Pension
Protection
Fund

Annual Report and Accounts

2005/06

HC 1586

£18

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Annual Report presented to Parliament by the Secretary of State for Work and Pensions in pursuance of paragraph 119(5) of the Pensions Act 2004 and Accounts presented to Parliament by the Secretary of State for Work and Pensions on behalf of the Comptroller and Auditor General in pursuance of paragraph 22 (6) (b) of Schedule 5 of the Pensions Act 2004.

Ordered by the House of Commons to be printed on 6 November 2006.

HC 1586 **London: The Stationery Office** **£18**

Role of the Pension Protection Fund

The Board of the Pension Protection Fund is a Public Corporation which derives its duties and powers from the Pensions Act 2004 and is accountable to Parliament through the Secretary of State for Work and Pensions. The Board of the Pension Protection Fund became operational on 6 April 2005.

It was established to pay compensation to members of defined benefit and hybrid occupational pension schemes where an employer has become insolvent, and where there are insufficient assets in the pension scheme to cover Pension Protection Fund levels of compensation. Providing certain conditions are met, the Pension Protection Fund will take over the assets of a pension scheme and pay compensation to eligible individuals. It is funded by an annual levy on defined benefit and hybrid pension schemes.

In addition, the Board of the Pension Protection Fund has taken over the role of the former Pension Compensation Board to pay compensation to defined benefit and defined contribution pension schemes where these schemes have suffered a loss that is attributable to dishonesty.

Vision, Mission and Values

As part of its approach to strategic direction, the Board developed a Vision, Mission and Values.

Vision

"A society where all can enjoy the security of a fair pension in retirement."

Mission

"Promoting increased confidence in and setting reasonable expectations for members of UK defined benefit pension schemes by:

- paying the right people the right compensation at the right time
- prudent and effective management of our investments to meet future obligations
- setting and collecting a levy which is appropriate and proportionate; balancing employer and member interests
- communicating clearly what we do and why."

Values

OUR VALUE	INTEGRITY + TRUST	COMPETENCE + PROFESSIONALISM	TEAMWORK + PARTNERSHIP	TRANSPARENCY	PROPORTIONALITY
DEMONSTRATED BY	BEING PRINCIPLED IN OUR ACTIONS RESPECTING CONFIDENTIAL INFORMATION ENSURING THAT RELIANCE CAN BE PLACED ON OUR WRITTEN AND ORAL STATEMENTS	POSSESSING THE APPROPRIATE RESOURCES, CAPABILITIES AND SKILLS TO ACHIEVE OUR GOALS	WORKING WITH OTHERS TO ACHIEVE THE BEST RESULTS CO-ORDINATING ACTIVITIES WITH THE PENSIONS REGULATOR WORKING EFFECTIVELY WITH COLLEAGUES CONSULTING OUR STAKEHOLDERS	DEMONSTRATING OPENNESS IN ALL OUR ACTIONS	MAKING BALANCED DECISIONS

The Board of the Pension Protection Fund

Annual Report and Accounts 2005/06

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1. Chairman's Foreword

Lawrence Churchill
Chairman

It is my pleasure to write the foreword to the second Annual Report of the Pension Protection Fund (PPF). This report is the first to cover operations after the formal commencement of our powers on 6 April 2005 and to include our report and accounts.

Much has been achieved in the last year:

- the importance of providing a safety net was underlined by the 43,000 scheme members associated with schemes already in our assessment period. That is 43,000 individuals and their families who now benefit from the security offered by the PPF
- the PPF established a strong reputation for constructive partnership with trustees, sponsoring employers and their representatives and advisors. A stakeholder perception audit, conducted in March 2006 by Ipos-MORI, reported both positive feedback and insights into how we can engage with various stakeholders even more successfully in the future
- the risk based levy was introduced at the earliest possible opportunity in the 2006/07 financial year. This was groundbreaking work and the UK is the first jurisdiction in the world to benefit from such a system. There were some difficult judgements on the balance between scheme members' security and levy payers' interests but we arrived at a proposal which was widely judged to be fair, simple and proportionate.

These achievements were made against a background of consistent understaffing as demand often outstripped supply, and a shortage of comprehensive accurate data on which risk management could be based.

On corporate governance, we adopted the Good Governance Standards for Public Services' recommendations and carried out a Board effectiveness review based on its principles. This was a helpful exercise and revealed areas where we felt Board effectiveness could be improved.

On the broader pensions landscape, the Pensions Commission produced a compelling analysis and a blueprint for the future which informed the White Paper "Security in retirement: towards a new pensions system" issued in May 2006. The PPF remains dedicated to bolstering security and confidence in occupational defined benefit schemes as part of the wider government agenda to provide security in retirement. Consciousness and understanding of risk in relation to pensions (both defined benefit and defined contribution) are still developing and the PPF intends to play a full role in stimulating risk awareness and incentivising risk reduction.

Encouraged by the Pensions Regulator, the PPF is beginning to consider how it could reach a judgement on how effectively the Pensions Regulator is carrying out its statutory duty to protect the PPF, as this will be an issue of major significance to levy payers.

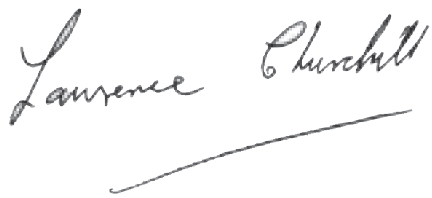
I flagged up in my foreword to last year's Annual Report that significant deficits might arise in the Fund in the early years. My judgement at the end of our first year of operation is that, while there is much to work on for the future, the results set out in our accounts are in line with our initial expectations.

Success could not have been achieved without constructive engagement with our stakeholders and I thank them for their time, expertise and insight. I would also like to record my special thanks to the staff who have worked extremely hard and with great purpose. In this regard I would like to thank Myra Kinghorn, our inaugural Chief Executive, for her dedication in leading the organisation from a concept to its first complete year of operation. On behalf of the Board I wish her every success as she resumes her non-executive portfolio career. I am delighted that we were able to appoint a successor promptly but after an extensive search. I look forward to working more closely with Partha Dasgupta, formerly our Director of Investment and Finance, in the years ahead. I would like to pay special tribute to the Non-executive Members who have contributed both expertise and time well in excess of what could be reasonably expected.

There is, of course, more to do. We do not yet have comprehensive data for all schemes, we are refining our risk models and we look forward to transferring schemes into the PPF at the end of their assessment periods. We believe in continuous improvement and will always strive to do better in providing the British public with the protection they deserve.

Looking forward to the year ahead, I share a sense of excitement about our strategy and our busy programme to take the PPF to the next challenging stage of its development.

Lawrence Churchill
Chairman



Date: 23 October 2006

2. Chief Executive's Report

The most significant outcome of our first year is that 43,000 individuals across the UK have financial security in retirement, which would not have existed without the creation of the PPF. For some, the benefits may not crystallise for many years but for others the effects are already meaningful. This values in human terms the protection that the PPF offers to individual scheme members and their families. It is estimated that there are more than 14 million members of defined benefit pension schemes in the UK[1] and these individuals can feel reassured that the PPF is in operation.

A key focus for the first year of our operations has been to build our capability. The expertise required to fulfil our objectives spans finance, investments, pensions, insurance, insolvency and administration. Value for money and efficiency have been important factors when determining the activities we outsource as opposed to those we undertake ourselves. As a result we have outsourced payments administration, investment management, insolvency risk measurement and our IT infrastructure. The first year's achievements are set against a back drop of being under-resourced for much of the year. This is reflected in the significant under-spend on our administration budget (£7.0 million against a budget of £10.2 million). We are seeking to redress the financial and resource balance in our second year, whilst remaining committed to financial discipline and exploiting scale economies.

During the year an initial levy and an administration levy were raised which financed the operation of the PPF. The accounts recognise initial levy income of £138 million and £12.6 million in administration levies.

The year was dominated by the consultations on our proposals to introduce the risk based levy. We undertook two public consultations during the summer and winter of 2005, lasting a total of seventeen weeks. The final levy proposals integrated the ideas contained in our initial proposals with those drawn from stakeholders' responses to our consultations. The policy to include incentives in the calculation of the levy, such as crediting deficit contributions and contingent assets, is consistent with our strategic intent of encouraging risk reduction. The first year was a revolution in pension protection; we will now focus on evolution to promote stability. The benefits of any enhancements to the levy design must exceed the costs and comply with the principles of fairness, proportionality and simplicity.

The PPF is seeking to provide security for members whilst containing costs for levy payers. In December 2005 we published our 2006/7 levy estimate of £575 million, fixing the levy scaling factor at that date. Incentive measures allowed schemes to reduce the cost of their levy payments if they were prepared to reduce the risk of their scheme failing. The combined effects of fixing the scaling factor in December 2005 together with the effect of financial market movements, employers providing more accurate data to D&B and schemes providing more accurate information on multi-employer structures between December 2005 and March 2006 means that the PPF now expects to raise £324 million in pension protection levy in 2006/7.

Although many of the short term risk factors have changed since the levy quantum was announced in December, the Board is still exposed to long term risk factors such as economic downturn or a significant claim and this must inform our thinking and our medium term financial strategy. Hence, we still expect to charge the price of risk over the medium term. Our long term measure of risk is different from an insurance company's buy-out cost, not least because this would need to include its profit margin.

The reduction of aggregate long term risk in the system is an important objective for the PPF; prevention should remain the preferred option for us and our stakeholders. The levy estimate was based on financial modelling, projecting forward the assets and liabilities of eligible pension schemes, allowing for changes in financial markets, insolvencies and discount rates. We will continue to improve our modelling capability by enhancing our long term risk model, working with the leading specialist consultancies, Hewitt, Bacon & Woodrow, Moody's and Barrie and Hibbert to supplement our own knowledge with their expertise. We will also be able to take into account the additional scheme and employer data that has become available since last year through the scheme return and voluntary forms.

For the year ahead, I shall be emphasising effective communication, innovation and delivery. Clear, open and honest communication is a prerequisite for building trust with our stakeholders. Our consultation on the risk based levy demonstrated our willingness to listen. The PPF workshops held across the UK covering the assessment process and risk based levy reinforced our commitment to share information. The initial focus of our communications has been business, professional advisers and trustees, due to the introduction of the risk based levy. We will broaden our communication to encompass scheme members. We will also take into account feedback from our stakeholder survey that suggests we need to increase the effectiveness of our contact with employers and trustees of smaller schemes.

In summary, we seek to be proportionate in our actions when setting the levy, determining our investment approach, considering the affordability of benefits and deciding to outsource activities or build capability. The interests of levy payers must be balanced by those of current and future beneficiaries of compensation.

Finally, I would like to thank the Board and staff of the PPF for their commitment, enthusiasm and support.

Partha Dasgupta
Chief Executive

Date: 23 October 2006

Partha Dasgupta
Chief Executive

[1] The Pensions Regulator's Annual report and accounts 2005/06

3. Management Commentary

3.1 Context: risk reduction

The PPF accounts for 2005/06 recognise 98 schemes as provisions. The 98 schemes had 43,000 members with a deficit provision of £485 million.

During its first year of operation the PPF took a number of significant steps to try to reduce insolvency and under funding risk in the defined benefit population:

- first, through the introduction of a risk based levy for all schemes from the earliest possible opportunity – in practice, from the 2006/07 financial year onwards
- second, through a series of incentive measures to encourage net risk reduction, minimise the likelihood of claims and potentially reduce the levy for individual schemes. These measures included:
  - recognition of special deficit-reduction contributions
  - recognition of certain types of contingent asset arrangements
  - proportionate risk based levy reduction starting where schemes are over 104% funded and leading to no risk based levy payment for schemes 125% or more funded on a Pension Protection Fund basis
  - an overall levy cap of 0.5% of scheme liabilities
  - setting the levy estimate at roughly half the true risk rate for the first year with the clear intention of moving towards the true risk rate over time. This represents a clear incentive for schemes to reduce the level of risk they are running.

Introduction of these measures was built around a structured consultation process described in Section 3.2. Reaction to the overall package of measures was in general positive, and take-up of incentives significant.

The introduction of the new scheme specific funding arrangements by the Pensions Regulator will also provide increased protection to the PPF over time, and the PPF worked closely with the Pensions Regulator on this approach.

3.2 Levies raised and consultations

3.2.1 Levies raised

An initial levy and an administration levy were collected in 2005/06 to finance the operation of the PPF. The initial levy was collected from eligible schemes in 2005/06 in advance of the development of proposals for a risk based levy. A flat rate was set based on the number and type of scheme members. A charge of £15 was made for each active member and for each pensioner member and person receiving a survivor's pension. A charge of £5 was made for each deferred member. The accounts recognise initial levy income of £138 million.

The administration levy was raised by the Secretary of State for Work and Pensions. The amount of levy to be raised was based on the estimated initial start up costs and ongoing administrative costs of the PPF for 2005/06. A charge was made per member but schemes were banded according to size (for full details please see a guide to the pension protection levies 2005/06 available at: http://www.pensionprotectionfund.org.uk/guide_to_levies.pdf). The total sum billed was £12.6 million of which £2.9 million was retained by the DWP to recover its costs for establishing the PPF (DWP's full costs will be recovered over a three year period) and £8.9 million was drawn down by the PPF as grant in aid (of which £7.0 million was spent during the year).

3.2.2 Risk Based Levy

The PPF's decision to introduce the risk based levy for all schemes three years ahead of initial expectations was driven by the views of a wide range of its stakeholders.

The PPF was, however, aware that all stakeholder groups: the actuarial, legal and accounting professions, large corporate bodies, smaller employers, trustees and scheme members would have strong views on the precise proposals for the risk based levy. Throughout the PPF's progress towards the 2006/07 levy year, it therefore sought to remain open to the views of stakeholders and to adapt and amend its proposals wherever possible.

In total, the PPF undertook 17 weeks of consultation. It published two consultation documents, a major interim update, and a formal response to the levy consultation.

The publication of the PPF's initial proposals for calculating both the scheme and risk based elements of the pension protection levy in July 2005 started the first 12 weeks of consultation. The response to that consultation was encouraging. The vast majority of the 220 responses received were supportive of the principles under which the levy would be introduced and the means by which both the underfunding and insolvency risk elements of the risk based levy would be calculated.

However, there was strong support for also taking account of deficit reduction contributions and contingent assets in the levy calculation. As a result, the PPF developed proposals to incorporate both these elements. The PPF also set a limit for a scheme's funding level above which no risk based levy would be payable, thereby providing a funding incentive for all schemes and sponsoring employers.

During the development of its proposals, the PPF kept stakeholders informed by announcing the appointment of Dun & Bradstreet (D&B) as its chosen insolvency risk provider in August 2005, and publishing a consultation update in October 2005 which provided an early indication of how the levy would be calculated for multi-employer schemes.

The second consultation exercise began with the publication of these revised proposals as well as the 2006/07 levy estimate in the middle of December 2005. This document provided the final pieces in the levy jigsaw with the announcement of the levy scaling factor. The PPF's proposals again met with widespread support. A series of six risk based levy roadshows were held across England, Scotland, Wales and Northern Ireland in February 2006 (see Section 3.3) which provided practical advice to stakeholders on what the implementation of the risk based levy meant for their scheme.

Since February the take up of the incentives package and the numbers of special contributions and contingent assets certified to us has been encouraging. The PPF believes that an open approach to consultation has assisted in making the implementation of the levy as efficient as possible.

For the 2007/08 levy year and beyond the PPF will continue to seek out the views of its stakeholders both through the formal consultation process and informally through meetings with and presentations made to a wide variety of audiences. This approach should ensure that stakeholders remain as well informed as possible and that the evolution of the pension protection levy calculation continues to be informed by stakeholder views and suggestions.

3.3 Trustee guidance and workshops

Trustees are one of the PPF's most important stakeholder groups, both as the main link between the PPF and scheme members, and as the key to a scheme progressing as smoothly and as quickly as possible through the assessment process. During 2005/06, the PPF carried out a series of projects designed to provide particular help to trustees and other stakeholders involved in the running of schemes. The most significant of these were the guidance for trustees on the assessment process, and the extensive programme of workshops covering both the levy and the assessment processes.

Trustee guidance
During the year, the PPF developed guidance covering every key stage of the assessment process, which was published on the PPF website. The guidance was updated and enhanced as experience of the assessment process increased. The guidance was supported on the website by over 100 Frequently Asked Questions, and through the PPF's dedicated Stakeholder Support Team, who in 2005/06 dealt with nearly 7,000 phone queries and just over 2,000 e-mails, the majority of them from trustees and pension scheme professionals.

In addition, the PPF also issued guidance on:

- valuation
- the role of insolvency practitioners
- compensation cap factors
- commutation factors
- early retirement factors
- complaints and reviews guide to the Pension Protection Fund levies 2005/06.

These documents can be accessed at: http://www.pensionprotectionfund.org.uk/index/publications.htm

Trustee workshops
A key element in the PPF's communications strategy with its stakeholders was the workshops held in a number of cities around the UK. During 2005/06, the PPF ran six workshops for trustees, scheme advisers and sponsoring employers on the risk based levy, and prepared a further series of three workshops, primarily for trustees, on the assessment process. This second series was run in May 2006. Both series involved presentations from a range of PPF staff, including both Executive Members of the Board and operational caseworkers.

In total, just over 500 people attended the workshops. Satisfaction levels with their content and presentation were high, with those agreeing or strongly agreeing that the event met their needs running at 93% (levy workshops) and 100% (assessment workshops).

3.4 Report against objectives

In spring 2005, the Board set five year strategic objectives for the PPF. These were to:

- maintain the solvency position of the Pension Protection Fund between predetermined limits
- play our part in building confidence in pensions
- pay the right people the right compensation at the right time
- ensure two way communications with stakeholders are effective
- achieve employee satisfaction levels sufficient to fulfil the Pension Protection Fund's purpose
- achieve high levels of stakeholder satisfaction in respect of the organisation's professionalism, policies, processes and helpfulness.

For 2006/07, the Board's fifth objective was changed to read:

- ensure investment in human capital to deliver the Board's functions.

The Board also identified the factors which it believed critical to the success of achieving these longer-term objectives:

- confidence and consensus building
- risk management and early warning systems
- incentivising strong levels of scheme funding.

The Board defined one year objectives for 2005/06 as part of the delivery of the five year strategic objectives and thereby contributing to fulfilling the critical success factors in the PPF's first year of operations.

Objectives for 2005/06 and progress made

Objective – set up and implement effective and robust systems for governance, internal controls and risk management for all aspects of the organisation's operations

During 2005/06, the PPF:

- established a framework of executive committees and systems for operational decisions to ensure effective delegation and internal controls
- created a programme management office to manage the portfolio of programmes and projects that the PPF needed to implement, and to provide programme and project governance. In June 2006 the PPF became the first public sector body to achieve P2MM level 3 and P3M3 accreditation in portfolio, programme and project management which are the industry benchmarks in these areas, building on "Prince 2" and "MSP" methodologies
- developed and implemented a risk management strategy that set out its policies for managing risk consistent with the Treasury Orange Book Management of Risk – Principles and Concepts
- contracted BDO Stoy Hayward to provide assurance to the Audit Committee and management on internal controls
- commissioned six internal audit reports from which all significant recommendations had been implemented by the balance sheet date
- put in place service level agreements with key outsourced service providers.

Objective – establish policies and practices that result in timely decisions enabling eligible pension schemes to be transferred into the Pension Protection Fund and also timely payments to be made to eligible scheme members

During 2005/06 the PPF:

- recruited skilled assessment team members and established a "case-worker" based structure for monitoring and assisting schemes in assessment
- worked with trustees to assist smooth progress through an assessment period
- received 953 Section 120 notices of which 66 were validated and 757 rejected (in most instances because the notices were received from ineligible defined contribution schemes). 130 Section 120 notices were still being processed at the end of the reporting period from which a further number were subsequently validated in the post-balance sheet period, leading to the recognition of the liabilities of 98 schemes in the accounts
- ensured that the 10,000 pensioner members of schemes in the assessment period were paid PPF levels of benefits in a timely fashion
- initiated a compensation payments project to consider alternative ways of administering payments to scheme members, which resulted in the decision – announced in June 2006 – to appoint Capita Hartshead as the compensation payment provider
- agreed project plans with all trustees entering an assessment period

- developed our capacity taking into account value for money, efficiency and effectiveness
- established close links with the National Insurance Services to the Pensions Industry (NISPI) at both an operational and policy level to develop initiatives to speed up Guaranteed Minimum Pension reconciliation work during assessment
- took over the functions of the Pension Compensation Board (which previously dealt with cases of suspected dishonesty) on 1 September 2005.

Objective – prudently and effectively manage investments to meet liabilities

During 2005/06 the PPF:

- prepared and published a Statement of Investment Principles (SIP) setting out the Board's investment strategy for investing levy monies including the portfolio benchmark and investment guidelines
- monitored Insight Investment and PIMCO as fund managers; State Street as the Custodian to the Fund; and Mercer as investment adviser to the Fund
- outperformed the benchmark by 0.1% (5.8% achieved against a benchmark of 5.7%)
- held quarterly meetings of the Investment Committee to review fund manager performance
- invested the assets of the Fraud Compensation Fund in money market funds managed by Fidelity Investment and Insight Investment
- developed a long term risk model to estimate the levy quantum for 2006/07 using economic, insolvency and actuarial information. The model can be used as an input to setting the required levy amount, and will be enhanced to allow the incorporation of additional data.

Objective – be in a position during the financial year 2006/07 to implement the risk based levy (in terms of funding and insolvency)

During 2005/06 the PPF:

- consulted on its plans for the risk based levy in July 2005 and received 220 written responses during the 12 week consultation from a broad range of industry stakeholders
- published an update to the consultation in October 2005 and final proposals in December 2005. These proposals were subject to a further five week consultation period and the Board received over 70 responses to this consultation
- published its levy estimate for 2006/7. The final levy proposals included both funding and insolvency factors and proposed a third factor of contingent assets following feedback during the consultation period
- implemented the proposal to recognise various types of contingent assets as a factor when calculating a scheme's risk based levy
- worked with the Pensions Regulator to identify the correct initial levy amounts for eligible schemes and issued invoices as soon as possible
- appointed D&B in August 2005 as insolvency risk provider and developed requirements with the firm during the consultation process
- worked with the Government Actuary's Department (GAD) on development of a methodology for adapting Minimum Funding Requirement valuations to estimate liabilities on a section 179 basis
- developed a business plan that targeted unit cost reduction.

