

SOCIAL SECURITY (ADMINISTRATION) ACT 1992

Account, of the National Insurance Fund, prepared pursuant to c.5, section 161(2) of the Social Security Administration Act 1992, for the year ending 31 March 2003, together with the Report of the Comptroller and Auditor General thereon. (In continuation of House of Commons paper No. 658 of 2002-2003)

Presented Pursuant To Social Security Administration Act 1992, C.5, S.161(2)

National Insurance Fund Account 2002-2003

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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. 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) places the National Insurance Fund under the control and management of the Inland Revenue (IR). The Chairman of the Board of IR is the Accounting Officer for the Fund. Section 161(2) of the Act requires IR to prepare accounts of the National Insurance Fund in such form, and in such manner and at such times, as the Treasury may direct. The accounts are prepared on a cash basis and must properly present the receipts and payments for the financial year and the balance held at the year end.

Operational responsibilities

National Insurance contributions are payable by employed earners, employers and others. IR is responsible for collecting these contributions and recording them against individuals' contribution records (which determine entitlement to social security benefits payable from the Fund). As Accounting Officer for the National Insurance Fund (NIF), I am responsible for the administration of the Fund, payments into the Fund and for the payment of rebates for personal pensions out of the Fund.

The Department for Work and Pensions (DWP) has overall responsibility for the award and payment of most benefits payable from the Fund including those relating to retirement, sickness and contribution based jobseeker's allowance. Entitlement to benefit is determined by the claimant satisfying qualifying conditions.

The Department of Trade and Industry (DTI) is responsible for making Redundancy Payment Scheme awards. The payment of awards and collection of receipts is contracted out to an accounting services provider.

The amounts received by, and paid out of, the Fund, and the resulting balance in the Fund, 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 Fund and payments expected to be made from the Fund in 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 Fund 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 Fund. The latest quinquennial report was laid before Parliament on 27 October 2003.

The Comptroller and Auditor General is required under Section 161(2) of the Social Security Administration Act 1992 to examine and certify the National Insurance Fund Account and to lay copies of it, together with his report, 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. A working balance is necessary because the Fund has no

borrowing powers and because changes in contribution levels in response to the needs of the Fund take time to implement. In his report on the financial provisions of the Social Security Bill 1992 the Government Actuary confirmed that it was prudent to plan for a minimum balance of one-sixth (16.7 per cent) of annual benefit expenditure. However it is only intended to cover the Fund against short-term disruptions.

The balance on the Fund has increased by £2,899 million compared with the position at 31 March 2002 (£23,630 million). At 31 March 2003 the balance in the Fund is £26,530 million (50 per cent of annual benefit expenditure).

The Government Actuary's next Report on the Government's benefits uprating and contributions re-rating Orders will be tabled in the New Year alongside the 2004 uprating 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 estimates of benefit payments and contributions, both huge figures, are sensitive to changes in a number of assumptions (such as the level of employment and earnings), as well as to changes in behaviour in relation to take-up of contracted out pension schemes. Short term fluctuations in the balance may not be a good guide to the long term position. Although the balance is currently greater than the minimum recommended level, in the recent past cash injections from the Consolidated Fund have been needed to maintain the minimum balance.

Responsibilities of the Accounting Officer

As Chairman of the Board of the Inland Revenue, I am the Accounting Officer for the National Insurance Fund. 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 Fund are carried out by other departments (DWP & DTI) and agencies on my behalf, and I receive assurances from them.

Sir Nicholas Montagu KCB
Accounting Officer
Inland Revenue

11 December 2003

Statement of Internal Control

- 1 This statement is given in respect of the National Insurance Fund White Paper Account.
- 2 As Accounting Officer for the Inland Revenue, I am responsible for ensuring that the Department maintain and operate a sound system of internal control that supports the achievement of departmental policies, aims and objectives whilst safeguarding the public funds and departmental assets for which I am personally responsible.
- 3 Whilst the Inland Revenue has overall responsibility for the stewardship of the Fund and for collecting National Insurance Contributions, the Department for Work and Pensions is responsible for Benefit payments and the Department for Trade and Industry is responsible for Redundancy Payments Scheme payments which are covered by the Fund. I have received letters of assurance from the Accounting Officers of those departments. In addition the Government Actuary is responsible for reporting to Parliament on the performance of the Fund.
- 4 The Department's control framework is designed to manage rather than eliminate the risk of failure to achieve departmental aims and objectives. It can therefore provide only reasonable and not absolute assurance of effectiveness.
- 5 During the year ended 31 March 2003 (and up to the date of approval of the annual accounts) we have made further progress in embedding risk management, and the Department is now compliant with the requirements set out in DAO (GEN) letter 13/00. Work on improving risk management will continue, in particular taking forward the risk improvement programme arising from the Cabinet Office's recent risk report.¹
- 6 As Accounting Officer I also have responsibility for reviewing the effectiveness of the system of internal control. The main elements of the Department's control framework are set out below.

6.1 Control environment

- a I have a clearly defined 'Statement of AO Responsibilities'
- b There is a Departmental Committee structure, with clear terms of reference and defined membership. There are four non-executive members on the Departmental Board, one of whom chairs the Departmental Audit & Security Committee (DASC). The DASC meets three times a year. The Departmental Management Committee (DMC) meets fortnightly to consider the plans and strategic direction of the Department.
- c In 2001-2002 we drew up a new accountability framework for operational Directors. During 2002-2003 we have agreed frameworks for the corporate support, policy and other head office Directors, and these came in to effect on 6 June 2003. These frameworks clarify generic corporate accountabilities, and complement our primary mechanisms for business accountabilities, which are the operating plans for each business area, and the individual performance agreements that are agreed annually. Frameworks for Board members will be drawn up during 2003-2004.
- d There is detailed guidance on standards of behaviour and conduct, diversity and equal opportunities on the Revenue intranet. The initial extensive fraud awareness programme, carried out by Internal Audit, was attended by 95% of all staff. A Fraud Awareness module is included in the National Induction Programme to ensure new members of staff receive the necessary awareness information. Following analysis of results from the initial programme new fraud awareness initiatives are being considered for launch in 2003-2004. In February 2003, our new policy on computer misuse was launched jointly by the Board and the Trade Unions. Every member of staff has received a copy of the policy.

6.2 Risk management

We continue to build on the progress we have made in embedding risk management processes in the Department.

Capacity to handle risk

In recognition of my personal responsibility, as Accounting Officer, for ensuring that we have effective risk management arrangements in the Department, I lead the risk management reviews at our DMC meetings.

We are continually looking at ways to improve the strategic risk management process. As a result of discussions I had with the Risk Support team and the chair of DASC, we have decided to set up a senior risk review group to examine risks and action plans in greater depth.

Risk management guidance is available to our staff through the intranet, and the Risk Support team provide additional advice and support (for example through presentations to staff, or by running risk workshops.)

The risk environment

The model of risk management that we have adopted requires upward reporting of risks (to ensure comprehensive risk identification) and risk stewardship arrangements which are top-down.

