

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

National Insurance Fund Account 2005-2006

ORDERED BY THE HOUSE OF COMMONS TO BE PRINTED 8 JANUARY 2007

The National Audit Office
scrutinises public spending
on behalf of Parliament.

The Comptroller and Auditor General,
Sir John Bourn, is an Officer of the
House of Commons. He is the head of the
National Audit Office, which employs some
850 staff. He, and the National Audit Office,
are totally independent of Government.

He certifies the accounts of all Government
departments and a wide range of other public
sector bodies; and he has statutory authority
to report to Parliament on the
economy, efficiency and effectiveness
with which departments and other bodies
have used their resources.

Our work saves the taxpayer millions of
pounds every year. At least £8 for every
£1 spent running the Office.

This account can be found on the National Audit Office web site at
www.nao.org.uk

Contents

	Page
Foreword	2
Statement on Internal Control	4
The Certificate and Report of the Comptroller and Auditor General	8
Receipts and Payments Account	10
Notes to the Account	11
Accounts Direction	21
Report by the Comptroller and Auditor General	23

Foreword

Statutory background

- 1 The National Insurance Scheme was established on 5 July 1948 to provide unemployment benefit, sickness benefit, retirement pensions and other benefits in cases where individuals meet the contribution and other qualifying conditions.
- 2 Under the Social Security Administration Act 1992 benefits due under the National Insurance Scheme are payable out of the National Insurance Fund (NIF). The funds required for meeting the cost of these benefits are mainly provided from National Insurance contributions payable by employed earners, employers and others. The Social Security Contributions and Benefits Act 1992 sets out the conditions governing entitlement to most benefits and the basis for assessing liability to pay National Insurance contributions.
- 3 Section 161(1) of the Social Security Administration Act 1992 (as amended by the Social Security Contributions (Transfer of Functions etc) Act 1999) placed the NIF under the control and management of the Inland Revenue (IR).
- 4 Following the Chancellor's announcement in his March 2004 budget speech, legislation received Royal Assent on 7 April 2005 bringing into existence a new department, HM Revenue & Customs (HMRC). This became a legal entity on 18 April 2005, incorporating the Inland Revenue and HM Customs and Excise.
- 5 The Acting Chairman of HMRC is the Accounting Officer for the Fund. Section 161(2) of the Social Security Administration Act 1992 requires HMRC to prepare accounts of the NIF in such form, and in such manner and at such times, as the Treasury may direct. The accounts are prepared on a cash basis and must properly present the receipts and payments for the financial year and the balance held at the year end.

Operational responsibilities

- 6 National Insurance contributions are payable by employed earners, employers and others. HMRC is responsible for collecting these contributions and recording them against individuals' contribution records (which determine entitlement to social security benefits payable from the NIF). As Accounting Officer for the NIF, I am responsible for the control and management of the Fund.
- 7 The Department for Work and Pensions (DWP) has overall responsibility for the award and payment of most benefits payable from the NIF including those relating to retirement, sickness and contribution based Jobseeker's Allowance. Entitlement to benefit is determined by the claimant satisfying qualifying conditions.
- 8 The Department of Trade and Industry (DTI) is responsible for making Redundancy Payment Scheme awards with the Insolvency Service, an agency of DTI, handling the payment of awards and collection of receipts.
- 9 The amounts received by and paid out of the NIF, and the resulting balance, depend on legislation, which is the responsibility of Treasury Ministers and the Secretary of State for Work and Pensions. In setting contribution rates, Treasury Ministers are required to have regard to changes in the general level of earnings, the state of the NIF and payments expected to be made from it in the future (Sections 141 and 143 of the Social Security Administration Act 1992).
- 10 The Government Actuary is required under Sections 142(1), 147(2) and 150(8) of the 1992 Social Security Administration Act to report on the likely effect on the NIF of the Government's annual Benefits Up-rating and Contributions Re-rating Orders. These reports are laid before Parliament and debated alongside the relevant orders. He is also required under Section 166 of the Act to report every five years on the long-term financial estimates of the NIF. The latest quinquennial report was laid before Parliament on 27 October 2003 and an update provided on 23 December 2004.

Audit arrangements

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

Financial performance

- 12 The National Insurance Scheme is financed on a pay-as-you-go basis with contribution rates set at a level broadly necessary to meet the expected benefits expenditure in that year, after taking into account any other payments and receipts, and to maintain a working balance. Changes in contribution levels in response to the needs of the Fund take time to implement therefore a working balance is necessary because the NIF has no borrowing powers. In his report on the financial provisions of the Social Security Bill 1992 the Government Actuary confirmed that it was prudent to plan for a minimum balance of one-sixth (16.7 per cent) of annual benefit expenditure.
- 13 The balance on the Fund has increased by £5,156 million compared with the position at 31 March 2005 (£29,103 million). At 31 March 2006 the balance held is £34,259 million (57 per cent of annual benefit expenditure).
- 14 The Government Actuary's next Report on the Government's Benefits Up-rating and Contributions Re-rating Orders will be tabled in the New Year alongside the 2006 Up-rating Order and the Re-rating Orders. The Orders, which will cover the financial year 2005-2006, are subject to debate and require the approval of both Houses.
- 15 The Government Actuary's Department estimates of benefit payments and contributions, both very large figures, are sensitive to changes in a number of assumptions (such as the level of employment and earnings). Short-term fluctuations in the balance may not be a good guide to the long-term position.

Responsibilities of the Acting Chairman of HM Revenue & Customs

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

Paul Gray
Accounting Officer

27 November 2006

Statement on Internal Control

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

Scope of responsibility

- 1 As Accounting Officer for the Great Britain National Insurance Fund (NIF), I have responsibility for the stewardship of the Fund and for maintaining a sound system of internal control that supports the achievement of HM Revenue & Customs' (HMRC) policies, aims and objectives, whilst safeguarding the public funds for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting.
- 2 Whilst HMRC has overall responsibility for the control and management of the Fund and for collecting National Insurance contributions, the Department for Work and Pensions is responsible for benefit payments and the Insolvency Service, an agency of the Department of Trade and Industry (DTI), is responsible for Redundancy Payments Scheme awards which are covered by the Fund.
- 3 I receive Letters of Assurance from the Accounting Officers of those Departments, approved by their audit committees, which refer to their own statements on internal control (SIC) and highlight any significant issues that impact on the Fund. In addition, the Government Actuary is responsible for reporting to Parliament on the performance of the Fund.

The purpose of the system of internal control

- 4 The system of internal control is designed to manage risk at a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks and achievement of departmental policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place in HMRC for the year ended 31 March 2006 and up to the date of the approval of the accounts, and accords with Treasury guidance.
- 5 Specific work undertaken on behalf of the NIF only forms a small part of the whole work of HMRC. A separate SIC is produced for HMRC 2005-2006 Accounts that fully sets out details of HMRC's capacity to handle risk and its risk and control framework, as well as disclosures that relate to issues outside of the scope of work relating to the NIF. Details of the full SIC can be found in HMRC's 2005-2006 Accounts.
- 6 A review of the investment policy applied to the NIF was undertaken in 2005-2006, including consultation with HM Treasury, we aim to apply its findings to investment activity from 2006-2007.

