

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

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# National Insurance Fund Account 2007-08



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# National Insurance Fund Account 2007-08

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# 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 Chief Executive of HMRC is the Principal Accounting Officer for the Fund. HM Treasury appointed me as Principal Accounting Officer for HMRC with effect from 10 November 2008. 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 Principal 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 (BERR) is responsible for making Redundancy Payment Scheme awards with the Insolvency Service, an agency of BERR, 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. The next report is due to be laid before Parliament sometime in Spring 2009.

## 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 £9,653 million compared with the position at 31 March 2007 (£38,220 million). At 31 March 2008 the balance held is £47,873 million (73 per cent of annual benefit expenditure).
- 13 The Government Actuary's next Report on the Government's Benefits Up-rating and Contributions Re-rating Orders will be tabled early 2009 alongside the 2009 Up-rating Order and the Re-rating Orders. The Orders, which will cover the financial year 2008-09, are subject to debate and require the approval of both Houses. These reports include estimates of both benefit payments and contributions which are sensitive to changes due to a number of assumptions made, such as the level of employment and earnings.

## Responsibilities of the Chief Executive of HM Revenue & Customs

- 14 As Chief Executive of HM Revenue & Customs, I am the Principal Accounting Officer for the NIF. My relevant responsibilities as Principal 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 Principal Accounting Officers' Memorandum issued by HM Treasury and published in 'Managing Public Money'. Many of the activities relating to the transactions of the NIF are carried out by other departments (DWP & BERR) and agencies on my behalf, and I receive letters of assurance from them as detailed in the Statement on Internal Control.

### Lesley Strathie

Principal Accounting Officer

5 December 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 Principal Accounting Officer for the Great Britain National Insurance Fund (NIF), I have responsibility for the stewardship of the Fund and maintaining a sound system of internal control that supports the achievement of HMRC's policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Managing Public Money.
- 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 (BERR), 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 to the achievement of Departmental policies, aims and objectives, to evaluate the likelihood of those risk 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 2008 and up to the date of approval of the annual report and accounts, and accords with HM Treasury guidance.
- 5 Specific work undertaken on behalf of the NIF forms only a small part of the whole work of HMRC. A separate SIC is produced for the HMRC 2007-08 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 2007-08.

## Capacity to handle risk

- 6 We continue to review and adapt HMRC'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 (see paragraphs 34-41).
- 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 the National Audit Office (NAO), provides me with independent advice on the effectiveness of the Department's governance, risk and control arrangements.

- 9 Between April 2007 and January 2008 a Risk Committee operated as one of a number of sub-committees of the Executive Committee. It had responsibility for taking an overview of risks facing HMRC and ensuring effective risk management. The committee:
- Reviewed the effectiveness of risk management and risk mitigation in HMRC, and identified improvements;
  - Considered whether existing risks were being well managed;
  - Identified new risks and allocated ownership.
- In January 2008 oversight of risk moved to the lines of business led by individual Executive Committee members.
- 10 In carrying out this role, the Risk Committee received information from individual Directors and Executive Committee members, as well as from other sub-committees. The Committee updated the Executive Committee with their assessment of HMRC's exposure to risk. It also informed the Audit Committee of changes to the risk management arrangements in the Department, to assist the Audit Committee in assessing the effectiveness of those arrangements.

### **The risk and control framework**

- 11 The current approach to risk management in HMRC involves the upward reporting of risks. The primary mechanism for this is the Director's 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.
- 12 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) sits regularly 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.
- 13 There is a NIF Audit Forum consisting of representatives from key Internal Audit units, NAO, 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**

- 14 As 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 letter and other reports.
- 15 I discuss significant control issues with my executive team as they arise, 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.

- 16 To provide me with an assurance on the effectiveness of the system of internal control, the Director of 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.
- 17 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 NIMB, 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**

- 18 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.
- 19 Recoveries of ARR take place where, for example, there are downward adjustments to earnings information on an individual's NI account. There are 2 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.
- 20 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, some outstanding debts have remained unactioned.
- 21 Some of the debt (albeit a minority) is up to 20 years old. Legal advice was taken on the practicality of pursuing unpaid amounts of this age and after much consideration agreement has been reached that only debt that has been identified since January 2004 (i.e. debt up to 5 years old) will be pursued. The latest NIRS2 scan indicates that this will reduce the outstanding amount to be recovered to approximately £5 million; the recovery strategy is being reviewed in the light of this latest information.

