Presented pursuant to the Government Resources Act 2000 c.20. s.6(4)

NHS Pension Scheme and NHS Compensation for Premature Retirement Scheme

Resource Accounts 2005-06

LONDON: The Stationery Office
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(For the year ended 31 March 2006)

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Contents

INTRODUCTION

The NHS Pension Scheme provides pensions in varying circumstances for employees of participating employers. The Scheme receives contributions from employees and employers to defray the costs of pensions and other benefits.

REPORT OF THE MANAGER

This report provides a summary of the arrangements to ensure the Scheme affairs are managed in an efficient way and gives a broad outline of the major benefits offered by the Scheme.

The specific features of the year have been:

- In July 05 – Launch of 3-year Pension Modernisation Change Programme;
- In October 05 – Implementation of the PenServer pension administration system;
- In October 05 – Setting up of the NHS Business Services Authority (BSA) and subsequent transition activity for transfer of the Agency to the NHS BSA on 1 April 2006;
- In October 05 – Electronic Staff Record (ESR) went live;
- Successful implementation of legislative changes (FACT, A Day);
- Successful completion of Business Continuity Planning tests;
- Outsourcing Project activity.

The key tasks for the forthcoming year are:

- Successful implementation of Legislative changes;
- Taking forward the outcome of Scheme Legal and Policy Reviews.

A full report of the activities, governance and performance of the NHS Pensions Agency Special Health Authority in 2005-06 can be found in the Authority's annual report and accounts, which are published in the Reference Suite of the Library at www.nhspa.gov.uk.

HOW THE SCHEME WORKS

The NHS Pension Scheme is an unfunded occupational scheme backed by the Exchequer, which is open to all NHS employees and employees of other approved organisations. The Scheme provides pensions, based on final salary, in varying circumstances for employees of participating employers. The Scheme receives contributions from employees and employers to defray the costs of pensions and other benefits.

Scheme provisions are governed by the following sets of Regulations:

- The NHS Pensions Scheme Regulations 1995, as amended
- The NHS (Compensation for premature retirement) Regulations 2002 Consolidated
- The Pensions (Increase) Act 1971
- NHS AVC Regulations
- NHS Gratuitous Expectations Regulations

During the financial year 2005-06, the NHS Pensions Agency Special Health Authority (the Agency) undertook the day-to-day administration of the Scheme, including calculation of benefits, maintenance of member records and payment of benefits (however please see the report of the changes to Scheme administration under "Post Balance Sheet Events").

In support of the Agency, NHS employers are required to explain the Scheme to their employees. In addition they submit pension data to the NHS Pensions Agency, and a significant number of employers calculate pensions benefit estimates for their employees.

As at 31 March 2006 there were 659 participating NHS Trusts, Primary Care Trusts, Local Health Boards and Health Authorities, 8,561 participating GP Practice employers and 351 Direction Bodies.

The employers of NHS Pension Scheme members are classified as Employing Authorities or Direction Bodies. Employing Authorities are defined in the Regulations and their staff have automatic entry to the Scheme. Non-NHS employers can apply for Direction Body status in order that their staff may join the Scheme provided they meet specified criteria.

NHS PENSION SCHEME BENEFITS

Contributions

In order to defray the costs of benefits, employers and members pay contributions. Most employees pay 6% of pensionable pay but manual staff pay 5%. The Government Actuary conducts actuarial reviews every five years and recommends an employer contributions rate in his Valuation report. In 2002-03 employers paid 7% but the rate did not include the cost of pension indexation funded directly by Treasury. In November 2002 Ministers announced the transfer of indexation costs to the Scheme costs with a commensurate increase in the Department of Health's baseline. The employer contribution rate increased to 14% from April 2003.

Benefits

The NHS Pension Scheme provides defined benefits, which are summarised below:

Annual Pensions

The Scheme is a "final salary" scheme. Annual pensions are normally based on 1/80th of the best of the last three years pensionable pay for each year of service. Members who are practitioners as defined by the Scheme Regulations have their annual pensions based upon total pensionable earnings over the relevant pensionable service.

Pensions Indexation

Annual increases are applied to pension payments at rates defined by the Pensions (Increase) Act 1971, and are based on changes in retail prices in the twelve months ending 30 September in the previous calendar year.

Lump Sum Allowance

A lump sum is payable on retirement which is normally three times the annual pension payment.

Ill-Health Retirement

Early payment of a pension, with enhancement, is available to members of the Scheme who are permanently incapable of fulfilling their duties effectively through illness or infirmity.

Death Benefits

A death gratuity of twice their final year's pensionable pay for death in service, and five times their annual pension for death after retirement is payable.

Additional Voluntary Contributions (AVCs)

Members can purchase additional service in the NHS Scheme and contribute to money purchase AVC's run by the Scheme's approved providers or by other FSAVC providers.

Transfer between Funds

Scheme members have the option to transfer their pension between the NHS Pension Scheme and another scheme when they move into or out of NHS employment.

Preserved Benefits

Where a scheme member ceases NHS employment with more than two years service they can preserve their accrued NHS pension for payment when they reach retirement age.

Compensation for Early Retirement

Where a member of the Scheme is made redundant they may be entitled to early receipt of their pension plus enhancement, at the employer's cost.

This list is an illustrative guide only, and is not intended to detail all the benefits provided by the Scheme or the specific conditions that must be met before these benefits can be obtained.

A REVIEW OF THE YEAR

Part-time staff access to the NHS Pension Scheme

During the year, the Agency has continued to work with Employment Tribunals to identify which cases appear to be "must win", "must fail" or "may succeed in part" as a consequence of the Preston and Others v Wolverhampton Healthcare NHS Trust employment tribunal case (the Preston case) and the subsequent test cases, appeals and cross-appeals.

Where it is found that an NHS employee has been denied access to the pension scheme on account of Scheme Regulations, the employee will be permitted to recover the lost service on receipt of an appropriate contribution from the member. The employer contribution will be absorbed by the pension scheme.

The total cost to employees of reinstatement is estimated to be around £5 million. The Scheme actuary has advised that the cost to the scheme cannot be accurately assessed without full member data, but is unlikely to exceed 3 times the employee reinstatement cost.

Interest on late payment of pension scheme benefits

From April 2000, under the provisions of Regulation T8 to the NHS Pension Scheme regulations, the Scheme has been required to pay interest automatically to members who suffer delay in receiving their pension scheme benefits. However, the Scheme has never implemented this regulation in full and has only paid interest on request by the member.

The Scheme is now reviewing all cases where benefits have been paid late since April 2001 and intends to make good the missing interest payments. Data are not available to estimate these costs, but they are not expected to be material in the overall context of the Scheme liability.

Change in the NHS Pension Scheme discount rate

Following a decision by the Financial Reporting Advisory Board (FRAB) that the discount rate for pension schemes should, in accordance with FRS17, be based on the AA corporate bond rate, the discount rate has been changed with effect from 1 April 2005 from a real rate of 3.5% to a real rate of 2.8% (6% to 5.37% gross). As a result the pension scheme liability as at 1 April 2005 increased by £18.3 billion (Note 23.5 to the Scheme accounts that follow this report refers).

National Fraud Initiative

On a bi-annual basis, the NHS Pension Scheme takes part in the National Fraud Initiative, which commenced in 1998 and is co-ordinated by the Audit Commission. This initiative allows the Scheme to submit approved data to the Audit Commission who match it against other data sources to ensure the payments are still being made to the individual originally entitled to the pension. This exercise was in addition to the Scheme's normal procedure of regularly confirming entitlement with individual pensioners. The table below provides an update of the position for all 4 exercises conducted since 1998, and lists the outstanding amounts, which are still being actively pursued.

	Total Identified £'s	Total Cases	Prior Years		2004-05		2005-06		Amount Outstanding at 31.3.2006
			Recovered	Written off	Recovered	Written off	Recovered	Written off	
NFI 98	1,739,000	308	1,022,200	529,400	22,600	34,100	7,700	800	122,200
NFI 2000	541,700	291	407,400	72,800	12,000	2,000	3,800	–	43,700
NFI 2002	798,400	373	433,000	27,000	122,400	60,000	12,000	33,500	110,500
NFI 2004	258,600	80	–	–	–	–	97,800	7,000	153,800
Total	**3,337,700**	**1,052**	**1,862,600**	**629,200**	**157,000**	**96,100**	**121,300**	**41,300**	**430,200**

An update on the progress of the exercises will be noted in next year's report.

Re-employment and the National Fraud Initiative

NHS Pension Scheme Regulations for NHS pensioners who become re-employed under the age of 60 do not allow their combined current earnings and pension to exceed their earnings prior to retirement. In order to keep the aggregated sum of their earnings and pension below the pre-retirement salary the pension is abated or in some cases suspended in full. If the pension is suspended and their current earnings still exceed their pre-retirement earnings there is no further penalty.

The onus is on the pensioner to advise the Pension Division if they become re-employed within the NHS. This is to enable Paymaster to assess whether or not future pension payments are affected and require abatement or suspension action. The attention of the pensioner is drawn to these regulations in the annual newsletter that is distributed to all recipients of an NHS pension every April.

In 2004 the NFI data match was extended to cover all NHS pensioners in receipt of benefits in a match against the NHS payroll records to identify those pensioners who were re-employed within the NHS. This match highlighted some 18,407 re-employed pensioners, of whom 5,887 fell into the under-60 category, where abatement or suspension should be in effect. Work has been completed in all cases where the combined earnings and pension exceeded £80,000. This resulted in a number of overpayments being identified with £19,000 being recovered, reductions to annual pensions in payment by £16,500 and savings of projected pension payments to age 60 of £124,500. Work is ongoing to review cases that fall within the £70,000-£80,000 range for compliance with Scheme regulations, the results of which will be reported next year.

Pension Increase

The annual pension increase applied for payments after 10 April 2005 was 2.7% (2004-05:2.8%). Pensions increase is based upon the rise in the retail price index (RPI) in the 12-month period up to the 30 September preceding the April uprating date.

In-house money purchase AVC provision

The Agency has continued to offer a broad range of in-house top up money purchase AVCs, including AVC and Stakeholder Pension facilities from Standard Life and Prudential and an AVC only facility from Equitable Life.

Scheme member take-up of both Standard Life and Prudential products has continued to improve during the year following low take-up in 2003-04. The Prudential and Standard Life have continued to accompany the Agency at NHS Conferences and made themselves available for local presentations on hospital and GP Practice premises.

On 5 April 2005, the Agency's 7-year contract with Equitable Life came to an end but was extended from 6 April 2005 on a limited basis. From April 2005 the arrangements with Equitable Life will remain open only to NHS Pension Scheme members who already hold AVCs with the company. All new AVCs will be taken with the Agency's other providers. This new arrangement brings the NHS Pension Scheme into line with other Equitable Life clients, to whom new business has been closed since 2000.

Scheme Funding and Liabilities

As at 31 March 2006 the liabilities of the pension scheme were valued at £165.4 billion (2005: £131.3 billion). As the NHS Pension Scheme is an unfunded scheme, these liabilities are underwritten by the Exchequer, which also funds the year on year difference between the scheme's contribution income and the actuarially assessed growth in scheme liability, interest charges and other in-year increases in liability. In 2005-06 this net deficiency was £9,280,631,000 (2004-05: £6,396,065,000) and is detailed in the Combined Revenue Account of the following scheme accounts.

Excess Vote 2005-06

An Excess Vote of £788.2 million was incurred by the Scheme in 2005-06. The reasons for this Excess Vote are given below, but primarily relate to an increase in Scheme liability caused by an omission of the hospital element of General Medical Practitioner service from the valuation of the closing scheme liability by the Scheme Actuary, resulting in 1) an increase in interest chargeable in 2005-06 which was not factored into the supply estimate (£165 million); and 2) an unbudgeted increase in the Scheme liability due to the change in discount rate (£400 million). Additionally, the Agency underestimated interest on the movement of the Scheme liability within the year (£200 million). These factors account for £765 million (97%) of the Excess Vote.

