

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

---

# National Insurance Fund Account 2006-2007

ORDERED BY THE HOUSE OF COMMONS TO BE PRINTED 1 APRIL 2008

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

The Comptroller and Auditor General, Tim Burr, 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 £9 for every £1 spent running the Office.

This account can be found on the National Audit Office web site at  
[www.nao.org.uk](http://www.nao.org.uk)

# Contents

	Page
Foreword	2
Statement on Internal Control	4
The Certificate of the Comptroller and Auditor General	9
Receipts and Payments Account	11
Notes to the Account	12
Accounts Direction	21
Annex	23
Report by the Comptroller and Auditor General	24

## 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 (now HM Revenue & Customs (HMRC)).
- 4 The Acting Chairman of HMRC is the Interim Principal Accounting Officer for the Fund. HM Treasury appointed me as Interim Principal Accounting Officer for HMRC with effect from 21 November 2007. 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

- 5 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.
- 6 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.
- 7 The Department for Business, Enterprise and Regulatory Reform (DBERR) is responsible for making Redundancy Payment Scheme awards with the Insolvency Service, an agency of DBERR, handling the payment of awards and collection of receipts.
- 8 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).
- 9 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

- 10 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

- 11 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.
- 12 The balance on the fund has increased by £3,961 million compared with the position at 31 March 2006 (£34,259 million). At 31 March 2007 the balance held is £38,220 million (62 per cent of annual benefit expenditure).
- 13 The Government Actuary's latest Report on the Government's Benefits Up-rating and Contributions Re-rating Orders was tabled in January 2008 alongside the 2008 Up-rating Order and the Re-rating Orders. The Orders, which will cover the financial year 2007-2008, are subject to debate and require the approval of both Houses.
- 14 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 the 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 Interim Principal Accounting Officer for the NIF. My relevant responsibilities as Interim Accounting Officer, including my responsibility for the propriety and regularity of the public finances for which I am answerable, and for keeping of proper records, are set out in the Accounting Officers' Memorandum issued by HM Treasury and published in 'Government Accounting' (now called 'Managing Public Money' since 1 October 2007). Many of the activities relating to the transactions of the NIF are carried out by other departments (DWP and DBERR) and agencies on my behalf, and I receive letters of assurance from them as detailed in the Statement on Internal Control.

*Dave Hartnett*  
Interim Principal Accounting Officer

8 February 2008

## 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 Interim Principal 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 (called 'Managing Public Money' since 1 October 2007).
- 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 (DWP) is responsible for benefit payments and the Insolvency Service, an agency of the Department for Business, Enterprise and Regulatory Reform (DBERR), 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 (SICs) 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 to 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 2007 and up to the date of the approval of the accounts, and accords with HM Treasury guidance.
- 5 Specific work undertaken on behalf of the NIF only forms a small part of the whole work of HMRC. A separate SIC is produced for the HMRC 2006-2007 Accounts that fully sets out details of HMRC's capacity to handle risk and its risk and control framework, as well as including disclosures that relate to issues outside of the scope of work relating to the NIF. The full SIC can be found in HMRC's published Accounts for 2006-2007.

### Capacity to handle risk

- 6 We continue to review and adapt the Department's risk management arrangements to ensure they are fit for purpose. Following the loss of Child Benefit customer data in October 2007 urgent measures have been put in place to improve the Department's security arrangements over customer data. An independent investigation into the Department's security procedures has already resulted in an interim report which was published on 17 December 2007. The Department will action recommendations contained within the full report (due for publication in the spring) and any further interim recommendations notified to the Department. Other reviews into the data security breach are ongoing and recommendations emerging from those reviews will also be actioned.
- 7 As head of the Department, I have a key role to play in promoting and supporting the risk management strategy. I am supported by Executive Committee members who are accountable for identifying, assessing and managing the risks within their portfolio. In turn, Directors are accountable to their Executive Committee members for risk management within their Directorates, and reporting on the actions they are taking to mitigate them.
- 8 The Audit Committee, supported by Internal Audit and informed by the work of National Audit Office (NAO), provides me with independent advice on the effectiveness of the Department's governance, risk and control arrangements.

- 9 The Risk Committee is a sub-committee of the Executive Committee, with responsibility for taking an overview of risks facing HMRC and ensuring effective risk management. The Committee
- Challenges the effectiveness of risk management and risk mitigation in HMRC;
  - Recommends future generic or specific measures to reduce risk;
  - Monitors and steers the management of existing risks; and
  - Identifies new risks and allocates ownership.

### The risk and control framework

- 10 The current approach to risk management in HMRC involves the upward reporting of risks. The primary mechanism for this is the Directors' monthly and quarterly performance reports. These Director-level risks inform the strategic risk management process, which is focused around the Departmental Risk Register. Ownership of the risks in the Departmental Risk Register is assigned at Executive Committee level, and at the next level of management down – the Delivery Manager.
- 11 The administration of National Insurance (NI) involves a number of business areas within HMRC ranging from processing offices through to information technology and debt management. A National Insurance Management Board (NIMB) has been set up to ensure that the different directorates involved in NI work together, at a strategic level, to plan, manage and improve the performance of the process. The NIMB sets key performance indicators, maintains a strategic risks and issues register, monitors and reports progress, and addresses any major performance issues arising within NI.
- 12 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

- 13 As Interim Principal Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by executive managers within the Department who have responsibility for the development and maintenance of the internal control framework, by the work of the internal auditors and comments made by NAO in management letters and other reports.
- 14 To provide me with an assurance on the effectiveness of the system of internal control, the Director of Internal Audit provides me with an annual opinion, a summary of the findings from every internal audit review, and he alerts me to significant control issues as they arise. The Chairman of the Audit Committee, who is a non-executive Board member, provides the Board with a written report after each Audit Committee meeting.
- 15 I discuss significant control issues with my executive team at our regular Executive Committee meetings. These meetings are informed by an assessment of our current exposure to risks associated with our major programmes and projects. They are further informed by feedback from a series of performance reviews held each quarter between the relevant Executive Committee manager and Director. The focus of these reviews is the progress being made in each Director's area to deliver value and the key issues/risks that could prevent the achievement of key targets/objectives by the year end. I also receive a detailed, monthly Management Report, which highlights potential areas of concern.