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

- 22 National Insurance Class 2 is a flat-rate weekly contribution paid by the self-employed. Payment of Class 2 contributions gives entitlement to a range of contributory benefits, but collection of outstanding Class 2 debts is a long standing issue which has been commented on in previous years.
- 23 The National Insurance Class 2 (NIC2) Group has focused on the recovery and enforcement of NIC2 debts prioritising those debts which were approaching the time-barred date. Changes were made to improve resource intensive processes and DMB took the lead in the development and implementation of a tactical solution to identify and remit time-barred debts annually, across four major IT systems. This work has not yet been concluded but there has been a positive result with reductions in the debt balance to date of approximately £381 million. The need to comply with enhanced data security controls means that the annual remission exercise for 2008-09 has been delayed but HMRC still expect to be able to remit up to a further £182 million from its IT systems by March 2009.
- 24 Going forward, in the absence of a change in policy to collect Class 2 & 4 together and with the small amounts involved (i.e. £2.30 per week), Class 2 is inherently costly for HMRC to service. Plans for a tactical IT solution have also been shelved. However, HMRC will continue to:

- monitor the debt balances;
- remit time-barred debts on our systems;
- look for ways with other HMRC stakeholders of supporting and maximising voluntary compliance by encouraging take up of direct debit;
- improve the effectiveness of early, relatively low cost, interventions like letters, texts and voice messages.

### **Incapacity Benefit Credits**

- 25 The Department for Work and Pensions (DWP) Pensions Service Computer System (PSCS) provides Incapacity Benefit start and end dates to NIRS2 where credits are awarded for relevant weeks. Due to interface problems between these two systems, some periods of incapacity were recorded incorrectly on NIRS2 over the period from 1994 to 2004.
- 26 In July 2007, a cross departmental exercise involving HMRC, the Department for Work and Pensions (DWP) and Northern Ireland Social Security Agency (NISSA) began work to correct these periods of incapacity. Data from the DWP PSCS system was extracted and compared with that held by NIRS2. Where appropriate, NIRS2 was updated and outputs generated leading to follow up actions by staff. DWP (and NISSA) focussed initially on addressing cases where people have been underpaid contributory based benefits or state pension. With respect to cases of overpayment, DWP introduced regulations allowing the continued payment of benefits at their current level for the duration of the claim. In addition to updating NIRS2, HMRC are in the process of writing to customers who now have gaps in their contribution records as a result of the removal of incorrect credits. Letters have been issued in two tranches (January and August 2008) and a further tranche of activity is being planned for later in 2008-09.
- 27 The work involved in this exercise has proven to be very complex and resource intensive. The majority of planned activities have now been completed; however, we don't expect to complete all of the follow up work until March 2009. Internal Audit are currently conducting a review of all other credit interfaces to ensure these are working effectively.

### **Non Matching Contribution Items**

- 28 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.
- 29 Up to 2006-07 the suspense files contained approximately 116 million items. For the 2006-07 tax year some 2 million new items were added to the suspense files; this represents about 3.5 per cent of the 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)**

- 30 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 per cent basic State Pension.
- 31 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. In such cases, HMRC attempted to trace the correct customer record clerically and, if this was unsuccessful, wrote to the customers asking for their NINOs. This was done at least twice (at the start of the child benefit claim and at the end). Where the customer did not reply, no further action was taken and as a consequence, their HRP entitlement could not be recorded.

- 32 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.
- 33 As reported last year, DWP and HMRC are working together to identify those customers who, potentially, might not have received their HRP entitlement. Our priority was to identify current pensioners whose benefits could be increased by correcting this problem. A scan of NIRS relating to pensioners has now been completed and we are currently analysing the results before determining next steps. DWP are exploring measures to address the problem for those working age customers approaching pension age. Additional work to compare and where necessary align current Child Benefit records and NIRS for other affected working age customers is scheduled for January 2009.

#### **Data Security: Data Loss**

- 34 Following the loss of Child Benefit data in November 2007 HMRC took immediate steps to enhance data security following the incident including:
- Appointment of data guardians;
  - A complete ban on the transfer of bulk data on removable media without adequate security protection such as encryption;
  - Removing the ability of all staff to save data to portable media such as CDs and memory sticks and reintroducing this only where there is a compelling business case to do so;
  - The provision of a Data Security Booklet to all staff.
- This action was taken across the whole of HMRC, including all areas involved in National Insurance work.
- 35 In the interim report published by HM Treasury on 17 December 2007 Kieran Poynter noted "..... the first actions that I would have recommended had already been taken by HMRC before I began my review ....."
- 36 A final report was published by HM Treasury on 25 June 2008 and the Chancellor made a further statement to Parliament on the same day. The Chancellor has accepted the report's detailed findings and recommendations in full and has endorsed in principle the direction of travel proposed by the review team.
- 37 The IPCC report was also published on 25 June 2008. The report found no evidence whatsoever of misconduct or criminality by any member of HMRC. HMRC is committed to implementing all of its recommendations.

