00171912

NAAFI

THE NAVY, ARMY and AIR FORCE INSTITUTES

Financial Statements 2005/2006

Contents

Chairman's Statement

Objectives

To provide 'home from home' retail, leisure, catering and related services to the British Armed Forces and their families, wherever there is a need.

To meet the needs of our customers by providing quality products, priced competitively, available consistently in attractive environments and served by trained, friendly and efficient staff.

To generate significant funds for the welfare of junior ranks and their families.

Review of the Year

This has been a year of significant change and challenge as NAAFI has adapted to changing military requirements. These changes have resulted in reduced sales and additional short-term costs, both impacting on profitability. Nevertheless NAAFI has continued to provide a flexible committed service whilst remaining profitable and investing for the future.

Performance

Sales fell during the year by 12.2%. The principal reasons were the transfer of sites in GB to commercial contractors, fewer personnel in Germany and Northern Ireland and the sudden imposition of further restrictions on smoking and drinking. In operational zones many of the NAAFI clubs are now alcohol and tobacco free. While undoubtedly promoting a healthier and safer lifestyle, these restrictions have challenged the traditional role of the NAAFI Club, particularly where alternative less restrictive venues exist nearby. On the positive side NAAFI has broadened its offer to focus more on the provision of food and non-alcoholic beverages, through a range of different outlet styles.

In Germany 'Pay as You Dine' (PAYD) has been very successfully implemented, with the model established initially at Elmpt being progressively rolled out to Fallingbostel and then to Hohne. Not only has this model provided satisfied customers, but it has also delivered 'gain share' payments to benefit Military welfare funds. School Catering operations have also been successfully converted to PAYD and fully integrated into the NAAFI garrison structure. Significant capital has been invested to upgrade facilities in Germany notably at Fallingbostel and Hohne. This capital has not only enhanced the traditional mess environment and upgraded the retail outlets, in line with our 'Store of the Future' project, but has also created new café style outlets, with an all-day family-friendly atmosphere. There have also been significant investments in improving facilities in the Falklands, Gibraltar and Cyprus – notably at Akrotiri. Alongside these investments, the product range has been improved with a particular emphasis on upgrading the fresh food offering – meat, fruit and vegetables - and hot take away snacks and coffee.

Providing value for money is a key objective for NAAFI. In Germany and Cyprus, the price of a basket of the top 100 selling lines is monitored monthly against the leading competitor. NAAFI is consistently lower in price. In other markets, suitable benchmarks are in place to ensure customers enjoy fair prices even though there is no local competition available. Sharper buying, new supplier relationships and improvements to supply chain management have funded this increased competitiveness. The Navision IT system, installed smoothly in Germany and Cyprus, has proved a valuable tool to aid the buyers as well as providing the basis for better control and standards by operational and financial staff.

Forward Locations performed well. These challenging deployments have always been NAAFI's priority. Iraq has continued to have NAAFI's particluar attention and performance was good in the 12 outlets there, with better control and an improved supply chain, which has now been consolidated with that of the Military. Afghanistan is the major new challenge with an even more extended and difficult supply chain. With less operational activity on Her Majesty's Ships, sales on NCS (Naval Canteen Services) were down 11%. We continue to upgrade our facilities on the ships with investment this year on HMS ArkRoyal. Better IT support for Forward Locations is now an important priority.

The cost base has shifted with reduced GB costs, though inevitably the rate of reduction is lagging the changes in sales with obvious implications for profits. Management is working closely with MOD staff to ensure a smooth handover of outlets to commercial contractors in accordance with MOD timetables. In Germany the expanded activities of catering and facilities management have of course increased costs to support this new business. Nevertheless the new garrison structure has mitigated this increase, while bringing local decisions closer to local customers. A particularly large one off cost was incurred in bidding for the Cyprus Multi Activity Contract (MAC). This bid has also been costly in management resource. A further one off non-cash cost of £1.6m was incurred in the write down of Warrior – the legacy of NAAFI Financial Services that was sold 6 years ago.

Profit for the year, before dividends was £1.3m compared to £7.4m the previous year. On the balance sheet net assets were maintained at £31m, net current assets were up to £14m and net cash also increased marginally at £20m.

The Pension Fund, whose gross assets and liabilities are more than 10 times the size of the Corporation's, continues to receive high priority. Based on current actuarial assumptions the Fund's assets and liabilities are healthy. However, as with all Pension Funds, minor changes in assumption can have a major impact. The Pension Fund is a subject of regular dialogue between the Corporation, the Fund Trustees and the MOD.

Strategy

Our strategy is to grow profitably our share of the available spend of the Military community through the effective delivery of retail, leisure, catering and other services to the satisfaction of our customers. The overall Military community is declining in numbers and lifestyles are changing, with increasingly service personnel, when not on expeditionary duties, based in local communities. This means a numerically declining market population. NAAFI must therefore win a greater share of this declining market by broadening its service offering, particularly in catering and facilities management and by returning to GB in a profitable manner. Given the reductions in troop numbers in Germany and Northern Ireland, it is essential that NAAFI has continuing access to the GB market. An important target is the Cyprus MAC contract, where NAAFI's strong bid for a range of services and amenities for the Military community, was based on its deep understanding of the needs of the Service Customer, backed by a flexible and cost effective structure. The outcome of this bid could have far reaching consequences for NAAFI.

People

This has been a difficult year for the people who work in NAAFI to serve the Armed Forces. Many have transferred to contractors and many know they will soon do so. These changes have been handled effectively and sensitively. Our people deserve no less. In Germany, new skills have had to be learnt. In Cyprus, the combination of delivering a step change in the ongoing business, and running a major bid, created heavy demand on our resources. In Iraq and Afghanistan, our people operate cheerfully and efficiently in the most hostile of environments. In the Falklands, Brunei, Belize and Kenya, our staff serve a long way from base. To all our 3,609 staff, many of whom come from Service families, the Board extends both its thanks for their committment and dedication and its congratulations on their excellent performance in demanding circumstances.

Alan Cole, Deputy Chair, and Clive Warner, Finance Director, have both recently left the Board. We owe them our gratitude for their very effective contribution to the Corporation. Alan will continue to Chair the Pension Fund Trustees. Sir Scott Grant has become Deputy Chair and we are recruiting a new Non-Executive Director. Hayden Robinson has since been appointed as Finance Director and will join the Board on 6 September 2006.

Prospects

The prospects for the current year remain challenging with conditions likely to remain difficult and the management of change requiring considerable resource and flexibility. The GB transfer programme will accelerate. PAYD will continue to roll out in Germany; there will be a significant investment programme; the Cyprus MAC result will have considerable impact; and Afghanistan will demand resources. Much will depend on the number and location of Military personnel and the extent of further restrictions on products. The Pension Fund will continue to require close attention, given its scale in relation to the Corporation.

However, we have a stable and effective management and much more robust processes than was ever previously the case, and communications with the MOD and particularly Permanent Joint Head Quarters are good. We have every confidence of fulfilling our broad based objective of 'Serving the Services'.

Dividend

The Board recommends a final dividend of £363k making £0.5m for the year (£2m in 2004/05), of which £137k has already been paid to Service Sports and Welfare Organisations over the past year. In making this recommendation the Board is mindful of the increased uncertainty in trading conditions, including the future of the Cyprus business, and its responsibilities to the Pension Fund.

AJ Hales, Chairman
8 August 2006

A. J. Hales

CEO's Operating Review

2005/06 A year of change and strategic progress

Throughout the year NAAFI has remained true to its aim of "Providing community support services to HM Armed Forces and their families." We have faced up to the challenges of a rapidly changing market place, while continuing to invest for the future by upgrading our outlets, enhancing our product ranges, improving value and developing our staff.

Highlights

- £9.5m of capital investment, key projects were:-
  - 15 outlet refurbishments in Germany including 3 Express Shops, 7 Heroes Bars and 2 cafés.
  - Implementation of Store of the Future concept in Hohne, Germany and Akrotiri, Cyprus.
  - Refurbishments in the Falklands Islands and Gibraltar.
  - One new opening in Northern Ireland, and
  - Continuing information systems improvements.
- Commencement of Germany schools catering service.
- Investors in People award gained in Elmpt, Germany.
- 8% decrease in reported accidents year-on-year.
- A 12.2% decrease in sales, primarily driven by our GB businesses.
- An average transaction value increase in our Germany retail outlets of 8.4%, despite increased competition.
- Increase in gross margin of 0.4 percentage points year-on-year.
- Operating profit improvements in core markets of Germany and Forward Locations.
- £1.3m of profit generated in the year, this includes a £1.6m write-off against our investment in Close Brothers Military Services.
- Cash balance increase to £20.2m.
- Improvement in working capital of £1.3m year-on-year.
- Debtor balance reduced by £1.9m year-on-year.
- Dividend of £0.5m (£0.1m paid, £0.4m proposed).
- Price cuts on 2,000 lines.

Progress during the year

During the year, the Corporation completed a strategic review which resulted in a comprehensive five year plan. This is now being reviewed as we are awaiting announcement on the future basing of British Forces in Germany and the award of the Cyprus MAC contract. The plan covers four themes; delivering our mission, growing our business, re-engineering our support structures and responding to our stakeholders.

Delivering our mission

During the year we delivered services to front line troops through 67 locations in Iraq, Afghanistan, HM Ships, Belize, the Balkans, the Falkland Islands, Ascension Island, Kenya, Brunei, Gibraltar and exercises in Norway and Poland. Our uniformed divisions, the 148th EFI Royal Logistics Corp and the Naval Canteen Service (NCS) continued to play an important role in bolstering troop morale, delivering a 'taste of home' to HM Forces working in active theatres.

The Corporation continues to recognise the welfare needs of our customers and during the year supported over 100 loss making establishments across the globe. We are also paying considerable welfare returns to the local chain of command at Elmpt and Fallingbostel in Germany, £0.1m in the year, where the working partnership between NAAFI and the Military is literally 'paying dividends'. Furthermore, we distributed £3.8m of amusement income, £0.1m of sponsorship, and are proposing a dividend from this year's profit of £0.4m.

Growing our business

Winning MOD Multi Activity Contracts (MAC) is essential to NAAFI's future, and during the year we commenced a new catering service in German schools and prepared bids for PAYD services at Hohne in Germany, and an extensive MAC contract in Cyprus. We strengthened our bid capabilities and explored options for a possible re-entry into the GB marketplace.

