Section 2

Consolidated Departmental Resource Accounts 2002-2003

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 deliver security for the people of the United Kingdom and the Overseas Territories by defending them, including against terrorism; and to act as a force for good by strengthening international peace and stability.

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

Departmental Boundary

At 31 March 2003 the Department consisted of the 11 (2001-02:11) Top Level Budget (TLB) Holders detailed in Note 27 to the financial statements, responsible for providing forces and support services required for a modern defence force. Within these TLBs there were 81 (2001-02: 84) reporting entities known as management groupings, including 31 (2001-02: 32) on-vote Defence Agencies listed in Note 31. Also included within the Departmental Boundary are Advisory Non-Departmental Public Bodies (NDPB) sponsored by the Department listed in Note 31. Defence Agencies with an accounts direction from HM Treasury also publish their own financial statements.

The five (2001-02: four) Defence Executive Agencies established as Trading Funds and owned by the Department at 31 March 2003 fall outside the Departmental Boundary and are detailed in Note 9. The change during the year was a result of vesting of the Army Base Repair Organisation (ABRO) as a Trading Fund.

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 during the year, the Department took over the responsibility for the payment of war disablement and war widows' pensions from the Department of Work and Pensions. All expenditure incurred under the provision of these services falls under a separate Request for Resources (RfR3), and is disclosed separately under Other Operating Costs.

QinetiQ Holdings Limited (hereafter referred to as '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

The Department sold 34% of its interest in QinetiQ to The Carlyle Group. In February 2003, QinetiQ acquired all the issued shares in QinetiQ Group plc, the company in which the Department had its original shareholding at 31 March 2002. QinetiQ is a company controlled by The Carlyle Group, but in which the Department has a significant equity interest. The sale followed the decision in September 2002 to select The Carlyle Group as the preferred bidder in the Department's selection of a strategic partner. The Department's intention is to sell the remaining stake in the company within 3 to 5 years, probably through a flotation on the stock market.

The Carlyle Group's track record in assisting companies to grow and develop, and secure private sector capital, should ensure that the business achieves its anticipated future potential and thus increase its value. On the eventual sale of its remaining stake, the Department will retain a special share to ensure that the defence and security interests of the country are protected.

Fixed Assets

Changes in fixed assets during the year are summarised in Notes 7, 8 and 9 to the financial statements. The impact of the professional valuations carried out during the year is reflected in the accounts. Although the overall result of the professional valuations shows only a small net increase in values over the previous year's, there were some significant increases and decreases in values by individual assets. Further details on professional valuations are given in Note 8.

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, and certain development expenditure is expensed, 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 £41,793,591,000 which has been charged to the General Fund. Cash voted by Parliament and drawn down for the provision of Defence Capability (RfR 1), Conflict Prevention (RfR 2) and War Pensions and Allowances (RfR 3) amounting to £27,136,321,000 has been credited to the General Fund (Note 17).

Operating and Financial Review

The Operating and Financial Review is included on pages 69 to 70.

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 Lord Bach of Lutterworth

Minister of State for the Armed Forces
The Right Honourable Adam Ingram JP, MP

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 2003:

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
Air Chief Marshal Sir Anthony Bagnall KCB OBE ADC FRAeS RAF

Second Permanent Under Secretary of State
Mr Ian Andrews CBE TD

First Sea Lord and Chief of the Naval Staff
Admiral Sir Nigel Essenhigh GCB ADC (to 16 September 2002)
Admiral Sir Alan West KCB DSC ADC (from 17 September 2002)

Chief of the General Staff
General Sir Michael Walker GCB CMG CBE ADC Gen (to 2 February 2003)
General Sir Mike Jackson KCB CBE DSO ADC Gen (from 3 February 2003)

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 (to 1 September 2002)
Air Chief Marshal Sir Malcolm Pledger KCB OBE AFC BSc FRAeS RAF (from 2 September 2002)

Chief Scientific Adviser
Professor Sir Keith O'Nions FRS

Non-Executive members
Charles Miller Smith, Chairman of Scottish Power (from 29 May 2002)
Philippa Foster Back, Director of the Institute of Business Ethics (from 10 July 2002)

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

General Sir Michael Walker GCB CMG CBE ADC Gen appointed Chief of the Defence Staff on 2 May 2003 in succession to Admiral Sir Michael Boyce GCB OBE ADC.

Air Marshal Sir Jock Stirrup KCB AFC FRAeS FCIM RAF appointed Chief of the Air Staff on 1 August 2003 in succession to Air Chief Marshal Sir Peter Squire GCB DFC AFC ADC FRAeS RAF.

Sir Peter Spencer KCB FREng appointed Chief of Defence Procurement from 1 May 2003 in succession to Sir Robert Walmsley KCB FEng FIEE.

Ivor Caplin Esq MP, Member for Hove has been appointed on 13 June 2003 as Parliamentary Under Secretary of State for Defence and Minister for Veterans in succession to Dr Lewis Moonie, MP.

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 three 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 Civil Service Pension Scheme (CSP) arrangements and the Armed Forces Pension Scheme (AFPS) respectively. The Department makes regular payments of Accruing Superannuation Liability Charge (ASLC) into the relevant pension schemes at rates determined by the Government Actuary.

On 1 October 2002 the new CSP arrangements came into effect. Since that date all new entrants to the Department have had the option to join either the defined benefits (DB) scheme, known as 'Premium', or to join the defined contributions (DC) scheme which is known as 'Partnership'. The previous scheme, now known as 'Classic', was closed to new members when the new CSP arrangements came into effect. Member contributions to Premium are 3.5% and are considered to be a general contribution to the scheme. Members in Classic continue to contribute 1.5% in respect of the Widows Pension Scheme (WPS) benefits. The Department's contributions to Partnership vary depending on the age of the individual and the amount that they contribute.

Both the Premium and Classic 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

The basic salary and annual increases of civilian members of the DMB, which could include a bonus payment, are performance related and are set by the Permanent Under Secretaries Remuneration Committee based in the Cabinet Office. The two Non-Executive Directors' remuneration, of which there is no performance-related element, is set by the Department within guidelines issued by the Cabinet Office.

Senior officers at two-star rank and above participate in the Performance Management and Pay System (PMPS). The main elements of the PMPS are:

a. An objective-setting regime complementary to the Department's developing performance management system embodied in the Defence Balanced Scorecard.

b. A performance-related incremental pay system.

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 2002-03, the DBA met its target of paying 99.9% 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 £1,196 (2001-02: £134,522).

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.

A Sustainable Development Steering Group has been set up to oversee the development and implementation of a Departmental Sustainable Development Strategy. 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 practical, 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 2002-03' and 'The Government's Expenditure Plans 2003-04: 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. The Departmental Performance Report forms the first Section of the Annual Report and Accounts.

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 28.

Provision of Information and Consultation with Employees

The MOD has a strong Whitley committee structure through which employees' representatives, in the form of recognised industrial and non industrial trades unions (TUs), are consulted on and informed of all matters likely to affect our civilian personnel. This structure is supported by formal policy and procedures for consulting and informing TUs. We also advocate the development of informal relationships with the TUs to discuss ideas together. Our policy makes clear that consulting the TUs is not a substitute for dealing with personnel direct, and vice versa. Managers and project leaders for example are encouraged to use all media available, including cascade briefings, newsletters and intranet websites/email. In respect of service personnel, the process operates through the chain of command, with no formal representation through the Trade Unions.

Auditor

The financial statements for the Department are audited by the Comptroller and Auditor General under the Government Resources and Accounts Act 2000. The Certificate and Report of the Comptroller and Auditor General on the financial statements are set out on pages 75 to 87.

Kevin Tebbit
Accounting Officer
22 October 2003

Operating and Financial Review

This is the first year that the Department is publishing the Departmental Performance Report (DPR) and the Departmental Resource Accounts as a single document. Presenting these two reports together as an "Annual Report and Accounts", in much the same way as in the commercial sector, increases the coherence of the Department's external reporting and is in line with Treasury best practice. The DPR deals mainly with the non-financial performance of the Department. It is structured along the lines of a Balanced Scorecard. The Defence Balanced Scorecard encapsulates the Defence Management Board's key objectives and priorities, including the Public Service Agreement targets, over the full range of the Department's business.

