

National Insurance Fund Account 1999-2000

Report of the Comptroller and Auditor General

HC 446

4 May 2001

Report

Report by the Comptroller
and Auditor General

Introduction

1. This report sets out the results of my audit of the National Insurance Fund Account for 1999-2000. The Fund provides for expenditure on benefits and allowances where individuals have paid sufficient National Insurance contributions and met other qualifying conditions.
2. In 1999-2000, £50,025 million was paid out of the Fund. This sum included £46,215 million of benefit payments, including Retirement Pension and Widows' Benefit (£37,705 million), Incapacity Benefit (£6,894 million) and contribution based Jobseeker's Allowance (£462 million).
3. Receipts amounted to £52,186 million, mainly National Insurance contributions of £50,592 million. The level of National Insurance contributions paid into the Fund is set at rates broadly necessary to meet expected benefit expenditure in the year after taking into account any other payments and receipts and to maintain a working balance. At 31 March 2000 the balance in the Fund was £14,438 million, an increase of £2,161 million compared with 31 March 1999.
4. On 1 April 1999, the Inland Revenue assumed responsibility from the Department of Social Security for managing the Fund. The Inland Revenue have responsibility for the collection of National Insurance contributions from employers, employed earners and the self-employed. The Department of Social Security retain responsibility for benefits paid to individuals through the Benefits Agency.
5. Part 1 of my report sets out the main results of my audit of the 1999-2000 Fund Account, focussing on estimated losses and underpayments due to fraud and error in benefit payments and estimated losses due to the fraudulent encashment of instruments of payment. Part 2 summarises progress made by the Inland Revenue in clearing the backlog of work arising from the delays and phased implementation of the new National Insurance Recording System (NIRS2).

Executive Summary

Losses and underpayments in benefit expenditure

6. Estimates made by the Department of Social Security and evidence gathered by the National Audit Office indicate there is a material level of irregular expenditure in the Account, arising from errors by officials in making benefit awards, from fraudulent benefit claims and instrument of payment fraud.

7. The Department of Social Security estimate that:
- the value of errors by officials in assessing Incapacity Benefit amounted to £252 million, which was 3.6 per cent of the expenditure of £6,894 million on this benefit. Of this sum, £189 million is estimated to have arisen from underpayments;
 - losses in Jobseeker's Allowance (contribution based) as a result of errors by officials, customers and fraud amounted to £54 million, which is 12 per cent of the expenditure of £462 million on this benefit; and
 - losses from the fraudulent encashment of order books and girocheques for benefit expenditure as a whole, that is expenditure accounted for in the accounts of the Department of Social Security as well as this Account, amounted to £108 million. The amount of the loss for benefits paid from this Account could be as much as £59 million.
8. The National Audit Office also estimate that the value of losses in Retirement Pension and Widows' Benefit from errors by officials amounted to £32 million. This loss is not material in the context of the expenditure of £37,705 million on these particular benefits, but I have taken it into account in my assessment of the overall level of irregular expenditure in the Account.
9. The Department of Social Security expect to publish in July 2001 the results of a review that they have carried out to estimate for the first time the extent of losses in Incapacity Benefit due to claimant fraud and error. A review of Retirement Pension in October 1998 estimated that losses from customer fraud and error amounted to up to £40 million each year.
10. On the basis of this evidence I have qualified my audit opinion on the Account.

Progress in implementing NIRS2

11. As at December 2000, the majority of the NIRS2 system had been implemented with the remaining non-priority functions scheduled for release by April 2001. This represents significant further progress since my last report on this matter in February 2000.
12. As a result of the earlier delays and phased implementation of NIRS2, a significant backlog of National Insurance work built up within the Inland Revenue's National Insurance Contributions Office, which they expect to clear, in most areas, by October 2001. The Department of Social Security have had to revise their own recovery plans, which had initially anticipated recovery by December 2000.
13. The Inland Revenue have introduced a number of initiatives to support recovery. This included a fundamental review of the way in which arrears of work in the National Insurance Contributions Office are prioritised and dealt with. More attention is now focussed on current work to prevent new arrears from building up. The Inland Revenue have also worked closely with the Benefits Agency to identify and agree their requirement for clearance of work arrears. On current predictions the Inland Revenue expect to return to normal working, in most areas, by October 2001. The subsequent clearance of work by the Benefits Agency is subject to separate plans.

