

Armed Forces Pension Scheme

(Incorporating the Non-Regular Permanent Staff Pension Scheme and the Army Careers Officers Pension Scheme)

Resource Accounts 2004-05

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Pension Scheme and the Army Careers Officers
Pension Scheme)**

Resource Accounts 2004-05

(For the year ended 31 March 2005)

*Ordered by the House of Commons to be printed
20 July 2005*

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Foreword

History and Statutory Background

The Armed Forces Pension Scheme (AFPS) is a salary-related, contracted out, occupational pension scheme open to most members of the Armed Forces. The Scheme is designed to meet the special requirements of Service life. Youth and fitness are important to the Services, and the Scheme provides immediate pension benefits to many of those who leave without completing a full career. The full career pension can be earned relatively early, at age 55, and invaliding and death benefits are available in the event of illness, injury or death, at different rates depending upon whether or not these are caused by service.

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

Principal Purpose and Administrative Aim

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

The Executive Board

The AFPS is managed and operated by AFPAA, an Agency within the MoD. The costs of administering the Scheme are borne by the MoD and are reflected in the Departmental Resource Accounts (DRAc). The Chief Executive of AFPAA has been designated by the Departmental Accounting Officer to be the Scheme Administrator and Senior Finance Officer for the AFPS. The Executive Board meets regularly to determine strategy, set objectives and review performance towards strategic goals. The Executive Board consists of:

Rear Admiral T A Spires	Chief Executive
Mr P D Northen	Agency Secretary / Deputy Chief Executive
Air Commodore I Harvey BSc RAF	Director Operations
Air Commodore J D Tonks BSc RAF	Director Joint Personnel Administration
Brigadier A D Harking OBE	Director Strategy, Requirements and Programmes
Dr P Collins (appointed on 1 April 04)	Deputy Director Joint Personnel Administration
Mr A L Maynard	Deputy Director Finance and Corporate Governance
Mr K J Ludlam	Non Executive Director

Other Schemes

The Scheme Statements summarise the transactions of not only the AFPS but also two smaller pension schemes, the Non-Regular Permanent Staff Pension Scheme (NRPS) and the Army Careers Officers Pension Scheme (ACOPS), also managed and operated by AFPAA, whose members amount to 0.43% of the AFPS total membership.

Auditors

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

Kevin Tebbit
Accounting Officer for the Armed Forces Pension Scheme
30 June 2005

Report of the Scheme Managers

Introduction

The AFPS is an unfunded, salary-related, contracted-out occupational pension scheme open to most members of the Armed Forces, administered by AFPAA and financed on an annual basis by the Consolidated Fund.

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

The above Instruments and Regulations apply to service personnel of the MoD only.

Further information about the Scheme is given in the explanatory booklet entitled: "Your Pension Scheme Explained", which is issued to all members and is available, on request, from the Scheme Administrator.

Managers, Advisers and Employers

Managers:

Accounting Officer:

Sir Kevin Tebbit KCB CMG
Permanent Secretary
Ministry of Defence
Whitehall
London SW1A 2HB

Finance Director:

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

Scheme Administrator:

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

Pension Policy:

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

Advisers:

Scheme Actuary:

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

Bankers:

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

Legal Advisers:

MoD Treasury Solicitors
Ministry of Defence
Whitehall
London SW1A 2HB

Auditor:

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

Employers:

Ministry of Defence

Changes to the Scheme

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

Pensions were increased by 2.8% (2003 1.7%) with effect from 12 April 2004 (7 April 2003).

Post balance sheet events

Following a decision by the Financial Reporting Advisory Board that the discount rate for pensions should, in accordance with FRS17, be based on the AA corporate bond rate, the discount rate has been changed with effect from 1 April 2005 from a real rate of 3.5% to a real rate of 2.8%. As a result, the pension liability at 1 April 2005 is estimated to have increased by £10bn. It is also estimated that the current service cost will increase by some £331m, although the interest charge should reduce by some £417m.

From 6 April 2005, there will be two Armed Forces Pension schemes for members of the Regular Armed Forces. The first scheme was introduced in 1975 and will be closed to new entrants from 6 April 2005. This scheme is known as AFPS 75. On 6 April 2005 a new scheme will be introduced for new entrants, known as the Armed Forces Pension Scheme 2005 (AFPS 05). Members of the AFPS 75 will be given the opportunity to transfer to AFPS 05 on 6 April 2006.