Operational activity during the year was dominated by events in Iraq (Operation TELIC). This operation required a significant deployment of UK personnel to the Gulf and involved complex and difficult logistical support operations. During the year, the Department was also committed to operations in Afghanistan, Sierra Leone and Balkans and in the UK, under Operation FRESCO, mobilised a large number of personnel to assist in the fire cover required during the firefighters' strike. Further details of these operations are given in Section 1 of the Annual Report and Accounts.

Financial Review

Last year the Department's Resource Accounts were qualified in respect of two supply system issues and an excess Vote in respect of RfR 1 net resource outturn. This year the Department planned and operated its financial controls so as to successfully remain within the Parliamentary controls. The NAO have removed one qualification in respect of one of the supply systems issues: that relating to MoD assets held by contractors. But it has not been possible to resolve the issue surrounding the qualification on stock consumption data. Significant progress continues to be made on this issue, and the Department is on track to resolve the issue in the current financial year.

Net Resource Outturn

The total Net Resource Outturn was £2,475 million below the Estimate. Schedule 1 provides a summary explaining the reasons for the underspend, but, in the main, the underspend was largely due to lower than forecast non-cash costs. The main underspend arose in respect of Request for Resources (RfR) 1, Defence Capability. RfR 2 (Conflict Prevention) and RfR 3 (War Pensions and Allowances) outcomes were close to the Estimates.

The Net Resource Outturn was £8,495 million above last year. The significant increase in costs was caused by a number of items. The main item was the impact of the Quinquennial valuation (see Note 8 for further details) of the fixed assets carried out during the year. This resulted in an additional charge to the resource outturn of some £4,000 million, comprising impairments and additional depreciation costs. An additional cost of £1,124 million also had to be borne in respect of nuclear decommissioning costs allocated to the Department by BNFL as a result of their review of their strategy on solid Intermediate Level Waste retrieval. Conflict Prevention costs were also higher by £500 million due to the war in Iraq. The remaining increase is spread over several cost headings detailed in Note 3.

Net Cash Requirement

The net cash requirement (NCR) was £1,312 million below the Estimate. The underspend in cash resources is mainly attributable to a reduction in operating costs after offsetting non-cash transactions, movements in working capital and lower than expected capital expenditure.

Financial Position

The net asset value at £81,438 million was £4,963 million below last year. The decrease is accounted for by a small decline in the value of fixed assets caused by a number of factors; mainly the impact of the Quinquennial valuation, disposals and reduction in investments. Working capital decreased by £1,052 million, mainly due to a reduction in stocks. Provision for liabilities and charges increased due to further provisions for nuclear decommissioning made in respect of BNFL, as referred to in Note 16.

Cash Flow

The amount drawn down from the Consolidated Fund was £27,136 million. This amount was mainly utilised to finance operating activities (£21,165 million) and net capital expenditure on fixed assets (£5,647 million). Cash and bank balances decreased by £216 million, after making payments to the Consolidated Fund in respect of prior year's Supply and Consolidated Fund receipts.

Future Developments

During the year, the Department selected The Carlyle Group as its strategic partner and sold them an interest of 34% in QinetiQ, a company involved in the supply of scientific and technical services. Defence remains a core business for QinetiQ , but it is now applying its expertise to solve commercial problems in diverse markets. The Carlyle Group will help the business to develop and grow, and secure private sector capital, with a view to achieving its anticipated future potential. It is the intention to sell the remaining stake in the company within 3 to 5 years, probably through a flotation on the stock market.

The Department continues to explore prospects and opportunities for using Private Finance Initiatives and Public Private Partnering arrangements to deliver best value without compromising operational effectiveness.

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; and
- 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 maintenance of military operational capability and for the preparation, conduct and analysis of military operations.

During the Financial Year 2002-03, the Department was divided into 11 business areas, each managed by a Top Level Budget (TLB) Holder, 5 Trading Fund Agencies and 7 Non-Departmental Public Bodies (NDPB) with delegated responsibilities. Included within the TLBs are 31 on-vote Defence Agencies whose Chief Executives are responsible for producing annual accounts which are laid before Parliament. Of the Trading Fund Agencies, the Defence Aviation Repair Agency, the Army Base Repair Organisation, the Defence Science and Technology Laboratory (DSTL), and the UK Hydrographic Office, report separately their financial results to their Ministerial Advisory Boards, and the Met Office to the UK Met Board chaired by the 2nd PUS. With the exception of the Defence Procurement Agency (DPA), responsibility for monitoring on-vote Defence Agencies' performance is within specific TLB Holder's responsibilities. The DPA reports to its Ministerial Advisory Board. Responsibility for monitoring NDPB's performance also falls within individual TLB Holders responsibilities. Statements on Internal Control are provided annually by TLB Holder's and Trading Fund Agency Chief Executives.

At the start of the year, the Department assumed responsibility for War Pensions Benefits (WPB). The WPB is administered by the Veterans Agency, the operating costs of which are part of the Central TLB. A Statement on Internal Control is provided annually by the Veterans Agency Chief Executive.

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control 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 and prioritise the risks to the achievement of Departmental policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. During the year, the Department continued to develop its system of internal control to achieve compliance with requirements for central government as set out in DAO (GEN) 13/00. The system was fully operational by 31 March 2003 and has been in place since then up to the date of approval of the annual report and accounts and accords with Treasury guidance.

As Accounting Officer, I also have responsibility for reviewing the effectiveness of the system of internal control. In June 2002, following a TLB-wide review of progress in embedding corporate governance and risk management processes, Defence Internal Audit (DIA) reported that significant progress had been made, and provided assurance that the progress was sufficient to ensure that mature governance and risk management processes would be in place by 1 April 2003. Recommendations necessary to deliver a fully supported system of internal control were addressed during the year.

In line with HM Treasury guidance, I have established the following processes:

- A Defence Management Board (DMB), which meets monthly to consider the plans, performance and strategic direction of the Department, which comprises the senior members of the Department and has two external independent members;
- A Defence Audit Committee (DAC), chaired by an external independent member of the DMB, 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 bodies, including:
  - Defence Environment and Safety Board
  - Departmental Security Officer
  - Defence Internal Audit
  - Director General Financial Management
  - National Audit Office
  - In addition, since the end of the financial year, the DAC has reviewed a report from the Director of Operational Capability providing assurance on the Department's operational capability;
- A Departmental Corporate Governance & Risk Management policy statement and strategy cascaded down through TLB Holders;
- 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. Operation of the system was reviewed during the year by DIA who gave substantial assurance on its effectiveness;
- A Departmental risk register, supported by operational-level risk registers, which complements the Defence Balanced Scorecard. The Departmental risk register has been reviewed and endorsed by both the DAC and the DMB;
- 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;
- Through TLB Holders, a cascaded system for ensuring that Business Continuity plans are in place, and that these plans are tested on a regular basis. An in-year, DIA-conducted audit gave assurance that Business Continuity plans had been established but highlighted the need for further work regarding their maintenance, review and testing. Recommendations to address these areas are being taken forward;
- An annual risk-based programme of internal audit provided by DIA, who is the primary source of independent assurance, is complemented by the activity of the Directorate of Operational Capability (DOC), which in turn provides independent operational audit and assurance to the Secretary of State and the Chief of Defence Staff;
- 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. Considerable efforts were made during the year to sustain financial control during the second transitional year of Stage 1 of resource accounting and budgeting (RAB). These efforts proved successful with the Department delivering its outputs within the resources devoted by Parliament, notwithstanding the considerable demands arising from the first five-yearly review of the valuations of the Department's fixed assets. This has, however, resulted in continued high loading on finance staff, although there are some signs that this is beginning to ease. Experience has exposed some issues surrounding the effectiveness of the Department's asset management systems, and continuing issues with the effectiveness of stock management systems and the generation of

accurate data on stock consumption. Both are being addressed as part of structured process improvement programmes. Looking ahead, the transition to RAB Stage 2 from 1 April 2003 is likely to continue the heavy workload on finance staffs;

- Appropriate assurance measures – in particular, a comprehensive policy document 'Assuring Delivery' and a 'Centre of Excellence' – to ensure that high-risk mission-critical projects and programmes carried out by the Department do not suffer from any of the common causes of failure identified by the Office of Government Commerce and the National Audit Office; and
- Appropriate mechanisms to strengthen the management of scientific risks, particularly to Service personnel health, and in health, safety and environmental matters.

