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PERMANENT SECRETARY

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Meg Hillier, MP
Chair Public Accounts Committee
Sent electronically

Dear Chair,

ARMED FORCES PENSION SCHEME – EXCESS VOTE 2019/20

1. It is with significant regret that I am writing to notify you of an outturn in excess of that voted for by Parliament in respect of the Armed Forces Pension Scheme (AFPS) in Financial Year 19/20.
2. The funding of the Armed Forces Pension Scheme (which also encompasses the Gurkha Pension Scheme, the Non-Regular Permanent Staff Pension Scheme, the Reserve Forces Pension Scheme and other minor pension schemes covering locally employed personnel) is not consolidated in the Ministry of Defence departmental financial statements and is voted for separately by Parliament.
3. As a separately voted activity, AFPS is required to report outturn performance against the financial control framework and produce a separate Annual Report and Accounts. In preparing for FY19/20 year-end reporting, a £0.5Bn omission has been identified from the Main and Supplementary estimates for AFPS Resource Annually Managed Expenditure (R-AME).
4. The financial management of AFPS is undertaken by Defence Business Services informed by analysis provided by the Government Actuary's Department (GAD). This includes projections of the Current Service Cost (CSC) – the estimated increase in the present value of pension scheme obligations resulting from the additional benefit accrued by scheme members in the current financial year. These CSC costs score against R-AME.

Cause of the Breach

5. In December 2018, the Court of Appeal held that the transitional protection offered to members of pension schemes subject to reform gave rise to discrimination in the treatment of younger members compared to those closer to retirement age. This is known as the 'McCloud Judgment'.
6. In FY19/20 GAD, for the first time, estimated the impact of the McCloud Judgement on AFPS pension scheme obligations. Specifically, GAD reported a change in the rate applied to pensionable pay for calculation of the CSC from 75.4% to 85.9%.
7. Unfortunately, the impact of this change was not identified nor taken account of by DBS in the data inputs to the AFPS pension cost model. As a result, the requirement to change model input assumptions was mistakenly overlooked leading to a £0.5Bn understatement of R-AME Main and Supplementary Estimates for FY19/20.
8. The rectification of this omission leads to an outturn in excess of the AFPS R-AME limit voted for by parliament and the qualification of the AFPS FY19/20 Annual Report and Accounts by the NAO.

Remedial Actions

9. This is an extremely disappointing outcome and I have directed my teams to address the procedural weaknesses exposed by this breach, specifically:
 - The underlying pensions model will be adjusted to reflect the CSC percentage recommended by GAD in calculating Main and Supplementary Estimates and in-year accounting entries;
 - There will be closer and more effective liaison between DBS and GAD as part of the Main and Supplementary Estimates process and GAD will be asked to provide independent subject matter expert validation of AFPS model outputs;
 - The MOD corporate finance team will also now undertake separate scrutiny and validation of AFPS Main and Supplementary Estimates prior to submission;
 - The underlying pensions model has been validated and verified by GAD as part of Macpherson assurance of business-critical models. These reviews will continue noting that the breach reported was due to input error and not model functionality;

- On a broader level, DBS will liaise with members of the UK Pensions Finance Working Group each year as part of the Supplementary Estimate process to validate that AFPS assessments align with the approaches being taken in the wider pensions environment.

10. All those involved recognise that any breach of the control framework is a very serious matter and are fully committed to ensuring there is no recurrence.

Yours sincerely,



STEPHEN LOVEGROVE

Copied to: Chair Defence Committee (Tobias Ellwood, MP)
Comptroller and Auditor General National Audit Office
SofS/PS
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