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

Armed Forces Pension Scheme

(Incorporating the Armed Forces Compensation Scheme)

Resource Accounts 2005-06

LONDON: The Stationery Office
HC 1508

20 July 2006
£8.00

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(For the year ended 31 March 2006)

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Report of the Scheme Managers

History and Statutory Background

The Armed Forces Pension Scheme (AFPS 75)

The Armed Forces Pension Scheme is an unfunded, defined benefit, salary-related, contracted-out occupational pension scheme open to most members of the Armed Forces, administered by the Armed Forces Personnel Administration Agency (AFPAA) and financed on an annual basis by the Consolidated Fund.

The Scheme is designed to meet the special requirements of Service life. Youth and fitness are important to the Services, and the Scheme provides immediate pension benefits to many of those who leave without completing a full career. The full career pension can be earned relatively early, at age 55, and invaliding and death benefits are available in the event of illness, injury or death, at different rates depending upon whether or not these are caused by service.

The Scheme rules are set out in "Prerogative Instruments" that derive their authority from Her Majesty The Queen and are not subject to approval, annulment or amendment by Parliament. For the Royal Navy and the Royal Marines the Prerogative Instrument is an Order in Council under the Naval and Marine Pay and Pensions Act 1865. For the Army, it is the Army Pension Warrant 1977 and, for the Royal Air Force, the Queen's Regulations.

The New Armed Forces Pension and Compensation Schemes

The Armed Forces (Pension & Compensation) Act 2004 is the primary legislation covering the new AFPS 05, Early Departure Payment (EDP) Scheme and Armed Forces Compensation Scheme (AFCS). These schemes were introduced on 6 April 2005.

The New Armed Forces Pension Scheme (AFPS 05)

From 6 April 2005, the new Armed Forces Pension Scheme (known as AFPS 05) was introduced for all new members of the Armed Forces. Those in service before this date have been given the opportunity to transfer to the new Scheme on 6 April 2006. The AFPS 05 is also an unfunded, defined benefit, salary-related, contracted out, occupational pension scheme. Pensions are paid immediately if an individual serves to age 55: those who have at least two years service who leave before age 55 will have their pensions preserved until age 65. Pensions may be payable to the spouse, civil partner, partner or to eligible children. Death-in-service lump sums are payable subject to nomination. There are no attributable ill-health benefits under the AFPS 05 as these will be considered under the War Pensions Scheme (WPS) or the new Armed Forces Compensation Scheme (AFCS).

The new scheme includes an Early Departure Payment (EDP) for those who leave before age 55 providing they have at least 18 years service and are at least 40 years of age. The EDP Scheme pays a tax-free lump sum and income of between 50% and 75% of preserved pension between the date of the individual's departure from the Armed Forces and age 55. The income rises to 75% of preserved pension at age 55 and is index linked. At age 65 the EDP stops and the preserved pension and preserved pension lump sum are paid.

The Armed Forces Compensation Scheme (AFCS)

The AFCS was introduced on 6 April 2005, replacing two separate compensation arrangements under the AFPS 75 and the WPS. The AFCS covers injury, illness and death that are caused by service on or after 6 April 2005. The AFCS is a tariff-based compensation scheme, which has been designed to be simple to understand and to produce quick, consistent and equitable decisions, using an evidence-based approach.

Principal Purpose and Administrative Aim

In administering the Armed Forces Pension Scheme and Armed Forces Compensation Scheme on behalf of the Ministry of Defence (MoD), the Armed Forces Personnel Administration Agency (AFPAA) and the Veterans Agency (VA) aim to ensure that all pension and compensation payments due to entitled pensioners and members of the Armed Forces are made in a timely and accurate fashion.

The Executive Boards

The AFPS and AFCS are managed and operated by AFPAA and the VA respectively, both Agencies being within the MoD. The costs of administering the Scheme are borne by the MoD and are reflected in the Departmental Resource Accounts (DRAc).

The Chief Executive of AFPAA has been designated by the Departmental Accounting Officer to be the Scheme Administrator and Senior Finance Officer for the AFPS. The Chief Executive of the VA is the Scheme Administrator and Senior Finance Officer for the AFCS.

The AFPAA and VA Executive Boards meet regularly to determine strategy, set objectives and review performance towards strategic goals. The Executive Boards consists of:

AFPAA Executive Board

Rear Admiral T A Spires	Chief Executive
Mr P D Northen	Agency Secretary / Deputy Chief Executive
Air Commodore I Harvey BSc RAF	Director Operations
Air Commodore J D Tonks BSc RAF	Director Joint Personnel Administration
Brigadier A D Harking OBE (from 18 Jan 06)	Director Agency Transformation
Brigadier A D Harking OBE (until 18 Jan 06)	Director Strategy, Requirements and Programmes
Brigadier R Bacon (from 18 Jan 06)	Director Strategy, Requirements and Programmes
Dr P Collins	Deputy Director Joint Personnel Administration
Mr A L Maynard	Deputy Director Finance and Corporate Governance
Mr K J Ludlam	Non Executive Director

VA Executive Board

Mr A Burnham	Chief Executive
Mr P Kitchen	Medical Director
Miss W Stewart	Director Corporate Services
Mr A Burke (until 3 June 05)	Director Operations
Mr G Mulrooney (from 3 June 05)	Director Operations Governance
Mr A Jablonowski	Non Executive Director
Professor H Drummond	Non Executive Director

Other Schemes

The Scheme Statements summarise the transactions of not only the AFPS and AFCS but also the four smaller pension schemes, The Gurkha Pension Scheme (GPS), the Non-Regular Permanent Staff Pension Scheme (NRPSPS), the Army Careers Officers Pension Scheme (ACOPS) and the new Reserve Forces Pension Scheme (RFPS), also managed and operated by AFPAA, whose members amount to 3.76% of the AFPS total membership.

Auditors

The accounts of the AFPS and AFCS are audited by the Comptroller and Auditor General under the Government Resources and Accounts Act 2000.

Audit

As Accounting Officer of the AFPS, I am responsible for the disclosure of the relevant audit information. I can confirm that:

- There is no relevant audit information of which the auditors are unaware;
- I have taken all necessary steps to ensure that I am aware of relevant audit information; and
- I have taken all necessary steps to establish that the auditors are aware of the information.

