



**Armed Forces Personnel  
Administration Agency**

# **Annual Report and Accounts 2006/2007**



# ANNUAL REPORT AND ACCOUNTS 2006/2007

Accounts, prepared pursuant to Section 7(2) of the Government Resources and Accounts Act 2000,  
together with the report of the Comptroller and Auditor General thereon.

Ordered by the House of Commons to be printed 12 July 2007

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# Chief Executive's Foreword



Rear Admiral Trevor Spires

This is the last Annual Report and Accounts for the Armed Forces Personnel Administration Agency after 10 years of operation as an Executive Agency of the Ministry of Defence. I am extremely proud to have been with the Agency as the chief executive for the last four years to witness the huge steps that have been taken to modernise and improve the quality of administrative support to the Armed Forces.

The Agency has been faced with many challenges since its formation in 1997, not least because it was one of the first Public Private Partnership arrangements in the Ministry of Defence. This presented opportunities to change ways of working, improve processes and install new technology to benefit our customers. The Armed Forces' morale and hence operational effectiveness depends in part upon AFPAA's continued ability to deliver a quality service that relieves individuals of administrative worries and distractions. In order to deliver that quality service the Agency has, over the last few years, developed and installed technology and processes to deliver personnel administration and information services on a harmonised basis known as Joint Personnel Administration (JPA). This project was one of the top five change projects in the MoD and this last year saw the culmination of all that work as JPA was rolled out firstly to the RAF in March 2006, the Navy in October 2006 and finally the start of Army rollout in March 2007. The success of the project, notwithstanding the early teething problems, is due to the tremendous dedication and hard work of both MoD and EDS personnel and the way in which they have applied the Partnering Principles of teamwork, innovation and continuous improvement. As a result we are now an established Agency of the future, delivering services using processes and procedures which reflect the approach and technology of a 21st Century organisation.

Whilst much of the focus of the last year was on the JPA project the Agency managed to maintain the high quality of service in its other outputs it was required to deliver and those worth highlighting include;

- The Delivery of Pay and Pensions lie at the heart of our business and despite having to divert key resources during rollout of JPA both Key Targets were achieved.

- The Joint Casualty and Compassionate Centre (JCCC) has been fully operational for 2 years. It has inevitably seen a rise in reporting with the ongoing overseas Operations particularly Iraq and Afghanistan. The Major Incident Centre (MIC) has also been activated on a number of occasions during the year to deal with inquiries following various incidents. The people involved in manning the JCCC and the MIC take great care and pride in providing a high quality service which by the very nature of the work can be extremely harrowing.
- The formation of the Pay and Allowance Casework Cell, to establish for the first time a consistent approach to the handling of pay related casework for the 3 Services, has enabled AFPAA to deal with over 2400 cases relating to regulations and administer write off/recovery action on a further 3350 cases.

On top of the huge challenge of JPA and the requirement to maintain delivery of a range of critical services, a key objective during the year, against a very challenging timeframe was to achieve merger with the Veterans Agency by April 2007. It is to the very real credit of all AFPAA's people that not only has JPA been rolled out and services delivered but also the Agencies merged successfully and the Service Personnel and Veterans Agency (SPVA) was launched on 1 April 2007.

Therefore, looking to the future, the formation of SPVA will allow for the first time, the MoD to provide a single organisation for serving personnel and Veterans to contact, facilitating access to information and advice on their pay, pensions, compensation claims, records of service and medal entitlement.

This is an extremely diverse and challenging set of outputs but one which I know, as Chief Executive of SPVA that the Agency, and in particular, its people, will tackle with enthusiasm and commitment.

A handwritten signature in blue ink that reads "Trevor Spires".

Rear Admiral Trevor Spires  
Chief Executive

# Management Commentary

## Part 1 - Operating Review

### Introduction

The Report and Accounts which follow, cover the period 1 April 2006 to 31 March 2007 and have been prepared with the direction dated 16 Jan 2006 given by the Treasury and in accordance with section 7 (2) of the Government Resources and Accounts Act 2000. Its purpose is to provide a public report on AFPAA's performance and results for the Financial Year 2006/07. This is the final Annual Report for AFPAA as a result of its merger with the Veterans Agency (VA) to form the Service Personnel and Veterans Agency from 1 April 2007.

### History

AFPAA was vested as a Tri-Service Defence Agency in April 1997, to provide a full range of pay, pensions and personnel administration services to the Armed Forces. In January 1998 the Agency's commercial Public Private Partnership (PPP) partner, Electronic Data Systems Defence Ltd (EDS), assumed responsibility for the delivery of Information Systems (IS).

The following are significant events which have shaped AFPAA and have contributed to its drive to improve and increase the services it provides to its primary customers, the individual men and women of the Armed Forces.

- **November 2000.** A renewed contract for the administration and payment of Armed Forces retired pay and pensions was awarded to Paymaster (1836) Ltd.
- **June 2001.** An amended agreement was signed with EDS redefining the partnering relationship to the mutual benefit of both parties.
- **October 2001.** The Army's Personnel, Pay and Pensions administration (PPPA) organisation transferred to AFPAA, at which time AFPAA was re-launched.
- **September 2002.** The formal incorporation of the Joint Personnel Administration Strategy Study within AFPAA ensured closer liaison with the rest of the Agency as the Joint Personnel Administration (JPA) project moves forward.

- **June 2004.** Creation of Tri- Service pensions delivery in Glasgow as the first phase of Joint Personnel Administration Centre (JPAC) implementation.
- **October 2004.** Completion of negotiations and amendment of contract with EDS for JPA implementation.
- **April 2005.** Joint Casualty and Compassionate Centre (JCCC) fully operational.
- **April 2005.** MoD Medal Office fully operational.
- **December 2005.** Tri Service Pay and Allowances Casework Cell (PACC) was formed within AFPAA Glasgow.
- **March 2006.** First Phase rollout of the Compensation and Pensions System (CAPS) to support both the Armed Forces Pension Schemes and the Veterans Agency's Pension and Compensation Schemes.
- **March 2006.** Rollout of Joint Personnel Administration (JPA) to the Royal Air Force.
- **October 2006.** Rollout of JPA to the Royal Navy.
- **March 2007.** Rollout of JPA to the Army begins.

### Defence Vision

As in previous years, this last year has seen AFPAA's outputs contribute to the overarching defence vision:

#### *A Force for Good in the World*

by its mission to support UK Defence Capability through the accurate payment of military personnel and provision of quality personnel administration and information services on a harmonised basis.

# Departmental Structure

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The Agency Owner chairs the Owners Advisory Board (OAB) which comprises senior officials of the Ministry of Defence and whose prime responsibility is to support the Owner in his responsibilities on behalf of the Secretary of State for Defence. The Board monitors the Agency's progress and performance against pre-determined aims, objectives and targets and represents the interests of the Agency's customers. There is one Non Executive Director on the board whose remuneration is met by the Agency.

**During the year 2006/07 the membership of the Board consisted of:**

Deputy Chief of Defence Staff (Personnel)	Air Marshal D Pocock
Chief of Staff (Personnel & Support) /2nd Sea Lord	Rear Admiral M Kimmons
Deputy Adjutant General / Director General Service Conditions (Army)	Major General M F N Mans CBE
ACOS Personnel Policy (RAF)	Air Commodore P Hughesdon
Defence Services Secretary	Rear Admiral P J Wilkinson
Director General Service Personnel (Policy)	Mr C Baker OBE
Non Executive Director AFPAA	Professor H Drummond

# Agency Structure

## AFPAA Joint Partnering Management Team (JPMT)

The JPMT is responsible for the management of the Agency, its performance, risks and partnering relationships. It provides the forum for business requiring joint consultation or agreement across the partnership. The JPMT membership during the year 2006/07 was as follows.



\* Prior to 1 January 2007 this post was held by Air Cdre Ian Harvey.

\*\* Prior to 1 January 2007 this post was held by Julie Kinnear.

## Non-Executive Directors (NEDs)

Kenneth Ludlam is a member of the JPMT and the AFPAA Executive Board (AEB) and also chairs the AFPAA Audit Committee. Professor Helga Drummond is a member of the JPMT, DCDS (Pers) Owners Advisory Board (OAB) and the AFPAA Audit Committee. The principal role of the Non Executive Directors is to offer the Chief Executive, and the Boards for which they are members, an independent view on AFPAA strategy and performance and on the implementation of JPA.

### AFPAA Executive Board (AEB)

The AEB is responsible for the direction and governance of the MoD components of the Agency: it complements the role of the JPMT. The AEB membership during the year 2006/07 was as follows:

<b>Chairman</b>	Chief Executive	RAdm Trevor Spires
	DCE/Agency Secretary	Peter Northen
	Director Change	Air Cdre David Tonks
	Director Strategy & Programmes	Brig Robin Bacon
	Director Operations	Cdre Angus Ross (Air Cdre Ian Harvey to 31 Dec 2006)
	Deputy Director Finance & Corporate Governance	Daren Gregg (Tony Maynard to 15 May 2006)
	NED	Kenneth Ludlam

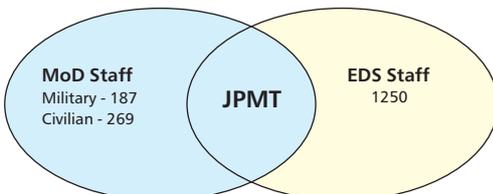
During the year, none of the Directors held company directorships or other significant interests which may conflict with their management responsibilities.

### Locations and Staff

During 2006/07 AFPAA operated from 4 sites at Gosport, Glasgow, Innsworth and Worthy Down. The Agency plans to vacate the Worthy Down site by 31 December 2007 and has a Future Accommodation Study Team which continues to assess the options for the possible relocation of the AFPAA functions at Innsworth in the light of MoD decisions on its future usage.

### Staff Numbers

As at 31 March 2007, AFPAA strength<sup>1</sup> was as follows:



<sup>1</sup> Civilian number includes contractors.

# Customers

## Serving or Former Service Personnel and Dependants

These are the end Customers of AFPAA's pay, pension and administration services. The quality of these services are measured against Key Targets (KTs) 1 and 2 (further details on KT's can be found on pages 10 and 11). The delivery of these KT's has a significant impact on the morale of current and former Service personnel and their dependants, and the effectiveness of their units.

## Volumes of payments and records maintained each month

Activity	Volume <sup>2</sup>
Pay records of Regular Services personnel	200,000
Records of Reserve personnel and Cadet Instructors	70,000
Pensions records of Regular Service, Gurkha and Locally Enlisted personnel including dependants (maintained by Paymaster (1836) Ltd)	385,000
Pensions records maintained but not currently in payment i.e. personnel still serving or with deferred or preserved pensions	490,000
<b>Total records maintained</b>	<b>1,145,000</b>

## Expenditure on pay, allowances and pensions in 2006/07 (in £ billions)

	Pay	Pensions	Total
Navy	1.694	0.654	2.348
Army	4.138	1.353	5.491
RAF	2.066	1.005	3.071
<b>Totals</b>	<b>7.898</b>	<b>3.012</b>	<b>10.910</b>

## The Personnel Management Authorities

Timely provision of accurate data is essential to enable effective manning and career management by each of the Personnel Manning Authorities. The delivery of JPA (Key Target 3) will support the delivery of better quality management information.

