising payments	NIRS2 used to perform monthly personal pension runs, process now stable. £1,656 million paid out for 1997-98 contributions. Almost all rebates now paid. Payments in respect of 1998-99 contributions ahead of schedule.	Yes
3	Maintain schedule for processing End of Year Returns to include: a) Posting of 1997-98 Class 1 contributions to account achieving 90 per cent by 31 December 1998; b) arrange sequence of posting of Class 1 contributions in order to maximise payment amounts	4.5 million of 1997-98 contributions outstanding at 31 March 1999. Currently only 18,900 outstanding. Processing now working well. Progress on 1998-99 contributions is ahead of schedule as are the payments of age related rebates and the updating of the DCI snapshot. The number of unposted items increased following the annual reconciliation exercise which has recently taken place for the 1997-98 tax year. At 4 December 1999 46.4 million contributions (96 per cent) for the 1998-99 tax year had been posted. The Inland Revenue are on course to meet their target of processing 98 per cent by the end of the year.	Yes
4	Maintain accounts for contributors that have had, or are currently in Class 1 employment. The NI record for contributors who pay Class 1 contributions posted for 1997-98 and correct periods of contracted out employment	Taskforce now working with Class 1 Directorate and the Inland Revenue's Contracted Out Employment Group to review functionality critical to maintain accounts. This review will include analysis and problem resolution. The functionality for Employers Index has been deferred because the Inland Revenue already have systems offering similar features. They are undertaking a review to determine the way forward.	Yes

continued ...

Figure 1 **Progress against stabilisation and recovery programme *continued***

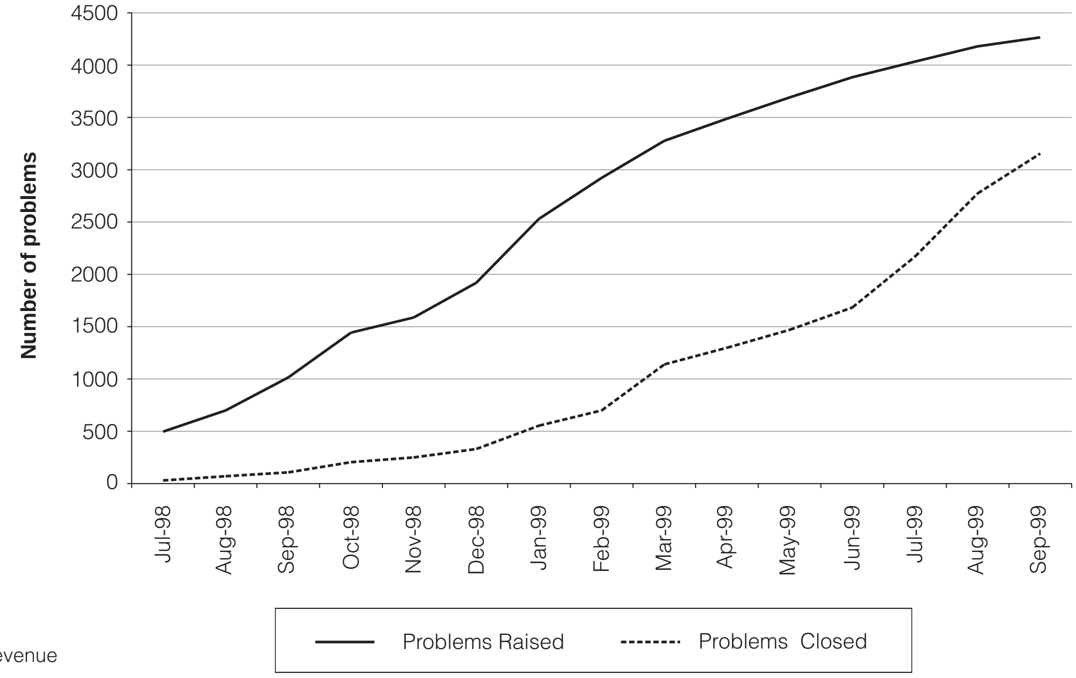
	Objective	Progress	Achieved
5	Provide Benefits Agency and the Employment Service with the necessary contribution /credit information (inc. 1997-98 tax year where appropriate) to enable new short term benefit claims to be assessed without emergency procedures	Processing of claims for jobseeker's allowance and incapacity benefit started slowly in November 1998. Most new claims processed using up to date contribution data. The system stockpile has been cleared and outputs distributed to BA offices to review claims.	Yes
6	Provide Benefits Agency with a regular service of accurate and timely Retirement and Widows Benefit calculations by 2nd November 1998.	Retirement pension and widows benefit functionality released in January 1999. Most new claims processed using up to date contribution data. The system stockpile has been cleared and outputs distributed to BA offices to review claims.	Yes
7	To provide Data Protection Prints in response to all subject access requests within the deadlines prescribed under the Data Protection Act 1984	Problems have been resolved and Inland Revenue are compliant with the requirements of the Data Protection Act. Prints are now being produced systematically and timeously.	Yes
8	Enable former Contributions Agency business units to continue recovery activity using stabilised business and system processes: Provision of appropriate operational support to develop user competence	Business units continue to review functionality in controlled environments, releasing functionality where safe to do so. Backlogs in most areas have now stabilised. There is still a problem with release of functionality to the business in the pensions area. A central support team has been set up as well as a network of "dialogue experts". Strategies for developing user competence and recovery management are now being developed	Yes
9	Enable BA business to recover backlogs from the period of emergency procedures imposed during and subsequent to migration	Backlogs now being addressed by Benefits Agency Field Operations, through a BA Major Incident forum. Significant progress made although the Agency have not met the original target date of October 1999 and recovery will continue throughout 2000.	Yes
10	Provide Inland Revenue with Computerisation of Pay As You Earn (COP) information to support their activities	The Inland Revenue are working to complete this objective. However, approximately 2.3 million end of year returns have been excluded from the COP interface for which pay and tax details are expected. An exercise is underway to resolve this issue. This impacts on the Inland Revenue business as compliance activity has been delayed. If the Inland Revenue are unable to complete this work there may be a loss to the Exchequer.	No
11	Ensure compliance with corporate governance requirements are maintained or any variance in control is risk assessed, documented and where appropriate approved	Corporate governance relates to management checks, security events, audit trail, etc. Internal Audit are working with the NIRS 2 Corporate Governance and Functional Enablement team in the areas of management checks, security and audit trails. As consequences of this approach, system improvements have been made but there is still work to be done.	No

