Presented pursuant to the GRA Act 2000 c.20. s.6

NHS Pension Scheme and NHS Compensation for Premature Retirement Scheme

Resource Accounts 2003-04

LONDON: The Stationery Office
HC 231

31 January 2005
£8.00

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(For the year ended 31 March 2004)

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Contents

INTRODUCTION

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

REPORT OF THE MANAGER

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

The specific features of the year have been:

- Continued successful participation in an exercise with the Audit Commission to identify deceased pensioners where the Scheme has not received notification of the death;
- The continued development of an online pensions service, which has lead to wider roll-out of web-based services throughout 2003-2004;
- Continuing work on implementing European Court of Justice rulings on part-time staff and certain classes of NHS employees with special rights within the Scheme.

HOW THE SCHEME WORKS

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

Scheme provisions are governed by the following sets of Regulations:

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

The day to day administration of the Scheme, including calculation of benefits, maintenance of member records and payment of benefits is undertaken by the NHS Pensions Agency. NHS employers are required to explain the Scheme to their employees. In addition they submit pension data to the NHS Pensions Agency, and a significant number of employers calculate pensions benefit estimates for their employees.

There are 664 participating NHS Trusts, Primary Care Trusts, Local Health Boards and Health Authorities, 9,588 participating GP Practice employers and 397 Direction Bodies. Employers are classified as Employing Authorities or Direction Bodies. Employing Authorities are defined in the Regulations and their staff have automatic entry to the Scheme. Non-NHS employers can apply for Direction Body Status to join their staff in the Scheme provided they meet specified criteria.

NHS PENSION SCHEME BENEFITS

Contributions

In order to defray the costs of benefits, employers and members pay contributions. Most employees pay 6% of pensionable pay but manual staff pay 5%. The Government Actuary conducts actuarial reviews every five years and recommends an employer contributions rate in his Valuation report. In 2002-03 employers paid 7% but the rate did not include the cost of pension indexation funded directly by Treasury. In November 2002 Ministers announced the transfer of indexation costs to the Scheme costs with a commensurate increase in the Department of Health's baseline. The employer contribution rate increased to 14% from April 2003, NHS employers continued to pay 7% and the additional 7% was paid by the Department. NHS employers will be charged 14% from April 2004.

Benefits

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

Annual Pensions

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

Pensions Indexation

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

Lump Sum Allowance

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

Ill-Health Retirement

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

Death Benefits

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

Additional Voluntary Contributions (AVCs)

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

Transfer between Funds

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

Preserved Benefits

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

Compensation for Early Retirement

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

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

A REVIEW OF THE YEAR

Part-time staff

The ramifications of the case of Preston and Others -v- Wolverhampton Healthcare NHS Trust, which concerns retrospective access rights for part-time employees, continued to unfold during the year. Following a series of test cases, appeals and cross-appeals, the Employment Tribunals have determined the basis for entitlement in the majority of circumstances that pertain to the NHS Scheme. The Agency is now working with the Employment Tribunals to identify which cases appear to "must win", "must fail" or "may succeed in part".

Where access has been denied by the Scheme regulations, then there will be no direct cost to employers. Employer contributions will be charged against scheme funds as increased liabilities.

Part-time Mental Health Officers

The Agency has continued to identify members and pensioners of the Scheme who worked part-time in the area of mental health, and may now have access to special rights.

Approximately 12,000 cases were actioned this year and there is now less than 1,000 still to be reviewed. The Agency remains on course to complete this exercise by December 2004.

NHS Pensions On-Line

The NHS Pensions On-Line service provides access via NHS employers to pensions records for members, it also allows Employers to submit data electronically instead of completing paper forms.

The increase in the use of electronic forms has also resulted in a significant reduction in error rates from 54% to 4%, meaning records are up to date and more reliable. Employers can use the system to model options and can respond to member requests for estimates more quickly at the touch of a button. There is instant access to 80% of the records.

Links with State Pension Scheme

As reported in the Resource Accounts for 2001-2002, a number of overpayments of pension have arisen in recent years due to delays in the changeover to a new National Insurance Recording System (NIRS). Initially these were primarily in those cases where an individual was in receipt of Incapacity Benefit after State pension age and moved onto retirement pension during the period June 1998 to March 2000. This was due to information about Guaranteed Minimum Pension (GMP) entitlements not being provided to the NHS Pensions Agency (NHSPA), which would enable the NHSPA to stop indexing GMP and, therefore, avoid double indexation by the NHSPA and the Department of Social Security. This lack of data however now affects a wider number of NHS pensions, and whilst interim data on GMPs has now been provided by the Inland Revenue, and the exercise to correct pension payments continues, overpayments continue to be discovered. In 2003-2004 financial year, overpayments totalling £18,493 (2002-2003: £53,104) have been written off. The remaining overpayments totalled £33,481, and as the remainder has substantially reduced, will not be reported on an individual basis in next year's account.

National Fraud Initiative

The NHS Pension Scheme takes part in the National Fraud Initiative, co-ordinated by the Audit Commission, which commenced in 1998, and continues to do so on a bi-annual basis. This initiative allows the Scheme to submit approved data to the Audit Commission who match it against other data sources to ensure the payments are still being made to the individual originally entitled to the pension. This exercise was in addition to the Scheme's normal procedure of regularly confirming entitlement with individual pensioners. The table below provides an update of the position for all 3 exercises conducted since 1998, and lists the outstanding amounts which are still being actively pursued.

	Total Identified £'s	Total Cases	Prior Years		2002-03		2003-04		Amount Outstanding
			Recovered	Written off	Recovered	Written off	Recovered	Written off	at 31.3.2004
NFI 98	1,730,000	305	932,296	235,200	68,804	95,000	21,100	199,200	178,400
NFI 2000	541,700	291	360,500	26,000	27,300	30,600	19,600	16,200	61,500
NFI 2002	774,400	362	-	-	-	-	433,000	27,000	314,400
Total	**3,046,100**	**958**	**1,292,796**	**261,200**	**96,104**	**125,600**	**473,700**	**242,400**	**554,300**

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

Pension Increase

The annual pension increase applied for payments after 9 April 2002 was 1.7%. The increase applied for payments after 7 April 2003 was 1.7%. Pensions increase is based upon the rise in the retail price index (RPI) in the 12 month period up to the 30 September preceding the April uprating date.

In-house money purchase AVC provision

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

Scheme member take-up of both Standard Life and Prudential products has been low during the year, which may track higher house prices, continuing concern about the level of Stock Market returns available for money purchase AVC products generally, and lingering doubts in the wake of earlier bad publicity following Equitable Life's closure to new business.

In reality 2003-04 could be seen as a better year, with some sense of stability and calm returning at the Equitable and upper quartile returns on investments reported for both Prudential and Standard Life. Overall policy gains remained modest however, with all similar companies cutting back on guaranteed bonuses, in line with generally lower future expectations. Prudential and Standard Life have continued to accompany the Agency at NHS Conferences and made themselves available for local presentations on hospital and GP Practice premises.

Next year will see the end of the Equitable's current 7 year contract to provide money purchase AVCs for NHS Scheme members. Although very few NHS Scheme members now take out new contracts with Equitable Life, managers are discussing the arrangements that will apply from April 2005 for the 27,000 plus members who still maintain an Equitable fund for their retirement. Managers expect to be able to publish details of the arrangements by the end of the calendar year.