Membership statistics

There are three groups of members, defined as follows:

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

Details of the membership of the Armed Forces Pension Scheme at 31 March 2005 were as follows: -

Active members

Officers	32,885
Other Ranks	<u>162,975</u>
Total active members	<u>195,860</u>

Deferred members

Total deferred members	290,312
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Pensioners in payment

Members	277,214
Dependants	<u>67,792</u>
Total pensioners in payment	<u>345,006</u>

Further Information

Any enquiries about the AFPS should be addressed to:

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

**Actuarial Statement for the Armed Forces Pension Scheme
for Accounts for the Year Ended 31 March 2005**

A. Liabilities

The capitalised value as at 31 March 2005 of expected future benefit payments under the Armed Forces Pension Scheme, for benefits accrued in respect of employment (or former employment) prior to 31 March 2005, has been assessed using the methodology and assumptions set out in Sections C and D below. The results are as follows:

Value of Liabilities	£ billion
Pensions in Payment	40.5
Deferred Pensions	5.3
Active Members (Past Service)	20.7
Total	66.5

B. Accruing Costs

The Armed Forces Pension Scheme is non-contributory for members. The cost of benefits accruing for each year of service is met by the employer. The cost of benefits accruing in the year 2004/2005 has been assessed as follows:

% of pensionable pay	
Officers	33.8%
Other ranks	18.2%
All ranks	22.1%
Actual rate charged to Employers for current year	22.1%

In relation to the pensionable payroll for the financial year 2004/2005 and using the rates of contribution described above, I understand the employer's charges in cash terms have been assessed as £1,202 million.

C. Methodology

The value of the liabilities has been obtained by projecting the accrued benefits, with allowance for expected future pay increases in respect of active members. The standard contribution rate for accruing costs has been determined using the entry age method, with assumed ages at entry of 22 years for officers, and 19 years for other ranks.

D. Assumptions

The assessments have been prepared in accordance with the Resource Accounting requirements, and in particular with the requirement that the discount rate net of price increases should be 3.5% p.a. (pension benefits under the scheme are increased in line with prices). The investment return in excess of earnings increases is 2% p.a.

The main financial assumptions made by the Government Actuary are:

- The gross rate of return in excess of earnings increases is 2.0%
- The gross rate of return is assumed to be 6.0% pa although this assumption has minor impact on the calculation of the liability.
- In nominal terms, these assumptions are then equal to an allowance for increase in salaries of 3.9% pa, an allowance for price inflation of 2.4% pa and an allowance for the rate of increase for pensions in payment and deferred pensions of 2.4% pa.

The demographic assumptions adopted for the assessments are based on those used by the Armed Forces Pay Review Body. The mortality assumptions have been updated to reflect the fact that mortality rates continue to decline and therefore members are expected to live for longer in retirement.

E. Notes

- (1) This Statement is based on the intermediate calculations carried out as at 31 March 2001 for the AFPS valuation, with an approximate updating to reflect known changes in scheme membership as at 31 March 2005.
- (2) The data for this assessment was gathered from AFPAA, MoD. The data has been compared with similar data provided for the 31 March 2004 assessment, in order to confirm its reliability.
- (3) The pension benefits taken into account in this assessment are those normally provided from the rules of the pension scheme, including normal retirement benefits, ill-health retirement benefits, and benefits applicable following the death of the member. The assessments do not include the cost of injury benefits (in excess of ill-health benefits), or redundancy benefits in respect of current employees. However, pension payments already being made in respect of such cases are included in this statement of liabilities in Section A above.

Stephen Humphrey
Government Actuary's Department
London

21 June 2005

Statement of Accounting Officer's Responsibilities

Under the Government Resources and Accounts Act 2000, the Accounting Officer is required to prepare resource accounts for each financial year, in conformity with a Treasury direction, detailing a combined financial statement for the Armed Forces Pension Scheme, the Non Regular Permanent Staff Pension Scheme and Army Careers Officers Pension Scheme.

With the exception of certain transactions (which are accounted for on a cash basis) the combined financial statements are prepared on an accruals basis and must give a true and fair view of the financial transactions of the combined Scheme during the year and the disposition, at the end of the financial year, of the combined net liabilities. Note 2 ("Accounting Policies") to the financial statements describes those transactions accounted for on a cash basis, the use of which has no material effect on the net outgoings for the year, or on the combined net liabilities at the year end.

HM Treasury has appointed the Permanent Head of the Department as Accounting Officer of the Department with responsibility for preparing the Department's accounts and for transmitting them to the Comptroller and Auditor General.

In preparing these financial statements, the Accounting Officer is required to comply with the Resource Accounting Manual prepared by HM Treasury, and in particular to:

- observe 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 Resource Accounting Manual, have been followed, and disclose and explain any material departures in the accounts, and
- ensure the combined financial statements have been prepared on the going concern basis, unless it is inappropriate to presume that the Schemes will continue in operation.

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

Statement on the System of Internal Control

Scope of responsibilities

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

The purpose of the system of internal control

2. The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of departmental policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place in the AFPS for the year ended 31 March 2005 and up to the date of approval of the annual report and accounts, and accords with current Treasury guidance.

