
Armed Forces Pension Scheme

(Incorporating the Armed Forces Compensation Scheme)

Annual Accounts 2016-17

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Annual Accounts

2016-17

(For the year ended 31 March 2017)

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Report of the Managers

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

1. Background to the Schemes

1.1 The Armed Forces Pension Scheme 2015 (AFPS 15)

On 1 April 2015 the AFPS 15 was introduced for all new members of the Armed Forces. All serving Service personnel who were members of an AFPS were automatically transferred to the AFPS 15, unless they qualified for Transitional Protection. The AFPS 15 is a voluntary, non-contributory, Career Average Revalued Earnings (CARE), unfunded, defined benefit, occupational pension scheme.

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

Pensions are paid immediately if an individual serves to age 60 with at least two years' qualifying service. Those who have at least two years' service who leave before age 60 will have their pensions preserved until State Pension Age. The Scheme also includes an EDP for those who leave before age 60 providing they have at least 20 years' service and are at least 40 years of age. The EDP is paid from the date of the individual's departure from the Armed Forces until State Pension Age, at which time the EDP stops and is replaced by the preserved pension. Pensions may be payable to the spouse, civil partner, partner or to eligible children. Death-in-service lump sums are payable to nominated recipients or eligible dependants.

1.2 The Armed Forces Pension Scheme 2005 (AFPS 05)

From 6 April 2005 until 31 March 2015, the AFPS 05 was the primary scheme for all new members of the Armed Forces. The Armed Forces (Pension & Compensation) Act 2004 is the primary legislation covering the AFPS 05 and the EDP Scheme 05. The AFPS 05 is a voluntary, non-contributory, final salary, unfunded, defined benefit, occupational pension scheme.

Pensions are paid immediately if an individual serves to age 55 with at least two years' qualifying service. Those who have at least two years' service who leave before age 55 will have their pensions preserved until age 65. The Scheme also includes an EDP for those who leave before age 55 providing they have at least 18 years' service and are at least 40 years of age. The EDP is paid from the date of the individual's departure from the Armed Forces until age 65, at which time the EDP stops and is replaced by the preserved pension. Pensions may be payable to the spouse, civil partner, partner or to eligible children. Death-in-service lump sums are payable to nominated recipients or eligible dependants.

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

1.3 The Armed Forces Compensation Scheme (AFCS)

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

1.4 The Armed Forces Pension Scheme 1975 (AFPS 75)

The AFPS 75 was the primary Scheme for Armed Forces personnel prior to 6 April 2005. The Scheme rules are set out in "Prerogative Instruments" that derive their authority from Her Majesty The Queen

and are not subject to approval, annulment or amendment by Parliament. The current prerogative instruments are the Naval and Marine (AFPS 75 and Attributable Benefits Scheme) Order 2010, the Army Pensions (AFPS 75 and Attributable Benefits Scheme) Warrant 2010 and the Air Force (AFPS 75 and Attributable Benefits Scheme) Order 2010. The AFPS 75 regulations are set out in Schedule 1 to the prerogative instruments.

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

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

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

1.5 The Armed Forces Attributable Benefits (AFAB) Scheme

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

The Scheme provides invaliding benefits to those discharged from the Services on medical grounds in respect of injuries caused by service on or before 5 April 2005, who have been awarded a benefit under the War Pensions Scheme and whose degree of disablement due to the disabling condition is 20% or more, and death benefits to dependants.

1.6 Reserve Forces Pension Schemes

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

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

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

On 1 April 2015 all active FTRSPS 97 and RFPS 05 members were transferred to AFPS 15, unless they qualified for Transitional Protection. Those members who transferred to the AFPS 15 had their FTRSPS 97 and RFPS 05 accrued pensions protected.

1.7 Non Regular Permanent Staff Pension Scheme (NRPSPS)

The NRPSPS, which covers non regular personnel in support of the Territorial Army, is a non-contributory pension scheme available to all members of the Non Regular Permanent Staff. The

NRPSPS closed to new entrants effective 31 August 2011 with any new appointments being FTRS appointments covered under the RFPS 05.

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

1.8 Gurkha Pension Scheme (GPS)

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

In March 2007, the Government announced the outcome of a Review of Gurkha Terms and Conditions of Service. It was announced that serving Gurkhas, and those who left service on or after 1 July 1997, would be given the right to transfer to either the AFPS 75 or AFPS 05, from October 2007.

From 1 April 2015 all new members of the Brigade of Gurkhas have joined the AFPS 15.

1.9 Minor Pension Schemes

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

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

1.10 Further Details

Further details on the above Schemes can be found at:

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

2. Management of the Schemes

2.1 Organisations Responsible for Managing the Schemes

The AFPS and AFCS are managed and operated by Defence Business Services (DBS), a business unit within the Ministry of Defence (MOD). The costs of administering the Schemes are borne by the MOD and are reflected in the Department's Annual Report and Accounts. This includes Comptroller and Auditor General's notional audit fee of £145k.

The MOD had a contract with Serco Ltd to provide management services to DBS which ceased on 18 April 2016. Up to and including this date the CEO and a number of Executive appointments were made through Serco Ltd. From 19 April 2016 the CEO, Chief Operating Officer, Chief Information Officer and Transformation Director positions were filled by MOD Executives. The Chief People Officer Serco Executive was retained until 24 June 2016. All other Serco Executives left DBS on 18 April 2016 and did not attend any of the DBS Board / Committee meetings as members during 2016-17.

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

The DBS Executive Leadership Team meets regularly and is responsible for managing DBS within agreed financial limits. It has primary authority for day-to-day management of DBS. Details of the Executive Leadership Team appointments can be found in the Governance Statement on page 21.

2.2 Corporate Governance of the Schemes

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

2.3 Arrangements Governing Determination of Contribution Rates and Benefits

Employer contributions provide funding for Scheme benefits at rates determined by the Secretary of State for Defence, taking advice from the Government Actuary's Department (GAD). The balance of funding required to meet Scheme benefits is provided by Parliament.

The last actuarial valuation undertaken of the AFPS was as at 31 March 2012 published in February 2015. The primary purpose of the 2012 actuarial valuation was to set the employer contribution rate payable from April 2015, in light of the introduction of the new pension arrangements from 1 April 2015, and the initial employer cost cap (maximum employer cost) which is required by the Public Service Pensions Act 2013.

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

3. Key Developments In Year

3.1 Changes to Scheme Contribution Rates

The AFPS is financed through the payment of employer contributions made in respect of serving members of the Scheme. Employer contributions are set as a percentage of Pensionable Pay, and different rates apply for Officers and Other Ranks. The contribution rates were last reviewed as part of the actuarial valuation as at 31 March 2012, which set the applicable rates for the period 1 April 2015 to 31 March 2019. The contribution rate for Officers is 52.4% and for Other Ranks 49.6%. These rates are unchanged from those payable during 2015-16.

Additional employer contributions are also payable in respect of the AFCS. The rates applicable during 2016-17 were 1.0% of Pensionable Pay for Officers and 2.4% of Pensionable Pay for Other Ranks. These rates are unchanged from those payable during 2015-16.

3.2 Changes in Benefits

There have been no changes to benefits during 2016-17.

3.3 Changes in Accounting Standards

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

3.4 Membership Statistics (Movement in Year)

Due to the complexity of the AFPS, the membership data below has moved away from an 'individual' being synonymous with a 'member'. In order to show the movements within each category, the membership table shows 'Benefits' instead of 'Members'.

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

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

Where a member has not claimed benefits within seven years of pension age, the member is out of time to claim. This is an assumption for membership reporting and actuarial valuation purposes only.

The databases used to manage Active and Deferred Members are dynamic systems that allow records to be updated retrospectively. It is, therefore, accepted that the opening balances in the membership table will not match to the previous year's closing balances. Active and Deferred benefits are held on a separate system to Benefits in Payment. It is, therefore, accepted that the movements between these categories may not reconcile due to timing differences.

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

The Minor Pension Schemes' membership data as at 31 March 2017, equating to 183 active members, 45 deferred members and 1,820 benefits in payment, are excluded from the membership table.

There are three groups, defined as follows:

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

Active members' benefits

	Active members brought forward from 31 March 2016	341,098
	Adjustment (see Membership Statistics note 1)	(1,467)
	Total active members' benefits at 1 April 2016	<u>339,631</u>
<i>Add:</i>	New entrants in year	18,026
	Transfers in	66
<i>Less:</i>	Death in service benefits	(141)
	Left active service with under two years' service and no benefits	(4,551)
	Left active service with deferred benefits	(16,471)
	Left active service and received benefits	(3,250)
	Total active members' benefits at 31 March 2017	<u>333,310</u>
	Active Full Time members at 31 March 2017	164,691
	Active Voluntary Reservist members at 31 March 2017	34,885

Deferred and unclaimed benefits

	Deferred and unclaimed benefits brought forward from 31 March 2016	465,395
	Adjustments (see Membership Statistics notes 1 and 2)	3,124
	Total deferred and unclaimed benefits at 1 April 2016	468,519
<i>Add:</i>	Benefits not immediately payable	16,878
	New benefit on divorce	331
<i>Less:</i>	Benefits transferred out	(226)
	Benefits taken up	(5,061)
	Benefits elapsed	(1,571)
	Death in deferment benefits	(454)
	Rejoiners	(36)
		478,380
	Being:	
	Deferred benefits	460,267
	Benefits due but unclaimed	18,113
	Total deferred and unclaimed benefits at 31 March 2017	478,380
	Deferred and unclaimed members at 31 March 2017	421,725
	Deferred and unclaimed Voluntary Reservist members at 31 March 2017	1,629