The following table summarises the reasons for the Excess Vote:

Cause of Excess	Impact on Excess
Increase in Scheme liabilities as a result of change in discount rate from 1 April 2005	£400 m
Error in calculating Request for Resources in relation to interest charges	£200 m
Increase in interest on Scheme liabilities charge due to omission of £2.7billion from 31 March 2005 liability	£165 m
Various net under/overspends and unbudgeted expenditure	£23 m
Total	**£788 m**

The Scheme has therefore requested a non-cash Excess Vote to cover the shortfall against the forecast resource outturn.

A detailed analysis of these variances is provided at in the notes to the Statement of Parliamentary Supply at page 29.

FUTURE DEVELOPMENTS

Pension Scheme Review

The Review Partners reached agreement on proposals for a new pension scheme for new entrants and changes to the current scheme for existing members. The consultation document is the result of three years of partnership working and recommends the retention of a final salary scheme for new entrants.

The consultation document was published on 1 August 2006 and details of the agreement can be found at www.nhsemployers.org. All NHS staff (not just scheme members) received information about the agreement and consultation process in their wage slips around the middle of September.

The consultation exercise started on 1 September 2006 and ran until the end of November after which it will be for Ministers to make the final decisions. Current plans are to introduce a new Scheme for new entrants by the end of 2007 and changes to the existing scheme by April 2008.

ADMINISTRATION EXPENSES

In 2005-06 the costs of administering the NHS Pension Scheme were met by NHS Pensions Agency Special Health Authority (NHSPA), which was in turn funded by the Department of Health. The annual accounts of the NHSPA can be found at www.nhspa.gov.uk.

Change in GP dynamisation factors

In December 2006, the Secretary of State for Health announced that General Medical Practitioners dynamisation factors totaling 48% would be applied to the years 2003-2008. Although this announcement was made after the end of the reporting period 2005-06, due to the impact being material to the accounts, and increasing the certainty of the accounting valuation, the new factors have been included within the estimate of the Scheme liability as at 31 March 2006 by the Government Actuary's Department.

POST BALANCE SHEET EVENTS

NHS Business Services Authority

In October 2003 the Secretary of State announced the intention to review the Department of Health's Arms Length Bodies, of which the NHS Pensions Agency SpHA was one. Subsequently, a report "Reconfiguring the Department of Health's Arms Length Bodies" was published which detailed the bodies that would merge, be abolished, or see their functions transferred. This was followed in November 2004 by the publication of "An Implementation Framework for reconfiguring the Department of Health's Arms Length Bodies", setting out the principles, processes and timescales by which the change programme would be implemented. As a result the NHS Pensions Agency was dissolved on 31 March 2006 and with effect from 1 April 2006, its functions were transferred to the NHS Business Services Authority, a Special Health Authority created on 1 October 2005.

MEMBERSHIP STATISTICS

Details of the current membership of the Scheme at 31 March 2006 are set out below:

Active Members

Active members at 1 April 2005	1,260,939
New entrants in the year	73,741
Transfers in	7,028
Retirements in year	(24,123)
Transfers out	(16,974)
Members leaving the Scheme with deferred pension rights	(3,524)
Members leaving the Scheme and taking a refund of contributions	(32,411)
Deaths	(1,327)
Active members at 31 March 2006	1,263,349

Deferred members

Deferred members at 1 April 2005	365,037
Members leaving who have deferred pension rights	3,524
Members taking up deferred pension rights	(4,411)
Deferred members at 31 March 2006	364,150

Pensioners in payment (including Compensation payments)

	Members	Dependants	Total
Pensioners in payment at 1 April 2005	–	–	520,167
Members retiring	23,123	–	23,123
New Dependants	–	4,502	4,502
Cessations in year	(9,905)	(2,480)	(12,385)
Pensioners in payment at 31 March 2006	–	–	535,407

Nick Scholte
Chief Executive, NHS Business Services Authority
25 January 2007

MANAGEMENT STRUCTURE AND ADVISERS

Accounting Officer:
Nick Scholte
NHS Business Services Authority
Bridge House
Newcastle Upon Tyne NE1 6SN

Scheme Administrator:
NHS Pensions Agency Special Health Authority to 31 March 2006, superseded by:
NHS Business Services Authority, Pensions Division from 1 April 2006
Hesketh House
200-220 Broadway
Fleetwood FY7 8LG

In-house AVC Providers:
Equitable Life Assurance Society
Walton Street
Aylesbury
Buckinghamshire HP21 7QW

Standard Life Assurance Company
Standard Life House
30 Lothian House
Edinburgh EH1 2DH

Prudential Plc
250 Euston Road
London NW1 2PQ

Actuary:
Government Actuary's Department
Finlaison House
15-17 Furnival Street
London EC4A 1AB

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

Bankers:
Paymaster (1836) Ltd
Sutherland House
Russell Way
Crawley
West Sussex RH10 1UH

NHS PENSION SCHEME
REPORT OF THE ACTUARY FOR THE ACCOUNTING YEAR ENDED 31 MARCH 2006

The report of the Actuary sets out the liabilities and accruing costs of the NHS Pension Scheme for the purposes of Resource Accounting.

1. Liabilities

The capitalised value as at 31 March 2006 of expected future benefit payments under the NHS Pension Scheme, for benefits accrued in respect of employment or former employment prior to 31 March 2006, has been assessed using the methodology and assumptions set out in sections 3 and 4 below. The results are as follows:

Value of Liabilities	£ billion
Pensions in Payment	44.9
Deferred Pensions	13.7
Active Members (Past Service)	106.8
Total	**165.4**

2. Accruing Costs

The cost of benefits accruing for each year of service is met partly by a specified contribution from members, with the balance of the cost of the benefits being met by the employers. The total cost of benefits accruing in the year 2005-06 has been assessed, using the methodology and assumptions set out in sections 3 and 4 below, as follows:

	% of Pensionable Pay
Current Service Cost	24%
Members' Average Contribution Rate	5.95%
Employers' share of Current Service Cost	18.05%
Actual rate charged to employers for current year	14.0%

The Current Service Cost disclosed in the scheme accounts was £7.37 billion. This was based on an estimated average payroll over the year of £30.722 billion.

3. Methodology

The value of liabilities has been obtained using the projected unit method with a one year control period, which allows for expected future pay increases in respect of active members. The liabilities and standard contribution rate include pension increases awarded since leaving service for pensioners and deferred pensioners, plus allowance for future pension increases for all categories of member.

4. Assumptions

The principal financial assumptions adopted for the pension assessments made in relation to this statement are an investment return in excess of price increases of 2.8% a year (most pension benefits under the scheme are increased in line with prices), and an investment return in excess of earnings increases of 1.3% a year. The gross rate of return is assumed to be 5.4% a year, although this assumption has only a minor impact on the calculation of the liability. In nominal terms these assumptions are then equivalent to an allowance for increases in salaries of 4.0% a year and an allowance for price inflation of 2.5% a year. The demographic assumptions adopted for the assessments are derived from the specific experience of the membership of the scheme to 31 March 2003, and other similar large public service pension schemes where some aspect of the experience is not readily available. Allowance has been made for the expected impact of Agenda for Change and the capped dynamisation factors which the Secretary of State for Health has specified should be used to revalue General Medical Practitioners' accrued benefits up the period ending 31 March 2008.

5. Notes

(i) Sections 1 and 2 of this statement are based on actuarial assessment carried out as at 31 March 2004 for the purposes of FRS17 (Resource Accounting), with an approximate updating for the subsequent financial years to reflect known changes that have occurred between 1 April 2004 and 31 March 2006, based on the available data. The method assumes that the profile of the membership has remained stable within the period, which may not necessarily be the case, and so the results should be viewed as an indication of the order of magnitude of the liabilities rather than a full actuarial assessment.

(ii) The actual rate charged to employers for 2005-06 at 14% of pensionable pay follows the recommendations made at the 1999 funding valuation, with an additional allowance for the cost of pension increases, which are now met by the scheme. The next valuation to determine funding rates is due as at 31 March 2004.

(iii) The pension benefits taken into account in this assessment are those normally provided from the rules of the Scheme, including normal retirement benefits, ill-health retirement benefits, and benefits applicable following the death of the member. The assessments include the cost of premature retirement benefits awarded on redundancy, and exclude the cost of Injury Benefits.

C D Daykin CB FIA
Government Actuary's Department

23 January 2007

STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

Under the Government Resources and Accounts Act 2000, HM Treasury has directed the NHS Pension Scheme and NHS Compensation for Premature Retirement Scheme to prepare for each financial year a statement of accounts in the form and on the basis set out in the Accounts Direction.

With the exception of certain transactions (which are accounted for on a cash basis) the combined financial statements are prepared on an accruals basis and must give a true and fair view of the financial transactions of the combined scheme during the year and the disposition, at the end of the financial year, of the combined net liabilities. Note 2, "Accounting Policies", to the financial statements describes those transactions, which are accounted for, on a cash basis, the use of which has no material effect on the net outgoings for the year nor on the combined net liabilities at the year end.

In preparing the financial statements, the Accounting Officer is required to comply with the requirements of the *Government Financial Reporting Manual* and in particular to:

- Observe the accounts direction issued by HM 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 standards, as set out in the Government Financial Reporting Manual have been followed, and disclose and explain any material departures in the financial statements; and
- Prepare the financial statements on a going concern basis.

The Department of Health has appointed Nick Scholte, Chief Executive of the NHS Business Services Authority as Accounting Officer for the NHS Pension Scheme and NHS Compensation for Premature Retirement Scheme. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding the assets of the pension scheme are set out in the Accounting Officers' Memorandum issued by HM Treasury and published in Annex 3 of the Government Financial Reporting Manual.

STATEMENT ON INTERNAL CONTROL

Scope of responsibility

The NHS Pensions Agency ceased to exist on 31 March 2006. The Statement on Internal Control for the Agency 2005-06 has been completed by the NHS Business Services Authority in its capacity as the body incorporating the functions previously carried out by the NHS Pensions Agency.

Due to the closure of the NHS Pensions Agency, I have signed this Statement on Internal Control being the Chief Executive of the NHS Business Services Authority and Accounting Officer to the NHS Pension Scheme.

As Accounting Officer, together with the former Chief Executive of the NHS Pensions Agency who was in post for 2005-06, I have responsibility for a sound system of internal control having been maintained that supports the achievement of the Agency's policies, aims and objectives. I also have responsibility for safeguarding the public funds and the Agency's assets for which I am personally responsible, as set out in the Accounting Officer's Memorandum issued by the Department of Health.

On 1 April 2004, the NHS Pensions Agency became a Special Health Authority and was accountable, through its Chair, to the Secretary of State for Health. The Agency's Senior Departmental Sponsor (SDS) in the Department of Health was responsible for ensuring that the Agency's procedures operated effectively, efficiently and in the interests of the public and the NHS. Regular business and financial reports were provided on a monthly basis to the Authority Board and direct to the Senior Departmental Sponsor on a quarterly basis.

The purpose of the system of internal control

The system of internal control is designed to manage risk to a reasonable level rather that 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 principal risks to the achievement of Agency policies, aims and objectives; and
- to evaluate the likelihood and impact 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 had been in place in the Agency for the year ended 31 March 2006 and up to the date of approval of these accounts. I acknowledge that there have been weaknesses during 2005-06, as reported in the paragraph "Significant Internal Control Issues" and that action is being taken to address these in 2006-07.

The following highlights how and where the management team are addressing the backlog of issues and planning for future improvement.

Capacity to handle risk

An Agency Risk Management Strategy was in place and the Agency's Executive Team had responsibility for ensuring this was delivered effectively. Risk workshops were held during the year, including joint risk workshops with the private sector Partner, Envision, and the continuing maintenance of a joint risk register. Also for the 2005-06 business planning round, templates were devised which linked business planning and risk management. The Agency's risk guidance and strategy was also available on the Agency's Intranet site. The Agency's Risk Manager and Internal Audit were available to provide advice and regularly benchmarked the Agency's risk management processes to ensure that good practice was reflected in the Agency's overall risk strategy.