Capacity to handle risk

3. Administration of the AFPS is an integral part of the military pay and pension services provided by the Armed Forces Personnel Administration Agency (AFPAA), an executive agency of the Ministry of Defence. AFPAA services are principally delivered through a commercial partnering agreement with EDS (Defence) Ltd. The arrangement for joint working with EDS is managed via the Agency's joint management board, the Joint Partnering Management Team (JPMT) which is chaired by the Chief Executive. The JPMT meets regularly to consider administration and strategic direction for the pension scheme. During FY2004/2005 a new Pensions Working Group was formed within the Agency, under the chairmanship of the agency's Director of Operations, to monitor pension related business operations and risk management issues. Controls in place, and controls to be put in place, are identified and recorded in individual risk register reports, including appropriate target dates. Mitigation actions are reviewed at each Working Group meeting. The Ministry of Defence only risks are also considered at a separate management board attended only by MoD senior staff.

4. Business and accounting operations of the AFPS are periodically reviewed by a number of audit bodies. These bodies include AFPAA's own internal Assurance Team, the Defence Internal Audit organisation, and the National Audit Office. Feedback is given on the risk compliance testing carried out by internal audit throughout the financial year.

5. Externally, the AFPS is represented on the HM Treasury led Public Sector Pensions Group meetings, which considers pension accounting issues. This forum helps to promote consistency and shares best practice across all public sector pension schemes. Representatives from all public sector pension schemes attend along with members of HM Treasury, the Government Actuaries Department and the National Audit Office.

6. The following processes and activities took place in the current year:

- The Agency's two non-executive directors were fully involved in the management of the Agency's business providing independent advice to AFPAA's Owners Advisory Board, the Joint Partnering Management Team and the AFPAA Executive Board.
- AFPAA's Audit Committee, chaired by a non-executive director, undertook a full programme of business. Its membership was reviewed and reduced to three members (2 Non-Executive Directors and Deputy Chief Executive/Agency Secretary). The committee undertook a self-assessment of its effectiveness with input from the National Audit Office and the Defence Internal Audit organisation.

- AFPAA's own Agency Assurance Team's compliance and assurance activities are linked directly to business risks including AFPS pension scheme risks. The annual programme is considered by the Audit Committee along with the forward Defence Internal Audit programme. Progress is monitored through the Audit Committee.
- Quarterly audits of pensions in payment records undertaken by Paymaster (1836) Ltd have been completed during the year.
- Full participation in the National (Pension) Fraud Initiative sponsored by the Audit Commission.
- An initial governance workshop took place with the Ministry of Defence Veterans Agency covering the new Armed Forces Compensation Scheme (AFCS) accounting, risk management and corporate governance issues. The AFPS will start accounting for AFCS payments from 1 April 2005.
- A senior management staff pension risk management workshop with Hogg Robinson was held during March 2005. Hogg Robinson PLC, as parent company to Paymaster (1836) Ltd, audit pension payment processes operated by Paymaster.

7. From 6th April 2005 new military pension arrangements will be taking place with the introduction of the new Armed Forces Pension Scheme 2005 (AFPS 05) (to run alongside the current scheme – AFPS 75), the Armed Forces Compensation Scheme (AFCS) and the Reserve Forces Pension Scheme (RFPS).

8. Planned improvements in risk handling capacity over the coming year include:

- The Joint Partnering Management Team will carry out a further strategic review of all risks (including pension schemes risks) and the overall agency risk management process.
- Governance arrangements and processes for the new Armed Forces Pension Scheme 2005, Armed Forces Compensation Scheme and Reserve Forces Pension Scheme will be finalised.
- A further risk management workshop is planned to assess the ongoing risks to the pension payment process under the new pension scheme arrangements.
- Paymaster (1836) Ltd currently uses an Interactive Data Extraction and Analysis (IDEA) tool to validate the integrity of pension payment data. An assessment of the adequacy of these checks will be made, and whether any further AFPAA directed IDEA software validation tests should be undertaken.

The risk and control framework

9. The AFPAA Audit Committee meets on a quarterly basis. Agenda items include AFPS specific issues, as well as Agency operations around military payroll. The Defence Internal Audit organisation and the National Audit Office observe on the Audit Committee and provide advice and guidance where appropriate. The AFPAA internal Assurance Team is in place to provide assurance through an agreed programme of work based on a balance of Internal Controls in place to manage risk and department led compliance reviews. Regular audits of pensions are undertaken on a quarterly basis at the Paymaster (1836) Ltd premises.

10. Planned improvements in the risk and control framework include:

- A review of the contractual relationship with Paymaster (1836) Ltd will be undertaken through a new structure of meetings. Amongst other things, these meetings will examine specific delegations of authority to Paymaster in relation to pension payment recoveries and to put in place risk controls where appropriate.
- The Executive Management Group of Paymaster (1836) Ltd will provide a formal annual statement on the system of internal controls for Armed Forces pension payments.

Review of effectiveness

11. As Accounting Officer for the AFPS, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the Ministry of Defence Defence Internal Audit organisation, AFPAA's own internal Assurance Team, and the executive managers within AFPAA, who have responsibility for the development and maintenance of the internal control framework, and comments made by the National Audit Office, our external auditors, in their management letter and other reports. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the AFPAA Executive Board, and the AFPAA Audit Committee. A plan to address weaknesses and ensure continuous improvement of the system is in place.