#### **Data Security: Data Sharing with other Departments**

- 38 In common with all other business streams within HMRC, areas involved in National Insurance work have taken action to review and improve data security procedures.
- 39 HMRC shares customer information with several other departments. We ensure that departments receiving HMRC information are aware of their statutory obligations under the provisions of the Data Protection Act including the need to comply with all of the principles of that Act such as the need to keep information safe and secure. These principles are set out in Memoranda of Understanding, Service Level or Partnership Agreements detailing the legal and administrative framework in which HMRC information may be used (including onward disclosure of HMRC information by the receiving department). However, we currently have no formal mechanism for those departments to report back to HMRC on how they comply with data security and what steps they have taken to prevent unlawful disclosures. In addition we have no method of gaining assurance from the receiving department that the data is being held securely and appropriately controlled.
- 40 The Data Security Programme is overseeing a review of HMRC's approach to granting roles and access to IT systems. This will include a review of access rights granted to other government departments and the controls in place to ensure they are granted, used and closed appropriately.

- 41 As part of this program all HMRC members of staff, including those working on National Insurance are required to attend one of a series of data security workshop events. These mandatory workshops are designed to remind staff of HMRC's data security obligations and to ensure they understand how they impact on their every day duties. This should help prevent the possibility of further data losses by up-skilling our staff on data security principles.

### **Assurance from DWP in respect of Contributory Benefit Payments**

- 42 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 control challenges which are described at a high level below.
- 43 In 2007-08, contributory benefits funded from the National Insurance Fund totalled £65.7 billion, which included £57.5 billion related to State Pension and £6.6 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 for 2007-08 estimate that losses from fraud and error in relation to State Pension and Bereavement Benefit were approximately £0.12 billion (0.2 per cent) and in relation to Incapacity Benefit approximately £0.12 billion (1.7 per cent).
- 44 Implementation of DWP's comprehensive error reduction strategy "Getting Welfare Right: Tackling Error in the Benefit System" continues with over 85 per cent of the initial initiatives now implemented. Although there was a shortfall in the targeted savings in 2007-08, additional activities have been identified to address this. DWP's focus on targeting benefit fraud also continues and was reported on favourably by NAO during the course of the year.
- 45 DWP agencies have identified that they may not have received all of the notifications they require from the HMRC NIRS2 system. As a result a number of customers may have received incorrect awards. The DWP Audit Committee has commissioned a review of this issue. A cross departmental task force has been established to address an issue where duplicate or insufficient National Insurance credits may have been allocated where customers are receiving more than one benefit – this may have impacted on some benefit awards.
- 46 Debt recovery remains an ongoing priority for DWP, the 2007-08 target being exceeded.

### **Assurance from BERR in respect of the Redundancy Payments Scheme**

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

**Lesley Strathie**  
Principal Accounting Officer  
5 December 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 2008 under the Social Security Administration Act 1992. These comprise the Receipts and Payments Account and the related notes. These financial statements have been prepared under the accounting policies set out within them.

## **Respective responsibilities of the Accounting Officer and auditor**

The Chief Executive of HM Revenue & Customs as 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 report to you whether, in my opinion, certain information given in the Foreword is consistent with the financial statements. I also report whether 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 addition, I report to you if HM Revenue & Customs has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by HM Treasury is not disclosed.

I review whether the Statement on Internal Control reflects HM Revenue & Customs compliance with HM Treasury's guidance, and I report if it does not. I am not required to consider whether this statement covers all risks and controls, or form an opinion on the effectiveness of HM Revenue & Customs 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 report 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 opinions**

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.

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, in accordance with the Social Security Administration Act 1992 and directions made thereunder by HM Treasury, for the year ended 31 March 2008 and the balance 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 HM Treasury directions made thereunder; and
- information given within the Foreword is consistent with the financial statements.

### Audit Opinion on Regularity

In my opinion, 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.

My report on the financial statements is at pages 24 to 28.