Re-engineering support structures

Significant focus was given to designing the future shape of our management team and support functions. This led to a year-on-year support cost reduction of £2.0m and a strengthening of our catering and facilities management skills and contract bidding capabilities.

We completed the integration of NAAFI Support Services during the year. This, combined with PAYD in Germany, provided the opportunity to restructure our operational team and introduce a new de-centralised structure. In Cyprus, a drive to bring the latest UK 'high street' standards to our outlets saw the introduction of British trained management into establishments.

We started an overhaul of our global supply chains, with a new Eddie Stobart contract negotiated for Germany, which is expected to generate annual savings of 6% and deliver new warehousing and lorry fleet facilities early next year.

We also strengthened our administration capabilities by bringing our Finance and IT teams together in one office and continued investment in Information Systems.

Responding to stakeholders

We know that understanding and reacting to the needs of customers, employees and our stakeholders will be central to future success. To this end, during the year we continued our market research programme concentrating on gaining a greater understanding of customer needs in Cyprus and Germany. As a direct consequence, a drive to lower retail pricing has been implemented, including the reduction of over 2,000 retail products and the introduction of a 'Price Match Promise'.

We completed retail Store of the Future refurbishments at Akrotiri in Cyprus and Hohne in Germany, as well as improving product ranges and launching a 'Food to Go' offer.

We have also improved our understanding of Military needs through stakeholder consultation, in particular working with the Permanent Joint Head Quarters (PJHQ) to ensure that our support of front line operations is as effective and efficient as possible.

Results

Total sales fell 12.2%, with the exit programme and trading restrictions in GB accounting for almost half of the reduction. Overall gross margin has risen by 0.4 percentage points to 31.1%.

Operating costs excluding exceptional item fell to £68.9m, despite a £3m charge for pension fund service costs (a £2m increase on last year). Focus on cost control generated savings of £2.0m in support costs and the exit of GB contributed a £1.4m saving in labour and operating costs.

The significant investment for the future during the year led to an increase in depreciation charge of £1.8m, a further charge of £1.6m was incurred as our investment in Close Brothers Military Services was reduced.

Overall surplus on ordinary activities fell by £6m year-on-year, with the impact of new pension accounting rules contributing £3m of this (£2m in operating costs and £1m from reduction in finance income) and the investment write off £1.6m.

Germany

Our core German business experienced a year-on-year sales decline of 7.8%, with customer numbers averaging only 60% of full strength throughout the year, and increasing pressure from UK internet and German high street competitors. These continued challenges are not unique to NAAFI with other service providers such as the YWCA starting to withdraw their offer from Germany. We are confident that our initiatives and strategy in Germany are working, despite the lack of customers, as is borne out by the 8.4% year-on-year increase in our average retail transaction value in the closing weeks of the year.

Significantly, operating profit has remained consistent, with improved margins, more focused ranges, better management of wastage and staff costs being the main drivers. Of particular note is an improvement in retail gross margin of 0.9 percentage points, despite a focus during the year on providing low prices. The quality of data to manage this margin, coming from our information systems (implemented in 2004), has undoubtedly enabled better control of margins.

Other highlights in Germany included the start of a new schools catering service, a £0.8m refurbishment of Hohne, one of our largest stores, the return of mobile food services through NAAFI vans, a new magazine and newspaper range, an improved fresh produce offer and the introduction of a wider range of chilled and frozen ready meals. The schools business has kept catering staff busy, with over 65,000 meals being produced each month.

Overall the German business is in good shape and awaiting improved troop numbers to drive forward future profitability.

Cyprus

Sales in Cyprus increased by 0.7%, providing a strong platform for our bid to win the five year MAC contract on the island. Profitability declined, with increased labour and utility costs in establishments, and a conscious decision to invest in support costs being the main drivers. During the year we undertook a significant retail refurbishment at Akrotiri, the trading from which has been extremely encouraging.

The major focus for the island during the year was of course the MAC bid, where we invested significant resources to produce a world class tender response and customer proposition.

Northern Ireland

In Northern Ireland sales are down 21%, where the process of 'normalisation' in the province reduced troop numbers by 14% in the year, leading to two establishments closing. High street competition also continues to become more accessible than ever before. On a positive note, we opened a new multi-site complex, the Rosebowl at Aldergrove, where significant capital investment has resulted in positive customer feedback and substantial sales.

With many establishments already at minimum operating configuration, the decline in sales in Northern Ireland was not entirely offset by cost savings, with a resulting reduction in profit.

Forward Locations

Central to NAAFI's mission remains the ability to provide services to the British Military wherever they may operate. During the year we operated out of 67 forward outlets with 358 staff.

In Iraq, EFI (Expeditionary Forces Institute) opened outlets at New Basrah Palace and Camp Smitty, and improved facilities were introduced at Shaibah with a new menu including Tchibo coffee and ice cream. Profitability in Iraq was strong, almost double the previous year. The main contributing factor being stability, with static geographical locations enabling improved labour utilisation and greater local sourcing of product.

Preparations to support increased deployments in Afghanistan included the sourcing of buildings that could be flat packed and sent by sea, improving warehousing and supply chain capabilities in Kabul with partners 3663 and Supreme, and strengthening the local management team.

In Gibraltar, the Europa Point shop and bowling alley were renovated, significant improvements in product ranges introduced and our first wireless internet access offer is being trialled there.

In the Falkland Islands we refurbished a leisure club in time to provide an excellent venue for enjoying World Cup football and prepared for further renovations early next year.

GB

GB sales declined by 17% year-on-year, and profit almost halved, due in the main to the continuing exit programme. During the year we handed over 67 establishments to other MAC contractors. The original MOD timetable was that all site handovers would be complete by 2005, but this is now likely to be extended to 2008, creating many financial and personnel planning challenges. Adding to the pressures and sales declines from the exit, many GB sites have also been adversely affected by the imposition of local restrictions on smoking and consuming alcohol. These are driving our customers onto the high street, depressing sales and profits yet further.

Staff costs have now been pared back to minimum levels and despite the increases in National Minimum Wage, the management team in GB still managed to achieve an excellent result in these circumstances.

Close Brothers Military Services

Our investment in Close Brothers Military Services has had a significant impact on reported profitability. First, Close Brothers announced a restructure that significantly devalued our investment by £1.6m. Furthermore, with declining revenues and the loss of its brokered insurance partner, income and dividends to NAAFI dropped by £0.2m year-on-year.

Financing

Net assets remained at £31m. Cash of £0.6m was generated, leaving end of year cash balances of £20.2m. The Board believe that the Corporation has sufficient resources to meet its requirements for the foreseeable future.

The value of our fixed assets was reduced by £0.6m, despite significant capital expenditure, mainly driven by accelerated depreciation from sites transferred to other contractors in GB. The value of investments fell by £1.6m following an impairment charge relating to Close Brothers Military Services, already detailed.

The reduction of debtors by £1.9m is extremely pleasing as the introduction of businesses such as schools catering in Germany is generating additional new debtors.

Changes to our systems and processes across the business have enabled improvements in the timing of payments to suppliers, which has enabled creditors to be reduced by £2.5m.

Treasury and Pension Policy

The Corporation invests its current cash holding under a Treasury policy agreed by the Board. Key points of this policy are that no individual bank exposure exceeds £4.0 million and money is only deposited with AA and AAA rated banks. Royal Bank of Scotland advises the Corporation on Treasury management.

The Corporation has significant flows in different currencies, and our aim is to reduce our exposure to exchange movements where possible, by using currencies generated from sales to fulfil payment commitments.

The provision of NAAFI's defined benefit pension scheme for our staff remains an important priority. The funds strategy is to invest in 25% equities, 65% bonds and 10% cash and other assets. The Trustee Board has undertaken a three-yearly valuation of the pension fund, the results of which will be available early in the new financial year. On the basis of this valuation, initial indications suggest that the fund is close to equilibrium, an extremely encouraging position, given the financial deficits of many other large corporate funds.

FRS17 (Financial Reporting Standard 17 - Retirement Benefits) requires that we value pension scheme liabilities at the financial year-end date as if the entire scheme were funded using bonds, with any resulting surplus over and above forecast commitments forming an asset on our balance sheet. Adopting bond yields for such a valuation exercise can, at times, be a volatile measure, however in 2005/06 our pension asset remained at £6m, with a resulting net charge to the revenue account of £2m (2004/05 £1m gain).

Risk

The major risks that NAAFI faces are changes in Military numbers and deployments, reliance on MOD contracts, increasing pressure from competitors, losing the MAC bid in Cyprus, controlling the exit from GB and the Pension Fund valuation. NAAFI continues to devote considerable effort to managing these risks.

The Corporation, with the Military Service Representatives and PJHQ, monitors changes in deployment and plans the controlled exit of GB and works to mitigate the effect of these changes.

Our Pension Fund is in good shape. However like all pension funds, there are external factors which may have a significant effect on the pension liability, including, life expectancy, investment earnings and inflation.

Social and Environmental Responsibilities

By its very nature, NAAFI serves a social objective in providing a service to the Military, and returning financial dividends for the benefit of that community. NAAFI also supports many different aspects of Military life through continued association with the Combined Services Sports Board and sponsorship of the Army Families' Federation and other similar organisations.

NAAFI has an environmental policy, the principal aims of which are to become more energy efficient, minimise the amount of waste that is created, and to ensure we adhere to all relevant MOD environmental guidelines.

Our catering services under the PAYD and schools contracts in Germany continue to be subject to strict nutritional guidelines ensuring that balanced meals with plenty of healthy options are offered. In our retail outlets our food packaging conforms to latest guidelines, with our Tesco range in particular leading the way in informative labelling. This year NAAFI has introduced a Tchibo coffee offer and improved cafés in large stores, not only to satisfy consumer demand, but in recognition that we have a duty of care in providing a non-alcoholic led leisure offering.

Employees

At the end of 2005/06 NAAFI had a total workforce consisting of 3,609 people, 1,446 employed in the UK, 1,442 in Germany and the remainder in 11 other countries. The composition of this work force being:-

Sex	Part-time %	Full-time %	Total %
Male	23.1	6.3	29.4
Female	34.5	36.1	70.6
Total	57.6	42.4	100

In addition to direct employees the Corporation manages circa 800 seconded staff from the MOD for contracts in Germany.

During the financial year our direct staff turnover rate was 57%. With high percentages of our workforce in some countries being dependants of HM Forces, staff retention is often impacted by troop deployments.