1.10 The Benefits Agency now have almost all key functionality. The live service to support the processing of new claims to contributory benefits has been running since January 1999. In April 1999, the functionality to enable the forecasting of Retirement Pensions entitlement was made available. Since November 1998 and January 1999 respectively, all short term and long term benefits have been processed using NIRS2 data. From April 1999 the Benefits Agency have also been revising awards using NIRS2 data.

1.11 There are, however, still areas within the Inland Revenue, primarily personal and occupational pensions, where some functionality has yet to be implemented to the business. The stabilisation plan aims for the complete release of this functionality by March 2000. Furthermore, there are some parts of the system, which were due for implementation in April 1999, but have been deferred until April 2000 and beyond.

1.12 In my Memorandum I noted that, at 31 December 1998, over 1,900 problems, of varying degrees of significance, had been raised with Andersen Consulting. Of these there were 1,589 were still to be resolved. At 30 September 1999 some 4,265 had been raised with Andersen Consulting and 3,154 have been resolved. These are set out in *Figure 2*.

Figure 2 **Resolution of NIRS2 problems**



Source: Inland Revenue

1.13 I recognise that the Inland Revenue have sought to prioritise these problems and to concentrate appropriate resources on the most significant problems. Of the 20 most serious problems notified, by the former Contributions Agency, to the Committee of Public Accounts in February 1999, 19 have been cleared and the one remaining is being addressed. The latest figures available from the Inland Revenue show the clearance of outstanding problems is improving, with problems now being resolved at faster rate than they are being raised.

1.14 I recognise that much has been achieved against the Stabilisation and Recovery Programme in releasing functionality to the business. However, I remain concerned about those areas where the system is not yet fully operational, in particular, personal and occupational pensions which I consider further in Part 5.

End of year returns

1.15 The processing of National Insurance contributions has been the top priority for the Inland Revenue and Andersen Consulting. At 30 September 1999, 45.1 million contribution items for the 1997-98 tax year had been posted with only 18,900 remaining to be posted. Each year, the number of unposted items increases following the annual reconciliation exercise. The purpose of this exercise is to ensure that all expected schemes from employers have been received and processed. The exercise has recently taken place in relation to the 1997-98 tax year. This is later than in a normal year, reflecting the delays in the implementation of NIRS2. As a result of the exercise, some 350 additional employers' schemes have now been processed, generating some 1.5 million additional items for posting to accounts. By 4 December 1999 all but 64,000 of these had been posted and the Inland Revenue consider that those remaining will be posted by 24 December 1999.

1.16 By 8 November 1999, 46.2 million contributions relating to the 1998-99 tax year had been processed. This represents some 96 per cent of the expected total for the year. This is a significant improvement on the previous year when only 15.4 million (34 per cent of expected total) had been successfully posted by the same date. This also represents an improvement in previous years under the old system.

1.17 With the improvement in the rate of posting of end of year returns, there has been a corresponding improvement in the payment of age related rebates. By 1 December 1999, some £2,050 million had been paid out of a forecast total of £2,100 million for the 1998-99 contribution year. This compares with a figure of £1,023 million for the same period last year.

Backlogs, additional costs and compensation

1.18 The stabilisation and recovery programme is incurring additional costs, primarily staff costs which the Inland Revenue expect to be around £1.37 million. They have assured me that these costs will be contained within the current budget without the need for additional funding.

1.19 One of the major elements of the contingency plans was the operation of the fax back service, whereby the former Contributions Agency provided the Benefits Agency with NIRS2 information to enable the calculation of benefit entitlement. This service ceased in June 1999 having handled some 300,000 enquiries at an additional cost of £292,000.

1.20 There were, however, significant backlogs that needed to be cleared. The Benefits Agency began to review the backlog of initial and emergency payments in April 1999. Where underpayments are found, arrears of benefit are being calculated and paid. Where overpayments are found, the Benefits Agency are writing to the claimant explaining the situation and offering appointments to those who wish to discuss their benefit claims. Those claimants may still be required to pay back any overpayment of benefit. The Secretary of State for Social Security has approved the re-commencement of recovery action.

1.21 In May 1999, the Inland Revenue told the Committee of Public Accounts that the Benefits Agency hoped the review of cases would be completed within six months, a timescale given to the House of Commons by the Secretary of State. The position at the end of November 1999 is that some 94 per cent of short term benefit cases (incapacity benefit and jobseeker's allowance) and 82 per cent long term benefit cases (retirement pension and widows benefit) requiring review have been cleared. In doing so the Benefits Agency have identified underpayments of £32 million and overpayments of £1.1 million. The total cost of clearing the backlogs is estimated to be £14.1 million and is being met from current budgets.

1.22 Furthermore, there has been a backlog of amendments to individual details on the NIRS2 accounts which could have an impact on the amounts of benefit paid to claimants. The backlog relating to short term benefits was cleared in

October 1999 and that relating to long term benefits in November 1999. The outputs from system backlogs have now been passed to Benefit Agency offices for review of benefit claims. The functionality to process these amendments on a daily basis is now in place.

1.23 Where appropriate, cases are being considered by the Benefits Agency for payments of compensation under the Departmental Special Payments Scheme. By 24 November 1999, some £127,000 had been paid out for unreasonable delays under the scheme. In addition, following the announcement of the Secretary of State on 1 February 1999, compensation payments of £10 have been issued to claimants of contributory benefits who have experienced an unreasonable delay in the assessment and subsequent payment of benefit because of NIRS2 problems. Over 200,000 such payments have been made at a cost of some £2 million which is being met from current budgets.