Scheme Funding and Liabilities

As at 31 March 2004 the liabilities of the pension scheme were valued at £104.2 billion. As the NHS pension Scheme is an unfunded scheme, these liabilities are underwritten by the Exchequer, which also funds the year on year difference between the scheme's contribution income and the actuarially assessed growth in scheme liability and interest charges. In 2003-04 this net deficiency was £6,193,919,000 (2003-04: £6,478,158,000) and is detailed in Schedule 2 of the following scheme accounts.

Scheme Valuation 2003

In accordance with the requirement in the Resource Accounting Manual to produce a full actuarial valuation of the pension scheme every four years, the Agency has commissioned the Government Actuary's Department (GAD) to produce a valuation as at 31 March 2003. However the results of this exercise were not available in time for them to be reflected in the 2003-04 financial statements. As a consequence the long-term pension liability in the 2003-04 accounts is based upon the valuation data as at 31 March 1999, as uprated annually by the GAD, and as such, some of the variables that might impact upon the overall scheme liability may have changed over the intervening period.

The Comptroller and Auditor General has advised the Agency that he intends to comment upon the matter in his certificate and report on the Scheme accounts. Therefore it is deemed appropriate to draw attention to the matter within the Statement on Internal Control, which accompanies the financial statements, and to highlight the steps being taken by the Agency and GAD to improve the timeliness of the valuation reporting cycle.

Analysis of Resource Outturn

As a consequence of a change in the way in which the Scheme accounts for its use of resources, the Agency technically underestimated the in-year growth of the Scheme liabilities. The Agency applied for, and received, permission from HM Treasury to utilise underspent funds in relation to a prior period adjustment to offset this breach. A fuller explanation of the matter can be found in the notes to Schedule 1 of the Scheme Accounts, which accompany this report.

Post Balance Sheet Events

Change In Status of the NHS Pensions Agency

The NHS Pensions Agency became a Special Health Authority with effect from 1 April 2004. This decision arose from recommendations made as part of the Quinquennial Review of the Agency and aims to align the management of the service more closely with the NHS. It fits with the policy of the Department of Health to shift the balance of responsibility for service delivery into the NHS and will enable us to develop closer ties to the service.

Arms Length Bodies Review

The recent review of the Department of Health's Arms Length Bodies, aimed at improving efficiency in the management of the NHS, has recommended that a central NHS Business Services Authority take over the functions of Prescription Pricing Authority, Counter Fraud and Security Management Service, Dental Practice Board and NHS Pensions Agency. Consequently, the NHS Pensions Agency will be dissolved by 1 October 2005, with all functions – including management of the NHS Pensions Scheme and NHS Compensation for Premature Retirement Scheme – transferring to the new NHS Business Services Authority.

Further detail of the transitional arrangements will be included in the pension scheme managers' report for the year ended 31 March 2005.

Pension Scheme Review

The NHS Employers organisation launched a consultation on the review of the NHS Pension Scheme 'Moving to a 21st century Pension Scheme' on the 10 January 2005. This is a three month consultation process after which the Government will consider possible changes to the Scheme.

Membership Statistics

Details of the current membership of the Scheme at 31 March 2004 are set out below:

Active Members

Active members at 1 April 2003	1,168,709
New entrants in the year	122,010
Transfers in	8,129
Retirements in year	22,113
Transfers out	17,195
Members leaving the Scheme and taking a refund of contributions	38,086
Deaths	7,522
Active members at 31 March 2004	1,213,932

Deferred members

Deferred members at 1 April 2003	334,697
Members leaving who have deferred pension rights	26,996
Members taking up deferred pension rights	4,282
Deferred members at 31 March 2004	357,411

Pensioners in payment (including Compensation payments)

	Members	Dependants	Total
Pensioners in payment at 1 April 2003			488,889
Members retiring	22,113		22,113
New Dependants		4,278	4,278
Deaths in year	9,250	2,237	11,487
Pensioners in payment at 31 March 2004			503,793

A Stuttard
Chief Executive
20 January 2005

MANAGEMENT STRUCTURE AND ADVISERS

Scheme Administrator :

NHS Pensions Agency Special Health Authority
Hesketh House
200-220 Broadway
Fleetwood
FY7 8LG

In-house AVC Providers :

Equitable Life Assurance Society
Walton Street
Aylesbury
Buckinghamshire
HP21 7QW

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

Prudential Plc
250 Euston Road
London
NW1 2PQ

Actuary :

Government Actuary's Department
New King's Beam House
22 Upper Ground
London
SE1 9RJ

Auditors :

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

NHS PENSION SCHEME
REPORT OF THE ACTUARY FOR THE ACCOUNTING YEAR ENDED 31 MARCH 2004

The Report of the Actuary relates to the NHS Pension Scheme and the funding of the Schemes' future liabilities.

1. Liabilities

The capitalised value as at 31 March 2004 of expected future benefit payments under the NHS Pension Scheme, for benefits accrued in respect of employment or former employment prior to 31 March 2004, has been assessed using the methodology and assumptions set out in sections 3 and 4 below. The results are as follows:

Value of Liabilities	**£ billion**
Pensions in Payment	32.5
Deferred Pensions	8.5
Active Members (Past Service)	63.2
Total	**104.2**

2. Accruing Costs

The cost of benefits accruing for each year of service is met partly by a specified contribution from members, with the balance of the cost of the benefits being met by the employers. The total cost of benefits accruing in the year 2003-2004 has been assessed, using the methodology and assumptions set out in sections 3 and 4 below, as follows:

	% of Pensionable Pay
Standard Contribution Rate	20.0%
Members' Average Contribution Rate	5.9%
Employers' share of standard cost	14.1%
Actual rate charged to employers for current year	7.0%

In relation to the pensionable payroll for the financial year, the employers' actual charges in cash terms were £3.59 billion for the financial year 2003-2004.

3. Methodology

The value of liabilities has been obtained using the projected accrued benefit method with allowance for expected future pay increases in respect of active members. The liabilities and standard contribution rate include pension increases awarded since leaving service for pensioners and deferreds, plus allowance for future pension increases for all categories of member. The standard contribution rate for accruing costs has been determined using the new entrant method.

4. Assumptions

The principal financial assumptions adopted for the pension assessments made in relation to this statement are an investment return in excess of price increases of 3.5% p.a. (most pension benefits under the scheme are increased in line with prices), and an investment return in excess of earnings increases of 2% p.a. The gross rate of return is assumed to be 7% p.a. although this assumption has only a minor impact on the calculation of the liability. In nominal terms these assumptions are then equivalent to an allowance for increases in salaries of 4.9% p.a. and an allowance for price inflation of 3.4% p.a. The demographic assumptions adopted for the assessments are derived from the specific experience of the membership of the scheme, and other similar large public service pension schemes where some aspect of the experience is not readily available.

5. Notes

(i) Sections 1 and 2 of this statement are based on the actuarial assessment carried out as at 31 March 1999, with an approximate updating for the subsequent financial years to reflect known changes that have occurred between 1 April 1999 and 31 March 2004, based on the available data. The method assumes that the profile of the membership has remained stable within the period, which may not necessarily be the case, and so the results should be viewed as an indication of the order of magnitude of the liabilities rather than a full actuarial assessment.

(ii) The actual rate charged to employers for 2003/04 at 14.0% of pay follows the recommendations made at the 1999 assessment.

(iii) The pension benefits taken into account in this assessment are those normally provided from the rules of the Scheme, including normal retirement benefits, ill-health retirement benefits, and benefits applicable following the death of the member. The assessments do not include the cost of injury benefits or premature retirement benefits awarded on redundancy.

