Presented pursuant to Act 2000 c.20, s.6

# Ministry of Defence

# Consolidated Departmental Resource Accounts 2001–02

LONDON: The Stationery Office
HC 47

21 November 2002
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# Ministry of Defence Consolidated Departmental Resource Accounts 2001–02

**(For the year ended 31 March 2002)**

**Laid in accordance with the Government Resources and Accounts Act 2000**

*Ordered by the House of Commons to be printed 21 November 2002*

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# Contents

# Annual Report

### History and Background

The present Ministry of Defence (MOD), the Department, was formed by the amalgamation in 1964 of the Ministry of Defence, the Admiralty, the War Office and the Air Ministry, and the inclusion in 1971 of the Ministry of Aviation Supply. In 1973, the operations of the Atomic Weapons Establishment (AWE) were transferred from the UK Atomic Energy Authority to the MOD.

### Principal Activity

The principal activity of the Department is to defend the United Kingdom and Overseas Territories, our people and interests, and to act as a force for good in the world by strengthening international peace and security. This reflects current policy.

Further definition of the Departmental Objectives in terms of output is given in Schedule 5, Resources by Departmental Aim and Objectives.

### Departmental Boundary

At 31 March 2002 the Department consisted of the 11 (2000–01: 11) Top Level Budget (TLB) Holders detailed in Note 26 to the financial statements, responsible for providing forces and support services required for a modern defence force. Within these TLBs there were 84 (2000–01: 93) reporting entities known as management groupings, including 32 (2000–01: 34) on-vote Defence Agencies listed in Note 30. Also included within the Departmental Boundary are Advisory Non-Departmental Public Bodies (NDPB) sponsored by the Department listed in Note 30. Defence Agencies with an accounts direction from HM Treasury also publish their own financial statements.

The four (2000–01: three) Defence Executive Agencies established as Trading Funds and owned by the Department at 31 March 2002 fall outside the Departmental Boundary and are detailed in Note 9. The change during the year was a result of vesting of the Defence Aviation Repair Agency (DARA) as a Trading Fund on 1 April 2001. Also, certain operations were removed from the Defence Evaluation and Research Agency (DERA) Trading Fund and vested in QinetiQ, a new Self Financing Public Corporation. The remaining Trading Fund is now known as the Defence Science and Technology Laboratory (DSTL). Further details on this reorganisation are given below under Future Developments.

The seven Executive NDPBs listed in Note 10 are sponsored by the Department and fall outside the Departmental Boundary. The accounts of these bodies are published separately.

As part of Machinery of Government changes, the Department acquired the War Pensions Agency (now the Veterans Agency) from the Department for Work and Pensions and the Security Services Group (SSG) from the Cabinet Office. The administrative costs in respect of the Veterans Agency and the results of SSG are reflected in these financial statements. The basis of accounting for Machinery of Government changes is shown in Note 1.

QinetiQ is a Self Financing Public Corporation which falls outside the Departmental Boundary. The Navy, Army and Air Force Institutes (NAAFI) is also outside the Departmental Boundary.

The transactions and balances of the Armed Forces Pension Scheme (AFPS) are not consolidated within these financial statements. The report and accounts of the AFPS are prepared separately.

### Future Developments

On 1 July 2001, certain operations were removed from the DERA Trading Fund and vested in QinetiQ, a new Self Financing Public Corporation wholly owned by the MOD. In March 2002 Ministers announced that in the prevailing market conditions, flotation of QinetiQ did not offer best value for money and a stake in the business would be sold to a strategic partner who would work with the Department to develop the value of the business with a view to flotation in 3–5 year's time. Following an open competition with nearly 40 companies expressing an interest in participation in the Public Private Partnership, it was announced in September that The Carlyle Group had been selected as the preferred partner.

The Department is now undertaking detailed negotiations with The Carlyle Group who have been granted a fixed period of exclusivity, and subject to the successful completion of negotiations, the Department is on track to complete the sale of an equity stake in QinetiQ by the end of 2002.

## Annual Report—*continued*

Subsequent to the year end, the payments of war disablement and war widows' pensions (the programme costs) payable by the Veterans Agency are being borne by the Department. The Army Base Repair Organisation became a Trading Fund on 1 April 2002.

### Fixed Assets

Changes in fixed assets during the year are summarised in Notes 7, 8 and 9 to the financial statements.

During the year, a professional valuation was carried out in respect of all fixed assets. Further details on the professional valuation are given in Note 23.

### Research and Development

Research and development expenditure is incurred mainly for the future benefit of the Department. Such expenditure is primarily incurred on the development of new fighting equipment and on the improvement of the efficiency and capability of existing fighting equipment.

Amounts spent on research are not capitalised, in accordance with SSAP13 "Accounting for Research and Development", and are included in Other Operating Costs detailed in Note 3.

Development expenditure is included in Intangible Assets, where appropriate, and shown in Note 7.

### Net Expenditure

The Operating Cost Statement shows net expenditure of £32,238,573,000 which has been charged to the General Fund. Cash voted by Parliament and drawn down for the provision of Defence Capability (RfR 1) and Conflict Prevention (RfR 2) amounting in total to £25,343,376,000 (including monies appropriated to the Department in respect of the Veterans Agency and SSG) has been credited to the General Fund (Note 17). An amount of £21,662,990 in respect of Resettlement Grant expenditure borne by the Department but included in monies voted to the Armed Forces Pension Scheme (AFPS) is also included in the total draw down of £25,343,376,000 shown above.

### Operating and Financial Review

The Operating and Financial Review is included on pages 8 to 9.

### Management

Ministers who had responsibility for the Department during the year were:

Secretary of State for Defence

The Right Honourable Geoffrey Hoon, MP

Minister of State for Defence Procurement

The Right Honourable Baroness Symons of Vernham Dean (until 10 June 2001)
The Lord Bach of Lutterworth (appointed 11 June 2001)

Minister of State for the Armed Forces

Mr John Spellar, MP (until 10 June 2001)
The Right Honourable Adam Ingram JP, MP (appointed 11 June 2001)

Parliamentary Under Secretary of State for Defence and Minister for Veterans

Dr Lewis Moonie, MP

### Composition of Defence Management Board (DMB), during the year ended 31 March 2002:

Permanent Under Secretary of State

Sir Kevin Tebbit KCB CMG

Chief of the Defence Staff

Admiral Sir Michael Boyce GCB OBE ADC

Vice Chief of the Defence Staff

Admiral Sir Peter Abbott GBE KCB (until 31 May 2001)
Air Chief Marshal Sir Anthony Bagnall KCB OBE ADC FRAeS RAF (appointed 1 June 2001)

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Second Permanent Under Secretary of State

Sir Roger Jackling KCB CBE (until 5 March 2002)
Mr Ian Andrews CBE TD (appointed 4 March 2002)

First Sea Lord and Chief of the Naval Staff

Admiral Sir Nigel Essenhigh GCB ADC

Chief of the General Staff

General Sir Michael Walker GCB CMG CBE ADC Gen

Chief of the Air Staff

Air Chief Marshal Sir Peter Squire GCB DFC AFC ADC FRAeS RAF

Chief of Defence Procurement

Sir Robert Walmsley KCB FEng FIEE

Chief of Defence Logistics

General Sir Sam Cowan KCB CBE ADC Gen

Chief Scientific Adviser

Professor Sir Keith O'Nions FRS

Since the end of the financial year the following changes in appointment have arisen:

Charles Miller Smith, Chairman of Scottish Power, appointed as non-executive member of the Defence Management Board on 10 June 2002.

Air Chief Marshal Sir Malcolm Pledger KCB OBE AFC BSc FRAeS RAF appointed as Chief of Defence Logistics on 2 September 2002 in succession to General Sir Sam Cowan KCB CBE ADC Gen.

Admiral Sir Alan West KCB DSC, appointed as First Sea Lord and Chief of the Naval Staff on 17 September 2002 in succession to Admiral Sir Nigel Essenhigh GCB ADC.

General Sir Michael Walker GCB CMG CBE ADC Gen to be appointed Chief of the Defence Staff on 1 April 2003 in succession to Admiral Sir Michael Boyce GCB OBE ADC.

General Sir Mike Jackson KCB CBE DSO ADC Gen to be appointed Chief of the General Staff on 31 January 2003 in succession to General Sir Michael Walker GCB CMG CBE ADC Gen.

Remuneration of Ministers, and details of salary and pension entitlements of the members of the DMB, are shown in Notes 2.3 and 2.4.

### The Methodology of Senior Appointments

The Senior Civil Service was formed in April 1996 through an Order in Council. The recruitment principles, and their application, under which senior appointments, including those of the Permanent Under Secretary of State and Second Permanent Under Secretary of State, are made are specified in the "Commissioners' Recruitment Code", responsibility for which lies with the Civil Service Commissioners.

The Chief of Defence Procurement and the Chief Scientific Adviser are recruited on 3 year fixed term appointments. The conditions covering the termination of their employment are set out in their contract documents.

The Chief of the Defence Staff, Vice Chief of the Defence Staff, Single-Service Chiefs of Staff and Chief of Defence Logistics are appointed on the recommendation of the Secretary of State for Defence to the Prime Minister. The final approval of the appointee lies with Her Majesty The Queen.

### Pension Liabilities

Pension liabilities for the majority of civilian personnel and Service personnel are provided by the Principal Civil Service Pension Scheme (PCSPS) and the Armed Forces Pension Scheme respectively. The Department makes regular payments of Accruing Superannuation Liability Charge (ASLC) into the relevant pension schemes at rates determined by the Government Actuary.

## Annual Report—*continued*

On 1 October 2002 the new Civil Service pensions arrangements came into effect. From that date all new entrants to the Department will have the option to join either the new defined benefits (DB) scheme, to be known as "Premium" or to join the new defined contributions (DC) scheme which will be known as the "Partnership Pension Account". They will not be able to join the current Principal Civil Service Pension Scheme which will be renamed the "Classic" and become a closed scheme. Existing members of the PCSPS may elect to join the new DB arrangements. Member contributions to the new DB scheme will increase from the current 1.5% (paid in respect of Widows Pension Scheme (WPS) benefits under the current PCSPS) to 3.5% and which will be a general contribution to the scheme. There should be no corresponding rise in the Department's ASLC contributions as a result of the introduction of the Premium scheme.

Both these schemes are accounted for as Defined Contribution schemes in accordance with Treasury requirements. The pension liabilities are not included in the Department's Balance Sheet. The financial statements of these schemes are published separately.

### Elements of Remuneration

Senior Civil Service and Ministers' emoluments are reviewed annually by the Review Body on Senior Salaries (SSRB). For civil servants outside the Senior Civil Service, emoluments are set on the basis of annual negotiations between the Department and the Trades Unions.

Emoluments for Service personnel are paid in accordance with rank and conditions of service and are reviewed annually by the Armed Forces Pay Review Body (AFPRB) or the SSRB.

### Performance Schemes

Civilian members of the DMB do not participate in any incentive/performance schemes. Their basic salary and annual increases, which are performance related, are set by the Permanent Under Secretaries Remuneration Committee.

Following recommendations of the SSRB, the MOD has introduced a new performance management and pay system (PMPS) for the senior officers at two-star rank and above. The main elements of the PMPS are:

(a) The introduction of an objective setting regime complementary to the Department's developing performance management system embodied in the Defence Balanced Scorecard.

(b) A revised assessment process including the introduction of a new report form for senior officers.

(c) The introduction of a performance related incremental pay system.

The first pay awards under PMPS will be payable with effect from 1 April 2002.

### Employees

The Department is committed to recruiting and retaining the best people for the job from all walks of life irrespective of race, gender or background.

### Payments to Suppliers

The Department's bills, with the exception of some payments to suppliers by units locally and outside Great Britain, are paid through the Defence Bills Agency (DBA). In 2001–02, the DBA met its target of paying 100% of all correctly submitted bills within eleven calendar days, ensuring that the Department is in compliance with its statutory obligation under the Late Payment of Commercial Debts (Interest) Act 1998. Commercial debt interest paid by units locally during the year amounted to £134,522 (2000–01: £2,323).

### Environmental Protection Policy

It is the Department's intention to comply with the Government's strategy for sustainable development and to take into consideration environmental and socio-economic factors in the development of policies, projects, acquisition programmes and training activities.

The Department is committed to compliance with the Environmental Protection Act 1990 and Environment Act 1995 and other relevant statutory provisions and any additional requirements arising from international treaties and protocols to which the UK is a signatory.

Where the Department has been granted specific exemptions, disapplications or derogations from legislation, international treaties and protocols, Departmental Standards and arrangements will be introduced which are, as far as reasonably practicable, at least as good as those required by the legislation. Any powers to disapply legislation on the grounds of national security will be invoked only when such action is absolutely essential for the maintenance of operational capability.

### Departmental Report

The MOD's Departmental Report which is presented to Parliament each year comprises the "Ministry of Defence Performance Report 2001–02" and "The Government's Expenditure Plans 2002–03: Ministry of Defence". The Departmental Report sets out the performance of the MOD against the objectives stated in Schedule 5 and also includes developments since the year-end, where appropriate.

### Financial Instruments

The Department does not trade or enter into any speculative transactions in foreign currencies. Forward contract commitments entered into to cover future expenditure in foreign currencies are stated in Note 27.

### Appropriation Accounts

With effect from the financial year 2001–02, the Departmental Resource Accounts replaced the Appropriation Accounts as the principal means by which the Department reports its financial results to Parliament.

### Commitment to Effective Corporate Governance

The Department is committed to achieving high standards of corporate governance and to integrity and high ethical standards in all its dealings. Throughout the financial period and up to the date of approval of the annual report and accounts, considerable progress has been made in achieving compliance with HM Treasury's Corporate Governance requirements for central government as set out in DAO (GEN) 13/00. This progress is reflected in the Department's Statement on Internal Control at pages 11 and 12. In particular, the Defence Audit Committee (DAC), a formal sub-committee of the Defence Management Board (DMB), which advises the DMB on the adequacy of internal and external audit arrangements and the effective operation of risk management, has reviewed the effectiveness of the Department's systems of internal control. Since the end of the financial year, Philippa Foster Back, Director of the Institute of Business Ethics, has been appointed as the non-executive Chair of the DAC, and Charles Miller Smith, Chairman of Scottish Power, has been appointed as a non-executive member of the DAC.

### Auditor

The financial statements for the Department are audited by the Comptroller and Auditor General under the Government Resoures and Accounts Act 2000. The Certificate and Report of the Comptroller and Auditor General on the financial statements are set out on pages 13 to 22.

*Kevin Tebbit*
Accounting Officer 13 November 2002

## Operating and Financial Review

2001–02 was the first year in which the Department managed its resources under the new Resource Accounting and Budgeting regime. It was also the first year in which military operations were assessed and managed through a separate Request for Resources (RfR2) reflecting the cross-Whitehall arrangements introduced to fund conflict prevention activities. The Department's Resource Accounts for 2000–01 were qualified by the National Audit Office in relation to information held on its supply systems and compliance with Financial Reporting Standard 15—Accounting for Fixed Assets. Excellent progress has been made in eliminating these concerns which are now confined to a limited number of specific aspects of supply systems information.

The Department also made further progress in developing its performance management regime—the Defence Balanced Scorecard—introduced in April 2000. The scorecard captures the Defence Management Board's key objectives and priorities and supports improved assessment, reporting and management of departmental performance. The Department Performance Report, which is being published concurrently with the accounts, gives full details of performance in each of the Scorecard's four perspectives—Output and Deliverables, Resource Management, Enabling Processes and Building for the Future—and across a broader range of related subjects. MOD's progress against its Public Service Agreement targets is also addressed throughout the report. The report highlights the success of UK's Armed Forces in acting as a force for good internationally, including on peace support and humanitarian operations. It also describes the vital contribution that MOD makes at home on a daily basis to the communities within which people live and work.

### Results

The net operating costs were £1,032 million (3.1%) lower than 2000–01 figures. Comparisons are however distorted by the inclusion in last year's outturn of accounting adjustments made in the course of improving the quality of resource data. The main items of operating costs which contributed to this reduction were reduced stock and impairment charges and a reduced deficit arising on disposal of fixed assets. These were offset by increased staff costs, depreciation charges and provisions for nuclear and other decommissioning costs.

Operating income showed a small increase and interest costs, including cost of capital charges, a small decline.

The reporting of output costs by Departmental objectives (Schedule 5) has been changed this year to provide a more objective breakdown of net operating costs into the various tasks and activities carried out. Similar analysis of costs is being applied to the planning process.

### Explanation of variances against Estimate—Net Resource Outturn

For the purposes of reporting of variances, this year's Resource Outturn was analysed between the provision for Defence Capability—Request for Resource (RfR)1 and Conflict Prevention RfR2.

RfR1—An excess over the Estimate of £602 million is explained in Schedule 1.

RfR2—The actual outturn was £530 million against an Estimate of £573 million.

### Explanation of variances against Estimate—Net Cash Requirement

The Net Cash Requirement was below the Estimate by £1.0 billion and is fully explained in Schedule 1.

### Financial position

The net assets at the year end were £86,554 million compared to last year's restated net assets of £86,649 million. These were restated to take account of adjustments required in order to comply with FRS 15; prior year adjustments on supply systems information and Machinery of Government changes which were accounted for as mergers.

Total fixed assets show an increase over last year of £559 million and net current assets are at about the same level as last year. Provision for liabilities and charges shows an increase of £633 million and this is mainly in respect of provisions made for nuclear and other decommissioning, reorganisations and legal claims. Other Creditors falling due after 1 year increased by £51 million.

### Public Private Partnership

The break up of the DERA Trading Fund into DSTL and QinetiQ during the year has proceeded well and both the independent operations are running in accordance with expectations. In September the Department announced that The Carlyle Group had been selected as the preferred partner for QinetiQ. The new partner will work with the Department to develop the value of the business with a view to flotation in 3-5 year's time.

## Operating and Financial Review—*continued*

### Future periods

The Chancellor of the Exchequer announced the outcome of the Spending Review on 15 July 2002. This set Departmental budgets for the financial years 2003–04 to 2005–06.

Capital investment represents a growing proportion of the overall defence spending over the next 3 years. The spending review settlement will ensure that the Department is able to continue with the full implementation of the Strategic Defence Review; to take forward the conclusions of the Department's work in response to the atrocities of September 11; and to modernise the business information systems. Full details will be provided in the Defence Investment Strategy 2002 document to be published in Autumn 2002.

The quinquennial review of the valuation of the Department's tangible land, buildings and fighting equipment fixed assets has been completed and the results are currently being reviewed and validated. The outcome will be reflected in the 2002–03 Accounts.

## Statement of Accounting Officer's Responsibilities

Under the Government Resources and Accounts Act 2000, the Department is required to prepare resource accounts for each financial year, in conformity with a Treasury direction, detailing the resources acquired, held, or disposed of during the year and the use of resources by the Department during the year.

The resource accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of the Department, the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the financial year.

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

In preparing the accounts the Accounting Officer is required to comply with the *Resource Accounting Manual* (RAM) prepared by HM Treasury, and in particular to:

- Observe the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis.
- Make judgements and estimates on a reasonable basis.
- State whether applicable accounting standards, as set out in the RAM, have been followed, and disclose and explain any material departures in the accounts.
- Prepare the accounts on a going concern basis.

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

## Statement on Internal Control

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of Departmental policies, aims and objectives, set by the Department's Ministers, whilst safeguarding the public funds and Departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting. The Chief of Defence Staff is responsible for the preparation and conduct of operations.

During the Financial Year 2001–02, the Department was divided into 11 business areas, each managed by a Top Level Budget (TLB) Holder, 4 Trading Fund Agencies and 7 Non-Departmental Public Bodies (NDPB) with delegated responsibilities. Included within the TLBs are 32 on-vote Defence Agencies whose Chief Executives are responsible for producing annual accounts which are laid before Parliament. With the exception of the Defence Aviation Repair Agency, the Defence Science and Technology Laboratory (DSTL)[1], the UK Hydrographic Office, and the Met Office, who report separately their financial results to their Ministerial Advisory Boards, responsibility for monitoring Agencies' performance is within specific TLB Holders' responsibilities. Responsibility for monitoring NDPB's performance also falls within individual TLB Holders' responsibilities. Statements on Internal Control are provided annually by TLB Holders and Trading Fund Agency Chief Executives.

The system of internal control has a number of dimensions (e.g. efficient organisational and budgetary structures, sound business processes, robust internal audit) but is, in particular, based on an ongoing process designed to identify the principal risks to the achievement of Departmental policies, aims and objectives, to evaluate the nature and extent of those risks and to manage them efficiently, effectively and economically. The system of internal control is designed to manage rather than eliminate the risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness.

As Accounting Officer, I also have responsibility for reviewing the effectiveness of the system of internal control. The following processes are in place:

- A Defence Management Board (DMB), which meets monthly to consider the plans, performance and strategic direction of the Department.
- A Defence Audit Committee (DAC), which has adopted a risk-based approach to internal control and is placed at the heart of the assurance process, co-ordinating the activities of internal audit, and drawing on reports from specialist assurance bodies, including:
  - Defence Environment and Safety Board;
  - Departmental Security Officer;
  - Defence Internal Audit;
  - Director General Financial Management;
  - National Audit Office.

In addition, the DAC is working to establish a means by which the Director of Operational Capability can provide assurance on the Department's operational capability.

The following mechanisms are also in place, or being developed, to provide me with a Department-wide view of risk:

- A central Corporate Governance and Business Risk cell to oversee the transition to a risk-based approach to internal control.
- A Departmental Performance Management System based on the Balanced Scorecard. Key Departmental Objectives, performance indicators and targets are defined annually by the DMB and cascaded to TLB Holders including through new Service Delivery Agreements. Performance is monitored and discussed quarterly at DMB meetings, including explicit consideration of key risks.
- Development of a Departmental risk register, supported by operational-level risk registers, which is linked to the performance management system.
- Through TLB Holders, a cascaded system for ensuring compliance with legal and statutory regulations. Each TLB holder is supported by an Audit Committee, which includes non-executive directors and at which representatives from the internal and external auditors are present. Like the DAC these committees have refocused their activities to provide advice on wider-business risk and assurance processes.
- An annual risk-based programme of internal audit provided by Defence Internal Audit, who are the primary source of independent assurance, and by the Directorate of Operational Capability (DOC), which provides independent operational audit and assurance.

## Statement on Internal Control—*continued*

- Annual and Quarterly Reports providing measurable performance indicators and more subjective assessments on the Health of Financial Systems from all TLB Holders and key functional specialists.

Through development of their own risk registers my TLB Holders have a good understanding of the key risks facing the achievement of their objectives and continue to apply considerable effort to building on the firm foundations of internal control that are already in place.