There is ownership of the most significant risks by individual Board members, with responsibility for managing them assigned to individual Directors.

Our risk management strategy requires teams throughout the Department to identify risks as part of their annual planning cycle, and include details of their top risks in regular performance reports.

6.3 Control activities

We have comprehensive procedures covering all aspects of the conduct of business. Financial procedures are set out in the Finance Manual and the Inland Revenue 'Guide' for staff, which are available on our intranet.

6.4 Information and communication

- a In September 2002 we appointed our first Director of Information Resources. The Departmental Information Strategy, which was agreed at DMC in February 2003, has three main principles
 - to manage our data, knowledge and information as a shared resource;
 - to make sure that people who work with data, information and knowledge can do so quickly, easily and cost effectively; and
 - to make sure that the data, information and knowledge we have is accurate, up to date and complete.
- b In 2001-2002 we started to develop a Balanced Scorecard to provide the Board with regular performance information on our strategic business drivers. The scorecard has been going through a process of refinement, in discussion with the Board, to ensure it meets their strategic needs.
- c We have continued with our programme of Modernisation Seminars. These are designed to develop all leaders to the same level of commitment to the Core Purpose and change, and enable them to communicate this message to their teams. A Board Member delivers a session to each seminar. During 2002-2003, there were 525 participants at 26 events.
- d Apart from their involvement in Modernisation Seminars, Board members and Directors have been active in explaining to staff the detail and implications of the Core Purpose and the transformation agenda through
 - articles in internal publications;
 - attendance at Departmental conferences and seminars;
 - personal visits to local offices; and
 - telephone open days for staff.

In addition, I took part in a week long 'back to the floor' event in one of our area offices.

- e To communicate and embed the Revenue's Core Purpose to all of our staff, we have begun a programme of modular-based interactive workshops which are designed to allow staff to discuss the key challenges facing the Revenue today. At the end of September 2003, 96% of all Revenue staff had completed two of the four modules.
- f We have a comprehensive range of indicators, against which we measure our performance. The results of key indicators, in particular those linking to our Public Service Agreement (PSA) and Service Delivery Agreements (SDA) are published in our Annual Report. Internal Audit validate a range of key indicators linked to PSA 1, and during 2003-2004 they will be exploring how best to provide an assurance over the other PSA targets.

6.5 Monitoring

- a The Director of Internal Audit reports regularly to the DASC, to standards defined in the Government Internal Audit Manual. These reports include the Director of Internal Audit's opinion on the adequacy and effectiveness of the Department's system of risk management, control and governance.
 - b The external independent Chair of the DASC reports to me.
 - c Our Quality Programme focuses on the improvement of individual performance in core business areas. It provides a clear structure for managing the quality of work, and the development of the necessary staff skills to deliver a quality service.
 - d Assessments of compliance with the principal recommendations in the Cabinet Office report 'Successful IT: Modernising Government in Action'.
 - e Quarterly reports from the Adjudicator on the outcome of complaint cases.
- 7 The Letters of Assurance that I have received from DWP and DTI highlight the following Internal Controls within those departments

7.1 DTI in respect of the Redundancy Payments Scheme

- a A risk register has been established and continues to be developed for the RPS and is subject to regular review. There have been no significant changes to the risk register over the year.
- b When a risk has been identified, ownership has been assigned to individuals to develop risk control strategies or equivalent for taking action to address the risk. These strategies and any improvement action plans have been developed and implemented in a timely manner.
- c The RPS's internal control components covering: the reliability of financial reporting; the effectiveness and efficiency of operations and compliance with applicable policies, procedures, laws and regulations is subject to ongoing assessment at Management Unit level.
- d Where a material weakness has been identified a corrective action plan has been developed to address the exposure at Management Unit level.
- e No material breakdowns in control have occurred during the year.

7.2 DWP in respect of contributory Benefit payments

- a DWP Quality Support Teams have continued to operate by examining a sample of benefit awards for accuracy in line with NAO principles. The Quality Support Teams' findings have been validated by DWP's Internal Audit with NAO examining a sample of the Quality Support Teams' findings to give assurance around the reported results.
- b DWP has reported during the year on a number of reviews that have a specific bearing on the NI Fund. Reviews of NI Number Applications Backlogs, DWP NI Fund accounting and an end to end review of Pension and Incapacity Benefit payments by Giro reported substantial assurances.

- c Within DWP's Pension Service a Programme Protection Strategy and Plan to reduce incorrect payments to customers has been implemented. The strategy and plan will be regularly reviewed and improvements made where found necessary. The Pension Service Programme Protection Unit analyses management information, examines trends and co-ordinates activity with Counter Fraud Investigation Services, operations and Internal Assurance Services. Activity introduced to minimise incorrect payments includes the establishment of a performance improvement team, inclusion of integral programme protection awareness within training delivery and interventions and checking focused on priority performance areas. They have developed a Service Improvement Plan that supports performance improvement and reduction of performance variations.

DWP have also reviewed the systems of internal control and have identified the following areas for improvement which relate to losses arising from fraud and error

- d The estimated level of losses arising from the fraudulent encashment of order books and giro cheques during the year is reported annually in the Resource Account. Similarly the estimate of losses attributable to fraudulent benefit claims of Income Support and Jobseeker's Allowance, which reports performance annually against the Department's Public Service Agreement target, is reported in the Resource Account and is also published as National Statistics.
- e The Department's counter-fraud strategy is kept under constant review in the light of information gained from our operational colleagues in the field. A more intelligence-led approach has been adopted, including greater use of data matching to identify inconsistencies and possible instances of fraud and error across a range of benefits, including use of data from other government departments. We are continuing to explore ways in which this can be further extended to additional data sources to which there is lawful access, whilst complying fully with the Data Protection Act.
- f Intelligence led fraud investigation has been further strengthened by the increasing functionality of Operational Intelligence Units. These Units are based in each Government Office Region and they are responsible for selecting cases for investigation, adding information and obtaining data through legal gateways. Officers authorised to collect data from financial institutions using powers conferred under the Social Security Fraud Act 2001 operate within these Operational Intelligence Units.
- g In addition DWP are working towards the delivery of a specification for the fraud community. This will set out the details, in percentage terms, of the effort to be invested in each of the DWP disciplines and will clearly demonstrate the link between investment of their investigative resource and the PSA target to reduce losses from fraud and error by 50% in Income Support and Jobseekers Allowance by March 2006, with a 25% reduction by March 2004. NI funded benefits will be identified in the specification.
- 8 There is a NIF Audit Forum composed of representatives from key departmental audit units such as the Inland Revenue, DWP, DTI and the NAO. 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.
- 9 Non-matching NI Contributions Information. In some instances we receive end of year information from employers that includes NI contributions information that we cannot match to the relevant contributor records. We apply well established routines to trace these non-matching items and make all reasonable effort to update contributor records. We have taken steps to encourage and assist employers to submit accurate information. These improvements have resulted in a continued reduction in the number of new cases each year. We have produced an action plan to enable further reduction in the number of non-matched items.