Significant internal control problems

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

Kevin Tebbit
Accounting Officer for the Armed Forces Pension Scheme

30 June 2005

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

I certify that I have audited the financial statements on pages 15 to 30 under the Government Resources and Accounts Act 2000. The financial statements have been prepared under the accounting policies set out on pages 20 and 21.

Respective responsibilities of the Accounting Officer and auditor

As described on page 9, the Accounting Officer is responsible for the preparation of the financial statements in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder and for ensuring the regularity of transactions. The Accounting Officer is also responsible for the preparation of the contents of the Accounts. My responsibilities, as independent auditor, are established by statute and I have regard to the standards and guidance issued by the Auditing Practices Board and the ethical guidance applicable to the auditing profession.

I report my opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder, and whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I report whether the contributions payable to the scheme have been paid in accordance with the Scheme rules and the recommendations of the actuary. I also report if, in my opinion, the Report of the Scheme manager is not consistent with the financial statements, if the Department has not kept proper accounting records for the Scheme or if I have not received all the information and explanations I require for my audit.

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

I review whether the statement on pages 10 to 12 reflects the Department's compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered whether the Accounting Officer's Statement on Internal Control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the entity's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

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

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

Opinion**In my opinion:**

- the financial statements give a true and fair view of the financial transactions of the Scheme for the year ending 31 March 2005, the net outgoings, recognised gains and losses, and cash requirement for the year and the amount and disposition at that date of its assets and liabilities, and have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by the Treasury;
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them; and
- the contributions payable to the Scheme during the year ended 31 March 2005 have been paid in accordance with the Scheme rules and the recommendations of the Actuary.

I have no observations to make on these financial statements.

John Bourn
Comptroller and Auditor General

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

7 July 2005

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

SCHEDULE 1

Summary of Resource Outturn

For the year ended 31 March 2005

			2004-05 Estimate				2004-05 Outturn		2003-04
							Net Total Outturn compared with Estimate		Prior-year
	<u>Gross Expenditure</u> £000	<u>A in A</u> £000	<u>Net Total</u> £000	<u>Gross Expenditure</u> £000	<u>A in A</u> £000	<u>Net Total</u> £000	<u>saving/ (excess)</u> £000	<u>Outturn</u> £000	
Request for Resources									
Armed Forces retired pay, Pensions etc	5,079,786	1,265,004	3,814,782	4,546,379	1,252,078	3,294,301	520,481	3,481,850	
Non-budget	-	-	-	-	-	-	-	3,587,208	
Total Resources	5,079,786	1,265,004	3,814,782	4,546,379	1,252,078	3,294,301	520,481	7,069,058	
Net Cash Requirement	-	-	1,662,493	-	-	1,447,143	215,350	1,335,138	

Summary of income payable to the Consolidated Fund

	Note	Forecast 2004-05		Outturn 2004-05	
		<u>Income</u> £000	<u>Receipts</u> £000	<u>Income</u> £000	<u>Receipts</u> £000
		Operating income and receipts – Excess A in A	15	-	-
Total		-	-	-	-

Explanation of the variation between Estimate and Outturn:

The Outturn is less than the Estimate due to lower interest on scheme liabilities than expected and revaluation of attributable injury provision.

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

The Outturn is less than the Estimate due to lower benefits payable and lower payments for attributable injuries than anticipated.

Reconciliation of Resources to Cash Requirements

	Note	2004-05		2004-05		Outturn compared with	
		<u>Estimate</u> Net <u>Total</u> £000	<u>Estimate</u> Net <u>Total</u> £000	<u>Outturn</u> Net <u>Total</u> £000	<u>Outturn</u> Net <u>Total</u> £000	<u>saving/ (excess)</u> £000	<u>Prior-year Outturn</u> £000
		Net Total Resources		3,814,782	3,814,782	3,294,301	3,294,301
Accruals adjustments:							
Non-cash items	21	(5,035,764)	(4,538,201)	(497,563)	(497,563)	(4,586,719)	
Changes in working capital other than cash	22	(94,648)	(139,774)	45,126	45,126	(5,265)	
Changes in creditors due after more than one year	23	135,786	135,613	173	173	14,529	
Use of provision	18.1	2,726,737	2,687,107	39,630	39,630	2,546,343	
Provision for Attributable Injury Benefits	20	115,600	8,097	107,503	107,503	(115,600)	
Prior year adjustment		-	-	-	-	(3,587,208)	
Net Cash Requirement		1,662,493	1,447,143	215,350	215,350	1,335,138	

The notes on pages 19 to 30 form part of these accounts.