## MoD Planning Staffs and Policy Makers

MoD and individual Service policy making and planning branches and other Defence Agencies require information and advice from AFPAA. This is to support the development and implementation of new policies, to inform the MoD's resource allocation process and to support Ministers in their discharge of Parliamentary business. The value of the funds disbursed on behalf of the Department by AFPAA, through its pay and pension service delivery, means that the Agency also plays a key role in informing MoD's financial reporting processes. In addition to the direct delivery of services to the Armed Forces, AFPAA must continue to discharge its responsibilities as part of a Department of State.

<sup>2</sup>Volume rounded to nearest 5,000.

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### Customer Satisfaction Survey (CSS)

As in previous years, a Customer Satisfaction Survey (CSS) is being conducted with corporate-level customers to cover performance during the period 2006/07. This reinforces AFPA's commitment to continuously monitor customers' views on Agency performance. The results of the 2005/06 survey showed minimal change from previous surveys in terms of perceived strengths and weaknesses. Much of this was attributable to the tight limits on business change in preparation for JPA release to the RAF. However, in some areas, such as service delivery, the survey recorded a drop in perceived performance. Work is underway to address these issues and completed actions include:

- The development of a customer engagement strategy which included presentations and road shows to raise issues and provide two-way feedback
- Improved back office access for HR professional users

A three-tier approach to the survey is being formulated for 2007/08 that captures the views of the individual Serviceman or woman, the HR professional user community and the corporate level customers, all of which is reflected in the strategic intent and Key Targets of the Service Personnel and Veterans Agency.

# Management Commentary

## Part 2 - Performance Review

### Performance Against 2006-07 Key Targets including Historical Data

The Agency management team used a monthly Balanced Scorecard (BSC) to help it manage all aspects of the business and has ensured a robust risk management structure is in place to allow it to manage key business risks. Performance is reported monthly to the Agency Owner DCDS(Pers). During 2006/07 the Agency narrowly missed achieving Key Target 6 relating to JPA target costs mainly because of the need to adjust the programme to match the realigned Defence Information Infrastructure (DII) programme upon which JPA depends.

Key Target	2004-05		2005-06		2006-07		
	Target	Performance	Target	Performance	KT	Target	Performance
<b>Pay Accuracy:</b>							
Error rate of accuracy No. of errors per 1,000 not to exceed	0.1%	Achieved 0.08%	0.1%	Not Achieved 0.23%	KT1 <sup>3</sup>	0.5%	Achieved 0.47%
<b>Pay Timeliness:</b>							
To make payments by the due date	99.9%	Achieved 99.9%	99.9%	Achieved 99.975%	KT1	99.9%	Achieved 99.92%
<b>Pensions Accuracy:</b>							
Error rate of accuracy No. of errors per 1,000 not to exceed	0.1%	Achieved 0.0%	0.1%	Achieved 0.00038%	KT2	0.1%	Achieved 0.00%
<b>Pensions Timeliness:</b>							
To make payments by the due date	99%	Achieved 99%	99%	Achieved 99.98%	KT2	99%	Achieved 99.93%
<b>Service Enhancement:</b>							
All change projects (Major Change ) to be delivered within project tolerances	96%	Achieved	-	-	-	-	-
All other change to be delivered in accordance with the AFPAA Change Control Steering Group	96%	Achieved	-	-	-	-	-
To support the delivery of the JPA Programme	Main Gate Approval Sept 04	Achieved	RAF Live Service Mar 06	Achieved Mar 06	KT3	RN Live Svce Oct 06 Army Live Svce Mar 07	Achieved Oct 06 Achieved Mar 07
To transform the Agency to deliver JPA services by delivering 100% of key critical path milestones in the Transformation Plan	Stage 1 Jun 04 Stage 2 Mar 05	Achieved	100% of Plan milestones	Achieved 100%	-	-	-
To deliver an effective Enquiry Centre Service.	-	-	-	-	KT4	To deal with 75% of queries received on first contact	Achieved 81.22%

<sup>3</sup>To keep monthly error rate of accuracy for the volume of payments within 0.5% (accuracy within 2% of net pay per individual pay account)

Key Target	2004-05		2005-06		KT	2006-07	
	Target	Performance	Target	Performance		Target	Performance
To confirm that the broad range of AFPAA's outputs are delivered to the agreed Service levels selected by the customer	Develop and agree KT	Achieved	90% of service levels selected by customer	Achieved 97.22%	-	-	-
To deliver an efficient and effective MoD medal service	-	-	Reduce backlog from 45,000 to 21,000 by 31 Mar 06	Achieved Backlog 18,587 at 31 Mar 06	KT7	To deliver medals from receipt of application to issue: Campaign 35 WDs Conduct & Reserve 45 WDs Historic 70 WDs	Achieved Campaign 20 WDs Conduct & Reserve 30 WDs Historic & WW2 40 WDs
<b>New contract post-2009:</b> To prepare for delivery of AFPAA services post-2009			Identify milestones by 31 Jul 05	Achieved	KT5	Achieve MoD Investment Approval Review (Initial Gate)	Achieved Revised strategy agreed by IAB Dec 06
<b>Efficiency:</b> To reduce the average unit cost of AFPAA services by n% (Total unit cost of reduction of 12% for a 4 year period from 2002-03)	6%	Achieved 10.3%	12% (4-year cumulative)	Achieved 13.6%	KT6	Achieve JPA Target Cost	Not Achieved JPA core costs 122% of the JPA Target Cost for 2006-07. (see commentary at head of page)

The metric used for accuracy monitors those elements of the end to end pay process that falls within AFPAA's control and, as such, does not represent the accuracy of the complete, end to end process. Specifically, it assumes a correct record of service, which is used to inform the pay calculation software.

### Key Targets for 2007-08

Key targets for the coming years are set against the Service Personnel Veterans Agency (SPVA) and were formally announced in Parliament on 26 June 2007 and can be found in the SPVA Corporate Plan 2007-12.

# Current Operations

## Delivering Services

To maintain current services, particularly the delivery of pay and pensions, whilst delivering Joint Personnel Administration to the RAF and RN and preparing for Army go live in March has been immensely challenging. The delivery of pay against Key Target 1 and pensions against Key Target 2 were both successfully achieved. These core services remain at the heart of the Agency business and with the delivery of the new JPA services to such a large customer base across the Army, in the coming months, the requirement to continue to deliver high quality Pay and Pension services will remain challenging.

The Joint Casualty and Compassionate Centre (JCCC) has been fully operational for 2 years with the responsibility for all casualty and compassionate reporting action for the three Services. It has sadly seen a rise in reporting with the ongoing Operations in Iraq and Afghanistan. The JCCC's Major Incident Centre (MIC) has also been activated on four

separate occasions during the year to deal with inquiries following major incidents in Iraq and Afghanistan. In addition, the JCCC has provided appropriate support in respect of:

- 239 Deaths.
- 416 very seriously ill and seriously ill.
- 85 incapacitating injuries and illnesses.
- 1,000 unlisted casualty personnel or dependants<sup>4</sup>.
- 5,700 requests for Compassionate leave travel.
- In excess of 114,300 telephone calls to/from Operations.



The Historic Casework and Deceased Estates Team

<sup>4</sup>This refers to minor injuries only.



Member of staff at the MoD Medal Office

The MoD Medal Office has had another busy and successful year; it has received just over 100,000 medal applications, of which only 3% were awaiting assessment at the end of the report year. All types of war and campaign medals are being delivered within the agreed terms of the Service Level Agreement thus achieving Key Target 7. This is particularly notable for the area of current medals, which includes the Iraq Medal and the Operational Service Medal for Afghanistan, where delivery to the home unit is achieved before service personnel return from their operational tours.

Early in 2006 the MoD Medal Office started to recruit and train new staff to work in the Historic Division to deal with a resurgence of interest in World War II medals. 44,000 applications were recorded and, at the close of this report year, only 2,100 awaited assessment, an all time low.

The formation of a Pay and Allowance Casework Cell (PACC) three months in advance of the reporting year, has enabled the Agency to ensure that the casework in respect of new tri-Service regulations (issued in support of JPA) and write-off/recovery action is resolved in a fair and consistent manner across all three Services. During 2006/07 AFPAA has dealt with over 2,400 cases relating to regulations governing entitlement and administered writes off/recovery action on a further 3,350 cases.

# Building for the Future

## Joint Personnel Administration

The rollout of JPA this year has been a significant milestone in the history of AFPAA and Service Personnel management. Despite a number of problems immediately following rollout, lessons have been learned and implemented and overall the project has been a success with Agency KT 3 having been achieved.

The rollout to the RAF Unit HR staff and Career Managers was achieved on time on 20 March 2006. By the first week of April 2006 RAF self-service users started to be brought onto the system. By the middle of April serious problems emerged with the number of users that could be supported by the system and

emergency controls were introduced to screen groups of users out of the system at specific times to allow the primary payroll functions to continue. There were a number of issues which contributed to the failure, none of which had emerged in the comprehensive testing carried out before going live. Nonetheless, basic payroll functions were maintained with a surprisingly low consequential error rate. Error rates around specialist pay, notably flying pay were greater than expected, but these were largely down to inaccurate set up and the rigour of the software in enforcing a new set of controls which had hitherto been subject to management judgement rather than business rule. Early experience with the Enquiry Centre did not provide the levels of customer satisfaction or problem resolution promised in our customer SLAs (Service Level Agreements) and immediate workarounds were introduced to address these deficiencies.

A number of lessons were learned as a result of the problems around RAF launch, mainly the need to phase in the take-on of self-service users in a much more carefully controlled fashion. Also, hardware improvements were made underpinning both the Oracle application and the Enquiry Centre Telephony. In addition, at RN rollout extra trained Enquiry Centre staff were made available to ensure the surge of RN new users could be met whilst continuing to provide the newly improved service to the RAF. Specialist pay received additional attention and both AFPAA and the RN were aware of the need to get the set up precise. This did not prevent a number of errors on transition, but these were swiftly corrected. The net results for RN rollout, with cutover achieved on schedule on 23 October 2006, were a much more successful introduction and a far higher degree of acceptance and satisfaction from the RN. There were few new lessons from RN rollout other than to reaffirm the importance of those learned earlier.



JPA Release 2

Rollout to the RAF had also revealed shortfalls in JPA accounting outputs. These concerned outputs to the Defence Financial Management System (DFMS), management controls and the provision of management information to budget holders. Rectification work was undertaken to enable both RN rollout and the preparation for Army rollout to proceed. Further refinement of these accounting aspects of JPA will continue. Further detail may be found in the Agency Statement of Internal Control that encompasses the Agency Accounts.

Also, the Management Information (MI) available to professional users, particularly to enable manpower planning and general administration processes is not easily accessible and as a result some development work is underway along with additional training for users to improve the overall MI capability.

The start of the phased Army rollout was achieved on 23 March 2007 and included Army and RAF reserves, a JPA mobilisation function, and the introduction of some limited additional functionality. Additional hardware has been installed to increase capacity to meet Army volumes, staffing is ready at levels to cover the initial surge of activity during the cutover period, communication plans are in place, and Army plans for the management of change have been fully prepared and rehearsed.

In recognition of the requirement for the co-ordination, control and communication aspects of the release of JPA to the Services a JPA Operations Room was established in March 2006. The Operations Room is a joint MoD/EDS team that is augmented during the rollout phases by the Service JPA Focal Points. The Operations Room launched a 'Getting it right and building confidence survey' as a result of initial feedback from the RAF and RN rollout to gather information on the quality of service delivered by the Enquiry Centre (EC).

Whilst the Key Target set against the EC was achieved the real credibility issue of Agency performance lay in the quality of service delivered and the survey provided an opportunity to establish measures to achieve levels of service expected by the customer now and in the future. The JPA Operations Room has been a resounding success demonstrating the values of an organisation that prides itself on excellent team work and customer focus.