- 10 My assessment of the effectiveness of the system of internal control is based on the work of the internal auditors, and reports from the chair of DASC, and is also informed by regular reports and updates from senior managers.
- 11 In making my assessment, I take account of the management letters made by the NAO, the C & AG's report to Parliament, and the findings of the Committee of Public Accounts (PAC).

Sir Nicholas Montagu KCB
Accounting Officer
Inland Revenue

11 December 2003

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

I certify that I have audited the financial statement, 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 Accounts.

Respective responsibilities of the Accounting Officer and Auditor

As described in the Responsibilities of the Accounting Officer in the Foreword, the Accounting Officer is responsible for the preparation of 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 guided by the Auditing Practices Board and the auditing profession's ethical guidance.

I report my opinion as to whether the financial statements properly present the receipts and payments and are properly prepared in accordance with the 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 Statement of Internal Control reflects compliance with Treasury's guidance 'Corporate Governance: statement on the system of internal control'. I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements.

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 judgements made by the Accounting Officer in the preparation of the financial statements.

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

Opinion

In my opinion

- The account properly presents the receipts and payments of the National Insurance Fund for the year ended 31 March 2003 and the balance held at that date and has been properly prepared in accordance with Section 161(2) of the Social Security Act 1992 and the directions made thereunder by the Treasury; and
- In all material respects receipts and payments have been applied to the purposes intended by Parliament and conform to the authorities which govern them.

See also my Report on the account.

John Bourn
Comptroller and Auditor General

18 December 2003

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Receipts and Payments Account for the year ended 31 March 2003

| Receipts | Notes | 2002-2003 £000 | 2001-2002 £000 |
|--|-------|--------------------------|--------------------------|
| National Insurance Contributions | 2 | 58,421,672 | 56,717,853 |
| Compensation for Statutory Sick Pay and Statutory Maternity Pay recoveries, from DWP | 3 | 755,000 | 687,300 |
| Income from Investments | 4 | 1,422,465 | 1,112,935 |
| State Scheme Premiums | 5 | 190,044 | 118,116 |
| Other receipts | 6 | 77,730 | 63,422 |
| Redundancy receipts | 7 | 24,123 | 21,097 |
| | | <u>60,891,034</u> | <u>58,720,723</u> |
| <i>Less</i> | | | |
| Payments | | | |
| Benefit Payments | 8 | 52,844,467 | 50,396,999 |
| Personal pensions | 9 | 3,276,384 | 2,763,856 |
| Administrative Costs | 10 | 1,241,496 | 839,073 |
| Redundancy payments | 7 | 252,923 | 230,365 |
| Transfers to Northern Ireland | 11 | 350,000 | 110,000 |
| Other Payments | 12 | 26,599 | 29,381 |
| | | <u>57,991,869</u> | <u>54,369,674</u> |
| Excess of receipts over payments | | 2,899,165 | 4,351,049 |
| Statement of Balance | | | |
| | | £000 | £000 |
| Opening balance | | 23,630,385 | 19,279,336 |
| Plus | | | |
| Excess of receipts over payments | | <u>2,899,165</u> | <u>4,351,049</u> |
| Closing balance | | <u>26,529,550</u> | <u>23,630,385</u> |

The notes on pages 12 to 21 form part of these accounts.

Sir Nicholas Montagu KCB
Accounting Officer
Inland Revenue

11 December 2003

Notes to the Account

1 Accounting policies

Basis of preparation of the Account

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

National Insurance Contributions

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

Employers are responsible for calculating contributions payable by themselves and their employees. Their records are subject to examination by the Inland Revenue. These checks and checks on other contributors may result in additional receipts or repayments in future years in respect of contribution liabilities for 2002-2003.

Payment of Social Security Benefits

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

Use of estimated figures

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

Net accounting

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

2 National Insurance Contributions

| Contributions | 2002-2003 £000 | 2001-2002 £000 |
|--|--------------------------|--------------------------|
| Class 1 (employed earner) | (i) 55,537,988 | 53,785,886 |
| Class 1A & 1B | (ii) 1,006,649 | 977,877 |
| Class 2(self-employed flat rate) | (iii) 294,318 | 296,217 |
| Class 3 (voluntary contributions) | (iv) 66,841 | 62,646 |
| Class 4 (self-employed earnings related) | (iii) 1,515,876 | 1,595,227 |
| | <u>58,421,672</u> | <u>56,717,853</u> |

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

- i Class 1 contributions are divided into two parts: primary contributions payable by employees and secondary contributions payable by employers.
- ii Class 1A contributions are paid by employers on most benefits provided to employees. Employers pay Class 1A contributions to the Inland Revenue Pay As You Earn scheme with their Class 1 contributions.

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

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

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

- iii Self employed persons pay Class 2 flat rate weekly contributions and Class 4 earnings related contributions.
- iv Class 3 voluntary flat rate contributions are paid to maintain a contributors National Insurance record for certain benefit and / or pension purposes.

GAD apportionment

The Social Security Administration Act 1992 requires that the Government Actuary 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 National Health Service. The NHS allocation is paid over at source before the contributions are paid into the National Insurance Fund and so the figures shown above are shown net of the NHS element.

GAD also allocate amounts recovered by employers in respect of Statutory Sick Pay and Statutory Maternity Pay from the Class 1 total. These are shown in the table below.

The amounts shown are net of refunds of £116,612,000 (2001-2002 £107,015,000), part of which is allocated to the NHS.

| | 2002-2003 £000 | 2001-2002 £000 |
|----------------|-------------------------|-------------------------|
| NHS allocation | 7,260,950 | 7,217,058 |
| SSP recoveries | 30,725 | 30,125 |
| SMP recoveries | 723,757 | 635,941 |
| | <u>8,015,432</u> | <u>7,883,124</u> |

3 Compensation for Statutory Sick Pay and Statutory Maternity Pay Recoveries

The amount of £755 million (£687.3 million in 2001-2002), paid from Department for Work and Pensions Vote, recompenses the National Insurance Fund for loss of revenue due to contribution receipts being reduced by recoveries in respect of statutory sick and statutory maternity payments paid by employers. This amount, paid by way of compensation, differs from the estimates of the amounts recovered in Note 2 because the two sets of estimates are drawn up at different times. The additions to national insurance contributions provided by Parliament are based on early estimates to enable compensation to be paid into the Fund before the end of the financial year, whereas the figures for recoveries by employers, shown in Note 2, are based on later estimates.

4 Income from investments

| | 2002-2003 | 2001-2002 |
|----------------------------|-------------------------|------------------|
| | £000 | £000 |
| Interest received | 1,315,289 | 1,098,707 |
| Profit on realisation | 192,486 | 33,160 |
| Less losses on realisation | (85,310) | (18,932) |
| | <u>1,422,465</u> | <u>1,112,935</u> |

During the year the value of investments increased from £21.4 billion at 31 March 2002 to £24.4 billion at 31 March 2003. A substantial proportion of the Fund continued to be held in short-term securities. At 31 March 2003 the proportion was approximately 45% (29.3% at 31 March 2002).