Part 1

Results of my 1999-2000 audit

Fraud and error in benefit payments

- 1.1 The Committee of Public Accounts has noted that the estimated level of fraud and customer and departmental error throughout the social security system is some £4 billion each year (31st Report Session 1999-2000 HC250).
- 1.2 Since April 1999 the Department of Social Security has had new performance management arrangements aimed at delivering secure and accurate services. These include a Public Service Agreement target to reduce by at least 10 per cent benefit losses from fraud and error in Income Support and Jobseeker's Allowance by March 2002. The baseline from which the reduction is to be measured is a loss of 9 per cent of expenditure on these two benefits which was the estimate for the twelve months October 1997 to September 1998 and amounted to £1.38 billion. From April 2001 there will be two additional targets of a 25 per cent reduction by March 2004 and a 50 per cent reduction by 2006.
- 1.3 In 1999-2000, expenditure on Income Support (£12,312 million) and Jobseeker's Allowance for claimants who do not have sufficient National Insurance contributions (£3,296 million), were accounted for on the Department of Social Security's Class XII Vote 1 Appropriation Account. My report on that account (HC 25-XII) notes the Department's progress against the Public Service Agreement targets and describes their methods of estimating the level of fraud and error in the various benefits they administer. These include:
- Benefit Reviews designed to provide reliable information on the estimated level of fraud and error by claimants, by means of an in-depth examination of the circumstances of random samples of claimants; and
 - Quality Support Teams that examine random samples of benefit awards to provide an estimate of losses and underpayments resulting from errors by officials.

Retirement Pensions and Widows' Benefit

- 1.4 Retirement pension is payable to people who have reached state pension age and meet the appropriate National Insurance contribution conditions. Widows' Benefit is a generic term covering Widow's Payment for widows whose husbands were not entitled to a retirement pension when they died, Widowed Mother's Allowance for widows with at least one qualifying child, and Widow's Pension.
- 1.5 In 1999-2000, the Benefits Agency's Quality Support Team carried out accuracy checks on a sample of awards of Retirement Pension and Widows' Benefit by officials in each of their Area Directorates. These checks identified errors in 5.2 per cent of the cases tested. The methodology used did not enable the Agency to estimate the monetary impact of these errors.

- 1.6 The National Audit Office examined a sample of awards of Retirement Pensions and Widows' Benefit and found a similar rate of errors by officials. From this, they were able to estimate that losses from this source in 1999-2000 amounted to some £32 million.
- 1.7 The latest Benefit Review of Retirement Pension was published in October 1998. The Review found that fraud was confirmed or suspected in only 0.1 per cent of claims and estimated that programme losses from this source amounted to up to £40 million each year.