In the UK and Germany we have an excellent relationship with Amicus, with whom we have a partnership agreement, whilst in other countries we also have strong relationships with local trade unions representing smaller groups of our employees. We regularly brief our recognised Trade Unions and employees on business strategy and performance through a wide range of communications, including our in-house magazine and newsletters.

We aim to pay market rates in each of the countries in which we operate, during 2005/06, our levels of pay increased by an average of 3.1% and the Corporation contributed £1.8m to the NAAFI Pension Scheme.

Highlights in 2005/06 included gaining the Investor in People standard for our PAYD operation in Elmpt, Germany and a significant reduction in reported accidents. Our 282 recorded accidents were 8% below last year's level, continuing the positive trend we have experienced from 2003/04, when 496 reports were received. Relative to the Health & Safety Executive (HSE) 2006 benchmark our performance is exceptionally good, at 21% lower.

The Future

The purpose for NAAFI remains clear – "to ensure that NAAFI remains a sustainable business that provides community support services for HM Armed Forces and their families". To this end we will be continuing to drive the business forward based on our strategic plans.

Delivering our mission

The next few years will see extensive refurbishment, new product ranges and a drive for lower pricing in all Forward Locations. We intend to continue providing fiscal returns to the Military through PAYD and MAC profits, amusement income and dividends and, where welfare need is important, we will continue to support loss making establishments.

Growing our business

Next year NAAFI will implement PAYD in the garrisons of Hohne and Paderborn and in future years will continue the roll out programme across Germany. In Cyprus, significant change will occur as we either increase our presence on the island, or manage a controlled exit, depending on the outcome of the bid.

To ensure that we remain a sustainable business, new sources of profitable income need to be found. The Corporation will be allocating resources to opportunities as they arise, preparing contract bids where appropriate, and assessing any suitable opportunities that emerge for re-entry into GB.

Re-engineering support costs

Building upon the excellent progress this year, we intend to continue making efficiency improvements to reduce support costs. With our business growing in catering and facilities management, we will be investing time and resources to ensure that we have the best possible people and processes in place to deliver excellent services.

In our Forward Locations we will be improving product availability through changes in physical supply chains and information systems over the next few years. We will be developing our rapid deployment capabilities building upon our experiences in Iraq and Afghanistan.

Responding to stakeholders

Over the next two years we will continue our customer research programme, roll out our Store of the Future concept to all large stores in Germany and Cyprus and improve our ranges and pricing in Forward Locations.

We intend to build further our strong relationships with Military stakeholders, particularly with PJHQ, to ensure we continually understand Military needs and troop deployments.

Summary

This has been a busy 12 months for NAAFI and throughout the year we have remained true to our mission and delivered welfare support to the British Military community.

We are part way through a significant change programme that will see our traditional retail and leisure facilities incorporated into a larger multi-faceted service offering which radically changes our entire business model including the structure and culture of the organisation.

Despite difficult trading conditions, I remain confident that we are building a business with a sustainable future that will continue to support our Military community wherever they are.

We are pleased to be able to return a welfare dividend of £0.5 million to the Services.

CM Reilly, Chief Executive Officer
8 August 2006

Five Year Record

REVENUE ACCOUNT	2002	2003	2004	2005 Restated	2006
	£'000	£'000	£'000	£'000	£'000
Turnover	261,222	258,062	260,417	257,520	226,217
Cost of sales	(181,824)	(176,938)	(174,494)	(179,184)	(156,432)
Other operating income	575	637	649	598	518
Gross surplus on trading	79,973	81,761	86,572	78,934	70,303
Operational costs	(81,188)	(77,465)	(80,423)	(74,894)	(68,929)
Exceptional operating income (net)	-	-	-	440	(1,600)
Profit/(Loss) on exchange	442	559	(287)	-	-
(Deficit)/Surplus on ordinary trading activities	(773)	4,855	5,862	4,480	(226)
Surplus on sales of properties and business	51	-	229	-	-
Income from investments	843	1,142	868	436	169
Interest receivable	557	740	755	652	578
Other finance income	-	-	-	2,000	1,000
Interest payable and similar charges	(142)	(199)	(185)	(127)	(202)
Surplus on ordinary activities	536	6,538	7,529	7,441	1,319

BALANCE SHEET	2002	2003	2004	2005	2006
	£'000	£'000	£'000	£'000	£'000
Fixed Assets					
Intangible assets	-	-	-	300	-
Tangible assets	11,083	10,112	13,287	14,789	14,214
Investments	2,813	3,100	3,264	3,264	1,664
Current Assets					
Stocks	14,145	14,525	15,403	15,579	15,717
Debtors: amounts falling due after more than one year	447	507	454	420	301
Debtors: amounts falling due within one year	9,189	10,197	8,625	8,561	6,744
Cash at bank and in hand	22,816	19,629	21,640	19,618	20,221
	46,597	44,858	46,122	44,178	42,983
Current Liabilities					
Creditors: amounts falling due within one year	(36,360)	(36,296)	(37,674)	(31,350)	(28,860)
Bank loans and overdrafts: amounts falling due within one year	(3,627)	-	-	-	-
	(39,987)	(36,296)	(37,674)	(31,350)	(28,860)
Net Current Assets	6,610	8,562	8,448	12,828	14,123
Provisions for liabilities and charges	(7,143)	(4,623)	(4,069)	(6,310)	(5,448)
Pension scheme surplus	-	-	-	6,000	6,000
Net Assets	13,363	17,151	20,930	30,871	30,553
Reserves					
Revaluation reserve	287	277	160	156	56
Revenue reserve	13,076	16,874	20,770	30,715	30,497
Total Reserves	13,363	17,151	20,930	30,871	30,553

The 2005 figures only have been restated for the effects of the adoption of FRS 17 and FRS 21; previous periods have not been restated due to a lack of information in this respect.

Board of Directors as at 8 August 2006

***Tony Hales*[1] BSc**
Non-Executive Chairman
Aged 58, joined NAAFI as Chairman in September 2001, following senior executive roles in industry. He is currently Chairman of British Waterways and Workspace Group, and a Non-Executive Director of Aston Villa. He was previously Chief Executive Officer of Allied Domecq and a Non-Executive Director of HSBC Bank and Reliance Security Group.
He is also Chairman of the NAAFI Nominations Committee.

Chris Reilly[2] MBA FCCA
Chief Executive
Aged 46, joined NAAFI as Finance Director in May 2001 and was appointed Chief Executive Officer in May 2002.
He has held a range of senior positions in the retail sector with Blockbuster, House of Fraser, Woolworths and Rumbelows.

Alison Clifford-King[3] BSc FCA
Non-Executive Director
Aged 40, joined the Board on 1 August 2004.
Alison is a Chartered Accountant and her career has been in finance and strategic planning roles in the retail and leisure sectors including Finance Director of Mothercare. Alison currently works as an independent consultant.
She is a member of the NAAFI Remuneration and Nominations Committees and chairs the NAAFI Audit Committee.

John Douglass[4]
Operations Director
Aged 51, joined the Board in May 2005.
John is responsible for NAAFI operations across the globe and has extensive experience in Operational and Commercial management across the international Arena. He was a Senior Executive of Safeway Stores for many years culminating in Stores Director.

Lieutenant General Sir Scott Grant[5] KCB MA
Non-Executive Deputy Chairman and Senior Independent Director
Aged 61, joined the Board in September 2001.
Sir Scott had a long and distinguished Military career, culminating in his appointments as Quartermaster General and Chief Royal Engineer. On leaving the Army in 2000, Sir Scott joined Thales Defence; and is now Vice President of Operations Thales UK.
He is a member of the NAAFI Audit, Remuneration and Nominations Committees.

Terry Morgan[6] MSc Feng FIEE
Non-Executive Director
Aged 57, joined the Board in October 2000.
Terry has had a number of senior appointments, particularly in the defence manufacturing industry with Royal Ordnance and BAE Systems. He is currently the Managing Director of Tube Lines, the operator of a major part of the London Underground.
He is Chairman of the NAAFI Remuneration Committee and a member of the NAAFI Audit and Nominations Committees.

Nigel Samuels[7]
Commercial Director
Aged 46, joined the Board in November 2004.
Nigel has significant experience in Commercial and Organisational development in both the private and public sector. He has held a number of Executive roles with Dixons Stores Group, Seeboard Energy Group and PRG New Zealand.

Paul Bryan FCIS FFA[8]
Company Secretary
Aged 56, joined NAAFI in July 2005.
He is a Chartered Company Secretary and has held similar positions in a variety of market sectors, among these, international banking with Standard Chartered, cement manufacturing at Blue Circle, television and film production at ATV and scientific filtration and DNA technology with Whatman plc.

1 PICTURE

2 PICTURE

3 PICTURE

4 PICTURE

5 PICTURE

6 PICTURE

7 PICTURE

8 PICTURE

-Alan Cole, formerly NAAFI Deputy Chairman, retired from the Board on 1 May 2006.
-Clive Warner, formerly Finance Director resigned from the Board on 31 May 2006.
The Corporation has a Directors' and Officers' liability insurance policy in force which indemnifies the Directors and Officers against the liability in the circumstances set out in the policy. It does not cover them for fraudulent or dishonest activities.
- No Director had, during the year or since the end of the year, any beneficial interest in any contract relevant to the Corporation's operations nor any interest in any of the Corporation's operations nor any interest in the shares of the Corporation.
- Hayden Robinson has been appointed as Finance Director and will join the Board on 6 September 2006.

Senior Management

Members of NAAFI Executive

Paul Bryan
Company Secretary

John Douglass
Operations Director

Bob Hounslow
Business Development Director

Phil Howe
Property Director

Jan Matthews
Director of PAYD

Martin Pearcy
Head of Risk Management

Chris Reilly
Chief Executive Officer

Nigel Samuels
Commercial Director

Shaun Stacey
Human Resources Director

Service Representatives to NAAFI

Commander Malcolm Brown MBE RN
Royal Navy Representative

Lieutenant Colonel Richard Horner MBE FISM RA
Army Representative

Group Captain Andrew Berridge MA RAF
Royal Air Force Representative

The 86th Annual Report of the Board of Management to the Council

The Board of Management submits its report and the audited financial statements for the year ended 29 April 2006.

Review of Activities
The Corporation is the official trading organisation of HM Forces, operating through a network of branches worldwide. Its activities are governed by the requirements of HM Forces.

A review of NAAFI's operations is included in the Chairman's statement on pages 1-2 and financial affairs are set out on pages 21-24 of this report.