Benefits in payment

	Benefits brought forward from 31 March 2016	
	- Members	352,350
	- Dependants	73,190
	Total	425,540
	Adjustments (see Membership Statistics note 1)	
	- Members	(181)
	- Dependants	27
	Total benefits at 1 April 2016	(154)
<i>Add:</i>	Benefits that became payable in the year	
	- Members	9,584
	- Dependants	3,895
<i>Less:</i>	Benefits that have ceased in the year	
	- Members	(6,846)
	- Dependants	(3,797)
	Total benefits in payment at 31 March 2017	428,222

Membership Statistics Notes

1. The brought forward balances from 31 March 2016 have been restated to account for better information obtained from the membership databases. The databases used to manage member data records are dynamic systems that allow records to be updated retrospectively. It is, therefore, accepted that the opening balances will not reconcile to the previous year's closing balances, hence the adjustment lines present in the membership table.
2. The 2015-16 membership table included 10,456 reported Deaths in Deferment, which were identified by a mortality screening using the National Fraud Initiative (NFI) dataset. Subsequent detailed analysis of the NFI matches determined that only 6,695 of the 10,456 were valid. This was due to the inclusion of duplicate records and records for which a date of death already existed in the report uploaded to NFI. The Deferred opening balance has, therefore, been increased by 3,761 records to correct the error. The adjustment of 3,124 shown in the membership table is the net of this correction and the routine opening balance adjustment, as detailed in Membership Statistics Note 1.

3.5 Financial Position as at 31 March 2017

As at 31 March 2017 the pension liability of the AFPS was valued at £191.8 billion (£145.2 billion as at 31 March 2016). The total change in liability represents a net increase of £46.6 billion, which includes an actuarial loss of £42.8 billion. The £42.8 billion consists of:

- £42.3 billion due to changes in financial assumptions;
- £0.5 billion due to experience items arising on pension liabilities.

The £42.3 billion change in financial assumptions represents the decrease in the discount rate (net of pension increases) to 0.24% from 1.37% (2016: a net increase from 1.3% to 1.37%).

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

A full reconciliation of the change in liability over the year is provided in note 12.4 to the accounts.

3.6 Contingencies Fund Drawdown

The Scheme submitted a request for £438.2 million to HM Treasury to draw money from the Contingencies Fund (under section 5.14d of the Supply and Estimate Guidance manual). The funds were required to address a shortfall in the net cash requirement amount, which originally appeared in the HM Treasury's Central Government Main Supply Estimates 2016-17, published in July 2016 (HC 967).

The shortfall in the net cash requirement arose due to an inadvertent publishing error by HM Treasury in the Central Government Main Supply Estimates 2016-17 (HC967), which was corrected via a Supplementary Estimate.

The funds were repaid to the Contingencies Fund in full on 23 March 2017.

3.7 Results for the Year

The 2016-17 net resource outturn was £5.336 billion which was within the voted estimate of £5.363 billion. Details can be found in the Statement of Parliamentary Supply on page 27.

In cash terms, the Scheme recorded a Net Cash Requirement (NCR) of £1.497 billion against the voted estimate of £1.509 billion, resulting in surplus cash of £12.441 million which will be returned to the Treasury during 2017-18.

4. Issues Arising and Key Activities During 2016-17

4.1 Tell Us Once

The Tell Us Once (TUO) service allows citizens on a voluntary basis to inform central and local government of bereavement in a single engagement. This can either be at the point of registering a death with a Registrar, by telephone or via the internet. It is hosted by the Department for Work and Pensions but is a cross-government resource.

The Scheme joined this service in March 2016. The benefit of being part of the TUO is the provision of a better service to the bereaved at a difficult time and a reduction in the number of days between the death of a pensioner and the Scheme being informed. The aim is to stop or reduce the number and value of overpayments and associated activities and costs of recovery. During 2016-17 the service provided the AFPS with 5,469 death notifications.

4.2 National Fraud Initiative

Commencing in 1998 and on a biennial basis the AFPS takes part in the National Fraud Initiative (NFI), co-ordinated by the Cabinet Office. This initiative allows the Scheme to submit approved data to the Cabinet Office who match it against other data sources to ensure the payments are still being made to the individual originally entitled to the pension. This exercise was in addition to the Scheme's normal procedure of regularly confirming entitlement with individual pensioners. The table below provides an update of the position for the exercises conducted since 2002 and lists the outstanding amounts which are still being actively pursued.

NFI Exercise	Total Cases	Total Identified £000	Prior Years		2016-17		Outstanding at 31/03/2017 £000
			Recovered £000	Written-off £000	Recovered £000	Written-off £000	
NFI 2002	252	1,071	767	275	1	0	28
NFI 2004	257	426	356	66	1	0	3
NFI 2006	297	789	702	82	1	0	4
NFI 2008	175	959	885	30	15	0	29
NFI 2010	126	695	630	6	25	0	34
NFI 2012	160	768	737	0	4	0	27
NFI 2014	215	827	566	0	203	0	58
NFI 2016	24	74	0	0	10	0	64

4.3 Membership Data Quality

In response to recommendations made by the National Audit Office and the identification of some serious weaknesses by the Defence Internal Audit, an AFPS Membership Data Improvement Project was established in 2015-16 to focus on the quality, accuracy and reliability of underlying membership data. A programme of improvement work will span a number of years. During 2016-17 several thousand pensioner records have been reviewed with some requiring corrective action. The Army, Royal Navy and RAF are also engaged with the project and are assisting in the analysis of the scheme active membership data. The Pensions Board and the Pensions Regulator also regularly review project progress.

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

The introduction of a new Single Tier State Pension from 6 April 2016 saw the end of contracting-out for Defined Benefit occupational pension schemes. The liability for tracking and maintaining contracted-out rights, known as Guaranteed Minimum Pension (GMP), was passed to individual pension schemes with notification to withdraw support services from HMRC National Insurance Contributions Office (NICO) from December 2018. This meant the AFPS needed to begin reconciliation of contracted-out data with HMRC's records prior to December 2018 to ensure the Scheme has full awareness of its liability at the point when the Scheme Reconciliation Service is withdrawn by HMRC.

There are a large range of significant administrative requirements arising from the changes. A governed project team was put in place to manage these changes with a senior Project Board meeting regularly to oversee progress. During the year the project has put in place a GMP Database to record, track and allow administration of GMP liabilities.

Reconciliation of member data is the larger piece of work. AFPS (non-active) member data and HMRC data has been imported into the GMP Database and analysed. In line with HM Treasury recommendations, membership matching work is underway and the project team are working closely with HMRC to ensure members are recorded accurately.

Going forward, HM Treasury recommend work should continue on membership reconciliation, with AFPS (active) data due to be analysed during 2017-18. Following matching of membership, activity will turn to ensuring correct member data is held, which will ensure correct GMP liabilities can be calculated and correct pension increases applied.

In Autumn 2017, HM Treasury will advise on the longer term solution for Indexation and Equalisation of pensions. New processes will need to be developed to meet these requirements, which will take effect from December 2018.

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

4.5 Quality Assurance

Defence Internal Audit have undertaken a programme of audits since the introduction of the AFPS 15. These highlighted a number of recommendations centred on the less routine aspects of pension administration. The Scheme Authority concluded that an additional tier of quality checking was warranted to ensure these more complex areas remained error free going forward. As a result an Authority 'Quality Assurance' team was established in October 2016 with a remit of reviewing processes and casework in these niche areas and ensuring the right desk instructions are current and available to all administrators.

5. Key Activities Arising for 2017-18

5.1 Life Certificate Exercise

A Life Certificate exercise will be undertaken in 2017-18 to canvass all AFPS and AFCS members residing overseas to confirm their continuing entitlement to pension and compensation benefits under the respective scheme rules. As with previously conducted exercises, failure to respond will result in the payment of pension being withheld.

5.2 Gone Away and Unclaimed Pensions

An exercise will be undertaken in 2017-18 to contact existing pensioners for whom a 'gone away' notification has been received following a postal communication attempt. The aim is to validate the last known address held on the pension administration system, or that obtained by undertaking a detailed tracing exercise, to ensure continuing entitlement to pension.

A similar exercise will also be undertaken in 2017-18 to contact a number of deferred scheme members that have reached scheme pension age but have not yet claimed their pension entitlement. Using information obtained by undertaking the detailed tracing exercise, members will be advised to contact Veterans UK to claim any pension that may be due.

6. Information for Members

6.1 Pension Increase Rate

The Pensions increase rate was 0.0% (1.2% in 2015-16) with effect from 11 April 2016 (6 April 2015).