Capacity to handle risk

- 7 HMRC's Executive Committee takes an active role in shaping the Department's risk management arrangements, determining the risk priorities, and reviewing progress in managing the risk in the Strategic Risk Register. They are supported in this by the Risk Management Group. This is a peer-review group of risk owners, who challenge the effectiveness of action to manage the top risks, and identify new emerging risks.
- 8 HMRC's Audit Committee, supported by Internal Audit and the National Audit Office (NAO), plays a key role in reviewing HMRC's risk arrangements, and is a catalyst for ensuring that HMRC continues to adapt and improve these.
- 9 HMRC have set up a network of governance practitioners, to help ensure a shared understanding across the Department of risk management principles and practices, and to identify and share examples of good practice.

The risk and control framework

- 10 HMRC have a new risk management framework in place. The framework is available to all staff through the HMRC Intranet site and sets out the principles, processes and accountabilities for risk management in HMRC.
- 11 There is a NIF Audit Forum consisting of representatives from key Internal Audit units, the National Audit Office, other Government Departments and management. The forum focuses on co-ordinating risk-based audit activity such as planning, reporting and implementation of recommendations and fostering opportunities for joint working and exchange of best practice.

Review of effectiveness

- 12 As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control within HMRC. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within HMRC who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports.
- 13 To provide me with an assurance on the effectiveness of the system of internal control, the Director of Internal Audit provides a summary of the findings from every internal audit review, raising significant control issues as they arise. The Chairman of the Audit Committee, who is also a non-Executive Board member, provides the Board with a written report after each Audit Committee meeting.
- 14 In making my assessment, I also take account of the management letters made by the NAO, the Comptroller & Auditor General's report to Parliament, and of the findings of the Committee of Public Accounts (PAC).
- 15 The Director Generals and other senior managers have drawn up statements that set out governance, risk and control arrangements in their business areas. Taking these into account, and the views of the Director of Internal Audit and the NAO, I recognise that there are a number of significant control weaknesses. Specific areas relating to the NIF requiring disclosure are

Update on issues raised in 2004-2005 Statement

Age Related Rebates

- 16 For 2004-2005 the target to process 98 per cent of Employers' Returns was achieved at the end of April 2006, one month late. 99 per cent was achieved by June 2006. To date a total of £3.1 billion has been paid in Age Related Rebates.
- 17 There are some residual issues with payments of Age Related Rebates the major one concerns where an employer, due to no fault of their own, made their returns using compression technology. HMRC was unable to open the return and process it accordingly. HMRC diagnosed the problem far later in the day than it should have done, causing a delay in the payment of Age Related Rebates. Payment of the majority of the outstanding amount was made on 1 September 2006 with further, smaller, amounts paid on 1 October and 1 November 2006. The total Age Related Rebates paid for this employer is £1.738 million. The pension scheme trustees are seeking redress which is currently being handled by the Department's solicitor.

Re-platforming of NIRS2

- 18 I last reported on this issue in the 2004-2005 SIC and can provide a positive update. All outstanding performance issues were resolved in November 2005 and the NIRS2 Migration programme formally ceased from 30 November 2005.

Class 2 National Insurance 'debt' balances

- 19 A cross-departmental working group has been looking at the outstanding debt on the Class 2 National Insurance (C2N) system. When HMRC is notified that a person is self-employed, they assume that they continue to be liable for C2N until told otherwise. As a result, some of the debt balance on the system will be false.
- 20 It was reported last year that £616 million of Class 2 debt was over 6 years old as at 6 April 2005 and therefore time-barred under the Limitation Act 1980. £333 million was estimated as time barred true debt and formally written off in the 2004-2005 IR Accounts. The remaining £283 million was considered not true debt and has been waived.
- 21 HMRC has addressed the ongoing issues by
- identifying and prioritising the £71 million 1999-2000 estimated true debt, which would have become time-barred after 6 April 2006. This has included work to trace missing contributors and prioritise for enforcement action. The true debt balance has now reduced by £16.5 million;
 - developing a strategy to clear debt balances from the systems in a timely fashion; and
 - reviewing the end-to-end C2N process to see whether any cost-effective changes could be made which would improve the position in future. Work continues on this aspect.
- 22 A director-level group has overseen these actions and made periodic reports to the HMRC Operating Committee.

Incapacity Benefit Credits

- 23 The Department for Work and Pensions' (DWP) Pension Service Computer System (PSCS) provides Incapacity Benefit start and end dates to NIRS2, where credits are awarded for relevant weeks. These contribution credits are used in the calculation to determine whether a particular tax year is a qualifying year for benefit purposes. We are aware that the information on periods of incapacity on NIRS2 and PSCS does not correlate in a number of cases, and during 2005 we have been working with the DWP to establish the full scope and extent of these mismatches.
- 24 In late July 2006 DWP and HMRC scanned PSCS to allow detailed comparison with the NIRS2 data so that the extent and significance of mismatches could be properly understood, and appropriate corrective action planned. The scan data is now being profiled against some 21 different scenarios in order to fully understand the number of contributors in each scenario and the potential impact. When the profiling work is complete, proposals for appropriate remedial action will be prepared and it is currently anticipated that implementation will begin in 2007.

New Issues Raised in 2005-2006

- 25 There were no new issues raised in 2005-2006.

Assurance from DWP in respect of Contributory Benefit payments

- 26 A Letter of Assurance has been received from the DWP that has been approved by their Audit Committee and contains details about their capacity to handle risk and their risk control framework. The Letter indicates significant internal control issues, which have been detailed at high level below
- 27 In 2004-2005, £2.6 billion was estimated to have been lost due to fraud and error in Social Security benefits. In 2005-2006, contributory benefits, funded from the National Insurance Fund, totalled £59.87 billion, which included £51.5 billion related to State Pension and £6.71 billion related to Incapacity Benefit, the remainder includes payments made in relation to Bereavement Benefit, Maternity Allowance, Christmas Bonus and Jobseeker's Allowance (Contributory). The latest global measurement figures estimate that losses from fraud and error in relation to State Pension were approximately £60 million (0.1 per cent) in 2004-2005 and in relation to Incapacity Benefit approximately £80 million (1.2 per cent).

- 28 During 2005-2006 it became evident that the National Insurance Recording System and DWP's Pension Service Computer System (PSCS) do not necessarily hold the same start and end dates for Incapacity Benefit claims. Incapacity Benefit start and end dates may translate into National Insurance credits which play a role in determining Qualifying Years for contributory benefit purposes. HMRC and DWP are still investigating the scale of this issue and arrangements are now in place to ensure IB start and end dates now being put on the two systems correlate. (refer Paragraphs 23 to 24)

Assurance from DTI in respect of the Redundancy Payments Scheme

- 29 A Letter of Assurance has been received from the DTI that has been approved by their Audit Committee and contains details about their capacity to handle risk and their risk control framework.
- 30 The Letter gives an assurance that there were no significant internal control issues that impact on the NIF.