Incapacity Benefit

- 1.8 Incapacity Benefit was introduced in April 1995 under the Social Security (Incapacity for Work) Act 1994 and replaced Invalidity Benefit and Sickness Benefit. It provides support to people under pension age who are unable to work due to incapacity and who have paid sufficient National Insurance contributions. Incapacity is assessed initially through the provision of medical certificates, and subsequently by the application of tests designed to determine whether claimants are capable of carrying out a range of work-related activities.
- 1.9 Incapacity Benefit is complex because many different aspects of a claimant's circumstances may affect the level of benefit due in any week. The Benefits Agency had to deal with many thousands of changes in circumstances in 1999-00. Some of these changes were not reported by the claimant when they should have been. This means that some errors in assessments by officials are unavoidable.
- 1.10 The Benefits Agency have a Quality Support Team for Incapacity Benefit, which visited each of the Agency's Area Directorates in 1999-00, to examine the accuracy of a representative sample of Incapacity Benefit awards.
- 1.11 Based on the findings of the Quality Support Team, the Department of Social Security estimate that in 1999-2000 errors by officials in assessing Incapacity Benefit amounted to £107 million, which is 1.6 per cent of expenditure on this benefit. This estimate comprises overpayments of £63 million and underpayments of £44 million.
- 1.12 The Quality Support Team extended their 1999-00 examination to include claims where customers would have received Incapacity Benefit had their contribution records not been considered deficient. Their examination of a sample of these records disclosed that some claimants had been incorrectly denied entitlement to Incapacity Benefit. The Department of Social Security estimate that, had these claims been correctly assessed, additional expenditure of £145 million would have been incurred.
- 1.13 By combining these results the Department of Social Security estimate that the value of official errors in Incapacity Benefit amounted to £252 million, which was 3.6 per cent of expenditure on that benefit. Of this sum, £189 million was estimated to have arisen from underpayments.
- 1.14 The National Audit Office examined a sample of cases reviewed by the Quality Support Team and confirmed the reasonableness of the Department of Social Security's estimates concerning Incapacity Benefit.

1.15 The Department of Social Security are currently undertaking a National Benefit Review, based on an examination of individual cases, to determine the extent of claimant fraud and error. They expect to publish the results of this review in July 2001. Until then, there will be no reliable evidence available about the extent of losses in Incapacity Benefit due to claimant fraud and error.

Jobseeker's Allowance (contribution based)

1.16 Jobseeker's Allowance (contribution based) was introduced in October 1996. It is a flat rate benefit, payable for the first six months of unemployment to claimants who have paid sufficient National Insurance contributions and who are actively seeking work.

1.17 From Benefit Reviews and checks carried out by their Quality Support Teams, the Department of Social Security estimate that in 1999-2000, losses in Jobseeker's Allowance (contribution based) as a result of errors by officials, customers and fraud amounted to £54 million, which is 12 per cent of expenditure on this benefit. This compares with an estimated loss from such causes of £73 million, which was 16 per cent of expenditure on this benefit in 1998-99.

1.18 The National Audit Office have carried out test checks of the individual cases examined by the Department of Social Security that provide the data for these estimates, and have reviewed the methodology used to calculate the estimates.

Losses due to fraudulent encashment of instruments of payment

1.19 The Benefits Agency estimate that losses arising from the fraudulent encashment of order books and girocheques for benefit expenditure as a whole, amounted to £108 million during 1999-2000. This figure comprises £89 million for order books and £19 million for girocheques and compares to a total of £102 million during 1998-99.

1.20 These estimates relate to all benefits paid by the Benefits Agency and the amounts for benefits paid from the Fund can not be reliably identified. If this estimated loss was allocated in proportion to benefit expenditure, the loss to the National Insurance Fund could be as much as £59 million. However, the Agency believe that a greater loss would occur on Income Support and Jobseeker's Allowance paid from Class XII, Vote 1 due to the greater risk of fraud on these benefits, compared with those benefits paid from the National Insurance Fund. On this basis, the loss to this account would be less than £59 million.

1.21 The Benefits Agency are taking action to prevent and detect instrument of payment fraud. These include a national Order Book Control Service, which aims to provide a more effective means of retrieving recalled order books, and steps to raise the profile and importance of this type of fraud. In addition, the Government have announced that Automated Credit Transfer will become the normal method of payment for benefits by 2005.

Audit opinion on the 1999-2000 National Insurance Fund Account

1.22 Based on the estimates made by the Department of Social Security and evidence gathered by the National Audit Office, I conclude that there is a material level of irregular expenditure in the Account, arising from errors by officials in making benefit awards, from fraudulent benefit claims and instrument of payment fraud. Therefore I have qualified my audit opinion.

