

SOCIAL SECURITY ADMINISTRATION ACT 1992

Account of the National Insurance Fund for the year ended 31 March 1997, together with the Report of the Comptroller and Auditor General thereon. (In continuation of House of Commons Paper No. 221 of 1996-97.)

Presented pursuant to Act 1992, c.5, s.161(2)

National Insurance Fund Account 1996-97

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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 met 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 places the National Insurance Fund under the control and management of the Secretary of State for Social Security. Section 161(2) of the Act requires the department 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. Contributions are collected by the Inland Revenue and the Contributions Agency. The Chief Executive of the Contributions Agency, as the Agency Accounting Officer, has overall responsibility for the recording of contributions against individuals' contribution records (which determine entitlement to social security benefits payable from the Fund) and for the payment of rebates and incentives for personal pensions.

Social Security Benefits payable from the Fund include those relating to retirement, sickness and unemployment. Entitlement to benefit is determined by the claimant satisfying qualifying conditions. The Chief Executive of the Benefits Agency, as Agency Accounting Officer, has overall responsibility for the award and payment of most benefits payable from the Fund. From April 1996 the Department for Trade and Industry (DTI) have been responsible for making redundancy awards. The Department for Education and Employment (DfEE) act as agents for DTI in making payment of redundancy awards and collecting receipts. The DfEE are also responsible for the award and payment of unemployment benefit and contribution based jobseeker's allowance.

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 working balance of one-sixth (16.7 per cent) of annual benefit expenditure.

To ensure that the balance on the Fund is maintained, 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 benefits uprating and contributions re-rating 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 Government Actuary's latest quinquennial review, entitled "National Insurance Fund Long Term Financial Estimates", was published on 31 January 1995.

The Social Security Act 1993 introduced a new power to enable payments to be made to the Fund out of monies provided by Parliament. Under this Act a grant of £1,900 million was made to the National Insurance Fund in 1996-97. Due to a higher than expected end of year Fund balance this was £248 million less than originally anticipated for the period. At 31 March 1997 the balance in the Fund was £7,737 million (18.54 per cent of benefit expenditure), a decrease of £98 million compared with the position at 31 March 1996. A further £1.5 million was received as reimbursement for deductions made by employers in respect of the national insurance contribution holiday provided by Section 38(5) of the Jobseekers Act 1995. Provision has been made in 1997-98 for a grant from the Consolidated Fund of £1,400 million, with an additional £2.5 million as reimbursement for the national insurance holiday.

Agency Annual Reports

Details of the performance of the Contributions Agency and that of the Benefits Agency and Employment Service are contained in their Annual Reports and Accounts.

Audit

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 on it, before Parliament.

Responsibilities of the Accounting Officer

The Permanent Secretary of the Department of Social Security is the Accounting Officer for the National Insurance Fund. Her relevant responsibilities as Accounting Officer, including her responsibility for the propriety and regularity of the public finances for which she is answerable, and for keeping of proper records, are set out in the Accounting Officers' memorandum issued by the Treasury and published in "Government Accounting" (HMSO). Many of the activities relating to the transactions of the Fund are carried out by other departments and agencies on her behalf.

Dame A Bowtell
Accounting Officer
18 December 1997

Department of Social Security

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

I certify that I have audited the financial statements on pages 4 to 14 which have been prepared in the form and manner directed by the Treasury and in accordance with the accounting policies set out in Note 1 on page 5.

Respective responsibilities of the Accounting Officer and auditor

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

Basis of opinion

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

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

Qualified opinion arising from fraudulent benefit claims and fraudulent encashment of instruments of payment.

In my opinion:

- the account properly presents the receipts and payments of the National Insurance Fund for the year ended 31 March 1997 and the balance held at that date and has been properly prepared in accordance with Section 161(2) of the Social Security Administration Act 1992; and
- except for expenditure arising from claimant fraud and fraudulent encashment of instruments of payment (paragraph 15 of my report) 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.

John Bourn
Comptroller and Auditor General

15 January 1998

National Audit Office
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London SW1W 9SP

Receipts and Payments Account for the year ended 31 March 1997

	Notes	1996-97 £000	1995-96 £000
Receipts			
National Insurance Contributions	2	41,681,860	39,849,882
Grant from Class XII, Vote 2	3	1,901,500	3,575,000
Compensation for Statutory Sick Pay and Statutory Maternity Pay recoveries	4	524,000	458,000
Income from investments	5	473,876	444,434
State Scheme Premiums	6	193,067	158,488
Other receipts	7	82,197	73,341
Redundancy receipts	8	25,780	23,571
		<u>44,882,280</u>	<u>44,582,716</u>
<i>Less</i>			
Payments			
Benefit payments	9	41,720,267	40,141,178
Personal pensions rebates and incentives	10	1,997,609	1,960,996
Administration costs	11	1,038,415	1,179,841
Redundancy payments	8	132,003	153,297
Transfers to Northern Ireland	12	75,000	125,000
Other payments	13	17,392	14,174
		<u>44,980,686</u>	<u>43,574,486</u>
Excess of payments over receipts		98,406	-
Excess of receipts over payments		-	1,008,230

Statement of Balances

Opening balance		7,835,829	6,827,599
<i>Less:</i> Excess of payments over receipts		98,406	-
<i>Add:</i> Excess of receipts over payments		-	1,008,230
Closing balance	14	<u>7,737,423</u>	<u>7,835,829</u>

The notes on pages 5 to 14 form part of these accounts

Dame A Bowtell
Accounting Officer
18 December 1997

Department of Social Security

Notes to the Account

Accounting policies 1 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 appendix 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 Contributions Agency and 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 1996-97.

Payment of Social Security Benefits

The Department of Social Security administers over 30 different social security benefits, financed either from the National Insurance Fund or from the Consolidated Fund through Class XII, Vote 1. 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 were paid by girocheque, payable order or credit transfer but mainly through order books encashable at a post office. 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. Improved apportionment of benefit expenditure has been achieved in this account with the introduction of the Programme Accounting Computer System. Where benefit encashments feature combined payments, these are allocated to the constituent benefits using this issues data.

Use of estimated figures

Certain figures 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, payments in respect of administrative costs and the contribution holiday scheme under the Jobseekers Act 1995 are all reported on this basis.

Net accounting

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

National Insurance Contributions	2a	1996-97 £000	1995-96 £000
Contributions			
Class 1 (employed earner)		39,813,410	38,060,482
Class 1A		466,450	486,400
Class 2 (self-employed flat rate)		599,000	590,000
Class 3 (voluntary contributions)		55,000	38,000
Class 4 (self-employed earnings related)		748,000	675,000
		<u>41,681,860</u>	<u>39,849,882</u>

The amounts shown are net of refunds of £62,442,000 (1995-96: £62,000,000)

Employers can make payment of Class 1A contributions either via Inland Revenue with their Class 1 contributions or direct to the Contributions Agency. Employers are not required to provide the Inland Revenue with details of the split between Class 1 and Class 1A contributions at the time of payment. The total amount of Class 1A contributions for the year is, therefore, estimated by the Government Actuary based on employers End of Year Returns. The Class 1A figure of £466.45 million is after an apportionment of £45.05 million (1995-96 £45 million) to the National Health Service and includes a known amount, before apportionment, of £323 million (1995-96 £306 million) collected by the Agency.

Contributions are shown net of amounts allocated to the National Health Service, amounts recovered by employers in respect of statutory sick payments and statutory maternity payments to their employees, and of amounts recovered by employers under Section 27 of the Jobseekers Act. These amounts, as shown in the table below, are estimated by the Government Actuary.

	1996-97 £000	1995-96 £000
NHS allocation	5,238,000	4,983,050
SSP recoveries (i)	97,600	36,300
SMP recoveries (ii)	340,800	524,300
Jobseekers Act Recoveries (iii)	500	—
	<u>5,676,900</u>	<u>5,543,650</u>

- i. Increase is due to the re-evaluation, by the Government Actuary, of the statutory sick pay liability incurred by employers in 1993-94 but not recovered from their contributions until 1994-95. The statutory sick pay figure includes an upward adjustment of £77 million in respect of 1994-95.
- ii. Reduction is due to a re-statement, by the Government Actuary, of estimated recoveries by employers over preceding years. The statutory maternity pay figure includes a downward adjustment of £53 million.
- iii. Under the Jobseekers Act 1995 employers who employ persons who have been unemployed for two years or more may, from April 1996, recover the secondary contributions payable in respect of these employees for the first twelve months of their employment.