Paul Gray
Accounting Officer

27 November 2006

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

I certify that I have audited the financial statements of the National Insurance Fund for the year ended 31 March 2006 under the Social Security Administration Act 1992. These comprise the Receipts and Payments Account and the Notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Accounting Officer and auditor

As described in the Responsibilities of the Acting Chairman of the Board of HM Revenue and Customs in the Foreword, the Accounting Officer is responsible for preparing the Foreword and the financial statements in accordance with the Social Security Administration Act 1992 and HM Treasury directions made thereunder and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements properly present the receipts and payments and whether the financial statements have been properly prepared in accordance with the Social Security Administration Act 1992 and HM Treasury directions made thereunder. I also report whether in all material respects the financial transactions conform to the authorities which govern them. I also report to you if, in my opinion, the Foreword is not consistent with the financial statements, if the National Insurance Fund has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I review whether the statement on pages 4 to 7 reflects the National Insurance Fund's compliance with HM Treasury's guidance on the Statement on Internal Control and I report if it does not. I am not required to consider whether the Accounting Officer's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the National Insurance Fund's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Foreword and consider whether it is consistent with the audited financial statements. I consider the implications for my certificate if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the National Insurance Fund's circumstances, consistently applied and adequately disclosed.

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

Opinion

In my opinion

- the financial statements properly present the receipts and payments of the National Insurance Fund for the year ended 31 March 2006 and the balances held at that date;
- the financial statements have been properly prepared in accordance with Section 161(2) of the Social Security Administration Act 1992 and directions made thereunder by HM Treasury; and
- in all material respects the financial transactions conform to the authorities which govern them.

My report on the financial statements is at pages 23 to 28.

John Bourn
Comptroller and Auditor General

22 December 2006

National Audit Office
157-197 Buckingham Palace Road
Victoria, London
SW1W 9SP

Receipts and Payments Account for the year ended 31 March 2006

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

	Notes	2005-2006 £000	2004-2005 £000
Receipts			
National Insurance contributions	2	66,402,164	61,569,903
Compensation for SSP,SMP,SAP,SPP recoveries*	3	1,351,889	1,433,000
Income from investments	4	1,363,605	1,254,832
State Scheme premiums	5	114,791	112,734
Other receipts	6	63,460	70,544
Redundancy receipts	7	37,553	31,772
		69,333,462	64,472,785
<i>Less</i>			
Payments			
Benefit payments	8	59,729,065	57,010,897
Personal pensions	9	2,514,703	3,441,358
Administrative costs	10	1,423,897	1,480,034
Redundancy payments	7	293,174	219,495
Transfers to Northern Ireland NIF	11	185,000	270,000
Other payments	12	31,602	30,002
		64,177,441	62,451,786
Excess of receipts over payments		5,156,021	2,020,999

Statement of balances

		2005-2006 £000	2004-2005 £000
Opening balance		29,102,605	27,081,606
<i>Plus</i>			
Excess of receipts over payments		5,156,021	2,020,999
Closing balance	14	34,258,626	29,102,605

*SSP: Statutory Sick Pay

SMP: Statutory Maternity Pay

SAP: Statutory Adoption Pay

SPP: Statutory Paternity Pay

Paul Gray
Accounting Officer

27 November 2006

The notes on pages 11 to 20 form part of these accounts.

Notes to the Account

1 Accounting policies

Basis of preparation of the Account

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

National Insurance contributions

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

Employers are responsible for calculating contributions payable by themselves and their employees. Their records are subject to examination by HMRC. These checks and checks on other contributors may result in additional receipts or repayments in future years in respect of contribution liabilities for 2005-2006.

Payment of Social Security benefits

The DWP administers a range of social security benefits, financed either from the NIF or from the Consolidated Fund through the DWP Resource Accounts. Where an individual is in receipt of more than one benefit, it is the DWP policy to combine amounts due into a single payment wherever practicable. NIF benefits are paid by cash cheque, payable order or credit transfer, with the last of these methods becoming increasingly common. The DWP retain details of benefits issued on the vast majority of payments, including combined payments, by means of an accounting interface with each of the benefit computer systems called the Programme Accounting Computer System (PACS). Apportionment of benefit expenditure has been achieved in this Account using PACS information.

Use of estimated figures

Certain receipts and payments during the year in the Account are based on estimates and may be subject to adjustment in subsequent years on the basis of more reliable information. These include the calculation of certain contribution receipts, allocation of contribution receipts to the NHS, recoveries and compensation in respect of statutory sick, maternity, adoption and paternity pay, and settlements with Northern Ireland NIF (NI NIF).

Net accounting

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

2 National Insurance contributions

	Notes	2005-2006 £000	2004-2005 £000
Contributions			
Class 1 (employed earner)	(i)	63,402,276	58,805,140
Class 1A & 1B	(ii)	1,031,396	833,555
Class 2 (self-employed flat rate)	(iii)	304,699	219,978
Class 3 (voluntary contributions)	(iv)	136,440	90,349
Class 4 (self-employed earnings related)	(v)	1,527,353	1,620,881
		<u>66,402,164</u>	<u>61,569,903</u>

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

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

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

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

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

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

NHS allocation

The Social Security Administration Act 1992 requires that the Government Actuary's Department (GAD) apportion the National Insurance contributions collected each year. The main focus of this exercise is to confirm the Class split in order to calculate the appropriate amount to be paid over to the NHS.

The NHS allocation is paid over by HMRC to the NHS before the contributions are paid into the NIF and so the figures shown above are shown net of the NHS element. NHS allocation was £18.4bn in 2005-2006 (£16.8bn in 2004-2005).

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

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

	Notes	2005-2006 £000	2004-2005 £000
Statutory Sick and Statutory Maternity pay	(i)	1,325,000	1,376,000
Statutory Adoption and Statutory Paternity pay	(ii)	26,889	57,000
Total		1,351,889	1,433,000

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

- i Recoveries in respect of Statutory Sick and Statutory Maternity payments are paid from the DWP Resource Accounts.
- ii Statutory Adoption and Statutory Paternity pay were introduced in April 2003 and the compensation due to the GB NIF is to be paid over by the DTI. The amount of compensation shown as due is based on estimates. The 2004-2005 figure relates to 2003-2004 and 2004-2005 amounts due which were paid in 2005-2006.

4 Income from investments

	2005-2006 £000	2004-2005 £000
Interest received	1,428,781	1,436,411
Profit on realisation	0	0
Losses on realisation	(65,176)	(181,579)
	1,363,605	1,254,832

During the year the value of investments at cost increased from £27.8 billion at 31 March 2005 to £34.8 billion at 31 March 2006. (Note 13).

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

5 State Scheme premiums

	2005-2006 £000	2004-2005 £000
State Scheme premiums	114,791	112,734

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

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

By 31 March 2006, around 31,299 individuals had been brought back into SERPS with a liability of some £128,842,000 of which £39,249,000 had been recovered. A total of £3,049,000 was recovered in 2005-2006. (See table below).

485 new members were identified between 1 April 2005 and 31 March 2006 with a total liability of £1,049,000. However, 207 members previously identified as Maxwell members were found to be members of other pension schemes – the total liability for these members amounts to £1,083,000 which has been adjusted.

New Maxwell Scheme members continue to be identified as individuals reach State Pension Age and following investigations with the Scheme Administrators. Members may also have been recorded under one scheme but are actually members of another. The pension liability for these members has to be transferred however, because the schemes have different revaluation rates, and so the value of the liability from one scheme could be different to the other. This accounts for changes in the scheme and overall liability from one year to the next.

Most actions are now settled and the trustees are resolving outstanding legal issues and moving to fully secure the benefits of their members. It is expected that eventually around £97 million of the total £128.8 million liability will be recovered.