5 State Scheme Premiums

State Scheme Premiums are payable in respect of employed persons who cease to be covered, in certain specific circumstances, by a contracted out pension scheme. The premiums buy back the persons' additional pension entitlement in the State Earnings Related Pension Scheme (SERPS). The collection total of £190,044,000 (2001-2002 £118,116,000) is net of refunds of £10,731,000 (2001-2002 £8,858,000).

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

By 31 March 2003, around 30,600 individuals had been brought back into SERPS with a liability of some £127,630,000 (a further liability of £215,678 was identified between 24/6/02 and 31/3/03) of which £35,109,912 had been recovered. A total of £545,000 was recovered in 2002-2003.

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 actually members of another. The pension liability for these members has to be transferred however, because the schemes have different revaluation rates, the value of the liability from one scheme could be different to the other, (ie a premium under Mirror Group could be for £1,000, but under Headington it could be only £800). This accounts for changes in the scheme and overall liability from one year to the next.

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

| Maxwell Pension Scheme | Liability at 31 March 2003 £ | Recovered by 31 March 2003 £ | Progress |
|---|------------------------------------|------------------------------------|---|
| Mirror Group Pension Scheme | 69,322,136 | 3,915,000 | State Scheme Premium bill capped at £66 million. A phased and gradually accelerating payment schedule has been agreed. Final payment due by 2020. |
| Headington Pension Plan | 49,236 | 727,110 | Membership of the scheme has still to be agreed before the final bill is confirmed. |
| MCWPS "Works" Scheme | 0 | 30,467,802 | Final payment of £10,467,802 paid September 2001. |
| Victoria Works Scheme | 364,960 | 0 | Schemes merged. Some payment of SSPs possible. |
| AGB Scheme | 10,579,015 | 0 | |
| AGB Research Scheme | 1,467,028 | 0 | |
| Maxwell Communications Pension Plan (Staff) | 10,329,619 | 0 | No current prospect of payment. |
| Maxwell Media Pension Plan | 411,074 | 0 | No current prospect of payment. |
| Total | 92,523,068 | 35,109,912 | |

6 Other receipts

| | 2002-2003 £000 | 2001-2002 £000 |
|---|-------------------|-------------------|
| Recoveries of damages in tort (i) | 60,683 | 57,762 |
| Compensation for Age Related Rebates (ii) | 14,422 | 3,429 |
| Unemployment benefit recoveries (iii) | 2,625 | 2,231 |
| | 77,730 | 63,422 |

- (i) The recoveries from damages paid to recipients of certain National Insurance Fund benefits. These amounts relate to recoveries from insurers and other bodies in respect of compensation claims for damages where National Insurance Fund benefits had already been paid to individual claimants by the Department for Work and Pensions.
- (ii) The National Insurance Fund received a payment of £14,421,765 from the Inland Revenue Administration Account, in respect of compensation for delayed payments of Age Related Rebates made to pension providers on behalf of their clients who opted out of SERPS in favour of a personal pension.
- (iii) Unemployment Benefit was replaced by Contributory Jobseekers Allowance in October 1996 and these are retrospective recoveries. These recoveries are all article 69 cases i.e reimbursement to the NIF from European countries for their citizens who have been paid unemployment benefit in the UK.

7 Redundancy Payments

Section 182 of the Employments Rights Act 1996 provides the Statutory basis for the National Insurance Fund to make Redundancy Payments.

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 RPS also has to protect the taxpayer's interests by ensuring that it does not make payments which can and should be made by the employers themselves.

The RPS also collects information about larger redundancies before they take place so that they can alert other agencies to be on hand to extend help to employees.

Redundancy payments are made from the Fund to employees whose employers have failed to make payments due or who were insolvent. The payments are awarded by the Department of Trade and Industry. The receipts represent amounts recovered from employers. The total debt outstanding at 31 March 2003 was £72 million which is disclosed as part of the Department of Trade and Industry's Resource Account Balance Sheet.

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

| | 2002-2003 £000 |
|--|-------------------|
| Outstanding debt at 31 March 2002 | 777,150 |
| Adjustment to the opening balance | (696,502) |
| Plus Redundancy payments in 2002-2003 | 252,923 |
| Less Receipts in 2002-2003 | (24,123) |
| Less Debt written off in 2002-2003 (note 15) | (237,419) |
| Outstanding debt at 31 March 2003 | <u>72,029</u> |
| | 2001-02 £000 |
| Outstanding debt at 31 March 2001 | 786,179 |
| Plus Redundancy payments in 2001-2002 | 230,365 |
| Less Receipts in 2001-2002 | (21,097) |
| Less Debt written off in 2001-2002 (note 15) | (218,297) |
| Outstanding debt at 31 March 2002 | <u>777,150</u> |

8 Benefit payments

| Benefits | | 2002-2003 £000 | 2001-2002 £000 |
|--|-------|-------------------|-------------------|
| Retirement Pension | (i) | 44,252,183 | 41,886,787 |
| Incapacity benefit | (ii) | 6,786,038 | 6,761,000 |
| Bereavement benefit | (iii) | 1,110,086 | 1,099,804 |
| Jobseeker's allowance (contributory) | (iv) | 505,033 | 464,312 |
| Christmas bonus for pensioners | (v) | 121,119 | 128,000 |
| Maternity allowance | (vi) | 68,426 | 55,639 |
| Guardians' allowance and child special allowance | (vii) | 1,582 | 1,457 |
| | | <u>52,844,467</u> | <u>50,396,999</u> |

- i The 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 customer who has paid National Insurance contributions and whose Statutory Sick Pay has ended or is not applicable.
- iii Bereavement Allowance replaced Widow's pension in April 2001 and is a regular payment for 52 weeks. Bereavement Payment replaced Widow's payment in April 2001 and is a lump sum payment. Both are based on the late husband or wife's National Insurance contributions.
- iv Contributory Job Seekers Allowance is payable to customers who are capable of working, available for work and actively seeking work who have been paid or treated as having paid a certain number of National Insurance contributions.
- v The Christmas Bonus is a tax free payment of £10 paid before Christmas to customers who are getting one or more qualifying benefits (e.g. retirement pension).
- vi Maternity Allowance is paid at a standard weekly rate dependent on earnings to a customer who can not get Statutory Maternity Pay; and
- vii Guardian's allowance is payable to people bringing up a child because one or both of the parents has died.

In some instances we receive end of year information from employers that includes NI contributions information that we cannot match to the relevant contributor records. We apply well established routines to trace these non-matching items and make all reasonable effort to update contributor records. We have taken steps to encourage and assist employers to submit accurate information. These improvements have resulted in a continued reduction in the number of new cases each year. We have produced an action plan to enable further reduction in the number of non-matched items.

The average annual SERPS underpayment in respect of these items is estimated at £167 million. It is also estimated that SERPS underpayments for individuals are most likely to range from £2.60 to £253.24 a year. Non-matched records are held in a Suspense File to ensure that if an individual provides new information the non-matched contributions can be posted to their record.