C D Daykin CB MA FIA 18 October 2004
Government Actuary
London

STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

Under the Government Resources and Accounts Act 2000, the Accounting Officer is required to prepare a combined financial statement for the NHS Pension Scheme and NHS Compensation for Premature Retirement Scheme in the form and on the basis determined by HM Treasury.

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

In preparing these financial statements, the Accounting Officer is required to satisfy himself that:

- Suitable accounting policies have been selected and applied consistently;
- The combined financial statements have been prepared on a going-concern basis, unless it is inappropriate to presume that either of the schemes will continue in operation;
- Reasonable and prudent judgements and estimates have been made;
- Applicable accounting standards have been followed, in accordance with the guidelines set out by HM Treasury, subject to any material departures disclosed in the financial statements.

The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which an Accounting Officer is answerable, for keeping proper records and for safeguarding the Schemes' assets, are set out in the Accounting Officers' Memorandum issued by HM Treasury and published in Government Accounting.

A Stuttard
Chief Executive
20 January 2005

STATEMENT ON INTERNAL CONTROL

Scope of responsibility

As Accounting Officer, I have responsibility for maintaining a sound system of internal control. This system of internal control supports the achievement of the NHS Pensions Agency's aims in administering the NHS Pensions Scheme's policies, aims and objectives, set by the Department of Health's Ministers, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting.

The Agency administers the Scheme, risk and accountability arrangements for the Scheme are through the Agency, the two overlap and are not handled separately in practice. During the period covered by this statement, the Agency was an Executive Agency of the Department of Health and was accountable directly to the Agency's Senior Departmental Sponsor (SDS) in the Department of Health and the Agency's Ministerial Advisory Board (MAB). The then Acting Chief Executive, Pat Corless, provided regular business and financial reports to both the SDS and the MAB. The Agency had an Audit and Risk Management Committee who reviewed and provided advice to her on audit, internal control and risk management issues.

On 1 April 2004, the NHS Pensions Agency became a Special Health Authority, and on 1 June 2004 I replaced Pat Corless as Chief Executive of the Agency. The remaining members of the management team were assembled between June and August 2004. The new management team does not include any of the former directors of the NHS Pensions Agency, who either retired or left the Agency, prior to my appointment. In addition, between April 2003 and August 2004, the Agency did not have a qualified Finance Director in post. This undoubtedly had an impact on the Agency's capacity to respond to and act upon emerging financial control and assurance issues, particularly those arising from the management of the contractual relationship with our major outsourced service provider, Envision.

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

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 Agency policies, aims and objectives, to evaluate the likelihood and impact of those risks being realised, and to manage them efficiently, effectively and economically. This process has been in place since July 2002 and up to the date of approval of the Scheme's resource accounts, and accords with Treasury guidance. However, there are several areas where weaknesses have been identified and which we are addressing during 2004-05.

Capacity to handle risk

An Agency Risk Management Policy and Strategy is in place, which covers all areas of business and financial risk. The Agency's Executive Team has responsibility for ensuring this is delivered effectively. Further risk workshops have been held during the year including two joint Risk Workshops with our private sector partner, Envision and the development of a joint risk register. In addition, during the reporting period, the Agency started to introduce Core Assurance Standards and a self-assessment toolkit, which included a section on risk management. Also, for the 2004/05 business planning round, templates were provided which linked business planning, performance management and risk management. The Agency's risk guidance is also available on the Agency's Intranet site. The Agency's Risk Manager and Internal Audit are available to provide advice and regularly benchmark the Agency's risk management processes to ensure that good practice is reflected in the Agency's risk strategy.

The risk environment

The Agency now has a hierarchy of Risk Registers covering Corporate, Operational, Partnership, Project and Fraud risks. Copies of the Corporate and Partnership Risk Registers have been routinely copied to the Audit and Risk Committee.

The principal risks of the Agency are actively managed through a Corporate Risk Register. The Executive Team reviews the register each month when risks and associated actions are evaluated. Corporate Risks are allocated to Executive Team members to manage, they are prioritised and actions are identified to improve management of each risk. The Corporate Risk Management priorities of the Agency, with particular regard to the Pension Scheme, during 2003-04 have been:

- Business Continuity Planning
- Contract Management

The Agency is committed to managing risks to an acceptable level on all aspects of business activity. During 2004-05 work has been undertaken to align the Agency's Corporate Risk Register with the Agency's Business Plans to ensure that all business priorities are risk assessed. The establishment of a separate Risk Management Committee has further strengthened management of the risk environment. This committee is chaired by the Chief Executive and comprises Non Executive Director members.

Review of effectiveness

As Accounting Officer, the Chief Executive of the Agency also has responsibility for reviewing the effectiveness of the system on internal control. The review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive directors within the Agency. The joint Audit and Risk Committee which was in place during 2003/04, advised the then Chief Executive on the implications of the result of reviews on the effectiveness of the system of internal control.

The accountability framework was strengthened during the year to take forward recommendations made by internal audit and the National Audit Office (NAO). To support the framework, the Agency published Corporate Governance material, including our core assurance standards and toolkit, on the Intranet site.

For 2003-04 the Agency Directors and the Operational Manager were formally allocated accountability for risk management, budgets and internal control. At the end of 2003-04 all Directors and the Operational Manager signed an assurance statement confirming the adequacy of risk management and internal control in their business area. The Agency's Private Sector Partner has also signed an annual assurance statement which sets out the processes they have in place to provide assurance over the effectiveness of their risk management and internal control. This statement was quality reviewed by internal audit and Agency Management and any issues or shortcomings in levels of assurance are being addressed in conjunction with our service partner.

The Agency has its own in-house Internal Audit Unit, which operates to standards within the Government Internal Audit Manual. They submit regular reports, which include independent opinion by the Head of Internal Audit on the adequacy and effectiveness of the Agency's system of internal control together with recommendations for improvement. Progress on the implementation of recommendations is managed primarily through the Agency's Audit Committee. Prior to 31 March 2004 the Agency had a joint Audit and Risk Committee. Following the creation of the Special Health Authority on 1 April 2004 a separate Audit Committee was established which is chaired by, and comprises the Board non-executive directors which will strengthen the overall Audit arrangements.

Significant internal control problems

Ongoing Control Issues

During 2003-04 we continued to address control weaknesses around Contract Management and Business Continuity Planning (BCP).

Contract management

In relation to contract management, the Audit and Risk Committee had expressed serious concerns over the inertia reached in reorganising the contract management structure in order to ensure a smooth handover to the new Special Health Authority Management.

Robust management action plans with timetables were developed for contract management during 2003-04. The majority of actions were cleared by the end of the financial year, with only a few actions remaining, which continue to be addressed. The Agency Board has agreed in principle the scope of a full review of the contract with Envision, including management arrangements. The review will commence in the last quarter of the 2004-05 financial year.

Business Continuity Planning

The Audit and Risk Committee had commented on the continued absence of a comprehensive and tested business continuity plan (BCP). The management team have worked with Envision to produce a plan, and the Agency now has a finalised integrated BCP and there is an ongoing programme, action plan and timetable covering testing, and the future review and development of the plan.

As part of the handover report from the Chair of the outgoing Audit and Risk Committee, a recommendation was made to ensure momentum is maintained on these two items and the key role of internal audit in highlighting progress was noted.