1.24 The issue of any compensation claim against Andersen Consulting for delays in delivery of the system is currently under consideration. Ministers have been considering the position taking account of the legal advice, the considerable efforts of Andersen Consulting in working closely with the Inland Revenue to deliver the remaining functionality and the commitment of the supplier to ensure that the system supports the current and future needs of the Inland Revenue and the Department for Social Security.

Independent review of the system

1.25 On 1 April 1999, the Inland Revenue took over responsibility for the NIRS2 system and the contractual relationship with Andersen Consulting. The Inland Revenue considered that a full independent technical review of the system should be carried out and commissioned PA Consulting to conduct an evaluation of the technical viability of the NIRS2 system and to consider this from both the current situation, and for the future, with NIRS2 as a potential platform for meeting business needs. The study was conducted between May and July 1999 and involved wide consultation within Inland Revenue, the Benefits Agency and Andersen Consulting.

1.26 PA Consulting main conclusions were that the design of NIRS2 was of good quality and, as such, the system is capable of providing a robust and reliable platform to meet the business needs of the Inland Revenue. However, they also concluded that following delivery and contractual acceptance, system defects had caused significant disruption to business operations. Work to rectify these defects is ongoing.

1.27 PA Consulting noted that individual system areas of NIRS2 are unable to absorb major change until they achieve an acceptable level of quality. PA Consulting estimated that not all areas of the system would reach this point before March 2000 or, in the worst case, mid 2001. The earlier estimated date depends on a substantial increase in the rate of fixes to the system, which may not be achieved. In any case, a further period of ideally six months would be required to consolidate NIRS2 operations and allow the transition into a steady-state service to Inland Revenue and Benefits Agency.

1.28 PA Consulting considered that NIRS2 currently performs acceptably within the service level agreement but there is a lack of reliable and agreed performance data and performance monitoring. Overall, the backlog and stabilisation process is not causing the NIRS2 system significant operational problems. However, in attempting to quantify and analyse backlogs, stabilisation plans, performance and defects, the management of NIRS2 is adversely affected by a lack of definitive management information, and by a proliferation of alternative, and sometimes conflicting, sources of information.

1.29 PA Consulting concluded that the priority is to now bring together the various strands of work around NIRS2 into a single plan that will guide the transition of NIRS2 from its current situation into a steady-state operational system. To achieve this the NIRS2 management team requires much better information concerning the status of NIRS2 and its key processes need to be improved and made effective. The Inland Revenue told me that action is being taken to achieve this.

1.30 I have examined the methodology and scope of the PA Consulting review and I note that the review raises some fundamental issues of concern and sets out the way forward. The main message to emerge from the review is the need for Andersen Consulting to implement strong management controls over the development and running of the system and for the Inland Revenue to be more pro active in managing its future system requirements and their delivery. In order to provide the Inland Revenue with a complete working system, the recommendations set out in the report should be implemented without delay. The Inland Revenue told me that they have established an improvement plan to monitor implementation.

1.31 One underlying concern arising from the review is that although the parties agree that with management control NIRS2 may reach an acceptable level of quality, their estimates of this vary from April 2000 to June 2001 at worst. In addition, the stabilisation of the system has to be achieved and consolidated before any functional change is undertaken. The Inland Revenue will need to be satisfied that the system is capable of sustaining future change, supported by appropriate management controls, as they develop the system to support the new end of year returns and stakeholder pensions.

Part 2: Benefit fraud and accuracy

Introduction

2.1 This part of my report sets out the measures taken by the Benefits Agency to combat benefit fraud and instrument of payment fraud (paragraphs 2.4 to 2.9). I also report on the level of accuracy in contribution based jobseeker's allowance (paragraphs 2.10 to 2.11), and the impact of the delay in implementing the new National Insurance Recording System (NIRS2) on contributory benefit expenditure in 1998-99 (paragraphs 2.12 to 2.13).

2.2 Tackling fraud and inaccuracy in the social security system continues to be one of the Benefits Agency's top priorities, helping to ensure that the right money is paid to the right person at the right time every time. The Government, through the issue in March 1999 of the Command Paper "A new contract for welfare" SAFEGUARDING SOCIAL SECURITY (Cm 4276) has endorsed tackling fraud as a priority task and introduced targets to reduce programme losses from fraud and error.

2.3 The notes to the Account outline the measures the Benefits Agency took to combat fraud in 1998-99, the results of that work and their proposals for the future. The results of my examination of these initiatives are included in my report on the Class XII, Vote 1 Appropriation Account for 1998-99 (HC 11 - XII 1999-2000).

Estimating the level of benefit fraud

2.4 Being a hidden crime, estimating the level of undetected benefit fraud is extremely difficult. To produce meaningful estimates, the Benefits Agency developed a methodology for benefit reviews that is considered to be unique among countries with systems of government and social security benefits similar to the United Kingdom's. The Benefits Agency's benefit reviews are designed to provide reliable estimates of the level of incorrectness due to fraud and claimant error, by means of in-depth examinations of the circumstances of random samples of claimants. They also collect information about the characteristics of those committing fraud and error to produce risk profiles enabling the Agency to target resources more efficiently and effectively.

2.5 For benefits charged to this account the results of benefit reviews undertaken to date are set out in *Figure 3*. There have been no further national reviews since my last report. Although the assessment of how far benefits might be materially affected by fraud and error is incomplete, the Agency are committed to reviewing all major benefits recorded on this account unless there are strong indications that a full review would not provide value for money.