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

Retirement pension and widow's benefit includes payment to Northern Ireland pensioners living abroad. For administrative convenience these payments are made by the Department for Work and Pensions with the cost being borne by the National Insurance Fund 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 2002-2003 is £8.5 million (£8.9 million in 2001-2002). Note 11 explains the relationship between the National Insurance Fund and the Northern Ireland National Insurance Fund.

9 Personal Pensions

| | 2002-2003 | 2001-2002 |
|---------------------------|------------------|-----------|
| | £000 | £000 |
| Personal Pension Payments | 3,276,384 | 2,763,856 |

The Pensions Schemes Act 1993, supplemented by the Pensions Act 1995, entitles employed earners with a personal pension to a 'minimum contribution' to their plan from the National Insurance Fund which, 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*1 Payments made in respect of Administration*

| | 2002-2003 | 2001-2002 |
|---|-------------------------|----------------|
| | £000 | £000 |
| Department for Work and Pensions | 908,280 | 488,970 |
| For administering the National Insurance Scheme. See analysis at (2) | | |
| Inland Revenue | 320,304 | 337,387 |
| For the collection of National Insurance Contributions. | | |
| Other departments | 12,912 | 12,716 |
| | <u>1,241,496</u> | <u>839,073</u> |

The Audit fee was £0.4m, however an additional £0.35m has been paid in 2002-2003 as the final payment for the audit of the 2000-2001 account.

With effect from 1 April 2002, administration payments to DWP from the Fund are calculated on a fixed charge basis. They are estimated at the beginning of each financial year based upon the Departmental Main Estimate for the year in question. Unlike previous years, adjustments are no longer made to future year recoveries to take into account any in-year changes to the Department's funding position.

2 Analysis of payments from the Fund in 2002-2003 in respect of Department for Work and Pensions' administrative costs

The main reason for the increase in recoveries from the Fund in 2002-2003 compared with 2001-2002 was

* the estimated recoveries from the Fund in 2001-2002 were understated by £259,418,062. The correct amount of initial recovery, therefore, should have been £748,388,264. Following agreement between Inland Revenue, Treasury and the NAO, the 2003-2004 recoveries from the Fund are being adjusted to take account of this under-recovery.

But there were other major changes in 2002-2003 which make like for like comparisons with the recoveries in 2001-2002 difficult

* a major change in the structure of the Department - from Department of Social Security to Department for Work and Pensions; and

* a change in the method of calculation, as agreed by Inland Revenue, Treasury and NAO, to recover NIF administration costs on a one-year fixed charge basis.

11 Transfers to Northern Ireland

| | 2002-2003 | 2001-2002 |
|----------------------------------|------------------|-----------|
| | £000 | £000 |
| Payments to Northern Ireland NIF | 350,000 | 110,000 |

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

| | 2002-2003 £000 | 2001-2002 £000 |
|-------------------------|---------------------------------|-------------------|
| Payments to Isle of Man | 21,789 | 20,253 |
| Other payments | 4,810 | 9,128 |
| | <u>26,599</u> | <u>29,381</u> |

Payments to the Isle of Man (Manx Insurance Fund) relate to net settlements in respect of insured persons who have paid national insurance contributions into one Fund but have received benefit from the other Fund.

13 Closing balance

| | 31 March 2003 £000 | 31 March 2002 £000 |
|---|-------------------------------------|-----------------------|
| Securities held by the Commissioners for the Reduction of the National Debt | | |
| At cost | 24,370,849 | 21,463,385 |
| 1 Market value | 25,515,385 | 22,166,821 |
| 2 Nominal value | 23,160,992 | 20,540,834 |
| Held by Paymaster (including uncleared cheques) | 8,988 | 32,567 |
| Other balances (i) | <u>2,149,713</u> | <u>2,134,433</u> |
| | <u>26,529,550</u> | <u>23,630,385</u> |

i Sums due from or owing to Government departments and overseas administrations in respect of the operation of the National Insurance Fund.

14 Securities Held by the Commissioners for the Reduction of the National Debt at 31 March 2003

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

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

| | Nominal Value £000 | Cost Price £000 | Market Value at 31 March 2002 £000 |
|--------------------------------------|-----------------------|--------------------|---|
| Government and government guaranteed | | | |
| Stocks : | | | |
| Up to one year | 6,100,219 | 6,169,153 | 6,233,529 |
| One to five years | 8,222,110 | 8,598,384 | 8,837,895 |
| Five to ten years | 3,964,722 | 4,212,639 | 4,399,572 |
| Over ten years | 1,985,958 | 2,215,384 | 2,426,406 |
| | <u>20,273,009</u> | <u>21,195,560</u> | <u>21,897,402</u> |
| Loans to Local Authorities: | | | |
| Temporary loans | 50,590 | 50,590 | 50,880 |
| Up to one year | 217,235 | 217,235 | 218,539 |
| Total Securities | <u>20,540,834</u> | <u>21,463,385</u> | <u>22,166,821</u> |

15 Losses

| | 2002-2003 £000 | Number of cases | 2001-2002 £000 | Number of cases |
|--|-----------------------|-----------------------|-------------------|--------------------|
| 1 Contributions National Insurance Fund share | | | | |
| Inland Revenue remissions and waivers (1a) | 117,114 | 191,546 | 53,118 | 142,589 |
| Inland Revenue debt transferred (1b) | 158,352 | - | 91,925 | - |
| Total Loss | <u>275,466</u> | <u>191,546</u> | <u>145,113</u> | <u>142,589</u> |
| 2 Benefits | 26,144 | 94,935 | 27,577 | 92,151 |
| 3 Redundancy write-off adjustment (see Note 7) | | | | |
| Write-off in year | 237,419 | 11,023 | 218,297 | 10,667 |
| 4 Administration | 1,646 | 2,500 | 173 | 6,155 |

1a Inland Revenue 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.

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

2 Organised Fraud: At the end of 2002-2003 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. Four of these operations included National Insurance Fund benefits. The loss to the National Insurance Fund was £609,818.67. 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 4 people were charged receiving in total 8 years.

Write-off of Debt through Easement: The Department of Work and Pensions's overpayment initiative, agreed with Treasury, enables the write-off of non-recoverable debt using estimating procedures. The aim is to re-target resources to more cost effective recovery. During 2002-2003 the package dealt with 61,986 cases involving overpayments of NI Fund benefits, writing off approximately £14.5 million. These overpayments would not have been recoverable under Social Security legislation. They were caused primarily by official error.

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

- 3 The figure represents amounts written off during the year in respect of redundancy payments to employees, deemed irrecoverable from their employers mainly due to insolvency. This figure is significantly greater than in previous years as a result of a review of the debt position which has resulted in irrecoverable debt being identified more quickly and a more realistic figure being reported.
- 4 The Department for Work and Pensions wrote off a number of high value losses in 2002-2003 which related proportionately to the National Insurance Fund White Paper Account. There were 681 salary related cases totaling £176,002, 544 non-salary related cases totaling £161,538 and 86 miscellaneous cases totaling £1,148,393. This figure is large due to the write off of unrecoverable debts built up since 1993 where for various reasons DWP have been unable to obtain repayment and legal advice has been that it would not be cost effective to pursue them further.