Maxwell Pension Scheme	Total Liability £000	Amounts recovered up to 31 March 2006 £000	Outstanding liability at 31 March 2006 £000	Progress
Mirror Group Pension Scheme	73,894	8,005	65,889	State Scheme Premium bill capped at £66 million. A phased and gradually accelerating payment schedule has been agreed. Final payment due by 2020.
Headington Pension Plan	776	776	0	Membership of the scheme has been agreed – all members' benefits have been secured.
MCWPS 'Works' Scheme	30,468	30,468	0	Final payment of £10,467,802 paid September 2001.
Victoria Works Scheme	382	0	382	Schemes merged. Some payment of SSPs possible.
AGB Scheme	10,742	0	10,742	
AGB Research Scheme	1,525	0	1,525	
Maxwell Communications Pension Plan (Staff)	10,635	0	10,635	No current prospect of payment.
Maxwell Media Pension Plan	420	0	420	No current prospect of payment.
Total	128,842	39,249	89,593	

6 Other receipts

	Notes	2005-2006 £000	2004-2005 £000
Recoveries of compensation payments	(i)	60,502	68,825
Unemployment benefit recoveries	(ii)	2,958	1,719
		63,460	70,544

- i The recoveries from damages paid to recipients of certain NIF benefits. These amounts relate to recoveries from insurers and other bodies in respect of compensation claims for damages where NIF benefits had already been paid to individual claimants by the DWP.
- ii Unemployment Benefit was replaced by contributory Jobseeker's Allowance in October 1996 and these are retrospective recoveries. These recoveries are all Article 69 cases i.e. reimbursement to the NIF from European countries for their citizens who have been paid unemployment benefit in the UK.

7 Redundancy payments and receipts

Section 182 of the Employment Rights Act 1996 provides the statutory basis for the NIF to make redundancy payments. The Insolvency Service makes the payments on behalf of the DTI.

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

Redundancy payments are made from the GB NIF to employees whose employers have failed to make payments due or who were insolvent. The payments are awarded by the Insolvency Service. The receipts represent amounts recovered from employers. The total debt outstanding owed by employers at 31 March 2006 was £97 million, which is disclosed as part of the DTI's Resource Account balance sheet.

	2005-2006 £000	2004-2005 £000
Outstanding debt as at 31 March	81,560	72,845
<i>Plus: Redundancy payments</i>	293,174	219,495
<i>Less: Receipts</i>	(37,553)	(31,772)
<i>Less: Debt written off</i>	(239,920)	(179,008)
Outstanding debt as at 31 March	97,261	81,560

8 Benefit payments

	Notes	2005-2006 £000	2004-2005 £000
State Pension	(i)	51,376,529	48,786,524
Incapacity Benefit	(ii)	6,703,549	6,596,786
Bereavement Benefits	(iii)	874,412	911,315
Jobseeker's Allowance (contributory)	(iv)	484,949	441,549
Christmas Bonus for pensioners	(v)	164,538	124,508
Maternity Allowance	(vi)	123,525	148,905
Guardians' and Child Special Allowance	(vii)	1,563	1,310
		59,729,065	57,010,897

- i The State Pension for people who have reached State Pension Age (currently 65 for men and 60 for women). It is based on National Insurance contributions and is made up of different elements, the largest of which is the basic State Pension, followed by the additional State Pension known as State Earnings Related Pension Scheme (SERPS).
- ii Incapacity Benefit is paid at three different rates dependent on age and term of incapacity to a person who has paid National Insurance contributions and whose Statutory Sick Pay has ended or is not applicable.
- iii Bereavement Allowance replaced Widow's pension in April 2001 and is a regular payment for 52 weeks. Bereavement Payment replaced Widow's payment in April 2001 and is a lump sum payment. Both are based on the late husband or wife's National Insurance contributions.
- iv Contributory Jobseeker's Allowance is payable to people who are capable of working, available for work and actively seeking work who have paid or are treated as having paid a certain number of National Insurance contributions.
- v Christmas Bonus is a tax free payment of £10 paid before Christmas to pensioners who are in receipt of one or more qualifying benefits.

- vi Maternity Allowance is paid for up to 26 weeks at a standard weekly rate, dependent upon earnings, to a person who cannot get Statutory Maternity Pay.
- vii Guardians' and Childs Special Allowance is payable to people bringing up a child because one or both of the parents has died. Responsibility for the payment of this allowance passed to HMRC in April 2003.

Where people receive more than one benefit these are generally paid together as a composite payment. This means that all of the amounts reported above consist partly or wholly of apportioned expenditure (see note 1).

State Pension and Bereavement Allowance includes payments to Northern Ireland pensioners living abroad as well as Great Britain. For administrative convenience these payments are made by the DWP with the cost for Northern Ireland being borne by the Great Britain NIF. It is not possible to provide an accurate figure for Northern Ireland's share of the expenditure on overseas pensions, but an estimate of the amount involved in 2005-2006 is £7.5 million (£7.8 million in 2004-2005).

9 Personal pensions

	2005-2006	2004-2005
	£000	£000
Personal pensions	2,514,703	3,441,358

The Pension Schemes Act 1993, supplemented by the Pensions Act 1995, entitles employed earners with a personal pension to a 'minimum contribution' to their plan from the NIF.

This, for 1997-1998 and later tax years, is based on earnings between the lower and upper earnings level and the age of the member. Similarly, from April 1997, members of Contracted Out Money Purchase (COMP) Schemes are entitled to a 'top-up' payment of age related rebate based on the age of the member and calculated using the earnings on which the contracted out rate of National Insurance contributions have been paid.

10 Administrative costs

Payments made in respect of Administration

	Notes	2005-2006	2004-2005
		£000	£000
Department for Work and Pensions	(i)	1,108,186	1,157,160
HM Revenue & Customs	(ii)	302,355	311,946
Department of Trade and Industry	(iii)	8,782	8,782
Department for Constitutional Affairs	(iv)	2,089	0
Office of National Statistics	(v)	750	681
Government Actuary's Department	(vi)	857	520
National Audit Office	(vii)	400	400
Debt Management Office	(viii)	258	282
Bank charges	(ix)	140	195
Scottish Executive Justice Department	(x)	74	58
General Register Office	(xi)	6	10
		1,423,897	1,480,034

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

- i For administration costs relating to the award and payment of contributory benefits on behalf of the Fund.
- ii For the collection of National Insurance contributions, maintenance of individual records and associated tasks.
- iii For the administration of the Redundancy Payments Scheme as required under the Employment Rights Act 1996. Including the cost of disputes referred to the Employment Tribunals Service.
- iv For the processing of applications for leave to appeal and appeals on points of law from decisions of the Appeals Service in respect of National Insurance benefits.

The administrative costs incurred by the Department for Constitutional Affairs (previously Lord Chancellors Department) for 2003-2004 and 2004-2005 were in dispute but have been paid in 2005-2006.

- v For services in relation to the administration of the National Insurance Scheme including the issue of certificates including replacements, prosecutions and deaths, processing of death registration, collation and issue of widow cards, processing of verifications and marriage validity checks.
- vi For actuarial services involving Social Insurance. The 2005-2006 charge also includes costs relating to some special exercises on Contracted-Out pensions and quinquennial review.
- vii For the annual audit of these Accounts and the production of the report thereon.
- viii For costs relating to the investment of NIF monies paid over to the National Debt Commissioners in pursuance of Section 161(3) of the Social Security Administration Act 1992.
- ix Bank charges incurred on the GB NIF bank account held at the Office of the Paymaster General.
- x For general costs in relation to the administration of the National Insurance Scheme i.e. to consider and issue decisions on applications and appeals in relation to National Insurance Benefits and medical appeal tribunals in Scotland.
- xi For services in relation to the administration of the National Insurance Scheme to include certificate verifications, extracts, death and postage.

