
Armed Forces Pension Scheme

(Incorporating the Armed Forces Compensation Scheme)

Annual Accounts 2015-16

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Annual Accounts

2015-16

(For the year ended 31 March 2016)

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Report of the Managers

This report provides a summary of the arrangements to ensure the Armed Forces Pension Scheme (AFPS) affairs are managed effectively and gives a broad outline of the major benefits offered by the individual Schemes.

1. Background to the Schemes

1.1 The Armed Forces Pension Scheme 2015 (AFPS 15)

From 1 April 2015 the AFPS 15 was introduced for all new members of the Armed Forces. All serving Service personnel who were members of an AFPS were automatically transferred to the AFPS 15, unless they qualified for Transitional Protection. The AFPS 15 is an unfunded, defined benefit, salary-related, occupational pension scheme.

The government offered Transitional Protection for those who were within 10 years of their respective Scheme's Normal Pension Age (NPA) on 1 April 2012. AFPS 75, AFPS 05 and FTRS 97 Full Commitment (FC) have a NPA of 55. Reserve Forces Pension Scheme (RFPS), Full Time Reserve Services (FTRS) 97 on Limited or Home Commitment (LC or HC) and Non-Regular Permanent Staff (NRPS) have a NPA of 60. This means members of AFPS 75, AFPS 05 or FTRS 97 FC who were aged 45 or over on 1 April 2012, stayed on their current pension scheme and their benefits were unaffected. Members of the RFPS (including those on Additional Duties Commitment), FTRS 97 on LC or HC or NRPS who were aged 50 or over on 1 April 2012, remained in their current pension scheme and their benefits were unaffected.

Transitional Protection was a government decision for all public service schemes, for those personnel who were nearest to their NPA and who, therefore, had less time to adjust their financial plans in response to the changes to their pension scheme. 12,345 members benefited from Transitional Protection.

The Scheme rules are set out in the Armed Forces Pension Regulations Statutory Instrument Order 2014, the Armed Forces Early Departure Payments (EDP) Scheme Regulations Statutory Instrument 2014 and the Armed Forces (Transitional Provisions) Pensions Regulations Statutory Instrument 2015.

Key features of the Scheme include:

- The EDP will normally be paid as a monthly income and one-off lump sum. However, members also have the choice to forego the lump sum and convert it into additional monthly income. This additional option is not available in the other Armed Forces Pension Schemes.
- A NPA of 60 and a Deferred Pension Age linked to the State Pension Age.
- The option to convert pension income into a tax-free lump sum at a transfer rate of £12 lump sum for £1 per annum pension income (up to HM Revenue and Customs limits).
- All serving members of the part-time Volunteer Reserve will be automatically enrolled in the new Scheme and for the first time will be entitled to be pensioned for attendance based paid service as well as for mobilised service.

Further details of the Scheme can be found at:

<https://www.gov.uk/government/publications/armed-forces-and-reserve-forces-pension-schemes-guidance-booklets>

1.2 The Armed Forces Pension Scheme 2005 (AFPS 05)

The Armed Forces (Pension & Compensation) Act 2004 is the primary legislation covering the AFPS 05 and the Early Departure Payment (EDP) Scheme 2005. From 6 April 2005 until 31 March 2015, the AFPS 05 was the primary scheme for all new members of the Armed Forces. The AFPS 05 is an unfunded, defined benefit, salary-related, occupational pension scheme. The Scheme is designed to meet the special requirements of Service life. Pensions are paid immediately if an individual serves to

age 55. Those who have at least two years' service who leave before age 55 will have their pensions preserved until age 65. The Scheme also includes an EDP for those who leave before age 55 providing they have at least 18 years' service and are at least 40 years of age. The EDP Scheme pays a tax-free lump sum and income of between 50% and 75% of preserved pension between the date of the individual's departure from the Armed Forces and age 55. The income rises to 75% of preserved pension at age 55 and is index linked. At age 65 the EDP stops and the preserved pension and preserved pension lump sum are paid. Pensions may be payable to the spouse, civil partner, partner or to eligible children. Death-in-service lump sums are payable to nominated recipients or eligible dependants.

From 1 April 2015 all active members were transferred to AFPS 15, unless they qualified for Transitional Protection. Those members transferring to the AFPS 15 had their AFPS 05 accrued pensions protected.

1.3 The Armed Forces Compensation Scheme (AFCS)

The Armed Forces (Pension & Compensation) Act 2004 is the primary legislation covering the AFCS. The AFCS was introduced on 6 April 2005, replacing two separate compensation arrangements under the Armed Forces Pension Scheme 1975 and the War Pension Scheme. The AFCS covers injury, illness and death that are caused by service on or after 6 April 2005. The AFCS is a tariff-based compensation scheme, which has been designed to be simple to understand and to produce consistent and equitable decisions, using an evidence-based approach.

1.4 The Armed Forces Pension Scheme 1975 (AFPS 75)

The AFPS 75 was the primary Scheme for Armed Forces personnel prior to 6 April 2005. The Scheme rules are set out in "Prerogative Instruments" that derive their authority from Her Majesty The Queen and are not subject to approval, annulment or amendment by Parliament. The current prerogative instruments are the Naval and Marine (AFPS 75 and Attributable Benefits Scheme) Order 2010, the Army Pensions (AFPS 75 and Attributable Benefits Scheme) Warrant 2010 and the Air Force (AFPS 75 and Attributable Benefits Scheme) Order 2010. The AFPS 75 regulations are set out in Schedule 1 to the prerogative instruments.

The AFPS 75 is an unfunded, defined benefit, salary-related, occupational pension scheme. It provides immediate pension benefits to many of those who leave without completing a full career but who have completed at least 16 years' reckonable service for Officers and 22 years' reckonable service for Other Ranks. The full career pension can be earned relatively early, at age 55, and invaliding and death benefits are available in the event of illness, injury or death at different rates depending upon whether or not these are caused by service. From 6 April 2005, unless already in payment at that date, these benefits are not provided for service related illness, injury or death but are provided by the Armed Forces Attributable Benefits (AFAB) Scheme where the cause is service prior to that date and the AFCS where the cause is service after that date. For those who leave without entitlement to immediate pension but who have completed at least two years' reckonable service a preserved pension is payable at the age of 60 for service before 6 April 2006 and age 65 for service from that date.

The AFPS 75 was closed to new members from 6 April 2005. Members of the AFPS 75 were given the opportunity to transfer to the AFPS 05 from this date.

From 1 April 2015 all active members were transferred to AFPS 15, unless they qualified for Transitional Protection. Those members transferring to the AFPS 15 had their AFPS 75 accrued pensions protected.

1.5 The Armed Forces Attributable Benefits Scheme

The current Scheme Rules are set out in Schedule 2 to the following prerogative instruments; the Naval and Marine (AFPS 75 and Attributable Benefits Scheme) Order 2010, the Army Pensions (AFPS 75 and Attributable Benefits Scheme) Warrant 2010 and the Air Force (AFPS 75 and Attributable Benefits Scheme) Order 2010.

The Scheme provides invaliding benefits to those discharged from the Services on medical grounds in respect of injuries caused by service on or before 5 April 2005, who have been awarded a benefit under

the War Pensions Scheme and whose degree of disablement due to the disabling condition is 20% or more.

1.6 Reserve Forces Pension Schemes

There are two non-contributory Reserve Forces occupational Pension Schemes for members of the Reserve Armed Forces: Full Time Reserve Services Pension Scheme (FTRSPS 97) and the Reserve Forces Pension Scheme (RFPS 05).

FTRSPS 97 is the Scheme applicable to those who gave Full Time Reserve Service as a member of the Reserve Forces before 6 April 2005. It was closed to new entrants and those starting new commitments from 6 April 2005.

From 1 April 2015 all active members were transferred to AFPS 15, unless they qualified for Transitional Protection. Those members transferring to the AFPS 15 had their FTRSPS 97 accrued pensions protected.

RFPS 05 is the Scheme applicable to those starting or renewing a Full Time Reserve Service (FTRS) commitment, including those on Additional Duties Commitment terms on or after 6 April 2005. Personnel mobilised under parts 4, 5 or 6 of the Reserve Forces Act 1996, (or corresponding provisions of the Reserve Forces Act 1980) from that date may choose to become members of RFPS 05. Members of FTRSPS 97 were given an opportunity to transfer to RFPS 05 from this date.

From 1 April 2015 all active members were transferred to AFPS 15, unless they qualified for Transitional Protection. Those members transferring to the AFPS 15 had their RFPS 05 accrued pensions protected.

1.7 Non Regular Permanent Staff Pension Scheme (NRPSPS)

The NRPSPS, which covers non regular personnel in support of the Territorial Army, is a non-contributory pension scheme available to all members of the Non Regular Permanent Staff. The NRPSPS closed to new entrants effective 31 August 2011 with any new appointments being FTRS appointments covered under the RFPS 05.

From 1 April 2015 all active members were transferred to AFPS 15, unless they qualified for Transitional Protection. Those members transferring to the AFPS 15 had their NRPSPS accrued pensions protected.

1.8 Gurkha Pension Scheme (GPS)

The GPS was established by Royal Warrant in 1949. It provides pensions for former members of the Brigade of Gurkhas, who have completed 15 years or more service, at rates based on those of the Indian Army.

In March 2007, the Government announced the outcome of a Review of Gurkha Terms and Conditions of Service. It was announced that serving Gurkhas, and those who left service on or after 1 July 1997, would be given the right to transfer to one of the two Armed Forces Pension Schemes for members of the Regular Armed Forces, from October 2007.

From 1 April 2015 all new members of the Brigade of Gurkhas will join the AFPS 15.

1.9 Minor Pension Schemes

In addition to the above Schemes, the AFPS also manages a number of Minor Pension Schemes covering Locally Employed Military Personnel in places such as Malta, Gibraltar, Singapore, Hong Kong, Seychelles, Sri Lanka, India/Pakistan (Hong Kong Singapore Royal Artillery).

With the exception of Gibraltar, these schemes are now closed to new members.

2. Management of the Schemes

The AFPS and AFCS are managed and operated by Defence Business Services (DBS), a business unit within the Ministry of Defence (MOD). The costs of administering the Schemes are borne by the MOD and are reflected in the Department's Annual Report and Accounts. This includes Comptroller and Auditor General's notional audit fee of £150k.

The MOD has a contract with Serco Ltd to provide management services to DBS. The Chief Executive Officer (CEO) and a number of the Executive appointments are made through Serco Ltd.

The CEO of DBS has been designated by the Departmental Accounting Officer (Stephen Lovegrove) to be the Scheme Administrator for both the AFPS and AFCS. The DBS Head of Resources has been designated by the Director General Finance to be the Senior Finance Officer for both the AFPS and AFCS. In administering the AFPS and AFCS on behalf of the MOD, DBS aims to ensure that all pension and compensation payments due to entitled pensioners and members of the Armed Forces are made in a timely and accurate manner.