- 16 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 statements into account, and observations from the Director of Internal Audit, the National Insurance Management Board, and from NAO, I recognise that there are a number of significant control weaknesses relating to the NIF. These are detailed below. All of these issues apply to both the Great Britain and Northern Ireland Funds, and numbers of items and monetary amounts quoted are the total impact across both Funds.

### **Age Related Rebates (ARRs) – Outstanding debt**

- 17 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.
- 18 Recoveries of ARR take place where, for example, there are downward adjustments to earnings information on an individual's NI account. There are two methods of recovering overpayments; automatically via the National Insurance Recording System 2 (NIRS2) – where recoveries are made from ARR payments due, or by the issue of a bill.
- 19 Where a bill is issued it should be followed up with a reminder if it remains unpaid. This process was not carried forward to NIRS2 and the issue was compounded by significant problems/system faults (which have since been fixed) that existed at the time with the new financial functionality. As a consequence, outstanding debts totalling £27.4 million have remained unacted.
- 20 Plans have been developed and we will enter into discussions with the Pensions Industry to agree how the recoveries will be handled.

### **Class 2 National Insurance 'debt' balances**

- 21 The level of debt apparently associated with outstanding Class 2 National Insurance Contributions (NICs) is a matter of concern and was also reported on in the 2005-2006 NAO standard report. To address the issue, HMRC decided that
- A Director level group should oversee the issue; and
  - A review should be undertaken with the aim of recommending proposals for change, including the possibility of the collection of Class 2 liability via the Self Assessment (SA) return.
- 22 This work has been monitored through the Class 2 NICs Directors Group and following the Class 2 Processes Review a number of minor changes have been introduced to improve the position. These include laying greater emphasis on payment by direct debit and, recognising that most Class 2 debts are very low value, wherever possible linking Class 2 and SA arrears for collection. Further improvement is likely to be achievable only through policy change. In the HM Treasury Report on Tax and NICs alignment published with the 2007 Pre Budget Report it was recognised that the two separate classes of self-employed NICs collected through two separate HMRC processes could be confusing for the self-employed. The Report while not proposing merging of Class 2 and Class 4 NICs announced that HMRC would be consulting on the scope for improvements to the collection of NICs from the self employed. It is expected that this consultation will start shortly.

### **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 we have continued our work with the DWP to establish the full scope and extent of these mismatches.



- 24 Having carried out a detailed comparison with the NIRS2 data we believe we now have a good idea of the extent and significance of mismatches that have occurred. There has been close liaison with DWP on this issue and a Ministerial Statement was made on 23 July 2007. In respect of cases where an overpayment may have occurred, the DWP have introduced regulations allowing the continued payment of these benefits at their current level to the individuals concerned for the duration of their claim.
- 25 Where the individual is under pension age the National Insurance contribution records will be corrected so that future claims will be correctly assessed. Where correcting the record results in any gaps in an individual's contribution record, HMRC will write to the individuals concerned advising them of the options for paying any missing contributions. DWP have started work on the cases and plan to complete the work on underpaid cases by early 2008.
- 26 During the course of the correction exercise it was found that in some cases the presence of incorrect approved training credits were preventing incapacity credits being posted across to NIRS2. These incorrect training credits were therefore removed and processes reviewed to prevent this from happening in future. Work is on-going to establish the extent of this issue outside those cases with incapacity credits.

### **Non matching contribution items**

- 27 In some instances we receive end of year information from employers that includes National Insurance contributions information that cannot be matched to the relevant contributor records. We apply well established routines to trace these non-matching items and make all reasonable effort to update contributor records. Where the items still cannot be matched they are kept permanently on non-matched suspense files. These are maintained to ensure that when an individual queries the completeness of their contribution record we can retrieve unmatched items from suspense files and credit them to the individual's contribution record.
- 28 Up to 2005-2006 the suspense files contained approximately 118 million items. For both the 2004 and 2005 tax years, some 1.7 million new items were added to the suspense files. This represents about three percent of each year's returns. We continue to undertake detailed analysis and work closely with key inter-departmental stakeholders to develop strategies to improve the quality of the data submitted from employers.

### **Home Responsibilities Protection (HRP)**

- 29 HRP was introduced in April 1978 to assist people, especially women, who were precluded from work for periods of caring responsibilities. HRP does not enhance a person's National Insurance record and does not appear as earnings, but is used to reduce the number of qualifying years needed to earn a 100% basic State Pension.
- 30 In Child Benefit cases HRP is normally recorded automatically when data is passed from the Child Benefit system to the National Insurance Recording System (NIRS). Before May 2000, there was no mandatory requirement for people claiming Child Benefit to provide their NI number and, where it was not provided, HMRC could not always match the Child Benefit data with the correct NI record, therefore some people may not have had their entitlement to HRP noted on their NI account.
- 31 Since the inception of HRP in 1978 there has been a clerical process in place to match Child Benefit data with the correct NI record, which involves writing to the individual to ask for their NI number, however replies were not followed up. There is no time limit on entitlement to HRP based on child benefit awards and any claims for HRP are investigated and, where appropriate, recorded on the individual's record. This information is then available when it is time to work out an individual pension award or it will automatically activate a Tax Year Review to re-visit a pension award.
- 32 We are currently investigating cases where people have raised queries with us about their entitlement to HRP. We are working with DWP to undertake a scan of the NIRS database which should help to identify other people affected by this issue. Current proposals would see this introduced during 2008.