The risk and control framework

The system of internal control was underpinned by compliance with the requirements of the core Controls Assurance Standards:

- Governance;
- Planning & Delivery;
- Risk Management;
- Resource Management

The Agency had both Audit and Risk Management Committees who reviewed and provided advice on audit, internal control and risk management issues.

The Agency had a number of Risk Registers in operation covering Corporate, Business, Project, Fraud and Partnership risks. Copies of the Corporate and Partnership Risk Registers were routinely copied to the Risk Management Committee.

The Corporate Risk Register is where the principal risks of the Agency were actively managed. The Executive Team reviewed this Register each month when risks and associated actions were evaluated. Corporate Risks were allocated to Executive Team members to manage, they were prioritised and actions identified to improve management of each risk. The Corporate Risk Management priorities of the Agency during 2005-06 have been:

- Transition to NHS Business Services Authority;
- Legal and policy review of some areas of Pension Scheme regulations;
- IT System Developments, particularly in relation to PenServer implementation;
- Financial Management, particularly in relation to Pension Scheme accounting;
- Modernisation of the NHS Pension Scheme and associated policy and legislative requirements;
- Communications – Internal and External;
- Business Continuity Planning

The Agency was committed to managing risks to an acceptable level on all aspects of business activity. The Agency's Corporate and Business Risk Registers have been aligned with the Agency's Corporate and Business Plans to ensure that all priorities and objectives have been risk assessed.

Review of effectiveness

Within the NHS Pensions Agency the Chief Executive had the responsibility for reviewing the effectiveness of the system of internal control on an ongoing basis during the course of the year. This was informed in a number of ways. The Assistant Director – Internal Audit provided an opinion on the overall arrangements for gaining assurance through the Assurance Framework and on the controls reviewed as part of the internal audit work. Executive managers within the Agency who had responsibility for the development and maintenance of the system of internal control provided assurances. The Assurance Framework itself provided evidence that the effectiveness of controls that manage the risks to the organisation achieving its principal objectives were reviewed. The review was also informed by findings of the National Audit Office as the Agency's External Auditors.

Advice on the implications of the result of the review of the effectiveness of the system of internal control came from internal mechanisms, e.g. the Authority Board, Audit Committee and Risk Management Committee, who played an important role in ensuring that the Agency had in place an effective and robust assurance framework. A plan to address weaknesses and ensure continuous improvement of the system was in place.

The assurance framework was strengthened during the year to take forward recommendations made by Internal Audit and the National Audit Office. To support the framework, the Agency published its Corporate Governance material, including the core assurance standards and toolkit, on the Intranet site.

The Agency's Executive Directors were formally allocated accountability for risk management, budgets and internal control. At the end of 2005-06, all Executive Directors signed an assurance statement confirming the adequacy of risk management and internal control in their business areas. Our private sector partner also signed an annual assurance statement, which set out the processes they had in place to provide assurance over the effectiveness of their risk management and internal control. This statement was quality reviewed by Internal Audit and Agency management.

The Agency had its own in-house Internal Audit Unit, which operated to standards within the Government Internal Audit Manual. They submitted regular reports, which included an independent opinion by the Assistant Director – Internal Audit on the adequacy and effectiveness of the Agency's system of internal control together with recommendations for improvement.

Significant Internal Control Issues

As a result of the comprehensive review of the system of internal control that the former Chief Executive and former officers of the NHS Pensions Agency conducted, and on the basis of documentation provided by the NHS Pensions Agency to the NHS Business Services Authority the internal control issues were identified during 2005-06 as:–

Excess Vote

In 2005-06 the Scheme incurred an Excess Vote of £788,226,976.06. The reasons for this are outlined in the Report of the Manager.

During 2006-07, the budgetary control process will be reviewed to ensure that systems are in place to identify deviations from the estimate, and management reviews to quality assure the process.

The Division will liaise with the GAD to seek agreement on any assumptions that they make which are likely to have an impact on the outturn against the Supply Estimate, and to obtain assurances that the statement of scheme liability has been made based on the inclusion of all relevant factors.

Completeness of Membership data

During 2005-06, the Agency commissioned the Government Actuary's Department (GAD) to undertake a valuation of the Scheme as at 31 March 2004, and an actuarial assessment of the Scheme liability as at 31 March 2006 based on the valuation results. The information provided to the Actuary to enable them to conduct their valuation is based upon an extract of the scheme membership database. The extract of data provided was based on 75% of all members data. As a result uprating factors have been used to extrapolate to 100%. The use of uprating factors per se does not introduce material uncertainty to the valuation result, provided that the rating up factors for each group are valid and the membership profile of the membership that is excluded from the data extract is similar to the profile of the membership that the Actuary receives. The Agency has no reason to believe that the data for members excluded from the valuation exercise is not similar in terms of age/sex/salary/past service distribution than for those included. However, this has not been validated.

An internal audit review was undertaken of the membership data used for valuation purposes, which verified that the characteristics of the data included in the extract was that which was expected. However, this audit did not review the representativeness of the excluded data. Future internal audit reviews will aim to consider this, hence providing additional assurance on this matter.

The Agency recognises the need to increase the percentage of membership data included within future valuations to reduce the potential uncertainty introduced by the uprating factors. The Agency had already implemented a data cleanse project in October 2004 to identify anomalies, omissions and correct errors in member records and updates from employers. Excellent progress was made and over 650,000 data items were cleansed by the end of March 2006. This phase of the project has now ceased and has been replaced by Data Cleanse Next Steps; the focus has changed to look at data quality coming from our employers across England and Wales. The main objectives of this phase of the project are as follows:

- Target those employers with the lowest levels of usable membership data via the Finance Directors to bring pension records up to date by personal letter;
- Face-to-Face meetings with these employers and/or software suppliers to come up with an action plan complete with timeframe for updating old records;
- Contact with all Finance Directors to highlight state of their records and the importance of updating;
- Consult with the Department of Health on measures to enforce NHS employers to comply with Scheme regulations to ensure timely updating of member records. The success of this is heavily dependant on the co-operation of the wider NHS.
- Continue to monitor progress against remaining strands from the Data Cleanse Project, including Non Updated Records Change control and ESR;
- Collaborative work with the Electronic Staff Record (ESR) Project Sponsor to agree Service Level Agreements with Strategic Health Authorities;
- Utilise the facility of Employer Error Handling once developed;
- Tidy up the Employing Authority Database structure;
- Publicise the need for accurate and timely updating through the following media:
    - Website;
    - Newsletters;
    - Workshops;
    - Attendance at some regional payroll groups across the country.

This phase will continue throughout the remainder of 2006-2007.

This work will support the business moving forward as this cleansing drive should see improved calculations and more updated accurate records to assist with future initiatives like Annual Benefit Statements, “Choice” documentation for new scheme etc.

Contributions Income

The Scheme collects both employee and employer contributions from each employing authority and GP practice on a monthly basis. The Scheme does not currently receive independent certification of the amounts it receives. The absence of such independent certification is mitigated by the circularisation of all employing authorities at the year end requiring each organisation’s Director of Finance to declare that the payments made are correct.

Proposed developments are being considered which will increase the level of assurance for future years, including:

- Consideration of the inclusion of a disclosure in all Employing Authorities Statement of Internal Control in their Statutory Accounts to declare that the correct Pensions deductions have been made and paid over.
- The inclusion of the circularisation exercise into the formal NHS Agreement of Balances exercise, which is subject to external audit.
- Requiring the Accounting Officer to sign the existing circularisation return.
- Increased scrutiny of circularisation returns and additional reconciliations.
- Improving on the 98.8% return rate for the circularisation exercise.

- Improved linkages with Department of Health pay branch to improve the understanding of factors likely to impact on the level of contributions received and owing.

For the 2007-08 Pension Scheme accounts onwards, consideration will be given, in conjunction with the Department of Health, National Audit Office and Audit Commission, as to the potential for each Employing Authority to have their annual contributions statement audited.

Benefit Payments

The testing during the year by Internal Audit on behalf of the National Audit Office of the calculation of death gratuities, ill health commutations and transfer out payments has detected errors which are not in themselves material, however has highlighted some specific control weaknesses.

The Senior Management Team has committed to review all the highlighted ill health commutations cases due to the manual nature of these calculations. All other findings reported by the NAO will also be reviewed by the Pensions Division's Performance and Quality Management Section to ensure best working practices are followed and the identified control weaknesses and any further control issues are eradicated.

Erroneous implementation of Regulation T8 within the Pensions regulations;

From April 2000, under the provisions of Regulation T8 to the NHS Pension Scheme regulations, the Scheme has been required to pay interest automatically to members who suffer delay in receiving their pension scheme benefits. However, the Scheme has never implemented this regulation in full and has only paid interest on request by the member.

The Scheme is now reviewing all cases where benefits have been paid late since April 2000 and intends to make good the missing interest payments. Data are not available to estimate these costs, but they are not expected to be material in the overall context of the Scheme liability.

The Authority Board and sub-committees are kept fully updated on issues and progress.

Nick Scholte
Chief Executive, NHS Business Services Authority
25 January 2007

THE CERTIFICATE OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSE OF COMMONS

I certify that I have audited the financial statements of the National Health Service Pension Scheme and National Health Service Compensation for Premature Retirement Scheme for the year ended 31 March 2006 under the Government Resources and Accounts Act 2000. These comprise the Statement of Parliamentary Supply, the Combined Revenue Account, the Statement of Recognised Gains & Losses, the Combined Balance Sheet, the Cashflow Statement and the related notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Accounting Officer and auditor

The Accounting Officer is responsible for preparing the Report of the Manager 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. The Report of the Actuary is the responsibility of the Schemes' actuary.

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

I report to you my opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the HM Treasury directions issued under the Government Resources and Accounts Act 2000. 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. I also report to you if, in my opinion, the Report of the Manager is not consistent with the financial statements, if the Report of the Manager is not consistent with the Report of the Actuary, if the Schemes have 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 relevant authorities regarding other transactions is not disclosed.

I review whether the statement on pages 14 to 18 reflects the Schemes' compliance with HM Treasury's guidance on the Statement on Internal Control, and I report if it does not. I am not required to consider whether the Accounting Officer's statement on internal control covers all risks and controls, or form an opinion on the effectiveness of the Schemes' corporate governance procedures or its risk and control procedures.

I read the other information contained in the Report of the Manager and the Report of the Actuary 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. It also includes an assessment of the significant estimates and judgments made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Schemes' circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error and that in all material respects the 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.

Qualified opinion

As explained more fully in the attached report, Parliament authorised a Request for Resources for the Scheme in the Appropriation Acts 2005 and 2006. Net resources of £26,792,404,000 were authorised for Request for Resources 1. Against this authorised limit, the Scheme incurred net resource expenditure of £27,580,631,000 as shown in Schedule 1 to the Resource Accounts for 2005-06 and have thus exceeded the authorised limit by £788,227,000.

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 Schemes' affairs as at 31 March 2006 and the net cash requirement, net resource outturn, recognised gains and losses and cashflows for the year then ended;
- The financial statements have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000; and
- Except for net resource expenditure of £788,227,000 in excess of the amount authorised for Request for Resources 1, referred to in paragraphs 7 to 18 of my report, 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.

Emphasis of matter – Contribution Income

At the end of each financial year, employers are required to confirm the level of employer and employee contributions paid over to the Scheme but these returns are not subject to independent audit. My audit highlighted concerns over the level of assurance that the Scheme has that the impact of changes within the NHS result in the complete disclosure of contribution accruals. I have not qualified my opinion in this respect but draw it to your attention.

Emphasis of matter – Scheme Liabilities

As described in note 23.2 to the accounts (page 44), the valuation of the Schemes' future pension liabilities requires the application of uprating factors to obtain a reliable estimate of the liability in respect of that percentage of total members whose records have not been updated. The Actuary seeks assurances from the Scheme that the factors applied are valid but the exercise carried out by scheme managers did not provide this assurance. Any resulting misstatement of liabilities is unlikely to be material and I have therefore not qualified my opinion but draw this to your attention.

My report on pages 21 to 27 provides further details of the qualification of my audit opinion and the two emphases of matter.

