



National Audit Office

**REPORT BY THE  
COMPTROLLER AND  
AUDITOR GENERAL**

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**HM Revenue & Customs**

# The efficiency of National Insurance administration

# Summary

**1** National Insurance involves obligatory payments to the Exchequer by people working in the UK and their employers. A person's payments history (including any credits awarded, for example as a registered jobseeker) determines entitlement to certain retirement and working-age welfare benefits, notably the basic State Pension and Jobseeker's Allowance.

**2** Within the system of National Insurance, HM Revenue & Customs (HMRC) has the major role of collecting payments and maintaining the National Insurance database of some 71 million personal histories (**Figure 1**). Other parties are also involved in National Insurance administration (**Figure 2** on page 6), notably:

- the Department for Work and Pensions which, in Great Britain, awards some National Insurance credits to individuals and issues National Insurance numbers to adults, and passes this information to HMRC. The Department for Work and Pensions is also responsible for welfare policy on National Insurance matters. It uses the National Insurance database to administer welfare benefits; and
- employers calculate the National Insurance liability of their employees, deduct this from their pay and pay this to HMRC, along with their own liability for National Insurance.

**3** National Insurance receipts totalled £97 billion in 2008-09. There are four classes of National Insurance:

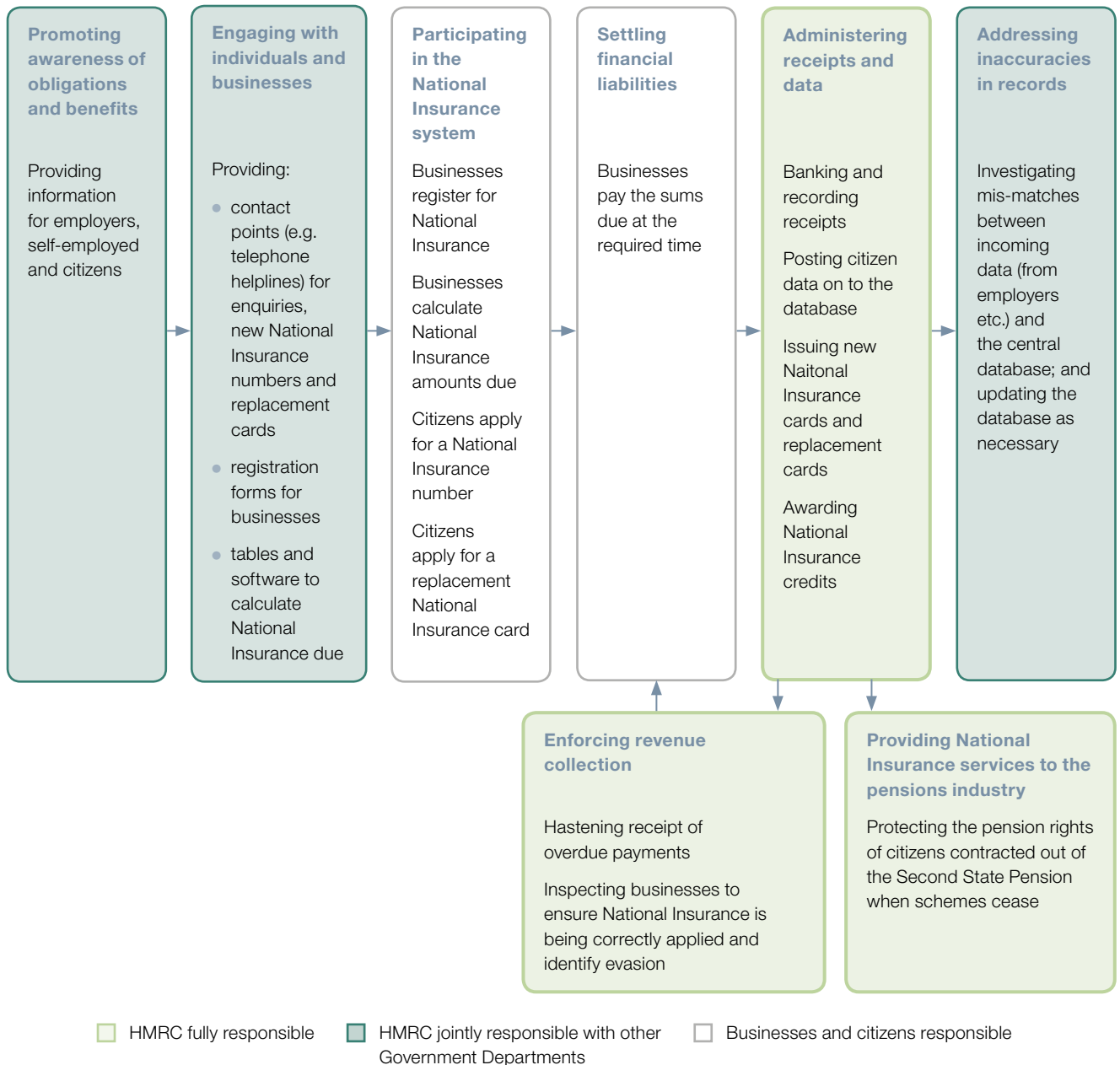
- Class 1 paid by employers and employees (97 per cent of receipts in 2008-09);
- Class 2 paid by the self-employed at a flat rate;
- Class 3 voluntary payments by citizens to increase their entitlement to welfare benefits; and
- Class 4 paid by the self-employed on profits.