The DBS Executive Committee meets regularly and is responsible for managing DBS within agreed financial limits. It has primary authority for day to day management of DBS. The Executive Committee consists of:

2.1 DBS Executive Committee (EC)

EC Members Composition - Serco

Rod McCurdy	Chief Executive Officer (CEO)
Simon Freeman	Chief Operating Officer (COO)
Vince Groome	Chief Information Officer (CIO)
Helen Hall	Chief People Officer (CPO)
Andy Tyler-Smith	Operations Director
Andrew Thompson (until 29/01/2016)	Service Development Director
Geoff Nield	Head of People Services
Nicola Smith	Transformation Director

EC Members Composition – MOD Personnel

Georgina Benzies	Head of Resources
Jon Parkin	Head of Veterans UK
Andy Dowds	Head of Finance
Commodore Ian Bisson	Head of Military Personnel
Andrew Stafford	Head of Civilian Personnel
Caroline Rumming	Head of National Security Vetting

On 19 April 2016 the management partner contract with Serco Ltd ceased. The CEO, COO, CIO, CPO and Transformation Director positions were retained and moved under MOD management. Responsibility for administration of the Schemes remains delegated to the CEO and the role of SFO to Head of Resources. The governance arrangements of the Schemes have remained the same as prior to 19 April 2016, as have the administration arrangements, with mainly the same personnel in place below Board level.

2.2 Corporate governance of the Schemes

The governance arrangements of the DBS, who are responsible for the administration of the Schemes, can be found in the Governance Statement on pages 19 to 26.

2.3 Arrangements governing determination of contribution rates and benefits

The last actuarial valuation undertaken of the AFPS was as at 31 March 2012 published in February 2015. The primary purpose of the 2012 actuarial valuation was to set the employer contribution rate payable from April 2015, in light of the introduction of the new pension arrangements from 1 April 2015, and the initial employer cost cap (maximum employer cost) which is required by the Public Service

Pensions Act 2013. Both the employer contribution rate and employer cost cap have been included in Scheme Regulations.

The next actuarial valuation will be carried out using data extracted as at 31 March 2016. This will set the employer contribution rate payable from April 2019 and will consider the cost of the Scheme relative to the employer cost cap. There are provisions in the Public Service Pension Act 2013 to adjust member benefits or contribution rates if the cost of the Scheme changes by more than 2% of pay. Subject to this 'employer cost cap' assessment, any required revisions to member benefits or contribution rates will be determined by the Secretary of State for Defence after consultation with the relevant stakeholders.

3. Key Developments In Year

3.1 Pension Increase Rate

The Pensions increase rate was 1.2% (2.7% in 2014-15) with effect from 6 April 2015 (7 April 2014).

3.2 Changes to Scheme Contribution Rates

The AFPS 15 was introduced from 1 April 2015. Like its predecessor schemes, the AFPS 75 and AFPS 05, membership is offered to serving military personnel on a non-contributory basis.

The schemes are financed through the payment of employer contributions made in respect of serving members of the scheme. Employer contributions are set as a percentage of Pensionable Pay, and different rates apply for Officers and Other Ranks. The contribution rates were last reviewed as part of the actuarial valuation as at 31 March 2012, which set the applicable rates for the period 1 April 2015 to 31 March 2019. As a consequence, the contribution rate for Officers increased to 52.4% in 2015-16, from 41.6% in 2014-15, and the rate for Other Ranks increased to 49.6% in 2015-16, from 28.2% in 2014-15. The increases to these rates have resulted in over £1bn of additional employer contributions being received during 2015-16.

Additional employer contributions are also payable in respect of the AFCS. The rates applicable during 2015-16 were 1.0% of Pensionable Pay for Officers and 2.4% of Pensionable Pay for Other Ranks. These rates are unchanged from those payable during 2014-15.

3.3 Changes in benefits

There have been no changes to benefits during 2015-16.

3.4 Changes in Accounting Standards

There are no changes in International Accounting Standards that have an impact on the AFPS or the AFCS.

3.5 Membership Data Quality

In response to recommendations made by the National Audit Office and the identification of some serious weaknesses by the Defence Internal Audit, an AFPS Membership Data Improvement Project has been established to focus on the quality, accuracy and reliability of underlying membership data. A programme of improvement work will span a number of years. Improvements made in 2015-16 include establishing clear lines of responsibility and accountability, internal 'sanity checks' of member lists used for the actuarial valuation of the Scheme and the alignment of membership reports which has resulted in an adjustment to the Deferred membership statistics, see membership table on pages 7 and 8.

3.6 Membership Statistics (movement in year)

The HM Treasury standard format for membership disclosure has been expanded due to the complexity of the AFPS. The membership data below has moved away from an 'individual' being synonymous with a 'member'. To reflect this, and to be able to show the movements within each category, the membership table shows 'Benefits' instead of 'Members'.

Individual members may be a member of more than one Scheme. A member may be entitled to more than one benefit under a Scheme.

Where a member is divorced and the ex-spouse is entitled to a proportion of the benefit, the deferred figures show both benefits when notified to AFPS post March 2006. Benefits in payment show both benefits.

Where a member has not claimed benefits by the age of 72, the member is out of time to claim. This is an assumption for membership reporting purposes only.

The databases used to manage Active and Deferred Members are dynamic systems that allow records to be updated retrospectively. It is therefore accepted that the opening balances in the membership table will not match to the previous year's closing balances.

The Government Actuary's Department (GAD) valuation includes a number of members with estimated benefits. This is due to one or more of the elements required to determine the benefit being missing from the database. This will be reviewed as part of the AFPS Membership Data Improvement Project.

The Minor Pension Schemes' membership data as at 31 March 2016, equating to 216 active members, 44 deferred members and 1,916 benefits in payment are excluded from the membership table.

There are three groups, defined as follows:

- Active members' benefits: benefits for personnel who are in service which is reckonable for pension purposes.
- Deferred and unclaimed benefits: benefits due at some future date or that have not been claimed that are attributable to former active members or their divorced spouses/civil partners.
- Benefits in payment: payments to former active members or divorced spouses/civil partners plus other beneficiaries such as widow(er)s, survivors and other dependants of former active members.

Active members' benefits

	Active members brought forward from 31 March 2015	165,598
	Adjustment (see Membership Statistics note 1)	186,110
	Total active members' benefits at 1 April 2015	351,708
<i>Add:</i>	New entrants in year	18,402
	Transfers in	37
<i>Less:</i>	Death in service benefits	(140)
	Left active service with under two years service and no benefits	(3,586)
	Left active service with deferred benefits	(20,339)
	Left active service and received benefits	(4,984)
	Total active members' benefits at 31 March 2016	341,098
	Active Full Time members at 31 March 2016	164,651
	Active Voluntary Reservist members at 31 March 2016	31,820

Deferred and unclaimed benefits

	Deferred and unclaimed benefits brought forward from 31 March 2015	468,020
	Adjustments (see Membership Statistics note 2)	(5,310)
	Total deferred and unclaimed benefits at 1 April 2015	462,710
<i>Add:</i>	Benefits not immediately payable	20,673
	New benefit on divorce	389
<i>Less:</i>	Benefits transferred out	(805)
	Benefits taken up	(4,884)
	Benefits elapsed	(1,894)
	Death in deferment benefits (see Membership Statistics note 3)	(10,794)
		465,395
	Being:	
	Deferred benefits	448,508
	Benefits due but unclaimed	16,887
	Total deferred and unclaimed benefits at 31 March 2016	465,395
	Deferred and unclaimed members at 31 March 2016	415,019
	Deferred and unclaimed Voluntary Reservist members at 31 March 2016	588

Benefits in payment

	Benefits brought forward from 31 March 2015	
	- Members	349,827
	- Dependants	73,136
	Total	422,963
	Adjustments (see Membership Statistics note 4)	
	- Members	(1,909)
	- Dependants	(272)
	Total benefits at 1 April 2015	420,782
<i>Add:</i>	Benefits that became payable in the year	
	- Members	10,944
	- Dependants	3,972
<i>Less:</i>	Benefits that have ceased in the year	
	- Members	(6,512)
	- Dependants	(3,646)
	Total benefits in payment at 31 March 2016	425,540

Membership Statistics Notes

- Following the introduction of the AFPS 15 on 1 April 2015, the Active membership disclosure has changed from members (165,598) to benefits (351,708). This is due to Active members now having multiple benefits, a legacy scheme benefit and an AFPS 15 benefit. The adjustment of 186,110 includes 27,363 Volunteer Reservists who are now captured as AFPS 15 members.
- Following recommendations made by the National Audit Office improvements have been made to the summary membership report. The reporting parameters are now aligned with the detailed membership lists provided to GAD for valuation purposes. These improvements have resulted in a net reduction of 5,310 deferred benefits, which have been treated as an experience gain in the actuarial valuation of the scheme.
- Deaths in Deferment include 10,456 deaths that were identified by a mortality screening, using the National Fraud Initiative dataset. These matches have now been recorded on the AFPS membership database, reducing the number of deferred records.
- The Pensioner count has been reduced by 2,181 for the Non Regular Permanent Staff (NRPS) Pension Scheme. NRPS pensions have been double counted in previous years as they were already included as members of the AFPS 75. This adjustment has been treated as an experience gain in the actuarial valuation of the scheme.

3.7 Financial position as at 31 March 2016

As at 31 March 2016 the pension liability of the AFPS was valued at £145.2 billion (£154.4 billion as at 31 March 2015). The total change in liability represents a net decrease of £9.2 billion, which includes an actuarial gain of £13.6 billion. The £13.6 billion consists of:

- £7.8 billion due to changes in financial assumptions;
- £2.2 billion due to changes in mortality assumptions;
- £0 billion due to changes in demographic assumptions (other than mortality);
- £3.6 billion due to experience items arising on pension liabilities.

The £7.8 billion change in financial assumptions represents the increase in the discount rate (net of pension increases) to 1.37% from 1.3% (2015: a net decrease from 1.8% to 1.3%) and the additional four years of short term pay restraint of 1% per annum.

An experience gain/loss reflects the extent to which events over the reporting period have not coincided with the actuarial assumptions made for the assessment.

A full reconciliation of the change in liability over the year is provided in note 11.4 to the accounts.

3.8 Results for the year

The 2015-16 net resource outturn was £5.92 billion which was within the voted estimate of £5.97 billion. Details can be found in the Statement of Parliamentary Supply on page 27.

In cash terms, the Scheme recorded a Net Cash Requirement (NCR) of £1.57 billion against the voted estimate of £1.64 billion, resulting in surplus cash of £65 million which will be returned to the Treasury during 2016-17.

3.9 National Fraud Initiative

On a biennial basis the AFPS takes part in the National Fraud Initiative (NFI), which commenced in 1998 and is co-ordinated by the Cabinet Office. This initiative allows the Scheme to submit approved data to the Cabinet Office 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 the exercises conducted since 2002 and lists the outstanding amounts which are still being actively pursued.

NFI Exercise	Total Cases	Total Identified £000	Prior Years		2015-16		Outstanding at 31/03/2016 £000
			Recovered £000	Written-off £000	Recovered £000	Written-off £000	
NFI 2002	252	1,071	766	275	1	0	29
NFI 2004	257	426	356	66	0	0	4
NFI 2006	297	789	701	82	1	0	5
NFI 2008	175	959	885	30	0	0	44
NFI 2010	126	695	629	6	1	0	59
NFI 2012	160	768	730	0	7	0	31
NFI 2014	143	630	0	0	566	0	64

3.10 Tell Us Once

The AFPS went live on the Tell Us Once (TUO) Scheme on 4 March 2016, which allows citizens on a voluntary basis to inform central and local government of bereavement in a single engagement, usually at the point of registration of a death. It is hosted by the Department for Work and Pensions but is a cross-government resource. The benefit of being part of the Scheme is the provision of a better service to the bereaved at a difficult time, and a reduction in the number of days between the death of a pensioner and the Scheme being informed. The aim is to stop or reduce the number and value of overpayments and associated activities and costs of recovery. As at 31 March 2016 the Scheme provided the AFPS with 321 death notifications.