To address audited weaknesses and ensure continuous improvement, further development of the Department's internal control framework is planned for 2003-04. In particular, I shall look to improve the Department's existing risk management capability as a result of the Treasury-led Risk Management Improvement Programme arising from the Cabinet Office Strategy Unit's risk report[1].

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.

Kevin Tebbit
Accounting Officer
22 October 2003

[1] Strategy Unit report – *Risk: Improving Government's Capability to Handle Risk and Uncertainty* – published 20 November 2002.

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

I certify that I have audited the financial statements on pages 88 to 141 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 97 to 103.

Respective responsibilities of the Accounting Officer and Auditor

As described on page 71, 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 Annual Report and 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 including the annual performance 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 Annual Report and 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 72 to 74 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 except that the scope of my work was limited as explained below. 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.

However the evidence available to me was limited in the following respect:

- 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 £1,128 million net credit to the Operating Cost Statement relating to movements in consumable stock and capital spares.

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. In forming my opinion I have also evaluated the overall adequacy of the presentation of information in the financial statements.

Qualified opinion arising from limitation in audit scope

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 value and disclosure of charges to the operating cost statement arising from stock written off and impairment of fixed assets, referred to in paragraphs 25 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 2003 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
- 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 issue 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 77 to 87.

John Bourn
Comptroller and Auditor General
29 October 2003

National Audit Office
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Victoria
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The Report of the Comptroller and Auditor General to the House of Commons

Section 1: Summary

1 The Ministry of Defence (the Department) is required by 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, particularly during the escalation of military operations. The Department has therefore had to invest considerable efforts in implementing resource accounting and budgeting, both in IT and staffing.

3 The Department has made significant efforts to improve the standard of its financial accounting information over the last four years. I qualified my audit opinion on the 2001-2002 resource accounts because I was unable to confirm some figures in the operating cost statement in respect of consumption charges for certain stock and fixed assets. The Department has continued over this last year to make strenuous efforts to secure further improvements. In Section 2 of my Report I consider whether the Department is still taking 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 still unable to confirm whether some stock and fixed asset accounting transactions generated by the Defence Logistics Organisation's Air environment are correctly recorded and accordingly I have qualified my audit opinion.

5 The Treasury's *Resource Accounting Manual* requires that losses and special payments be reported in Departments' Resource Accounts. The Ministry of Defence has faced significant changes in its expenditure programmes over recent years because of a variety of factors, including changes in threat and advances in weapons technology and the scale of change in organisational structures. These factors have led to many of the losses and special payments recorded in Note 29 to the 2002-2003 Resource Accounts. In Section 4 of my Report I consider some of the more significant losses.

6 In Section 5 of my Report I confirm that according to Departmental records the maximum numbers of military personnel maintained during 2002-2003 for the Naval, Army and Air Force Services in all active and reserve categories were within the numbers voted by Parliament.

7 The Department continues to demonstrate a strong and effective grip on the accounts production process. For 2002-2003, 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 first Resource Accounts for 1999-2000, on which I placed a disclaimer covering a range of accounting deficiencies, the Department has consistently made good progress during the last three years in improving the quality of its accounts. During 2002-2003 the Department has successfully cleared one of the two substantive issues which together with an excess vote 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 2001-2002 Accounts[1] I explained my reasons for qualifying my audit opinion. I was unable to confirm whether charges to the operating cost statement for the use of departmental stock and capital spares by contractors were complete and whether stock and fixed asset accounting transactions generated by the Defence Logistics Organisation's Air environment were complete or correctly recorded. The Department has made good progress on the first of these issues so that it no longer contributes to a qualification of the audit opinion.

Charges to the operating cost statement for the use of departmental stock and capital spares by contractors are more robust

9 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 (capital spares) or stock 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 Defence Logistics Organisation maintains a central database of these items where they are not already accounted for on departmental inventory systems. The gross value of these stock and capital spares items in the Department's Resource Accounts amount to some £819 million. After provisions for obsolescence and depreciation are taken into account the net book value is some £324 million.

10 In my Report on the 2001-2002 Accounts I noted the progress made by the Defence Logistics Organisation to account more accurately for these assets. However, the accounting treatment adopted to create closing balances for these items meant that I was unable to confirm whether the charges to the operating cost statement for the use of departmental stock and capital spares by contractors was complete and I qualified my opinion in this regard. At the time the Defence Logistics Organisation was aiming to improve data capture and estimating techniques to remedy this for the 2002-03 Accounts.

[1] MOD: Departmental Resource Accounts 2001-2002 HC 47 Session 2002-2003: 21 November 2002

11 Over the last year the Defence Logistics Organisation has made further improvements to the accuracy of the balance sheet data. The existence of some 98 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 77 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. And the classification between stock and capital spares has been refined. In addition, the Defence Logistics Organisation undertook a review of how stock and capital spares issued to contractors are recorded in the stock accounting systems and posted to the general ledger. The review established revised accounting treatments for items issued to contractors, the disposal of items held by contractors and the calculation of obsolescent provisions and depreciation.

12 As a result, the Defence Logistics Organisation has been able to estimate a net charge of some £244 million in respect of charges for the use of departmental assets by contractors. These charges have been recognised in the operating cost statement. I have examined the basis of the calculation of this charge and concluded that it is robust and accurately recorded in the operating cost statement. As a result I have been able to remove my qualification in this regard.

The Department has remained within its resource budgets for 2002-2003

13 I also had to qualify my opinion on the 2001-2002 accounts because the Department had breached its resource budget approved by Parliament for Request for Resource 1 "provision of defence capability". I noted in my Report[2] last year that the Department had implemented a more robust system for monitoring resource expenditure during the year so that appropriate levels of additional resources could be requested from Parliament if required. Schedule 1 of the Departmental Resource Accounts summarises the Department's expenditure and net cash requirement against these revised budgets authorised by Parliament. The Department has remained within all of its budgets for 2002-2003 subject to Parliamentary control.

14 Through its in year monitoring procedures the Department identified during the course of 2002-2003 that it required additional provision and presented Supplementary Estimates to Parliament as summarised below.

£000	Main Estimate	Winter Supplementary	Spring Supplementary	Total	Outturn	Variance
Gross Resource provision RfR 1	32,683,620	178,668	10,980,190	43,842,478	41,180,611	2,661,867
* A in A RfR 1	1,395,807	0	300,142	1,695,949	1,449,767	246,182
* Net Resource provision RfR 1	31,287,813	178,668	10,680,048	42,146,529	39,730,844	2,415,685
* Net Resource provision RfR 2	341,141	213,849	600,844	1,155,834	1,117,429	38,405
* Net Resource provision RfR 3	1,186,720	0	0	1,186,720	1,165,411	21,309
Capital	5,843,772	110,620	835,796	6,790,188	6,512,466	277,722
* Non operating A in A	217,169	0	277,501	494,670	373,756	120,914
* Net Cash Requirement	26,091,927	729,844	1,481,201	28,302,972	26,991,365	1,311,607

* Subject to Parliamentary control

15 The Department has significantly underspent against its budget in respect of two elements of Parliamentary control and has provided explanations for these variances in the notes to Schedule 1. Request for Resource 1 "provision of defence capability" is underspent by some £2,416 million or 5.7 per cent. The reasons for this include:

- over estimate of some £733 million of the effect of the quinquennial revaluation of fixed assets;
- over estimate of some £200 million for the impact of amended fixed asset lives affecting the resource consumption of the Commander-in-Chief Fleet;

[2] MOD: Departmental Resource Accounts 2001-2002 HC 47 Session 2002-2003: 21 November 2002

- a decision taken not to write down the value of Swordfish torpedoes saving some £170 million resource consumption;
- fixed asset reclassifications by the Defence Logistics Organisation of some £550 million; and
- a range of other smaller provision movements.

16 The overall net cash requirement is underspent by £1,312 million or 4.6 per cent. The Department attributes this to an underspend on relevant cash operating costs and an overestimate of working capital movements.

Other developments in Resource Accounting and the disclosure of financial information

The Department has undertaken a major revaluation of its fixed asset base

17 Note 8 to the 2002-2003 Resource Accounts summarises the Department's holdings of tangible fixed assets. The 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 to complete as a single exercise. Revised valuations were obtained, validated and posted to the accounts in 2002-2003 for the Land and Building and Fighting Equipment asset categories. However some valuation work was still being undertaken after the year end for Plant, Machinery and Vehicles and IT and Communications Equipment asset categories. The Department has therefore made adjustments to the year end balances to bring these revised valuations into the 2002-2003 resource accounts.