6.2 AFPS Additional Voluntary Contributions (AVCs)

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

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

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

6.3 Freestanding Additional Voluntary Contributions (FSAVC)

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

6.4 Stakeholder Pensions

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

6.5 Managers, Advisers and Employers

Managers

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7. Disclosure of Information to Auditors

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

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

Stephen Lovegrove
Accounting Officer for the AFPS and AFCS

26 June 2017

**Report of the Actuary for the Armed Forces Pension Scheme
for Accounts for the Year Ended 31 March 2017**

Introduction

1. This statement has been prepared by the Government Actuary's Department at the request of Defence Business Services (DBS), a part of the Ministry of Defence (MoD). It summarises the pensions disclosures required for the 2016-17 Annual Report and Accounts of the Armed Forces Pension Scheme (AFPS).
2. AFPS is a defined benefit pension scheme with various different benefit structures. The Armed Forces Pension Scheme 2015 (AFPS15), and its associated Early Departure Payment Scheme (EDP15), was introduced from 1 April 2015. The provisions of AFPS15 and EDP15 are set out in regulations (<http://www.legislation.gov.uk/ukSI/2014/2336/made>). The Armed Forces Pension Scheme 1975 (AFP75) and the Armed Forces Pension Scheme 2005 (AFPS05) are final salary defined benefit schemes, the rules of which are set out in the Army Pensions (Armed Forces Pension Scheme 1975 and Attributable Benefits Scheme) Warrant 2010 (and Naval and Marine, and Royal Air Force equivalents), and the Armed Forces Pension Scheme Order 2005 (SI 2005/438), and subsequent amendments. The scheme is wholly unfunded. The liabilities disclosed in this statement also include an allowance for the benefits accrued by personnel who are in the Reserve Forces Pension Scheme (RFPS), the Full-Time Reserve Service Pension Scheme (FTRS), the Non-Regular Permanent Staff Pension Scheme (NRPS) and the Gurkha Pension Scheme (GPS); benefits payable from the AFPS05 Early Departure Payments (EDP) arrangement; and benefits payable from the other minor overseas schemes that are included in the AFPS accounts.
3. The statement is based on an assessment of the liabilities as at 31 March 2015, with an approximate updating to 31 March 2017 to reflect known changes.

Membership data

4. Tables A to C summarise the principal membership data as at 31 March 2015 used to prepare this statement.

Table A – Active members

31 March 2015 membership data		2016-17 accounts
Number (thousands)	Total salaries (pa) (£ billion) ¹	Total salaries implied by receipts (£ billion)
166	5.5	5.6

¹ April 2015 increase not included in salaries

Table B – Deferred members

31 March 2015 membership data	
Number (thousands)	Total deferred pension (pa) (£ billion) ²
419	1.0

² April 2015 increase not included in pension amounts

Table C – Pensions in payment

31 March 2015 membership data		2016-17 accounts
Number (thousands)	Total pension (pa) (£ billion) ³	Total pension (pa) (£ billion)
394	3.8	4.0

³ April 2015 increase included in pension amounts

Methodology

5. The present value of the liabilities has been determined using the Projected Unit Credit Method (PUCM), with allowance for expected future pay increases in respect of active members, and the principal financial assumptions applying to the 2016-17 Accounts. The contribution rate for accruing costs in the year ended 31 March 2017 was determined using the PUCM and the principal financial assumptions applying to the 2015-16 Accounts. In accordance with Paragraph 70 of International Accounting Standard 19, the contribution rate for accruing costs has been calculated using the benefit formula approach. This approach attributes the cost of benefit accrual, throughout each member's active membership of the scheme, in line with how members' pensions are built up under the scheme regulations.
6. This statement takes into account the benefits normally provided under the scheme, including age retirement benefits, ill-health retirement benefits and benefits applicable following the death of the member. It does not include the cost of injury benefits (in excess of ill-health benefits). It does not include premature retirement and redundancy benefits in respect of current active members, although the assessment of liabilities includes pensions already in payment in respect of such cases.
7. The liabilities disclosed in this statement include the benefits accrued by personnel who are in the Gurkha Pension Scheme (GPS), together with an approximate allowance in respect of past service costs for current GPS members resulting from the Gurkha Offer to Transfer.
8. The liabilities disclosed in this statement include the benefits accrued by personnel who are in the minor overseas schemes covered by the AFPS accounts.

Principal financial assumptions

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

Table D – Principal financial assumptions

Assumption	31 March 2017	31 March 2016
Rate of return (discount rate)	2.80%	3.60%
Rate of earnings increases*	4.55%	4.2%
Rate of future pension increases	2.55%	2.20%
Rate of return in excess of:		
Pension increases (CPI)	0.24%	1.37%
Earnings increases	(1.70)%	(0.60)%
Expected return on assets:	n/a	n/a

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

10. The pension increase assumptions up to and including 31 March 2017 are based on the Consumer Price Index (CPI) expectation of inflation.

Demographic assumptions

11. Table E summarises the demographic assumptions adopted to prepare this statement, which were derived from the specific experience of the scheme membership. The table refers to the standard mortality tables known as the 'S1 tables' with the percentage adjustments to those tables derived from scheme experience.

Table E – Post-retirement mortality assumptions

Member pensioners

Males	Officers: 88% of S1NMA mortality Other ranks: 118% of S1NMA mortality
Females	Officers: 88% of S1NFA mortality Other ranks: 118% of S1NFA mortality

Partners / Spouses

Males	Officers: 88% of S1NMA mortality Other ranks: 118% of S1NMA mortality
Females	Officers: 88% of S1NFA mortality Other ranks: 118% of S1NFA mortality

12. These assumptions are the same as those adopted for the 2015-16 Annual Report and Accounts. Mortality improvements are in accordance with those incorporated in the 2014-based principal population projections for the United Kingdom. This assumption is in line with the latest Office of National Statistics projections.
13. The contribution rate used to determine the accruing cost in 2016-17 was based on the demographic and financial assumptions applicable at the start of the year, that is, those adopted for the 2015-16 Annual Report and Accounts.

Liabilities

14. Table F summarises the assessed value as at 31 March 2017 of benefits accrued under the scheme prior to 31 March 2017 based on the data, methodology and assumptions described in paragraphs 9 to 13. The corresponding figures for the previous four year ends are also included in the table.

Table F – Statement of Financial Position

£ billion

	31 March 2017	31 March 2016	31 March 2015	31 March 2014	31 March 2013
Total market value of assets	nil	nil	nil	nil	nil
Value of liabilities	191.8	145.2	154.4	129.5	118.0
Surplus/(Deficit)	(191.8)	(145.2)	(154.4)	(129.5)	(118.0)
of which recoverable by employers	n/a	n/a	n/a	n/a	n/a

Accruing costs

15. The cost of benefits accrued in the year ended 31 March 2017 (the Current Service Cost) is based on a standard contribution rate of (for Officers) 52.6% and (for Other Ranks) 51.6%.
16. Table G shows the Current Service Cost, which is met fully by the employer. The corresponding figures for 2015-16 are also included in the table.

Table G – Contribution rate

Percentage of pensionable pay	1 April 2016 to 31 March 2017	1 April 2015 to 31 March 2016
	Officers	52.6%
Other Ranks	51.6%	54.4%

17. For the avoidance of doubt, the actual rates of contributions payable by employers, 52.4% (for Officers) and 49.6% (for Other Ranks) of pensionable pay for 2016-17, are not the same as the employers' share of the standard contribution rate as above (52.6% for Officers and 51.6% for Other Ranks for 2016-17). This is because the actual employer contribution rate was determined as part of a funding valuation using different assumptions. The key difference between the assumptions used for funding valuations and Annual Report and Accounts is the discount rate. The discount rate for Annual Report and Accounts is set each year by HM Treasury to reflect the requirements of the accounting standard IAS 19.
18. The pensionable payroll for the financial year 2016-17 was £5.6 billion (derived from contributions payable by employers over the year). Based on this information, the accruing cost of pensions in 2016-17 (at (for Officers) 52.6% and (for Other Ranks) 51.6% of pay) is assessed to be £2.9 billion.
19. There have been no past service costs in the year 2016-17.
20. I am not aware of any events that have led to a material settlement or curtailment gain over 2016-17.

Sensitivity analysis

21. The results of any actuarial calculation are inherently uncertain because of the assumptions which must be made. In recognition of this uncertainty I have been asked to indicate the approximate effects on the actuarial liability as at 31 March 2017 of changes to the most significant actuarial assumptions.
22. The most significant assumptions are the discount rate, general earnings increases and pension increases (currently based on CPI). A key demographic assumption is pensioner mortality.
23. As a result of recent and anticipated developments in relation to the Armed Forces workforce, there is significant uncertainty associated with timings of member exits (withdrawals and retirements) in future. Relatively few members of the AFPS remain in service until their normal pension age. However, a significant proportion retire with immediate benefits in the form of an Immediate Pension (IP) or Early Departure Payments (EDP), often from around age 40. The numbers of members reaching their IP or EDP qualification points could potentially have an impact on the scheme liabilities and so we have included an indication of the approximate effect (on the total past service liability) of a 5% increase in the number of new entrants reaching IP/EDP point compared to the main liability calculations.
24. Table H shows the indicative effects on the total liability as at 31 March 2017 of changes to these assumptions (rounded to the nearest %).

Table H - Sensitivity to significant assumptions

Change in assumption	Approximate effect on total liability		
Financial assumptions			
(i) discount rate*:	+½% a year	- 11%	- £20.7 billion
(ii) (long-term) earnings increase*:	+½% a year	+ 1%	+ £1.3 billion
(iii) pension increases*:	+½% a year	+ 11%	+ £20.4 billion
Demographic assumptions			
(iv) additional 1 year increase in life expectancy at retirement		+ 3%	+ £4.8 billion
(v) a 5% increase in the proportion of new entrants who reach IP/EDP point		+ 0%	+ £0.7 billion

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

Statement of Accounting Officer's Responsibilities

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

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

- Observe the accounts direction issued by HM Treasury including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- Make judgements and estimates on a reasonable basis;
- State whether applicable accounting standards, as set out in the FReM have been followed, and disclose and explain any material departures in the financial statements; and
- Prepare the financial statements on a going concern basis.