The Service Personnel and Veterans Agency will ensure that customer focus remains a priority. To this end a new Key Target 4 which will help track the wider aspects of the quality of service, coupled with the development of a key target to establish customer satisfaction measure for future years, will enable the Agency to better understand and meet customers' needs.

A complementary system to JPA, the Compensation and Pensions System (CAPS) is designed to support both the Armed Forces Pension Scheme (AFPS) and the Armed Forces Compensation Scheme (AFCS). During the year the 3 phase approach used by JPA was applied and data was successfully migrated first for the RAF, then RN and finally the Army. Also, the major CAPS functionality was tested and implemented during the year and the administration of the AFPS and AFCS are now managed through CAPS. An ongoing programme will ensure that a single system for the administration of tri-service Compensation and Pensions is supported and maintained.

## Agency Transformation

The Agency has continued to restructure itself progressively to support the phased introduction of JPA and the consequent closure of legacy services. Where lessons have emerged from operational experience with JPA, changes have been made as necessary to training, staff numbers and organisation - for example the JPA Enquiry Centre.

During the year the Agency has continued to make progress with its estate rationalisation plans. Planning in support of AFPAA's withdrawal from the Worthy Down site by December 2007 is now well advanced. Final draw down activities will not commence until JPA Army rollout actions have been successfully completed in July 2007. The Agency also continues to carefully consider its options with respect to its presence on the Innsworth site. Whilst the RAF will have departed the site by March 2008 to form a combined HQ at RAF High Wycombe, the future of the site is still to be decided. It remains the Agency's strategic intent to reduce its estate footprint and options to achieve this are being thoroughly considered.

## AFPAA/VA Merger

Following a ministerial announcement in July 2006 that AFPAA and VA were to merge, a joint governance structure to manage the implementation of the merger was established. This laid the foundations successfully to allow merger to take place at the beginning of April 2007. To ensure that both agencies maintained the high quality of service delivered to customers and recognising the significant change programme in AFPAA as JPA continues to rollout it was agreed that merger would be phased rather than a big bang at April 07. A programme was developed to cover the various work strands necessary to achieve merger by April which included the development of the new agency Key Targets, Framework Document, Corporate Plan and performance management processes and the necessary management restructuring. Communication plans and Agency culture were also key activities. The organisational benefit of merger is the rationalisation of the support functions and studies that recommended the steady state structure for each function were completed for implementation during 2007/08.

A significant area of implementation centred on the achievement of a coherent amalgamation of each Agency's business outputs. Work in this area has necessarily been phased so as to achieve as much early benefit as possible, whilst recognising the need to identify and set in train activities which will achieve substantial longer term benefits. This twin track approach has led to a number of improvements being delivered to the Agency's customers at the time of merger. These include: improved initial customer handling arrangements; a more consistent approach following a death in service, hence reducing the stress on relatives at a harrowing time; improved welfare provision to both serving and ex-serving personnel. For the longer term, work has commenced on plans to harmonise call centre activities and to rationalise and improve the delivery of the service pension and compensation schemes.

## Future contract

The current contracts with EDS and Paymaster expire in November 2009. In preparation to recompetition, an informal Industry day was held in 2006 and this reinforced the message that we need a bounded requirement to run an effective competition for the future delivery of services after the expiry of the current contracts. However, several developing change programmes within the MoD have introduced uncertainties, which will not be resolved until at least mid 2008, and these will affect service delivery requirements for the Agency. Consequently, rather than pursuing a single long term contract, a revised procurement strategy of competing an interim contract of around 2 to 3 years followed by a longer term contract has been agreed by the MoD Investment Approvals Board.

# Corporate Services

The Agency Secretary is responsible for ensuring the services to achieve AFPAA outputs through the delivery of a range of corporate enabling functions. These include the operation of performance management tools such as the Balanced Scorecard and Risk Registers; performance reporting to the Agency Owner on Key Targets; financial management including support of JPA; commercial (contracts) management; handling Parliamentary and public correspondence; personnel support to MoD staff; business planning and reporting; Corporate Governance including support to the AFPAA Audit Committee; communications and delivery of a culture change programme.

## Corporate Governance

The Agency's Corporate Governance is founded upon two essential elements: an Audit Committee supported by an Assurance team that provides independent advice to the Chief Executive, the JPMT and the AFPAA Executive Board (AEB); and a robust risk management process that is embedded throughout the Agency's management structure.

Audit Committee membership consists of the Agency's two Non Executive Directors (NEDs) and DCE/Agency Secretary with both the National Audit Office and Defence Internal Audit invited to observe. The Committee met 4 times in 2006-07 and looked critically at a variety of key areas of the Agency's business to ensure that adequate controls had been identified to manage and mitigate risks to the business outputs. The Committee looked particularly closely at JPA as the major challenge and area of risk to the Agency in 2006/07. The Committee also directed the audit programme of the Internal Assurance Team. Both NEDs are part of the JPMT, one also serves on the AEB and the other on the Agency Owner's Advisory Board.

## Risk Management

Risk management is embedded throughout the Agency. The highest level risks, with the potential to impact across the Agency, are reviewed monthly by the JPMT who consider probability and the impact on time, cost and performance against the Agency's objectives and key targets. Particular attention is also paid to the controls that are put in place to mitigate the risks. The risk management process is reviewed regularly by the JPMT. The principal corporate risks and mitigation activity at March 2007 are set out below.

## AFPAA Primary Risks and Mitigating Actions as at March 2007

Risk	Mitigation Activities include:
Failure to implement the relocation of AFPAA staff from Innsworth in a timely and controlled manner will impact on the ability to deliver required outputs.	<ul style="list-style-type: none"> <li>• New project plan to be devised following outcome of a Land Command study into re-location of specific assets from Germany to the UK</li> <li>• New Investment Appraisal Business Case to be completed.</li> <li>• Decision on options to be taken forward.</li> </ul>
Over-demands are placed on JPAC which will affect the delivery of Service Levels and consequently impact on the JPA Programme and Agency reputation.	<ul style="list-style-type: none"> <li>• Effective training and communication strategies for Service personnel using JPAC.</li> <li>• Monitoring calls to assess behaviours and effectiveness of processes.</li> <li>• Analysis of calls to match needs and resources.</li> </ul>

## Human Resources

AFPAA is committed to the principles of Equality and Diversity and opposes all forms of unlawful or unfair discrimination on the grounds of colour, race, ethnic or national origin, gender, age, religious beliefs, marital status, sexual orientation or disability. It is in AFPAA's best interests and those who work in it, to ensure that all human resources, talents and skills are considered when employment opportunities arise. Every measure possible is taken to ensure that individuals, whether they are already in AFPAA or applicants for posts from outside AFPAA, are treated fairly and that decisions made on recruitment, selection, promotion and career management are based solely on objective and job related criteria. Approximately 5% of MoD civilian staff, men and women were employed in part time or job share posts. Additionally the same group had 10 people registered as disabled.

The Agency continues to be an accredited Investor in People and carried out an internal IIP health check during 2006. It has demonstrated its commitment to developing its people by delivering core training and tailored training events to meet individual and business needs.

The management team received quarterly updates and reports on Health and Safety to help ensure the Agency maintained its good record. A full Safety Health Environment and Fire MoD external audit was completed during 2006/07 and the Agency achieved a high score for its performance.

## Communication and Employee Involvement

AFPAA management knows that communications and employee involvement are essential to the successful running of the Agency. Communication with employees is achieved by regular cascade briefings on key issues throughout the Agency. The Chief Executive and the EDS Account Director carry out comprehensive site briefings on a regular basis, which include the opportunity for staff questions and feedback. Directors of the Joint Personnel Management Team also carry out team briefings which include the opportunity for staff questions and feedback.

Additionally a news magazine is distributed quarterly and there is a corporate intranet site which staff on all sites can access. The intranet site contains up to date information on all important issues relating to AFPAA and is supplemented by well maintained and comprehensive notice boards at each site. Efforts to improve internal communications will continue.

External communications to the wider MoD have been reinforced substantially not least because of the changes being wrought by JPA. In addition to specific targeted communication in partnership with the Services related to JPA, a range of articles have been placed with MoD and Service publications to increase understanding of the Agency's role more generally.

## Parliamentary Business

During 2006/07 520 letters from MPs were answered, comprising 369 drafts for ministers and 151 replies from CE or his deputy. Draft answers were provided to 80 Parliamentary Questions. 421 replies were sent to members of the public who had written with questions about AFPAA services.

## Impact on the Community

The Agency is conscious of its impact on local communities and encourages staff to engage in a range of voluntary activities including fundraising events for local charities.

# Looking Ahead

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The coming year will centre on the performance of the new Service Personnel and Veterans Agency enabling it to deliver improved services to the Armed Forces and the Veterans community via the Joint Personnel Administration Centre (JPAC) and the Veterans Helpline respectively.

The Strategic focus will include: the completion of the rollout of JPA to the Army; work to deepen the integration of the merged Agency in order to deliver benefits in both improved service to Serving personnel and Veterans, and operating efficiencies; and laying the foundations for both the interim and longer term contracts for commercial support to the business.

The following are just some of the services that will continue to be provided, and form the focus of the SPVA 2007/08 Corporate Plan.

- Pay, allowances and expenses through JPA self service access
- War Disablement Pensions
- Armed Forces Pension Schemes
- Armed Forces Compensation Scheme
- Administration of medals and veterans badges
- Casualty and Compassionate administration via the Joint Casualty and Compassionate Centre (JCCC)
- A nationwide Welfare Service providing support to Veterans and Widows
- Pay and allowance dispute resolution via the Pay and Allowance Casework Cell (PACC)
- An Enquiry Centre service for both Armed Forces personnel and Veterans

Careful consideration was given during the merger planning stages to the necessary organisational structure to ensure that early harmonisation of outputs was achieved, particularly in the delivery of service pension and compensation schemes. This has been reflected in the initial structure adopted by the new Agency. Plans to benchmark the delivery of call centre activities against both private and public sector standards are well advanced and will offer recommendations for further improvement. Similarly, a technical study aimed at providing the combined Agency with a much improved information system and communication infrastructure to support future improvements in output delivery is already underway.

# Management Commentary

## Part 3 - Financial Review

### Budgetary Structure

AFPAA operates as a Basic Level Budget within DCDS(Pers)'s Higher Level Budget. The breakdown of expenditure shown below provides detail of the Agency expenditure over the year to administer £7.898bn in Pay and Allowances and £3.012bn in Pensions.

### Financial Performance

The gross operating costs for the year ended 31 March 2007 were £135,298k and net operating costs were £135,263k. Total net liabilities at 31 March 2007 amounted to £11,904k. Total net assets are shown as negative due to the restructuring of the reporting of fixed assets and the creation of the Single Balance Sheet Owners. Subsequently the net asset balance on the Agency balance sheet has become negative following the removal of these assets. This action has not impacted on the Agency's ability to conduct its business.

### Expenditure Breakdown for FY 2006-07

	Note	FY06-07 Outturn	FY06-07 Budget
Service Pay	2	11,889	11,725
Civilian Pay	2	8,352	7,010
Travel	4	917	530
IT	4	694	1,228
Training	4	106	274
Partnering	4	90,724	79,609
Contracted costs	4	4,142	5,060
Stock costs	4	2,717	1,071
Depreciation	4	4,216	4,785
Other	3 & 4	11,291	1,667
<b>TOTAL OPERATING COSTS</b>		<b>135,298</b>	<b>112,959</b>

The difference between 06-07 outturn and 06-07 budget was primarily caused by higher than expected partnering costs. Higher partnering costs were due primarily to the need to adjust the JPA programme to match the realigned DII programme upon which JPA depends.