Objective – establish and operate strong internal financial and management controls and ensure that the organisation has access to sufficient financing to meet operating and capital expenditure requirements

During 2005/06 the PPF:

- developed a supplier management strategy to ensure that value for money was obtained for outsourced services
- put in place internal financial controls including management accounting to enable accurate cash flow forecasting
- held its operating and capital expenditure requirements within the in-year budget
- recruited a specialist risk manager to introduce preferred risk management techniques.

Objective – establish that the organisation has enough staff to meet its needs with the right skills and knowledge and is considered to be a good employer

During 2005/06 the PPF:

- developed a recruitment strategy focused on ensuring that there was sufficient technical expertise available within the organisation – in particular, in the areas of actuarial support, investments and financial modelling, levy implementation and policy development and insolvency and recovery. However, as mentioned in the Chairman's and Chief Executive's reports the PPF experienced staff shortages in some areas due to high demand in the marketplace for the skills which were sought
- periodically reviewed its resourcing requirements and embarked upon a second phase of recruitment during the second half of the year to increase competent capacity in key areas where there were long term requirements for specialist skills
- used a combination of permanent staff and secondments from the private and public sector to support the organisation's activities
- achieved an 80% response rate and a 90% general satisfaction rate in a staff survey conducted in March 2006.

Objective – design and implement an Information Systems/ Information Technology strategy which supports the activities of the organisation

During 2005/06 the PPF:

- appointed BT to provide voice, data, and network services to the PPF
- outsourced the core Information Technology infrastructure, and subsequently remote access, business continuity, disaster recovery and strategy support services
- provided uninterrupted access to its website and received around 270,000 visits to the website during the reporting period
- prioritised the development of business tools for the implementation of the risk based levy and to support the assessment team in its activities
- initiated a corporate data model project to design the long term data platform for the organisation.

Objective – operate a strong working partnership with the Pensions Regulator supported by clear documentation detailing the way in which each organisation supports the other

During 2005/06 the PPF:

- working with the Pensions Regulator, sought to "maximise recovery" for pension schemes which came into an assessment period under the provisions of section 137 of the Pensions Act 2004 through which the PPF obtains the pension scheme's creditor rights. Claims for an estimated £66,000,000 were lodged during the period, which will reduce the size of the deficit for the PPF where schemes enter the fund
- held regular meetings with the Pensions Regulator, including two joint meetings of the Boards
- put in place service level agreements
- developed operating procedures to clarify roles and responsibilities in different insolvency proceedings
- worked with the Pensions Regulator to develop an electronic scheme return to reduce administration for schemes
- worked with the Department for Work and Pensions and the Pensions Regulator within the framework established by the tripartite Memorandum of Understanding (available at: http://www.pensionprotectionfund.org.uk/tmou.pdf) and with the Department through the Management Statement and Financial Memorandum (available at: http://www.pensionprotectionfund.org.uk/financial_memorandum.pdf).

Objective – communicate clearly what we do and why, to scheme members, trustees, professional advisers and other stakeholders

During 2005/06 the PPF:

- issued professional guidance to trustees on the assessment period processes, to actuaries on how to undertake section 179 and section 143 valuations, and to insolvency practitioners
- prepared and published a Statement of Investment Principles (SIP), two consultation documents, and a consultation update document
- provided, through its website, information to stakeholders including a dedicated area on the

3.4 Report against objectives contd

risk based levy featuring forms, policies and frequently asked questions

- undertook six risk based levy workshops explaining the workings of the levy to stakeholders and published two factsheets
- kept in contact with stakeholders. Board Members and staff spoke at over 30 conferences and seminars, often as keynote speakers, to communicate the PPF's policy and approach
- commissioned a stakeholder perceptions audit from Ipos-Mori, the key findings from which included:

  87% of interviewees had a spontaneous understanding of the role of the PPF

  70% of interviewees knew a fair amount about the risk based levy

  67% of interviewees stated that the information received from the PPF was 'very' or 'fairly' trustworthy

  61% of interviewees stated that the PPF works in an open and transparent way

  74% of interviewees rated PPF communications as average or better.

3.5 Risks to achieving the PPF's objectives

In the normal course of business, the PPF is exposed to a number of risks which may impact on the achievement of its strategic objectives. The PPF has developed a risk management strategy that enables it to identify and monitor such risks and put in place mitigation strategies to limit any adverse impact.

Information on the key areas of risk and the management of these risks is set out below:

Reputational risk
The PPF has worked hard to develop a good reputation with its key stakeholders. The maintenance of this reputation is vital to the achievement of the PPF's objectives and in building confidence in pensions. The PPF takes an active role in its stakeholder management and communications which is delivered through an experienced communications team. The PPF's approach is underpinned by a detailed stakeholder and communications plan which is subject to regular review.

Investment risk
The liabilities of the fund are financed substantially by the levies raised and income earned from the investment of these funds. In future monies will also come into the fund from the assets of schemes entering the fund. The PPF appointed three fund managers following a rigorous selection approach that was supported by an experienced firm of investment consultants. The spread of fund managers provides a breadth of skills and experience, as well as reducing the risk of concentration.

The allocation of assets invested is set out in the PPF's Statement of Investment Principles (SIP) 2005 which details the maximum level of holdings permitted in different investment classes and analyses the risks in greater detail. A separate custody firm ensures that assets are held securely and delivered in a timely fashion to enable trades to be completed. In addition, the custody firm provides an independent reconciliation of transactions and valuations which are reviewed by an in-house investment accountant.

The PPF regularly benchmarks the performance of its fund managers using recognised indices; an external firm provides the initial review which is then subject to internal consideration. Oversight of this process is provided by the Investment Committee.

Policy and regulatory risk
From time to time the scope of the PPF's responsibilities may change to help meet the wider aims of government. A significant change in scope could impact on the capability of achieving the PPF's current objectives unless this is managed effectively.

The PPF meets regularly with key stakeholders to ensure that it is aware of any change at the earliest possible stage.

Any change is delivered through the PPF's programme management office that ensures a controlled delivery whilst minimising any impact on our existing organisational capability.

Solvency risk

The most significant financial risk facing the PPF is its solvency position. The PPF employs recognised techniques to produce actuarial valuations of its liabilities on an ongoing basis and as schemes pass through the assessment process.

The PPF's levy quantum was developed using a stochastic long run risk model which was produced with the support of recognised external experts.

The PPF has an in-house insolvency team that engages in negotiations on corporate insolvencies to maximise its recovery of pension debt.

Corporate failure risk

The unexpected failure of a large sector of industry would have a significant impact on the PPF's solvency position and reputation. The Pensions Regulator helps minimise this risk through its statutory objective "to reduce the risk of situations arising that may lead to compensation from the Pension Protection Fund". In addition, the Financial Services Authority helps to contain risk through its capital adequacy and financial stability requirements. The Accounting Standards Board and the International Accounting Standards Board have helped to make risk more transparent through their respective publication of FRS17 and IAS19.

The PPF is enhancing the control framework in this area through the development of an early warning process and investigating the use of financial instruments to hedge this risk.

External or environment risk

The PPF's operations and solvency are sensitive to changes in its external environment. These can occur through a wide range of external changes including demographics, investment returns and the economy. The PPF has identified that this is an area in which it can develop its capabilities and has put in place plans to recruit appropriate specialists. Once in place these specialists will be deployed to monitor risks and introduce appropriate mitigation strategies.

3.6 Financial review

3.6.1 Accounting Officer Statement

In accordance with the standard practice for public bodies contained in HM Treasury guidance, the then Chief Executive of the Board of the Pension Protection Fund, Myra Kinghorn, was appointed Accounting Officer on 2 March 2005 and served until she stood down from her position as Chief Executive on 12 May 2006. I was appointed Accounting Officer for the Board with effect from 12 May 2006, initially on an interim basis and then, with effect from 21 June 2006, on a permanent basis, coincident with my appointment as Chief Executive.

These accounts therefore cover the period of operation of the Board from 6 April 2005 to 31 March 2006 under Mrs Kinghorn's tenure as Accounting Officer. However, in signing these accounts I also have to take account of events in the post year-end period, both up until 12 May 2006, and in the period between 12 May 2006 and the date of signing these accounts, during which I have been Accounting Officer. In deciding to sign these accounts, I have:

- reviewed the documentation provided by Mrs Kinghorn to me on the handover of Accounting Officer responsibilities, in particular the interim Statement on Internal Control she prepared when she stood down as Chief Executive, as well as minutes of Board meetings and Executive committees, together with financial, operating and other management information;
- met with Mrs Kinghorn, other Board Members, and senior managers on the Board's staff to review transactions and events occurring during Mrs Kinghorn's tenure as Accounting Officer;
- met with fellow Board Members, as well as senior managers on the Board's staff, and reviewed minutes of Board meetings and Executive committees, together with financial, operating and other management information; to review transactions and events occurring after my appointment as Accounting Officer;

so that I can satisfy myself as to the completeness and accuracy of the accounts and accompanying statements. Having completed these assurance processes, I am satisfied that it is in order for me to sign these accounts.

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

Audit

The Pensions Act 2004 requires the Board of the Pension Protection Fund's accounts to be audited by the Comptroller and Auditor General. His certificate and report are on pages 41-42. The cost of the audit is shown in Note 3.3b and no services other than the audit are provided by the Comptroller and Auditor General. The Comptroller and Auditor General also audited the accounts of the Pension Compensation Board to 31 August 2005 and the cost of that audit is shown in Note 2.3; no other services other than the audit were provided by the Comptroller and Auditor General to the Pensions Compensation Board.

Partha Dasgupta
Chief Executive and Accounting Officer

Date: 23 October 2006

3.6.2 Introduction to the Funds

The PPF is responsible for two funds created under the Pensions Act 2004, the Pension Protection Fund and the Fraud Compensation Fund. The PPF is also self-accounting in respect of its operating expenses and so effectively runs its own Administration Fund. This review considers each of these three funds separately.

3.6.3 Pension Protection Fund

The principal activity of the PPF is to pay compensation to members of defined benefit pension schemes where the scheme's employer has become insolvent and where the scheme's assets are inadequate to meet its protected liabilities (as defined in the Pensions Act 2004). It will take over the assets and liabilities of these schemes and, in order to make up the shortfall between assets and liabilities, raise protection levies designed to ensure the long term solvency of the Fund. As this review covers the first year of operation of the Fund from 6 April 2005, and because the Pensions Act 2004 requires an assessment period of a minimum of twelve months to validate a scheme for transfer into the Fund, no transfers of scheme assets and liabilities occurred during the year under review, and no compensation payments were made. The first transfers of scheme assets and liabilities, and the first payments of compensation, are expected to occur before the end of 2006.

Levies The protection levy for 2005/06 was designed simply to raise an initial amount of funding for the PPF and was not directly derived from any estimates of pension scheme deficits that the PPF could inherit during the year. The original estimate of £150 million for the initial levy was based on extrapolating the per capita based charges set by the Secretary of State for the Department for Work and Pensions over sample data from individual pension schemes; in the event the accounts recognise actual initial levy income of some £138 million. The calculation, billing and collection of this initial levy were undertaken on the PPF's behalf by the Pensions Regulator. By the end of the period under review, £99 million had been collected and had been invested with the Fund's investment managers or was held on deposit pending investment. As at the date of this report, a further £31 million had been collected, leaving £8 million outstanding. A debt collection programme has been initiated with the Pensions Regulator to recover these outstanding amounts.

For 2006/07, protection levies will be raised incorporating risk based factors (principally scheme underfunding and employer insolvency risks) and scheme-based factors (principally the value of scheme liabilities). The long term modelling completed by the PPF in December 2005, estimated a levy of £575 million based on projections of asset and liability information from a representative sample of over 1,000 pension schemes. The model incorporated projections of insolvencies, interest rate changes and financial market returns, reflecting the major risk factors to which the PPF is exposed. Since December 2005, when the levy estimate of £575 million was announced, the PPF's view has changed on the likely amount to be raised in 2006/07 (which is to be based on schemes' positions as at 31 March 2006). The change in the amount of levy to be collected is due to a combination of:

- market movement
- funding changes
- more accurate data provided to D&B by employers
- more accurate data on multi-employer structures

The PPF's best estimate (at the date of this report) is that it will raise protection levies in 2006/07 totalling £324 million.

Provisions for compensation payments The operation of the assessment period process required under the Pensions Act 2004 means that no claims were settled during the period under review, that is, no Transfer Notices were issued by the PPF accepting the assets and liabilities of pension schemes. The accounts of the Fund show that the PPF has however recognised provisions in respect of 98 pension schemes (including those already in an assessment period) totalling £485 million where the PPF judges eventual entry into the Fund to be probable. "Probable" in this context is defined as schemes where the employer insolvency event occurred on or before the Fund's accounting date; where no scheme rescue is judged likely; and where protected liabilities exceed scheme assets (including recoveries from insolvent employers) at the assessment date.

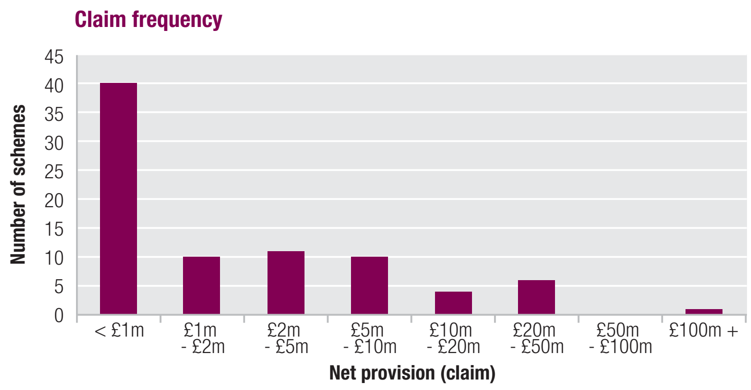
The provisions for claims are arrived at as follows:

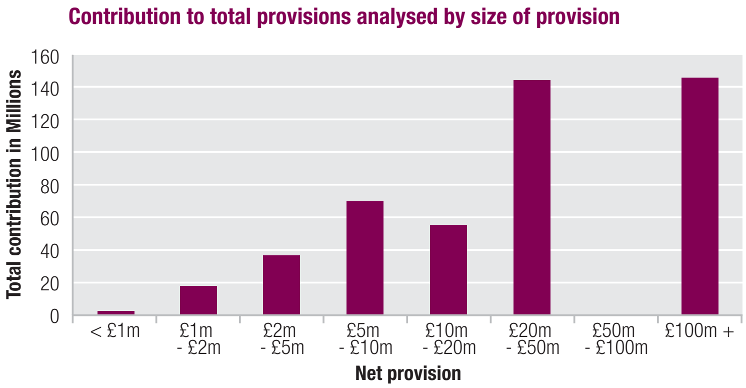
For schemes where eventual entry is considered probable:	£ million
Scheme assets valued at:	1,878
Estimates of recoveries from insolvent employers:	66
Protected liabilities valued at:	(2,429)
Provisions for claims	(485)

In other words, the schemes included in these provisions are in aggregate 80% funded against their protected liabilities, after asset recoveries, on the Fund's ongoing actuarial basis.

The largest single scheme contributes £144 million to the total provision for claims, while the top 5 schemes contribute £246 million. 80% of the total provision for claims is concentrated in just 17% of schemes.

This pattern of contribution can be represented graphically as follows:





The accounts as at 31 March 2006 disclose contingent liabilities associated with 113 schemes valued at £483 million. This is where the PPF judges eventual entry into the Fund to be less than probable, but higher than remote. The value represents the PPF's estimate of the contingent liabilities for claims of all these 113 schemes, and of these 97 schemes with an aggregate provision of £396 million fall into the Type 4 category (as defined in the Actuary's Supplementary Report). Type 4 schemes are schemes where the risk of employer insolvency is considered significant, that is, on average, 29% in any one year; however, the PPF has decided to include 100% of the aggregate allowance for claims value in contingent liabilities.

This level of probable and possible claims is more or less in line with the PPF's expectations, in the context of a period which the PPF considers relatively benign for the UK economy. The rate of corporate insolvencies during the year was 0.7% (compared with a 10 year average of 1.1%) while real interest rates remained low, corporate profits remained high and the economy as a whole continued to grow.

The PPF received 953 insolvency notices during the year, of which the vast majority (757) related to defined contribution schemes and so had no impact on the Fund. 66 notices were validated by the year end, and 130 were in the process of validation. As might be expected during the first year of operation, the PPF noted in some cases a time lag between the date of the insolvency event and the submission by the insolvency practitioner of the notice, as insolvency practitioners became used to these new notification requirements.

Asset recovery

The PPF has a single aim in an insolvency situation. That is to maximise the recovery of the pension scheme debt. The starting position is to determine the dividend that would be received under a liquidation. The PPF takes this as the minimum amount that should be sought for the recovery of the pension scheme debt. Any other alternatives have to prove that they provide a recovery which is demonstratively better than the liquidation outcome.

The size of many pension scheme debts in recent times, and the fact that the PPF takes on the pension scheme's role as creditor where the scheme begins to wind up on formal insolvency, means that the PPF may become a significant player in such an arrangement. In such cases the PPF becomes involved as it is likely to hold the controlling vote at any meeting of creditors held in relation to the prospective insolvency proceedings.

Where it is obvious that the collapse into insolvency (and therefore the entry of the scheme into a PPF assessment period) is inevitable, a compromise over the funding position of the scheme as it begins wind-up may improve the prospect of rescue, while also resulting in a better funding deal for the pension scheme than would otherwise be possible. In these circumstances the PPF will want be involved in discussions about the proposal in order to attempt to "maximise recovery" for the pension scheme.

The rescue process itself will often involve a Clearance Notice being sought from the Pensions Regulator, for example to avoid the Pensions Regulator imposing a Financial Support Direction on connected parties to the rescue. Where this happens, the PPF and the Pensions Regulator work very closely together to try and maximise the prospect of a satisfactory outcome.

Expenses Investment expenses consist of fund management fees and custody charges charged to the Protection Fund, as permitted by the Pension Protection Fund (Payments to meet Investment Costs) Regulations 2005 (SI 2005/1610).

Solvency The recognition of the full actuarial value of probable claims on the Fund, set against the value of the Fund's existing net assets, leads to a deficit on the Fund's balance sheet of £343 million.

This can be summarised as follows:

	£ million
Pension Protection Fund net assets	142
Scheme assets valued at:	1,878
Estimates of recoveries from insolvent employers:	66
Total assets	2,086
Protected liabilities valued at:	(2,429)
Deficit	(343)

In other words, the Fund is in aggregate 86% funded against its protected liabilities, after asset recoveries, on its ongoing actuarial basis.

3.6.4 Fraud Compensation Fund

The Pensions Compensation Board (PCB) was disbanded on 31 August 2005, and its principal activity of providing compensation to occupational pension schemes that suffer a loss that can be attributable to dishonesty passed to the PPF. Its assets, liabilities and outstanding caseload were transferred to the PPF on 1 September 2005. The assets are held in a ring-fenced fund called the Fraud Compensation Fund.

Levies Neither the PCB nor the PPF considered it necessary to raise a Fraud Compensation Levy in 2005/06, nor does the PPF currently anticipate raising a levy in 2006/07. This is based on the PPF's view of the level of funds it already controls compared with the level in process and its current view that the likely incidence of future claims will continue to be very low.

The PPF will keep under review the level of assets compared with the level of liabilities.

Claims Six outstanding claims were handed over by PCB to the PPF and no new claims have been received by the PPF. One claim is now considered unlikely to result in a payment but the PPF discloses in its accounts contingent liabilities of £2.8 million reflecting the five remaining claims which may possibly result in a payment.

Investment In September 2005, the PPF published a Statement of Investment Principles for the Fraud Compensation Fund, benchmarking its investment performance against Bank of England repo rate and allowing investments in cash, deposits and money market funds.

In March 2006, the PPF appointed Insight Investment Management and Fidelity Investments to manage money market funds for the Fund, and funds totalling £3 million were invested in the same month, having been held in the Fund's interest-bearing operating bank account pending the appointment of fund managers.

Expenses The majority of the operating expenses of £64,000 disclosed in the Fraud Compensation Fund's accounts relate to the period from 6 April 2005 to 31 August 2005 and were incurred by the PCB. Following the transfer from PCB to the PPF on 31 August 2005, all operating expenses incurred in administering the Fraud Compensation Fund in periods from 1 September 2005 on will be accounted through the Administration Fund of the PPF.

3.6.5 Administration Fund

The PPF is an autonomous Public Corporation under the stewardship of the Department for Work and Pensions (DWP) and is therefore responsible for accounting for its own income and operating and capital expenditures. The PPF is funded by drawing down grant-in-aid from DWP as empowered by Section 116 of the Pensions Act 2004. These grant-in-aid payments are in turn funded by the DWP raising an annual PPF administration levy on eligible pension schemes as set out in Section 117 of the same Act. The Board and DWP's powers, together with the processes described below by which these powers are utilised, led the PPF to consider it appropriate for the accounts of its Administration Fund to be prepared on a going concern basis.

The key risks facing the PPF in this funding process therefore relate to the accuracy and completeness of its budgeting processes, which inform the DWP's setting of the rate of the administration levy; and the accuracy and completeness of its forecasting processes, which generate the amounts of grant-in-aid drawn down to cover forecast expenditure in the next period.

These risks are mitigated by robust financial disciplines such as:

- the PPF submits each year a Strategic Plan for the three years ahead to the DWP
- the first year of the Strategic Plan sets out a detailed Business Plan, with the objectives for the year and the associated budgeted expenditure required to fulfil those objectives. This Business Plan informs the DWP's calculation of the PPF administration levy
- the regular review of actual in-year expenditures against budgets and the preparation of regular forecasts of expenditures for the remainder of the year
- approval by the Accounting Officer of specific periodic (normally quarterly) draw down requests.

The PPF had sufficient funding on hand throughout 2005/06 to meet operating and capital expenditure requirements. At no time were payments to staff or suppliers delayed due to inadequate funding.

The PPF operated during 2005/06 well within the operating and capital expenditure budgets developed by DWP during the establishment of the PPF. Total operating expenditure amounted to £7.0 million compared with the budget of £10.2 million. The net result for the year of an operating surplus of £2.1 million (after depreciation and impairment adjustments) represents grant-in-aid drawn down in respect of the last quarter of 2005/06 which was in fact not expended during the quarter, with the DWP's agreement. This surplus was taken fully into account in calculating the draw-down for the first quarter of 2006/07.

The PPF budget for 2006/07 was agreed with the DWP in September 2005 to inform the setting of the PPF administration levy for 2006/07. This budget covered all aspects of operating expenditure including staff costs, outsourced services and consultancy and advisory services. The DWP decided to leave the rates of administration levy charge unchanged for 2006/07.