John Bourn
Comptroller and Auditor General
26 January 2007

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

Report of the Comptroller and Auditor General on the NHS Pension Scheme and NHS Compensation for Premature Retirement Scheme Resource Accounts 2005-06

Executive Summary

I have qualified my opinion on the NHS Pension Scheme's 2005-06 Resource Account because of an Excess Vote in the Scheme's Request for Resources.

I have also reported on weaknesses in the Scheme's arrangements to demonstrate the completeness of income and for validating the assumptions on which the valuation of the Scheme's future pension liabilities are based. I have not qualified my opinion in these respects.

Further details are given below.

Introduction

1. The NHS Pension Scheme is an unfunded occupational scheme supported by the Exchequer and open to all NHS employees and employees of approved organisations. In order to defray the costs of benefits both employers and members pay contributions at rates determined by the Scheme Actuary.

2. At 31 March 2006 the employing organisations of members of the NHS Pension Scheme comprised 659 NHS Trusts, Primary Care Trusts, Local Health Boards and Health Authorities, 8,561 GP practices and 351 Directed Bodies (non-NHS employers meeting specific criteria) in England and Wales.

3. In accordance with HM Treasury guidance the Scheme's long term liabilities to pay pensions are valued by the Scheme Actuary in accordance with Financial Reporting Standard (FRS) 17 – Retirement Benefits. The Combined Balance Sheet of the Resource Account (page 31) shows a liability of £165.4 billion at 31 March 2006 compared to £130.6 billion at 31 March 2005. At 31 March 2004 the liability stood at 102.7 billion.

4. The Scheme managers collect employer and employee contributions and use these to fund payments to existing pensioners with the excess receipts being paid into the Consolidated Fund. The Combined Revenue Account of Resource Account (page 30) shows that 2005-06 contribution income totalled £6.3 billion. Payment of pensions are shown as a movement on the Scheme liability provision in note 23.5 to the accounts (page 45) and totalled £3.8 billion in 2005-06 leaving £2.5 billion due to be paid over to the Consolidated Fund.

My obligations as auditor

5. Under the Government Resources and Accounts Act 2000 (the Act), I am required to examine and certify all Resource Accounts received under the Act. I am required, under International Auditing Standards (UK and Ireland), to obtain evidence to give reasonable assurance that the Scheme's financial statements are free from material misstatement. In forming my opinion I examine, on a test basis, evidence supporting the disclosures in the financial statements and assess the significant estimates and judgements made in preparing them. I also consider whether the accounting policies are appropriate, consistently applied and adequately disclosed. I have qualified my opinion on the NHS Pension Scheme's 2005-06 financial statements due to an Excess Vote in the Scheme's Request for Resources. This results in a breach of regularity as this expenditure did not have Parliamentary Authority. Details are provided in paragraphs 7 to18.

6. In addition I have drawn attention, without qualifying my opinion, to weaknesses that exist in the arrangements for:

i) Demonstrating completeness of contribution income. Details are provided in paragraphs 19 to 21.

ii) Validating the assumptions on which the Scheme's future pension liabilities are based. I provide full details of the issues in paragraphs 22 to 28.

Excess Vote

7. In 2005-06, the Scheme expended more resources than Parliament had authorised. By so doing, the Scheme breached Parliament's control of expenditure and incurred what is termed an "excess" for which further parliamentary authority is required. I have qualified my opinion on the Scheme's 2005-06 Resource Accounts in this regard. The purpose of this section of my report is to explain the reasons for this qualification and to provide information on the extent and nature of the breach to inform Parliament's further consideration.

My responsibilities with regard to the breach of regularity

8. As part of my audit of the Scheme's financial statements, I am required to satisfy myself that, in all material respects, the expenditure and income shown in the Resource Accounts have been applied to the purposes intended by Parliament and conform to the authorities which govern them; that is, they are "regular". In doing so, I have had regard, in particular, to Parliamentary authority and in particular the Supply limits Parliament has set on expenditure. By incurring expenditure that is unauthorised and is thus not regular, the Scheme has breached Parliament's controls.

Background to the excess

9. Parliament authorises and sets limits on departmental expenditure on two bases – 'resources' and 'cash'. Such amounts are set out in Supply Estimates for which Parliament's approval and authority is given in an annual Appropriation Act.

10. By this means, Parliament has authorised a 'Request for Resources' for the Scheme. It thereby authorises amounts for current (rather than capital) expenditure which are net of forecast income, known as operating Appropriations in Aid. Parliament sets limits on the amount of operating Appropriations in Aid that can be applied towards meeting expenditure. The amounts authorised for Requests for Resources and Appropriations in Aid together represent a limit on the gross current expenditure that may be incurred under each Request for Resources. Parliament has also authorised a single 'Net Cash Requirement' for the Scheme. This is the limit on the amount of cash that can be used. The Scheme's Net Cash Requirement covers all of its Requests for Resources, plus working capital requirements.

11. The Net Cash Requirement also represents the maximum amount of cash that may be provided to the Scheme from the Consolidated Fund. It is net of the amount of cash that the Scheme receives relating to income that Parliament has authorised as Appropriations in Aid.

Limits

12. The limits described above for the Scheme were set out in the Main Supply Estimate for 2005-06 (HC2), as amended by the Spring Supplementary Estimate (HC827). The limit for Request for Resources 1 was set at net expenditure of £26,792,404,000 together with a limit on Appropriations in Aid of £6,771,846,000. The Net Cash Requirement was set at £1,000. These limits were authorised in the Appropriation Acts of 2005 and 2006. The breaches reported below are against these limits.

Amount of excess

13. The Statement of Parliamentary Supply (page 28) to the accounts shows net expenditure on Request for Resources 1 of £27,580,631,000 which is £788,227,000 (2.94 per cent) in excess of the amount authorised. Contributions income authorised to be appropriated in aid of expenditure on this Request for Resources was limited to £6,771,800,000. Income earned and applied fell short of this limit by £202,477,000 and gross expenditure was £585,750,000 greater than provided for, resulting in the excess of £788,227,000. The Scheme propose to ask Parliament to authorise £788,227,000 as additional use of resources by an Excess Vote.

Details and causes

14. I have set out in the table below a summary of the contributing factors.

Cause of Excess	**Impact on Excess**
Income: Paragraph 15	
Additional pension contributions being lower than forecast	£125 m
Lower than expected transfers in from other pension schemes offset by corresponding increase in liabilities	£43 m
Impact on premature retirement pre-funding resulting from Primary Care Trust restructuring	£28 m
Premature retirements recharges to employers lower than expected	£5 m
Sub-total	**£201 m**
Expenditure: Paragraph 16	
Increase in Scheme liabilities as a result of change in discount rate from 1 April 2005	£400 m
Error in calculating request for resources in relation to interest charges	£200 m
Increase in interest on liabilities charge due to omission of £2.7 billion from 31 March 2005 liability	£165 m
Enhancements higher than forecast	£15 m
Sub-total	**£780 m**
Compensating Adjustments: Paragraph 17	
Current service cost lower than expected due to lower than expected contribution income on which it is determined	(£132) m
Impact on outgoings from lower than expected transfers in from other pension schemes	(£43) m
Reclassification of premature retirement costs into overall Scheme liability	(£18) m
Sub-total	**(£193) m**
Total	**£788 m**

15. Income was lower than forecast by £201 million but the changes were not detected in sufficient time to seek a Supplementary Estimate from Parliament to reduce the Excess. Scheme managers based their Estimate of appropriations in aid on the assumption that previous trends of membership increases would continue but this proved to be wrong and led to contribution income being £125 million lower than expected. Similarly the managers predicted the rate of transfers in to the Scheme would remain at the same rate as in previous years but this was also an incorrect assumption and resulted in a further shortfall of estimated income of £43 million. Recharges to employers of early retirement costs were found to be £5 million lower than the Scheme managers had forecast. Lastly Scheme managers estimated that contribution income from enhanced premature retirements would increase during 2005-06 as a result of the restructuring of Primary Care Trusts. Their forecast however, proved to be deficient by £28 million. The Scheme managers told me they believe this to be because the restructuring exercise occurred later than they expected, although I was unable to obtain any evidence to support that this was the cause of the shortfall.

16. In addition to the lower than expected income the Scheme spent £780 million more than expected, although these costs relate entirely to notional (that is non cash) items. Of this some £565 million is attributable to an omission by the Scheme Actuary. In April 2006 the Scheme actuary advised Scheme managers that the valuation of Scheme liabilities at 31 March 2005 had omitted the hospital service elements of General Medical Practitioners amounting to £2.7 billion. As disclosed in the Combined Balance Sheet on page 31 this has been re-stated in the prior year comparatives but the increased liability carried into 2005-06 increased the interest on Scheme liabilities charge by £165 million more than budgeted. Liabilities for future pension costs are carried in the Scheme balance sheet discounted to present values. On 1 April 2005 the discount rates used to determine scheme liabilities at present values was reduced from 3.5 per cent to 2.8 per cent and in respect of the £2.7 billion omitted from the Actuary's opening valuation, this added a further £400 million to Scheme liabilities which increased the non budget outturn of the Request for Resources by £400 million more than scheme managers had estimated. In addition to this omission in compiling the Parliamentary Estimate of the interest on scheme liabilities charges Scheme managers made an error in their calculations and set their estimate a further £200 million lower than outturn. A further £15 million expenditure was incurred as a result of enhancements to pensions exceeding forecast; the Scheme managers emphasise however that such enhancements are largely under the control of employers and not the Scheme itself.

17. Compensating adjustments to the Schemes' Combined Revenue Account offset £193 million of the impacts of the lower than expected income and higher than expected expenditure. The lower than expected level of contribution income had a knock-on effect in reducing current service cost charges by £132 million. Current service costs are calculated as being 24 per cent of pensionable pay, which in turn is determined as 14 per cent of employer contributions. A further offset arises because the £43 million shortfall on estimated income from transfers into the NHS Scheme affects outgoings by the same amount. Lastly, on consolidation into the overall scheme liability figure the premature retirement element of Scheme liabilities was reduced by £18 million more than anticipated.

18. Of the £788 million excess, £565 million resulted from the accounting impacts of the accidental omission of GP liabilities and was outside the control of Scheme managers. Had the Scheme managers been able to better monitor expenditure and contribution income however, they should have been able to advise Parliament via the Supplementary Estimate procedures of some of these variances from estimate and the excess might have been reduced by around £223 million.

Completeness of Contribution Income

19. The Scheme collects on a monthly basis employee and employer contributions from each employing authority and GP practice. There is no independent verification of the sums paid over but the Scheme circularises employing authorities at each year-end to confirm contributions receivable to salary payments. These returns from employers to the Scheme confirming contributions payable are not subject to audit and are not certified by an independent reviewer.

20. The Statement of Parliamentary Supply on page 28 shows the Scheme expected to receive £6.8 billion in income in 2005-06 but outturn was only £6.6 billion. Of this £6.3 billion was receivable as contributions from employers and employees. Scheme managers believe around £125 million of the shortfall in expected income results from growth in Scheme membership during 2005-06 falling to under 0.2 per cent having been expected to continue at around 3.9 per cent. It is not clear why membership growth was significantly lower than expected and Scheme managers have explained to me their plans to improve linkages with the Department of Health pay branch and the wider NHS to obtain better information on recruitment and retention rates in employing authorites. My audit has not identified any additional causes for the shortfall.

21. While the employer returns introduced in 2004-05 are a step forward, experience in 2005-06 identified weaknesses in the assurances they offer. There are over 9,000 employers in the Schemes and, as noted in paragraph 20 above, understanding the impact on contributions income from trends in recruitment and retention and restructuring is complex. As a result of my audit I have concerns that these complexities, if not understood fully, could undermine confidence that

contribution income is complete. The NHS Business Services Authority have identified a range of actions which they intend to implement, in conjunction with the Department of Health, for future years which would provide further assurances. I will continue to closely review the level of assurances available in 2006/07 and future years together with the actions to be taken by Scheme managers to improve this situation as set out in paragraph 31 of my report.

