Presented pursuant to c.5, section 161(2) of the Social Security Administration Act 1992

National Insurance Fund Account 2003-2004

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Foreword

Statutory background

The National Insurance Scheme was established on 5 July 1948 to provide unemployment benefit, sickness benefit, retirement pensions and other benefits in cases where individuals meet the contribution and other qualifying conditions.

Under the Social Security Administration Act 1992 benefits due under the National Insurance Scheme are payable out of the National Insurance Fund (NIF). The funds required for meeting the cost of these benefits are mainly provided from National Insurance Contributions (NIC) payable by employed earners, employers and others. The Social Security Contributions and Benefits Act 1992 sets out the conditions governing entitlement to most benefits and the basis for assessing liability to pay National Insurance Contributions.

Section 161(1) of the Social Security Administration Act 1992 (as amended by the Social Security Contributions (Transfer of Functions etc.) Act 1999) places the NIF under the control and management of the Inland Revenue (IR). The Deputy Chairman of the Board of IR is the Accounting Officer for the Fund. Section 161(2) of the Act requires IR to prepare accounts of the NIF in such form, and in such manner and at such times, as the Treasury may direct. The accounts are prepared on a cash basis and must properly present the receipts and payments for the financial year and the balance held at the year-end.

Operational responsibilities

National Insurance Contributions are payable by employed earners, employers and others. IR is responsible for collecting these contributions and recording them against individuals' contribution records (which determine entitlement to social security benefits payable from the NIF). As Accounting Officer for the NIF, I am responsible for the control and management of the Fund. The Department for Work and Pensions (DWP) has overall responsibility for the award and payment of most benefits payable from the NIF including those relating to retirement, sickness and contribution based jobseeker's allowance. Entitlement to benefit is determined by the claimant satisfying qualifying conditions.

The Department of Trade and Industry (DTI) is responsible for making Redundancy Payment Scheme awards. The Insolvency Service, an agency of DTI, handles the payment of awards and collection of receipts.

The amounts received by, and paid out of the NIF, and the resulting balance , depend on legislation, which is the responsibility of Treasury Ministers and the Secretary of State for Work and Pensions. In setting contribution rates, Treasury Ministers are required to have regard to changes in the general level of earnings, the state of the NIF and payments expected to be made from it in the future (Sections 141 and 143 of the Social Security Administration Act 1992).

The Government Actuary is required under Sections 142(1), 147(2) and 150(8) of the 1992 Social Security Administration Act to report on the likely effect on the NIF of the Government's annual benefits uprating and contributions re-rating Orders. These reports are laid before Parliament and debated alongside the relevant orders. He is also required under Section 166 of the Act to report every five years on the long-term financial estimates of the NIF. The latest quinquennial report was laid before Parliament on 27 October 2003.

Audit arrangements

The Comptroller and Auditor General is required under Section 161(2) of the Social Security Administration Act 1992 to examine and certify the NIF Account and to lay copies of it, together with his report on it, before Parliament.

Financial performance

The National Insurance Scheme is financed on a pay-as-you-go basis with contribution rates set at a level broadly necessary to meet the expected benefits expenditure in that year, after taking into account any other payments and receipts, and to maintain a working balance. Changes in contribution levels in response to the needs of the Fund take time to implement, therefore a working balance is necessary because the NIF has no borrowing powers. In his report on the financial provisions of the Social Security Bill 1992 the Government Actuary confirmed that it was prudent to plan for a minimum balance of one-sixth (16.7 per cent) of annual benefit expenditure. However it is only intended to cover the fund against short-term disruptions.

The balance on the fund has increased by £552 million compared with the position at 31 March 2003 (£26,530 million). At 31 March 2004 the balance held is £27,082 million (49 per cent of annual benefit expenditure).

The Government Actuary's next Report on the Government's benefits uprating and contributions re-rating Orders will be tabled in the New Year alongside the 2004 up-Rating Order and the re-rating Orders. The Orders, which will cover the financial year 2004-2005, are subject to debate and require the approval of both Houses.

The Government Actuary's Department (GAD) estimates of benefit payments and contributions, both huge figures, are sensitive to changes in a number of assumptions (such as the level of employment and earnings). Short term fluctuations in the balance may not be a good guide to the long term position. Although the balance is currently greater than the minimum recommended level, in the past cash injections from the Consolidated Fund have been needed to maintain the minimum balance.

Responsibilities of the Deputy Chairman of the Board of the Inland Revenue

As Deputy Chairman of the Board of the Inland Revenue, I am the Accounting Officer for the NIF. My relevant responsibilities as Accounting Officer, including my responsibility for the propriety and regularity of the public finances for which I am answerable, and for keeping of proper records, are set out in the Accounting Officers' Memorandum issued by the Treasury and published in 'Government Accounting'. Many of the activities relating to the transactions of the NIF are carried out by other departments (DWP & DTI) and agencies on my behalf, and I receive assurances from them.

Paul Gray 13 December 2004
Accounting Officer
Inland Revenue

Statement on Internal Control

1 This statement is given in respect of the Great Britain National Insurance Fund White Paper Account.

Scope of responsibility

2 As Accounting Officer for the Great Britain National Insurance Fund, I have responsibility for the stewardship of the Fund and for maintaining a sound system of internal control that supports the achievement of the Inland Revenue's policies, aims and objectives, whilst safeguarding the public funds for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting.

3 Whilst the Inland Revenue has overall responsibility for the control and management of the Fund and for collecting National Insurance Contributions, the Department for Work and Pensions is responsible for benefit payments and the Insolvency Service, an agency of the Department of Trade and Industry, is responsible for Redundancy Scheme payments which are covered by the Fund. I receive Letters of Assurance from the Accounting Officers of those Departments that refer to their own statements on internal control (SIC) and highlight any significant issues that impact on the Fund. In addition, the Government Actuary is responsible for reporting to Parliament on the performance of the Fund.

The purpose of the system of internal control

4 The system of internal control is designed to manage risk at a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks and achievement of departmental policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place in the Inland Revenue for the year ended 31 March 2004 and up to the date of the approval of the accounts, and accords with Treasury guidance.

5 Specific work undertaken on behalf of the NIF only forms a small part of the whole work of the IR. A separate Statement on Internal Control (SIC) is produced for the Inland Revenue's 2003-2004 Resource Accounts and Trust Statement that fully sets out details of the Department's capacity to handle risk and its risk and control framework, as well as disclosures that relate to issues outside of the scope of work relating to the NIF. Details of the full SIC can be found in the Department's 2003-2004 Annual Report that incorporates the Resource Accounts and Trust Statement.

6 The main elements of the Department's capacity to handle risk and the risk and control framework are summarised below.

Control environment

7 I have a clearly defined 'Statement of Accounting Officer Responsibilities'.

8 There is a Departmental Board and committee structure, with clear terms of reference and defined membership. Throughout 2003-2004 the Departmental Audit and Security Committee (DASC) was chaired by a non-executive director.