11 Transfers to Northern Ireland NIF

	2005-2006 £000	2004-2005 £000
Payments to Northern Ireland NIF	185,000	270,000

The amount shown in this Account is in respect of financial adjustments made by the National Insurance Joint Authority between the Great Britain National Insurance Fund and the Northern Ireland National Insurance Fund in accordance with Section 177 of the Social Security Administration Act 1992.

These financial adjustments are consequential upon the arrangements made for co-ordinating the systems of insurance established in the two countries to ensure that they operate, to such an extent as is provided in those arrangements, as a single system. They adjust the balances in the two Funds in proportion to the population of working age as established by the latest available Census returns in the two countries. Payments are made on a provisional basis and are adjusted when end of year balances in the two funds are available.

12 Other payments

	Notes	2005-2006 £000	2004-2005 £000
Payments to Isle of Man	(i)	24,819	23,322
SSP/SMP/SPP/SAP payments	(ii)	3,316	2,570
Incapacity Benefit	(iii)	3,467	4,110
		<u>31,602</u>	<u>30,002</u>

- i Payments to the Isle of Man (Manx Insurance Fund) relate to net settlements in respect of people who have paid National Insurance contributions into one Fund but have received benefit from the other Fund.
- ii Payments made to people where their employer has failed to make the payments required under legislation.
- iii Under the Income Tax Acts, Incapacity Benefit is assessed as taxable income. Tax is deducted from Incapacity Benefit every time a payment is made to a person, and paid to HMRC, monthly in arrears.

13 Securities held by the Commissioners for the Reduction of the National Debt (CRND) at 31 March 2006

The National Debt Commissioners are responsible, in accordance with Section 161(3) of the Social Security Administration Act 1992 for the investments of the NIF. They are authorised to invest in accordance with directions given by Treasury and in line with the Memorandum of Understanding between HMRC and CRND as detailed in Note 4.

	Nominal Value £000	Cost Price £000	Market Value at 31 March 2006 £000
Government and Government Guaranteed Stocks			
Up to one year	19,567,828	19,681,512	19,735,298
One to five years	12,010,938	12,130,721	12,384,408
Five to ten years	2,517,693	2,668,055	2,824,620
Over ten years	360,762	317,877	433,307
Total securities	34,457,221	34,798,165	35,377,633

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

14 Closing balance

	Notes	31 March 2006 £000	31 March 2005 £000
Securities held by the CRND at cost (note 13)		34,798,165	27,840,460
Funds held by Paymaster General (incl. uncleared payments)		883	(455)
Other balances	(i)	(540,422)	1,262,600
		34,258,626	29,102,605

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

15 Losses

	Notes	2005-2006		2004-2005	
		Amount £000	No. of cases	Amount £000	No. of cases
Contributions NIF share *					
HMRC remissions and waivers	(i)	420,381	203,015	224,741	120,999
HMRC debt transferred	(ii)	675	0	4,548	0
Total contributions loss		421,056	203,015	229,289	120,999
Benefits	(iii)	42,709	132,999	27,600	93,112
Redundancy write-off	(iv)	239,920	0	179,008	0
Administration	(v)	920	29,960	1,040	20,229
Total losses		704,605	365,974	436,937	234,340

* HMRC wrote off in the 2004-2005 IRTrust Statement £333m time barred Class 2 debt. £137 million (97,084 cases) of this, as reflected in the HMRC remissions and waivers figure, was actually written off from contributor accounts in November 2005. A proportion of this being appropriate to the Northern Ireland National Insurance Fund, it is not possible for HMRC to provide details of the NI NIF share of that debt. Paragraphs 19-22 of the Statement on Internal Control outline this issue in more detail.

- i HMRC grants remissions in respect of unpaid contributions where pursuit is unlikely to be successful and waives arrears when pursuit of the debt is regarded as neither practical nor cost effective. The amount of £420,381,000 includes £308,818,000 in respect of remissions for the period October 2004 to October 2005.
- ii Relating to National Insurance debts in respect of insolvent companies where the National Insurance Contributions Office are responsible for the subsequent write-off or recovery.
- iii The Benefit losses are the responsibility of the DWP and can be attributed to the following

Serious and Organised Fraud

Investigations are done by the Fraud Investigation Service (Organised). A total loss of £1,939,000 was incurred on cases over £100,000 closed in 2005-2006, and are included in the Vote Losses and Special Payments statement of the DWP Consolidated Resource Account. These investigations involve frauds using false/hijacked identities to claim benefits and the theft and manipulation of instruments of payment. The persons committing the frauds are criminals usually working in a criminal network rather than ordinary benefit claimants.

Of the 13 cases which were concluded in the 2005-2006 year where the amount was in excess of £100,000, two were in excess of £250,000 and are briefly detailed below. Owing to the nature of the fraud involved it is not possible to separate out the elements relating to Vote funds and National Insurance Funds, hence the total has been included in the DWP Consolidated Resource Account Losses and Special Payments and included here as a note only.

Operation Valday

A Post Office Internal Fraud involving the Sub Postmaster manipulating his payment records and over claiming from the DWP with a total loss of £286,101. There was no specific benefit involved. The sum of £257,000 has been repaid to the DWP by the Post Office. The individual was sentenced to two years imprisonment.

Operation Achel

A Post Office Internal Fraud involving the Sub Postmaster stealing and manipulating order books with a total loss of £487,967. Because of the manipulations there is no way of allocating these losses to specific benefits. The individual involved was sentenced to three years imprisonment. The DWP is seeking to recover the money through the courts and the Proceeds of Crime Act.

Wherever possible the DWP seek to recover losses through either the DWP systems, the Courts or increasingly using their Financial Investigation Unit to recover the monies through the Proceeds of Crime Act. Overall 755 people were prosecuted successfully with 70 per cent receiving custodial sentences.

Write-off of debt through easement

The DWP overpayment initiative, agreed with Treasury, enables the write-off of non-recoverable benefit debt using estimating procedures. The aim is to re-target resources to more cost-effective recovery. During 2005-2006 the initiative dealt with 94,584 cases involving overpayments of National Insurance Fund benefits, writing off approximately £29.7million. These overpayments would not have been recoverable under Social Security legislation. They were caused primarily by official error.

Jobseeker's Allowance losses are reported in the DWP Consolidated Resource Account.

- iv The figure represents amounts written off during the year in respect of redundancy payments to employees, deemed irrecoverable from their employers mainly due to insolvency.
- v These losses are largely due to the write off of unrecoverable administration debts built up since 1993 where for various reasons DWP have been unable to obtain repayment and legal advice has confirmed that it would not be cost effective to pursue them further.