3.11 Events after the reporting period

The result of the referendum held on 23 June was in favour of the UK leaving the European Union. This is a non-adjusting event. A reasonable estimate of the financial effect of this event cannot be made. Sensitivity analysis around the key financial assumptions underpinning the actuarial valuation of the Scheme liabilities that may potentially be affected by this decision can be found in the Report of the Actuary on pages 16 and 17.

4. Key activities arising for 2016-17

4.1 Changes to Contracting-Out Rules and Single Tier New State Pension

The Government announced the cessation of contracting-out for Defined Benefit (DB) occupational schemes in January 2013, with proposals for a Single Tier State Pension. Contracting-out for DB schemes will cease from April 2016, with the State Second Pension (S2P) no longer accruing.

The introduction of a new single-tier pension from 6 April 2016 will see the end of contracting-out. The liability for tracking and maintaining contracted out rights, known as Guaranteed Minimum Pension (GMP), will be passed across to individual pension schemes and support services from HMRC (NICO) will be scaled down and eventually withdrawn in December 2018. This means that the AFPS needs to reconcile contracted-out data with HMRC's records prior to December 2018 to ensure that the scheme has full awareness of its liability at the point when the Scheme Reconciliation Service is withdrawn by HMRC.

The initial assessment provided by GAD of the impact to the Scheme liability for the transitional indexation protection during 2016 to 2018 is £200 million, and has been treated as a Past Service Cost within this year's accounts (see note 4 to the accounts).

From December 2018, HMRC intend to issue individual statements to scheme members confirming the individual's contracted-out benefits and the relevant service dates and schemes under which these benefits are held. Thereafter, HMRC's contracted-out liability reconciliation service will cease.

There are a range of administrative requirements arising from the proposed changes which are being assessed. A specific project has been set up to deal with this significant change.

Key activities identified within the scope of the project are:

- Assess the scope of the validation task and determine the appropriate IT system infrastructure;
- Identify the member population impacted to inform the optimum solution for the scheme to deliver the changes;
- Implement the preferred option during 2016-17.

5. Information for Members

5.1 AFPS Additional Voluntary Contributions (AVCs)

Added Pension: Under AFPS 15 Active members (including Reserves) are able to pay personal contributions in order to purchase Added Pension. This is a choice between increasing just their own benefits, or both theirs and their dependants' benefits, and can be purchased by paying a lump sum or fixed monthly payments.

Added Years: Added Years AVCs purchased prior to April 2015 will remain unchanged in accordance with the AFPS 75 and AFPS 05 rules. Service personnel will pay their AVCs and the additional years' service will be added to the individual's Scheme benefits when they leave Service.

These AVCs and their associated liabilities are recognised in these Accounts.

5.2 Freestanding Additional Voluntary Contributions (FSAVC)

Active members may contribute to a FSAVC (or other private pension arrangement). The contribution is passed to the relevant institution and is a private arrangement between the member and the institution, and as such these transactions are not recognised in these Accounts.

5.3 Stakeholder Pensions

The Stakeholder pension is a private pension that was introduced by the Government to help people save for their retirement. Scottish Widows has been designated as the preferred provider of Stakeholder pensions to the Armed Forces. The contribution is passed to the relevant institution and is a private arrangement between the member and the institution, and as such these transactions are not recognised in these Accounts.

5.4 Managers, Advisers and Employers

Managers

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6. Disclosure of information to auditors

So far as I am aware, there is no relevant audit information of which the Scheme's auditor is unaware. I have taken all steps that I ought to have taken to make myself aware of any relevant audit information and to establish that the Scheme's auditor is aware of that information.

I take personal responsibility for the Report of the Managers and Financial Statements and the judgements required for determining that they are fair, balanced and understandable. I can confirm that the Report of the Managers and Financial Statements as a whole are fair, balanced and understandable.

Stephen Lovegrove
Accounting Officer for the AFPS and AFCS

29 June 2016

**Report of the Actuary for the Armed Forces Pension Scheme
for Accounts for the Year Ended 31 March 2016**

Introduction

1. This statement has been prepared by the Government Actuary's Department at the request of the Ministry of Defence ('MOD'). It summarises the pensions disclosures required for the 2015/16 Accounts of the Armed Forces Pension Scheme ('the scheme' or 'AFPS').
2. The AFPS is a defined benefit pension scheme with various different benefit structures. The Armed Forces Pension Scheme 2015 ('AFPS 15'), and its associated Early Departure Payment Scheme ('EDP 15'), was introduced from 1 April 2015. The provisions of AFPS 15 and EDP 15 are set out in regulations¹. The Armed Forces Pension Scheme 1975 ('AFPS 75') and the Armed Forces Pension Scheme 2005 ('AFPS 05') are final salary defined benefit scheme, the rules of which are set out in the Army Pensions (Armed Forces Pension Scheme 1975 and Attributable Benefits Scheme) Warrant 2010 (and Naval and Marine, and Royal Air Force equivalents), and the Armed Forces Pension Scheme Order 2005 (SI 2005/438), and subsequent amendments. The scheme is wholly unfunded. I am not aware of any informal practices operated within the scheme which lead to a constructive obligation (under IAS 19 constructive obligations should be included in the measurement of the actuarial liability). The liabilities disclosed in this statement also include an allowance for the benefits accrued by personnel who are in the Reserve Forces Pension Scheme (RFPS), the Full-Time Reserve Service Pension Scheme (FTRS), the Non-Regular Permanent Staff Pension Scheme (NRPS) and the Gurkha Pension Scheme (GPS); benefits payable from the AFPS 05 Early Departure Payments (EDP) arrangement; and benefits payable from the other minor overseas schemes that are included in the AFPS accounts.
3. The statement is based on an assessment of the liabilities as at 31 March 2012, with an approximate updating to 31 March 2016 to reflect known changes.

Membership data

4. Tables A to C summarise the principal membership data as at 31 March 2012 used to prepare this statement.

Table A – Active members

31 March 2012 membership data		2015-16 accounts
Number (thousands)	Total pensionable pay † (£ million pa)	Total pensionable pay * (£ million pa)
191	6,080	5,569

† Including increases applying in April of year

* Excluding increases applying in April of year and estimated based on data as at 29 February 2016. Includes salaries received by Volunteer Reservists which have been pensionable from 1 April 2015.

¹ <http://www.legislation.gov.uk/uk/si/2014/2336/made>
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/320808/20140614-af-early-depart-scheme-regulations-clean.pdf

Table B – Deferred members

31 March 2012 membership data		2015-16 accounts
Number (thousands)	Total deferred pension † (£ million pa)	Number (thousands) *
399	963	407

† Including increases applying in April of year

* Estimated based upon data as at 29 February 2016

Table C – Pensions in payment

31 March 2012 membership data		2015-16 accounts
Number (thousands)	Total pension † (£ million pa)	Total pension * (£ million pa)
380	3,348	3,793

† Including increases applying in April of year

* Excluding any increases applying in April of year (no increase in April 2016) and estimated based on data as at 29 February 2016

Methodology

5. The present value of the liabilities has been determined using the Projected Unit Credit Method (PUCM), with allowance for expected future pay increases in respect of active members, and the principal financial assumptions applying to the 2015-16 Accounts. The contribution rate for accruing costs in the year ended 31 March 2016 was determined using the PUCM and the principal financial assumptions applying to the 2014-15 Accounts.
6. This statement takes into account the benefits normally provided under the scheme, including age retirement benefits, ill-health retirement benefits and benefits applicable following the death of the member. It does not include premature retirement and redundancy benefits in respect of current active members, although the assessment of liabilities includes pensions already in payment in respect of such cases. It does not include the cost of additional death benefits or injury benefits provided through the Armed Forces Compensation Scheme (in excess of ill-health benefits).
7. The liabilities disclosed in this statement include the benefits accrued by personnel who are in the Gurkha Pension Scheme (GPS), together with an approximate allowance in respect of past service costs for current GPS members resulting from the Gurkha Offer to Transfer.
8. The liabilities disclosed in this statement include the benefits accrued by personnel who are in the minor overseas schemes covered by the AFPS accounts.

Principal financial assumptions

9. The principal financial assumptions adopted to prepare this statement are shown in Table D.

Table D – Principal financial assumptions

Assumption	31 March 2016	31 March 2015
Rate of return (discount rate)	3.60%	3.55%
Rate of earnings increases*	4.20%	4.20%
Rate of future pension increases	2.20%	2.20%
Rate of return in excess of:		
Pension increases (CPI)	1.37%	1.30%
Earnings increases	-0.60%	-0.65%
Expected return on assets:	n/a	n/a

* short term adjustments have been made to this assumption for the period to 2020

10. The pension increase assumption up to and including 31 March 2016 are based on the Consumer Price Index (CPI) expectation of inflation.

Demographic assumptions

11. The demographic assumptions adopted to prepare this statement were derived from the specific experience of the scheme membership.
12. The standard mortality tables known as S1NXA are used (for normal health pensioners, ill health pensioners and dependants) but with mortality rates adjusted to 88% (Officers) and 118% (Other Ranks) of actual rates. These assumptions are the same as those adopted for the 2014-15 Annual Accounts. Mortality improvements are in accordance with those incorporated in the 2014-based principal population projections for the United Kingdom. This assumption has been updated in line with the latest ONS projections. The 2014-15 Annual Accounts were based on the 2012-based projections.
13. The contribution rate used to determine the accruing cost in 2015-16 was based on the demographic and financial assumptions applicable at the start of the year: that is, those adopted for the 2014-15 Accounts.

Liabilities

14. Table E summarises the assessed value as at 31 March 2016 of benefits accrued under the scheme prior to 31 March 2016 based on the data, methodology and assumptions described in paragraphs 4 to 14. The corresponding figures for the previous four year ends are also included in the table.

Table E – Statement of Financial Position

£ Billion

	31 March 2016	31 March 2015	31 March 2014	31 March 2013	31 March 2012
Total market value of assets	Nil	Nil	Nil	Nil	Nil
Value of liabilities	(145.2)	(154.4)	(129.5)	(118.0)	(105.6)
Surplus/(Deficit)	(145.2)	(154.4)	(129.5)	(118.0)	(105.6)
of which recoverable by employers	N/A	N/A	N/A	N/A	N/A

Accruing costs

15. The cost of benefits accrued in the year ended 31 March 2016 (the Current Service Cost) is based on a standard contribution rate of 55.5% of Officer pensionable salaries, and 54.4% of Other Ranks pensionable salaries. The AFPS is non-contributory for members.
16. Table F shows the Current Service Cost, which is met fully by the employer. The corresponding figures for 2014-15 are also included in the table.

Table F – Contribution rate

Percentage of pensionable pay	1 April 2015 to 31 March 2016	1 April 2014 to 31 March 2015
Officers	55.5%	56.9%
Other Ranks	54.4%	44.8%

17. For the avoidance of doubt, the actual rate of contributions payable by employers, 52.4% for Officers and 49.6% for Other Ranks of pensionable pay for 2015-16 (this excludes the cost of the Armed Forces Compensation Scheme), is not the same as the employers' share of the standard contribution rate determined for the purposes of the Annual Accounts as above (55.5% for Officers and 54.4% for Other Ranks for 2015-16). This is because the actual employer contribution rate was determined as part of a funding valuation using different assumptions. The key difference between the assumptions used for funding valuations and Accounts is the discount rate. The discount rate for Accounts is set each year by HM Treasury to reflect the requirements of the accounting standard IAS19.
18. The pensionable payroll for the financial year 2015-16 was £5.6 billion (derived from contributions payable by employers over the year). Based on this information, the accruing cost of pensions in 2015-16 (at 55.5% for Officers and 54.4% for Other Ranks of pay) is assessed to be £3.0 billion.
19. There is a past service cost of £0.2bn during 2015-16 which reflects a Government policy announcement which will affect the way the Guaranteed Minimum Pension element of certain members' benefits will be increased in retirement.