SCHEDULE 2

Revenue Account

For the year ended 31 March 2005

	Note	2004-05	2003-04
		<u>£000</u>	<u>£000</u>
Income			
Contributions receivable	3	(1,247,663)	(1,225,849)
Transfers in	4	(4,145)	(4,354)
Other income	5	(270)	(354)
		<u>(1,252,078)</u>	<u>(1,230,557)</u>
Outgoings			
Pension Cost	6	1,245,994	1,224,237
Enhancements	7	1,669	1,612
Transfers In	8	4,145	4,354
Other Interest Payable	10	8,178	9,531
Interest on Scheme Liabilities	9	3,772,941	3,356,516
		<u>5,032,927</u>	<u>4,596,250</u>
Movement on provision for attributable injury	20	(86,548)	115,600
Adjustment to pensions liability	19	(400,000)	-
Net outgoings for the year		<u>3,294,301</u>	<u>3,481,293</u>

STATEMENT OF RECOGNISED GAINS AND LOSSES

Actuarial (gain)/loss	18.4	<u>762,358</u>	<u>5,159,624</u>
Total recognised (gains) and losses for the financial year		<u>762,358</u>	<u>5,159,624</u>

The notes on pages 19 to 30 form part of these financial statements.

SCHEDULE 3

Balance Sheet

As at 31 March 2005

	Note	31 March 2005 £000	31 March 2004 £000
Current assets:			
Debtors	13	1,478	1,060
Cash at bank		63,719	37,419
		<u>65,197</u>	<u>38,479</u>
Creditors: amounts falling due within one year			
Pensions	14	(273,147)	(132,955)
Amounts due to the Consolidated Fund			
Excess Appropriations in Aid	15	0	(557)
Unspent Supply	16	(63,719)	(36,862)
		<u>(336,866)</u>	<u>(170,374)</u>
Net current liabilities, excluding pension liability		(271,669)	(131,895)
Creditors: amounts due after more than one year	17	0	(135,613)
Provision for liabilities and charges:			
Pension liability	18.1	(66,500,000)	(63,800,000)
Attributable Injury Benefit	20	(20,955)	(115,600)
Net liabilities, including pension liability		<u>(66,792,624)</u>	<u>(64,183,108)</u>
Financed by:			
Revenue account:			
Balance brought forward		(64,183,108)	(56,876,772)
Financing from the Consolidated Fund		1,474,000	1,372,000
Net outgoings for the year (Schedule 2)		(3,294,301)	(3,481,293)
Actuarial gain / (loss) (STRGL)	18.4	(762,358)	(5,159,624)
Consolidated Fund Extra Receipts:			
Excess Appropriations in Aid for current year	15	0	(557)
Consolidated Fund Creditor for Cash unspent (current year)	16	(63,719)	(36,862)
Adjustment for Consolidated Fund Creditor for unspent Supply (prior year)	16	36,862	-
Balance carried forward		<u>(66,792,624)</u>	<u>(64,183,108)</u>

Kevin Tebbit
Accounting Officer for the Armed Forces Pension Scheme

30 June 2005

The notes of pages 19 to 30 form part of these financial statements.

SCHEDULE 4

Cash Flow Statement

for year ended 31 March 2005

	Note	2004-05	2003-04
		£000	£000
Net cash outflow from operating activities (note a)		(1,447,143)	(1,334,581)
Paid to / (from) the Consolidated Fund		(557)	(44,546)
Financing (note b)		1,474,000	1,372,000
Increase / (Decrease) in cash during the period		26,300	(7,127)

A. Reconciliation of net outgoings to operating cash flows

	Note	2004-05	2003-04
		£000	£000
Net outgoings for the year (Schedule 2)		(3,294,301)	(3,481,293)
Adjustment for movements in working capital other than cash	22	139,774	5,265
Adjustment for creditors falling due after more than one year	23	(135,613)	(14,529)
Increase in pension provision	18.1	5,018,935	4,580,753
Increase in pension provision – enhancements and transfers in	18.1	5,814	5,966
Increase/(decrease) in provision for injury benefits	20	(86,548)	115,600
Adjustment of pension liability	19	(400,000)	-
Use of provisions – pension liability	18.1	(2,664,125)	(2,517,298)
Use of provisions – refunds and transfers	18.1	(22,982)	(29,045)
Use of provisions – attributable injury benefits	20	(8,097)	-
Net cash outflow from operating activities		(1,447,143)	(1,334,581)

B. Analysis of financing and reconciliation to net cash requirement

	Note	2004-05	2003-04
		£000	£000
From the Consolidated Fund (Supply): current year		1,474,000	1,372,000
Net Financing		1,474,000	1,372,000
(Increase) / decrease in cash		(26,300)	7,127
Net cash flows other than financing		1,447,700	1,379,127
Adjustments for payments and receipts not related to supply			
Payment from / (to) the Consolidated Fund		(557)	(44,546)
Amounts due to the Consolidated Fund, received and not paid over – 15 excess appropriations in aid relating to current year		-	557
Net Cash Requirement (Schedule 1)		1,447,143	1,335,138

The notes of pages 19 to 30 form part of these financial statements

Notes to the Accounts

1. Basis of Preparation of the Scheme Statements

1.1 The Scheme Statements have been prepared in accordance with the relevant provisions of the *Resource Accounting Manual* for 2004-05 issued by the Treasury, which reflect the requirements of Financial Reporting Standard (FRS) 17 Retirement Benefits. These accounts now show the unfunded pension liability and movements in that liability during the year. The accounts also have regard to the recommendations of the Statement of Recommended Practice entitled *Financial Reports of Pension Schemes* to the extent that these are appropriate.