9 Accountability frameworks are in place for all Directors in operational, policy and corporate support areas. These complement our primary mechanisms for business accountabilities, which are the operating plans for each business area.

Capacity to handle risk

10 Within the Inland Revenue the strategic risk management process continues to be the six-monthly risk stocktakes by the Departmental Management Committee (DMC). These have been effective in reinforcing the importance of having a clear and structured view of key risks when reviewing performance or for decision making.

11 A Risk Review Group (RRG) has been set up to look at risk reports in detail, and bring forward recommendations for discussion at DMC on how to reduce our risk exposure.

12 Risk management guidance is available to all staff through the Intranet with additional support provided by the Risk Support team.

The risk and control framework

13 During the year we drew the elements of our risk management strategy into a single document, which has been approved by DASC and DMC.

14 Risk management is a mandatory element of the business planning process and is incorporated into our commissioning note for the annual planning round.

15 Directors from the Department update their top risks on the Corporate Risk Register at six-monthly intervals, which is then used to inform the DMC and RRG discussions, and assists in determining whether action is needed to reduce exposure on specific risks.

Review of effectiveness

16 As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control within the Inland Revenue. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within the Inland Revenue who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I have taken advice on the effectiveness of internal control from the Departmental Board, DMC and the RRG, and from the chair of DASC, and plans to address weaknesses and ensure continuous improvement of the system are in place.

17 The Director of Internal Audit meets regularly with Board members and senior Directors, and reported in Spring and Autumn to the DASC, to the standards defined in the Government Internal Audit Manual. These reports included his opinion on the adequacy and effectiveness of the Departments system of risk management, control and governance.

18 Following the Spring and Autumn DASC meetings, the external independent Chair of the DASC, along with the Director of Internal Audit, presented her Certificate of Assurance to the Accounting Officer. This highlighted the areas where, in her opinion, the risk exposure needs to be reduced. This certificate is recorded in the Director of Internal Audit's Assurance report provided to the Accounting Officer.

19 Specific areas within the IR relating to the NIF requiring disclosure are

Progress on deficiency notices

- Deficiency Notices are statements inviting individuals to consider if their National Insurance record was correct and how much voluntary Class 3 contributions they would have to pay in any specific year for it to count as a qualifying year. The former Contributions Agency decided to suspend the Deficiency Notice exercise in 1998 so as to focus resources on those areas seen as priorities during the early years of the new NIRS2 computer system. An exercise to issue Deficiency Notices to individuals in respect of the six tax years 1996-1997 to 2001-2002 was successfully concluded at the end of September 2004.

Requiring updates

Progress on non-matching Items

- The Accounting Officer reported on this issue in the 2002-2003 SIC. These items are a result of inaccurate information received from employers on end of year submissions, representing about 4% of the total year's returns. Steps continue to encourage and assist employers to submit accurate information, which will enable reductions in the number of non matching items.

Progress on Age Related Rebates

- This issue has been reported on by the NAO for the last five years and is largely resolved. This issue is further disclosed in the DWP Resource Accounts SIC as the account included a provision.

Payments to the National Insurance Funds

20 Because of errors in administrative processes going back to the mid 1990's, the Inland Revenue have not paid over to the Great Britain and Northern Ireland NIFs the full amount shown in the NIF Accounts as due. Over that period, the Inland Revenue has instead paid some £1bn to the Exchequer. Had it been paid over at the right time, the NIF would have invested it in government Securities and earned additional investment income, which is in the process of being quantified, although there has been no overall loss to the Exchequer. The Inland Revenue has removed the source of these errors and is in discussion with the Treasury over corrections to be made.

Assurance from DWP in respect of Contributory Benefit Payments

21 A Letter of Assurance has been received from the DWP which contains details about their capacity to handle risk and their risk control framework. The Letter indicates that the following significant internal control issues impact on the NIF.

22 DWP continues to suffer significant losses from fraud and error. Whilst there has been a sharp reduction in the level of customer fraud, official error figures have increased slightly. Measures to improve control in this area included

- better targeted fraud investigation and corrective work through Operational Intelligence Units;
- improvements to claims processing, assisted by better IT, further to increase accuracy levels;
- more data sharing to correct cases early and providing clearer messages to customers (e.g. Targeting Fraud Campaign);
- further implementation of the Payment Modernisation Project, eliminating Order Book fraud;
- a review of the Verification Framework and the Security Against Fraud and Error incentive scheme has taken place and has led to
  - a risk-scoring mechanism being developed, which will ensure that local authorities focus their attention on those cases most likely to be incorrect;
  - the Department providing local authorities with monthly data-matching and risk-based reviews enabling them to identify fraud and error at an earlier stage; and
  - the Benefit Fraud Inspectorate are involved in carrying out Comprehensive Performance Assessments to ensure that local authorities participate more fully in counter-fraud activities.

23 The inability to account accurately for the money it is due to pay people, or what is due from people, has led to the qualification of the DWP's Resource Accounts in each year. Since the last Statement on Internal Control, the DWP has continued to pursue a number of long and short-term measures to remove these qualifications.

24 The implementation of the Modernisation Programme continues to represent a major challenge to the DWP, with any delays likely to have a significant impact upon our ability to deliver agreed efficiency targets and/or

performance levels. Risks around the change programme are actively managed by the Efficiency Board, which has the benefit of significant DWP Executive Team representation.

25 As reported in last year's DWP SIC they continue to suffer from non-compliance with business and financial checks and controls. The letter of assurance outlines the action being taken to address this.

26 As part of their examination of Incapacity Benefit, NAO were unable to locate a significant number of supporting case papers. As a consequence of this, they have made an additional qualification to the DWP Resource Accounts on the grounds of limitation of scope, which is also the case for the NIF Accounts. The DWP have arranged for a formal project to review the adequacy of our records management and storage arrangements, to allow them to determine the scale of this problem and implement any necessary improvement activities.

Assurance from Insolvency Service in respect of the Redundancy Payments Scheme

27 A Letter of Assurance has been received from the DTI, on behalf of the Insolvency Service, that has been approved by their Audit Committee and contains details about their capacity to handle risk and their risk control framework.

28 The Letter gives an assurance that there were no significant internal control issues that impact on the NIF.

29 There is a NIF Audit Forum consisting of representatives from key Internal Audit Units, the National Audit Office and management. The Forum focuses on co-ordinating risk-based audit activity such as planning, reporting and implementation of recommendations and fostering opportunities for joint working and exchange of best practice.

30 In making my assessment, I also take account of the management letters made by the NAO, the C&AG's report to Parliament, and of the findings of the Committee of Public Accounts (PAC).

Paul Gray 13 December 2004
Accounting Officer
Inland Revenue

The Certificate of the Comptroller and Auditor General to the Houses of Parliament

I have audited the financial statements, comprising the Receipts and Payments Account and the Notes under the Social Security Administration Act 1992. These financial statements have been prepared in the form and on the basis determined by Treasury and in accordance with the accounting policies set out in note 1 to the Account.