Corporation Results
The final (loss)/surplus for the year after charging dividends amounting to £1.6m (2004/05 £3.75m) was (£0.3m) (2004/05 £3.7m).

Future Developments
NAAFI will continue to provide high quality retail, leisure and catering services for the Armed Forces and their families.

Further investment is planned in Germany to continue to upgrade the retail experience and to support PAYD.

The Corporation has also tendered for the award of a Multi Activity Contract in respect of the British Forces Bases in Cyprus, which includes the Corporation's existing operations there. The announcement of the preferred bidder is expected to be in November 2006.

In GB judicious investment will continue to be made to maintain services prior to the transfer of the business to contractors, which is expected to be completed by 2008.

Health and Safety
Our policy is to provide and maintain safe and healthy working conditions, equipment and systems of work for all our employees, and also to provide such information, training and supervision as they need for this purpose. We accept responsibility for the health and safety of other people who may be affected by our activities whilst, for example, attending our premises.

Whilst all employees have a responsibility in relation to health and safety matters, ultimately, at Board level, the Chief Executive Officer has overall responsibility.

Reports on health and safety are regularly made to the Board.

Employment Policies
We aim to create a working environment in which every current or prospective employee is given equal opportunity in selection, development and promotion.

Employment of Disabled Persons
Our policy is to ensure that equal opportunities are given to applications from registered disabled persons applying for employment vacancies, taking into account the qualifications of such applicants against the requirements of the positions for which they apply. If an existing employee becomes disabled, every effort will be made to assist rehabilitation and, where necessary, to retrain for continued employment. It is our policy that the training, development and promotion of disabled persons is, as far as possible, identical to that of other employees.

Employee Involvement
Our policy is to inform employees of matters which concern them as employees and, through regular consultation with employee representatives, to take into account their views. We seek by these means to cultivate awareness of relevant factors affecting the performance of our business. We also distribute information to employees through a wide range of communications, including our in-house magazine and newsletters.

Employees actively participate in decisions which affect the operation and running of our pension scheme. In the UK and Germany we have a strong relationship with Amicus (our recognised Trade Union), with whom we have established a partnership agreement providing both negotiation and consultation processes. We have good relationships with other trade unions representing small groups of our employees in other countries.

Directors and their Interests
The Directors who held office during the year are shown on page 11.

Staff
The Board wishes to record its appreciation of the continued loyalty of the staff of the Corporation.

Creditor Payment Policy
The Corporation's current policy concerning the payment of the majority of its trade creditors is to follow the CBI's Prompt Payers Code. (Copies available from the CBI, Centre Point, 103 New Oxford Street, London, WC1A 1DU).
For other suppliers, the Corporation's policy is to:

a) Settle the terms of payment with those suppliers when agreeing the terms of each transaction.
b) Ensure that those suppliers are made aware of the terms of payment by inclusion of the relevant terms in contracts.
c) Pay in accordance with its contractual and other legal obligations.

The payment policy applies to all payments to creditors for revenue and capital supplies of goods and services without exception.

The number of days credit taken by the Corporation from its suppliers at the year end is 26 days (2004/05 - 35 days).

Charitable Contributions
Charitable contributions during the year amounted to £2,519 (2004/05 £3,378) to a variety of different organisations. Employees are encouraged to support and contribute informally to a range of Services' charities.

Corporation Accounts
NAAFI is a company limited by guarantee incorporated under the Companies Act.

Independent Auditors
PricewaterhouseCoopers LLP have expressed their willingness to continue in office as auditors and a resolution to reappoint PricewaterhouseCoopers LLP as auditors to the Corporation will be proposed at the Annual General Meeting.

AGM
The Corporation's Annual General Meeting will be held on 27 October 2006.

PA Bryan

By order of the Board
PA Bryan, Company Secretary, London Road, Amesbury, Wiltshire, SP4 7EN
8 August 2006   Company No. 171912

Corporate Governance Statement

1 Introduction

The Board of Management has voluntarily applied the principles contained in section one of the 2003 Combined Code on Corporate Governance ("the Code").

The Board confirms that the Corporation has been in compliance with the Code's provisions throughout the year.

The following statement sets out how the Corporation has applied the principles and complied with the provisions of the Code.

2 The Board of Management

The Board has in place a schedule of matters requiring its prior approval, which is reviewed each year.

These include (but are not restricted to) the establishment and constitution of Board Committees, identification of strategic objectives, approval of business plans, budgets and financial reports, capital expenditure above £200,000, provision of guarantees, Treasury arrangements and risk management policies.

The aim is to safeguard the assets of NAAFI and to ensure the proper control and management of the Corporation.

The Board has also delegated other matters to the Executive Directors and managers of the Corporation.

The operations and effectiveness of the Board of Management are maintained by the following:

a) The balance on the Board between Executive and Non-Executive Directors. There are 5 Non-Executive Directors and 4 Executive Directors. However at the year end there was a vacancy for 1 Non-Executive Director and 1 Executive Director which are in the process of being filled.

b) The Board of Management is headed by Tony Hales, who is the Non-Executive Chairman. The Deputy Chairman, Lt Gen Sir Scott Grant, is also the Senior Independent Director.

c) There is a clear division of responsibility between the Chairman and the Chief Executive Officer; the Chief Executive Officer has day-to-day responsibility for managing the business of the Corporation within the delegated powers.

d) A timetable of Board and Committee Meeting dates and business is prepared well in advance for each year which enables Directors carefully to plan their commitments. The timetable provides for the Board of Management to meet on six occasions each year. Over the last year, the Board met on six occasions.

e) The agenda and detailed Board digests are prepared and circulated to Directors well in advance of each Board Meeting. Presentations are given by Directors and other senior management at Board Meetings in support of the digests.

The Chairman and the Deputy Chairman are also members of the NAAFI Council. The NAAFI Council meets twice a year, one of the meetings being the Annual General Meeting. Membership of the NAAFI Council is comprised of Senior Military Officers and senior representatives of the Ministry of Defence, as well as the Chairman and Deputy Chairman. Council is the governing body of NAAFI and directs its strategy and gives general business direction.

The Chairman and the other Non-Executive Directors meet at least twice each year without the Executive Directors being present (unless they are needed for specific items of business). The Non-Executive Directors meet once a year, without the Chairman being present, in order to review his performance.

There is an induction process to provide new Directors with training appropriate to the individual's requirements. Non-Executive Directors meet senior management and visit NAAFI outlets both in the United Kingdom and abroad.

The Board is also kept up to date with issues of a regulatory nature which affect both NAAFI and the Directors.

During 2005/06, in accordance with the Code, a Board session was dedicated to an evaluation of the performance of the Board, its Committees and the Directors.

All Directors, Executive and Non-Executive, are subject to annual appraisal.

3 The Chairman

The Chairman was appointed as a Director and as Chairman on 10 September 2001 and re-appointed following the Nominations Committee and Council approval for three years from September 2004.

A brief pen portrait of Mr Hales and details of his other appointments are given on page 11.

NAAFI considers that Mr Hales continues to be able to allocate sufficient time for his duties with NAAFI and his other commitments.

4 Other Non-Executive Directors

All NAAFI Non-Executive Directors are appointed for an initial period of three years and are eligible for appointment for a further three year period. All appointments are made initially by recommendation of the Nominations Committee and are then subject to approval by the Board and by Council.

In addition, all Non-Executive Directors are subject to retirement by rotation and re-election by Council at the Annual General Meeting at least once every three years.

The general terms and conditions of appointment of the Non-Executive Directors are retained by the Company Secretary; these set out the expected time commitment, together with all other relevant aspects including remuneration, expenses, notification of other commitments and other matters relevant to the appointment and its continuance.

The fees for the Non-Executive Directors are approved by the Council following Board recommendation and are set out on page 17.

All Non-Executive Directors have access to the Company Secretary and may take independent professional advice at the Corporation's expense in connection with matters relating to the business of the company should the need arise.

Prospective appointments are considered by the Nominations Committee which agrees a specification for and the capabilities required by the role. Executive search consultants are used to recommend potential candidates for consideration for appointment as Non-Executive Directors. The Executive search consultants used by NAAFI are totally independent of NAAFI and have no connection or interest in NAAFI. Only after a rigorous interview process is any appointment recommended to the Board.

The Board considers that all the Non-Executive Directors are independent.

5 Executive Directors

The Chief Executive Officer is appointed upon the recommendation of the Nominations Committee and the Board, with confirmation by the NAAFI Council. He serves under a contract of employment with NAAFI providing for not less than 12 months' notice of termination to be given either by NAAFI or by the Director.

Other Executive Directors are appointed by the Board on the recommendation of the Nominations Committee. They serve under a contract of employment with NAAFI providing for not less than 6 months' notice of termination to be given either by NAAFI or by the Director. Clive Warner, who resigned on 31 May 2006 served under a contract of employment with NAAFI providing for not less than 12 months' notice of termination to be given either by NAAFI or by the Director.

Details of the remuneration of the Executive Directors are set out on page 17. The remuneration of the Chief Executive Officer is approved by the Remuneration Committee and by Council, whilst that of the other Executive Directors is approved by the Remuneration Committee and advised to Council.

All Executive Directors have access to the Company Secretary and may take independent professional advice at the Corporation's expense, in connection with matters relating to the business of the company should the need arise.

6 Committees of the Board

There are three Committees of the Board, formally appointed by Board Resolution with appropriate delegation of authority. During the financial year, the authorities were reviewed and in each case renewed.

Corporate Governance Statement

The Board Committees are:

a) The Audit Committee

This is now chaired by Alison Clifford-King who took over from Alan Cole following the latter's retirement on 1 May 2006. The Committee meets three times each year. The timetable of business for each meeting is approved before the year commences.

All the Non-Executive Directors except for the Chairman are members of the Committee. In attendance, as required, are the Chairman, the Company Secretary, the Chief Executive Officer, the Finance Director, the Head of Risk Management and the external auditors. The Committee meets with the external auditors at least once each year without management being present.

The Audit Committee reviews the financial and internal reporting process, the system of internal controls, the management of risks and the external and internal audit process. The Committee also recommends to the Board, proposals for the appointment of the external auditors, and is directly responsible for their remuneration, oversight of their work and monitoring of their independence.

Each of the Non-Executive Directors has, through their other business activities, significant experience in financial matters. In addition, Alison Clifford-King is a Chartered Accountant.

The Committee's terms of reference are available on the Corporation's website.