Relocation allowances 2b The Department of Social Security looks continually for ways to bring the tax and national insurance systems closer together. It has been a long established practice whereby relocation allowances paid to employees permanently transferred at the employers' expense were excluded from earnings for national insurance purposes. In 1997 the Department obtained legal advice on this issue which confirmed that national insurance contributions should have been payable on some relocation allowances from 6 April 1975. On 30 July 1997 the Department announced their intention, with Treasury approval, to bring the national insurance contributions treatment of relocation allowances closer into line with tax rules, such that certain relocation allowances would be subject to national insurance from 6 April 1998.

Work is continuing to clarify and quantify the different relocation allowances paid to employees and the resultant loss to the National Insurance Fund will be reported when agreed figures are available.

Grant 3 These amounts, paid from Class XII, Vote 2, were based on the Government Actuary's estimate made in November 1996, of the grant needed to maintain a reasonable working balance on the Fund at 31 March 1997, and include an estimate of £1.5 million to meet the cost of the employers contribution holiday scheme.

Compensation for statutory sick pay and statutory maternity pay recoveries 4 The amount, paid from Class XII, Vote 2, 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. These amounts, paid by way of compensation, differ from the estimates of the amounts recovered in Note 2a 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 2a, are based on later estimates.

Income from investments 5		1996-97	1995-96
		£000	£000
	Interest received	460,778	438,396
	Profit on realisation	34,051	14,892
	Less losses on realisation	(20,953)	(8,854)
		<u>473,876</u>	<u>444,434</u>

During the year the Fund increased from £6.4 billion at 31 March 1996 to £6.7 billion at 31 March 1997. A substantial proportion of the Fund continued to be held in short-term securities (at 31 March 1997 the proportion was approximately 30 per cent). Although interest rates remained stable throughout the year at an average of 5.90 per cent, interest receipts rose due to the increased size of the Fund.

Sales of longer term securities (those with a maturity date of one year or more) totalled around £1,480 million (nominal value) of which 50 per cent was to meet cash withdrawals and maintain adequate liquidity levels; the remainder was in respect of switches of securities to improve yield and the portfolio spread.

State Scheme Premiums 6 State Scheme Premiums are payable in respect of employed persons who cease to be covered, in certain specified 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 amounts shown are net of refunds of £13,640,000 (1995-96 £12,757,000).

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 Agency is seeking recovery of these premiums from the Maxwell pension schemes. By 31 March 1997, 26,749 individuals had been brought back into SERPS with a liability of some £122 million of which £1 million had been recovered by that date. The Agency is pursuing the balance of £121 million from the schemes but it is unlikely that the full amount will be recovered.

Other receipts	7	1996-97 £000	1995-96 £000
Recoveries of damages in tort		82,191	73,340
Other receipts		<u>6</u>	<u>1</u>
		82,197	73,341

Redundancy payments 8 and receipts 8 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 for Trade and Industry. The receipts represent amounts recovered from employers. The total debt outstanding at 31 March 1997 was £712 million.

Benefit payments	9	1996-97 £000	1995-96 £000
Benefits			
Retirement pension		31,994,561	29,962,569
Incapacity benefit		7,661,624	7,905,940
Unemployment benefit		587,298	1,101,827
Jobseeker's allowance (contributory)		332,708	-
Widows' benefit		981,241	1,016,385
Christmas bonus for pensioners		128,614	124,179
Maternity allowance		32,725	28,557
Guardians' allowance and child special allowance		<u>1,496</u>	<u>1,721</u>
		41,720,267	40,141,178

All the benefits consist partly or wholly of apportioned expenditure.

Retirement pension and widow's benefit include payment to Northern Ireland pensioners living abroad. For administrative convenience these payments are made by the Department of Social Security 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 is £11 million. Note 12 explains the relationship between the National Insurance Fund and the Northern Ireland National Insurance Fund.

Jobseeker's allowance was introduced in October 1996 to replace unemployment benefit and income support for the unemployed. It is a joint initiative between the Benefits Agency and the Department for Education and Employment, with the Secretaries of State having joint accountability for policy. The process involves approximately 40,000 staff across both Departments dealing with over one million people each week. The aim of the benefit is to improve the operation of the labour market by helping people in their search for work, whilst ensuring that they understand and fulfil the conditions for receiving benefit. It also aims to improve the service to unemployed people and to secure better value for money for the tax payer.

Personal Pensions	10	1996-97	1995-96
		£000	£000
Rebates		1,993,416	1,950,256
Incentives		4,193	10,740
		<u>1,997,609</u>	<u>1,960,996</u>

The Social Security Act 1986 entitles employed earners with a personal pension plan to a "minimum contribution" to their plan from the National Insurance Fund, equal to the sum of the rebate granted to members of occupational pension schemes contracted out of the State Earnings Related Pension Scheme (SERPS) and a further two per cent of their earnings between the lower earnings level and the upper earnings level (the incentive payment). Incentive payments were only payable for the tax years 1988-89 to 1992-93 for members of Contracted Out Salary Related (COSR) and Contracted Out Money Purchase (COMP) Schemes, and for the tax years 1987-88 to 1992-93 for members of Personal Pension Schemes. Any incentive payments currently being made, and any future payments, are in respect of late claims. The sum above comprises the amounts forwarded to personal pension providers.

Administrative costs	11	(1) Payments made in respect of Administration	1996-97	1995-96
			£000	£000
		Department of Social Security	924,815	1,080,750
		For administering the National Insurance Scheme. See analysis at (2).		
		Inland Revenue	97,435	84,205
		For the collection of National Insurance Contributions.		
		Other Departments		
		Includes Audit fee of £0.8m	16,165	14,886
			<u>1,038,415</u>	<u>1,179,841</u>

Administration payments made from the Fund each year consist of two elements:

i) the initial estimate of costs for the year in question, and ii) adjustments to account for any difference between the initial and final estimates for previous years (see Note 11 (2)). The reduction in payments to the Department of Social Security is

due to a downward adjustment of £86 million to compensate for overestimates of administrative costs in previous years (see Note 11 (2) below).

As reported in the 1995-96 Account, Inland Revenue are now paid a fixed charge and there are no further adjustments to charges arising in previous years.

In advance of the introduction of the jobseeker's allowance the Treasury directed that any costs of administering unemployment benefit notified after 31 March 1996 shall not be charged to the National Insurance Fund, but be paid from Class IX Vote 3 (Department for Education and Employment (DfEE): Employment Service).

Changes in the DfEE's approach to apportioning expenditure on measures to help the long term unemployed (see note (i) in section 11 (3)) and the continuing fall in the numbers claiming unemployment benefit, resulted in the Fund over reimbursing the Department of Social Security by some £231 million between 1992-93 and 1995-96. As recovery would have resulted in the refunding of a corresponding amount of Treasury grant, no adjustments were made.

(2) Analysis of payments from the Fund in 1996-97 in respect of Department of Social Security administrative costs

DSS costs are recovered from the Fund over a three year cycle. In year one payment of an estimate of the cost for the year is made from the Fund to DSS. In year two the final estimate for year one is calculated. In year three adjustments are made to compensate for the difference between the initial and final estimates.

	Estimate for 1996-97 £000	Adjustments for previous years £000	Amount paid in 1996-97 £000
Department of Social Security			
Headquarters, Benefits Agency, Contributions Agency, Information Technology Services Agency Post Office/Girobank	791,126 219,469 <u>1,010,595</u>	(74,918) (10,862) <u>(85,780)</u>	716,208 208,607 <u>924,815</u>

A comparison of initial and final estimates for 1996-97 will be provided in the accounts for 1997-98.

(3) Comparison of initial and final estimates of administrative costs for 1995-96

	Initial Estimate £000	Final Estimate £000	Difference £000	Final Estimate for 1994-95 £000
DSS (HQ,BA,CA,ITSA)	835,278	769,134	(66,144)	748,102
DfEE	174,549	105,667	(68,882)	150,087
Post Office/Girobank charges	222,370	208,096	(14,274)	211,711
	<u>1,232,197</u>	<u>1,082,897</u>	<u>(149,300)</u>	<u>1,109,900</u>
Inland Revenue	92,354	96,268	3,914	89,225

Explanation of variations

(i) between initial and final estimates for 1995-96

The variation in the DSS costs is due to the percentage of Benefits Agency's costs attributable to the National Insurance Fund being lower than originally estimated.

Until March 1996 DSS reimbursed DfEE (Employment Services) for the cost of administering unemployment benefit and income support, apportioning costs between the two based on benefit expenditure. The initial estimate was based on a split of 30 per cent unemployment benefit and 70 per cent income support, whilst the final estimate showed that due to the continuing fall in numbers claiming unemployment benefit, the ratio should have been 17 per cent unemployment benefit and 83 per cent income support.

(ii) between the final estimates for 1994-95 and 1995-96

The reduction in the DfEE charge is mainly due to the overall reduction in the Employment Service's running costs.