Emerging Control Issues

With specific reference to the NHS Pension and Compensation for Early Retirement Schemes, the management team continues to work to address emerging control weaknesses in the following areas:

Accuracy of NHS employer pension scheme contributions

Whilst it is the responsibility of every employer of NHS Pension Scheme members to ensure the accuracy of the contributions it pays over to the Agency, the Accounting Officer must be assured that the NHS Pensions Agency is receiving the correct level of contributions due to the Scheme. To this end, the Agency has continued to work with NHS employers during 2003-04 to verify the accuracy of contributions paid over to the Agency, and as part of this verification exercise has issued over 10,500 statements of contributions to NHS employers. The return of statements from employers has improved on the previous year to 94% from NHS employers and 96% from GPs. This exercise highlighted a number of discrepancies between our records and those of the employer, mainly due to posting inaccuracies which were subsequently corrected. However it is felt that the documentation to support this process could be improved and we are currently working with our service partner to improve this.

In addition to the above exercise, the Agency has conducted a sample reconciliation of its records to the financial statements of NHS employers to verify transactions and balances between the organisations. Agreement has been reached within acceptable tolerance levels, in all cases where information was clearly available. For 2004-05 onwards, a balances agreement exercise will be rolled out to every NHS Trust and PCT under the auspices of the Whole of Government Accounts consolidation exercise.

The Agency recognises that more could be done to ensure that all contributions due are accounted for, and will be looking to enhance the year-end exercises to achieve assurance on this aspect of contributions income.

The Agency will also take advantage of the introduction of the Electronic Staff Record (ESR) system as a means of further improving the accuracy of employer contributions and is actively engaged with the ESR project team.

Internal Controls Assurance from out-sourced service providers

The Agency is continuing to work with its private sector partners to strengthen the internal control processes and procedures within the service streams they provide, with particular emphasis being placed on the IT development and Finance streams.

This focus on improving internal controls will also form part of the forthcoming review of the contract with the Envision consortium.

All of the above issues are being actively managed by the Agency Board and supported by the NHS Pensions Agency Special Health Authority Audit and Risk Management committees.

Other Issues - Compliance with FRS17

In accordance with the requirement in the Resource Accounting Manual to produce a full actuarial valuation of the pension scheme every four years, the Agency has commissioned the Government Actuary's Department (GAD) to produce a valuation as at 31 March 2003. However the results of this exercise were not available in time for them to be reflected in the 2003-04 financial statements. As a consequence the long-term pension liability in the 2003-04 accounts is based upon the valuation data as at 31 March 1999, as uprated annually by the GAD, and as such, some of the variables that might impact upon the overall scheme liability may have changed over the intervening period. However the uprating exercise undertaken by the Scheme Actuary is the best indication of the order of magnitude of the scheme liabilities at 31 March 2004 available at this time.

Whilst it follows that the scheme liabilities in the accounts for the year ending 31 March 2005 will be based on the accounting valuation as at 31 March 2003, the Agency is actively engaged in several initiatives to improve the timelines of scheme valuations for future years, including:

- Working with the ESR project team and increasing the use of on-line member record updating by employers via the Pensions On-Line system, so that the timeliness, reliability and completeness of the data, upon which valuations are based, are improved;
- Working with the GAD, HM Treasury and the Department of Health to streamline and harmonise the valuation process;
- Working with the GAD to provide improved disclosure of the potential impact on the pension scheme liability of major changes to the NHS pay and workforce structure that occur between valuations;
- Using the "Faster Closing" initiative as a driver to inform the future timetable for the provision of actuarial data.

A Stuttard
Chief Executive
20 January 2005

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

I certify that I have audited the financial statements on pages 21 to 25 under the Government Resources and Accounts Act 2000. The financial statements have been prepared under the accounting policies set out on pages 26 to 28.

Respective responsibilities of the Accounting Officer and auditor

As described on page 12, the Accounting Officer is responsible for the preparation of the financial statements in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder and for ensuring the regularity of transactions. The Accounting Officer is also responsible for the preparation of the contents of the Accounts. My responsibilities, as independent auditor, are established by statute and I have regard to the standards and guidance issued by the Auditing Practices Board and the ethical guidance applicable to the auditing profession.

I report my opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder, and 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 report whether in all material respects the contributions payable to the schemes have been paid in accordance with the Scheme rules and the recommendations of the actuary. I also report if, in my opinion, the Report of the Scheme Manager is not consistent with the financial statements, if the Authority has not kept proper accounting records for the Scheme or if I have not received all the information and explanations I require for my audit.

I read the other information contained in the Accounts and consider whether it is consistent with the audited financial statements. I consider the implications for my certificate if I become aware of any apparent misstatements or material inconsistencies with the financial statements.

I review whether the statement on pages 13 to 16 reflects the Authority's compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered whether the Accounting Officer's Statement on Internal Control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the entity's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

I conducted my audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Authority in the preparation of the financial statements, and of whether the accounting policies are appropriate to the schemes' circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by error, or by fraud or other irregularity, 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. However, the Authority were unable to provide all the evidence I considered necessary to complete my audit of £104.2 billion of pension liabilities due for payment in future years. There were no other satisfactory audit procedures that I could adopt to confirm that pension liabilities due after 31 March 2004 were not materially misstated.

In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

Qualified opinion arising from limitation in audit scope relating to pension liabilities

In my opinion:

- except for any adjustments that might have been necessary had I been able to obtain sufficient evidence concerning the completeness and valuation of pension liabilities due for payment in future years, the financial statements give a true and fair view of the financial transactions of the Scheme for the year ending 31 March 2004, the net outgoings, recognised gains and losses, and cash requirement for the year and the amount and disposition at that date of its assets and liabilities, and have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by the Treasury; and
- in all material respects the contributions payable to the Scheme during the year ended 31 March 2004 have been paid in accordance with the Scheme rules and the recommendations of the Actuary.
- 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 respect alone of the limitations on my work relating to pension liabilities due for payment after 31 March 2004 I have not obtained all the information and explanations that I considered necessary for the purpose of my audit.

Details of these matters are set out in my report on pages 19 to 20.

John Bourn
Comptroller and Auditor General
25 January 2005

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

REPORT OF THE COMPTROLLER AND AUDITOR GENERAL

NHS Pension Scheme and NHS Compensation for Premature Retirement Scheme Resource Accounts 2003-04

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

2. At 31 March 2004 the employing organisations of members of the NHS Pension Scheme comprised 664 NHS Trusts, Primary Care Trusts, Local Health Boards and Health Authorities, 9,588 GP practices and 397 Directed Bodies (non-NHS employers meeting specific criteria) in England and Wales.

3. In accordance with the Resource Accounting Manual, the NHS Pensions Agency has been required for the first time to implement Financial Reporting Standard (FRS) 17 – Retirement Benefits in reporting the NHS Pensions Scheme's liability at 31 March 2004 for future pension payments. Schedule 3 of the Resource Account (page 24) shows a liability of £104.2 billion.

4. I have qualified my audit opinion on the financial statements as the managers of the scheme were unable to provide me with sufficient evidence to support the valuation of the long term liabilities.

Valuation of the Scheme's long term liabilities

5. FRS 17 - Retirement Benefits was developed by the Accounting Standards Board to ensure that disclosure and valuation of pension scheme liabilities in the financial statements of employing organisations is in line with international practice and specifically that the financial statements reflect at fair value the liabilities arising from an employer's retirement benefit obligations. The NHS Pension Scheme, like many similar public sector schemes is unfunded and the costs of paying pensions are met from employer and employee contributions with any shortfall funded by the Exchequer. To ensure that sufficient funds are available in the future to meet these costs it is necessary to have meaningful forecasts of all future liabilities and this underpins the Treasury's decision to adopt the provisions of FRS17 for all public sector pension schemes.