HM Treasury has appointed the Permanent Secretary of the Department as Accounting Officer for the Armed Forces Pension Scheme. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding the assets of the pension scheme, are set out in Managing Public Money published by HM Treasury.

The Governance Statement

Scope of Responsibilities

1. As the Accounting Officer for the Armed Forces Pension Scheme (AFPS) and the Armed Forces Compensation Scheme (AFCS), collectively “the Schemes”, I have responsibility for maintaining a sound system of governance that supports the achievement of the Schemes’ policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Managing Public Money. Where necessary I, or officials on my behalf, engage with HM Treasury officials on funding and policy issues pertaining to these Schemes.

2. In discharging this responsibility, I am responsible for putting in place proper arrangements for the governance of the Schemes’ affairs which facilitate the effective discharge of their statutory functions and which include arrangements for the management of risk.

3. The Schemes have adopted the Corporate Governance Code for Central Government as far as is practicable in the context of a pension scheme. The Executive Leadership Team have operated in accordance with the recognised precepts of good corporate governance: leadership, effectiveness, accountability and sustainability.

The Purpose of the Governance Framework

4. The governance framework comprises the systems and processes, and culture and values, by which the Schemes are administered and controlled. It also includes the activities by which they account to Parliament. The governance framework has been in place for the Schemes for the year ended 31 March 2017 and up to the date of the approval of the annual accounts.

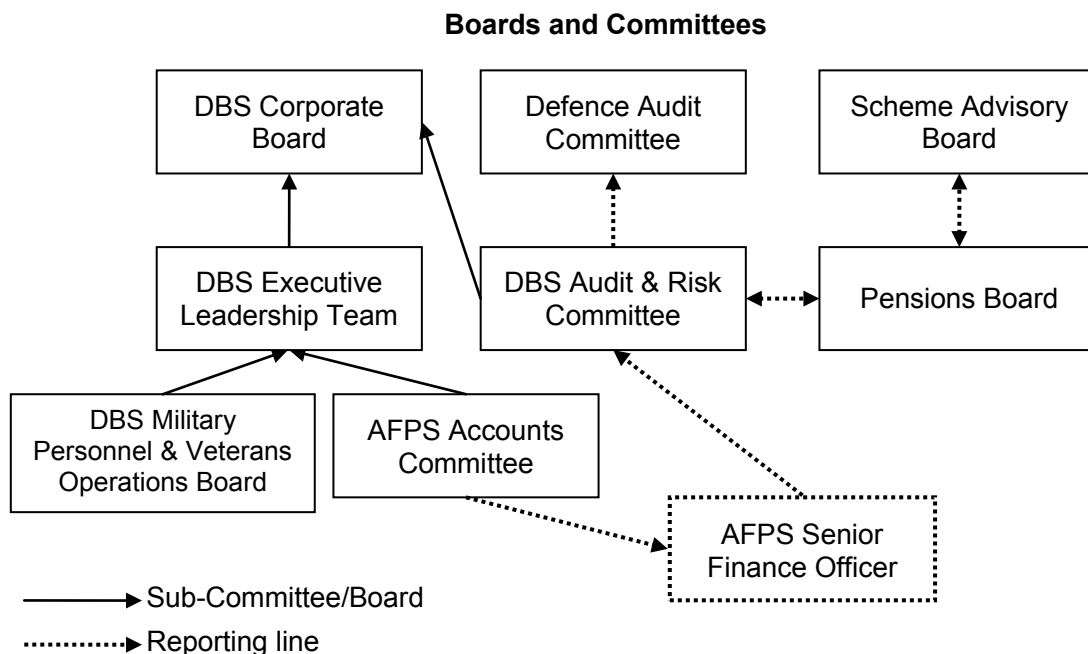
5. The system of internal control is a significant part of the governance framework and is designed to manage risk to a reasonable level. It cannot eliminate all risk of failure to achieve policies, aims and objectives and therefore can only provide reasonable, and not absolute, assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of the Schemes’ policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically.

The Schemes’ Governance Framework

6. I delegated budget holder and delivery authority responsibility of the Schemes to the Chief Executive Officer (CEO) of the Defence Business Services (DBS), who sub-delegated the administrative management of the Schemes to DBS Head of Veterans UK. Director General Finance delegated the role of Senior Finance Officer (SFO) for the Schemes to DBS Head of Resources.

7. The Ministry of Defence (MOD) had a contract with Serco Ltd to provide management services to DBS which ceased on 18 April 2016. Up to and including this date the CEO and a number of Executive appointments were made through Serco Ltd. From 19 April 2016 the CEO, Chief Operating Officer, Chief Information Officer and Transformation Director positions were filled by MOD Executives. The Chief People Officer Serco Executive was retained until 24 June 2016. All other Serco Executives left DBS on 18 April 2016 and did not attend any of the DBS Board / Committee meetings as members during 2016-17. Their details are, therefore, not included in Tables 1 and 2.

8. Administration of the Schemes is delivered through a combination of MOD civilian personnel and contractors, CSC Computer Sciences Ltd (CSC), via a commercial partnering agreement which came into effect on 11 November 2012. The arrangement for joint working with CSC is governed by commercial agreements and is managed by DBS Military Personnel & Veterans Operations Board (MP&V OB). On 3 April 2017, Computer Sciences Corporation (the parent company of CSC Computer Sciences Ltd) merged with the Enterprise Services business of Hewlett Packard Enterprise (HPE) to create DXC Technology. Effective on that date DXC Technology became the parent company of CSC Computer Sciences Ltd. The MOD remains contracted to CSC Computer Sciences Ltd and, therefore, from a contractual perspective the change will have no impact to DBS and the Schemes.



9. The **DBS Corporate Board** comprises of a Non-Executive Chair, two other Non-Executive Directors (NEDs), the DBS CEO, two DBS Executive Heads and the Head of MOD Corporate Services Transformation Team. The previous Non-Executive Chair and one of the previous Non-Executive Directors were members of the Board until 18 April 2016. They did not attend any meetings during 2016-17 and, therefore, their details are not included in Table 1. The Board oversees the conduct of business in DBS, supports and supervises the DBS executive management, leads on compliance with all applicable Government/Defence policies and governs and oversees the transformation programmes and service delivery issues. No specific review of Board performance was undertaken in 2016-17.

Table 1 – Composition of the DBS Corporate Board	Meetings Attended
Non-Executive Chair: Peter Shortt (from 19 April 2016)	4 of 4
Executive Members:	
Kathy Barnes, Chief Executive Officer	4 of 4
Tamsin Woodeson, Chief Operating Officer	3 of 4
Georgina Benzies, Head of Resources	4 of 4
Richard Vincent (until 27 January 2017) Head of MOD Corporate Services Transformation Team	3 of 3
Keith Dearness (from 20 February 2017) Deputy Head of MOD Corporate Services Transformation Team	1 of 1
John Cook (from 18 April 2016 to 28 February 2017) Head of Defence Assurance and Information Security	3 of 3
Non-Executive Directors:	
Paul Smith	3 of 4
Vivienne Bracken (from 1 February 2017)	1 of 1

10. The **DBS Executive Leadership Team (ELT)** is chaired by the CEO and comprises the Executive Heads of Department and the Schemes' SFO. The ELT is responsible for managing DBS within Corporate Board agreed financial limits, primary authority for day-to-day management of DBS, save for those matters reserved to the Corporate Board. The ELT meets once a month and convened 11 times between April 2016 and March 2017. No specific review of Committee performance was undertaken in 2016-17.

Table 2 – Composition of the DBS Executive Leadership Team	Meetings Attended
Chief Executive Officer: Kathy Barnes, (Chair)	11 of 11
Executives:	
Tamsin Woodeson, Chief Operating Officer	10 of 11
Pete Bennington, Chief Information Officer	9 of 11
Helen Hall (Serco) , Chief People Officer (until 24 June 2016)	2 of 2
Ben Kinley, Head of People Change & Development (from 31 May 2016)	8 of 11
Jenny Sandham, Transformation Director	9 of 11
Georgina Benzies, Head of Resources & Schemes' SFO	9 of 11
Jon Parkin, Head of Veterans UK (until 22 May 2016); Head of National Security Vetting (from 23 May 2016 until 31 December 2016); UK Security Vetting Chief Operating Officer (from 1 January 2017)	11 of 11
Rob Rowntree, Acting Head of Veterans UK (from 23 May 2016)	9 of 9
Andy Dowds, Head of Finance & Procurement Services	9 of 11
Commodore Ian Bisson, Head of Military Personnel (until 18 January 2017)	5 of 8
Brigadier Paul Burns, Head of Military Personnel (from 19 January 2017)	4 of 4
Andrew Stafford, Head of Civilian Personnel	11 of 11
Caroline Rummig, Head of National Security Vetting (until 22 May 2016)	2 of 2
Neil Watkinson, UK Security Vetting Managing Director (from 7 November 2016)	4 of 4
James Clare, UK Security Vetting Project (from 19 April 2016)	8 of 11
Kate Silver, UK Security Vetting Project (from 19 April 2016 until 31 December 2016)	2 of 8
Colonel Mike Sykes, Assistant Chief of Staff (from 19 April 2016 until 20 March 2017)	10 of 10

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

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

13. The **DBS Audit & Risk Committee (ARC)**, a sub-committee of the DBS Corporate Board, comprises of two Non-Executives and one MOD Executive, and is attended by members of the ELT. The chair of the Pensions Board also has a standing invitation and attends most committees. The ARC supports the CEO in discharging her responsibilities for Risk Control and Governance by reviewing the comprehensiveness, reliability and integrity of DBS's Risk and Assurance framework, agreeing priority risk areas for Defence Internal Audit (DIA) annual programme, reviewing the outcome of work by DIA and National Audit Office (NAO) and following progress on completion of actions. The ARC reviewed the 2016-17 AFPS Accounts prior to approval by the Defence Audit Committee. The Committee met six times between April 2016 and March 2017.