16 Special payments

| | 2002-2003 | | 2001-2002 | |
|------------------|--------------|---------------|-----------|-------------|
| | £000 | No of Cases | £000 | No of Cases |
| Special payments | 5,808 | 10,356 | 3,159 | 7,179 |

These are mainly payments to claimants who have been wrongly advised on benefit entitlement.

The Australian social security agreement ended with effect from 1 March 2001. An extra statutory payment scheme was set up to pay enhanced state retirement pension to those people with residence in Australia during the currency of the Agreement, up to 5 April 2001, who have now returned to live permanently in the UK. In the financial year to 31 March 2003, payments were made amounting to approximately £2 million (£1 million in 2001-2002).

A special exercise was carried out relating to Bereavement benefit. Form BD8 (certificate of registration of death) is issued by Registrars for social security purposes. The form makes reference to benefits that could be claimed by a surviving spouse. The wording of the form was amended to reflect the introduction of bereavement benefit in April 2001. However, supply of the revised form was delayed by as much as six months (to October 2001) with the result that some registrars continued to issue the old version of BD8 which contained no reference to bereavement benefit. Some potential claimants (all widowers) either lost statutory entitlement to bereavement benefit or payment of their benefit was unreasonably delayed. Financial redress has been offered in the form of either extra-statutory payments in lieu of lost bereavement benefit or ex-gratia compensation for delay. Further information can be found in Pensions Bulletin 02/02.

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; and
 - c a statement of balances;and shall include such notes as may be necessary for the purposes referred to in the attached schedule.
- 3 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.
- 4 The format of the statement of account and the disclosure requirements are in the attached schedule.
- 5 The foreword and the account shall be signed by the Accounting Officer.
- 6 The Accounts Direction shall be reproduced as an annex to the accounts.
- 7 This direction supersedes the Account's Direction dated 7 December 1995.

B Glicksman
Treasury Officer of Accounts

16 October 2000

Schedule

Format of Account and Disclosure requirements - Great Britain

- 1 The foreword shall state that the account has been prepared in accordance with a direction issued by Treasury in pursuance of Section 161(2) of the Social Security Administration Act 1992. The foreword will also include details of the following :
 - a statutory background;
 - b operational responsibilities;
 - c financial performance;
 - d audit arrangements; and
 - e responsibilities of the Accounting Officer.
- 2 The receipts and payments account and statement of balances shall conform to the formats shown in the Annex, although minor variations may be made.
- 3 The notes shall include
 - a analysis of the payments and receipts included under the headings set out in the attached format, including any explanation or background that may be necessary to understand the accounts;
 - b in the 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 ...

| Receipts | Notes | 20() £000 | 20() £000 |
|---|-------|---------------|---------------|
| 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 | | | |
| <i>Less</i> | | | |
| Payments | | | |
| Benefit payments | | | |
| Personal pensions | | | |
| Administrative costs | | | |
| Redundancy payments | | | |
| Transfers to Northern Ireland | | | |
| Other payments | | | |
| Excess of receipts over payments | | | |
| Statement of balances | | | |
| Opening balance | | £000 | £000 |
| <i>Plus</i> | | | |
| Excess of receipts over payments | | | |
| <i>Less</i> | | | |
| 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 provides for expenditure on benefits and allowances where individuals have paid sufficient National Insurance contributions and met other qualifying conditions. In 2002-2003, receipts amounting to £60.9 billion were paid into the Fund and payments of £58.0 billion were paid out of it. The balance on the Fund was some £26.5 billion at the end of the year.
- 2 The National Insurance Recording System (NIRS2) maintains details on over 65 million National Insurance accounts for individual contributors and approximately 1 million new accounts are created each year. The system supports a variety of activities contributing to pension and benefit payments. It records details of individuals' and employers' National Insurance contributions, calculates contribution based benefits, provides data to other Government Departments and pays age-related contribution rebates in respect of occupational and personal pension holders.
- 3 The Inland Revenue have responsibility for the collection of National Insurance contributions from employers, employees, the self-employed and for those who pay contributions voluntarily. The Department for Work and Pensions are responsible for benefits paid to individuals and these are currently administered through The Pension Service and Jobcentre Plus. The Department for Trade and Industry have overall responsibility for administration of the Redundancy Payments Service which is funded by the National Insurance Fund. Accountability for the National Insurance Fund overall rests with the Inland Revenue who receive formal Letters of Assurance on particular aspects from the other Government Departments.
- 4 This report records the results of my audit examination of the 2002-2003 account and developments, including
 - The balance on the National Insurance Fund;
 - The compensation scheme for the late payment of Age-related Rebates;
 - Duplicate Age-related Rebate payments and compensation;
 - Contribution Deficiency Notices;
 - Additional costs arising from the delayed implementation of NIRS2 and the subsequent business stabilisation that followed this; and
 - Non-matched contributions Suspense Files.

The Balance on the National Insurance Fund

- 5 National Insurance contribution rates are set at levels intended to meet expected benefit expenditure each year, after taking into account other Fund receipts and payments, and to maintain a working balance. At 31 March 2003, the balance on the National Insurance Fund was £26.5 billion - some 50 percent of annual benefit expenditure - an increase of £2.8 billion compared to 31 March 2002.
- 6 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. 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. From 1993 to 1998 grants totalling £20.3 billion were made from the Consolidated Fund to maintain this working balance (see Figure 1 below). In the Foreword to the account, the Accounting Officer has set out the context and reasons for the balance. He has explained that the balance is one of the matters taken into account when Ministers review annually National Insurance contributions and that the Government Actuary reports on the likely effect on the balance of the Government's benefits Up-rating and contributions Re-rating Order. These Orders can be subject to debate and require the approval of both Houses.

Figure 1: Receipts and payments of the National Insurance Fund (£ billion)

| | Receipts (excluding receipts from Consolidated Fund) | Payments | Surplus/ (Deficit) before receipt from Consolidated Fund | Receipts from Consolidated Fund ⁽¹⁾ | Balance at end of year |
|---------|---|-----------------|---|---|-----------------------------------|
| 1990-91 | 34.5 | 33.0 | 1.5 | | 11.8 |
| 1991-92 | 34.7 | 38.1 | (3.5) | | 8.3 |
| 1992-93 | 35.7 | 40.6 | (4.9) | | 3.5 |
| 1993-94 | 36.7 | 43.2 | (6.5) | 7.6 | 4.5 |
| 1994-95 | 38.9 | 42.9 | (4.0) | 6.3 | 6.8 |
| 1995-96 | 41.0 | 43.6 | (2.6) | 3.6 | 7.8 |
| 1996-97 | 43.0 | 45.0 | (2.2) | 1.9 | 7.7 |
| 1997-98 | 46.9 | 46.0 | 0.9 | 0.9 | 9.6 |
| 1998-99 | 50.3 | 47.6 | 2.7 | | 12.3 |
| 1999-00 | 52.2 | 50.0 | 2.2 | | 14.4 |
| 2000-01 | 56.1 | 51.3 | 4.8 | | 19.3 |
| 2001-02 | 58.7 | 54.4 | 4.4 | | 23.6 |
| 2002-03 | 60.9 | 58.0 | 2.9 | | 26.5 |

Rounding mean that some rows do not add up precisely

Note 1 These amounts paid from the Consolidated Fund were based on the Government Actuary's estimate of the sum needed to maintain a reasonable working balance on the Fund.