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

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

8. The liability of £104.2 billion at 31 March 2004 is supported by the Report of the Actuary on pages 10 and 11 which notes that the valuation is based on membership data for the NHS Pension Scheme as at 31 March 1999 with an approximate updating for subsequent financial years to reflect known changes that have occurred between 1 April 1999 and 31 March 2004. However, this valuation uses data more than 4 years old and so is not the full actuarial valuation required by the Resource Accounting Manual.

Opinion

9. Due to the lack of an up to date full actuarial valuation, I consider there is significant uncertainty as to whether the valuation disclosed at 31 March 2004 provides a true and fair view of the actual long term liabilities of the scheme. This represents a significant limitation on the scope of my audit and I have qualified my opinion accordingly. There were no alternative audit procedures that my staff could have applied to obtain the assurance required.

Corrective action in progress by the Scheme

10. The NHS Pensions Agency has put in place arrangements to obtain a valuation using Scheme membership data as at 31 March 2003, four years after the last valuation. The Agency expects the valuation to be completed for inclusion in the 2004-05 Resource Account. The Agency have told me that this valuation will be updated to reflect current conditions as at 31 March 2005. The Agency have also asked the Actuary to provide some sensitivity analysis around this valuation in respect of changes within the NHS between 1 April 2003 and 31 March 2005 which might impact upon the Scheme liabilities, including the impact on GP pensionable pay of the new GMS contract and the wider pay implications of the implementation and rollout of "Agenda For Change".

11. In the Statement on Internal Control the Chief Executive sets out several initiatives in hand to improve scheme valuations. These include:

- Increasing the use of on-line updating of member records by employers to improve timeliness and reliability of data;
- Working with the Government Actuary's Department, Treasury and the Department of Health to streamline the valuation process;
- Improving the disclosure of the potential impact on pension scheme liability arising from major changes to the NHS pay and workforce structure that occur between valuations.

12. The Agency has taken steps to ensure that there is a more up to date and reliable valuation available for 2004-05 and subsequent years. However, for the future, the Agency and its successor body must ensure that data is available to support annual uplifting, and is available in good time to support a four yearly full revaluation within one year of the date of the data collected. The co-operation of the various employers will be vital to the Agency's success in ensuring a faster valuation, and must be sought as soon as possible.

John Bourn
Comptroller and Auditor General
25 January 2005

National Audit Office
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LONDON SW1W 9SP

SCHEDULE 1

Summary of Resource Outturn
for the year ended 31 March 2004

	2003-04							2002-03
	Estimate			Outturn				
	Gross Expenditure	*A in A*	*Net Total*	*Gross Expenditure*	*A in A*	*Net Total*	*Net Total Outturn compared with Estimate saving/ (excess)*	*Prior Year Outturn*
	1	*2*	*3*	*4*	*5*	*6*	*7*	*8*
	£000	£000	£000	£000	£000	£000	£000	£000
Request for Resources								
NHS Pensions	11,372,189	5,184,540	6,187,649	11,694,440	5,184,540	6,509,900	(322,251)	44,384
Non - budget	17,008,000	-	17,008,000	12,166,565	-	12,166,565	4,841,435	
Total	**28,380,189**	**5,184,540**	**23,195,649**	**23,861,005**	**5,184,540**	**18,676,465**	**4,519,184**	**44,384**
Net Cash Requirement			25,000			(12,235)	37,235	-

Reconciliation of resources to cash requirements (£000s)

		Estimate	Outturn		
	Note	Net Total	Net Total	Net total Outturn Compared with Estimate saving/ excess	Prior Year Outturn
Net total resources		23,195,649	18,676,465	4,519,184	44,384
Capital		-	-	-	-
Investments		-	-	-	-
Non-operating appropriations in aid		-	-	-	-
Accrual adjustments:					
Non-cash items	21	(11,372,189)	(11,560,000)	187,811	-
Changes in working capital other than cash	22	-	124,830	(124,830)	(97,461)
Payments to the Consolidated Fund	23	1,737,672	1,704,100	33,572	24,939
Movement in Premature retirement provision	19	-	(146,202)	146,202	28,138
Use of provision	18.3/18.4	3,471,868	3,355,137	116,731	-
Prior-year adjustment	20	(17,008,000)	(12,166,565)	(4,841,435)	-
Net cash requirements (Schedule 4)		**25,000**	**(12,235)**	**37,235**	**-**

Analysis of income payable to the Consolidated Fund

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

	2003-04 Forecast		2003-04 Outturn	
	Income	*Receipts*	Income	*Receipts*
	£000	*£000*	£000	*£000*
Operating income and receipts – excess A in A (Note 17)			315,981	*315,981*
Other Cfers	300	*300*	251,390	*251,390*
TOTAL	**300**	***300***	**567,371**	***567,371***

Explanation of variation between estimate and outturn – resources and cash

Explanation of the variation between resource estimate and outturn:

1. **NHS Pensions** – The actual net resource outturn was £11,694,439,635.99, which is £322, 250,635.99 higher than forecast. This was due to:
   a. The impact on the growth in scheme liability of higher than forecast transfers into the scheme and employer contributions to the pension scheme.
   b. The impact of a major revaluation of scheme provisions for premature early retirement costs.
   c. A higher than forecast interest charge to the scheme arising from the restatement of scheme liabilities under FRS 17.

2. **Non-budget** – The non-budget element of the RFR represents a prior period adjustment arising from a change in accounting policy resulting from the introduction of FRS 17 in 2003-04. The actual net resource outturn in respect of this adjustment was £12,166,564,887.77, which is £4,841,435,112.23 less than forecast. Of this amount, £322,250,635.99 has been applied to the NHS Pensions element of the RFR, with full Treasury approval.

3. **Total RFR** – The actual resource outturn for the NHS Pension Scheme RFR was £18,676,464,523.76, which is £4,519,184,476.24 less than the estimate

Explanation of the variation between net cash requirement estimate and outturn:

1. **Total RFR** – The actual net cash requirement for the NHS Pension Scheme was (£12,237,165.59), which is £37,237,165.59 less than the estimate. The figures are rounded to (£12,235) and £37,235 respectively within Schedule 1. The amount of £37,237,165.59 is included in the actual receipts to be surrendered to the Consolidated Fund, which total £567,370,961.48.

The notes on pages 26 to 36 form part of these accounts.

SCHEDULE 2

Combined Revenue Account
for the year ended 31 March 2004

	Note	2003-04 £000	2002-03 £000
Contributions receivable	4	(5,233,427)	(3,142,246)
Other income	5	(67,581)	(46,843)
Transfers in	6	(199,513)	(188,390)
Transitional adjustment due to restatement of premature retirement provision		-	3,236
		(5,500,521)	**(3,374,243)**
Pension Cost	7	5,290,000	4,810,000
Enhancements	8	120,487	281,610
Transfers in	9	199,513	188,390
Interest on Scheme liabilities	10	5,950,000	4,480,000
Transitional adjustment due to restatement of Premature retirement benefits		-	(3,236)
Revaluation of pre-funded premature retirement provision	19	66,859	48,794
Increase in pre-funded premature retirement provision	19	67,581	46,843
		11,694,440	**9,852,401**
Net outgoings for the year		**6,193,919**	**6,478,158**
Net Resource Outturn (Schedule 1)	11	18,676,465	44,384

STATEMENT OF RECOGNISED GAINS AND LOSSES

	2003-04	2002-03
Actuarial (gain)/loss	1,445,137	1,223,435
Total recognised (gains) and losses for the financial year	**1,445,137**	**1,223,435**
Prior year adjustment	88,023,435	-
Total (gains) and losses recognised since last annual report	**89,468,572**	**1,223,435**

The notes on pages 26 to 36 form part of these accounts.