Processes were developed during 2005/06 covering the financial operations of the PPF, including financial controls, procurement processes, and procedures for appointing suppliers and service providers, and assignment of levels of authority for staff.

3.6.6 Going concern

The PPF remains entirely confident that the Pension Protection Fund remains solvent and that its accounts can be prepared on a going concern basis.

- cash flows out of the Fund for compensation payments will be at a very low level during the early years of the Fund's operation, and the current level of funding is considered adequate to ensure cash will be available to meet compensation payments as they fall due
- relevant accounting standards require the Fund to recognise immediately the full present value of probable scheme deficits but the Fund cannot recognise the future streams of protection levy income which will effectively bridge the gap between the assets and liabilities of schemes it transfers in. The PPF is fully confident that its levy raising powers (and its powers to increase levies up to a ceiling set by the Secretary of State for Work and Pensions), and the processes for calculating, billing and collecting levies which it is developing, justify viewing the Fund as a going concern. The PPF's levy-raising powers are set out in Sections 175 to 180 of the Pensions Act 2004
- the PPF also has reserve powers (in extreme circumstances after due consultation and with the approval of the Secretary of State) to reduce benefit payments both for scheme members already within the fund and for new scheme members entering the fund. These powers are set out in the Pensions Act 2004, Schedule 7, paragraphs 29 and 30 covering powers to alter rates of revaluation and indexation, and to vary the percentage paid as compensation.

The PPF is fully confident that the Fraud Compensation Fund is solvent, and that its accounts can be prepared on a going concern basis, since:

- the Fund would be 107% funded even if all the claims currently under consideration were to result in compensation payments
- the PPF has powers to raise further fraud compensation levies to reflect further claims made on the Fund. The PPF's powers are set out in Section 189 of the Pensions Act 2004 and in the Occupational Pension Schemes (Fraud Compensation Levy) Regulations 2006
- the time required to investigate and decide whether payment (including any interim settlements) should be made has in the past proved adequate to raise any required further levy income.

This view is formed in the case of the Administration Fund because:

- of the robust financial procedures adhered to, as set out under section 3.6.5, governing the setting of operating budgets, in-year reviews and forecasts and the drawing down of grant-in-aid.

4. Directors' Report

4.1 Corporate governance

The Board is committed to adhering to high standards of corporate governance and details of its compliance with HM Treasury's Corporate Governance in central government departments: "Code of good practice" are set out in the Audit Committee Report at 4.4.3.

In accordance with the Pensions Act 2004, the Board has a majority of Non-executive Members, including a Non-executive Chairman. All Non-executive Members are independent, having no current or previous material relationship with the organisation as an employee, officer or contractor. All Board Committees are chaired by Non-executive Members. The Board Secretary acted as Secretary to the Board and its Committees during the reporting period.

Attendance at meetings from 1 April 2005 – 31 March 2006

	Board	Non-Executive	Audit	Remuneration	Investment	Decision
No of Meetings	14	3	5	3	4	1
Lawrence Churchill	14	3	n/a	3*	n/a	1*
Ian Abrams	14	3	5	n/a	4	n/a
Mark Baker	12	2	1*	3	3	1
Michael Deakin	12	3	4	n/a	4	1
Jeannie Drake	12	3	n/a	3	n/a	n/a
Christopher Hughes	12	2	5	3	n/a	n/a
Myra Kinghorn	13	n/a	n/a	n/a	4	1
Partha Dasgupta	14	n/a	n/a	n/a	4	1
Alan Duncan	12	n/a	n/a	n/a	n/a	0

* Exercising rights of attendance – Non-executive Board Members may elect to attend meetings of the Remuneration Committee and all Board Members may elect to attend meetings of the Investment Committee.

There were no meetings of the Reconsideration Committee as no business for this committee arose during the reporting period.

4.2 Board and Committee structure and membership at publication date

Board

1 Lawrence Churchill
Chairman
(Chair)

2 Ian Abrams
Non-executive Member
(Chair)

3 Mark Baker CBE
Non-executive Member
(Chair) (Chair)

4 Michael Deakin
Non-executive Member
(Chair)

5 Jeannie Drake CBE
Non-executive Member
(Chair)

6 Christopher Hughes
Non-executive Member and Senior Independent Director

7 Partha Dasgupta
Chief Executive and Accounting Officer

8 Alan Duncan
Director of Compensation

9 Vacancy
Chief Operating Officer

10 Vacancy
Director of Financial Risk

Reconsideration Committee

Non-executive Committee

Investment Committee

Decision Committee

Remuneration Committee

Audit Committee

Committee membership

- Non-executive Committee
- Audit Committee
- Remuneration Committee
- Investment Committee
- Decision Committee
- Reconsideration Committee

Lawrence Churchill

Before joining the PPF, Lawrence Churchill was Chief Executive of Zurich Financial Services, UK Irish and International (2002-4). Lawrence holds a number of non-executive positions, including as a member of the Board of Actuarial Standards.

Ian Abrams

Ian Abrams has been a Non-executive Director of Mizuho International plc since 2003 prior to which he was its managing director. Ian holds a number of non-executive positions.

Mark Baker

Mark Baker CBE was formerly Chairman of Magnox plc and has been Chairman of Electricity Pensions Ltd since 1996. Mark was Deputy Independent Chairman of the Police Negotiating Board from 2000 to 2005 and is a member of the Senior Salaries Review Body.

Michael Deakin

Michael Deakin set up a consultancy business in October 2003 providing strategic investment advice to pension funds. Prior to this Michael was Chief Investment Officer and an Executive Director of Insight Investment.

Full biographies for Board Members can be found at:

Jeannie Drake

Jeannie Drake CBE has been Deputy General Secretary of the Communications Workers Union since 1995. Jeannie holds a number of non-executive positions and has recently served as one of the three Pensions Commissioners. Jeannie has recently completed her term as President of the TUC.

Christopher Hughes

Christopher Hughes is Head of International at the solicitors' practice Wragge & Co LLP, of which he was formerly managing partner. Christopher has also been a Board Member of Severn Trent Water Authority and the Chairman of Newman Tonks Group plc. Christopher is the Senior Independent Director of the Board of the Pension Protection Fund.

Partha Dasgupta

Partha Dasgupta is Chief Executive and Accounting Officer.

Prior to joining the PPF, Partha was Managing Director of Barclays Global Investors, Fixed Income Europe.

Alan Duncan

Alan Duncan is Director of Compensation. Alan started his career in 1977 with Coopers and Lybrand. In 1984 Alan joined Fidelity Investments undertaking a series of international roles, latterly Vice-President for Business Development and Strategic Planning. Prior to joining the PPF, Alan was Director of Operations at INVESCO Pensions Limited.

http://www.pensionprotectionfund.org.uk/index/the-board/the-board-members.htm

4.3 Board Report

The Board's functions are defined by the Pensions Act 2004. To ensure that the Board complied with its statutory remit a Statement of Operating Principles and Scheme of Delegations was produced which included those functions which are reserved for the Board under the Act; this document is available at http://www.pensionprotectionfund.org.uk/statement_of_operating_principles.pdf

Infrastructure
The Board focussed much of its energies in 2005/06 on ensuring that a robust infrastructure, resourcing and processes were put in place to enable the organisation to fulfil its remit. This included approving the budget and overall structure and development of the organisation, scrutinising the due diligence processes for the appointment of third party suppliers, receiving proposals for the development of Information Technology, office and project management systems and the translation of policy into business processes. The Board will continue to review the resourcing needs of the organisation as the organisation's role develops and schemes start to enter the Fund.

Levy
Following extensive consultation the Board agreed a levy estimate of £575 million for 2006/07. This figure did not represent the full insurance cost of covering the risk but sought to provide an incentive to levy payers to achieve fuller funding more quickly and to balance the interests of those to whom compensation would be paid with minimising costs for levy payers.

Contracts
The Board approved the appointment of D&B to assess insolvency risk in August 2005.

Communications strategy and stakeholder engagement
The Board agreed a Communications Strategy in 2005/06. A key aim of the plan was to develop and maintain good relationships with stakeholders. This was furthered through consultation, meetings, briefings, workshops, speaking engagements, the provision of guidance and information and by listening and responding to suggestions received. Feedback from stakeholders about the Board's approach to communication is set out in the executive summary of the Ipos-Mori Stakeholder Perception Audit available at: http://www.pensionprotectionfund.org.uk/mori_summary.pdf

Formal arrangements with the Department for Work and Pensions and the Pensions Regulator were set out in the tripartite memorandum of understanding between the Department for Work and Pensions, the Board of the Pension Protection Fund and the Pensions Regulator, available at: http://www.pensionprotectionfund.org.uk/tmou.pdf

Board performance
A review of the performance of the Board and governance was led by the Chairman of the Board through individual interviews with, and feedback from, Board Members. The Good Governance Standards for Public Services was used to underpin the principles of the review. The outcome of the review was reported back to the full Board in January 2006. A number of proposals came out of the review and are being implemented. This includes that from 2006/07 Board Members will participate in a 360 degree appraisal process, where each Member of the Board provides feedback on other Members of the Board.

Standards
Board Members adhered to a code of conduct which complied with the Cabinet Office's model code. The Code encompassed the Seven Principles of Public Life defined by the Committee on Standards in Public Life and included sections on openness and responsiveness; accountabilities; personal responsibilities, conflicts of interest and confidentiality.

Board Members registered interests with the Board Secretary throughout the year. The register of interests may be viewed at: http://www.pensionprotectionfund.org.uk/board_register_of_interests.pdf

Where Board Members were aware of a conflict of interest the Chairman and Board Secretary were advised of this and the Board Member did not participate in the discussion of that item or, where appropriate, left the meeting for that item.

4.4 Reports required under the Pensions Act 2004

4.4.1 Strategy and objectives

A key function of the Board was to set the strategic direction of the organisation and to assess its performance in meeting the objectives which stem from this high level policy. Following on from two days of strategy formulation in March 2005, the Board conducted a review of the implementation of its strategic objectives in October 2005. The Board held a further strategy day in March 2006 to focus on assessing the performance of the PPF in meeting its first year objectives; to review and revise existing objectives; and to review and revise targets and performance indicators. The Board considered a full written review of the organisation's performance in meeting its first year objectives at its meeting in May 2006.

Information on the organisation's performance in meeting its first year objectives can be found in the Business Plan for 2006/07 http://www.pensionprotectionfund.org.uk/business_plan_0607.pdf . The organisation's long and short term objectives, key specific actions for 2006/07 and performance indicators are set out in the Strategic Plan 2006/07 – 2007/08 at: http://www.pensionprotectionfund.org.uk/strategic_plan.pdf

4.4.2 Non-executive Committee

The Non-executive Committee met formally on three occasions between 6 April 2005 and 31 March 2006. The matters reserved to the Committee are set out in section 112 of the Pensions Act 2004, these are:

(a) the duty to keep under review the question whether the Board's internal financial controls secure the proper conduct of its financial affairs

(b) the duty to determine under sub-paragraph (5) (a) of paragraph 12 of Schedule 5, subject to the approval of the Secretary of State, the terms and conditions as to remuneration of any Chief Executive appointed under sub-paragraph (4) of that paragraph

(c) the duty to determine under paragraph 13(3)(a) of that Schedule, subject to the approval of the Secretary of State, the terms and conditions as to remuneration of any member of staff who is also to be an Executive Member of the Board

(d) the duty to determine under paragraph 13(3)(b) of that Schedule, the terms and conditions as to remuneration of any member of staff of a description prescribed for the purposes of that provision.

The Committee received reports from the Audit and Remuneration Committees at each of its meetings. The Committee also considered arrangements for the future recruitment of Non-executive Members of the Board to ensure that it continues to contain an appropriate balance of skills and experience, whilst facilitating renewal. The Non-executive Committee also met once without a formal agenda.

4.4.3 Audit Committee

The Audit Committee met on five occasions between 6 April 2005 and 31 March 2006. Both the internal and external auditors had full access to meeting papers and minutes and attended meetings of the Committee; in addition, separate discussions were held with the Chairman of the Audit Committee. Internal auditors were appointed on an interim basis from the Department for Work and Pensions Risk Assurance Division until the appointment of BDO Stoy Hayward in January 2006. The National Audit Office provided the external audit service.

In 2005/06 the Committee:

- carried out a tender exercise to appoint internal auditors, BDO Stoy Hayward
- reviewed reports received from the internal auditors and the Executive's action plan to implement recommendations
- reviewed financial procedures
- monitored the organisation's top-down risk register
- reviewed the organisation's accounting policies
- reviewed the organisation's whistleblowing policy.

The Audit Committee monitored and commented on the organisation's risk management processes and reported on these to the Non-executive Committee after each meeting.

4.4 Reports required under the Pensions Act 2004 contd

Audit reports
Six internal audit reports were received from the DWP Risk Assurance Division in January 2006, which covered the following areas:

- freedom of information and data protection
- levy consultation exercise
- financial arrangements (investments and funding arrangements)
- commercial banking
- assessments
- accounting and financial procedures.

Overall the audit reports found limited assurance, reflecting the stage of development of the organisation which had yet to complete a full year in operation at the time of these initial audits.

The six audit reports produced 47 recommendations of which all but six had been implemented by 31 March 2006. BDO Stoy Hayward took forward the work started by the DWP Risk Assurance Division and reviewed the organisation's implementation of the recommendations from four of the internal audit reports (follow-up reports for assessment processes and freedom of information and data protection had not been completed by June 2006). In June 2006 BDO Stoy Hayward confirmed that the PPF had implemented all bar one of the recommendations of the four internal audit reports. This included recommendations outstanding at 31 March 2006 where a completion date of June or earlier had been agreed. A later completion date had been agreed with the internal auditors in two cases and the implementation of these was on track at the date of publication of this report.

In addition the organisation produced six monthly accounts to provide a "dry run" exercise for the production of the accounts for the year and to help finalise accounting policies. The National Audit Office provided feedback on the six monthly accounts and all its suggestions were incorporated when producing the annual accounts.

An internal assessment of compliance with HM Treasury's documents: Corporate Governance in central government departments: "Code of good practice" and the Orange Book Management of Risk – Principles and Concepts was undertaken in March 2006 and an internal audit report on corporate governance and risk management was received in June 2006. Over the reporting period the Board complied with the standard set by the corporate governance code, with the exception that its Audit Committee's terms of reference had not been published on the website. As required under the code, the Director of Investment and Finance was a member of the Board throughout the reporting period. The terms of reference for the Board and its committees are available at: http://www.pensionprotectionfund.org.uk/index/the-board.htm

The Audit Committee monitored and commented on the organisation's risk management processes and reported on these to the Non-executive Committee after each meeting.

4.4.4 Remuneration Committee
The Remuneration Committee met on three occasions between 6 April 2005 and 31 March 2006.

In 2005/06 the Committee:

- ensured that appropriate objectives were in place for the Executive Directors against which performance was measured in 2005/06 and initiated a similar process for 2006/07. The Committee was unable to finalise the latter arrangements until after the end of the year under review. The process for translating corporate objectives into personal objectives in a timely fashion needed to be more streamlined in future years to ensure that Executive Directors' objectives are finalised before the start of the financial year
- reviewed the performance of the Chief Executive in discussion with the Chairman and that of the Executive Directors in discussion with the Chief Executive
- reviewed the pay levels of Executive Members of the Board
- was consulted on proposals for staff remuneration arrangements, including the introduction of a staff bonus scheme
- was consulted on proposals made to the Department for Work and Pensions for the annual pay round for staff.

4.5 Reports from other Board Committees

4.5.1 Decision Committee

The Decision Committee met once between 6 April 2005 and 31 March 2006 to consider the terms on which the PPF would support an arrangement between the trustees and the sponsoring employer of a scheme. The Board's support was necessary as the PPF would become a contingent creditor if the arrangement proceeded.

The Decision Committee undertakes first stage reviews of decisions that have been the subject of a formal complaint, and takes decisions on matters normally delegated to the Chief Executive that he refers back to the Committee as well as specific decisions assigned to it by the Board where that is judged necessary in the light of possible reviews/ complaints.

Members of the Decision Committee cannot be members of the Reconsideration Committee and vice versa so that those who have participated in the original decision will not be compromised should the matter move to a second stage review or complaint.

4.5.2 Reconsideration Committee

The Reconsideration Committee did not meet in 2005/06 but a workshop was held to consider the processes and procedures to which the Committee would adhere.

The Reconsideration Committee is a Committee of the Board required to be established by the Pensions Act[2] for the purpose of carrying out the second stage of the formal appeals process for reviews and complaints.

4.5.3 Investment Committee

- The Investment Committee met on four occasions between 6 April 2005 and 31 March 2006.

In 2005/06, the Committee:

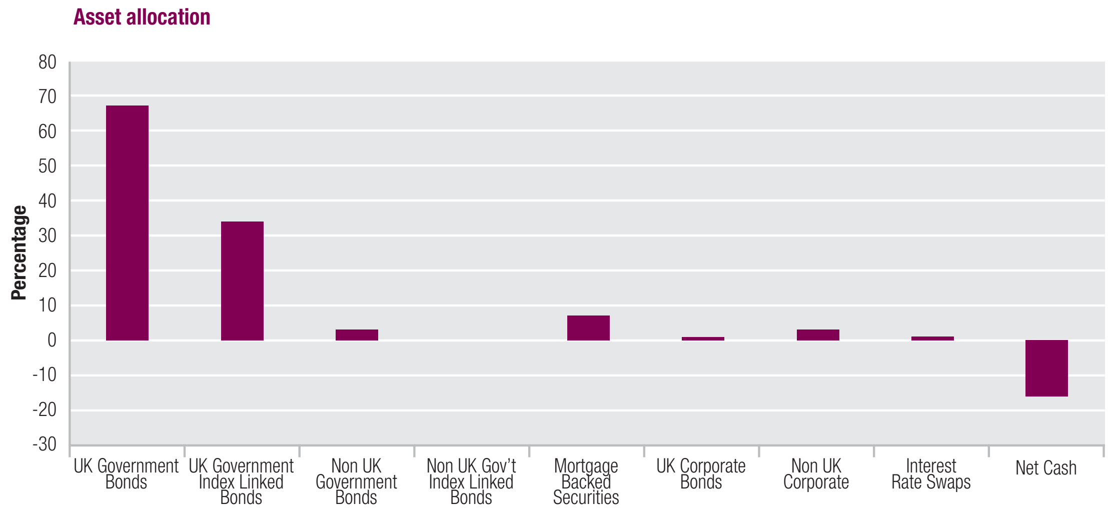
- prepared and published the Statement of Investment Principles 2005 (SIP), approved by the Board. This document set out the strategy in respect of the investment of initial levy funds. The performance benchmark of the fund was designed to reflect the nature and type of the liabilities contained in defined benefit schemes, and so the benchmark consisted of 2/3 of the return on the Over 10 year Gilt Index, and 1/3 of the return on the Over 15 year index-linked Gilts Index. Investment management was (as is required under the Pensions Act 2004) outsourced to external fund managers. The SIP will be reviewed annually and is available at: http://www.pensionprotectionfund.org.uk/sip05.pdf
- monitored the performance and compliance of Insight Investment and PIMCO with their agreed mandates. The first investment was made on 12 July 2005. Goldman Sachs had been appointed as a third fund manager but did not receive its first funds until April 2006
- reviewed reports from State Street, Custodian to the Fund, and monitored its compliance with agreed standards
- reviewed reports from Mercer Investment Consulting, adviser to the Fund, and monitored its compliance with agreed standards
- received presentations from the fund managers, the Custodian and adviser to the fund.

The total fund performance since inception has been 5.8% compared to a benchmark return of 5.7%. This should be interpreted in the context of performance of bond markets in general. Since inception of the fund in August 2005, UK government bond yields initially rose, however towards the end of 2005 yields at longer maturities fell, signalling a rally due to the increased demand from pension funds. However, much of the good performance of bond markets was offset in the first quarter of 2006 as yields rose worldwide as the US economy continued to grow and Europe and Japan showed signs of strength.

[2] Its precise remit is set out in Sections 207 and 208 of the following Regulations: The Pension Protection Fund (Review and Reconsideration of Reviewable Matters) Regulations 2005 (2005 No 669) as amended and The Pension Protection Fund (Maladministration) Regulations 2005 (2005 no 650).

4.5 Reports from other Board Committees contd

The asset allocation of the fund is illustrated below. The negative cash position reflects the use of forward contracts by fund managers. The fund was mainly invested in benchmark assets of gilts and index linked gilts with some limited exposure to overseas bonds.



4.6 Corporate Social Responsibility

Equal opportunities
The PPF is committed to the promotion of equal opportunities and diversity to ensure that the human resources, talent and skills of all employees are maximised through the application of policies and procedures which are consistent and equitable and which recognise the expertise and ability of each individual.

To ensure that this policy is adhered to the PPF monitors equal opportunities and makes decisions about recruitment and promotion based on non-discriminatory and job related criteria.

Environmental policy
The PPF's work is office based with limited environmental impact; however, a recycling programme is operated for cartridges, paper and cardboard. The office's lighting system is motion sensitive which is designed to minimise energy wastage. The PPF has developed and is developing further on-line forms for its stakeholders.

Community and charitable work
The PPF's staff operate a social fund which raised £245 for the Royal Marsden Hospital during the reporting period. The PPF has decided to organise a community based event in 2006 and staff will be invited to participate.

Staff at the PPF may elect to make contributions to their favourite charities through payroll giving which is designed to make such donations more tax-efficient.

The PPF has published an Employee Handbook for its staff which provides full guidance on the areas listed above.

Socially responsible investment
The PPF believes that companies and governments with positive social, environmental, ethical and political principles can reasonably be expected to offer strong long term financial performance and stability. It therefore regards a preference for investment in securities issued by such organisations as consistent with the best financial interests of the Fund and its beneficiaries.

In its regular review of fund managers' performance, the PPF monitors the way that managers take account of social, ethical, environmental and political considerations in their investment decisions.

4.7 Complaints

Complaints received were responded to in the first instance by the Stakeholder Support Team. Where a complaint related to a particular area of the organisation's work staff from that team were involved in resolving the complaint. In 2005/06 four complaints were received and handled in accordance with the Review & Complaints procedure. All cases were resolved at the first stage of the complaints process.