*T J Burr*  
Comptroller and Auditor General  
12 January 2009

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

# Receipts and Payments Account for the year ended 31 March 2008

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

	Notes	<b>2007-08</b> <b>£000</b>	2006-07 £000
<b>Receipts</b>			
National Insurance contributions	2	<b>75,549,355</b>	68,211,839
Compensation for statutory pay recoveries	3	<b>1,865,510</b>	1,160,089
Income from investments	4	<b>2,379,403</b>	1,846,136
State Scheme premiums	5	<b>77,206</b>	73,828
Other receipts	6	<b>53,487</b>	51,280
Redundancy receipts	7	<b>35,911</b>	40,811
		<b>79,960,872</b>	71,383,983
<i>Less</i>			
<b>Payments</b>			
Benefit payments	8	<b>65,683,857</b>	62,054,551
Personal pensions	9	<b>2,507,767</b>	3,019,671
Administrative costs	10	<b>1,391,016</b>	1,433,476
Redundancy payments	7	<b>212,624</b>	245,454
Transfers to Northern Ireland NIF	11	<b>452,000</b>	630,000
Other payments	12	<b>60,574</b>	39,659
		<b>70,307,838</b>	67,422,811
Excess of receipts over payments		<b>9,653,034</b>	3,961,172

## Statement of balances

Opening balance		<b>38,219,798</b>	34,258,626
<i>Plus</i>			
Excess of receipts over payments		<b>9,653,034</b>	3,961,172
Closing balance	13	<b>47,872,832</b>	38,219,798

### Lesley Strathie

Principal Accounting Officer  
5 December 2008

*The notes on pages 13 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 HM 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 received are 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 contributions allocated to the National Health Service (NHS).

Employers are responsible for calculating their own and their employees contributions. Their records are subject to examination by HMRC. These checks and other checks on contributors may result in additional receipts or repayments in future years in respect of contribution liabilities for 2007-08.

### *Payment of Social Security benefits*

The DWP administers a range of social security benefits, financed either from the NIF or from the Consolidated Fund. 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 to the Northern Ireland NIF.

### *Net accounting*

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

## 2 National Insurance contributions

	Notes	<b>2007-08</b> <b>£000</b>	2006-07 £000
Class 1 (employed earner)	i	<b>72,525,107</b>	65,104,163
Class 1A & 1B	ii	<b>950,884</b>	1,056,509
Class 2 (self-employed flat rate)	iii	<b>289,968</b>	308,756
Class 3 (voluntary contributions)	iv	<b>91,611</b>	111,366
Class 4 (self-employed earnings related)	v	<b>1,691,785</b>	1,631,045
		<b><u>75,549,355</u></b>	<u>68,211,839</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 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 GAD to apportion the National Insurance contributions collected each year, confirming the Class split in order to calculate the appropriate amount to be paid over to the NHS (as per Social Security Act 1992 (c.5 ss161-162)).

The NHS allocation is paid over by HMRC to the NHS before the contributions are paid into the NIF and so the figures above are shown net of the NHS element. The NHS allocation was £21.0 billion in 2007-08 (£18.9 billion 2006-07).

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

	Notes	2007-08 £000	2006-07 £000
Statutory Sick and Statutory Maternity pay	i	1,832,045	1,134,000
Statutory Adoption and Statutory Paternity pay	ii	33,465	26,089
<b>Total</b>		<b>1,865,510</b>	<b>1,160,089</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 Statutory Sick and Statutory Maternity pay recoveries are paid from DWP Voted funds.
- ii Statutory Adoption and Statutory Paternity pay recoveries are paid over by the BERR.

**4 Income from investments**

	<b>2007-08</b>	2006-07
	<b>£000</b>	£000
Interest received	<b>2,379,403</b>	1,999,623
Profit on realisation	–	331,180
Losses on realisation	–	(484,667)
	<b><u>2,379,403</u></b>	<u>1,846,136</u>

The value of investments increased from £38.6 billion at 31 March 2007 to £49.2 billion at 31 March 2008 (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.

**5 State Scheme premiums**

	<b>2007-08</b>	2006-07
	<b>£000</b>	£000
State Scheme Premiums	<b>77,206</b>	73,828

State Scheme Premiums are payable in respect of employed persons who cease to be covered, in certain specific circumstances, by a contracted out pension scheme. The premiums buy back the persons' additional pension entitlement in the State Earnings Related Pension Scheme (SERPS). The collection total of £77.2 million (2006-07 £73.8 million) is net of refunds of £6.2 million (2006-07 £8 million).

In October 1992, the Government decided that people 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 2008, around 31,564 individuals had been brought back into SERPS with a SERPS premium liability of £128.9 million of which £45,249 has been recovered. Between 1 April 2007 and 31 March 2008 115 new members were identified with a total SERPS premium liability of £165,018. 7 members previously identified as Maxwell scheme members were found to be members of other pension schemes – the total liability for these member's amounts to £21,010 which has been removed from the Maxwell Scheme liability total. A total of £3 million was recovered in 2007-08.

New Maxwell Scheme members continue to be identified following investigations with the Scheme Investigator and as individuals reach State Pension Age. 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 as 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 £128.9 million liability will be recovered.