Sensitivity analysis

20. The results of any actuarial calculation are inherently uncertain because of the assumptions which must be made. In recognition of this uncertainty I have been asked to indicate the approximate effects on the actuarial liability as at 31 March 2016 of changes to the most significant actuarial assumptions.
21. The most significant assumptions are the discount rate, general earnings increases and pension increases (currently based on CPI). A key demographic assumption is pensioner mortality.
22. As a result of the scheme reform and the MOD's New Employment Model, there is significant uncertainty associated with timings of member exits (withdrawals and retirements) in future. Relatively few members of the AFPS remain in service until their normal pension age. However, a significant proportion retire with immediate benefits in the form of an Immediate Pension (IP) or Early Departure Payments (EDP), often from around age 40. The numbers of members reaching their IP or EDP qualification points could potentially have an impact on the scheme liabilities and so we have included an indication of the approximate effect (on the total past service liability) of a 5% increase in the number of new entrants reaching IP/EDP point compared to the main liability calculations.
23. Table G shows the indicative effects on the total liability as at 31 March 2016 of changes to these assumptions (rounded to the nearest ½%).

Table G - Sensitivity to significant assumptions

Change in assumption	Approximate effect on total liability	
Financial assumptions		
(i) discount rate*: +½% a year	- 10%	- 14.1billion
(ii) (long term) earnings increase*: +½% a year	+ 1%	+ 0.8 billion
(iii) pension increases*: +½% a year	+ 10%	+ 14.6 billion
Demographic assumptions		
(iv) additional 1 year increase in life expectancy at retirement	+ 3%	+ 3.8 billion
(v) a 5% increase in the proportion of new entrants who reach IP/EDP point	+ 0%	+ 0.5 billion

* Opposite changes in the assumptions will produce approximately equal and opposite changes in the liability.

Statement of Accounting Officer's Responsibilities

Under the Government Resources and Accounts Act 2000, the Ministry of Defence, with the consent of HM Treasury, has directed the Armed Forces Pension Scheme to prepare for each financial year a statement of accounts in the form and on the basis set out in the Accounts Direction. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of the combined schemes at the year end and of the net resource outturn and cashflows for the financial year.

In preparing the accounts, the Accounting Officer is required to comply with the requirements of the Government Financial Reporting Manual (FReM) and in particular to:

- Observe the accounts direction issued by HM Treasury including the 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 FReM have been followed, and disclose and explain any material departures in the financial statements; and
- Prepare the financial statements on a going concern basis.

HM Treasury has appointed the Permanent Secretary of the Department as Accounting Officer for the Armed Forces Pension 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 Managing Public Money published by HM Treasury.

The Governance Statement

Scope of Responsibilities

1. Joining the Ministry of Defence (MOD) as Permanent Secretary on 25 April 2016, as the Accounting Officer for the Armed Forces Pension Scheme (AFPS) and the Armed Forces Compensation Scheme (AFCS), collectively “the Schemes”, I and my predecessor have responsibility for maintaining a sound system of governance that supports the achievement of the Schemes’ policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Managing Public Money. Where necessary I, or officials on my behalf, engage with HM Treasury officials on funding and policy issues pertaining to these Schemes.
2. In discharging this responsibility, I am responsible for putting in place proper arrangements for the governance of the Schemes’ affairs which facilitate the effective discharge of their statutory functions and which include arrangements for the management of risk.
3. The Schemes have adopted the Corporate Governance Code for Central Government as far as is practicable in the context of a pension scheme. The Executive Committee have operated in accordance with the recognised precepts of good corporate governance: leadership, effectiveness, accountability and sustainability.

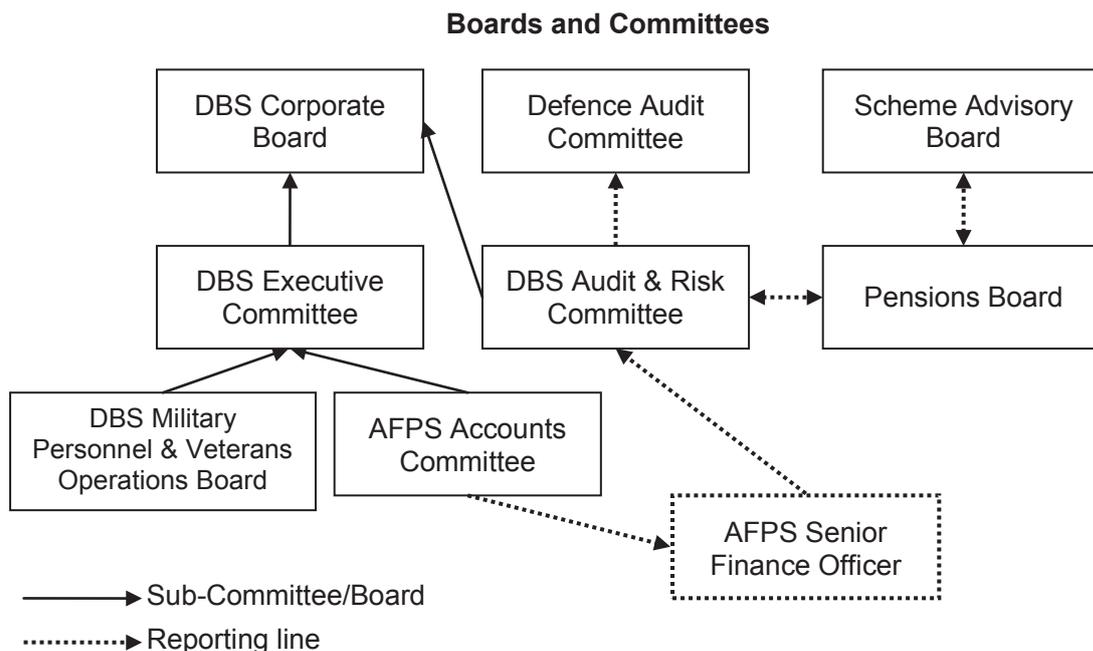
The Purpose of the Governance Framework

4. The governance framework comprises the systems and processes, and culture and values, by which the Schemes are administered and controlled. It also includes the activities by which they account to Parliament.
5. The system of internal control is a significant part of the governance framework and is designed to manage risk to a reasonable level. It cannot eliminate all risk of failure to achieve policies, aims and objectives and therefore can only provide reasonable, and not absolute, assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of the Schemes’ policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically.
6. The governance framework has been in place for the Schemes for the year ended 31 March 2016 and up to the date of the approval of the annual accounts.

The Schemes’ Governance Framework

Arrangements in place until 18 April 2016

7. I and my predecessor have delegated budget holder and delivery authority responsibility of the Schemes to the Chief Executive Officer (CEO) of the Defence Business Services (DBS), who has sub-delegated the administrative management of the Schemes to DBS Head of Veterans UK. Director General Finance has delegated the role of Senior Finance Officer (SFO) for the Schemes to DBS Head of Resources. The MOD has a contract with Serco Ltd to provide management services to DBS. The CEO and a number of the Executive appointments are made through Serco Ltd and these appointments are detailed in paragraph 11 below.
8. Administration of the Schemes is delivered through a combination of MOD civilian personnel and contractors and CSC Computer Sciences Ltd (CSC), via a commercial partnering agreement which came into effect on 11 November 2012. The arrangement for joint working with CSC is governed by commercial agreements and is managed by DBS Military Personnel & Veterans Operations Board (MP&V OB).



9. The **DBS Corporate Board** comprises of a Non-Executive Chair, two other Non-Executive Directors (NEDs), the DBS CEO, two DBS Executive Heads and the Head of MOD Corporate Services Transformation Team. The Board oversees the conduct of business in DBS, supports and supervises the DBS executive management, leads on compliance with all applicable Government/Defence policies and governs and oversees the transformation programmes and service delivery issues.

10. The Corporate Board is required to consider its own effectiveness on a regular basis. The Board reviewed its effectiveness during 2015/16 using a self assessment questionnaire. Results indicated strengths in a number of key areas, such as objectives, strategy and remit, performance measurement, relationship with key stakeholders, risk management and relationship with audit committee, internal audit and corporate reporting. Areas of focus highlighted include further development of the Board’s responsibilities in respect of propriety, fraud and other leakage, together with the means to exercise effective governance of such aspects.

Corporate Board Members Composition	Meetings Attended
Non-Executive Chair: Keith Archer-Jones	6 of 6
Executive Members – Serco:	
Rod McCurdy, Chief Executive Officer	6 of 6
Simon Freeman, Chief Operating Officer	6 of 6
Executive Members – MOD Personnel:	
Georgina Benzies, Head of Resources	5 of 6
Richard Vincent Head of MOD Corporate Services Transformation Team	5 of 6
Non-Executive Directors:	
Chris Wright	5 of 6
Paul Smith	5 of 6

11. The **DBS Executive Committee (EC)** is chaired by the CEO and comprises the Executive Heads of Department and the Schemes' SFO. The EC is responsible for managing DBS within Corporate Board agreed financial limits, primary authority for day to day management of DBS save for those matters reserved to the Corporate Board. The EC meets once/twice a month and convened 20 times between April 2015 and March 2016. No specific review of Committee performance was undertaken in 2015/16.

EC Members Composition – Serco	Meetings Attended
Chief Executive Officer: Rod McCurdy, (Chair)	16 of 20
Executives:	
Simon Freeman, Chief Operating Officer	18 of 20
Vince Groome, Chief Information Officer	15 of 20
Helen Hall, Chief People Officer	19 of 20
Andy Tyler-Smith, Operations Director	16 of 20
Andrew Thompson, Service Development Director (until 29 Jan 16)	9 of 16
Nicola Smith, Transformation Director	15 of 20
Geoff Nield, Head of People Services	19 of 20
EC Members Composition - MOD Personnel	Meetings Attended
Executives:	
Georgina Benzies, Head of Resources	17 of 20
Jon Parkin, Head of Veterans UK	18 of 20
Andy Dowds, Head of Finance	15 of 20
Commodore Ian Bisson, Head of Military Personnel	16 of 20
Andrew Stafford, Head of Civilian Personnel	18 of 20
Caroline Ruming, Head of National Security Vetting	17 of 20

12. The **DBS Military Personnel & Veterans Operations Board (MP&V OB)**, a sub-committee of the EC, manages the commercial agreements with CSC. The Service Delivery Management Team within DBS actively monitors the performance of CSC against over 700 Measures of Performance (MOPs). Any failure to meet MOPs, and actions to ensure future compliance, are discussed at the monthly Service Delivery Working Group attended by representatives from both DBS and CSC, and reported to the MP&V OB. The Board is also responsible for reviewing unit level risks on a monthly basis, with the most critical escalated to the EC where the impacts are assessed and appropriate mitigating action taken.

13. The **AFPS Accounts Committee**, a sub-committee of the EC, undertakes a detailed review of financial performance of the Schemes on a monthly basis. Membership of the AFPS Accounts Committee includes three EC members: Head of Resources (as Schemes' SFO), Head of Veterans UK (as Scheme Administrator) and Head of Finance (as an independent). Escalations and a monthly summary report from the AFPS Accounts Committee are submitted to the EC for review, decision and endorsement.