- 7 On 27 October 2003, the Government Actuary published his Quinquennial Review of the Fund as at 1 April 2000, the main purpose of which is to estimate the contribution rates required to be paid to the Fund in future years in order to meet expenditure on a pay-as-you-go basis under the current benefit and contribution structure. The report also shows projections of the balance of the Fund if current contribution rates remain unchanged in the future. As the Government Actuary makes clear, projections of the balance on the Fund are subject to considerable uncertainties, even in the very short-term. Such projections can therefore only be considered as broad indications as to possible future experience, and the uncertainties inherent in the projections must be borne in mind. The Government Actuary reported that, subject to these caveats, under the current price uprating, the balance on the Fund would be expected to continue to increase in future, both in absolute terms and as a multiple of annual expenditure, if the current rates of contribution continue. The projected balance grows by 2010-2011 to some 90 per cent of total expenditure in the year, on the assumption of 1.5 per cent a year real earnings growth. This does not allow for the current policy of increasing basic state pension by at least 2.5 per cent a year. However, other figures in the report show that the effect of this underpinning is not expected to make a material difference, at least in the short term.

Fraud and Error in Benefits paid from the National Insurance Fund

- 8 The benefits paid out of the National Insurance Fund in 2002-2003 included Retirement Pension and Bereavement Benefit (£45,363 million), Incapacity Benefit (£6,786 million) and contribution-based Jobseeker's Allowance (£505 million). The National Audit Office's examination indicated that in total the level of fraud and error in these benefits was significantly less than one per cent of total expenditure. Therefore, I was able to give an unqualified audit opinion in this respect.

The National Insurance Recording System (NIRS2)

- 9 In 1995, Andersen Consulting (now called Accenture) was awarded a contract with the then Contributions Agency of the Department of Social Security to develop and operate the new National Insurance Recording System which is called NIRS2. The system was released into live operation in stages from February 1997 to January 1999. I have reported to Parliament on previous occasions on aspects of the development and operation of the NIRS2 system and the arrears of work that had built up as a result of delays and the phased implementation of the system. The Inland Revenue consider that the system has continued to operate within the expectations of the contractual service level agreements, and they note that the seven system releases since April 2000 have all been introduced successfully and preparation for an eighth is well underway.

Compensation scheme for the late payment of Age-related Rebates

- 10 In my report on the National Insurance Account for 1998-99, I noted that the former Contributions Agency had introduced a special scheme to compensate individuals contracted out of the State Earnings Related Pension Scheme (SERPS), where rebate payments had been made late as a result of NIRS2 implementation difficulties and delays. The Inland Revenue concluded these compensation arrangements in April 2003 following consultation with the pensions industry on how best to publicise the ending of the arrangements and to identify any final cases. Should cases emerge subsequently, individuals can seek redress under other compensation arrangements. The Department for Work and Pensions also ended their special compensation arrangements in April 2003. Figure 2 shows the compensation analysed by year.

Figure 2: Age-related Rebates and benefits compensation costs

| | 1998-1999 £m | 1999-2000 £m | 2000-2001 £m | 2001-2002 £m | 2002-2003 £m | Total £m |
|----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-------------|
| Inland Revenue | 21.83 | 19.49 | 14.04 | 3.43 | 22.33 | 81.12 |
| DWP | – | 2.57 | 1.28 | 0.70 | 0.04 | 4.60 |

Rounding mean that some rows do not add up precisely

Source: Inland Revenue and DWP

Duplicate Age-related Rebate payments and Compensation

- 11 The National Audit Office in 1999-2000 first identified cases of duplicate age-related Rebate payments made by the Inland Revenue to pension providers as a result of duplicate submission and processing of employers' end-of-year returns. In October 2002, the Inland Revenue recovered some £62 million of overpaid rebates in respect of 1,070 schemes from amounts due to pension providers .
- 12 The Inland Revenue introduced a number of additional checks and controls into the systems during 2002-2003 aimed at preventing possible further duplicate payments. They also considered that they required further assurance and initiated with Accenture, supported by the Inland Revenue's Internal Audit Office, a joint review of the payment processes for age-related Rebates. The review is scheduled to be completed by March 2004.
- 13 The National Audit Office examination showed that the level of duplicate rebates had reduced in 2002-2003 as a result of additional checks and controls that had been introduced. Nonetheless there remain some residual and lesser problems, but work is in progress to resolve these by the end of March 2004.
- 14 Because of the time between the rebate overpayments being made by the Inland Revenue and being recovered in 2002, individual pension scheme members may have been adversely affected and have suffered a loss to their pension fund due to a downturn in the investment market in this period. The extent of this will depend on the accounting arrangements and the investment strategy of the individual scheme. The Inland Revenue worked closely with the pensions industry representative bodies and the Government Actuary's Department to determine the most appropriate method of calculating any losses incurred by individuals and compensating them accordingly. The Inland Revenue agreed in October 2003 with all concerned the principles and methodology to be adopted in calculating the losses. As part of the agreed claims process, the Inland Revenue then started sending out claim packs to affected schemes with details of the individuals concerned and the amounts that were recovered. The Inland Revenue are aiming to settle as many claims as possible before 31 March 2004.
- 15 With Treasury approval, the Inland Revenue provided some £15.3 million in their Resource Account for 2002-2003 to cover the cost of the compensation to be paid.

Contribution Deficiency Notices

- 16 Individuals have to pay or be credited with sufficient National Insurance contributions each tax year for it to be classed as a qualifying year for benefit or basic state pension purposes. It was the then Contributions Agency's practice to send a Deficiency Notice to individuals who did not contribute enough, inviting them to consider if their National Insurance Contribution record was correct and how much voluntary Class 3 contributions they would have to pay for the year for it to count as a qualifying year. The former Contributions Agency decided to suspend the Deficiency Notice exercise so as to focus resources on those areas seen as priorities during the early years of the new NIRS2 system. Deficiency Notices were last issued for the year 1995-1996.
- 17 The Paymaster General decided to extend the deadline and run a six year catch up exercise prior to the Inland Revenue announcement on 5 April 2003. The full reasoning was amplified in a written statement to Parliament on 16 May 2003 and the Inland Revenue announced that the deadline for payment of Class 3 contributions would be extended to 5 April 2008. This can be dependent on the date of issue of the Deficiency Notice (prior to March 2004, April 2008 applies, after March 2004, April 2009 applies). They also announced that an exercise would be started later in the year to write to everyone due a deficiency notice for the six years up to 2001-2002. The production of Deficiency Notices is planned to resume, as an annual exercise in late 2004. The Inland Revenue conducted two pilot exercises in July and September to help prepare for the main six-year exercise which began in early November 2003. The first pilot exercises sent out five thousand Deficiency Notices and results showed that around 15 percent of people are likely to respond with further enquiries, although a very small percentage (around 2 percent) made immediate payments of voluntary contributions. Results from the second pilot were broadly in line with the first. Nearly half the enquiries concerned the need to make corrections to the National Insurance contributions record because the individual had been working or receiving benefits during the relevant period. These results are consistent with the experience of the former Contributions Agency before the suspension of Deficiency Notices, and are being used to help ensure support for the main exercise.