**Transfers to
Northern Ireland**

- 12 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. The amount shown represents the amount estimated to be due in 1996-97 after an adjustment of £4,883,000 in favour of the Northern Ireland National Insurance Fund in respect of 1995-96.

Other Payments

	1996-97	1995-96
	£000	£000
Payment to Isle of Man	16,120	13,692
Other payments	1,272	482
	<u>17,392</u>	<u>14,174</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.

Closing Balance	14		31 March 1997	31 March 1996
			£000	£000
		Securities, etc held by National Debt Commissioners		
		At cost	6,732,691	6,413,315
		1) Market value	6,886,055	6,440,789
		2) Nominal value	6,774,635	6,319,583
		Held by Paymaster (including uncleared cheques)	(2,737)	(22,313)
		Other balances*	<u>1,007,469</u>	<u>1,444,827</u>
			<u>7,737,423</u>	<u>7,835,829</u>

* Mainly sums due from or owing to Government Departments, Post Office Counters Limited and overseas administrations out of the operation of the national insurance scheme.

The bank overdraft shows the position as recorded in the National Insurance Fund's books of account at 31 March 1997. However, because a number of payable orders had not been presented for payment, the actual balance held by the Paymaster at that date was in credit.

**Securities held by the
National Debt
Commissioners at
31 March 1997**

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 Government Guaranteed and Local Authority Securities.

	Nominal Value	Cost Price	Market Value at 31 March 1997
	£000	£000	£000
Government and Government Guaranteed Stocks:			
Up to one year	1,873,010	1,869,070	1,878,321
One to five years	1,547,214	1,526,986	1,579,631
Five to ten years	1,580,804	1,561,049	1,612,909
Over ten years	<u>1,639,962</u>	<u>1,631,888</u>	<u>1,671,271</u>
	<u>6,640,990</u>	<u>6,588,993</u>	<u>6,742,132</u>
Loans to Local Authorities:			
Temporary loans	2,100	2,100	2,125
Up to one year	130,540	130,540	130,722
One to five years	<u>1,000</u>	<u>1,000</u>	<u>1,000</u>
	<u>133,640</u>	<u>133,640</u>	<u>133,847</u>
Sundry Securities	<u>5</u>	<u>5</u>	<u>5</u>
Total Securities	6,774,635	6,722,638	6,875,984
Cash at bank	-	10,053	10,071
	<u>6,774,635</u>	<u>6,732,691</u>	<u>6,886,055</u>

Losses		£000	No of Cases
	16		
	1. Contributions		
	National Insurance Fund share		
	a) Inland Revenue: Remissions	43,631	633,249
	b) Inland Revenue: Debt transferred	93,791	18,238
	c) Contributions Agency	571,380	64,717
	Total loss	708,802	716,204
	2. Benefits	23,163	168,996
	3. Redundancy	161,146	19,706
	4. Post Office and other losses	131	
	5. Administration	532	

1a) Inland Revenue advise Contributions Agency of remissions they have granted, in respect of unpaid contributions where pursuit is unlikely to be successful.

1b) Inland Revenue transfer national insurance debts for subsequent recovery and/or write-off by the Contributions Agency.

1c) Contributions Agency waives arrears of national insurance contributions when pursuit of the debt is regarded as neither practical nor cost effective. The figure at 1c includes estimated arrears of £530,000,000 in respect of the non-payment, by Civil Service departments, of national insurance contributions on various allowances paid to crown employees serving overseas. The Department of Social Security's original view was that these allowances were not subject to national insurance contributions, and national insurance contributions had not been collected in the past. However, the Department received legal advice which indicated that, according to legislation, national insurance contributions were in fact due. In response, the Government laid down regulations to put the long established practice on a legislative footing from 6 April 1997. The Contributions Agency have decided not to pursue arrears of contributions from 6 April 1975 to 5 April 1997, since to do so would entail considerable administrative costs, not only for the Department of Social Security but also for other departments with large numbers of staff serving overseas, and would not result in an overall increase in Government revenue.

2 The figure for benefit losses includes an amount of £5,436,781 in respect of unemployment benefit, but this amount is subject to uncertainty owing to incomplete reporting of these losses by Unemployment Benefit Offices to Department for Education and Employment. Jobseeker's allowances losses are reported in the Class XII Vote 1 Appropriation Account.

3 This figure represents amounts written off during the year in respect of redundancy payments to employees, deemed irrecoverable from their employers mainly due to insolvency.

Special Payments	17	£000	No of Cases
	1. Claimants wrongly advised of their entitlement	263	138
	2. Others	<u>146</u>	<u>141</u>
		<u>409</u>	<u>279</u>

Benefit Security Review

18 The Benefits Agency (BA) aims to pay the right money to the right person at the right time, every time. It seeks to provide safeguards against fraud and abuse and ensure that its systems detect and recover overpayments quickly and accurately. The BA's Security Strategy (1995-2000) has the aim of addressing security and control in all relevant areas to achieve a demonstrable and sustained reduction in the level of fraud and error.

Quantifying the level of fraud and incorrectness and assessing the areas of risk are essential to the effective control and protection of public expenditure. Therefore, a programme of Benefit Reviews of all major benefits has been undertaken. The main National Insurance Fund benefits already reviewed and reported on are retirement pension and unemployment benefit. Reviews are planned for incapacity benefit and jobseeker's allowances.

Instrument of Payment (IOP) fraud includes theft, counterfeiting and false reports of loss. It can involve either individuals or organised gangs. It is estimated that fraudulent IOP losses during 1996-97 were in the order of £84 million for order books and £17.8 million for girocheques. Order book losses have reduced from £133 million in 1995-96, reflecting the success of measures put in place to prevent and deter fraud. Girocheque losses remain at around the same level as last year (1995-96 £17 million). These figures relate to all benefits as figures for National Insurance Fund benefits cannot be separately identified.

The drive to improve control was complemented by other initiatives during 1996-97. This included the further extension of new claim activity to verify customers circumstances.

Special programmes of work to remind people of their obligations to report changes of circumstances and larger programme of claims reviews and of data matching were also undertaken. Overall it is estimated that their programmes of work achieved savings across all activities and benefits of £1.5 billion in 1996-97. The amount relating to National Insurance Fund benefits cannot be identified separately.

Department of Social Security Accounts

Direction given by Her Majesty's Treasury

**Direction given by
Her Majesty's Treasury**

The Treasury in accordance with section 161(2) of the Social Security Administration Act 1992 hereby gives the following Direction.

- 1 The statement of account which it is the duty of the Department of Social Security to prepare in respect of the transactions of the National Insurance Fund for the financial year ended 31 March 1995 and in respect of any subsequent financial year, shall comprise:
 - (a) a foreword;
 - (b) an account of receipts and payments;
 - (c) a statement of balances;

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

- 2 The Accounting Officer shall observe all relevant accounting and disclosure requirements in 'Government Accounting' and any other guidance issued by HM Treasury as amended or augmented from time to time.
- 3 The format of the statement of account and the disclosure requirements are in the attached schedule.
- 4 The foreword and account shall be signed by the Accounting Officer.
- 5 The Accounts Direction shall be reproduced as an annex to the accounts.

Jamie Mortimer
Treasury Officer of Accounts
7 December 1995

Schedule

FORMAT OF ACCOUNT AND DISCLOSURE REQUIREMENTS

- 1 The foreword shall state that the account has been prepared in accordance with a direction issued by Treasury in pursuance of Section 161(2) of the Social Security Administration Act 1992. The foreword will also include details of the following:
 - (a) statutory background;
 - (b) operational responsibilities;
 - (c) financial performance;
 - (d) audit arrangements;
 - (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) analyses 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;
 - (d) details of any irregular, uncertain or special payments.

Annex

Receipts and Payments Account for the year ended 31 March.....

	Notes	19[]-[] £000	19[]-[] £000
Receipts			
National Insurance Contributions			
Grant from Class XIII, Vote 2			
Compensation for Statutory Sick Pay and Statutory Maternity Pay recoveries			
Income from Investments			
State Scheme Premiums			
Other receipts			
Redundancy receipts			
<i>Less</i>			
Payments			
Benefit payments			
Personal pensions			
Administrative Costs			
Redundancy payments			
Transfers to Northern Ireland			
Other payments			
Excess of receipts over payments			
[Excess of payments over receipts]			

Statement of Balances

	£000	£000
Opening balance		
<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.

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

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Executive Summary

Introduction

1. The National Insurance Fund was established in 1948 to pay Social Security benefits to individuals who had paid qualifying national insurance contributions. In 1996-97 the National Insurance Fund received £41,682 million in contributions from employers, employed earners and the self-employed. The main benefits paid out of the Fund in 1996-97 were;

	£ million
• retirement pension	31,995
• incapacity benefit	7,662
• widows benefit	982
• unemployment benefit	587
• jobseeker's allowance	333

2. Section 161 of the Social Security Administration Act 1992 requires me to examine and certify the National Insurance Fund Account and this report records the results of my examination of the 1996-97 account.