The resource budget allocation for FY 2006-07 was £107.5m. Actual outturn was £127.1m, with the overspend resulting primarily from the re-profiling of EDS costs related to JPA.

### Departmental Resource Accounts (DRAc)

AFPAA also provides input to Centre Top Level Budget (TLB) for the completion of the TLB DRAc. AFPAA's input comprises all costs incurred by the Agency, regardless of where responsibility for the charge lies. Communicated costs are not included in DRAc accounts.

The biggest difference between AFPAA's DRAc submission and its Agency accounts is the inclusion in the former of debtor and creditor balances in respect of Armed Forces pay and allowances.

## Financial Administration of Managed Funds

AFPAA manages tri-Service pay and pensions delivery, and the monies disbursed on behalf of the Department are known as Managed Funds. Information from these pay systems transfers income and expense data on the Managed Funds to MoD's core financial accounting system Departmental Financial Management System.

Following the introduction of JPA the Control Accounts related to the legacy pay systems are being gradually closed down. Most of the RAF accounts and a few of the RN accounts have already been closed and the remaining RAF, RN and all the Army accounts should be closed in 2007/08. The 160 or so accounts used by the legacy systems are being replaced by just 33 accounts under JPA.

## Financial Monitoring and Audit of the EDS Contract

Improvements in the budgeting, monitoring and verification of EDS costs have continued. A programme of validation exercises is still being undertaken in year and quarterly reports provided to the Audit Committee detailing the work undertaken and findings.

An Output Cost Model has now been implemented to support the Actual Target Prices (ATP) for legacy and JPA services, providing further financial management data to enhance the Agency's decision making processes.

## Armed Forces Pension Scheme (AFPS)

CE AFPAA is the AFPS Scheme Administrator and the Senior Finance Officer for the AFPS TLB. AFPAA has an independent Resource Accounting and Budgeting (RAB) system for the AFPS, which produces monthly In Year Management accounts as well as the year end AFPS Scheme Statements. The National Audit Office (NAO) formally audits the Scheme Statements and the accounts for 2005-06 were laid in Parliament on 20 July 2006.

The Scheme statements also include the Armed Forces Compensation Scheme (AFCS) which is accounted for by AFPAA on behalf of the Veterans Agency.

The AFPS continues to participate in the National Fraud Initiative (NFI), the main aim of which is the detection and prevention of fraudulent pension claims against public sector schemes. The NFI 2006 exercise is currently underway with 296 cases being investigated as potential deaths with the pension still in payment. The NFI 2004 exercise concluded with 219 cases where the pension continued in payment after the date of death. This amounted to £425K net overpayments with £250k recovered to date. The projected savings to the Scheme were £9.8m. No prosecutions have yet been made.

In addition to the AFPS, CE AFPAA is also the Scheme Administrator for the Non-Regular Permanent Staff Pension Scheme and the Army Career Officers Pension Scheme. These schemes are included in the AFPS accounts.

## Statement on disclosure of audit information

So far as the Accounting Officer is aware, there is no relevant audit information of which the Agency's auditors are unaware and the Accounting Officer has taken all steps he ought to have taken to make himself aware of any relevant audit information and to establish that the Agency's auditors are aware of that information.

## Policy and achievements on supplier payments

It is MoD policy to settle terms of payments with suppliers when agreeing the terms of each transaction, to ensure that suppliers are made aware of the terms of payment, and to settle all bills within 30 days of receipt or earlier.

Payments to suppliers are predominantly made by the Defence Bills Agency (DBA) on AFPAA's behalf. Overall DBA performance reported in their accounts for 2006-07 was that 99.9% of all certified bills submitted for payment were paid within 11 days.

### Pension liabilities

Details of the pension schemes available to AFPAA employees and the costs of these schemes are disclosed in the Remuneration Report on page 23.

### Auditors

The accounts of the Agency are audited by the Comptroller and Auditor General under Section 7(2) of the Government Resources and Accounts Act 2000.

The fee of £46k is in respect of statutory audit work only. No other services were provided by the auditors.

A handwritten signature in blue ink that reads "Trevor Spires". The signature is written in a cursive style with a horizontal line underneath.

Trevor A Spires  
Accounting Officer  
Armed Forces Personnel Administration Agency  
28 June 2007

# Remuneration Report

## Remuneration Policy

1. The AFPAA Executive Board is composed of officers of HM Armed Forces, civil servants and two Non Executive Directors.
2. AFPAA does not have a Remuneration Committee and the salaries of all military and civilian Board members, including the Chief Executive, are determined at national level. Military Board members' salaries are recommended by the Armed Forces Pay Review Body and ratified by Parliament. The Agency Secretary/Deputy Chief Executive's remuneration was determined by the Senior Civil Service Salaries Review Body. The salaries of the Deputy Director of Finance and Corporate Governance and Deputy Director Joint Personnel Administration were determined by negotiation between Ministry of Defence and Civil Service Trade Unions. The salaries of the Non Executive members are determined by the Chief Executive in line with Ministry of Defence guidelines.

## Service Contracts

3. Military members of the Board are appointed by standard service posting procedures. MoD civilian members of the Board are appointed by MoD Civil Service standard procedures. Non Executive members of the Board are appointed on fixed term contracts renewable by agreement.
4. Tony Maynard left the appointment of Deputy Director Finance and Corporate Governance on 15 May 2006.
5. Daren Gregg was appointed Deputy Director Finance and Corporate Governance on 17 May 2006 and left on promotion on 04 May 2007.
6. Ian Harvey left the appointment of Director Operations on 31 December 2006.
7. Angus Ross was appointed Director Operations on 18 December 2006.
8. Dr Paul Collins left the appointment of Deputy Director JPA on 14 August 2006.

## Salary and Pension Entitlements

9. Details of remuneration and pension entitlements of Board members are shown in the following table.
10. 'Salary' includes gross salary, performance pay or bonuses; overtime; reserved rights to London weighting or London allowances; recruitment and retention allowances; private office allowances and any other allowance to the extent that it is subject to UK taxation.
11. None of the members of the Board received any Benefits in Kind.
12. The table in para 14 on page 24 refers to remuneration during the financial year, and is subject to audit. The schedules reflect remuneration for that part of the year during which individuals were either providing services to, or employed by, AFPAA.
13. For 2006-07, employers' contributions of £3,477k were payable at rates in the range 10 to 36.3 percent of pensionable pay, based on salary bands. Employer contributions for PCSPS were reviewed in 2005-06 and employer contributions for the AFPS were reviewed during 2006-07. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the schemes.

14. The salary and pension entitlements of the Executive Board of Armed Forces Personnel Administration Agency for the year ended 31 March 2007 are as follows:

	Salary Including Performance Pay 2006-07 £'000	Salary Including Performance Pay 2005-06 £'000	Real increase/(decrease) in Pension and related lumpsum £'000	Total Accrued Pension at 31/3/07 and related lumpsum £'000	CETV at 31/3/06 £'000	CETV at 31/3/07 £'000	Real increase /(decrease) in CETV £'000	Employer contribution to partnership pension account incl risk benefit cover £'000
°Rear Admiral TA Spires Chief Executive	95-100	90-95	0-2.5 plus 0.5 lumpsum	45-50 plus 135-40 lumpsum	866	885	19	0
Mr PD Northern Agency Sec/Deputy Chief Executive	80-85	65-70	0-2.5	25-30	338	362	12	0
Air Commodore * I Harvey Dir Ops	65-70	80-85	0-2.5 plus 5-10 lumpsum	40-45 plus 120-125 lumpsum	851	446	(384)	0
Air Commodore JD Tonks Dir JPA	85-90	80-85	0-2.5 plus 5-10 lumpsum	40-45 plus 130-135 lumpsum	797	838	40	0
Commodore A Ross Dir Ops	20-25	0	0-2.5 plus 0.5 lumpsum	30-35 plus 100-105 lumpsum	339	354	3	0
Brigadier * R J Bacon Dir S&P	85-90	20-25	0-(2.5) plus 0-(5) lumpsum	35-40 plus 105-110 lumpsum	821	356	(449)	0
Mr AL Maynard # Deputy Dir Finance & Corp Gov	0-5	50-55	0-2.5 plus 0.5 lumpsum	15-20 plus 55-60 lumpsum	318	331	1	0
Mr D Gregg # Deputy Dir Finance & Corp Gov	40-45	0	0-2.5 plus 0.5 lumpsum	10-15 plus 40-45 lumpsum	172	182	7	0
Dr P H Collins # Deputy Dir JPA	25-30	60-65	0-2.5 plus 0.5 lumpsum	25-30 plus 75-80 lumpsum	562	559	5	0
Mr K J Ludlam Non Executive Dir	15-20	15-20	0	0	0	0	0	0
Prof H Drummond Non Executive Dir	5-10	5-10	0	0	0	0	0	0

\*\* opted to join PCSPS Premium scheme # opted to remain in PCSPS Classic scheme \* opted to join AFPS05 scheme  
No directors received any benefits-in-kind during the year

## Pension Benefits

15. Pension benefits are provided through the Armed Forces Pension Scheme (AFPS) and the Principal Civil Service Pension Schemes (PCSPS). These schemes are unfunded multi-employer defined benefits schemes but AFPAA is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out as at 31 March 2005 for AFPS and 31 March 2003 for PCSPS. Details can be found in the resource accounts for these schemes, which are published and laid before the House of Commons.

### a) Armed Forces Pension Scheme (AFPS)

AFPS is a contracted-out, unfunded, defined benefit occupational pension scheme. On 06 April 2005 the existing scheme, known as AFPS75 was closed to new entrants and a new scheme AFPS05 opened. Benefits in the scheme accrue unevenly throughout service and in addition a lump sum equivalent to three years' pension is payable on retirement. Those officers who took the Armed Forces Pension Scheme's Offer To Transfer transferred their benefits into the new scheme. Under the terms of the new scheme the benefits are structured differently and different actuarial assumptions are applied to the valuation of the benefits.

An example would be an officer who had served for more than 16 years is entitled, under AFPS75, to a pension payable immediately on retirement. Under the new scheme though, as the officer is under the age of 55 years old, he will not be entitled to a full pension until 65 years and will receive a calculated Early Departure Payment until that age. Therefore under the terms of AFPS75, the CETV is calculated on the basis of the pension being paid immediately from the date of the calculation until the death of the scheme member, while in the new scheme, the CETV is calculated based upon the member receiving his pension from the age of 65 years old until his death. It follows that in the new scheme, the benefits are in payment for a significantly shorter period of time and the value is therefore significantly lower, and the resulting real increase is negative.

Employer contribution is 36.3% for Officers and 21.8% for other ranks based on pensionable salary.

### b) Principal Civil Service Pension Scheme (PCSPS)

From 1 October 2002, civil servants may be in one of three statutory based 'final salary' defined benefit schemes (classic, premium and classic plus). The schemes are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under classic, premium and classic plus are increased annually in line with changes in the Retail Prices Index. New entrants after 1 October 2002 may choose between membership of Premium or joining a good quality 'money purchase' stakeholder based arrangement with a significant employer contribution (partnership pension account).