Table 3 – Composition of the DBS Audit & Risk Committee	Meetings Attended
Non-Executive Members:	
Paul Smith	6 of 6
Neville Mackay	6 of 6
MOD Executive Members:	
Richard Vincent (until 27 January 2017) Head of MOD Corporate Services Transformation Team	5 of 5
Keith Dearness (from 20 February 2017) Deputy Head of MOD Corporate Services Transformation Team	1 of 1

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

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

16. The DIA undertook an audit of ‘Overarching Governance and Oversight of AFPS’ in January 2017. Their report indicated a Substantial Assurance and that the framework of controls in place to ensure effective overarching governance and oversight of AFPS were established and found to be working as intended.

Financial Management

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

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

Risk Assessment

19. Risk assessment processes within DBS are in place throughout the year. Risks are identified and recorded on the business unit risk registers and are reviewed on a monthly basis by the MP&V OB. The most critical are escalated to the ELT where the impacts are assessed and appropriate mitigating action taken. The ARC has oversight of all risks raised within DBS. Any risks not capable of being

managed at Committee level would be escalated to the Chief of Defence People (CDP) and/or Director General Finance, and ultimately to me for action. No risks were escalated by DBS in 2016-17.

The Risk and Control Framework

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

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

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

23. The DBS Risk Management Strategy (Framework) v5.2 is compliant with MOD's Directive JSP892. During this period the ELT has continued to ensure that the seven key fundamental principles have been used to underpin the way that risks are managed within DBS:

- **Nested Risks and Associated Action Plans;**
A nested approach to risk management in accordance with the DBS Risk Governance structure, ensuring risks are owned from the business (Assistant Head) level through to DBS Senior Management level, with each level taking responsibility for mitigation actions within their scope of responsibility.
- **Clear Links to Governance Approach;**
Risks are managed throughout the DBS Governance structure ensuring that responsibilities and escalation routes are clearly identified within a formalised structure. This also includes Shared (MOD/Commercial Partner) risk. Risks are standing agenda items at a variety of DBS Governance forums, including the DBS Corporate Board, ELT, as well as within the Functional Governance areas of Operations, Transformation, People and Technology. The Minutes of the Boards record Actions, Decisions and Escalations and are used as a vehicle to provide feedback to the Risk Owner/Manager and to update the Risk Register.
- **Independent Quality Assurance;**
A dedicated Risk Management Team providing oversight and implementation of the Risk Management Strategy throughout DBS. Providing assurance and guidance to individual risk owners, and ensuring a risk management culture is embedded throughout DBS.
- **Managing Risk Volumes;**
The implementation of a nested risk structure ensuring that for each governance group handling risks, the number of risks remains manageable.
- **Risk Appetite & Thresholds;**
Definition of a risk appetite statement that is also expressed as a series of boundaries in time, cost and performance, with tolerance levels allowable for risk at differing levels of the organisation.
- **Risk Aggregation;**
Pillars being responsible for escalating risks which exceed their tolerances, and the DBS Risk Manager responsible for aggregating common risks from two or more pillars which collectively exceed the tolerance.
- **Management of Strategic Risks;**
Strategic risks are identified at any time at any level of the business, and then managed at the ELT.

Fraud

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

25. Since 2012/13 DBS has canvassed 76,000 pensioners to confirm their continuing entitlement to pension under the Scheme rules. The exercise was completed during 2013/14 and resulted in 782 pensions being withheld due to unreported deaths or other unreported changes in circumstances affecting pensioner's entitlement. Recovery of overpayments is being pursued on a case by case basis as each case is investigated. To date there are 633 pensions withheld with an annual saving valued at £2.6M per year. The policy for future exercises is currently under review with a view to a further exercise being undertaken during 2017-18 in relation to both AFPS and AFCS overseas members.

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

Information Assurance

27. Data is managed in accordance with the principles of HM Government's Information Assurance Maturity Model (IAMM) and Departmental Policies. The CEO is the Senior Information Risk Owner (SIRO) for DBS, with Information Asset Owners (IAOs) and DBS Risk Management (RM) Team supporting the SIRO. Information Assurance (IA) training remains a mandatory requirement. The IA team have produced additional training aids for Cyber Awareness, Security Briefing and specific IAO training and guidance.

28. The IA team continue to focus on the IA governance structure, IA risk management and upward reporting through the IAOs, DBS RM Team, SIRO, MOD Head Office & Corporate Services (HOCS) and to the MOD Chief Information Officer (CIO). Building on the identification of the information assets within DBS, Memorandum of Understandings (MOUs) are now in place with third parties and Delivery Partners responsible for handling DBS information assets and work is underway to implement a programme of assurance activity to ensure on-going protection of the information. The completion of Privacy Impact Assessments across DBS is now integrated. IAO Steering Group meetings continue on a quarterly basis to review IA risks and allow upward reporting to the DBS SIRO and HOCS.

29. Work continues to identify areas for improvement within IA across DBS and how IAMM is integrated across the Organisation. The Defence Assurance Information Security Team, on behalf of MOD SIRO, completed a review in July 2016 to assess IA maturity of DBS across the IAMM Framework. MP&V has been assessed as operating at IAMM Level 3. The IA team has a plan of action to address all recommendations from the report. The team also has a dashboard that clearly states the evidence DBS has against the measures under IAMM and Government Security Policy Framework (SPF). There is a scheduled plan to review all IA policies and procedures during 2017-18.

30. There have been three data losses reported during the year in relation to the Schemes. One incident involved two AFCS claim forms being returned to Tomlinson House by a DBS Vets Welfare

Office. These forms were posted using recorded mail and received at Tomlinson House, where they were subsequently lost. The customers were notified of the loss and the incident was evaluated as a serious incident. Another incident involved the loss of hospital case notes for an AFCS claimant by the Veterans UK Appeals Team. The customer was notified of the loss and the incident was evaluated as a serious incident. The final incident involved the loss of a copy death certificate for an AFCS death in service claim. The original death certificate was returned to the claimant. The claimant was not notified of the loss as death certificates are in the public domain and the loss related to a copy. The incident was evaluated as a minor incident.

Business Continuity

31. AFPS/AFCS output from DBS Norcross and Glasgow and the development and implementation of future Compensation and Pensions System (CAPS) pensions and allowances solutions at DBS Gosport, are governed by Business Continuity (BC) measures outlined in the DBS Business Continuity Management Strategy 2017-18. Business Impact Analysis (BIA) for the AFPS team in Glasgow and associated BIA for pensions operations at DBS Norcross are all complete and in-date.

32. The Disaster Recovery (DR) Plan for CAPS moved to Version 4.0 on 7 December 2016. It is subject to annual review and test in parallel with on-going CAPS transformation and was tested on 10 November 2016.

33. The CSC Business Process Outsourcing (BPO) Service Delivery BCP is currently at Version 10.0. This plan covers the Joint Personnel Administration Centre (JPA) Enquiry Centre (EC) and back-office pension activity.

34. The BPO pension team last underwent an exercise (to transfer work activity from Glasgow to Gosport) in September 2015. A similar exercise is in scope for 2017-18. There were no significant BC incidents affecting pensions' delivery during 2016-17.

Review of Effectiveness

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

36. During 2016-17 AFPS continued a programme of data cleansing activities to improve the accuracy and reliability of underlying membership data and minimise financial risk. The first Pension Board annual report was published, demonstrating that the Board continued to develop its capacity to provide an overview of pensions, improve communications and ensure compliance with scheme regulations. Last year we said we planned to review the AFPS annual Newsletter and this has now concluded, resulting in an improved content, design and layout.

37. The Department wanted to raise awareness of Scheme benefits to its members and motivate the Armed Forces community to start thinking about their pension throughout their service career, not just as they are reaching the end of it. In order to achieve this the 'Service to Civvy' publicity campaign was created and launched in December 2016. By the end of March 2017 the campaign had realised a social media reach of over 40,000 and over 6,000 direct views of the campaign videos on the various platforms. There has been a 10% uptake in requests for pension forecasts that can be directly attributed to the campaign and a notable rise in deferred pension applications since its launch.

Internal Audit

38. The AFPS assurance programme was developed by DIA with the support of PricewaterhouseCoopers and commenced in 2013-14. The programme is intended to form the basis of a rolling year on year programme of assurance, undertaken by DIA. The programme has been reviewed by the Pensions Board Chair and the DBS ARC, with progress reports regularly taken by the DBS ARC throughout 2016-17. The Head of DIA, or one of his senior managers, attends meetings of the ARC and provides expert advice on audit issues.

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

40. DIA reported that largely adequate and effective controls were in place for most of the pension administration processes and governance arrangements examined. These included awarding preserved pensions, resolution of internal disputes, providing information to members, application of legislative changes and the overarching governance and oversight of AFPS.

41. However, some significant weaknesses were identified in the processes surrounding Debt Management, which resulted in that audit receiving a limited assurance opinion. The DIA supported the actions being undertaken to address findings in this area.