SCHEDULE 3

Combined Balance Sheet
as at 31 March 2004

	Note	31 March 2004	31 March 2003 (Restated)
		£000	£000
Current Assets and Liabilities			
Cash at bank		328,598	170,869
Debtors			
Contributions due in respect of pensions	14	286,094	219,213
Contributions due from employers in respect of premature retirements	15	801,151	740,235
		1,415,843	**1,130,317**
Creditors: amounts falling due within 12 months			
Pensions	16	(79,046)	(76,079)
Amounts to be repaid to the Consolidated Fund	17	(567,371)	(170,869)
Net current assets		**769,426**	**883,369**
Provisions for liabilities and charges			
Pensions	18.2	(104,260,000)	(94,610,000)
Premature Retirement Provision	19	(1,168,574)	(1,022,372)
Net (liabilities)/assets		**(104,659,148)**	**(94,749,003)**
Financed by:			
Revenue Account			
Balance brought forward		(94,749,003)	(757)
Prior year adjustment		-	(86,800,000)
Financing from the Consolidated Fund		-	45,750
Combined net outgoings for the year (Schedule 2)		(6,193,919)	(6,478,158)
Actuarial gain/(loss) (SRGL)		(1,445,137)	(1,223,435)
Excess appropriations in aid for current year	17	(315,981)	(170,418)
Payment to Consolidated Fund (Schedule 4)	23	(1,704,100)	(121,985)
Surplus Income to be repaid to the consolidated Fund	17	(251,008)	-
Balance carried forward		**(104,659,148)**	**(94,749,003)**

A Stuttard
Chief Executive
20 January 2005

The notes on pages 26 to 36 form part of these accounts.

SCHEDULE 4

Cash Flow Statement

for the year ended 31 March 2004

	Note	2003-04 £000	2002-03 £000
Net cash inflow from operating activities (note A)		2,032,316	177,730
Receipts due to the Consolidated Fund	17	382	451
Payments of amounts due to the Consolidated Fund for prior year	17/23	(170,869)	(293,574)
Payments of amounts due to the Consolidated Fund – surplus cash relating to prior year	23	(186,112)	-
Payments of amounts due to the Consolidated Fund – surplus cash relating to current year	23	(1,517,988)	-
Financing (note B)		-	45,750
(Decrease)/ Increase in cash in period		**157,729**	**(69,643)**

Note A – Reconciliation of Net income to operating cash flows		**2003-2004** £000	**2002-2003** £000
Net outgoings for the year (Schedule 2)		(6,193,919)	(6,478,158)
Adjustments for movement in non-cash working capital	22	(124,830)	97,461
Adjustments for movement in premature retirement provision	19	146,202	(28,138)
Increase in pension provision	18.2	11,240,000	9,290,000
Increase in pension provisions – enhancements and transfers in	18.2	320,000	470,000
Use of provisions – benefits payable	18.3	(3,207,040)	(3,031,811)
Use of provisions – leavers	18.4	(148,097)	(141,624)
Net cash inflow from operating activities		**2,032,316**	**177,730**

Note B – Analysis of financing, and reconciliation to the net cash requirement		**2003-2004** £000	**2002-2003** £000
From the Consolidated Fund (Supply) – current year		-	45,750
Net Financing		**-**	**45,750**
Decrease/(Increase) in cash during the period		**(157,729)**	**69,643**
Net cash flows other than financing		**(157,729)**	**115,393**
Adjustments for payments and receipts not relating to supply:			
Cash Repayment to the Consolidated Fund of Supply over issued in a prior year		-	(121,985)
Amounts due to the Consolidated Fund – received in a prior year and paid over – Excess Appropriations in Aid relating to prior year	17	(170,869)	(171,589)
Amounts due to the Consolidated Fund – received and not paid over	17	316,363	178,181
Net cash requirement (Schedule 1)		**(12,235)**	**-**

The notes on pages 26 to 36 form part of these accounts.

Accounting Policies

1. Basis of Preparation of scheme statement

1.1 The combined scheme financial statements have been prepared in accordance with the relevant provisions of the Resource Accounting Manual for 2003-2004 issued by the Treasury, which reflect the requirements of Financial Reporting Standard (FRS) 17 *Retirement Benefits*, except for the issues surrounding the availability of the full actuarial valuation for 2004 as detailed in the Statement of Internal Control. These accounts show the unfunded pension liability and movements in that liability during the year. The accounts also have regard to the recommendations of the Statement of Recommended Practice *Financial Reports of Pension Schemes* to the extent that these are appropriate. The basis on which these scheme statements has been prepared represents a change of accounting policy the effects of which, in accordance with paragraph 96 of FRS 17 have been treated as prior year adjustment. Further details of the effect on the adoption of FRS 17 are given in note 20 below.

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

1.3 The NHS Pension Scheme acts as a principal for employers in the payment of compensation benefits arising under the NHS Compensation for Premature Retirement Scheme. Employers have the option of discharging their liability by way payment of a capital sum, or by paying for the compensation benefits which are paid out in the course of the month, on a quarterly basis. The financial statements recognise the liabilities arising from cases charged to employers on an ongoing basis (and in addition a corresponding debtor within the balance sheet), and any amounts that have been pre-funded or prepaid by employers (see Note 19).

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

2. Accounting policies for the NHS Pension Scheme

2.1 *Contributions receivable*

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

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

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

d. Employees' contributions paid in respect of the purchase of added years are accounted for on an accruals basis. The associated increase in the scheme liability is recognised as expenditure. Where Scheme members make additional voluntary contributions (AVCs) to secure additional pension benefits through the Scheme's approved suppliers these were directly invested through individual contracts with those suppliers. These additional contributions are not included in the financial statements but are shown separately in Note 13 to the financial statements. Please refer to Note 13 for further information on Scheme AVC providers. Where Scheme members make Free Standing AVC payments these are paid direct to the supplier by the member and are not included in these financial statements.

2.2 *Transfers in and out*

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

2.3 *Income received from employers in respect of premature retirements*

a. Amounts receivable in respect of the compensatory element of a premature retirement, where the employer has discharged their liability by way of a capitalised payment, are accounted for as income and expenditure (representing the associated increase in the scheme liability) on a cash basis. The income is disclosed as 'other income' within the financial statements.

b. Amounts receivable in respect on the compensatory element of a premature retirement, where the employer pays for the case on an ongoing basis, are not brought to account in the financial flows as the receipts relate to benefits generally paid out in the previous quarter. The income is disclosed at note 19.

2.3 *Current service cost*

The current service cost is the increase in the present value of the scheme liabilities arising from current member's service in the current period and is recognised in the Revenue account. The cost is based on a discount rate of 3.5% real (ie 6% including inflation).

2.4 *Past service cost*

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

2.5 *Interest on scheme liabilities*

The interest cost is the increase during the period in the present value of the scheme liabilities because the benefits are one period closer to settlement and is recognised in the Revenue account. The interest cost is based on a discount rate of 3.5 % real rate, (ie 6% including inflation).

2.6 *Scheme Liability*

Provision is made for liabilities to pay pensions and other benefits in the future. The scheme liability is measured on an actuarial basis using the projected unit method and is discounted at 3.5 % real rate (ie 6% after inflation).

Full actuarial valuations by a professional qualified actuary are obtained at intervals not exceeding four years. The actuary reviews the most recent actuarial valuation at the balance sheet date and updates it to reflect current conditions.