The Audit Committee has also sponsored the development of whistleblowing arrangements throughout the Corporation to deal, in confidence, with complaints from employees about any accounting or financial management impropriety or other questionable business practice or conduct. These arrangements are periodically reviewed.

The Board has also implemented a policy which controls the amount of non-audit services provided by the external auditors. Any non-audit services by the auditors must be approved by the Audit Committee. In 2005/06 this was limited to assisting the Corporation with its research of International Financial Reporting Standards.

b) The Remuneration Committee

This Committee is chaired by Terry Morgan. The Committee plans to meet as of need but at least twice a year - during the financial year it met twice.

All the Non-Executive Directors except for the Chairman are members of the Committee. In attendance are the Chairman, the Chief Executive Officer and, on occasions, the Human Resources Director and/or the Company Secretary. Individuals do not remain in the meeting when their own terms are under discussion.

The Committee's terms of reference are available on the Corporation's website.

The Committee is authorised by the Board to set the overall management remuneration policy for NAAFI, and the individual remuneration arrangements for Executive Directors and certain other Senior Executives (except for the Chief Executive Officer and NAAFI Chair where the Committee recommends arrangements for approval by the President of the NAAFI Council).

The Committee also approves any termination or post-employment payments to Executive Directors and Senior Executives.

The Committee seeks outside professional advice from remuneration consultants and such other advisers as it requires. These advisers are totally independent of NAAFI and have no other interest in or other connection with NAAFI.

c) The Nominations Committee

This Committee is chaired by the Chairman of the NAAFI Board of Management and membership comprises all the Non-Executive Directors.

In attendance is the Company Secretary together with such other management or advisers as the Committee may require.

The Committee plans to meet as of need but at least twice each year – during the financial year it met three times.

The Committee is authorised by the Board to process and recommend to the Board membership of the Board and its standing committees, and to ensure that appropriate succession planning and development programmes are in place.

The Corporation's policy on Executive Directors taking up external appointments is also operated by the Nominations Committee – it is policy to allow one such external appointment. The Remuneration Committee policy is to allow the remuneration for one such appointment to be retained by the individual.

The terms of reference of the Committee are available on the Corporation's website.

Details of attendance at Board and Committee meetings are set out below:

	Board (6)	Audit (3)	Remuneration (2)	Nominations (3)
A J Hales	6	3*	2*	3
A Clifford-King	6	3	2	3
A Cole[1]	6	3	2	3
Sir Scott Grant	5	3	2	3
J Douglass	6	N/A	N/A	N/A
T Morgan	4	3	1	2
C Reilly	6	2*	2*	2*
N Samuels	6	N/A	N/A	N/A
C Warner[2]	6	3*	N/A	N/A

[1] Alan Cole retired from the Board on 1 May 2006

[2] Clive Warner resigned from the Board on 31 May 2006

* In attendance by invitation of the Committee.

7 Remuneration

The Directors are responsible for preparing the Remuneration Committee report in accordance with the requirements of relevant legislation. This report is set out on pages 17-18.

8 Internal Control and Risk Management

The Board of Management is responsible for the operation of NAAFI's internal controls and reviewing its effectiveness.

The system of controls is designed to create effective and efficient operations and to manage, not eliminate, risk in the business.

The Board receives an annual report from the Head of Risk Management on internal controls and risk management. This is a detailed review and deals in particular with the embedding of risk management in the business, giving special attention to the identification of new risks and ensuring that controls are in place to manage them.

Key aspects of the Board's review of controls are:

a) Audit Committee

The Audit Committee reviews major business and financial risks, the controls in place, and information on the procedures and results of risk management work.

Through the Audit Committee, the Board has reviewed the effectiveness of NAAFI's internal controls in accordance with relevant guidance contained in 'Internal Controls Guidance for Directors on the Combined Code'.

b) Risk Management Committee

The Risk Management Committee acts as the focus for reviewing risk and ensuring it is covered by insurance where appropriate, in particular it reviews health and safety, environmental, security, legal, and regulatory compliance matters. This Committee is chaired by the Chief Executive Officer.

Corporate Governance Statement

c) Internal Finance and Operational Controls

The Directors of NAAFI are also responsible for the Corporation's internal controls within the separate operations, including safe-guarding of assets and ensuring proper accounting records are in place and that management information is accurate. Comprehensive review and management action is undertaken, with controls amended and updated to align with the risk profile of the business.

Controls are made more effective by NAAFI's organisational structure which has clear lines of responsibility and accountability.

d) Identification of Business Risks

Business risks are regularly reviewed by the business units, assessing the risk impact and the control procedures in place. Major emerging risks are also reviewed at meetings of the Board, of the Audit Committee and of the Risk Management Committee.

e) Major Corporate Information Systems

There is a comprehensive budgeting system, with an annual budget approved by the Board. Monthly management reporting packs include full details of the key data in the business, with any significant variances examined and explained, with clear action plans and accountability where necessary. Cash flow forecasts are prepared to ensure that the Corporation has adequate funds and resources.

f) NAAFI Council

The Board reports to the NAAFI Council on a half yearly basis, giving details of progress in key areas of the business.

g) Management Audit

NAAFI's controls are subject to regular review by the risk-focused Management Audit, which reports regularly to the Audit Committee. The Audit Committee approves the Management Audit plans, on behalf of the Board, and ensures that the scope of work, the authority and the resources of the department are kept under review.

The Head of Risk Management has direct access to the Audit Committee and reports directly to the Chief Executive Officer. He is also responsible for Management Audit.

A direct telephone line, to the Head of Risk Management, is in place to enable any employee to advise management, on a totally confidential basis, of any delicate issue of major concern affecting NAAFI.

h) External Audit

The Audit Committee also receives reports on internal controls and procedures from the external auditors.

9 Going Concern

NAAFI, being the official trading organisation of HM Forces, has its activities governed by the requirements of HM Forces through the NAAFI Council. The NAAFI Council is made up of four senior Service Officers, two senior Ministry of Defence representatives and the Chairman and Deputy Chairman of NAAFI.

The Board of NAAFI ensures that the above stated requirements are met.

Given this corporate structure and after making appropriate enquiries, the Directors have formed a judgement, at the time of approving the financial statements, that there is a reasonable expectation that the Corporation has adequate resources to continue its operational existence for the foreseeable future. For this reason, the Directors continue to adopt the going concern basis in preparing the financial statements.

PA Bryan

By order of the Board
PA Bryan, Company Secretary, London Road, Amesbury, Wiltshire, SP4 7EN
8 August 2006 Company No. 171912

Remuneration Committee Report

The Board's Remuneration Committee is responsible for determining remuneration for our Executive Directors and senior managers, and for defining the remuneration, benefits and terms and conditions of service for each Executive Director. The Committee is assisted in determining the remuneration of the Corporation's Executive Directors by examining external benchmarking surveys.

The Committee consists of the Non-Executive Directors excluding the Chairman, and is chaired by Terry Morgan.

Our policy in relation to the base salary of our Executive Directors and senior managers is to pay at a level which is competitive against similar sized retail organisations and which reflects the responsibility, difficulty and complexity of the roles, compared to external benchmarks. The base salaries of the Executive Directors were increased by an average of 3.1% during the year.

Each Executive Director participates in an incentive plan which is intended to reward the achievement of pre-determined and demanding performance goals by discretionary non-pensionable cash bonuses calculated as a percentage of salary. Performance goals are set on an annual basis geared to our business objectives.

The maximum bonus payment in any one year is set at 50% and is linked directly to our profits. For the year 2005/06, no bonus was paid to Executive Directors as the profit performance targets were not achieved.

Executive Directors may participate in the same pension scheme as other employees. The scheme provides for a normal retirement age of 61 for Directors and Directors pay an annual contribution equal to 6% of pensionable pay.

Executive Directors have service contracts that are terminable on a year's notice given by either party.

Each Non-Executive Director has been appointed for a term of three years renewable for a further term of three years by agreement with the NAAFI Council. They are independent of the Corporation and are free from any business or other relationship that could materially interfere with them exercising independent judgement. The remuneration of Non-Executive Directors is determined by the Board and is agreed by the Council.

The Remuneration Committee Report will be proposed for approval by the NAAFI Council at the forthcoming Annual General Meeting.

Elements of Remuneration Package of each Director in 2005/06

	Basic Salary	Fees	Benefits in Kind	Employer's Pension Contributions	Total 2006	Total 2005
	£	£	£	£	£	£
Continuing						
A Clifford-King	-	15,000	-	-	15,000	10,000
Lt Gen Sir Scott Grant	-	18,750	-	-	18,750	17,625
AJ Hales	-	50,000	-	-	50,000	50,000
T Morgan	-	18,000	-	-	18,000	16,750
CM Reilly	186,120	-	22,447	22,275	230,842	234,326
N Samuels	125,000	-	18,357	17,070	160,427	73,449
J Douglass	120,000	-	9,398	13,724	143,122	-
Retired						
AJ Cole	-	30,000	-	-	30,000	25,834
CH Warner	134,000	-	14,773	17,491	166,264	159,790
M Guffogg	-	-	-	-	-	63,803
N McCausland	-	-	-	-	-	87,829
VJ Steel	-	-	-	-	-	10,609
	565,120	131,750	64,975	70,560	832,405	750,015

Mr AJ Hales' fees include £15,000 (2004/05 £12,500) which he waived and was paid as a donation to The Soldier's, Sailor's, Airmen and Families Association.
Mr AJ Cole retired from the Board on 1 May 2006.
Mr CH Warner resigned from the Board on 31 May 2006.
Other Director's benefits in kind include car, petrol, private health insurance and housing allowance.

Pension Benefits Earned by Directors in 2005/06

	Additional accrued benefits earned in the year £	Accrued Entitlement £	Transfer value at 29 April 2006 £	Transfer value at 30 April 2005 £	Increase in transfer value less Directors' contributions £
CM Reilly	2,496	10,709	81,905	56,262	19,292
J Douglass	2,112	2,112	21,390	-	16,095
N Samuels	2,292	3,318	25,626	7,155	12,320
CH Warner	2,777	10,257	122,965	78,475	38,139
M Guffogg	-	-	-	26,931	-

	Accrued deferred pension at 29 April 2006 £pa	Increase in accrued pension during 2005/06 £pa	Corporation element of transfer value at 29 April 2006 of the increase in accrued pensions £
CM Reilly	10,709	2,274	11,041
J Douglass	2,112	2,112	16,095
N Samuels	3,318	2,264	11,271
CH Warner	10,257	2,575	24,519

The accrued deferred pension shown is that which would be paid annually from the NAAFI Pension Fund on retirement based on service to 29 April 2006. The increase in accrued pension during the year excludes any increase for inflation. The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 less Directors' contribution. Directors have the option to pay Additional Voluntary Contributions; neither the contribution nor the resulting benefits are included in the above table.