42. DIA also reported that AFPS management continued to support improvements to control, with all of the agreed management actions in follow up audits having been implemented. This included the actions in relation to the Manage Payment to the Children of Deceased Service Personnel Audit, which had received a No assurance opinion and been a major contributing factor to the overall Limited Assurance opinion given in the AFPS Annual Audit Report for the previous financial year. It also included actions in relation to the Data Assurance and the Pension on Divorce Audits, both of which received a Limited Assurance opinion.

Significant Governance Issues

43. In response to the DIA's findings relating to Debt Management process weaknesses, management is taking steps to address them. Other than this issue identified by the DIA, and ongoing work to address membership data quality, I am pleased to report that there have been no other significant governance issues arising during 2016-17. Overall I have drawn assurance from the controls in place to govern the Schemes and I am content that there has been no reduction in their effectiveness.

Future Improvements

44. Following the 'Service to Civvy' publicity campaign further enhancements to the online calculators are planned to ensure they reflect the current campaign, changing demands and address legislative changes. These upgrades will improve functionality and the efficiency of Scheme administration. The next phase of the campaign will use external media channels, focusing on feedback and volumetrics to measure success.

45. In order to further enhance the Tell Us Once service, Veterans UK are seeking to improve the customer reporting functions, thereby reducing the level of notifications received that do not relate to the AFPS, which in turn will reduce administration.

46. Further opportunities will be taken to improve the overall quality of membership data. This includes, as part of the Membership Data Improvement programme, an ongoing exercise to trace individuals who have not yet claimed their pension and those who have moved away from the last known address held by the Scheme. In addition, a further Life Certificate exercise is planned for 2017-18 for overseas members.

Summary

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

Statement of Parliamentary Supply

Summary of Resource Outturn 2016-17

This section has been subject to audit

£000								2016-17	2015-16
	Estimate				Outturn			Voted outturn compared with Estimate: saving/ (excess)	Outturn
	Note	Voted	Non-Voted	Total	Voted	Non-Voted	Total		
Annually Managed Expenditure	SOPS1	5,363,454		5,363,454	5,335,791		5,335,791	27,663	5,916,926
- Resource									
Total Budget		5,363,454		5,363,454	5,335,791		5,335,791	27,663	5,916,926
Non-Budget									
-Resource									
Total		5,363,454		5,363,454	5,335,791		5,335,791	27,663	5,916,926

Net Cash Requirement 2016-17

£000	Note	2016-17	2016-17		2015-16
		Estimate	Outturn	Outturn compared with Estimate savings/ (excess)	Outturn
	SOPS2	1,509,181	1,496,740	12,441	1,572,881

Administration Costs 2016-17

2016-17	2016-17	2015-16
Outturn	Estimate	Outturn
-	-	-

As explained in the Report of the Managers on page 4, the costs of administering the Schemes are borne by the MOD and are reflected in the Department's Annual Report and Accounts.

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

The Notes on page 28 form part of this Statement.

Notes to the Statement of Parliamentary Supply

SOPS1. Analysis of net resource outturn by section

£000	2016-17									2015-16 Outturn
	Outturn						Estimate		Total	
	Administration			Programme			Total	Net Total		Net total compared to Estimate
Gross	Income	Net	Gross	Income	Net					
Spending in Departmental Expenditure Limit Voted:	-	-	-	-	-	-	-	-	-	-
Non Voted:	-	-	-	-	-	-	-	-	-	-
Annually Managed Expenditure Voted:										
A: Retired pay, pensions and other payments to ex-service personnel	-	-	-	8,295,423	(2,959,632)	5,335,791	5,335,791	5,363,454	27,663	5,916,926
Non Voted:	-	-	-	-	-	-	-	-	-	-
Total	-	-	-	8,295,423	(2,959,632)	5,335,791	5,335,791	5,363,454	27,663	5,916,926

SOPS2. Reconciliation of Net Resource Outturn to Net Cash Requirement

	Note	Estimate £000	Outturn £000	Net Total outturn compared with Estimate: savings/ (excess) £000
Net Resource Outturn	SOPS1	5,363,454	5,335,791	27,663
Accruals adjustments:				
Non cash items		(8,263,106)	(8,295,423)	32,317
Changes in working capital other than cash		(922)	10,770	(11,692)
Use of provision:				
Pension		4,319,588	4,365,009	(45,421)
Compensation Scheme		90,167	80,593	9,574
Net cash requirement		1,509,181	1,496,740	12,441

Parliamentary Accountability Disclosures

This section has been subject to audit.

Losses and Special Payments

	2016-17	2015-16
Total number of losses	2,381	4,368
Total value of losses (£'000)	306	159

There were no individual losses greater than £300,000 or special payments.

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

I certify that I have audited the financial statements of the Armed Forces Pension Scheme (incorporating the Armed Forces Compensation Scheme), for the year ended 31 March 2017 under the Government Resources and Accounts Act 2000. The financial statements comprise: the Combined Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity; and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the Statement of Parliamentary Supply and related notes, and the information in the Parliamentary Accountability disclosures that is described as having been audited.

Respective responsibilities of the Accounting Officer and auditor

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

Scope of the audit of the financial statements

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

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

Opinion on regularity

In my opinion, in all material respects:

- the Statement of Parliamentary Supply properly presents the outturn against voted Parliamentary control totals for the year ended 31 March 2017 and shows that those totals have not been exceeded; and
- the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on financial statements

In my opinion:

- the financial statements give a true and fair view of the state of the Scheme's affairs as at 31 March 2017 and of its net operating cost for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions issued thereunder.

Opinion on other matters

In my opinion:

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

Matters on which I report by exception

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

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

Report

I have no observations to make on these financial statements.

Sir Amyas C E Morse
Comptroller and Auditor General

3 July 2017

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

Combined Statement of Comprehensive Net Expenditure

for the year to 31 March 2017

		2016-17	2015-16
	Note	<u>£000</u>	<u>£000</u>
Principal Arrangements – Armed Forces Pension Scheme			
Income			
Contributions receivable	3	(2,957,714)	(2,916,315)
Transfers In	4	(1,918)	(847)
Expenditure			
Current Service cost	5	2,926,936	3,052,506
Past Service cost	5	-	200,000
Enhancements	6	1,213	1,009
Transfers In	7	1,918	847
Pension financing cost	8	5,202,042	5,459,139
Net Expenditure		<u>5,172,477</u>	<u>5,796,339</u>
Armed Forces Compensation Scheme			
Movement in provision for AFCS	15	112,825	71,003
Compensation financing cost	15	50,489	49,584
Net Expenditure		<u>163,314</u>	<u>120,587</u>
Combined Net Expenditure	SOPS1	<u>5,335,791</u>	<u>5,916,926</u>
Other Comprehensive Net Expenditure			
Pension re-measurements:			
Actuarial loss / (gain) – Armed Forces Pension Scheme	12.7	42,832,900	(13,591,808)
Actuarial loss / (gain) – Armed Forces Compensation Scheme	15	487,027	(30,231)
Total Comprehensive Net Expenditure for the year ended 31 March 2017		<u>48,655,718</u>	<u>(7,705,113)</u>

The Notes on pages 35 to 45 form part of these accounts.

Combined Statement of Financial Position

as at 31 March 2017

		2017	2016
	Note	£000	£000
Principal arrangements – Armed Forces Pension Scheme			
Current assets:			
Receivables	9	271,053	249,650
Cash and cash equivalents	10	12,441	65,036
Total current assets		<u>283,494</u>	<u>314,686</u>
Current liabilities:			
Payables	11	(551,874)	(594,116)
Total current liabilities		<u>(551,874)</u>	<u>(594,116)</u>
Net current liabilities, excluding pension liability		<u>(268,380)</u>	<u>(279,430)</u>
Pension liability	12.4	(191,800,000)	(145,200,000)
Net liabilities, including pension liabilities		<u>(192,068,380)</u>	<u>(145,479,430)</u>
Armed Forces Compensation Scheme			
Receivables	13	903	329
Payables (within 12 months)	14	(2,377)	(1,523)
Provisions for liabilities and charges	15	(1,982,016)	(1,412,268)
Net liabilities		<u>(1,983,490)</u>	<u>(1,413,462)</u>
Combined Schemes – Total net liabilities		<u>(194,051,870)</u>	<u>(146,892,892)</u>
Taxpayers' equity:			
General fund		(194,051,870)	(146,892,892)
		<u>(194,051,870)</u>	<u>(146,892,892)</u>

Stephen Lovegrove
Accounting Officer for the AFPS and AFCS

26 June 2017

The Notes on pages 35 to 45 form part of these accounts.

Combined Statement of Changes in Taxpayers' Equity

for the year ended 31 March 2017

		2016-17	2015-16
	Note	£000	£000
Balance at 1 April		(146,892,892)	(156,170,886)
Net Parliamentary Funding – drawn down		1,444,145	1,636,721
Net Parliamentary Funding – deemed		65,036	1,196
Supply payable adjustment	10	(12,441)	(65,036)
Excess Vote – Prior Year		-	-
CFERs payable to the Consolidated Fund		-	-
Contingencies Fund Advance		438,193	100,000
Repayment to the Contingencies Fund		(438,193)	(100,000)
Combined Net Expenditure for the Year	SOPS1	(5,335,791)	(5,916,926)
Actuarial (loss) / gain – Armed Forces Pension Scheme	12.7	(42,832,900)	13,591,808
Actuarial (loss) / gain – Armed Forces Compensation Scheme	15	(487,027)	30,231
Net change in Taxpayers' Equity		(47,158,978)	9,277,994
Balance at 31 March		(194,051,870)	(146,892,892)

The Notes on pages 35 to 45 form part of these accounts.