Main Findings and Conclusions

3. One of the Benefits Agency's main priorities is to tackle fraud and abuse. I support the action being taken by the Benefits Agency to combat benefit fraud and my report records the measures they are taking to reduce fraud in benefits paid from the Fund. Notwithstanding these efforts Benefit Agency reviews have estimated total losses of £102 million arising from the fraudulent encashment of girocheques and order books which if proportioned to benefits paid from the National Insurance Fund would produce a potential loss to the Fund of up to £56 million. The Benefits Agency believe, however, that the greater loss would occur on income support and income based jobseeker's allowance due to the greater risk of instruments of payment fraud on those benefits compared with National Insurance Fund benefits. In addition a joint review by the Employment Service and Benefits Agency estimated that the underlying level of confirmed or strongly suspected unemployment benefit fraud was £86 million. I therefore have no alternative but to qualify my opinion on the account.

4. I also report on levels of error in awards of both unemployment benefit of some £38.3 million and jobseeker's allowance, £34.1 million. Jobseeker's allowance replaced unemployment benefit in October 1996 and is jointly administered by the Employment Service and the Benefits Agency with responsibility for payment resting with the Benefits Agency. I have reported on this allowance in my report on the Class XII, Vote 1 Appropriation Account for 1996-97 (HC251 – xii) where I record the actions proposed by the Benefits Agency to make improvements in future.

5. My report records the measures taken by the Contributions Agency and Inland Revenue to maximise the yield to the National Insurance Fund by identifying underpayments of national insurance contributions by employers. In 1996-97 Agency inspectors identified some £153 million of underpayments during visits to employer's premises but were unable to determine how successful they had been in recovering underpayments from employers.

6. I welcome the introduction of a yield tracking system, in October 1997, which will provide information on identified contribution debt for previous years. However, there remains no reliable information on which to assess how successful the Agency have been in recovering current year underpayments which, in 1996-97, was some £66 million. I have recommended that the Agency investigate the extent to which employers are paying identified underpayments for the current year, without increasing the burden on business.

7. During 1996-97 the Contributions Agency and Inland Revenue issued new guidance to contractors in the construction industry to clarify the criteria for determining whether their workers are self employed. My report identifies that up to 200,000 individuals have been transferred to employed status which could lead to an increase in receipts to the Fund of around £300 million. In response to concerns from within the construction industry the Agency and Inland Revenue have increased the number of visits to construction industry contractors to some 12,000 during 1997-98.

8. The Agency have taken steps to improve their control over Class 2 debt due from the self employed. These included the introduction, in April 1995, of a computer system which provides an automated dialling facility to contact debtors direct by telephone.

9. However, the Agency continued to experience difficulties in managing this debt which has reduced the yield to the National Insurance Fund. The value of debt outstanding has increased from £217 million to £314 million during 1996-97 of which some £138 million is outstanding from 332,000 contributors with whom the Agency have been unable to make contact. My report records the Agency's proposals to address this issue in 1997-98 including issuing a single written request to each debtor covering all individual liabilities and attempting to make contact with a sample of debtors either to obtain payment or ascertain their current circumstances.

. . . continued

- Introduction**
- 1 Section 161 of the Social Security Administration Act 1992 requires me to examine and certify the National Insurance Fund account. This report brings to Parliament's attention significant matters arising from my examination of the account for 1996-97.
- 2 The first part of the report sets out the results of my examination of benefit expenditure focusing on benefit fraud (paragraphs 3 to 15), unemployment benefit errors (paragraphs 16 to 27), and on jobseeker's allowance errors (paragraphs 28 and 29). The second part examines compliance with national insurance contribution legislation in 1996-97 (paragraphs 30 to 83) and contributions debt management (paragraphs 84 to 101).
- Benefit fraud**
- 3 Tackling fraud and abuse in the social security system continues to be one of the Benefits Agency's top priorities, helping to ensure that the right money is paid to the right person at the right time every time. Note 18 to the account outlines the measures the Agency took to combat fraud in 1996-97, the results of that work and their proposals for the future. The results of my examination of these initiatives are included in my report on the Class XII, Vote 1 appropriation account for 1996-97 (HC 251-XII, 1997-98). My report on that account refers to matters relating to benefits charged to the National Insurance Fund.
- Retirement Pension**
- 4 Note 9 to the account shows that almost £32 billion was charged to the National Insurance Fund in respect of retirement pensions in 1996-97. Retirement pension is the largest single social security benefit and is payable to over 10 million claimants. The basic rates from 8 April 1996 were £61.15 a week for a single person and £97.75 for a married couple.
- 5 In my report on the National Insurance Fund Account for 1995-96 (HC 211, 1996-97) I reported that in 1996 the Benefits Agency had undertaken a review of a sample of retirement pensions awards focusing on the fraud risks of impersonation and the suppression of information about a claimant's death. This review found no evidence of these types of fraud in the sample of cases examined. I also reported that reviews of income support and housing benefit in 1994 and 1995 had respectively found no evidence of fraud in the retirement pension element of the total benefits in payment. As a result of these reviews the Benefits Agency concluded that there was a low risk of fraud in retirement pensions.
- 6 During 1996 the Benefits Agency undertook a second review of income support to estimate the underlying level of fraud in the benefit. The sample of 4,350 income support claimants included 1,200 (27.5 per cent) who were also receiving a retirement pension. Once again the review found no evidence of fraud on the retirement pension element of the total benefit in payment.
- 7 The Benefits Agency are not, however, complacent about the security of the retirement pension system. The Agency continue to have in place a Pensions Security Action Plan which is reviewed and updated every three months and involves close liaison between the Agency's security branch and the pensions benefit support branch. Reviews reconsider fraud risk ratings and monitor the implementation of preventative controls. I support the Agency's efforts to review periodically the risk of fraud in retirement pensions.

Unemployment benefit and jobseeker's allowance

- 8 Unemployment benefit was replaced from 7 October 1996 by the new jobseeker's allowance. Note 9 to the account shows that, in total, some £920 million was charged to the National Insurance Fund in respect of unemployment benefit and jobseeker's allowance in 1996-97.
- 9 In 1994 a joint Employment Service and Benefits Agency review of entitlement to unemployment benefit estimated that confirmed or strongly suspected fraud in the benefit amounted to some £86 million. In the absence of further reviews there is no evidence to suggest that the underlying level of fraud in unemployment benefit or the new jobseeker's allowance has changed materially since the original review.

Benefit fraud investigation service

- 10 In April 1996 the Benefits Agency and Employment Service fraud investigation staff combined to form the Benefit Fraud Investigation Service. This new service has over 5,000 specialist fraud investigators deployed in Benefits Agency Offices and Job Centres throughout the country.
- 11 The Benefit Fraud Investigation Service do not routinely collect information in a form to provide a breakdown of its achievements by benefit savings and prosecutions for individual National Insurance Fund benefits. However, information is available for a special exercise, the Investigative Action on Collusive Employers Project, which commenced in April 1996. This project's main aims are to investigate and, where appropriate, prosecute fraudulent collusive employers, stop fraudulent claims and act as a deterrent against fraud. The project also aims to identify those employers who encourage their staff to claim benefit fraudulently. The Service also liaises with other agencies and departments to ensure that other crimes are notified to the proper authorities. The Benefits Agency reported the following achievements from the project in 1996-97:
- 202 collusive employer cases authorised by solicitors for prosecution;
 - weekly benefit savings totalling £16.1 million of which £1.3 million were recoverable overpayments;
 - the discovery of 36 illegal immigrants; and
 - savings of £1.5 million identified for other agencies or departments.

Impact of fraud on the account and my audit opinion

- 12 The Benefits Agency's programme of reviews will in time, cover all major benefits reported in this account. When the programme is complete it will be possible to estimate the potential overall loss arising from claimant fraud. The Agency have reviewed Retirement Pension, the major benefit in this account, and found there was a very low risk of fraud and the potential loss was very small.
- 13 A joint team of both Contributions Agency and Benefits Agency staff are taking forward a range of measures to improve security and checking procedures prior to the issue of a national insurance number or acceptance of a claim to benefit. The Agencies implemented new procedures in October 1997 which they expect to have

a significant impact in reducing the risk of fraud resulting from the use of false identities. This Departmental project is also significantly involved in Contributions Agency activities in relation to action against collusive employers. I will monitor developments during my work on the 1997-98 Account.