18 The overall net impact of the revaluation exercise has been a decrease in the carrying value of fixed assets of some £310 million. This reflects upwards revaluations of some £6,074 million and downwards revaluations of some £6,384 million of which £3,904 million is in respect of permanent downward revaluations, adjustments for depreciation and capital charges which has been charged to the operating cost statement. The Department had forecast a potential impact of some £4,637 million in additional resource costs and submitted a request for this amount in the Spring Supplementary Estimates. The results of the Department's quinquennial revaluation exercise are summarised in the table below.

£000	NBV of assets at 31 March 2002 (1)	NBV of assets subject to revaluation (2)	Percentage valued	Increased valuations	Reduced valuations	Net increase/ (decrease)	Impact on operating cost statement	Impact on reserves
Land and Buildings	14,348,075	13,425,454	96.19%	3,359,720	2,904,647	455,073	1,623,143	2,078,216
Fighting Equipment	27,280,885	25,941,088	98.98%	2,232,589	3,151,621	-919,032	2,110,255	1,191,223
Plant Machinery and Vehicles	4,142,223	3,926,405	77.36%	419,578	283,293	136,285	134,215	270,500
IT and Communications equipment	827,876	659,555	46.84%	62,406	44,851	17,555	36,795	54,350
Total	46,599,059	43,952,502	95.42%	6,074,293	6,384,412	-310,119	3,904,408	3,594,289

Notes:

(1) the remaining fixed asset categories were excluded from this exercise: capital spares (£7,557,664k) are managed as part of the Department's stock inventory and are subject to separate arrangements for quinquennial revaluation; Assets in the Course of Construction (£13,984,112k) are not subject to quinquennial revaluation.

(2) Some assets had already been revalued in 2001-2002 and were excluded from the current exercise.

19 Some 95.4 per cent of the eligible asset base was revalued. The Department has identified a variety of reasons for the non valuation of the remaining 4.6 percent. In many cases the assets had been purchased within the last few years and were deemed to have up to date values and a number of assets due for disposal were excluded from the exercise. However some assets were omitted from the review in error. The Department has estimated that some £400 million or 1 per cent fall into this category.

20 Note 18 to the 2002-2003 Resource Accounts summarises the effects of the quinquennial revaluation on the reserves. Due to system constraints within certain departmental fixed asset registers the Department cannot roll forward the revaluation reserve that existed for individual land and building assets prior to the quinquennial revaluation. The Department is reviewing the future accounting treatment for this element of the revaluation reserve.

21 The Department has undertaken a detailed review of the quinquennial revaluation process to identify what worked well and improvements that might be made to the process in future. The Department made extensive use of workshops to communicate and discuss key decisions and issues and to monitor progress. And the Department kept my staff fully informed of plans, methodologies and progress. However the Department considered that the next quinquennial revaluation process should be subject to more formal project management disciplines which will improve strategic direction, support and approval from senior managers and clarify the policy roles of the teams involved. It has also determined that quinquennial revaluation should become embedded into the routine financial management process and a key change to underpin this is the proposal to move to a rolling programme of professional revaluations. The Department considers this to be more manageable and practical while still ensuring the requirements of the *Resource Accounting Manual* are met. The Department is currently consulting with my staff on future arrangements.

The Department has reported some £630 million net additional resource costs were incurred on operations in Iraq during 2002-03

22 Note 27 to the Resource Accounts summarises the financial impact of operation TELIC during 2002-2003. TELIC is the UK name for military operations in Iraq. This is the first major conflict where the Department has accounted for a military operation on a resource basis and this has generated a number of issues not encountered in previous operations managed under a cash accounting regime. In early 2003 the Department received some £600 million resources and £400 million capital from the Treasury for the net additional costs of preparing for operation TELIC. The funding excludes wages and salaries of armed forces and civilian personnel as these would have been incurred anyway and the costs of training and exercises which have been cancelled because of the operational commitment are excluded. After several months of preparation, hostilities commenced on 20 March 2003 some eleven days before the end of the financial year.

23 A particular accounting issue for the Department has been to determine the correct level of stock consumption to report in the 2002-2003 resource accounts. The stock accounting systems generate consumption transactions for stock and ammunition when the materiel is issued to frontline units even though it may be stored locally for some time before use. This is because accounting transactions cannot be generated automatically by systems, some of which are manual, after a certain point in the supply chain. This can result in an overstatement of stock consumption particularly during a period of build up of stock levels at the front line. The Department recognised the need for greater visibility of stock movements in its report *Operations in Iraq – First Reflections*[3] and concluded it needs a common robust tracking system to enable equipment and stock to be tracked throughout the supply chain in fast-moving complex operations. Other accounting issues include:

[3] Ministry of Defence July 2003

- the loss or impairment of fighting and other equipments which have to be recognised in the correct accounting period on an accruals basis;
- assets acquired quickly to support operations need to be brought to account correctly;
- the Department's chart of accounts is not designed to record automatically the cost of individual operations.

24 The Department therefore undertook a specific review to examine the financial impact of these issues and determine the correct additional resource costs of operation TELIC attributable to the 2002-2003 account. This involved a detailed examination of available accounting and inventory information including records held locally in Iraq. My staff have reviewed the Department's estimates of the cost of operation TELIC up to 31 March 2003 in particular estimates for stock consumption and impairment of fixed assets and concluded that they are robust. Some of the remaining stock and fixed assets sent to Iraq are still in use there for peacekeeping purposes. Until all unused stock and fixed assets are returned to the United Kingdom the Department will be unable to make a comprehensive assessment of stock consumption and the level of asset impairment in order to determine the full cost of operation TELIC since 1 April 2003.

Section 3: Are the Department's Resource Accounts for 2002-2003 true and fair?

25 My certificate on pages 75 and 76 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 one of the issues that led me to qualify my opinion on the 2001-2002 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 2002-2003 Resource Accounts I have qualified my audit opinion because I am unable to confirm whether certain charges to the operating cost statement in respect of stock and capital spares managed by the Department's Defence Logistics Organisation are correctly recorded.

Some stock and fixed asset accounting transactions generated by the Defence Logistics Organisation's Air environment may not be correctly recorded

26 In my Report on the 2001-2002 accounts I noted the problems the Department had with existing stock inventory systems which were not designed to provide stock accounting data for accruals based financial accounts. While progress has been and continues to be made, 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.

27 In the 2002-2003 accounts this autobalance procedure generated a net credit to the operating cost statement of some £1,128 million. In the previous year it had generated a credit of £340 million. During 2002-2003 the gross monthly postings varied between a £114 million credit and £117 million charge for consumable stock and a £763 million credit and a £262 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 both the definition of quantity and the unit price are changed simultaneously in the stock management system. This software programme error is being rectified. 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. The Defence Logistics Organisation has improved the transaction mapping from the inventory system through the accounting system in this regard.

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 and has mapped many of the transactions and re-programmed the software where required. However the effect of this cannot be measured until the following accounting period. The Defence Logistics Organisation has undertaken a detailed review of each source of the autobalance and its potential financial impact. It considers that the problem will become more manageable by October 2003. After the first five months of 2003-2004 the autobalance mechanism has generated a net charge to the operating cost statement of some £72 million. The gross monthly postings varied between a £8 million credit and £9 million charge for consumable stock and a £225 million credit and a £201 million charge for capital spares.

Section 4: The Department has reported significant losses and special payments

30 The Department's expenditure programmes are subject to many changes in requirements because of advances in weapons technology; changes in threat and the pace and scale of changes in organisational structures. These changes can result in the Department having to abandon procurement or development projects before the equipments are introduced into service or write off the value of assets no longer required. In my Report on the 2000-2001 Accounts[4] I noted the impact of these factors on specific equipment programmes.

31 The Treasury gives departments delegated authority to write off such expenditure as a loss or special payment after careful appraisal of all the facts, but requires departments to bring them to Parliament's attention at the earliest opportunity. Nevertheless, investigation of the circumstances can take some time. Where final details cannot be reported this may be noted as an advisory loss in departmental resource accounts.

32 Note 29 of the Department's Resource Accounts for 2002-2003 discloses losses, special payments and gifts. In summary the Department has reported total losses of £131 million (12,765 cases) and total special payments of £129 million (1,327 cases) written off during the year. The Department has also identified some £1,015 million losses incurred in previous years and not previously reported as well as a number of potential losses which have not yet been quantified fully. I highlight below some of the more significant cases recorded in the Note.