While substantial progress has been made across the Department in the implementation of new Corporate Governance requirements, we now need to build upon our internal control framework to produce a more robust assessment of key risks, recognising organisational dependencies, so that resources and management effort can be targeted to best effect. In the finance area, considerable efforts were made during the year to sustain financial control with the transition to Stage 1 of resource accounting and budgeting. Substantial progress was made, although decisions late in the financial year resulted in an excess on voted provision. The transition has meant continued high pressure on finance staff and, experience of their operation has exposed a number of issues surrounding the Department's financial processes and systems. The latter are being introduced in an integrated programme of adaptations and enhancements. The transition to Stage 2 of resource accounting and budgeting from 1 April 2003 is likely to require considerable further efforts to sustain financial control, inevitably continuing the heavy workload on finance staffs.

My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within the Department who have responsibility for the development and maintenance of the internal control framework and by comments made by the external auditors in their management letter and other reports.

I expect to have the processes and mechanisms necessary to implement Treasury guidance developed to sufficient maturity by 31 March 2003.

*Kevin Tebbit*
Accounting Officer 13 November 2002

[1] On 1 July 2001 certain operations were removed from the DERA Trading Fund and vested in QinetiQ, a new Self Financing Public Corporation. The remaining Trading Fund was renamed as DSTL.

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

I certify that I have audited the financial statements on pages 23 to 66 under the Government Resources and Accounts Act 2000. These financial statements have been prepared under the historical cost convention as modified by the revaluation of certain fixed assets and stocks, and the accounting policies set out on pages 31 to 35.

## Respective responsibilities of the Accounting Officer and Auditor

As described on page 10, the Accounting Officer is responsible for the preparation of the financial statements in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder and for ensuring the regularity of financial transactions. The Accounting Officer is also responsible for the preparation of the other contents of the Accounts. My responsibilities, as independent auditor, are established by statute and guided by the Auditing Practices Board and the auditing profession's ethical guidance.

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

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

I review whether the statement on pages 11 and 12 reflects the Department's compliance with Treasury's guidance Corporate Governance: Statement on Internal Control. I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements.

## Basis of audit opinion

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

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

- The Department has undertaken a substantial amount of work to ensure that the Balance Sheet reflects fairly the value of stock and fixed assets held by industry. However the Department has been unable to capture data on the usage of these stock and fixed assets. As a result I have been unable to confirm the completeness of charges to the Operating Cost Statement in respect of consumption of stock and depreciation of fixed assets held by industry.
- Many of the Department's stock management systems were designed primarily for logistics purposes and have not lent themselves to providing the data required to account for financial transactions on an accruals basis. Consequently accounting transactions may not be correctly recorded. The evidence available to me was limited in respect of a £340 million credit to the Operating Cost Statement relating to stocks written off and impairment of fixed assets.

In respect of the above, there were no other satisfactory procedures I could adopt to confirm that charges and credits to the Operating Cost Statement for certain stock and fixed assets were complete or correctly recorded.

**Qualified opinion arising from limitation in scope and expenditure in excess of amounts authorised**

In my opinion:

- except for any adjustments that might have been found to be necessary had I been able to obtain sufficient evidence concerning:
  - the completeness and value of charges to the operating cost statement arising from the consumption of certain stock and fixed assets, stock written off and impairment of fixed assets, referred to in paragraphs 20 to 29 of my Report;

  the financial statements give a true and fair view of the state of affairs of the Ministry of Defence at 31 March 2002 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the year then ended, and have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by Treasury; and
- except for resource expenditure of £601.8 million in excess of the amount authorised for Request for Resource 1, referred to in paragraphs 30 to 42 of my Report, in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

In respect alone of the limitations on my work relating to the issues mentioned above I have not obtained all the information and explanations that I considered necessary for the purpose of my audit. My Report on these financial statements is at pages 15 to 22.

*John Bourn* 14 November 2002
Comptroller and Auditor General
National Audit Office
157–197 Buckingham Palace Road
Victoria
London SW1W 9SP

## Report of the Comptroller and Auditor General to the House of Commons

## Section 1: Summary

1. Since 1999–2000 the Ministry of Defence (the Department) has been required in accordance with Directions issued by the Treasury to prepare annual Resource Accounts. The Resource Accounts, drawn up on an accruals basis, should be prepared in accordance with the Treasury's *Resource Accounting Manual* and should give a true and fair view of the state of affairs of the Department and of its net operating costs, recognised gains and losses and cashflows for the year.

2. In producing its Resource Accounts the Department faces a number of challenges. It undertakes a wide range of complex functions and holds a vast range of assets. Some of these assets are held by contractors for manufacture and repair purposes. It has many old information systems which although adequate for the purposes they were designed for, are not suited in all respects to the production of accurate and timely accruals based information. The Department has therefore had to invest considerable efforts in implementing resource accounting and budgeting, both in IT and staffing.

3. At the introduction of the resource accounting and budgeting initiative the Department had little information on the value or extent of its asset base, and it struggled, initially to complete acceptable accounts. The Department recognised that much needed to be done and made significant efforts to improve the standard of its financial accounting information. These measures led to progressive improvements over the last three years. I qualified my audit opinion on the 2000–01 resource accounts in respect of an uncertainty over the value of stock obsolescent provisions, the value of Departmental stock and certain fixed assets held by contractors and stock consumption charges to the operating cost statement. I also disagreed with the accounting treatment of the costs of major refits and overhauls. The Department has continued over this last year to make strenuous efforts to secure further improvements to the extent that I have been able to remove fully my qualification in respect of stock provisions and accounting for the cost of major refits and overhauls. In Section 2 of my Report I consider whether the Department is continuing to take appropriate steps to implement resource accounting effectively.

4. In Section 3 of my Report I explain why I do not yet consider the Department's resource accounts are robust enough to support a true and fair opinion. I conclude that although major improvements have been achieved in the accuracy and reliability of its stock management information, further progress is required. Because of continuing problems in this information I am unable to confirm the completeness or values of charges to the operating costs statement in respect of certain stock and fixed assets and accordingly I have qualified my audit opinion.

5. For 2001–02 and future years the Department along with the rest of central Government must contain both resource consumption and cash expenditure within the limits approved by Parliament and within a control framework set by HM Treasury. This year the Department's resource consumption for 'Provision of Defence Capability' has exceeded the estimate approved by Parliament and requires an excess Vote to regularise this resource consumption. In Section 4 of my Report I consider the reasons for this and the action the Department is taking to prevent this occurring in the future.

6. In Section 5 of my Report I confirm that according to Departmental records the maximum numbers of military personnel maintained during 2001–02 for the Naval, Army and Air Force Services in all active and reserve categories were within the numbers voted by Parliament.

7. The Department is continuing to demonstrate a strong and effective grip on the accounts production process. For 2001–02, it has again submitted Resource Accounts for audit in line with the timetable agreed with my staff and the Treasury. And it has accelerated their finalisation and publication. When compared with the quality of the Department's Resource Accounts for 1999–2000, on which I placed a disclaimer covering a range of accounting deficiencies, the Department has consistently made good progress in improving the quality of its accounts. During 2001–02 the Department has successfully cleared two of the four substantive issues which were the basis for the qualification of my audit opinion last year and it assures me it is fully aware of what remains to be done and is committed to securing the necessary improvements. My staff will continue to work closely with the Department in this task.

## Section 2: Is the Department still making good progress to implement Resource Accounting effectively?

8. In my Report on the 2000–01 Accounts[1] I explained my reasons for qualifying my audit opinion. These included the quality of data supporting the write down of stock values; the completeness and valuation of Departmental assets held by contractors and whether stock accounting transactions were complete or correctly recorded. I also identified other areas on which the Department would need to continue to make progress. These included ownership of financial accounting data and underlying audit trails; the completeness of creditor and accrual estimates and accounting for asset transfers, re-classifications and disposals.

### The Department has made good progress on two specific issues so that they no longer contribute to an audit qualification

#### The Department has developed more robust data models to improve the quality of stock provisions

9. The Department maintains 13 principal logistics management systems, collectively known as Supply Systems. Together these systems hold details of over 3 million different types of items. As well as consumable stock, the Supply Systems hold fixed asset items including fighting equipment; capital spares (such as aircraft engines) and certain items of plant and machinery.

10. The Department has identified that many of the items held on the supply systems are in excess of requirements, or obsolete because the equipment they support is no longer in use. I have previously reported on the progress the Department is making to reduce these stock holdings[2]. The Department must reflect these factors in its Resource Accounts by reducing stock values appropriately. In my Report on the 2000–01 Accounts I noted that although the Department had introduced a consistent policy across all three Services for writing down stock values it had been unable to calculate this value accurately. Not all the information required was held in a readily accessible form.

11. The Defence Logistics Organisation has provided £3,513 million for stock-write-down in its balance sheet and charged £405 million to the operating cost statement in 2001–02. I am pleased to note that the Defence Logistics Organisation has refined its data collection and analysis techniques to more accurately determine the appropriate level of provision. These techniques include an analysis of future demand by individual stock items. As a result I have been able to remove my qualification in this regard.

#### The Department has complied with the requirements of FRS15 to account for the costs of major refits and overhauls

12. In my Report on the 2000–01 Accounts I noted that the Department had not complied with key aspects of Financial Reporting Standard 15. This sets out the principles of accounting for the initial measurement, valuation and depreciation of tangible fixed assets. Certain fixed assets such as ships, submarines and aircraft wear out at a substantially quicker rate than might be assumed from their planned out of service date. To maintain planned capability, these assets have to undergo periodically major refits or overhauls, the cost of which can be very significant when compared with the net book value of the asset. The Department had not reflected the costs of these refits in the value of these assets.

13. Following consultation with my staff the Department undertook extensive analysis of costs incurred in the major overhaul and refits of ships, submarines and aircraft. The Department concluded that for aircraft, there was no significant distortion to the operating cost statement year on year by expensing the costs of refits and overhauls as they were incurred. These annual charges reflected fairly the consumption charges that would have been incurred had the costs been capitalised. However for ships and submarines the Department has determined that it is appropriate to capitalise the costs of major refits and overhauls for larger vessels and has capitalised some £779 million in respect of past refits and overhauls and £273 million for current repairs. The costs will be depreciated and charged to the operating cost statement over time until the next major overhaul or refit. In this way the Department is correctly recognising in its Accounts by way of depreciation the gradual wearing out of these major assets until the next refit or overhaul takes place. I have been able to remove my qualification in this regard.

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[1] MOD: Departmental Resource Accounts 2002–01 HC 443 Session 2001–02: 18 December 2001.

[2] Progress in Reducing Stocks HC 898 Session 2001–02: 20 June 2002.

## The Department has made good progress on other issues during the year

### Creditors and accruals are now more robust

14. The proper identification of creditors and accruals relies on the ability to match data on the delivery of goods or services, to the receipt of an invoice and to its eventual payment. The current Departmental systems do not have automated interfaces and most processes for matching the transactions are manual. The Department is currently implementing a new purchase order system. I reported last year that there was a significant level of correction of these balances in preparing the final account. The Department has made good progress and far fewer adjustments were required to the creditor and accrual balances.

### The Department can account more accurately for asset transfers and re-classifications

15. I noted in my Report on last year's accounts that the Department had problems supporting fully the £1,178 million net balance shown on the 'other movements' line in Note 7 (Intangible Fixed Assets) and Note 8 (Tangible Fixed Assets) of the Resource Account. The 2001–02 Resource Account reports the overall net balance on the 'other movements/transfers' line of Notes 7 and 8 as £118 million, a significant reduction. The Department attributes the balance to reclassifications between tangible fixed asset categories, intangible fixed assets, stock and transfers to operating costs. In light of my concerns last year, the Department has provided my staff with explanations for all of this balance and I am satisfied that it is fairly stated.

### The Department has improved again its management validation and audit trails

16. The Department's Resource Accounts are a consolidation of accounts prepared by the eleven top level budget holders across the Department. The accounts of these top level budget holders are in turn a consolidation of accounts produced by 84 management groupings. It is fundamental to the production of an account as complex as this that figures should be fully supported by good and clear documentation and be subjected to thorough scrutiny by management—prior to being submitted to my staff for external examination.

17. My staff found that the Department has made further improvements in this area since last year. In particular the Department changed the way it consolidated its accounts. This allowed the 84 management groupings a single opportunity to produce validated and supportable accounts. The second and final consolidated account incorporates audit adjustments only. Consequently the Department undertook a more thorough validation at an earlier stage compared to last year. As a result, this year the Department has made far fewer adjustments between the first and final version of the Resource Accounts. In summary these amounted to £297 million decrease in net assets and £152 million increase in net operating costs.

## Other developments in Resource Accounting and the disclosure of financial information

### The Department has revised its objectives for Schedule 5

18. The Department has revised its objectives to align with those set out in its Public Service Agreement with HM Treasury[3]. In order to achieve consistency from year to year HM Treasury's *Resource Accounting Manual* requires Departments to restate the prior year according to the new objectives and explain the changes in a note to the accounts. The notes to the accounts should disclose current and prior year figures on the basis of the previous aim and objectives. Alternatively where this can be achieved only at disproportionate cost, the current year figures may be restated against the previous objectives. The Department has adopted this latter approach.

### The Department is undertaking a quinquennial review of its asset valuations

19. Note 8 to the 2001–02 Resource Accounts summarises the Department's holdings of tangible fixed assets. HM Treasury's *Resource Accounting Manual* requires that tangible fixed assets are professionally revalued at least once every 5 years. In December 2001 the Department started such a quinquennial review to determine up to date professional valuations of its assets at 1 April 2002. Because of the vast range of assets it holds, this has been a complex task for the Department and some valuation work is still being undertaken.

[3] Spending Review 2000: Public Service Agreements 2001–04 Cm4808 July 2000.

## Section 3: Are the Department's Resource Accounts for 2001–02 true and fair?

20. My certificate on pages 13 to 14 explains that I am required to report my opinion as to whether the financial statements give a true and fair view. I noted in Section 2 of my Report the Department has made significant progress in addressing some of these issues that led me to qualify my opinion on the 2000–01 Resource Accounts. But there is still more that the Department is required to do in order to be in a position to produce Accounts which could be considered to be free from material mis-statement. In the context of the 2001–02 Resource Accounts I have qualified my audit opinion because I am unable to confirm the completeness of charges to the operating cost statement in respect of consumption of certain stock and fixed assets.

### I am unable to confirm some figures in the Department's Operating Cost Statement in respect of consumption charges for certain stock and fixed assets

21. In my Report on the 2000–01 accounts I noted the problems the Department had in accounting correctly for stock consumption. In particular, systems were not in place to capture data on the consumption of Departmental stock by contractors. And existing stock inventory systems were not designed to provide stock accounting data for accruals based financial accounts. While progress has been and continues to be made, these issues are unlikely to be fully resolved until current systems are replaced with an integrated stock management and accounting system.

#### There are incomplete charges to the operating costs statement for the use of stock and capital spares by contractors

22. Assets belonging to the Department may be held by contractors for a number of reasons. For example spare parts may be supplied to contractors to carry out repairs on major components or items may be supplied for incorporation into new builds or modifications. The contractor has responsibility for maintaining information on the items held. The degree of detail to be recorded by the contractor varies according to the contract type. The value of these stock and capital spares items should be reflected in the Department's Balance Sheet. And the use of these assets by contractors should be reflected as charges for consumption of stock items or depreciation for the use of capital spares.

23. In my Report on the 2000–01 Accounts I noted the progress made by the Defence Logistics Organisation to capture data on these assets more accurately and maintain a record of their movement. Incomplete records and unvalidated asset valuations meant that I was uncertain whether the values were complete or fairly stated and I qualified my opinion in this regard. At the time the Defence Logistics Organisation was aiming to provide accurate figures for the 2001–02 Account.

24. The gross value of these stock and fixed assets in the Department's Resource Accounts amount to some £1,057 million. After provisions for obsolescence and depreciation are taken into account the net book value is some £591 million. Over the last year the Defence Logistics Organisation has made significant improvements to the accuracy of the data. The existence of some 96 per cent of the assets has been confirmed by reference to updated returns from contractors. This has been supplemented with compliance visits to selected contractors to confirm their stock management systems record accurately their holding of Departmental assets. Some 64 per cent of values have been derived from existing validated pricing records held by the Department; while the remaining items have been valued using estimating techniques based on the type of asset and an average price. The ownership of some 84 per cent of items has been attributed to specific Integrated Project Teams within the Defence Logistics Organisation which will further improve future validation and control.

25. In order to create the 31 March 2002 closing balances, the Department removed the opening balances at 1 April 2001 and substituted new values for the closing position. The more usual business process would be to record stock issued to contractors and stock usage by contractors during the year to determine the closing stock balance held by contractors. However there are no specific values for these transactions in the resource account. As a result, the only charges in respect of assets held by contractors that have been posted to the Operating Cost Statement reflect the change in stock provision for obsolescence and the change in the accumulated depreciation. Currently contractors are unable to provide transaction data without incurring additional cost to support the detail of their operations during the year.

26. I have concluded that the balance sheet values for these stock and fixed assets held by industry are essentially complete and correct. However because of the absence of a full audit trail I have been unable to determine the completeness of stock consumption and depreciation charges to the operating cost statement regarding the usage of these assets by contractors and I have qualified my opinion in this regard. The Defence Logistics Organisation recognises there are further improvements to be made and is developing data capture processes and estimating techniques to remedy this in the 2002–03 accounts. And it will seek transaction data from contractors as new contracts are awarded.

**Certain stock accounting transactions are not completely or correctly recorded.**

27. The supply system for the Defence Logistics Organisation's Air environment continues to generate data that cannot be wholly supported. Each month the stock accounting system compares opening and closing values with the movements generated by the stock inventory system. Where there is a difference a reconciling balance is automatically created. This ensures that the accounts reflect the stock inventory system, however there is no supporting audit trail as the procedure is embedded within the software programme. In the 2001–02 accounts this "autobalance" procedure generated a net credit to the operating cost statement of some £340 million. In the previous year it had generated a charge of £440 million. During 2001–02 the gross monthly postings varied between a £45 million credit and £25 million charge for consumable stock and a £261 million credit and a £177 million charge for capital spares.

28. The Defence Logistics Organisation has reviewed the larger autobalance transactions to determine possible causes. For example, spurious transactions are generated when the stock management system recorded a stock issue against a zero stock holding. This software programme error has now been rectified. In previous years a large part of the autobalance was caused by the inability of the stock inventory system to differentiate whether an item received from a contractor was a new or repaired item. For financial accounting purposes this distinction is important as a repaired item will already be held on the Balance Sheet. The Defence Logistics Organisation has improved the transaction mapping from the inventory system through the accounting system in this regard. A further area of concern is where the stock inventory system records items on repair as negative stockholdings. However when these balances are corrected the autobalance mechanism assumes the movement represents additions of new items. Items on repair tend to be capital spares and the value of these can be considerable.

29. Because of the lack of audit trail I have been unable to determine whether stock write-off and permanent diminution of capital spares charges to the operating cost statement generated by the autobalance mechanism are correct and I have qualified my opinion in this regard. The Defence Logistics Organisation recognises there are further improvements to be made. Additional resources have been tasked to review the autobalance activity to develop refinements to the Air environment stock inventory and accounting systems.

## Section 4: Is the Department's resource outturn within the limits approved by Parliament?

30. In April 2001, the Government moved to a new resource based financial management system following agreement of Parliamentary Committees and Royal Assent to the Government Resources and Accounts Act 2000. This move to full resource accounting and budgeting is in accordance with the original timetable set out in the 1995 White Paper "Better Accounting for the Tax Payer's Money"[4] and comprises:

- Completion of the first resource based public expenditure survey in the 2000 Spending Review[5];
- Presentation of the first full set of resource based Estimates for 2001–02 in March 2001; and
- Resource Accounts replacing cash based Appropriation Accounts in respect of 2001–02.

31. Resource budgeting uses resource accounting information as the basis for planning and controlling public expenditure. It distinguishes between resource consumption and capital investment and requires departments to match their costs to the time of service delivery.

32. Supply Estimates are the means by which Government seeks authority from Parliament for its spending each year. The Main Estimates are presented to Parliament at the start of the financial year and Supplementary Estimates may be presented during the course of the year if the Government decides to ask Parliament for additional provision. Parliament's vote on the annual Appropriation Act approves the Main Estimates and retrospectively approves any changes advised in the Supplementary Estimates. The Appropriation Act sets out for each Request for Resource the ambit or scope of the expenditure, net resources, resource appropriations in aid (current income) and non operating appropriations in aid (income from the sale of capital assets and from repayment of loans). Parliament also approves the net cash requirement for each Estimate (but not for each Request for Resource).

33. Through its in year monitoring procedures the Department identified during the course of 2001–02 that additional provision was required and presented Supplementary Estimates to Parliament as summarised below.

| *£000* | *Main Estimate* | *Winter Supplementary* | *Spring Supplementary* | *Total* | *Outturn* |
|---|---|---|---|---|---|
| Gross Resource provision RfR 1 | 30,665,167 | 121,463 | 1,671,759 | 32,458,389 | 33,060,206 |
| * A in A RfR 1 | 1,255,800 | 50,482 | 2,325 | 1,308,607 | 1,351,417 |
| * Net Resource provision RfR 1 | 29,409,367 | 70,981 | 1,669,434 | 31,149,782 | 31,751,599 |
| Gross Resource provision RfR 2 | 184,259 | 0 | 388,918 | 573,177 | 530,016 |
| * A in A RfR 2 | 0 | 0 | 0 | 0 | 0 |
| * Net Resource provision RfR 2 | 184,259 | 0 | 388,918 | 573,177 | 530,016 |
| Capital | 5,573,181 | 300 | 515,208 | 6,088,689 | 6,306,572 |
| * Non operating A in A | 173,413 | 300 | 162,820 | 336,533 | 359,090 |
| * Net Cash Requirement | 24,205,998 | 71,481 | 1,636,556 | 25,914,035 | 24,873,679 |

* Subject to Parliamentary control

34. Schedule 1 of the Departmental Resource Accounts summarises the Department's expenditure and net cash requirement against these revised budgets authorised by Parliament. In respect of key elements of Parliamentary control the Department has:

- exceeded its target for appropriations in aid on Request for Resource 1 by some £43 million;
- underspent its budget for Request for Resource 2 "Conflict Prevention" by some £43 million;
- exceeded its target for non operating cost appropriations in aid by approximately £23 million; and
- underspent its overall net cash requirement by about £1,040 million.