The PPF has published guidance on how complaints will be handled and this is available at: http://www.pensionprotectionfund.org.uk/index/other_guidance/complaints_and_reviews.htm

4.8 Freedom of Information

Where the content of an enquiry indicated that it should be treated formally as a request for information under the Freedom of Information Act 2000[3] it was logged separately from other enquiries. The PPF received seven requests for information which were considered under the Freedom of Information Act 2000 during the reporting period. The organisation was unable to disclose the information requested; in four instances this related to restricted information, the release of which is prohibited by The Pensions Act 2004; in one to commercial sensitivity, and, in two the information requested was not held.

Wherever possible and appropriate the organisation will provide information requested and during the reporting period the Stakeholder Support Team responded to nearly 7,000 phone calls and just over 2,000 e-mails.

A publication scheme and Freedom of Information procedures were published during the year and are available at: http://www.pensionprotectionfund.org.uk/index/publications.htm

[3] The Freedom of Information Act 2000 came into force in January 2005 and gives people a general right of access to information held by or on behalf of public authorities.

5. Remuneration report
(subject to audit – see auditor's report pages 41-42)

The table below sets out Board Members' fees and other benefits in 2005/06

	Salary (in bands of £5,000)	Pensions			
	Period end 31 March 2006	Real increase in pension and related lump sum	Total accrued pension at age 60 at 31/3/2006	Cash Equivalent Transfer Value at 5/4/2006 (unless other date stated	Real increase in Cash Equivalent Transfer Value
	£'000	£'000	£'000	£'000	£'000
Lawrence Churchill Chairman	80-85	0-2.5	0-5	50	25
Myra Kinghorn Former Chief Executive	140-145	0-2.5	0-5	53	28
Partha Dasgupta Chief Executive from 21 June 2006 and formerly Director of Investment and Finance	120-125	0-2.5	0-5	23	15
Alan Duncan Director of Compensation	115-120	0-2.5	0-5	30	24
Ian Abrams Non-executive Member	10-15	n/a	n/a	n/a	n/a
Mark Baker CBE Non-executive Member	10-15	n/a	n/a	n/a	n/a
Michael Deakin Non-executive Member	10-15	n/a	n/a	n/a	n/a
Jeannie Drake CBE Non-executive Member	10-15	n/a	n/a	n/a	n/a
Christopher Hughes Non-executive Member	10-15	n/a	n/a	n/a	n/a

Contracts

The former Chief Executive was appointed in September 2004 on a three-year fixed term contract but stood down from office on 12 May 2006. The Chief Executive was appointed to his post on 21 June 2006 on a three-year fixed term contract and had formerly held the position of Director of Investment and Finance having been appointed to this position in 2004 on a three-year fixed term contract. The current Director of Compensation was appointed in February 2005 on an 18 month contract, pending extension of his leave to stay in the country. Leave to stay in the country may only be applied for 28 days before expiry of the current leave to stay and confirmation of the extension of the postholder's leave to stay in the country must be received before his contract can be extended.

The Chairman of the Pension Protection Fund was appointed by the Secretary of State in July 2004 for a three-year term of office. All other Non-executive Members of the Board were appointed by the Secretary of State in December 2004 for a three-year term of office.

Remuneration

The Executive Directors received a fixed salary which is reviewable annually by the Remuneration Committee. The Remuneration Committee during this period comprised Mark Baker CBE (Chairman), Jeannie Drake CBE and Christopher Hughes, who are all Non-executive Members of the Board.

The Chairman was paid a fixed salary and pension contribution and was contracted to work for the Pension Protection Fund for two days a week. All other Non-executive Members received a fixed fee of £15,000 per annum based on an estimated time commitment of two days per month. Non-executive Board Members' remuneration was not performance related and there was no provision for compensation in the event of termination.

Bonuses

Executive Directors were eligible for an annual bonus of up to 10% of their base salary. The bonus level was set when initial remuneration packages were determined by reference to Executive Directors within comparable organisations. Base pay covered normal competent performance and any bonus paid represented a significant contribution or achievement in addition to this. Bonuses were determined by the Remuneration Committee which assesses the performance of each Executive Director against the objectives and the targets for meeting these objectives for the year. There was no contractual undertaking to make termination payments for any of the Executive Directors.

Notice periods

The Chief Executive has a notice period of six months and the Executive Directors a notice period of three months.

Non-executive Members' appointments can be terminated on a month's notice by either the Board or the Non-executive Member. The Chairman's appointment is subject to a notice period of six months which can be terminated by the Secretary of State or by the postholder in writing; the right to notice can be waived by the Secretary of State or the postholder and the postholder can accept payment in lieu of notice.

Pensions

The pension entitlement of the Chief Executive and Executive Directors was based on the Inland Revenue's earnings cap of £105,600. Employees do not accrue defined benefits in the Civil Service pension scheme until they have been members for two years, before which their entitlement on leaving service is to apply for a transfer value to a personal or stakeholder pension.

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

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

The partnership pension account is a stakeholder pension arrangement. The employer makes a basic contribution of between 3 per cent and 12.5 per cent (depending on the age of the member) of pensionable salary into a stakeholder pension product chosen by the employee from a selection of approved products. The employee does not have to contribute but where they do make contributions, the employer will match these up to a limit of 3 per cent of pensionable salary (in addition to the employer's basic contribution). Employers also contribute a further 0.8 per cent of pensionable salary to cover the cost of centrally-provided risk benefit cover (death in service and ill health retirement). Further details about the Civil Service pension arrangements can be found at: www.civilservice-pensions.gov.uk

Cash Equivalent Transfer Values (CETV)
A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies. The CETV figures, and from 2003-04 the other pension details, include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the Civil Service pension arrangements and for which the CS Vote has received a transfer payment commensurate with the additional pension liabilities being assumed. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost. CETVs are calculated within the guidelines and framework prescribed by the Actuarial Profession.

Please note that the factors used to calculate the CETV were revised on 1 April 2005 on the advice of the Scheme Actuary. The CETV figure for 31 March 2005 has been restated using the new factors so that it is calculated on the same basis as the CETV figure for 31 March 2006.

Real increase in CETV
This reflects the increase in CETV effectively funded by the employer. It takes account of the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

Partha Dasgupta
Accounting Officer[4]

Date: 23 October 2006

[4] Partha Dasgupta was interim Accounting Officer between 12 May 2006 and 21 June 2006 when he was appointed as Chief Executive and permanent Accounting Officer.

6. Financial Statements for the period 6 April 2005 to 31 March 2006

6.1 Statement of the Board of the Pension Protection Fund's and the Accounting Officer's responsibilities for these accounts

Under paragraph 22 of Part 4 of Schedule 5 to the Pensions Act 2004 the Board is required to prepare a statement of accounts which complies with any accounting directions given by the Secretary of State with the approval of the Treasury.

The accounts are prepared on an accruals basis and must give a true and fair view of the Board's income and expenditure and cash flows for the financial year and the state of affairs at the year end.

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

- observe the Accounts Direction issued by the Secretary of State with the permission of the 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 Government Financial Reporting Manual have been followed, and disclose and explain any material departures in the accounts; and
- prepare the accounts on a going concern basis unless it is inappropriate to presume that the entity will continue in operation.

On 2 March 2005, the Secretary of State appointed the then Chief Executive, Myra Kinghorn, as the Accounting Officer for the Board. This appointment expired with effect from 12 May 2006 when Mrs Kinghorn stood down as Chief Executive. I was appointed Accounting Officer for the Board with effect from 12 May 2006, initially on an interim basis and then, with effect from 21 June 2006, on a permanent basis, coincident with my appointment as Chief Executive. The relevant responsibilities of Accounting Officers, including the responsibility for the propriety and regularity of the public finances and for the keeping of proper records and financial procedures are set out in the model "Non-Departmental Public Bodies Accounting Officers' Memorandum" issued by the Treasury and published in Government Accounting. Although the Board of the Pension Protection Fund is now classified as a Public Corporation rather than a Non-Departmental Public Body, I still consider this guidance to be the most appropriate for me to follow as Accounting Officer for the Board.

Partha Dasgupta
Accounting Officer

Date: 23 October 2006

6.2 Statement on internal control

Scope of responsibility
For the period covered by these accounts and up until 12 May 2006 when she stood down as Chief Executive, Myra Kinghorn had responsibility as Accounting Officer for maintaining a sound system of internal control that supported the achievement of the Pension Protection Fund's policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which she was personally responsible, in accordance with the responsibilities assigned to her in Government Accounting.

She was also responsible for ensuring that proper records were maintained as set out in the Non-Departmental Public Bodies Accounting Officer Memorandum, issued by the Treasury and published in Government Accounting, Annex 8.1.

I was appointed Accounting Officer with effect from 12 May 2006, and have therefore carried out these same responsibilities for internal control, safeguarding public funds and record keeping from that date up to the date of signing these accounts. As described in section 3.6.1, there was a full and rigorous handover of Accounting Officer responsibilities from Mrs Kinghorn to myself, which included the preparation by Mrs Kinghorn of an Interim Statement on Internal Control covering her tenure as Accounting Officer. This Statement on Internal Control therefore represents a consolidation of statements made by Mrs Kinghorn in respect of her period of office, and made by me in respect of my period of office.

Our responsibility to ensure compliance with the requirements of the Board of the Pension Protection Fund's Management Statement and Financial Memorandum with the Department for Work and Pensions has been supplemented by regular meetings with our departmental Stewardship team and the Board and Executive team of the Pensions Regulator. These meetings covered updates on the implementation of our strategic objectives, helped formulate our future business direction and highlighted the inherent risks and opportunities in implementing our policies.

These meetings have been supplemented by a regular dialogue between the Executive team and officials at the Department for Work and Pensions and the Pensions Regulator.

The purpose of the system of internal control
The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of the Board's policies, aims and objectives; to evaluate the likelihood of those risks being realised and the impact should they be realised and to manage them efficiently, effectively and economically.

The system of internal control has been developed since the Board opened for business on 6 April 2005 and key systems and procedures were subject to internal audit review during the period ended 31 March 2006.

All significant internal audit recommendations which were due during the period were implemented by 31 March 2006. The developing system of internal control, which was in place in Board for the period ended 31 March 2006 and up to the date of the signing of these accounts, accords with Treasury guidance.

Capacity to handle risk
The Board of the Pension Protection Fund aims to manage risk at a reasonable level to achieve and add value to its policies, aims and objectives. We do not aim to eliminate all risk of failure but we do aim to eliminate surprises and to maintain risk to as low a level as is reasonably practicable and commercially appropriate.

The Board monitors the significant risks to achieving our strategic goals and has delegated to the Audit Committee the responsibility for ensuring that an appropriate risk management strategy is in place and embedded throughout the organisation.

The risk management process is led by the Risk Management Committee, chaired by the Chief Executive (or, in their absence, one of the Executive Directors). The membership includes a wide spread of skills and knowledge including a specialist risk manager. The Committee obtained an annual report on compliance to Treasury standards from the risk manager in respect of risk management and from the board secretary in respect of governance. This report concluded that a basically sound system of internal control was in place in respect of these functions, and that no significant exceptions were found in respect of the operation of relevant controls.

In March 2006, the then Chief Executive approved our "Risk Management Strategy" which communicates our approach to risk management in the Pension Protection Fund. This document, which is available to all staff, gives detailed guidance on responsibilities and management of risk and will form the basis for our formal training programme.

The Management Committee, which comprises the Executive Members and senior managers across the organisation regularly discuss risk management and agree key policies.

In my opinion, the Board has made good progress in developing its risk management processes in its first period of operation including:

- a risk workshop led by the risk manager in January 2006 identified the key risks to our strategic objectives and determined the control strategy for each risk. This enabled the production of a top down risk profile and prioritisation of risk activities
- agreement of a risk appetite by the Board that enables the organisation to understand risks that are considered to be tolerable as well as defining key aspects of the reporting processes
- the use of risk management in key projects and initiatives to improve the likelihood we will achieve the expected outcomes, including the introduction of programme management office
- the introduction of a significant number of procedures that support the risk management strategy, including the management of external suppliers and outsourcing partners
- the development of staff knowledge through presentations by the risk manager covering inherent/residual risk and control effectiveness
- a series of risk workshops led by the head of risk and the risk manager to identify risks to team objectives. Although not complete for every team, these have resulted in a series of risk profiles for key functions across the organisation which are maintained by the heads of the respective teams and reviewed as a minimum annually.

These developments have provided the foundation for continuing progress in risk management in the post year end period.

The risk and control environment
The risk management process underpins the risk management strategy and provides a continual cycle that both informs and is informed by the strategic objectives of the Board of the Pension Protection Fund.

The Board has identified risks at four levels:

- **Macro risk assessment** We are currently undertaking a macro risk assessment which is set at the highest level and consider risks that may materially impact the defined benefit pension schemes 'system'.
- **Top down risk profile** This is the process whereby we capture the key risks to the achievement of our strategic objectives.
- **Process or team assessment** This process drives at the heart of our operational capability and considers those risks which may adversely impact on the objectives of a process or team. Additionally the risks identified will inform the Top Down Risk Profile.
- **Project assessment** The final aspect of our risk identification approach looks at the risks that accrue from our change portfolio. We have recently introduced a programme office capability which will improve the effectiveness of this aspect of our approach, including through training and accreditation on MSP and PRINCE2 techniques.

Risk management information is recorded in risk registers which are regularly reviewed and updated. The assessment of the level of risk informs both the priority and ownership of risks. Risks are identified and controlled by:

- Identifying the objective and the risks which may prevent the achievement of that objective
- Assessing the inherent risk with reference to predetermined criteria covering impact and likelihood
- Considering risk against the appetite set by the Board
- Determining appropriate control strategy [tolerate, treat, transfer, terminate]
- Identifying controls in place to manage the risk
- Assessing the residual risk after the application of controls
- Preparing an action plan for activities to achieve the control strategy
- Assigning responsibility for ownership of risk and action plans.

The Risk Management Committee meets monthly and considers risk and internal control matters across the organisation. There is an independent Audit Committee chaired by a Non-executive Board Member with appropriate financial expertise which meets quarterly. This Committee oversees the control environment and risk management framework and receives reports from our internal and external auditors on our system of internal control.

Internal audit services were initially supplied on an interim basis by the Risk Assurance Division of the Department for Work and Pensions until the appointment of BDO Stoy Hayward LLP in January 2006. Internal audits are undertaken on those processes which are considered to be higher risk or as specifically agreed with management.

The work undertaken by internal audit is agreed with management and the Audit Committee and is amended as defined by the Board's continuous review of its needs and as the priorities for management change. All work undertaken by the Risk Assurance Division of the Department for Work and Pensions and BDO Stoy Hayward is operated to criteria in the Government Internal Audit Standards. They submit reports that include their independent opinion on the appropriateness and effectiveness of the Board's internal controls, together with their recommendations for improvement.

In my opinion, the Board has made good progress in implementing an effective risk management framework within the Board's operations, and this progress has accelerated since December 2005 when a specialist Risk Manager was appointed to support the work of the Head of Risk. We continually strive to achieve high standards of risk management and have the opportunity to enhance the framework further with the following enhancements planned for implementation by 31 December 2006:

- control self assessment framework
- process/Team risk assessments
- staff training.

Review of effectiveness

As Accounting Officer, I also have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control has been informed by:

- the assurances I sought and received from the former Chief Executive and Accounting Officer who held office throughout the period covered by these accounts and up until 12 May 2006, as detailed in the Interim Statement on Internal Control she prepared on leaving office
- the assurances I sought and received from other Board Members and senior staff of the Board of the Pension Protection Fund detailing the work undertaken to ensure risk management and control is addressed in their areas of responsibility
- the work of the internal auditors and the Board Members and senior managers who have responsibility for the development and maintenance of the internal control framework, and
- comments made by the external auditors in their management letter and other reports. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Audit Committee and a plan to address any reported weaknesses and to ensure continuous improvement of the system is in place.

Significant internal control issues

The Board of the Pension Protection Fund is a brand new organisation and the system of internal control has developed through the period. These developments have been implemented as the Board has taken up its functions over the period and as staff have designed and implemented processes, systems and procedures to carry out these functions as they fell due. Difficulties in recruiting suitably qualified staff in certain specialist areas has been an issue during the period, but has not compromised the organisation's ability to introduce processes, systems and procedures when required during the period. Processes, including control processes, were improved during the period, in the light of experience and specifically in response to internal audit work and other reviews. The implementation of a small number of improvements to control processes were not planned for completion by year end and were on track for successful completion by the dates accepted by management and agreed with internal auditors. The effectiveness of the system of internal control was therefore enhanced as these improvements were put in place, and so did not operate uniformly throughout the period. Nevertheless, I am satisfied that no significant internal control issues materialised in the Board of the Pension Protection Fund up to 31 March 2006 and up to the date of this report.

Partha Dasgupta
Accounting Officer

Date: 23 October 2006

6.3 The Certificate and Report of the Comptroller and Auditor General to the Houses of Parliament

I certify that I have audited the financial statements of the Board of the Pension Protection Fund for the year ended 31 March 2006 under the Pensions Act 2004. These comprise the Operating Statement, the Balance Sheet, the Cashflow Statement and Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Board of the Pension Protection Fund, the Accounting Officer and Auditor

The Board of the Pension Protection Fund and Accounting Officer are responsible for preparing the Annual Report, the Remuneration Report and the financial statements in accordance with the Pensions Act 2004 and directions made thereunder by the Secretary of State for Work and Pensions and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of the Board of the Pension Protection Fund and the Accounting Officer's Responsibilities.

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

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Pensions Act 2004 and directions made thereunder by the Secretary of State for Work and Pensions. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I also report to you if, in my opinion, the Annual Report is not consistent with the financial statements, if the Board of the Pension Protection Fund have not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by relevant authorities regarding remuneration and other transactions is not disclosed.

I review whether the statement on pages 38 to 40 reflects the Board of the Pension Protection Fund's compliance with HM Treasury's guidance on the Statement on Internal Control, and I report if it does not. I am not required to consider whether the Accounting Officer's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Board of the Pension Protection Fund's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Chairman's Foreword, Chief Executive's Report, Management Commentary, Director's Report, Appendix A, Appendix B, Appendix C and the unaudited part of the Remuneration Report. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Board of the Pension Protection Fund and Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Board of the Pension Protection Fund's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

Opinions

In my opinion:

- the financial statements give a true and fair view, in accordance with the Pensions Act 2004 and directions made thereunder by the Secretary of State for Work and Pensions, of the state of the Board of the Pension Protection Fund's affairs as at 31 March 2006 and of its deficit (net result) for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Pensions Act 2004 and directions made thereunder by the Secretary of State for Work and Pensions; and
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.

John Bourn
Comptroller and Auditor General

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

John Bourn

Date: 27 October 2006

"The maintenance and integrity of the PPF's website is the responsibility of the Accounting Officer; the work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website."

6.4 Aggregate financial statements

6.4.1 Operating statement for the period 6 April 2005 to 31 March 2006

All amounts in £000s	Pension Protection Fund		Fraud Compensation Fund		Administration Fund		Total Funds
	Notes	Appendix 1	Notes	Appendix 2	Notes	Appendix 3	
STATUTORY OPERATING ACTIVITIES							
Operating income							
Income from levies	1.2	138,043	2.2	–		–	138,043
Income from grant-in-aid		–		–	3.2	8,991	8,991
Total operating income		**138,043**		**–**		**8,991**	**147,034**
Operating expenses							
Staff costs		–		–	3.3 (a)	(3,619)	(3,619)
Other costs	1.3	(1)	2.3	(64)	3.3 (b)	(3,259)	(3,324)
Depreciation and impairment charges		–	–		3.5	(109)	(109)
Total operating expenses		**(1)**		**(64)**		**(6,987)**	**(7,052)**
Net operating surplus/(deficit)		**138,042**		**(64)**		**2,004**	**139,982**
INVESTMENT ACTIVITIES							
Interest on operating bank accounts	1.3	325	2.4	126	3.4	149	600
Investment income	1.4	1,615	2.5	1		–	1,616
Change in fair value of investments	1.5	1,562		–		–	1,562
Investment Expenses	1.6	(114)		–		–	(114)
Net investment return		**3,388**		**127**		**149**	**3,664**
CLAIMS ACTIVITIES							
Claims for compensation	1.7	(484,511)	2.6	–		–	(484,511)
Net cost of claims		**(484,511)**		**–**		**–**	**(484,511)**
NET RESULT		**(343,081)**		**63**		**2,153**	**(340,865)**

Statement of total recognised gains and losses
There are no recognised gains or losses other than the net result disclosed above.

The accounting policies and notes on pages 46 to 85 form part of these financial statements.

6.4 Aggregate financial statements contd

6.4.2 Balance Sheet as at 31 March 2006

All amounts in £000s		Pension Protection Fund		Fraud Compensation Fund		Administration Fund	Total Funds
BALANCE SHEET	Notes	Appendix 1	Notes	Appendix 2	Notes	Appendix 3	
Fixed assets		**–**		**–**	3.5	**1,805**	**1,805**
Total investment assets	1.8	**85,177**	2.7	**3,012**		**–**	**88,189**
Cash	1.9a	17,079	2.8a	11	3.6a	3,172	20,262
Other current assets	1.9b	39,234	2.8b	–	3.6b	15	39,249
Current liabilities	1.9c	(60)	2.8c	(23)	3.6c	(1,263)	(1,346)
Net current assets/ (liabilities)		**56,253**		**(12)**		**1,924**	**58,165**
Total assets less current liabilities		**141,430**		**3,000**		**3,729**	**148,159**
Non-current liabilities	1.10						
Actuarial liabilities							
Claims provisions		(484,511)		–		–	(484,511)
Total non-current liabilities		**(484,511)**		**–**		**–**	**(484,511)**
TOTAL NET ASSETS/ (LIABILITIES)		**(343,081)**		**3,000**		**3,729**	**(336,352)**
Represented by:							
Net result		(343,081)		63		2,153	(340,865)
Revaluation and other reserves		–	2.9	2,937	3.7	1,576	4,513
Total levy payers' funds		**(343,081)**		**3,000**		**3,729**	**(336,352)**

The accounting policies and notes on pages 46 to 85 form part of these financial statements.

The Board of the Pension Protection Fund approved these accounts on 23 October 2006 and authorised the Accounting Officer to sign this Balance Sheet on the same date.