16 Special payments

	Notes	2005-2006		2004-2005	
		£000	No of cases	£000	No of cases
Wrongly advised benefit	(i)	2,087	4,200	1,770	3,435
Extra-Statutory payments to certain UK Residents with Australian Residence	(ii)	0	0	2,000	4,000
		<u>2,087</u>	<u>4,200</u>	<u>3,770</u>	<u>7,435</u>

- i Represents payments to claimants who have been wrongly advised on benefit entitlement.
- ii The Australian social security agreement ended with effect from 1 March 2001. An extra statutory payment scheme was set up to pay enhanced state retirement pension to those people resident in Australia during the currency of the Agreement, up to 5 April 2001, who have now returned to live permanently in the UK. On 18 November 2004, the Pensions Act 2004 introduced legislation to put these extra-statutory payments on a statutory footing.

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

Annex

Accounts Direction given by Her Majesty's Treasury

- 1 In accordance with Section 161(2) of the Social Security Administration Act 1992, HM Treasury hereby gives the following Direction.
- 2 HM Revenue & Customs has a duty to prepare each year a statement of the transactions on the National Insurance Fund of Great Britain. For the year ended 31 March 2006, and all subsequent years until this direction is amended, this statement shall comprise
 - a a foreword;
 - b an account of receipts and payments; and
 - c a statement of balances,
 and shall include such notes as may be necessary for the purposes referred to in the attached schedule.
- 3 The Accounting Officer shall observe all relevant accounts and disclosure requirements in '*Government Accounting*' and any other guidance issued by HM Treasury as amended or augmented from time to time.
- 4 The format of the statement of account and the disclosure requirements are in the attached schedule.
- 5 The foreword and the account shall be signed by the Accounting Officer.
- 6 The Accounts Direction shall be reproduced as an annex to the accounts.
- 7 This direction supersedes the Accounts Direction dated 16 October 2000.

Ian Carruthers FCA CFPA
Head of the Central Accountancy Team, HM Treasury

10 February 2006

Schedule - Format of Account and Disclosure requirements

- 1 The **foreword** shall state that the account has been prepared in accordance with a direction issued by Treasury in pursuance of Section 161(2) of the Social Security Administration Act 1992. The foreword will also include details of the following
 - a statutory background;
 - b operational responsibilities;
 - c financial performance;
 - d audit arrangements; and
 - e responsibilities of the Accounting Officer.
- 2 The **receipts and payments account** and **statement of balances** shall conform to the formats shown in the Annex, although minor variations may be made.
- 3 The **notes** shall include
 - a analysis of the payments and receipts included under the headings set out in the attached format, including any explanation or background that may be necessary to understand the accounts;
 - b in the note on administrative costs, the estimated costs for the current year and the adjustments for previous years separately identified;
 - c a statement of the securities in which the National Insurance Fund is invested by the National Debt Commissioners in accordance with Section 161(3) of the Social Security Administration Act 1992; and
 - d details of any irregular, uncertain or special payments.

Annex

Receipts and Payments Account for the year ended 31 March XXXX

	Notes	20XX-XX £000	20XX-XX £000
Receipts			
National Insurance contributions			
Grant from Class XIII, Vote 2			
Compensation for Statutory Sick pay and Statutory Maternity pay recoveries			
Compensation for Statutory Adoption pay and Statutory Paternity pay recoveries			
Income from investments			
State Scheme premiums			
Other receipts			
Redundancy receipts			
		_____	_____
		_____	_____
<i>Less</i>			
Payments			
Benefit payments			
Personal pensions			
Administrative costs			
Redundancy payments			
Transfers to Northern Ireland			
		_____	_____
Other payments			
		_____	_____
Excess of receipts over payments		_____	_____

Statement of Balances at 31 March

	Notes	20XX-XX £000	20XX-XX £000
Opening balance			
<i>Plus: Excess of receipts over payments (or less excess of payments over receipts)</i>			
Closing balance			

The notes on page X to X form part of these accounts.

Report by the Comptroller and Auditor General

Introduction

- 1 The National Insurance Fund (the Fund) provides for the receipt of contributions and for expenditure on benefits and allowances to individuals who have paid sufficient National Insurance contributions and have met other qualifying conditions. In 2005-2006, receipts amounting to £69.3 billion were paid into the Fund and payments of £64.2 billion were paid out of it. At 31 March 2006 the balance on the Fund was some £34.3 billion.
- 2 Until April 2005 the Inland Revenue was responsible for the collection of National Insurance contributions and the administration of the National Insurance Fund. Following the merger of the Inland Revenue and HM Customs and Excise this responsibility passed to HM Revenue and Customs (HMRC) which is now accountable for the Fund. In this report, references to HMRC also cover the functions of the Inland Revenue.
- 3 The Department for Work and Pensions (DWP) pays benefits to claimants and these are currently administered through the Pension Service and Jobcentre Plus. The Department for Trade and Industry is responsible for the Redundancy Payments Service which is funded by the National Insurance Fund. HMRC receives annual Letters of Assurance from the other Government Departments on their areas of responsibility.
- 4 This report records the results of my audit examination of the 2005-2006 account and developments, including
 - the estimated level of fraud and error in benefits paid from the National Insurance Fund;
 - the balance on the Fund and Investments in Gilts;
 - Incapacity Benefit recording in NIRS2;
 - employers' End of Year PAYE returns; and
 - age-related rebates –impact of delayed processing of electronic returns from employers.

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

- 5 In 2005-2006 DWP paid out £59.7 billion in benefits from the Fund. Most of this was for state pensions (£51.4 billion), incapacity benefits (£6.7 billion), bereavement benefits (£0.9 billion) and contribution-based jobseeker's allowance (£0.5 billion).
- 6 The National Audit Office, based on information provided by DWP and its own independent testing, has concluded that an estimated £250 million (some 0.4 per cent of benefits payments) may have been lost from the Fund in overpayments in 2005-2006 due to fraud and error. As Figure 1 shows, with the exception of Incapacity Benefit, where the estimates of fraud and error have increased from 1.2 per cent to 1.8 per cent of expenditure due to the DWP's latest annual review of official error, the estimates of fraud and error in 2005-2006 are in line with the levels reported in 2004-2005. While the overall level of fraud and error is significant, in all material respects the £59.7 billion of benefit payments made by the Fund are in accordance with the governing authorities and have been applied to the purposes intended by Parliament. On this basis I have decided not to qualify my opinion on the payments of these benefits.

Figure 1 : Estimates of benefit overpayments due to Fraud and Error

Benefit	2005-2006 NIF payments	Fraud and Error		2004-2005 NIF payments	Fraud and Error	
	£bn	£m	%	£bn	£m	%
State Pension	51.4	70	0.1	48.8	60	0.1
Incapacity Benefit	6.7	120	1.8	6.6	80	1.2
Contribution based – Jobseeker’s Allowance	0.5	30	6.0	0.4	30	6.8
Other Benefits ¹	1.1	30	2.7	1.2	30	2.5
Total	59.7	250	0.4	57.0	200	0.3

Notes

- 1 The estimated rate of fraud and error on un-reviewed benefits, for which the Department for Work and Pensions has no reliable review information, has been set at 2.7 per cent.
- 2 Overpayment estimates rounded to nearest £10 million.
- 3 Payments rounded to nearest £0.1 billion.