The net cash requirement underspend arises from several causes including an underspend on relevant cash operating costs, smaller than forecast working capital movements, including the deferment of a payment into court pending an appeal against adjudication and a lower than expected cash draw-down for the loans made to Trading Funds.

[4] Better Accounting for the Taxpayer's Money: Resource Accounting and Budgeting in Government July 1995 Cm 2929.

[5] Spending Review 2000, New public spending plans 2001–04 July 2000 Cm 4807.

## The Department has exceeded its voted net resources for RfR 1

35. However, under Request for Resource 1 "Provision for Defence Capability" the Department has incurred resource consumption of £31,752 million against voted provision of £31,150 million and exceeded the net resource provision authorised by Parliament by £601.8 million or 1.9 per cent of its Estimate. It is proposed to ask Parliament to provide for the excess by voting a further supply grant for resource of £601,816,500.45.

### The main cause of the excess vote is unforecast charges arising from the impairment of fixed assets

36. The Joint Force Harrier was formed on 1 April 2000 and currently operates two aircraft types—the Sea Harrier FA2 air defence aircraft flown by RN personnel and the RAF Harrier GR7 a ground attack/ reconnaissance aircraft flown by RAF personnel. The Department intended that both the Sea Harrier FA2 and the Harrier GR7 would be replaced by a common aircraft type by 2012.

37. On 28 February 2002 the Minister of State for the Armed Forces announced to Parliament[6] that Joint Force Harrier would migrate to an all Harrier GR force maximising investment in one aircraft type. The Department plans to upgrade the GR7 to GR9 standard—aircraft systems will be enhanced to extend lives and give Harrier the capability to operate with smart weapons. To that end the Sea Harrier FA2 will be withdrawn from service earlier than planned, by 31 March 2006.

38. Of the 56 Sea Harriers, the Department has identified 15 for immediate disposal. The carrying value of £262 million of these aircraft and their associated development cost has been written off to the operating cost statement. The Department has drawn up a schedule for taking the remaining Sea Harriers out of service over the next 4 years. This has required an increase in their depreciation rate to reduce their carrying value to a disposal value by the out of service date. As a result an additional charge of £24 million has been incurred to the operating cost statement for 2001–02.

39. The Department had not considered at an early stage the financial consequences of the decision to withdraw the Sea Harrier. This prevented the Department from seeking additional resource provision from Parliament through the Spring Supplementary Request for Supply procedure in February 2002.

40. In addition to the decision to withdraw the Sea Harrier, the Department identified after review other fixed and rotary winged aircraft which no longer met their planned capability. But it did not do so until the end of the financial year after the Department's Supplementary Estimates had been agreed. These reviews resulted in decisions to dispose of or scrap three Tornado aircraft and 14 Lynx and Gazelle helicopters deemed to be damaged beyond repair. This generated further writes-off of asset carrying values to the operating cost statement amounting to some £76 million. The Department also identified at a late stage a reduction to the carrying values for a class of submarine, amounting to some £59 million. A series of smaller changes to the carrying values of a range of fighting equipment and capital spares holdings resulted in further charges to the operating cost statement of some £175 million.

41. The Department approached my staff in March 2002 to discuss a potential impairment to the operational capability of Skynet satellites. These support a secure communications system across much of the world; but some satellites have not functioned fully as planned since their launch. The Department undertook a review of the operational capability of the satellites and this was completed in May 2002. The review concluded that there was indeed an impairment and that it was appropriate to adjust the carrying value to reflect this. In total some £106 million has been written off to the operating cost statement to reduce the carrying value of these assets.

42. Because the impairment was identified at the end of the financial year this prevented the Department from seeking additional resource budget from Parliament through the Spring Supplementary Request for Supply procedure in February 2002. The impairment has contributed to the Department's excess net resource expenditure.

### The Department is improving its financial forecasting

43. For Treasury control purposes, departments' budgets comprise three-year Departmental Expenditure Limits (DEL) consisting of both resource and capital elements. In addition, departments are authorised to incur other expenditure which does not fall within DEL and is termed Annually Managed Expenditure (AME). Under a transitional regime introduced in the 2000 Spending Review, the non-cash costs introduced by resource accounting and budgeting (cost of capital charges, depreciation and provisions for future expenditure) are included in AME rather than DEL. This was to allow departments time to gain more experience in monitoring and forecasting these items. They become part of the three year expenditure limits from 1 April 2003.

[6] Hansard 28 Feb 2002 Column 1453W.

44. In the first year of managing under Resource Budgeting the Department focused efforts on meeting Treasury control totals and tried to manage centrally against Parliamentary control totals. Top Level Budget Holders were required to monitor and forecast but not to control resource consumption classified as AME. Because of the Department's large and diverse asset base, AME makes up a significant part of the overall resource consumption. This meant there were no automatic checks on the affordability of decisions taken to withdraw assets early, generating impairments and writes-off, and forecasts were not sufficiently reliable due to the lack of prior experience of managing such resource consumption.

45. To mitigate an excess of resource consumption during 2002–03, the Department has implemented a more robust system for monitoring all consumption during the year. In particular, the Department will check thoroughly that Top Level Budget Holders' estimates for Annually Managed Expenditure items are complete before submission of the Spring Supplementary Estimates to Parliament in 2003.

## Section 5: Ministry of Defence—Votes A

46. The Ministry of Defence's Votes A is presented annually to Parliament to seek statutory authority for the maximum numbers of personnel to be maintained for service with the armed forces. Note 29 to the Accounts shows that the maximum numbers maintained during 2001–02 for the Naval, Army and Air Force Services in all active and reserve categories were within the numbers voted by Parliament. My staff have been provided with strength returns to support this Note to the financial statements.

*John Bourn* 14 November 2002
Comptroller and Auditor General
National Audit Office
157–197 Buckingham Palace Road
Victoria
London SW1W 9SP

## SCHEDULE 1

### Summary of Resource Outturn
for the year ended 31 March 2002

| | Estimate | | | Outturn | | | Net Total Outturn compared to Estimate Savings/ (Excess) |
|---|---|---|---|---|---|---|---|
| | Gross Expenditure 1 | A-in-A 2 | Net Total 3 | Gross Expenditure 4 | A-in-A (note 4) 5 | Net Total 6 | 7 |
| | £000 | £000 | £000 | £000 | £000 | £000 | £000 |
| **Request for Resources 1** | **32,458,389** | **1,308,607** | **31,149,782** | **33,060,206** | **1,308,607** | **31,751,599** | **(601,817)** |
| **Request for Resources 2** | **573,177** | — | **573,177** | **530,016** | — | **530,016** | **43,161** |
| **Total Resources** | **33,031,566** | **1,308,607** | **31,722,959** | **33,590,222** | **1,308,607** | **32,281,615** | **(558,656)** |
| **Non operating cost A-in-A** | | | **336,533** | | | **336,533** | — |
| **Net cash requirement** | | | **25,914,035** | | | **24,873,679** | **1,040,356** |

**Outturn in Respect of Prior Year**

The corresponding figures for 2000–01 outturn were as follows:

| | |
|---|---|
| **Total Resources (Restated)** | 33,291,998 |
| **Non operating cost A-in-A** | 336,746 |
| **Net cash requirement** | 23,518,880 |

**Reconciliation of resources to cash requirement**

| | Note | £000 | £000 | £000 |
|---|---|---|---|---|
| Net total resources | Sch 2 | 31,722,959 | 32,281,615 | (558,656) |
| **Capital:** | | | | |
| *Purchase of fixed assets | 7/8 | | | |
| — RfR 1 | | 5,788,045 | 6,080,680 | (292,635) |
| — RfR 2 | | 61,000 | 56,069 | 4,931 |
| — RfR 1 Capitalised provisions | | | 160,880 | (160,880) |
| New loans to the Trading Funds | 9 | 238,300 | 7,600 | 230,700 |
| **Non operating cost A-in-A:** | | | | |
| Net book value of fixed assets disposed | 7/8/3 | (252,376) | (299,589) | 47,213 |
| Repayment of loans made to the Trading Funds | 9 | (84,157) | (59,501) | (24,656) |
| Excess non operating costs Appropriation-in-Aid payable to the Consolidated Fund | | — | 22,557 | (22,557) |
| **Repayment of Loans from the National Loans Fund** | Sch 4 | 1,344 | 1,343 | 1 |
| *Carried forward to next page* | | 37,475,115 | 38,251,654 | (776,539) |

*The notes on pages 31 to 66 form part of these financial statements.*

**SCHEDULE 1**—*continued*

| | Note | £000 | £000 | £000 |
|---|---|---|---|---|
| *Brought forward from previous page* | | 37,475,115 | 38,251,654 | (776,539) |
| **Accruals adjustments:** | | | | |
| Non-cash transactions— Included in operating costs | Sch 4 | | (8,375,718) | |
| Surplus arising on disposal of fixed assets | Sch 4 | | (39,179) | |
| Revaluation reserve released on disposal of fixed assets | 3 | | 50,845 | |
| Included in net interest payable | 5 | | (232,636) | |
| Capitalised provisions shown above | | | (160,880) | |
| | | (7,556,914) | (8,757,568) | |
| Cost of capital charge | 17 | (5,284,828) | (5,124,775) | |
| | | (12,841,742) | (13,882,343) | 1,040,601 |
| *Changes in working capital other than cash | Sch 4 | 944,000 | 270,697 | 673,303 |
| Transitional adjustment, being adjustment of outstanding balances relating to the Department's Appropriation Accounts for 2000—01 | | — | (59,542) | 59,542 |
| *Use of provisions for liabilities and charges | 16 | 336,662 | 286,025 | 50,637 |
| Working capital movements in respect of the Machinery of Government changes during the year | | — | 7,188 | (7,188) |
| Net cash requirement | Sch 4 | **25,914,035** | **24,873,679** | **1,040,356** |

*Stated in accordance with Schedule 1 requirement to include accruals within the movements in the year

### Explanation of the variation between estimate and outturn (net total resources)

The excess of net resource outturn of £602 million against estimate relates mainly to a series of decisions on impairments, taken towards the end of the year and after year end: to advance the out-of-service date of Sea Harrier (which had the greatest impact on the results of the Air Officer Commander-in-Chief RAF Strike Command); on Skynet satellites, which affected the results of the Chief of Defence Logistics; on submarines, which affected the results of the Commander-in-Chief Fleet; and a range of other, smaller changes to fighting equipment and capital spares holdings. These increases were partially offset by a reduction in costs as a result of implementing FRS 15 (see Note 1). In Note 26, the excess of net resource outturn is analysed by TLB Holders. As part of the normal course of business resources need to be reallocated and redistributed between TLB Holders as and when required in order to optimise the use of those resources in the generation of military capability and its effective use on operations. This process contributed to the in-year excess and shortfall shown against some of the TLB Holders. These offset each other, with no material impact on the Department's total net resource requirements.

*The notes on pages 31 to 66 form part of these financial statements.*

**SCHEDULE 1**—*continued*

### Explanation of the variation between estimate and outturn (net cash requirement)

The variation of net cash requirement against Estimate of £1,040 million represents a reduction in operating costs after offsetting non-cash transactions; smaller movements than forecast in working capital, including the deferment of a payment into court pending an appeal against an adjudication; a lower amount of cash draw down for the loans made to Trading Funds; offset by an increase in capital expenditure.

### Prior-period adjustments

The prior year's figure for total resource outturn has been reduced by £22,181,000 to reflect adjustments in respect of the Machinery of Government changes and the effect of change in accounting policy on fixed assets arising on the full implementation of FRS 15, see Note 25.

### Analysis of income payable to the Consolidated Fund

In addition to Appropriations-in-Aid the following income relates to the Department and is payable to the Consolidated Fund. (Cash receipts are shown in italics).

| | 2001–02 Forecast | | 2001–02 Outturn | |
|---|---|---|---|---|
| | Income | *Receipts* | Income | *Receipts* |
| | £000 | *£000* | £000 | *£000* |
| Operating income and receipts—excess A-in-A | — | — | 42,810 | *42,810* |
| Non operating income and receipts—excess A-in-A | — | — | 22,557 | *22,557* |
| **Subtotal** | — | — | 65,367 | *65,367* |
| Other operating income and receipts not classified as A-in-A | 25,011 | *25,011* | 35,133 | *29,244* |
| Other non-operating income and receipts not classified as A-in-A | — | — | — | — |
| Other amounts collectable on behalf of the Consolidated Fund | — | — | — | — |
| | **25,011** | *25,011* | **100,500** | *94,611* |

The table above does not include a payment made during the year to the Consolidated Fund of £46,429,000 representing a part repayment of a loan made to QinetiQ of £50 million. This loan was created on the formation of QinetiQ as a Self Financing Public Corporation.

**Notes:**

i) Actual Outturn—resources.
Request for Resources 1: Provision of Defence Capability.
Actual amount net resources outturn £31,751,598,500.45. Actual amount of excess in resources over Estimate £601,816,500.45.

ii) Request for Resources 2: Conflict prevention.
Actual amount net resource outturn £530,016,000.00. Actual amount of savings in resources over Estimate £43,161,000.00.

iii) Actual Outturn—cash.
Net cash requirement: Outturn net requirement was £24,873,679,192.35.

iv) The amount surrenderable to the Consolidated Fund was £455,974,221.46.

*The notes on pages 31 to 66 form part of these financial statements.*

## SCHEDULE 2

### Operating Cost Statement
for the year ended 31 March 2002

| | Note | 2001–02 £000 | Restated (Note 25) 2000–01 £000 |
|---|---|---|---|
| Staff costs | 2 | 9,456,121 | 8,998,743 |
| Other operating costs | 3 | 18,623,539 | 19,980,211 |
| Gross operating costs | | 28,079,660 | 28,978,954 |
| Operating income | 4 | (1,195,682) | (1,143,765) |
| **Net operating cost before interest** | | **26,883,978** | 27,835,189 |
| Net interest payable | 5 | 229,820 | 235,726 |
| Cost of capital charge | 17/25 | 5,124,775 | 5,199,429 |
| **Net operating cost** | | **32,238,573** | 33,270,344 |
| **Net resource outturn** | 6 | **32,281,615** | 33,291,998 |

### Statement of Recognised Gains and Losses
for the year ended 31 March 2002

| | Note | 2001–02 £000 | 2000–01 £000 |
|---|---|---|---|
| Net (gain) on revaluation of fixed assets and stocks | 18 | (1,955,801) | (3,236,470) |
| Receipts of donated assets and (gain) on revaluation | 18 | (38,799) | (169,061) |
| Prior year adjustments | 25 | (960,962) | (272,543) |
| Surplus generated on formation of QinetiQ and Defence Science and Technology Laboratory (DSTL) and disestablishment of the Defence Evaluation and Research Agency (DERA). Details in Note 17. | 17 | (297,066) | — |
| **Recognised (gains) during the year** | | **(3,252,628)** | (3,678,074) |

*The results shown above are in respect of continuing activity.*

*The notes on pages 31 to 66 form part of these financial statements.*

## SCHEDULE 3

### Balance Sheet
as at 31 March 2002

| | Note | 31 March 2002 £000 | 31 March 2002 £000 | Restated (Note 25) 31 March 2001 £000 | Restated (Note 25) 31 March 2001 £000 |
|---|---|---|---|---|---|
| **Fixed Assets** | | | | | |
| Intangible assets | 7 | 19,527,222 | | 19,901,482 | |
| Tangible fixed assets | 8 | 68,140,835 | | 67,487,339 | |
| Investments | 9 | 671,046 | | 391,478 | |
| | | | 88,339,103 | | 87,780,299 |
| **Current Assets** | | | | | |
| Stocks and work-in-progress | 11 | 6,396,304 | | 6,515,170 | |
| Debtors | 12 | 1,230,646 | | 1,004,722 | |
| Cash at bank and in hand | 13 | 631,986 | | 302,775 | |
| | | 8,258,936 | | 7,822,667 | |
| Creditors: amounts falling due within one year | 14 | 4,624,471 | | 4,218,428 | |
| **Net current assets** | | | 3,634,465 | | 3,604,239 |
| **Total assets less current liabilities** | | | 91,973,568 | | 91,384,538 |
| Creditors: amounts falling due after more than one year | 15 | 448,381 | | 397,231 | |
| Provisions for liabilities and charges | 16 | 4,970,948 | | 4,337,798 | |
| | | | 5,419,329 | | 4,735,029 |
| **Net assets** | | | **86,554,239** | | 86,649,509 |
| **Taxpayers' equity** | | | | | |
| General fund | 17 | | 74,657,623 | | 75,991,550 |
| Revaluation reserve | 18 | | 10,549,019 | | 9,231,992 |
| Donated assets reserve | 18 | | 1,347,597 | | 1,425,967 |
| | | | **86,554,239** | | 86,649,509 |

*Kevin Tebbit*
Accounting Officer

13 November 2002

*The notes on pages 31 to 66 form part of these financial statements.*

## SCHEDULE 4

### Cash Flow Statement
for the year ended 31 March 2002

| | Note | 2001–02 £000 | Restated (Note 25) 2000–01 £000 |
|---|---|---|---|
| **Net cash outflow from operating activities before interest** | A | **19,781,577** | 17,946,697 |
| **Returns on investments and servicing of finance** | B | **(4,887)** | (33,010) |
| **Net capital expenditure and financial investment** | C | **5,088,289** | 5,582,269 |
| **Payments to the Consolidated Fund** | | **147,843** | 227,529 |
| **Financing from the Consolidated Fund (supply)** | 13 | **(25,343,376)** | (23,631,201) |
| **Repayment of loans from the National Loans Fund** | | **1,343** | 1,268 |
| **(Increase)/decrease in cash at bank and in hand** | 13 | **(329,211)** | 93,552 |

**Notes to the cash flow statement:**

**A. Net cash outflow from operating activities before interest**

| | Note | 2001–02 £000 | 2000–01 £000 |
|---|---|---|---|
| Net operating cost before interest | Sch 2 | 26,883,978 | 27,835,189 |
| Non-cash transactions: | | | |
| —Depreciation and amortisation charges | 3 | (6,120,520) | (5,835,696) |
| —Permanent diminution in value of fixed assets | 3 | (1,249,948) | (1,695,487) |
| —Provisions to reduce value of stock to its net realisable value | 3 | (439,186) | (928,740) |
| —Auditors' remuneration | 3 | (4,170) | (4,742) |
| —Surplus/(deficit) arising on disposal of fixed assets | 3 | 39,179 | (263,633) |
| —Fixed Assets written off | 3 | (74,923) | — |
| —*Movement in provisions for liabilities and charges (excluding capitalised provisions) | | (526,150) | (114,578) |
| | | (8,375,718) | (8,842,876) |
| Dividends received from Trading Funds | 4 | 7,431 | 27,144 |
| *Adjustments for movements in working capital other than cash | | | |
| —Increase/(decrease) in stocks/WIP | | 140,505 | (1,150,852) |
| —Increase/(decrease) in debtors | | 221,462 | 84,659 |
| —(Increase)/decrease in creditors | | 638,741 | (415,746) |
| | | 1,000,708 | (1,481,939) |
| Paid against provisions for liabilities and charges | | 265,178 | 409,179 |
| | | **19,781,577** | 17,946,697 |

**B. Returns on investments and servicing of finance**

| | Note | 2001–02 £000 | 2000–01 £000 |
|---|---|---|---|
| Dividends received from Trading Funds | 4 | (7,431) | (27,144) |
| Interest received | | (10,785) | (14,720) |
| Interest paid | | 245,965 | 250,463 |
| Deduct: Unwinding of discount on provisions for liabilities and charges | 5 | (232,636) | (241,609) |
| | | 13,329 | 8,854 |
| | | **(4,887)** | (33,010) |

**C. Analysis of capital expenditure and financial investment**

| | Note | 2001–02 £000 | 2000–01 £000 |
|---|---|---|---|
| Acquisition of fixed assets | | 5,428,113 | 5,919,015 |
| Proceeds on disposal of fixed assets | | (287,923) | (317,987) |
| | | 5,140,190 | 5,601,028 |
| Repayment of loans made to the Trading Funds and QinetiQ | 9 | (59,501) | (18,759) |
| Loans made to Trading Funds | 9 | 7,600 | — |
| | | **5,088,289** | 5,582,269 |

*The notes on pages 31 to 66 form part of these financial statements.*

**SCHEDULE 4**—*continued*

| | Note | **2001–02** £000 | Restated (Note 25) 2000–01 £000 |
|---|---|---|---|
| **Analysis of Financing** | | | |
| Parliamentary Funding from the Consolidated Fund (Supply) | 13 | 25,343,376 | 23,631,201 |
| (Increase)/decrease in cash at bank and in hand during the year | 13 | (329,211) | 93,552 |
| Funding from the Contingency Fund | | 1,000,000 | — |
| Repayment to the Contingency Fund | | (1,000.000) | — |
| Consolidated Fund Extra Receipts received and not paid over including excess operating appropriation-in-aid of £42,810,000 and non-operating appropriation-in-aid of £22,557,000 | | 69,430 | 4,323 |
| Consolidated Fund Extra Receipts received in prior year paid over | | (4,323) | (30,456) |
| Repayment of loan from QinetiQ repaid to Consolidated Fund | | (46,429) | — |
| Grant drawn in the previous year and not spent, repaid to the Consolidated Fund during the year | | (71,910) | (179,740) |
| Deduct funding appropriated in respect of Machinery of Government changes | | (27,712) | — |
| Transitional adjustment, being adjustment to working capital of outstanding balances relating to the Department's appropriation accounts for 2000–01 | | (59,542) | — |
| Net cash requirement | Sch 1 | **24,873,679** | 23,518,880 |

**Amount of grant actually issued to support the net cash requirement = £25,343,376,433.54.**

*The movements shown above exclude assets and liabilities at 31 March 2001 in respect of DARA which was established as a Trading Fund as at 1 April 2001 and which is outside the Departmental Boundary.

| | £000 | £000 |
|---|---|---|
| **Fixed Assets** | — | 69,969 |
| **Stock** | 26,173 | — |
| **Debtors** | 3,624 | — |
| **Creditors** | (14,672) | — |
| | | 15,125 |
| **Provision for liabilities and charges** | | (491) |
| | | 84,603 |

*The notes on pages 31 to 66 form part of these financial statements.*

## SCHEDULE 5

**Resources by Departmental Aim and Objectives**
for the year ended 31 March 2002

### Aim

To ensure the security and defence of the United Kingdom and the Overseas Territories, including against terrorism, and to support the Government's foreign policy objectives, particularly in promoting international peace and security.