### Assurance from DWP in respect of Contributory Benefit payments

- 33 A Letter of Assurance has been received from the DWP that has been approved by their Audit Committee. It contains details about their capacity to handle risk and their risk control framework. The letter indicates significant internal control issues, which are described at high level below.
- 34 In 2006-2007, contributory benefits funded from the National Insurance Fund totalled £62.1 billion, which included £53.8 billion related to State Pension and £6.7 billion related to Incapacity Benefit. The remainder included 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 and Bereavement Benefit were approximately £130 million (0.2 per cent) in 2006-2007 and in relation to Incapacity Benefit approximately £110 million (1.7 per cent).
- 35 Debt recovery remains an ongoing priority for DWP. Significant progress has been made in addressing debt recovery targets and this was recognised by the C&AG in his 2006-2007 audit report.
- 36 The Incapacity Benefit Credits issue raised by DWP in their letter of assurance is described in paragraphs 22-25 above.
- 37 Non-compliance with DWP processes, operational instructions, controls and checks is a long-standing issue which received significant management attention during 2006-2007, and priority will continue to be given to this issue in 2007-2008.

### Assurance from DBERR in respect of the Redundancy Payments Scheme

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

*Dave Hartnett*  
Interim Principal Accounting Officer

8 February 2008

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

I certify that I have audited the financial statements of the Great Britain National Insurance Fund for the year ended 31 March 2007 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 Chairman of the Board of HM Revenue & 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 Great Britain 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 8 reflects the Great Britain 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 Great Britain 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 Great Britain 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.

## Opinions

### Audit opinion

In my opinion

- the financial statements properly present the receipts and payments of the Great Britain National Insurance Fund for the year ended 31 March 2007 and the balance held at that date; and
- the financial statements have been properly prepared in accordance with Section 161(2) of the Social Security Administration Act 1992 and HM Treasury directions made thereunder.

### Audit Opinion on regularity

In my opinion, in all material respects, the financial transactions have been applied to the purposes intended by Parliament and conform to the authorities which govern them.

My report on the financial statements is at pages 24 to 29.

*T J Burr*  
Comptroller and Auditor General

28 March 2008

National Audit Office  
151 Buckingham Palace Road  
Victoria  
London SW1W 9SS

# Receipts and Payments Account for the year ended 31 March 2007

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

	Notes	2006-2007 £000	2005-2006 £000
<b>Receipts</b>			
National Insurance contributions	2	<b>68,211,839</b>	66,402,164
Compensation for statutory pay recoveries	3	<b>1,160,089</b>	1,351,889
Income from investments	4	<b>1,846,136</b>	1,363,605
State Scheme premiums	5	<b>73,828</b>	114,791
Other receipts	6	<b>51,280</b>	63,460
Redundancy receipts	7	<b>40,811</b>	37,553
		<b>71,383,983</b>	69,333,462
<i>Less</i>			
<b>Payments</b>			
Benefit payments	8	<b>62,054,551</b>	59,729,065
Personal pensions	9	<b>3,019,671</b>	2,514,703
Administrative costs	10	<b>1,433,476</b>	1,423,897
Redundancy payments	7	<b>245,454</b>	293,174
Transfers to Northern Ireland NIF	11	<b>630,000</b>	185,000
Other payments	12	<b>39,659</b>	31,602
		<b>67,422,811</b>	64,177,441
Excess of receipts over payments		<b>3,961,172</b>	5,156,021

## Statement of balances

Opening balance		<b>34,258,626</b>	29,102,605
<i>Plus</i>			
Excess of receipts over payments		<b>3,961,172</b>	5,156,021
Closing balance	14	<b>38,219,798</b>	34,258,626

*Dave Hartnett*  
Interim Principal Accounting Officer

8 February 2008

*The notes on pages 12 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 by the Fund 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 2006-2007.

### *Payment of Social Security benefits*

The DWP administers a range of social security benefits, financed either from the NIF or from the Consolidated Fund. 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 primarily paid by credit transfer; with a small percentage being paid by cheque or payable order. The DWP accounts for benefit expenditure using the Programme Accounting Computer System (PACS). This system is used as the basis for producing the benefit payment figures that are accounted for in the NIF Account.

### *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	2006-2007 £000	2005-2006 £000
<b>Contributions</b>			
Class 1 (employed earner)	i	<b>65,104,163</b>	63,402,276
Class 1A & 1B	ii	<b>1,056,509</b>	1,031,396
Class 2 (self-employed flat rate)	iii	<b>308,756</b>	304,699
Class 3 (voluntary contributions)	iv	<b>111,366</b>	136,440
Class 4 (self-employed earnings related)	v	<b>1,631,045</b>	1,527,353
		<b>68,211,839</b>	66,402,164

Different groups of people pay different classes of contributions. These can be summarised as follows

- i Class 1 contributions are divided into two parts: primary contributions payable by employees and secondary contributions payable by employers.
- ii Class 1A contributions are paid by employers on most benefits provided to employees. Employers pay Class 1A contributions to the HMRC Pay As You Earn (PAYE) 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 PAYE 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 £18.9bn in 2006-2007 (£18.4bn 2005-2006).

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

	Notes	2006-2007 £000	2005-2006 £000
Statutory Sick and Statutory Maternity pay	i	1,134,000	1,325,000
Statutory Adoption and Statutory Paternity pay	ii	26,089	26,889
<b>Total</b>		<b>1,160,089</b>	<b>1,351,889</b>

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. The amounts paid over are based on estimates.

- 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 recoveries are paid over by the DBERR.