Combined Statement of Cash Flows

for the year ended 31 March 2017

		2016-17	2015-16
	Note	£000	£000
Cash flows from operating activities			
Combined net expenditure for the year	SOPS1	(5,335,791)	(5,916,926)
Adjustments for non-cash transactions:			
Increase in receivables – principal arrangements	9	(21,403)	(89,824)
(Increase) / Decrease in receivables - AFCS	13	(574)	(45)
Increase in payables – principal arrangements	11	10,353	2,977
Increase / (Decrease) in payables – AFCS	14	854	(747)
Increase in pension provision	12.4	8,128,978	8,711,645
Increase in pension provision – enhancements and transfers in	12.4	3,131	1,856
Use of provisions – pension liability	12.5	(4,357,009)	(4,281,599)
Use of provisions – refunds and transfers	12.6	(8,000)	(40,094)
Increase in provisions – compensation Scheme	15	163,314	120,587
Use of provisions – compensation Scheme	15	(80,593)	(80,711)
Net cash outflow from operating activities		(1,496,740)	(1,572,881)
Cash flows from financing activities			
From the Consolidated Fund (Supply): current year		1,444,145	1,636,721
From the Contingencies Fund		438,193	100,000
Repayment to the Contingencies Fund		(438,193)	(100,000)
Net Financing		1,444,145	1,636,721
Net (Decrease) / Increase in cash and cash equivalents in the period before adjustment for receipts and payments to the Consolidated Fund		(52,595)	63,840
Receipts due to the Consolidated Fund which are outside the scope of the Scheme's activities		-	-
Payments of amounts due to the Consolidated Fund		-	-
Net (Decrease) / Increase in cash and cash equivalents in the period after adjustment for receipts and payments to the Consolidated Fund	10	(52,595)	63,840
Cash and cash equivalents at the beginning of the period	10	65,036	1,196
Cash and cash equivalents at the end of the period	10	12,441	65,036

The Notes on pages 35 to 45 form part of these accounts.

Notes to the Accounts

1. Basis of Preparation of the Scheme Financial Statements

The financial statements of the combined Scheme have been prepared in accordance with the relevant provisions of the 2016-17 Government Financial Reporting Manual (FReM) issued by HM Treasury. The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector. IAS 19 Employee Benefits and IAS 26 Accounting and Reporting by Retirement Benefit Plans are of particular relevance to these statements.

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

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

1.2 Contributions to the Scheme by employers are set at rates determined by the Scheme's Actuary and approved by HM Treasury. The contributions partially fund payments made by the Scheme, the balance of funding being approved by Parliament through the annual Supply Estimates process.

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

1.4 The financial statements of the Scheme show the financial position of the AFPS at the year end and the income and expenditure during the year. The Statement of Financial Position shows the unfunded net liabilities of the Scheme; the Statement of Comprehensive Net Expenditure shows, amongst other things, factors contributing to the change in the net liability analysed between the pension cost, enhancements and transfers in, and the Interest on the Scheme liability. Further information about the actuarial position of the Scheme is dealt with in the Report of the Actuary, and the Scheme financial statements should be read in conjunction with that Report.

1.5 The Armed Forces Compensation Scheme (AFCS) provides payments to Scheme members in compensation for deaths and injuries, occurring on or after 6 April 2005 and which are considered to be attributable to service in the Armed Forces.

1.6 The AFCS is accounted for in the same way as the AFPS. Contributions are received by employers at rates set by the Scheme's Actuary, with the remaining balance of funding being approved by Parliament through the annual Supply Estimates process. Administration costs for the AFCS are also borne by MoD and are reported in the Department's Statement of Comprehensive Net Expenditure (SoCNE).

2. Statement of accounting policies

The accounting policies contained in the FReM follow IFRS to the extent that they are meaningful and appropriate in the public sector context.

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 Scheme financial statements.

2.1 Contributions receivable

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

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

2.2 Transfers in

Transfers in to 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

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

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 Statement of Comprehensive Net Expenditure. The cost is based on a discount rate of 3.6% real (i.e. 1.37% including inflation), this was 1.3% (3.55% including inflation) in 2015-16.

2.5 Past service costs

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 SoCNE on a straight line basis over the period in which increases in benefit vests.

2.6 Pension financing cost

The financing 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 Statement of Comprehensive Net Expenditure. The financing cost is based on the discount rate of 3.6% real (i.e. 1.37% including inflation), this was 1.3% (3.55% including inflation) in 2015-16.

2.7 Other expenditure

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 credit method and as at 31 March 2016 was discounted at 3.6% real (i.e. 1.37% including inflation). The discount rate changed on 31 March 2017 to 2.8% real (i.e. 0.24% including inflation) and the Scheme liability was discounted at this rate. Further details of the financial assumptions used are set out at Note 12 to these accounts and in the Report of the Actuary on pages 13 to 17.

2.8.2 Full actuarial valuations by a professionally qualified actuary are typically obtained at intervals not exceeding four years. The most recent actuarial valuation was carried out as at 31 March 2012. The actuary reviews the most recent actuarial valuation at the Statement of Financial Position date and updates it to reflect current conditions.

2.9 Pension benefits payable

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

2.10 Unclaimed pension benefits

Unclaimed pension benefits are accounted for as a decrease in the Scheme liability on an accruals basis for up to seven years past pension entitlement age.

2.11 Pension payments to those retiring at their normal retirement age

Under the AFPS 15 Scheme members do not automatically receive a lump sum, but are given the choice to convert pension income into a tax-free lump sum. For all other Schemes a retiring member has no choice over the allocation of benefits awarded 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.

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

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 as long as the receiving scheme is not a funded defined contribution scheme. Transfers out of the Scheme are accounted for on a cash basis as a reduction in Scheme liability.

2.13 Lump sums payable on death in service

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.

2.14 Actuarial gains and losses

Actuarial gains and losses arising from any new valuation and from updating the latest actuarial valuation to reflect conditions at the Statement of Financial Position date are recognised in the Statement of Comprehensive Net Expenditure for the year.

2.15 Armed Forces Compensation Scheme

A provision is made within these accounts to provide for payments due to Scheme members in compensation for deaths and injuries, occurring on or after 6 April 2005 and which are considered to be attributable to service in the Armed Forces.

2.16 Cash and cash equivalents

Cash and cash equivalents comprise of cash in hand and current balances with banks and similar institutions, which are readily convertible to cash and are subject to insignificant risk of changes in value and have an original maturity of three months or less. For the purpose of the consolidated cash flow statement, cash and cash equivalents are stated net of bank overdrafts. Where relevant, bank overdrafts are included within payables on the Combined Statement of Financial Position, and separately disclosed within note 10.

3. Contributions receivable

	<u>2016-17</u>	<u>2015-16</u>
	£000	£000
Employer	2,956,501	2,915,306
Employees:		
Purchase of added pension and years	1,213	1,009
	<u>2,957,714</u>	<u>2,916,315</u>

£2.98Bn contributions are expected to be payable to the Scheme in 2017-18.

During the year ended 31 March 2017, employer contributions represented an average of 52.5% of pensionable pay (2015/16: 52.4%).

4. Transfers-in (see also Note 7)

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

	2016-17	2015-16
	<u>£000</u>	<u>£000</u>
Individual transfers in from other Schemes	1,918	847
	<u>1,918</u>	<u>847</u>

5. Service Cost

	2016-17	2015-16
	<u>£000</u>	<u>£000</u>
Current service cost (see Note 12.4)	2,926,936	3,052,506
Past service cost (see Note 12.4)	-	200,000
	<u>2,926,936</u>	<u>3,252,506</u>

6. Enhancements (see also Note 12.4)

	2016-17	2015-16
	<u>£000</u>	<u>£000</u>
Purchase of added pension and years	1,213	1,009
	<u>1,213</u>	<u>1,009</u>

7. Transfers in – additional liability

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

	2016-17	2015-16
	<u>£000</u>	<u>£000</u>
Individual transfers in from other schemes	1,918	847
	<u>1,918</u>	<u>847</u>

8. Pension financing cost (see also Note 12.4)

	2016-17	2015-16
	<u>£000</u>	<u>£000</u>
Net interest on defined benefit liability	5,202,042	5,459,139
	<u>5,202,042</u>	<u>5,459,139</u>

Statement of Financial Position – Armed Forces Pension Scheme

9. Receivables

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.

	2017	2016
	<u>£000</u>	<u>£000</u>
Amounts falling due within one year:		
Overpaid pensions	8,369	5,231
Bereavement Scholarship Scheme	398	201
Ministry of Defence – SCAPE & AVC receipts and Transfers In	243,636	242,292
Prepayments	16,536	-
	<u>268,939</u>	<u>247,724</u>
Amounts falling due after more than one year:		
Overpaid pensions	2,114	1,926
	<u>271,053</u>	<u>249,650</u>

10. Cash and cash equivalents

	2017	2016
	<u>£000</u>	<u>£000</u>
Balance at 1 April	65,036	1,196
Net change in cash balances	(52,595)	63,840
Balance at 31 March	<u>12,441</u>	<u>65,036</u>
The following balances at 31 March were held at:		
Government Banking Services	12,441	65,036
Balance at 31 March	<u>12,441</u>	<u>65,036</u>

11. Payables

	2017	2016
	<u>£000</u>	<u>£000</u>
Amounts falling due within one year:		
Pensions	437,836	438,311
HM Revenue & Customs	64,843	59,501
Third party organisations	872	866
Ministry of Defence	35,882	30,402
	<u>539,433</u>	<u>529,080</u>
Amounts issued from the Consolidated Fund for supply but not spent at year end	12,441	65,036
	<u>551,874</u>	<u>594,116</u>

12. Pension Liabilities

12.1 Assumptions underpinning the pension liability

The Armed Forces Pension Scheme is an unfunded defined benefit scheme. The Government Actuary's Department carried out an assessment of the Scheme liabilities as at 31 March 2017. The Report of the Actuary on pages 13 to 17 sets out the scope, methodology and results of the work the Actuary has carried out.