Part 2

The new National Insurance System

Introduction

- 2.1 The National Insurance Recording System records details of individuals' National Insurance contributions, calculates contributory benefits, provides data to other Government Agencies, and pays age related contribution rebates to occupational and personal pension holders. In 1995, Andersen Consulting (now Accenture) were awarded a contract with the former Contributions Agency of the Department of Social Security, to develop and operate a replacement system, called NIRS2. Key parts of the system were released on a staged basis to the former Contributions Agency of the Department of Social Security from July 1998.
- 2.2 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. In July 1999, the Committee of Public Accounts (22nd Report Session 1998-99 HC 182) 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 losing out through the loss of investment income.
- 2.3 Following my report on the National Insurance Fund account for 1998-99 (HC 146 1999-2000) in February 2000, the Committee of Public Accounts published a report in August 2000 (31st Report of 1999-00 HC 350), which noted the good progress that the Inland Revenue had made in resolving the outstanding problems with the NIRS2 system.

The latest position

- 2.4 As at December 2000, the majority of the system had been implemented across the business. Most of the remaining non-priority functions are scheduled for release by April 2001. But some will be carried over and introduced in 2001-02, because they are of lower priority than other new changes needed to support the developing requirements of the National Insurance System. This represents significant further progress since my last report on this matter in February 2000.
- 2.5 As a result of the earlier delays and phased implementation, a significant backlog of National Insurance work built up. The Inland Revenue's National Insurance Contributions Office expect to clear this, in most areas, by October 2001. Further, the Department of Social Security have had to revise their own recovery plans, which had initially anticipated recovery by December 2000.

- 2.6 Figures at the end of December 2000 indicate there were some 8.5 million National Insurance items waiting to be processed against a planned position of 9.0 million, compared with 14.2 million outstanding in July 2000. The Inland Revenue estimate that some 1.9 million of these items fall within categories of work which could affect the Benefits Agency's recovery. Of these only around 200,000 will result in a benefit payment review. These reviews may result in some claims being adjusted.
- 2.7 The Inland Revenue have introduced a number of initiatives to support the recovery programme. They have carried out a fundamental review of their approach that now focuses more attention on current work to stop new arrears from building up, and gives priority to work areas that have an immediate impact on individuals' pension or benefit claims. To support this approach the Inland Revenue have introduced an integrated plan for clearing arrears of work in the National Insurance Contributions Office and are nearing completion of a plan for recovery in their network offices. The Inland Revenue have also worked closely with the Department of Social Security to identify and agree the Benefits Agency's requirements for clearance of arrears. The Inland Revenue have allocated additional resources with the aim of enabling the recovery programme to be carried out efficiently.
- 2.8 The Inland Revenue's priorities are to clear the arrears which have a significant impact on the Benefits Agency's recovery by 31 March 2001, and to return to normal levels of work in most areas within the National Insurance Contributions Office by October 2001. Examples of the approach to recovery in certain work areas are discussed in the following paragraphs.

Validation checks

- 2.9 When NIRS2 runs validation checks, the system identifies potential inaccuracies in contributions received for clerical investigation and resolution. In these cases the contributions concerned are not used in benefit calculations until the check is cleared. Arrears of some 1.2 million items were built up in 1997-98 and 1998-99.
- 2.10 To support the recovery programme a decision was made in October 2000 to clear the majority of discrepancies identified by the NIRS2 validation checks for 1997-98 and 1998-99 without the usual follow up action. This decision was taken on the basis that there will be no adverse impact on the individual's pension and contributory benefit entitlement. The Inland Revenue have developed the changes needed to NIRS2 to clear these cases and the necessary work is targeted for completion by April 2001.