Results of benefit reviews of National Insurance Fund Benefits

Figure 3

Benefit review	Date results published	Percentage of claims where fraud confirmed or strongly suspected	Estimated Programme loss £ millions
Retirement pension	March 1996	Up to 0.13	Up to 40
Jobseekers Allowance (Contributions-based)	October 1998	9.3	46.9

Source: Benefits Agency

Investigative action on employers

2.6 In my reports on previous years accounts I described a special exercise to investigate and, where appropriate, prosecute employers colluding in benefit fraud, both to prevent frauds and to act as a deterrent against fraud. For 1998-99, the Benefits Agency have reported post-validation savings of £26.6 million against a target of £33 million, but secured 362 prosecutions against a target of 320.

2.7 As with the previous year the Agency's savings figure was subject to validation procedures before being released for publication. This reduced the initial estimate of £32.7 million by some 19 per cent.

Losses due to fraudulent encashment of instruments of payment

2.8 The notes to this account also provide an estimate of losses arising from the fraudulent encashment of order books and girocheques for benefit expenditure as a whole, which amounted to £102.6 million during 1998-99. Statistical evidence is not available to determine losses for individual benefits paid from this account, but if the allocation of estimated loss was calculated in proportion to benefit expenditure, the loss to the National Insurance Fund could be as much as £56.6 million. The Benefits Agency believe, however, that a greater loss would occur on income support and income based jobseeker's allowance paid from Class XII, Vote 1 due to the greater risk of fraud on these benefits compared with those paid from the National Insurance Fund. On this basis the loss to this account would be less than £56.6 million.

Impact of fraud on the account and on my audit opinion

2.9 The original intention was that the Benefits Agency's benefit reviews should, over time, cover all major benefits reported in this account and give a more complete estimate of the potential overall loss from benefit fraud. In forming my audit opinion I am required to confirm that the account is free from material misstatement whether caused by error, fraud or other irregularity. In view of the level of claimant fraud on contributions based jobseeker's allowance and encashment fraud indicated by the Benefits Agency's work, and the incomplete coverage of all benefits, I have no alternative but to qualify my opinion on the National Insurance Fund Account.

Accuracy in awards of jobseeker's allowance

Background

2.10 Jobseeker's allowance (contribution based) is a flat rate benefit, introduced on 7 October 1996, payable for the first six months of unemployment to claimants who have paid sufficient national insurance contributions and who are actively seeking work.

Results of my 1998-99 audit

2.11 In my report on the Class XII, Vote 1 Appropriation Account 1998-99 (HC 11 – XII 1999-2000) I reported the results of my audit of jobseeker's allowance including the contribution based element of the benefit. I noted that the total error found during my audit of contributions based jobseekers allowance in 1998-99 account was some £44.9 million (9.5 per cent of expenditure on the contribution based element of the allowance) and consisted of overpayments of £35.6 million and underpayments of £9.3 million. This represents a small improvement over 1997-98 (gross error 9.7 per cent) and I noted in my report the measures proposed by the Benefits Agency and Employment Service to make further improvements in the future.

Delays to the new National Insurance Recording System

2.12 Delays to the new National Insurance Recording System and the failure to post the required number of national insurance contributions to individual contributors' accounts by 31 December 1998 have resulted in some claimants of contributory based benefits being awarded and paid on an interim or emergency basis during 1998-99. This was because the Benefits Agency did not have sufficient details of claimants' contribution records to finalise contributory benefit awards such as retirement pension; widow's benefit, incapacity benefit and contributions based jobseeker's allowance. In addition some claimants who should have been awarded a contributory benefit were awarded and paid benefits such as income support from Class XII Vote 1 Appropriation Account instead. Furthermore some claimants may have been awarded a contributory benefit to which they were not entitled, as contribution conditions may not have been satisfied. Under these circumstances payments made from this account may have been over and understated with an opposite impact on the Class XII Vote 1 Appropriation Account. The backlog of interim and emergency cases have been mostly reviewed and cleared (paragraph 1.20). Underpayments totalling £32 million and overpayments totalling £1.1 million have been identified.

2.13 The Benefits Agency aim to review all cases assessed under the interim and emergency arrangements during 1999-2000. Where the incorrect benefit or the wrong rate has been paid the Agency will take corrective action either by paying arrears or, where appropriate, following the rules governing the treatment of overpayments. Additionally the Agency propose to make any adjustments necessary to correct amounts wrongly paid either from this account or Class XII Vote 1 Appropriation Account.

Part 3: Compliance with National Insurance legislation

Introduction

3.1 This part of my report sets out the results of my examination of the former Contributions Agency's compliance work. My examination focussed on Class 1 contributions (paragraphs 3.4 to 3.14), Class 1A contributions (paragraphs 3.15 to 3.18), Class 2 contributions (paragraphs 3.19 to 3.21), and the transfer of the Contributions Agency to the Inland Revenue (paragraphs 3.22 to 3.23).

3.2 Section 162 of the Social Security Administration Act 1992 requires the Secretary of State for Social Security to pay receipts of National Insurance contributions into the National Insurance Fund, after deducting allocations due to the National Health Service. The notes to the Account show the amounts paid into the Fund in respect of each class of contribution in 1998-99.

3.3 My examination includes work to confirm that contributions received have been properly brought to account in accordance with Parliament's intentions. As I have no rights of access to records maintained by employers and the self-employed, my audit is limited to reviewing the measures taken by the former Contributions Agency and the Inland Revenue to monitor and enforce compliance with contributions law.

Class 1 contributions

Background

3.4 Class 1 National Insurance contributions represented 96 per cent of the £48,831 million contributions paid into the National Insurance Fund in 1998-99. These contributions are payable by employees and their employers. Around 95 per cent of Class 1 contributions are collected by the Inland Revenue alongside the Pay As You Earn (PAYE) system.

Compliance work

3.5 The former Contributions Agency continued to seek to maximise the contributions yield from their compliance work. They achieved their compliance target in 1998-99 by visiting some 56,000 employers and identifying £188 million Class 1 arrears. This included £134 million relating to previous years, and £54 million relating to the year in which the visit took place.