Employee contributions are set at the rate of 1.5% of pensionable earnings for classic and 3.5% for premium and classic plus. Benefits in classic accrue at the rate of 1/80th of pensionable salary for each year of service. In addition a lump sum equivalent to three years' pension is payable on retirement. For premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike classic, there is no automatic lump sum (but members may give up or commute some of their pension to provide a lump sum). Classic plus is essentially a variation of premium, but with benefits in respect of service before 1 October 2002 calculated broadly as classic.

The partnership pension account is a stakeholder pension arrangement. The employer makes a basic contribution of between 3% and 12.5% (depending on the age of the member) into a stakeholder pension product chosen by the employee. The employee does not have to contribute but where they do make contributions, these will be matched by the employer up to a limit of 3% of pensionable salary (in addition to the employer's basic contribution). Employers also contribute a further 0.8% of pensionable salary to cover the cost of centrally-provided risk benefit cover (death in service and ill health retirement).

Further details about the Civil Service pension arrangements can be found at the website [www.civilservice-pensions.gov.uk](http://www.civilservice-pensions.gov.uk).

16. The table shown on page 24 discloses the member's cash equivalent transfer value (CETV) accrued at the beginning and end of the reporting period. The real increase in CETV is effectively funded by the employer. It takes account of the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.
17. A CETV is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which the disclosure applies. The CETV figures, and from 2003-04 the other pension details, include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the CSP arrangements and for which the CS Vote has received a transfer payment commensurate to the additional pension liabilities being assumed. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost. CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries.
18. The factors used to calculate the CETV for members of the PCSPS were revised for 2006/07 following advice from the Cabinet Office. The figures for 31 March 2006 have been recalculated using the new factors and this has led to changes to the figures published last year.



Trevor A Spires  
Accounting Officer  
Armed Forces Personnel Administration Agency  
28 June 2007

# Financial Statements for the Year Ending 31 March 2007

## Statement of Agency's and Chief Executive's responsibilities

Under Section 7(2) of the Resource Accounts Act 2000, Treasury has directed the Armed Forces Personnel Administration Agency to prepare a statement of accounts for each financial year, in the form and on the basis set out in the Financial Reporting Manual.

The financial statements are to be prepared on an accruals basis and must give a true and fair view of the state of the Agency's affairs at the year end, and of its income, expenditure and cash flows for the financial year.

In preparing the financial statements the Agency is required to:

- observe the Accounts Direction issued by the Treasury, including relevant accounting and disclosure requirements and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting and financial reporting standards have been followed, and disclose and explain any material departures in the financial statements; and
- prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Agency will continue in operation.

The Departmental Accounting Officer for the Ministry of Defence has appointed the Chief Executive of the Armed Forces Personnel Administration Agency as the Accounting Officer for the Agency. His relevant responsibilities as Accounting Officer, including his responsibility for the propriety and regularity of the public finances for which he is answerable and for the keeping of proper records are set out in the Accounting Officer's Memorandum, issued by the Treasury and published in "Government Accounting".

# Statement on the System of Internal Control

## Scope of responsibility

1. As Chief Executive, I have personal responsibility for maintaining a sound system of internal control that supports the achievement of the Armed Forces Personnel Administration Agency's (AFPAA) 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 Government Accounting.
2. I am accountable directly to the Ministry of Defence Principal Accounting Officer for the propriety and regularity of AFPAA's expenditure, and for prudent and economical administration of the Agency in compliance with Departmental rules. As Chief Executive, I acknowledge my responsibility for ensuring that an effective system of internal control is maintained by AFPAA.

## The purpose of the system of internal control

3. 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 Agency 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 AFPAA for the year ended 31 March 2007 and up to the date of approval of the annual report and accounts, and accords with current Treasury guidance.

## Capacity to handle risk

4. AFPAA is an executive agency of the Ministry of Defence. AFPAA services are principally delivered through a commercial partnering agreement with EDS (Defence) Ltd. The arrangement for joint working with EDS is managed via the Agency's joint management board, the Joint Partnering Management Team (JPMT) chaired by the Chief Executive. The JPMT review all 'Business Level' risks. Controls in place and controls to be put in place are identified and recorded in individual risk register reports, including appropriate target dates. Mitigation actions are reviewed at each meeting. A separate register of business level risks relating to Ministry of Defence only risks is considered not less than 3 times a year, out of committee, by the Agency Executive Board attended only by MOD senior staff.
5. Risk owners and risk managers are identified as part of the risk management process within the Agency. Members of AFPAA's project management teams are trained in appropriate risk management skills. Information and guidance is available to other managers involved in the risk management process, as appropriate. AFPAA has just completed the delivery of the core of one of the Ministry of Defence's top 5 modernisation projects, Joint Personnel Administration (JPA). This has introduced new harmonised pay and personnel processes for the whole of the Armed Forces.

## The risk and control framework

6. The AFPAA contract with EDS sets out the structure for the ownership and management of risk. The risk element of the contract was reviewed as part of the JPA contract amendment. The Joint Risk Policy Statement outlines the approach to management of risk within the Agency and is signed by both CE AFPAA and EDS Account Director.
7. Risk Process and Procedures support both the Contract and the Risk Policy and include the structure for management and escalation of risks. The procedures outline the requirement to consider risks to the achievement of business and personal objectives.
8. AFPAA Agency 'Business Level' risks are linked to Agency objectives through the Balanced Scorecard and Critical Success Factors. They are reviewed monthly by the JPMT. Risks to service delivery performance are managed by the Service Delivery Working Group and early identification of potential risks flows from EDS Service Delivery Reports, as well as customer feedback. Risks to support functions are considered and managed by the Business Support Steering Group and its specialist working groups.
9. The risks identified to the delivery and introduction of JPA, both AFPAA specific and also wider programme risks, are managed on a daily basis within the JPA project teams and through the MOD Governance structure for JPA. AFPAA specific JPA risks are managed through the JPMT at its monthly meetings and specific JPA readiness reviews.
10. AFPAA Audit Committee is fully established and meets quarterly. The Defence Internal Audit organisation and the National Audit Office observe on the Audit Committee and provide advice and guidance where appropriate. An Agency Assurance Team is in place to provide internal assurance through an agreed programme of work based on a balanced review of the Agency risks.

### Business continuity

11. The Agency has a Business Continuity Management strategy that was reviewed in the current year and has recently recruited a BC Manager to assist with the regular reviews and annual testing of BC and DR plans. It remains the intention to move to a more rigorous and realistic testing of plans but pressures of rolling out JPA to the RN and Army has meant deferring the first live disaster recovery test to not earlier than July 2007. Additional scenario-based walkthroughs were conducted prior to RN and Army go-live. All current Business Continuity Plan practitioners have completed the relevant training and regular site meetings involving both sides of the AFPAA partnership and site landlords are held as part of the routine review and updating of the process. Following the merger of VA/AFPAA it is the intention to review all BCP plans to ensure a common and unified approach.

### Review of effectiveness

12. As Chief Executive, I also have personal 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 the work of the MoD internal auditors, AFPAA's own internal assurance team, and the executive managers within AFPAA, who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors, in their management letter and other reports. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the AFPAA Executive Board, the AFPAA Audit Committee and Joint Partnering Management Team who are responsible for managing business risk and a plan to address weaknesses and ensure continuous improvement of the system is in place.

13. In the current year the effectiveness of the system of internal control operating within my Agency has been subject to continuous review. Activities that have significantly contributed to maintaining and improving effectiveness include:

The Agency's two non-executive directors were fully involved in the management of the Agency's business providing independent advice to AFPAA's Owner's Advisory Board, the JPMT and the AFPAA Executive Board.

The AFPAA Audit Committee, chaired by a non-executive director, undertook a full programme of business which included the close examination of procedures in place to manage Agency risks in relation to financial propriety and the introduction of JPA.

The AFPAA Assurance Team completed a number of compliance and assurance activities in relation to both financial propriety and business risks. They draw on the risk register produced from the annual strategic review of risk by the JPMT to shape their work programme. They also worked closely with business areas to assist them to develop adequate management controls within the new system and business processes associated with JPA; this work is ongoing.

JPMT steering groups and working groups continued to manage risk utilising risk registers put in place to reflect the agency risk management procedures and guidance established in 2005. The JPMT carries out a monthly review of all risks and undertakes a strategic review twice a year. Two strategic reviews took place in 2006/07 the first in June 2006 and the second in February 2007. The second taking account of the merger with the Veterans Agency (VA) to ensure a robust procedure was in place at the time of launching the new agency. The merger has led to fresh thinking about operational processes, structures, values and behaviours and this is being reflected in the way the Agency goes about its day to day business. The Agency also contributed to formal risk assessments on the viability of JPA rollout to the RN and to the Army. Risk Management is embedded not only at Board level but in lower level projects and joint MoD/EDS working.

Regular checkpoints of progress and Armed Forces readiness reviews took place in respect of JPA. An Agency "Ops Room" created to pre-empt and overcome problems that may arise during JPA rollout to the Services, has proved to be invaluable in managing issues promptly and effectively. Contingency plans to manage the top ten risks should any of these mature remain in force.

A joint VA and AFPAA Project Team was set up to manage the merger of AFPAA and the VA. The Agency management boards review progress on a monthly basis. The merger is scheduled to shape and deliver significant efficiencies.

An Agency Operating Model, created to manage the manpower resources required to take the Agency forward in both the pre and post JPA eras, has assisted significantly in the manpower planning and ensured that Agency staff with the appropriate skill sets and competences have been matched to the new Joint Personnel Administration supporting roles.

The "Model Office", established to provide a facility for "dry running" newly created and revised processes in a controlled environment, has continued to be successful in reducing Agency risks, as it has enabled a number of potential gaps and weaknesses in procedures to be resolved without exposing them in a live environment.

A single Change Management focal point was established within the Agency in 2006 to manage changes to AFPAA systems with the MOD Service Personnel Joint Requirements Steering Group (JRSG) becoming responsible for prioritising all changes within JPA. In this respect, a process is now being trialled whereby annually each Service will be asked to state their Top 10 priorities and these will be pulled together to provide an overall Top 10. However it is not anticipated that any change to JPA will be countenanced for some months and then the first post rollout release will be a clean up release, so in effect the first major change to JPA will not be before October 2007.

A JPA Accounting "Get Well" team was established to take forward issues in respect of JPA accounting and management information. Progress is ongoing; further details are given at paragraph 15 below.

The Agency's reputation has been bolstered through improved medals delivery and excellent work by the JCCC with accompanying publicity. JPA reputation is being rebuilt following initial setbacks through closer customer liaison. A 1500 sample customer feedback survey is currently being conducted.

14. Further improvements in the risk and internal control framework are planned over the coming year as JPA becomes established and the merger of AFPAA and the VA enable a recasting of operational structures. A JPA Post-Project Evaluation is also scheduled to commence in June 2007.