#### 4 Income from investments

	<b>2006-2007</b> <b>£000</b>	2005-2006 £000
Interest received	<b>1,999,623</b>	1,428,781
Profit on realisation	<b>331,180</b>	0
Losses on realisation	<b>(484,667)</b>	(65,176)
	<b><u>1,846,136</u></b>	<u>1,363,605</u>

During the year the value of investments at cost increased from £34.8 billion at 31 March 2006 to £38.6 billion at 31 March 2007 (Note 13).

The responsibilities of HMRC and the Commissioners for the Reduction of National Debt (CRND) in respect of the investment of surplus NIF funds are set out in a Memorandum of Understanding. A change to the NIF Investment Strategy made during 2006-2007 is described in Note 13.

#### 5 State Scheme premiums

	<b>2006-2007</b> <b>£000</b>	2005-2006 £000
State Scheme premiums	<b>73,828</b>	114,791

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 person's entitlement to an additional state pension. The collection total of £73,828,000 (2005-2006: £114,791,000) is net of refunds of £8,021,000 (2005-2006: £8,038,000).

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 the State Earnings Related Pension Scheme (SERPS). Individuals were not required to pay premiums for the years that they were contracted out of SERPS but HMRC is seeking recovery of these premiums from the Maxwell pension schemes.

By 31 March 2007, around 31,449 individuals had been brought back into SERPS with a liability of some £128,719,590 of which £42,249,148 had been recovered. 150 new members were identified between 1 April 2006 and 31 March 2007 with a total liability of £269,783. However, 138 members previously identified as Maxwell members were found to be members of other pension schemes – the total liability for these members amounts to £392,372, which has been removed. A total of £3,000,000 was recovered in 2006-2007.

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 were actually members of another. However, the pension liability for these members has to be transferred 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 £128.7 million liability will be recovered.



## 6 Other receipts

	Notes	2006-2007 £000	2005-2006 £000
Recoveries of compensation payments	i	48,011	60,502
Unemployment benefit recoveries	ii	3,099	2,958
Compensation receipts	iii	170	0
		<b>51,280</b>	<b>63,460</b>

- 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 Jobseekers Allowance in October 1996 and these are retrospective recoveries. These recoveries are all reimbursements to the NIF from European countries for their citizens who have been paid unemployment benefit in the UK.
- iii Compensation received from HMRC for failure to collect Class 2 contributions.

## 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 DBERR.

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 2007 was £107 million, which is disclosed in the DBERR Resource Account.

	2006-2007 £000	2005-2006 £000
<b>Outstanding debt as at 31 March</b>	<b>97,261</b>	81,560
<i>Plus</i> Redundancy payments	<b>245,454</b>	293,174
<i>Less</i> Receipts	<b>(40,811)</b>	(37,553)
<i>Less</i> Debt written off	<b>(194,675)</b>	(239,920)
<b>Outstanding debt as at 31 March</b>	<b>107,229</b>	<b>97,261</b>

## 8 Benefit payments

	Notes	2006-2007 £000	2005-2006 £000
State Pension	i	53,785,935	51,376,529
Incapacity Benefit	ii	6,682,940	6,703,549
Bereavement Benefits	iii	799,368	874,412
Jobseeker's Allowance (contributory)	iv	482,276	484,949
Maternity Allowance	v	175,492	164,538
Christmas Bonus for pensioners	vi	126,633	123,525
Guardian's Allowance and Child's Special Allowance	vii	1,907	1,563
		<b>62,054,551</b>	<b>59,729,065</b>

- 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 benefits consist of Bereavement Allowance, which is a regular payment for 52 weeks, and Bereavement Payment, which is a lump sum payment. Both are based on the National Insurance contributions of the deceased spouse.
- 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 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.
- vi Christmas Bonus is a tax free payment of £10 paid before Christmas to pensioners who are in receipt of one or more qualifying benefits.
- vii Guardian's Allowance and Child's Special Allowance is payable to people bringing up a child because one or both of the parents has died.

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 Benefits include 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 2006-2007 is £7.2 million (£7.5 million in 2005-2006).

## 9 Personal pensions

	<b>2006-2007</b>	2005-2006
	<b>£000</b>	£000
Personal pensions	<b>3,019,671</b>	2,514,703

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 1997-98 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	2006-2007 £000	2005-2006 £000
DWP	i	<b>1,111,733</b>	1,108,186
HMRC	ii	<b>286,200</b>	302,355
Tribunals Service	iii	<b>23,946</b>	0
DBERR	iv	<b>8,782</b>	8,782
Tribunals Development Group	v	<b>1,019</b>	2,089
Office of National Statistics	vi	<b>791</b>	750
Government Actuary's Department	vii	<b>189</b>	857
National Audit Office	viii	<b>400</b>	400
Debt Management Office	ix	<b>196</b>	258
Bank charges	x	<b>136</b>	140
Scottish Executive Justice Department	xi	<b>78</b>	74
General Register Office	xii	<b>6</b>	6
		<b>1,433,476</b>	<b>1,423,897</b>

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 administration, organisation and holding of appeals in respect of National Insurance related benefits arising from decisions of the Department for Work and Pensions. This is a new agreement for 2006-2007.
- iv 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.
- v 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.
- vi For services in relation to the administration of the National Insurance Scheme to include 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.
- vii For actuarial services involving Social Insurance. The 2005-2006 charge included costs relating to some special exercises on contracted-out pensions and the quinquennial review.
- viii For the annual audit of these Accounts.
- ix 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.
- x Bank charges incurred on the GB NIF bank account held at the Office of the Paymaster General.
- xi For general costs in relation to the administration of the National Insurance Scheme i.e. consider and issue decisions on applications and appeals in relation to National Insurance Benefits and medical appeal tribunals in Scotland.
- xii 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**

	<b>2006-2007</b>	2005-2006
	<b>£000</b>	£000
Payments to Northern Ireland NIF	<b>630,000</b>	185,000

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 coordinating 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	<b>2006-2007</b>	2005-2006
		<b>£000</b>	£000
Payments to Isle of Man	i	<b>28,303</b>	24,819
SSP/SMP/SPP/SAP payments	ii	<b>2,938</b>	3,316
Incapacity Benefit	iii	<b>3,434</b>	3,467
State Pension Lump Sum	iv	<b>4,984</b>	0
		<b>39,659</b>	31,602

- 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 Act 2007, Incapacity Benefit is assessed as taxable income. Tax is deducted from Incapacity Benefit every time a payment is made to a customer and paid to HMRC monthly in arrears.
- iv Under the Income Tax Act 2007, State Pension Deferred Lump Sum is assessed as taxable income. Tax is deducted from State Pension Deferred Lump Sum every time a payment is made to a customer and paid to HMRC monthly in arrears.