**6 Other receipts**

	Notes	<b>2007-08</b>	2006-07
		<b>£000</b>	£000
Recoveries of compensation payments	i	<b>50,302</b>	48,011
Unemployment benefit recoveries	ii	<b>3,185</b>	3,099
Compensation receipts	iii	–	170
		<b><u>53,487</u></b>	<u>51,280</u>

- 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

	<b>2007-08</b>	2006-07
	<b>£000</b>	£000
<b>Outstanding debt as at 31 March</b>	<b>107,229</b>	97,261
Plus: Redundancy payments	<b>212,624</b>	245,454
Less: Receipts	<b>(35,911)</b>	(40,811)
Less: Debt written-off	<b>(168,935)</b>	(194,675)
<b>Outstanding debt as at 31 March</b>	<b>115,007</b>	107,229

Section 182 of the Employment Rights Act 1996 provides the statutory basis for the NIF to make redundancy payments to employees who have been made redundant but whose former employers are unable to make appropriate redundancy payments, usually because of insolvency.

The payments are made by the Insolvency Service. The receipts represent amounts recovered from employers. The total debt outstanding owed by employers at 31 March 2008 was £115 million and is disclosed in the Insolvency Agency Accounts

## 8 Benefit payments

	Notes	<b>2007-08</b>	2006-07
		<b>£000</b>	£000
State Pension	i	<b>57,538,300</b>	53,785,935
Incapacity Benefit	ii	<b>6,614,901</b>	6,682,940
Bereavement Benefits	iii	<b>733,710</b>	799,368
Jobseeker's Allowance (contributory)	iv	<b>424,880</b>	482,276
Maternity Allowance	v	<b>243,093</b>	175,492
Christmas Bonus for pensioners	vi	<b>127,137</b>	126,633
Guardian's Allowance and Child's Special Allowance	vii	<b>1,836</b>	1,907
		<b>65,683,857</b>	62,054,551

- 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. It is payable for 182 days and no additional benefit is payable for dependents.

- v. Maternity Allowance is paid for up to 39 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 an individual is in receipt of more than one benefit, it is DWP policy to combine amounts due into a single payment wherever practicable. This means that all of the amounts reported above consist partly or wholly of apportioned expenditure. NIF benefits are primarily paid by credit transfer, with a small percentage being paid by cheque or payable order.

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 2007-08 is £6.9 million (2006-07: £7.2 million).

## 9 Personal pensions

	<b>2007-08</b>	2006-07
	<b>£000</b>	£000
Personal Pensions	<b>2,507,767</b>	3,019,671

The Pensions Scheme 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

	Notes	<b>2007-08</b>	2006-07
		<b>£000</b>	£000
DWP	i	<b>1,096,322</b>	1,111,733
HMRC	ii	<b>259,074</b>	286,200
Tribunals Service	iii	<b>23,946</b>	23,946
BERR	iv	<b>8,782</b>	8,782
Tribunals Development Group	v	<b>1,058</b>	1,019
Office of National Statistics	vi	<b>775</b>	791
Government Actuary's Department	vii	<b>205</b>	189
National Audit Office	viii	<b>408</b>	400
Debt Management Office	ix	<b>111</b>	196
Bank charges	x	<b>251</b>	136
Scottish Executive Justice Department	xi	<b>84</b>	78
General Register Office	xii	-	6
		<b>1,391,016</b>	1,433,476

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.
- 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 Insolvency 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.
- 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>2007-08</b>	2006-07
	<b>£000</b>	£000
Payments to Northern Ireland NIF	<b>452,000</b>	630,000

The amount shown in this Account is in respect of financial adjustments made 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.

Transfers between Great Britain and Northern Ireland National Insurance Funds are made so that, as far as possible, the balance in the Northern Ireland Fund is maintained at 2.84 per cent of the joint balance of the two funds. The system of parity payments acts as a final safeguard against serious imbalances between the Great Britain and Northern Ireland Insurance Funds.

**12 Other payments**

	Notes	<b>2007-08</b>	2006-07
		<b>£000</b>	£000
Payments to Isle of Man	i	<b>31,268</b>	28,303
SSP/SMP/SPP/SAP payments	ii	<b>3,280</b>	2,938
Incapacity Benefit	iii	<b>3,265</b>	3,434
State Pension Lump Sum	iv	<b>22,761</b>	4,984
		<b>60,574</b>	39,659

- 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 customer and paid to HMRC monthly in arrears.
- iv. Under the Income Tax Acts, 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 Closing balance**

	Notes	<b>31 March</b>	31 March
		<b>2008</b>	2007
		<b>£000</b>	£000
Monies held by the CRND at cost	i	<b>49,178,184</b>	38,646,381
Funds held by Paymaster General (incl. uncleared payments)		<b>(442)</b>	(4,272)
Other balances	ii	<b>(1,304,910)</b>	(422,311)
		<b>47,872,832</b>	38,219,798

- i. 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 HM Treasury and in line with the Memorandum of Understanding between HMRC and CRND.
- ii. Sums due from or owing to government departments and overseas administrations in respect of the operation of the NIF.