### Significant internal control problems

#### JPA

15. During the past year AFPAA achieved three extremely significant milestones by rolling out JPA to its RAF and RN customers and to the Army on 26 March 2007 with the first Army pay run scheduled for April 2007. This immensely complex undertaking has involved the migration of 18 million rows of data and the introduction of new policies and business processes supported by new integrated technology. Initial teething problems with RAF specialist pay and expenses were overcome and the first RN payroll in November 2006 was successful. There are now no systemic problems with the delivery of RAF and RN pay and allowances. However, following RAF go-live a number of concerns about JPA support to Departmental accounting processes and some weaknesses in AFPAA internal controls were identified as indicated below. These have had a temporary impact on the Department's ability to exercise full financial control and increased the risk to the timeliness and quality of the Departmental Resource Accounts (DRAC).
  - **Management Reports.** JPA feeds information into the Defence Financial Management System in a highly summarised form. Budget managers therefore need to be able to draw detailed information directly from JPA. But the functionality to enable them to do so was not available at RAF go-live. Standard reports on payroll costs were produced and then refined from mid September 2006 onwards. In December 2006 Top Level Budget managers confirmed they now had sufficient information from JPA to exercise adequate high-level financial control over RAF costs. This was also achieved for the RN following its first JPA payroll in November. Standard reports on expenses were delivered to budget managers in early March 2007.
  - The requirement for the finance community to run customised budget manager reports was not fully appreciated. Therefore to supplement the standard reports, a customised reporting capability has been planned for delivery in September 2007, it being necessary to de-conflict this work from rollout of JPA to the Army. In addition, JPA was not configured to cope with the way the Department wished to handle operational cost attribution and this was not sufficiently appreciated until after RAF go-live. Interim reports and manual processes were put in place by November 2006 to enable the correct attribution of the cost of RAF and RN operational augmentees. An automated solution is planned for delivery in September 2007.
  - **JPA Control Account Reconciliation.** There are 33 JPA control accounts to be reconciled each month that contain the transactional detail that supports the figures recorded in the financial accounts associated with JPA. Attention was initially focused upon the rectification of core JPA system performance issues and control account reconciliation did not commence until July 2006, by which time a sizeable backlog had developed. A catch-up programme brought control account reconciliations up to date by mid February. The necessary speed and quality of reconciliation was generally maintained throughout the remainder of the financial year albeit with a varying unreconciled balance on net pay. The key challenge is now to close down this balance. The value of the JPA control accounts "correcting journals" to move misbooked transactions between sub control accounts has to date been

abnormally high; notwithstanding that some correcting actions will routinely be required. This arose from the overriding pressure to pay the RAF in the early weeks following rollout at a time when accounting processes were very immature; added to the unavoidable consequence of transferring systems while some transactions are incomplete. Corrective action has been taken and journals of such value are not expected to arise in steady state. The resources and processes for steady state reconciliation activity have been reinforced and additional temporary support will be retained at least until the end of June 2007 to ensure that the year-end reconciliation task is completed in time and to an acceptable standard. By February 2007 the level of reconciliation achieved on JPA control accounts was better than that under previous pay systems.

- The issues identified through the control account reconciliation process, and those that have arisen otherwise during JPA operations have been consolidated and prioritised to inform a programme of improvements to JPA finance related business processes that commenced in February 2007 and will continue during financial year 2007/08. This includes the revision as necessary of existing written instructions for staff and the provision of additional instructions to fill any gaps that exist

- **Overpayments and Recovery.** While the vast majority of RAF and RN personnel have been paid correctly under JPA there have been a very few cases where large overpayments have been made to individuals. As a result of these errors, controls on the payments process have been reviewed and where necessary tightened to identify potentially erroneous payments before they are released. Controls limiting the size of payments will be put in place. Additional retrospective scrutiny was carried out to identify any further individual cases where corrective action was required.

- Problems also arose in respect of the recovery of debts, particularly from those who have left the service. At the end of January 2007 a backlog was outstanding for recovery. This problem over the accumulation of debts from those discharged from Service was caused by a mix of JPA faults, operator error and incorrect unit intervention. A manual process for the calculation of debts, assisted by a standalone software tool to allow calculation of Tax and National Insurance (NI), was put in place to ensure the correct quantification of debts. In January 2007 recovery action commenced on the backlog. Wider investigations subsequently revealed further post-discharge debts for which recovery action will be undertaken. Initial problems were also experienced with the recovery of advances for expenses but a robust process is now in place to recover over-issues of advances of expenses made to Service personnel.

- In parallel with this immediate action, a wider process review is underway to ensure, amongst other things, that debts on discharge from Service are minimised. JPA system changes have not been possible prior to Army rollout because of constraints during the cutover process but the possibility of subsequent amendments to assist debt recovery is being investigated.

16. AFPAA continues to work with the MoD finance community to resolve problems as they arise. Additional resources and expertise have been brought in both temporarily and for the longer term.

#### Legacy Control Accounts

17. In last year's SIC reference was made to ongoing issues with legacy control accounts. While some issues still remain these are being resolved following the transfer of records to JPA. A number of write-offs have been necessary, which total approximately £200K. The potential to write-off up to a further £3M remains, although work continues to minimise this figure. The final position is unlikely to be known until later in 2007.



Trevor A Spires  
Chief Executive  
Armed Forces Personnel Administration Agency  
28 June 2007

# The certificate and report of the Comptroller and Auditor General to the House of Commons

I certify that I have audited the financial statements of AFPAA for the year ended March 2007 under the Government Resources and Accounts Act 2000. These comprise the Operating Cost Statement and Statement of Recognised Gains and Losses, the Balance Sheet, the Cashflow Statement and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having being audited.

## **Respective responsibilities of the Agency, the Chief Executive and auditor**

The Agency and Chief Executive, as Accounting Officer, are responsible for preparing the Annual Report, which includes the Remuneration Report, and the financial statements in accordance with the Government Resources and Accounts Act 2000 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 and the part of the Remuneration Report to be audited 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 give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000. I report to you whether, in my opinion, certain information given in the Annual Report, which comprises the Chief Executive's Foreword, Operating Review, Performance Review, Financial Review and Remuneration Report is consistent with the financial statements. I also report whether in all material respects the expenditure and income 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 the Agency 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 regarding remuneration and other transactions is not disclosed.

I review whether the Statement on Internal Control reflects the Agency's 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 to form an opinion on the effectiveness of the Agency's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report 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 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 and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Agency and Chief Executive in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Agency'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 and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error, and that in all material respects the expenditure and income 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 and the part of the Remuneration Report to be audited.

## Opinions

### Audit Opinion

In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by HM Treasury, of the state of the Agency's affairs as at 31 March 2007, and of the net operating cost, recognised gains and losses and cashflows for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000; and
- The information given within the Annual Report, which comprises, the Chief Executive's Foreword, Operating Review, Performance Review, Financial Review and Remuneration Report is consistent with the financial statements.

### Audit Opinion on Regularity

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

### Report

I have no observations to make on these financial statements.



John Bourn  
Comptroller and Auditor General  
National Audit Office  
157-197 Buckingham Palace Road  
Victoria  
London SW1W 9SP

4 July 2007

# Financial Statements for the Year Ending 31 March 2007

<b>Operating Cost Statement</b> For the year ending 31 March 2007			
	<b>Note</b>	<b>2006/07</b> <b>£'000</b>	<b>2005/06</b> <b>£'000</b>
<b>Operating Costs</b>			
Staff Costs	2	20,241	21,923
Accommodation costs	3	4,417	4,314
Administration costs	4	110,640	112,058
<b>Gross operating Costs</b>		<u>135,298</u>	<u>138,295</u>
<b>Less: Commutation Fees</b>		(35)	(48)
<b>Operating income</b>		-	-
<b>Net operating costs</b>		<u><u>135,263</u></u>	<u><u>138,247</u></u>

All of the Armed Forces Personnel Administration Agency activities are continuing.

<b>Statement of Recognised Gains and Losses</b> For the year ending 31 March 2007			
	<b>Note</b>	<b>2006/07</b> <b>£'000</b>	<b>2005/06</b> <b>£'000</b>
Unrealised net Gain:			
On revaluation of fixed assets and stocks	11	78	824
Recognised Gains relating to the year		<u>78</u>	<u>824</u>
Recognised Gains		<u><u>78</u></u>	<u><u>824</u></u>

The movement in Government Funds is set out at Note 12 on page 45.

The notes on pages 37 to 48 form an integral part of these financial statements.

# Financial Statements for the Year Ending 31 March 2007

<b>Balance Sheet as at 31 March 2007</b>		<b>31 March 2007</b>		<b>31 March 2006</b>	
	<b>Note</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Fixed Assets</b>					
Intangible assets	5	5,271		6,991	
Tangible assets	5	<u>2,554</u>	7,825	<u>25,317</u>	32,308
<b>Current assets</b>					
Stocks	6	767		1,309	
Debtors and prepayments	7	<u>1,899</u>		<u>4,467</u>	
		2,666		5,776	
<b>Current liabilities</b>					
Creditors due within one year	8	<u>(22,201)</u>		<u>(22,712)</u>	
<b>Net current liabilities</b>			<u>(19,535)</u>		<u>(16,936)</u>
<b>Total Assets less Current Liabilities</b>			(11,710)		15,372
Creditors due in more than one year	8		(0)		(2,553)
Provisions for liabilities and charges	9		(194)		(224)
<b>Net (liabilities)/assets</b>			<u>(11,904)</u>		<u>12,595</u>
<b>Taxpayers' equity</b>					
General Fund	10		(11,908)		4,225
Revaluation Reserve	11		4		8,370
			<u>(11,904)</u>		<u>12,595</u>

The notes on pages 37 to 48 form an integral part of these financial statements.



Trevor A Spires  
Accounting Officer  
Armed Forces Personnel Administration Agency  
28 June 2007

The Financial Statements were authorised to be issued on 12 July 2007. The authorised for issue date represents the date of despatch by the Accounting Officer for laying before the House of Commons.

# Financial Statements for the Year Ending 31 March 2007

<b>Cash Flow Statement</b>			
<b>For the year ending 31 March 2007</b>			
	Note	2006/07 £'000	2005/06 £'000 restated
<b>Net cash outflow from operating activities</b>	18	127,207	121,113
<b>Capital expenditure</b>			
Payments to acquire intangible fixed assets		716	887
Payments to acquire tangible fixed assets		1,111	1,211
<b>Net cash outflow before financing</b>		<u>129,034</u>	<u>123,211</u>
<b>Financing</b>			
Payments on Defence Resource Accounts		129,034	123,211
Receipts on Defence Resource Accounts			
<b>Voted expenditure appropriated in year</b>		<u>129,034</u>	<u>123,211</u>
<b>Increase/(decrease) in cash</b>		<u>0</u>	<u>0</u>

The notes on pages 37 to 48 form an integral part of these financial statements.

# Financial Statements for the Year Ending 31 March 2007

## Notes to the Accounts

### Note 1: ACCOUNTING POLICIES

#### A. Basis of accounting

The financial statements for the Armed Forces Personnel Administration Agency have been prepared in accordance with the Financial Reporting Manual issued by HM Treasury. The financial statements have been prepared under the historical cost convention, modified to account for the revaluation of fixed assets to reflect their value to the business by reference to their current costs.

#### B. Value Added Tax

The Agency is not separately registered for Value Added Tax (VAT) as the Ministry of Defence accounts for VAT centrally. The Agency's accounts do, however, include non-recoverable VAT attributable to its activities.

#### C. Notional charges

- 1) A notional charge for interest on capital is included in the Operating Cost Statement. This is calculated as 3.5% of the average value of total net assets in accordance with Ministry of Defence accounting policy. Where AFPAA is the principal, but not exclusive user of a building, the full cost of capital and depreciation charges are offset by notional income from the other occupants.
- 2) Notional amounts are included in the Operating Cost Statement for charges and income in respect of services provided to and from other areas of the Ministry of Defence. The amounts charged are calculated to reflect the full cost of providing these services to the Agency.
- 3) AFPAA is not charged an audit fee by the National Audit Office. The audit fee shown represents the notional charge to the Operating Cost Statement based on the advised costs of the services provided.