1.2 The Scheme Statements summarise the transactions of the Armed Forces Pension Scheme. The Balance Sheet shows the deficit on the Scheme; the Revenue Account shows, inter alia, the movements in the liability analysed between the pension cost, enhancements and transfers in, and the interest on the scheme liability. The actuarial position of the pension scheme is dealt with in the Report of the Government Actuary, and the Scheme Statements should be read in conjunction with that Report.

1.3 The AFPS is a contracted-out, unfunded, defined benefit pay-as-you-go occupational pension scheme operated by the MoD on behalf of members of the Armed Services who satisfy certain membership criteria. The employer's charge to the pension Scheme is met by payment of an Accruing Superannuation Liability Charge (ASLC), calculated as a percentage of pensionable pay based on rank. The ASLC contribution made by the MoD partially funds the payments made by the AFPS in year.

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

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

1.6 The Scheme Statements summarise the transactions of not only the AFPS but also two smaller pension schemes, the NRPS and the ACOPS. The latter two Schemes are administered and managed in a similar way to the AFPS.

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

1.8 The Actuarial Statement, shown on pages 7 and 8, which takes account of future obligations, has been prepared by the Government Actuary's Department and should be read in conjunction with the Scheme Statements. The Actuarial Statement has been prepared using the projected accrued benefit method, the actuarial valuation itself being undertaken on a quadrennial basis.

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

2. Accounting Policies**2.1 Contributions Receivable**

2.1.1 Employers' normal pension contributions (ASLCs) are accounted for on an accruals basis.

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

2.2 Transfers in and out

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

2.3 Other Income

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

2.4 Current Service Cost

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

2.5 Past Service Costs

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

2.6 Interest on Scheme Liabilities

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

2.7 Other Payments

2.7.1 Other payments are accounted for on an accruals basis.

2.8 Scheme Liability

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

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

2.9 Pensions benefits payable

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

2.10 Pension payments to those retiring before their normal retirement age

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

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

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

2.12 Lump sums payable on death in service

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

2.13 Actuarial gains and losses

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

2.14 Attributable Injury Benefits

2.14.1 Provision is made to account for the repayment of incorrectly paid benefits as a result of a decision by the Court of Appeal on 19 November 2003 on assessment of attributable pensions. The provision is expected to be cleared by next 2005-06 financial year.

3. Pensions Contributions Receivable

Employer's contributions are receivable from MoD in respect of active members of the AFPS and amount to an average of 22.1% (2003-04: 22.1%) of pay.

	2004-05	2003-04
	<u>£000</u>	<u>£000</u>
Employers	1,245,994	1,224,237
Employees:		
Additional Voluntary Contributions	<u>1,669</u>	<u>1,612</u>
	<u>1,247,663</u>	<u>1,225,849</u>

4. Pensions transfers-in

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

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Individual transfers in from other schemes	4,145	4,354
	<u>4,145</u>	<u>4,354</u>

5. Other income

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

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Miscellaneous income (including refund of gratuities)	270	354
	<u>270</u>	<u>354</u>

6. Pension Cost

The current service cost is the increase in the present value of the scheme liabilities arising from current member's service in the current period. The current service cost is assumed to be the same as the employer's contributions receivable.

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Current Service Cost	1,245,994	1,224,237
	<u>1,245,994</u>	<u>1,224,237</u>

7. Enhancements (see note 3)

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Employees AVCs and added years	1,669	1,612
	<u>1,669</u>	<u>1,612</u>

8. Transfers In (see note 4)

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

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Individual transfers in from other schemes	4,145	4,354
	<u>4,145</u>	<u>4,354</u>

9. Interest Charge (see note 18.1)

The interest charge in the year has been determined by taking 6% of the opening balance plus 6% of the average of the movements in the year, which are deemed to accrue evenly during the year. The movements in the year exclude the interest charge and the actuarial gains/losses.

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Interest charge for the year	3,772,941	3,356,516
	<u>3,772,941</u>	<u>3,356,516</u>

10. Other Interest Payable

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

National Debt Office Advances:

The National Debt Office (NDO) advances money to the MoD to fund life commutations, a benefit available to officers of the three Services. The number of pensioners eligible to apply for life commutation is decreasing year on year. Life commutation is only available to those serving on or before 31 March 1978 and applies only to that part of the pension earned by service up to 6 April 1980. The loan is converted into a ten-year annuity at the end of the calendar year, and a repayment is made on 1 April each year (see Note 14). From 1 January 2005, the NDO ceased funding life commutations and the total outstanding loan was settled in full on 1 April 2005.