Statement of Directors' Responsibilities

Statement of Directors' Responsibilities

United Kingdom Company law requires the Directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Corporation and of the surplus or deficit of the Corporation for that period. The Directors are required to prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Corporation will continue in business.

The Directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 29 April 2006 and that applicable accounting standards have been followed.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Corporation and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Corporation and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Auditors and Disclosure of Information to Auditors

Each Director as at the date of this report, has confirmed that insofar as they are aware there is no relevant audit information (that is, information needed by the Corporation's auditors in connection with preparing their report) of which the Corporation's auditors are unaware, and they have taken all the steps they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Corporation's auditors are aware of that information.

P.A. Bryan

By order of the Board
PA Bryan, Company Secretary
8 August 2006

Independent Auditors' Report to the Members of the Navy, Army and Air Force Institutes

We have audited the financial statements of NAAFI for the year ended 29 April 2006 which comprise the Revenue Account, the Statement of Total Recognised Gains and Losses, the Note of Historical Cost Surplus, the Balance Sheet, the Cash Flow Statement,and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Corporation's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Annual Report of the Board of Management to the Council is consistent with the financial statements. The information given in the Annual Report of the Board of Management to the Council includes that specific information presented in the Chief Executive Officer's Operating Review that is cross referred from the Business Review section of the Annual Report of the Board of Management to the Council. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises only the Chairman's Statement, the Chief Executive Officer's Operating Review, the Five Year Record, the Board of Directors, the Senior Management, the Annual Report of the Board of Management, the Corporate Governance Statement, the Remuneration Committee Report and the Statement of Directors' Responsibilities. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

We also, at the request of the Directors (because the Corporation applies the Financial Services Authority Listing Rules as if it were a listed company), review whether the corporate governance statement reflects the Corporation's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Corporation's Corporate Governance procedures or its risk and control procedures.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Corporation's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Corporation's affairs as at 29 April 2006 and of its profit and cash flows for the year then ended;

- the financial statements have been properly prepared in accordance with the Companies Act 1985; and

- the information given in the Annual Report of the Board of Management to the Council is consistent with the financial statements.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Uxbridge
8 August 2006

Navy, Army and Air Force Institutes (a company limited by guarantee)
Revenue Account - for the year ended 29 April 2006

	Note	2006 £'000	2005 Restated £'000
Turnover	2	226,217	257,520
Cost of sales		(156,432)	(179,184)
Other operating income		518	598
Gross surplus on trading		70,303	78,934
Operational costs excluding exceptional items	3	(68,929)	(74,894)
Exceptional operating (costs)/income (net)	7	(1,600)	440
Total Operational Costs		(70,529)	(74,454)
(Deficit)/Surplus on ordinary trading activities		(226)	4,480
Income from investments	12	169	436
Interest receivable	4	578	652
Other finance income	9	1,000	2,000
Interest payable and similar charges	5	(202)	(127)
Surplus on ordinary activities		1,319	7,441

All amounts above relate to continuing operations.

The notes on pages 25 to 35 form part of these financial statements

Statement of Total Recognised Gains and Losses - for the year ended 29 April 2006

	2006 £'000	2005 Restated £'000
Surplus on ordinary activities	1,319	7,441
Actuarial loss recognised in pension scheme	-	(14,000)
	1,319	(6,559)
Prior year adjustment - pension scheme	6,000	
Total gains recognised since last annual report	7,319	

Note of Historical Cost Surplus - for the year ended 29 April 2006

	2006 £'000	2005 Restated £'000
Surplus on ordinary activities	1,319	7,441
Realisation of property valuation gains of prior years	(96)	96
Difference between historical cost depreciation charge and the actual depreciation charge for the year calculated on the revalued amount	4	4
Historical cost surplus before dividends for the financial year	1,227	7,541

Reconciliation of Movement in Reserves - for the year ended 29 April 2006

	2006 £'000	2005 Restated £'000
Surplus on ordinary activities	1,319	7,441
Dividend	(1,637)	(3,750)
	(318)	3,691
Actuarial loss recognised in pension scheme	-	(14,000)
Opening reserves (previously £20,930k before adding a prior year adjustment of £20,250k to restate 24 April 2004 figures, disclosed in Note 17)	30,871	41,180
Closing reserves	30,553	30,871

The notes on pages 25 to 35 form part of these financial statements

Balance Sheet as at 29 April 2006

	Note	2006 £'000	2005 Restated £'000
Fixed Assets			
Intangible assets	10	-	300
Tangible assets	11	14,214	14,789
Investments	12	1,664	3,264
		15,878	18,353
Current Assets			
Stocks	13	15,717	15,579
Debtors	14	7,045	8,981
Cash at bank and in hand		20,221	19,618
		42,983	44,178
Current Liabilities			
Creditors: amounts falling due within one year	15	(28,860)	(31,350)
Net Current Assets		14,123	12,828
Total assets less current liabilities		30,001	31,181
Provisions for liabilities and charges	16	(5,448)	(6,310)
Net assets excluding pension scheme surplus		24,553	24,871
Pension scheme surplus	9	6,000	6,000
Net assets including pension scheme surplus		30,553	30,871
Reserves			
Revaluation reserve	17	56	156
Revenue reserve	17	30,497	30,715
Total Reserves		30,553	30,871

Approved by the Board of Management on 8 August 2006

A J Hales

AJ Hales Chairman

CM Reilly

CM Reilly *Chief Executive Officer*

The notes on pages 25 to 35 form part of these financial statements

Cash Flow Statement
for the year ended 29 April 2006

	Note	2006 £'000	2006 £'000	2005 £'000	2005 £'000
Net cash inflow from operating activites	18		6,699		5,664
Returns on investments and servicing of finance					
Interest and similar income received		747		653	
Interest and similar costs paid		-		(128)	
			747		525
Capital expenditure and financial investment					
Tangible fixed assets purchased		(6,096)		(5,601)	
Proceeds from sale of tangible fixed assets		581		343	
			(5,515)		(5,258)
Dividend paid			(1,637)		(3,750)
Acquisitions and disposals					
Purchase of business		-		(631)	
Net cash acquired with business		-		1,424	
			-		793
Cash inflow/(ouflow) before management of liquid resources and financing			294		(2,026)
Management of liquid resources					
Decrease in deposits	19		1,040		4,051
Increase in cash in the period	19		1,334		2,025

Reconciliation of net cash flow to movement in net liquid funds

	Note	2006 £'000	2006 £'000	2005 £'000	2005 £'000
Increase in cash in the period		1,334		2,025	
Cash outflow from decrease in liquid resources		(1,040)		(4,051)	
Net change in cash resulting from cash flows	19		294		(2,026)
Translation differences	19		309		4
Movement in net liquid funds in the period			603		(2,022)
Net liquid funds at the start of year	19		19,618		21,640
Net liquid funds at end of year	19		20,221		19,618

The notes on pages 25 to 35 form part of these financial statements

Notes to the Financial Statements for the Year Ended 29 April 2006

1. Accounting Policies

The financial statements have been prepared in accordance with the Companies Act 1985 and with accounting standards in the United Kingdom. A summary of the important accounting policies, which have been applied consistently with the exception of the adoption of new accounting standards, is set out below. These financial statements are presented in accordance with the most recent Financial Reporting Standards (FRS) with the exception of FRS 23 and FRS 26, which are not mandatory until financial periods commencing on or after 1 January 2007.

Changes in accounting policies, together with the impact of such changes on comparative information in respect of prior periods, are explained below as follows:

(a) FRS 17 - Retirement Benefits

Assets and liabilities arising from retirement benefit obligations and the related funding are reflected at fair value in the financial statements, and operating and finance costs/income are recognised in the accounting periods in which they arise.

(b) FRS 21 - Events after the balance sheet date

Dividends are recognised only when declared. Proposed dividends are not recognised as a liability at the balance sheet date.

(c) FRS 25 - Financial Instruments - Disclosure and Presentation

Costs associated with capital instruments that are classified as liabilities should be allocated to accounting periods on a fair basis over the period the instrument is in issue. The presentation requirements of FRS 25 have been adopted in the current year and the remaining disclosure requirements of FRS 25 will be adopted on adoption of FRS 26.

(d) Reclassification of Operating Costs

Costs arising for the provision of labour for services rendered to the MOD have been reclassified between operating costs and cost of sales for 2006 and 2005 only.

Reconciliation of Revenue Account

for the year ended 30 April 2005

	As reported 2005	FRS 17 Retirement Benefits	FRS 21 Events after the Balance Sheet Date	Reclassification	Total Adjustments	As restated 2005
	£'000	£'000	£'000	£'000	£'000	£'000
Turnover	257,520	-	-	-	-	257,520
Cost of sales	(177,640)	-	-	(1,544)	(1,544)	(179,184)
Other operating income	598	-	-	-	-	598
Gross surplus on trading	**80,478**	-	-	**(1,544)**	**(1,544)**	**78,934**
Operational costs excluding exceptional item	(77,353)	1,000	-	1,459	2,459	(74,894)
Exceptional operating income (net)	440	-	-	-	-	440
Loss on exchange	(85)	-	-	85	85	-
Total operational costs	**(76,998)**	**1,000**	-	**1,544**	**2,544**	**(74,454)**
Surplus on ordinary trading activities	3,480	1,000	-	-	1,000	4,480
Income from investments	436	-	-	-	-	436
Interest receivable	652	-	-	-	-	652
Other finance income	-	2,000	-	-	2,000	2,000
Interest payable and similar charges	(127)	-	-	-	-	(127)
Surplus on ordinary activities before dividend	**4,441**	**3,000**	-	-	**3,000**	**7,441**
Dividends	(2,000)	-	2,000	-	2,000	-
Surplus on ordinary activities after dividend	**2,441**	**3,000**	**2,000**	-	**5,000**	**7,441**

The reclassification relates to Military labour costs being reallocated from operating costs to cost of sales.