**4** The operational structure within HMRC splits responsibilities as follows:

- the National Insurance Contributions Office (the Contributions Office) is responsible for maintaining the personal histories on the National Insurance database;
- PAYE, Self Assessment and National Insurance Contributions Directorate is responsible for designing and maintaining administrative processes;
- certain activities, such as debt management and checking compliance, are conducted through HMRC-wide systems that cover other taxes, thereby allowing HMRC to deploy resources more efficiently and minimise burdens on business; and
- support activities, such as IT and accommodation, are organised and controlled centrally to help secure benefits from economies of scale.

**Figure 1**

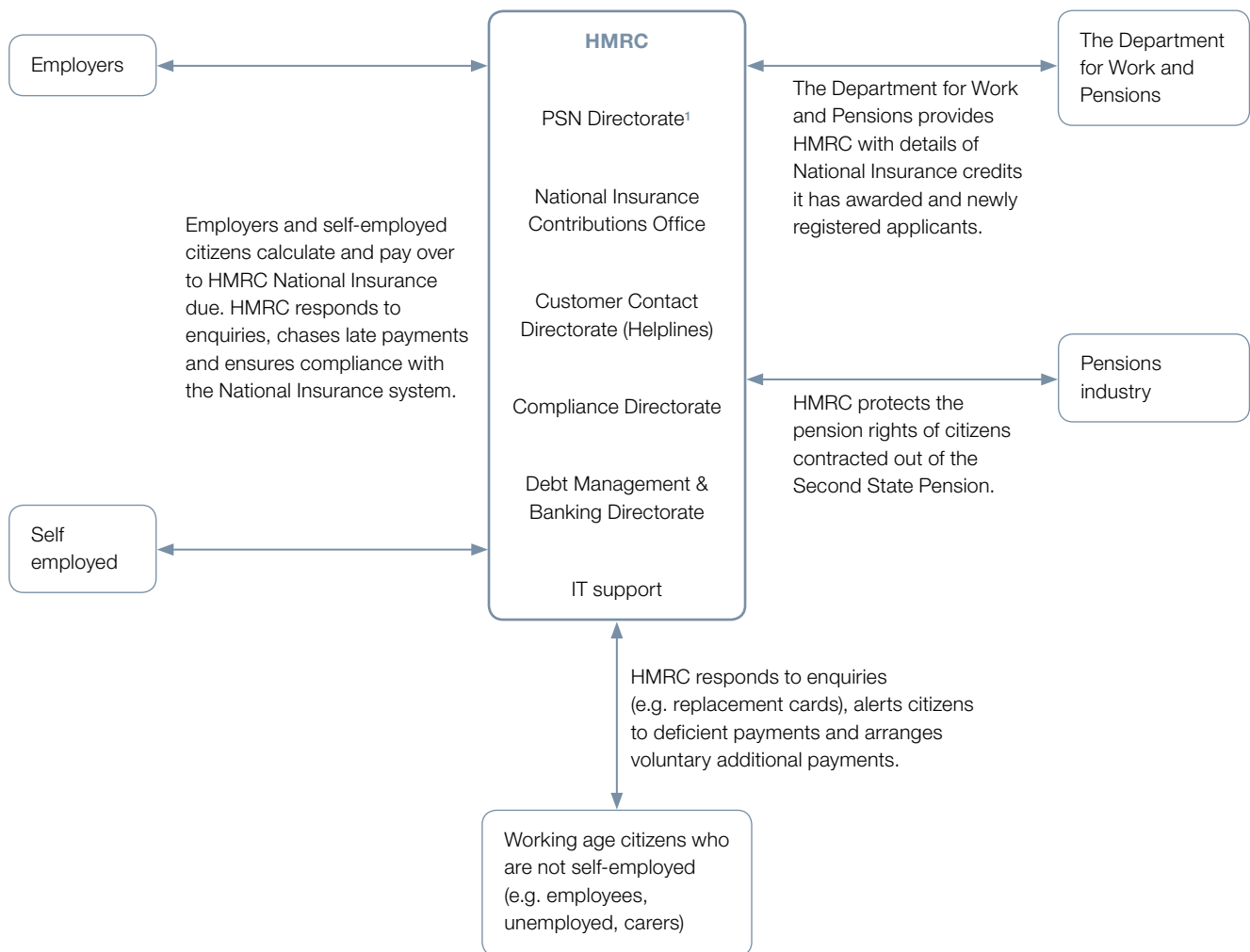
Summary of the main stages of National Insurance administration involving HMRC