Managers, Advisers and Employers

Managers:

Accounting Officer:

Mr Bill Jeffrey CB (from 21 Nov 05)
Sir Kevin Tebbit KCB CMG (to 11 Nov 05)
Permanent Under-Secretary of State for Defence
Ministry of Defence
Whitehall
London SW1A 2HB

Finance Director:

Mr T A Woolley
Ministry of Defence
Whitehall
London SW1A 2HB

AFPS Scheme Administrator:

RAdm T A Spires
Chief Executive
Armed Forces Personnel Administration Agency
RAF Innsworth
Gloucester GL3 1EZ

AFCS Scheme Administrator:

Mr A Burnham
Chief Executive
Veterans Agency
Norcross
Blackpool FY5 3WP

Pension Policy:

Mr J Miller CB
Director General Service Personnel Policy
Ministry of Defence
Whitehall
London SW1A 2HB

Advisers:

Scheme Actuary:

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

Bankers:

HM Paymaster General
Bank of England
Threadneedle Street
London EC2R 8AH

Legal Advisers:

MoD Treasury Solicitors
Ministry of Defence
Whitehall
London SW1A 2HB

Auditor:

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

Employers:

Ministry of Defence

Changes to the Scheme

During the year the following changes were made to the Scheme:

Pensions were increased by 3.1% (2004 2.8%) with effect from 11 April 2005 (12 April 2004).

Membership statistics

There are three groups of members, defined as follows:

- Active Members: personnel who are in service, which is reckonable for pension purposes.
- Deferred Pensioners: former actives who are not currently in pensionable service but who are entitled to AFPS benefits at some future date.
- Pensioners in Payment: former actives who are currently receiving AFPS benefits, plus other AFPS beneficiaries such as widow(er)s, survivors and other dependants of former actives.

Active members (figures rounded to nearest 5)

	Active members at the start of the year	195,860
Add:	New entrants in year	20,380
	Transfers in	125
Less:	Leavers in year	22,030
	Transfers out	1,025
Active members at the end of the year		**193,310**
Deferred members		
	Deferred members at the start of the year	290,312
Add:	Members leaving who have deferred pension rights	12,020
Less:	Members taking up deferred pension rights	5,699
Deferred members at the end of the year		**296,633**
Pensioners in payment		
	Pensioners at the start of the year	345,006
Add:	New pensions starting in the year	14,547
Less:	Pensions that have ceased in the year	9,132
Pensioners at the end of the year		**350,421**

Further Information

Any enquiries about the AFPS should be addressed to:

The Scheme Administrator
Armed Forces Personnel Administration Agency
Building 182
RAF Innsworth
Gloucester GL3 1EZ

Any enquiries about the AFCS should be addressed to:

The Scheme Administrator
Veterans Agency
Tomlinson House
Norcross
Blackpool FY5 3WP

Bill Jeffrey

Accounting Officer for the Armed Forces Pension Scheme
and Armed Forces Compensation Scheme 17 July 2006

Actuarial Statement for the Armed Forces Pension Scheme for Accounts for the Year Ended 31 March 2006

A. Liabilities

The capitalised value as at 31 March 2006 of expected future benefit payments under the Armed Forces Pension Scheme, for benefits accrued in respect of employment (or former employment) prior to 31 March 2006, has been assessed using the methodology and assumptions set out in Sections C and D below. The results are as follows:

Value of Liabilities	£ billion
Pensions in Payment	45.1
Deferred Pensions	8.4
Active Members (Past Service)	22.9
Total	**76.4**

B. Accruing Costs

The Armed Forces Pension Scheme is non-contributory for members. The cost of benefits accruing for each year of service is met by the employer. The cost of benefits accruing in the year 2005-2006 (excluding the cost of the AFCS) has been assessed as follows:

% of pensionable pay	
Officers	44.6%
Other ranks	26.3%
All ranks equivalent (combined 25% Officer & 75% Other Ranks)	30.9%

I understand that the split of total pay between pensionable and non-pensionable items is not readily available and for practical purposes the employer's charge is calculated by applying rates consistent with total pay to the year's payroll. The cost of accruing benefits applicable to total pay are 42.1% pa for Officers and 25.6% for Other Ranks giving an all ranks equivalent of approximately 29.7%. This compares to 22.8% of total pay being charged to the employer (excluding the cost of the AFCS), expressed as an all ranks equivalent.

In relation to the payroll for the financial year 2005-2006 and using the rates of contribution described above (on total pay), I understand that the employer's charges in cash terms have been assessed as £1,291 million (excluding charges for the AFCS).

C. Methodology

The value of the liabilities has been obtained by projecting the accrued benefits, with allowance for expected future pay increases in respect of active members.

The standard contribution rate for accruing costs has been determined using the entry age method, with assumed ages at entry of 24 years for officers, and 19 years for other ranks.

D. Assumptions

The assessments have been prepared in accordance with the Resource Accounting requirements, and in particular with the requirement that the discount rate net of price increases should be 2.8% p.a. (pension benefits under the scheme are increased in line with prices). The investment return in excess of earnings increases is 1.3% p.a.

The main financial assumptions made by the Government Actuary are:

- The gross rate of return in excess of earnings increases is 1.3% pa.
- The gross rate of return is assumed to be 5.4% pa although this assumption has a minor impact on the calculation of the liability.
- In nominal terms, these assumptions are then equivalent to an allowance for increase in salaries of 4.0% pa, an allowance for price inflation of 2.5% pa and an allowance for the rate of increase for pensions in payment and deferred pensions of 2.5% pa.

The demographic assumptions adopted for the assessments are based on those used by the Armed Forces Pay Review Body. The mortality assumptions are the same as those used for the actuarial statement as at 31 March 2005.

We are expecting to revise the demographic assumptions once the formal 31 March 2005 valuation of the scheme has been finalised and we expect that this will affect the liabilities disclosed as at 31 March 2007 in the 2006-07 Resource Accounts. As part of this, the mortality assumptions are likely to be updated to reflect the fact that mortality rates continue to decline and therefore members are expected to live for longer in retirement.

E. Notes

(1) This Statement is based on the formal valuation carried out as at 31 March 2005 for the AFPS, with an approximate updating to reflect known changes in scheme membership as at 31 December 2005.

(2) The liabilities in Section A include the benefits accrued by personnel who are in the Gurkha Pension Scheme. Full data was not available for this group of personnel and therefore only a very approximate allowance has been made.

(3) The data for this assessment was gathered from AFPAA, MoD. The data has been compared with similar data provided for the 31 March 2005 assessment, in order to confirm its reliability.

(4) The pension benefits taken into account in this assessment are those normally provided from the rules of the pension scheme, including normal retirement benefits, ill-health retirement benefits, and benefits applicable following the death of the member. Benefits payable from the Armed Forces Compensation Scheme have not been included. The assessments do not include the cost of redundancy benefits in respect of current employees. However, pension payments already being made in respect of such cases are included in this statement of liabilities in Section A above.

Stephen Humphrey

Government Actuary's Department 10 July 2006
London

Statement of Accounting Officer's Responsibilities

Under the Government Resources and Accounts Act 2000, the Ministry of Defence with the consent of HM Treasury has directed the Armed Forces Pension Scheme to prepare for each financial year a statement of accounts in the form and on the basis set out in the Accounts Direction.