Reconciliation of Balance Sheet
as at 30 April 2005

	As reported 2005 £'000	FRS 17 Retirement Benefits £'000	FRS 21 Events after the Balance Sheet Date £'000	Total Adjustments £'000	As restated 2005 £'000
Fixed Assets					
Intangible assets	300				300
Tangible assets	14,789	-	-	-	14,789
Investments	3,264	-	-	-	3,264
	18,353	-	-	-	18,353
Current Assets					
Stocks	15,579	-	-	-	15,579
Debtors	8,981	-	-	-	8,981
Cash at bank and in hand	19,618	-	-	-	19,618
	44,178	-	-	-	44,178
Current Liabilities					
Creditors: amounts falling due within one year	(32,850)	-	1,500	1,500	(31,350)
Net Current Assets	**11,328**	**-**	**1,500**	**1,500**	**12,828**
Total assets less current liabilities	**29,681**	**-**	**1,500**	**1,500**	**31,181**
Provisions for liabilities and charges	(6,310)	-	-	-	(6,310)
Net assets excluding pension scheme surplus	**23,371**	**-**	**1,500**	**1,500**	**24,871**
Pension scheme surplus	-	6,000	-	6,000	6,000
Net assets including pension scheme surplus	**23,371**	**6,000**	**1,500**	**7,500**	**30,871**
Reserves					
Revaluation Reserve	156	-	-	-	156
Revenue Reserve	23,215	6,000	1,500	7,500	30,715
Total Reserves	**23,371**	**6,000**	**1,500**	**7,500**	**30,871**

The effect on the prior year balances as a result of FRS 17 and FRS 21 have been accounted for in Note 17.

Basis of accounting
The financial statements have been made up to the last Saturday in April. The financial statements are prepared as Corporation accounts. The financial statements are prepared under the historical cost convention, except for certain properties which are included in the financial statements at valuation, and in accordance with the requirements of the Companies Act 1985.

Turnover
Turnover represents the amounts receivable for goods supplied and services rendered to customers and is exclusive of value added tax. In accordance with FRS 5, sales through outlets are shown net of staff discounts. Turnover comprises income invoiced to the MOD and is recognised when the services are rendered.

Taxation
NAAFI is not subject to taxation and hence no tax or deferred taxation is accrued, provided for or recognised.

Intangible assets - goodwill
Goodwill arising on the acquisition of businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight line basis over its useful economic life. Provision is made for any impairment.

Fixed assets and depreciation
Depreciation is provided so as to write off the cost (or valuation) of tangible fixed assets by equal annual instalments over their estimated useful lives, as follows:

Freehold buildings	Up to 50 years
Leasehold land and buildings	Over the remaining period of lease
Fixtures and fittings	Up to 7 years according to type
Vehicles	Up to 4 years
IT equipment	Up to 5 years according to type
Software	Up to 2 years

No depreciation is provided on freehold land. Expenditure on buildings on Ministry or Service owned land or any other land on which there is no security of tenure is charged against revenue. In the case of substantial projects where tenure can be reasonably assured for the life of the asset, these are capitalised and depreciated over a period of up to 7 years. No depreciation is provided on assets in the course of construction, which are capitalised on completion to the relevant fixed asset category and depreciated accordingly.

When a review for impairment is conducted, the recoverable amount is assessed by comparison of the carrying value of the asset against the higher of net realisable value or value in use. The value in use is determined from estimated discounted future cash flows. Discount rates used are based on the individual circumstances.

Investments
Investments are shown at cost less provision for impairment.

Leased assets
All leases are operating leases and the rentals are charged/credited to the revenue account, as they arise.

Property valuation
Properties which were depreciated over more than five years were revalued either internally or externally on 3 May 1997 on the basis of existing use market value (except when another basis was more appropriate) by members of the Royal Institution of Chartered Surveyors and have been retained and not updated in the balance sheet at valuation. Additions since that valuation are stated at cost.

Stocks
Stocks are stated at the lower of cost and net realisable value. Cost is generally computed on the basis of selling price less appropriate trading margins. Where necessary, provision is made for obsolete, slow moving or defective stock.

Currency translation
Operating results of overseas trading are translated into sterling at the average rate of exchange for the year. Assets and liabilities held in overseas currencies are translated into sterling at the rates of exchange ruling at the end of the year except for stocks and tangible fixed assets which are translated at the rates ruling at the date of purchase. Differences on exchange are dealt with through the revenue account.

Pension funding
The Corporation has adopted FRS 17 'Retirement Benefits' in these accounts. These disclosures are set out in note 9. Assets and liabilities arising from retirement benefit obligations and the related funding are reflected at fair value in the financial statements, and operating and finance costs/income are recognised in the financial periods in which they arise. Gains and losses arising from actuarial experience during the accounting period are recognised in the statement of total recognised gains and losses. In prior years, variations from the regular cost of providing defined benefits were recognised over the remaining service life of the employee. Prior years results have been adjusted to reflect this change.

2. Segmental

Segmental information by geographical area is as follows:

	Turnover		(Deficit)/Surplus on Ordinary Trading Activities		Net Assets	
	2006	2005	2006	2005 Restated	2006	2005 Restated
	£'000	£'000	£'000	£'000	£'000	£'000
Great Britain	86,336	104,737	(3,404)	680	(864)	(327)
Overseas	139,881	152,783	3,178	3,800	31,417	31,198
Total	226,217	257,520	(226)	4,480	30,553	30,871

Goods supplied and services provided to customers comprise different elements of retail and leisure services. These supplies and services comprise both cash and credit transactions to troops and their families. In addition to retail supplies and services NAAFI provides club and entertainment and contract catering services. All of NAAFI's customer base is considered as one business segment. The disclosure of geographical trading results and segmented information under Statement of Standard Accounting Practice No. 25 is given above.

3. Operational costs excluding exceptional items

	Note	2006 £'000	2005 Restated £'000
Staff costs	6	44,273	44,189
Operating leases - property		997	1,440
Other pension costs		3,000	1,000
Profit/(loss) on exchange		112	(85)
Other costs		13,573	21,987
Hire charges for furnishing and equipment (including operating leases)		743	1,085
Auditors' remuneration for audit		140	160
Auditors' remuneration for non- audit		5	15
Depreciation of tangible fixed assets	11	6,273	4,516
Amortisation of goodwill	10	300	331
(Profit)/Loss on the sale of fixed assets		(487)	-
Assets written off		-	256
Total		68,929	74,894

The Directors consider that the nature of the business is such that analysis of the expenses shown above is more informative than that set out in the Companies Act 1985.
Non-audit services provided were updates on IFRS accounting.

4. Interest Receivable and Similar Income

	2006	2005
	£'000	£'000
Income from deposits	578	652
	578	652

5. Interest Payable and Similar Charges

	2006	2005
	£'000	£'000
Discount on unwinding the present value of the restructuring provision	202	127
	202	127

6. Employees and Directors

6.1 Employees

	2006	2005 Restated
	No.	No.
The average number of persons employed by the Corporation (including Directors) during the year was:	3,609	4,093

	2006	2005
The aggregate payroll cost of these persons was:	£'000	£'000
Wages and salaries	39,770	39,703
Social security costs	2,633	2,557
Other pension costs	1,870	1,929
	44,273	44,189

6.2 Directors

	2006	2005
	£'000	£'000
Aggregate emoluments: excluding pension contribution less expenses	762	688
Pension contributions	71	62

Retirement benefits are accruing to four Directors (2004/05 four Directors) under the Corporation's defined benefit scheme.

Emoluments of the highest paid Director are as follows:	£	£
Aggregate emoluments	208,567	207,982
Accrued pension benefit	10,709	8,213

7. Exceptional Operating (Costs)/Income (net)

	2006	2005
	£'000	£'000
Release of prior year accruals no longer required	-	2,892
Provision for onerous lease	-	(2,452)
Warrior impairment (see Note 12)	(1,600)	-
	(1,600)	440

8. Dividends Paid

	2006	2005 Restated
Equity Ordinary	£'000	£'000
Final paid	1500	3,250
Interim paid	137	500
	1,637	3,750

In addition the Directors' are proposing a final dividend in respect of the financial year ending 29 April 2006 of £363k (£2m 2004/05).

9. Pensions

The Corporation's pension scheme, referred to in the accounting policy note, is a defined benefit scheme, based on final salaries. Contributions made by the employees and by the Corporation are held in a trustee-administered fund which is completely independent of the Corporation.

The total net pension cost for the Corporation was £2m (2004/05 £1m gain), the balance sheet debtor is £6m (2004/05 £6m). The pension cost has been assessed in accordance with the advice of the independent actuaries using the actuarial methods and assumptions set out below.
The most recent actuarial valuation of the scheme took place as at 31 December 2002 and was published in December 2003.

The information in these accounts is based on the triennial actuarial valuation at 31 December 2002. The actuarial method used was the projected unit method. The assumptions most significantly affecting the results of the valuation are those relating to the rates of return on future investments of the fund and increases in salaries and pensions. It was assumed that the annual investments return would be 5.7% on existing assets and 6.5% on future contributions, salary increases would average 4.5% and present and future pensions would increase by 3%.

At 31 December 2002, the total market value of the assets of the scheme was £290.3m (excluding members' additional voluntary contributions of £0.6m) and the actuarial value of the assets was sufficient to cover 100.2% of benefits accrued to its members at that date, allowing for assumed future increases in earnings.

The total contributions paid to the scheme in the year (in addition to members' contributions) amounted to £2.1m (2004/05 £2.1m).

A valuation of the scheme as required by FRS 17 has been performed at the 2006 year end by an independent qualified actuary. This actuarial valuation shows a £6m surplus in the net present value of pension scheme liabilities over the fair value of scheme assets at 29 April 2006. The disclosures required under FRS17 'Retirement Benefits' are given below.

The Disability and Other War Pension Provision which is included in note 16 within other provisions, is an unfunded post retirement benefit under FRS17. A discount rate of 4.5% has been used to arrive at the provision.

Information about the Scheme

The scheme is a defined benefit scheme. The last actuarial valuation upon which the FRS17 figures have been based was as at 29 April 2006. Contributions have been paid by the employer at the rate of 10% to 31 December 2004, then at a rate of 14.6% to 30 April 2006. The percentages are of pensionable salaries during the year.