Source: National Audit Office

5 This report looks at how HMRC has administered its National Insurance responsibilities, focusing on efficiency in using resources since 2006-07. We look in detail at the Contributions Office. We also consider the roles of other units administering National Insurance: the customer contact helplines handling National Insurance enquiries; and the Debt Management & Banking and Local Compliance directorates, where National Insurance forms part of their work alongside other taxes, and separate National Insurance information is not routinely available.

**Figure 2**  
HMRC's interaction with others



**NOTE**

1 PSN: PAYE, Self Assessment and National Insurance Contributions Directorate.

**6** Part One explains HMRC's approach to administering National Insurance and increasing efficiency. Part Two provides our analysis of value for money, based on:

- the extent to which HMRC has minimised costs by eliminating waste and adopting more efficient practices;
- whether productivity and quality of service have been maintained or improved; and
- whether the level of work awaiting processing has remained stable or reduced.

Part Three looks at the governance arrangements for National Insurance administration, covering the arrangements for joint working within HMRC and between HMRC and the Department for Work and Pensions; and medium to longer term planning arrangements. Appendix One explains our main research methods.

## Key findings

### Reductions in staff

**7** HMRC has successfully reduced the number of staff deployed on National Insurance administration. Staffing levels in the main operating units fell by between 16 and 31 per cent in the four years to 2009-10. The reduction at the Contributions Office was 31 per cent, equivalent to 1,209 full time staff. The staff reductions have contributed to HMRC's wider savings targets set by the Spending Reviews of 2004 and 2007.

**8** The Contributions Office achieved its staff reductions through a new system for managing operational performance, a series of procedural changes to eliminate waste and a reduction in workload partly from greater automation. The innovative management changes form part of HMRC's wider PaceSetter initiative to improve the efficiency of operations. Where activities were comparable over the period since 2006-07, the Contributions Office has successfully increased productivity by between 22 per cent and 45 per cent up to March 2010. The availability of funding for IT improvements is in part constraining further operational changes that the Office has identified to make better use of staff.

### The effect of staff reductions on efficiency

**9** It is likely that the reduction in staff numbers has led to an improvement in overall efficiency, although the extent of the improvement is not clear. We define efficiency as the relationship between costs of the system and the operational performance achieved. HMRC does not have a clear picture of the total costs incurred in administering National Insurance, and how these have changed. In 2008-09, it spent £343 million administering National Insurance. Precise comparisons with previous years (2007-08: £383 million and 2006-07: £321 million) are of limited value as HMRC has progressively improved the way it captures costs associated with National Insurance administration and how it allocates central costs to different activities. For example, compared to 2007-08,

in 2008-09 indirect costs from central department expenditure allocated to National Insurance administration fell by £21 million as the Department improved its management information. Within the Contributions Office, direct paybill costs fell from £84 million (2006-07) to £65 million (2008-09).