**13 Securities held by the Commissioners for the Reduction of the National Debt (CRND) at 31 March 2007**

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.

Following a review by HMRC, CRND and HM Treasury, a change to the NIF investment strategy was approved in December 2006; this change has resulted in lower administrative charges to the NIF. The change was actioned in January 2007 when all gilt holdings were sold and the proceeds placed into the Debt Management Account Deposit Facility (DMADF).

	<b>31 March 2007</b>
	<b>£000</b>
Monies deposited in the Debt Management Account Deposit Facility	<b>38,646,381</b>

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

#### 14 Closing balance

	Note	<b>31 March 2007 £000</b>	31 March 2006 £000
Securities held by the CRND at cost (note 13)		<b>38,646,381</b>	34,798,165
Funds held by Paymaster General (including uncleared payments)		<b>(4,272)</b>	883
Other balances	i	<b><u>(422,311)</u></b>	<u>(540,422)</u>
		<b><u>38,219,798</u></b>	<u>34,258,626</u>

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

#### 15 Losses

	Notes	<b>2006-2007</b>		2005-2006	
		<b>Amount £000</b>	<b>No. of cases</b>	Amount £000	No. of cases
Contributions NIF share					
HMRC remissions and write-offs	i	<b>560,953</b>	<b>113,838</b>	420,381	203,015
Insolvency debts	ii	<b>2,492</b>	<b>0</b>	675	0
Total contributions loss		<b><u>563,445</u></b>	<b><u>113,838</u></b>	<u>421,056</u>	<u>203,015</u>
Benefits	iii	<b>35,699</b>	<b>118,851</b>	42,709	132,999
Redundancy write-off	iv	<b>194,675</b>	<b>0</b>	239,920	0
Administration	v	<b>0</b>	<b>0</b>	920	29,960
Total losses		<b><u>793,819</u></b>	<b><u>232,689</u></b>	<u>704,605</u>	<u>365,974</u>

- i Remissions in respect of unpaid contributions are granted when HMRC has decided not to pursue the liability, for example on the grounds of value for money or official error. Write-offs occur when there is no practical means of pursuing the liability.
- ii Relating to National Insurance debts in respect of insolvent companies where the National Insurance Contributions Office is responsible for the subsequent write-off or recovery. Case numbers are not available for these losses.
- iii The Benefit losses are the responsibility of the DWP. Parts of these losses are a result of serious and organised fraud as described below.

*Serious and Organised Fraud*

A national team of specialised officers within DWP's Fraud Investigation Service conducts investigations into organised and systematic abuse of the benefit system. A total loss of £1,946,000 was incurred on cases closed during 2006-2007 relating to 61 cases. The total has been included in the DWP Consolidated Resource Account Special Losses and is included here as a note only.

Two operations were closed which, individually, involved amounts of fraud before recoveries of over £250,000. The first concerned counterfeit DWP giro cheques that were presented across the United Kingdom from December 2003 to November 2004; in total £335,000 had been netted as result of these crimes. Prison sentences totalling 10 years and 11 months were administered to 4 culprits, 2 years and 8 months suspended sentences to 2, and a 2 year community rehabilitation order to the one remaining. Court orders have been issued requiring the two main perpetrators to repay £292,000 and £73,000.

The second fraud concerned DWP giro cheques stolen from the Royal Mail postal system, which were subsequently altered. In total £314,000 was netted. All ten people arrested pleaded guilty to conspiracy and have now been sentenced. 4 of the culprits received a total of 11 years six months imprisonment, 4 received a total of 510 hours Community Punishment and 2 received a total of 3 years Community Rehabilitation. A Confiscation order was also issued for the amount of £41,000.

Wherever possible the DWP seek to recover losses through the Departmental systems, the Courts or increasingly by using their Financial Investigation Unit to recover monies through the Proceeds of Crime Act. Cases referred to DWP Financial Investigation Unit for further investigation have resulted in confiscation orders of £4,742,000, compensation orders of £449,000, and voluntary repayments of £1,233,000 being obtained.

- 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. No case numbers are available for these losses.
- v The Department for Work and Pensions (DWP) process NIF benefit payments on behalf of the NIF. For 2006-2007 it is not possible to separately identify NIF related Administration losses from those relating solely to DWP. Therefore all losses are recorded in the DWP Administration Losses Statement contained within DWP's Resource Accounts for 2006-2007.

**16 Special payments**

	2006-2007		2005-2006	
	Amount £000	No. of cases	Amount £000	No. of cases
Wrongly advised benefit	<b>1,368</b>	<b>3,109</b>	2,087	4,200

These are payments to customers, in receipt of contributory benefits, mainly State Pension and Incapacity Benefit, who have been wrongly advised on benefit entitlement. These payments are made on either an extra-statutory or ex-gratia basis, and are mainly funded from the DWP Resource Account; 14 extra-statutory payments totalling £48,000 were funded from the National Insurance Fund and are included in the above totals.