Respective responsibilities of the Accounting Officer and the Auditor

As described in the Responsibilities of the Accounting Officer in the Foreword, the Accounting Officer is responsible for the preparation of the financial statements in accordance with Social Security Administration Act 1992 and Treasury Directions made thereunder and for ensuring the regularity of financial transactions. The Accounting Officer is also responsible for the preparation of the Foreword. My responsibilities, as independent auditor, are established by statute and I have regard to the standards and guidance issued by the Auditing Practices Board and the ethical guidance applicable to the auditing profession.

I report my opinion as to whether the financial statements properly present the receipts and payments and are properly prepared in accordance with Social Security Administration Act 1992 and Treasury Directions made thereunder and whether 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. I also report if, in my opinion, the Foreword is not consistent with the financial statements, if the Accounting Officer has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I review whether the National Insurance Fund's Statement of Internal Control reflects compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements.

I am not required to consider, nor have I considered, whether the Accounting Officer's Statement of Internal Control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the corporate governance procedures or its risk and control procedures.

The maintenance and integrity of the Inland Revenue's website is the responsibility of the Accounting Officer. The work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

Basis of audit opinion

I conducted my audit in accordance with United Kingdom 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 significant estimates and judgements made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are appropriate to the National Insurance Fund's circumstances, consistently applied and adequately disclosed.

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 the financial transactions conform to the authorities which govern them.

However the Department for Work and Pensions were unable to provide all the evidence I considered necessary to complete my audit of £6,713 million of expenditure on Incapacity Benefit. There were no other satisfactory procedures that I could adopt to confirm that expenditure on Incapacity Benefit had been applied to the purposes intended by Parliament.

Opinion

In my opinion

- except for any adjustments that might have been found to be necessary had I been able to obtain sufficient evidence concerning the occurrence, measurement and regularity of incapacity benefit expenditure, the financial statements properly present the receipts and payments of the National Insurance Fund for the year ended 31 March 2004 and the balance held at that date and have been properly prepared in accordance with Section 161(2) of Social Security Administration Act 1992 and directions made thereunder by Treasury; and
- in all material respects the receipts and payments have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

In respect alone of the limitations on my work relating to incapacity benefit

- I have not obtained all the information and explanations that I considered necessary for the purpose of my audit; and
- I was unable to determine whether proper accounting records had been maintained.

Details of these matters are set out in my Report on the Account.

John Bourn
Comptroller and Auditor General

10 January 2005

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Receipts and Payments Account for the year ended 31 March 2004

	Notes	2003-2004 £000	2002-2003 £000
Receipts			
National Insurance contributions	2	**58,587,219**	58,421,672
Compensation for SSP & SMP recoveries*	3	**1,313,000**	755,000
Income from investments	4	**1,257,379**	1,422,465
State Scheme premiums	5	**143,806**	190,044
Other receipts	6	**77,635**	77,730
Redundancy receipts	7	**26,991**	24,123
		61,406,030	60,891,034
Less			
Payments			
Benefit payments	8	**54,797,011**	52,844,467
Personal pensions	9	**3,771,333**	3,276,384
Administrative costs	10	**1,754,093**	1,241,496
Redundancy payments	7	**237,893**	252,923
Transfers to Northern Ireland	11	**260,000**	350,000
Other payments	12	**33,644**	26,599
		60,853,974	57,991,869
Excess of receipts over payments		**552,056**	2,899,165

Statement of balances

	£000	£000
Opening balance	**26,529,550**	23,630,385
Plus		
Excess of receipts over payments	**552,056**	2,899,165
Closing balance	**27,081,606**	26,529,550

The notes on pages 11 to 19 form part of these accounts.

* SSP: Statutory Sick Pay
SMP: Statutory Maternity Pay

Paul Gray 13 December 2004
Accounting Officer
Inland Revenue

Notes to the Account

1 Accounting policies

Basis of preparation of the Account

This Account has been prepared in accordance with Section 161(2) of the Social Security Administration Act 1992. It has been prepared on a cash basis with no provision for accruals and in a form directed by the Treasury, shown as an annex to this account.

National Insurance contributions

The Account shows those contributions received during the year. The amounts shown are due to the NIF after recoveries by employers of amounts due in respect of any statutory sick and statutory maternity payments made to their employees and after deduction of specified percentages of contributions allocated to the National Health Service (NHS).

Employers are responsible for calculating contributions payable by themselves and their employees. Their records are subject to examination by the IR. These checks and checks on other contributors may result in additional receipts or repayments in future years in respect of contribution liabilities for 2003-2004.

Payment of Social Security benefits

The DWP administers a range of social security benefits, financed either from the NIF or from the Consolidated Fund through the DWP Resource Accounts. Where an individual is in receipt of more than one benefit, it is the Department's policy to combine amounts due into a single payment wherever practicable. NIF benefits are paid by girocheque, order books encashable at a post office, payable order or credit transfer, with the last of these methods becoming increasingly common. It is currently not practicable for the DWP to account precisely for all expenditure on individual benefits at the time payable instruments are encashed. Instead, they rely on statements from Post Office Ltd of all separate and combined order book payments falling within nine accounting groups allocated by Post Office Ltd. The Department retain details of benefits issued on the vast majority of payments, including combined payments, by means of an accounting interface with each of the benefit computer systems called the Programme Accounting Computer System (PACS). Apportionment of benefit expenditure has been achieved in this Account using PACS and other information.

Use of estimated figures

Certain receipts and payments during the year in the account are based on estimates and may be subject to adjustment in subsequent years on the basis of more reliable information. Certain classes of contribution receipts, allocation of contribution receipts to the NHS, recoveries and compensation in respect of statutory sick pay and statutory maternity pay, and settlements with Northern Ireland NIF (NI NIF) are all reported on this basis.

Net accounting

National Insurance Contributions, state scheme premiums, personal pensions and benefit payments are all shown net of refunds or recoveries.

2 National Insurance contributions

	Notes	**2003-2004 £000**	2002-2003 £000
Contributions			
Class 1 (employed earner)	i	**55,944,033**	55,537,988
Class 1A & 1B	ii	**788,278**	1,006,649
Class 2 (self-employed flat rate)	iii	**242,963**	294,318
Class 3 (voluntary contributions)	iv	**69,845**	66,841
Class 4 (self-employed earnings related)	v	**1,542,100**	1,515,876
		58,587,219	58,421,672

Different groups of people pay different classes of contributions. Currently there are six classes: 1, 1A, 1B, 2, 3 and 4. These can be summarised as follows

i Class 1 contributions are divided into two parts: primary contributions payable by employees and secondary contributions payable by employers.

ii Class 1A contributions are paid by employers on most benefits provided to employees. Employers pay Class 1A contributions to the Inland Revenue Pay As You Earn scheme with their Class 1 contributions.

Employers are not required to provide the Inland Revenue with details of the split between Class 1 and Class 1A contributions when making payment via the Pay As You Earn scheme. The total amount of Class 1A contributions for the year is, therefore, estimated by the Government Actuary based on employers' End of Year Returns.