Additional costs arising from delayed implementation of NIRS2

- 18 In July 2000, the Inland Revenue endorsed an Integrated Recovery Programme to resolve difficulties following the implementation of NIRS2. This programme had two main objectives:
- to bring the overall amount of work down to an acceptable level; and
 - to clear the arrears that had had most impact on benefit and pensions entitlement.
- 19 In May 2001, the Inland Revenue's Departmental Management Committee approved further funding to introduce a broad range of business process improvements, supported by further enhancements to NIRS2, to ensure that the work could be managed on a sustainable basis going forward. Additional costs of £67.9 million incurred by the Inland Revenue and the Department for Work and Pensions are set out below.

Figure 3: Additional costs arising out of the delayed implementation of NIRS2

| Element | 1999-2000 £m | 2000-2001 £m | 2001-2002 £m | 2002-2003 £m |
|--|-----------------|-----------------|-----------------|-----------------|
| NICO additional pay costs | – | 7.1 | 4.0 | – |
| Business Services additional costs | 1.3 | 9.6 | 13.1 | 2.6 |
| DWP additional pay costs | – | 13.1 | 13.6 | 3.6 |
| Total costs of Integrated Recovery Programme | 1.3 | 29.7 | 30.7 | 6.2 |

Rounding mean that this Figure does not add up precisely to the text

Source: Inland Revenue and DWP

- 20 The Inland Revenue considered that the additional funding had two principal benefits. Firstly, it enabled them and the Department for Work and Pensions to bring down the arrears of work that had accrued following the implementation of NIRS2 to an acceptable level and to complete their respective business recoveries. This was achieved against a background of increasing amounts of work being received by the NI Contributions Office (NICO). The Inland Revenue considered that, without this additional funding, there would have been a risk that further backlogs could have built up on top of the existing arrears. Secondly, it provided a basis for longer term process and business improvements. The Inland Revenue considered that without this action to secure longer term improvements there would have been a significant risk that they would have failed to cope with the amount of new work coming into the NICO and this would have presented an ongoing, recurring problem, unrelated to the introduction of NIRS2. As well as enabling the Inland Revenue to put in place more durable processes to deal with the increase in work they were experiencing, this funding enabled NICO to introduce more modern business processes and clear work automatically that would otherwise have needed to be cleared clerically.
- 21 The Inland Revenue decided to introduce a Steering Group to oversee the recovery and stabilisation programme. This was a joint team, chaired by NICO's Director supported by senior representatives from other related areas of the Department, including its Internal Audit Office, and DWP. The Steering Group met monthly, directed the programme of work, managed the funding allocated to it and reported progress regularly to the Departmental Management Committee.

Non-matched Contributions Suspense Files

- 22 In some instances the Inland Revenue receive End of Year information from employers that includes small numbers of NI contributions information that they cannot match to the relevant contributor records. This is the result of inaccurate information received from employers on End of Year submissions. These non matching items generally concern short-term or low-paid workers, where there is little incentive for either employee or employer to provide the details, particularly where turnover is high or where the employee has come from abroad and has never applied for a NI number. The Inland Revenue take all reasonable actions to trace and update contributor records. If, despite the application of NIRS2 matching routines and all reasonable effort by the Inland Revenue, the items still cannot be matched they are kept permanently on non-matched Suspense Files. These are maintained to ensure that when an individual queries the completeness of their contribution record, the Inland Revenue can retrieve unmatched items from Suspense Files and credit them to the individual's contribution record.
- 23 The Suspense Files have existed since the introduction of the first computerised National Insurance recording system. There are two non-matched Suspense Files, together containing over 100 million items. The NIRS1 suspense file relates to items up to the end of the 1995-1996 tax year and the NIRS2 file contains items relating to the 1996-1997 tax year onwards. Historical analysis of these files by the Inland Revenue identified little likelihood of any effect on the payment of short-term benefits. However, a joint Department for Work and Pensions and Inland Revenue report in October 2002 identified that the main impact of non-matching was in respect of State Earnings Related Pensions (SERPS). The Departments estimated that, possibly around 3 million non-matching items could have an impact on benefit payment, if one assumed that it would be possible in practice to link all non-matching items to the correct account. On the basis of this assumption, in most cases the SERPS underpayment in respect of these items for individuals was likely to be less than £1 a week and in 70 percent of cases it was likely to be less than £2 a week. A small percentage might be as much as £250 a year. But the feasibility of making a match would depend on whether the information from the employer's End of Year Return is adequate.
- 24 Subsequently, more targeted work explored the practicability of tracing all non-matched items by clerically or electronically checking to employer's returns a sample of non-matching items from 1995-1996. This exercise showed that in the vast majority of cases this extra effort generated no impact at all on benefits, and confirmed the Department's view that further clerical checking was not cost justified.
- 25 The number of non-matching items has reduced over the years as the Inland Revenue have introduced a number of initiatives including
- Improvements to the employers' end of year return which allowed more personal details to be captured;
 - Enhancements to the systems that trace and match contributions;

- Provision of a payroll cleansing service to enable employers to cleanse their end of year returns in respect of NI numbers before submission to the Inland Revenue; and
 - Continual review of the guidance for employers to enable them to provide the right information more easily and quickly.
- 26 The numbers of non-matched suspense file items placed on the Suspense File fell from 4.2 million (8 per cent of total returns) in 1997-98, to 2.2 million (4 per cent) in 2002-03. In addition, in December 2002 the Inland Revenue produced an action plan to determine how best to reduce further the number of non-matched items, including:
- Electronic submission of information by employers to enhance tracing and matching;
 - Better checks on the quality of employees' personal details submitted on employers' end of year returns; and
 - Research into those employers who have most commonly had errors on their end of year returns leading to non-matching items to determine what can be done to assist them to reduce the numbers occurring in future.

Conclusions

- 27 This report records the final costs and resolution of various consequences of the National Insurance system problems experienced in the late 1990s, some of which I have reported on in detail in earlier years. It also records some continuing challenges for the Inland Revenue in the maintenance of individuals' National Insurance contribution records, upon which a large amount of the public's benefit entitlement depends. The quality of contributions information received from employers remains a particular and enduring challenge that various measures are addressing.

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