14. The **DBS Audit & Risk Committee (ARC)**, a sub-committee of the DBS Corporate Board, comprises of two Non-Executives and one MOD Executive, and is attended by members of the EC. The chair of the Pensions Board also has a standing invitation and attends most committees. The ARC supports the CEO in discharging his responsibilities for Risk Control and Governance by reviewing the comprehensiveness, reliability and integrity of DBS’s Risk and Assurance framework, agreeing priority risk areas for Defence Internal Audit (DIA) annual programme, reviewing the outcome of work by DIA and NAO and following progress on completion of actions. In 2015/16 the ARC undertook a deep dive of the Veterans UK top six risks, which included a number of specific AFPS risks. The ARC reviewed the 2015/16 AFPS Accounts prior to approval by the Defence Audit Committee. The Committee met eight times between April 2015 and March 2016.

ARC Members Composition	Meetings Attended
Non-Executives: Paul Smith Neville Mackay (from 1 May 2015)	8 of 8 7 of 7
MOD Executive: Richard Vincent Head of MOD Corporate Services Transformation Team	8 of 8

15. The **Defence Audit Committee (DAC)** is responsible for making a recommendation to the Accounting Officer for approval of the AFPS Accounts prior to publication. The DAC gains assurance on the reliability of the financial and reporting disclosures from the DBS ARC review. The DAC comprises of a Non-Executive Chair and three other NEDs. The DAC is also attended by the Permanent Secretary for Defence or the MOD Director General Finance, the Head of DIA and a representative from the National Audit Office.

16. The **Scheme Advisory Board** and **Pensions Board**. As recommended by the Independent Public Service Pensions Commission, the Secretary of State for Defence, who acts as the Armed Forces Pension Scheme Manager, agreed the structure and composition of the Scheme Advisory Board and Pensions Board in July 2014. The Boards have been in place from 1 April 2015.

17. The Government introduced a framework for the governance and administration of public service pension schemes under the Public Service Pensions Act 2013, which also provides an extended regulatory oversight by The Pension Regulator. The Scheme Advisory Board is responsible for advising the Scheme Manager in relation to the desirability of changes to the Scheme. The Pensions Board is responsible for assisting the Scheme Manager with compliance of the Scheme rules and legislation relating to the governance and administration of the Scheme; including any requirements imposed by the Pension Regulator.

Arrangements in place since 19 April 2016

18. On 19 April 2016 the management partner contract with Serco Ltd ceased. The CEO, Chief Operating Officer, Chief Information Officer, Chief People Officer and Transformation Director positions were retained and moved under MOD management. Responsibility for administration of the Schemes remains delegated to the CEO and the role of SFO to Head of Resources. The governance arrangements of the Schemes have remained the same as prior to 19 April 2016, as have the administration arrangements, with mainly the same personnel in place below Board level.

Financial Management

19. The Schemes’ financial management arrangements conform to the requirements of HM Treasury as laid out in “Managing Public Money”. The DBS Head of Resources is the SFO for the Schemes and is a key member of the EC. The Schemes’ financial management reports provide the level of detail for effective oversight and are reviewed by the AFPS Accounts Committee on a monthly basis. CSC provides an operations dashboard of pension volumes/values which is reviewed by the Military Personnel & Veterans Operation Board on a monthly basis. Performance against Key Performance Indicators is reviewed by the DBS Corporate Board. Management’s confidence in the financial/management information and reporting is supported through the work of these Committees/Boards and is reviewed by DIA as part of a rolling three year audit programme of the Schemes.

20. The Pensions Finance Team, with input from the Government Actuary's Department and challenge from HM Treasury and the Office of Budget Responsibility, refined future forecasts to take into account new and emerging trends, central assumptions and anticipated changes in behaviour as a result of perceived and actual changes to the Schemes. The Pensions Finance Team falls under the responsibility of DBS Head of Resources but worked closely with DBS Veterans UK throughout the financial year to ensure emerging issues were factored into in-year forecasts. Pensions Finance and Veterans UK also liaised with other major UK Public Pension Schemes throughout the year to identify best practice on a number of ongoing initiatives.

21. A review¹ of internal governance was conducted following the transfer of responsibility of the Pensions Finance Team to DBS Head Resources from Head Veterans UK in April 2014, on the merger between DBS and Service Personnel & Veterans Agency. This confirmed that the line management arrangements for Pensions Finance should remain unchanged, but recommended a few changes to improve the engagement between operations and finance staff to maintain coherence and better manage volatile demand, and to improve governance of change and the management and accuracy of membership data. These proposals have been implemented.

Risk Assessment

22. Risk assessment processes within DBS are in place throughout the year. Risks are identified and recorded on the business unit risk registers and are reviewed on a monthly basis by the MP&V OB. The most critical are escalated to the EC where the impacts are assessed and appropriate mitigating action taken. The ARC has oversight of all risks raised within DBS. Any risks not capable of being managed at Committee level would be escalated to the Chief of Defence People (CDP) and/or Director General Finance, and ultimately to me for action. No risks were escalated by DBS in 2015/16.

The Risk and Control Framework

23. A framework of internal controls within the Schemes' day to day operations (including authorisations, reconciliations and separation of duties) control the risks of fraud or error; the framework is documented to current best practice standards and is incorporated within the process guides provided for staff. This framework is maintained, updated and reviewed on an annual basis by the DBS Process Controls Management Team.

24. Risk owners and managers are identified as part of the risk management process. Formal risk management training is provided to project and operational teams. Risk management information and guidance is available to all on the MOD intranet.

25. Oversight of the Schemes' rules and policies and advice on their application is provided by the CDP's Service Personnel Policy branch.

26. The DBS Risk Management Strategy (Framework) v5.0 is compliant with MOD's Directive JSP892. During this period the EC has continued to ensure that the seven key fundamental principles have been used to underpin the way that risks are managed within DBS:

- **Nested Risks and Associated Action Plans;**
A nested approach to risk management in accordance with the DBS Risk Governance structure, ensuring risks are owned from the business (Assistant Head) level through to DBS Senior Management level, with each level taking responsibility for mitigation actions within their scope of responsibility.
- **Clear Links to Governance Approach;**
Risks are managed throughout the DBS Governance structure ensuring that responsibilities and escalation routes are clearly identified within a formalised structure. This also includes Shared (MOD/Commercial Partner) risk. Risks are standing agenda items at a variety of DBS Governance forums, including the DBS Corporate Board, EC, Senior Leadership Team as well as within the Functional Governance areas of Operations, Transformation, People and Technology. The Minutes of the Boards record Actions, Decisions and Escalations and are

¹Pension Finance Review.V4 dated 10 Dec 15

used as a vehicle to provide feedback to the Risk Owner/Manager and to update the Risk Register.

- Independent Quality Assurance;
A dedicated Risk Management Team providing oversight and implementation of the Risk Management Strategy throughout DBS. Providing assurance and guidance to individual risk owners, and ensuring a risk management culture is embedded throughout DBS.
- Managing Risk Volumes;
The implementation of a nested risk structure ensuring that for each governance group handling risks, the number of risks remains manageable.
- Risk Appetite & Thresholds;
Definition of a risk appetite statement that is also expressed as a series of boundaries in time, cost and performance, with tolerance levels allowable for risk at differing levels of the organisation.
- Risk Aggregation;
Pillars being responsible for escalating risks which exceed their tolerances, and the DBS Risk Manager responsible for aggregating common risks from two or more pillars which collectively exceed the tolerance.
- Management of Strategic Risks;
Strategic risks are identified at any time at any level of the business, and then managed at the EC.

Fraud

27. All staff within MOD have direct access to the Fraud Incident and Irregularity Reporting Unit (FIIRU), which is the single place to report fraud, bribery, corruption, theft and irregularity within the MOD. Suspicions or concerns can be reported anonymously or confidentially to the FIIRU. Potential AFPS fraudulent claims are reported to the MOD Fraud Incident and Irregularity Reporting Unit for investigation by the MOD Police (MDP) or Royal Military Police. DBS continues to utilise the National Fraud Initiative (NFI) to identify potential AFPS fraudulent claims and a small internal team is resourced to investigate any potential fraudulent AFCS claims. The Report of the Managers on pages 2 to 12 contains details of the results of the NFI exercises since 2002.

28. Since 2012/13 DBS has canvassed 76,000 pensioners to confirm their continuing entitlement to pension under the Scheme rules. The exercise was completed during 2013/14 and resulted in the suspension of 782 pensions due to unreported deaths or other unreported changes in circumstances affecting pensioner's entitlement. Recovery of overpayments is being pursued on a case by case basis as each case is investigated. To date there are 686 pensions suspended with an annual saving valued at £2.9M per year. The policy for future exercises is currently under review.

29. The Government's major reforms of pensions from 6 April 2015 allowed members of money purchase pension schemes to access their pension pot flexibly and draw their pension savings as a lump sum rather than having to use them to buy an annuity. As part of these reforms, transfers of pension funds from unfunded public service defined benefit schemes (such as the AFPS) to schemes that permitted members to draw their pension pot flexibly were banned. The change in rules was announced in the Chancellor of the Exchequer's Autumn Statement on 3 December 2014 and prevents further transfers to non-Defined Benefit schemes. For those individuals who made a pension transfer request prior to this change, Veterans UK pensions administrators conducted due diligence checks on the receiving Scheme provider and issued an information warning about pension liberation scams and what to look for, with the application to transfer declaration forms. Despite these checks, some private pension providers are under investigation for possible fraudulent activity.

Information Assurance

30. Data is managed in accordance with the principles of HM Government's Information Assurance Maturity Model (IAMM) and Departmental Policies. The CEO is the Senior Information Risk Owner (SIRO) for DBS, with Information Asset Owners (IAOs) supporting the SIRO. Information Assurance (IA) training remains a mandatory requirement, with specific IAO and NED modules.

31. Significant efforts have been made during this year to continue to focus on the IA governance structure, IA risk management and upward reporting through the IAOs, SIRO and to the MOD Chief Information Officer (CIO). Building on the identification of the information assets within DBS, Memorandum of Understandings (MOUs) are now in place with third parties and Delivery Partners responsible for handling DBS information assets and work is underway to implement a programme of assurance activity to ensure on-going protection of the information. The completion of Privacy Impact Assessments across DBS is now integrated. IAO Steering Group meetings continue on a quarterly basis to review IA risks and allow upward reporting to the DBS CIO and SIRO.

32. Work continues to identify areas for improvement within IA across DBS and how IAMM is integrated across the Organisation. Defence Assurance Information Security Team on behalf of MOD SIRO will shortly undertake a review to assess IA maturity of DBS across the IAMM Framework with fieldwork and reporting expected to be completed by July 2016.

33. There has been one data loss reported during the year in relation to the Schemes. The incident involved the accidental disclosure of a customer's information (Name and Service Number) to four other recipients. The customer was informed of the accidental release of their information and reminders issued to staff to ensure letters are checked before release. This was evaluated as a minor incident.

Business Continuity

34. AFPS/AFCS output from DBS Norcross and Glasgow and the development and implementation of future Compensation and Pensions System (CAPS) pensions and allowances solutions at DBS Gosport, are governed by Business Continuity (BC) measures outlined in the DBS Business Continuity Programme Management Strategy 2015-16 which is currently undergoing annual review. Business Impact Analysis (BIA) for key business areas has been completed and indicate that individual Business Continuity Plans (BCP) are required.

35. The Disaster Recovery (DR) Plan for CAPS was updated to version 3.0 on 31 October 2015. It is subject to periodic review, in parallel with the ongoing CAPS transformation.