With the exception of certain transactions (which are accounted for on a cash basis) the financial statements are prepared on an accruals basis and must give a true and fair view of the financial transactions of the scheme during the year and the disposition, at the end of the financial year, of the 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 net liabilities at the year end.

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

- Observe the accounts direction issued by HM Treasury including 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 financial statements; and
- Prepare the financial statements on a going concern basis.

HM Treasury has appointed the Permanent Head of the Department as Accounting Officer for the Armed Forces Pension Scheme. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding the assets of the pension scheme are set out in the Accounting Officers' Memorandum issued by HM Treasury and published in Annex 3 of the Government Financial Reporting Manual.

Statement on the System of Internal Control – Armed Forces Pension Scheme (AFPS) and Armed Forces Compensation Scheme (AFCS) 2005-2006

Scope of responsibilities

1. As the Accounting Officer for the Armed Forces Pension Schemes (AFPS) and the Armed Forces Compensation Scheme (AFCS), I have personal responsibility for maintaining a sound system of internal control that supports the achievement of the AFPS and AFCS policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting.

The purpose of the system of internal control

2. 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 departmental policies, aims and objectives to evaluate the likelihood of risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place for the AFPS and the AFCS for the year ended 31 March 2006 and up to the date of approval of the annual report and accounts, and accords with current Treasury guidance.

Capacity to handle risk

3. Administration of the AFPS is undertaken by two Agencies within the Ministry of Defence. Administration of the AFPS is an integral part of the military pay and pension services provided by the Armed Forces Personnel Administration Agency (AFPAA). Administration of the AFCS is the responsibility of the Veterans Agency (VA). Risk management and internal control are embedded in the day-to-day operations of the AFPS and AFCS business and management systems. Each Agency has a management board structure and a risk management process embracing as necessary MoD's commercial partners EDS (Defence) Ltd and Paymaster (1836) Ltd.

4. Business and accounting operations of the AFPS and the AFCS are periodically reviewed by a number of audit bodies. These bodies include Internal Audit and assurance teams within the MoD and the Agencies, and the National Audit Office. Feedback is given on the risk compliance testing carried out by the internal audit throughout the financial year.

5. Externally, the AFPS and the AFCS are represented on the HM Treasury led Public Sector Pension Scheme Accountants Forum which helps to promote consistency and shares best practice across all public sector pension schemes. Representatives from all public sector pension schemes attend along with members of HM Treasury, the Government Actuary's Department and the National Audit Office.

6. Risk owners and risk managers are identified as part of the risk management process within the Agencies. Members of the Agencies' management teams are trained in appropriate risk management skills.

The risk and control framework

7. The AFPAA contract with EDS sets out the structure for the ownership and management of risk. A Joint Risk Policy Statement outlines the approach to management of risk within the AFPAA and is signed by both CE AFPAA and EDS Account Director. The Veterans Agency publishes a Risk Management Strategy and Risk Management Framework which details all the processes by which the VA identify, evaluate and control risks.

8. Risk Process and Procedures include the structure for management and escalation of risks. The procedures outline the requirement to consider risks to the achievement of business and personal objectives. The Agencies' strategic risks are linked to Agency objectives through Balanced Scorecard performance reports. They are reviewed monthly by executive management and regularly by the Agencies' Audit Committees. Service delivery reports and monitoring by specialist working groups enable early identification of potential risks.

9. The Agencies' Audit Committees are fully established and meet regularly. Agenda items include AFPS specific issues as well as wider Agency business. The Defence Internal Audit organisation and the National Audit Office observe on the Audit Committees and provide advice and guidance where appropriate. Both Agencies have Assurance Teams to provide internal assurance through an agreed programme of work based on a balanced review of the Schemes' risks. Regular audits of pensions in payment are undertaken on a quarterly basis at the Paymaster (1836) Ltd premises (the company contracted to undertake payments to retired service personnel and their dependants).

Review of effectiveness

10. As Accounting Officer for the AFPS and the AFCS, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of internal auditors, assurance teams and audit committees, the executive managers for the scheme, 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. A plan to address weaknesses and ensure continuous improvement of the systems is in place.

11. In the current year, the effectiveness of the systems of internal control operating within AFPAA and the VA have been subject to continuous review. Activities that have significantly contributed to maintaining and improving effectiveness include:

- The Agencies' Non-Executive Directors were fully involved in the management of the Agencies' business, providing independent advice to executive management and the Agencies' Owner's Advisory Board. One of the Non-Executive Directors is common to both Agencies.
- The Agencies' Audit Committees, chaired by a Non-Executive Director, undertook a full programme of business which included the close examination of procedures in place to manage Agency risks in relation to financial propriety and the management of the AFPS and AFCS schemes.
- The Agencies' Assurance Teams completed a number of compliance and assurance activities in relation to both financial propriety and business risks, including AFPS and AFCS risks.
- Joint Governance workshops between the Agencies took place covering accounting, risk management and corporate governance issues for the AFCS.
- A risk assurance workshop with Paymaster (1836) Ltd was held to ensure all risks were identified and control processes were in place for all pension payments. An annual assurance statement is signed by the Executive Board of Paymaster (1836) Ltd.
- Quarterly audits of all pension payments administered by Paymaster (1836) Ltd were undertaken.
- The Agencies participated in the National Fraud Initiative sponsored by the Audit Commission; used, in this context, to identify potentially fraudulent AFPS payments.

Significant internal control problems

12. There are no significant internal control problems in relation to the Armed Forces Pension Scheme or in relation to the Armed Forces Compensation Scheme.

13. There is, however, an emerging issue concerning the way information has been shared between the VA and AFPAA and their predecessors, dating back as far as 1973, which has resulted in incorrect payment of a limited number of pensions. This matter is being taken forward by the Agencies under the auspices of Project Collins, with potential impact on a number of pension cases administered by AFPAA.

14. In addition, the MoD has been unable to provide sufficient evidence to support the completeness and valuation of the provision it has made for the liabilities for compensation payable relating to AFCS cases where claims have yet to be made. Given the unique nature of the new AFCS scheme, the Department has been unable to rely on claim rates and values of other schemes to aid its estimation. Nor is information available on the frequency of potentially eligible incidents or the propensity to claim within the Armed Forces. This situation reflects the consequence of the introduction of the new AFCS scheme. It has led to a technical qualification of the AFPS accounts. However, the National Audit Office auditors have not identified any underlying weakness in the scheme administration related to this matter.

Bill Jeffrey
Accounting Officer for the Armed Forces Pension Scheme
and Armed Forces Compensation Scheme 17 July 2006

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

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

Respective responsibilities of the Accounting Officer and Auditor

The Accounting Officer is responsible for preparing the financial statements in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions made thereunder and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's Responsibilities.