Class 1B contributions were introduced on 6 April 1999 and are payable by employers where they have entered into a PAYE Settlement Agreement for tax enabling them to settle their National Insurance and Income Tax liability in a lump sum after the end of the tax year.

The figures for Class 1A and Class 1B have been combined.

iii Class 2 Self employed persons pay flat rate weekly contributions.

iv Class 3 voluntary flat rate contributions are paid to maintain a contributor's National Insurance record for certain benefit and/or pension purposes.

v Class 4 Self employed persons pay earnings related contributions.

GAD apportionment

The Social Security Administration Act 1992 requires that GAD apportion the National Insurance Contributions collected each year. The main focus of this exercise is to confirm the Class split in order to calculate the appropriate amount to be paid over to the NHS. The NHS allocation is paid over at source before the contributions are paid into the NIF and so the figures shown above are shown net of the NHS element. NHS allocation was £14,901m in 2003-2004 (£7,261m 2002-2003).

Additionally, GAD also allocates amounts recovered by employers in respect of Statutory Sick Pay and Statutory Maternity Pay from the Class 1 total.

3 Compensation for Statutory Sick Pay and Statutory Maternity Pay recoveries (SSP & SMP)

	2003-2004	2002-2003
	£000	£000
Compensation for SSP & SMP recoveries	**1,313,000**	755,000

The amount paid from the DWP Resource Accounts re-compensates the NIF for loss of revenue due to contribution receipts being reduced by recoveries in respect of statutory sick and statutory maternity payments paid by employers.

4 Income from investments

	2003-2004	2002-2003
	£000	£000
Interest received	**1,361,503**	1,315,289
Profit on realisation	**27,082**	192,486
Losses on realisation	**(131,206)**	(85,310)
	1,257,379	1,422,465

During the year the value of investments increased from £24.4 billion at 31 March 2003 to £26.6 billion at 31 March 2004. A substantial proportion of the investments continue to be held in short-term securities. At 31 March 2004 the proportion was approximately 62% (45% at 31 March 2003). The fall in realised profit is due to downward movements in gilt prices as gilt yields have risen in the last year.

5 State Scheme premiums

	2003-2004	2002-2003
	£000	£000
State Scheme premiums	**143,806**	190,044

State Scheme Premiums are payable in respect of employed persons who cease to be covered, in certain specific circumstances, by a contracted out pension scheme. The premiums buy back the persons' additional pension entitlement in the State Earnings Related Pension Scheme (SERPS). The collection total is net of refunds.

In October 1992, the Government agreed that persons whose pension entitlement was no longer covered by specified Maxwell pension schemes could be brought back into SERPS. Individuals were not required to pay premiums for the years they were contracted out of SERPS but the IR is seeking recovery of these premiums from the Maxwell pension schemes.

By 31 March 2004, around 30,625 individuals had been brought back into SERPS with a liability of some £127,617,537 (25 new members were identified between 6 April 2003 and 31 March 2004 with a total liability of £92,072. However, 10 members previously identified as Maxwell members were found to be members of other pension schemes - the total liability for these members amounts to £104,535 which has been removed) of which £35,654,912 had been recovered. A total of £545,000 was recovered in 2003-2004.

New Maxwell Scheme members continue to be identified as individuals reach State Pension Age and following investigations with the Scheme Administrators. Members may also have been recorded under one scheme but were actually members of another. The pension liability for these members has to be transferred however, because the schemes have different revaluation rates, the value of the liability from one scheme could be different to the other, (i.e. a premium under Mirror Group could be for £1,000, but under Headington it could be only £800). This accounts for changes in the scheme and overall liability from one year to the next.

Most actions are now settled and the Trustees are resolving outstanding legal issues and moving to fully secure the benefits of their members. It is expected that eventually around £97 million of the total £127.6 million liability will be recovered.

Maxwell Pension Scheme	Liability at 31 March 2004 £	Recovered by 31 March 2004 £	Progress
Mirror Group Pension Scheme	68,777,136	4,460,000	State Scheme Premium bill capped at £66 million. A phased and gradually accelerating payment schedule has been agreed. Final payment due by 2020.
Headington Pension Plan	49,236	727,110	Membership of the scheme has still to be agreed before the final bill is confirmed.
MCWPS 'Works' Scheme	0	30,467,802	Final payment of £10,467,802 paid September 2001.
Victoria Works Scheme	366,087	0	Schemes merged.
AGB Scheme	10,550,969	0	Some payment of SSPs possible.
AGB Research Scheme	1,479,377	0	
Maxwell Communications Pension Plan (Staff)	10,329,654	0	No current prospect of payment.
Maxwell Media Pension Plan	413,146	0	No current prospect of payment.
Total	**91,965,605**	**35,654,912**	

6 Other receipts

	Notes	**2003-2004 £000**	2002-2003 £000
Recoveries of compensation payments	i	**66,577**	60,683
Compensation for age related rebates	ii	**9,326**	14,422
Unemployment benefit recoveries	iii	**1,732**	2,625
		77,635	77,730

i The recoveries from damages paid to recipients of certain NIF benefits. These amounts relate to recoveries from insurers and other bodies in respect of compensation claims for damages where NIF benefits had already been paid to individual claimants by the DWP.

ii The NIF received a payment of £9,326,096 from the IR Resource Account, in respect of compensation for delayed payments of Age Related Rebates made to pension providers on behalf of their clients who opted out of SERPS in favour of a personal pension.

iii Unemployment Benefit was replaced by Jobseekers Allowance in October 1996 and these are retrospective recoveries. These recoveries are all article 69 cases i.e. reimbursement to the NIF from European countries for their citizens who have been paid unemployment benefit in the UK.

7 Redundancy payments

Section 182 of the Employment's Rights Act 1996 provides the statutory basis for the NIF to make Redundancy Payments. The Insolvency Service (INS) makes the payments on behalf of the DTI.

The Redundancy Payments Scheme (RPS) ensures that employees who have been made redundant are paid the statutory money due to them when their employers are unable to do so, usually because of insolvency. In doing so, the RPS also has to protect the taxpayer's interests by ensuring that it does not make payments which can be made by the employers themselves.

The total debt outstanding at 31 March 2004 was £73 million, which is disclosed as part of the DTI's Resource Account Balance Sheet.

In 2002-2003 a joint review of the Redundancy Payments Scheme was undertaken which involved inputs from the National Audit Office, the Insolvency Service and the Inland Revenue. One of the consequences of this review was that £929 million of debt was written off to leave a more realistic recoverable balance. This includes a retrospective write-off of £692 million to bring the NIF accounting practice into line with that of the Department for Trade and Industry. This adjustment does not impact upon NIF receipts and payments in any year.