36. The Business Process Outsourcing Service Delivery BCP has undergone review and update moving to Version 9.0 on 21 March. This plan covers the Joint Personnel Administration Centre Enquiry Centre and back-office pension activity.

37. During the year sufficient BC testing was undertaken and there were no significant BC incidents affecting pensions' delivery. Specific BC plans were established during the year to respond to the risk of the Eurozone debt crisis and the potential collapse of European banks, ensuring that funds due to overseas AFPS/AFCS members are protected.

Review of Effectiveness

38. As Accounting Officer, I have responsibility for reviewing the effectiveness of the governance framework. My review is informed by the work of the MOD internal auditors DIA, the executive managers within the DBS who have responsibility for the development and maintenance of the internal control framework, the ARC who are responsible for risk control and governance, the DAC who are responsible for reviewing and endorsing the year end accounts and comments made by the external auditors in their management letter and other reports.

39. AFPS 15 was successfully launched on 1 April 2015 against a challenging delivery schedule. All three main schemes AFPS 15, AFPS 75 and AFPS 05 are now delivered on a business as usual basis. The Annual Benefit Information Statements (BIS) rolling programme to all members commenced in September 2015. The BIS provides scheme members with a description of the benefits earned. As at the end of March 2016 over 130,000 statements had been issued. The newly formed Pensions Board is now established, meeting quarterly to assist the scheme manager in securing compliance with scheme regulations, governance and administration of legislation.

Internal Audit

40. The AFPS assurance programme was developed by DIA with the support of PricewaterhouseCoopers and commenced in 2013/14. The programme is intended to form the basis of

a rolling year on year programme of assurance, undertaken by DIA. The programme has been reviewed and progress reports regularly taken by the DBS ARC throughout 2015/16. The Head of DIA, or one of his senior managers, attends meetings of the ARC and provides expert advice on audit issues.

41. DIA has reported their Annual Audit Opinion for the AFPS as one of Limited Assurance. This opinion is based on the audit programme undertaken, advisory work performed, attendance at key meetings, engagement with line management and other developments within DBS where they are known to be relevant.

42. DIA reported that the overall governance arrangements and that of day-to-day management control were in place and remained largely effective. The AFPS had been supported in-year by the DBS Governance framework and by the establishment of the new AFPS Pensions Board. Two full assurances were issued against Additional Voluntary Contributions and CSC Management Reporting. Three substantial assurances were issued against Apply Pension Transfers, Cash Forecasting & Actuarial and Effectiveness of Support to AFPS Pensions Board. AFPS management continued to support improvements to control, including both follow up audits in-year reporting satisfactory progress.

43. However, in three specific audits this year, examining Manage Payment to the Children of Deceased Service Personnel, Pensions on Divorce and Data Assurance some serious weaknesses in control were identified. While these control weaknesses were not considered to have a material impact on the AFPS accounts, the DIA's opinion was that they represented potential for significant impact to individuals and carried with them reputational risk for the MOD. DIA stressed that their overall opinion did not reflect any fundamental changes or weakening to the overall framework and management continue to demonstrate positive action against audit findings.

Significant Governance Issues

44. In response to the DIA's findings detailed above, management has taken steps to address them, including the AFPS Membership Data Improvement Project. Other than the issues identified by the DIA I am pleased to report that there have been no other significant governance issues arising during 2015/16. Overall I have drawn assurance from the controls in place to govern the Schemes and I am content that there has been no reduction in their effectiveness.

Future Improvements

45. A review of the AFPS annual Newsletter is planned, to ensure it provides the right level of information in the most effective way. The Schemes will be engaging with external partnership/stakeholder channels for members' feedback on the Newsletter going forward.

46. Further enhancements to online calculators are planned to meet changing demands and to address legislative changes. These upgrades will improve functionality and efficiency of Scheme administration.

Summary

47. As a result of these reviews I have concluded that the Schemes have operated in line with the Corporate Governance Code for Central Government, and the governance, risk management and internal control framework is well established and working effectively although with acknowledged weaknesses. I am confident these will continue to be addressed over the coming year.

Statement of Parliamentary Supply

Summary of Resource Outturn 2015-16

This section has been subject to audit

£000								2015-16	2014-15
	Estimate				Outturn			Voted outturn compared with Estimate: saving/ (excess)	Outturn
	Note	Voted	Non-Voted	Total	Voted	Non-Voted	Total		
Annually Managed Expenditure	SOPS1	5,965,732		5,965,732	5,916,926		5,916,926	48,806	6,446,395
- Resource									
Total Budget		5,965,732		5,965,732	5,916,926		5,916,926	48,806	6,446,395
Non-Budget									
-Resource									-
Total		5,965,732		5,965,732	5,916,926		5,916,926	48,806	6,446,395

Net Cash Requirement 2015-16

£000	Note	2015-16	2015-16		2014-15
		Estimate	Outturn	Outturn compared with Estimate savings/ (excess)	Outturn
	SOPS2	1,637,917	1,572,881	65,036	2,532,948

Administration Costs 2015-16

2015-16	2015-16	2014-15
Outturn	Estimate	Outturn
-	-	-

As explained in the Report of the Managers section 2 page 5, the costs of administering the Schemes are borne by the MOD and are reflected in the Department's Annual Report and Accounts.

Figures in the areas outlined in bold are voted totals or other totals subject to Parliamentary control.

Notes to the Statement of Parliamentary Supply

SOPS1. Analysis of net resource outturn by section

£000	2015-16									2014-15 Outturn
	Outturn						Estimate			
	Administration			Programme			Total	Net Total	Net total compared to Estimate	Total
Gross	Income	Net	Gross	Income	Net					
Spending in Departmental Expenditure Limit Voted:	-	-	-	-	-	-	-	-	-	-
Non Voted:	-	-	-	-	-	-	-	-	-	-
Annually Managed Expenditure Voted:										
A: Retired pay, pensions and other payments to ex-service personnel	-	-	-	8,834,088	(2,917,162)	5,916,926	5,916,926	5,965,732	48,806	6,446,395
Non Voted:	-	-	-	-	-	-	-	-	-	-
Total	-	-	-	8,834,088	(2,917,162)	5,916,926	5,916,926	5,965,732	48,806	6,446,395

SOPS2. Reconciliation of Net Resource Outturn to Net Cash Requirement

	Note	Estimate £000	Outturn £000	Net Total outturn compared with Estimate: savings/ (excess) £000
Net Resource Outturn	SOPS1	5,965,732	5,916,926	48,806
Accruals adjustments:				
Non cash items		(8,866,657)	(8,834,088)	(32,569)
Changes in working capital other than cash		71,939	87,639	(15,700)
Use of provision:				
Pension		4,380,519	4,321,693	58,826
Compensation Scheme		86,384	80,711	5,673
Net cash requirement		1,637,917	1,572,881	65,036

Parliamentary Accountability Disclosures

This section has been subject to audit

Losses and Special Payments

There are no losses or special payments totalling more than the £300,000 threshold.

The Certificate and Report of the Comptroller and Auditor General to the House of Commons

I certify that I have audited the financial statements of the Armed Forces Pension Scheme (incorporating the Armed Forces Compensation Scheme), for the year ended 31 March 2016 under the Government Resources and Accounts Act 2000. The financial statements comprise: the Combined Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity; and the related notes. I have also audited the Statement of Parliamentary Supply and related notes, and the information in the Parliamentary Accountability disclosures that is described as having been audited. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Accounting Officer and auditor

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Accounting Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Government Resources and Accounts Act 2000. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Scheme's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Accounting Officer; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the Report of the Managers, Report of the Actuary and the Governance Statement to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

I am required to obtain evidence sufficient to give reasonable assurance that the Statement of Parliamentary Supply properly presents the outturn against Parliamentary control totals and that those totals have not been exceeded. The voted Parliamentary control totals are Annually Managed Expenditure (Resource), Non-Budget (Resource) and Net Cash Requirement. I am also required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on regularity

In my opinion, in all material respects:

- the Statement of Parliamentary Supply properly presents the outturn against voted Parliamentary control totals for the year ended 31 March 2016 and shows that those totals have not been exceeded; and
- the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on financial statements

In my opinion:

- the financial statements give a true and fair view of the state of the Scheme's affairs as at 31 March 2016 and of its net operating cost for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions issued thereunder.

Opinion on other matters

In my opinion:

- the Parliamentary Accountability Disclosures to be audited have been properly prepared in accordance with HM Treasury directions made under the Government Resources and Accounts Act 2000; and
- the information given in the Report of the Managers and the Report of the Actuary for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I report by exception

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- adequate accounting records have not been kept or returns adequate for my audit have not been received from branches not visited by my staff; or
- the financial statements and the Parliamentary Accountability Disclosures to be audited are not in agreement with the accounting records and returns; or
- I have not received all of the information and explanations I require for my audit; or
- the Governance Statement does not reflect compliance with HM Treasury's guidance.

Report

I have no observations to make on these financial statements.

Sir Amyas C E Morse
Comptroller and Auditor General

30 June 2016

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

Combined Statement of Comprehensive Net Expenditure

for the year to 31 March 2016

		2015-16	2014-15
	Note	<u>£000</u>	<u>£000</u>
Principal Arrangements – Armed Forces Pension Scheme			
Income			
Contributions receivable	2	(2,916,315)	(1,865,164)
Transfers In	3	(847)	(831)
Expenditure			
Current Service cost	4	3,052,506	2,662,588
Past Service cost	4	200,000	30,000
Enhancements	5	1,009	805
Transfers In	6	847	831
Pension financing cost	7	5,459,139	5,597,036
Net Expenditure		<u>5,796,339</u>	<u>6,425,265</u>
Armed Forces Compensation Scheme			
Movement in provision for AFCS	14	71,003	(30,331)
Compensation financing cost	14	49,584	51,461
Net Expenditure		<u>120,587</u>	<u>21,130</u>
Combined Net Expenditure	SOPS1	<u>5,916,926</u>	<u>6,446,395</u>
Other Comprehensive Net Expenditure			
Pension re-measurements:			
Actuarial (gain) / loss – Armed Forces Pension Scheme	11.7	(13,591,808)	20,995,339
Actuarial (gain) / loss – Armed Forces Compensation Scheme	14	(30,231)	203,611
Total Comprehensive Net Expenditure for the year ended 31 March 2016		<u>(7,705,113)</u>	<u>27,645,345</u>

The Notes on pages 35 to 43 form part of these accounts.

Combined Statement of Financial Position

as at 31 March 2016

		2015-16	2014-15
	Note	£000	£000
Principal arrangements – Armed Forces Pension Scheme			
Current assets:			
Receivables	8	249,650	159,826
Cash and cash equivalents	9	65,036	1,196
Total current assets		<u>314,686</u>	<u>161,022</u>
Current liabilities:			
Payables	10	(594,116)	(527,299)
Total current liabilities		<u>(594,116)</u>	<u>(527,299)</u>
Net current liabilities, excluding pension liability		<u>(279,430)</u>	<u>(366,277)</u>
Pension liability	11.4	(145,200,000)	(154,400,000)
Net liabilities, including pension liabilities		<u>(145,479,430)</u>	<u>(154,766,277)</u>
Armed Forces Compensation Scheme			
Receivables	12	329	284
Payables (within 12 months)	13	(1,523)	(2,270)
Provisions for liabilities and charges	14	(1,412,268)	(1,402,623)
Net liabilities		<u>(1,413,462)</u>	<u>(1,404,609)</u>
Combined Schemes – Total net liabilities		<u>(146,892,892)</u>	<u>(156,170,886)</u>
Taxpayers' equity:			
General fund		(146,892,892)	(156,170,886)
		<u>(146,892,892)</u>	<u>(156,170,886)</u>

Stephen Lovegrove
Accounting Officer for the AFPS and AFCS

29 June 2016

The Notes on pages 35 to 43 form part of these accounts.