3.6 The yield tracking system introduced in 1997 to monitor arrears relating to previous years, has helped the former Contributions Agency to make some progress towards evaluating the effectiveness of their compliance work. The system enables them to establish the stage of each individual debt but not to confirm that all arrears have been collected. The results for arrears relating to prior periods, identified in 1998-99, are set out in *Figure 4*.

Class 1 Yield Tracking results for 1998 - 99

Figure 4

	£ million	Per cent
Contribution arrears identified	134	-
Arrears collected, waived or written off (1)	27	20.5
Arrears disputed by employers (2)	10	7.4
Arrears being progressed	97	72.1

Source: Inland Revenue

3.7 The remaining arrears of £54 million identified in 1998-99 relate to the financial year in which the visits took place. This consists of actual underpayments identified up to the time of the visit and estimated amounts to the end of the year. In such cases, employers were instructed to make payment of the actual underpayment with their next PAYE remittance.

3.8 The former Contributions Agency re-visited a sample of these employers. Their main findings were that 62 per cent of current year underpayments originally identified had been collected or the reasons for non payment were valid. In a further 22 per cent of cases, the employer had either not accepted the ruling of the inspector, or had failed to pay the amount identified. The main reasons for non-compliance were changes in circumstances or payment practices, or the employer disputed the amount identified. In 16 per cent of cases, the findings of the re-visit cast doubt on the accuracy of the original amount identified by the inspector. The Inland Revenue told me that they are establishing the reasons for these doubts and propose to implement measures to address them.

3.9 I am concerned that the former Contributions Agency had no effective procedures in place to ensure actual current year underpayments are paid. The Inland Revenue told me that they have procedures in place and that from April 2000 the combined compliance field organisation will adopt the Inland Revenue methods of establishing underpayments and settlements. I will monitor the effectiveness of these arrangements.

Employer compliance survey

3.10 The former Contributions Agency conducts annual surveys on a random sample of employers to determine the extent to which employers comply with National Insurance contribution legislation and to help inform future compliance and education initiatives. In my previous report, I noted that further analysis of the survey results for 1997-98 by Departmental statisticians found that small employers, with up to 50 employees, account for the biggest proportion of errors, whereas employers with between 51 and 250 employees accounted for a greater financial value of underpayments. As a result, the Agency completely reviewed and updated the guidance that they sent to employers for the 1999-2000 year.

3.11 The 1998-99 survey was based on an inspection of some 950 employers covering some 2,600 employees' records. The main findings indicate that there has been an improvement in compliance by employers during the year. The overall rate of error fell slightly from 8.7 per cent to 8.6 per cent but the value of over and underpayments fell from £222 million to £130 million. The common causes of error continued to be incorrect use of National Insurance tables and rates and also incorrect application of earnings periods. I welcome the improvement in compliance levels but recognise that the real impact of the revised guidance will not become apparent until the results of the 1999-2000 exercise are known.

Employment status of construction industry workers

3.12 In my previous reports I noted the joint action taken by the former Contributions Agency and the Inland Revenue in monitoring action by the construction industry to determine that their workers were properly categorised as employed or self employed. Following a change in practice in April 1997, which was supported by construction industry employers, both organisations estimated that some 150,000 workers would be re-categorised as employed, and this would lead to an increase in the yield to the National Insurance Fund. The increase in revenue would arise because Class 1 contributions payable by employed workers and their employers are greater than the combined Class 2 and Class 4 contributions payable by the self employed.

3.13 The former Contributions Agency and Inland Revenue developed a programme of assistance to encourage voluntary compliance by contractors. In 1998-99 the former Contributions Agency carried out 6,285 visits and the Inland Revenue 5,036 totalling 11,321.

3.14 I noted in my last report that neither organisation had maintained separate records to enable them to measure the full effect of status changes in the construction industry. Where a construction industry employer is the subject of a compliance review the status of their workers is examined and records are maintained of the number of reviews where incorrect status has been challenged. However because the Inland Revenue and the former Contribution Agency did not review every employee each year they have not been able to measure the full extent of incorrect status in the industry.

Class 1A contributions

Background

3.15 The notes to the Account show that receipts of Class 1A contributions paid into the National Insurance Fund in 1998-99 amounted to some £547 million, representing 1.1 per cent of total contribution receipts. This class of contribution was introduced in 1991-92 and is payable by employers on the private use of cars and fuel provided to company directors and employees earning over £8,500 a year.

Class 1A compliance

3.16 In previous reports I have outlined the steps the former Contributions Agency took to secure employers' compliance with this class of contribution. Their work included the inspection of businesses which had been targeted because the Agency considered there was a greater risk of non-compliance. I noted that in 1997-98 the Agency had surveyed a representative sample of employers to obtain reliable information on Class 1A compliance and error rates. The results of the survey had shown that there was an estimated total underpayment of £19.5 million for 1997-98. Further analysis of the survey results indicated that the main reason for underpayments was miscalculation by employers. In February 1999 the former Contributions Agency, therefore, revised the guidance, to employers for the 1999-2000 year and is continuing its programme of customer education.

3.17 The former Contributions Agency and the Inland Revenue have reported that in 1998-99 their inspectors identified underpayments of some £20 million and £10 million respectively relating to 1998-99 and earlier years during visits to high risk employers. They also carried out a survey of a representative sample of employers for the 1998-99 year. The survey was based on inspecting records for all company cars for 1,200 randomly selected employers who were known to have paid Class 1A contributions in the previous year.

3.18 The main findings of this survey indicate that the estimated average underpayment rose from £299 in 1997-98 to £338 and the total underpayment increased by £6.9 million to £26.4 million in respect of the 1998-99 tax year. In spite of efforts made the former Contributions Agency to increase compliance levels, I am concerned that employer accuracy is deteriorating. I recommend that the Inland Revenue undertake a comprehensive analysis of the causes of non compliance and review guidance to employers in the light of their findings.