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

I report to you my opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I also report to you if, in my opinion, the Report of the Scheme Managers is not consistent with the financial statements, the Report of the Scheme Managers is not consistent with the Actuary's Report, if the Department has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by relevant authorities regarding remuneration and other transactions is not disclosed.

I review whether the statement on pages 11 to 13 reflects the Department'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 to form an opinion on the effectiveness of the Department's corporate governance procedures or its risk and control procedures.

I read the other information to be published with the financial statements and consider whether it is consistent with the audited financial statements. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board, except that the scope of my audit was limited as explained below. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Department's circumstances, consistently applied and adequately disclosed.

I planned my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

The Certificate of the Comptroller and Auditor General to the House of Commons *(continued)*

In estimating the provision for liabilities for the Armed Forces Compensation Scheme the scheme managers were unable to provide me with robust data to support the level of provision made. There were no additional audit procedures I could undertake to provide me with assurance as to the level of provision. The scope of my audit was therefore limited in this respect.

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

In my opinion:

- except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to the valuation of the provision for the liabilities of the Armed Forces Compensation Scheme, the financial statements give a true and fair view of the Scheme for the year ending 31 March 2006, the net resources, the net outgoings, recognised gains and losses and the 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;
- 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; and
- In respect solely of the limitation on my work relating to the Armed Forces Compensation Scheme provision I have not obtained all the information and explanations that I considered necessary for the purposes of my audit.

Please see also my attached report.

John Bourn
Comptroller and Auditor General

18 July 2006

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

Report by the Comptroller and Auditor General

Introduction

1. The Armed Forces Pension Scheme (AFPS) is a salary-related, contracted out, occupational pension scheme open to most members of the Armed Forces. It is administered by the Armed Forces Personnel Administration Agency (AFPAA), an executive agency of the Ministry of Defence and financed on an annual basis through Parliamentary Supply from the Consolidated Fund.

2. On 6 April 2005, the existing Scheme, known as AFPS75, was closed to new entrants and a new Scheme, AFPS05 opened. Both Schemes are accounted for together within the AFPS resource account.

3. On 6 April 2005, the Ministry of Defence introduced a new compensation scheme for the Armed Forces. The Armed Forces Compensation Scheme (AFCS) replaces previous arrangements for attributable benefits (under the War Pensions Scheme (WPS) and AFPS75) for injuries, illnesses or deaths caused by Service after 6 April 2005. It aims to implement modern, fair and simpler arrangements which focus help on the more severely disabled. Compensation is payable in accordance with a defined tariff scheme and is dependant on claims being lodged within five years of the injury.

4. Funding for the AFCS is directly linked to funding for AFPS05 and AFPS75 and cannot be disaggregated. As a result, AFCS is accounted for within the AFPS account.

5. The MoD is required, under S 7(2) of the Government Resources and Accounts Act 2000, to produce accounts for the AFPS which meet the financial reporting requirements specified in the Government Financial Reporting Manual. This required that liabilities that meet the definition of a provision as given in Financial Reporting Standard 12 "Provisions, Contingent Liabilities and Contingent Assets" must be included as such in the financial statements.

6. FRS12 requires that a provision should be recognised when:

(a) an entity has a present obligation (legal or constructive) as result of a past event;

(b) it is probable that a transfer of economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

7. For the AFCS, the MoD has a present, legal obligation to pay compensation to those with attributable injuries from the point the injury is incurred. An appropriately valued provision is therefore required to be included in the financial statements of the AFPS.

8. Under Section 7(3) of the Government Resources and Accounts Act 2000, I am required to provide an audit opinion as to whether the financial statements of the AFPS provide a true and fair view of the state of affairs of the entity. My opinion on these financial statements is qualified because:

- the scope of my audit was limited as the Ministry of Defence was unable to provide me with sufficient evidence to support the completeness and valuation of the provision for the liabilities for compensation payable relating to cases where claims have yet to be made amounting to £24,229,000; and
- because of this lack of evidence, I have been unable to audit this provision. There were no other audit procedures I could adopt to confirm that the AFCS provision was not materially mis-stated.

Determination of the valuation of the AFCS provision

9. The MoD has examined all available sources of evidence to support the current liability for the AFCS scheme and has worked hard to estimate the provision required under FRS 12. However, given the unique nature of the scheme the Department have been unable to rely on claim rates and values of other schemes to aid their estimation, and information on the frequency of potentially eligible incidents in the Armed Forces and the propensity to claim of Armed Forces personnel is not available. Whilst the provision included in the accounts represents their best estimate, they have been unable to obtain sufficient evidence to support the completeness and valuation of the claims provision. This situation reflects the consequence of the introduction of the new AFCS scheme and I have identified no underlying weakness in the scheme administration related to this matter.

Effect on net resource outturn

10. As part of the annual Appropriation Act, Parliament approved a limit to the total net resource outturn of the scheme of £4,458,545,000. Net resource outturn of £4,341,400,000 is included in the accounts, leading to a surplus of £117,145,000. Should the liability be larger than has already been provided for in the accounts by an amount in excess of the surplus, this would mean that the scheme would have breached the parliamentary control total. My audit is not qualified in this respect.

Future Effects of the limitation in scope

11. The Armed Forces Compensation Scheme is a new scheme. Over the coming years, a history of injury type and frequency will build, as will an understanding of the propensity of the Armed Forces personnel to claim under this Scheme. Until sufficient information becomes available to provide me with suitable evidence to validate the underlying assumptions, my audit is likely to remain limited in its scope. The MoD have informed me that they will continue to take all steps possible over the next 12 months to support an accurate estimate of the provision required in the accounts.

12. This qualification is in respect of the Armed Forces Compensation Scheme liability only. I am satisfied that the reported liability for the AFPS05 and AFPS75 Pension Schemes is valued at a level that is true and fair.

John Bourn
Comptroller and Auditor General

18 July 2006

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

Statement of Parliamentary Supply

Summary of Resource Outturn 2005-06

	2005–06 Estimate			2005–06 Outturn				2004–05 Outturn
	Gross Expenditure	*A-in-A*	*Net Total*	*Gross Expenditure*	*A-in-A*	*Net Total*	*Net Total outturn compared with Estimate saving/ (excess)*	*Net Total*
Request for Resources	£000	£000	£000	£000	£000	£000	£000	£000
Armed Forces retired pay, Pensions etc	5,823,783	1,365,238	4,458,545	5,706,638	1,365,238	4,341,400	117,145	3,294,301
Non-budget	10,000,000	–	10,000,000	8,200,000	–	8,200,000	1,800,000	–
Total Resources	**15,823,783**	**1,365,238**	**14,458,545**	**13,906,638**	**1,365,238**	**12,541,400**	**1,917,145**	**3,294,301**

Summary of Net Cash Requirement 2005-06

				2005–06	2004–05
		Estimate	*Outturn*	*Net Total outturn compared with Estimate savings/ (excess)*	*Outturn*
	Note	£000	£000	£000	£000
Net Cash Requirement	4	1,723,220	1,694,058	29,162	1,447,143

Summary of Income Payable to the Consolidated Fund

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

		Forecast 2005–06		Outturn 2005–06	
		Income	*Receipts*	Income	*Receipts*
	Note	£000	*£000*	£000	*£000*
Total	5	–	–	44,825	*14,661*

Explanation of the variation between Estimate and Outturn:
The Outturn is less than the Estimate due to a lower than anticipated Discount Rate Adjustment and lower interest on scheme liabilities.

