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National Insurance Fund Account 2004-2005

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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 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) placed the NIF under the control and management of the Inland Revenue (IR).

Following the Chancellor's announcement in his March 2004 budget speech, legislation received Royal Assent on 7 April bringing into existence a new department, HM Revenue and Customs. This became a legal entity on 18 April 2005, incorporating the Inland Revenue and HM Customs and Excise. HM Revenue and Customs (HMRC) have prepared these accounts and references to HMRC also cover the functions of the Inland Revenue.

The Deputy Chairman of the Board of HMRC is the Accounting Officer for the Fund. Section 161(2) of the Social Security Administration Act 1992 requires HMRC 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. HMRC 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 with the Insolvency Service, an agency of DTI, handling 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 and an update provided 23 December 2004.

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.

The balance on the fund has increased by £2,021 million compared with the position at 31 March 2004 (£27,082 million). At 31 March 2005 the balance held is £29,103 million (51 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 later this year alongside the 2005 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 estimates of benefit payments and contributions, both very large 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.

Responsibilities of the Deputy Chairman of the Board of HM Revenue and Customs

As Deputy Chairman of the Board of the HM Revenue and Customs, 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 and DTI) and agencies on my behalf, and I receive letters of assurance from them as detailed in the Statement on Internal Control.

Paul Gray 18 January 2006
Accounting Officer

Statement on Internal Control

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

Scope of responsibility

1 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 HM Revenue and Customs (HMRC) and previously Inland Revenue (IR) 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.

2 Whilst HMRC 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.

3 I receive Letters of Assurance from the Accounting Officers of those Departments, approved by their audit committees, 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 IR for the year ended 31 March 2005 and in HMRC 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 HMRC. A separate SIC is produced for the Inland Revenue 2004-2005 Resource Accounts and Trust Statement that fully sets out details of HMRC'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 Inland Revenue 2004-2005 Accounts.

6 The main elements of the HMRC'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 The Commissioners of HMRC, created by the Act of Parliament, met in April 2005 and put in place a high level governance structure to include:

- The Departmental Board
- An Executive Committee
- An Operating Committee
- An Audit Committee.

More details of which are contained within the Statement on Internal Control in the Inland Revenue 2004-2005 Accounts.

9 I also plan to carry out a review of the investment policy applied to the NIF, reporting before the end of the financial year, and aiming to apply its findings to investment activity from 2006-2007. Amongst its terms of reference will be a consideration of the types of investment made relative to the size of the fund and the costs of making those investments.

Capacity to handle risk

10 The creation of HMRC presented significant risks both in terms of achieving the merger of the former HM Customs and Excise and IR, and maintaining delivery of Business Objectives. The decision was therefore taken to de-risk the process as far as possible by ensuring legislation addressed the specific issues necessary to get the new organisation in place, while carefully managing the integration both to minimise the impact on delivery and to ensure there was no spend on HMRC prior to successful enactment of the Bill.

11 Staff in the two former Departments continue to have access, through the Intranet to risk management guidance. HMRC are in the process of drawing this guidance together into a single risk framework.

12 The Executive Committee meets weekly and considers the progress in managing top risks as part of those meetings. Work is also in progress to draw up a single risk framework for HMRC.

The risk and control framework

13 The risk management frameworks developed in the two former departments, although different, were consistent with common risk management principles and practices. Each involved a process for identifying top risks, taking account of impact and probability, and the upward reporting of these. The new risk management framework HMRC are putting in place will retain these fundamental elements and will seek to embed them across the organisation. HMRC are also putting in place arrangements to integrate risk and performance reporting. Risk management is also a key component of the Management Framework that has been developed for all HMRC managers.

14 There is a NIF Audit Forum consisting of representatives from key Internal Audit Units, the National Audit Office, Other Government Departments 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.

Review of effectiveness

15 As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control within HMRC. 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 HMRC 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.

16 To provide me with an assurance on the effectiveness of the system of internal control, the Director of Internal audit provides a summary of the findings from every internal audit review, raising significant control issues as they arise. The Chairman of the Audit Committee, who is also a non-Executive Board member, provides the Board with a written report after each Audit Committee meeting.

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

18 The Director General and other senior managers have drawn up statements that set out governance, risk and control arrangements in their business areas. Taking these into account, and the views of the Director of Internal Audit and NAO, I recognise that there are a number of significant control weaknesses. Specific areas relating to the NIF requiring disclosure are:

Update on Issues Raised in 2003-2004 Statement

19 Payments to the National Insurance Funds from HMRC

Last year I reported on an accumulated underpayment owed from the HMRC to the National Insurance Fund. During 2004-2005 the IR implemented controls to prevent similar underpayments occurring in the future. In March 2005 the IR with the agreement of HM Treasury, paid over £938 million to the Fund to make good the underpayment.

20 Non-matching Items

I reported on this issue in the 2003-2004 SIC. We continue to look at how best to further reduce the number of non-matched National Insurance contributions and we have introduced a number of initiatives to address these issues. The Modernising PAYE Processes for Customers (MPPC) programme and the introduction of a quality standard will ensure that the quality of data received will be improved. We also commissioned MORI to undertake independent research on non-matching items, the results, ideas and suggestions from employers have, where possible, been fed into initiatives already underway with our Data Quality Task Force programme.

New Issues Raised in 2004-2005

21 Age Related Rebates

As part of the Modernising PAYE Processes for Customers (MPPC) programme we developed a data routing and validation system called the External Routing Interface Component (ERIC). ERIC supports the processing of employers' End-of-Year returns (EYRs) and was planned to go live in April 2005 but was delayed until June 2005. The delay in processing EYRs has impacted the payment schedule of Age Related Rebates to pension providers.

The Government Actuary Department calculates the percentage rebate rates and assumes that 80% of rebates will be processed by the beginning of November each year. This year around 70% have been paid by the beginning of November.

HMRC has been in regular discussion with Pension Industry representatives and has plans in place to ensure that the remaining rebates are paid over as quickly as possible.

22 Re- platforming of NIRS2

The National Insurance Recording System (NIRS) is a single Head of Duty system administered by HMRC with the purpose of recording contribution and credit data, maintenance of personal details, liability and Contracted–out Scheme information.

NIRS is a strategic IT system supporting key business operations in both HMRC and DWP. Responsibility for development and operational management of the system transferred from Accenture on 2 January 2005, in accordance with the provisions of the Inland Revenue's ASPIRE contract. The new contract required the ASPIRE suppliers to re-platform the NIRS system onto modern software and hardware. The agreed strategy was to undertake this over three phases. The final phase was completed on the August 2005 Bank Holiday weekend following extensive testing and liaison with our stakeholders.