Partha Dasgupta
Accounting Officer

Date: 23 October 2006

6.4.3 Cash flow statement for the period 6 April 2005 to 31 March 2006

All amounts in £000s		Pension Protection Fund	Fraud Compensation Fund	Administration Fund	Total Funds
CASH FLOW STATEMENT	Notes				
Cash balance at start of period	i)	**–**	**2,943**	**–**	**2,943**
Cash flow from operating activities		99,079	79	3,510	102,668
Cash transfers to Fund Managers		(82,000)	(3,011)	–	(85,011)
Capital expenditure		–	–	(338)	(338)
Net cash flow		**17,079**	**(2,932)**	**3,172**	**17,319**
Cash balance at end of period		**17,079**	**11**	**3,172**	**20,262**

Reconciliation of the operating surplus/(deficit) to the cash flow from operating activities	Pension Protection Fund	Fraud Compensation Fund	Administration Fund	Total Funds
Operating surplus/(deficit)	138,042	(64)	2,004	139,982
Interest on operating bank accounts	325	126	149	600
Management fees and custody charges (reported in "Investment Return")	(114)	–	–	(114)
Depreciation and impairment	–	–	109	109
Movement in current liabilities	60	(19)	1,263	1,304
Movement in other debtors	(39,234)	36	(15)	(39,213)
Cash flow from operating activities	99,079	79	3,510	102,668

i) The cash balance at the start of the period for the Fraud Compensation Fund represents the cash balance held by the Pensions Compensation Board at 6 April 2005. This is accounted for in the accounts of the Board of the Pension Protection Fund under the operation of the principles of merger accounting, as explained further in Note 2.1b).

6.4.4 General accounting policies

a) Basis of preparation
These accounts are prepared in accordance with the Accounts Direction dated 2 August 2005 given to the Board of the Pension Protection Fund by the Secretary of State, with the approval of the Treasury, in accordance with the Pensions Act 2004 (Schedule 5, Part 4, Paragraph 22 (2) (b)). It requires the Board's accounts to give a true and fair view of the income and expenditure and cash flows for the financial year, and the state of affairs at the year end. It requires the Board to prepare accounts in accordance with the Government Financial Reporting Manual. This Manual in turn requires accounts to be produced on an accruals basis following, as far as appropriate, private sector practice based on generally accepted accounting practice in the United Kingdom (UK GAAP), i.e. the requirements of the Companies Act and the accounting standards issued or adopted by the Accounting Standards Board, including, where appropriate, Statements of Recommended Practice (SORPs).

These financial statements have been prepared on an historical cost basis, modified to account for the revaluation of fixed assets and investments.

The specific accounting policies adopted by the Board in order to comply with these requirements include the following:

b) Segmental reporting
The Board of the Pension Protection Fund was created by the Pensions Act 2004 and this Act specifies that the Board must hold, manage and apply two ring-fenced funds:

- the Pension Protection Fund; and
- the Fraud Compensation Fund.

Additionally, as a separate statutory corporate body, the Board is responsible for the management and control of its own administration functions, funded by grant in aid from DWP.

The Board has therefore adopted an accounting policy in compliance with SSAP25 which presents the financial transactions and balances of these three separate streams of activity in a coordinated set of primary statements in a columnar format. An aggregate total is also presented in order to indicate the total value of the transactions and balances for which the Board is responsible.

However, to assist users of the accounts to navigate to their areas of particular interest, an appendix to the accounts is then devoted to each of the three segments described above, which consists the accounting policies and detailed notes relating only to that segment.

c) Accruals basis
All items of income and expenditure are accounted for on an accruals basis. The application of this general policy to specific items of income and expenditure is detailed in the notes for that specific item within the appendix devoted to the relevant segment.

d) Going concern
These accounts have been prepared on a going concern basis.

e) Related parties
The Board considers the following to be related parties for the purposes of these accounts:

a) Individual Board Members and staff;

b) The Department for Work and Pensions, to whom the Board is accountable as a Public Corporation for the achievement of a number of pensions policy objectives;

c) The Pensions Regulator, a Non-Departmental Public Body, also accountable to the Department for Work and Pensions, with whom the Board shares certain pensions policy objectives.

Transactions with these parties are discussed below.

a) Transactions relating to the remuneration of individual Board Members and staff are disclosed in Note 3.3 a) and in the Remuneration Report section of the Annual Report. There were no transactions other than the payment of salaries and expenses during the accounting period.

Michael Deakin, a Non-executive Member of the Board and Chair of the Investment Committee, was formerly Chief Investment Officer and an Executive Director of Insight Investment Management. In order to avoid any potential conflict of interest, Mr Deakin took no part in the decisions to appoint Insight Investment

Management as fund managers to the Pension Protection Fund and the Fraud Compensation Fund.

b) Transactions relating to the provision of funding to the Board to cover its operating expenses by the Department for Work and Pensions through the grant-in-aid process, and the related administration levy, are disclosed in Note 3.2.

Expenditure incurred by DWP in establishing the Board and its functions prior to the Pension Protection Fund opening for business on 6 April 2005 is also discussed in Note 3.2. In particular, the Information Systems and Information Technology assets acquired by DWP as part of this establishment project, and brought into use by the Board on 6 April 2005, are disclosed in Note 3.5.

The Board has also been able to procure goods and services at discounted rates by having access to central purchasing arrangements managed by DWP's Commercial Policy and Procurement Division and by the Office for Government Commerce. It is not practical to quantify the value-for-money benefit to the Board from these arrangements.

Of the accommodation costs disclosed in Note 3.3 b), £388,000 was payable to the Estates Division of DWP who manage the facility occupied by the Board and its staff and through whom all related facilities costs, including rent, rates and property service charges, are routed. DWP Estates charge no explicit fee for this property management service.

DWP's Internal Assurance Services provided internal audit services to the Board on an interim basis pending the appointment of the Board's own internal auditor. DWP provided these services at no charge.

c) As set out in Note 1.2, protection levies in 2005/06 have been calculated, billed and collected on the Board's behalf by the Pensions Regulator. As disclosed in Note 3.3 b) the Board has contributed £190,000 to the Pensions Regulator's costs of carrying out these data collection, data processing, billing and collection activities.

f) Whole of Government Accounts

HM Treasury is responsible under the Government Resources and Accounts Act 2000 for preparing Whole of Government Accounts for a group of bodies each of which appears to the Treasury to exercise functions of a public nature or to be entirely or substantially funded from public money. The Board of the Pension Protection Fund is not one of these publicly funded bodies and so lies outside of the "Whole of Government Accounts boundary". The transactions and balances of the Board will not therefore be consolidated into the Whole of Government Accounts. However, in line with best practice set out in the Government Financial Reporting Manual, the Board will disclose separately any of its assets and liabilities (in particular its debtors and creditors) with entities that, to the best of the Board's knowledge, lie inside the Whole of Government Accounts boundary.

g) Post balance sheet events

The Board has carried out a detailed review of events since the balance sheet date, and has incorporated into these financial statements any material adjustments it considered necessary arising from that review, including events with an impact on the valuation of provisions and contingent liabilities in both the Pension Protection Fund and the Fraud Compensation Fund. As far as the Board is aware, at the date of signing these financial statements, there have been no further material post balance sheet events necessitating adjustment to these financial statements. Schemes have entered Pension Protection Fund assessment in the post year end period with insolvency dates of 1 April 2006 or later and therefore the Pension Protection Fund may have an obligation in relation to these schemes in future years. A list of schemes that have entered assessment is available on the Pension Protection Fund website. These events occurring after the balance sheet date are non-adjusting for the purposes of the 2005/06 accounts, but nonetheless readers of the accounts might want to be aware of them.

Accounting policies and notes relating to the operation of the Pension Protection Fund for the period 6 April 2005 to 31 March 2006

Note 1.1 Accounting policies

a) Income recognition

- Protection Levy income is recognised on an accruals basis, that is, on the basis of the value of levies billed in, or in respect of, the levy year, and taking into account provisions for bad debts. The Board may decide to set up provisions, for example, where a pension scheme has been billed for a Protection Levy but its eligibility for pension protection has been disputed; in such cases, the Board may decide out of prudence to provide against the non-payment of the bill should the scheme's ineligibility be confirmed
- interest income arising from cash deposits, fixed interest securities and similar investments is accounted for on a daily basis as interest is earned.

b) Investment assets and investment return

Investment assets are included in these accounts at fair value, which is defined as follows:

- quoted securities are valued at closing prices, which may be defined as mid-market price or last traded price depending on the convention of the stock exchange or other market on which they are quoted
- all other assets for which a recognised investment exchange does not exist are valued at a fair value estimated by the appointed custodian, fund manager or other appropriately qualified professional adviser, and approved by the Board
- pooled investment vehicles are valued at the average of the closing bid and offer prices (if both prices are published) or, if single-priced, at the closing single price
- investments denominated in foreign currency are valued in sterling using the closing spot rates of exchange from a recognised information source.

Investment return is defined as the net total of:

- investment income earned on invested assets, including interest, dividends and (where appropriate) rental income on properties; plus
- the "change in the fair value of investments" defined above, including gains and losses realised on the disposal of investments; unrealised gains and losses on investments held at the accounting date, that is, the difference between acquisition cost and current market value; and gains and losses arising on the translation of investments (including cash, payables and receivables) denominated in foreign currencies into sterling; less
- fund management fees and custody charges charged to the Protection Fund, as permitted by the Pension Protection Fund (Payments to meet Investment Costs) Regulations 2005 (SI 2005/1610)
- "acquisition cost" includes the costs associated with purchase transactions such as brokers' fees and commissions, and sales proceeds are stated net of the same costs associated with disposal transactions.

c) Actuarial liabilities, provisions and contingent liabilities for claims

The Board recognises the full value of the liabilities of the Fund disclosed in the annual actuarial valuation of the Fund, prepared and signed by the appointed actuary in accordance with the Pensions Act 2004 (Schedule 5, Part 4, Paragraph 22 (2)(a). This represents the present value of the liability to pay compensation to the members, both deferred and retired, of all pension schemes in respect of which Transfer Notices have been issued, valued on the assumptions set out in the actuary's report. Since no Transfer Notices have been issued in the period to 31 March 2006, there are no actuarial liabilities to disclose in these accounts.

The Board recognises provisions for claims in respect of schemes where eventual entry into the Protection Fund is judged probable, and discloses contingent liabilities for claims in respect of schemes where eventual entry into the Protection Fund is judged possible. No liability is recognised or disclosed for claims in respect of schemes where eventual entry into the Protection Fund is judged unlikely. In all cases, the liability is valued at the net deficit impacting the Protection Fund, that is, scheme liabilities valued at protected benefit levels, net of assets under the scheme trustees' control, including asset recoveries from insolvent employers. Each element of this process is discussed in greater detail below.

i) Population of schemes
When considering provisions and contingent liabilities for claims on the Protection Fund, the Board reviews schemes in the following categories:

1. Schemes remaining in an Assessment Period at the Fund's accounting date

2. Schemes accepted into an Assessment Period in the post year end period, where the date of employer insolvency (and hence the effective date of the commencement of Assessment) was prior to the Fund's accounting date

3. Schemes accepted into an Assessment Period in the post year end period, where the date of employer insolvency (and hence the effective date of the commencement of Assessment) was after the Fund's accounting date

4. Schemes in respect of which a notice of employer insolvency has been received by the Board but which the Board has not yet been able to validate, regardless of the date of employer insolvency

5. Schemes where no notice of employer insolvency has yet been received but where, based on the Board's specific knowledge of circumstances prevailing at the accounting date, entry into Assessment is considered likely in the foreseeable future

6. Schemes associated with employers with the lowest failure scores (and hence the highest risk of insolvency in the foreseeable future) as measured by the Board's independent insolvency risk measurer, D&B.

The Board also reviews the requirement for a reserve for claims incurred but not reported ("IBNR reserve") which, by definition, cannot be associated with individual schemes.

ii) Likelihood
Having established the population of schemes which it needs to consider for the purposes of setting up provisions and disclosing contingent liabilities, the Board then considers claims information on those schemes in order to reach judgements on the likelihood of schemes' eventual entry into the Protection Fund. The following guidelines apply to these considerations:

Schemes judged "probable" for eventual entry include:

1. Schemes in Assessment for which a Scheme Failure Notice has been validated;

2. Schemes in Assessment at the accounting date for which no Scheme Failure Notice has yet been received; and schemes accepted into Assessment after the accounting date but where the effective Assessment Date is within the accounting period; and schemes, in respect of whose employer a Notice of Insolvency had been received but not yet validated, but where the potential effective Assessment Date would be within the accounting period; in all cases

   - where there is no reliable evidence that a scheme rescue will occur: and
   - in respect of which current estimates of the protected liabilities as at the Assessment Date are in excess of current estimates of scheme assets (including any recoveries from insolvent employers) at the Assessment Date; and
   - where those estimates of assets and liabilities are believed to be reliable. Where no reliable estimates are available, the values involved would be considered as contingent liabilities.

Schemes judged “possible” for eventual entry include:

1. Schemes accepted into Assessment after the accounting date and schemes, in respect of whose employer a Notice of Insolvency had been received but not yet validated, where the employer insolvency event occurred after the accounting date and where there is no evidence either that a scheme rescue may occur or that scheme assets (including any recoveries from insolvent employers) as at the assessment date are adequate to meet protected liabilities valued at the assessment date

2. Schemes, in respect of whose employer no Notice of Insolvency has yet been received, but where there is reason to believe that entry into Assessment is likely in the foreseeable future, and in respect of which current estimates of the protected liabilities as at the accounting date are in excess of current estimates of scheme assets (including any recoveries from insolvent employers) at the accounting date.

Schemes judged “unlikely” eventually to enter the Protection Fund include:

1. Schemes in respect of which there is reliable evidence that a scheme rescue will occur

2. Schemes in respect of which current estimates of scheme assets at the Assessment Date (including any recoveries from insolvent employers) are in excess of current estimates of the protected liabilities at the Assessment Date.

iii) Materiality

Recognising the desirability of minimising the administrative burden on schemes in (or being considered for entry into) Assessment, the Board has decided to classify schemes into material and non-material schemes, according to the following criteria for material schemes:

- scheme assets at the latest valuation exceeded £60 million or 5% of the Fund’s balance sheet assets value, or
- scheme MFR liabilities according to the latest MFR valuation exceeded £60 million or 5% of the Fund’s balance sheet liabilities value, or
- where a calculation of 1.7 times MFR liabilities less 1.4 times assets exceeded £20 million or 5% of the estimated Fund net deficit; or
- the effective date of the scheme’s latest MFR valuation was earlier than 31 March 2004;
- with an overriding requirement that at least 65% in aggregate of the Fund’s provisions must relate to material schemes.

For material schemes, additional specific information on scheme assets and liabilities was sought, as described in paragraphs iv) 1 and vi) 1 below. For non-material schemes, robust estimation techniques were developed to enable existing information on scheme assets and liabilities to be used without the need to place additional burdens on scheme trustees to provide further detailed information. These techniques are described in paragraphs iv) 2 and vi) 2 below.

iv) Scheme assets

Pension scheme assets will be valued in the deficit calculations described above in ways consistent with the valuation policies for the Fund’s own investments, which are also consistent with the valuation policies used in the accounts of pension schemes themselves, as set out in the Statement of Recommended Practice “Financial Reports of Pension Schemes”. Scheme asset information has been captured in the following ways:

1. For schemes which are considered material to the Fund's liabilities, actual asset information at the Fund's accounting date has been obtained from scheme trustees and used in the calculations

2. For schemes which are not considered material to the Fund's liabilities, scheme asset information has been extracted from other information readily available to the Board, such as the latest actuarial valuation or audited scheme accounts. These asset values have then been indexed forward to the Fund's accounting date using generally accepted investment return indices appropriate to the asset classes in which the schemes' investments are held. Further adjustments are then made to allow for benefit payments between the valuation date and the Fund's accounting date using assumptions consistent with those used to estimate scheme liabilities. The Board consulted in June 2006 with the Actuarial Profession on the methodology for making these adjustments.

v) Asset recoveries from insolvent employers

The experiencing by an employer of an insolvency event may trigger the right for trustees to claim the debt due to a scheme under section 75 of the Pensions Act 1995 (deficiencies in scheme assets). These may be unsecured or secured by charges over other employer assets such as real estate or machinery and equipment. These claims may also entitle trustees to be party to negotiations relating to the reconstruction, re-financing or acquisition by a third party of the employer's business, out of which trustees may acquire assets such as a shareholding in the reconstructed company. Under section 137 of the Pensions Act 2004, these rights to pursue debts and to acquire assets are exercisable by the Board. The Board's policy for recognising these recoverable assets is to take them into account when assessing the net deficit of schemes in the categories described in paragraph a above.

The Board's policy for valuing these recoverable assets is guided by the principle of prudence. Specifically:

1. Unsecured claims recoverable as cash out of the liquidation of the employer company will be valued at the amount assessed by the Board to be recoverable as dividends from the liquidation (adjusted as necessary to account for the time value of money over the projected future period of dividend distributions). The Board's assessment of recoverable amounts will be based on available evidence. For example, where the liquidator has not yet made any dividend distributions nor produced any estimate of likely dividends, the Board assesses the recoverable value as nil. Where a liquidator has produced an estimate of likely dividends, the Board will test this estimate against any history of actual dividend distributions to assess its probable accuracy. Where a liquidator has produced a range of estimates of likely dividends, the Board assesses the recoverable value using the lower value in the range

2. Secured claims will be valued by the Board at the full face value of the claim, provided the Board is satisfied that the value of the security at least covers the claim value. If the Board assesses the value of the security as less than the face value of the claim, it will provide against the shortfall

3. Other assets acquired by the Board on behalf of trustees will be valued at fair value, in compliance with accounting standards or valuation guidelines appropriate to the type of asset, for example:

   - Quoted securities are valued at closing prices, which may be defined as mid-market price or last traded price depending on the convention of the stock exchange or other market on which they are quoted
   - Unquoted securities including private equity will be valued in accordance with the "International Private Equity and Venture Capital Valuation Guidelines" issued by the British, French and European venture capital associations. These guidelines emphasise the evidence base required to produce reliable valuations, for example, the enterprise's value implied by a history of dividend payments; the net asset value from the latest audited accounts; the value of recent share dealings, adjusted to take account of the non-open market nature of those dealings; or (for recent acquisitions) the acquisition cost. Where the Board uses acquisition cost to value these assets, the value will normally be assessed at nil, since no explicit purchase price has been paid to acquire the asset.

vi) Scheme liabilities

Scheme liabilities are taken into account in assessing the net deficits of schemes in the categories described in paragraph i ("Population of schemes") above at the net present value, at the Fund's accounting date, assessed by the Fund's appointed actuary as being the realistic cost of settling the liabilities for compensation on an continuing basis from the Fund as a going concern. This value will therefore not be the same value as the liabilities disclosed in actuarial valuations obtained under section 143 of the Pensions Act 2004 ("valuation of assets and protected liabilities") nor as disclosed in valuations obtained under section 179 of the Act ("valuations to determine scheme underfunding").

It should also be noted that the criterion for accepting a scheme into the Fund involves comparing scheme assets with protected liabilities at the Assessment Date. Provisions may therefore be recognised (or contingent liabilities disclosed) in respect of schemes where protected liabilities valued on a statutory basis are estimated to exceed assets at the Assessment Date, but where differential movements in asset and liability values mean that assets are estimated to exceed protected liabilities valued on a realistic basis at the accounting date. The aggregate deficit for schemes in (or likely to enter) Assessment recognised as provisions (or disclosed as contingent liabilities) may therefore include values for individual schemes "in surplus" at the accounting date.

Consistent with its desire to minimise the administrative burden on schemes in (or being considered for entry into) assessment, the Board has decided to use liability information already in existence or generated by trustees and their actuaries for other purposes, such as Minimum Funding Requirement valuations, or valuations under section 143 or section 179 of the Act. Methodologies have been developed in consultation with the Actuarial Profession (and quality-assured by the Government Actuary's Department) for transforming liability information produced for MFR, section 143 or section 179 purposes at past dates into liability values on the Fund's own realistic basis at the Fund's accounting date. This transformation is then supplemented by:

1. For schemes which are considered material to the Fund's liabilities, further liability information has been obtained from scheme trustees, such as details of changes to benefit designs, material changes to the membership, and significant benefit payments or bulk transfers between the scheme's valuation date and the Fund's accounting date, and used in the calculations.

2. For schemes which are not considered material to the Fund's liabilities, further adjustments may then be made to allow for benefit payments between the valuation date and the Fund's accounting date using assumptions consistent with those used to estimate scheme assets. The Board consulted in June 2006 with the Actuarial Profession on the methodology for making these adjustments.

d) Current liabilities

Current liabilities arise as a consequence of the accruals basis of accounting for income and expenditure, to ensure all liabilities falling due on or before the accounting date which had not been settled by the accounting date are disclosed within the Board's accounts.

Note 1.2 Income from levies

In 2005/06 an initial levy has been charged to eligible pension schemes, based only on scheme factors, such as numbers of members and the balance between active and retired members. From 2006/07 on, the levy will be based also on risk factors, such as the risk of employer insolvency.

The billing and collection of the initial levy raised in 2005/06 was administered on the Board's behalf by the Pensions Regulator under the provisions of section 181 of the Pensions Act 2004. The Board's accounts therefore place significant reliance on the levy accounting records of the Pensions Regulator and the control environment for its activities to verify eligibility for pension protection and to calculate, bill and collect protection levies; the Board has received appropriate assurances from the Pensions Regulator as to the effectiveness of controls over these processes. The Board has supplemented these assurances with its own controls over the transfer of levy receipts from the Pensions Regulator to the Board and the reconciliation of transfers to the records of levy collections. Certain questions over eligibility for pension protection remain unresolved at the period end due to the complex nature of the legislative issues raised but the Board believes that resolution of these issues will not result in any material reduction in its initial levy income.

Initial levy income is accounted for in these financial statements on an accruals basis, that is, by recognising the current best estimate of the Levy to be collected in respect of 2005/06. Levy collections in this respect are estimated net of provisions for bad debts and levies deemed to be uncollectible – see Note 1.9b – Debtors.

Note 1.3 Interest and charges on operating bank account

The bank account operated by the Board for the Pension Protection Fund was interest bearing. The account was used to collect initial levy monies and to transfer cash to the custodian for investment by the fund managers. Interest was therefore earned on these monies as funds were building up to the required levels for efficient investment by fund managers. Bank charges of £1,000 were incurred on the operation of this bank account.

Note 1.4 Investment income

Investment income earned during the period consists of:

	£000s
Income arising from:	
UK Government Fixed Interest stocks	904
UK Government Index Linked stocks	69
Non UK Government stocks	136
Corporate bonds	79
Deposit interest	386
Other	41
Total investment income	**1,615**

Note 1.5 Change in fair value of investments

The total change in fair value of investments during the period consists of:

	£000s
Arising on:	
Asset classes further analysed in Note 1.8	2,025
Other investment assets	(463)
Total change in fair value of investments	**1,562**

Note 1.6 Investment expenses

Investment expenses consist of fund management fees and custody charges charged to the Pension Protection Fund, as permitted by the Pension Protection Fund (Payments to meet Investment Costs) Regulations 2005 (SI 2005/1610).