**14 Losses**

	Notes	<b>2007-08</b>		<b>2006-07</b>	
		<b>Amount</b>	<b>No. of</b>	<b>Amount</b>	<b>No. of</b>
		<b>£000</b>	<b>cases</b>	£000	cases
Contribution losses	i	<b>451,496</b>		563,445	
Benefits	ii	<b>43,342</b>	<b>137,895</b>	35,699	118,851
Redundancy write-off	iii	<b>168,935</b>		194,675	
Total losses		<b>663,773</b>		793,819	

- i Contribution losses include remissions, write-offs and insolvency debts. 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. No case numbers are available for these losses following a change in processes.
- ii The Benefit losses are the responsibility of the DWP and can be attributed to the following:-

#### *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 £6.5 million was incurred on cases closed up to 31 March 2008 relating to 21,195 cases.

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, Special Losses, and is included here as a note only.

During the year, three operations were closed. In the first DWP cheques were stolen from the Royal Mail in London and their values altered before being cashed. Two men were jailed for 5½ years and 3½ years respectively for their roles in the fraud totalling more than £3.5 million.

The second fraud, a joint operation with the Post Office Investigation Section, concerned a number of lost in transit order book frauds. These order books had not been scanned through the PO computer system and it was strongly suspected that these were internal frauds. The investigation uncovered a series of fraudulent activity totalling almost £0.5 million. Two suspects were detained under Section 14 of the Criminal Procedure Scotland Act 1995 and subsequently charged with embezzlement totalling £0.4 million. A private prosecution was made by the Post Office and a settlement was made out of court.

The third case involved an allegation of multiple claims to benefit. At the outset of this investigation the main suspect potentially had control of over 23 claims in total and at one point there were 13 live claims to benefit. During the course of the investigation 17 bank accounts were discovered and a further 6 accounts were discovered at the subsequent house search. The suspect was charged with 15 charges in total under the Theft Act 1968 and in September 2007 pleaded guilty to false accounting and obtaining money by deception and was sentenced to 33 months imprisonment at Isleworth Crown Court.

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

- iii. 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.

#### **15 Special payments**

	2007-08		2006-07	
	Amount £000	No. of cases	Amount £000	No. of cases
Wrongly advised benefit	1,370	4,377	1,368	3,109

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 accounted for in the DWP Resource Account.

## Annex

## National Insurance Account – Great Britain Accounts Direction given by Her Majesty’s Treasury

- 1 In accordance with Section 161(2) of the Social Security Administration Act 1992, 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,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;
  - 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;
  - d) details of any irregular, uncertain or special payments.

## Annex

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

	Notes	200x £000	200y £000
<b>Receipts</b>			
National Insurance contributions			
Grant from Request for Resources 1			
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	200x £000	200y £000
Opening balance			
<i>Plus:</i> Excess of receipts over payments (or less excess of payments over receipts)			
<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 2007-08, receipts amounting to £80 billion were paid into the Fund and payments of £70.3 billion were paid out of it. At 31 March 2008 the balance on the Fund was £47.9 billion.
- 2 HM Revenue and 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, Disability and Carers Service and Jobcentre Plus. The Department for Business, Enterprise & Regulatory Reform 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 examination of the 2007-08 Fund account, including:
  - i) the estimated level of over and underpayments of benefits 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 maintaining National Insurance contribution records on the National Insurance Recording System (NIRS2).