The re-platforming was completed to plan with all functions working as expected with batch processing showing significant performance improvements. Initial difficulties with limited access to the system, affecting a number of users in HMRC but not DWP users, have been largely resolved. Further changes may be required over the next few weeks to strengthen the solutions already introduced.

23 Class 2 National Insurance 'debt' balances

Class 2 National Insurance (C2N) is a flat rate contribution (currently £2.10 per week) paid by the self-employed. When the HMRC are notified that a person is self-employed, HMRC assume that they continue to be liable for C2N until they are told otherwise. Inevitably, some of the debt balance held on the HMRC systems will be false – for example, where a person has ceased self-employment, but failed to notify HMRC.

As a result of a combination of factors, the level of C2N debt balance has continued to rise over a number of years, and £616 million of it was over six years old as at 6 April 2005 and therefore time-barred. A cross-departmental working group was set up in February 2005 to gain an understanding of the end to end C2N process – which included establishing what percentage of the total balance represents true debt. In June 2005, the departmental Operating Committee agreed the following actions:

- Within the time-barred irrecoverable balance of £616 million, the level of true debt is estimated as £333 million, which has been formally written-off. The remainder of the balance, which is not debt, has been written out of the accounts
- We will pursue as a priority those balances, estimated as £71 million, which will become time-barred and irrecoverable after 6 April 2006
- We will look at options for reviewing the C2N policy and processes
- A director-level group will oversee all actions and report regularly to the Operating Committee.

24 Incapacity Benefit credits

The Department for Work and Pensions' (DWP) Pension Service Computer System (PSCS) provides Incapacity Benefit start and end dates to NIRS2, where credits are awarded for relevant weeks. These contribution credits are used in the calculation to determine whether a particular tax year is a qualifying year for benefit purposes. We are aware that the information on periods of incapacity on NIRS2 and PSCS does not correlate in a number of cases, and during 2005 we have been working with the DWP to establish the full scope and extent of these mismatches.

It is currently scheduled that in the summer of 2006 DWP and HMRC will be: scanning PSCS to identify start and end dates for Incapacity Benefit, whether or not people affected are pensioners or deceased, and rebuild cases and; cross matching this information against NIRS2 in a test environment. We aim to put together options to correct the situation in the summer of 2006.

Assurance from DWP in respect of Contributory Benefit Payments

25 A Letter of Assurance has been received from the DWP that has been approved by their Audit Committee and contains details about their capacity to handle risk and their risk control framework. The Letter indicates significant internal control issues which have been detailed at high level below.

26 Losses from fraud and error in the benefit system continue to be a problem for the DWP. In 2004-2005 Contributory Benefits, funded from the NIF, totalled £57 billion of which £48.7 billion related to Retirement Benefit and £6.6 billion related to Incapacity Benefit. DWP estimate that 2004-2005 losses from fraud and error in relation to Retirement Benefit is approximately £60 million (0.1%) and approximately £80 million (1.2%) in relation to Incapacity Benefit.

Assurance from DTI 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.

Paul Gray
Accounting Officer

18 January 2006

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

I certify that 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 Auditor

As described in the Responsibilities of the Deputy Chairman of the Board of HM Revenue and Customs in the Foreword, the Accounting Officer is responsible for the preparation of the financial statements in accordance with the 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 on Internal Control reflects the Department's compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by the 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 on 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.

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 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.

Opinion

In my opinion

- the financial statements properly present the receipts and payments of the National Insurance Fund for the year ended 31 March 2005 and the balance held at that date and have been properly prepared in accordance with Section 161(2) of the 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 conform to the authorities which govern them.

My report on the financial statements is at pages 26 to 33.

John Bourn
Comptroller and Auditor General

1 February 2006

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Receipts and Payments Account for the year ended 31 March 2005

Prepared in accordance with Section 161 of the Social Security Administration Act 1992.

	Notes	**2004-2005 £000**	2003-2004 £000
Receipts			
National Insurance contributions	2	**61,569,903**	58,587,219
Compensation for SSP, SMP, SAP, SPP recoveries*	3	**1,433,000**	1,313,000
Income from investments	4	**1,254,832**	1,257,379
State scheme premiums	5	**112,734**	143,806
Other receipts	6	**70,544**	77,635
Redundancy receipts	7	**31,772**	26,991
		64,472,785	61,406,030
Less			
Payments			
Benefit payments	8	**57,010,897**	54,797,011
Personal pensions	9	**3,441,358**	3,771,333
Administrative costs	10	**1,480,034**	1,754,093
Redundancy payments	7	**219,495**	237,893
Transfers to Northern Ireland NIF	11	**270,000**	260,000
Other payments	12	**30,002**	33,644
		62,451,786	60,853,974
Excess of receipts over payments		**2,020,999**	552,056

	2004-2005 £000	2003-2004 £000
Statement of balances		
Opening balance	**27,081,606**	26,529,550
Plus		
Excess of receipts over payments	**2,020,999**	552,056
Closing balance	**29,102,605**	27,081,606

* SSP: Statutory Sick Pay
SMP: Statutory Maternity Pay
SAP: Statutory Adoption Pay
SPP: Statutory Paternity Pay

Paul Gray
Accounting Officer

18 January 2006

The notes on pages 12 to 22 form part of these accounts.

Notes to the Accounts

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, maternity, adoption and paternity 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 HMRC. These checks and checks on other contributors may result in additional receipts or repayments in future years in respect of contribution liabilities for 2004-2005.

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 DWP policy to combine amounts due into a single payment wherever practicable. NIF benefits are paid by cash cheque, order books encashable at a post office, payable order or credit transfer, with the last of these methods becoming increasingly common. The DWP cannot 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 DWP 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 the Benefits Expenditure Monitoring System.

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. These include the calculation of certain contribution receipts, allocation of contribution receipts to the NHS, recoveries and compensation in respect of statutory sick, maternity, adoption and paternity pay, and settlements with Northern Ireland NIF (NI NIF).

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	2004-2005 £000	2003-2004 £000
Contributions			
Class 1 (employed earner)	i	**58,805,140**	55,944,033
Class 1A and 1B	ii	**833,555**	788,278
Class 2 (self-employed flat rate)	iii	**219,978**	242,963
Class 3 (voluntary contributions)	iv	**90,349**	69,845
Class 4 (self-employed earnings related)	v	**1,620,881**	1,542,100
		61,569,903	58,587,219

In March 2005 the Inland Revenue paid over £938 million to the Great Britain and Northern Ireland National Insurance Funds to make good an accumulated underpayment of National Insurance. £907 million of this relates to the Great Britain National Insurance Fund in respect of contributions reported in previous years, reducing the amount of money due from HMRC to the NIFs.