Note 1.7 Claims for compensation

The claims value recognised here consists of the aggregate value of provisions for schemes where eventual entry into the Fund is considered probable, and where reliable estimates can be made of the impact on the Fund, in accordance with the policies and processes set out in Note 1.1c).

Claims have been valued as follows, in respect of 98 schemes:

	Value at Fund's accounting date £000s
Scheme assets	1,878,757
Asset recoveries	65,843
Protected liabilities	(2,429,111)
Net deficit	**(484,511)**

In compliance with the Fund's materiality tests described in Note 1.1c) (iii), 65% of the closing net deficit value of £484,511,000 relates to schemes treated as material. A total of 27 schemes out of the total of 98 were treated as material.

Readers should refer to the Actuary's Supplementary Report as at 31 March 2006, in particular Annexes 6 and 7, for further detailed information on the calculation of these provisions.

Note 1.8 Investments

The table below details the purchases, sales, and realised and unrealised gains or losses achieved by the Fund's appointed investment managers, categorised by asset class.

All amounts in £000s	Market Value as at 6/4/2005	Purchases	Sales	Gain/Loss	Market Value as at 31/3/2006
Investments					
UK Government Bonds	0	331,991	(275,228)	725	57,488
UK Government Index Linked Bonds	0	85,018	(57,230)	1,149	28,937
Non UK Government Bonds	0	11,148	(8,492)	(78)	2,578
Non UK Gov't Index Linked Bonds	0	7,120	(6,887)	8	241
Mortgage Backed Securities	0	47,502	(42,061)	101	5,542
UK Corporate	0	1,220	(196)	(10)	1,014
Non UK Corporate	0	2,596	(142)	(14)	2,440
Money market funds	0	5,717	(5,754)	37	0
Interest rate swaps	0	2,696	(2,278)	145	563
Other	0	163	(19)	(38)	106
Total investments	**0**	**495,171**	**(398,287)**	**2,025**	**98,909**
Other investment assets					
Cash deposits (sterling and foreign)					7,038
Foreign Exchange contracts					(51)
Income receivable					596
Amounts payable, net of amounts receivable, for outstanding investment trades					(21,315)
Total other investment assets					**(13,732)**
Total market value					**85,177**

The portfolios managed by the fund managers were valued as follows:

£000s	Funds invested in the period	Investment return	Closing value	Investment return %
Managed by:				
Insight Investment Management	41,000	2,134	43,134	7.0
PIMCO	41,000	1,043	42,043	3.5
Total	**82,000**	**3,177**	**85,177**	**5.8**

Investment return in this table is stated gross of investment expenses of £114,000 and net of interest on the Fund's operating bank accounts of £325,000.

The investment return percentage figures are calculated by WM Performance Measurement Services, who provide an objective and consistent analysis of the Pension Protection Fund's portfolio. WM calculate investment returns using the time-weighted rate of return method, which allows for the effects of the amounts and timing of flows of money into and out of the portfolio. During the period, there were significant differences in the patterns of the flows of cash to the two investment managers.

Note 1.9 Net current assets

a) Cash at Bank

As described in the accounting policy on "Segmental Reporting", the Board of the Pension Protection Fund is responsible for three ring-fenced funds. To improve controls over the three funds and ensure that only allowable items of income and expenditure are transacted within each fund, the Board has opened separate bank accounts for the three funds. The Pension Protection Fund account is used to collect the Protection Levy and to transfer cash to the custodian for investment by the fund managers. It will eventually be used also for processing compensation payments.

All bank accounts are interest bearing, at rates that the Board consider competitive given the operating requirements of the accounts.

The average balance during the year on the Protection Fund bank account was £7,747,000, and the average interest rate payable on the account was 4.6%.

The cash balance at the year end represents funds being built up for eventual transfer to the Fund's third investment manager, Goldman Sachs Asset Management. Funds were first invested with Goldman Sachs in April 2006.

b) Other current assets consist of:

		£000s
Levy debtors	i	33,264
Cash in transit	ii	5,959
Interest receivable		11
Total other current assets		**39,234**

i Levy debtors
Levy debtors represent levies billed to qualifying pension schemes remaining unpaid at the accounting date. They are stated after allowing for provisions for bad debts and levies deemed to be uncollectible. The value of provisions at the accounting date was, for the Pension Protection Fund, nil.

ii Cash in transit
Cash in transit represents initial levy money collected by the Pensions Regulator awaiting transfer to the Pension Protection Fund. This cash was received by the Pension Protection Fund during the first week of April 2006.

The value of debtors that falls inside the Whole of Government Accounts boundary is: nil.

c) Current liabilities consist of:

	£000s
Accruals and trade creditors	(60)
Total current liabilities	**(60)**

These trade creditors represent fund management expenses incurred in respect of the year and outstanding at the accounting date (see note 1.6).

The value of creditors that falls inside the Whole of Government Accounts boundary is: nil.

Note 1.10 Non-current liabilities

	Notes	£000s
Actuarial liabilities	a	(–)
Provision for claims	b	(484,511)
Total non-current liabilities		**(484,511)**

a) Actuarial liabilities
As at 31 March 2006, the Pension Protection Fund had no actuarial liabilities to account for, as no schemes had been accepted into the Protection Fund, and consequently no Transfer Notices had been issued (see note 1.1c)).

b) Provisions for claims on the Pension Protection Fund
As at 31 March 2006, the Pension Protection Fund recognises provisions in respect of 98 pension schemes where the Board considers that eventual entry into the Fund is probable (as defined in Note 1.1(c)(ii)), and where reliable estimates of the difference between those schemes' protected liabilities and assets (including any recoveries from insolvent employers) can be made (as defined in Note 1.1(c)(iv) to (vi)). Note 1.7 gives further detail of how this value was arrived at.

Note 1.11 Contingent liabilities

As at 31 March 2006, the Pension Protection Fund discloses contingent liabilities in respect of 113 schemes valued at £482,969,000 where the Board considers that eventual entry into the Fund is possible (that is, the likelihood of entry is less than probable, but higher than remote). The Actuary's Supplementary Report as at 31 March 2006 included in the Annual Report and Accounts classifies these contingent liabilities into 4 types and readers should refer to the Supplementary Report, in particular Annex 2, for definitions and further detail of these contingent liabilities types.

Values in £000s Type of contingent liability	Liabilities	Assets	Net deficit
1*	301,935	238,095	63,840
2	83,100	62,345	20,755
3	6,353	3,828	2,525
4	2,835,988	2,440,139	395,849
Total	**3,227,376**	**2,744,407**	**482,969**

* includes anticipated recoveries of £7,763,000.

The Board has also considered the need to disclose a liability for claims "incurred but not reported". The limited evidence from the first period of operation indicates that there are no material liabilities associated with schemes where the employer insolvency event has not yet been reported to the Board. The Board recognises that further experience may lead to a different conclusion in future years and will keep this matter under review as statistical information on the reporting of claims builds up, particularly comparing the date of reports by insolvency practitioners to the dates of trigger insolvency events.

Note 1.12 Financial Instruments

FRS13, Derivatives and Other Financial Instruments, requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities. Because of the non-trading nature of the Pension Protection Fund's activities and the way it is financed, the Fund is not exposed in this area to the same financial risks faced by business entities.

Funding risk The Fund's Statement of Investment Principles 2005 describes the major risk facing the Fund as "funding risk", that is, the risk of deterioration in the relationship between the assets held by the Fund for the purposes of paying compensation and the fund's liabilities to pay compensation. The Board has no powers to raise income other than by raising Protection Levies and only limited powers to borrow to fund compensation payments. The Fund's assets arise from the receipt of Protection Levies and from the transfer in of scheme investments on scheme entry into the Pension Protection Fund, so the Fund's funding strategy is designed to mitigate the risks, both in the short and the long term, that the Fund's assets will be inadequate to meet its liabilities. Specifically, the Board will target the Fund towards reaching an appropriate ongoing funding level, to be achieved by the prudent management of the Fund's assets and the setting of a levy on eligible schemes that is fair and proportionate.

In this context, the Board has determined that the Fund's initial assets should be invested only in government bonds, non-government bonds, index-linked bonds, cash, or derivative instruments relating to these asset types.

Liquidity risk The Fund is not exposed to significant liquidity risks as the Board is of the opinion that the assets of the Fund, including its investment assets, are readily realisable. In the early years of the Fund's operations, it is in any case anticipated that compensation payments will be fully covered by income from Protection Levies so that the liquidation of investments will not be necessary.

Foreign currency risk The Fund's income, costs and liabilities are denominated in sterling. The Fund's Statement of Investment Principles for 2005 required its fund managers, should they decide to hold assets denominated in currencies other than sterling, to hedge fully the associated currency risk. The Fund was therefore not exposed to any residual foreign currency risk during the period.

To: the Board of the Pension Protection Fund

From: Stephen Rice, Appointed Actuary

The actuarial valuation of the Pension Protection Fund as at 31 March 2006

1. Introduction

The Board of the Pension Protection Fund ('the Board') is required by paragraph 22 of schedule 5 to the Pensions Act 2004 to prepare a statement of accounts in respect of each financial year. Each statement of accounts must contain an actuarial valuation of the assets and liabilities of the Pension Protection Fund prepared and signed by the Appointed Actuary.

This is the first actuarial valuation of the Pension Protection Fund. The effective date of this valuation is 31 March 2006 which coincides with the end of the Fund's first financial period.

At its meeting on 26 April 2006 the Board appointed me to prepare this valuation and I am addressing this report on the valuation to them. As required by paragraph 22(5) of schedule 5 to the Pensions Act 2004, the Board will be sending a copy of this report, as part of the statement of accounts, to the Secretary of State and also to the Comptroller and Auditor General. No party, apart from the Board, the Secretary of State and the Comptroller and Auditor General, should rely on any part of this report.

This report does not contain advice on the funding of compensation payable from the Pension Protection Fund.

In my view, whilst the Professional Conduct Standards of the Actuarial Profession apply to the preparation of this report, there are no professional practice standards which directly apply.

2. Value of assets

The value of the Pension Protection Fund assets is determined in accordance with regulations 2, 4 and 5 of the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006 (SI 2006/597).

I have adopted the value of the assets of the Fund as stated in the audited statement of accounts prepared by the Board for the financial period ending on 31 March 2006. I have not adopted either of the adjustments made available by regulations 4 and 5 as neither is relevant as at 31 March 2006.

Accordingly I have taken the value of the assets of the Pension Protection Fund as at 31 March 2006 as £141,490,000.

3. Value of liabilities

The value of the Pension Protection Fund liabilities is determined in accordance with regulation 3 of the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006. This requires:

(a) the liabilities of the Pension Protection Fund shall be any sums or properties falling to be paid or transferred out of the Fund required to meet liabilities listed in section 173(3) of the Pensions Act 2004; and

(b) the value of a liability shall be the present value of that liability at the valuation date.

According to the statement of accounts prepared by the Board for the financial period ending on 31 March 2006 a sum of £60,000 was required, as at 31 March 2006, to meet liabilities listed in section 173(3) of the Pensions Act 2004. This was in respect of trade creditors; there were no liabilities in respect of persons entitled to compensation because by 31 March 2006 the Board had not as yet assumed responsibility for any pension scheme. Accordingly I have taken the value of the liabilities of the Pension Protection Fund as at 31 March 2006 as £60,000.

4. Conclusion

In respect of the Pension Protection Fund as at 31 March 2006, the value of the assets was £141,490,000 and the value of the liabilities was £60,000.

The apparent surplus of £141,430,000 in the Pension Protection Fund as at 31 March 2006 does not convey the whole picture because there were some pension schemes that had entered into an assessment period, as defined in section 132 of the Pensions Act 2004, with effect from a date on or before 31 March 2006. In addition to this formal report on the assets and liabilities, I have estimated a provision in respect of the assets, potential recoveries and liabilities of those schemes which, in the Board's judgment, are likely to be transferred into the Pension

Protection Fund. This provision will be shown in the statement of accounts being prepared by the Board for the financial period ending on 31 March 2006.

I have also estimated contingent liabilities as at 31 March 2006 in respect of other pension schemes which, in the Board's judgment, are likely to be transferred into the Pension Protection Fund in the near future. These contingent liabilities will be disclosed in footnotes to the statement of accounts prepared by the Board for the financial period ending on 31 March 2006.

Stephen Rice
Appointed Actuary

Stephen Rice

Date: 23 October 2006

Job Title
Chief Actuary

Qualification
Fellow of the Institute of Actuaries

Employer
The Board of the Pension Protection Fund

To: the Board of the Pension Protection Fund

From: Stephen Rice, Chief Actuary to the Board of the Pension Protection Fund

Provisions and contingent liabilities of the Pension Protection Fund as at 31 March 2006

1. Introduction
The Board of the Pension Protection Fund ("the Board") is required by paragraph 22 of schedule 5 to the Pensions Act 2004 to prepare a statement of accounts in respect of each financial year. Each statement of accounts must contain an actuarial valuation of the assets and liabilities of the Pension Protection Fund. This actuarial valuation is set out in my report to the Board dated 23 October 2006.

The statement of accounts also contains provisions and discloses contingent liabilities that require actuarial estimation. This report contains these actuarial estimates. It also contains actuarial balance sheets for the Pension Protection Fund showing liabilities and provisions in comparison with the corresponding assets. The Board is responsible for the accounting policies, and this report has been prepared within the framework which it has determined.

This report does not contain advice on the funding of compensation payable from the Pension Protection Fund.

In my view, whilst the Professional Conduct Standards of the Actuarial Profession apply to the preparation of this report, there are no professional practice standards which directly apply.

2. Provisions
Under Financial Reporting Standard 12 (FRS 12) of the UK Accounting Standards Board, a provision should be recognised when:

- an entity has a present obligation (legal or constructive) as a result of a past event;
- it is probable that a transfer of economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

The application of this requirement in the accounting standard to the Board's statement of accounts as at 31 March 2006 is set out in Annex 1.

3. Contingent liabilities
Under FRS 12, a contingent liability is not recognised as a liability because it is either:

- a possible obligation (it has not yet been confirmed whether there is an obligation that could lead to a transfer of economic benefits); or
- a present obligation that does not meet the recognition criteria in FRS 12 (i.e. it is not probable that a transfer of economic benefits will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

A contingent liability should, however, be disclosed if the possibility of an outflow of economic benefit to settle an obligation is more than remote. The application of this requirement in the accounting standard to the Board's statement of accounts for the financial period ending on 31 March 2006 is set out in Annex 2.

4. Data
The data used for this valuation is summarised in Annex 3.

5. Compensation provided by the Pension Protection Fund
The compensation provided by the Pension Protection Fund is summarised in Annex 4.

6. Assumptions
Calculations of provisions and contingent liabilities are performed using two sets of assumptions (Basis 1 and Basis 2). These two bases are set out in full in Annex 5.

Basis 1
The assumptions in Basis 1 are consistent with the cost to the Pension Protection Fund of paying compensation. The three financial assumptions – discount rate in deferment, discount rate in payment for non-increasing compensation and discount rate in payment for increasing compensation – are derived from zero-coupon swap yield curves. The demographic assumptions are the same for Basis 1 and 2. Account is taken of:

- the average age of pensioners entitled to non-increasing compensation
- the average age of pensioners entitled to increasing compensation
- for non-pensioners, the number of years between their average age and normal pension age.

Zero-coupon swaps:

- can be used to match estimated compensation cash flows with precision, and
- are issued by investment banks where, in the context of full collateralisation, the risk and impact of default is small.

Given this minimal default risk, no reduction to Basis 1 yields is considered necessary.

Basis 2
The assumptions in Basis 2 are those used for section 179 valuations but subject to the two changes being consulted upon in my open letter dated 15 June 2006 to the UK Actuarial Profession. Taken together, they represent a very broad estimate of the assumptions that insurers would use to calculate a price for taking on pensions liabilities at PPF compensation levels as at 31 March 2006. This approach has been derived from discussions with insurance companies and with actuaries dealing with insurance companies about buy-out costs. Account has also been taken of the paper dated November 2005 produced by the Pensions Board of the UK Actuarial Profession entitled "Estimating the Cost of Securing Benefits with Insurance Companies". I recognise the practicalities of buying out benefits at the PPF compensation level on a significant scale and that the actual cost of buy out will differ from that suggested by calculations undertaken on this basis, particularly when one bears in mind the size of the PPF liabilities and the limited market capacity. However, I consider that Basis 2 represents a reasonable proxy for this cost in the context of this report.

7. Calculations of provisions and contingent liabilities
The method of calculation of provisions and contingent liabilities varied according to the data that the Board was holding about the scheme as at the date of this report.

- If the Board was in possession of a section 143 or a section 179 valuation, then the established methodology for rolling forward a section 179 valuation from a date earlier than 31 March 2006 to 31 March 2006 was used. This methodology is available in the risk based levy section of the Pension Protection Fund website at:

http://www.pensionprotectionfund.org.uk/s179rollforward.pdf

- If the Board was not in possession of a section 143 or a section 179 valuation, but did have a Minimum Funding Requirement (MFR) valuation, then the established methodology for rolling forward an MFR valuation from a date earlier than 31 March 2006 to 31 March 2006 was used. This methodology is available in the risk based levy section of the Pension Protection Fund website at:

http://www.pensionprotectionfund.org.uk/mfr_roll-forward.pdf

Cash flow information about the period from the latest section 143 or section 179 or MFR valuation (as appropriate) up until 31 March 2006 was sought from certain schemes where:

(a) as at 31 March 2006, an insolvency event notice under section 120 of the Pensions Act 2004 had been received by the Board from an insolvency practitioner in respect of an insolvency event on or before 31 March 2006 and

(b) the Board had not stated that the insolvency event was not a qualifying insolvency event, and

(c) one of the following applied:

- assets at the latest valuation exceeded £60 million or 5% of the PPF actuarial balance sheet assets value, or
- MFR liabilities according to the latest MFR valuation exceeded £60 million or 5% of the PPF actuarial balance sheet liabilities value, or
- 1.7 * MFR liabilities – 1.4 * assets (i.e. a very rough estimate of a scheme's section 179 deficit as at 31 March 2006) exceeded £20 million or 5% of the estimated PPF net deficit, or
- the effective date of the latest MFR valuation was earlier than 31 March 2004.

Broadly the aim with (c) was to collect more information in respect of schemes with a large asset value or a large value of liabilities, or a large deficit or valuation information which was not relatively up to date.

Where cash flow information was forthcoming from schemes from which it was sought, this information was used to provide a more precise estimate of the scheme assets and liabilities as at 31 March 2006 than was available using the roll-forward methodology. Where the information was not forthcoming (as happened in the case of some schemes where the effective date of the latest MFR valuation was before 31 March 2004), the roll-forward methodology was used without adjustment.

In aggregate the provisions for schemes where the roll-forward method was used without adjustment was less than 35% of total provisions for both Basis 1 and Basis 2.

The roll-forward methodology was adapted, for both Basis 1 and Basis 2, to make it appropriate for the different assumptions.

The results of the calculations of the provisions and contingent liabilities, on both Basis 1 and Basis 2, are set out in Annex 6. The two estimates provided can be seen as an indication of the different values that can be placed on the provisions and contingent liabilities on different assumptions, but they do not represent upper and lower bounds of the full range of reasonable estimates that could be made.

It is my opinion that the data collection processes and calculation methods described in this section (and detailed in Annex 3) have resulted in calculations that represent the best available estimate of provisions and contingent liabilities in aggregate for the Pension Protection Fund. I recognise that the use of summary data and roll-forward methodologies inevitably introduce approximations into the calculations, but I consider they remain appropriate for calculating aggregate provisions and contingent liabilities for the purposes of this Supplementary Report.

8. Actuarial Balance Sheets
Annex 7 sets out the actuarial balance sheets for the Pension Protection Fund as at 31 March 2006, including the proposed provisions as liabilities. For this purpose the liabilities are taken to be:

(a) the present value of the liabilities of the Pension Protection Fund to pay sums or transfer property, as required under section 173(3) of the Pensions Act 2004; this value is taken as £60,000, the same figure as was used in my actuarial valuation report of 23 October 2006; and

(b) my estimate of the present value of the provisions, as set out in Annex 6 of this report, which amount to £2,429,111,000 on Basis 1, and to £2,622,735,000 on Basis 2.

Accordingly I have taken the liabilities of the Pension Protection Fund as at 31 March 2006 as £2,429,171,000 on Basis 1 and £2,622,795,000 on Basis 2.

In the actuarial balance sheets for the Pension Protection Fund as at 31 March 2006, the assets are:

(a) the value of the Pension Protection Fund assets determined in accordance with regulations 2, 4 and 5 of the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006

(SI 2006/597); this value is taken as £141,490,000, the same figure as was used in my actuarial valuation report of 23 October 2006; and

(b) my estimate of the sum of the estimated values of the assets in the schemes that generated the provisions described in section 2 of this report, plus any anticipated recoveries (£65,843,000); these amount to £1,944,600,000.

Accordingly I have taken the value of the assets of the Pension Protection Fund as at 31 March 2006 as £2,086,090,000.

Stephen Rice
Chief Actuary

Stephen Rice

Date: 23 October 2006

Job Title
Chief Actuary

Qualification
Fellow of the Institute of Actuaries

Employer
The Board of the Pension Protection Fund

Annex 1

Provisions in the Statement of Accounts for the financial period ending on 31 March 2006

The statement of accounts as at 31 March 2006 contains provisions in respect of eligible schemes as defined in section 126 of the Pensions Act 2004 in relation to which:

- an insolvency event notice under section 120 of the Pensions Act 2004 had been received by the Board from an insolvency practitioner on or before the date of this report,
- the Board had stated on or before the date of this report that the insolvency event was a qualifying insolvency event,
- the insolvency date was on or before 31 March 2006,
- a withdrawal notice under section 122(2)(b) of the Pensions Act 2004 had not been received on or before the date of this report (and, in the Board's judgment, is unlikely to be received) from the insolvency practitioner, and
- as at the insolvency date, the value of the assets was, in the Board's judgment, likely to have been less than the amount of the protected liabilities as defined in section 131 of the Pensions Act 2004.

Annex 2

Contingent liabilities in the Statement of Accounts for the financial period ending on 31 March 2006

Four types of contingent liabilities are disclosed in footnotes to the statement of accounts.