#### D. Fixed assets and depreciation

On 1 April 2006 the Ministry of Defence transferred responsibility for accounting for fixed assets from AFPAA to other parts of the Department. Where the Agency retains the risks and rewards of ownership of these assets they continue to be accounted for on the Agency's balance sheet in accordance with FRS 5 and SSAP 21. In all other cases the costs of the use of these assets are communicated to AFPAA by the asset owners and charged to the operating costs statement.

Where the Agency retains the risks and rewards of ownership the following applies with regards to assets:

##### (1) Intangible Assets

Software licences are capitalised as Intangible Assets where the Agency is the beneficial user, the useful life exceeds one year and the costs of acquisition and installation exceeds the Agency's capitalisation threshold.

##### (2) Land and buildings

Where the Agency is the beneficial user of the Departmental Estate, such estate is treated as an asset of the Agency although legal ownership rests with the Secretary of State for Defence. All of the Agency's assets are freehold.

Professional valuations of land and buildings are carried out every five years, the last full valuation having been carried out in 2005.

##### (3) Plant equipment

Plant equipment is capitalised where the Agency is the beneficial user, the useful life exceeds one year and the cost of acquisition and installation exceeds the Agency's capitalisation threshold. Plant equipment assets are revalued annually using indices in accordance with MoD policy.

#### (4) IT equipment

IT equipment is capitalised where the Agency is the beneficial user, the useful life exceeds one year and the cost of acquisition and installation exceeds the Agency's capitalisation threshold. IT equipment assets are revalued annually using indices in accordance with MoD policy.

Under the Agreement with EDS, although EDS holds legal title to the IT and Communications equipment assets, the Agency has continuing and exclusive use of those assets. Following a review of the accounting treatment in 2004, the EDS owned assets and, where appropriate, the associated liability to EDS have been capitalised.

#### (5) Depreciation and Amortisation

Freehold land and Assets Under Construction (AUC) are not depreciated. Depreciation and amortisation on all other fixed assets is calculated to write-off the cost or valuation of assets by equal instalments over their estimated useful lives, which are normally assumed to be as follows:

Asset Category	Life
Intangible	3-5 years
Buildings	25 years
Plant equipment	15 years
Office equipment	5 years
IT equipment	3-5 years
IT assets (EDS owned)	3-5 years

#### (6) Disposal of assets

The Agency does not receive any cash benefit for assets disposed of, any cash receipts being accounted for centrally by the Ministry of Defence.

#### (7) Capitalisation Threshold

Assets are capitalised by the Agency where the useful life exceeds one year and the cost of acquisition and installation is greater than £10,000 inclusive of VAT.

### E. Cash, Taxation and Social Security Liabilities

The Agency does not pay or receive money on its own account. Cash payments are made and receipts collected by the Ministry of Defence's central accounting organisations on behalf of the Agency. All transactions are brought to account by the Ministry of Defence in the Departmental Resource Accounts and are recorded by the Agency when charged to this account. All such transactions are disclosed in aggregate in the Cash Flow Statement.

As the Ministry of Defence charges the Agency during the year with the gross payments, inclusive of PAYE and National Insurance Contributions due to Agency employees, the Department is liable for the payment of any liabilities which may be due to HM Revenue and Customs or Department for Work and Pensions at the balance sheet date, and these are not disclosed in the Agency's balance sheet.

### F. Going Concern

The Armed Forces Personnel Administration Agency ceased to be an Agency with effect from 01 April 2007. The Armed Forces Personnel and Administration Agency's functions will continue with the Service Personnel and Veterans Agency, the accounts have therefore been prepared on a going concern basis.

## **G. Debtors**

Long outstanding debts are assessed on a bi-annual basis to ensure that action is taken to write off bad debts. Debts are monitored regularly in normal day to day activities.

The Agreement with EDS contains tight guidelines for the imposition of failure charges where performance levels fall below set criteria. Such charges will be raised as debtors and recovered from EDS under the timescales set down in the Agreement. AFPAA additionally has the right to waive part or all of these charges and in the event of this happening, write off action is required and will be reflected in the accounts.

The amended Agreement allows for a reconciliation between the Annual Target Price and actual costs incurred by EDS. Where actual costs are below the Annual Target Price, the Agreement provides for a sharing of these efficiency savings. Such amounts are included in debtors.

## **H. Stocks**

Stocks are stated at the lower of current replacement cost and net realisable value. Cost comprises purchase price and includes expenses incidental to acquisition. Current replacement cost applies to stocks expected to be used or sold in the ordinary course of business and represents the cumulative revaluation of stock using the latest cost of acquisition. Net realisable value applies to stocks which are not intended to be used or sold in the ordinary course of business.

Where appropriate, provision is made for obsolete, surplus and defective stock. The provision is based on 100% of the purchase price of the medals, excluding bullion scrap value, for surplus stocks.

## **I. Pension Costs**

Staff are covered by the provisions of the Principal Civil Service Pension Schemes (PCSPS) and the Armed Forces Pension Scheme (AFPS). Contributions are paid to AFPS and the Paymaster General at rates determined from time to time by the Government Actuary and advised by the Treasury. These contributions were charged to the Agency as a cash cost for the period of these financial statements.

The AFPS is an unfunded defined benefits scheme and the Agency is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out as at 31 March 2005.

The PCSPS are unfunded multi-employer defined benefits schemes and the Agency is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out as at 31 March 2003.

## **J. Accruals**

The Agency's accruals policy is to accrue for work in progress at the year end and this is reflected in the accounts.

## **K. Provisions for liabilities and Charges**

Provisions are included in the accounts for future liabilities due in respect of AFPAA staff who leave under the Flexible or Compulsory Early Retirement Schemes. The provision is charged to the Operating Cost Statement for the year in which the obligation was made. Future costs are charged on an accruals basis against the related provision.

## **L. Revaluation Reserve**

Adjustments arising on revaluation of owned fixed assets are transferred to a Revaluation Reserve or the Operating Cost Statement as appropriate.

## Note 2: STAFF COSTS AND NUMBERS

Rear Admiral Spires received an annual remuneration of £96K excluding pension contributions. He is a member of the Armed Forces Pension Scheme.

In line with Departmental policy, contract staff numbers and costs are included in this heading.

1. The average number of employees during the year was as follows:

	2006/07	2005/06
	No.	No.
Military	187	222
Civil Service	200	226
Contract Staff	69	48
	<u>456</u>	<u>496</u>

2. Staff costs can be analysed as follows:

	2006/07	2005/06
	£'000	£'000
Salaries and wages	14,049	15,390
Contract staff costs	1,529	1,454
Social Security costs (ERNIC)	1,186	1,333
Pension costs	3,477	3,746
	<u>20,241</u>	<u>21,923</u>

## Note 3: ACCOMMODATION COSTS

	2006/07	2005/06
	£'000	£'000
Innsworth costs	1,155	1,132
Glasgow costs	1,606	1,508
Works maintenance	237	282
Communicated Asset Costs	931	884
Utilities	72	74
Rent	416	434
	<u>4,417</u>	<u>4,314</u>

Accommodation costs comprise cash costs, communicated costs and capitation rate based costs.

**Note 4: ADMINISTRATION COSTS**

	2006/07 £'000	2005/06 £'000 restated
EDS Contractual costs	90,974	92,042
Paymaster	2,500	2,684
Net Write offs (see note 17)	3,659	955
Asset Write offs	24	-
IT equipment, maintenance and software	694	325
Consultancy	1,642	1,235
Travel and subsistence	917	939
Supplies and services consumed	676	748
Pension costs	-	41
Training	106	118
Office supplies	145	152
Audit fee	46	44
Miscellaneous	119	77
Funeral costs	1,373	523
Telecommunications	469	816
Currency charges	996	689
Cost of capital charges	(321)	717
IT & Communications equipment depreciation	2,232	2,712
IT & Communications equipment impairment	109	2,265
Plant equipment depreciation	6	30
Communicated Costs Plant and Equipment	26	-
Intangible asset amortisation	1,978	1,895
Intangible asset impairment	458	3,105
Stock provisions	104	189
Stock consumption	2,406	2,261
Stock write on	-	(52)
Stock write offs	207	-
Disposal costs of excess stocks	1	7
Provisions movement	5	75
Notional income from Veterans Agency (see note 5)	(316)	(2,534)
Notional income from Veterans Agency for EDS costs	(595)	-
	<b><u>110,640</u></b>	<b><u>112,058</u></b>

## Note 5: FIXED ASSETS

	Intangible Fixed Assets £'000	Land and Buildings £'000	Plant equipment £'000	IT & Comms equipment £'000	AUC £'000	Tangible Fixed Assets £'000	Total Fixed Assets £'000
<b>Cost or valuation</b>							
At 1 April 05	9,759	25,003	483	8,197	-	33,683	43,442
Additions	716	-	-	377	734	1,111	1,827
Revaluations	-	-	3	-	-	3	3
Impairments	(640)	-	-	(403)	-	(403)	(1,043)
Transfers	-	(25,003)	(400)	-	-	(25,403)	(25,403)
Disposals	-	-	-	(2,410)	-	(2,410)	(2,410)
Reclassification	-	-	-	(1)	-	(1)	(1)
<b>At 31 March 07</b>	<b>9,835</b>	<b>0</b>	<b>86</b>	<b>5,760</b>	<b>734</b>	<b>6,580</b>	<b>16,415</b>
<b>Depreciation and Amortisation</b>							
At 1 April 06	2,768	3,849	55	4,462	-	8,366	11,134
Amount in year	1,978	-	6	2,232	-	2,238	4,216
Revaluations	-	-	-	-	-	-	-
Impairments	(182)	-	-	(294)	-	(294)	(476)
Transfers	-	(3,849)	(47)	-	-	(3,896)	(3,896)
Write (off)/on	-	-	-	24	-	24	24
Disposals	-	-	-	(2,412)	-	(2,412)	(2,412)
Reclassifications	-	-	-	-	-	-	-
<b>At 31 March 07</b>	<b>4,564</b>	<b>0</b>	<b>14</b>	<b>4,012</b>	<b>0</b>	<b>4,026</b>	<b>8,590</b>
<b>Net Book Value</b>							
At 1 April 06	6,991	21,154	428	3,735	0	25,317	32,308
<b>At 31 March 07</b>	<b>5,271</b>	<b>0</b>	<b>72</b>	<b>1,748</b>	<b>734</b>	<b>2,554</b>	<b>7,825</b>

Included within IT assets are £123k of assets legally owned by EDS for exclusive beneficial use by AFPAA and £81k of assets legally owned by EDS for beneficial use by AFPAA and Veterans Agency. Included within Intangible assets are £1,248k of assets legally owned by EDS for beneficial use by AFPAA and Veterans Agency. These assets have been accounted for in accordance with FRS 5 (Substance of transactions). A notional income amount of £316k has been included in Administration Costs (note 4) in respect of Veterans Agency's share of the depreciation charges and cost of capital charges in respect of assets used in the Compensation and Pensions System (CAPS) project.

On 1 April 2006 the Ministry of Defence transferred responsibility for accounting for fixed assets from AFPAA to other parts of the Ministry of Defence. Where the agency retains the risks and rewards of ownership of these assets they will continue to be accounted for on the Agency's balance sheet in accordance with FRS 5 and SSAP 21. In other cases the costs of the use of these assets will be communicated to AFPAA by the asset owners and charged to the operating cost statement. Consequently, these centrally accounted for assets will not be included on the Agency's balance sheet as they will be accounted for as operating leases under SSAP 21.