## 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;
  - c a statement of balances, andand 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
<b>Receipts</b>			
National Insurance contributions			
Grant from Request for Resources 1			
Transfer from Great Britain			
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>			
<b>Payments</b>			
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:</i> Excess of receipts over payments			
<b>Closing balance</b>			

*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 the payment of benefits and allowances to individuals who have paid sufficient National Insurance contributions and have met other qualifying conditions. In 2006-2007, receipts amounting to £71.4 billion were paid into the Fund and payments of £67.4 billion were paid out of it. At 31 March 2007 the balance on the Fund was £38.2 billion.
- 2 HM Revenue & Customs (the Department) is responsible for the collection of National Insurance contributions and the administration of the National Insurance Fund. The Department for Work and Pensions (DWP) pays benefits to customers and these are currently administered through the Pension Service and Jobcentre Plus. The Department for Business, Enterprise and Regulatory Reform (formerly the Department for Trade and Industry) is responsible for the Redundancy Payments Service which is funded by the National Insurance Fund. HMRC receive annual Letters of Assurance from these other Government Departments on their areas of responsibility.
- 3 This report records the results of my audit examination of the 2006-2007 Fund account, including
  - i the estimated level of incorrect benefit payments from the Fund due to fraud and error;
  - ii the balance on the Fund and Investments in the Debt Management Account Deposit Facility; and
  - iii the issues currently faced by the Department in the maintenance of National Insurance Contribution Records on NIRS 2. These include: the recording of Incapacity Benefit credits and Home Responsibilities Protection, the processing of employers' End of Year PAYE Returns, and the impact of processing delays on the payment of age-related rebates.

## Estimated level of incorrect benefit payments due to fraud and error

- 4 In 2006-2007 DWP paid out £62.1 billion in contributory benefits from the Fund. Most of this was for state pensions (£53.8 billion), incapacity benefits (£6.7 billion), bereavement benefits (£0.8 billion) and contribution-based jobseeker's allowance (£0.5 billion).
- 5 The best available information provided by DWP on fraud and error in the payment of contributory benefits is that an estimated £270 million (some 0.4 per cent of benefit payments) may have been lost through overpayments incorrectly paid from the Fund in 2006-2007 because of fraud and error, as shown in Figure 1. This compares with estimated overpayments of £250 million in 2005-2006. The DWP's best available information shows that a further estimated amount of £150 million in contributory benefits may have been underpaid because of error in 2006-2007.
- 6 The overall level of fraud and error is equivalent to some 0.7 per cent of benefits payments. I nevertheless consider that in all material respects the £62.1 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.
- 7 The DWP carries out extensive work to measure the level of incorrect payments due to fraud and error in the benefits system. The range of exercises are intended to reflect fraud and error risks associated with individual benefits. More regular review is applied to those benefits which are considered to be more susceptible to fraud and error and the approach can be broadly split into three categories:
  - continuous programmes of checking, validating and evaluating error and fraud, as applied on Jobseeker's Allowance;
  - periodic National Benefit Reviews to assess error and fraud in the benefits not covered by the continuous measurement process, such as State Pension and Incapacity Benefit. The State Pension was last reviewed in 2006, and Incapacity Benefit in 2001; and
  - annual reviews to estimate the level of official error.

For other benefits with lower levels of expenditure and lower risks of fraud and error, annual statistical assessments of fraud and error are carried out based largely on historic data.

**Figure 1 National Insurance Fund: Estimated level of incorrect payments due to fraud and error 2006-2007**

2006-2007	Total payments	Estimated overpayments		Estimated underpayments	
		£ million	% of benefit expenditure	£ million	% of benefit expenditure
Benefit	£ million	£ million	% of benefit expenditure	£ million	% of benefit expenditure
State Pension and Bereavement Benefit	54,585.3	130	0.2	80	0.2
Incapacity Benefit	6,682.9	110	1.7	60	0.8
Contribution-based jobseeker's Allowance	482.3	20	4.8	0	0.5
Other	304.1	10	1.8	0	1.4
<b>Total for 2006-2007</b>	<b>62,054.6</b>	<b>270</b>	<b>0.4</b>	<b>150</b>	<b>0.2</b>
<b>Total for 2005-2006</b>	<b>59,729.1</b>	<b>250</b>	<b>0.4</b>	<b>110</b>	<b>0.2</b>

Source: All estimated overpayment and estimated underpayment figures are based on fraud and error rates provided by the Department for Work and Pensions Information Directorate and derived from the global fraud and error estimates for 2006-2007 published on 13 December 2007 which superseded estimates used in the Department for Work and Pensions Resource Account 2006-2007 Note 44 Payment Accuracy. The fraud and error estimates have been applied to the actual payments from the Fund rounded to the nearest £10 million.

Fraud and error estimate figures and percentage rates are rounded to assist presentation. Total figures may not cross cast due to roundings on individual figures.

- 8 As part of the audit of benefit expenditure, including DWP's estimate of fraud and error, the NAO reviewed the DWP's approach to sampling and the methodology applied in checking, including re-performance of a sample of items. The NAO also reviewed the DWP's processes for interpreting the data and generating estimates of error and fraud. As a result, I am satisfied that the figures reported by the DWP are the best estimates available. In making this statement the NAO has specifically obtained assurances around the estimation of error in un-reviewed benefits and in the confidence intervals used in the DWP's analysis.
- 9 The estimates of fraud and error are based on analysis of samples of benefit payments and are subject to a degree of statistical uncertainty. This is quantified in the form of confidence intervals and expressed as a percentage expectation that the true value of the estimated error lies within a particular range. DWP applies confidence intervals of 95 per cent in accordance with the standards applicable to generating National Statistics.
- 10 The DWP has therefore estimated that, whilst the best estimate of overpayments is £270 million, the true levels of overpayment could lie in the range from £200 million to £400 million.<sup>1</sup> For underpayments, the equivalent figures are an estimate of £150 million within a range of £100 million to £250 million. These estimates have been subject to rigorous statistical analysis and I am satisfied that the assumptions underpinning these estimates are sufficiently robust.
- 11 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 are considered in more detail in my report on the DWP Resource Accounts (HC 875, 25 July 2007).