- 14 The notes to this account also provide an estimate of losses arising from the fraudulent encashment of order books and girocheques for benefit expenditure as a whole, which amounts to £102 million. Statistical evidence is not available to determine losses for individual benefits paid from the National Insurance Fund, if the allocation of the estimated loss was calculated in proportion to benefit expenditure the loss to the Fund would be of the order of up to £56 million. The Benefits Agency believe, however, that the greater loss would occur on income support and income based jobseekers allowance due to the greater risk of instruments of payment fraud on these benefits compared with National Insurance Fund benefits.
- 15 In forming my audit opinion I am required to confirm that the account is free from material misstatement; whether caused by error, fraud or other irregularity. In view of the level of claimant fraud and encashment fraud indicated by the Benefits Agency's work I have no alternative but to qualify my opinion on the National Insurance Fund Account.
- 16 In 1996-97 unemployed individuals who had paid sufficient national insurance contributions were paid unemployment benefit until 5 October 1996 and jobseeker's allowance from 7 October.

**Contributory
benefits to the
unemployed**

Errors in unemployment benefit

Background

- 17 Note 9 to the account shows that some £587 million has been charged to the National Insurance Fund in 1996-97 in respect of unemployment benefit. This benefit was a flat-rate benefit payable for the first year of any spell of unemployment to claimants who had paid sufficient national insurance contributions and who were actively seeking work. Unemployment benefit was payable at a rate of £48.25 a week from 11 April 1996, with an increase payable for adult dependants.
- 18 The benefit was administered by the Department for Education and Employment through a network of local offices operated by the Employment Service, an Executive Agency. The Department for Education and Employment acted as agent for the Department of Social Security in administering the benefit and in paying income support to unemployed people.
- Results of 1996-97 audit*
- 19 I have reported on the National Insurance Fund account for 1996-97 because of the level of error in unemployment benefit expenditure. The following paragraphs analyse the errors disclosed by the 1996-97 audit and the reasons for the errors.

- 20 My audit findings are based on an examination of unemployment benefit awards made in 1996-97 selected randomly at a representative sample of Employment Service job centres. The sampling techniques used enabled me to extrapolate the results of the examination to provide an estimate of the overall financial error in unemployment benefit expenditure in 1996-97.
- 21 My examination of unemployment benefit awards found that 3.0 per cent of those awards contained monetary errors. Some were non-cash errors where claimants received the correct amount of money but the wrong benefit, for example income support instead of unemployment benefit. In such cases the charge to the National Insurance Fund account would be understated and the charge to the Class XII, Vote 1 appropriation account would be overstated.
- 22 The remaining errors were cash errors, where claimants were overpaid or underpaid by reference to their entitlement. I estimate that cash errors resulted in overpayments to claimants of £15.4 million and underpayments of £2.8 million, representing 3.1 per cent of unemployment benefit expenditure. After taking non-cash errors into account, the overall error rate was 6.5 per cent. See Table 1.

Table 1: Unemployment benefit – National Audit Office audit results for 1996-97

	Estimated value of error (£M)	Value of error as a percentage of reported expenditure
Cash overpayments	15.4	(2.6)
Non-cash overstatements	5.2	(0.9)
Total overstatements	20.6	(3.5)
Cash underpayments	2.8	(0.5)
Non-cash understatements	14.9	(2.5)
Total understatements	17.7	(3.0)
Gross cash error	18.2	(3.1)
Gross cash and non-cash error	38.3	(6.5)

Reasons for errors

- 23 Some 20 per cent of the errors arose because claimants provided the Employment Service with incorrect information at the time of the award. For example, some claimants failed to provide reliable information about their occupational pensions or part time earnings, or withheld information which would have resulted in the suspension of their claims.
- 24 The remaining errors were mainly attributable to the Employment Service. Overpayments occurred because unemployment benefit was awarded, for example, when claimants had exhausted their entitlement, when they failed to satisfy the availability for work conditions, or when they had not paid sufficient national insurance contributions.
- 25 The majority of underpayments occurred because of errors in claimants' national insurance contribution records, or in the interpretation of these records, and because of mistakes in awards of additional allowances for qualifying adult dependants. In most cases where claimants were underpaid unemployment benefit

they were awarded income support instead and suffered no financial loss, although the charge to the National Insurance Fund account was understated (paragraph 21).

- 26 In my report on the National Insurance Fund 1995-96 (HC 221), I referred to measures taken by the Employment Service in earlier years to reduce the level of error in unemployment benefit. My examination in 1996-97 has confirmed that measures to counter inaccurate awards for adult dependants and erroneous awards made to individuals who had exhausted their entitlement to unemployment benefit some years ago, remained effective in reducing these types of errors. As in 1995-96, however, this improvement was partially offset by increases in other types of error, arising from the failure of claimants to provide accurate information at the time of the award and errors in the interpretation of claimants' national insurance contribution records.
- 27 The overall level of error fell between 1995-96 and 1996-97 from 6.9 per cent to 6.5 per cent. The Employment Service told me that progress on reducing error levels had continued, despite the considerable input required from their experienced staff in preparing for the implementation of jobseeker's allowance.

Errors in jobseeker's allowance

Background

- 28 Note 9 to the account shows that some £333 million has been charged to the National Insurance Fund in respect of jobseeker's allowance. This is a flat rate benefit, introduced on 7 October 1996, payable for the first six months of unemployment to claimants who had paid sufficient national insurance contributions and who are actively seeking work. Jobseeker's allowance was payable at a rate of £47.90 per week, for individuals over 25 years of age and £37.90 for those under 25.

Results of 1996-97 audit

- 29 In my report on the Class XII, Vote 1 Appropriation Account 1996-97 (HC251-XII) I gave details of the introduction of this benefit, how it is administered and the findings from my audit of jobseeker's allowance in 1996-97. This included the results of my audit of jobseeker's allowance paid to the unemployed who had paid sufficient national insurance contributions. My examination found that some 10.2 per cent of awards with a total value of £34.1 million were in error and in my report I noted the remedial action proposed by the Benefits Agency to make improvements for the future. I will continue to monitor developments and report, if necessary, my findings to Parliament.

National insurance contributions

- 30 **Introduction**
Section 162 of the Social Security Administration Act 1992 requires the Secretary of State for Social Security to pay receipts of national insurance contributions into the National Insurance Fund, after deducting the allocations due to the National Health Service. Note 2a to the account shows the amounts paid into the Fund in respect of each class of contribution in 1996-97.

- 31 My examination of the National Insurance Fund account includes work to confirm that contributions received have been properly brought to account in accordance with Parliament's intentions. As I have no rights of access to records maintained by employers and the self-employed, my staff review measures taken by the Contributions Agency and the Inland Revenue to monitor and enforce compliance with contributions law.
- 32 This part of the report sets out the results of my examination of the Contributions Agency's compliance work. My examination focused on Class 1 contributions (paragraphs 33 to 73), Class 1A contributions (paragraphs 74 to 79), Class 2 contributions (paragraphs 80 to 83) and developments in contribution debt management (paragraphs 84 to 101).

Class 1 contributions

Background

- 33 Class 1 national insurance contributions represented over 95 per cent of the £41,682 million contributions paid into the National Insurance Fund in 1996-97. These contributions are payable by employees and their employers. Around 94 per cent of Class 1 contributions are collected by the Inland Revenue alongside the pay as you earn (PAYE) system.

Compliance work

- 34 The Contributions Agency have continued to seek to maximise the contributions yield from their compliance work. They achieved their compliance target in 1996-97. They visited some 69,000 employers and identified £153 million Class 1 arrears against a target of £150 million, including some £23 million identified without the need to actually make a visit. In 1995-96 the Agency inspectors visited some 94,000 employers and identified some £152 million contribution arrears. The Agency have, therefore, succeeded in maintaining the level of arrears identified whilst conducting fewer inspection visits.
- 35 The yield of £153 million in 1996-97 includes some £66 million which relates to the current year. This consists of actual underpayments identified up to the time of the survey and estimated amounts to the end of the year. Employers are requested to make payment of the actual current year underpayment with their next PAYE remittance and to ensure future compliance with requirements which should result in any estimated amount being paid in due course. The Agency have not yet introduced procedures to ensure actual current year underpayments are paid nor do they monitor continuing compliance by employers. They have been considering how they could improve both recovery of current year underpayments and future compliance, while avoiding placing excessive burdens on business.
- 36 I noted in my report last year that the Contributions Agency planned to investigate the extent to which employers are paying the current year's additional liability identified during surveys. I am concerned that the Agency have not pursued this in 1996-97 and I recommend that they give the matter a high priority in 1997-98, to ensure that yields identified on surveys are collected to maximise the proceeds to the National Insurance Fund.