Explanation of the variation between estimate net cash requirement and outturn net cash requirement:
The Outturn is less than the Estimate due to a lower level of benefits payable than anticipated.

The notes on pages 22 to 36 form part of these accounts.

Combined Revenue Account

for the year ended 31 March 2006

	Note	2005–06 £000	2004–05 £000
Income			
Contributions receivable	7	(1,405,108)	(1,247,663)
Transfers in	8	(4,717)	(4,145)
Other pension income	9	(238)	(270)
		(1,410,063)	**(1,252,078)**
Outgoings			
Pension cost	10	1,670,617	1,245,994
Enhancements	11	657	1,669
Transfers In	12	4,717	4,145
Interest on Scheme liabilities	13	3,979,361	3,772,941
Other Interest Payable	14	–	8,178
		5,655,352	**5,032,927**
Movement on provision for Project Collins	21	8,792	–
Movement on provision for attributable injury	20	9,825	–
Revaluation at year end for attributable injury	20	–	(86,548)
Adjustment to pensions liability		–	(400,000)
Net outgoings for the year		**4,263,906**	**3,294,301**

Armed Forces Compensation Scheme

	Note	£000	£000
Movement in provision for AFCS	19	31,967	–
Interest on scheme liabilities	19	702	–
Net outgoings for the year		**32,669**	**–**
Combined net outgoings for the year	3	**4,296,575**	**3,294,301**

Statement of Recognised Gains and Losses

for the year ended 31 March 2006

	Note	2005–06 £000	2004–05 £000
Actuarial (gain)/loss	18.8	(1,086,490)	762,358
Discount rate adjustment	3	8,200,000	–
Recognised gains and losses for the financial year		**7,113,510**	**762,358**

The notes on pages 22 to 36 form part of these accounts.

Combined Balance Sheet

As at 31 March 2006

	Note	31 March 06 £000	31 March 05 £000
Current assets:			
Debtors	15	13,870	1,478
Cash at bank and in hand	16	59,486	63,719
		73,356	**65,197**
Creditors (amounts falling due within one year)	17(a)	(184,002)	(336,866)
		(184,002)	(336,866)
Net current liabilities, excluding pension liability		**(110,646)**	**(271,669)**
Provision for liabilities and charges:			
Pension liability	18.5	(76,400,000)	(66,500,000)
Attributable injury benefit	20	(2,643)	(20,955)
Project Collins	21	(8,792)	–
Armed Forces Compensation Scheme	19	(31,395)	–
Net liabilities, including pension liability		**(76,553,476)**	**(66,792,624)**
Taxpayers' equity:			
General fund	22	(76,553,476)	(66,792,624)
		(76,553,476)	**(66,792,624)**

Bill Jeffrey
Accounting Officer for the Armed Forces Pension Scheme
and Armed Forces Compensation Scheme 17 July 2006

The notes on pages 22 to 36 form part of these accounts.

Cash Flow Statement

for the year ended 31 March 2006

	Note	2005–06 £000	2004–05 £000
Net cash outflow from operating activities	23(a)	(1,649,233)	(1,447,143)
Payments of amounts due to the Consolidated Fund	23(b)	–	(557)
Financing	23(b)	1,645,000	1,474,000
(Decrease)/Increase in cash in the period	23(c)	**(4,233)**	**26,300**

The notes on pages 22 to 36 form part of these accounts.

Notes to the Accounts

1. Basis of Preparation of the Scheme Statements

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

1.2 In addition to the primary statements prepared under UK GAAP, the FReM also requires the scheme to prepare an additional statement – a *Statement of Parliamentary Supply*. This, and its supporting notes, show outturn against estimate in terms of the net resource requirement and the net cash requirement.

1.3 The Scheme Statements summarise the transactions of the Armed Forces Pension Scheme incorporating the new Armed Forces Compensation Scheme (AFCS). The Balance Sheet shows the deficit on the schemes; the Revenue Account shows, inter alia, the movements in the liabilities analysed between the pension cost, enhancements and transfers in, and the interest on the schemes' liabilities. The actuarial position of the pension scheme is dealt with in the Report of the Actuary, and the Scheme Statements should be read in conjunction with that report.

1.4 The AFPS is a contracted-out, unfunded, defined benefit pay-as-you-go occupational pension scheme operated by the MoD on behalf of members of the Armed Services who satisfy certain membership criteria. The employer's charge to the pension scheme is met by payment of a Superannuation Contribution Adjusted for Past Experience (SCAPE), calculated as a percentage of military pay based on rank. The SCAPE contribution made by the MoD partially funds the payments made by the AFPS in year.

1.5 Funding from the Consolidated Fund is required to meet the difference between the payments to pensioners and the amounts receivable from MoD. In addition, funding is required to finance movements in working capital including increases or decreases in bank balances.

1.6 Administration expenses (staff, office facilities, etc.) are borne through the Operating Cost Statement of the MoD.

1.7 The Scheme Statements summarise the transactions of not only the AFPS but also the Reserve Forces Pension Scheme (RFPS) and the AFCS. These are administered and managed in a similar way to the AFPS.

1.8 Members have no choice over the allocation of benefits between the lump sum and the annual pension. However, there are two forms of commutation for existing pensioners – resettlement commutation and life commutation, where the pensioner has the option to abate their pension in return for a lump sum. Benefit payments are accounted for on an accruals basis.

1.9 The Actuarial Statement, shown on pages 8 and 9, which takes account of future obligations, has been prepared by the Government Actuary's Department and should be read in conjunction with the Scheme Statements. The Actuarial Statement has been prepared using the projected accrued benefit method, the actuarial valuation itself being undertaken on a quadrennial basis.

1.10 The accounting policies adopted by the scheme are described below. They have been applied consistently in dealing with items that are considered material in relation to the Scheme Statements.

2. Statement of accounting policies

The accounting policies contained in the FReM follow UK generally accepted accounting practice for companies (UK GAAP) to the extent that it is meaningful and appropriate to the public sector.

Where the FReM permits a choice of accounting policy, the accounting policy which has been judged to be most appropriate to the particular circumstances of the Scheme for the purpose of giving a true and fair view has been selected. The accounting policies adopted have been applied consistently in dealing with items considered material in relation to the accounts.