Class 2 contributions

Background

3.19 Class 2 contributions are payable at a flat rate by the self employed and are collected by the former Contributions Agency; in 1998-99 the rate was £6.35 per week. The notes to the Account show that £567 million was paid into the National Insurance Fund in 1998-99 in respect of this class of contribution of which some £439 million was paid by direct debit. Most of the remaining contributions were paid by the self-employed quarterly on receipt of bill from the former Contributions Agency.

Class 2 compliance work

3.20 The focus of Class 2 compliance work is to identify previously unregistered individuals who have a liability to pay and then to ensure that they pay regularly. In 1998-99 the Agency reported that they had achieved their target in identifying £24 million of contribution arrears from previously non-compliant individuals.

3.21 I have reported in previous years that the former Contributions Agency and Inland Revenue had planned to exchange information held on their respective computer systems. The aim of this exchange of information was to identify individuals who may not have been fully complying with their requirements to pay both Class 2 and Class 4 contributions. The Inland Revenue told me that over 7,700 cases have been examined since the arrangements for the exchange of information were introduced. They found that 66 per cent of these cases indicated non-compliance, with potential unpaid Class 2 contributions of some £4.3 million for collection which is being actively pursued. They also told me that they intend to continue with this exercise as they expect to identify further cases of non-compliance and further increase the yield to the National Insurance Fund.

Transfer of the Contributions Agency to the Inland Revenue

3.22 The Contributions Agency transferred from the Department of Social Security to the Inland Revenue on 1 April 1999. From this date the Agency field offices were integrated into the Inland Revenue Regional structure. The Newcastle based operations became an executive office of the Inland Revenue, known as the National Insurance Contributions Office. The Inland Revenue told me that with the transfer of former Contributions Agency compliance staff to the Inland Revenue and the adoption of Inland Revenue methods of establishing underpayments, they expect considerable improvements in the reliability of the amounts of underpayments recorded as due and the eventual collection of these sums. The transfer was also aimed at:

- providing better customer service;
- reducing the administrative burden on employers and individuals;
- improving compliance with national insurance legislation;
- facilitating greater alignment of tax and national insurance; and
- making better use of resources.

3.23 Accounting Officer responsibility for the National Insurance Fund account also transferred from the Department for Social Security to the Inland Revenue from April 1999. However, responsibility for the 1998-99 account remains with the Accounting Officer for the Department of Social Security.

Part 4: National Insurance Contribution debt management

Introduction

4.1 This part of my report covers the activities of the former Contributions Agency and the Inland Revenue to ensure that, as far as possible, all amounts due to the National Insurance Fund are actively pursued. My work in this area covered the arrangements for the management of National Insurance contribution debt (paragraphs 4.2 to 4.3). I also examined the actions the Inland Revenue propose to take in respect of the recommendations I made in my last report on Class 1 national insurance contribution debt (4.4 to 4.7) and Class 2 contribution debt (paragraphs 4.8 to 4.13).

Management of contribution debt

4.2 In my last report I noted that the former Contributions Agency had a number of recording and billing systems specific to individual business units, but these did not provide sufficient debt or performance management information.

4.3 I reported that the former Contributions Agency had initiated a review of debt management arrangements to provide a consistent debt collection strategy and a recording system to facilitate improved management of debt and accountability. This review was due for completion in April 1999. However, following the transfer of the Agency to the Inland Revenue, the Inland Revenue undertook further reviews of the management of Class 1 and Class 2 contribution debt, as part of a wider review of the former Agency's operations. These included a review of the debt management arrangements, with the focus on how best to clear the problem debts from the past. They have also identified how the National Insurance collection and debt follow up procedures should be aligned with Inland Revenue procedures.

Class 1 contribution debt

4.4 The Inland Revenue collect the majority of Class 1 National Insurance contributions from employers on a monthly basis alongside the PAYE system. In addition, they are responsible for collecting any underpayments they identify in the course of their compliance visits to employers.

4.5 The former Contributions Agency was responsible for collecting Class 1 underpayments from employers in cases where there were no potential tax irregularities requiring the case to be referred to the Inland Revenue. Underpayments relating to prior tax years are actively monitored to ensure that the debt is paid.

4.6 All debt, except where civil proceedings action is being considered, is recorded on a central Index of Employers, but this system cannot readily be accessed except on an individual employer basis and does not produce a summary of outstanding debt. In my last report I noted that the former Contributions Agency expected that these problems should be resolved once the Employers Index had been fully integrated into the new National Insurance Recording system by April 1999. The Inland Revenue told me that the interface between the two systems has been completed but a full integration has been deferred whilst the Inland Revenue have a strategic look at alternative arrangements using their existing systems for debt management.

4.7 They explained that they were aiming to unify former Contributions Agency and Inland Revenue debt management activities in order to achieve the most efficient and co-ordinated approach. In order to do this they were looking at the legislative, procedural, staffing and information technology support issues involved. In particular, they are seeking to use the Inland Revenue's summary proceedings and distraint procedures to enforce national insurance debts more effectively and to exploit the potential of their new integrated debt management system to automate clerical processes and provide better management information. I remain concerned, however, that there continues to be no central record of Class 1 debt.

Class 2 contribution debt

4.8 Self employed contributors can pay their Class 2 National Insurance contributions either by monthly direct debit arrangements or by paying quarterly bills. The former Contributions Agency maintained three separate systems, the quarterly billing system, debt management system and civil recovery system to record and pursue outstanding Class 2 debt.

4.9 Last year I reported that the former Contributions Agency estimated that overall Class 2 outstanding debt at 31 March 1998 was £513 million, equivalent to 85 per cent of Class 2 national insurance contribution receipts for 1997-98. I was concerned at the high level of outstanding debt and I recommended that the Agency should treat as a matter of urgency, its review of Class 2 debt as part of an ongoing debt management project. But this project has been superseded by a further review of operations following the transfer of the former Contributions Agency to the Inland Revenue.