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 HMRC 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 contributors National Insurance record for certain benefit and/or pension purposes.

v Class 4 Self-employed persons pay earnings related contributions.

NHS Allocation

The Social Security Administration Act 1992 requires that the Government Actuary's Department 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 by HMRC to the NHS before the contributions are paid into the NIF and so the figures shown above are shown net of the NHS element. NHS allocation was £16.8 billion 2004-2005 (£14.9 billion 2003-2004).

Additionally, GAD also allocates amounts recovered by employers in respect of statutory sick, maternity, adoption and paternity pay from the Class 1 total.

3 Compensation for Statutory Sick, Maternity, Adoption and Paternity Pay

	Notes	**2004-2005 £000**	2003-2004 £000
Statutory Sick and Maternity Pay	i	**1,376,000**	1,313,000
Statutory Adoption and Paternity Pay	ii	**57,000**	0
Total		**1,433,000**	1,313,000

The Government compensates the NIF for loss of revenue due to contribution receipts being reduced by recoveries of statutory sick, maternity, adoption and paternity pay. The compensation is drawn down from the Consolidated Fund and then paid over to the NIF by other Government Departments, as the NIF has no facility to do so.

i Recoveries in respect of statutory sick and statutory maternity payments are paid from the DWP Resource Accounts.

ii Statutory adoption and paternity pay were introduced in April 2003 and the compensation due to the NIF is to be paid over by the DTI. At present actual data is not available and the amount of compensation shown as due is based on estimates. The estimated payment from the DTI of £57 million will be reviewed during 2005-2006 and adjusted to reflect known actuals.

4 Income from Investments

	2004-2005 £000	2003-2004 £000
Interest received	**1,436,411**	1,361,503
Profit on realisation	**0**	27,082
Losses on realisation	**(181,579)**	(131,206)
	1,254,832	1,257,379

During the year the value of investments at cost increased from £26.6 billion at 31 March 2004 to £27.8 billion at 31 March 2005.

The responsibilities of HMRC and the Commissioners for the Reduction of National Debt in respect of the investment of surplus NIF funds are set out in a Memorandum of Understanding. The current Investment Strategy requires the balance of the Fund to be invested in gilt holdings with a residual maturity of no longer than 20 years.

5 State Scheme Premiums

	2004-2005 £000	2003-2004 £000
State Scheme Premiums	**112,734**	143,806

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 receipt totals are shown net of refunds.

In October 1992, the Government decided 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 HMRC is seeking recovery of these premiums from the Maxwell pension schemes.

By 31 March 2005, around 30,814 individuals had been brought back into SERPS with a liability of some £128,827,000 of which £36,200,000 had been recovered. A total of £545,000 was recovered in 2004-2005. (See table below)

189 new members were identified between 6 April 2004 and 31 March 2005 with a total liability of £601,140. However, 126 members previously identified as Maxwell members were found to be members of other pension schemes – the total liability for these members amounts to £484,368 which has been adjusted.

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 are actually members of another. The pension liability for these members has to be transferred however, because the schemes have different revaluation rates, and so the value of the liability from one scheme could be different to the other. 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 £128.8 million liability will be recovered.

Maxwell Pension Scheme	Total Liability	Amounts Recovered up to 31 March 2004 £	Outstanding Liability at 31 March 2005 £	Progress
Mirror Group Pension Scheme	74,263,619	5,005,000	69,258,619	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	776,346	727,110	49,236	Membership of the scheme has still to be agreed before the final bill is confirmed.
MCWPS 'Works' Scheme	30,467,802	30,467,802	0	Final payment of £10,467,802 paid September 2001.
Victoria Works Scheme	359,837	0	359,837	Schemes merged. Some payment of SSPs possible.
AGB Scheme	10,710,496	0	10,710,496	
AGB Research Scheme	1,480,980	0	1,480,980	
Maxwell Communications Pension Plan (Staff)	10,351,566	0	10,351,566	No prospect of payment.
Maxwell Media Pension Plan	416,643	0	416,643	No prospect of payment.
Total	**128,827,289**	**36,199,912**	**92,627,377**	

The closing balance at 31 March 2004 was incorrectly reported in the 2003-2004 account as £91,965,605. This should have been reported as £92,510,605.

6 Other Receipts

	Notes	2004-2005 £000	2003-200 £000
Recoveries of compensation payments	i	**68,825**	66,577
Compensation for Age Related Rebates	ii	**0**	9,326
Unemployment benefit recoveries	iii	**1,719**	1,732
		70,544	77,635

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 In 2003-2004 the NIF received a payment of £9,326,096 from HMRC (accounted for in their Resource Accounts), 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. 2003-2004 was the last year compensation was paid over to the NIF.

iii Unemployment Benefit was replaced by contributory Jobseeker's 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 Rights Act 1996 provides the statutory basis for the NIF to make Redundancy Payments. The Insolvency Service makes the payments on behalf of the DTI.

The Redundancy Payments Scheme 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 scheme also has to protect the taxpayers interests by ensuring that it does not make payments which can be made by the employers themselves.

The total debt outstanding owed by employers at 31 March 2005 was £81.6 million, which is disclosed as part of the DTI's Resource Account Balance Sheet.

	2004-2005 £000	2003-2004 £000
Outstanding debt at 31 March	**72,845**	72,029
Plus redundancy payments	**219,495**	237,893
Less receipts	**(31,772)**	(26,991)
Less debt written off (note 15)	**(179,008)**	(210,086)
Outstanding debt at 31 March	**81,560**	72,845

8 Benefit Payments

	Notes	2004-2005 £000	2003-2004 £000
Benefits			
Retirement Pension	i	**48,786,524**	46,256,228
Incapacity benefit	ii	**6,596,786**	6,794,397
Bereavement benefits	iii	**911,315**	999,972
Jobseeker's Allowance (contributory)	iv	**441,549**	497,981
Christmas bonus for pensioners	v	**124,508**	121,870
Maternity allowance	vi	**148,905**	124,840
Guardians' and child special allowance	vii	**1,310**	1,723
		57,010,897	54,797,011

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 Jobseeker's allowance is payable to people who are capable of working, available for work and actively seeking work who have 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 HMRC 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 amounts reported above consist partly or wholly of apportioned expenditure.

Retirement pension and widow's benefit includes payment to Northern Ireland pensioners living abroad as well as Great Britain. For administrative convenience these payments are made by the DWP with the cost for Northern Ireland 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 2004-2005 is £7.2 million (£8.2 million in 2003-2004). Note 11 explains the relationship between the Great Britain and the Northern Ireland National Insurance Funds.