## Estimated level of over and underpayments of benefits from the Fund due to fraud and error

- 4 In 2007-08 DWP paid out £65.7 billion in contributory benefits from the Fund. Most of this was for state pensions (£57.5 billion), incapacity benefits (£6.6 billion), bereavement benefits (£0.7 billion) and contribution-based jobseeker's allowance (£0.4 billion).
- 5 The Social Security Contributions and Benefits Act 1992 and related legislation specifies entitlement criteria for each benefit and the method to be used to calculate the amount of benefit to be paid. Where benefit is paid to an individual who is not entitled to that benefit or at a rate which is more than that specified in the legislation, the excess expenditure has not been applied to the purposes intended by Parliament. Where benefit is paid at rates either more or less than those specified in legislation then such transactions do not conform to the authorities which govern them.
- 6 As shown in Figure 1, DWP estimated that overpayments of contributory benefits, due to fraud and error, totalled £280 million (some 0.4 per cent of benefit payments) in 2007-08, compared with £270 million in 2006-07. It also estimated that £150 million (some 0.2 per cent of benefit payments) was underpaid in 2007-08, compared with £150 million in 2006-07.
- 7 State Pension, including Bereavement Benefit, is the largest single benefit stream accounting for some £58.3 billion or around 89 per cent of the total benefit payments of £65.7 billion. The level of over and underpayments are lowest in State Pension, each representing 0.2 per cent of relevant expenditure. This is because State Pension is easy to claim, relatively straightforward to determine as the benefit calculation is based on National Insurance records, and largely unaffected by changes in circumstances.
- 8 The level of overpayments in other contributory benefits is higher. Incapacity Benefit, where overpayments are equivalent to 1.7 per cent of relevant expenditure, requires a certain level of National Insurance credits, and the potential exists for entitlement to change in the shorter term. Jobseeker's Allowance, where overpayments equal five per cent of relevant expenditure, requires consideration of a range of income and expenditure information for a potential claimant to establish eligibility to, and the value of, the benefit and may be subject to numerous changes as the claimant's circumstances change.

**Figure 1 National Insurance Fund: Estimated level of incorrect payments due to fraud and error 2007-08**

2007-08	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	58,272.0	140	0.2%	90	0.2%
Incapacity Benefit	6,614.9	110	1.7%	50	0.8%
Contribution-based Jobseeker's Allowance	424.9	20	5.0%	0	0.5%
Other	372.1	10	1.8%	0	0.8%
<b>Total for 2007-08</b>	<b>65,683.9</b>	<b>280</b>	<b>0.4%</b>	<b>150</b>	<b>0.2%</b>
<b>Total for 2006-07</b>	<b>62,054.6</b>	<b>270</b>	<b>0.4%</b>	<b>150</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 in note 44 – 'Payment Accuracy' of their Resource Account 2007-08. 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.

- 9 As part of the audit of benefit expenditure, the NAO reviewed DWP's approach to testing benefit payments and estimating of the levels of over and underpayments due to error and fraud. The NAO has confirmed that the figures reported by the DWP are the best estimates available. In making this assessment the NAO obtained assurances around the estimation of error in un-reviewed benefits and in the confidence intervals used in the DWP's analysis. On the basis of this examination I am satisfied that, in all material respects, the £65.7 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.
- 10 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 2007-08 (HC 863, 13 August 2008).

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

- 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 2008 the balance on the National Insurance Fund was £47.9 billion – equivalent to some 72.9 per cent of annual benefit expenditure – an increase of £9.6 billion compared to 31 March 2007.

- 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 2008 Up-rating and Re-rating Orders, the Government Actuary estimated that the balance of the Fund at 31 March 2009 is likely to be £56.9 billion (81.5 per cent of estimated benefit payments in 2008-09) – which significantly exceeds one-sixth of estimated payments.<sup>1</sup> The Government Actuary is currently undertaking his Quinquennial Review of the National Insurance Fund which is due for publication in spring 2009.

## **Maintenance of National Insurance Contribution Records on NIRS2**

- 14 The National Insurance Recording System (NIRS2) maintains details of over 70 million National Insurance accounts for individual contributors and approximately one million new accounts are created each year. The NIRS2 system 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.
- 15 Incorrect or missing information about contributions or other benefit credits in an individual's National Insurance record could result in errors in the payment of State Pension and other contribution-based benefits. As reported in the Statement on Internal Control, the Department has identified errors in contribution records arising from non matched contributions items and from differences between NIRS2 and other benefit systems, including DWP's Pension Service Computer System (PSCS) and the recording of incapacity benefit and other credits, and the child benefit system and the recording of periods of home responsibility protection.

## **Items Not Matched to NIRS2 Contribution Records**

- 16 Incomplete and 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. While the Department applies matching routines in NIRS2 in an effort to resolve these cases this is not always successful. Of the 55.2 million P14 annual returns for individual employees received from employers for the 2006-07 tax year some two million items, with a value of £279 million, could not be matched with a contributor account. Over the years the number of these unmatched items has accumulated, the Department estimates that by the end of the 2006-07 tax year its suspense files included 116 million unmatched items.
- 17 The majority of the non-matching items held in suspense relate to short-term or low-paid employments which are unlikely to qualify for contribution based benefits. There is therefore little incentive for either the employee or employer to provide the details. The Department estimates that of the two million unmatched items in 2006-07, some 1.6 million items fell into this category. The Department nevertheless maintains the suspense file so it can examine and retrieve unmatched items where it receives information from individuals on the completeness of their record.
- 18 The Department is performing further analysis work of non matched items which have arisen during the last three years and plans to have completed this review by December 2008. The results of this exercise will inform further activity to reduce the quantum of unmatched items accumulating in the future which will reduce the potential risk of inaccurate benefit or pension payments being made in the future.