Valuation of the Scheme's long term liabilities

22. The scheme is required to comply with the provisions of Financial Reporting Standard 17 – Retirement Benefits (FRS 17). FRS 17 requires that the financial statements reflect the actuarially calculated liabilities arising from an employer's retirement benefit obligations. The NHS Pension Scheme, like many similar public sector schemes is unfunded and the cash required to meet the payment of pensions is met from employer and employee contributions with any shortfall financed by the Exchequer.

23. FRS 17 requires a full actuarial valuation of scheme liabilities every three years, although Treasury require such a valuation only every four years to fit in with the Government spending review cycle. In addition to this liability valuation, the rules and regulations of the NHS Scheme require a funding valuation every five years in order to determine the contributions members and employers should make to the Scheme. The liability valuation must reflect the best estimate of the present value of the amounts that will actually be paid out taking into account all expected changes in factors affecting the payments. In between full valuations the Treasury, in line with FRS 17, require annual updates of the value of liabilities to reflect current conditions.

24. The scheme liability must be calculated by an actuary and reflect expected future benefit payments arising in respect of both current and deferred pensioners and currently active members of the scheme. The actuarial assumptions used in determining the cash flows arising from these future scheme obligations are fundamental to the valuation. Assumptions are required for numerous factors including salary growth rates and mortality rates. Changing the assumptions will generally have a material impact on the results of the valuation.

25. The liability of £165.4 billion at 31 March 2006 is supported by the Report of the Actuary which notes that the valuation is based on membership data for the NHS Pension Scheme as at 31 March 2003 with an approximate updating for subsequent financial years to reflect known changes that have occurred up to 31 March 2006. My review of the methodology employed by the actuary has not identified any material weaknesses on the operating effectiveness of their internal systems for processing FRS 17 information.

26. My discussions with the Government Actuary in relation to the NHS Scheme has identified two concerns. Firstly, while all pension schemes have significant uncertainties over future liabilities, the NHS Scheme has a larger number of uncertainties due to the size and complexity of membership. For example, the nature of new GP contracts of employment introduced in 2004 generate increased levels of uncertainty in the NHS Scheme. Sensitivity analysis in relation to GPs suggests around £1 billion could be added to liabilities for each additional 0.5 per cent increase in pay rates over the baseline assumption of 3.5 per cent. As disclosed in the report of the manager on page 8, following an announcement by the Minister for NHS Reform in December 2006 capping GP Pensions between 2003 and 2008 there is increased certainty and this has led to the Scheme's future pension liabilities at 31 March 2006 being revalued downwards by £2.1 billion. The uncertainties inherent in the NHS Pension Scheme increase the importance of up to date membership data.

27. The second area of concern relates to Scheme membership records. At 31 March 2006 only 75 per cent of member records had been updated. Within this overall total there are some membership groups where the updating is much lower. These percentages are significantly worse than for the other major public sector pension schemes. In valuing the future pension liabilities of Scheme members the Government Actuary's Department apply uprating factors to obtain a reliable estimate of the liability in respect of that percentage of total members whose records have not been updated. The Actuary asked the Scheme to validate that the assumptions underpinning the uprating factors are accurate in all membership groups whether updated or not. Despite written

assurances from the Scheme managers to the Actuary, it is now clear that the exercise undertaken by Scheme managers did not provide this validation. The Scheme managers believe that this deficiency does not materially affect the overall Scheme liability at 31 March 2006. An assessment of possible impacts leads us to accept this argument, although there is no specific work we can do to confirm the Scheme managers' assumption. Nevertheless we consider that the Scheme must put in place robust mechanisms both for ensuring membership records are updated promptly and for properly validating future uprating factors.

28. The Scheme managers have advised me that they plan to carry out a full validation of the uprating factors applied in the valuation at 31 March 2007 and I will review their work as part of my 2006-07 audit. This is discussed further in paragraph 32 of my report.

Future Plans

29. NHS Business Services Authority has informed me that it has put in place a comprehensive programme of actions to address the issues identified by my audit, as detailed in the Statement on Internal Control on pages 14 to 18.

Excess Vote

30. The Authority has commenced a fundamental review of its estimation and expenditure monitoring processes to ensure that future Excess Votes are avoided, and has instigated the following measures:

- Supply estimates produced by the Pensions Division will be robustly reviewed by the Director of Finance of the NHS Business Services Authority and presented to the Executive Board prior to formal sign off by the Accounting Officer.
- The Director of Finance of the NHS Business Services Authority will receive and review regular financial monitoring reports on the Scheme Accounts. The Director of Finance will also ensure that appropriate staff have a greater understanding of the impact of any changes to accounting policies, and that these impacts are identified on a timely basis.
- Scheme managers will work closely with the Scheme Actuary to ensure they understand and are consistent in their estimation process with the calculation methodologies used by the Actuary in the composition of the Scheme liabilities statement.
- The Actuary will ensure that a robust quality process is maintained to avoid a recurrence of the omission identified in 2005-06.

Completeness of Contribution Income

31. The Authority recognises the need to further develop the Income Assurance exercise introduced in 2004-05 and developed in 2005-06 as the primary source of assurance on the completeness of income. This will be a collaborative process involving the Department of Health, National Audit Office, Audit Commission and other organisations deemed necessary, to ensure that a more robust process is adopted. These discussions will seek to introduce an agreed compliant solution for future years which will increase the level of assurance. Avenues being explored include the following:

- Improving links between Employing Authority annual accounts and contribution statements;
- Enhancing the profile of the annual circularisation exercise within the formal NHS Agreement of Balances exercise, which is subject to external audit;
- Improving links with Department of Health pay branch to improve the understanding of factors likely to impact on the level of contributions received and owing.

Valuation of Liabilities

32. The NHS Business Services Authority recognises the need to increase the percentage of membership data which is up to date and hence included within future valuations. This will reduce the need for extrapolation and rating up. A data cleanse project has already been implemented to identify anomalies, omissions and correct errors in member records and updates from employers. This has targeted those employers with the lowest levels of usable data. In addition consultations are on-going with the Department of Health on measures to enforce NHS employers to comply with Scheme regulations and ensure the timely updating of membership records. BSA's management will remain focused on ensuring that all membership data received by the Pensions Division is processed efficiently. Whilst the Data Cleanse project will produce improved membership data in the medium term, efforts will also be focused on providing a robust validation of the use of up rating factors.

John Bourn
Comptroller and Auditor General
26 January 2007

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

Statement of Parliamentary Supply
Summary of Resource Outturn 2005-06

Request for Resources	Note	Estimate: *Gross Expenditure*	Estimate: *A in A*	Estimate: *Net Total*	Outturn: *Gross Expenditure*	Outturn: *A in A*	Outturn: *Net Total*	2005-06 £000s Outturn: *Net Total outturn compared with Estimate: Saving/(excess)*	2004-05 £000s Outturn: *Net Total*
Pensions and associated payment		15,664,250	(6,771,846)	8,892,404	15,850,000	(6,569,369)	9,280,631	(388,227)	6,396,065
Pensions – Non budget		17,900,000	–	17,900,000	18,300,000	–	18,300,000	(400,000)	–
Total resources	5	**33,564,250**	**(6,771,846)**	**26,792,404**	**34,150,000**	**(6,569,369)**	**27,580,631**	**(788,227)**	**6,396,065**

Summary of net cash requirement 2005-06

	Note	2005-06 £000s: *Estimate*	2005-06 £000s: *Outturn*	2005-06 £000s: *Net Total outturn compared with Estimate: Saving/(excess)*	2004-05 £000s: *Outturn*
Net cash requirement	6	1	0	1	0

The Scheme has incurred an Excess Vote of £788,226,976.06 as the voted net resource requirement has been breached. The Scheme will seek Parliamentary approval for the Excess Vote in the next Appropriation Act.

Summary of income/cash payable to the Consolidated Fund

Expenditure for which resources are sought within the estimate are resource based and relate to increases to the Pension Scheme liability. Details of cash based expenditure can be found in notes 23.6 and 23.7, and are accounted for as a release of Pension Scheme liability. Surplus cash is surrendered to the Consolidated fund as cash income exceeds the cash benefits the Scheme currently pays out. The surplus cash cannot be used to offset the Excess Vote as this is an entirely resource and not a cash based excess.

	Note	2005-06 Forecast Income £000	2005-06 Forecast ***Receipts*** £000	2005-06 Outturn Income £000	2005-06 Outturn ***Receipts*** £000
Other amounts collectable on behalf of the Consolidated Fund		228	*228*	228	–
Excess cash receipts to be surrendered to the Consolidated Fund	7/29	–	*2,845,515*	2,626,297	*2,068,386*
Total		**228**	***2,845,743***	**2,626,525**	***2,068,386***

Explanation of the variation between estimate and outturn resulting in an excess vote (net total resources):

Income

i. Contributions – Growth in active scheme membership reduced from 3.87% to 0.19% and is the main contributory reason to the outturn being £125 million less than estimated.

ii. Transfers In – The amount of transfers into the Scheme were less than forecast and resulted in the outturn being £43 million less than estimated. There is a direct one for one relationship with the corresponding expenditure stream (see expenditure point v below).

iii. Premature Retirements Recharged to the employer – The amount was lower than forecast by £5 million.

iv. Premature Retirements Prefunded by the employer – The amount was less than forecast by £28 million. The estimate originally provided for an increase in contributions for enhanced premature retirements resulting from the restructuring of Primary Care Trusts, however this did not take place when originally anticipated.

Expenditure

i. Change in discount rate – The change in discount rate on 1 April 2005 from 3.5% to 2.8% caused an increase in the pensions liability amounting to £18.3 billion. The original calculation was £17.9 billion based on opening liabilities of £127.9 billion. However, this omitted the hospital service elements of General Medical Practitioners and the subsequent restatement to £130.6 billion has resulted in an additional increase of £18.3 billion, £400 million higher than forecast.

ii. Interest – As a consequence of the £2.7 billion increase in the opening scheme liability at 1.4.2005 (explained in point i above) a further interest charge of £165 million was realised that was not budgeted for. This is the interest charged on the additional liability, and also the increase on the revised assessment of the impact of the change in discount rate amounting to £400 million. In addition there was an omission within the calculation of interest amounting to £200 million by the Agency.

iii. Current Service Cost – This is lower than estimated by £132 million as a consequence of the relationship with employer contribution income. The income figure is used to estimate the pensionable payroll figure on which the Current Service Cost is calculated. As the outturn figure for employer contributions was lower than forecast, there was a direct impact on the calculation of the Current Service Cost.

iv. Enhancements – The outturn was higher than forecast by £15 million.

v. Transfers In – There is a direct one for one relationship with the corresponding income stream for Transfers In (income point ii above).

vi. Premature Retirements Prefunded by the employer – There was a change in accounting policy in 2004-05 on the treatment of the liability for the enhanced pension entitlement and the full impact of how this would be included within the movement in the scheme liability was not fully known. Consequently no provision within the estimate was made for expenditure in relation to Prefunded Premature Retirements. The outturn of £52 million therefore has no corresponding budget.

vii. Other Expenditure – There was a change in accounting policy during 2005-06 in how the liability for the enhancement of pension due to premature retirement was treated for amounts recharged to employers on an ongoing basis. Prior to 2005-06 the future liability for the rechargeable pension costs was disclosed as a separate liability. In 2005-06 this liability was assimilated into the overall liability of the scheme, however this decision was made after the estimate had been submitted. As expenditure is now accounted for as a release of pension provision it is not classified as an expenditure item, therefore the budget of £70 million was not utilised.