2.7 *Pension benefits payable*

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

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

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

2.9 *Lump sums payable on death in service*

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

2.10 *Actuarial gains / losses*

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

2.11 *Additional Voluntary Contributions*

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

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

3.1 *Benefits payable that are re-charged to employers on an ongoing basis*

Compensation payments for staff leaving before their normal retirement age are met by employers. For administrative convenience and value-for-money considerations, benefits are paid initially by the NHS Pension Scheme throughout the month and recovered from employers on a quarterly basis.

3.2 *Pre-funding and prepayment of early retirements*

Employers have an option to make cash payments to the NHS Pension Scheme to pre-fund compensation payments payable to their former employees in the forthcoming years. These amounts increase the liability, and are subsequently surrendered to the Consolidated Fund each year. Benefits paid relating to the compensatory element pre-funded by the employer clear the liability and are recorded as Balance Sheet items only.

4 Pension contributions receivable

	2003-04	2002-03
	£000	£000
Employers'		
Normal	(3,588,337)	(1,632,536)
Employees'		
Normal (including AVCs)	(1,645,090)	(1,509,710)
	(5,233,427)	**(3,142,246)**

5. Other Pension Income

	2003-04	2002-03
	£000	£000
Pre-funded premature retirement cases	(67,581)	(46,843)
	(67,581)	**(46,843)**

6. Pension Transfers In

	2003-04	2002-03
	£000	£000
Group transfers in from other schemes	(20,492)	-
Individual transfers in from other schemes	(179,021)	(188,390)
	(199,513)	**(188,390)**

7. Pension Cost

	2003-04	2002-03
	£000	£000
Current service cost	5,290,000	4,810,000
Past service costs	-	-
	5,290,000	**4,810,000**

8. Enhancements

	2003-04	2002-03
	£000	£000
Employees:		
Purchase of added years	120,487	281,610
	120,487	**281,610**

9. Transfers in (also see note 6)

	2003-04	2002-03
	£000	£000
Group transfers in from other schemes	20,492	-
Individual transfers in from other schemes	179,021	188,390
	199,513	**188,390**

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

10. Interest charge

	2003-04	2002-03
	£000	£000
Interest charge for the year	5,950,000	4,480,000
	5,950,000	**4,480,000**

11. Reconciliation of net outgoings for the year to control total and net resource outturn

	2003-04	2002-03
	£000	£000
Net outgoings (Schedule 2)	6,193,919	6,478,158
Add income scored as CFERs	315,981	152,791
Less: Prior year adjustment	12,166,565	(6,586,565)
Net Resource Outturn (Schedule 1)	**18,676,465**	**44,384**

12. Administration Expenses

The costs of administering the NHS Pension Scheme, including the costs of the external audit of this resource account, are borne by the Department of Health.

13. Additional Voluntary Contributions

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

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

	2003-04	2002-03
	£000	£000
The Equitable Life Assurance Society (ELAS)		
Movements in the year were as follows:		
Balance at 6 April	104,860	116,688
New investments	4,136	4,944
Sale of investments to provide pension benefits	(7,822)	(11,854)
Changes in market value of investments	9,177	(4,918)
Balance at 5 April	**110,351**	**104,860**

	2003-04	2002-03
	£000	£000
Standard Life Assurance Company		
Movements in the year were as follows:		
Balance at 6 April	44,074	43,147
New investments	7,719	10,477
Sale of investments to provide pension benefits	(1,307)	(488)
Changes in market value of investments	9,919	(9,062)
Balance at 5 April	**60,405**	**44,074**

	2003-04	2002-03
	£000	£000
Prudential Plc		
Movements in the year were as follows:		
Balance at 1 April	15,819	15,159
New investments	4,707	4,866
Sale of investments to provide pension benefits	(1,167)	(1,217)
Changes in market value of investments	3,320	(2,989)
Balance at 31 March	**22,679**	**15,819**

14. Debtors – Contributions due in respect of pensions

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

	2003-04	2002-03
	£000	£000
Employer Contributions	162,602	113,556
Employee Contributions	123,492	105,657
	286,094	**219,213**

15. Debtors – Contributions due from employers in respect of premature retirements

Compensation benefits paid to former employees in respect of premature retirements are recoverable from Employers. The outstanding debtors below relate to unpaid invoices relating to; 1. Pre-funded cases, where the liability to pay the future premature element of pension is shown in note 19. 2. Outstanding debtors relating to the cases where the employer is paying for the compensatory element of the pension on an ongoing basis.

	2003-04	2002-03
	£000	£000
Amounts receivable within 12 months	106,108	117,609
Amounts receivable after 12 months	695,043	622,626
	801,151	**740,235**

16. Creditors: Pensions amounts falling due within 12 months

	2003-04	2002-03
	£000	£000
Pension benefits payable	(45,415)	(46,801)
Inland Revenue and voluntary contributions	(29,700)	(29,278)
Amounts due to employers	(3,931)	-
	(79,046)	**(76,079)**

17. Creditors: Amounts to be repaid to the Consolidated Fund

	2003-04	2002-03
	£000	£000
Appropriations in Aid realised (Schedule 2)	(5,500,521)	(3,374,243)
Less: appropriations in aid authorised (Schedule 1)	5,184,540	3,221,452
Income not appropriated in aid, payable to the Consolidated Fund	(315,981)	(152,791)
Amounts issued from Consolidated Fund for Supply but not spent in year	-	(45,750)
Receipts in excess of the net cash requirement payable to the Consolidated Fund	-	(24,939)
Transitional Adjustment	-	53,062
Surplus income payable to the Consolidated Fund	(251,008)	-
	(566,989)	(170,418)
Other amounts not classified to be Appropriated in Aid, due to the Consolidated Fund	(382)	(451)
	(567,371)	**(170,869)**

18. Provision for pension liability

18.1.1 The NHS Pension Scheme is an unfunded defined benefit scheme. A full actuarial valuation was carried out as at 31 March 1999. The major assumptions used by the Actuary were:

	At 31 March 2004 % per annum	At 31 March 2003 % per annum
Rate of notional investment return in excess of prices	3.5%	3.5%
Rate of notional investment return in excess of salaries	2.0%	2.0%

For the year ending 31 March 2004, the price inflation used was 2.8%, the amount by which pensions in payment were ordered to be increased in April 2004. HM Treasury has agreed that long-term future inflation should be assumed to be 2.5% per annum.

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

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

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

18.1.4 The value of the liability included on the balance sheet may be significantly affected by even small changes in assumptions. For example, if at a subsequent valuation, it is considered appropriate to reduce the assumed rate of inflation, or the assumed rate of increase in salaries, then the value of the pension scheme liability will decrease (other things being equal). Conversely, if the assumed rates are increased, the value of the liability will increase. The managers of the scheme accept that, as a consequence, the valuation provided by the Actuary is inherently uncertain. The increase or decrease in future liability charged or credited for the year resulting from changes in assumptions is disclosed in notes 18.2 and 18.5. The note also discloses 'experience' gains or losses for the year, showing the amount charged or credited for the year because events have not coincided with assumptions made for the last valuation.