The Department has incurred significant constructive losses

33 HM Treasury's *Government Accounting* defines a constructive loss as one where, for example, services are correctly ordered, delivered or provided, and are paid for as being in conformity with the order, but which owing to a change of policy or similar reason prove not to be needed or to be less useful than when the order was placed.

[4] MOD: Departmental Resource Accounts 2000-2001 HC 434 Session 2000-2001: 18 December 2001

Joint Tactical Information Distribution System Sea Harrier

34 Joint Tactical Information Distribution System (JTIDS) is a secure electronic countermeasure resistant high capacity, tactical datalink system. It provides digital and voice communication and accurate relative navigation capabilities to air, land and maritime tactical operations using the Link 16 message standard. It is currently in service with the Royal Air Force and other NATO forces and was to be fitted to naval ships and aircraft, one of which is Sea Harrier.

35 The project comprised an upgrade to the Sea Harrier's radar, the supply of JTIDS terminals and the integration of the JTIDS equipment with the aircraft's existing avionics systems. I reported last year[5] on the Department's decision in February 2002 to withdraw the Sea Harrier from service by 31 March 2006, earlier than planned. In light of this decision the Department terminated the development and production contracts of JTIDS incurring a constructive loss of some £77.7 million.

The Department has reported other significant losses

JP233 anti personnel landmines

36 The United Kingdom announced a complete ban on the use of anti-personnel mines by UK troops in May 1997 and became one of the first nations to sign the Ottawa Convention in December the same year. The UK was then one of the first forty countries to ratify the Convention on 31 July 1998 committing to the withdrawal and destruction of all British Forces antipersonnel land mines by 2003. The £985 million loss represents the full cost of the JP233 land mines as well as the decommissioning costs.

The Department has given advance notification of significant losses

37 HM Treasury's *Government Accounting* requires that losses and special payments should be brought to the attention of Parliament at the earliest opportunity. Notification is separate from the accounting treatment, which will depend on the nature of the loss or special payment. A loss should be noted in the accounts even if it may be reduced by subsequent recoveries. The Department has provided advance notification for the following significant losses.

Defence Stores Management Solution

38 Following its formation the Defence Logistics Organisation initiated a comprehensive business change programme to underpin the Strategic Defence Review[6] goal of achieving lower support costs through asset reductions to fund enhancements to military capability. The Defence Stores Management Solution was one of a number of projects in the Defence Logistics Organisation's business change programme. The Defence Stores Management Solution was intended to provide a single common inventory across the Defence Logistics Organisation, which would enable more accurate tailoring of stock holdings to the real level of demand. The existing inventory systems were not capable of making intelligent predictions of future usage nor were they capable of tracking materiel in the industrial repair loop. They shared no common language, were complex and not linked adequately with either the purchasing or accounting functions.

[5] MOD: Departmental Resource Accounts 2001-2002 HC 47 Session 2002-2003: 21 November 2002.

[6] Strategic Defence Review Cm 3999 July 1998

39 The Department had found that traditional bespoke systems could be expensive to design and build and were difficult to maintain and upgrade over time. In October 1999 the Defence Logistics Organisation examined a range of potential commercial off the shelf packages for the Defence Stores Management Solution and selected the Indus PassPort software package. It was intended that as an off the shelf package, enhancements would be minimal and be incorporated into the standard package by the supplier which the Department would fund. Following testing to compare the software functionality to departmental logistic processes, the project team identified essential changes to the software package to meet the Defence Stores Management Solution requirement.

40 In June 2000 the Department's Investment Approvals Board approved a budget of £133.6 million for the development and production of the Defence Stores Management Solution. The through-life 10 year cost estimate for the project was £605m and the target date for initial implementation was October 2002. Funding for the project was not taken into the core defence programme during the Department's annual planning round in autumn 2000. The then Chief of Defence Logistics therefore undertook in April 2001 to find the necessary resources from within the Defence Logistics Organisation's current funding on the assumption that future costs would be reduced through efficiencies. In October 2001 the target date for initial operating capability was revised to December 2003 because of budget constraints. And in December 2001, to reduce costs further, the scope of the project was reduced to be initially a replacement for the Air environment inventory system which as the oldest of the legacy inventory systems was considered to be increasingly difficult to support.

41 In November 2001, serious doubts were emerging in the Defence Logistics Organisation's Executive Board about the technical validity of the single all-encompassing application adopted for the Defence Stores Management Solution and about whether the levels of benefit which it would offer were sufficient to merit proceeding. Subsequently, in the Department's annual planning round, following the substantial savings actions that had been necessary that autumn to allow the Defence Logistics Organisation (and Department) to remain within budget, it was concluded that, unlike the previous year, the Business Change Programme (and within it the Defence Stores Management Solution) should be put on a formal funding basis. The Defence Management Board considered four alternatives for the funding of components of the Business Change Programme. In the event, it concluded that the Defence Stores Management Solution did not command sufficient priority pending the outcome of the 2002 Spending Review. As a result of these factors, the Defence Logistics Organisation's own senior management board suspended the Defence Stores Management Solution project. Contracts with suppliers were then terminated and settled. Total accrued expenditure on the Defence Stores Management Solution project was some £130.5 million.

42 The Department commissioned a post project evaluation review at the end of 2002 into the reasons for the suspension of the Defence Stores Management Solution project and what remedial measures should be put in place to ensure that such failures did not recur in future. The review concluded more widely that there were a number of weaknesses in the management of the Business Change Programme at the time within the Defence Logistics Organisation and in its supervision by the Department.

43 In particular the post project evaluation review found that there were weaknesses in Department level change management. The change initiatives affecting the Defence Logistics Organisation were highly challenging and potentially clashing. But at Department level there was no framework within which the impact of major change initiatives could be tested for deliverability and managed once launched; nor for providing support and challenge services to change managers to ensure their programmes remained on track and deliverable.

44 The post project evaluation review also identified weaknesses in strategic change management inside the Defence Logistics Organisation. Its Business Change Programme was constructed in an environment of significant strategic change. But the Defence Logistics Organisation had ineffective arrangements for strategic change management. This was seen in significant changes in the governance of the Business Change Programme during its lifetime; and key weaknesses in the mechanisms put in place for strategic programme support and co-ordination.

45 There were weaknesses in the programme management of the Business Change Programme itself. The Department's post project evaluation review identified poor financial governance; weak benefits management; poor communications; risks materialising that need not have done so had they been identified at the outset and managed appropriately; and failure to establish an effective programme management organisation.

46 The Department's review also noted weaknesses in the scrutiny and approvals process. Although the Business Change Programme projects including the Defence Stores Management Solution did not meet the Department's Investment Approvals Board standing requirements in important areas acting as key tests of project viability – especially on affordability and benefits management – the projects were not rejected.

47 The Department has already put in place a number of initiatives to address the weaknesses identified from the post project evaluation review. At the beginning of 2002 the Department determined it should introduce a tighter top-level control process for the delivery of change across the Department. It created an integrated 'Defence Change Programme' for the whole Department covering all major initiatives to ensure that they are deliverable and are effectively managed and supported. The programme is overseen by the Change Delivery Board chaired by the second Permanent Under Secretary. Under these new arrangements the Defence Logistics Organisation's Business Change Programme has been revised to provide greater focus on accountability, deliverability and benefits management. Governance and peer reviews will be conducted at all stages of a project lifecycle. A peer review plan will be developed by the senior responsible officer and form a key part of any investment appraisal submission.

48 The Department has estimated that some £130.5 million was incurred in the development of the Defence Stores Management Solution. Following the suspension of the project, the Investment Approvals Board approved retention of those elements of the project identified as being of future value to the Department. These are in the main computer hardware and are valued at some £12.2 million. The remaining £118.3 million has been noted as a loss and comprises £77.9 m capital expenditure written off in 2002-2003 and £40.5 million revenue expenditure charged to the accounts in 2000-2001 and 2001-2002.

Nuclear submarine facilities at Devonport

49 In 1997 the Department contracted Devonport Management Limited (now known as Devonport Royal Dockyard Ltd) to design and build new and upgraded facilities (known collectively as D154) for the refitting and refuelling of the Royal Navy's submarines, including the Vanguard class submarines which provide the United Kingdom's nuclear deterrent through the Trident missile system. The main elements of the project are expected to be completed in 2004. In 1997 the Department obtained Treasury approval for funding of £650 million and estimated the project's most likely costs would be £576 million. Total project costs are now estimated to be £933 million of which the Department will pay £890 million to the contractor some £314 million more than the budgeted cost. I examined this construction project and the reasons for cost overruns in my Report[7] last year.