9 Personal Pensions

	2004-2005 £000	2003-2004 £000
Personal Pension Payments	**3,441,358**	3,771,333

The Pension 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 1997-1998 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

		2004-2005 £000	2003-2004 £000
Payments made in respect of Administration			
Department for Work and Pensions	i	**1,157,160**	1,422,893
Inland Revenue	ii	**311,946**	320,422
Department of Trade and Industry	iii	**8,782**	8,782
Lord Chancellors Department	iv	**0**	0
Office of National Statistics	v	**681**	581
Government Actuary's Department	vi	**520**	467
National Audit Office	vii	**400**	400
Commissioners for the Reduction of the National Debt	viii	**282**	260
Bank Charges	ix	**195**	235
Scottish Executive Justice Department	x	**58**	43
General Register Office	xi	**10**	10
		1,480,034	1,754,093

The administration costs relate to the services directly attributable to the NIF and are reimbursed to the respective service provider from the NIF. The costs are fixed for the year and will not be adjusted unless it is considered that the service has been subject to a serious and unforeseen adverse impact.

i For administration costs relating to the award and payment of benefits on behalf of the Fund.

Of the 2003-2004 payment of £1,423 million to the DWP, £1,163 million relates to work done for that year. The balance of £260 million relates to work done for 2001-2002 and a payment of this sum was made following agreement between the DWP, the Inland Revenue, HM Treasury and the NAO.

ii For the collection of National Insurance contributions, maintenance of individual records and associated tasks.

iii For the administration of the Redundancy Payments Scheme as required under the Employment Rights Act 1996.

iv The administrative costs incurred by the Lord Chancellors Department (now Department for Constitutional Affairs) for 2003-2004 and 2004-2005 are yet to be agreed and should be paid in 2005-2006.

v For services in relation to the administration of the National Insurance Scheme to include the issue of certificates, processing of Death registration, collation and issue of Widow cards and Marriage validity checks.

vi For Actuarial services involving Social Insurance.

vii For the annual audit of these Accounts and the production of the report thereon.

viii For investment services provided in pursuance of Section 161(3) of the Social Security Administration Act 1992.

ix Bank charges incurred on the GB NIF Account.

x For general costs in relation to the administration of the National Insurance Scheme i.e. consider and issue decisions on applications and appeals in relation to NI Benefits and medical appeal tribunals in Scotland.

xi For services in relation to the administration of the National Insurance Scheme to include certificate verifications, extracts, death and postage.

11 Transfers to Northern Ireland

	2004-2005 £000	2003-2004 £000
Payments to Northern Ireland NIF	**270,000**	260,000

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.

12 Other payments

	Notes	**2004-2005 £000**	2003-2004 £000
Payments to Isle of Man	i	**23,322**	23,830
SSP/SMP/SPP/SAP	ii	**2,570**	3,989
Incapacity benefit	iii	**4,110**	5,825
		30,002	33,644

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. SPP and SAP have been paid from 2004-2005.

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 HMRC, monthly in arrears.

13 Securities Held by the Commissioners for the Reduction of the National Debt (CRND) at 31 March 2005

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 and in line with the Memorandum of Understanding between HMRC and CRND as detailed in Note 4.

	Nominal value	Cost price	**Market Value at 31 March 2005**
	£000	£000	**£000**
Government and Government Guaranteed Stocks			
Up to one year	14,291,254	14,356,431	**14,361,677**
One to five years	9,400,805	9,463,363	**9,612,066**
Five to ten years	3,429,511	3,605,041	**3,805,190**
Over ten years	451,771	415,625	**543,129**
Total securities	27,573,341	27,840,460	**28,322,062**

	Nominal value	Cost price	**Market Value at 31 March 2004**
	£000	£000	**£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**
Total securities	25,565,525	26,580,628	**27,150,084**

14 Closing balance

	Note	**31 March 2005 £000**	31 March 2004 £000
Securities held by the CRND at Cost		**27,840,460**	26,580,628
Funds held by Paymaster General (including uncleared payments)		**(455)**	1,134
Other balances	i	**1,262,600**	499,844
Total		**29,102,605**	27,081,606

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

15 Losses

	Notes	**2004-2005**		2003-2004	
		Amount £000	**Number of cases**	Amount £000	Number of cases
*Contributions NIF share**					
HMRC remissions and waivers	i	**224,741**	**120,999**	135,931	112,017
HMRC debt transferred	ii	**4,548**	**0**	11,871	0
Total loss		**229,289**	**120,999**	147,802	112,017
Benefits	iii	**27,600**	**93,112**	26,316	95,058
Redundancy write-off	iv	**179,008**	**0**	210,086	0
Administration	v	**1,040**	**20,229**	1,475	19,373

* HMRC wrote off in the 2004-2005 IR Trust Statement £333 million in relation to time barred Class 2 debt. A proportion of this being appropriate to the NI NIF, it is not possible for HMRC to provide details of the NI NIF share of that debt. Paragraph 8.3 of the Statement on Internal Control outlines this issue in more detail.

i HMRC 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 amount of £224,741,000 includes £223,081,000 in respect of Remissions for the period October 2003 to October 2004.

ii Relating to National Insurance debts in respect of insolvent companies where the National Insurance Contributions Office are responsible for the subsequent write-off or recovery.

iii The Benefit losses are the responsibility of the DWP and can be attributed to the following

Organised Fraud

During 2004-2005 the Counter Fraud Investigation Unit had investigated and brought prosecutions from 12 operations which each involved a loss to public funds of over £100,000, eight of which included an element NIF benefit. The loss to the National Insurance Fund in respect of those eight operations was £434,838. 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 20 people were convicted of offences, receiving in total nearly 29 years imprisonment.

Write-off of Debt through Easement

The DWP overpayment initiative, agreed with Treasury, enables the write-off of non-recoverable benefit debt using estimating procedures. The aim is to re-target resources to more cost-effective recovery. During 2004-2005 the initiative dealt with 65,302 cases involving overpayments of NI Fund benefits, writing off approximately £17.7 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 DWP Resource Account.

iv 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.

v These losses are large due to the write-off of unrecoverable administration debts built up since 1993 where for various reasons DWP have been unable to obtain repayment and legal advice has confirmed that it would not be cost effective to pursue them further.