2.1 Pension contributions receivable

2.1.1 Employer's normal pension contributions (SCAPE) are accounted for on an accruals basis.

2.1.2 Employees' pension contributions and amounts received in respect of the purchase of added years of service are accounted for on an accruals basis. Contributions deducted from employees' salaries are in respect of 'in-scheme' Additional Voluntary Contributions (AVCs). Neither Free-Standing Additional Voluntary Contributions (FSAVCs) nor payments to providers of stakeholder pensions are brought into account in this statement. The associated increase in the scheme liability is recognised as expenditure.

2.2 Transfers in and out

2.2.1 Transfers in and out of the scheme in respect of individual members are accounted for as income and expenditure (representing the associated increase in the scheme liability) on a cash basis.

2.3 Other income

2.3.1 Other income is accounted for on an accruals basis. To the extent that this income represents an increase in the scheme liability, it is also reflected in expenditure.

2.4 Current service cost

2.4.1 The current service cost is the increase in the present value of the scheme liabilities arising from current members' service in the current period and is recognised in the Revenue Account. The cost is based on a discount rate of 2.8% real (i.e. 5.37% including inflation).

2.5 Past service costs

2.5.1 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 increases in benefit vest.

2.6 Interest on scheme liabilities

2.6.1 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 the discount rate of 2.8% real (i.e. 5.37% including inflation).

2.7 Other payments

Other payments are accounted for on an accruals basis.

2.8 Scheme liability

2.8.1 Provision is made for liabilities to pay pensions and other benefits in the future. The scheme liability is measured on an actuarial basis using the projected unit method and is discounted at 2.8% (i.e. 5.37% after inflation).

2.8.2 Full actuarial valuations by a professionally 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.

2.9 Pensions benefits payable

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

2.10 Pension payments to those retiring at their normal retirement age

2.10.1 Where a retiring member has no choice over the allocation of benefits receivable between the value of the lump sum and the annual pension, the transaction is accounted for as a decrease in the scheme liability on an accruals basis.

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

2.11.1 The AFPS is a non-contributory pension scheme; therefore no refund will be made to members on leaving the scheme. Members may request that the value of their service be transferred to a salary related occupational pension scheme, or to a statutory scheme. Transfers out of the scheme are accounted for on a cash basis.

2.12 Lump sums payable on death in service

2.12.1 Lump sum payments on death in service are accounted for on an accruals basis. They are funded through normal pension contributions and are a charge on the pension provision.

2.13 Actuarial gains and losses

2.13.1 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 Gain and Losses for the year.

2.14 Attributable Injury Benefits

2.14.1 Provision is made to account for the repayment of incorrectly paid benefits as a result of a decision by the Court of Appeal on 19 November 2003 on assessment of attributable pensions. The provision is expected to be cleared by the end of the next financial year.

2.15 Armed Forces Compensation Scheme

2.15.1 The Armed Forces Compensation Scheme came into effect on 6th April 2005, and provision is made within these accounts to provide for payments due to scheme members in compensation for deaths and injuries, occurring on or after that date and which are considered to be attributable to service in the Armed Forces.

3. Reconciliation of net resource outturn to net outgoings

The adjustment of £8.2 billion reflects the difference between the estimate and accounting treatment of the change in the discount rate from 3.5% to 2.8% with effect from 1 April 2005. Parliamentary approval was given for the necessary resources, and was reflected as a non-budget item in the Estimates and in the Statement of Parliamentary Supply.

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

		2005–06			2004–05
		Outturn	**Supply Estimate**	**Outturn compared with Estimate**	
	Note	£000	£000	£000	£000
Net Resource outturn		12,541,400	14,458,545	1,917,145	3,294,301
Non-supply income (CFERs)	5	(44,825)	–	44,825	–
Adjustment for effects of change in discount rate		(8,200,000)	(10,000,000)	(1,800,000)	–
Net Outgoings		**4,296,575**	**4,458,545**	**161,970**	**3,294,301**

4. Reconciliation of resources to cash requirement

	Note	**Estimate**	**Outturn**	**Net Total outturn compared with Estimate savings/ (excess)**
		£000	£000	£000
Net Resource Outturn	3	14,458,545	12,541,400	1,917,145
Accruals adjustments:				
Non cash items	24	(15,820,782)	(13,906,638)	(1,914,144)
Changes in working capital other than cash		157,940	161,023	(3,083)
Changes in creditors falling due after more than one year		–	–	–
Use of provision:				
Pension		2,906,094	2,868,862	37,232
Attributable injury benefits		20,954	28,137	(7,183)
Compensation Scheme		469	1,274	(805)
Net cash requirement		**1,723,220**	**1,694,058**	**29,162**

5. Analysis of income payable to the Consolidated Fund

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

	Forecast 2005–06		Outturn 2005–06	
	Income	***Receipts***	**Income**	***Receipts***
	£000	£000	£000	£000
Operating income and receipts – excess A-in-A	–	–	44,825	–
Excess cash surrenderable to the Consolidated Fund	–	–	–	*14,661*
Total income payable to the Consolidated Fund	–	–	44,825	*14,661*

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

		2005–06	2004–05
	Note	£000	£000
Operating income		(1,410,063)	(1,252,078)
Income authorised to be appropriated-in-aid		1,365,238	1,252,078
Operating income payable to the Consolidated Fund	5	**(44,825)**	**–**

Revenue account

7. Pensions contributions receivable

Employers' contributions are receivable from MoD in respect of active members of the AFPS and amount to an average of 30.9% (2004-05: 22.1%) of pay.

	2005–06	2004–05
	£000	£000
Employers	1,404,451	1,245,994
Employees:		
Additional Voluntary Contributions	657	1,669
	1,405,108	**1,247,663**

8. Pensions transfers-in *(see also Note 12)*

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

	2005–06	2004–05
	£000	£000
Individual transfers in from other schemes	4,717	4,145
	4,717	**4,145**

9. Other pension income

Miscellaneous income consists of contributions to enhance $\frac{1}{3}$ rate Forces Family Pensions to $\frac{1}{2}$ rate, and refunds of resettlement commutation on re-entry into the pension scheme.

	2005–06	2004–05
	£000	£000
Miscellaneous income (including refund of gratuities)	238	270
	238	**270**

10. Pension cost

The current service cost is the increase in the present value of the scheme liabilities arising from current members' service in the current period.

	2005–06	2004–05
	£000	£000
Current service cost *(see Note 18.5)*	1,670,617	1,245,994
	1,670,617	**1,245,994**

11. Enhancements *(see also Note 18.5)*

	2005–06	2004–05
	£000	£000
Employees AVCs and added years	657	1,669
	657	**1,669**

12. Transfers in *(see also Note 8)*

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.