In pursuance of this aim, the Department has the following objectives:

| | Gross Costs | Income | Net |
|---|---|---|---|
| | £000 | £000 | £000 |
| **Objective 1:** Achieving success in the tasks we undertake | 2,844,126 | (222,989) | 2,621,137 |
| **Objective 2:** Being ready to respond to the tasks that might arise | 27,511,370 | (927,054) | 26,584,316 |
| **Objective 3:** Building for the future | 3,078,759 | (45,639) | 3,033,120 |
| | **33,434,255** | **(1,195,682)** | **32,238,573** |

*Comparative figures are not available for 2000–01—See notes and additional details in Note 24.*

*The notes on pages 31 to 66 form part of these financial statements.*

# Notes to the Accounts

## 1. Statement of Accounting Policies

### Introduction

1.1 These financial statements have been prepared in accordance with the Accounts Direction issued by HM Treasury dated 31 January 2002 and comply with the requirements of HM Treasury's RAM. In order to reflect the particular circumstances of the Department, the following exceptions to the RAM have been made:

– The Operating Cost Statement is not segmented into programme and non-programme expenditure, as agreed with HM Treasury.
– Separate statements are not prepared for non-agency parts of the Department, as agreed with HM Treasury.

### Accounting Convention

1.2 These financial statements are prepared on an accruals basis under the historical cost convention, modified to include the revaluation of certain fixed assets and stocks.

### Basis of preparation of Departmental Resource Accounts

1.3 These financial statements comprise the consolidation of the Department, its Defence Agencies and those Advisory NDPBs sponsored by the Department which are not self-accounting. The Defence Agencies and the Advisory NDPBs sponsored by the Department are listed in Note 30.

1.4 Four of the Department's agencies are established as Trading Funds. They therefore fall outside Voted Supply and are subject to a different control framework. Consequently, the Department's interests in the Trading Funds are included in the financial statements as fixed asset investments. Executive NDPBs operate on a self-accounting basis and are not included in the consolidated accounts. They receive grant-in-aid funding from the Department which is treated as an expense in the Operating Cost Statement.

1.5 The restructuring of the DERA Trading Fund during the year resulted in the disestablishment of DERA and the vesting of DSTL as a Trading Fund and the formation of a Self Financing Public Corporation called QinetiQ. DSTL and QinetiQ fall outside the Voted Supply and are subject to a different control framework. The Department's interests in DSTL and QinetiQ are included in the financial statements as fixed asset investments.

1.6 The AFPS is not consolidated within these financial statements. Separate accounts are prepared by the AFPS.

1.7 Machinery of Government changes which involve the merger of two or more Departments into one new Department, or the transfer of functions or responsibility of one part of the public service sector to another, are accounted for using merger accounting as described in FRS 6.

### Net Operating Costs

1.8 Costs are charged to the Operating Cost Statement in the period in which they are incurred and matched to any related income. Costs of VAT recoverable Contracted-Out Services are included net of related VAT. Other costs are VAT inclusive, although a proportion of this VAT is recovered via a formula agreed with HM Customs and Excise. Surpluses and deficits on disposal of fixed assets and stock are included within Other Operating Costs (Note 3).

1.9 Income from services provided to third parties is included in operating income, net of related VAT. Dividends are included in the operating income in the year in which the cash is received.

### Fixed Assets

1.10 Through the application of the Modified Historical Cost Accounting Convention (MHCA), the Department's fixed assets are expressed at their value to the Department on an inflation-adjusted basis, i.e. at actual or estimated current values. The Department achieves this through the application of prospective indices that are applied in April of each financial year and look ahead to the subsequent balance sheet date. A suite of indices is determined by the Department's Senior Economic Advisor, in conjunction with the Defence Analytical Services Agency. Different indices are used for the following asset categories and are "self correcting" in the subsequent financial year i.e. they are adjusted to account for the actual change in prices as compared to the earlier prediction:

– Land (by region and type)
– Buildings (UK and specific overseas indices)

## Notes to the Accounts—*continued*

– Fighting Equipment (one index for each of the three Sea, Air and Land systems)
– Plant, Machinery and Vehicles
– IT and Communications Equipment—Office Machinery and Computers
– IT and Communications Equipment—Communications Equipment

1.11 Additionally all fixed assets are subject to a quinquennial revaluation by external professional valuers in accordance with FRS15.

1.12 Assets in the course of construction are valued at cost and are subject to indexation. On completion they are released from the project account into the appropriate asset category.

1.13 The Department's policy on the capitalisation of subsequent expenditure under FRS15 is to separately account for material major refits and overhauls when their value is consumed by the Department over a different period to the life of the corresponding core asset and where this is deemed to have a material effect on the carrying values of a fixed asset and the depreciation charged. Subsequent expenditure is also capitalised where it is deemed to enhance significantly the operational capability of the equipment, including extension of life and when it is incurred to replace or restore a component of an asset that has been treated separately for depreciation purposes.

1.14 As a result of implementing FRS15 during the year, the net operating costs were reduced by £57,260,919 (2000–01 £56,670,000). The net impact on the Balance Sheet was to increase fixed assets by £86,069,000 (31 March 2001; £165,979,000).

### Intangible Assets

1.15 Pure and applied research costs are charged to the Operating Cost Statement in the period in which they are incurred.

1.16 Development costs are capitalised where they contribute towards defining the specification of an asset that will enter production. The development costs are amortised over the planned operational life of that asset type, e.g. class of ship or aircraft, on a straight-line basis. Amortisation commences when the asset type first enters operational service within the Department. If it is decided to withdraw a whole asset type early then any remaining unamortised development costs are written off to the Operating Cost Statement along with the underlying asset.

### Tangible Fixed Assets

1.17 The useful economic lives of tangible fixed assets are reviewed annually and adjusted where necessary. The capitalisation threshold is £10,000.

1.18 In these financial statements, guided weapons, missiles and bombs (GWMB) and capital spares are categorised as fixed assets and subject to depreciation. The depreciation charge in the Operating Cost Statement also includes the cost of GWMB fired to destruction. The principal asset categories and their useful economic lives, depreciated on a straight line basis, are:

| | Category | Years |
|---|---|---|
| Land and Buildings | Land | Indefinite, not depreciated |
| | Buildings, permanent | 50 |
| | Buildings, temporary | 5–20 |
| | Leasehold | Shorter of expected life and lease period |
| Fighting Equipment (including GWMB) | | Useful economic life (on a pooled basis for GWMB) |
| Plant, Machinery and Vehicles | Plant and Machinery | 5–15 |
| | Specialised Vehicles (includes non-fighting vessels and aircraft) | Useful economic life |
| | Other standard vehicles | 3–5 |
| IT and Communications Equipment | Computers | 3–7 |
| | Satellites | Useful economic life |
| | Communications Equipment | Useful economic life |
| Operational Heritage Assets * | | As other tangible fixed assets |

## Notes to the Accounts—*continued*

| | Category | Years |
|---|---|---|
| Capital Spares | Items of repairable material retained for the purpose of replacing parts of an asset undergoing repair, refurbishment, maintenance, servicing, modification, enhancement or conversion. | Useful economic life (on a pooled basis, consistent within the life of the prime equipment supported) |

* Operational Heritage Assets are included within the principal asset category to which they relate.

### Donated Assets

1.19 Donated assets (i.e. those assets that have been donated to the Department) or assets for which the Department has continuing and exclusive use but does not own legal title and for which it has not given consideration in return are capitalised at their current valuation on receipt and are revalued/depreciated on the same basis as purchased assets.

1.20 A donated assets reserve represents the value of the original donation, additions, any subsequent revaluation and indexation (MHCA). Amounts equal to the donated asset depreciation charge and impairment costs arising during the year, are released from this reserve to the Operating Cost Statement. On disposal, the net book value of a donated asset is released from the reserve to the Operating Cost Statement.

### Impairment

1.21 The charge to the Operating Cost Statement in respect of impairment arises on decision to sell a fixed asset and take it out of service; on transfer of a fixed asset into stock; on reduction in service potential and where the application of MHCA indices causes a downward revaluation below the historical cost and which is deemed to be permanent in nature. Any reversal of an impairment cost is recognised in the Operating Cost Statement to the extent that the original charge was recognised in the Operating Cost Statement. The remaining amount is recognised in the revaluation reserve.

### Disposal of Tangible Fixed Assets

1.22 Disposal of assets is handled by two specialist agencies: Defence Estates for property assets and the Disposal Services Agency for non-property assets.

1.23 Property assets identified for disposal are included at the open market value with any resulting changes in the net book value charged to the Operating Cost Statement under Impairment or credited to the revaluation reserve as appropriate. On subsequent sale the surplus or deficit is included in the Operating Cost Statement under surplus/deficit on disposal of fixed assets.

1.24 Non-property assets are subject to regular impairment reviews. An impairment review is also carried out when a decision is made to dispose of an asset and take it out of service. Any write down in value to the net recoverable amount (NRA) is charged to the Operating Cost Statement under Impairment. The surplus or deficit at the point of disposal is included in the Operating Cost Statement under surplus/deficit on disposal of fixed assets. Non-property assets, where the receipts on sale are anticipated not to be separately identifiable, are transferred to stock at their NRA and shown under assets declared for disposal. Any write down on transfer is included in the Operating Cost Statement under Impairment.

1.25 Disposals shown in Notes 7 and 8 also include fixed assets written off during the year due to damage, loss and destruction.

### Leased Assets

1.26 Assets held under finance leases are capitalised as tangible fixed assets and depreciated over the shorter of the lease term or their estimated useful economic lives. Rentals paid are apportioned between reductions in the capital obligations included in creditors, and finance charges charged to the Operating Cost Statement. Expenditure under operating leases is charged to the Operating Cost Statement in the period in which it is incurred. In circumstances where the Department is the lessor of a finance lease, amounts due under a finance lease are treated as amounts receivable and reported in Debtors.

## Notes to the Accounts—*continued*

### Private Finance Initiative (PFI) Transactions

1.27 Where the substance of the transaction is that the risks and rewards of ownership remain with the Department, the assets and liabilities remain on the Department's Balance Sheet. Service charges in respect of on-balance sheet PFI deals are apportioned between reduction in the capital obligation and charges to the Operating Cost Statement for service performance and finance cost. Where the risks and rewards are transferred to the private sector the transaction is accounted for in the Operating Cost Statement through service charges in accordance with FRS5 and Treasury Guidance.

### Investments

1.28 Investments represent holdings that the Department intends to retain for the foreseeable future. Fixed asset investments are stated at market value where available, otherwise they are stated at cost. They include Public Dividend Capital of those Executive Agencies owned by the Department and established as Trading Funds. Investments may either be equity investments, held in the name of the Secretary of State for Defence, or medium or long-term loans made with the intention of providing working capital or commercial support.

1.29 Joint Ventures are accounted for using the Gross Equity method of accounting. Under this method the Department's share of the aggregate gross assets and liabilities underlying the net equity investments are shown on the face of the Balance Sheet. The Operating Cost Statement includes the Department's share of the investee's turnover.

### Stocks and Work-in-Progress

1.30 Stock is valued at current replacement cost, or historical cost if not materially different. Provision is made to reduce cost to net realisable value where there is no expectation of consumption or sale in the ordinary course of the business.

1.31 Internal Work-in-Progress represents ongoing work on the manufacture, modification, enhancement or conversion of stock items. This is valued on the same basis as stocks. External Work-in-Progress represents ongoing work on production or repair contracts for external customers. This is valued at the lower of current replacement cost and NRV.

1.32 Assets declared for disposal include stock held for disposal and those non-property fixed assets identified for disposal where receipts are not anticipated to be separately identifiable.

### Provisions for Liabilities and Charges

1.33 Provisions for liabilities and charges have been established under the criteria of FRS12 and are based on realistic and prudent estimates of the expenditure required to settle future legal or constructive obligations that exist at the Balance Sheet date.

1.34 Provisions are charged to the Operating Cost Statement unless they have been capitalised as part of the cost of the underlying facility where the expenditure provides access to current and future economic benefits. In such cases the capitalised provision will be depreciated as a charge to the Operating Cost Statement over the remaining estimated useful economic life of the underlying asset. All long-term provisions are discounted to current prices by use of HM Treasury's Test Discount Rate (TDR) which is currently 6%. The discount is unwound over the remaining life of the provision and shown as an interest charge in the Operating Cost Statement.

### Reserves

1.35 The Revaluation Reserve reflects the unrealised element of the cumulative balance of revaluation and indexation adjustments on fixed assets and stocks (excluding donated assets and those financed by Government grants). The Donated Asset Reserve reflects the net book value of assets that have been donated to the Department.

1.36 The General Fund represents the balance of the taxpayers' equity.

## Notes to the Accounts—*continued*

### Pensions

1.37 Present and past employees are mainly covered by the PCSPS for civilian personnel and the AFPS for Service personnel. There are separate scheme statements for the AFPS and the PCSPS as a whole.

1.38 Both pension schemes are contracted out, unfunded, defined benefit pay as you go occupational pension schemes, although they are being accounted for as if they were defined contribution schemes in adopting FRS17, in accordance with the HM Treasury RAM. The employer's charge is met by payment of an ASLC, which is calculated based on a percentage of pensionable pay. The ASLC represents an estimate of the cost of providing future superannuation protection for all personnel currently in pensionable employment. In addition, civilian personnel contribute 1.5% of salary to fund a widow/widower's pension. The Department's Balance Sheet will only include a creditor in respect of pensions to the extent that the contributions paid to the pension funds in the year fall short of the ASLC and widow/widower's pension charges due.

1.39 The pension schemes undergo a reassessment of the ASLC contribution rates by the Government Actuary at three-yearly intervals. Provisions are made for costs of early retirement programmes and redundancies up to the normal retirement age and charged to the Operating Cost Statement.

### Early Departure Costs

1.40 The Department provides in full for the cost of meeting pensions up to normal retirement age in respect of civilian personnel early retirement programmes and redundancies announced in the current and previous years. Pensions payable after normal retirement age are met by the PCSPS for civilian personnel.

1.41 There is no comparable early retirement or redundancy scheme for Service personnel but an immediate entitlement to draw pension under the AFPS accrues after 22 years' service for other ranks and 16 years' service for Officers, or earlier in circumstances where exceptional approval is given.

### Cost of Capital Charge

1.42 A charge, reflecting the cost of capital utilised by the Department, is included in the Operating Cost Statement and credited to the General Fund. The charge is calculated using the HM Treasury standard rate of 6% in real terms on all assets less liabilities except for:

- Donated assets and cash balances with the Office of HM Paymaster General (OPG) where the charge is nil.
- Liabilities for the amounts to be surrendered to the Consolidated Fund and for amounts due from the Consolidated Fund where the charge is nil.
- Assets financed by grants, where the charge is nil.
- Additions to heritage collections where the existing collection has not been capitalised, where the charge is nil.

1.43 The cost of capital charge on the fixed asset investments in Trading Funds and in Self Financing Public Corporation is calculated at a specific rate applicable to the Trading Fund or Self Financing Public Corporation and based on its underlying net assets.

### Foreign Exchange

1.44 Transactions that are denominated in a foreign currency are translated into Sterling using the General Accounting Rate (GAR) ruling at the date of each transaction. US$ and Euros are purchased forward from the Bank of England. Monetary assets and liabilities are translated at the spot rate applicable at the Balance Sheet date and the exchange differences are reported in the Operating Cost Statement.

1.45 Overseas non-monetary assets and liabilities are subject to annual revaluation and are translated at the spot rate applicable at the Balance Sheet date and the exchange differences are taken to the revaluation reserve for owned assets, or the donated asset reserve for donated assets.

## Notes to the Accounts—*continued*

### 2. Staff Numbers and Costs

2.1 The average number of whole-time equivalent persons employed during the year was: Service 210,178 (2000–01: 211,333) and Civilian 94,399 (2000–01: 100,398). [Source: Defence Analytical Services Agency]

2.2 The aggregate staff costs, including grants and allowances paid were as follows:

| | **2001–02** £000 | Restated 2000–01 £000 |
|---|---|---|
| Salaries and Wages | 7,495,685 | 7,238,098 |
| Social Security costs | 505,797 | 502,527 |
| Pension costs (see Note 2.4) | 1,305,099 | 1,255,917 |
| Redundancy and severance payments | 149,540 | 2,201 |
| | **9,456,121** | 8,998,743 |
| Made up of: | | |
| Service | 7,014,144 | 6,674,226 |
| Civilian | 2,441,977 | 2,324,517 |
| | **9,456,121** | 8,998,743 |

2.3 For the year ended 31 March 2002 the salary, pension entitlements and the value of any taxable benefits-in-kind for Ministers in respect of their services to the Department is detailed below and should be read in conjunction with the following notes.

### Ministerial Salaries and Allowances

† The presentation below is based on payments made by the Department and thus recorded in these Accounts. In respect of Ministers in the House of Commons, Departments bear only the cost of the additional ministerial remuneration. The salary for their services as an MP was £49,822 pa with effect from 1 April 2001 rising to £51,822 pa with effect from 20 June 2001: (2000–01 £48,371 pa), and various allowances to which they are entitled are borne centrally by the House of Commons. However, the arrangements for Ministers in the House of Lords is different in that they do not receive a salary but rather an additional remuneration which cannot be quantified separately from their Ministerial salaries. This total remuneration, as well as the allowances to which they are entitled, is paid by the Department and is therefore shown in full in the figures below.

** Lords Ministers 2000–01 allowances figures were disclosed separately by way of a note last year and were thus not included in the 2000–01 salary figures disclosed in the Ministers salary table. The 2000–01 comparative figures for Lords Ministers have therefore been changed to include these allowances to provide a direct comparison to 2001–02 disclosures. This change only affects the 2000–01 salary figure for The Right Honourable Baroness Symons of Vernham Dean.

*** Lords Ministers' Night Subsistence paid to The Right Honourable Baroness Symons of Vernham Dean was £3,593 in 2001–02 (2000–01: £18,297) and to The Lord Bach of Lutterworth was £20,460 in 2001–02. These figures are included in the salary figures disclosed. No Minister received payment of the London Supplement allowance this year.

Ministers who have not attained the age of 65, and who are not re-appointed to a relevant Ministerial or other paid office within three weeks, are eligible for a severance payment. No such payments were made in 2001–02 or the previous year. As a Cabinet Minister, The Right Honourable Geoffrey Hoon, MP drew less than his full entitlement of Ministerial salary until 9 June 2001. Full Ministerial Salary for the post of Secretary of State for Defence during 2001–02 was £68,157.

### Ministerial Pensions

Pension benefits to Ministers are provided by the Ministerial Pension Scheme (MPS) which is part of the Parliamentary Contribution Pension Fund (PCPF) for Members of Parliament. The MPS provides benefits on a 'final salary' basis with a 1/50th accrual rate, taking account of all service as a Minister. Benefits are payable on retirement from ministerial office on or after age 65, or on the payment of benefits under the main PCPF scheme. Members pay contributions of 6% of their Ministerial salary. There is also an employer contribution of 7.5% of the Ministerial salary paid by the Exchequer. In the event of retirement because of serious ill health, the MPS pension is brought into payment immediately. On death, pensions are payable to the surviving spouse at a rate of five-eighths of the Minister's pension. On death in service, the MPS provides for a lump sum gratuity of three times the Ministerial salary. Pensions increase in payment in line with changes in the Retail Prices Index. On retirement, it is possible to commute part of the pension for a lump sum.

## Notes to the Accounts—*continued*

As the House of Commons and not the Department meets the Exchequer contribution to the cost of pension provision for Ministers, the pension details are included in the Resource Accounts on a 'for information basis'.

Exceptionally as part of the arrangements for introducing disclosure of Ministerial pensions, for the purposes of disclosure in the 2001–02 resource accounts, Departments have been instructed to include only those Ministers who were in post on 31 March 2002. For subsequent resource accounts disclosure will include those who left before the end of the reporting year.

### Benefits-in-kind for Ministers

Ministers' private use of official cars is exempt under the rules governing the definition of taxable benefits-in-kind. No Minister was provided with living accommodation at public expense during the year to 31 March 2002 or the year to 31 March 2001.

**Figures for 2001–02 in bold, 2000–01 in italics.**

| | Age | Salary (as defined below) £000 | Real Increase/ (Decrease) in Pension at retirement £000 | Total Accrued Pension at retirement as at 31 March £000 | Taxable Benefits-in-kind (to nearest £100) £ | *Until*/From |
|---|---|---|---|---|---|---|
| *Secretary of State for Defence:* | | | | | | |
| The Right Honourable Geoffrey Hoon, MP† | **48** | **60–65** | **0–2.5** | **0–5** | **Nil** | |
| | *47* | *45–50* | | | | |
| *Minister of State for Defence Procurement:* | | | | | | |
| The Lord Bach of Lutterworth† | **55** | **60–65** | **0–2.5** | **0–5** | **Nil** | **11 June 2001** |
| The Right Honourable Baroness Symons of Vernham Dean†** | **50** | **15–20** | | | **Nil** | ***10 June 2001*** |
| | *49* | *65–70* | | | | |
| *Minister of State for the Armed Forces:* | | | | | | |
| The Right Honourable Adam Ingram JP, MP† | **55** | **25–30** | **0–2.5** | **0–5** | **Nil** | **11 June 2001** |
| Mr John Spellar, MP† | **54** | **5–10** | **Nil** | **Nil** | **Nil** | ***10 June 2001*** |
| | *53* | *30–35* | | | | |
| *Parliamentary Under Secretary of State for Defence and Minister for Veterans:* | | | | | | |
| Dr Lewis Moonie, MP† | **55** | **25–30** | **0–2.5** | **0–5** | **Nil** | |
| | *54* | *25–30* | | | | |

Salary includes gross salary, performance pay and allowances paid.

The salary, pension entitlements and the value of taxable benefits-in-kind for the Department's senior management board, the DMB, were as below.