	2003-2004
	£000
Outstanding debt at 31 March 2003	**72,029**
Plus redundancy payments in 2003-2004	**237,893**
Less receipts in 2003-2004	**(26,991)**
Less debt written off in 2003-2004 (note 15)	**(210,086)**
Outstanding debt at 31 March 2004	**72,845**

	2002-2003
	£000
Outstanding debt at 31 March 2002	777,150
Adjustment to the opening balance	(696,502)
Plus redundancy payments in 2002-2003	252,923
Less receipts in 2002-2003	(24,123)
Less debt written off in 2002-2003 (note 15)	(237,419)
Outstanding debt at 31 March 2003	72,029

8 Benefit payments

	Notes	**2003-2004**	2002-2003
		£000	£000
Benefits			
Retirement pension	i	**46,256,228**	44,252,183
Incapacity benefit	ii	**6,794,397**	6,786,038
Bereavement benefit	iii	**999,972**	1,110,086
Jobseeker's allowance (contributory)	iv	**497,981**	505,033
Christmas bonus for pensioners	v	**121,870**	121,119
Maternity allowance	vi	**124,840**	68,426
Guardians' and child special allowance	vii	**1,723**	1,582
		54,797,011	52,844,467

i Retirement Pension is the State pension for people who have reached State Pension Age (currently 65 for men and 60 for women). It is based on National Insurance contributions and is made up of different elements, the largest of which is the basic state pension, followed by the additional state pension known as State Earnings Related Pension Scheme (SERPS).

ii Incapacity Benefit is paid at three different rates dependent on age and term of incapacity to a person who has paid National Insurance Contributions and whose Statutory Sick Pay has ended or is not applicable.

iii Bereavement Allowance replaced Widow's pension in April 2001 and is a regular payment for 52 weeks. Bereavement Payment replaced Widow's payment in April 2001 and is a lump sum payment. Both are based on the late husband or wife's National Insurance contributions.

iv Contributory Job Seekers Allowance is payable to people who are capable of working, available for work and actively seeking work who have been paid or are treated as having paid a certain number of National Insurance Contributions.

v Christmas Bonus is a tax free payment of £10 paid before Christmas to pensioners who are in receipt of one or more qualifying benefits.

vi Maternity Allowance is paid for up to 26 weeks at a standard weekly rate, dependent upon earnings, to a person who cannot get Statutory Maternity Pay.

vii Guardian's allowance is payable to people bringing up a child because one or both of the parents has died. Responsibility for the payment of this allowance passed to the IR in April 2003.

Where people receive more than one benefit these are generally paid together as a composite payment. This means that all of the benefits reported above consist partly or wholly of apportioned expenditure.

Retirement pension and widow's benefit includes payment to Northern Ireland pensioners living abroad. For administrative convenience these payments are made by the DWP with the cost being borne by the NIF in Great Britain. It is not possible to provide an accurate figure for Northern Ireland's share of the expenditure on overseas pensions, but an estimate of the amount involved in 2003-2004 is £8.2million (£8.5 million in 2002-2003). Note 11 explains the relationship between the Great Britain and the Northern Ireland National Insurance Funds.

9 Personal pensions

	2003-2004 £000	2002-2003 £000
Personal pension payments	**3,771,333**	3,276,384

The Pensions Schemes Act 1993, supplemented by the Pensions Act 1995, entitles employed earners with a personal pension to a 'minimum contribution' to their plan from the NIF. This, for 1997-98 and later tax years, is based on earnings between the lower and upper earnings level and the age of the member. Similarly, from April 1997, members of Contracted Out Money Purchase (COMP) Schemes are entitled to a 'top-up' payment of age related rebate based on the age of the member and calculated using the earnings on which the contracted out rate of National Insurance Contributions have been paid.

10 Administrative costs

Payments made in respect of administration

	2003-2004 £000	2002-2003 £000
Department for Work and Pensions*		
For administering the National Insurance Scheme.	**1,422,893**	908,280
Inland Revenue		
For the collection of National Insurance Contributions	**320,422**	320,304
Department of Trade and Industry	**8,782**	8,782
Lord Chancellor's Department	**0**	1,711
Office of National Statistics	**581**	588
Government Actuary's Department	**467**	467
National Audit Office	**400**	750
Commissioners for the Reduction of the National Debt	**260**	250
Bank charges	**235**	279
Scottish Executive Justice Department	**43**	75
General Register Office	**10**	10
	1,754,093	1,241,496

* Analysis of payments from the Fund in 2003-2004 in respect of Department for Work and Pensions' administrative costs

Of the payment of £1,423m to the DWP, £1,163m relates to work done for 2003-2004. The balance of £260m relates to work done for 2001-2002 and a payment of this sum was made following agreement between the Department, the Inland Revenue, HM Treasury and the NAO. The increased level of payments to the DWP is due primarily to the Department's ongoing Welfare Modernisation programme. It is expected that the costs relating to this will decrease as new benefit processing systems are implemented.

11 Transfers to Northern Ireland

	2003-2004 £000	2002-2003 £000
Payments to Northern Ireland NIF	**260,000**	350,000

The amount shown in this account is in respect of financial adjustments made by the National Insurance Joint Authority between the National Insurance Fund and the Northern Ireland National Insurance Fund in accordance with Section 177 of the Social Security Administration Act 1992. These financial adjustments are consequential upon the arrangements made for co-ordinating the systems of insurance established in the two countries to ensure that they operate, to such an extent as is provided in those arrangements, as a single system. They adjust the balances in the two Funds in proportion to the population of working age as established by the latest available Census returns in the two countries. Payments are made on a provisional basis and are adjusted when end of year balances in the two funds are available. An adjustment of £12.1m agreed in March 2004 in respect of 2002-2003 formed part of the calculations for 2003-2004.

12 Other payments

	Notes	2003-2004 £000	2002-2003 £000
Payments to Isle of Man	i	**23,830**	21,789
SSP/SMP	ii	**3,989**	1,534
Other payments	iii	**5,825**	3,276
		33,644	26,599

i Payments to the Isle of Man (Manx Insurance Fund) relate to net settlements in respect of people who have paid National Insurance Contributions into one Fund but have received benefit from the other Fund.

ii Payments made to people where their employer has failed to make the payments required under legislation.

iii Under the Income Tax Acts, Incapacity Benefit is assessed as taxable income. Tax is deducted from Incapacity Benefit every time a payment is made to a person, and paid to the Inland Revenue, monthly in arrears.

13 Securities held by the Commissioners for the Reduction of the National Debt (CRND) at 31 March 2004

The National Debt Commissioners are responsible, in accordance with section 161(3) of the Social Security Administration Act 1992, for the investments of the NIF. They are authorised to invest in accordance with directions given by Treasury.