[7] The construction of nuclear submarine facilities at Devonport HC90 Session 2002-03: 6 December 2002

50 The facilities are not an asset of the Department although the Department has recorded its investment in the facility through the contractor as a prepayment in the Resource Accounts. In this way it recognises the construction cost of upgrading the facilities as a deferred benefit of receiving reduced service charges for the refit activity work undertaken by the contractor.

51 The Department has recently re-assessed the use it will make of this facility. The refitting and refuelling cycle has been extended and the number of Fleet submarines reduced. In addition the repair time for the new Astute class is expected to be less than for the current Fleet submarines and there is a degree of uncertainty over the number of refits the Vanguard class submarines will require. On this basis the Department determined the level of facility it would now construct and estimated the costs of this to be some £287 million less than the current value. This has been written off in the 2002-2003 Resource Accounts and noted as a loss.

Section 5: Ministry of Defence – Votes

52 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 32 to the Accounts shows that the maximum numbers maintained during 2002-2003 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
Comptroller and Auditor General
29 October 2003

National Audit Office
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London SW1W 9SP

Schedule 1

Summary of Resource Outturn

for the year ended 31 March 2003

	Estimate			Outturn			Net Total 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	43,842,478	1,695,949	42,146,529	41,180,611	1,449,767	39,730,844	2,415,685
Request for resources 2	1,155,834	–	1,155,834	1,117,429	–	1,117,429	38,405
Request for resources 3	1,186,720	–	1,186,720	1,165,411	–	1,165,411	21,309
Total resources	46,185,032	1,695,949	44,489,083	43,463,451	1,449,767	42,013,684	2,475,399
Non operating cost A-in-A			494,670			373,756	120,914
Net cash requirement			28,302,972			26,991,365	1,311,607

Outturn in Respect of Prior Year
The corresponding figures for 2001-02 outturn were as follows:

Total Resources (Restated)	33,518,671
Non operating cost A-in-A	336,533
Net cash requirement (Restated)	26,099,592

Reconciliation of resources to cash requirement

	Note	Estimate £000	Outturn £000	Savings/ (Excess) £000
Net total resources	Sch 2	44,489,083	42,013,684	2,475,399
Capital:				
*Purchase of fixed assets:				
– RfR 1	7/8	6,251,336	6,169,637	81,699
– RfR 2	7/8	523,852	318,690	205,162
– RfR 1 Capitalised provisions			(10,061)	10,061
New loans to the Trading Funds	9	15,000	34,200	(19,200)
Non operating cost A-in-A:				
Net book value of fixed assets disposed	7/8/3	(433,022)	(360,555)	(72,467)
Net book value of investments disposed	9		(47,824)	47,824
Part proceeds of disposal of certain fixed assets payable to Consolidated Fund			44,300	(44,300)
Repayment of loans made to the Trading Funds and QinetiQ after deducting loan repayments treated as CFERs amounting to £49,900,000 shown against outturn	9	(61,648)	(9,677)	(51,971)

The notes on pages 97 to 141 form part of these financial statements.

	Note	Estimate £000		Outturn £000	Savings/ (Excess) £000
***Repayment of Loans from the National Loans Fund**	Sch 4			1,426	(1,426)
		50,784,601		48,153,820	2,630,781
Accruals adjustments:					
Non-cash transactions-Included in operating costs	Sch 4			(15,715,065)	
Surplus arising on disposal of fixed assets	Sch 4			(36,863)	
Revaluation reserve released on disposal of fixed assets	3			1,041	
Included in net interest payable	5			(247,703)	
Capitalised provisions shown above				10,061	
		(17,940,817)		(15,988,529)	
Cost of capital charge	17	(5,289,218)		(5,074,726)	
		(23,230,035)		(21,063,255)	(2,166,780)
*Changes in working capital other than cash	Sch 4	336,569		(347,359)	683,928
*Use of provisions for liabilities and charges	16	411,837		395,323	16,514
Adjustment for movements on cash balances in respect of collaborative projects	13	–		(6,000)	6,000
Working capital movements in respect of Machinery of Government changes during the year				305	(305)
Adjustment for a prior year item included in net resource outturn	26	–		(141,469)	141,469
Net cash requirement	Sch 4	**28,302,972**		**26,991,365**	**1,311,607**

* 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)

In respect of Request for Resources 1, the underspend of £2,416 million against Estimate relates mainly to a series of decisions taken late in the year reflecting the Departmental impact of the Quinquennial Revaluation of Fixed Assets (see Note 8.4); amended Fixed Asset lives affecting the results of the Commander-in-Chief Fleet; not writing off Spearfish Torpedoes, Fixed Asset reclassifications affecting the Chief of Defence Logistics; along with a range of other smaller provision movements. In Note 27, the underspend 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 shortfalls and excesses shown against some of the TLB Holders. These offset each other, with no material impact on the Department's Total Resources.

There was an underspend on Request for Resources 2 of £38 million. Analysis of costs by operations conducted during the year is shown in Note 27.

The notes on pages 97 to 141 form part of these financial statements.

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

The variation of Net Cash Requirement against Estimate of £1,312 million is mainly attributable to a reduction in operating costs after offsetting non-cash transactions, movements in working capital and lower capital expenditure.

Prior-period adjustments

The prior year's figure for the total resource outturn has been increased by £1,237,056,000 in respect of War Pensions and Allowances. The responsibility for the payment of these costs was taken over by the Department as part of Machinery of Government changes with effect from 1 April 2002. The opening Balance Sheet was adjusted, in accordance with Note 26, to reflect liabilities in respect of a number of overseas pension schemes.

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).

	2002-03 Forecast		2002-03 Outturn	
	Income £000	*Receipts £000*	Income £000	*Receipts £000*
Operating income and receipts – excess A-in-A	–	–	–	–
Non operating income and receipts – excess A-in-A	–	–	–	–
Subtotal	–	–	–	–
Other operating income and receipts not classified as A-in-A	–	–	39,197	*39,197*
Other non-operating income and receipts not classified as A-in-A	–	–	39,427	*39,427*
Other amounts collectable on behalf of the Consolidated Fund	–	–	–	–
	–	–	78,624	*78,624*

The table above does not include loans repaid by QinetiQ amounting to £49,900,000 and an amount of £44,300,000 in respect of sale of certain fixed assets which are repayable to the Consolidated Fund at the year end. Other non-operating income and receipts not classified as A-in-A shown above represents proceeds on part sale of QinetiQ amounting to £39,427,365.

Notes:

i. Actual Outturn – resources.

Request for resources 1: Provision of Defence Capability.

Actual amount net resources outturn £39,730,844,789.26. Actual amount of savings in resources over Estimate £2,415,684,210.74.

ii. Request for resources 2: Conflict prevention.

Actual amount net resources outturn £1,117,429,000.00. Actual amount of savings in resources over Estimate £38,405,000.00.

iii. Request for resources 3: War Pensions and Allowances, etc.

Actual amount net resources outturn £1,165,411,117.31. Actual amount of savings in resources over Estimate £21,308,882.69.

The notes on pages 97 to 141 form part of these financial statements.

iv. Actual Outturn – cash.

Net cash requirement: Outturn net requirement was £26,991,365,062.76.

v. The amount surrenderable to the Consolidated Fund was £279,692,811.63. An amount of £39,664,440.67 was recoverable from Consolidated Fund in respect of prior year.

The notes on pages 97 to 141 form part of these financial statements.

Schedule 2

Operating Cost Statement

for the year ended 31 March 2003

	Note	2002-03 £000	Restated (Note 26) 2001-02 £000
Staff costs	2	9,969,242	9,456,121
Other operating costs	3	27,840,791	19,860,595
Gross operating costs		**37,810,033**	29,316,716
Operating income	4	(1,357,700)	(1,195,682)
Net operating cost before interest		**36,452,333**	28,121,034
Net interest payable	5	266,532	229,820
Cost of capital charge	17	5,074,726	5,124,775
Net operating cost		**41,793,591**	33,475,629
Net resource outturn	6	**42,013,684**	33,518,671

Statement of Recognised Gains and Losses

for the year ended 31 March 2003

	Note	2002-03 £000	2001-02 £000
Net (gain) on revaluation of fixed assets and stocks	18	(4,463,447)	(1,955,801)
Receipts of donated assets and (gain) on revaluation	18	(521,653)	(38,799)
Prior year adjustments	26	152,917	(960,962)
Surplus generated on formation of QinetiQ and Defence Science and Technology Laboratory (DSTL) and disestablishment of the Defence Evaluation and Research Agency (DERA).	17	–	(297,066)
Recognised (gains) during the year		**(4,832,183)**	(3,252,628)

The results shown above are in respect of continuing activity.