**Figures for 2001–02 in bold, 2000–01 in italics.**

| | Age | Salary (as defined below) £000 | Real Increase/ (Decrease) in Pension at retirement £000 | Total Accrued Pension at retirement as at 31 March £000 | Taxable Benefits-in-kind (to nearest £100) £ | *Until*/From |
|---|---|---|---|---|---|---|
| *Permanent Under Secretary of State:* | | | | | | |
| Sir Kevin Tebbit KCB CMG | **55** | **135–140** | **3.5–4** | **55–60** | **26,100** | |
| | *54* | *125–130* | *2.5–3* | *50–55* | | |
| *Chief of the Defence Staff:* | | | | | | |
| Admiral Sir Michael Boyce GCB OBE ADC | | *Consent to disclose withheld* | | | | From 16 Feb 01 |
| General Sir Charles Guthrie GCB LVO OBE ADC Gen | | *Consent to disclose withheld* | | | | *To 15 Feb 01* |
| *Vice Chief of the Defence Staff:* | | | | | | |
| Air Chief Marshal Sir Anthony Bagnall KCB OBE ADC FRAeS RAF | **56** | **100–105** | **4–4.5** | **60–65** | **17,100** | **From 1 June 01** |
| Admiral Sir Peter Abbott GBE KCB | **60** | **20–25** | **(0.5–1)** | **55–60** | **3,400** | ***To 31 May 01*** |
| | *59* | *115–120* | *(0–0.5)* | *55–60* | | |

## Notes to the Accounts—*continued*

**Figures for 2001–02 in bold, 2000–01 in italics.**

| | Age | Salary (as defined below) £000 | Real Increase/ (Decrease) in Pension at retirement £000 | Total Accrued Pension at retirement as at 31 March £000 | Taxable Benefits-in-kind (to nearest £100) £ | *Until*/From |
|---|---|---|---|---|---|---|
| *Second Permanent Under Secretary of State:* | | | | | | |
| Mr Ian Andrews CBE TD | **48** | **5–10** | **3–3.5** | **25–30** | **Nil** | **From 4 Mar 02** |
| Sir Roger Jackling KCB CBE | **58** | **105–110** | **3–3.5** | **45–50** | **21,400** | ***To 5 Mar 02*** |
| | *57* | *105–110* | *2.5–3* | *40–45* | | |
| *First Sea Lord and Chief of the Naval Staff:* | **57** | **120–125** | **1–1.5** | **60–65** | **20,500** | |
| Admiral Sir Nigel Essenhigh GCB ADC | *56* | *20–25* | *2.5–3* | *55–60* | | From 16 Jan 01 |
| Admiral Sir Michael Boyce GCB OBE ADC | | *Consent to disclose withheld* | | | | *To 15 Feb 01* |
| Chief of the General Staff: | | | | | | |
| General Sir Michael Walker GCB CMG CBE ADC Gen | **57** | **120–125** | **1–1.5** | **60–65** | **20,500** | |
| | *56* | *110–115* | *2.5–3* | *55–60* | | From 17 Apr 00 |
| General Sir Roger Wheeler GCB CBE ADC Gen | *59* | *5–10* | *(1.5–2)* | *55–60* | | *To 16 Apr 00* |
| *Chief of the Air Staff:* | | | | | | |
| Air Chief Marshal Sir Peter Squire GCB DFC AFC ADC FRAeS RAF | **56** | **120–125** | **1–1.5** | **60–65** | **20,500** | |
| | *55* | *110–115* | *2.5–3* | *55–60* | | From 20 Apr 00 |
| Air Chief Marshal Sir Richard Johns GCB CBE LVO ADC FRAeS RAF | *61* | *5–10* | *(1–1.5)* | *55–60* | | *To 19 Apr 00* |
| *Chief of Defence Procurement:* | | | | | | |
| Sir Robert Walmsley KCB FEng FIEE | **61** | **115–120** | **1–1.5** | **5–10** | **31,800** | |
| | *60* | *110–115* | *0.5–1* | *5–10* | | |
| *Chief of Defence Logistics:* | | | | | | |
| General Sir Sam Cowan KCB CBE ADC Gen | **60** | **120–125** | **1–1.5** | **60–65** | **Nil** | |
| | *59* | *115–120* | *(0–0.5)* | *55–60* | | |
| *Chief Scientific Adviser:* | | | | | | |
| Professor Sir Keith O'Nions FRS | **57** | **120–125** | **1.5–2** | **35–40** | **19,700** | |
| | *56* | *110–115* | *0–0.5* | *30–35* | | |

Salary includes gross salary, performance pay and allowances paid.

Benefit-in-kind figures for civilian members of the DMB represent the value obtained from the private use of official cars, and for Service members of the DMB represents the value obtained from use of Official Service Residences. The Department has an arrangement with the Inland Revenue where MOD pays the tax liability that would ordinarily be paid by the individual. The tax liability consists of income tax, and where applicable, employees NIC. This tax liability is therefore included in the figures disclosed to arrive at the full "value" of the benefit to the individual.

Last year there was no requirement to disclose Ministerial pensions and benefits-in-kind figures for the year ended 31 March 2001, hence comparative figures are not shown for 2000–01.

The prior year pension figure for Professor Sir Keith O'Nions has been restated to include the transfer in of 27 years 219 days service.

Details of Chief Executives and other senior staff of agencies are given in the agency accounts.

### Pensions

2.4 The Principal Civil Service Pension Scheme (PCSPS) and Armed Forces Pension Scheme (AFPS) are unfunded multi-employer defined benefit schemes but the Ministry of Defence is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out at 31 March 1999 for the PCSPS and at 31 March 1997 for the AFPS. Details can be found in the resource accounts of these schemes which are published and laid before the House of Commons. The PCSPS accounts are also available on the web at www.civilservice-pensions.gov.uk.

## Notes to the Accounts—*continued*

For 2001–02, employers' contributions of £210,648,857 in respect of civilian staff were payable to the OPG (Restated 2000–01: £213,716,812) at one of the four rates in the range of 12 to 18.5 per cent of pensionable pay, based on salary bands. Rates will remain the same for the next two years, subject to revalorisation of the salary bands. Employer contributions to the PCSPS are to be reviewed every four years following a full scheme valuation by the Government Actuary.

For Service personnel, employers' contributions of £1,094,449,935 (2000–01: £1,042,199,646) were also made to the AFPS based on rates determined by the Government Actuary plus £3,592,982 (2000–01: £3,654,433) of additional voluntary contributions and transfers in from other schemes. The applicable rates were 33.8% of pensionable pay for Officers and 18.2% for other ranks. Employers' contributions to the AFPS are to be reviewed during 2002–03.

The contribution rates reflect benefits as they are accrued, not when costs are actually incurred, and reflect past experience of the scheme.

2.5 Certain other employees are covered by other schemes such as the NHS Superannuation Scheme and the Teachers' Superannuation Scheme. Contributions to these schemes in 2001–02 are included within the amount of £210,648,857 shown in Note 2.4 above.

### 3. Other Operating Costs

| | **2001–02 £000** | Restated (Note 25) 2000–01 £000 |
|---|---|---|
| Operating expenditure: | | |
| – Fuel | 159,980 | 184,757 |
| – Stock consumption | 1,293,656 | 1,712,811 |
| – Surplus arising on disposal of stock (net) | (53,186) | (80,192) |
| – Provisions to reduce stocks to net realisable value | 439,186 | 928,740 |
| – Stocks written off | 215,072 | 595,188 |
| – Movements: includes personnel travelling, subsistence/relocation costs and movement of stores and equipment. | 718,262 | 624,860 |
| – Utilities | 234,492 | 240,368 |
| – Property management | 1,221,595 | 1,176,396 |
| – Hospitality and entertainment | 7,198 | 8,466 |
| – Accommodation charges | 338,239 | 330,803 |
| – Equipment support costs | 2,419,281 | 2,457,112 |
| – (Decrease)/increase in nuclear and other decommissioning provisions (Note 16) | 137,811 | (269,222) |
| – IT and telecommunications | 527,095 | 520,627 |
| – Professional fees | 559,169 | 522,116 |
| – Other expenditure | 1,738,584 | 1,771,332 |
| – Research expenditure | 1,003,298 | 1,239,304 |
| Depreciation and amortisation: | | |
| – Intangible assets (Note 7) | 1,015,592 | 944,832 |
| – Tangible owned fixed assets (Note 8) | 5,139,386 | 4,941,161 |
| – Donated assets depreciation—release of reserve | (42,255) | (56,821) |
| – Tangible fixed assets held under finance leases (Note 8) | 7,797 | 6,524 |
| Impairment of fixed assets (Notes 7 & 8) | 1,249,948 | 1,695,487 |
| *Deficit arising on disposal of fixed assets including write offs amounting to £74,922,930: | | |
| – Intangible and tangible fixed assets | 86,589 | 262,239 |
| – Donated assets—release of reserve | (50,845) | 1,394 |
| Abortive capital expenditure written off | 12,537 | 2,629 |
| Bad debts written off | 1,794 | 5,984 |
| (Decrease)/increase in bad debts provision | 1,827 | (7,740) |
| Rentals paid under operating leases | 199,023 | 145,344 |
| Auditors' remuneration—audit work only | 4,170 | 4,742 |
| Grants-in-Aid | 46,208 | 44,387 |
| Exchange differences on foreign currencies: net deficit/(surplus) | (7,964) | 26,583 |
| **Total Other Operating Costs** | **18,623,539** | 19,980,211 |

*In prior years write offs of fixed assets were not identified separately.

# Notes to the Accounts—*continued*

## 4. Operating Income

| | 2001–02 £000 | Restated 2000–01 £000 |
|---|---|---|
| **External customers** | | |
| Rental Income—property | 46,003 | 41,536 |
| Other | 970,795 | 928,156 |
| **Other Government Departments and Trading Funds** | | |
| Rental income—property | 2,507 | 2,486 |
| Dividends received from Trading Funds (Note 9) | 7,431 | 27,144 |
| Other | 168,946 | 144,443 |
| | **1,195,682** | 1,143,765 |
| Of which: | | |
| Appropriations-in-Aid | 1,176,897 | 1,135,737 |
| CFER—Payable to the Consolidated Fund | 18,785 | 8,028 |
| | **1,195,682** | 1,143,765 |
| **Appropriation-in-Aid shown on Schedule 1 is the lower of the amounts shown in Estimate and the Outturn:** | | |
| Outturn: | | |
| – Operating Income (see above) | 1,176,897 | 1,135,737 |
| – Adjustment relating to the Machinery of Government changes during the year—net operating costs equals Appropriation-in-Aid | 34,901 | — |
| Included in other operating costs: | | |
| – Refunds of formula based VAT recovery | 42,132 | — |
| – Profit on disposal of stock (net) (Note 3) | 53,186 | — |
| – Profit on disposal of fixed assets (net) (Note 3) | 39,179 | — |
| – Foreign exchange gain | 5,122 | — |
| | 1,351,417 | 1,135,737 |
| Estimate: | | |
| Appropriation-in-Aid as shown in the Spring Supplementary Estimate | 1,308,607 | 1,359,796 |
| **Excess Appropriation-in-Aid payable to the Consolidated Fund as CFERs** | **42,810** | — |

## 5. Net Interest Payable

| | 2001–02 £000 | Restated 2000–01 £000 |
|---|---|---|
| **Interest receivable:** | | |
| —Bank interest | (5,742) | (8,996) |
| —Loans to Trading Funds | (4,300) | (4,966) |
| —Finance leases | — | (477) |
| —Loans to a Self Financing Public Corporation—QinetiQ | (6,719) | — |
| —Other | — | (298) |
| | **(16,761)** | (14,737) |
| **Interest payable:** | | |
| —Bank interest | 6,927 | 465 |
| —Loan interest | 3,693 | 4,173 |
| —Unwinding of discount on provision for liabilities and charges (Note 16) | 232,636 | 241,609 |
| —Finance leases | 3,190 | 4,214 |
| —Commercial debt | 135 | 2 |
| | **246,581** | 250,463 |
| **Net interest payable** | **229,820** | 235,726 |

## Notes to the Accounts—*continued*

### 6. Reconciliation of Net Operating Cost to Control Total and Net Resource Outturn

| | 2001–02 £000 | Restated 2000–01 £000 |
|---|---|---|
| Net operating cost (Schedule 2) | 32,238,573 | 33,270,344 |
| —Remove non-supply expenditure and income | — | — |
| —Add income scored as Consolidated Fund Extra Receipts and included in operating income and interest | 77,943 | 21,654 |
| —Adjustment in respect of Machinery of Government changes | (34,901) | — |
| **Net resource outturn** | **32,281,615** | 33,291,998 |

Net operating cost is the total of expenditure and income appearing in the Operating Cost Statement. Net resource outturn is the total of those elements of expenditure and income that are subject to parliamentary approval and included in the Department's Supply Estimate. The outturn against the Estimate is shown in the Summary of Resource Outturn (Schedule 1).

### 7. Intangible Assets

| | |
|---|---|
| **Cost or Valuation** | £000 |
| At 1 April 2001 | 23,303,871 |
| Additions | 1,053,851 |
| Disposals | (875,567) |
| Permanent diminution | (33,666) |
| Revaluations | 584,817 |
| Transfers/Reclassifications | (881,376) |
| At 31 March 2002 | 23,151,930 |
| **Amortisation** | |
| At 1 April 2001 | (3,402,389) |
| Charged in Year | (1,015,592) |
| Permanent diminution in value | 21,226 |
| Disposals | 851,984 |
| Revaluations | (68,942) |
| Transfers/Reclassifications | (10,995) |
| At 31 March 2002 | (3,624,708) |
| **Net Book Value:** | |
| **At 31 March 2002** | **19,527,222** |
| At 1 April 2001 | 19,901,482 |

*Note:*

i) Intangible asset valuations are based on the actual costs incurred over time, where available, or derived by applying a ratio to the tangible fixed asset valuations based on the historical relationship between development and production costs. The intangible asset valuations were indexed using the appropriate Gross Domestic Product (GDP) deflator to determine the opening balance sheet valuation.

ii) Additions on intangible and tangible fixed assets (Note 8) include accruals amounting in total to £1,690,228,000 (2000–01: £1,170,057,000).

## Notes to the Accounts—*continued*

### 8. Tangible Fixed Assets

| | Land and Buildings £000 | Fighting Equipment £000 | Plant, Machinery and Vehicles £000 | IT and Comms Equipment £000 | Capital Spares £000 | Assets in the Course of Construction £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| **Cost or Valuation** | | | | | | | |
| At 1 April 2001 (Restated) | 16,524,385 | 41,465,014 | 6,392,445 | 1,594,567 | 18,959,221 | 11,887,648 | 96,823,280 |
| Additions | 53,758 | 41,521 | 95,705 | 87,490 | 360,174 | 4,444,250 | 5,082,898 |
| Capitalised provisions | — | 160,713 | — | — | 167 | — | 160,880 |
| Donations | 22,323 | — | 899 | 19 | — | — | 23,241 |
| Impairment | (136,205) | (65,502) | (11,216) | (187,834) | (23) | (2,581) | (403,361) |
| Disposals | (270,156) | (749,026) | (431,223) | (46,683) | (1,031,254) | 1,319 | (2,527,023) |
| Revaluations | 479,472 | 433,489 | 357,838 | (19,402) | (144,023) | 15,103 | 1,122,477 |
| Other movements | 188,252 | 2,308,906 | 87,059 | 159,752 | (139,069) | (2,361,627) | 243,273 |
| At 31 March 2002 | 16,861,829 | 43,595,115 | 6,491,507 | 1,587,909 | 18,005,193 | 13,984,112 | 100,525,665 |
| **Depreciation** | | | | | | | |
| At 1 April 2001 (Restated) | (2,147,176) | (13,972,883) | (1,743,950) | (719,448) | (10,752,484) | — | (29,335,941) |
| Charged in year | (649,154) | (2,995,654) | (592,385) | (228,347) | (681,643) | — | (5,147,183) |
| Impairment | 1,095 | (293,646) | (119,704) | 25,011 | (446,903) | — | (834,147) |
| Disposals | 51,848 | 708,831 | 345,842 | 38,342 | 1,031,231 | — | 2,176,094 |
| Revaluations | 78,359 | 134,406 | (294,006) | 106,133 | (35,864) | — | (10,972) |
| Other movements | 151,275 | 104,716 | 54,919 | 18,276 | 438,133 | — | 767,319 |
| At 31 March 2002 | (2,513,753) | (16,314,230) | (2,349,284) | (760,033) | (10,447,530) | — | (32,384,830) |
| **Net Book Value:** | | | | | | | |
| **At 31 March 2002** | **14,348,076** | **27,280,885** | **4,142,223** | **827,876** | **7,557,663** | **13,984,112** | **68,140,835** |
| At 31 March 2001 (Restated) | 14,377,209 | 27,492,131 | 4,648,495 | 875,119 | 8,206,737 | 11,887,648 | 67,487,339 |

*Note:*

i) Additions on intangible assets (Note 7) and tangible fixed assets include accruals amounting in total to £1,690,228,000 (2000–01: £1,170,057,000).

ii) Other movements comprise reclassifications between tangible fixed asset categories, intangible assets, stock and transfers to operating costs. It also includes assets transferred to a Trading Fund not included within the Departmental Boundary.

8.1 The net book value of tangible fixed assets by each major class of asset includes an amount of £94,098,000 (2000–01: £92,596,000) in respect of assets held under finance leases. The movement in the year incorporates prior year adjustments. Detail by asset category is as follows:

| | Land and Buildings £000 | Fighting Equipment £000 | Plant, Machinery and Vehicles £000 | IT and Comms Equipment £000 | Capital Spares £000 | Assets in the Course of Construction £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| **Gross Cost:** | | | | | | | |
| **At 31 March 2002** | **30,828** | **15,389** | **80,272** | **4,793** | **—** | **—** | **131,282** |
| At 31 March 2001 | 29,186 | 15,389 | 70,440 | 5,280 | — | — | 120,295 |
| **Accumulated Depreciation:** | | | | | | | |
| **At 31 March 2002** | **—** | **(9,324)** | **(26,258)** | **(1,602)** | **—** | **—** | **(37,184)** |
| At 1 April 2001 (restated) | — | (7,507) | (18,784) | (1,408) | — | — | (27,699) |

## Notes to the Accounts—*continued*

8.2 Analysis of Land and Buildings:

| | Freehold £000 | Long lease £000 | Short lease £000 | Beneficial Use* £000 | Total £000 |
|---|---|---|---|---|---|
| **Net Book Value:** | | | | | |
| **At 31 March 2002** | **13,624,574** | **256,379** | **59,671** | **1,985,400** | **15,926,024** |
| At 1 April 2001 (restated) | 13,199,200 | 426,167 | 56,038 | 2,113,508 | 15,794,913 |

The net book values at 31 March 2002 and 1 April 2001 include assets in the course of construction of £1,577,948,000 and £1,417,704,000 respectively.

* Relates to properties that are being used by the Department where no legal title is held. Such properties have been valued on the same basis as all other properties used by the Department.

8.3 Professional valuation of Land and Buildings was carried out by external valuers, as follows:

| Year last valued | Valuation £000 |
|---|---|
| Before 1 April 1998 | 9,080,169 |
| 1998–99 | 1,324,532 |
| 1999–2000 | 217,149 |
| 2000–01 | 471,421 |
| 2001–02 | 879,008 |

8.4 Property valuations were carried out by Weatherall Green and Smith, members of the Royal Institution of Chartered Surveyors (RICS) and the Incorporated Society of Valuers and Auctioneers (ISVA), in accordance with the RICS Appraisal and Valuation Manual.

8.5 Property valuations were based on existing use value to the Department, and do not take account of value from an alternative use. Consequently, the majority of the Departmental estate has been valued based on depreciated replacement cost (DRC).

### 9. Investments

| | Trading Funds | | Other | QinetiQ | Total |
|---|---|---|---|---|---|
| | Public Dividend Capital | Loans | Investments | | |
| | £000 | £000 | £000 | £000 | £000 |
| At 1 April 2001 | 347,534 | 43,943 | 1 | | 391,478 |
| Movements during the year: | | | | | |
| **Transactions on restructuring of DERA (now DSTL)** | | | | | |
| Write down Public Dividend Capital | (224,988) | | | | (224,988) |
| Loans written off | | (23,976) | | | (23,976) |
| **Creation of QinetiQ** | | | | | |
| Shares acquired | | | | 345,830 | 345,830 |
| Loan A | | | | 50,000 | 50,000 |
| Loan B | | | | 100,000 | 100,000 |
| **DARA vested as a Trading Fund** | | | | | |
| Public Dividend Capital | 42,303 | | | | 42,303 |
| Loans set up on vesting | | 42,300 | | | 42,300 |
| New loans | | 7,600 | | | 7,600 |
| Repayment of Loans | | | | | |
| QinetiQ | | | | (50,000) | (50,000) |
| DARA | | (7,115) | | | (7,115) |
| The UK Hydrographic Office | | (258) | | | (258) |
| DSTL | | (2,128) | | | (2,128) |
| At 31 March 2002 | 164,849 | 60,366 | 1 | 445,830 | 671,046 |

## Notes to the Accounts—*continued*

Public Dividend Capital and Loans at 31 March 2002 were held in the following Trading Funds:

| | Public Dividend Capital | Loans | Interest Rate |
|---|---|---|---|
| | £000 | £000 | |
| DSTL | 50,412 | 5,320 | 8.375% p.a. |
| Met Office | 58,867 | — | — |
| The UK Hydrographic Office | 13,267 | 12,261 | 8.375% p.a. |
| DARA | 42,303 | 42,785 | 4.882% p.a. |
| | 164,849 | 60,366 | |

Analysis of loans repayable by instalments:

| | Due within one year | Due after one year |
|---|---|---|
| | £000 | £000 |
| DSTL | 2,128 | 3,192 |
| Met Office | — | — |
| The UK Hydrographic Office | 279 | 11,983 |
| DARA | 2,115 | 40,670 |
| | 4,522 | 55,845 |

The loan to QinetiQ of £100 million is repayable on the earlier of 30 June 2008 or the date of flotation of QinetiQ. Interest is accruing on the loan at floating rates related to LIBOR and is rolled over for the first 4 years of the loan.

9.1 Other Investments

Investments, including “Golden” Shares, were held in the following at 31 March 2002 and 31 March 2001:

| | |
|---|---|
| | **7.5% Non-cumulative Irredeemable Preference Shares at £1 each** |
| Chamber of Shipping Limited | 688 Shares |
| British Shipping Federation Limited | 55,040 Shares |
| | **Preferential “Golden” Shares at £1 each** |
| Devonport Royal Dockyard Limited | 1 Share |
| Rosyth Royal Dockyard Limited | 1 Share |
| Atomic Weapons Establishment plc | 1 Share |
| Atomic Weapons Establishment Pension Trustees Limited | 1 Share |
| QinetiQ Group plc* | *1 Share |
| QinetiQ Limited* | *1 Share |
| BAE Systems Marine (Holdings) Ltd (formerly VSEL Limited) | 1 Share |
| | **Non Preferential Shares of £1 each** |
| International Military Services Limited | 19,999,999 Shares |
| | **Ordinary Shares of £1 each** |
| Atomic Weapons Establishment plc | 1 Share |
| QinetiQ Group plc* | *345,830,039 Shares |

* *Investments held at 31 March 2002 only.*

9.2 Net assets

The reported net assets, after deducting loans due to MOD, of the investments held at 31 March 2002 and 31 March 2001 were:

| | 31 March 2002 | 31 March 2001 |
|---|---|---|
| | £000 | £000 |
| The UK Hydrographic Office | 36,634 | 32,811 |
| Met Office | 165,848 | 159,177 |
| Defence Aviation Repair Agency (DARA) | 51,758 | — |
| Defence Evaluation and Research Agency (DERA) | — | 586,000 |
| Defence Science and Technology Laboratory (DSTL) | 128,000 | — |
| QinetiQ | 312,500 | — |
| **Total** | 694,740 | 777,988 |

## Notes to the Accounts—*continued*

During the year, a dividend of £5,000,000 (2000–01: £25,000,000) was received from the Defence Evaluation and Research Agency, and a dividend of £2,430,775 (2000–01: £2,144,000) was received from The UK Hydrographic Office in respect of the financial year ended 31 March 2001. These are included within operating income. No dividend was received from the Met Office or the Defence Aviation Repair Agency.