- 37 Until recently there were no procedures to confirm that prior years' underpayments identified on surveys are collected. To measure the effectiveness of the survey process the Agency introduced in October 1997 a yield tracker system to monitor the progress of debts in respect of closed years, which will also identify outstanding cases for investigation. I will monitor the effectiveness of this system during my examination of the National Insurance Fund in 1997-98.
- 38 In addition to the Contributions Agency's compliance work, Inland Revenue compliance officers completed some 50,000 visits to employers to check, amongst other things, their compliance with PAYE. They identified underpayments of £289 million, of which £47 million related to Class 1 contributions, including interest and penalties.
- 39 Contribution yields are reported separately by the Contributions Agency and the Inland Revenue for their internal management purposes so it is not possible to add them together to provide a picture of overall yield. Cases which are referred from the Agency to the Inland Revenue, because there are potential tax irregularities may, therefore, be included in both organisations' results. For these cases the Agency will report identified yield, which following further examination by the Inland Revenue may be adjusted upwards or downwards. The Agency's information system records that, during 1996-97, some £17 million of national insurance contributions was referred to the Inland Revenue which could be included in both organisations' results.
- 40 Under the joint working arrangements agreed in January 1996 to minimise the burden on employers, the Inland Revenue must accept all cases referred to them by the Contributions Agency and contact the employer within a prescribed timescale. The Inland Revenue then carry out a review. When the case is cleared, the Inland Revenue provide the Agency with details of the tax and national insurance contributions underpaid together with an explanation for any differences from the amount of national insurance contributions yield originally identified by the Agency.
- 41 For 1996-97 and earlier years, if the Inland Revenue identified a smaller underpayment of national insurance contributions than had been referred to them, the Agency did not adjust the amount claimed against their yield target. From 1997-98, in cases where the Inland Revenue consider that the Agency have over-assessed the amount of contributions underpayments and the Agency agree, the difference will be deducted from the Agency's claimed survey yield.
- 42 As part of the joint working programme, by the end of 1997 every Contributions Agency region and its Inland Revenue counterpart will have agreed a framework document designed to encourage better liaison at local office level. The Inland Revenue and the Agency are instituting procedures which aim to ensure that cases are progressed as quickly and accurately as possible, and with the minimum of duplication of work. I will monitor progress on these issues during my work on the 1997-98 account.
- 43 In my report last year I noted that the Contributions Agency had developed a new computer system known as the Yield Analysis Statistical System. The purpose is to assist field office inspectors in identifying the type of businesses likely to yield the greatest financial return from inspections and those employers who make errors in calculating their contributions liability.

- 44 The system is available in each region and is updated monthly by a central team. The extent to which field office inspectors actually use the system is left to individual discretion and there are no plans currently to monitor either the volume or effectiveness of usage.
- 45 The Inland Revenue are currently developing an employers database for their employer compliance staff. This system will incorporate a risk assessment facility which will cover all employers to enable the Inland Revenue to better target non-compliant employers. The Inland Revenue have agreed to pilot access to this systems by Agency staff, in a few locations, and to prepare a user requirement for joint use as a result. I recommend that the Agency review the benefits of each system and determine which system, or combination of systems, will provide the most effective means of identifying higher risk employers.
- 46 In 1996-97 the Contributions Agency and the Inland Revenue commenced a joint programme of reviews of government departments and other public sector bodies to check compliance with national insurance and income tax legislation. One review has been completed and the Department of Social Security repaid some £18.5 million arrears of income tax and national insurance contributions covering a seven year period. The Agency and Inland Revenue expect to complete several more reviews in 1997-98.

Employment status of construction industry workers

- 47 In my report last year I noted that the Contributions Agency and the Inland Revenue had issued new guidance to help contractors in the construction industry correctly determine the employment status of their workers. Contractors were asked to review their workers employment status by 5 April 1997 and, where appropriate, to be paying Class 1 contributions by that date. The Agency and the Inland Revenue agreed that they would not specifically target the industry by way of additional compliance activity in the 1996-97 tax year whilst these changes were made.
- 48 The Agency and the Inland Revenue recognised that many labour only workers in construction might have been incorrectly classified as self employed but they could not predict, with accuracy, the number involved. The Agency currently estimate that up to 200,000 individuals have transferred to employed status which could lead to an increase in receipts to the National Insurance Fund of around £300 million in 1997-98. The increase in revenue arises because Class 1 contributions payable by employed workers is greater than the combined Class 2 and Class 4 contributions payable by the self employed.
- 49 The Agency and the Inland Revenue have received representations from various building federations, unions and from contractors who voluntarily complied with the new guidance highlighting the competitive advantage gained by non compliant contractors. In response to these concerns the Agency and Inland Revenue have increased the number of visits to construction industry contractors to some 12,000 during 1997-98.
- 50 A more precise evaluation of the number of workers whose employment status has changed and the financial impact on the National Insurance Fund will become possible once employer end of year national insurance returns have been processed. I shall continue to monitor developments during my audit of the 1997-98 account.

- 51 Current legislation concerning the treatment of construction industry workers who are engaged via an employment agency produces different results for income tax and national insurance purposes. A construction agency worker is normally considered to be employed for national insurance contribution purposes and self employed for income tax. Historically the Agency treated workers who were self employed for tax purposes as also self employed for national insurance contributions purposes resulting in a loss to the National Insurance Fund. The Agency have decided to enforce existing national insurance legislation which should increase yield to the National Insurance Fund and the Inland Revenue are going to align income tax legislation with effect from 6 April 1998.

Proposed legislative changes

- 52 The Agency is currently in the process of securing legislative authority to impose penalties on employers where there is evidence of failure to notify commencement of a business, late payment or inaccurate returns. Certain national insurance contribution offences are being re-classified and civil penalties against directors will effectively replace the current limited criminal sanctions. The Agency expect to introduce these measures in April 1999 which will bring their enforcement powers closer to those of the Inland Revenue. This should act as an incentive to employers to comply voluntarily with national insurance contributions legislation.

Spend to save initiative

- 53 The Contributions Agency bid for and received an additional £9 million funding for 1997-98 under the Chancellor of the Exchequer's Spend to Save initiative announced in November 1996. In return, the Agency have assessed that an additional yield of £82 million can be expected. Providing this level of funding continues for another two years the Agency expect to achieve a further £95 million and £110 million respectively over the two years.
- 54 My staff have worked closely with the Agency's Internal Audit unit in monitoring the progress made by the Agency on this initiative.
- 55 Internal Audit noted that the Agency have approached this exercise from the view that all work conducted, and yield claimed, should be in respect of specific areas of national insurance avoidance and the informal economy which would not have been conducted from mainstream funding, for example:
- joint reviews with the Benefits Agency in respect of employers in collusion with their employees to avoid paying national insurance contributions;
 - targeting specific accountants known to be involved in national insurance contributions avoidance schemes; and
 - targeting specific trades and professions eg taxi drivers, jointly with the police in some cases.

Wherever possible clear demarcation between mainstream compliance and spend to save activities has been established and the Agency do not expect the target requirement for spend to save to adversely impact upon the achievement of targets set for other compliance work.

- 56 The Agency initially planned to include the proposed self employed information exchange with the Inland Revenue in their spend to save activities. This project will not now proceed until 1998-99. As the Agency expected this exercise to yield some £14 million, they now need to obtain this yield from other initiatives in order to meet their target. This has put an additional burden on the Agency but they are confident that their overall target will be achieved. At 30 September 1997 some £28 million had been identified from spend to save activities. The systems for identifying, monitoring and recording this yield have been evaluated by Internal Audit who are satisfied with the results.
- 57 The Agency have developed a separate management information system for spend to save monitoring purposes covering both yield and associated costs. In addition dedicated line managers and supervisors have been appointed. I will continue to monitor progress and inform Parliament of the outcome.

Statutory Maternity Pay

- 58 Note 2a to the Account discloses that some £340 million was recovered by employers in respect of Statutory Maternity Pay. Statutory Maternity Pay is payable by employers to qualifying employees. Employers can claim all or part of Statutory Maternity Pay paid to employees from the Contributions Agency by deducting qualifying amounts paid from their national insurance contributions liabilities.
- 59 The Agency have recently completed a random survey of over 3,000 employees paid Statutory Maternity Pay in 1996-97 to monitor compliance with national insurance legislation. The survey identified that:
- some 21 per cent of payments of statutory maternity pay to employees in 1996-97 contained errors; and
 - some 23 per cent of cases contained errors in the amounts recovered from the Contributions Agency.

The main causes of error were:

- incorrect calculations of average earnings and the earnings period;
- incorrect rates of Statutory Maternity Pay paid to employees;
- clerical mistakes when compiling claims.

The total value of under and over-recoveries was some £11.6 million or 3 per cent of total Statutory Maternity Pay recovered. In view of the large volume of errors identified I recommend that the Agency review and clarify their guidance to employers.