	Nominal value £000	Cost price £000	Market value at 31 March 2004 £000
Government and government guaranteed stocks			
Up to one year	16,297,334	16,440,151	**16,461,433**
One to five years	3,674,665	4,039,123	**4,101,606**
Five to ten years	4,325,700	4,564,021	**4,910,252**
Over ten years	1,267,826	1,537,333	**1,676,793**
	25,565,525	26,580,628	**27,150,084**
Loans to Local Authorities			
Up to one year	0	0	**0**
Total securities	25,565,525	26,580,628	**27,150,084**

	Nominal value £000	Cost price £000	Market value at 31 March 2003 £000
Government and government guaranteed stocks			
Up to one year	10,690,713	10,885,467	10,980,819
One to five years	6,867,253	7,374,528	7,723,547
Five to ten years	3,960,168	4,167,895	4,584,616
Over ten years	1,633,358	1,933,459	2,216,695
	23,151,492	**24,361,349**	**25,505,677**
Loans to Local Authorities			
Up to one year	9,500	9,500	9,708
Total securities	**23,160,992**	**24,370,849**	**25,515,385**

14 Closing balance

	31 March 2004 £000	31 March 2003 £000
Securities held by the CRND at cost (see note 13)	**26,580,628**	24,370,849
Funds held by Paymaster (including uncleared cheques)	**1,134**	8,988
Other balances (i)	**499,844**	2,149,713
Total	**27,081,606**	26,529,550

i Sums due from or owing to Government Departments and overseas administrations in respect of the operation of the NIF.

15 Losses

		2003-2004		2002-2003	
		£000	**Number of cases**	£000	Number of cases
1	**Contributions NIF share**				
	IR remissions and waivers (1a)	**135,931**	**112,017**	117,114	191,546
	IR debt transferred (1b)	**11,871**	**0**	158,352	0
	Total loss	**147,802**	**112,017**	275,466	191,546
2	**Benefits**	**26,316**	**95,058**	26,144	94,935
3	**Redundancy write-off adjustment** (see Note 7)	**0**	**–**	692,000	–
	Write-off in year	**210,086**	**–**	237,419	11,023
4	**Administration**	**1,475**	**19,373**	1,646	2,500

1a IR grant remissions in respect of unpaid contributions where pursuit is unlikely to be successful and waives arrears when pursuit of the debt is regarded as neither practical nor cost effective. The majority of the figure of £135,931,000 derives from remissions made in the period October 2002 to October 2003, that being the period for which IR remissions are accounted. The prior year figure is stated on the same basis.

1b IR transfer national insurance debts in respect of insolvent companies for subsequent recovery and/or write-off by the National Insurance Contributions Office (NICO).

2 Organised Fraud: At the end of 2003-2004 the Counter Fraud Investigation Unit had investigated and brought prosecutions from 11 operations which each involved a loss to public funds of over £100,000. Four of these operations included National Insurance Fund benefits. The loss to the National Insurance Fund was £196,297.36. All of these fraud cases involved organised or systematic abuse of the benefit system and involved either instrument of payment fraud or multiple identity fraud. In total three people were charged receiving in total seven years.

Write-off of Debt through Easement: The Department of Work and Pension's overpayment initiative, agreed with Treasury, enables the write-off of non-recoverable debt using estimating procedures. The aim is to re-target resources to more cost effective recovery. During 2003-2004 the package dealt with 55,539 cases involving overpayments of NI Fund benefits, writing off approximately £13 million. These overpayments would not have been recoverable under Social Security legislation. They were caused primarily by official error.

Jobseeker's allowance losses are reported in the Department of Work and Pensions Resource Account.

3 The figure represents amounts written off during the year in respect of redundancy payments to employees, deemed irrecoverable from their employers mainly due to insolvency. This figure is significantly greater than in previous years as a result of a review of the debt position, which has resulted in irrecoverable debt being identified more quickly and a more realistic figure being reported.

4 The Department for Work and Pensions wrote off a number of high value losses in 2003-2004, which related proportionately to the NIF White Paper Account. There were 741 salary related cases totaling £35,896, 16,582 non-salary related cases totaling £985,288 and 23 miscellaneous cases totaling £118,520. This figure is large due to the write off of unrecoverable debts built up since 1993 where for various reasons DWP have been unable to obtain repayment and legal advice has been that it would not be cost effective to pursue them further.

16 Special payments

	2003-2004		2002-2003	
	£000	**Number of cases**	£000	Number of cases
Special payments	**5,152**	**7,773**	5,808	10,356

These are mainly payments to claimants who have been wrongly advised on benefit entitlement. The number of cases for the financial year to 31 March 2004 was 3,773 (7,356 in 2002-2003).

The Australian social security agreement ended with effect from 1 March 2001. An extra statutory payment scheme was set up to pay enhanced state retirement pension to those people with residence in Australia during the currency of the Agreement, up to 5 April 2001, who have now returned to live permanently in the UK. In the financial year to 31 March 2004, payments were made amounting to approximately £3 million, representing around 4,000 cases (£2 million in 2002-2003 representing around 3,000 cases). This amount represents ongoing costs for the complete financial year. This is the fourth year for which payments have been made, and the third complete financial year.

Annex

Accounts Direction given by Her Majesty's Treasury

1 In accordance with Section 161(2) of the Social Security Administration Act 1992, the Treasury hereby gives the following Direction.

2 The Inland Revenue has a duty to prepare each year a statement of the transactions on the National Insurance Fund of Great Britain. For the year ended 31 March 2000, and all subsequent years until this direction is amended, this statement shall comprise

a a foreword;

b an account of receipts and payments;

c a statement of balances;

and shall include such notes as may be necessary for the purposes referred to in the attached schedule.

1 The Accounting Officer shall observe all relevant accounts and disclosure requirements in 'Government Accounting' and any other guidance issued by HM Treasury as amended or augmented from time to time.

2 The format of the statement of account and the disclosure requirements are in the attached schedule.

3 The foreword and the account shall be signed by the Accounting Officer.

4 The Accounts Direction shall be reproduced as an annex to the accounts.

5 This direction supersedes the Account's Direction dated 7 December 1995.

B Glicksman 16 October 2000
Treasury Officer of Accounts

Schedule

Format of Account and Disclosure requirements - Great Britain

1 The foreword shall state that the account has been prepared in accordance with a direction issued by Treasury in pursuance of Section 161(2) of the Social Security Administration Act 1992. The foreword will also include details of the following

a statutory background;

b operational responsibilities;

c financial performance;

d audit arrangements; and

e responsibilities of the Accounting Officer.

2 The receipts and payments account, and statement of balances shall conform to the formats shown in the Annex, although minor variations may be made.

3 The notes shall include

a analysis of the payments and receipts included under the headings set out in the attached format, including any explanation or background that may be necessary to understand the accounts;

b in the notes on administrative costs, the estimated costs for the current year and the adjustments for previous years separately identified;

c a statement of the securities in which the National Insurance Fund is invested by the National Debt Commissioners in accordance with Section 161 subsection (3) of the Social Security Administration Act 1992; and

d details of any irregular, uncertain or special payments.