#### Note 6: STOCKS

	2006/07 £'000	2005/06 £'000
Medals stocks owned by AFPAA	767	1,309
	<u>767</u>	<u>1,309</u>

#### Note 7: DEBTORS AND PREPAYMENTS

	2006/07 £'000	2005/06 £'000
Trade debtors: EDS	1,856	4,236
Other	41	-
Prepayments	2	231
	<u>1,899</u>	<u>4,467</u>

There are no balances with Central Government Departments, NHS Trusts or Local Authorities.

#### Note 8: CREDITORS

<b>Amounts falling due within one year</b>	2006/07 £'000	2005/06 £'000
Trade creditors: EDS	0	103
Trade creditors: Other	<u>655</u>	<u>460</u>
	655	563
Accruals: EDS	18,226	21,744
Accruals: Other	<u>3,320</u>	<u>405</u>
	<u>21,546</u>	<u>22,149</u>
<b>Amounts falling due after one year</b>	<u>22,201</u>	<u>22,712</u>
Trade creditors: EDS	<u>0</u>	<u>2,553</u>
	<u>22,201</u>	<u>25,265</u>

There are no balances with Central Government Departments, NHS Trusts, Local Authorities. There is a balance of £40k with Royal Mint, a Public Corporation, included within Other Accruals.

**Note 9: PROVISIONS FOR LIABILITIES AND CHARGES**

<b>Early Retirement Provision</b>	<b>2006/07 £'000</b>	<b>2005/06 £'000</b>
Opening Balance at 1 April 2006	224	199
Utilised in year	(34)	(50)
Increase in provision	4	75
Balance at 31 March 2007	<u><b>194</b></u>	<u><b>224</b></u>

Payments of £34k are expected to be made in 2007-08 with the remainder of the payments expected to be made by 2013-14.

**Note 10: GENERAL FUND**

	<b>Note</b>	<b>2006/07 £'000</b>	<b>2005/06 £'000</b>
Net Voted Expenditure		129,034	123,211
Notional costs	19	3,159	1,610
Realised element of the revaluation reserve	11	99	584
Transfer of assets to SBSOs		(13,162)	-
Less:			
Net expenditure for the year in respect of the Agency operations	18	<u>(135,263)</u>	<u>(138,247)</u>
Net decrease in General Fund		(16,133)	(12,842)
General Fund at 1 April		4,225	17,067
General Fund at 31 March		<u><b>(11,908)</b></u>	<u><b>4,225</b></u>

**Note 11: REVALUATION RESERVE**

	Note	2006/07 £'000	2005/06 £'000
Revaluation reserve at 1 April		<u>8,370</u>	<u>8,130</u>
Depreciation on revalued element of fixed assets	5	-	(96)
Revaluation in year on fixed assets	5	3	813
Revaluation in year on stocks		78	107
Transfer element of Fixed Assets		<u>(8,348)</u>	<u>-</u>
Realised element transferred to General Fund	10	(99)	(584)
<b>Revaluation reserve at 31 March</b>		<u><b>4</b></u>	<u><b>8,370</b></u>

**Note 12: RECONCILIATION OF MOVEMENT IN GOVERNMENT FUNDS**

	Note	2006/07 £'000	2005/06 £'000
At 1 April		<u>12,595</u>	<u>25,197</u>
Revaluation Reserve movement in year	11	(8,366)	240
General Fund movement in year	10	(16,133)	(12,842)
Total movement in year		<u>(24,499)</u>	<u>(12,602)</u>
<b>At 31 March</b>		<u><b>(11,904)</b></u>	<u><b>12,595</b></u>

### Note 13: RELATED PARTY TRANSACTIONS

AFPAA is an Executive Agency of the Ministry of Defence. The Ministry of Defence is regarded as a related party. Due to the partnering relationship that exists between AFPAA and EDS, 5 members of the EDS Management team sit on the Joint Partnering Management Team (JPMT) alongside the AFPAA Executive Board. These senior managers oversee the partnering agreement, contributing and reviewing on a regular basis major activities of the Agency. AFPAA also receives supplies from Royal Mint, a Public Corporation, also regarded as a related party.

During the period 1 April 2006 to 31 March 2007, AFPAA has had various material transactions with the Ministry of Defence, EDS and with other entities for which the Ministry of Defence is regarded as the parent Department, as well as with Royal Mint.

During the year none of the senior and other key management staff, or other related parties, has undertaken any material transactions with AFPAA.

### Note 14: FINANCIAL COMMITMENTS AND CONTINGENT LIABILITIES

There are no capital commitments to be disclosed in these financial statements. However, at 31 March 2007, the Agency was committed, under the amended Agreement with EDS, to make payments totalling £111.87m up to the end of the contract in 2009.

At contract termination, due to take place on 31 December 2009, AFPAA has an option to buy back the IT equipment that is being utilised by EDS at Fair Market Value.

### Note 15: DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

FRS 13, Derivatives and Other Financial instruments, requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities.

Because of the largely non-trading nature of its activities and the way in which government Agencies are financed, the Agency is not exposed to the degree of financial risk faced by business entities. Moreover, financial instruments play a much more limited role in creating or changing risk than would be typical of the listed companies to which FRS 13 mainly applies.

Financial assets and liabilities are generated by day-to-day operational activities and are not held to change the risks facing the Agency in undertaking its activities, or for trading. The fair values of all the Agency's financial assets and liabilities approximate to their book values. In line with FRS 13, short term debtors and creditors (those which mature or become payable within 12 months from the balance sheet date) have been excluded from these disclosures (except for those relating to currency risk).

#### Interest rate risk

The Agency has no financial assets and liabilities on which interest is earned or paid, and is therefore not exposed to significant interest rate risk.

#### Currency risk

The Agency does not hold assets or liabilities denominated in a foreign currency, and income and expenditure denominated in a foreign currency is negligible. The Agency does, however, bear the foreign exchange costs of payments made in local currencies to Service personnel serving overseas. The Agency is not exposed to significant currency risk.

The Ministry of Defence, through whose Resource Account the Agency is financed, enters into forward purchase contracts annually with the Bank of England to cover the majority of its foreign exchange requirements for the following year. The details of the outstanding foreign currency contracts are given in its Departmental Resource Account.

## Liquidity risk

The Agency is not exposed to significant liquidity risk, as the liquidity requirements are met by financing from the Ministry of Defence Resource Account, and it has no borrowing facilities. The Department's resource requirements are voted annually by Parliament.

### Note 16: POST BALANCE SHEET EVENT

At 01 April 2007 the Armed Forces Personnel Administration Agency merged with the Veterans Agency to form the new agency of Service Personnel and Veterans Agency.

### Note 17: LOSSES STATEMENT

Under the Service Provision Agreement between AFPAA and EDS, a Failure Charge can be deducted from the monies payable to EDS. Failures are defined as being where performance against a specified and agreed Service Level has not been achieved. Under the charging mechanism in place, a maximum charge that could be invoked is calculated. Discretion exists for a lesser sum to be charged in instances where the maximum charge is deemed inappropriate (e.g. when the reason for a service delivery failure cannot be apportioned solely to EDS). Additionally, the charge can be abated in total, for example when a Service Delivery Failure is adjudged to be as a consequence of circumstances outside EDS' control. Under the terms of Government Accounting the Agency has to apply to HM Treasury for overall authority to abate the charge after its calculation. During the Financial Year 2006/2007 the total calculated adjusted sum under the Service Provision Agreement was £3,515k.

### Note 18: RECONCILIATION OF NET OPERATING COST TO NET CASH FLOWS

	2006/07 £'000	2005/06 £'000 restated
<b>Net Expenditure from operating activities</b>	<b>135,263</b>	<b>138,247</b>
<b>Adjustments for non cash transactions</b>		
Increase in Provisions from Operating Cost Statement	(4)	(75)
Depreciation, amortisation, amounts written off fixed assets and stock	(5,014)	(10,839)
Cost of capital	321	(717)
Notional costs	(4,391)	(3,356)
Stock Provisions	(104)	(189)
Notional Income from Veterans Agency	911	2,534
<b>Movements in net current assets:</b>		
Increase/(Decrease) in Stocks	(308)	(1,156)
Increase/(Decrease) in debtors	(2,567)	(2,874)
(Increase)/Decrease in creditors	3,066	(512)
<b>Payments made against Provisions for Liabilities and Charges</b>	<b>34</b>	<b>50</b>
<b>Net Cash Outflow from operating activities</b>	<b><u>127,207</u></b>	<b><u>121,113</u></b>

#### Note 19: NON CASH AND NOTIONAL COST ITEMS

The notional cost elements, included under the headings of Accommodation Costs (note 3), and Administration Costs (note 4), are as follows:

	2006/07 £'000	2005/06 £'000
<b>NON CASH COSTS:</b>		
IT depreciation	2,232	2,712
IT impairment	109	2,265
Buildings depreciation	-	884
Plant & Machinery Depreciation	6	30
Intangibles Amortisation	1,978	1,895
Intangibles Impairment	458	3,105
Write Off of Fixed Assets	24	-
Write on of stock	-	(52)
Write off of stock	207	-
	<u>5,014</u>	<u>10,839</u>
	2006/07 £'000	2005/06 £'000
<b>NOTIONAL COSTS:</b>		
Worthy Down costs	-	-
Innsworth costs	1,155	1,132
Glasgow costs	1,606	1,508
Communicated Asset costs	957	-
MOD Overhead costs	627	672
Audit fee	46	44
Compulsory Early Retirement Payments in Year	-	71
Cost of Capital charge	(321)	717
Notional Income from Veterans Agency	(911)	(2,534)
	<u>3,159</u>	<u>1,610</u>

# Glossary of Terms

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AEB	AFPAA Executive Board
AFCS	Armed Forces Compensation Scheme
AFPAA	Armed Forces Personnel Administration Agency
AFPS	Armed Forces Pensions Schemes
ATP	Actual Target Price
AUS	Assets Under Construction
BSC	Balanced ScoreCard
CAPS	Compensation and Pensions System
CSS	Customer Satisfaction Survey
DBA	Defence Bills Agency
DCDS(Pers)	Deputy Chief of Defence Staff (Personnel)
DII	Defence Information Infrastructure
DFMS	Defence Financial Management System
DRAc	Departmental Resource Accounts
EDS	Electronic Data Systems Defence Ltd
Fin & CG	Finance and Corporate Governance
IAB	Investment Approvals Board
IS	Information Systems
JCCC	Joint Casualty and Compassionate Centre
JPA	Joint Personnel Administration
JPAC	Joint Personnel Administration Centre
JPMT	Joint Partnering Management Team
JRSG	Joint Requirements Steering Group
KT	Key Targets
MI	Management Information
MIC	Major Incident Centre
MoDMO	MoD Medal Office
NAO	National Audit Office
NED	Non-Executive Director
NFI	National Fraud Initiative
OAB	Owners Advisory Board
PACC	Pay and Allowances Casework Cell
PCSPS	Principal Civil Service Pension Scheme
PPE	Post-Project Evaluation
PPP	Public Private Partnership
PPPA	Army's Personnel, Pay and Pensions Administration
RAB	Resource Accounting and Budgeting
SBSO	Single Band Sheet Owner
SIC	Statement of Internal Control
SLA	Service Level Agreement
SPVA	Service Personnel and Veterans Agency
TLB	Top Level Budget
VA	Veterans Agency

Printed in the UK by The Stationery Office Limited  
on behalf of the Controller of Her Majesty's Stationery Office  
ID5554010 09/07 19585

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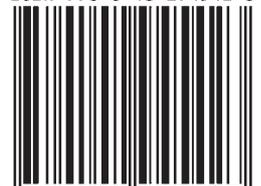
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ISBN 978-0-10-294542-3



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