9.3 The Department has a 100% interest in the non-preferential shares of International Military Services Limited, a company registered in England. International Military Services Limited ceased trading on 31 July 1991. Following settlement of outstanding contracts, the company will be liquidated. The Department has written down the value of the investment to nil.

9.4 All the shares held are unlisted and are valued at historical cost. The 7.5% Non-cumulative irredeemable preference shares in Chamber of Shipping Limited and British Shipping Federation Limited are valued at 1p each reflecting the value at which shares would be recovered by the two companies should membership by the Department be ceded, as laid down in the articles of association of the respective companies.

9.5 "Golden" shares confer on the Secretary of State for Defence special rights regarding ownership, influence and control, including voting rights in certain circumstances, under the individual articles of association of the relevant companies in which the shares are held. Further detailed information can be obtained from the companies' individual annual reports and accounts which can be obtained from:

| Company | Registration Number |
|---|---|
| Devonport Royal Dockyard Limited, Devonport Royal Dockyard, Devonport, Plymouth PL1 4SG | 02077752 |
| Rosyth Royal Dockyard Limited, Rosyth Royal Dockyard, Rosyth, Fife KY11 2YD | SC101959 |
| Atomic Weapons Establishment plc, AWE Aldermaston, Reading, Berkshire RG7 4PR | 02763902 |
| Atomic Weapons Establishment Pension Trustees Limited, AWE Aldermaston, Reading, Berkshire RG7 4PR | 02784144 |
| QinetiQ Group plc, 85 Buckingham Gate, London SW1E 6PD | 4154556 |
| QinetiQ Limited, 85 Buckingham Gate, London SW1E 6PD | 3796233 |

### 10. Related Party Transactions

10.1 The Defence Science and Technology Laboratory, The UK Hydrographic Office, the Met Office and the Defence Aviation Repair Agency operate as Executive Defence Agencies financed by Trading Fund. QinetiQ was formed as a Self Financing Public Corporation. These fall within the ambit of the Department and are regarded as related parties outside the Departmental Boundary with which the Department has had material transactions. All transactions are carried out on terms which are contracted on an arm's length basis, and are subject to internal and external audit. The NAAFI is outside the Departmental Boundary and is also regarded as a related party.

The following bodies are Executive NDPBs of the MOD. They are self-accounting on an accruals basis, and are regarded as related parties. During the year, each NDPB has had a material transaction with the Department, as listed below:

#### Fleet Air Arm Museum

Grant-in-Aid: £528,325 (2000–01: £513,331).

Flag Officer Maritime Aviation (Chairman), Commodore Naval Aviation (Deputy Chairman), Commanding Officer HMS Heron (RNAS Yeovilton), Commanding Officer HMS Seahawk (RNAS Culdrose), Director Support Operations (Rotary Wing), and Assistant Director Policy Co-ordination & Aviation (Director Naval Operations) are members of the Board of Trustees.

#### National Army Museum

Grant-in-Aid: £4,684,103 (2000–01: £4,113,011).

Parliamentary Under Secretary of State for Defence (Chairman), Adjutant General and Command Secretary (Adjutant General) are members of the Council. However, the Charter for the National Army Museum is being amended, with no MOD representation required on the Board. This avoids potential conflicts of interests.

## Notes to the Accounts—*continued*

**Royal Air Force Museum**

Grant-in-Aid: £5,992,022 (2000–01: £4,815,037).

No Departmental representation.

**Royal Marines Museum**

Grant-in-Aid: £655,784 (2000–01: £619,378).

Chief of Staff Headquarters Royal Marines, Corps Secretary Headquarters Royal Marines and Corps Regimental Sergeant Major, Royal Marines Stonehouse, Plymouth are members of the Board of Trustees.

**Royal Naval Museum**

Grant-in-Aid: £875,359 (2000–01: £944,619).

Naval Base Commander Portsmouth and Chief of Staff (Warfare) CinCFleet are members of the Board of Trustees.

**Royal Navy Submarine Museum**

Grant-in-Aid: £485,303 (2000–01: £436,190).

Flag Officer Submarines is a member of the Board of Trustees.

**Oil and Pipelines Agency** (profits to be surrendered to the Consolidated Fund after the year-end).

Agency Fees: £1,412,800 (2000–01: £1,605,097), VAT recovery £247,200 (2000–01: £208,009).

Director Defence Fuels Group is a member of the Board of Directors.

**Other**

Ian Andrews CBE TD, Second Permanent Under Secretary of State, is a trustee of the Imperial War Museum and is a Director of the Confederation of Construction Clients which makes them both related parties of Ministry of Defence.

The payments made to these entities were:

| | | £000 |
|---|---|---|
| Imperial War Museum | — compensation contribution towards the relocation of film archive and laboratories from the Hayes Site to facilitate MOD's PFI project | 3,886 |
| | — other transactions | 5 |
| Confederation of Construction Clients | | 12 |
| Receipts from the Imperial War Museum were: | | |
| Rental/Service charges in respect of Hayes Site | | (130) |
| Provision of occupational service | | (5) |

During the year there was also various works of art and other items transferred to and from the Imperial War Museum. No value was attributed to these items.

*Note:*

i) The Department also pays a number of grants to other bodies outside the Departmental Boundary. These include Grants-in-Aid to the Royal Hospital Chelsea and the Commonwealth War Graves Commission.

ii) The museums are designated NDPBs under the National Heritage Act 1983. Each NDPB is required to produce annual accounts in accordance with the Charities (Accounts and Reports) Regulations 1995 (Statutory Instrument 1995 No. 2724). The Oil and Pipelines Agency is a corporate body established under the Oil and Pipelines Act 1985.

## Notes to the Accounts—*continued*

### Joint Ventures and Collaborative Projects

10.2 European Transonic Windtunnel GmbH (ETW):

The Department has a 31 per cent interest in ETW, a non-profit making company, which is jointly owned by the governments of France, Germany, the Netherlands and the United Kingdom. ETW provides facilities for developments or research relating to air vehicles. Under a Memorandum of Understanding extended in January 2000, the Department is committed to making further payments of £780,000 up to 31 March 2004, of which £598,000 will be recovered from the Department of Trade and Industry. The contributions made to ETW are charged to operating costs when incurred.

The Department is also involved in collaborative projects with various foreign countries for the development and production of fighting equipment. Costs capitalised represent the Department's proportion of the total cost of a project.

### 11. Stocks and Work in Progress

| | **31 March 2002 £000** | Restated (Note 25) 31 March 2001 £000 |
|---|---|---|
| Work in progress | 40,748 | 28,597 |
| Raw materials and consumables | 6,350,728 | 6,467,336 |
| Assets declared for disposal | 4,828 | 19,237 |
| | **6,396,304** | 6,515,170 |

### 12. Debtors

| | **31 March 2002 £000** | Restated (Note 25) 31 March 2001 £000 |
|---|---|---|
| **Amounts falling due within one year** | | |
| Trade debtors | 119,389 | 103,795 |
| Deposits and advances | 27,748 | 27,729 |
| Value Added Tax | 248,195 | 178,138 |
| Amounts owed by Other Government Departments | 7,628 | 21,274 |
| Amounts owed by entities in which the Department has a participating interest | 10,520 | 3,316 |
| Armed Forces Pension Scheme | 7,870 | 8,584 |
| Other debtors | 255,891 | 232,225 |
| Prepayments and accrued income | 364,429 | 247,718 |
| Net investment in finance leases (where the Department is the lessor) | — | 1,298 |
| | **1,041,670** | 824,077 |
| **Amounts falling due after one year** | | |
| Trade debtors | 22,568 | 340 |
| Other debtors | 86,050 | 62,449 |
| Prepayments and accrued income | 80,358 | 109,038 |
| Net investment in finance leases (where the Department is the lessor) | — | 8,818 |
| **Total debtors amounts falling due after one year** | **188,976** | 180,645 |
| **Total Debtors** | **1,230,646** | 1,004,722 |

*Note:*

i) Other debtors include loans for house purchase and other loans made to staff amounting to £99,867,277 (2000–01: £103,746,877). The number of staff with house purchase loans was 14,766 (2000–01: 14,757).

# Notes to the Accounts—*continued*

## 13. Cash at Bank and in Hand

| | 31 March 2002 £000 | Restated (Note 25) 31 March 2001 £000 |
|---|---|---|
| At 1 April | 302,775 | 396,327 |
| Net Cash Inflow/(Outflow): | | |
| Received from Consolidated Fund | 25,343,376 | 23,631,201 |
| Utilised | (25,014,165) | (23,724,753) |
| Increase/(decrease) during year | 329,211 | (93,552) |
| **At 31 March** | **631,986** | 302,775 |

| | 31 March 2002 £000 | 31 March 2001 £000 |
|---|---|---|
| Represented by: | | |
| Balances at the OPG | 533,518 | 85,300 |
| Commercial Banks and Cash in Hand | 98,468 | 217,475 |
| | **631,986** | 302,775 |

**The balance at 31 March comprises:**

| | 31 March 2002 £000 | 31 March 2001 £000 |
|---|---|---|
| Cash due to be paid to the Consolidated Fund in respect of: | | |
| Consolidated Fund Extra Receipts received during the year and due to be paid to the Consolidated Fund (Note 14) | 69,430 | 4,323 |
| Amounts issued from the Consolidated Fund for supply but not spent at the year end (included in Creditors) | 380,656 | 71,910 |
| Other amounts retained by Department | — | 59,542 |
| Amounts held in respect of Collaborative Projects (see note below) | 181,900 | 167,000 |
| **Total** | **631,986** | 302,775 |

*Note:*

i) The cash at bank balance includes £181,900,000 (2000–01: £167,000,000) of sums advanced by foreign governments to the Department on various collaborative projects where the United Kingdom is the host nation. Advances made by foreign governments for the procurement of defence equipment on their behalf are also included in this amount. The corresponding liability for these advances is shown under creditors falling due within one year.

## 14. Creditors: amounts falling due within one year

| | 31 March 2002 £000 | Restated (Note 25) 31 March 2001 £000 |
|---|---|---|
| Trade creditors | 427,277 | 273,428 |
| Payments received on account | 11,647 | 93,901 |
| Other taxation and social security | 158,851 | 108,714 |
| Other creditors | 395,260 | 1,083,313 |
| Accruals and deferred income | 3,061,450 | 2,369,073 |
| Obligations under finance leases | 4,984 | 5,762 |
| Payable to the Consolidated Fund | 455,974 | 76,233 |
| Amounts owed to Other Government Departments | 3,497 | 86,677 |
| Amounts owed to undertakings in which the Department has a participating interest | 104,107 | 119,983 |
| Loans | 1,424 | 1,344 |
| | **4,624,471** | 4,218,428 |

## Notes to the Accounts—*continued*

*Note:*

i) Amounts payable to the Consolidated Fund amounting to £455,974,221.46 (2000–01: £76,232,951.83) comprise:

| | **31 March 2002** £000 | 31 March 2001 £000 |
|---|---|---|
| CFERs received during the year | 4,063 | 4,323 |
| Excess Operating Appropriation-in-Aid | 42,810 | — |
| Excess Non-Operating Appropriation-in-Aid | 22,557 | — |
| | 69,430 | 4,323 |
| CFERs accrued at year end | 5,888 | — |
| Amount drawn but not spent at the year end | 380,656 | 71,910 |
| | 455,974 | 76,233 |

ii) Loans are from the National Loans Fund in respect of the Armed Forces Housing Loans. These are fully repayable between years 2012 and 2028, with the last instalment due on 20 February 2028. Interest on the loans is payable at rates ranging from 4.25% to 7% per annum.

iii) Included in other creditors are amounts advanced by foreign governments to the MOD in respect of various collaborative projects where the United Kingdom is the host nation and for the procurement of defence equipment on their behalf of £181,900,000 (2000–01: £167,000,000).

### 15. Creditors: amounts falling due after more than one year

| | **31 March 2002** **£000** | 31 March 2001 £000 |
|---|---|---|
| Other creditors | 303,981 | 256,882 |
| Accruals and deferred income | 1,364 | 4,399 |
| Obligations under finance leases: | | |
| – Amounts payable between one and two years | 8,300 | 9,264 |
| – Amounts payable between two and five years | 16,676 | 17,708 |
| – Amounts payable over five years | 63,126 | 52,518 |
| Amounts owed to Other Government Departments | — | 101 |
| Loans: (Note 14) | | |
| – Amounts payable between one and two years | 1,509 | 1,424 |
| – Amounts payable between two and five years | 5,090 | 4,803 |
| – Amounts payable over five years | 48,335 | 50,132 |
| | **448,381** | 397,231 |

### 16. Provisions for Liabilities and Charges

| | Nuclear Decommissioning £000 | Other Decommissioning and Restoration Costs £000 | Early Retirement Commitments £000 | Other £000 | Total £000 |
|---|---|---|---|---|---|
| At 1 April 2001 (restated) | 3,574,809 | 100,456 | 122,702 | 539,831 | 4,337,798 |
| Increase in Provision | 97,552 | 55,896 | 50,023 | 346,791 | 550,262 |
| Unwinding of discount | 217,753 | 3,256 | 4,383 | 7,244 | 232,636 |
| Amounts released | (13,128) | (2,509) | (5,377) | (2,510) | (23,524) |
| Reclassifications | — | (4,800) | 27 | 3,694 | (1,079) |
| Amounts capitalised | 160,713 | 167 | — | — | 160,880 |
| Utilised in year | (149,742) | (8,496) | (37,054) | (90,733) | (286,025) |
| **At 31 March 2002** | **3,887,957** | **143,970** | **134,704** | **804,317** | **4,970,948** |

## Notes to the Accounts—*continued*

### Analysis of amount charged/(credited) to Operating Cost Statement

| | **2001–02 £000** | 2000–01 Restated £000 |
|---|---|---|
| Charged/(Credited) to: | | |
| Staff costs | 111,708 | (24,197) |
| Movements | (1,518) | — |
| Equipment Support | — | (26,959) |
| Nuclear and Other Decommissioning provisions | 137,811 | (269,222) |
| Other costs | 278,737 | 433,976 |
| Net interest (receivable/payable) | 232,636 | 241,609 |
| | **759,374** | 355,207 |
| Made up of: | | |
| Increase | 550,262 | 753,631 |
| Release | (23,524) | (640,033) |
| | 526,738 | 113,598 |
| Unwinding of discount | 232,636 | 241,609 |
| Net increase in provisions | **759,374** | 355,207 |

### General

16.1 The level of provisions for liabilities and charges may be affected by two reviews currently under way: the proposal by HM Treasury that the Cost of Capital Charges should be reduced from the current level of 6% to a future level of 3.5%; and an examination of the methodology for calculating the costs of nuclear decommissioning (see note 16.2 below) and the appropriate absolute level of those future costs. It is expected that the results of at least the latter review will be reflected in the Department's Resource Accounts for 2002–03.

### Nuclear Decommissioning

16.2 Nuclear decommissioning provisions relate principally to the cost of decommissioning, treating and storing nuclear waste arising at British Nuclear Fuels plc (BNFL), United Kingdom Atomic Energy Authority (UKAEA), and MOD sites and for the Departmental share of planning and constructing a national repository for the eventual disposal of that waste.

Liabilities have arisen since the late 1940s and will continue well into the future as a result of ongoing production and operations associated with the manufacture and reprocessing of Special Nuclear Materials (SNM). The majority of the liability is historic and relates to facilities used for the production of SNM by BNFL and its predecessor the UKAEA. The Atomic Weapons Establishment is the other main source of MOD's liabilities.

The liabilities include the costs associated with decommissioning and care and maintenance of redundant facilities (the conditioning, retrieval and storage of contaminated materials), research and development and the procurement of capital facilities to handle the various waste streams.

Calculation of the provision to cover the liabilities is based on schedules of information received by the MOD from major decommissioning contractors. These schedules are based on technical assessments of the processes and methods likely to be used in the future to carry out the work. Estimates are based on the latest technical knowledge and commercial information available, taking into account current legislation, regulations and Government policy. The amount and timing of each obligation are therefore sensitive to these factors. These sensitivities and their likely effect on the calculation and amount of the liabilities are reviewed on an annual basis.

The latest estimate of the undiscounted cost of dealing with the MOD's nuclear liabilities is £16,622,092,000 (2000–01: £16,039,637,000).

The estimate of £3,887,957,000 (2000–01: £3,574,809,000) at 31 March 2002 represents the liabilities discounted at 6% and expressed in 2001–02 money values.

## Notes to the Accounts—*continued*

The estimated timescale over which the costs will need to be incurred is as follows:

| | **2002** | 2001 |
|---|---|---|
| | **£bn** | £bn |
| Up to 3 years | 0.8 | 0.7 |
| From 4 to 10 years | 1.4 | 1.2 |
| Beyond 10 years | 1.7 | 1.7 |
| **Total** | **3.9** | 3.6 |

The bulk of the earlier anticipated costs relate to pre and post 1971 liabilities allocated to the Department. The significance of pre and post 1971 refers to the formation date of BNFL. Specific liabilities refer to the BNFL Sellafield, Springfields, Capenhurst, Calder Hall and Chapelcross sites.

Later provisions have been made to cover the costs associated with the research, development and construction of the NIREX Deep Waste Repository (DWR). The provisions have been based on advice provided by NIREX.

However, the policy for the disposal of intermediate and high level waste has yet to be clarified following the previous Government's rejection, in May 1997, of planning consent for the proposed DWR. Pending the current Government's consideration of a House of Lords Sub-Committee report on means of disposing of radioactive waste, the UK holders of such waste are working on the assumption that a repository will not be available earlier than 2040. This will necessitate the continued provision of interim storage.

### Other Decommissioning and Restoration

16.3 Other decommissioning and restoration provisions relate primarily to contaminated sites where the Department has a constructive or a legal obligation to restore the sites for normal use and for the decommissioning of certain fighting equipment and GWMB.

### Early Retirement Pensions

16.4 Where the Department implements an early retirement scheme, provision is made for future liability payable to civilian early retirees. This includes provisions arising from the "80:20 Scheme" under which 20% of the cost was borne by the Department and 80% was borne by the Civil Superannuation Vote. This scheme was terminated in 1997 and the full cost of the obligations under the scheme are now borne by the Department.

### Other

16.5 Other provisions include costs arising from the disposal of fixed assets; redundancy and relocation costs associated with reorganisation and restructuring; and amounts payable under guarantees, litigation and contractual arrangements. Provisions include those concerning an adjudication decision where an appeal is pending.

### 17. Reconciliation of Net Operating Costs to changes in General Fund

| | **2001–02** | 2000–01 |
|---|---|---|
| | **£000** | £000 |
| Net operating cost for the year (Sch 2) | (32,238,573) | (33,292,525) |
| Paid and payable to the Consolidated Fund | (527,584) | (93,565) |
| Parliamentary funding from the Consolidated Fund (Sch 4) | 25,343,376 | 23,631,201 |
| Transfer to General Fund of realised element of: | | |
| – revaluation reserve (Note 18) | 638,774 | 622,954 |
| – donated asset reserve (Note 18) | 24,069 | (1,983) |
| Non-cash charges: | | |
| – cost of capital charge (Sch 2) | 5,124,775 | 5,182,688 |
| – auditors' remuneration (Note 3) | 4,170 | 4,677 |
| Surplus arising on restructuring of DERA (see below) | 297,066 | — |
| Net increase/(decrease) in General Fund | (1,333,927) | (3,946,553) |
| General Fund at 1 April | 75,991,550 | 78,931,210 |
| | 74,657,623 | 74,984,657 |
| Restatement of opening General Fund at 31 March 2001 (Note 25) | — | 1,006,893 |
| **General Fund at 31 March** | **74,657,623** | 75,991,550 |

## Notes to the Accounts—*continued*

### Surplus arising on restructuring of DERA

| | £000 |
|---|---|
| Write down of Public Dividend Capital in former DERA Trading Fund | (224,988) |
| Loans written off in DERA | (23,976) |
| Shares issued in QinetiQ | 345,830 |
| Loans issued in QinetiQ | 150,000 |
| Assets retained by MOD | 50,200 |
| Surplus | 297,066 |

### Transactions in respect of DERA restructuring

| | £m | £m |
|---|---|---|
| Net Assets of former DERA at 30 June 2001 before restructuring | | 710.3 |
| Less: Assets retained by DERA (now DSTL) | | (100.8) |
| Assets transferred to MOD | | 609.5 |
| Less: Fair value adjustments | | |
| — Open market value adjustment to Land (£24.4m) and investment (£0.1m) | (24.5) | |
| — Contribution to costs of relocating DSTL | (27.8) | |
| — Additional provisions for pensions and other items | (11.2) | |
| | | (63.5) |
| | | 546.0 |
| Less: Assets retained by MOD | | |
| — Ranges land and buildings | (50.6) | |
| — Net liability of Defence Diversification Agency | 0.4 | |
| | | (50.2) |
| Assets sold to QinetiQ | | 495.8 |
| Consideration Received: Shares | | 345.8 |
| Loans A and B | | 150.0 |
| | | 495.8 |

### 18. Reserves

| | Revaluation Reserve £000 | Donated Asset Reserve £000 |
|---|---|---|
| At 1 April 2001 | 9,277,923 | 1,425,967 |
| Prior year adjustment | (45,931) | — |
| Restated at 1 April 2001 | 9,231,992 | 1,425,967 |
| Arising on revaluation during the year (net) | 1,968,696 | 2,603 |
| Additions during the year | — | 23,241 |
| Transfers and reclassifications | (12,895) | 12,955 |
| Transferred (to)/from Operating Cost Statement | — | (93,100) |
| Transferred (to)/from General Fund | (638,774) | (24,069) |
| **At 31 March 2002** | **10,549,019** | 1,347,597 |

### 19. Capital Commitments

Capital Commitments for which no provision has been made in these financial statements, were as follows:

| | **31 March 2002 £000** | 31 March 2001 £000 |
|---|---|---|
| Contracted but not provided for | **17,532,005** | 21,647,788 |

# Notes to the Accounts—*continued*

## 20. Financial Commitments

20.1 Commitments under operating leases:

| | Land and Buildings | | Other | |
|---|---|---|---|---|
| | **31 March 2002 £000** | 31 March 2001 £000 | **31 March 2002 £000** | 31 March 2001 £000 |
| The Department was committed to making the following payments during the next year in respect of operating leases expiring: | | | | |
| Within one year | 8,205 | 1,987 | 9,268 | 12,096 |
| Between two and five years | 12,052 | 10,291 | 26,394 | 47,907 |
| After five years | 142,425 | 134,428 | 96,272 | 174,864 |
| | **162,682** | 146,706 | **131,934** | 234,867 |

## 21. Private Finance Initiative (PFI) Commitments

21.1 The payments made during the year in respect of on and off balance sheet PFI transactions were £538,023,000 (2000–01: £457,966,000).