1. Type 1 contingent liabilities are in respect of eligible schemes as defined in section 126 of the Pensions Act 2004 in relation to which:

- an insolvency event notice under section 120 of the Pensions Act 2004 had been received by the Board from an insolvency practitioner on or before the date of this report,
- the Board had stated on or before the date of this report that the insolvency event was a qualifying insolvency event,
- the insolvency date was on or after 1 April 2006,
- a withdrawal notice under section 122(2)(b) of the Pensions Act 2004 had not been received as at the date of this report (and, in the Board's judgment, is unlikely to be received) from the insolvency practitioner, and
- as at the insolvency date, the value of the assets was, in the Board's judgment, likely to have been less than the amount of the protected liabilities as defined in section 131 of the Pensions Act 2004.

2. Type 2 contingent liabilities are in respect of eligible schemes in relation to which:

- an insolvency event notice under section 120 of the Pensions Act 2004 was received by the Board from an insolvency practitioner on or before the date of this report,
- the Board had stated on or before the date of this report that the insolvency event was NOT a qualifying insolvency event,
- in the Board's judgment, a subsequent insolvency event, which will be a qualifying insolvency event, is likely, and
- as at 31 March 2006, the value of the assets was, in the Board's judgment, likely to have been less than the amount of the protected liabilities, as defined in section 131 of the Pensions Act 2004.

3. Type 3 contingent liabilities are in respect of eligible schemes in relation to which:

- in the Board's judgment, no insolvency event has taken place, but the Board is nonetheless expecting to receive an insolvency event notice under section 120 of the Pensions Act 2004 from an insolvency practitioner in the future, and
- the Board has sufficient data about the scheme to be able to make an estimate of a contingent liability.

4. Type 4 contingent liabilities are in respect of schemes where:

- the D&B failure score is available to the Board and, as at 31 March 2006, this score was less than 10, and
- the Board in its view had sufficient information as at the date of this report about the scheme to enable underfunding as at 31 March 2006 to be estimated, and
- as at 31 March 2006, the value of the assets was, in the Board's

judgment, likely to have been less than the amount of the protected liabilities.

Out of a population of 4,594 schemes considered, 119 had a failure score of less than 10 associated with it. The average annual insolvency probability, weighted by underfunding, for the 119 schemes was 27% (using D&B's table as at 31 March 2006 for converting failure scores to insolvency probabilities).

Type 4 contingent liabilities exclude any scheme already within the provisions or other categories of contingent liabilities.

Data

There are 98 schemes which contribute to the provision in the statement of accounts for the financial period ending on 31 March 2006; liabilities in respect of another two schemes have not been recognised (i.e. not included in the provision) because the value of their assets was, in the Board's judgment, likely to have exceeded the amount of the protected liabilities at their insolvency date. For Type 1 liabilities this recognition test was also undertaken at the insolvency date. For Type 2, Type 3 and Type 4 liabilities the recognition test assessment was undertaken at the valuation date since a qualifying insolvency event had not occurred.

The numbers of schemes contributing to the various types of liabilities are given in the table below:

Liability	Number of schemes	Number of pensioners *	Number of non-pensioners *
Provision	100 (98 recognised)	10,338	33,024
Type 1 contingent liability	13 (12 recognised)	1,975	5,332
Type 2 contingent liability	4 (3 recognised)	549	1,940
Type 3 contingent liability	1	111	264
Type 4 contingent liability	119 (97 recognised on basis 1, and 104 recognised on basis 2)	n/a	n/a

* Data in respect of recognised schemes only.

This valuation has not been undertaken using member-by-member data from all the schemes included within our valuation. Instead the historic valuation results available for the schemes have been used and rolled forward on a global basis. As such the valuation will not be as accurate as one undertaken using membership data for each scheme. This approach, whilst perhaps inappropriate for valuation purposes for some schemes on an individual basis, in aggregate is, in my opinion, acceptable for estimating provisions and contingent liabilities. Generally there is no reason to doubt the quality of the information provided within a particular scheme's valuation report. It is important, however, to note that any errors contained within the original scheme valuation will carry through to this valuation.

Because of the lack of uniformity of data summaries in individual schemes' valuation reports, it has not been possible to provide any other summary data about schemes in the various liability categories.

Annex 4

Summary of compensation provided by the Pension Protection Fund

Broadly speaking, the Pension Protection Fund provides two levels of compensation:

1. For individuals who have reached their scheme's normal pension age or, irrespective of age, are either already in receipt of survivors' pension or a pension on the grounds of ill health, the Board pays from the Pension Protection Fund **100% level of compensation**.

In broad terms and in normal circumstances, this means a starting level of compensation that equates to 100% of the pension in payment immediately before the start of the assessment period, as defined in section 132 of the Pensions Act 2004. This is subject to a review of the rules of the scheme by the Board.

The part of this compensation that is derived from pensionable service on or after 6 April 1997 will be increased each year in line with the Retail Prices Index capped at 2.5%. This could, potentially, result in a lower rate of increase than the scheme would have provided.

2. For the majority of people below their scheme's normal pension age the Board pays from the Pension Protection Fund **90% level of compensation**.

In broad terms and in normal circumstances, this means 90% of the pension an individual had accrued immediately before the assessment date (subject to a review of the rules of the scheme by the Board) plus revaluation in line with the increase in the Retail Prices Index between the assessment date and the commencement of compensation payments (subject to a maximum increase for the whole period calculated by assuming RPI rose by 5% each year). This compensation is subject to an overall cap, which presently equates to £26,050 at age 65 (the cap is adjusted according to the age at which compensation comes into payment).

Once compensation is in payment, the part that derives from pensionable service on or after 6 April 1997 will be increased each year in line with the Retail Prices Index capped at 2.5%. Again, this could result in a lower rate of increase than the scheme would have provided.

In addition there is also compensation for certain survivors.

The Board has the ability to alter the levy to meet its liabilities. However, in extreme circumstances compensation could be reduced.

- revaluation and indexation could be reduced by the Board if circumstances required it
- levels of compensation could be reduced by the Secretary of State on the recommendation of the Board.

Annex 5

Assumptions

1. Discount rate in deferment (net of increases up to normal pension age).

For each non-pensioner, the liability for the period of deferment is obtained by discounting the value of the compensation at normal pension age at the rates below.

Basis 1
The discount rate assumed in deferment, net of increases up to normal pension age, is 1.0% p.a.

The objective was to derive a single discount rate that most closely matched a valuation of a member's compensation with attaching survivor's pension from the zero coupon swap curve, the RPI swap curve and the LPI [0, 2.5%] swap curve as at 31 March 2006:

Given a cashflow at a specific future duration, and by fixing the compensation in payment assumptions at 4.5% for pre-1997 benefit and 2.1% for post-1997 benefit (see below for further information on how these discount rates were obtained), a pre-retirement discount rate (net of RPI increases in deferment) can be found which gives the same discounted value for the cashflow as a swap rate valuation. As duration varies, so does the pre-retirement discount rate implied by a swap rate valuation.

1% p.a. was chosen after consideration of the average value of the period of time to normal pension age for non-pensioners in the schemes in the valuation.

Basis 2
The discount rate assumed in deferment, net of increases up to normal pension age, is Yield A – 0.7%.

Yield A is determined, as at 31 March 2006, as 50% of the sum of the FTSE

Actuaries Government Securities Index Linked annualised Real Yield Over 15 years Index assuming:

(a) 5% inflation; and

(b) 0% inflation.

Yield A as at 31 March 2006 was 1.1%, so the discount rate assumed in deferment, net of increases up to normal pension age, is 0.4% p.a.

2. Discount rate in payment for non-increasing compensation

For each pensioner and each non-pensioner, for the period from which payments are assumed to commence, the liability is obtained by discounting at the rates below.

Basis 1
The discount rate assumed in payment for non-increasing compensation is 4.5% p.a.

The objective was to derive a single discount rate that most closely matched a valuation of a member's compensation with attaching survivor's pension from the zero coupon swap curve as at 31 March 2006.

The implied single discount rate was calculated at a variety of ages. 4.5% p.a. was chosen after consideration of the average age of pensioners for the schemes in the valuation who would receive pre-1997 compensation.

Basis 2
The discount rate assumed in payment for non-increasing compensation is Yield B.

Yield B is determined, as at 31 March 2006, as the annualised yield on the FTSE Actuaries Government 10 year Fixed Interest Index.

Yield B as at 31 March 2006 was 4.4%, so the discount rate assumed in payment for non-increasing compensation is 4.4% p.a.

3. Discount rate in payment for increasing compensation (net of compensation increases)

For each pensioner and each non-pensioner for the period from which payments are assumed to commence the liability is obtained by discounting at the rates below.

Basis 1
The discount rate assumed in payment for increasing compensation (net of compensation increases) is 2.1% p.a.

The objective was to derive a single discount rate that most closely matched a valuation of a member's compensation with attaching survivor's pension using the zero coupon swap curve and the LPI [0, 2.5%] swap curve.

The implied single discount rate was calculated at a variety of ages. 2.1% was chosen after consideration of the average age of pensioners for the schemes in the valuation who would receive post-1997 compensation.

Basis 2
The discount rate assumed in payment for increasing compensation (net of compensation increases) is the greater of (Yield B – 2.5%) and (Yield C – 0.5%).

Yield C is determined, as at 31 March 2006, as 50% of the sum of the FTSE Actuaries Government Securities Index-Linked annualised Real Yield Over 5 years Index assuming:

(a) 5% inflation; and

(b) 0% inflation.

Yield B as at 31 March 2006 was 4.4% and Yield C was 1.3%, so the discount rate assumed in payment, net of compensation increases, is 1.9% p.a.

4. Mortality

For both Basis 1 and Basis 2, the mortality table used in respect of a member is PMA92, with PFA92 being used in respect of the member's dependant, in each case with the medium cohort mortality improvement rates. These mortality tables are published by the Continuous Mortality Investigation of the UK Actuarial Profession. For each individual, the set of mortality rates used are those applicable to that individual's year of birth.

5. Proportion married

For both Basis 1 and Basis 2, 80% of members are assumed to be married or to have a relevant partner.

6. Age difference between member and dependant

For both Basis 1 and Basis 2, female assumed to be three years younger than male.

7. Expenses

For Basis 1 there is no allowance for expenses, because Pension Protection Fund expenses are met from the administration levy rather than the Fund.

For Basis 2,
a) Estimated wind-up expenses
3% of liabilities (excluding benefit installation/payment expenses) up to £50 million; plus

2% of liabilities (excluding benefit installation/payment expenses) between £50 million and £100 million; plus

1% of liabilities (excluding benefit installation/payment expenses) in excess of £100 million.

b) Benefit installation/payment expenses
Non-pensioners
An allowance of £500 per member is made.

Pensioners
An allowance of £350 per member is made.

Annex 6

Calculation of provisions and contingent liabilities

98 schemes were considered in relation to the provision in the statement of accounts for the financial period ending on 31 March 2006, yielding the following estimated provisions on Basis 1 and Basis 2:

	Basis 1 (£)	Basis 2 (£)
	2,429,111,000	2,622,735,000

The estimated amounts for the various types of contingent liabilities were as follows:

Type of contingent liability	Basis 1 (£)	Basis 2 (£)
1	63,840,000	84,717,000
2	20,755,000	26,908,000
3	2,525,000	3,018,000
4	395,849,000	626,577,000
Total	**482,969,000**	**741,220,000**

Note that the liabilities recognised as provisions are the present value of the liabilities calculated at 31 March 2006 on the relevant basis. The liabilities recognised as contingent liabilities are the present value of the deficit calculated at 31 March 2006 on the relevant basis

Shown below are the total assets and total liabilities that correspond to the above deficit (contingent liabilities).

Type of contingent liability	Basis 1 (£)	Basis 2 (£)	Assets
1	301,935,000	322,812,000	238,095,000*
2	83,100,000	89,253,000	62,345,000
3	6,353,000	6,846,000	3,828,000
4	2,835,988,000	n/a	2,440,139,000
4	n/a	3,201,818,000	2,575,241,000

* includes an estimate of anticipated recoveries of £7,763,000

Annex 7

Actuarial balance sheet

On Basis 1 the Pension Protection Fund actuarial balance sheet is as follows;

Assets	£	Liabilities	£
The value of the Pension Protection Fund assets determined in accordance with the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006	141,490,000	The present value of the liabilities of the Pension Protection Fund to pay sums or transfer property as required under section 173(3) of the Pensions Act 2004	60,000
The sum of the estimated values of the assets in the schemes that generated the provisions, plus any anticipated recoveries	1,944,600,000*	The present value of the provisions	2,429,111,000
Total assets	2,086,090,000	Total liabilities	2,429,171,000
Total assets less total liabilities			(343,081,000)
Assets/liabilities			86%

* Inclusive of anticipated recoveries of £65,843,000.

On Basis 2 the Pension Protection Fund actuarial balance sheet is as follows;

Assets	£	Liabilities	£
The value of the Pension Protection Fund assets determined in accordance with the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006	141,490,000	The present value of the liabilities of the Pension Protection Fund to pay sums or transfer property as required under section 173(3) of the Pensions Act 2004	60,000
The sum of the estimated values of the assets in the schemes that generated the provisions, plus any anticipated recoveries	1,944,600,000*	The present value of the provisions	2,622,735,000
Total assets	2,086,090,000	Total liabilities	2,622,795,000
Total assets less total liabilities			(536,705,000)
Assets/liabilities			80%

* Inclusive of anticipated recoveries of £65,843,000.

Accounting policies and notes relating to the operation of the Fraud Compensation Fund for the period 6 April 2005 to 31 March 2006

Note 2.1 Accounting policies

a) Transfer from the Pension Compensation Board

On 1 September 2005, the Board of the Pension Protection Fund assumed responsibility for the functions of the Pension Compensation Board (PCB). The Pensions Act 2004 requires the Board to manage these functions through a distinct ring-fenced fund called the Fraud Compensation Fund. The transfer of the assets and liabilities of the PCB associated with this transfer of responsibility has been dealt with under the "Machinery of Government changes" provisions of the Government Financial Reporting Manual, which requires them to be accounted for using merger accounting (as defined in FRS6 "Acquisitions and Mergers"). Merger accounting has been interpreted in this situation as requiring the results and cash flows of the PCB to be brought into the financial statements of the Fraud Compensation Fund from the beginning of the financial period in which the merger occurred, i.e. from 6 April 2005. The net assets of the PCB as at the beginning of the financial period have been brought onto the balance sheet of the Fraud Compensation Fund at fair value as disclosed in the PCB's accounts for the financial year ended 5 April 2005. The income, expenditure and any other recognised gains and losses of the PCB have been brought into the operating statement of the Fraud Compensation Fund at the values stated in the PCB's closing accounts for the period 6 April to 31 August 2005.

FRS6 "Acquisitions and Mergers" also requires the restatement of corresponding figures by including the results for all the combining entities for the previous period and their balance sheets for the previous balance sheet date. Comparative figures for the previous full year of PCB's operations (year ended 5 April 2005) are therefore set out below.

Operating Statement:

All amounts in £000s		Fraud Compensation Fund for the period 6 April 2005 to 31 March 2006	PCB for the year ended 5 April 2005
STATUTORY OPERATING ACTIVITIES			
Income from levies	2.2	–	3,449
Operating expenses	2.3	(64)	(207)
Net operating surplus/(deficit)		**(64)**	3,242
Interest and other investment income	2.4	127	146
Claims for compensation	2.6	–	(2,377)
NET RESULT		**63**	**1,011**

Balance Sheet:

All amounts in £000s		Fraud Compensation Fund as at 31 March 2006	PCB as at 5 April 2005
Investment assets	2.7	3,012	2,935
Cash	2.8a	11	8
Debtors and prepayments	2.8b	–	36
Current liabilities	2.8c	(23)	(42)
Net current assets/(liabilities)		(12)	2
Total net assets		3,000	2,937
Represented by:			
Net result		63	1,011
Revaluation and other reserves	2.9	2,937	1,926
Total levy payers' funds		3,000	2,937

b) Income recognition
The accrual bases for different sources of income are as follows:

- interest income arising from cash deposits, fixed interest securities and similar investments is accounted for on a daily basis as interest is earned
- Fraud Compensation Levy income is recognised on an accruals basis.

c) Investments
The investment assets of the Fraud Compensation Fund are held in the form of units in liquidity funds managed by external fund managers. Interest is accounted on these funds on a daily basis and is settled by the fund managers issuing new units in the liquidity funds which are added to the Board's holdings in those funds. These liquidity funds are therefore valued as cash, at £1 per unit.

d) Current liabilities
Current liabilities arise as a consequence of the accruals basis of accounting for income and expenditure, to ensure all liabilities falling due on or before the accounting date which had not been settled by the accounting date are disclosed within the Board's accounts.

e) Claims
Within the Fraud Compensation Fund, the Board recognises provisions for claims where it judges that it is probable that the claim will be validated and a compensation payment to the claimant scheme be made from the Fund. Where the Board judges that validation of the claim is possible (i.e. that the likelihood is greater than remote but lower than probable) a contingent liability will be disclosed. Where the Board judges that the likelihood of validation is remote, the Fund will not recognise any provisions nor disclose any specific contingent liabilities.

Note 2.2 Income from levies

Neither PCB (in the period to 31 August 2005) nor the Board of the Pension Protection Fund (in the period from 1 September 2005) raised any new Fraud Compensation Levy in the period to 31 March 2006. PCB did transfer to the Board responsibility for the collection of levy debtors outstanding as at 31 August 2005 (see note 2.8b) but provisions were set up for substantially all of these debtors in PCB's accounts to 31 August 2005 (see note 2.3). No new information has come to light in the period since 1 September 2005 which would lead the Board to release any of these provisions and so disclose any levy income.

No levy income is therefore recognised in these accounts.

In the year to 5 April 2005, PCB raised a levy set at 23p per pension scheme member. This levy raised a total of £3,449,000.

Note 2.3 Operating expenses

	Fraud Compensation Fund for the period 6 April 2005 to 31 March 2006 £000s	PCB for the year ended 5 April 2005 £000s
Levy collection fee	–	125
Remuneration and Travel expenses of PCB's Chairman and Board Members	2	4
Management fee paid to the Office of the Pensions Ombudsman	8	16
Legal fees	8	16
Accountancy services	10	8
General office expenses, accommodation costs and Information Technology software and maintenance costs	1	2
Audit fees	8	5
Printing costs	3	4
Corporation Tax	9	27
Provisions for levy collection costs and doubtful debts	15	–
Total operating expenses	**64**	**207**

The majority of the operating expenses for the current period disclosed above relate to the period from 6 April 2005 to 31 August 2005 and are accounted for here due to the operation of merger accounting as described in Note 2.1a). The only exception relates to additional audit fees incurred in completing the audit of PCB's accounts to 31 August 2005 which were in excess of those estimated by PCB. Following the transfer from PCB to the Board of the Pension Protection Fund on 31 August 2005, all future operating expenses incurred in administering the Fraud Compensation Fund in periods from 1 September 2005 on will be accounted through the Administration Fund of the Pension Protection Fund.

Note 2.4 Interest income

The bank accounts operated by PCB and also by the Board of the Pension Protection Fund for the Fraud Compensation Fund were both interest bearing. On 1 September 2005, cash totalling £2,977,000 was transferred from PCB to the Board, and was held on deposit until the Board had determined its investment strategy and appointed fund managers. Transfers to the fund managers were completed in March 2006.

Note 2.5 Investment income

The investment assets of the Fraud Compensation Fund are held in the form of units in liquidity funds managed by external fund managers. Interest is accounted on these funds on a daily basis and is settled by the fund managers issuing new units in the liquidity funds which are added to the Board's holdings in those funds. The investment income disclosed here therefore represents the interest earned on these liquidity funds from the date funds were first invested, in March 2006, to the accounting date.

Note 2.6 Compensation payments and provisions for claims

As described in more detail in note 2.10, the Board does not consider it appropriate at this time to recognise provisions for any claims currently under consideration by the Board, as it considers it does not yet have adequate evidence to judge whether it is probable that these claims will be validated and subsequently paid.

In the year to 5 April 2005, PCB made one compensation payment totalling £2,377,000 in respect of the Cheney Pension Scheme.

Note 2.7 Investment assets

The investment assets of the Fraud Compensation Fund are held in the form of units in liquidity funds managed by external fund managers. Interest is accounted on these funds on a daily basis and is settled by the fund managers issuing new units in the liquidity funds which are added to the Board's holdings in those funds. These liquidity funds are therefore valued as cash, at £1 per unit. The closing values of the funds as at 31 March 2006 were:

	£000s
Liquidity Fund managed by:	
Insight Investment Management	1,506
Fidelity Investments	1,506
Total investment assets	**3,012**

The investments of PCB at 5 April 2005 consisted of bank deposits valued at £2,935,000.

Note 2.8 Net current assets

a) Cash at Bank
As described in the accounting policy on "Segmental Reporting", the Board of the Pension Protection Fund is responsible for three ring-fenced funds. To improve controls over the three funds and ensure that only allowable items of income and expenditure are transacted within each fund, the Board has opened separate bank accounts for the three funds. The Fraud Compensation Fund account is used to collect fraud compensation levies, to transfer cash to the fund managers and to pay out compensation claims.

All bank accounts are interest bearing, at rates that the Board consider competitive given the operating requirements of the accounts.

The average balance on the Fraud Compensation Fund operating bank account for the period from 1 September 2005 to 31 March 2006 was £2,957,000, and the average interest rate payable on the account was 4.46%

b) **Other current assets** consisted of:

	Fraud Compensation Fund as at 31 March 2006 £000s	PCB as at 5 April 2005 £000s
Levy debtors	15	18
Cash in transit from the Pensions Regulator	–	14
Provisions for levy collection costs and doubtful debts	(15)	–
Accrued interest	–	4
Total other current assets	**–**	**36**

The Board of the Pension Protection Fund did not raise any Fraud Compensation Levy during the accounting period, and the levy debtors disclosed in the Fraud Compensation Fund relate to debtors transferred by PCB when it was closed on 31 August 2005.

The value of debtors that falls inside the Whole of Government Accounts boundary is: nil (PCB as at 5 April 2005: £14,000).

c) Current liabilities consist of:

	Notes	Fraud Compensation Fund as at 31 March 2006 £000s	PCB as at 5 April 2005 £000s
Accruals and trade creditors		(14)	(15)
Provision for corporation tax	i	(9)	(27)
Total current liabilities		(23)	(42)

The value of creditors that falls inside the Whole of Government Accounts boundary is: £19,000. (PCB as at 5 April 2005: £33,000).

i) Provision for corporation tax
Income earned on the assets of the Pensions Compensation Board was deemed to be subject to corporation tax and this provision relates to the tax payable on the net income of the PCB for its final accounting period ended 31 August 2005. The transfer of PCB's assets to the Board of the Pension Protection Fund means that those assets are now subject to the Pension Protection Fund (Tax) Regulations 2006 and so exempt from income tax, corporation tax and capital gains tax.