16 Special Payments

	Notes	**2004-2005**		2003-2004	
		£000	**No of Cases**	£000	No of Cases
Wrongly advised benefit	i	**1,770**	**3,435**	2,152	3,773
Extra-Statutory payments to certain UK Residents with Australian Residence	ii	**2,000**	**4,000**	3,000	4,000
		3,770	**7,435**	5,152	7,773

i Represents payments to claimants who have been wrongly advised on benefit entitlement.

ii 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 resident in Australia during the currency of the Agreement, up to 5 April 2001, who have now returned to live permanently in the UK. On 18 November 2004, the Pensions Act 2004 introduced legislation to put these extra-statutory payments on a statutory footing.

In the 2004-2005 financial year up to 18 November 2004, the fifth and final extra-statutory payments were made.

Annex

National Insurance Account – Great Britain

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 Accounts Direction dated 7 December 1995.

B Glicksman
Treasury Officer of Accounts 16 October 2000

Schedule

Format of Account and Disclosure requirements

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.

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

2 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 note 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(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	**20XX**	20XX
		£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			
Administrative Costs			
Redundancy payments			
Transfers to Northern Ireland			
Other payments			
Excess of receipts over payments			

Statement of Balances

	£000	£000
Opening balance		
Plus		
Excess of receipts over payments		
Less		
[Excess of payments over receipts]		
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 is intended to provide for expenditure on benefits and allowances where individuals have paid sufficient National Insurance contributions and have met other qualifying conditions. In 2004-2005, receipts amounting to £64.4 billion (mainly in the form of National Insurance contributions) were paid into the Fund and payments of £62.5 billion (mainly contribution-based benefits) were paid out of it. The balance on the Fund was some £29.0 billion at the end of the year.

2 From April 2003 an additional one per cent National Insurance contribution has been collected and allocated directly to the National Health Service, totalling some £16.8 billion in 2004-2005 (£14.9 billion in 2003-2004). The payments do not pass through the National Insurance Fund.

3 The National Insurance Recording System (NIRS2) maintains details on some 70 million National Insurance accounts for individual contributors and approximately one million new accounts are created each year. The NIRS2 system supports a number 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.

4 Responsibility for the collection of National Insurance contributions from employers, employees, the self-employed and for those who pay additional contributions was vested in the Inland Revenue until April 2005 when the Department was integrated into HM Revenue and Customs. In this report, references to HM Revenue and Customs also cover the functions of the Inland Revenue.

5 The Department for Work and Pensions is responsible for benefits paid to claimants 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 now rests with HM Revenue and Customs who receive formal Letters of Assurance from the other Government Departments on their areas of responsibility.

6 This report records the results of my audit examination of the 2004-2005 account and developments, including

- estimated fraud and error in benefits paid from the National Insurance Fund;
- the balance on the Fund and Investment in Gilts;
- contribution Deficiency Notices;
- Incapacity Benefit recording in NIRS2;
- employers' End-of-Year PAYE returns;
- impact of delayed processing of electronic returns from employers; and
- NIRS Replatforming.

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

7 Most of the expenditure on benefits paid out of the National Insurance Fund was on Retirement Pension (£48.8 billion), Incapacity Benefit (£6.6 billion), Bereavement benefits (£911 million) and contribution-based Jobseeker's Allowance (£442 million).The National Audit Office's work was based on information provided by the Department for Work and Pensions (DWP) about estimated losses, and its own independent testing. The National Audit Office concluded that it is likely that overall less than 1 per cent of the total expenditure paid out of the National Insurance Fund on contributory benefit payments was lost through fraud and error, and on this basis I have not qualified my audit opinion on the expenditure for these benefits.

8 The DWP's estimates of fraud and error are based on a range of exercises incorporating

- annual assessments of official error for short term and long-term benefits;
- the outputs of National Benefit Reviews which provide a snapshot of the level of fraud and customer error; and
- other assessments of fraud and error rates for benefits that are otherwise unreviewed.

9 Because of the varying nature and timing of these exercises, historic estimates underpin the DWP's estimated fraud and error figures.

10 My report on the DWP Resource Account (HC 447, 26 January 2006) describes changes in the DWP processes for estimating fraud and error. This highlights a move to increased transparency and the estimated levels of fraud and error by benefit stream are recorded in Figure 1 below.

Figure 1: Total estimates of benefit overpayments due to Fraud and Error

	2004-2005 NIF payments	**Fraud and Error**		2003-2004 NIF payments	Fraud and Error	
Benefit	**£bn**	**£m**	**%**	£bn	£m	%
Retirement Pension	**48.8**	**60**	**0.1**	46.3	50	0.1
Incapacity Benefit	**6.6**	**80**	**1.2**	6.8	80	1.2
Contributions based - Jobseeker's Allowance	**0.4**	**30**	**5.7**	0.5	30	5.9
Other Benefits	**1.2**	**30**	**2.7**	1.2	30	2.7
Total	**57.0**	**190**	**0.3**	54.8	200	0.4

Notes

1 Components of this table may not add up to the total due to rounding.

2 Overpayment estimates rounded to the nearest £10 million.

3 Payments rounded to the nearest £0.1 billion.

Source: Fraud and error figures derived from Department for Work and Pensions Resource Account 2004-2005 – Note 44 Payment Accuracy with additional estimates derived for this Report from the Department's continuous Jobseeker's Allowance fraud and error measurement exercise.

11 I qualified my audit opinion last year in respect of Incapacity Benefit as the Department could not locate the evidence to support the eligibility to Benefit in some 106 of 800 cases selected for review. The Department's response to this, reviewed by my staff and recorded in my report on the DWP Resource Account (HC 447, 26 January 2006) has subsequently enabled me to remove that qualification for 2004-2005, as the Department has been able to confirm that missing case files have reduced to just under 1 per cent of cases selected for review across all benefits. Notwithstanding this positive development the Department recognises the continuing weaknesses within the document retrieval process. I will continue to monitor action taken by the Department to further improve document management systems. The problems with Incapacity Benefit recording described in paragraphs 24 to 30 of this report do not impact upon my audit opinion for 2004-2005.