21.2 The payments which the Department is committed to make during the year 2002–03 are analysed below by time-bands specifying the period in which the individual commitment expires:

| | **31 March 2002 £000** | 31 March 2001 £000 |
|---|---|---|
| In the 1st year | 1,600 | 11,868 |
| In the 2nd to 5th years | — | 24,490 |
| In the 6th to 10th years | 336,807 | 339,054 |
| In the 11th to 15th years | — | 77,704 |
| In the 16th to 20th years | 75,383 | 57,406 |
| In the 21st to 25th years | 18,835 | 10,533 |
| In the 26th to 30th years | 85,914 | 73,473 |
| In the 41st to 45th years | 6,250 | 6,250 |

21.3 The following information is provided for those schemes assessed as off balance sheet:

| Project Description | Capital Value* £000 | Contract Start/End Dates | |
|---|---|---|---|
| Army White Vehicle Fleet in Germany: Pathfinder project providing, managing and maintaining the Army's fleet of 3,000 support vehicles in Germany | 52,000 | Feb 1996 | Apr 2002 |
| Training, Administration and Financial Management Information System (TAFMIS): Provision of training administration and financial management information systems to the Army Training and Recruiting Agency (ATRA) | 41,000 | Aug 1996 | Aug 2007 |
| Material Handling Equipment (MHE): Pathfinder project providing 1,400 items of equipment on a Tri-Service basis | 8,000 | Sep 1997 | Jun 2002 |
| Hazardous Stores Information System (HSIS): Provision of an information management service for hazardous stores safety datasheets with 2,000 users | 1,000 | Feb 1997 | Dec 2007 |
| Defence Fixed Telecommunications System (DFTS): Integration of 50 fixed telecommunications networks used by the Armed Forces and MOD, including the delivery of voice, data, LAN interconnect and other WAN services | 70,000 | Jul 1997 | Jul 2007 |
| Electronic Messaging Service: Interoperability of messaging services for the Army | 33,000 | Jul 1997 | Apr 2007 |
| Medium Support Helicopter Aircrew Training Facility (MSHATF): Provision of 6 flight simulator training facilities, covering 3 different types of helicopter, at RAF Benson | 114,000 | Oct 1997 | Oct 2037 |
| Hawk Synthetic Training Facility: Provision of replacement simulator training facilities at RAF Valley | 19,000 | Dec 1997 | Dec 2015 |

## Notes to the Accounts—*continued*

| Project Description | Capital Value* £000 | Contract Start/End Dates | |
|---|---|---|---|
| Joint Services Command and Staff College (JSCSC): Design and delivery of a new tri-Service Command and Staff Training College infrastructure and supporting services, including single residential accommodation and married quarters | 92,769 | Jun 1998 | Aug 2028 |
| Attack Helicopter Training Service: Provision of full mission simulator, 3 field deployable simulators, ground crew, maintenance and armament training | 165,000 | Jul 1998 | Sep 2027 |
| Family Quarters Yeovilton: Provision of married quarters accommodation for 88 Service families at RNAS Yeovilton | 8,200 | Jul 1998 | Jul 2028 |
| RAF Lyneham Sewage Treatment: Refurbishment of existing sewage treatment facilities, serving a population of 7,000, to meet regulatory standards at RAF Lyneham | 3,809 | Aug 1998 | Aug 2023 |
| Tidworth Water and Sewerage: Pathfinder project providing water, sewerage and surface water drainage, serving a population of 12,000 military and dependants at Tidworth | 6,000 | Sep 1998 | Aug 2018 |
| RAF Mail: Provision of informal messaging services for the RAF | 12,000 | Nov 1998 | Nov 2008 |
| Fire Fighting Training Units: Provision of fire fighting training for the Naval Recruiting and Training Agency (NRTA) | 22,500 | Apr 1999 | Apr 2019 |
| Light Aircraft Flying Training: Provision of flying training and support services for Air Experience Flying (AEF) and University Air Squadron (UAS) Flying Training | 20,000 | Apr 1999 | Mar 2009 |
| Tornado GR4 Synthetic Training Service: Provision of aircraft training service at RAF Marham and RAF Lossiemouth | 61,700 | Jun 1999 | Jun 2031 |
| Army Foundation College: Provision of teaching and training facilities for the further vocational education and military training of high-quality school leavers | 73,408 | Feb 2000 | Dec 2029 |
| RAF Cosford/RAF Shawbury Family Quarters: Provision of married quarters accommodation for 145 Service families at RAF Cosford and RAF Shawbury | 15,083 | Jun 2000 | Jun 2025 |
| Central Scotland Family Quarters: Provision of married quarters accommodation for 164 Service Families in Central Scotland | 24,713 | Jan 2001 | Jan 2021 |
| Tri-Service Material Handling Equipment: Provision of Tri-Service materials handling capability | 35,000 | Jun 2000 | Jun 2010 |
| Commercial Satellite Communication Service (INMARSAT): Provision of world-wide commercial satellite communication system for Royal Navy Ships to run for 5 years | 2,600 | Mar 2001 | Mar 2006 |
| E3D Sentry Aircrew Training Service: E3D Sentry simulators instructors and maintainers at RAF Waddington | 6,929 | Jul 2000 | Dec 2030 |
| Lynx MK 7 and 9 Aircrew Training Service: Provision for simulator training facility for Lynx MK 7 and 9 helicopter aircrew | 15,436 | Jul 2000 | Mar 2013 |
| Tri-Service White Fleet: Provision, management and maintenance of support vehicles in the UK | 40,000 | Jan 2001 | Jan 2011 |
| Family quarters at Wattisham: Provision of married quarters accommodation for 250 service families | 34,200 | May 2001 | Jan 2028 |
| Family quarters at Bristol/Bath/Portsmouth: Provision for married quarters accommodation for 317 service families | 78,010 | Nov 2001 | Apr 2028 |
| Defence Housing Executive Information Systems (DOMIS): Provision for a management information system for the Defence Housing Executive | 11,600 | Oct 2001 | Sept 2010 |
| Marine Support to Range and Aircrew Training | 11,000 | Dec 2001 | Dec 2012 |
| Astute Class Training | 41,000 | Sep 2001 | Sep 2031 |

* The capital value is based on private sector partners' capital investment, where known, or otherwise the capital value of the public sector comparator.

The following PFI projects, where service delivery has commenced, are treated as on balance sheet and their service payment commitments are included in the table shown above: Lossiemouth FQs; RAF Fylingdales; Defence Helicopter Flying School; Defence Animal Centre; Naval Communication; Provision of storage facilities; Main Building Redevelopment and a part of the Joint Services Combined Staff College.

The following on balance sheet PFI projects have not yet entered service: Heavy Equipment Transporter.

Contracts for further PFI projects have been signed since the end of the financial year. The projects and their estimated capital values are as follows: Field Electrical Power Supplies (£56 million); Material Handling Equipment Service (£39 million) and Strategic Sealift (£180 million).

No specific contingent liabilities have been identified in respect of the PFI contracts listed above.

## Notes to the Accounts—*continued*

### 22. Contingent Liabilities

Contingent liabilities estimated at some £550,000,000 (2000–01: £205,000,000) were identified relating mainly to ongoing contractual negotiations with third parties.

### 23. Post Balance Sheet Events

QinetiQ

On 1 July 2001, certain operations were removed from the DERA Trading Fund and vested in QinetiQ, a new Self Financing Public Corporation wholly owned by MOD. In March 2002 Ministers announced that in the prevailing market conditions, flotation of QinetiQ did not offer the best value for money and a stake in the business would be sold to a stategic partner who would work with the Department to develop the value of the business with a view to flotation in 3-5 years time. Following an open competition with nearly 40 companies expressing an interest in participation in the Public Private Partnership, it was announced in September that The Carlyle Group had been selected as the preferred partner.

The Department is now undertaking detailed negotiations with The Carlyle Group who have been granted a fixed period of exclusivity, and subject to the successful completion of negotiations, the Department is on track to complete the sale of an equity stake in QinetiQ by the end of 2002.

Quinquennial Valuations

In accordance with the accounting policy and in compliance with Treasury RAM, the Department carried out a professional valuation of all its tangible fixed assets, excluding capital spares maintained on the supply systems. The professional valuation was carried out during the year ended 31 March 2002 with a view to incorporating the valuation in the books with effect from 1 April 2002.

These results are currently being validated by the Department in consultation with the professional valuers and the TLB Holders and will be incorporated in the books after the validation exercise has been completed.

Recovery of HMS Sussex

A US salvage company, Odyssey Marine Exploration, has found what is believed to be the wreck of the HMS Sussex, which sank in the Western Mediterranean in 1694 carrying gold and silver coins valued at the time at £1 million. The wreck and its contents are legally the property of Her Majesty's Government.

A licensing agreement was signed on 27 September 2002 between the Disposal Services Agency of the Ministry of Defence, on behalf of HM Government, and Odyssey. Under the agreement the net proceeds of sale of coins and other marketable artefacts will be shared between the two parties. HM Treasury will receive the net proceeds of the sale of the gold and silver coins, with the proceeds from the sale of any other artefacts being accounted for by the Ministry of Defence.

The value of potential proceeds for the Ministry of Defence for this venture is not yet known nor indeed quantifiable until the intitial stages of exploration and recovery have been completed. At this stage therefore no income or asset has been recognised in the Ministry of Defence accounts. Expenses (including legal costs) incurred by the Ministry of Defence on this project will be borne by the Department's voted funds.

### 24. Notes to Schedule 5

The net costs of the Departmental Objectives are determined as follows:

**Objective 1: Achieving success in the tasks we undertake**

This objective comprises the following:

| | Gross Costs £000 | Income £000 | Net £000 |
|---|---|---|---|
| Operations | 530,016 | — | 530,016 |
| Other military tasks | 1,580,360 | (81,073) | 1,499,287 |
| Contributing to the community | 401,834 | (8,285) | 393,549 |
| Helping to build a safer world | 331,916 | (133,631) | 198,285 |
| Total Objective 1 | **2,844,126** | **(222,989)** | **2,621,137** |

## Notes to the Accounts—*continued*

Costs are identified as follows:

*Operations* comprises the additional costs incurred deploying the armed forces in military operations, e.g. in the Balkans and Afghanistan, over and above the costs of maintaining the units involved at their normal states of readiness.

*Other military tasks* includes ongoing military commitments, e.g. to security in Northern Ireland and Overseas Commands, and the costs of identifying and countering the threat of terrorist attack on the UK mainland, and of maintaining the integrity of UK waters and airspace.

*Contributing to the community* includes ongoing support activities, e.g. search and rescue, administration of cadet forces. In addition, it includes the costs of assistance to Other Government Departments and agencies, e.g. in counter drugs operations.

*Helping to build a safer world* includes the costs of defence diplomacy undertaken to build confidence and security with our allies. It also includes the Department's support of wider British interests.

**Objective 2: Being ready to respond to the tasks that might arise**

The costs of delivering the military capability to meet this objective are analysed among force elements of the front line commands, including joint force units where these have been established, and a small number of centrally managed military support acitivities.

In addition to the direct operating costs of the front line units, they include the attributed costs of logistical and personnel support, identified by reference to the output costs of supplier Management Groupings.

In common with all Objectives, these also contain a share of the costs of advising ministers and accountability to Parliament, and apportioned overheads for head office functions and centrally provided services. The total comprises the full costs, including support services, of force elements grouped under the following headings.

| | Gross Costs £000 | Income £000 | Net £000 |
|---|---|---|---|
| Royal Navy | | | |
| Aircraft carriers | 329,911 | (5,352) | 324,559 |
| Frigates and Destroyers | 1,780,494 | (54,518) | 1,725,976 |
| Smaller warships | 356,593 | (11,627) | 344,966 |
| Amphibious ships | 304,272 | (15,027) | 289,245 |
| Strategic sealift | 53,556 | (4,288) | 49,268 |
| Fleet support ships | 400,564 | (18,547) | 382,017 |
| Survey and other vessels | 211,808 | (6,470) | 205,338 |
| Naval aircraft | 1,166,152 | (31,385) | 1,134,767 |
| Submarines | 3,334,008 | (55,465) | 3,278,543 |
| Royal Marines | 464,940 | (20,715) | 444,225 |
| | 8,402,298 | (223,394) | 8,178,904 |
| Army | | | |
| Field units | 7,170,124 | (139,176) | 7,030,948 |
| Other units | 2,789,561 | (218,015) | 2,571,546 |
| | 9,959,685 | (357,191) | 9,602,494 |
| Royal Air Force | | | |
| Strike/attack and offensive support aircraft | 3,517,065 | (84,954) | 3,432,111 |
| Defensive and surveillance aircraft | 1,653,404 | (33,180) | 1,620,224 |
| Reconnaissance and maritime patrol aircraft | 963,080 | (39,475) | 923,605 |
| Tankers, transport and communications aircraft | 1,088,635 | (46,984) | 1,041,651 |
| Future capability | 144,660 | (2,530) | 142,130 |
| Other aircraft and RAF units | 924,593 | (34,802) | 889,791 |
| | 8,291,437 | (241,925) | 8,049,512 |
| Centre Grouping | | | |
| Joint and multinational operations | 384,706 | (34,181) | 350,525 |
| Centrally managed military support | 473,244 | (70,363) | 402,881 |
| | 857,950 | (104,544) | 753,406 |
| Total Objective 2 | **27,511,370** | **(927,054)** | **26,584,316** |

## Notes to the Accounts—*continued*

Most groupings are self explanatory. The following however should be noted:

*Smaller warships* includes mine hunting and offshore patrol vessels.

*Amphibious ships* includes assault ships providing platforms for landing craft and helicopters, and Royal Fleet Auxiliary landing support ships.

*Strategic sealift* is the Roll-On Roll-Off ferry facility supporting the Joint Rapid Reaction Force.

*Fleet support ships* includes Royal Fleet Auxiliary ships providing tanker and replenishment support to warships.

*Survey and other vessels* includes ocean and coastal survey and ice patrol ships.

*Naval aircraft* include Sea King, Lynx and Merlin helicopters deployed in anti-submarine, airborne early warning, Royal Marine support, and reconnaissance and attack roles.

*Submarines* includes the operating costs of submarines and support of nuclear propulsion and weapons systems, including nuclear decommissioning.

*Army—Field units* includes 1 (UK) Armoured Division, 3 (UK) Division, Joint Helicopter Command and Theatre troops.

*Army—Other units* includes 2, 4 and 5 Divisions, UK Support Command (Germany), Land support and training.

*Strike/attack and offensive support aircraft* includes Tornado GR1/GR1A/GR1B/GR4/GR4A, Joint Force Harrier and Jaguar aircraft deployed in strike/attack and offensive support roles.

*Defensive and surveillance aircraft* includes Tornado F3 and Sentry AEW1 aircraft deployed in UK air defence, and NATO and UN peacekeeping commitments.

*Reconnaissance and maritime patrol aircraft* includes Canberra and Nimrod R1 aircraft deployed on reconnaissance, and Nimrod MR2 aircraft on maritime patrol. (Tornado GR1A/4A included in *strike/attack and offensive support aircraft* also undertake reconnaissance roles.)

*Tankers, transport and communications aircraft* includes C-17, Hercules, Tristar and VC10 aircraft providing air transport and air to air refuelling, and smaller transport aircraft (BAe 125/146 and Squirrel helicopters) used in a rapid communications role.

*Future capability* includes primarily the preparatory costs for the introduction of the Eurofighter aircraft.

*Other aircraft and RAF units* includes ground forces (eg the RAF Regiment) and miscellaneous aircraft not included elsewhere.

*Joint and multinational operations* includes Chief of Joint Operations HQ and the costs less receipts of UK participation in NATO.

*Centrally managed military support* includes intelligence operational support and Special Forces.

### Objective 3: Building for the future

This objective comprises the following elements:

| | Gross Costs £000 | Income £000 | Net £000 |
|---|---|---|---|
| Research | 1,000,583 | (333) | 1,000,250 |
| Equipment programme | 2,078,176 | (45,306) | 2,032,870 |
| Total Objective 3 | **3,078,759** | **(45,639)** | **3,033,120** |

*Research* comprises the costs, including capital charges, of the Research Building Block, and research expenditure incurred by other TLBs.

*Equipment Programme* refers to the administration and programme costs, primarily of the Defence Procurement Agency, associated with specifying requirements for and procurement of fighting equipment and other assets. The values of fixed asset additions are shown in Note 8.

## Notes to the Accounts—*continued*

### Attribution to Objectives

Gross expenditure of £23,961,188,600 (71.7%) and Operating Income of £632,398,048 (52.9%) were allocated to tasks, force elements or activities directly supporting the Objectives. The remainder were apportioned in one of two ways:

— by means of cost attributions to "customer" Management Groupings, using local output costing systems to identify the full local costs of services provided. Cost attributions from suppliers are analysed onward to final outputs on advice from the recipients. If specific advice is not given, attributed costs are assumed to follow the same pattern as locally incurred expenditure:

— as an element of central overhead, shared among Objectives in proportion to all other attributions. The force elements etc. described above receive a share of the expenditure and income components of these overheads, on the basis of their net costs. The central overheads comprised:

| | Gross Costs £000 | Income £000 | Net £000 |
|---|---|---|---|
| Support for ministers and Parliament | 5,392 | — | 5,392 |
| Departmental corporate services | 1,407,737 | (239,868) | 1,167,869 |
| Strategic management | 279,434 | (10,846) | 268,588 |

*Support for ministers and Parliament* includes the central provision of advice to ministers and the costs, wherever incurred in the Department, of dealing with Parliamentary business.

*Departmental corporate services* comprises internal support functions, eg payment of bills, payroll administration, and housing and medical care for service personnel.

*Strategic management* comprises Departmental policy making functions in strategic, personnel, scientific and medical matters.

### Prior year figures

The 2000–01 operating costs and income could only be restated in the format of Schedule 5 and Note 24 at disproportionate cost. The estimated costs of the former objectives are as follows:

| | | **2001–02** | | 2000–01 | | |
|---|---|---|---|---|---|---|
| | Gross Costs £000 | Income £000 | Net £000 | Gross Costs £000 | Income £000 | Net £000 |
| Objective 1 | 29,759,459 | (837,144) | 28,922,315 | 30,376,529 | (799,091) | 29,577,438 |
| Objective 2 | 667,424 | (328,049) | 339,375 | 796,432 | (270,720) | 525,712 |
| Objective 3 | 3,007,371 | (30,489) | 2,976,882 | 3,241,148 | (73,954) | 3,167,194 |
| | **33,434,254** | **(1,195,682)** | **32,238,572** | 34,414,109 | (1,143,765) | 33,270,344 |

Objective 1: Provide and direct Armed Forces able to undertake successfully a major operation on a similar scale and duration to the Gulf War, or two medium scale operations (of similar size to that in Kosovo), one involving warfighting, and sustain them simultaneously for up to six months, whilst meeting long standing commitments and being able to rebuild a bigger force should a major threat to Europe re-emerge.

Objective 2: In order to achieve the above, provide an effective defence policy, planning and management infrastructure.

Objective 3: Provide fighting equipment for the Armed Forces using Smart Procurement principles, so that they maintain the military capability to conduct the operational tasks required of them.

### Capital employed

The deployment of the Department's capital in support of its objectives does not follow the pattern of operating costs. Net assets totalling £66,436 million (76.8%) support the military capability required to meet Objective 2. The remainder comprises assets wholly attributable to tasks within Objective 1 (£3,645 million—4.2%), and intangible assets, fighting equipment and other assets in the course of construction, and assets related to equipment procurement within Objective 3 (£16,473 million—19.0%).

# Notes to the Accounts—*continued*

## 25. Restatement of Balance Sheet and Operating Cost Statement at 31 March 2001

| **Balance Sheet** | Published accounts at 31 March 2001 £000 | FRS15 Changes £000 | Supply Systems £000 | Machinery of Government Changes £000 | Restated at 31 March 2001 £000 |
|---|---|---|---|---|---|
| Fixed Assets | | | | | |
| Intangible assets | 19,901,482 | — | — | — | 19,901,482 |
| Tangible fixed assets | 66,832,436 | 165,979 | 487,349 | 1,575 | 67,487,339 |
| Investments | 391,478 | — | — | — | 391,478 |
| Current Assets | | | | | |
| Stocks and work in progress | 6,214,262 | — | 298,861 | 2,047 | 6,515,170 |
| Debtors | 994,120 | — | — | 10,602 | 1,004,722 |
| Cash at bank and in hand | 299,232 | — | — | 3,543 | 302,775 |
| Creditors: amounts falling due within one year | (4,210,414) | — | — | (8,014) | (4,218,428) |
| Creditors: amounts falling due after more than one year | (397,231) | — | — | — | (397,231) |
| Provisions for liabilities and charges | (4,336,818) | — | — | (980) | (4,337,798) |
| Net assets | 85,688,547 | 165,979 | 786,210 | 8,773 | 86,649,509 |
| Taxpayers' equity | | | | | |
| General fund | 74,984,657 | 211,914 | 786,210 | 8,769 | 75,991,550 |
| Revaluation reserve | 9,277,923 | (45,935) | — | 4 | 9,231,992 |
| Donated assets reserve | 1,425,967 | — | — | — | 1,425,967 |
| | 85,688,547 | 165,979 | 786,210 | 8,773 | 86,649,509 |

| **Operating Cost Statement** | Published accounts at 31 March 2001 £000 | FRS15 Changes £000 | Supply Systems £000 | Machinery of Government Changes £000 | Restated at 31 March 2001 £000 |
|---|---|---|---|---|---|
| Staff costs | 8,979,453 | — | — | 19,290 | 8,998,743 |
| Other operating costs | 20,024,309 | (73,284) | — | 29,186 | 19,980,211 |
| Gross operating costs | 29,003,762 | (73,284) | — | 48,476 | 28,978,954 |
| Operating income | (1,129,557) | — | — | (14,208) | (1,143,765) |
| Net operating cost before interest | 27,874,205 | (73,284) | — | 34,268 | 27,835,189 |
| Net interest (receivable)/payable | 235,632 | — | — | 94 | 235,726 |
| Cost of capital charge | 5,182,688 | 16,614 | — | 127 | 5,199,429 |
| Net operating cost after interest | 33,292,525 | (56,670) | — | 34,489 | 33,270,344 |

25.1 Changes to the reported figures at 31 March 2001 are explained as follows:

(a) Balance Sheet (Schedule 3)

The increase in prior year's net assets of £960,962,000 is represented by adjustments arising in respect of the following:

(i) Supply systems and Assets in Industry

During the course of the year work continued on improving the quality of the data on the Defence Logistics Organisation (DLO) supply systems, including Army Fighting Equipment. These supply systems hold details of fighting equipment, capital spares (such as aircraft engines), certain items of plant and machinery and consumable stocks. Also, work continues on the verification and validation of defence equipment with contractors (Assets in Industry).