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<sup>1</sup> Report by the Government Actuary on the drafts of the Social Security (Contributions) (Re-rating and National Insurance Funds Payments) Order 2008 Cm 7312 January 2008.

## Incapacity Benefit

- 19 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. As previously reported<sup>2</sup>, some periods of incapacity in DWP's PSCS records have been incorrectly reported on NIRS2. Since September 2004, the Department and DWP have been working together to understand the nature of these mismatches and plan their response, including the development of scans of the computer records to allow the interrogation and correction of errors.
- 20 In July 2007, they began work to correct those records in NIRS2 which are affected and to contact the individuals concerned. This work has focussed on those who have been underpaid contribution based benefits or State Pension. Where overpayments have occurred, the DWP has introduced regulations to allow the payments of benefits to be maintained at their current level for the duration of the claim. The work of comparing data has proved to be more complex and more resource intensive than originally envisaged and completion is now expected by March 2009.
- 21 The Department estimates the maximum number of pensioners affected by errors in their State Pension due to the inaccurate recording of periods of Incapacity on NIRS2 is up to 90,000, and that over 80 per cent of these cases involve overpayments. The Department will undertake further analysis of the errors in the payment of State Pension and Incapacity Benefit as the cases are reviewed.

## Home Responsibilities Protection recording in NIRS2

- 22 Home Responsibilities Protection (HRP) was introduced in 1978 to protect the benefit entitlement of people who were caring for others and not able to work. HRP reduces the number of qualifying years needed to earn a full basic state pension.
- 23 Most people who receive child benefit are entitled to HRP. The entitlement is recorded automatically when data is passed from the child benefit computer system to NIRS2 at the start and the end of the claim period. Prior to May 2000, the absence of a requirement for people claiming child benefit to provide their National Insurance number led to an under recording of HRP entitlement on NIRS2. Although the Department wrote to these individuals, no action was taken where they failed to reply.
- 24 In October 2008, the Department has started work with DWP to identify individuals over pension age who may not have had their HRP entitlement correctly recorded in NIRS2. A further exercise focusing on individuals of working age is scheduled to start in early 2009.
- 25 In the light of the problems identified in recording National Insurance credits and HRP entitlement, the Department has asked its Internal Audit to perform an end to end review of NIRS2 processing to identify if there are any similar issues affecting other credits. It is also establishing a Joint Steering Committee with DWP to oversee the investigation and resolution of issues relating to the recording of credits on NIRS2.

## Summary and Conclusions

- 26 Based on the latest information available, DWP estimated that in 2007-08 £280 million of contributory benefits may have been overpaid, due to fraud and error, and a further £150 million may have been underpaid. I nevertheless consider that in all material respects the £65.7 billion of benefit payments made from the Fund have been applied in accordance with Parliament's intentions and conform with the authorities which govern them.

<sup>2</sup> National Insurance Fund Account 2006-2007 HC 466 Session 2007-08, Report by the Comptroller and Auditor General, paragraphs 24 to 28.

- 27 At 31 March 2008 the balance on the National Insurance Fund was £47.9 billion – equivalent to some 72.9 per cent of annual benefit expenditure – an increase of £9.6 billion compared to 31 March 2007. The Government Actuary has estimated that the balance of the Fund at 31 March 2009 will be £56.9 billion, equivalent to 81.5 per cent of estimated benefit payments in 2007-08. This significantly exceeds the minimum working balance of one-sixth of estimated benefit payments that the Government Actuary advised in 1992 was prudent to plan for to ensure a reasonable working balance is maintained.
- 28 The National Insurance Recording System (NIRS2) maintains details on over 70 million National Insurance accounts for individual contributors. 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. It has also invited Internal Audit to review the processing of National Insurance credits, to identify if there are any similar issues affecting other credits on NIRS2, and established a Joint Steering Committee with DWP to oversee the investigation and resolution of these issues. The processing of National Insurance credits is complex and the resolution of the differences between NIRS2 and DWP systems require both Departments and their respective providers of information services to work closely together. The Departments' decision to establish a Joint Steering Committee to oversee this work is an important first step towards ensuring that procedures governing the updating of NIRS2 operate effectively and any residual historical differences in the contribution records are corrected. The Departments need to ensure that a joint action plan and clear timetable is put in place for this work and that it is supported by adequate resources.

*TJ Burr*  
Comptroller and Auditor General  
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