<sup>1</sup> The DWP's best estimate of the upper and lower limits of the range for overpayments is based on a 95 per cent confidence interval.

## The Balance on the Fund and Investments in the Debt Management Account Deposit Facility

- 12 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.
- 13 In his report on the financial provisions of the Social Security Bill in 1992, the Government Actuary confirmed it was prudent to plan for a minimum working balance of one sixth (16.7 per cent) of annual benefit expenditure. As the audited accounts show, at 31 March 2007 the balance on the National Insurance Fund was £38.2 billion – equivalent to some 61.5 per cent of annual benefit expenditure – an increase of £3.9 billion compared to 31 March 2006.
- 14 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 2007 Up-rating and Re-rating Orders, the Government Actuary estimated that the balance of the Fund at 31 March 2008 is likely to be £43.3 billion (65.6 per cent of estimated benefit payments in 2007-2008) – which significantly exceeds one-sixth of estimated payments.<sup>2</sup>
- 15 The Commissioners for the Reduction of the National Debt (CRND) are responsible for the investments of the Fund in accordance with directions given by the Treasury and in line with a memorandum of understanding between HMRC and CRND. 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 was implemented from January 2007, which involved the sale of all gilt holdings and placing the proceeds into the Debt Management Account Deposit Facility (DMADF). As a result of this change CRND administrative charges met from the Fund will be lower. The Funds investments in the DMADF are expected to earn a rate of interest close to the Official Bank of England Rate (Base Rate).

## Maintenance of National Insurance Contribution Records on NIRS 2

- 16 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.
- 17 The Department has taken a number of steps in recent years to improve the accuracy and timeliness of processing of National Insurance contributions data on NIRS2. These involve the steps to improve the accuracy of information submitted by employers and to overcome processing delays. The Department is working with DWP to correct historical differences between DWP systems and NIRS2 in the recording of incapacity benefit credits and home responsibility protection.

## Employers' End of Year PAYE Returns: Inaccuracies

- 18 Inaccurate information in employers' End of Year Returns can in some instances prevent the Department from matching National Insurance contributions information to the relevant contributor records. The Department estimates that the current number of unmatched items held in the suspense files is 118 million.

<sup>2</sup> Report by the Government Actuary on the drafts of the Social Security (Contributions) (Re-rating and National Insurance Funds Payments) Order 2007 Cm 7021 January 2007

- 19 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. The Department 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 in non-matched suspense files. The Department can examine and retrieve unmatched items from the suspense files when it receives information from individuals on the completeness of their record. As part of improvement strategies to protect contributor account data and future benefit entitlement the Department is performing further analysis work and the results of this will be made available during the early part of 2008-2009.
- 20 The Department 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, it has been mandatory from April 2005 for all large employers (those with more than 250 employees) to submit End of Year Returns electronically. Medium-sized employers (50 – 249 employees) have been required to 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% in 2005 to 5% in 2006 and were 1.4% in 2007.

### Employers' End of Year PAYE Returns: processing delays

- 21 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 the Department processing individual's End of Year Returns from their employer. It aims to pay at least 80 per cent of age-related rebates by 1st October, six months after the end of the financial year to which they relate.
- 22 As I reported last year, the problems with 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. As a consequence the Department 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 a significant period of time to complete the processing of returns. Work on completing the processing of the 2004-2005 returns was substantially completed during 2007 and the residual 23,000 scheme returns (containing 800,000 individual items, equivalent to about 1.4% of total expected items for the year) are now being worked through.
- 23 The processing of the 2005-2006 and 2006-2007 End of Year Returns has run much more smoothly than 2004-2005 and targets are now being achieved. By the beginning of October 2007 the Department had processed 88 per cent of all 2006-2007 End of Year Returns to NIRS2 and had paid 90 per cent of the total number of expected rebate payments.

### Incapacity Benefit

- 24 Individuals claiming Incapacity Benefit may be entitled to receive National Insurance credits for periods when they are incapable of work. These credits accrue towards an individual's entitlement to state pension and other contributory benefits. The DWP's Pension Service Computer System (PSCS) records periods of incapacity for those claiming Incapacity Benefit and provides NIRS2 with this information to allow the relevant credits to be recorded against the individual's National Insurance account.
- 25 As I have previously reported, the move from NIRS to NIRS2 in 1998 resulted in a range of conversion problems, including some relating to recording incapacity credits. In September 2004, the Department and DWP became aware that the information on periods of incapacity on NIRS2 and on PSCS did not match in all cases. Incorrect or missing information about incapacity credits in an individual's National Insurance record could result in errors in the payment of State Pension and other contribution-based benefits to the individual.

- 26 Since November 2005, the link on recording Incapacity Benefit between PSCS and NIRS2 computer systems has worked effectively. The Departments have therefore been working together to understand the nature of the residual mismatches of data between the two systems. This work included some initial data scans to identify the full range of scenarios that might arise from mismatched records and the actions needed to correct these records. The DWP estimates that as result of the mismatches in data up to 30,000 people may have had underpayments of contributory benefit and about 90,000 have had overpayments.
- 27 On 23 July 2007 the Under Secretary of State for Work and Pensions announced the steps the Government intends to take for the past cases where errors have occurred.
- For underpayments, the DWP is identifying all cases that have occurred and the correct amount of contributory benefit to be paid, and reviewing any associated income-related benefit. This work began in August 2007 and is expected to be completed by early 2008. The DWP intends to contact all individuals affected by the review.
  - For overpayments, where the payments have been made and received in good faith, the Government is introducing new regulations that will allow DWP to continue paying these benefits at their current level to the individuals affected for the duration of their claim.
  - For those under pension age, the Department is correcting the National Insurance contribution records so that any future claim is correctly assessed. The Department will also write to the individuals concerned offering them an opportunity to pay any missing National Insurance contributions that may be identified.
- 28 The Department's preliminary analysis suggests, however, that errors in the payment of state pension as a result of inaccurate recording of Incapacity Benefit credits is likely to involve estimated annual overpayments of state pension of less than £25 million to up to 75,000 individuals. In addition, estimated annual underpayments of pension of between £2.7 million and £5 million to up to 15,000 individuals are likely to have been made. For Incapacity Benefit, the Department's preliminary analysis suggests that estimated annual overpayments could be £60 million and estimated annual underpayments could be up to £60 million. I will report on the outcome of Departments' review in my report on the 2007-2008 Accounts.