Interest Paid:

The interest paid represents the interest accrued and is payable on 1 April 2005.

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
National Debt Office: Interest	8,178	9,531
	<u>8,178</u>	<u>9,531</u>

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

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Net outgoings (Schedule 2)	3,294,301	3,481,293
Add: Income not appropriated in aid, payable to the Consolidated Fund (note 15)	0	557
Add: Prior year adjustment	0	3,587,208
Net Resource Outturn (Schedule 1)	<u>3,294,301</u>	<u>7,069,058</u>

12. Administrative fee and expenses

All costs of administering the Armed Forces Pension Scheme are borne by MoD.

13. Debtors - contributions due in respect of pensions

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.

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Amounts falling due within one year:		
Overpaid pensions	1,861	1,780
Less Provision for bad debts	(719)	(919)
	<u>1,142</u>	<u>861</u>
Amounts falling due after one year:		
Overpaid pensions	336	199
Total Debtors	<u>1,478</u>	<u>1,060</u>

14. Creditors - amounts falling due within one year for pensions

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Pensions	76,218	65,631
Inland Revenue	40,565	25,702
National Debt Office – Principal and Interest	156,074	41,622
Third party organisations	290	-
	<u>273,147</u>	<u>132,955</u>

15. Creditors - amounts falling due within one year for Consolidated Fund excess appropriations in aid

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Appropriations in aid realised (Schedule 2)	-	(1,230,557)
Less: appropriations in aid authorised (Schedule 1)	-	1,230,000
Income not appropriated in aid, payable to the Consolidated Fund	-	(557)

16. Creditors - amounts falling due within one year: Unspent supply (see Schedule 1)

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Net cash requirement (Schedule 1)	1,447,143	1,335,138
Parliamentary Funding		
Drawn down (Schedule 4)	(1,474,000)	(1,372,000)
Deemed Supply (settlement of prior year's creditor for supply)	(36,862)	-
Amounts issued from the Consolidated Fund for supply, but not spent	(63,719)	(36,862)

17. Creditors: amounts falling due after more than one year

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Amounts due between 1 and 5 years:		
National Debt Office – Principal	0	135,613
	0	135,613

18. Provision for pension liability

18 a) The Armed Forces Pension Scheme is an unfunded defined benefit scheme. A full actuarial valuation was carried out as at 31 March 2001 by the Government Actuary's Department. The major financial assumptions used by the actuary when providing the assessment of the accrued liabilities as at the following dates for the Resource Accounting assessments were:

	At 31 March 2005	At 31 March 2004	At 31 March 2003
Rate of increase on salaries	3.9%	3.9%	4.9%
Rate of increase in pensions in payment and deferred pensions	2.4%	2.4%	3.4%
Inflation assumption	2.4%	2.4%	3.4%
Discount rate	3.5%	3.5%	3.5%

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

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

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

18 d) The value of the liability included on the balance sheet may be significantly affected by even small changes in assumptions. For example, if at a subsequent valuation, it is considered appropriate to reduce the assumed rate of inflation, or the assumed rate of increase in salaries, then the value of the pension scheme liability will decrease (other things being equal). Conversely, if the assumed rates are increased, the value of the liability will increase. The managers of the scheme accept that, as a consequence the valuation provided by the Actuary is inherently uncertain. The increase or decrease in future liability charged or credited for the year resulting from changes in assumptions is disclosed in notes 18.4 and 18.5. The note also discloses 'experience' gains or losses for the year, showing the amount charged or credited for the year because events have not coincided with assumptions made for the last valuation.

18.1 Analysis of movement in scheme liability

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Scheme liability at 1 April	(63,800,000)	(56,600,000)
Current service cost (note 6)	(1,245,994)	(1,224,237)
Interest on pension scheme liability (note 9)	(3,772,941)	(3,356,516)
	<u>(5,018,935)</u>	<u>(4,580,753)</u>
Income received in respect of enhancements (note 7)	(1,669)	(1,612)
Pension transfers (note 8)	(4,145)	(4,354)
	<u>(5,024,749)</u>	<u>(4,586,719)</u>
Benefits paid (note 18.2)	2,664,125	2,517,298
Pension payments to and on account of leavers (note 18.3)	22,982	29,045
	<u>2,687,107</u>	<u>2,546,343</u>
Adjustment to pension liability (note 19)	400,000	-
Actuarial gain / (loss) (note 18.4)	(762,358)	(5,159,624)
	<u>(362,358)</u>	<u>(5,159,624)</u>
Scheme liability at 31 March	<u>66,500,000</u>	<u>63,800,000</u>

18.2. Analysis of benefits paid

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Pensions to retired employees and dependents (net of recoveries of overpayments)	2,316,389	2,201,476
Commutations and lump sum benefits on retirement	<u>347,737</u>	<u>315,822</u>
Per cash flow statement (Schedule 4a)	<u>2,664,126</u>	<u>2,517,298</u>

18.3 Analysis of payments to and on account of leavers

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Individual transfers to other schemes	<u>22,982</u>	<u>29,045</u>
Per cash flow statement (Schedule 4a)	<u>22,982</u>	<u>29,045</u>

18.4 Analysis of actuarial gain / (loss)

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Experience gains / (losses) arising on scheme liabilities	(762,358)	(59,624)
Changes in assumptions underlying the present value of scheme liabilities	-	(5,100,000)
Per Statement of Realised Gains and Losses	<u>(762,358)</u>	<u>(5,159,624)</u>

18.5 History of experience gains and losses

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

19. Adjustment to pension liability

An adjustment of £400m was required to the scheme liability to remove junior officers and other ranks previously included in the membership statistics used to calculate the pension liability.