The Balance on the Fund and Investment in Gilts

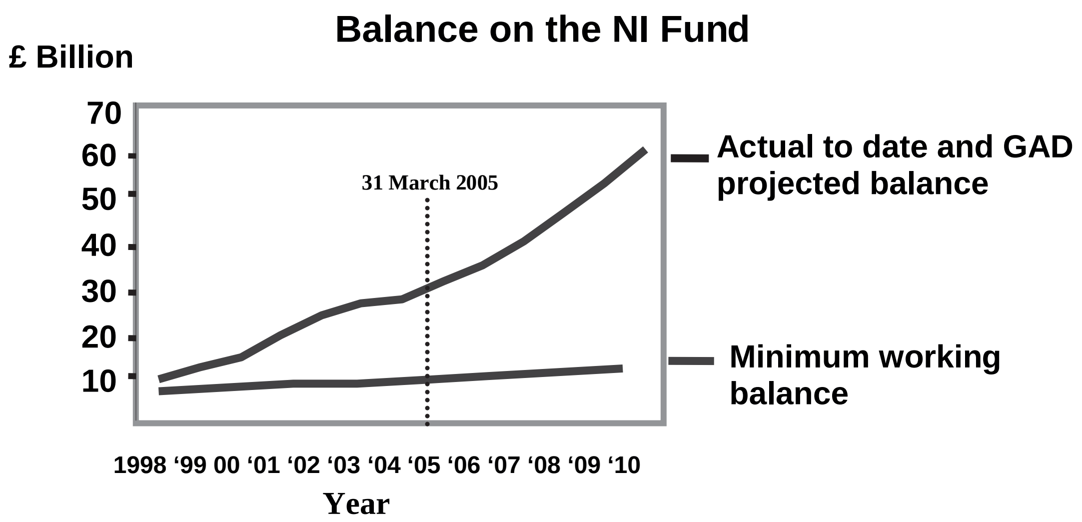
12 National Insurance contribution rates are set at levels intended to meet expected benefit expenditure each year, after taking into account other Fund receipts and payments, and to maintain a working balance. In the Foreword to the Account, the Accounting Officer has set out the context and reasons for the balance. 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. He has explained that the balance is one of the matters taken into account when Treasury Ministers review annually National Insurance contributions and that the Government Actuary's Department (GAD) reports on the likely effect on the balance of the Government's benefits Up-rating and contributions Re-rating Orders. These Orders can be subject to debate and require the approval of both Houses.

13 In his report on the financial provisions of the Social Security Bill in 1992, 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. This equated to around £9.5 billion in 2004-2005. At 31 March 2005, the balance on the National Insurance Fund was £29.0 billion - some 51 per cent of annual benefit expenditure - an increase of £2.0 billion compared to 31 March 2004. Up-rating and Re-rating Orders were laid before Parliament in February 2005 and GAD forecast that the balance on the Fund would rise by an average of £5.8 billion per year over the next five years to some £60.3 billion by March 2010, which would equate to around 80 per cent of forecast annual benefit expenditure.

14 As described in Note 2 to the Account, Employers' PAYE returns received by HM Revenue and Customs do not split figures into Income Tax and National Insurance elements. The Department has to use an algorithm to achieve this split and to determine how much to pay over daily to the NI Funds. This algorithm was amended when the additional 1 per cent National Insurance contribution for the NHS was introduced from April 2003. Subsequent work by HM Revenue and Customs and GAD showed small inaccuracies in the split between tax receipts and NI contributions, necessitating an adjustment of some £1.8 billion, which was paid over to the Fund in 2004-2005.

15 Over the past three years I have reported on the increase in the balance on the Fund. Figure 2 below shows the increase in the balance on the Fund in recent years and the GAD projection to 2010. From 1991-1992 to 1996-1997 NI receipts were less than related expenditure and the Exchequer made grants totalling some £20.3 billion to support the Fund. Since then, no Exchequer support has been necessary and GAD projections to 2010 and beyond, based on current assumptions, show that Exchequer funding will not be needed.

Figure 2: Balance on the NI Fund: Comparison of recommended minimum working balance with actual balance to date and GAD projection



Source: NAO

16 The Fund is invested by the Commissioners for the Reduction of the National Debt (CRND) in a mixture of "non-marketable" gilt-edged securities and short-term deposits. These funds represent some 5 per cent of National Debt NLF gilts and debt payable in sterling, and reduce the Government's need to borrow externally on financial markets. The maturity of investments is shown in Figure 3 below.

Figure 3: Analysis of maturity of investments held at 31 March 2005

Gilt-edged securities and short-term deposits	Market value £billiion
Up to one year	14.4
One to five years	9.6
Five to ten years	3.8
Over ten years	0.5
Total	**28.3**

17 Following the integration of the operations of CRND with those of the UK Debt Management Office (DMO) in July 2002, it was recognised that the National Insurance Fund's investment policy and governance arrangements, which had been unchanged for over 30 years, should be reviewed. Pending the outcome of that review, CRND has agreed with HM Revenue and Customs to adopt a "passive" investment stance whereby the current holdings of gilts are maintained and the overall duration of the portfolio is allowed to shorten by the non-reinvestment of maturing gilts. However, short-term gilts may be purchased from time to time to ensure compliance with HM Revenue and Customs target that the amount invested in 'cash' assets is equivalent to no more than 25 per cent of annual benefit expenditure.

18 In the autumn of 2005, the Department initiated a review of NIF investment policy, including consideration of the types of investment made relative to the size of the Fund and the costs of making those investments. The review includes Treasury and the Government Actuary's Department interests.

Contribution Deficiency Notices

19 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. Prior to 1998, it was the former Contributions Agency's practice to send a Deficiency Notice to individuals of working age who did not make sufficient contributions in a particular year, inviting them to consider if their National Insurance contribution record was correct and informing them 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 took the decision 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.

20 I reported last year on two separate exercises whereby the Government committed to writing to all individuals who should have received a Deficiency Notice in respect of the intervening six year period. HM Revenue and Customs handled those cases where the individual was still of working age, whilst the Department for Work and Pensions dealt with the issue of Deficiency Notices to those individuals who had reached pensionable age between April 1998 and October 2004.

21 In respect of the six year exercise, HM Revenue and Customs achieved their target of issuing 10.02 million notices by the end of September 2004. The routine annual production of Deficiency Notices started again in October 2004, covering the 2002-2003 contribution year. Only a very small percentage of Deficiency Notice recipients made immediate payments of voluntary National Insurance contributions and HM Revenue and Customs collected £67.6 million by the end of May 2005. Of this sum £54.9 million was in respect of the six year exercise and £12.7 million in respect of 2002-2003. 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 further contributions. The Department estimated that the administration costs of this part of the Deficiency Notice project was £65.3 million.

22 The Department for Work and Pensions faced a far more complex situation with a target population of 670,000 individuals who had reached State Pension age, where there was potentially an immediate impact on pension entitlement. The Department's work involved 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 would be better off if they paid the voluntary National Insurance contributions indicated in the Deficiency Notices. The exercise commenced in September 2004 and was completed by the end of September 2005. The Department issued 414,427 letters, including 79,160 to Pension Credit customers, in line with the planned profile. At the end of September 2005, over 363,000 customer contacts had been received, and 20,890 customers made voluntary contributions to improve their State Pension. The total amount of arrears paid to pensioners relating to these additional contributions was £28.1 million, an average of over £1,400 per customer.