(ii) FRS 15

Implementation of FRS 15 during the year resulted in capitalisation of certain refit costs which in prior years were written off to the Operating Cost Statement.

## Notes to the Accounts—*continued*

(iii) Machinery of Government Changes

During the year, the Department acquired the War Pensions Agency (now renamed The Veterans Agency) from the Department for Work and Pensions, and the Security Services Group (SSG) from the Cabinet Office. In accordance with the Treasury RAM, the acquisitions are accounted under merger accounting rules requiring the restatement of the opening Balance Sheet and prior year's Operating Cost Statement.

(b) Operating Cost Statement (Schedule 2) and Cash Flow Statement (Schedule 4)

The table above shows the impact of prior year adjustments to the Operating Cost Statement.

Due to the nature of the changes affecting the supply systems, it has not been possible to apportion the impact of the changes between those relating to the prior year and those relating to earlier years. Consequently, these changes have not been reflected in the prior year's Operating Cost Statement.

The effect of Machinery of Government changes and FRS 15 adjustments have been reflected in the prior year's Operating Cost Statement.

The prior year's Cash Flow Statement has been revised to reflect these changes.

### 26. Segmental Analysis of Net Resource Outturn by Top Level Budget (TLB) Holders

| | 2001–02 | | | | | | **Restated 2000–01** |
|---|---|---|---|---|---|---|---|
| | Other Current Expenditure £000 | Grants £000 | Operating Appropriation-in-Aid £000 | **Total Net Resource Outturn £000** | Total Net Resource Estimate £000 | Total Net Outturn Compared with Estimate £000 | **Total Net Resource Outturn £000** |
| Commander-in-Chief Fleet | 3,869,898 | — | (16,275) | **3,853,623** | 3,753,988 | (99,635) | **4,018,651** |
| General Officer Commanding (N Ireland) | 615,884 | — | (1,649) | **614,235** | 610,097 | (4,138) | **646,993** |
| Commander-in-Chief Land Command | 5,122,808 | 118 | (181,686) | **4,941,240** | 4,941,303 | 63 | **4,849,049** |
| Air Officer Commanding-in-Chief RAF Strike Command | 4,157,669 | — | (29,410) | **4,128,259** | 3,864,373 | (263,886) | **3,890,978** |
| Chief of Joint Operations | 477,612 | — | (29,098) | **448,514** | 470,774 | 22,260 | **555,252** |
| Chief of Defence Logistics | 8,967,161 | 1,521 | (268,177) | **8,700,505** | 8,705,344 | 4,839 | **10,751,878** |
| 2nd Sea Lord/ Commander-in-Chief Naval Home Command | 723,709 | — | (40,181) | **683,528** | 678,803 | (4,725) | **668,772** |
| Adjutant General | 1,711,955 | — | (27,229) | **1,684,726** | 1,663,195 | (21,531) | **1,603,902** |
| Air Officer Commanding-in-Chief RAF Personnel & Training Command | 1,096,029 | — | (166,128) | **929,901** | 932,071 | 2,170 | **891,432** |
| Central | 2,888,232 | 148,237 | (435,955) | **2,600,514** | 2,437,396 | (163,118) | **2,689,798** |
| Defence Procurement Agency | 2,727,895 | — | (18,304) | **2,709,591** | 2,678,301 | (31,290) | **2,324,418** |
| Major customers' research budgets* | 414,153 | — | — | **414,153** | 414,137 | (16) | **400,875** |
| Total (RfR 1) | 32,773,005 | 149,876 | (1,214,092) | **31,708,789** | 31,149,782 | (559,007) | **33,291,998** |
| Total (RfR 2) | 530,016 | — | — | **530,016** | 573,177 | 43,161 | — |
| Total carried forward | 33,303,021 | 149,876 | (1,214,092) | **32,238,805** | 31,722,959 | (515,846) | **33,291,998** |

## Notes to the Accounts—*continued*

| | 2001–02 | | | | | | Restated 2000–01 |
|---|---|---|---|---|---|---|---|
| | Other Current Expenditure | Grants | Operating Appropriation-in-Aid | **Total Net Resource Outturn** | Total Net Resource Estimate | Total Net Outturn Compared with Estimate | **Total Net Resource Outturn** |
| Total brought forward | 33,303,021 | 149,876 | (1,214,092) | **32,238,805** | 31,722,959 | (515,846) | **33,291,998** |
| Income netted off against operating expenditure between TLB holders | (2,294) | — | 2,294 | | | | |
| Items netted off against other operating costs but treated as Appropriation-in-Aid for Schedule 1 (Note 4) | 139,619 | | (139,619) | | | | |
| Excess Operating Appropriation-in-Aid | | | 42,810 | **42,810** | | (42,810) | — |
| | 33,440,346 | 149,876 | (1,308,607) | **32,281,615** | **31,722,959** | **(558,656)** | **33,291,998** |
| | | | | **Sch 1** | **Sch 1** | | |

* Major customers' research budgets is not a Top Level Budget (TLB) Holder.

### 27. Financial Instruments

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

#### Liquidity risk

The Department's revenue and capital resource requirements are voted annually by Parliament and are therefore not exposed to significant liquidity risks.

#### Interest rate risk

A significant proportion of the Department's financial assets and liabilities carry nil or fixed rates of interest. The exposure to interest risk is therefore not significant.

#### Foreign currency risk

The Department enters into forward purchase contracts annually with the Bank of England to cover the majority of its foreign exchange requirements for the following year. The details of the outstanding foreign currency contracts were as follows:

| Currency | Foreign currency US$/Euro 000 | Weighted average exchange rate (=£1) | **31 March 2002 Sterling £000** | 31 March 2001 Sterling £000 |
|---|---|---|---|---|
| US Dollar | 880,000 | 1.3885 | 633,777 | 878,638 |
| Euro | 956,000 | 1.6114 | 593,273 | 530,415 |

The 31 March 2002 mid-market closing rates for US Dollar and Euro were £/$1.424 and £/Euro 1.6323 respectively.

#### Fair values

*Financial assets*

The Department's financial assets include investments and loans made in Trading Funds, MOD agencies funded through a Trading Fund and QinetiQ, a Self Financing Public Corporation. The net assets of these bodies (excluding MOD loans) and the interest rates applicable to these loans are shown in Note 9. Other financial assets fair values approximate to their book values.

# Notes to the Accounts—*continued*

*Financial liabilities*

The Department's liabilities include loans from National Loans Fund and Obligations under finance leases amounting in total to £149.4 million. The fair values of these liabilities will be different from their book values but since these represent only 1.5 per cent of the gross liabilities and provisions, the impact on the Department's net assets will not be material. The fair values of provisions for liabilities and charges are not materially different to its book value which are stated after discounting at the Treasury rate of 6 per cent. The fair values of other liabilities approximate to their book values.

## 28. Losses and Special Payments

| **Losses Statement** | £000 |
|---|---|
| Total (14,416 cases) | 42,072 |
| **Details (cases over £100,000)** | |
| **Cash Losses** | |
| A write-off of £1,605,320.29 arose relating to an irreconcilable balance on the RN/RM Control Account for issues of advances to RN Officers/Ratings. This write-off was a result of erroneous bookings made over a number of years. Since 1st April 1998 the Armed Forces Personnel Administration Agency (AFPAA) in conjunction with its commercial partner has introduced systems for the administration, control and reconciliation of this account. Procedures are now in place to prevent similar bookkeeping errors occurring in the future. | 1,605 |
| **Claims Abandoned** | |
| Treasury approval has been obtained to abandon a claim against an allied naval force for £641,052.82. The claim arose from undercharges for the naval usage of an armament depot between 1990 and 1991. Regulations are currently under review and procedures have been amended to prevent a recurrence of this type of loss. | 641 |
| Treasury approval has been granted to abandon 4 claims totalling £449,305.98 against a foreign government in respect of training provided in 1991 and 1992. | 449 |
| Treasury approval has been obtaineed to abandon a claim in respect of debts owed by a foreign government for material, goods and services supplied to its Navy between November 1989 and May 1996. Despite persistent efforts, there is no realistic prospect of recovering the debts totalling £215,369.21. Procedures have been put in place to prevent a recurrence. | 215 |
| Tenants of a hangar at a former RAF station went into liquidation. With no scope for recovery of rent and rates this resulted in a write-off of £104,450 as a claim abandoned. | 104 |
| Tenants of a hangar at a former RAF station went into liquidation but initially not fully vacating the building so rent continued to accrue. With no scope for recovery this resulted in a write off of £112,441.12 as a claim abandoned. | 112 |
| **Fruitless Payments** | |
| Payments amounting to £748,000 were made between June 1999 and January 2000 for the purchase of Intellectual Property Rights licences in order to run a competition for an Armoured Piercing Extended Performance (APEP) Round for the 30mm RARDEN Cannon. The programme was subsequently cancelled because industry was unable to demonstrate a cost-effective solution to satisfy the requirement. | 748 |
| A fruitless payment of £650,000 was made following litigation for the termination of a Diving Support Vessel hire contract. The hire contract was cancelled by the MOD after safety concerns were raised during the operation of the vessel's diving bell and no acceptable technical solution could be found. The MOD made no payment to the contractor but this was subsequently contested and a settlement reached. Systems are now in place to prevent a recurrence of this type of loss. | 650 |
| As a result of the Territorial Army Strategic Defence Review Drawdown, the Army Board determined that a number of Territorial Army Officers should compulsorily retire or resign. This decision was not promulgated until some time later as the Army Board was keen to ensure that the selection boards had been completed in accordance with the regulations. Officers were therefore retained in the TA for an extra year without the ability to undertake training, and were prevented from earning their Bounty. On legal advice, the Commander-in-Chief authorised payment of Bounty to all Officers involved. Changes have been made in the operating procedures to prevent a recurrence. | 343 |
| On 14 May 2000 an overhead cable was hit by a lorry belonging to a third party. An antenna was brought down and damaged and transmissions could not be made from the site until repairs had been made. The contractor claimed that this incident was beyond his control and therefore BT claimed Force Majeure and requested a payment of £275,243.54 from the MOD to cover downtime. It was agreed to pay 60% of their claim (£165,000 ex VAT) in full and final settlement of their claim whilst not admitting liability. | 194 |
| **Stores and other Losses** | |
| Following the closure of a Regional Depot, finalisation of the Depot's equipment and stores accounts revealed that, in a number of instances, accounting procedures covering movement of equipment and stores had not been fully complied with and as a result the audit trail was incomplete. MOD Police carried out an investigation on certain adjustments within the Accommodation Stores Account but were unable to prove that theft or fraud had occurred. Although no physical loss was proven the value of all stores unaccounted for must be written off as a loss. The need for improved internal monitoring has been highlighted and effected. | 1,527 |

## Notes to the Accounts—*continued*

| | |
|---|---|
| On 18 September 1999 a military vehicle was involved in a road accident, causing considerable damage to a sophisticated radar system and its integrated trailer. No other military vehicles were involved and no personnel sustained injuries. A subsequent investigation determined that the direct cause of the accident was human error. One military person has been disciplined. Procedures have been put in place to prevent a recurrence. | 601 |
| In May 1999 a fire occurred in a Quartermasters stores and spread to the nearby forage barn. The fire caused extensive damage to stores, equipment and building infrastructure. No personnel or livestock sustained injuries. A subsequent investigation was unable to determine the direct cause or responsibility for the fire. | 324 |
| Value of equipment and buildings damaged or destroyed during the civil disturbances at a base in a foreign country. | 177 |
| A number of unreconciled repair vouchers representing missing items of stores were identified as part of a routine inspection on an operation. Due to considerable effort by the relevant staff branches and investigation teams in theatre, much of the equipment has been recovered. The remaining items were written off. There is no evidence to suggest fraud. Measures have been put in place to help prevent a recurrence. | 165 |
| In preparation for the Long Overhaul Period (Refuelling) of a HM Ship, a store was requested to return two repairable NSS Transducers to an allied country for refurbishment. As the store had been requested to treat this as a priority task, the two transducers were hastily, but incorrectly, packaged and duly despatched. On arrival, it was discovered that the transducers had been damaged during transportation and were considered to be beyond economical repair. Their value has therefore had to be written off as a loss. To prevent a recurrence of this stores, loss, new packaging procedures have been introduced. | 155 |
| During recovery from operations in a foreign country, equipment belonging to a unit was containerised and transported back to the UK. During this journey, a single container was broken into and equipment was stolen to the value of £114,485.39. The matter was investigated in accordance with the relevant regulations and remedial action has been implemented to prevent a recurrence. It is widely believed that this was a case of opportunist theft. | 114 |
| **Other Note** | |
| There were 66 instances of supplies and services being provided on a reciprocal basis to Commonwealth and Foreign Navy vessels during visits to British naval ports totalling £650,689.73. | 651 |
| **Constructive Losses** | |
| Armed Controlled Effective Anti Tank Munition (ACEATM), a joint collaborative project with two Foreign Governments to provide a man portable anti tank weapon system, was approved for full development by the Minister of Defence Procurement on 22 October 1990. Subsequent to the completion of development in November 1998, the two Foreign Governments pulled out of this collaborative programme and the UK decided to continue production alone. Prior to the award of a production contract, MOD reviewed funding priorities against operational requirements and concluded that the ACEATM programme could not be sustained. The programme was cancelled in May 2001. | 10,864 |
| A loss arising from expenditure incurred on the development of specialised communication equipment prior to the project being cancelled. A decision was taken in August 2000 not to proceed with this requirement due to its failure to make technological progress. Costs of £3,536,224 had been incurred up to this period and has been written off as a constructive loss. | 3,536 |
| A constructive loss of £2,651,219 was incurred in 2001–02 by the Admiralty Simulator 1117 (AS1117) training system project for delivery of a Submarine Command Team Trainer for the Swiftsure and Trafalgar class submarine update programme. However, it was determined that the Sound Room originally planned was no longer capable of satisfying the training requirement for the evolving capability of the submarine's operational sonar suite. A revised approach to the training solution was adopted which delivered initial Sound Room capability in Januay 2001. The sum written off represents the balance of expenditure after recovery of re-usable items. | 2,651 |
| Payments amounting to £1,436,941.48 were made between January 1998 and April 2001 for the purchase of 10 All Up Round Containers (AURC) and to compensate for the purchase of long lead items for the production of a further 390 containers. 10 containers were delivered to the MOD in January 1998, but the following assessment of the AURC's compatibility with other equipment and a review of the operational requirement in the light of the lessons learned it was decided to terminate the contract. | 1,437 |
| **Gifts** | |
| Infrastructure support, logistical equipment and communications equipment were gifted to a Foreign Government. Details of the transfers were notified to the House of Commons in a Departmental Minute dated 30 August 2002. | 742 |
| **Special Payments** | |
| Total (100 cases) | 74,262 |
| **Detail (cases over £100,000)** | |
| Ex-gratia payments have been made on account to British Nuclear Fuels plc and the United Kingdom Atomic Energy Authority towards the cost of treating and disposing of nuclear wastes and decommissioning plant at British Nuclear Fuels plc sites. The total paid to date is £1,053,000,000. | 72,362 |

# Notes to the Accounts—*continued*

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|---|---|
| An ex-gratia payment to a company for reimbursement of costs incurred in bidding for a contract for the operation and management of aircraft and maintenance activities at an RAF station. The payment results from a change in acquisition strategy, which led to the cancellation of the tender process and a claim from the lowest bidder for reimbursement of their bidding costs. The claim was settled out of court by independent arbitration. The initial claim was made in 1998. | 1,600 |
| Due to sub-standard living and working conditions on board HMS Fearless a special payment was made to all personnel and embarked troops. The total for 2001–02 was £127,619.28. | 128 |

**Advance Notification**

Advance Notification is given of a review of the Defence Logistics Organisation's Business Change Programme, which may lead to a re-assessment of the future value of the Department of some capitalised past investment, and possibly to some of that past investment being written off.

## 29. Non-Operational Heritage Assets

29.1 The Department owns a range of non-operational heritage assets from historically significant defence equipment, through archive information, to museum and art collections. In accordance with HM Treasury policy non-operational heritage assets are normally valued except where:

(a) the cost of the valuation outweighs the benefits that the knowledge of the valuation would deliver; or

(b) it is not possible to establish a sufficiently reliable valuation.

On the above basis, no non-operational heritage assets, except land, were valued at the year-end.

29.2 The scope and diversity of the holdings of non-operational heritage assets which are not valued is illustrated by the examples detailed in the table below:

| Item | Location | Description |
|---|---|---|
| HMS Victory | Portsmouth | HMS Victory is a 100 gun, first rate ship of the line, most famous for her role as Lord Nelson's Flagship at the Battle of Trafalgar. Victory was commissioned into the fleet in 1778 and serves today as flagship to 2nd Sea Lord/Commander-in-Chief Naval Home Command. Open to the public since 1928, Victory now attracts around 400,000 visitors a year. |
| Army Historic Aircraft Flight | Middle Wallop | Formed in the late 1980s, the flight consists of eight aircraft and makes about 14 public appearances between Easter and October. |
| Historic Gun Collection | DSDC Donnington | The museum currently holds a collection of 749 small arms of British and foreign origin together with a small number of larger weapons. |
| Battle of Britain Memorial Flight | RAF Coningsby | Formed in 1973 the Memorial Flight operates 11 mainly World War 2 aircraft that appear at in excess of 250 airshows, public events and state occasions. Memorial Flight aircraft can also be viewed by the public at their hangar at RAF Coningsby. |
| MOD Art Collection | Various locations | The MOD Art Collection comprises approximately 800 works of fine art and 250 antiques such as clocks and furniture. Many other miscellaneous items, such as photographs and manuscripts are contained in the archive. At the core of the collection are works commissioned by (and bequeathed to) the Admiralty during the 19th century, and those given to the Admiralty and to the War Office by the War Artists Commission at the end of the Second World War. Items from the MOD art collections are displayed in conference rooms and senior officers' accommodation throughout the defence estate. The most important items are on permanent public display in the National Maritime Museum and on temporary loan to many other public museums and galleries. |
| Records and artworks | Portsmouth, London | The Admiralty and Institute of Naval Medicine Libraries and the Air Historical Branch (London) comprise text and records of historical and research items. Although not open to the public, access is available on application. |
| Artefacts, records and artworks | Various locations | Some 69 Regimental and Corps Museums exist across the country. Ownership of the buildings and contents of the museums varies between the MOD, local authorities and regimental associations. The museums, which are open to the public, trace the history of the regiments and comprise displays of uniforms, weapons, medals and records. |

## Notes to the Accounts—*continued*

### 30. Entities within the Departmental Boundary

The entities within the boundary during 2001–02 were as follows:

**Executive Agencies**
Armed Forces Personnel Administration Agency
Army Base Repair Organisation
Army Personnel Centre
Army Training and Recruiting Agency
British Forces Post Office
Defence Analytical Services Agency
Defence Bills Agency
Defence Communication Services Agency
Defence Dental Agency
Defence Estates
Defence Geographic and Imagery Intelligence Agency
Defence Housing Executive
Defence Intelligence and Security Centre
Defence Medical Training Organisation
Defence Procurement Agency
Defence Secondary Care Agency
Defence Storage and Distribution Agency
Defence Transport and Movements Agency
Defence Vetting Agency
Disposal Services Agency
Duke of York's Royal Military School
Medical Supply Agency
Ministry of Defence Police
Naval Manning Agency
Naval Recruiting and Training Agency
Pay and Personnel Agency
Queen Victoria School
RAF Personnel Management Agency
RAF Training Group Defence Agency
Service Children's Education
Veterans Agency
Warships Support Agency

**Advisory Non-Departmental Public Bodies**
Advisory Committee on Conscientious Objectors
Animal Welfare Advisory Committee
Armed Forces Pay Review Body
Dartmoor Steering Group
Defence Nuclear Safety Committee
Defence Scientific Advisory Council
Independent Board of Visitors for Military Corrective Training Centres
National Employers' Liaison Committee
Review Board for Government Contracts
Royal Military College of Science Advisory Council

**Other Entities**
The Reserve Forces and Cadet Associations (formerly TAVRA)

## Notes to the Accounts—*continued*

### 31. Votes A Statement - Statement of Approved Maximum Armed Forces Numbers

31.1 Votes A statement is presented annually to Parliament to seek authority for the maximum numbers of personnel to be maintained for service with the Armed Forces for the year and is audited by the National Audit Office.

31.2 Maximum numbers of personnel to be maintained for service with the Armed Forces:

| | Numbers voted by the House of Commons | Maximum numbers maintained | Peak Dates |
|---|---|---|---|
| Officers, Men & Women for NAVAL SERVICE | 46,025 | 42,421 | 1 April 2001 |
| Officers, Men & Women for ARMY SERVICE | 128,195 | 118,121 | 1 February 2002 |
| Officers, Men & Women for AIR FORCE SERVICE | 57,485 | 53,804 | 1 April 2001 |

31.3 Maximum numbers of personnel to be maintained for service with the Reserve Forces:

| | Numbers voted by the House of Commons | Maximum numbers maintained | Peak Dates |
|---|---|---|---|
| Reserve Naval and Marine Forces | 17,340 | 15,133 | 1 March 2002 |
| Special Members of the Reserve Naval Forces | 250 | — | — |
| Reserve Land Forces | 84,000 | 75,667 | 1 May 2001 |
| Special Members of the Reserve Land Forces | 6,000 | — | — |
| Reserve Air Forces | 23,750 | 19,965 | 1 April 2001 |
| Special Members of the Reserve Air Forces | 430 | 50 | 1 May 2001 |

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