	2005–06	2004–05
	£000	£000
Individual transfers in from other schemes	4,717	4,145
	4,717	**4,145**

13. Interest on scheme liabilities *(see also Note 18.5)*

The interest charge in the year has been determined by taking 5.37% of the opening balance plus 5.37% of the average of the movements in the year, which are deemed to accrue evenly during the year. The movements in the year exclude the interest charge and the actuarial gains/losses.

	2005–06	**2004–05**
	£000	£000
Interest charge for the year	3,979,361	3,772,941
	3,979,361	**3,772,941**

14. Other interest payable

The expenditure is in respect of interest paid to the National Debt Office.

National Debt Office Advances:
The National Debt Office (NDO) advanced money to the MoD to fund life commutations, a benefit available to officers of the three Services. The number of pensioners eligible to apply for life commutation is decreasing year on year. Life commutation is only available to those serving on or before 31 March 1978 and applies only to that part of the pension earned by service up to 6 April 1980. From 1 January 2005, the NDO ceased funding life commutations and the total outstanding loan was settled in full on 1 April 2005.

Interest Paid:
The interest paid represents the interest accrued and was payable on 1 April 2005.

	2005–06	**2004–05**
	£000	£000
National Debt Office:		
Interest	–	8,178
	–	**8,178**

Balance Sheet

15. Debtors – contributions due in respect of pensions

15(a) Analysis by type

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

	2005–06	2004–05
	£000	£000
Amounts falling due within one year:		
Overpaid pensions	4,040	1,861
Less Provision for bad debts	(1,450)	(719)
SCAPE receipts due from MoD	10,866	–
	13,456	**1,142**
Amounts falling due after one year:		
Overpaid pensions	414	336
Total Debtors	**13,870**	**1,478**

15(b) Intra-Government balances

	Amounts falling due within one year		Amounts falling due after more than one year	
	2005–06	2004–05	2005–06	2004–05
	£000	£000	£000	£000
Balances with other central government bodies:				
Ministry of Defence	10,866	–	–	–
Balances with bodies external to government	2,590	1,142	414	336
At 31 March	**13,456**	**1,142**	**414**	**336**

16. Cash at bank

	2005–06	2004–05
	£000	£000
Balance at I April	63,719	37,419
Net change in cash balances	(4,233)	26,300
Balance at 31 March	**59,486**	**63,719**
The following balances at 31 March were held at:		
Office of HM Paymaster General	59,486	63,719
Balance at 31 March	**59,486**	**63,719**

17. Creditors – amounts falling due within one year

17(a) Analysis by type

	2005–06	2004–05
	£000	£000
Amounts falling due within one year:		
Pensions	79,593	76,218
Compensation	805	–
HM Revenue & Customs	43,658	40,565
National Debt Office – Principal and Interest	–	156,074
Third party organisations	460	290
	124,516	273,147
Amounts issued from the Consolidated Fund for supply not spent at year end	14,661	63,719
Consolidated Fund extra receipts due to be paid to the Consolidated Fund	44,825	–
	184,002	**336,866**

17(b) Intra-Government balances

	Amounts falling due within one year	
	2005–06	**2004–05**
	£000	£000
Balances with other central government bodies:		
HM Revenue & Customs	43,658	40,565
National Debt Office	–	156,074
Consolidated Fund	59,486	63,719
Balances with bodies external to government	80,858	76,508
	184,002	**336,866**

18. Provision for pension liability

18.1 The Armed Forces Pension Scheme is an unfunded defined benefit scheme. A full actuarial valuation was carried out as at 31 March 2005 by the Government Actuary's Department. The major financial assumptions used by the actuary when providing the assessment of the accrued liabilities as at the following dates for the Resource Accounting assessments were:

	At 31 March 2006	At 31 March 2005	At 31 March 2004
Rate of increase on salaries	4.0%	3.9%	3.9%
Rate of increase in pensions in payment and deferred pensions	2.5%	2.4%	2.4%
Inflation assumption	2.5%	2.4%	2.4%
Discount rate	2.8%	3.5%	2.4%

18.2 The scheme managers are responsible for providing the Actuary with information he 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 pensioners and pensioners;
- Benefit structure, including details of any discretionary benefits and any proposals to amend the scheme;
- Income and expenditure; 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.

18.3 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.

18.4 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 increase or decrease the assumed rate of inflation, or increases in salaries, then the value of the pension liability will increase or decrease. The managers of the scheme accept that, as a consequence the valuation provided by the Actuary is inherently uncertain. The increase or decrease in future liability charged or credited for the year resulting from changes in assumptions is disclosed in notes 18.8 and 18.9. 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.

18.5 Analysis of movements in scheme liability

	2005–06	**2004–05**
	£000	£000
Scheme liability at 1 April	**(66,500,000)**	**(63,800,000)**
Discount rate adjustment	(8,200,000)	–
Current service cost (Note 10)	(1,670,617)	(1,245,994)
Interest on pension scheme liability (Note 13)	(3,979,361)	(3,772,941)
	(13,849,978)	(5,018,935)
Income received in respect of enhancements (Note 11)	(657)	(1,669)
Pension transfers (Note 12)	(4,717)	(4,145)
	(13,855,352)	(5,024,749)
Benefits paid (Note 18.6)	2,845,602	2,664,125
Pension payments to and on account of leavers (Note 18.7)	23,260	22,982
	2,868,862	2,687,107
Adjustment to pension liability	–	400,000
Actuarial gain / (loss) (Note 18.8)	1,086,490	(762,358)
Scheme liability as 31 March	**(76,400,000)**	**(66,500,000)**

18.6 Analysis of benefits paid

	2005–06	2004–05
	£000	£000
Pensions to retired employees and dependents (net of recoveries of overpayments)	2,429,830	2,316,389
Commutations and lump sum benefits on retirement	415,772	347,736
Per cash flow statement	**2,845,602**	**2,664,125**

18.7 Analysis of payments to and on account of leavers

	2005–06	2004–05
	£000	£000
Individual transfers to other schemes	23,260	22,982
Per cash flow statement	**23,260**	**22,982**

18.8 Analysis of actuarial gain/(loss)

	2005–06	2004–05
	£000	£000
Experience gains / (losses) arising on scheme liabilities	1,086,490	(762,358)
Per Statement of Recognised Gains and Losses	**1,086,490**	**(762,358)**

18.9 History of experience gains and losses

	2005–06	2004–05	2003–04	2002–03
Experience (gains) and losses on scheme liabilities:				
Amount (£000)	(1,086,490)	762,358	59,624	1,116,073
Percentage of the present value of the scheme liabilities	(1.4%)	1.1%	0.1%	2.0%
Total actuarial loss/(gain):				
Amount (£000)	(1,086,490)	762,358	5,100,000	1,116,073
Percentage of the present value of the scheme liabilities	(1.4%)	1.1%	8.0%	2.0%

19. Provision for liabilities and charges – Armed Forces Compensation Scheme

Armed Forces Compensation Scheme

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

The scheme is required to provide for the injuries to military personnel that have occurred whilst in service. The provision reflects claims that have been made based on injuries that have occurred, including those incidents occurred but not yet reported. Military personnel have up to 5 years to make a claim under the AFCS.