**10** On operational performance, there have been no major failures in systems but trends at a business unit level create uncertainty about how far National Insurance administration has become more efficient. The Contributions Office's operational performance has been mixed. In 2009-10, the Contributions Office achieved 92.9 per cent for processing data accurately against its target of 96.5 per cent, and was below target on its response times on correspondence. Since 2007-08, the Contributions Office has improved its performance for overall accuracy of processing but response times for correspondence have deteriorated. On productivity, the Contributions Office has demonstrated improved performance where comparisons are possible. Against productivity targets set to challenge teams to improve their performance each year, 50 per cent of its 129 measured activities met their targets in 2009-10. Of the 20 activities using most staff, nine met or exceeded their productivity target, with two missing their target by more than 25 per cent. More generally, the Contributions Office achieved accreditation to the Cabinet Office's Customer Service Excellence standard in 2009.

**11** As regards other business units, while the revenue yield to cost ratio of compliance work has increased, much of the work focuses on Income Tax so the effects on National Insurance compliance are uncertain. On the telephone helplines, performance has fluctuated reflecting the wider trends in HMRC's handling of telephone enquiries on which we reported in January 2010. On debt management, levels of National Insurance write-offs and Class 2 debt have increased, as HMRC has tended to prioritise higher value debts.

**12** Across the wider system of National Insurance there remains a number of long-standing data accuracy issues which if not resolved may affect people's future pension and benefit entitlements. In 2009, HMRC and the Department for Work and Pensions established a Credits Steering Group to resolve inaccuracies arising from data mismatches between the two Departments. Errors requiring action include incorrect recording of individuals' periods of incapacity on HMRC's database during the period from 1994 to 2004, and omissions in recording some people's entitlement to Home Responsibility Protection that determines State Pension qualification for individuals with caring responsibilities.

### Steps taken to improve the efficiency of entire processes

**13** In complex administrative systems, overall efficiency will only be maximised if processes are managed in their entirety rather than as a series of discrete activities. Where connected activities are located in different operating units, there is a risk that opportunities to reduce duplicated or low value work are not taken. In the context of National Insurance, HMRC and the Department for Work and Pensions both recognise this risk, and have actively encouraged operating units to work together to resolve issues and take advantage of opportunities to secure efficiency savings.

**14** In line with HMRC's approach on implementing PaceSetter, the Contributions Office has largely focused on activities within its immediate control rather than reviewing end-to-end processes across operating units. A number of important efficiency enhancing projects got underway in 2009. For example, the Contributions Office and the customer contact centre are working together in using PaceSetter techniques to streamline processes to resolve more queries at the first point of contact. HMRC has also begun to work with the Department for Work and Pensions to make the process of issuing National Insurance numbers to adults more efficient. The timing reflects HMRC's approach of embedding PaceSetter within operating units as a realistic first step. Scope exists therefore for a more coordinated approach, starting with a systematic review of where the different operating units engage with each other.

### Management information

**15** Additional management information could facilitate further efficiencies:

- It is good practice for annual productivity performance information to facilitate year-on-year comparison. The Contributions Office's performance information does not allow this, in part due to the changing nature of its work.
- HMRC has also not determined the full cost of individual activities and, where appropriate, married costs with linked activities in other operating units.
- It does not monitor all volumes of activity in administering National Insurance, or how costs of fully automated systems for processing incoming work compare with systems requiring staff input.

### Strategic planning

**16** A key strategic aim for the National Insurance system is maintaining accurate records on the database. This is because of the effect of an individual's record on future entitlements to pension and other benefits. While improving the quality of data on the database is a key priority for the Contributions Office it should not be regarded as the responsibility of the Contributions Office alone. There is a need for closer working across the different business units within the National Insurance system, and with employers, to drive up accuracy in the data they submit to the Contributions Office. In addition, qualifying criteria for pensions and benefits can change, for example, the number of years of contributions required. The Department therefore needs to ensure that in setting the required standards of accuracy it takes account of all reasonable scenarios of future welfare changes.