23 The Department expected the exercise to take 12 months with a minimum six month close down period, at a total administrative cost of £33.3 million. There were a number of external factors which could have impacted on the ability of the Department to deliver this programme within this timescale. These included the closure of the front line telephony centre in Cardiff (due to the site being subject to a compulsory purchase order), the transfer of functions to other sites, and the inclusion of the more complex Pension Credit cases where Deficiency Notices were mailed out from 31 May 2005.

Incapacity Benefit recording in NIRS2

24 Individuals in receipt of Incapacity Benefit payments also receive National Insurance credits. The Department for Work and Pensions' Pensions Service Computer System (PSCS) provides Incapacity Benefit start and end dates to NIRS2, where National Insurance credits are awarded for relevant weeks. These contribution credits are used in the calculation to determine whether a particular tax year is a qualifying year for benefit purposes. The move from NIRS to NIRS2 in 1998 resulted in a range of conversion problems, including some around Incapacity Benefit recording. HM Revenue and Customs prioritised the problems and in 2002-2003, according to this prioritisation, Incapacity Benefit recording was considered. In September 2004, HM Revenue and Customs and DWP became aware that the information on periods of incapacity on NIRS2 and on PSCS did not match in all cases.

25 In 2005 HM Revenue and Customs and DWP checked this information by running data comparisons between PSCS data and that held on NIRS2. This comparison was limited to the main areas impacting on Incapacity Benefit (six out of a total of 23 areas) and so did not provide a complete picture. Based on this data comparison, of the 8.9 million periods of Incapacity Benefit checked (relating to some 6.4 million accounts), some 7 million were found to have matching dates with both systems holding the same data. However, there were 1.9 million periods (relating to some 1.6 million accounts) that did not match and the discrepancies required investigation. Discrepancies included additional errors where credits had not been properly awarded within NIRS2. Both systems contain errors.

26 HM Revenue and Customs estimated that there were some 1.6 million incorrect accounts of people of working age and some 63,000 incorrect pensioner accounts affected. As noted above, the estimates were based on the limited data comparison and may be subject to change, but are indicative of the potential scale of the problem. However, individuals will only be affected where the calculation as to whether a particular year is a qualifying year for benefit entitlement purposes is affected. HM Revenue and Customs and the Department for Work and Pensions have been able to identify the ways in which customers might be affected but, as at October 2005, were not able to estimate the number affected or the financial impact on customers.

27 The types of cases potentially affected are

- customers may have acted on a Deficiency Notice (see paragraphs 19 to 23 above), issued on the basis of incorrect information, and paid additional contributions where they were not actually deficient. Conversely, they may not have been included in the Deficiency Notice exercise but may now be deficient because the credit position has changed;
- the Department may have issued Pension forecasts using account information that may well change as a result of the changes in Incapacity credits. The changes may affect the forecast pension position of the individual and may provide them with an inaccurate foundation upon which to plan for their financial future upon retirement;

- inaccurate records could affect whether the relevant contribution conditions have been satisfied for present or future contribution based benefit claims, such as Incapacity Benefit and Jobseeker's Allowance. The Department has not estimated the number of benefit awards affected and the likely financial effect. The operational impact of this work, as well as the resource requirement, is a major concern for the Department for Work and Pensions;
- although the majority of cases affected will be those which impact on future entitlement, there will be a smaller number of cases where the individual has reached pensionable age and the pension award had been calculated on the basis of incorrect contribution information. As at the end of September 2005, the Departments were considering options relating to revising pension awards, compensation for under-payments and reclaiming overpayments; and
- pensioners abroad and those with benefit entitlement which acts as a passport to other benefits, may also be affected.

28 From November 2005, the link on Incapacity Benefit between NIRS2 and PSCS was working. Furthermore, HM Revenue and Customs had tightened procedures to ensure there are no clerical errors at the point that information is entered onto the systems. The focus of the Departments' work during 2005 was to establish the full scope and extent of the problems identified. The Department for Work and Pensions planned to run a full data check across all PSCS areas to identify all periods of Incapacity on the system, but the Department estimate the earliest date this can be run to be July 2006. HM Revenue and Customs plan then to compare this data against that held on NIRS2 to identify mismatches between the systems, including all the individual cases. Only then will the scale and extent of the problem be clear, and both Departments plan to take action to correct the records on their respective systems.

29 The cost of additional work to resolve the consequences of the faults is subject to final agreement, but are likely to be borne jointly by HM Revenue and Customs and the Department for Work and Pensions, and will not fall on the National Insurance Fund.

30 The NAO will consider, and I will report further as necessary in due course on, the Departments' detailed action plans and their progress where claimants have been underpaid or overpaid benefit, or have been disadvantaged in other ways, as a result of the inaccurate Incapacity data on the Departments' systems.

Employers' End of Year PAYE Returns

31 In some instances, HM Revenue and Customs receive End-of-Year information from employers that includes 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 obtained a National Insurance number. If, despite the application of NIRS2 matching routines and all reasonable efforts by HM Revenue and Customs, 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, HM Revenue and Customs can retrieve unmatched items from Suspense Files and credit them to the individual's contribution record.

32 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 per cent of each year's returns. Processing problems during the summer of 2005 meant that the Department could not estimate the numbers of new Suspense items in respect of 2004-2005. I reported in previous years that a joint Department for Work and Pensions and HM Revenue and Customs report in October 2002 identified that, potentially, some 2 million non-matching items could impact on benefit entitlement. HM Revenue and Customs 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.

33 HM Revenue and Customs is instituting a major programme of change called "Modernising PAYE Processes for Customers" (MPPC). The first phase of this focussed on support for the mandatory electronic submission of End-of-Year returns for all large employers (those with more than 250 employees) from April 2005. HM Revenue and Customs expected that electronic submission of End-of-Year returns and the application of a consistent quality standard would improve the quality of data received and will be more efficient than the current processes. A quality standard was introduced to ensure employers submitted more accurate information.

34 Outside the main scope of the MPPC End-of-Year Phase 1 project, HM Revenue and Customs took the opportunity to review how it dealt with non-matched items and how it might streamline contact with employers. Revised processes were implemented in July 2005 whereby all employer enquiries in respect of End-of-Year returns are now addressed and followed up collectively for that employer. The Department also produces schedules of correct information and National Insurance numbers, which are forwarded to employers to help ensure that their returns are correct for the following year and that employees have their correct National Insurance number.