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

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

The key assumptions used by the Actuary were:

	At 31 March 2017	At 31 March 2016	At 31 March 2015	At 31 March 2014	At 31 March 2013
Long term rate of increase in salaries	4.55%	4.2%	4.2%	4.5%	3.95%
Inflation assumption	2.55%	2.2%	2.2%	2.5%	1.7%
Discount rate net of pension increases	0.24%	1.37%	1.3%	1.8%	2.35%
Mortality rate at age 60					
- Current Pensioners	Years	Years	Years	Years	Years
• Officers Men	29.5	29.4	29.6	29.3	29.2
• Officers Women	31.6	31.5	32.1	31.8	32.6
• Other Ranks Men	26.9	26.8	26.9	27.4	27.1
• Other Ranks Women	29.0	28.9	29.4	29.9	30.5
- Future Pensioners (from active status) *					
• Officers Men	31.1	31.0	31.9	31.6	31.7
• Officers Women	33.2	33.1	34.4	34.1	35.2
• Other Ranks Men	28.5	28.4	29.1	29.7	29.5
• Other Ranks Women	30.6	30.4	31.6	32.2	33.0

* Life expectancies for active members have been calculated from age 60 based on members aged 45 as at 31 March 2017, or aged 40 at earlier accounting dates.

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

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

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

12.2 Analysis of the pension liability

	At 31 March 2017 £Bn	At 31 March 2016 £Bn	At 31 March 2015 £Bn	At 31 March 2014 £Bn	At 31 March 2013 £Bn
Pensions in Payment	103.7	73.8	92.3	74.0	69.2
Deferred Pensions	32.3	23.8	25.0	22.1	17.2
Active Members (Past Service)	55.8	47.6	37.1	33.4	31.6
Total	191.8	145.2	154.4	129.5	118.0

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

The value of the liability on the Statement of Financial Position may be significantly affected by even small changes in assumptions. For example, if at a subsequent valuation, it is considered appropriate to increase or decrease the assumed rate of inflation, or increases in salaries, the value of the pension liability will increase or decrease. The managers of the Scheme accept that, as a consequence, the valuation provided by the Actuary is inherently uncertain. The increase or decrease in future liability charged or credited for the year resulting from changes in assumptions is disclosed in notes 12.7 and 12.8. The notes also disclose 'experience' gains or losses for the year, showing the amounts charged or credited for the year because events have not coincided with assumptions made for the last valuation.

12.3 Sensitivity Analysis

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

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

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

The table below shows the indicative effects on the total liability as at 31 March 2017 of changes to these assumptions (rounded to the nearest ½%).

Change in assumption	Approximate effect on total liability		
Financial assumptions			
(i) discount rate*	+½% a year	- 11%	- £20.7 billion
(ii) long term earnings increases*	+½% a year	+ 1%	+ £1.3 billion
(iii) pension increases*	+½% a year	+ 11%	+ £20.4 billion
Demographic assumptions			
(iv) additional one year increase to life expectancy at retirement*		+ 3%	+ £4.8 billion
(vi) a 5% increase in the proportion of new entrants who reach IP/EDP point		+ 0%	+ £0.7 billion

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

12.4 Analysis of movements in the Scheme liability

	2016-17	2015-16
	£000	£000
Scheme liability as at 1 April	(145,200,000)	(154,400,000)
Current service cost (Note 5)	(2,926,936)	(3,052,506)
Past service cost (Note 5)	0	(200,000)
Pension financing cost (Note 8)	(5,202,042)	(5,459,139)
Enhancements (Note 6)	(1,213)	(1,009)
Pension transfers in (Note 7)	(1,918)	(847)
	<u>(8,132,109)</u>	<u>(8,713,501)</u>
Benefits payable (Note 12.5)	4,357,009	4,281,599
Pension payments to and on account of leavers (Note 12.6)	8,000	40,094
	<u>4,365,009</u>	<u>4,321,693</u>
Actuarial (loss) / gain (Note 12.7)	(42,832,900)	13,591,808
Scheme liability at 31 March	(191,800,000)	(145,200,000)

12.5 Analysis of benefits paid

	2016-17	2015-16
	£000	£000
Pensions to retired employees and dependants (net of recoveries or overpayments)	3,999,748	3,866,751
Commutations and lump sum benefits on retirement	357,261	414,848
Total benefits paid	4,357,009	4,281,599

12.6 Analysis of payments to and on account of leavers

	2016-17	2015-16
	<u>£000</u>	<u>£000</u>
Individual transfers to other Schemes	8,000	40,094
Total payments to and on account of leavers	<u>8,000</u>	<u>40,094</u>

12.7 Analysis of actuarial (loss) / gain

	2016-17	2015-16
	<u>£000</u>	<u>£000</u>
Experience (losses) / gains arising on Scheme liabilities	(532,900)	3,591,808
Changes in assumptions underlying the present value of Scheme liabilities	(42,300,000)	10,000,000
Total actuarial (loss) / gain	<u>(42,832,900)</u>	<u>13,591,808</u>

12.8 History of experience (gains) / losses

	2016-17	2015-16	2014-15	2013-14	2012-13
Experience losses / (gains) on Scheme liabilities: (£000)	532,900	(3,591,808)	4,195,339	(3,005,056)	(42,737)
Percentage of the present value of the Scheme liabilities	0.28%	(2.47%)	2.72%	(2.32%)	(0.04%)
Losses / (Gains) arising due to changes in actuarial assumptions: (£000)	42,300,000	(10,000,000)	16,800,000	11,400,000	9,200,000
Percentage of the present value of the Scheme liabilities	22.05%	(6.89%)	10.88%	8.80%	7.80%
Total amount recognised in Combined Statement of Comprehensive Net Expenditure: (£000)	42,832,900	(13,591,808)	20,995,339	8,394,944	9,242,737
Percentage of the present value of the Scheme liabilities	22.33%	(9.36%)	13.60%	6.48%	7.83%
Total cumulative actuarial loss / (gain): (£000)	103,166,347	60,333,447	73,925,255	52,929,916	44,534,972

Statement of Financial Position – Armed Forces Compensation Scheme

13. Receivables

	2017	2016
	<u>£000</u>	<u>£000</u>
Amounts falling due within one year:		
Overpaid compensation	903	329
	<u>903</u>	<u>329</u>

14. Payables

	<u>2017</u>	<u>2016</u>
	£000	£000
Amounts falling due within one year:		
Compensation	2,377	1,523
	<u>2,377</u>	<u>1,523</u>

15. Provision for liabilities and charges

Armed Forces Compensation Scheme

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

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

Assumptions underpinning the provision for AFCS liability

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

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

% per annum	31 March 2017	31 March 2016
Gross discount rate	2.8%	3.60%
CPI inflation	2.55%	2.20%
GIP increases	2.55%	2.20%
Discount rate net of CPI	0.24%	1.37%
Discount rate net of GIP increases	0.24%	1.37%

The key demographic assumption is in respect of mortality. The mortality assumptions adopted follow a consistent approach to the AFPS mortality assumptions for resource accounting as at 31 March 2017. The levels of future mortality improvement have been assumed in accordance with the improvements incorporated in the published 2014-based principal population projections for the United Kingdom (prepared by Office of National Statistics).

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

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

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

	2016-17	2015-16
	£000	£000
AFCS Provision		
Balance at 1 April	(1,412,268)	(1,402,623)
Use of provision in year	80,593	80,711
Interest on Scheme Liabilities	(50,489)	(49,584)
Revaluation at year end	(112,825)	(71,003)
Actuarial (loss) / gain	(487,027)	30,231
Balance at 31 March	(1,982,016)	(1,412,268)
Breakdown of Balance at 31 March:		
Incidents incurred but not yet claimed – Lump Sums and Guaranteed Income Payments	(158,416)	(147,668)
Guaranteed Income Payments – “In Payment”	(1,594,800)	(1,064,400)
Guaranteed Income Payments – “Underlying Entitlement”	(228,800)	(200,200)
	(1,982,016)	(1,412,268)

16. Financial Instruments

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

17. Contingent Liabilities disclosed under IAS 37

In 2015-16 a Contingent Liability of £1.5Bn was reported in respect of the European Court of Human Rights Gurkha judgment. This has now been removed as the outcome was in MOD's favour, and was a final decision that has no further right of appeal.

18. Related-party transactions

The Schemes fall within the ambit of the MOD which is regarded as a related party, and the Schemes have had various material transactions with the Department during the year.

During 2016-17, the Schemes received employer contributions (SCAPE) and employees' contributions from MOD in respect of active members of the AFPS. These contributions totalled £2.96Bn (see Note 3).

AFPS also made repayment to MOD in regards to benefits that had been paid by MOD on behalf of the AFPS. For transactions relating to 2016-17 these totalled £435.6M.

None of the managers of the Schemes, key managerial staff or other related parties has undertaken any material transactions with the Schemes during the year. Certain key managerial staff and members of the Executive Committee are members of the Scheme. The benefits they are entitled to are not different to other members of the Scheme.

19. Date of authorisation for issue

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

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