Source: *Fraud and error figures derived from Department for Work and Pensions Resource Account 2005-2006, note 44 Payment Accuracy.*

- 7 The DWP carries out extensive work to measure the level of fraud and error in the benefits system
 - Jobseeker’s Allowance is subject to a continuous rolling programme of checking, validation and fraud and error evaluation;
 - benefits not covered by the continuous measurement process, such as State Pension and Incapacity Benefit, are subject to periodic National Benefit Reviews which provide a snapshot assessment of fraud and error. The State Pension was reviewed in 2006. Incapacity Benefit was last reviewed in 2001;
 - Incapacity Benefit and State Pension are also subject to annual reviews to estimate the level of official error; and
 - for other benefits with lower levels expenditure and lower risks of fraud and error, annual statistical assessments of fraud and error are carried out based largely on historic data.

In undertaking the audit the National Audit Office reviews the work of the DWP in producing the estimate of fraud and error, including a review of its methodology, checking procedures and underlying sample work. The National Audit Office also undertakes its own work to validate independently the conclusions of the DWP.

- 8 The DWP exercises also provide data on underpayments in state pension and jobseeker’s allowance. The estimates of total underpayments from claimant error and official error are £73 million for state pension and £14 million for jobseeker’s allowance.
- 9 The DWP has launched a number of initiatives to tackle fraud and error in benefit payments, including contributory benefits funded by the National Insurance Fund. These initiatives, which are outlined in my report on the DWP Resource Accounts (HC 1710, 7 November 2006), include
 - on fraud: a publicity campaign to target fraud, legislative reform to support fraud investigations and the matching of client data between accessible systems to spot inconsistency and therefore potentially fraudulent claims;
 - on official error: the setting up of an Official Error Task Force to support a demonstrable and measurable reduction in benefit complexity and, by implication, official error rates; and
 - on customer error: consistent with previous Departmental initiatives, emphasis is being placed on preventing new error, reminding customers of their responsibilities and identifying and correcting error already in the benefits system.

- 10 My staff will continue to monitor the progress of these initiatives and I will report on them in due course.

The Balance on the Fund and Investments in Gilts

- 11 Parliament sets the rates for National Insurance contributions each year through its approval of rates set out in the Social Security Benefits Up-rating and Social Security (Contributions) (Re-rating and National Insurance Funds Payments) Orders. The contribution rates are set at levels intended to meet expected benefit payments each year, after taking into account other Fund receipts and payments, 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.
- 12 In his report on the financial provisions of the Social Security Bill in 1992, the Government Actuary confirmed it was prudent to plan for a minimum working balance of one sixth (16.7 per cent) of annual benefit expenditure. As the audited accounts show, at 31 March 2006 the balance on the National Insurance Fund was £34.3 billion – equivalent to some 57 per cent of annual benefit expenditure - an increase of £5.0 billion compared to 31 March 2005.
- 13 The balance of the Fund is one of the matters taken into account when Treasury Ministers review annually National Insurance contributions. This review is informed by the Government Actuary's annual report on the drafts of the Up-rating and Re-rating Orders, which also considers the projected balance of the Fund. In his report on the 2006 Up-rating and Re-rating Orders, the Government Actuary concluded that no Treasury balance is required for 2006-2007 as the balance of the Fund at 31 March 2007 is estimated to be £37.3 billion (60.1 per cent of estimated benefit payments) - and so significantly exceeds one-sixth of estimated payments. As Figure 2 shows, the Government Actuary forecasts that the balance on the Fund could rise by an average of £5.4 billion per year over the next five years to some £60.6 billion by March 2011, which would equate to almost 80 per cent of forecast annual benefit expenditure.

Figure 2: Balance on the NI Fund: Comparison of Fund balance and benefit payments to date and GAD projection

£ billion	2003-2004 Actual ¹	2004-2005 Actual ¹	2005-2006 Forecast	2006-2007 Forecast	2007-2008 Forecast	2008-2009 Forecast	2009-2010 Forecast	2010-2011 Forecast
Receipts	61.4	64.4	68.7	70.8	74.7	79.0	83.8	88.5
Payments	60.8	62.4	64.4	66.8	69.8	73.7	77.7	81.4
Excess of receipts over payments	0.6	2.0	4.3	3.9	4.9	5.3	6.0	7.1
Balance of Fund at end of year	27.0	29.0	33.4	37.3	42.3	47.5	53.5	60.6
Balance at end of year as a percentage of benefit payments	49.4	50.8	55.5	60.1	64.6	68.8	73.5	79.5

Source:

- 1 Figures for 2003-2004 and 2004-2005 taken from audited accounts.
- 2 Forecasts for 2005-2006 and following years taken from the Report by the Government Actuary on the drafts of the Social Security (Contributions) (Re-rating and National Insurance Funds Payments) Order 2006 Cm 6732 January 2006

- 14 The Fund is invested by the Commissioners for the Reduction of the National Debt (CRND) in a mixture of 'non-marketable' gilt-edged securities and short-term deposits. During 2005-2006 HMRC conducted a review of the governance arrangements for the Funds investments and the investment policy. Following discussions with the Treasury, a new investment policy will be implemented from December 2006.

Incapacity Benefit recording in NIRS2

- 15 The National Insurance Recording System (NIRS2) maintains details on over 70 million National Insurance accounts for individual contributors and approximately one million new accounts are created each year. The NIRS2 system supports a number of activities contributing to pension and benefit payments. It records details of individuals' and employers' National Insurance contributions, provides information which allows the calculation of contribution based benefits, provides data to other Government Departments and supports the payment of age-related contribution rebates to occupational and personal pension holders.
- 16 Individuals in receipt of Incapacity Benefit payments also receive National Insurance credits. The DWP's Pension Service Computer System (PSCS) which is used to record, assess and pay claims for Incapacity Benefit, provides NIRS2 with information on Incapacity Benefit liabilities to allow the relevant credits to be recorded against the individual's National Insurance account. These contribution credits are used in the calculation to determine whether a particular tax year is a qualifying year for benefit purposes.
- 17 As I have previously reported, the move from NIRS to NIRS2 in 1998 resulted in a range of conversion problems, including some relating to Incapacity Benefit recording. Due to the prioritisation of examination of these conversion problems, HMRC only began to consider the issues surrounding the recording of Incapacity Benefit in 2002-2003. In September 2004, HMRC and DWP became aware that the information on periods of incapacity on NIRS2 and on PSCS did not match in all cases.
- 18 In 2005 the Departments worked together on a preliminary exercise to understand the nature of the problem by running data comparisons between PSCS data and that held on NIRS2. This work allowed them to identify the ways in which customers might be affected but did not allow them to estimate the number of contributors' accounts affected or the financial impact. Incorrect or missing information for periods of incapacity on an individual's National Insurance contribution record on NIRS2 could cause a number of incorrect actions. These include possible errors in the payment of contribution based benefit claims and pensions as a result of inaccurate recording of Incapacity Benefit liabilities in the system.
- 19 From November 2005, the link on recording Incapacity Benefit between PSCS and NIRS2 computer systems has worked effectively. HMRC and DWP have also looked at other processing issues that have contributed to some ongoing data inconsistencies, and a plan of necessary corrective action is currently being developed by both departments. HMRC is now working with the DWP on a project to identify and correct missing or erroneous periods of incapacity liability recorded on NIRS2.
- 20 During 2006, the DWP scanned the PSCS system to identify all periods of incapacity recorded. This identified some 12 million separate incapacity liability periods relating to some 8.6 million accounts. As part of a preliminary analysis, HMRC has matched the results of the scan against the corresponding records for periods of incapacity liability recorded on a sub-set of the NIRS2 database. The results of this matching exercise have been used to identify
- the full range of scenarios that might arise from mismatched records;
 - the possible actions needed to review and correct NIRS2 and, in some instances, PSCS records; and
 - where the changes result in a change in benefit entitlement in a prior period, the arrangements for corrective action. The action that is taken in respect of over and under payments will need to be authorised by HMRC and DWP Ministers.
- 21 The full extent of the errors in the NIRS2 contribution records and the financial consequences in terms of overpayments and underpayments of benefit will not be known until a full data check across all NIRS2 contribution accounts is completed. HMRC expect to begin a full review of NIRS2 contribution accounts based on an updated scan of the PSCS database in the first half of 2007.