4.10 The Inland Revenue estimate broadly that some £416 million of recorded debt was outstanding at 31 March 1999. However, because of problems with information technology systems some elements of this amount are unreliable. It will be some time before an accurate assessment of Class 2 debt can be made.

4.11 The Inland Revenue told me that they propose to implement an action plan in 1999-2000 and 2000-01 to tackle the problems of outstanding debt. The key strands of the plan are to resolve:

- Some 570,500 cases (220,000 in 1997-98) on the debt management system where no contact has been made with the contributor;
- Some 37,000 cases which are currently stockpiled in the debt management system awaiting transfer to the civil recovery system;
- Some 44,000 in civil recovery cases awaiting litigation;
- An estimated 500,000 cases outstanding because there has been no download of unpaid quarterly bills into the debt management system since June 1998. It will not be until May 2000, that the download of quarterly bills into the debt management system commences.

4.12 The Inland Revenue told me that they have already reviewed a sample of nearly 3,000 cases where no contact had been made with the debtor. In over 25 per cent of cases examined the contributors have paid in full; or made a definite offer to pay; or commenced an instalment plan. In only 23 per cent of cases no contact could be made with the contributor. In 17 per cent of cases the contributor made no offer to repay and court action will be instigated. In 35 per cent of cases the contributor's address had changed, or the contributor was insolvent or had ceased trading as self employed. The results of this exercise so far indicate that there is potentially a substantial increase in receipts to the National Insurance Fund.

4.13 I welcome the progress that has been made but there is still much to do, and receipts to the National Insurance Fund are not being maximised. While I recognise the need for the Inland Revenue to assess business priorities once the transfer of the Contributions Agency had taken place, I strongly recommend that they complete the action plan to deal with outstanding Class 2 debt promptly.

Part 5: Personal Pensions and State Scheme Premiums

Introduction

5.1 This part of my report sets out the results of my audit of expenditure on Personal Pensions and the receipts from State Scheme Premiums in 1998-99. This covers: the issues of compensation (paragraphs 5.5 to 5.8); the loss of financial data (paragraph 5.9); the results of the audit (paragraphs 5.10 to 5.12), backlogs (paragraphs 5.13 to 5.15); losses on Guaranteed Minimum Pension (paragraph 5.16) and State Scheme Premiums (paragraphs 5.18 to 5.20).

Background

5.2 The notes to the Account disclose that Personal Pensions paid out from the National Insurance Fund during 1998-99 in respect of 1997-98 contributions was £1,656 million. This was less than the forecast total of £2,100 million.

5.3 The Pensions Schemes Act 1993 entitled employed earners with a contracted out money purchase or personal pension plan to a minimum contribution to their plan from the Fund. Where an individual takes out a personal pension scheme, the Fund makes a contribution to the scheme, based on that part of the employee's earnings on which National Insurance contributions have been paid. There are some 5.5 million people in the United Kingdom with personal pension schemes. The Pensions Act 1995 changed the basis of calculation of the minimum contribution (rebate) and this is now assessed on the basis of the earnings and for the first time the age of the individual. The legislation requires the rebate to be paid directly into an individual's pension fund.

5.4 I reported last year that the former Contributions Agency were unable to make the normal pattern of payments to personal pension providers. Such payments are dependent upon the timely posting of end of year returns to individual national insurance accounts. However, in the period from April to September 1998, the Fund was only able to make payments, in respect of 1997-98 contributions, totalling £634 million (some 31 per cent of the estimated total payments due). By 31 March 1999, some £1,656 million (86 per cent) of the total payments for the year had been paid.

Compensation

5.5 When it became clear that national insurance rebates in respect of the 1997-98 tax year were going to be paid late, the Government decided to give individuals an amount in recognition for this delay. This amount was set by the Government, following discussion with the Government Actuary's Department, at an additional one half of one per cent of the rebate cumulatively for each month of delay, after October 1998, with the objective of replacing any State Earnings Related Pension benefits foregone at an annual rate of 6 per cent (the prevailing gilt interest rate). At 1 November 1999 some £34.95 million had been paid out.

5.6 In my Memorandum I noted that the impact of the delays in payment to personal pension schemes was that significant monies remained in the National Insurance Fund balance earning interest from investment in low risk Government securities. At the time, this was estimated to result in a gain to the National Insurance Fund of some £58 million. This is, however, not necessarily the amount that would have accrued to pension holders had the funds been paid to personal pension schemes and invested on their behalf in the equity market or elsewhere over the period concerned.

5.7 The Inland Revenue told me that, in line with recommendations of the Committee of Public Accounts, they have reviewed these compensation arrangements. (Treasury Minute (22nd Report)). They drew attention to the fact that as the rebates already contain an allowance to reflect an assumption that age related rebates are paid, on average, 12 months after the middle of the financial year to which they relate individuals have been compensated for the whole period before which rebates were actually paid, through a combination of the inbuilt rebate allowance and the additional interest. They explained that in effect the Government has made a gain through retaining money in the Fund for longer than normal, but all of this gain has been paid over to pension providers in the form of the in built allowance, supplemented by additional payments from October 1998. They consider that the Government has made neither a gain nor a loss.

5.8 Individual policy holders may, however, seek additional compensation, on an actuarial basis. To date some 70 claims for additional compensation have been submitted to the Inland Revenue. The Parliamentary Commission for Administration is also considering the matter in respect of one of these cases.

Audit of Personal Pensions 1998-99

5.9 My audit of personal pensions expenditure in 1998-99 has been made difficult due to a significant loss of auditable accounting data covering the period April to October 1998. Andersen Consulting were unable to provide details of all payments processed by the NIRS2 system, in the necessary auditable form, during this period as the data was destroyed in a fire and they were unable to restore the data, held off site, without diverting significant resources away from the stabilisation and recovery programme. The Inland Revenue told me that new procedures have been introduced by Andersen Consulting to ensure that sufficiently robust data recovery procedures have been put in place.