Joint working programme

- 60 In my report on the National Insurance Fund account for 1995-96 I noted that the Contributions Agency and Inland Revenue were introducing new measures under a joint working programme to help reduce the administrative burden on businesses of complying with national insurance and taxation legislation. The two organisations have always worked together to varying degrees on Class 1 compliance but liaison has now become more structured.

- 61 The joint working programme incorporates some 35 individual projects of which 10 have been completed. Ongoing projects cover a wide range of issues including:
- continued improvements in the procedures for conducting survey visits;
 - greater exchange of information in cases where both the Agency and Inland Revenue need to visit the same employer, aimed at reducing the extent of duplication and thereby the burden on such employers;
 - the introduction of common leaflets and forms wherever possible;
 - greater exchange of information and common access to computerised information, subject to taxpayer confidentiality;
 - a study to establish the costs to businesses of compliance with national insurance and income tax requirements;
 - continued development of an Employers Helpline which gives general advice on all aspects of pay as you earn, national insurance contributions, statutory sick pay and statutory maternity pay; and
 - the issue of a simplified joint annual pack.
- 62 The joint working programme has been successful in improving the co-ordination between the Contributions Agency and Inland Revenue and in reducing the administrative burden on businesses. I will continue to monitor developments during my work on the 1997-98 National Insurance Fund account.

End of Year Returns

- 63 At the end of each tax year, employers must complete an individual return for each person they have employed during the year showing both the employer's and employee's Class 1 contributions for the year and the earnings on which each employee has paid contributions. Information on the returns is entered onto the individual's national insurance contribution record. The Contributions Agency carry out a series of checks to provide assurance that the information provided on the return is reliable. The checks identify returns which may contain incorrect information and which require further investigation.
- 64 My staff reviewed the Agency's procedures for the processing and checking of the end of year returns. They confirmed that the Agency achieved the target of processing 98 per cent of 1995-96 end of year returns by 31 December 1996. My staff also confirmed that 94 per cent of queries were cleared by the target date of 31 March 1997.
- 65 The Agency have redesigned the end of year return to accommodate the requirements of the 1995 Pensions Act. They have, at the same time, taken the opportunity to incorporate those changes necessary for processing manual returns by optical character recognition, which the Agency plan to trial during 1998-99.

66 The Agency have also commenced a project to identify inaccuracies in employer payroll details by using volunteer employers to provide payroll information to the Agency who then check the validity of key information to their contributor records. The main aims of the project are:

- to reduce the number of cases where end of year returns fail to match with a recognised national insurance number which should speed up the process and reduce the amount of corrective work currently required;
- the early identification of potential benefit fraud cases;
- to identify any misuse of national insurance numbers; and
- provide a proactive service to participating employers.

This initiative has many potential benefits and I will monitor progress during my work on the 1997-98 account.

Secretary of State targets

67 Since obtaining Agency status in 1991 the Contributions Agency have had targets set each year by the Secretary of State to measure the Agency's success in operating the national insurance scheme and providing a service to their customers. The Agency have agreed new targets with effect from 1 April 1997 which took into account recommendations made in my report on The Contributions Agency's Customer Charters (HC266, 1996-97). These look at a wider range of Agency activities, are more customer focused and designed to place more emphasis on quality, accuracy and value for money. The Agency were not in a position to trial these new targets and therefore agreed with the Secretary of State to review them in mid 1997 as they envisaged, at the outset, potential practical problems in implementing them. This review will provide assurance that the new targets are meeting the needs of the business and its customers.

68 I note that the Contributions Agency Internal Audit unit have, as a consequence of the changes, examined the procedures for in year monitoring of target achievement and found that:

- there is a lack of clearly laid down criteria for defining how performance is to be measured and how achievement is to be judged;
- there is a lack of awareness as to what constitutes achievement when a target covers a combination of quantity, quality and timeliness; and
- the absence of a clear understanding of target requirements has resulted in various interpretations being made which carries the risk of inconsistent application.

69 The Agency, as part of this mid year review, have agreed to issue clearer, more detailed definitions and criteria for success in meeting the new targets. I will review the progress and impact during my work on the 1997-98 account.

Crown employees' overseas allowances: liability for national insurance

- 70 In my report last year I noted that the Department of Social Security had obtained advice which questioned the legality of exempting overseas allowances paid to crown employees working abroad from national insurance contributions. Note 16 to the account discloses that the Contributions Agency have quantified the liability in respect of the various allowances and have waived some £530 million in national insurance contributions due from these Departments since April 1975.
- 71 The Agency considered that pursuing arrears of contributions from April 1975 would have put an undue administrative burden on the Departments concerned and would not lead to a net benefit to the Exchequer.

Relocation expenses: liability for national insurance

- 72 Note 2b to the account discloses that the Department have received legal advice in 1997 which questioned the long standing practice whereby relocation expenses paid to employees were excluded from earnings for national insurance purposes. The Department, with Treasury approval, intend to include certain relocation expenses as earnings for national insurance purposes from 6 April 1998, generally in line with existing tax rules.
- 73 The Department are attempting to clarify and quantify the relocation expenses paid to employees from April 1975 to determine the impact on the National Insurance Fund. I shall maintain a close watch on progress and inform Parliament of the outcome.

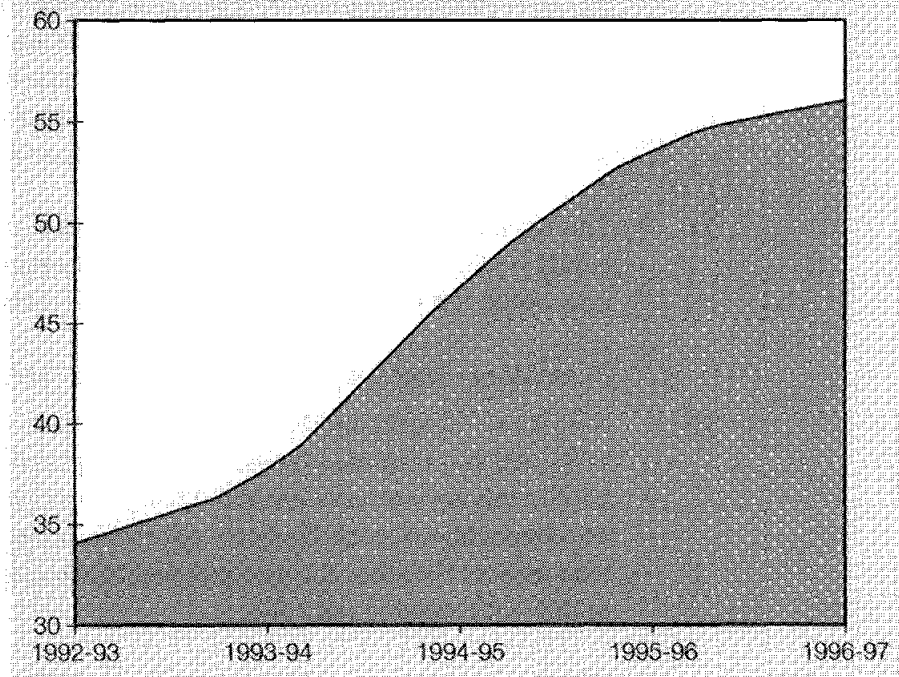
Class 1A contributions

- 74 Note 2a to the account shows that receipts of Class 1A contributions paid into the National Insurance Fund in 1996-97 amounted to some £466 million, representing 1.1 per cent of total contribution receipts. This class of contribution was introduced in 1991-92 and is payable by employers on the private use of cars and fuel provided to company directors and employees earning over £8,500 a year.

Class 1A compliance

- 75 My reports on the National Insurance Fund accounts for previous years have outlined the steps the Contributions Agency have taken to secure employers' compliance with this new class of contribution. The Agency and the Inland Revenue reported that in 1996-97 their inspectors identified underpayments of some £20 million and £17 million respectively. The proportion of Class 1A payments found by the Agency's inspectors to be in order has increased each year. See Figure 1.

Figure 1: Percentage of payments in orders



Proportion of Class 1A payments found to be in order

- 76** As the Contributions Agency's inspectors target businesses where they consider there is a greater risk of non-compliance the results of the compliance work may not be representative of employers as a whole. The Agency have therefore examined a representative sample of employers to obtain reliable information on Class 1A compliance and error rates.
- 77** I noted in my report last year that the main risk associated with Class 1A contributions was that employers were not making payments at all. The sample identified a potential shortfall in collection of £100 million per annum. I recommended that the Agency focus their attention in 1996-97 on these aspects.
- 78** In response the Agency examined a much larger sample of employers who have not paid Class 1A contributions with the objective of evaluating the level of non-compliance with the relevant legal requirement rather than focussing on the accuracy of payments being made by existing contributors.
- 79** The main findings arising from the survey indicated that:
- an estimated 46,000 employers are not complying with their requirement to pay Class 1A contributions;
 - the vast majority of non compliant employers were either unaware of their liability (43 per cent), had properly assessed their liability but failed to make payment (26 per cent) or were unaware of how to calculate and make payment (7 per cent); and
 - only 11 per cent of employers were adjudged to have avoided payment.