Combined Revenue Account
for the year ended 31 March 2006

	Note	2005-06 £000	2004-05 (Restated) £000
Income			
Contributions receivable	9	(6,296,404)	(5,708,307)
Special contributions – Prefunded premature retirement contributions	9	(51,609)	(52,470)
Other income – Premature retirement benefits paid and subsequently recharged to the employer	9	(64,235)	(65,281)
Transfers in	10	(157,121)	(173,158)
		(6,569,369)	**(5,999,216)**
Outgoings			
Pension Cost	11	7,370,000	5,800,000
Enhancements	12	171,270	154,372
Transfers in	13	157,121	173,158
Prefunded premature retirements	14	51,609	52,470
Interest on Scheme liabilities	15	8,100,000	6,150,000
Other expenditure – premature retirement benefits paid and subsequently recharged to employers	16	–	65,281
		15,850,000	**12,395,281**
Net outgoings for the year		**9,280,631**	**6,396,065**

Statement of Recognised Gains and Losses
for the year ended 31 March 2006

	Note	2005-06	2004-05
Prior year adjustment		2,700,000	–
Revaluation cost of estimated discounted future cash flows in respect of early retirement charges	20	(85,729)	–
Actuarial loss on Pension Scheme Liabilities	23.8	3,968,315	14,898,832
Total recognised losses for the financial year		**6,582,586**	**14,898,832**

The notes on pages 33 to 49 form part of these accounts

Footnote: In the 2004-05 Accounts prefunded premature retirement costs were included within enhancements. The prior year comparatives have now been restated to show these elements separately.

The prior year adjustment is required to include £2.7 billion in the Scheme liability due to the previous omission of the hospital elements of General Medical Practitioner service in 2004-05. The increase in closing Scheme liability had no effect on the net resource outturn for 2004-05.

Combined Balance Sheet
as at 31 March 2006

	Note	2005-06 £000	2004-05 (Restated) £000
Current Assets and Liabilities			
Debtors	18a	514,200	521,168
Prepayments – Prepaid pension benefits	19	56,190	–
Cash at bank and in hand	21	999,166	490,212
		1,569,556	1,011,380
Creditors (amounts falling due within one year)	22a	(1,569,556)	(1,011,380)
Net current assets, excluding pension liability		–	–
Estimated discounted future cash flows in respect of early retirement recharges	20	830,036	744,307
		830,036	**744,307**
Provisions for liabilities and charges:			
Pension Scheme Liability	23.5	(165,400,000)	(131,344,307)
Total net liabilities, including pension liabilities		(164,569,964)	(130,600,000)
Taxpayers' equity:			
General fund	25	(164,569,964)	(130,600,000)
		(164,569,964)	(130,600,000)

Nick Scholte
Chief Executive, NHS Business Services Authority
25 January 2007

The notes on pages 33 to 49 form part of these accounts.

Footnote: The prior year comparative debtors figure has been restated due to the reclassification of contributions due from employers in respect of premature retirements recharged to employers on an ongoing basis to Estimated discounted future cash flows in respect of early retirement charges. From the total disclosed in 2004-05 of £764,607 million, the invoiced debtor amount of £20.3 million is included within the debtors figure shown at note 18a.

The net Pension Scheme liability in 2004-05 has been re-stated from £127.9 billion to £130.6 billion. This restatement of the 2004-05 liability resulted from an omission by the Scheme Actuary. In April 2006 the Scheme Actuary advised scheme managers that the valuation of liabilities at 31 March 2005 did not include the hospital service element of General Medical Practitioners. The resultant increase in liability was £2.7 billion.

Amounts repaid to the Consolidated Fund are no longer disclosed separately on the Balance Sheet, however can be seen at note 25.

Cash Flow Statement

For the year ended 31 March 2006

	Note	2005-06 £000	2004-05 (Restated) £000
Net cash inflow from operating activities	26a	2,577,112	2,103,701
Payments of amounts due to the Consolidated Fund	29	(2,068,386)	(1,942,371)
Amounts not classified to be appropriated in aid, due to the Consolidated Fund		228	284
Increase in cash in the period	26b	**508,954**	**161,614**

The notes on pages 33 to 49 form part of these accounts.

Notes to the Scheme Statements for the year ended 31 March 2006

Accounting Policies

1. Basis of Preparation of scheme statements

1.1 The combined scheme financial statements have been prepared in accordance with the relevant provisions of the Financial Reporting Manual (FReM) for 2005-06 issued by the Treasury, which reflect the requirements of Financial Reporting Standard (FRS) 17 *Retirement Benefits*. These accounts show the unfunded pension liability and movements in that liability during the year. The accounts also have regard to the recommendations of the Statement of Recommended Practice *Financial Reports of Pension Schemes* to the extent that these are appropriate.

1.2 The combined scheme financial statements summarise the transactions of the National Health Service Pension Scheme and the National Health Service (Compensation for premature retirement) Scheme. The balance sheet shows the deficit on the scheme; the Revenue Account shows, *inter alia*, the movements in the liability analysed between the pension cost, enhancements and transfers in, and the interest on the scheme liability. The actuarial position of the pension scheme is dealt with in the report of the Actuary, and the scheme statement should be read in conjunction with that Report.

1.3 The NHS Pension Scheme acts as a principal for employers in the payment of compensation benefits arising under the NHS Compensation for Premature Retirement Scheme. Employers have the option of discharging their liability by way of payment of a capital sum, or by paying for the compensation benefits, which are paid out in the course of the month, on a quarterly basis. The financial statements recognise the liabilities arising from cases charged to employers on an ongoing basis (and in addition a corresponding debtor within the balance sheet).

1.4 The accounting policies adopted are described below. They have been applied consistently in dealing with items that are considered material in relation to the combined financial statements.

---

2. Accounting policies for the NHS Pension Scheme

2.1 *Contributions receivable*

a. Employers' normal pension contributions are accounted for on an accruals basis.

b. Employers' special pension contributions are accounted for in accordance with the agreement under which they are paid or, in the absence of such an agreement, on an accruals basis.

c. Employees' pension contributions which include amounts in respect of added years (dealt with in (d) below) are accounted for on an accruals basis.

d. Employees' contributions paid in respect of the purchase of added years are accounted for on an accruals basis. The associated increase in the scheme liability is recognised as expenditure. Where Scheme members make additional voluntary contributions (AVCs) to secure additional pension benefits through the Scheme's approved suppliers these were directly invested through individual contracts with those suppliers. These additional contributions are not included in the financial statements but are shown separately in Note 17 to the financial statements. Please refer to Note 17 for further information on Scheme AVC providers. Where Scheme members make Free Standing AVC payments these are paid direct to the supplier by the member and are not included in these financial statements.

2.2 *Transfers in and out*

Transfers in are normally accounted for as income and expenditure (representing the associated increase in the scheme liability) on a cash basis, although group transfers in may be accounted for on an accruals basis where the scheme has formally accepted or transferred a liability.

2.3 *Current service cost*

The current service cost is the increase in the present value of the scheme liabilities arising from current member's service in the current period and is recognised in the Revenue account. The cost is based on a discount rate of 2.8% (2004-05: 3.5%) real (i.e. 5.37% including inflation [2004-05: 6%]).

2.4 *Past service cost*

Past service costs are increases in the present value of the scheme liabilities related to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits. Past service costs are recognised in the revenue account on a straight line basis over the period in which increase in benefit vest.

2.5 *Interest on scheme liabilities*

The interest cost is the increase during the period in the present value of the scheme liabilities because the benefits are one period closer to settlement and is recognised in the Revenue account. The interest cost is based on a discount rate of 2.8% (2004-05: 3.5%) real (i.e. 5.37% including inflation [2004-05: 6%]).

2.6 *Scheme Liability*

Provision is made for liabilities to pay pensions and other benefits in the future. The scheme liability is measured on an actuarial basis using the projected unit method and is discounted at 2.8% (2004-05: 3.5%) real (i.e. 5.37% including inflation [2004-05: 6%]).

For the purposes of FRS17 accounting, full actuarial valuations by a professional qualified actuary are obtained at intervals not exceeding four years. The actuary reviews the most recent actuarial valuation at the balance sheet date and updates it to reflect current conditions. The most recent actuarial review took place as at 31 March 2004.

2.7 *Pension benefits payable*

Pension benefits payable are accounted for as a decrease in the scheme liability on an accrual basis.

2.8 *Pension payments to and on account of leavers before their normal retirement age.*

Where a member of the pension scheme is entitled only to a refund of contributions, the transaction is accounted for as a decrease in the scheme liability on a cash basis.

2.9 *Lump sums payable on death in service*

Lump sum payments on death in service are accounted for on an accruals basis. They are a direct charge to the pension scheme as they are not funded through the normal pension contributions.

2.10 *Actuarial gains/losses*

Actuarial gains and losses arising from any new valuation and from updating the latest actuarial valuation to reflect conditions at the balance sheet date are recognised in the Statement of Recognised Gains and Losses for the year.

2.11 *Additional Voluntary Contributions*

Additional Voluntary Contributions ('AVCs') are deducted from employees' salaries and are paid over directly by the employing departments to the approved AVC providers.

3. Accounting policies for the NHS Compensation for Premature Retirement Scheme

3.1 Compensation payments or the costs of service enhancements for staff leaving before their normal retirement age are met by employers. For administrative convenience and value-for-money considerations, benefits are paid initially by the NHS Pension Scheme throughout the month and recovered from employers on a quarterly basis (this method is referred to as "quarterly recharging").

3.1.1 The Secretary of State may alternatively allow employers to make a cash payment, as either a lump sum or in five annual instalments, to the NHS Pension Scheme in order to discharge their liabilities to the Scheme and to fund compensation payments payable to their former employees in the forthcoming years (this is referred to as "pre-funding").

3.1.2 Except where stated otherwise below, the accounting policies outlined at Note 2 above apply.

Accounting for pre-funded income in respect of rechargeable early retirement pension enhancements

3.2 Where the employer chooses to pay by one-off lump sum, this amount is recognised as income at the point the employee's pension becomes payable. Where the employer chooses to pay by instalments, income is recognised when the instalment becomes due, with the amounts due from the employer in respect of future uninvoiced instalments disclosed by way of a note to the debtors disclosure.

3.2.1 Any amounts receivable in respect of an employer's decision to allow an employee's early departure, where the employer has discharged their liability by way of a capitalised payment, are accounted for as special pension scheme contributions (see 2.1b). All amounts received are appropriated-in-aid of Scheme expenditure.

Accounting for pre-funded liabilities in respect of early retirement pension enhancements

3.2.2 In cases where a member's pension entitlement is enhanced to compensate for early retirement, the costs of such enhancements are recognised in the pension scheme liability at the point of the member's retirement.

Accounting for quarterly recharge income in respect of early retirement pension enhancements

3.3 Where the employer chooses to pay quarterly, income is recognised as invoices are raised.

3.3.1 Amounts receivable in respect of the compensatory element of a premature retirement, where the employer pays for the case on an ongoing basis, are classified as "Other Income" to the pension scheme and are appropriated-in-aid.

3.3.2 In recognition of the fact that significant future cashflows will arise from these arrangements, the estimated future cashflows which may accrue to the Scheme after the balance sheet date, discounted to current values, are disclosed on the balance sheet.

3.3.3 The above asset will be revalued on an annual basis and any net increases or decreases will be debited/credited to the General Fund, and disclosed within the Statement of Recognised Gains and Losses.

3.3.4 This represents a change in accounting policy from prior years where these amounts were disclosed as known debtors. The change follows discussions with HM Treasury as to the most appropriate treatment of these items.

3.3.5 In accordance with the requirements of FRS18 (Accounting policies), the prior year has been restated to reflect these changes.

Accounting for quarterly recharge liabilities in respect of early retirement pension enhancements

3.3.6 In cases where a member's pension entitlement is enhanced to compensate for early retirement, the costs of such enhancements are recognised in the pension scheme liability at the point of the member's retirement

3.3.7 This latter treatment represents a change in accounting policy from previous years. In prior years, the liabilities arising from such early departures were disclosed on the pension scheme balance sheet but outside of the main pension scheme liability. However the total liabilities disclosed on the balance sheet remain unchanged.

3.4 None of the changes to the above accounting policies represents a departure from the Financial Reporting Manual (FReM).

4. Reconciliation of Estimates, accounts and budgets

The adjustment of £18.3 billion to the Scheme liability reflects the difference between the Estimates and accounting treatment of the change in the discount rate from 3.5% to 2.8% with effect from 1 April 2005. Parliamentary approval was given for the necessary resources (estimated at £17.9 billion), and was reflected as a non-budget item in the Estimates and in the Statement of Parliamentary Supply.