Note 2.9 Reserves

	£000s
PCB net asset reserve	2,937
Movement in the period	–
Closing balance	**2,937**

The reserves figure of £2,937,000 represents the net assets of the Pensions Compensation Board, valued at fair value as at 5 April 2005, which have been brought onto the balance sheet of the Fraud Compensation Fund under the operation of merger accounting as described in Note 2.1b).

Note 2.10 Contingent liabilities

Six claims for compensation were in process at the date of the dissolution of the Pension Compensation Board and responsibility for finalising these cases was transferred to the Board of the Pension Protection Fund. No new claims have been received since that date (1 September 2005). Further investigation of these claims is being carried out to verify both the loss of assets by the claimant schemes, and to verify that the loss was caused by dishonesty. Claims may eventually fail on either of these counts.

Final determination of these cases will depend on evidence being produced to the Board's satisfaction on these points, as well as evidence that reasonable efforts have been made to recover losses from other sources, so that losses paid by the Board are minimised. These processes could take a considerable time to complete and may extend over several years. In the meantime the Board does have powers to make discretionary interim awards in case of immediate need. No such awards were made during the accounting period.

The Board considers that the evidence so far made available to it is inadequate to judge whether it is probable that claims will be validated and paid. The Board therefore considers it inappropriate to recognise provisions for these claims at the accounting date. However, the Board considers that five of the claims in process may possibly be validated and result in a payment from the Fraud Compensation Fund, and the values of these claims are disclosed as contingent liabilities below. One claim is now considered unlikely to result in a payment from the Fund, and is not included in the values disclosed below as at 31 March 2006, having been disclosed as a contingent liability in previous accounts of the Pensions Compensation Board.

Further investigation of one claim included as a contingent liability by PCB has resulted in a re-statement to increase significantly the value of the claim. In one other case, further examination of the case has led to a classification of one part of the claim (involving the non-payment to trustees of employee contributions) as "possible", and another part of the claim (involving non-payment to trustees of employer contributions) as "remote".

Should a claim be validated, the successful claimant scheme would be entitled to interest based on 100% of the value of the validated loss, to be calculated at a rate of 2% above base rate, for the period between the effective date of loss and the date of payment of compensation. The contingent liabilities disclosed below include interest calculated on this basis up to 31 March 2006.

Values in £000s	At 31 March 2006	At 31 August 2005	At 31 March 2005
Number of claims	5	6	6
Value of contingent liabilities	£2,806	£2,288	£2,313

The movement from 31 August 2005 to 31 March 2006 can be summarised as follows:

	Values in £000s	Number of claims
Value disclosed at 31 August 2005	2,288	6
Reclassification of claims (or parts of claims)	(45)	(1)
Re-statement of claim value	444	–
Further interest on claims (including on re-stated values)	119	–
Value disclosed at 31 March 2006	2,806	5

Note 2.11 Financial instruments

FRS13, Derivatives and Other Financial Instruments, requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities. Because of the non-trading nature of the Fraud Compensation Fund's activities and the way it is financed, the Fund is not exposed in this area to the same financial risks faced by business entities.

Funding risk – The Fund's Statement of Investment Principles describes the major risk facing the Fund as not having sufficient funds to pay compensation as required under the Pensions Act 2004. The Board has no powers to raise income other than by raising Fraud Compensation levies and no powers to borrow to fund compensation payments. The Fund's assets arise from the receipt of Fraud Compensation Levies, so the Fund's funding strategy is designed to mitigate the risks, both in the short- and the long-term, that the Fund's assets will be inadequate to meet its liabilities. Specifically, the Board will target the Fund towards a balance between securing the compensation payments for schemes whilst setting a fair and proportionate levy. All Fund investments will therefore be held in cash deposits or equivalent vehicles such as liquidity funds.

Liquidity risk – The Fund is not exposed to significant liquidity risks as the Board is of the opinion that

- the assets of the Fund, including its investment assets, are highly liquid and readily realisable; and
- the time required to investigate claims and decide whether payment (including any interim settlements) should be made is adequate to raise any levy income required over and above the funds already under the Board's control.

Interest rate risk – As described in Note 2.10, successful claimants on the Fund are entitled to interest based on 100% of the value of the validated loss, to be calculated at a rate of 2% above base rate, for the period between the effective date of loss and the date of payment of compensation. The Fund therefore faces the risk that the return on its investments will be inadequate to cover these interest payments. The Fund's Statement of Investment Principles recognises this risk and describes the investment strategy designed to mitigate it.

Foreign currency risk – The Fund has no significant exposure to foreign currency in respect of its compensation activities as all of its income, costs, assets and liabilities are denominated in sterling.

Accounting policies and notes relating to the operation of the Board of the Pension Protection Fund's Administration Fund for the period 6 April 2005 to 31 March 2006

Note 3.1 Accounting policies

a) Income recognition

The accrual bases for different sources of income are as follows:

- interest income arising from cash deposits is accounted for on a daily basis as interest is earned
- grant in aid income is recognised in the same period as the forecast expenditure necessitating the draw down of that grant in aid.

b) Fixed assets and Capitalisation policies

- intangible fixed assets:

  The costs of purchasing major software licences are capitalised as intangible fixed assets.

  The costs of major software and software development and enhancement including related consultancy costs, are capitalised as tangible fixed assets, although ongoing software maintenance costs are written off in the year they occurred.

- tangible fixed assets:

  The costs of purchasing hardware are capitalised as tangible fixed assets provided the cost of the hardware, either as a single item or as a group of related items bought for a common purpose, exceeds £1,000.

c) Depreciation policies

Depreciation is provided on all fixed assets at rates calculated to write down the cost or valuation (less any estimated residual value) of each asset evenly over its expected useful life as follows:

Information Technology costs (IT costs):

• Information Technology equipment	3 years
• major software licences	3 years or the life of the licence if shorter
• software & software development and enhancement	3 years.

Fixed assets are valued at current replacement cost which is calculated by applying appropriate Office for National Statistics indices to the historical cost of the asset. Any surplus on revaluation of fixed assets is credited to a revaluation reserve in the Statement of Total Recognised Gains and Losses; any permanent diminution in the value of a fixed asset on revaluation is charged (and captioned as an impairment charge) to the Operating Statement in the period when it occurs.

d) Current liabilities

The Board's policy for current liabilities is to account on an accruals basis for all liabilities falling due on or before the accounting date which had not been settled by the accounting date. This includes all goods and services supplied during the accounting period but not paid for as at the accounting date.

Accounting for these liabilities may involve the use of estimates.

Note 3.2 Grant in aid

The operating expenses of the Board of the Pension Protection Fund are funded by the Board drawing down from DWP, normally on a quarterly basis, the cash needed to fund its forecast operating expenses. This is known as grant in aid and is detailed in section 116 of the Pensions Act 2004. The Act also empowers the Secretary of State to raise an administration levy to recover these (and other) costs from qualifying defined benefit and hybrid occupational pension schemes. These powers are detailed in section 117 (1) of the Act. This levy is raised on an annual basis, using the Board's operating expense budget for the relevant year as one source of information in setting the overall levy – see the note below.

Administration Levy

The Pensions Act 2004 empowers the Secretary of State for Work and Pensions to raise a Pension Protection Fund administration levy, from which to fund the operating costs of the Board and other associated costs. These other costs consist of the expenses incurred by the DWP in establishing the Board and its operating infrastructures prior to the Board opening for business on 6 April 2005. These establishment costs include the expenses of appointing and remunerating Board Members and staff prior to 6 April 2005; of developing policies and processes for the initial operating functions of the Board, particularly in the legal, HR, accounting and procurement areas; of identifying and fitting out the premises from which the Board would begin its operations; and of specifying and installing the Information Systems and Information Technology systems to support the Board's initial operating functions. The Board understands that it is DWP's intention to recover these costs over the first three financial years of the administration levy.

The establishment costs can be analysed as follows:

	£000s
Treated as operating expenses	6,487
Treated as capital expenditure (Information Systems and Information Technology systems)	2,498
Total establishment costs	**8,985**

The Board have been advised by DWP that the total administration levy raised by the Secretary of State in 2005/06, and its disposition during the year, can be summarised as follows:

	£000s
Total administration levy raised	12,645
Retained by DWP to recover establishment costs	(2,995)
Grant in aid drawn down by the Board	(8,991)
Surplus carried forward to future levy years	**659**

Note 3.3 Operating expenses

a) Staff costs

Staff costs charged to the Administration Fund consisted of:

	Period ended 31 March 2006 £000s
Salaries and wages	1,985
Social security costs	186
Other pension costs	365
Temporary staff	30
Seconded staff	1,053
Total	**3,619**

The average number of staff employed, including secondment and temporary staff, was:

	No.
Permanent employees	52
Secondment and temporary staff	12
Total	64

Details of the remuneration of members of the Board of the Pension Protection Fund are given in the Remuneration Report in section 5 of the Annual Report. The staff costs reported include the costs of all Board Members.

Employees of the Board of the Pension Protection Fund are eligible for membership of the Principal Civil Service Pension Scheme (PCSPS) and can opt to join the defined benefit section, or to contribute to a stakeholder (defined contribution) arrangement. The PCSPS is an unfunded multi-employer defined benefit salary related scheme but the Board is unable to identify its share of the underlying assets and liabilities. Defined benefit contributions are therefore accounted for by the Board as if they were contributions to a defined contribution scheme. A full actuarial valuation of PCSPS was carried out as at 31 March 2003 and details can be found in the Cabinet Office: Civil Superannuation Resource Accounts (www.civilservice-pensions.gov.uk).

During the period to 31 March 2006, employers' contributions of £320,000 were payable to the defined benefit section of the PCSPS at one of four rates in the range 16.2% to 24.6%. The scheme's actuary reviews employer contributions every four years following a full scheme valuation. From 2006-07, the salary bands will be revised and the rates will be in a range between 17.1% and 25.5%. These contribution rates reflect the benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme.

Employees of the Board can opt to open a partnership pension account, which is a stakeholder pension with an employer contribution. Employers' contributions of £45,000 were paid to one or more of a panel of three appointed stakeholder pension providers. Employer contributions were age-related and range from 3% to 12.5% of pensionable pay, and employers also match employee contributions up to 3% of pensionable pay.

In addition, employer contributions were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service and ill health retirement of these employees.

At 31 March 2006, pension contributions in respect of the month of March 2006 totalling £44,000 were outstanding, and were paid over to PCSPS in April 2006 in accordance with legislative requirements.

b) Other costs
Other costs charged to the Administration Fund consisted of:

	Period ended 31 March 2006 £000s
Training and recruitment costs	140
Staff Travel, expenses and hospitality	61
Advisory and other professional services	1,102
Statutory audit costs	171
Accommodation	515
General office expenses	136
Information Technology and telephony	902
Billing and collection costs (protection levies)	190
Publicity & communications	42
Total	**3,259**

Other costs include where appropriate Value Added Tax which the Board is not able to recover. In compliance with SSAP5, this irrecoverable VAT is included in the cost of the items reported in the financial statements.

Note 3.4 Interest income

As described in Note 3.2, the Board draws down grant in aid from DWP on a periodic (normally quarterly) basis to cover forecast expenditure, and these funds are held in interest bearing accounts to cover, for example, monthly salary payments and regular supplier payments. The Board therefore earns interest income on these funds, and this income is used to reduce the grant in aid requirement in the subsequent period.

Note 3.5 Fixed assets

The fixed assets included in the Administration Fund consist of information and communication technology assets held for the purposes of the Board's operations and administration. They include the Information Technology hardware and software assets acquired by DWP as part of the project to establish the Board of the Pension Protection Fund and brought into use by the Board from 6 April 2005. The book cost of these assets has been brought into the Board's Administration Fund accounts as at 6 April 2005 through reserves, analogous to donated assets. "Additions in the period" represents further fixed assets acquired directly by the Board during the period.

Impairment and depreciation charges are made in relation to these assets in accordance with the policy set out in Note 3.1c). However, charges that relate to the assets transferred to the Board by DWP are then offset against the fixed asset reserve, with the intention of writing off the reserve over the useful life of the fixed assets concerned (see note 3.7). The net charge to the Operating Statement is arrived at as follows:

	Note	£000s
Total impairment charges in the period (see below)	i	135
Total depreciation charges in the period (see below)	i	896
Offset against fixed asset reserve (see below)	ii	(922)
Net charge to Operating Statement		109

i Analysis of fixed asset
The net book value of fixed assets at 31 March 2006 is arrived at as follows:

All amounts in £000s	Tangible fixed assets	Intangible assets	Total
Cost at 6 April 2005	2,449	49	2,498
Additions in period	312	26	338
Impairment charges	(135)	–	(135)
Depreciation/amortisation charged in the period	(876)	(20)	(896)
Net Book Value at 31 March 2006	1,750	55	1,805

Tangible fixed assets consist of installed computer hardware and operating systems; intangible assets consist of software licences.

ii Transfer to reserves
As explained above, impairment and depreciation charges on the assets acquired by DWP as part of the project to establish the Board are offset against the associated fixed asset reserve. The total value of £922,000 is broken down as follows:

	£000s
Impairment charges on tangible fixed assets	135
Depreciation charges on tangible fixed assets	771
Depreciation on intangible assets	16
Total transferred to reserves	922

Note 3.6 Net current assets

a) Cash at Bank

As described in the accounting policy on “Segmental Reporting”, the Board of the Pension Protection Fund is responsible for three ring-fenced funds. To improve controls over the three funds and ensure that only allowable items of income and expenditure are transacted within each fund, the Board has opened separate bank accounts for the three funds. The Administration Fund account is used to receive grant in aid from DWP and to pay staff and other suppliers of goods and services.

All bank accounts are interest bearing, at rates that the Board consider competitive given the operating requirements of the accounts.

The average balance during the period on the Administration Fund bank account was £3,334,000, and the average interest rate payable on the account was 4.49%

b) Other current assets

Other current assets consist solely of amounts recoverable from staff in respect of season ticket and other similar loans. The value of debtors that falls inside the Whole of Government Accounts boundary is: nil.

c) Current liabilities consist of:

	£000s
Accruals and trade creditors	1,263
Total current liabilities	**1,263**

The value of creditors that falls inside the Whole of Government Accounts boundary is: £560,000.

Note 3.7 Reserves

	£000s
Fixed asset reserve	2,498
Movement in the period	(922)
Closing balance	**1,576**

The reserve of £2,498,000 relates to the fixed assets which were brought into use when the Board of the Pension Protection Fund opened for business on 6 April 2005, having been acquired by DWP as part of the project to establish the Pension Protection Fund. The book cost of these assets has been brought into the Board’s Administration Fund accounts as at 6 April 2005 through reserves, analogous to donated assets.

The movement in the period represents impairment and depreciation charges on these assets which has been charged to operating expenses in the first instance (see note 3.5) but then offset against the fixed asset reserve with the intention of writing off the reserve over the useful life of the fixed assets concerned.

Note 3.8 Financial Instruments

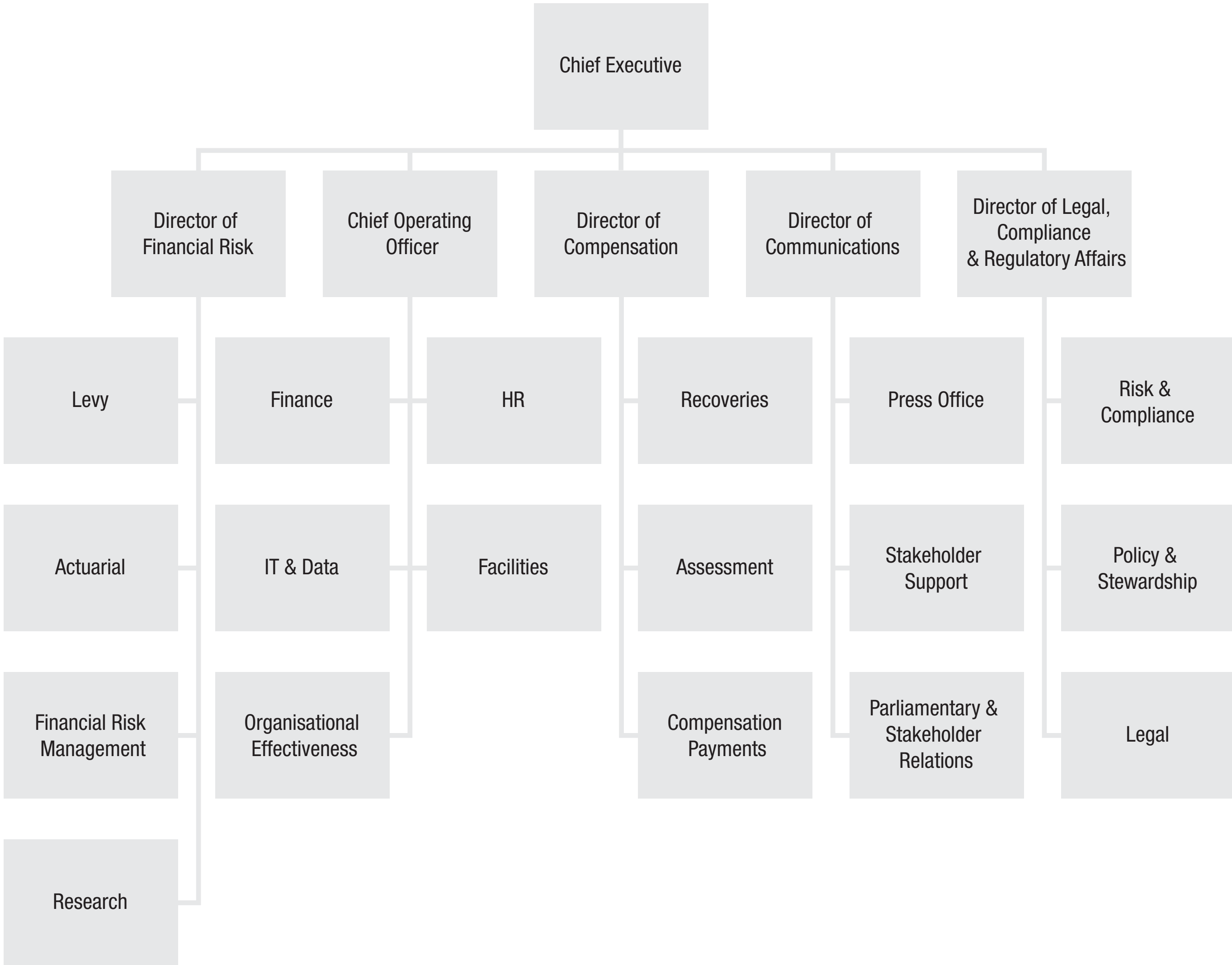
FRS13, Derivatives and Other Financial Instruments, requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities. Because of the non-trading nature of the Board of the Pension Protection Fund's administration activities and the way it is financed, the Board is not exposed in this area to the degree of financial risk faced by business entities. For example, the Board has no powers to borrow to fund administration activities or to raise income other than by the grant-in-aid process described in Note 3.2. Financial assets and liabilities are generated by the Board's routine operational activities, and are not held to change the risks facing the Board in carrying out its administration functions.

Liquidity risk Both the Board's resource and capital requirements are funded by grant-in-aid from its sponsor department, DWP. The Board is therefore not exposed to significant liquidity risks.

Interest rate risk The Board has no power to borrow to fund administration activities and therefore is not exposed to any interest rate risk. Any surplus funds on its Administration account are held in interest-bearing accounts- see Note 3.6a).

Foreign currency risk The Board has no significant exposure to foreign currency in respect of its administration activities.

Organisation chart at date of publication



The Executive team

Management Committee[5]

Partha Dasgupta **Chief Executive**

Alan Duncan **Director of Compensation**

Naomi L'Estrange **Director of Legal, Compliance & Regulatory Affairs**

Paul Reynolds **Director of Communications**

Chief Operating Officer (vacancy)

Director of Financial Risk (vacancy)

Heads of Teams

Actuarial Stephen Rice

Assessment Stuart Barker

Board Support Veronica Branton

Chairman's Office John Taylor

Compensation Payments (vacancy)

Facilities Caroline Dear

Finance Jeff Highfield

Financial Risk Management Jean-Pierre Charmaille

HR Sue Holmes

IT & Data Alan Losty

Legal David Taylor

Levy Sara Protheroe

Operational Effectiveness Jeff Wickett

Parliamentary & Stakeholder Relations (vacancy)

Policy & Stewardship Charles Ramsden

Press Office (vacancy)

Recoveries Richard Favier

Research Gwyn Haache

Stakeholder Support Trevor Davis

[5] The Management Committee was not formed until after the end of the reporting period.

Glossary

The "PPF"

the Board of the Pension Protection Fund was established as a body corporate under the Pensions Act 2004 and is run by a Board which must consist of:

(a) a Chairman
(b) the Chief Executive of the Board, and
(c) at least five other persons ("ordinary members").

The abbreviations "Pension Protection Fund" and "PPF" are used in the document to describe the Board of the Pension Protection Fund.

The "Board"

the Members of the Board of the Pension Protection Fund are referred to in the Directors' Report as the "Board".

The "DWP"

The Department for Work and Pensions is the PPF's sponsoring department. The PPF is accountable to Parliament through the Secretary of State for Work and Pensions.

The Pensions Regulator

the Pensions Regulator has a statutory duty "to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund".

Section 120 notices

a prescribed notice to the Pension Protection Fund required under the Pensions Act 2004 which must be completed by an insolvency practitioner when he becomes aware that an insolvent employer has sponsored an occupational pension scheme.

Section 143 valuations

an actuarial valuation carried out on a prescribed basis, required under the Pensions Act 2004 to determine whether, as at the assessment date, the value of the pension scheme's assets was less than the amount of its protected liabilities.

Section 179 valuations

an actuarial valuation, carried out on a prescribed basis, required under the Pensions Act 2004 to determine, for the purpose of calculating the risk based levy, the funding of an eligible pension scheme.

Printed in the UK for The Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office
ID5455558 11/06 AM4298

Printed on Paper containing 75% post consumer waste and 25% ECF pulp.

Pension
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Fund

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

Online
www.tsoshop.co.uk

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ISBN 0-10-294363-X
9 780102 943634