5.10 In addition, I noted a number of areas where there were significant weaknesses in financial control. These included a number of cases where problems with the processing of end of year returns resulted in the creation of duplicate contribution entries on individual records, leading to duplicate payments to the same pension scheme. I also noted a number of cases where an individual had two or more pension schemes open, resulting in multiple rebate payments to the pension providers. This occurred where there had been no ability to process changes to the individuals pension scheme. As a result of these duplicate payments, expenditure from the National Insurance Fund is overstated by some £238,000 which will need to be recovered from the schemes.

5.11 I also noted a number of cases where the payment to the pension provider exceeded the maximum rebate payable under the regulations. Inland Revenue told me that these were due to duplicate payments combined into one payment or to keying errors and that they propose to take corrective action in all these cases. All three problems have been raised with Andersen Consulting as system problems requiring a fix. One of these problems has been resolved and the Inland Revenue told me that the remaining two should be fixed in January and March 2000.

5.12 I am concerned that these problems and weaknesses should have arisen after acceptance of this key part of the system. To address these issues, the Inland Revenue need to establish better management information to enable performance monitoring, for example exception reporting. The Inland Revenue told me that they have introduced a 100 per cent management check for all on line financial transactions carried out on NIRS 2 involving the creation of payments and recoveries of pension schemes. I will look at the effectiveness of these procedures during my audit of the 1999-2000 account.

Private Pensions backlogs

5.13 In my Report last year, I reported on the backlogs arising from the delays to the system. Within the private pensions area important parts of the system have yet to be implemented to the business, and there are still significant backlogs of information waiting to be processed. In August 1999, there were over 670,000 items waiting to be processed, together with almost 1.4 million processed items, held on magnetic tape, awaiting input onto the system. As a significant proportion of these items relate to changes in personal pension scheme details and individual circumstances, there is a significant risk of over/under payments and/or payments to the wrong pension if they are not properly actioned. This risk will continue until the backlogs are cleared. Clearance of the backlogs affected is dependent on some significant NIRS2 functionality being released into the business area.

5.14 Any change in the individual circumstances of the pension holder has a potential impact on the accuracy and regularity of the rebate payment. At August 1999, there was a backlog of some 107,000 changes in individual circumstances waiting to be processed. Of these some 37,000 could cause under/over payments. In addition significant resources will be required in the Inland Revenue to take corrective action once these backlogs have been processed.

5.15 When a pension scheme closes, the members of the scheme will either contract back into the State Earnings Related Pension Scheme or transfer to another personal pension scheme. By August 1999, there were around 14,000 schemes waiting to be closed down and changes processed. As there is no management information available to provide details of money paid out unnecessarily, I am unable to estimate the likely impact on the National Insurance Fund.

Losses on Guaranteed Minimum Pension for Public Service Pension Schemes

5.16 Due to delays in implementing the system, a number of overpayments of public sector pensions have occurred where an individual was in receipt of Incapacity Benefit after normal retirement age and moved onto Retirement Pension after May 1998. The former Contributions Agency failed to provide information about entitlement to a Guaranteed Minimum Pension (GMP) to public service pension schemes to enable the pension scheme to stop uprating the GMP element of the individual's pension. As a result both the public service scheme and the Benefits Agency paid the uprating. Processes have been in place since February 1999 for retirement pension and widows benefit cases to notify Pension

Schemes of their GMP liability. Difficulties still exist where retirement pension and widows benefit claims cannot be processed due to the National Insurance accounts not being in a feasible state and lack of functionality prevents correction. Pension Schemes, including local authorities, are able to write to Inland Revenue in cases where no GMP statement has been received and they can clerically calculate the amount for them. I have not been able to quantify the number and amounts of these overpayments made by public sector pension schemes.

State Scheme Premiums

5.17 State Scheme Premiums are payable on behalf of individuals who cease to be covered by a contracted out pension scheme and wish to buy back their additional pension rights under the State Earnings Related Pension Scheme. The premiums are payable by the pension scheme and are collected by the Inland Revenue. Premiums totalled £102.5 million in 1998-99 (1997-98 - £194 million).

5.18 With contingency arrangements continuing to operate and growing backlogs in the processing of data, the Inland Revenue have been unable to issue State Scheme Premium demands which has resulted in delayed receipts to the Fund due to non payment of premiums to buy back State Earnings Related Pension Scheme rights. The Inland Revenue have collected some £102.5 million partly on the basis of estimates by the pension providers. This represents a shortfall of over £90 million on the forecast for 1998-99. Furthermore, because of the basis of calculation, these estimates will need to be validated once the system is fully operational.

Maxwell Pension Schemes

5.19 In October 1992, the Government agreed that persons whose pension entitlement was no longer covered by specific Maxwell pension schemes could be brought back into State Earnings Related Pension Scheme. Individuals were not required to pay premiums for the years contracted out of State Earnings Related Pension Scheme but the Agency is seeking recovery of these premiums from the Maxwell pension schemes. By 31 March 1999, around 30,000 individuals had been brought back into State Earnings Related Pension Scheme with a liability of some £126 million. To date, only £3.2 million has been recovered (£700,000 in 1998-99). A large series of Maxwell claims were finalised in October 1999 and settlements are being apportioned among the trustees. Additionally, monies held for legal reasons should become available to the trustees in early 2000. This should lead to an accelerated pattern of payments by mid 2000 from schemes with sufficient funds. The Department of Social Security are reviewing the position of each of the Maxwell schemes. I am concerned that a substantial sum is still owed to the National Insurance Fund and I recommend that the Inland Revenue make a concerted effort to seek recovery of this debt from these pension funds.

John Bourn
Comptroller and Auditor General

14 February 2000

National Audit Office
157-197 Buckingham Palace Road
Victoria
London SW1W 9SP