The outturn of £18.3 billion exceeded the estimate by £400 million. This was due to an underestimate of the closing Scheme liability as at 31 March 2005 from which the £17.9 billion estimate was derived. Further details of this can be found in the Report of the Manager.

For accounting purposes, the effects of the change in the discount rate are reflected through reserves and not in the Revenue account. There is thus a difference between the basis on which the Statement of Parliamentary Supply and the Revenue account have been prepared. For 2006-07 the Estimates and the accounting treatment will be brought into line.

5. Reconciliation of net resource outturn to net outgoings

	Note	Outturn	Supply Estimate	2005-06 Outturn compared with Estimate	2004-05 Outturn
		£000	£000	£000	£000
Net Resource Outturn		27,580,631	26,792,404	(788,227)	6,396,065
Adjustment for Change in Discount Rate		(18,300,000)	(17,900,000)	400,000	–
Net Outgoings		**9,280,631**	**8,892,404**	**(388,227)**	**6,396,065**

6. Reconciliation of Resources to cash requirement

	Note	Estimate	Outturn	Net total outturn compared with estimate: Savings/(excess)
		£000	£000	£000
Net Resource Outturn	5	8,892,404	9,280,631	(388,227)
Accruals adjustments				
Non-cash items	27	(15,594,250)	(15,850,000)	255,750
Use of pension provision		3,856,332	3,943,072	(86,740)
Excess cash receipts surrenderable to the Consolidated Fund	7	2,845,515	2,626,297	219,218
Net cash requirement		**1**	**0**	**1**

7. Analysis of income payable to the Consolidated Fund

In addition to appropriations in aid, the following income relates to the scheme and is payable to the Consolidated Fund (cash receipts being shown in italics).

	Note	Forecast 2005-06 Income	Forecast 2005-06 *Receipts*	Outturn 2005-06 Income	Outturn 2005-06 *Receipts*
		£000	*£000*	£000	*£000*
Other amounts collectable on behalf of the Consolidated Fund		228	*228*	228	–
Excess cash surrenderable to the Consolidated Fund	29	–	*2,845,515*	2,626,297	*2,068,386*
Total income payable to the Consolidated Fund		228	*2,845,743*	2,626,525	*2,068,386*

8. Reconciliation of income recorded within the Revenue Account to operating income payable to the Consolidated Fund

	2005-06	2004-05
	£000s	£000s
Operating Income	(6,569,369)	(5,999,216)
Gross income	(6,569,369)	(5,999,216)
Income authorised to be appropriated-in-aid	6,569,369	5,999,216
Operating income payable to the Consolidated Fund	–	–
	–	**–**

9. Pension Contributions receivable

	2005-06	2004-05
	£000s	£000s
Employers		
Normal	(4,301,122)	(3,890,167)
Employees		
Normal	(1,995,282)	(1,818,140)
Special contributions – prefunded premature retirements	(51,609)	(52,470)
Other income – re-chargeable early retirement costs	(64,235)	(65,281)
	(6,412,248)	**(5,826,058)**

10. Pension transfers in (see also note 13)

	2005-06	2004-05
	£000s	£000s
Group transfers in from other schemes	(154,040)	(173,158)
Individual transfers in from other schemes	(3,081)	–
	(157,121)	**(173,158)**

11. Pension Cost

	2005-06	2004-05
	£000s	£000s
Current service cost	7,370,000	5,800,000
	7,370,000	**5,800,000**

12. Enhancements

	2005-06	2004-05 (Restated)
	£000s	£000s
Enhancements	171,270	154,372
	171,270	**154,372**

13. Pension transfers in (see also note 10)

	2005-06	2004-05
	£000s	£000s
Pension transfers in	157,121	173,158
	157,121	**173,158**

14. Prefunded premature retirement contributions (see also note 9)

	2005-06	2004-05 (Restated)
	£000s	£000s
Prefunded premature retirement contributions	51,609	52,470
	51,609	**52,470**

15. Interest on Scheme liabilities

	2005-06	2004-05
	£000s	£000s
Interest charge for the year	8,100,000	6,150,000
	8,100,000	**6,150,000**

16. Other expenditure

	2005-06	2004-05
	£000s	£000s
Premature retirement benefits paid and subsequently recharged to employer	–	65,281
	–	**65,281**

From April 2005, amounts paid to pensioners in respect of any enhancements of pension benefits in respect of compensation for early retirement are classed as a release of pension scheme provisions and form part of the benefits paid reported in Note 23.6.

17. Additional Voluntary Contributions

The NHS Pension Scheme provides for employees to make additional voluntary contributions (AVCs) to increase their pension entitlement or to increase life assurance cover. Employees may arrange to have agreed sums deducted from their salaries, for onward payment direct to the approved provider, or may choose to make their own arrangements by making periodic payments to an insurance company or scheme institution which offers Free Standing Additional Voluntary Contributions Schemes. The NHS employers are responsible for payments made to the Scheme's approved provider. Members participating in this arrangement receive an annual statement from the approved provider made up to 5 April each year confirming the amounts held in their account and the movements in the year.

Members have a choice of funds in which their AVCs can be invested and the aggregate amounts of AVC investments were as follows:

	2005-06	2004-05
	£000s	£000s
The Equitable Life Assurance Society (ELAS)		
Movements in the year were as follows:		
Balance at 6 April	113,441	110,351
New investments	2,764	3,433
Sale of investments to provide pension benefits	(6,675)	(6,437)
Changes in market value of investments	11,954	6,094
	121,484	**113,441**

	2005-06	2004-05
	£000s	£000s
Standard Life Assurance Company		
Movements in the year were as follows:		
Balance at 6 April	72,373	60,405
New investments	6,998	6,631
Sale of investments to provide pension benefits	(1,460)	(1,564)
Changes in market value of investments	18,493	6,901
	96,404	**72,373**

	2005-06	2004-05
	£000s	£000s
Prudential Plc		
Movements in the year were as follows:		
Balance at 1 April	27,836	22,934
New investments	6,729	5,048
Sale of investments to provide pension benefits	(3,800)	(2,446)
Changes in market value of investments	6,579	2,254
*Post Audit Adjustment	–	46
	37,344	**27,836**

* The 2004-05 closing balance has been restated due to a post-audit change to the closing balance previously advised by Prudential.

18a. Debtors – Contributions due in respect of pensions

Employers are responsible for the payment to the Pension Scheme of both Employer and Employee contributions. Contributions should be paid over by the Employer by the 19th of the month, for contributions relating to the previous month.

Employers are also responsible for the payment of special contributions, either as a lump sum or in five annual instalments, to the NHS Pension Scheme where employees receive enhanced pension benefits upon retirement. Where lump sums or annual instalments have been invoiced but not yet paid, these are disclosed below. Where such amounts due have yet to be invoiced, these are disclosed separately in the table below.

Employees may also pay for the costs of enhanced early retirement benefits by quarterly recharge. Such contributions to the scheme are classified as other income. Where such charges have been invoiced but remain unpaid as at the year end, these are disclosed below.

Amounts due within One Year	**2005-06**	**2004-05 (Restated)**
	£000s	£000s
Employer Contributions	336,224	344,117
Employee Contributions	154,278	152,944
Invoiced prefunded premature retirement contributions	6,120	3,807
Invoiced re-chargeable premature retirement contributions	17,578	20,300
	514,200	**521,168**
Un-invoiced future instalments due from NHS employers	11,148	15,555
Total	**525,348**	**536,723**

Included within these figures is £409,809,002.01 (2004-05: £480,174,223.99) that will be due to the Consolidated Fund once the debts are collected.

18b. Intra-Government Balances

	Amounts falling due within one year 2005-06	**Amounts falling due within one year 2004-05**	**Amounts falling due after more than one year 2005-06**	**Amounts falling due after more than one year 2004-05**
Balances with other central government bodies	171,686	158,034	–	–
Balances with local authorities	–	–	–	–
Balances with NHS Trusts	317,542	313,852	–	–
Balances with public corporations and trading funds	–	–	–	–
Balances with bodies external to government	24,972	49,282	–	–
At 31 March	**514,200**	**521,168**	**–**	**–**

19. Prepayments – Prepaid pension benefits

	2005-06	**2004-05**
	£000s	£000s
Prepaid pension benefits	56,190	–
Total	**56,190**	**–**

20. Estimated discounted future cash flows in respect of early retirement recharges

Where the employer chooses to pay quarterly recharges, income is recognised as invoices are raised.

Amounts receivable in respect of the compensatory element of a premature retirement, where the employer pays for the case on an ongoing basis, are classified as "Other Income" to the pension scheme and are appropriated-in-aid.

In recognition of the fact that significant future cashflows will arise from these arrangements, the estimated future cashflows which may accrue to the Scheme after the balance sheet date, discounted to current values, are disclosed on the balance sheet.

This represents a change in accounting policy from prior years where these amounts were disclosed as known debtors. The change follows discussions with HM Treasury as to the most appropriate treatment of these items.

In accordance with the requirements of FRS18, the prior year has been restated to reflect these changes.

	2005-06	2004-05 (Restated)
	£000s	£000s
Balance c/f 1 April	744,307	751,462
Revaluation of estimated discounted future cash flows in respect of rechargeable premature retirements	85,729	(7,155)
Balance at 31 March	**830,036**	**744,307**

21. Cash at bank and in hand

	2005-06	2004-05
	£000s	£000s
Balance at 1 April	490,212	328,598
Net change in cash balances	508,954	161,614
Balance at 31 March	**999,166**	**490,212**
The following balances at 31 March were held at:		
Office of HM Paymaster General	994,899	488,888
Commercial banks and cash in hand	4,267	1,324
Balance at 31 March	**999,166**	**490,212**

22. Creditors – in respect of pensions

22a. Analysis by type

	2005-06	2004-05
	£000s	£000s
Amounts falling due within one year		
Pensions	(120,854)	(7,196)
HM Revenue & Customs	(38,358)	(31,820)
Voluntary deductions	(207)	(139)
Amounts due to Employers:		
Initial Widows Claims	(178)	–
Prefunded premature retirements	(611)	(1,171)
Rechargeable premature retirements	(373)	(668)
	(160,581)	(40,994)
Consolidated Fund extra receipts due to be paid to the Consolidated Fund:		
Received	(999,166)	(490,212)
Receivable	(409,809)	(480,174)
	(1,408,975)	(970,386)
	(1,569,556)	**(1,011,380)**

The methodology by which pensions creditors are estimated has been changed for 2005-06. This has resulted in an increase to the pension creditor over that disclosed in previous years. The method used in 2004-05 was to capture the amounts paid in April in the following financial year where the pension due date related to the previous financial year.

Pension payments are made throughout the month and there is no fixed date used for all payments, such as the last day of the month. The new method introduced calculates the value that relates to the previous financial year for all payments made on each day of the month.

As the amounts are not material in the context of the balance sheet, the 2004-05 comparator has not been restated here. However the retrospective difference at 31 March 2005 using the new method was calculated to be £119,550 and this adjustment is shown in notes 23.5 and 29.

22b. Intra-Government Balances

	Amounts falling due within one year 2005-06	Amounts falling due within one year 2004-05	Amounts falling due after more than one year 2005-06	Amounts falling due after more than one year 2004-05
Balances with other central government bodies	(1,448,026)	(1,003,324)	–	–
Balances with local authorities	–	–	–	–
Balances with NHS Trusts	(469)	(344)	–	–
Balances with public corporations and trading funds	–	–	–	–
Balances with bodies external to government	(121,061)	(7,712)	–	–
At 31 March	**(1,569,556)**	**(1,011,380)**	**–**	**–**

23. Provisions for pension liabilities

23.1 The NHS Pension Scheme is an unfunded defined benefit scheme. An actuarial valuation was carried out as at 31 March 2004. The major assumptions used by the Actuary were:

	At **31 March 2006** % per annum	At **31 March 2005** % per annum
Rate of notional investment return in excess of prices	2.8%	3.5%
Rate of notional investment return in excess of salaries	1.3%	2.0%

For the year ending 31 March 2006, the price inflation used was 2.5%, in line with HM Treasury's long-term future inflation assumption.