Combined Statement of Changes in Taxpayers' Equity

for the year ended 31 March 2016

		2015-16	2014-15
	Note	£000	£000
Balance at 1 April		(156,170,886)	(131,058,489)
Net Parliamentary Funding – drawn down		1,636,721	2,487,952
Net Parliamentary Funding – deemed		1,196	46,192
Supply payable adjustment	9	(65,036)	(1,196)
Excess Vote – Prior Year		-	-
CFERs payable to the Consolidated Fund		-	-
Contingencies Fund Advance		100,000	116,000
Repayment to the Contingencies Fund		(100,000)	(116,000)
Combined Net Expenditure for the Year	SOPS1	(5,916,926)	(6,446,395)
Actuarial gain / (loss) – Armed Forces Pension Scheme	11.7	13,591,808	(20,995,339)
Actuarial gain / (loss) – Armed Forces Compensation Scheme	14	30,231	(203,611)
Net change in Taxpayers' Equity		9,277,994	(25,112,397)
Balance at 31 March		(146,892,892)	(156,170,886)

The Notes on pages 35 to 43 form part of these accounts.

Combined Statement of Cash Flows

for the year ended 31 March 2016

		2015-16	2014-15
	Note	£000	£000
Cash flows from operating activities			
Combined net expenditure for the year	SOPS1	(5,916,926)	(6,446,395)
Adjustments for non-cash transactions:			
(Increase) / Decrease in receivables – principal arrangements	8	(89,824)	4,716
Decrease / (Increase) in receivables - AFCS	12	(45)	(28)
(Decrease) / Increase in payables – principal arrangements	10	2,977	56,094
(Decrease) / Increase in payables – AFCS	13	(747)	(256)
Increase in pension provision	11.4	8,711,645	8,289,624
Increase in pension provision – enhancements and transfers in	11.4	1,856	1,636
Use of provisions – pension liability	11.5	(4,281,599)	(4,291,258)
Use of provisions – refunds and transfers	11.6	(40,094)	(95,341)
Increase in provisions – compensation Scheme	14	120,587	21,130
Use of provisions – compensation Scheme	14	(80,711)	(72,870)
Net cash outflow from operating activities		(1,572,881)	(2,532,948)
Cash flows from financing activities			
From the Consolidated Fund (Supply): current year		1,636,721	2,487,952
From the Contingencies Fund		100,000	116,000
Repayment to the Contingencies Fund		(100,000)	(116,000)
Net Financing		1,636,721	2,487,952
Net Increase / (Decrease) in cash and cash equivalents in the period before adjustment for receipts and payments to the Consolidated Fund		63,840	(44,996)
Receipts due to the Consolidated Fund which are outside the scope of the Scheme's activities		-	-
Payments of amounts due to the Consolidated Fund		-	-
Net Increase / (Decrease) in cash and cash equivalents in the period after adjustment for receipts and payments to the Consolidated Fund	9	63,840	(44,996)
Cash and cash equivalents at the beginning of the period	9	1,196	46,192
Cash and cash equivalents at the end of the period	9	65,036	1,196

The Notes on pages 35 to 43 form part of these accounts.

Notes to the Accounts

1. Basis of Preparation of the Scheme Financial Statements

The financial statements of the combined Scheme have been prepared in accordance with the relevant provisions of the 2015-16 Government Financial Reporting Manual (FRoM) issued by HM Treasury. The accounting policies contained in the FRoM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector. IAS 19 Employee Benefits and IAS 26 Accounting and Reporting by Retirement Benefit Plans are of particular relevance to these statements.

In addition to the primary statements prepared under IFRS, the FRoM also requires the Scheme to prepare an additional statement – a Statement of Parliamentary Supply. This statement and its supporting notes, shows Outturn against Estimate in terms of the net resource requirement and the net cash requirement.

1.1 The Armed Forces Pension Scheme (AFPS) is an unfunded, defined benefit pay-as-you-go occupational pension scheme operated by the Ministry of Defence (MOD) on behalf of members of the Armed Forces who satisfy the membership criteria.

1.2 Contributions to the Scheme by employers are set at rates determined by the Scheme's Actuary and approved by HM Treasury.

1.3 The contributions partially fund payments made by the Scheme, the balance of funding being approved by Parliament through the annual Supply Estimates process.

1.4 The administrative expenses associated with the operation of the Scheme are borne by MOD and are reported in the Department's Statement of Comprehensive Net Expenditure (SoCNE).

2. Contributions receivable

	2015-16	2014-15
	£000	£000
Employer	2,915,306	1,864,359
Employees		
AVCs	1,009	805
	2,916,315	1,865,164

The increase of over £1Bn contributions from 2014-15 to 2015-16 is as a result of the change in employer contribution rates and has no impact on pension entitlement. Further details can be found at the Report of the Managers page 6 section 3.2. £2.9Bn contributions are expected to be payable to the Scheme in 2016-17.

3. Transfers-in (see also Note 6)

The nature of the recruitment into the Armed Forces eliminates the opportunity for group transfers into the Scheme.

	2015-16	2014-15
	£000	£000
Individual transfers in from other Schemes	847	831
	847	831

4. Service Cost

	2015-16	2014-15
	£000	£000
Current service cost (see Note 11.4)	3,052,506	2,662,588
Past service cost (see Note 11.4)	200,000	30,000
	3,252,506	2,692,588

Details of the £200M past service cost can be found at the Report of the Managers page 10 section 4.1.

5. Enhancements (see also Note 11.4)

	2015-16	2014-15
	<u>£000</u>	<u>£000</u>
Purchase of added pension and years	1,009	805
	<u>1,009</u>	<u>805</u>

6. Transfers in – additional liability

Amounts receivable in respect of inward transfers increase the pension liability to the same extent. This increase is reflected in the Statement of Comprehensive Net Expenditure as expenditure as part of the movements in the provision during the year.

	2015-16	2014-15
	<u>£000</u>	<u>£000</u>
Individual transfers in from other schemes	847	831
	<u>847</u>	<u>831</u>

7. Pension financing cost (see also Note 11.4)

	2015-16	2014-15
	<u>£000</u>	<u>£000</u>
Net interest on defined benefit liability	5,459,139	5,597,036
	<u>5,459,139</u>	<u>5,597,036</u>

Statement of Financial Position – Armed Forces Pension Scheme

8. Receivables

8.1 Analysis by type

Overpayments to pensioners are inherent in the nature of the Scheme. Payments to pensioners continue until notification of death is received or until non-return of a life certificate.

	2015-16	2014-15
	<u>£000</u>	<u>£000</u>
Amounts falling due within one year:		
Overpaid pensions	5,231	4,548
Bereavement Scholarship Scheme	201	213
Ministry of Defence – SCAPE & AVC receipts and Transfers In	242,292	152,880
	<u>247,724</u>	<u>157,641</u>
Amounts falling due after more than one year:		
Overpaid pensions	1,926	2,185
	<u>249,650</u>	<u>159,826</u>

8.2 Analysis by organisation

	Amounts falling due within one year		Amounts falling due after more than one year	
	2015-16	2014-15	2015-16	2014-15
	£000	£000	£000	£000
Balances with other central government bodies:				
Ministry of Defence	242,292	152,880	-	-
Devolved Administrations (AFBSS)	201	213	-	-
Balances with bodies external to government	5,231	4,548	1,926	2,185
Total receivables	247,724	157,641	1,926	2,185

9. Cash and cash equivalents

	2015-16	2014-15
	£000	£000
Balance at 1 April	1,196	46,192
Net change in cash balances	63,840	(44,996)
Balance at 31 March	65,036	1,196
The following balances at 31 March were held at:		
Government Banking Services	65,036	1,196
Balance at 31 March	65,036	1,196

10. Payables

10.1 Analysis by type

	2015-16	2014-15
	£000	£000
Amounts falling due within one year:		
Pensions	438,311	408,559
HM Revenue & Customs	59,501	59,199
Third party organisations	866	841
Ministry of Defence	30,402	57,424
Bereavement Scholarship Scheme	-	80
	529,080	526,103
Amounts issued from the Consolidated Fund for supply but not spent at year end	65,036	1,196
	594,116	527,299

10.2 Analysis by organisation

	Amounts falling due within one year	
	2015-16	2014-15
	£000	£000
Balances with other central government bodies:		
HM Revenue & Customs	59,501	59,199
Consolidated Fund	65,036	1,196
Ministry of Defence	30,402	57,424
Department for Business, Innovation & Skills	-	80
Balances with bodies external to government	439,177	409,400
Total payables	594,116	527,299

11. Pension Liabilities

11.1 Assumptions underpinning the pension liability

The Armed Forces Pension Scheme is an unfunded defined benefit scheme. The Government Actuary's Department carried out an assessment of the Scheme liabilities as at 31 March 2016. The Report of the Actuary on pages 13 to 17 sets out the scope, methodology and results of the work the Actuary has carried out.

The Scheme managers together with the Actuary and the Auditor have signed a Memorandum of Understanding that identifies, as far as practicable, the range of information that the Scheme managers should make available to the Actuary in order to meet the expected requirements of the Scheme Auditor. This information includes, but is not limited to, details of:

- Scheme membership, including age and gender profiles, active membership, deferred pensioners 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 key assumptions used by the Actuary were:

	At 31 March 2016	At 31 March 2015	At 31 March 2014	At 31 March 2013	At 31 March 2012
Long term rate of increase in salaries	4.2%	4.2%	4.5%	3.95%	4.25%
Inflation assumption	2.2%	2.2%	2.5%	1.7%	2.0%
Discount rate net of pension increases	1.37%	1.3%	1.8%	2.35%	2.8%
Mortality rate at age 60					
- Current Pensioners	Years	Years	Years	Years	Years
• Officers Men	29.4	29.6	29.3	29.2	29.0
• Officers Women	31.5	32.1	31.8	32.6	32.4
• Other Ranks Men	26.8	26.9	27.4	27.1	27.0
• Other Ranks Women	28.9	29.4	29.9	30.5	30.4
- Future Pensioners (from active status) *					
• Officers Men	31.0	31.9	31.6	31.7	31.5
• Officers Women	33.1	34.4	34.1	35.2	35.0
• Other Ranks Men	28.4	29.1	29.7	29.5	29.4
• Other Ranks Women	30.4	31.6	32.2	33.0	32.9

* Life expectancies for active members have been calculated from age 60 based on members aged 45 as at 31 March 2016, or aged 40 at earlier accounting dates.

These key assumptions are inherently uncertain, since it is impossible to predict with any accuracy future changes in the rate of salary increases, inflation, longevity or the return on corporate bonds. The Actuary uses professional expertise in arriving at a view of the most appropriate rates to use in the annual valuation of the Scheme liabilities. However, the Scheme managers acknowledge that the valuation reported in these Accounts is not certain, since a change in any one of these assumptions will either increase or reduce the liability. For example, on its own, even a small rise in the assumed rate of inflation will result in an increase in the pension liability.

The assumption that has the biggest impact on the amount of the reported liability is the discount rate net of price inflation. As set out in the FReM, and as required by IAS 19, the discount rate net of price inflation is based on yields on high quality corporate bonds. The rates are set out in the above table. Any decrease in the discount rate net of price inflation leads to a significant increase in the reported liability.