Non-matched items

- 2.11 Non-matched items are created when the National Insurance Contributions Office are unable to post contributions received from employers to contributors' accounts, because the information supplied by the employer in respect of the contributor is incorrect or missing. There is a backlog of 1 million such items arising from 1997-98 and 1998-99 and a further 500,000 relating to 1999-2000.

2.12 The normal response involves a two-stage process to attempt to allocate the contributions correctly. The first step is an internal tracing action. If this is unsuccessful, contact is made with the employer or the employee. Because of concerns about the relative age of these items and the impact on employers, the Inland Revenue have conducted a pilot exercise to determine the viability of carrying out this second step. The pilot exercise has confirmed that there could be an adverse reaction from employers and that the gains from trying to obtain the additional information are minimal. In view of this the decision was taken that internal tracing action would only be undertaken for 1997-98 and 1998-99 items.

Personal pensions

2.13 The Inland Revenue estimate that there are about 1.5 million cases where end of year returns indicate that a suitable notice of termination of contracted-out pension scheme membership has not been received by the National Insurance Contributions Office. These cases are investigated with the pension schemes concerned, and in some cases the employers, to ensure that contributors' records are accurate and to secure the smooth processing of benefit entitlement in retirement and death cases.

2.14 The Inland Revenue has sought to identify and deal immediately with high priority cases where there is an immediate impact on benefit entitlement. Following this, they propose to group the remaining cases together by pension scheme and clear them. This is intended to avoid duplication of effort for the Inland Revenue, pension schemes and employers.

Items in the Inland Revenue network

2.15 In addition to the arrears of work in the National Insurance Contributions Office, National Insurance work is undertaken in the Inland Revenue's network of local offices. A task force has recently recommended the adoption of a targeting regime to cover all National Insurance work in the local office network and to adopt a recovery plan which complements that already in place in the National Insurance Contributions office. The Inland Revenue plan to clear all arrears in network offices during the course of 2001-02.

New work awarded to Accenture

2.16 In April 2000, the Inland Revenue agreed an extension to the contract with Accenture, worth an estimated £144 million, to develop NIRS2 in line with the Government's policy to modernise welfare and benefit delivery.

John Bourn
Comptroller and Auditor General

30 April 2001

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THE CERTIFICATE AND REPORT OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSES OF PARLIAMENT

I certify that I have audited the financial statements on pages 6 to 19 under the Social Security Administration Act 1992. These financial statements have been prepared in the form and manner directed by HM Treasury and in accordance with the accounting policies set out on page 7.

Respective responsibilities of the Accounting Officer and auditor

As described on page 2 the Accounting Officer is responsible for the preparation of the financial statements and for ensuring the regularity of financial transactions. It is my responsibility to form an independent opinion, based on my audit, on those statements and on the regularity of the financial transactions included in them, and to report my opinion to you.

Basis of opinion

I conducted my audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the judgements made by the Accounting Officer in the preparation of the financial statements.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by error, or by fraud or other irregularity and that, in all material respects, the receipts and payments have been applied to the purposes intended by parliament and conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

I review whether the statement on pages 2 to 4 reflects compliance with HM Treasury's guidance "Corporate governance: statement on the system of internal financial control". I report if it does not meet the requirements specified by HM Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements.

Qualified opinion arising from fraudulent benefit claims, errors in benefit awards and fraudulent encashment of instruments of payments

In my opinion:

- the account properly presents the receipts and payments of the National Insurance Fund for the year ended 31 March 2000 and the balance held at that date and has been properly prepared in accordance with Section 161(2) of the Social Security Administration Act 1992 and directions made thereunder by HM Treasury; and
- except for irregular expenditure arising from fraudulent benefit claims, errors in benefit awards and fraudulent encashment of instruments of payment in all material respects the receipts and payments have been applied to the purposes intended by Parliament and conform to the authorities which govern them.

Details of these matters are set out in my report on pages R1 to R9.

John Bourn
Comptroller and Auditor General

30 April 2001

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