23.2 The scheme managers are responsible for providing the Actuary with the information the Actuary needs to carry out the valuation. The information includes, but is not limited to, details of:

- Scheme membership, including age and gender profile, active membership, deferred pensions and pensioners;
- Benefit structure, including details of any discretionary benefits and any proposals to amend the scheme;
- Income and expenditure, including details of expected bulk transfers into or out of the scheme; and
- Following consultation with the Actuary, the key assumptions that should be used to value the scheme liabilities, ensuring that the assumptions are mutually compatible and reflect a best estimate of future experience.

The information provided to the Actuary to enable them to conduct their valuation is based upon an extract of the scheme membership database. The extract of data provided was based upon 75% of all members data. Uprating factors have therefore been used to extrapolate to 100%. The use of uprating factors per se does not introduce additional material uncertainty to the valuation result, provided that the rating up factors for each group are valid and the membership profile of the membership that is excluded from the data extract is similar to the profile of membership that the Actuary receives. The Agency has no reason to believe that the data for members excluded from the valuation exercise is not similar in terms of age/sex/salary/past service distribution than for those included. However, this has not been validated.

23.3 Pension scheme liabilities accrue over employees' periods of service and are discharged over the period of retirement and, where applicable, the period for which a spouse or eligible partner survives the pensioner. In valuing the scheme liability, the Actuary must estimate the impact of several inherently uncertain variables far into the future. These variables include not only the key financial assumptions noted in the table above, but also assumptions about the changes that will occur in the future in the mortality rate, the age of retirement and the age from which a pension becomes payable.

23.4 The value of the liability included on the balance sheet may be significantly affected by even small changes in assumptions. For example, if at a subsequent valuation, it is considered appropriate to reduce the assumed rate of inflation, or the assumed rate of increase in salaries, then the value of the pension scheme liability will decrease (other things being equal). Conversely, if the assumed rates are increased, the value of the liability will increase. The managers of the scheme accept that, as a consequence, the valuation provided by the Actuary is inherently uncertain. The increase or decrease in future liability charged or credited for the year resulting from changes in assumptions is disclosed in notes 23.1 and 23.5. The note also discloses 'experience' gains or losses for the year, showing the amount charged or credited for the year because events have not coincided with assumptions made for the last valuation.

23.5 Analysis of movement in scheme liability

	Note	2005-06 £000s	2004-05 (Restated) £000s
Scheme liability at 1 April		(131,344,307)	(104,260,000)
Change due to overnight change in discount rate		(18,300,000)	–
Revised Scheme Liability		(149,644,307)	(104,260,000)
Current service cost	11	(7,370,000)	(5,800,000)
Enhancements	12	(171,270)	(154,372)
Transfers in	13	(157,121)	(173,158)
Prefunded premature retirements	14	(51,609)	(52,470)
Interest on pension scheme liability	15	(8,100,000)	(6,150,000)
Benefits payable	23.6	3,777,414	3,412,532
Pension payments to and on account of leavers	23.7	165,658	176,300
Adjustment relating to prior year pension payments	22a	119,550	–
Actuarial gain/(loss)	23.8	(3,968,315)	(17,598,832)
Assimilation of quarterly rechargeable early retirement cost liability	24	–	(744,307)
Scheme liability at 31 March		**(165,400,000)**	**(131,344,307)**

Within the closing Scheme liability it is estimated by the GAD that there is £2 billion that relates to employer funded enhanced premature retirement costs, which equates to 1.1% of the total Scheme liability.

During the year ended March 2006, contributions represented an average of 19.95% percent of pensionable pay.

23.6 Analysis of benefits paid

	2005-06 £000s	2004-05 £000s
Pensions or annuities to retired employees and dependants (net of recoveries or overpayments)	3,251,685	2,951,822
Commutations and lump sum benefits on retirement	525,729	460,710
Per cash flow statement	**3,777,414**	**3,412,532**

The prior year comparative has been restated to include death gratuities of £46,025 million which was previously disclosed within the analysis of movement in Scheme liability.

23.7 Analysis of payments to and on account of leavers

	2005-06 £000s	2004-05 £000s
Refunds to members leaving service	16,848	17,684
Group transfers to other schemes	5,441	906
Payment to State Scheme	6,302	8,165
Individual transfers to other schemes	137,067	149,545
Per cash flow statement	**165,658**	**176,300**

23.8 Analysis of actuarial losses

	2005-06	2004-05 (Restated)
	£000s	£000s
Experience losses arising on the scheme liabilities	–	(13,598,832)
Changes in assumptions underlying the present value of scheme liabilities	(3,968,315)	(4,000,000)
Per Statement of Recognised Gains and Losses	**(3,968,315)**	**(17,598,832)**

Scheme liabilities are calculated by reference to assumptions, which are set with regard to the actual experience of the scheme, taking account of known future changes. Actual scheme experience will usually be different; for example, rates of staff turnover, mortality and salary progression are unlikely to be exactly as assumed. The actuarial gain/loss shows the financial impact of actual experience being different to that assumed.

Included within the figure for 2004-05 is an adjustment of £2.7 billion relating to General Medical Practitioners Terminated Officer service omitted from the liabilities statement in 2004-05.

23.9 History of Experience losses

	2005-06	2004-05 (Restated)	2003-04
	£000s	£000s	£000s
Experience and losses on the scheme liabilities:			
Amount	–	13,598,832	1,445,137
Percentage of the present value of the scheme liabilities	–	10.4%	1.4%
Total amount recognised in Statement of Recognised Gains and Losses:			
Amount	3,968,315	17,598,832	1,445,137
Percentage of the present value of the scheme liabilities	2.4%	13.4%	1.4%

24. Analysis of movement in rechargeable premature retirement provision

	2004-05 (Restated)
	£000s
Balance at 1 April	(751,462)
Amounts invoiced to employer in year	(65,281)
Benefits paid	65,281
Revaluation of provision (see note 28)	7,155
Provision assimilated into Scheme liability (see note 23.5)	744,307
Balance at 31 March	**0**

In accordance with the change in accounting policy with regard to quarterly rechargeable early retirement liabilities set down at Note 3.3.6, these liabilities have been consolidated within the main pension scheme liability with effect from 1 April 2005.

For consistency the prior year pension scheme liability figure has also been restated to include these liabilities (note 23.5 refers).

25. General Fund

	2005-06	2004-05 (Restated)
	£000s	£000s
Balance at 1 April	(127,900,000)	(104,659,148)
Prior year adjustment	(2,700,000)	–
Restated Balance at 1 April	(130,600,000)	(104,659,148)
Net Parliamentary Funding	–	–
Overnight Increase in Scheme liabilities	(18,300,000)	–
Net Transfer from Operating Activities		
Combined Net Outgoings	(9,280,631)	(6,396,065)
CFERS repayable to the Consolidated Fund	(1,408,747)	(970,102)
Adjustment from prefunded premature retirement provision included within the SRGL	–	417,112
Adjustment for prefunded premature retirement long term debtor	–	(17,965)
Revaluation cost of estimated discounted future cash flows in respect of early retirement recharges	85,729	–
Payment to the Consolidated Fund	(1,098,000)	(1,375,000)
Actuarial gains and losses (SRGL)	(3,968,315)	(17,598,832)
Balance at 31 March	**(164,569,964)**	**(130,600,000)**

The actuarial loss in 2004-05 has been re-stated to include the £2.7 billion loss arising from the previous omission of hospital element of General Medical Practitioner service. Refer to the Report of the Manager for further details.

26. Notes to the Cash Flow Statement

26a. Reconciliation of net outgoings to operating cash flows

	Note	2005-06 £000s	2004-05 £000s
Net outgoings for the year		(9,280,631)	(6,396,065)
Adjustments for non-cash transactions:			
Movement in working capital other than cash	28	(49,185)	(241,402)
Increase in pension provision	27	15,850,000	12,330,000
Use of provisions – pension liability	23.6	(3,777,414)	(3,412,532)
Use of provisions – refunds and transfers	23.7	(165,658)	(176,300)
Net cash inflow from operating activities		**2,577,112**	**2,103,701**

26b. Reconciliation of Net Cash Requirement to increase in cash

	2005-06 £000s	2004-05 £000s
Net cash requirement	–	–
From the Consolidated Fund (Supply) – current year	–	–
Due to the Consolidated Fund (non-Supply) – received in a prior year and paid over	(490,212)	(328,598)
Amounts due to the Consolidated fund received and not paid	999,166	490,212
Increase/(decrease) in cash	**508,954**	**161,614**

27. Non-cash items

	Note	2005-06 £000s	2004-05 (Restated) £000s
Increase in pension provision:			
Current service cost	11	7,370,000	5,800,000
Enhancements	12	171,270	154,372
Transfers	13	157,121	173,158
Prefunded premature retirements	14	51,609	52,470
Interest on pension scheme liability	15	8,100,000	6,150,000
		15,850,000	**12,330,000**

28. Movements in working capital, other than cash

	2005-06 £000s	2004-05 (Restated) £000s
Movement in debtors – Pension contributions	6,968	(178,230)
Movement in creditors – falling due within 12 months – Pensions	119,587	(38,052)
Adjustment for prefunded premature retirement debtor	–	(17,965)
Adjustment for movement in premature retirement provision	–	(7,155)
Adjustment for change in pension creditor estimation methodology	(119,550)	–
Movement in prepaid pension benefits	(56,190)	–
	(49,185)	**(241,402)**

29. Payments to the Consolidated Fund

	Note	2005-06 £000s	2004-05 £000s
Payments of amounts due to the:			
Consolidated fund – Realisation of prior years net debtors and creditors		480,174	238,773
Consolidated Fund – Surplus cash relating to current year		1,098,000	1,375,000
Surplus cash surrendered to the:			
Consolidated Fund relating to the prior year		370,662	–
Adjustment relating to change in methodology of the estimated pension creditor	22a	119,550	–
		2,068,386	**1,613,773**
Payments of amounts due to the Consolidated Fund for the prior year (Excess AinA)		–	315,981
Amounts not classified to be appropriated in aid, due to the Consolidated Fund		228	382
Surplus cash to be surrendered to the Consolidated Fund relating to the prior year		–	12,235
		2,068,614	**1,942,371**

30. Contingent liabilities disclosed under FRS 12

The NHS Pension Scheme guarantees to meet the pension payments in the event of a default by one or more of the NHS Pension Scheme's approved Additional Voluntary Contributions (AVC) providers. Therefore there is a maximum contingent liability of the full balance of the AVC investments as at 31 March 2006, which are disclosed at note 17. The scheme does not however guarantee pension payments from the other free-standing AVC providers.

The contingent liabilities noted in previous years in respect of the outcome of the Preston and Others Vs Wolverhampton Healthcare NHS Trust employment tribunal, and in respect of part-time NHS employees denied access to the pension scheme, are now estimated by the scheme actuary to be around £15 million.

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31. Losses

During the year, losses arose in 5,153 cases (2004-05: 4,259 cases). The total loss was £445,302 (2004-05: £352,311). These figures include write-offs in respect of the cases highlighted in the review of the year, and all relate to claims abandoned.

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32. Financial Instruments

FRS13 *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 non-trading nature of its activities and the way in which government departments are financed, the NHS Pension Scheme is not exposed to the degree of financial risk faced by business entities. Moreover, financial instruments play a more limited role in creating or changing risk than would be typical of the listed companies to which FRS13 mainly applies.

32.1 Liquidity risk

Resources voted by Parliament finance the NHS Pension Scheme's net revenue resource requirements. The NHS Pension Scheme is not therefore exposed to significant liquidity risks.

32.2 Interest rate risk

All of the NHS Pension Scheme's financial assets and liabilities carry nil or fixed rates of interest. The Scheme is not therefore exposed to an interest rate risk.

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33 Related Party Transactions

The National Health Service Pension Scheme and the National Health Service (Compensation for Premature Retirement) Scheme fall within the ambit of the Department of Health, which is regarded as a related party. During the year, the Schemes have had material transactions with NHS employers, and other government departments, whose employees are members of the Schemes. None of the Managers of the Schemes, key managerial staff or other related parties have undertaken any material transactions with the Schemes during the year.

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