The notes on pages 97 to 141 form part of these financial statements.

Schedule 3

Balance Sheet

as at 31 March 2003

	Note	31 March 2003		Restated (Note 26) 31 March 2002	
		£000	£000	£000	£000
Fixed Assets					
Intangible assets	7	19,437,608		19,527,222	
Tangible fixed assets	8	66,444,536		68,140,835	
Investments	9	429,678		671,046	
			86,311,822		88,339,103
Current Assets					
Stocks and work-in-progress	11	5,337,125		6,396,304	
Debtors	12	2,201,652		1,257,241	
Cash at bank and in hand	13	415,928		631,681	
		7,954,705		8,285,226	
Creditors: amounts falling due within one year	14	5,383,850		4,662,209	
Net current assets			2,570,855		3,623,017
Total assets less current liabilities			88,882,677		91,962,120
Creditors: amounts falling due after more than one year	15	450,333		448,381	
Provisions for liabilities and charges	16	6,994,227		5,112,417	
			7,444,560		5,560,798
Net assets			**81,438,117**		86,401,322
Taxpayers' equity					
General fund	17		65,445,156		74,504,706
Revaluation reserve	18		14,181,634		10,549,019
Donated assets reserve	18		1,811,327		1,347,597
			81,438,117		86,401,322

Kevin Tebbit
Accounting Officer
22 October 2003

The notes on pages 97 to 141 form part of these financial statements.

Schedule 4

Cash Flow Statement

For the year ended 31 March 2003

	Note	2002-03 £000	Restated (Note 26) 2001-02 £000
Net cash outflow from operating activities before interest	A	**21,165,066**	21,007,490
Returns on investments and servicing of finance	B	**4,363**	(4,887)
Net capital expenditure and financial investment	C	**5,647,360**	5,088,289
Payments to the Consolidated Fund		**533,726**	147,843
Financing from the Consolidated Fund (supply)	13	**(27,136,321)**	(26,568,984)
Repayment of loans from the National Loans Fund		**1,559**	1,343
(Increase)/decrease in cash at bank and in hand	13	**215,753**	(328,906)
Notes to the cash flow statement:			
A. Net cash outflow from operating activities before interest			
Net operating cost before interest	Sch 2	36,452,333	28,121,034
Non-cash transactions:			
– Depreciation and amortisation charges	3	(6,981,455)	(6,120,520)
– Impairment in value of fixed assets	3	(5,388,224)	(1,249,948)
– Provisions to reduce value of stock to its net realisable value	3	(111,125)	(439,186)
– Stocks written-off – net (Note 1)	3	(321,811)	–
– Auditors' remuneration	3	(3,405)	(4,170)
– Surplus/(deficit) arising on disposal of tangible fixed assets	3	45,260	39,179
– Surplus/(deficit) arising on disposal of investments	3	(8,397)	–
– Fixed Assets written off – net	3	(101,604)	(74,923)
– Fixed Asset investment written off	3	(219,886)	–
– Capital project expenditure written off	3	(584,928)	–
– Movement in provisions for liabilities and charges (excluding capitalised provisions)	16	(2,039,490)	(526,150)
		(15,715,065)	(8,375,718)
Dividends received from Trading Fund	4	8,587	7,431
Adjustments for movements in working capital other than cash (Note 2)			
– Increase/(decrease) in stocks/WIP		(26,645)	140,505
– Increase/(decrease) in debtors		540,276	248,057
– (Increase)/decrease in creditors		(507,279)	601,003
		6,352	989,565
Paid against provisions for liabilities and charges		412,859	265,178
		21,165,066	21,007,490
B. Returns on investments and servicing of finance			
Dividends received from Trading Fund	4	(8,587)	(7,431)
Interest received		(21,704)	(10,785)
Interest paid		282,357	245,965
Deduct: Unwinding of discount on provisions for liabilities and charges	5	(247,703)	(232,636)
		34,654	13,329
		4,363	(4,887)

Schedule 4 continued to next page.

The notes on pages 97 to 141 form part of these financial statements.

	Note	2002-03 £000	Restated (Note 26) 2001-02 £000
C. Analysis of capital expenditure and financial investment			
Acquisition of fixed assets		6,116,938	5,428,113
Proceeds on disposal of tangible fixed assets		(404,774)	(287,923)
Proceeds on disposal of investments		(39,427)	–
		5,672,737	5,140,190
Repayment of loans made to the Trading Funds and QinetiQ	9	(59,577)	(59,501)
Loans made to Trading Funds	9	34,200	7,600
		5,647,360	5,088,289
Analysis of Financing			
Parliamentary Funding from the Consolidated Fund (Supply)	13	27,136,321	26,568,984
(Increase)/decrease in cash at bank and in hand during the year	13	215,753	(328,906)
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		90,437	69,430
Consolidated Fund Extra Receipts received in prior year paid over		(69,430)	(4,323)
Part proceeds of certain fixed assets payable to Consolidated Fund		44,300	–
Grant drawn in the previous year and not spent, repaid to the Consolidated Fund during the year		(420,321)	(71,910)
Repayment of loan to Qinetiq repaid to Consolidated Fund		–	(46,429)
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 –2001		–	(59,542)
Adjustment for movements on cash balances in respect of collaborative projects		(6,000)	–
Adjustment for Machinery of Government change during the year		305	–
Net cash requirement	Sch 1	**26,991,365**	26,099,592

Amount of grant actually issued to support the net cash requirement = £27,136,320,807.65.

Note 1: In 2001-02, stock write off (£215,072,000) and capital project expenditure written off (£12,537,000) were adjusted against the working capital movements.

Note 2: The movements shown above exclude assets and liabilities at 31 March 2002 in respect of ABRO which was established as a Trading Fund at 1 April 2002, and which is outside the Departmental Boundary.

	£000	£000
Fixed Assets		44,381
Stock	20,912	
Creditors	(666)	
		20,246
		64,627

The notes on pages 97 to 141 form part of these financial statements.

Schedule 5

Resources By Departmental Aim And Objectives

for the year ended 31 March 2003.

Aim

The principal activity of the Department is to deliver security for the people of the United Kingdom and the Overseas Territories by defending them, including against terrorism; and to act as a force for good by strengthening international peace and stability.

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

	2002-03			Restated (Note 26) 2001-02		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
Objective 1: Achieving success in the tasks we undertake	**3,752,347**	**(277,683)**	**3,474,664**	2,844,126	(222,989)	2,621,137
Objective 2: Being ready to respond to the tasks that might arise	**34,711,064**	**(1,016,998)**	**33,694,066**	27,511,370	(927,054)	26,584,316
Objective 3: Building for the future	**3,487,027**	**(60,547)**	**3,426,480**	3,078,759	(45,639)	3,033,120
	41,950,438	**(1,355,228)**	**40,595,210**	33,434,255	(1,195,682)	32,238,573
Paying war pensions and allowances	**1,200,853**	**(2,472)**	**1,198,381**	1,237,056	–	1,237,056
Total	**43,151,291**	**(1,357,700)**	**41,793,591**	34,671,311	(1,195,682)	33,475,629

See additional details in Note 25.

The notes on pages 97 to 141 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 25 February 2003 and comply with the requirements of HM Treasury's Resource Accounting Manual (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.
- The Department's fixed assets are not analysed using the categories set out in the RAM. The different categorisation of the fixed assets became effective from the year 2002-03, but dispensation from this new requirement has been granted by HM Treasury until 2004-05.

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 31.

1.4 Five 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 Department's interest in QinetiQ, a Self-Financing Public Corporation, is included in the financial statements as a fixed asset investment. At 31 March 2002, the interest was in QinetiQ Group plc.