Financial Assumptions

	2006	2005	2004
	%	%	%
Rate of increase in salaries	4.50%	4.25%	4.25%
Rate of increase of deferred pensions	3.00%	2.75%	2.75%
Rate of increase in pensions in payment	3.25%	3.00%	3.00%
Discount rate	5.10%	5.30%	5.70%
Inflation assumption	3.00%	2.75%	2.75%

Fair Value of Scheme Assets and Expected Rate of Return:

	2006 *Expected* rate of return	2006 Fair value	2005 *Expected* rate of return	2005 Fair value	2004 *Expected* rate of return	2004 Fair value
	%	£m	%	£m	%	£m
Equities	7.80%	90	7.80%	83	8.00%	101
Index linked securities	4.50%	31	4.40%	39	4.75%	36
Fixed interest securities	5.10%	207	5.10%	197	5.25%	171
Cash and other assets	4.00%	25	3.80%	7	3.75%	3
Total fair value	5.66%	353	5.68%	326	6.07%	311

Reconciliation of Scheme Assets and Liabilities to the Balance Sheet:	2006	2005	2004
	£m	£m	£m
Fair value of the scheme assets	353	326	311
Actuarial value of scheme liabilities	(347)	(320)	(294)
Pension surplus recognised in balance sheet	6	6	17

Components of Defined Benefit Cost for the Current Year	2006	2006	2005	2005
	£m	£m	£m	£m
Analysis of amounts charged to operating costs;				
Current service cost		3		1
Analysis of the amount charged to other finance income;				
Interest on pension scheme liabilities	17		17	
Expected return on assets in the pension scheme	(18)		(19)	
Net credit to other finance income		(1)		(2)
Total Revenue Account charge/(credit)		2		(1)

Analysis of Amounts Recognised in the Statement of Total Recognised Gains and Losses	2006	2005
	£m	£m
Actual return less expected return on pension scheme assets	21	6
Experience gain on scheme liabilties	11	-
Loss on change in assumptions (financial and demographic)	(32)	(20)
Actuarial loss recognised in Statement of Total Recognised Gains and Losses	-	(14)

History of Experience Gains and Losses	2006	2006	2005	2005	2004	2004
	%	£m	%	£m	%	£m
Difference between the actual and expected return on scheme assets	5.95	21	2	6	6	18
Experience gain on scheme liabilities	3.13	11	-	-	-	-
Change on assumptions	-	(32)	-	(20)	-	5
Total actuarial (Loss)/Gain recognised in Statement of Total Recognised Gains and Losses	-	-	4	(14)	8	23

Analysis of the Movement in Surplus in the Scheme During the Year	2006	2005
	£m	£m
Surplus at the start of the year	6	17
Contributions paid	2	2
Current service cost	(3)	(1)
Other finance income	1	2
Actuarial loss	-	(14)
Surplus in the Scheme at the end of the year	6	6

10. Intangible Fixed Assets

	Goodwill 2006 £'000
Cost or valuation at 30 April 2005	631
Amortisation at 1 May 2005	331
Amortisation for the year	300
Amortisation at 29 April 2006	*(631)*
Net book amount at end of year	-
Net book amount at start of year	*300*

11. Tangible Fixed Assets

Cost or Valuation	Freehold properties £'000	Long leasehold properties £'000	Short leasehold properties £'000	Fixtures & fittings £'000	IT equipment £'000	Motor vehicles £'000	Assets in the course of construction £'000	Total £'000
At start of year	80	135	100	38,890	11,345	1,530	1,424	53,504
Additions at cost	-	-	-	2,196	593	404	2,749	5,942
Disposals and deletions	-	(135)	-	(4,797)	(1,157)	(319)	-	(6,408)
At end of year	80	-	100	36,289	10,781	1,615	4,173	53,038
Cost or Valuation at 29 April 2006 is represented by:								
Valuation at 3 May 1997	80	-	100	-	-	-	-	180
Cost	-	-	-	36,289	10,781	1,615	4,173	52,858
Depreciation								
At start of year	17	22	46	31,283	6,448	899	-	38,715
Provided during year	2	1	5	3,730	2,121	414	-	6,273
Eliminated on disposals and deletions	-	(23)	-	(4,661)	(1,157)	(323)	-	(6,164)
Reallocations	-	-	-	(342)	341	1	-	-
At end of year	19	-	51	30,010	7,753	991	-	38,824
Net book amount at end of year	61	-	49	6,279	3,028	624	4,173	14,214
Net book amount at start of year	63	113	54	7,607	4,897	631	1,424	14,789

Freehold and leasehold properties include properties held for resale with a net book amount of £60,978 (2005 £62,933).
Equipment held under finance leases has been fully depreciated.

On an historical cost basis properties would have been included at:	2006 £'000	2005 £'000
Opening Cost	1,341	1,341
Disposals	(50)	-
Depreciation	(1,264)	(1,262)
	27	79

12. Investments

The Corporation has an investment in an associated undertaking as follows:

Name of undertaking	Country of incorporation and operation	Description of shares held	Proportion of nominal value of issued shares	Principal activity
Close Brothers Military Services Limited (formerly known as Warrior Group Limited)	England	Ordinary 1p shares	20%	Financial services

Close Brothers Military Services Limited have an accounting reference date of 31 July.

The consolidated balance sheet of Close Brothers Military Services Limited at 29 April 2006, extracted from their management accounts and stated in accordance with the Corporation's accounting policies, was as follows:

	2006	2005
	£'000	£'000
Fixed assets	5,843	6,429
Current assets	56,511	52,245
Creditors due within one year	(50,694)	(47,507)
Close Brothers Military Services Ltd shareholders' funds	11,660	11,167

The consolidated summarised profit & loss account has been shown below:	2006	2005
	£'000	£'000
Turnover	2,544	2,446
Profit after taxation	301	263
Retained Profit	301	173

Investment income relating to NAAFI's 20% share was £169k (2005 £436k).

Close Brothers Military Services Limited have an accounting reference date of 31 July.

	Investment in shares		
	Cost	Provision	Total
	£'000	£'000	£'000
At start of year	4,605	(1,341)	3,264
Impairment during the year	-	(1,600)	(1,600)
At end of year	4,605	(2,941)	1,664

Had NAAFI equity accounted for the investment in the associated undertaking the results and net assets would have decreased by £651,000.

Impairment has occurred due to a reorganisation in Close Brothers Military Services Limited business, resulting in significantly lower cash flows than previously expected.

13. Stocks

Stocks comprise goods for resale in the ordinary course of business.

14. Debtors

Amounts falling due after more than one year:

	2006 £'000	2005 £'000
Debtors repayable by instalments	245	336
Other debtors	56	84
	301	420

Amounts falling due within one year:

	2006 £'000	2005 £'000
Trade debtors	5,163	6,776
Amounts due from associated undertaking	221	687
Debtors repayable by instalments	62	26
Other debtors, prepayments and accrued income	1,298	1,072
	6,744	8,561
	7,045	8,981

15. Creditors

Amounts falling due within one year:

	2006 £'000	2005 Restated £'000
Trade creditors	15,534	19,513
Taxation and social security	917	1,254
Other creditors	948	1,456
Accrued expenses and deferred income	11,461	9,127
	28,860	31,350

16. Provisions for Liabilities and Charges

	Restructuring Provision £'000	Other £'000	Total £'000
At start of year	4,801	1,509	6,310
Utilised during year	(756)	(539)	(1,295)
Discount on unwinding the present value of the restructuring provision	202	-	202
Charge to revenue account - non-exceptional	21	100	121
Exchange adjustment	110	-	110
At end of year	4,378	1,070	5,448

Restructuring
The provision comprises lease commitments under sub-lease arrangements and other staff termination payments. The provision is expected to be utilised over the next 8 years.

Other
The other provision includes business, legal and regulatory claims and is expected to be utilised within 10 years.

17. Reserves

	Revaluation Reserve £'000	Revenue Reserve £'000
Revenue reserve at 24 April 2004 (as previously reported)	160	20,770
Prior year adjustment:		
Dividend paid	-	3,250
Surplus on pension scheme	-	17,000
At 24 April 2004 as restated	160	41,020
Transfer to revenue reserve of excess depreciation on revalued assets	(4)	4
Transfer from revenue account (restated)	-	7,441
Dividend paid	-	(3,750)
Actuarial loss on pension scheme	-	(14,000)
At 30 April 2005 as restated	156	30,715
Transfer from revenue account	-	1,319
Dividend paid	-	(1,637)
Transfer to revenue reserve representing revaluation surplus realised during year	(96)	96
Transfer to revenue reserve of excess depreciation on revalued assets	(4)	4
	56	30,497

18. Reconciliation of Operating Results to Operating Cash Flows

	2006 £'000	2005 Restated £'000
(Deficit)/Surplus on ordinary trading activities	(226)	4,480
Depreciation	6,273	4,516
Profit from sale of fixed assets	(487)	-
Increase in impairment provision	1,600	-
Amortisation of goodwill	300	331
(Increase) in stock	(138)	(169)
Decrease in debtors	1,936	81
(Decrease) in creditors	(2,490)	(4,187)
(Decrease)/Increase in provisions	(862)	2,029
Difference between pension charge and cash contribution	1,000	(1,000)
Non cash items included in trading results	(207)	(417)
Net cash inflow from operating activities	6,699	5,664

19. Analysis of Net Liquid Funds

	At start of year £'000	Cash flow £'000	Exchange movement £'000	At end of year £'000
Cash at bank and in hand				
Deposits	13,847	(1,040)	36	12,843
Other cash	5,771	1,334	273	7,378
	19,618	294	309	20,221

20. Capital and Financial Commitments

	2006 £'000	2005 £'000
Contracted but not provided for	3,449	3,654

Future annual commitments under non-cancellable operating leases	2006		2005	
	Property £'000	Other £'000	Property £'000	Other £'000
Expiring within one year	76	122	-	142
Expiring between two and five years	-	195	78	216
Expiring in five years or more	2,121	-	2,051	-
	2,197	317	2,129	358

21. Related Party Transactions

Close Brothers Military Services has been treated as an investment of the Corporation. Transactions during the year with Close Brothers Military Services represent the reimbursement of costs incurred on behalf of Close Brothers Military Services. Other transactions relate to the supply of financial service products to NAAFI Financial Services by Close Brothers Military Services. Commission is payable to the Corporation on elements of the ongoing financial services business carried out by Close Brothers Military Services of £169,000 (2004/05 £173,000). A net amount of £2,359,000 (2004/05 £1,482,000) was received from Close Brothers Military Services for these transactions in the period to 29 April 2006 with £221,000 (2004/05 £687,000) due from Close Brothers Military Services at the year end.

The Corporation has taken advantage of the 90% exemption for related party transactions.

22. Ultimate Controlling Party

The Directors consider that the MOD is the ultimate controlling party of the Corporation.

NAAFI

NAAFI HQ, London Road, Amesbury, Wiltshire, SP4 7EN