Receipts and Payments Account for the year ended 31 March XXXX

	Notes		**XXXX**		XXXX
		£000	**£000**	£000	£000
Receipts					
National Insurance contributions					
Grant from Class XIII, Vote 2					
Compensation for Statutory Sick Pay and Statutory Maternity Pay recoveries					
Income from investments					
State scheme premiums					
Other receipts					
Redundancy receipts					
Less					
Payments					
Benefit payments					
Personal pensions					
Administration costs					
Redundancy payments					
Redundancy payments					
Transfers to Northern Ireland					
Other payments					
Excess of receipts over payments					

Statement of Balances

	£000	**£000**	£000	£000
Opening balance				
Plus				
Excess of receipts over payments				
[*Less*				
Excess of payments over payments]				
Closing balance				

The notes on pages (-) to (-) form part of these accounts.

Report by the Comptroller and Auditor General

Introduction

1 The National Insurance Fund provides for expenditure on benefits and allowances where individuals have paid sufficient National Insurance contributions and met other qualifying conditions. In 2003-2004, receipts amounting to £61.4 billion (mainly in the form of National Insurance contributions) were paid into the Fund and payments of £60.9 billion (mainly contribution-based benefits) were paid out of it. The balance on the Fund was some £27.1 billion at the end of the year.

2 The National Insurance Recording System (NIRS2) maintains details on some 70 million National Insurance accounts for individual contributors and approximately 1 million new accounts are created each year. The system supports a variety of activities contributing to pension and benefit payments. It records details of individuals' and employers' National Insurance contributions, calculates contribution based benefits, provides data to other Government Departments and pays age-related contribution rebates to occupational and personal pension holders.

3 The Inland Revenue has responsibility for the collection of National Insurance contributions from employers, employees, the self-employed and for those who pay contributions voluntarily. The Department for Work and Pensions is responsible for benefits paid to individuals and these are currently administered through the Pension Service and Jobcentre Plus. The Department for Trade and Industry has overall responsibility for administration of the Redundancy Payments Service which is funded by the National Insurance Fund. Accountability for the National Insurance Fund overall rests with the Inland Revenue who receive formal Letters of Assurance on particular aspects from the other Government Departments.

4 This report records the results of my audit examination of the 2003-2004 account and developments, including

- Estimated Fraud and Error in benefits paid from the National Insurance Fund;
- The balance on the Fund;
- Contribution Deficiency Notices;
- Non-matched contributions suspense files; and
- Duplicate Age-related Rebate payments and compensation.

Estimated Fraud and Error in benefits paid from the National Insurance Fund

5 Most of the expenditure on benefits paid out of the National Insurance Fund in 2003-2004 was incurred on Retirement Pension and Bereavement Benefit (£47,256 million), Incapacity Benefit (£6,794 million) and contribution-based Jobseeker's Allowance (£498 million). The National Audit Office, based on evidence provided by the Department for Work and Pensions about estimated losses and its own independent testing, has concluded that it is likely that significantly less than one per cent of the total expenditure in 2003-2004 on Retirement Pension and Bereavement Benefit and contribution-based Jobseeker's Allowance was lost through fraud and error. On that basis I have not qualified my audit opinion on the expenditure for these benefits.

6 From a programme of checks the Department was able to estimate that overpayments of Incapacity Benefit in 2003-2004 arising from errors by officials amounted to some £67 million (around 1 per cent of expenditure on the benefit). However, customers did not gain any advantage from £15 million of this amount of overpayment, because if Incapacity Benefit had not been in payment, other benefits should have been payable equivalent to their entitlement to Incapacity Benefit. It was also estimated that underpayments amounted to around £97 million, although for £79 million of the underpayments customers suffered no financial losses as they received other benefits up to the level of their entitlement to Incapacity Benefit.

7 In order to verify these estimates the National Audit Office sought to examine an independent sample of 800 Incapacity Benefit cases to check that eligibility conditions were met and that accurate payments had been made. In 106 cases the Department were unable to locate the supporting papers, which include the medical assessment that provides evidence of customers' entitlement to Incapacity Benefit. As a result this limits the National Audit Office's ability to confirm the accuracy of the Department's estimates, although the results from the 694 cases checked were consistent with those of the Department. The absence of this evidence from the 106 cases is a significant limitation on the scope of the audit and I have qualified my audit opinion to reflect this.

The Balance on the Fund

8 National Insurance contribution rates are set at levels intended to meet expected benefit expenditure each year, after taking into account other Fund receipts and payments, and to maintain a working balance. At 31 March 2004, the balance on the National Insurance Fund was £27.1 billion - some 50 percent of annual benefit expenditure - an increase of £0.5 billion compared to 31 March 2003.

9 In his report on the financial provisions of the Social Security Bill in1992, the Government Actuary confirmed it was prudent to plan for a minimum working balance of one sixth (16.7 per cent) of annual benefit expenditure. A working balance is necessary because the Fund has no borrowing powers and because changes in contribution levels in response to the needs of the Fund take time to implement. In the Foreword to the account, the Accounting Officer has set out the context and reasons for the balance. He has explained that the balance is one of the matters taken into account when Ministers review annually National Insurance contributions and that the Government Actuary reports on the likely effect on the balance of the Government's benefits Up-rating and contributions Re-rating Order. These Orders can be subject to debate and require the approval of both Houses.

Contribution Deficiency Notices

10 Individuals have to pay or be credited with sufficient National Insurance contributions each tax year for it to be classed as a qualifying year for benefit or basic state pension purposes. It was the then Contributions Agency's practice to send a Deficiency Notice to individuals who did not contribute enough, inviting them to consider if their National Insurance contribution record was correct and how much voluntary Class 3 contributions they would have to pay for the year for it to count as a qualifying year. The former Contributions Agency decided to suspend the Deficiency Notice exercise in 1998 to focus resources on those areas seen as priorities during the early years of the new NIRS2 system.

11 I reported last year the circumstances of the Inland Revenue writing to customers who should have received a Deficiency Notice in respect of the previous six years. The Inland Revenue handled those cases where the individual was still of working age, whilst the Department for Work and Pensions are dealing with the issue of Deficiency Notices to those individuals who had reached pensionable age between April 1997 and October 2004.

12 Following a pilot exercise, the Inland Revenue started writing to customers in October 2003, gradually increasing the production of Deficiency Notices to approximately 328,000 per week. The Inland Revenue achieved their target of issuing 10.02 million notices by the end of September 2004. Around 23 per cent of people receiving a notice responded with further enquiries, as invited by the Deficiency Notice. Some enquiries were in respect of the need to make corrections to the National Insurance contributions record because the individual had been working or receiving benefits during the relevant period. Around 220,000 individuals requested pension forecasts. The routine annual production of Deficiency Notices started again in October 2004, covering the 2002-03 contribution year

13 By the end of September 2004, only a very small percentage of Deficiency Notice recipients (around 1.7 percent or 170,000 individuals) made immediate payments of voluntary National Insurance contributions and the Inland Revenue expects to collect up to £49 million as a result of both exercises. Because of the number of variable factors involved, it is not possible to provide an estimate of additional benefit entitlement as a result of these contributions.