### Home responsibilities protection recording in NIRS2

- 29 Home Responsibilities Protection (HRP) was introduced in 1978 to assist people who were precluded from work during periods of caring responsibilities to protect a person's entitlement to basic state pension or their spouse's entitlement to bereavement benefit. It can be awarded for any complete tax years when an individual was unable to work or their earnings were low because they were caring for a child or a sick or disabled person. Whilst HRP does not enhance a person's National Insurance contribution record it does reduce the number of qualifying years needed to earn a full basic state pension.
- 30 Most people who receive child benefit are entitled to HRP. For cases where child benefit has been awarded, entitlement to HRP is normally recorded automatically when data is passed from the child benefit computer system to NIRS2 at the start and the end of the child benefit claim. Before May 2000 there was no mandatory requirement for people claiming child benefit to provide their National Insurance number. Where this information was missing, the Department could not always match the child benefit data with the appropriate National Insurance record and therefore some contributor accounts on NIRS2 may not have had their entitlement to HRP recorded. While the Department has written to individuals to ask for their National Insurance numbers, outstanding replies were not followed up.
- 31 The Department is working with DWP to identify any individuals, both under and over pension age, who may not have had HRP correctly recorded on their NIRS2 contribution record. The best estimate available to DWP is that about 40,000 pensions are in payment where pensioners may not have had their entitlement to HRP recorded.
- 32 The Department plans to obtain more detailed information on the full extent of the errors in the NIRS2 contribution records and the financial consequences in terms of overpayments and underpayments of pension by comparing data held on the child benefit computer system since 1978 with NIRS2 records. This work is anticipated to be started in October 2008. I will report on these developments in due course.

## Summary and Conclusions

- 33 Based on the latest information provided by DWP an estimated £270 million may have been lost through the overpayment of contributory benefits from the Fund in 2006-2007 because of fraud and error. A further estimated amount of £150 million in benefits may have been underpaid due to error. This level of fraud and error is equivalent to some 0.7 per cent of benefits payments, I nevertheless consider that in all material respects the £62.1 billion of benefit payments made from the Fund have been applied in accordance with Parliament's intentions.
- 34 At 31 March 2007 the balance on the National Insurance Fund was £38.2 billion – equivalent to some 61.5 percent of annual benefit expenditure – an increase of £3.9 billion compared to 31 March 2006. The Government Actuary, in his report on the 2007 Up-rating and Re-rating Orders, has estimated that the balance of the Fund at 31 March 2008 will be £43.3 billion, equivalent to 65.6 per cent of estimated benefit payments in 2007-2008. This significantly exceeds the minimum working balance of one-sixth of estimated benefit payments he advised in 1992 that it was prudent to plan to ensure a reasonable working balance is maintained. The Government Actuary is currently undertaking his Quinquennial Review of the National Insurance Fund and he will report in due course.
- 35 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 Department has taken steps to improve the accuracy of information submitted by employers and to overcome processing delays. In 2007, the Department has processed 2006-2007 employer End of Year Returns in line with targets and has succeeded in helping to reduce employer error rates.
- 36 The Department is working with DWP to correct historical differences between DWP systems and NIRS2 in the recording of Incapacity Benefit credits and Home Responsibility Protection. The Department first became aware of the significant differences between its records and those of the DWP in 2004. The Departments have started the task of checking and, where necessary, updating records of periods of incapacity on NIRS2 and expect this to be completed during 2007-2008.
- 37 The Department has identified some individuals that may not have had HRP correctly recorded on their NIRS2 contribution record prior to May 2000. The Department has yet to establish the full extent of the errors in the NIRS2 contribution records and the financial consequences in terms of overpayments and underpayments. It has launched a project to compare and correct data held on the child benefit computer system since 1978 with NIRS2 records.

*T J Burr*  
Comptroller and Auditor General

28 March 2008

National Audit Office  
151 Buckingham Palace Road  
Victoria  
London SW1W 9SS

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](mailto:enquiries@nao.gsi.gov.uk)

DG Ref: A06160 8347RC

Printed in the UK for The Stationery Office Limited  
on behalf of the Controller of Her Majesty's Stationery Office  
04/08



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

**Online**

**[www.tsoshop.co.uk](http://www.tsoshop.co.uk)**

**Mail, Telephone, Fax & E-mail**

TSO

PO Box 29, Norwich, NR3 1GN

Telephone orders/General enquiries: 0870 600 5522

Order through the Parliamentary Hotline Lo-call 0845 7 023474

Fax orders: 0870 600 5533

E-mail: [customer.services@tso.co.uk](mailto:customer.services@tso.co.uk)

Textphone 0870 240 3701

**TSO Shops**

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, Parliamentary Square,  
London SW1A 2JX

Telephone orders/General enquiries 020 7219 3890

Fax Orders 020 7219 3866

Email [bookshop@Parliament.uk](mailto:bookshop@Parliament.uk)

Internet [bookshop.Parliament.uk](http://bookshop.Parliament.uk)

**TSO@Blackwell and other Accredited Agents**

ISBN 978-0-10-328772-0



9 780103 287720