In accordance with IAS 19 the Scheme Managers are required to undertake a sensitivity analysis for each significant actuarial assumption as of the end of the reporting period, showing how the defined benefit obligation would have been affected by changes in the relevant actuarial assumption that were reasonably possible at that date. This analysis, including details of the methods and assumptions used in preparing the sensitivity analyses, the limitations of these methods, and the reasons for any changes in methods and assumptions used in preparing the sensitivity analyses, are included in the analysis of the pension liability below.

11.2 Analysis of the pension liability

	At 31 March 2016 £Bn	At 31 March 2015 £Bn	At 31 March 2014 £Bn	At 31 March 2013 £Bn	At 31 March 2012 £Bn
Pensions in Payment	73.8	92.3	74.0	69.2	62.6
Deferred Pensions	23.8	25.0	22.1	17.2	14.4
Active Members (Past Service)	47.6	37.1	33.4	31.6	28.6
Total	145.2	154.4	129.5	118.0	105.6

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 into the future. The 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.

The value of the liability on the Statement of Financial Position may be significantly affected by even small changes in assumptions. For example, if at a subsequent valuation, it is considered appropriate to increase or decrease the assumed rate of inflation, or increases in salaries, the value of the pension liability will increase or decrease. 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 11.7 and 11.8. The notes also disclose 'experience' gains or losses for the year, showing the amounts charged or credited for the year because events have not coincided with assumptions made for the last valuation.

11.3 Sensitivity Analysis

A sensitivity analysis for each significant actuarial assumption as at the end of the reporting period is detailed below.

The most significant assumptions are the discount rate, general earnings increases and pension increases (currently based on CPI). A key demographic assumption is pensioner mortality.

As a result of the scheme reform and the MOD's New Employment Model, there is significant uncertainty associated with timings of member exits (withdrawals and retirements) in future. Relatively few members of the AFPS remain in service until their normal pension age. However, a significant proportion retire with immediate benefits in the form of an Immediate Pension (IP) or Early Departure Payments (EDP), often from around age 40. The numbers of members reaching their IP or EDP qualification points could potentially have an impact on the scheme liabilities and so we have included an indication of the approximate effect (on the total past service liability) of a 5% increase in the number of new entrants reaching IP/EDP point compared to the main liability calculations.

The table below shows the indicative effects on the total liability as at 31 March 2016 of changes to these assumptions (rounded to the nearest ½%).

Change in assumption		Approximate effect on total liability		
Financial assumptions				
(i)	discount rate*	+½% a year	-10%	-£14.1 billion
(ii)	long term earnings increases*	+½% a year	+1%	+£0.8 billion
(iii)	pension increases*	+½% a year	+10%	+£14.6 billion
Demographic assumptions				
(iv)	additional one year increase to life expectancy at retirement*		+3%	+£3.8 billion
(vi)	a 5% increase in the proportion of new entrants who reach IP/EDP point		+0%	+£0.5 billion

* Opposite changes in the assumptions will produce approximately equal and opposite changes in the liability.

11.4 Analysis of movements in the Scheme liability

	2015-16	2014-15
	£000	£000
Scheme liability as at 1 April	(154,400,000)	(129,500,000)
Current service cost (Note 4)	(3,052,506)	(2,662,588)
Past service cost (Note 4)	(200,000)	(30,000)
Pension financing cost (Note 7)	(5,459,139)	(5,597,036)
Enhancements (Note 5)	(1,009)	(805)
Pension transfers in (Note 6)	(847)	(831)
	<u>(8,713,501)</u>	<u>(8,291,260)</u>
Benefits payable (Note 11.5)	4,281,599	4,291,258
Pension payments to and on account of leavers (Note 11.6)	40,094	95,341
	<u>4,321,693</u>	<u>4,386,599</u>
Actuarial gain / (loss) (Note 11.7)	13,591,808	(20,995,339)
Scheme liability at 31 March	(145,200,000)	(154,400,000)

11.5 Analysis of benefits paid

	2015-16	2014-15
	£000	£000
Pensions to retired employees and dependants (net of recoveries or overpayments)	3,866,751	3,808,262
Commutations and lump sum benefits on retirement	414,848	482,996
Total benefits paid	4,281,599	4,291,258

11.6 Analysis of payments to and on account of leavers

	2015-16	2014-15
	<u>£000</u>	<u>£000</u>
Individual transfers to other Schemes	40,094	95,341
Total payments to and on account of leavers	<u>40,094</u>	<u>95,341</u>

11.7 Analysis of actuarial (loss) / gain

	2015-16	2014-15
	<u>£000</u>	<u>£000</u>
Experience gains / (losses) arising on Scheme liabilities	3,591,808	(4,195,339)
Changes in assumptions underlying the present value of Scheme liabilities	10,000,000	(16,800,000)
Total actuarial gain / (loss)	<u>13,591,808</u>	<u>(20,995,339)</u>

11.8 History of experience (gains) / losses

	2015-16	2014-15	2013-14	2012-13	2011-12
Experience (gains) / losses on Scheme liabilities: (£000)	(3,591,808)	4,195,339	(3,005,056)	(42,737)	746,322
Percentage of the present value of the Scheme liabilities	(2.47%)	2.72%	(2.32%)	(0.04%)	0.71%
(Gains) / Losses / arising due to changes in actuarial assumptions: (£000)	(10,000,000)	16,800,000	11,400,000	9,200,000	300,000
Percentage of the present value of the Scheme liabilities	(6.89%)	10.88%	8.80%	7.80%	0.28%
Total amount recognised in Combined Statement of Comprehensive Net Expenditure: (£000)	(13,591,808)	20,995,339	8,394,944	9,242,737	1,046,322
Percentage of the present value of the Scheme liabilities	(9.36%)	13.60%	6.48%	7.83%	0.99%
Total cumulative actuarial loss/(gain): (£000)	60,333,447	73,925,255	52,929,916	44,534,972	35,292,235

Statement of Financial Position – Armed Forces Compensation Scheme

12. Receivables

	2015-16	2014-15
	<u>£000</u>	<u>£000</u>
Amounts falling due within one year:		
Overpaid compensation	329	284
	<u>329</u>	<u>284</u>

13. Payables

	<u>2015-16</u>	<u>2014-15</u>
	£000	£000
Amounts falling due within one year:		
Compensation	1,523	2,270
	<u>1,523</u>	<u>2,270</u>

14. Provision for liabilities and charges

Armed Forces Compensation Scheme

The Armed Forces Compensation Scheme (AFCS) was introduced from 6 April 2005 to provide compensation where service is the only or main cause of an injury, illness or death. As compensation for pain and suffering, the AFCS makes a lump sum payment for qualifying injuries and illnesses caused mainly by service. The value is determined by a tariff which has 15 levels. For more serious injuries and illnesses (within tariff levels 1-11) where a loss of earnings capacity may be expected, an ongoing Guaranteed Income Payment (GIP) is awarded.

The Scheme is required to provide for the injuries to military personnel that have occurred whilst in service. The provision reflects claims that have been made based on injuries that have occurred, including those injuries occurred but not yet claimed. Military personnel have up to 7 years to make a claim under the AFCS.

Assumptions underpinning the provision for AFCS liability

As for previous years, the actuarial assumptions used in assessing liabilities for GIPs are consistent with those used for resource accounting in respect of the AFPS.

Assumptions fall into two categories, financial and demographic. The main financial assumptions adopted as prescribed by HM Treasury are set out below.

% per annum	31 March 2016	31 March 2015
Gross discount rate	3.60%	3.55%
CPI inflation	2.20%	2.20%
GIP increases	2.20%	2.20%
Discount rate net of CPI	1.37%	1.30%
Discount rate net of GIP increases	1.37%	1.30%

The key demographic assumption is in respect of mortality. The mortality assumptions adopted follow a consistent approach to the AFPS mortality assumptions for resource accounting as at 31 March 2016. The levels of future mortality improvement have been assumed in accordance with the improvements incorporated in the published 2014-based principal population projections for the United Kingdom (prepared by Office of National Statistics).

The projections have been adjusted for Scheme-specific effects. Details of rank were not available, and for the purposes of determining the mortality assumption to be used it has been assumed that all the GIPs relate to other ranks rather than officers. Mortality for members and their spouses and children is assumed to be consistent with the relevant AFPS assumption for other ranks.

Where members have been awarded a GIP but have not yet been discharged the liability has been estimated on the assumption that they are discharged on the accounting date.

For incidents incurred but not yet claimed the GIP and Lump Sum liability is estimated using the assumption that the amount to be awarded will be consistent with historical awards and rejections based on a comparable level of injury being sustained.

	2015-16	2014-15
	£000	£000
AFCS Provision		
Balance at 1 April	(1,402,623)	(1,250,752)
Use of provision in year	80,711	72,870
Interest on Scheme Liabilities	(49,584)	(51,461)
Revaluation at year end	(71,003)	30,331
Actuarial gain/(loss)	30,231	(203,611)
Balance at 31 March	(1,412,268)	(1,402,623)
Breakdown of Balance at 31 March:		
Incidents incurred but not yet claimed – Lump Sums and Guaranteed Income Payments	(147,668)	(162,823)
Guaranteed Income Payments – “In Payment”	(1,064,400)	(977,800)
Guaranteed Income Payments – “Underlying Entitlement”	(200,200)	(262,000)
	(1,412,268)	(1,402,623)

15. Financial Instruments

As the cash requirements of the Scheme are met through the Estimates process, financial instruments play a more limited role in creating and managing risk than would apply to a non-public sector Scheme of a similar size. There are no material financial instruments in relation to the Scheme.

16. Contingent Liabilities disclosed under IAS 37

The British Gurkha Welfare Society has lodged an appeal with the European Court of Human Rights in relation to the offer to transfer from the Gurkha Pension Scheme (GPS) to the AFPS 75 or 05. The Secretary of State for Defence provided details of a broad estimate, produced by GAD, of £1.5bn for the capitalised cost of providing retired Gurkhas with AFPS equivalent pensions for all pensionable service before 1 July 1997 [[HC Deb 8 July c789W](#)]. However this estimate is subject to significant uncertainty, and the actual impact on the scheme accounts will depend on a range of factors which cannot be accurately predicted at this time. Examples of some of these uncertainties are, the scope and precise details of any legal judgement, the proportion of members taking up any option to transfer to the AFPS, future exchange rates, the relative level of pensions paid by GPS and AFPS, and the assumptions underpinning future accounting assessments of the scheme.

17. Related-party transactions

The Schemes fall within the ambit of the MOD, which is regarded as a related party. During the year, the Schemes received employer contributions (SCAPE) and employees' contributions from MOD in respect of active members of the AFPS. These contributions totalled £2.92Bn (see Note 2). None of the managers of the Schemes, key managerial staff or other related parties has undertaken any material transactions with the Schemes during the year. Certain key managerial staff and members of the Executive Committee are members of the Scheme. The benefits they are entitled to are not different to other members of the Scheme.

18. Events after the Reporting Period

The result of the referendum held on 23 June was in favour of the UK leaving the European Union. This is a non-adjusting event. A reasonable estimate of the financial effect of this event cannot be made. Sensitivity analysis around the key financial assumptions underpinning the actuarial valuation of the Scheme liabilities that may potentially be affected by this decision can be found in the Report of the Actuary on pages 16 and 17.

19. Date of authorisation for issue

The financial statements have been authorised for issue by the Accounting officer on the same date as the C&AG's certificate.

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