## Conclusion on value for money

**17** HMRC has taken significant steps to improve the efficiency of National Insurance administration but it needs to demonstrate more clearly that it is achieving value for money from the £343 million spent on this work. The highlights of the change achieved include the significant reduction in the number of staff deployed, action taken to require employers to communicate with HMRC electronically and examples of increased staff productivity in the Contributions Office. These are significant achievements, not least as there have been no significant system failures during the period of change. However, HMRC is achieving some but not all of its operational targets, a number of long-standing data accuracy issues persist and it has achieved limited progress in implementing efficiency initiatives involving more than one operating unit. Better information on the impact of operational changes and on how units interact with each other would allow HMRC to secure further efficiency savings.

## Recommendations

**18 Steps that would help improve efficiency in the short term:** These recommendations should enable HMRC to identify opportunities for increasing efficiency more systematically, and facilitate a more informed approach to setting operational priorities.

- a** **HMRC has restricted its process reforms to activities within each operating unit rather than as part of an end-to-end review of processes across units.** To help maximise efficiency in National Insurance administration HMRC should develop its approach in two ways. It should give priority to applying PaceSetter principles to whole processes, encouraging operating units to work together to secure efficiencies. HMRC should also give renewed effort to maximising the value from resources applied to corrective work, either by dealing with root causes or applying priorities for securing the accuracy of the National Insurance database most cost-effectively.
- b** **The full cost of individual activities within the Contributions Office has not been determined and, where appropriate, married with linked activities in other operating units.** To inform decisions on future design of activities, especially the mix between staff and IT support, HMRC should at regular intervals, and not less than annually, determine the full costs incurred on individual activities, within the Contributions Office and across other operating units.
- c** **The performance data of the Contributions Office does not show clearly how productivity has changed over time.** Where the mix of work varies significantly from year to year for individual activities, HMRC should consider adopting a system of unitisation, which grades the complexity of work into standard units of processing time, to enable comparisons between years.

**19 Steps that would help to increase efficiency in the longer term:** These recommendations should enable HMRC to adopt a more strategic approach to increasing efficiency and provide operating units with a clearer planning framework.



- a **There is limited planning across National Insurance administration to ensure that the goal of accuracy of the National Insurance database is consistently applied and its targets take account of the longer term costs and consequences of inaccurate processing.** HMRC should be clear about the standard of accuracy it is seeking to achieve over the longer term and take account of possible scenarios of future welfare changes.
- b **The operating units in HMRC set their priorities largely independently of each other.** Notwithstanding its strategic approach to administering National Insurance, HMRC should set guidelines to the operating units on increasing efficiency over the next three years. The guidelines should specify the areas of investment that should have priority; which underlying problems should have greater attention; and where operating units should endeavour to work more closely.
- c **There is limited strategic thinking around the system's long-term future.** HMRC is developing an overarching operational strategy based on its approach to different types of customer behaviour. To inform future investment decisions, the strategy should be underpinned by a clear and costed picture of the end-to-end processes it administers – including National Insurance. This should cover long-term objectives, key issues that could have a major impact on efficiency and the potential contribution of further automation.
- d **There is low visibility of how existing costs compare with the cheapest possible administrative solution.** Although there are presently very limited funds available for major IT enhancements, HMRC should consider how individual administrative procedures might undergo a more fundamental change over the longer term to achieve optimum efficiency. It should also consider the opportunities for reducing incorrect or incomplete incoming data and for exerting greater control of how work is received, with special attention to further reducing the use of more costly paper-based processes. Such consideration would help provide strategic direction to operational changes, determine the strength of opportunities for investment and ensure that HMRC is ready to progress changes should funds for further automation become available.

**20 A step that would help demonstrate more clearly the progress made by HMRC in optimising efficiency:** This recommendation should enable HMRC to meet its obligations in *Managing Public Money* for managing resources and help drive value for money across the system.

- a **HMRC has not clearly demonstrated the extent to which it is achieving value for money. Unlike other taxes, National Insurance spans two Departments and has important objectives that go beyond the collection of revenue.** HMRC's monitoring and reporting of performance on National Insurance should reflect its various objectives. Senior management should have full visibility of results across the end-to-end process, progress in improving joint working between operational units and areas where action could improve the efficiency of the process and benefit the customer.