14 The Department for Work and Pensions face a far more complex situation with a target population of 670,000 individuals who have reached State Pension age where there is an immediate impact on pension entitlement. The Department's work involves complex hypothetical calculations of contributions and benefit entitlement to ensure that the pensioners are given sufficient information to enable them to make the decision on whether they will be better off if they pay the voluntary National Insurance contributions indicated in the Deficiency Notices. The exercise commenced in September 2004 and is expected to take 12 months with a minimum six month close down period. The Department expects a 70 per cent response rate to the initial Deficiency Notices and around 25 per cent of the individuals who respond to make additional contributions, totalling around £32 million. The Department for Work and Pensions estimates the arrears of benefit expenditure, including interest on back dated payments, will amount to £103 million.

15 Deficiency Notices and associated notes are by their nature long and complex, and are potentially difficult for many recipients to understand and interpret. In drafting these documents, the Department liaised with, and took the advice of, the Social Security Advisory Committee and Voluntary Organisations, including Help the Aged, Age Concern and the Citizens Advice Bureau. Independent research commissioned by the Department for Work and Pensions found that 98 per cent of pensioners understood their Deficiency Notices.

16 Departmental estimates of the cost of administering the Deficiency Notice work are £65.3 million for the Inland Revenue and £32.8 million for the Department for Work and Pensions.

Non-matched Contributions Suspense Files

17 In some instances the Inland Revenue receive End of Year information from employers that includes small numbers of National Insurance contributions information that they cannot match to the relevant contributor records. This is the result of inaccurate information received from employers on End-of-Year submissions. These non matching items generally concern short-term or low-paid workers, where there is little incentive for either employee or employer to provide the details, particularly where turnover is high or where the employee has come from abroad and has never applied for a National Insurance number. The Inland Revenue take all reasonable actions to trace and update contributor records. If, despite the application of NIRS2 matching routines and all reasonable effort by the Inland Revenue, the items still cannot be matched they are kept permanently on non-matched Suspense Files. These are maintained to ensure that when an individual queries the completeness of their contribution record, the Inland Revenue can retrieve unmatched items from Suspense Files and credit them to the individual's contribution record.

18 The Suspense Files contain over 100 million items. For each of the last four years, some 2.2 million new items have been added to the Suspense Files. This represents about four percent of each year's returns. I reported last year that a joint Department for Work and Pensions and Inland Revenue report in October 2002 identified that, potentially, some 2 million non-matching items could impact on benefit entitlement. The Inland Revenue was looking at how best to further reduce the number of non-matched items and they have introduced a number of initiatives to address these issues.

19 The Inland Revenue is instituting a major programme of change called "Modernising PAYE Processes for Customers" (MPPC). The first phase of this will focus on Employer End of Year returns to support the mandatory electronic submission of End of Year returns for all large employers (those with more than 250 employees) from April 2005. A quality standard has been introduced and will be applied across all channels to encourage employers to make sure that they submit accurate information.

20 The Inland Revenue expects that electronic submission of End-of-Year returns and the application of a consistent quality standard will improve the quality of data received, will be more efficient than the current processes and should reduce the number of items being placed on the suspense file. Small employers (those with less than 50 employees) will be required to submit returns electronically by 19th May 2010, and are being offered an incentive of £250 in the first year they move to electronic submission. The incentive could amount to £825 in total for a small employer if full electronic submission is made from 19th May 2005. Medium sized employers must submit end of year returns electronically by 19th May 2006.

21 Although outwith the main scope of MPPC End of Year Phase 1, the Inland Revenue has taken the opportunity to review how it deals with non matched items and streamline contact with employers. Revised processes will be implemented from April 2005 and all employer enquiries in respect of End of Year returns will be addressed and followed up collectively for that employer. The Department will produce a schedule of correct information and National Insurance numbers, which will be forwarded to employers at the end of each year to help ensure that their returns are correct for the next year.

22 The Inland Revenue has commissioned independent research on non-matching National Insurance contributions. The research is based on the 400 employers with the highest number of non-matched End of Year returns on the 2002-2003 non-matched Suspense File. The project is intended to look at possible underlying reasons which lead to non-matching items, what can be done to assist employers in improving the quality of submitted data, to identify potential improvements to guidance and processes, with the aim of reducing, and if possible preventing, non-matching items in the future. This research will report later in 2004-2005.

Duplicate payments of Age-related Rebates

23 Age related rebates are paid to an individual's personal pension scheme where an individual contracts out of the State Earnings Related Pension Scheme. They are based on contributions paid and the age of the contributor.

24 The National Audit Office in 1999-2000 first identified cases of duplicate Age-related Rebate payments made by the Inland Revenue to pension providers as a result of duplicate submission and processing of employers' end-of-year returns. I reported last year that in October 2002 the Inland Revenue recovered £62 million of overpaid rebates in respect of 1,070 schemes from amounts due to pension providers

25 Further to my report last year, a full review of the Age-related Rebate payment process was undertaken by a joint group which included the Inland Revenue's Business Services Group, Internal Audit and Accenture (the Department's IT service provider for National Insurance systems). The objective of the review was to assess the system of internal controls to ensure that adequate controls were in place to address and minimise inherent risk. Where the need for additional controls was identified, these have been applied retrospectively and corrective action taken. The work in this area includes a reconciliation process between the information on the NIRS2 system and what has been paid to the pension providers. This reconciliation process covers the past six years and will now operate twice-yearly.

26 The results of this reconciliation work, together with the National Audit Office's work on age-related Rebates, show that after a number of years trying to resolve the system weaknesses, the Department has implemented robust controls which will help prevent duplicate payments happening and going unnoticed in the future.

Summary and Conclusions

27 It is likely that significantly less than one percent of the total expenditure in 2003-04 on Retirement Pension and Bereavement Benefit and contribution-based Jobseeker's Allowance was lost through fraud and error. However, in a significant number of sampled cases the Department for Work and Pensions was unable to find the evidence of customers' entitlement to Incapacity Benefit, and I have qualified my audit opinion to reflect this.

28 The Inland Revenue has achieved significant success in issuing 10.02 million National Insurance contribution Deficiency Notices in the past year to catch up on the six years for which the Deficiency Notice exercise had been suspended during the early years of the new NIRS2 system. The Department for Work and Pensions' Deficiency Notice exercise, in respect of those who have reached State Pension age, is far more complex and will continue throughout 2004-2005 and 2005-2006.

29 The Departments' estimates of the administrative costs of Deficiency Notice exercises amount to almost £100 million. They estimate that their exercises will generate £81million in additional NI contributions, made up of £32 million for the Department for Work and Pensions' exercise and up to £49 million for the Inland Revenue exercises. The Department for Work and Pensions estimates the arrears of benefit expenditure will amount to £103 million.

30 Inaccurate National Insurance contributions information received from employers continues to generate over two million contribution records each year that cannot be matched to relevant contributors, despite the Inland Revenue's efforts to trace them. The Department has taken, and has in hand, a range of important initiatives to assist employers in improving the quality of their data. Nevertheless, non-matched NI contributions will remain a significant problem for the Department to manage in years to come.

John Bourn
Comptroller and Auditor General

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