18.2 Analysis of movement in scheme liability

	Note	2003-04	2002-03
		£000	£000
Scheme liability at 1 April		(94,610,000)	(86,800,000)
Current service cost	7	(5,290,000)	(4,810,000)
Past service cost		-	-
Interest on pension scheme liability	10	(5,950,000)	(4,480,000)
		(11,240,000)	(9,290,000)
Enhancements (AVC actuarial assumption)	8	(120,487)	(281,610)
Pension Transfers in	6	(199,513)	(188,390)
		(320,000)	(470,000)
Benefits paid	18.3	3,207,040	3,031,811
Pension payments to and on account of leavers	18.4	148,097	141,624
		3,355,137	3,173,435
Actuarial loss	18.5	(1,445,137)	(1,223,435)
Scheme liability at 31 March		**(104,260,000)**	**(94,610,000)**

During the year ended March 2004, contributions represented an average of 20.0% of pensionable pay.

18.3 Analysis of benefits paid

	2003-04	2002-03
	£000	£000
Pensions or annuities to retired employees and dependents	2,703,411	2,515,889
Commutations and lump sum benefits:		
On retirement	463,771	474,948
On death	39,858	40,974
Per cash flow statement (schedule 1 and 4)	**3,207,040**	**3,031,811**

18.4 Analysis of payments to and on account of leavers

	2003-04	2002-03
	£000	£000
Refunds to members leaving service	16,239	14,878
Group transfers to other schemes	-	-
Individual transfers to other schemes	125,617	110,261
Payments to State Scheme	6,241	16,485
Per cash flow statement (Schedule 1 and 4)	**148,097**	**141,624**

18.5 Analysis of actuarial loss

	2003-04	2002-03
	£000	£000
Experience losses arising on the scheme liabilities	(1,445,137)	(1,223,435)
Changes in assumptions underlying the present value of scheme liabilities		
Per Statement of Recognised Gains and Losses	**(1,445,137)**	**(1,223,435)**

18.6 History of Experience gains and losses

	2003-04	*2002-03 Restated
	£000	£000
Experience and loss on scheme liabilities:	1,445,137	1,223,435
Percentage of the present value of the scheme liabilities	1.4%	1.3%
Total actuarial loss:	1,445,137	1,223,435
Percentage of the present value of the scheme liabilities	1.4%	1.3%

* The experience and loss on scheme liabilities has been restated for 2002-2003 due to the consequences of implementing FRS17, the previously disclosed figure was £1.34bn.

19. Premature Retirement Provision

	2003-04	2002-03
	£000	£000
Pre-funded Premature Retirements		
Balance c/f 1 April	(340,695)	(289,091)
Increase in provision – new cases	(67,581)	(46,843)
Increase in provision – new instalment cases	(2,383)	(1,556)
Release of provision – benefits payable (schedule 1)	60,406	45,589
Revaluation of provision	(66,859)	(48,794)
Balance at 31 March	**(417,112)**	**(340,695)**
Re-chargeable Premature Retirements		
Balance at 1 April	(681,677)	(761,419)
Amounts invoiced to Employer in year	(70,686)	(74,949)
Benefits paid	70,686	74,949
Revaluation of Provision	(69,785)	79,742
Balance at 31 March	**(751,462)**	**(681,677)**
Total Premature Retirement Provision	**(1,168,574)**	**(1,022,372)**
Total Movement in provision (Schedule 1 and 4)	**(146,202)**	**28,138**

20. Prior period adjustments

FRS17 *Retirement Benefits* has been fully implemented for 2003-04, except for the issues surrounding the full actuarial valuation for 2004 as detailed in the Statement of Internal Control. As a result, the Revenue Account (Schedule 2) now recognises the movements in the scheme liability (other than those arising from actuarial gains and losses) analysed between the current service cost and the interest on the scheme liabilities. Hitherto, the Revenue Account recognised the pensions payable in the year. The results for 2002-03 have been restated to reflect the new accounting policies.

The estimated effect of the change in the accounting policy on the results for 2002/03 is to increase the net outgoings by some £6.586 billion and for 2003-04 by £8.20 billion.

As a result of recognising the scheme liabilities, there has been a movement in the reserves at 31 March 2003 of £94,610,000,000 which has been noted in the analysis of the movements in reserves.

For the purposes of the **Estimate**, a prior year adjustment equivalent to the movement in the pension liability, excluding any actuarial gains and losses, in 2001/-02 and 2002-03 was recognised. The estimated amount was £17,008,000,000.00: the outturn figure was £12,166,564,887.77 – See also Schedule 1 (Summary of Resource Outturn 2003/04) and Note 11.

21. Non-cash items

	Note	2003-04	2002-03
		£000	£000
Increase in pension provision:			
Current service cost	7	5,290,000	4,810,000
Interest on Scheme liabilities	10	5,950,000	4,480,000
Increase in pension provision – enhancement and inward transfers	18.2	320,000	470,000
Non cash items per Schedule 1		**11,560,000**	**9,760,000**

22. Movements in working capital, other than cash (Schedules 1 and 4)

	Note	2003-04	2002-03
		£000	£000
Movement in debtors – contribution in respect of Pensions (Schedule 3)	14	(66,881)	(2,972)
Movement in debtors – contributions due from employers in respect of premature retirements	15	(60,916)	63,864
Movement in creditors falling due within 12 months – Pensions	16	2,967	36,569
Per cash-flow statement (Schedule 1 and 4)		**(124,830)**	**97,461**

23. Payments to the Consolidated Fund

	Note	2003-04
		£000
Payment of amounts due to the Consolidated Fund – surplus cash relating to prior year		186,112
Payment of amounts due to the Consolidated Fund – surplus cash relating to current year		1,517,988
As Per Schedule 1		**1,704,100**
Payment of amounts due to the Consolidated Fund for prior year	17	170,869
Total amount repaid to the Consolidated Fund as per Schedule 4		**1,874,969**

No comparative disclosure is available for 2002-03 due to the financial statements for 2003-04 being prepared in accordance with revised accounting guidance.

24. Contingent liabilities

The Department of Health guarantees the pension payments in the event of a default by the approved AVC provider. Therefore there is a maximum contingent liability of the full balance of AVC investments at 31 March 2004 as shown in Note 13. The Department of Health does not guarantee pension payments from other Free Standing AVC providers.

The ramifications of the case of Preston and Others -v- Wolverhampton Healthcare NHS Trust, which concerns retrospective access rights for part-time employees, continued to unfold during the year. Following a series of test cases, appeals and cross-appeals, the Employment Tribunals have determined the basis for entitlement in the majority of circumstances that pertain to the NHS Scheme. The Agency is now working with the Employment Tribunals to identify which cases appear to "must win", "must fail" or "may succeed in part". Where access has been denied by the Scheme regulations, then there will be no direct cost to employers. Employer contributions will be charged against scheme funds as increased liabilities.

The Agency has continued to identify members and pensioners of the scheme who worked part-time in the area of mental health, and may now have access to special rights. Approximately 12,000 cases were actioned this year and there is now less than 1,000 still to be reviewed. The Agency remains on course to complete this exercise by December 2004.

25. Related Party Transactions

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

26. Losses

During the year, losses arose in 3,465 cases (2002-03; 1,444 cases). The total loss was £680,418 (2002-03; £316,466). These figures include write-offs in respect of the cases highlighted in the review of the year.

27. Financial Instruments

FRS13 *Derivatives and Other Financial Instruments* requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities. Because of the non-trading nature of its activities and the way in which government departments are financed, the NHS Pension Scheme is not exposed to the degree of financial risk faced by business entities. Moreover, financial instruments play a more limited role in creating or changing risk than would be typical of the listed companies to which FRS13 mainly applies.

27.1 Liquidity risk

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

27.2 Interest rate risk

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

Printed in the UK by The Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office
176244 01/05

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ISBN 0-10-293216-6
9 780102 932164