	AFCS incidents incurred but not yet reported	AFCS known claims	AFCS total provision
	£000	£000	£000
Balance at 1 April 2005	–	–	–
Set up of provision in year	30,000	–	30,000
Use of provision in year	–	(1,274)	(1,274)
Interest on Scheme Liabilities	–	702	702
Revaluation at year end	(5,771)	7,738	1,967
Balance at 31 March 2006	**24,229**	**7,166**	**31,395**

20. Provision for liabilities and charges – Attributable Injury Benefits

Attributable Injury

As a result of the decision by the Court of Appeal on 19 November 2003, a review commenced on all decisions on entitlement to attributable pensions for those conditions that led to invaliding or death-in-service where AFPS administrators have previously not accepted War Pension Scheme decisions on attributability.

Over 117,000 cases have been reviewed with over £36 million payments made to date. The provision has been revalued and an anticipated £2.6 million further payments are due in 2006-07.

	2005–06	2004–05
	£000	£000
Balance at 1 April	**(20,955)**	**(115,600)**
Movement of provision in year:		
Use of provision in year	(9,825)	–
Revaluation at year end	28,137	8,097
	–	86,548
Balance at 31 March 2006	**(2,643)**	**(20,955)**

21. Project Collins

As a result of work undertaken on Project Haven, where certain pension entitlements were erroneously taxed, it was discovered that many individuals were in receipt of the wrong rate of attributable pension due to the application of incorrect rates. This issue is now being reviewed under Project Collins. The financial impact and number of affected pension cases has not yet been fully assessed; however, the estimated potential cost has been assessed as £8.792 million.

22. General Fund

The General Fund represents the total assets less liabilities of the pension scheme, to the extent that the total is not represented by other reserves and financing items.

	2005–06	2004–05
	£000	£000
Balance at 1 April	(66,792,624)	(64,183,108)
Discount rate adjustment	(8,200,000)	–
Adjusted Opening Balance	(74,992,624)	(64,183,108)
Net Parliamentary Funding:		
Draw down	1,645,000	1,474,000
Deemed	63,719	36,862
Year end adjustment:		
Supply creditor – current year	(14,661)	(63,719)
Net Transfer from operating activities:		
Net outgoings	(4,296,575)	(3,294,301)
CFERs repayable to Consolidated Fund	(44,825)	–
Actuarial gains and losses (SRGL)	1,086,490	(762,358)
Balance at 31 March	**(76,553,476)**	**(66,792,624)**

23. Notes to the Cash Flow Statement

23(a) Reconciliation of net outgoings to operating cash flows

	Note	2005–06	2004–05
		£000	£000
Net outgoings for the year		(4,296,575)	(3,294,301)
Adjustment of pension liability		–	(400,000)
(Increase)/Decrease in Debtors		(12,392)	(418)
(Decrease)/Increase in Creditors		(148,631)	4,579
Increase in pension provision	18.5	5,649,978	5,018,935
Increase in pension provision – enhancements and transfers in	18.5	5,374	5,814
Use of provisions – pension liability	18.6	(2,845,602)	(2,664,125)
Use of provisions – refunds and transfers	18.7	(23,260)	(22,982)
Increase/(Decrease) in provision for attributable injury benefits	20	9,825	(86,548)
Use of provisions – attributable injury benefits	20	(28,137)	(8,097)
Increase in compensation provision	19	32,669	–
Use of provision – compensation scheme	19	(1,274)	–
Increase/(Decrease) in provision for Project Collins	21	8,792	–
Net cash outflow from operating activities		**(1,649,233)**	**(1,447,143)**

23(b) Analysis of financing and reconciliation to the net cash requirement

	2005–06	2004–05
	£000	£000
From the Consolidated Fund (Supply) – current year	1,645,000	1,474,000
Net financing	1,645,000	1,474,000
(Increase)/decrease in cash	4,233	26,300)
Adjustments for payments and receipts not related to Supply		
Payment from/(to) the Consolidated Fund	–	(557)
Amounts due to the Consolidated Fund, received and not paid over – Excess appropriation-in-aid relating to current year	44,825	–
Net cash requirement per Statement of Parliamentary Supply	**1,694,058**	**1,447,143**

23(c) Reconciliation of Net Cash Requirement to (decrease)/increase in cash

		2005–06	2004–05
	Note	£000	£000
Net cash requirement		(1,694,058)	(1,447,143)
From Consolidated Fund (Supply) – current year		1,645,000	1,474,000
Amounts due to/(from) the Consolidated Fund	3	44,825	(557)
(Decrease)/Increase in cash		**(4,233)**	**26,300**

24. Non-cash items

	2005–06	2004–05
	£000	£000
Discount rate adjustment	8,200,000	–
Current service cost	1,670,617	1,245,994
Enhancements	657	1,669
Transfers in	4,717	4,145
Interest on Pension Scheme liability	3,979,361	3,772,941
Interest on Compensation Scheme liability	702	–
Revaluation of Attributable Injury Provision	9,825	(86,548)
Revaluation of Compensation Scheme Provision	31,967	–
Revaluation of Project Collins Provision	8,792	–
Adjustment to pension liability	–	(400,000)
Non-cash items (See Note 4)	**13,906,638**	**4,538,201**

25. Financial Instruments

FRS 13, *Derivatives and Other Financial Instruments*, requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities. Because of the non-trading nature of its activities and the way in which government departments are financed, the AFPS is not exposed to the degree of financial risk faced by business entities. Moreover, financial instruments play a much more limited role in creating or changing risk than would be typical of the listed companies to which FRS 13 applies. In line with FRS13, short term debtors and creditors (those that mature or become payable within twelve months from the balance sheet date) have been excluded from these disclosures.

Liquidity Risk

Resources voted by Parliament finance the combined AFPS/AFCS net revenue resource requirements. The schemes are not therefore exposed to significant liquidity risks.

Interest Rate Risk

All of the schemes' financial assets and liabilities carry nil or fixed rates of interest. The schemes are not therefore exposed to any interest rate risk.

26. Losses

During the year, losses arose in 2,206 cases (2004-05; 314 cases). The total loss was £463,583.71 (2004-05; £369,198) and this relates to the write-off of pension overpayments.

27. Related-party transactions

The schemes fall within the ambit of the MoD, which is regarded as a related party. During the year, the schemes have had material transactions with the Department whose employees are members of the schemes. None of the managers of the schemes, key managerial staff or other related parties have undertaken any material transactions with the schemes during the year.

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