35 HM Revenue and Customs commissioned MORI to carry out independent research on non-matching National Insurance contributions. The research, which was structured by industry sector and geographical location, was based on the 400 employers with the largest volume of non-matched End-of-Year returns. The research looked at the underlying reasons why employers submit inaccurate or incomplete data; what more could be done to assist employers and what improvements could be made to HM Revenue and Customs' processes to reduce the number of non-matched items; the awareness and usefulness of HM Revenue and Customs support guidance; National Insurance tracing service and the Payroll Cleansing System; and how HM Revenue and Customs could improve services in the future.

36 The MORI report made reference to employers' high awareness of MPPC requirements. It also recorded specific employer comments, which included a number of ideas and suggestions to reduce the number of the non-matching End-of-Year Returns. These ideas and suggestions have been carefully examined and where practical have been fed into initiatives already underway with HM Revenue and Customs Data Quality Task Force. On the whole MORI found that employers wanted to provide HM Revenue and Customs with as much information as possible and they believed that they were doing as much as they could.

Impact of delayed processing of electronic returns from employers

37 As part of MPPC, HM Revenue and Customs developed a data routing and validation system, called ERIC (External Routing Interface Component). ERIC supports the processing of electronically submitted End-of-Year returns from employers, as well as those submitted using paper or magnetic media. ERIC was originally planned to go live at the start of the 2005-2006 financial year but was delayed until 5 July 2005. This led to a delay in processing all End-of-Year returns. One impact of this was that the contribution records provided from the NIRS2 system to the Pensions Service and to Jobcentre Plus were not as up to date as they could have been. This has required the introduction of some additional processes within the Pension Service so that staff can obtain details of contributions paid in 2004-2005 when they are relevant to the calculation of the State Pension. For working age customers, the lack of complete information only impacted on the calculation of contribution based benefits from the start of the new benefits year in January 2006, and then only a small number of cases.

38 Individuals who contract out of State Earnings Related Pension Scheme (SERPS) or the Second State Pension (S2P), are entitled to a percentage rebate (the age-related rebate) of their National Insurance contributions which is paid to the pension provider. These rebate payments are triggered by the Department processing individual's End-of-Year returns from their employer. The problems outlined in the paragraph above resulted in some delays in the processing and the payment of age related rebates to the pension providers.

39 At intervals of not more than five years, the Government Actuary is required to undertake a review of the level of the reductions in National Insurance contributions and rebates for members of contracted-out pension schemes. This review, undertaken separately from the Government Actuary's quinquennial review of the National Insurance Fund, concludes with a report from the Government Actuary to Parliament. This report must be accompanied by a separate report from the Secretary of State for Work and Pensions setting out the government's decisions on the terms for contracting out, in the light of the Government Actuary's report. The latest such report to Parliament by the Secretary of State, in March 2001, set the contacting-out terms for the quinquennium 2002-2007: age-related rebates payable over this period are calculated on the assumption that they are paid to the pension provider on average one year after the middle of the financial year to which they relate, i.e. on average by 6 October 2005 in respect of the 2004-2005 tax year.

40 In practice HMRC aims to pay at least 80% of age-related rebates by 12 months after the middle of the financial year to which they relate, i.e. by 6 October 2005 in respect of the 2004-2005 tax year. If the Department fails to achieve the 80 per cent target, there could be a direct effect on investment opportunities for the pension providers and a risk that the pensions industry could, subsequently, claim compensation, as happened following the delayed implementation of the NIRS2 system in 1998. The Department was in close consultation with the pensions industry representatives and other interested parties throughout the summer of 2005. In

the event, despite the delays referred to in paragraph 28 above, the Department paid around 70 per cent of rebate payments by 1 November 2005 and achieved their 80 per cent payment target by 1 December.

NIRS2 Replatforming

41 In July 2004, support and operation of the HM Revenue and Customs' IT systems and infrastructure moved to a new supplier. Subsequently the NIRS2 system was moved to a new IT platform. This migration of NIRS2 represented a significant challenge due to the system's complexity and the need to update both hardware and system software, and was originally planned to take place in one go over Christmas 2004. Significant technical challenges were subsequently encountered, and HM Revenue and Customs instead devised a phased approach to the migration which provided a significant reduction in risk. Three phases were scheduled, for May, July, and the end of August.

42 The first two phases were successful with minimal impact on front-line business and without major incident. The final phase completed the successful migration to new hardware, introduced new versions of the operating system and database, located in a new data centre, using new networks, while ensuring that all functionality continued to work as expected. Significantly faster batch processing speeds were experienced immediately. However, following the migration, some technical problems were triggered by relatively few but very complex business transactions. These resulted in system disruption for users in both NICO and DWP during peak work periods. The DWP were not significantly affected but HMRC users experienced some constraints on the types of complex workloads they could perform. This resulted in a backlog of work in the business which the Department planned to deal with as soon as possible.

Summary and Conclusions

43 Following some positive actions by the Department for Work and Pensions, I was able to remove my qualification arising from missing Incapacity Benefit case files from the DWP Resource Account 2004-2005 (HC 447, 26 January 2006). This has allowed me to also remove my qualification from the National Insurance Fund Account in this regard. I also have welcomed the DWP's improved payment accuracy disclosures of the fraud and error figures by benefit stream which has enhanced the transparency of those benefits most significantly impacted on by fraud and error.

44 The Department's investment policy review, initiated in autumn 2005, is to be welcomed particularly at a time when the balance on the NI Fund is at an historically high level and projected to continue to rise.

45 The Deficiency Notice exercises carried out by HM Revenue and Customs and DWP are estimated to cost almost £100 million and have been carried to plan and timetable. They were successful particularly in helping a significant minority of pensioners to improve their financial circumstances by making good deficiencies in their NI contribution record.

46 HM Revenue and Customs' and DWP's investigations of errors in the electronic recording of data related to Incapacity Benefit have revealed a significant problem for both Departments and potentially for some of those in receipt of this benefit currently and in the past. The Departments appreciate the need to correct the errors and understand that there may be difficult decisions to be taken in undertaking what could be a large and complex task which comes on top of routine processing.

47 As reported in previous years, inaccurate National Insurance contributions information from employers continues to generate contribution records that can not be matched to relevant contributors. HM Revenue and Customs' various major initiatives over recent years should help employers to improve the quality of their data. However, problems with certain IT processing systems during the summer of 2005 meant that the Department could not estimate the number of non-matched National Insurance contribution items in respect of 2004-2005 and therefore they could not use that number to demonstrate the effects that their various initiatives should be achieving by now. This deficiency should be made good during 2006.

48 Certain major changes in IT systems this year have posed significant challenges to the Department and their IT partners, and have to a limited extent disrupted the handling of some customers' records and caused delays which the Department plan to catch up as soon as possible. The Department's phased approach to transferring IT systems to a new platform helped minimise the risks in this major project and reduce disruption.

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