The Contributions Agency have estimated that the financial effect of non-compliance may be around £33 million per annum. The survey results indicate that in the majority of instances employers are overlooking their commitment rather than wilfully avoiding it. I therefore recommend that a clear and prominent reminder is issued with the employers annual end of year pack. The Agency should continue to give high priority to identify those employers who are failing to discharge their liabilities.

Class 2 contributions

Background

- 80 Class 2 contributions are payable at a flat rate – £6.05 per week in 1996-97 – by the self-employed and are collected by the Contributions Agency. Note 2a to the account shows that £599 million was paid into the National Insurance Fund in 1996-97 in respect of this class of contribution. During 1996-97 some £454 million Class 2 contributions were paid by direct debit. Most of the remaining contributions were paid by the self-employed quarterly on receipt of an invoice from the Contributions Agency.

Class 2 compliance work

- 81 The focus of the Contributions Agency's Class 2 compliance work is to identify individuals with a liability to pay and then to ensure that they pay regularly. In 1996-97 the Agency reported that they identified 40,916 individuals with an unpaid Class 2 liability against a target of 40,000. The value of the liabilities from these 40,916 individuals was some £28 million.
- 82 I noted in my report last year that the Contributions Agency and Inland Revenue planned to exchange information on their respective self-employed databases with the aim of identifying individuals who may not be fully complying with their requirements to pay both Class 2 and Class 4 contributions. The Social Security Administration (Fraud) Act 1997 allows the Inland Revenue to supply information to the Department of Social Security for use in the prevention, investigation and detection of fraud and to confirm the accuracy of information held by the Department.
- 83 To address concerns raised by the Data Protection Registrar and civil liberties organisations, the Department of Social Security are producing a voluntary Code of Practice for data matching. As a result of this the proposed data exchange is not expected to take place until early 1998. I will monitor developments and report progress in my report on the 1997-98 Account.
- Debt management** 84 One of the main aims of the Contributions Agency's compliance work is to maximise the yield to the National Insurance Fund by identifying underpayments. It is equally important for the Agency to have effective debt management arrangements to ensure that the underpayments identified by their work are actually collected and paid into the Fund.
- 85 The National Insurance Fund account is currently prepared on a cash basis, with no provision for accruals. The Department of Social Security account for contributions received in the year of account and are not required to disclose contribution debts owed to the Fund at the year end. Accruals based resource accounts will be prepared across the Department of Social Security from 1998-99.

Initially the National Insurance Fund account will continue to be prepared on a cash basis. It has been decided in principle that the National Insurance Fund will move to an accruals basis in 1999-2000 to coincide with the publication of resource accounts. The application of accruals to national insurance contributions income has not yet been agreed, but nonetheless the Agency will still have a responsibility to maintain adequate debt collection procedures to maximise the yield to the Fund.

86 Although the Contributions Agency have a target for collecting contribution arrears and reported that they had recovered £242 million (target £220 million) in 1996-97 they do not, at present, maintain a central record showing the total of Class 1 contribution debt outstanding. In the absence of such information it is difficult to assess how successful the Agency have been in recovering contribution debts.

87 The Contributions Agency are introducing a new computer system to help them manage contribution records. The system should provide information on the level of outstanding debt in respect of national insurance contributions and on the Agency's success at recovering it. The new computer system is being phased in from February 1997 with plans to incorporate the debt management system by April 1999.

Class 1 contribution debt

88 The Inland Revenue collect the majority of Class 1 national insurance contributions from employers on a monthly basis alongside the PAYE system. In addition, they are currently responsible for collecting any underpayments they identify in the course of their compliance visits to employers. This includes amounts identified originally by Contributions Agency inspectors and referred to the Inland Revenue because the case involved potential tax irregularities.

89 The Contributions Agency are responsible for collecting Class 1 underpayments from employers only in cases where there were no potential tax irregularities requiring the case to be referred to the Inland Revenue. In the case of underpayments relating to prior tax years they monitor the debt actively to ensure that it is paid. The introduction of a yield tracking system (paragraph 37) will assist the Agency in evaluating the effectiveness of their debt collection processes.

Class 2 contribution debt

90 Self employed contributors have the option of paying their Class 2 national insurance contributions either monthly by direct debit or in quarterly instalments. Contributors who choose to pay quarterly receive a payment request from the Agency's quarterly billing system. The Agency allow a period of thirty-five days for payment after which any unpaid liabilities in excess of a civil proceedings limit of £150 are transferred to a debt management system.

91 In my report last year I noted that in April 1995 the Contributions Agency introduced a new, highly automated, system for managing and progressing Class 2 debt. The system provides an automated dialling facility to contact debtors by telephone or, where such contact is unsuccessful, will issue written reminders.

- 92 I noted in my report last year that outstanding debts at 31 March 1996 totalled £217 million and included £54 million in respect of around 100,000 contributors with whom the Agency have been unable to make contact. The value of outstanding debts at 31 March 1997 has increased to £314 million with £138 million outstanding from 332,000 contributors where no contact has been made.
- 93 At the time the computer system was designed the Agency's enforcement arrangements required contact to have been made with a debtor prior to the commencement of civil recovery proceedings. Where contact could not be established such cases were to be returned to the quarterly billing section for further enquiries. The Agency removed this restriction in July 1996 and upgraded the system in April 1997 to allow such cases to be considered for legal action through civil recovery.
- 94 The Agency have not yet, however, referred any of these cases where debtors have not been directly contacted for civil recovery action. Many of the debts are now over 2 years old and no recent application for payment has been issued. The Agency are concerned that the circumstances of many debtors may have changed, for example debtors may be unemployed and in receipt of benefit. Until recently the debt management system could not link individual debts to individual debtors, this facility only became available in October 1997. The Agency propose issuing a single written request to each debtor which will detail all individual debts. In addition the Agency have referred a small sample of cases to their local offices who have attempted to make contact with relevant debtors in an effort to either obtain payment or ascertain the debtors current circumstances.
- 95 The Agency plan to monitor the response from the combined application for payment and the results of local office enquiries. They expect that a large proportion of debts will not be immediately enforceable and they will consider how best to clear this large backlog, including civil recovery where appropriate, once more information is available. I am concerned that the level of debts is increasing and that there is a risk that many of them will not be recovered. I recommend that the Agency give a high priority to clearing these debts before the new debt management system is introduced in April 1999. I will monitor progress in 1997-98.
- 96 In my report last year I noted that the debt collection unit also experienced difficulties in transferring some 13,000 cases with a total value of £3 million from the debt management system to the civil recovery system where contact had been made with the debtor. The Agency successfully cleared these cases in April 1997 and new cases are being referred for civil recovery as appropriate.
- 97 During 1996-97 the quarterly billing system transferred some £205 million into the debt management system. Of this some £42 million (20 per cent) had to be returned because liabilities were disputed by contributors. This casts doubt about the accuracy of the records held on the quarterly billing system and the need for them to be updated. I recommend that the Agency should, as a matter of urgency, update and correct the data on the quarterly billing system.
- 98 The Agency commissioned a post implementation review of their debt management system. The report acknowledged that the system has been successful in meeting the main objectives. However, it took longer than expected to develop and incurred

significant additional costs because the original specification would not have met the Agency's objectives for debt management, and because of additional facilities not included in the original specification.

- 99 The Agency are trialling several initiatives to improve the effectiveness of the debt collection process including the recent acceptance of automated payments from debit cards which now account for some 2.5 per cent of payments received.
- 100 The Agency's civil recovery section collected some £17 million against a target to collect £20 million during 1996-97. The section were, however, reorganised during the year which resulted in the closure of two offices and a 40 per cent reduction in staff with a significant increase in workload. I will monitor their progress during my work on the 1997-98 account.
- 101 The Agency are seeking legislative powers to impose penalties on non compliant employers (paragraph 52) and the self employed. In addition, and as part of the same Bill, the Agency are seeking to secure legislation which will allow distraint action to be taken against long outstanding debtors. This facility should become available in April 1999 and will considerably strengthen the Agency's debt enforcement powers.

John Bourn
Comptroller and Auditor General

15 January 1998

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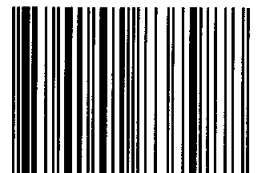
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