- 22 The National Audit Office will continue to monitor the progress against the HMRC action plan for identifying and correcting mismatches between the data held on PSCS and NIRS2. It will also examine the action taken where inaccurate incapacity data has led to claimants being paid the wrong benefit, or being disadvantaged in other ways. I will report on these developments in due course.

Employers' End of Year PAYE Returns

- 23 Inaccurate information in employers' End of Year Returns can in some instances prevent HMRC from matching National Insurance contributions information to the relevant contributor records. These non matching items generally concern short-term or low-paid workers, where there is little incentive for either employee or employer to provide the details. HMRC applies matching routines in NIRS2 in an effort to resolve these cases. If it is not able to resolve these items they are kept permanently on non-matched Suspense Files. HMRC can examine and retrieve unmatched items from the Suspense Files when it receives information from individuals on the completeness of their record.
- 24 HMRC estimates that the current number of unmatched items held in the Suspense Files is 112 million. As part of improvement strategies to protect contributor account data and future benefit entitlement HMRC plans to perform further work analysing extracts of data from the last three tax years, 2003-2004 to 2005-2006. HMRC plans that this analysis should be completed by July 2007 which will then allow findings to be evaluated against ongoing strategies to improve data quality improvements and reduce the number of non matched items.
- 25 HMRC has also introduced a number of initiatives which will assist it in managing unmatched items going forward. Under the Modernising PAYE Processes for Customers (MPPC) project, from April 2005 it is mandatory for all large employers (those with more than 250 employees) to submit End of Year Returns electronically. Medium-sized employers (50 – 249 employees) must file online from 2006. Online filing is helping to ensure a consistent standard in the quality of data received and more accurate information from employers. Employer error rates for Returns sent over the internet fell from 13 per cent in 2005 to 5 per cent in 2006. In addition, from July 2005 it has provided employers with schedules of correct information and National Insurance numbers, to help ensure that their returns are correct for the following year and that employees have their correct National Insurance number.

Age-related rebates - Impact of delayed processing of electronic returns from employers

- 26 Individuals who contract out of the State Earnings Related Pension Scheme (SERPS) or the Second State Pension (S2P) are entitled to a percentage rebate (the age-related rebate) of their National Insurance contributions, which is paid to the pension provider. These rebate payments are triggered by HMRC processing individuals' End of Year returns from their employer.
- 27 As I reported last year, the problems with the introduction of a new system to support the processing of 2004-2005 End of Year Returns submitted electronically resulted in delays in the processing and the payment of age related rebates to the pension providers. The External Routing Interface Component (ERIC) was originally planned to go live at the start of the 2005-2006 financial year but was delayed until 5 July 2005. Despite the delay, a contingency back-up system allowed 935,000 employers to file online successfully (compared with 85,000 in 2003-2004), and limited the adverse effects to data processing.
- 28 HMRC aims to pay at least 80 per cent of age-related rebates by 1 October, six months after the end of the financial year to which they relate. In practice the delays encountered in processing employers End of Year returns for 2004-2005 meant that this was not possible. In the event HMRC paid around 70 per cent of rebate payments by 1 November 2005 and achieved its 80 per cent payment target by 1 December 2005. In some cases, however, because of the complexity of a small number of exceptional cases, it has taken over 12 months to complete the processing of returns and some age-related rebates for 2004-2005 are still outstanding.
- 29 HMRC consulted with the pensions industry representatives and other interested parties throughout the summer of 2005 on the delays in processing and their implications for the processing of age-related rebates. As noted in the Statement on Internal Control, HMRC has received one significant claim seeking the outstanding age-related rebate for the sum of £1.8 million, which has now been paid, plus a claim for compensation which is being considered.

- 30 The processing of 2005-2006 End of Year Returns has run much more smoothly than in the first year that ERIC was implemented and targets are being achieved. By the beginning of October 2006 HMRC had processed 80 per cent of all End of Year returns to NIRS2 and had paid 82 (target 80 per cent) of the total number of expected rebate payments.

Summary and Conclusions

- 31 The National Audit Office has estimated that £250 million may have been lost from the Fund in overpayments in 2005-2006 due to fraud and error. While this level of error and fraud is significant, equivalent to some 0.4 per cent of benefits payments and higher than in the previous year, in all material respects the £59.7 billion of benefit payments made from the Fund have been applied in accordance with Parliament's intentions. I have therefore decided not to qualify my opinion on the payments of these benefits.
- 32 HMRC's investigation into the problems in recording incapacity liabilities on NIRS2 have revealed significant differences between its records and those of the DWP. Despite having first become aware of this problem in 2004, DWP and HMRC still cannot quantify the consequences in full for individual benefit recipients. DWP and HMRC have nevertheless developed and tested an approach for beginning the large and complex task of checking and, where necessary, updating periods of incapacity liability on PSCS and NIRS2. They will start this project in 2007-2008.
- 33 As reported in previous years, inaccurate National Insurance contributions information from employers continues to generate contribution items that cannot be matched to relevant contributors' records. HMRC's initiatives over recent years to improve the quality of data submitted by employers have been undermined by problems with certain IT processing systems. However the problems encountered in 2005 have been largely overcome in 2006, when HMRC has been able to process 2005-2006 employer End of Year Returns in line with targets and reduce employer error rates.

John Bourn
Comptroller and Auditor General

22 December 2006

National Audit Office
157-197 Buckingham Palace Road
Victoria, London
SW1W 9SP

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP
Tel: 020 7798 7400
Email: enquiries@nao.gsi.gov.uk

DG Ref: A05160 6909RC

Published by TSO (The Stationery Office) and available from:

Online

www.tso.co.uk/bookshop

Mail, Telephone, Fax & E-mail

TSO

PO Box 29, Norwich NR3 1GN

Telephone orders/General enquiries 0870 600 5522

Fax orders 0870 600 5533

Order through the Parliamentary Hotline

Lo-call 0845 7 023474

E-mail book.orders@tso.co.uk

Textphone 0870 240 3701

TSO Shops

123 Kingsway, London WC2B 6PQ

020 7242 6393 Fax 020 7242 6394

16 Arthur Street, Belfast BT1 4GD

028 9023 8451 Fax 028 9023 5401

71 Lothian Road, Edinburgh EH3 9AZ

0870 606 5566 Fax 0870 606 5588

The Parliamentary Bookshop

12 Bridge Street, Parliament Square,

London SW1A 2JX

Telephone orders/General enquiries 020 7219 3890

Fax orders 020 7219 3866

Email bookshop@parliament.uk

Internet www.bookshop.parliament.uk

TSO@Blackwell and other Accredited Agents

ISBN 978-0-10-328659-4



9 780103 286594