20. Provision for liabilities and charges – attributable injury benefits

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

Over 117,000 cases have been reviewed with over £7m payments made to date. The provision has been revalued and an anticipated £20m further payments are due in 2005-06. On investigating the pension caseload, the number of pensions affected was significantly less than estimated in the opening provision made in 2003-04. All payments are expected to be cleared in 2005-06.

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Balance at 1 April	(115,600)	-
Set up of provision in year	-	(115,600)
Use of provision in year	8,097	-
Revaluation at year-end	86,548	-
Balance at 31 March	<u>(20,955)</u>	<u>(115,600)</u>

21. Non-cash items

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Current service cost	1,245,994	1,224,237
Enhancements	1,669	1,612
Transfers in	4,145	4,354
Interest on Scheme liability	3,772,941	3,356,516
Revaluation of attributable injury provision	(86,548)	-
Adjustment to pension liability	(400,000)	-
Per cash-flow statement (Schedule 1)	<u>4,538,201</u>	<u>4,586,719</u>

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

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
(Increase) / decrease in debtors (note 13)	(418)	(76)
Increase / (decrease) in creditors falling due within one year (note 14)	140,192	5,341
Per cash-flow statement (Schedule 4 and Schedule 1)	<u>139,774</u>	<u>5,265</u>

23. Movements in creditors falling due after more than one year (see Schedules 1 and 4)

	<u>2004-05</u>	<u>2003-04</u>
	£000	£000
Increase / (decrease) in balance owed to National Debt Office (note 17)	(135,613)	14,529
	<u>(135,613)</u>	<u>14,529</u>

24. Intra-government balances

	Debtors: Amounts falling Due within one year <u>£000</u>	Debtors: Amounts falling Due after more than one year <u>£000</u>	Creditors: Amounts falling Due within one year <u>£000</u>	Creditors: Amounts falling Due after more than one year <u>£000</u>
Balances with other central government bodies:				
Inland Revenue	-	-	40,565	-
National Debt Office	-	-	156,074	-
Consolidated Fund	-	-	63,719	-
Balances with bodies external to government	1,141	336	76,508	-
At 31 March 2005	<u>1,141</u>	<u>336</u>	<u>336,866</u>	<u>-</u>
Balances with other central government bodies:				
Inland Revenue	-	-	25,702	-
National Debt Office	-	-	41,622	135,613
Consolidated Fund	-	-	36,862	-
Balances with bodies external to government	861	199	65,631	-
At 31 March 2004	<u>861</u>	<u>199</u>	<u>169,817</u>	<u>135,613</u>

25. Related Parties

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

26. Financial Instruments

FRS 13, *Derivatives and Other Financial Instruments*, requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities. Because of the non-trading nature of its activities and the way in which government departments are financed, the AFPS is not exposed to the degree of financial risk faced by business entities. Moreover, financial instruments play a much more limited role in creating or changing risk than would be typical of the listed companies to which FRS 13 applies.

In line with FRS13, short term debtors and creditors (those that mature or become payable within twelve months from the balance sheet date) have been excluded from these disclosures.

Liquidity Risk

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

Interest Rate Risk

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

27. Losses

During the year, losses arose in 314 cases (2003-04; 306 cases). The total loss was £369,198.41 (2003-04; £291,463.06) and this relates to the write-off of pension overpayments.

28. Post Balance Sheet Events

Following a decision by the Financial Reporting Advisory Board that the discount rate for pensions should, in accordance with FRS17, be based on the AA corporate bond rate, the discount rate has been changed with effect from 1 April 2005 from a real rate of 3.5% to a real rate of 2.8%. As a result, the pension liability at 1 April 2005 is estimated to have increased by £10bn. It is also estimated that the current service cost will increase by some £331m, although the interest charge should reduce by some £417m.

From 6 April 2005, there will be two Armed Forces Pension schemes for members of the Regular Armed Forces. The first scheme was introduced in 1975 and will be closed to new entrants from 6 April 2005. This scheme is known as AFPS 75. On 6 April 2005 a new scheme will be introduced for new entrants, known as the Armed Forces Pension Scheme 2005 (AFPS 05). Members of the AFPS 75 will be given the opportunity to transfer to AFPS 05 on 6 April 2006.

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