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 in accordance with the Financial Reporting Standards (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)
- Fighting Equipment (one index for each of the three Sea, Air and Land systems)
- Plant, Machinery and Vehicles – Motor Vehicles and Trailers
- Plant, Machinery and Vehicles – Other Transport Equipment
- Plant, Machinery and Vehicles – Machinery and Equipment
- 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 (ACOC) 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 charge. 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.

Intangible Assets

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

1.15 Development costs are capitalised where they contribute towards defining the specification of an asset that will enter production. Development costs not capitalised are charged to Other Operating Costs. 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 the whole or a significant part of an asset type early, then a corresponding proportion of any remaining unamortised development costs are written off to the Operating Cost Statement along with the underlying tangible fixed assets. For the purposes of development costs, a significant withdrawal of assets is deemed to be 20% or greater of the total of the asset class.

Tangible Fixed Assets

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

1.17 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 Buildings, permanent Buildings, temporary Leasehold	Indefinite, not depreciated Useful economic life 5 – 20 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 Specialised Vehicles (includes non-fighting vessels and aircraft) Other standard vehicles	5 – 15 Useful economic life 3 – 5
IT and Communications Equipment	Computers Satellites Communications Equipment	3 – 7 Useful economic life Useful economic life
Operational Heritage Assets*		As other tangible fixed assets
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

1.18 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.

1.19 A donated assets reserve represents the value of the original donation, additions, any subsequent professional revaluation and indexation (MHCA) or a professional valuation. Amounts equal to the donated asset depreciation charge, impairment costs and deficit/surplus on disposal arising during the year, are released from this reserve to the Operating Cost Statement.

Impairment

1.20 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. Impairment also includes the cost of capital spares that are embodied into a fixed asset, as part of a major refit and overhaul, but which cannot be capitalised in accordance with FRS 15. 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

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

1.22 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.

1.23 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.

1.24 Disposals exclude fixed assets written off and written on. These items are included within Other Movements in Notes 7 and 8.

Leased Assets

1.25 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.

Private Finance Initiative (PFI) Transactions

1.26 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 FRS 5 and Treasury Guidance.

Investments

1.27 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 the 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.

1.28 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

1.29 Stock is valued at current replacement cost, or historical cost if not materially different. Provision is made to reduce cost to net realisable value (NRV) where there is no expectation of consumption or sale in the ordinary course of the business. Stock provision is released to the operating costs on consumption, disposal and write-off.

1.30 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.

1.31 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.

1.32 Stocks written-off, included within other operating costs, represents the book value of stock which has been scrapped, destroyed or lost during the year, and adjustments to agree the book values with the figures shown on the supply systems.

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 was 6% for the financial year 2002-03. 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.

Pensions

1.37 Present and past employees are mainly covered by the CSP arrangements for civilian personnel and the AFPS for Service personnel. There are separate scheme statements for the AFPS and CSP 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 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 if they are members of Classic and 3.5% if they are members of Premium. 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.

1.40 The Department operates a number of small pension schemes for civilians engaged at overseas locations. These schemes have been accounted for in accordance with the application of SSAP 24 – *Accounting for Pension Costs*, as set out in the HM Treasury RAM. With effect from 1 April 2003 they will be accounted for in accordance with FRS 17 – *Retirement Benefits* once that standard fully replaces SSAP 24.

1.41 The disclosures required under FRS 17 are included in Note 2.4

Early Departure Costs

1.42 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 CSP arrangements for civilian personnel.

1.43 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

1.44 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 for financial year 2002-03 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.

1.45 The cost of capital charge on the fixed asset investments in the Trading Funds and in the Self Financing Public Corporation is calculated at a specific rate applicable to those entities, and is based on their underlying net assets.

Foreign Exchange

1.46 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.

1.47 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.

2. Staff Numbers and Costs

2.1 The average number of whole-time equivalent persons employed during the year was: Service 211,453 (2001-02: 210,178) and Civilian 92,358 (2001-02: 94,399). [Source: Defence Analytical Services Agency]

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

	2002-03 £000	Restated 2001-02 £000
Salaries and Wages	7,819,361	7,495,685
Social Security costs	506,837	505,797
Pension costs (see Note 2.4)	1,357,703	1,305,099
Redundancy and severance payments	285,341	149,540
	9,969,242	9,456,121
Made up of:		
Service	7,385,185	7,014,144
Civilian	2,584,057	2,441,977
	9,969,242	9,456,121

2.3 For the year ended 31 March 2003 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 £55,118 pa with effect from 1 April 2002 (2001-02 £49,822 pa with effect from 1 April 2001 rising to £51,822 pa with effect from 20 June 2001), 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' Night Subsistence paid to The Lord Bach of Lutterworth was £27,133 in 2002-03 (£20,460 in 2001-02). (2001-02 £3,593 to The Right Honourable Baroness Symons of Vernham Dean). 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 2002-03 or the previous year.

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.

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 Account 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 were 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

Minister's private use of Official cars is exempt under the rules governing the definition of taxable benefits-in-kind. Mr Hoon was provided with living accommodation from 1 October 2002. The value of the benefit is calculated in accordance with the Inland Revenue regulations. No tax is charged on the living accommodation itself; a charge is made on the value of associated services, limited to 10% of the taxable Ministerial salary.

Figures for 2002-03 in bold, 2001-02 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 †	**49**	**65-70**	**0-2.5**	**5-10**	**3,500**	
	48	*60-65*	*0-2.5*	*0-5*	*Nil*	
Parlimentary Under Secretary of State and Minister of State for Defence Procurement:						
The Lord Bach of Lutterworth † **	**56**	**90-95**	**0-2.5**	**5-10**	**Nil**	
	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*
Minister of State for the Armed Forces:						
The Right Honourable Adam Ingram JP,MP †	**56**	**35-40**	**0-2.5**	**0-5**	**Nil**	
	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*
Parliamentary Under Secretary of State for Defence and Minister for Veterans:						
Dr Lewis Moonie, MP †	**56**	**25-30**	**0-2.5**	**0-5**	**Nil**	
	55	*25-30*	*0-2.5*	*0-5*	*Nil*	
Salary includes gross salary, performance pay and allowances paid.						

A. 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 2002-03 in bold, 2001-02 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	**56**	**150-155**	**4-4.5**	**60-65**	**29,200**	
	55	*135-140*	*3.5-4*	*55-60*	*26,100*	
Chief of the Defence Staff						
Admiral Sir Michael Boyce GCB OBE ADC	**59**	**175-180**	**11-11.5**	**85-90**	**25,400**	*CONSENT TO DISCLOSE WITHHELD LAST YEAR*
Vice Chief of the Defence Staff						
Air Chief Marshal Sir Anthony Bagnall KCB OBE ADC FRAeS RAF	**57**	**125-130**	**2-2.5**	**60-65**	**20,500**	
	56	*100-105*	*4-4.5*	*60-65*	*17,100*	1 June 01
Admiral Sir Peter Abbott GBE KCB	*60*	*20-25*	*(0.5-1)*	*55-60*	*3,400*	*31 May 01*
Second Permanent Under Secretary of State						
Mr Ian Andrews CBE TD	**49**	**115-120**	**8-8.5**	**35-40**	**29,500**	
	48	*5-10*	*3-3.5*	*25-30*	*Nil*	4 March 02

	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
Sir Roger Jackling KCB CBE	*58*	*105-110*	*3-3.5*	*45-50*	*21,400*	*5 Mar 02*
First Sea Lord and Chief of the Naval Staff Admiral Sir Alan West KCB DSC ADC	**54**	**65-70**	**2-2.5**	**60-65**	**12,100**	**17 Sep 02**
Admiral Sir Nigel Essenhigh GCB ADC	**58** *57*	**60-65** *120-125*	**1-1.5** *1-1.5*	**60-65** *60-65*	**10,400** *20,500*	***16 Sep 02***
Chief of the General Staff General Sir Mike Jackson KCB CBE DSO ADC Gen	**59**	**20-25**	**2-2.5**	**60-65**	**3,300**	**3 Feb 2003**
Chief of the General Staff General Sir Michael Walker GCB CMG CBE ADC Gen	**58** *57*	**105-110** *120-125*	**1.5-2** *1-1.5*	**60-65** *60-65*	**17,900** *20,500*	***2 Feb 2003***
Chief of the Air Staff Air Chief Marshal Sir Peter Squire GCB DFC AFC ADC FRAeS RAF	**57** *56*	**125-130** *120-125*	**2-2.5** *1-1.5*	**60-65** *60-65*	**22,500** *20,500*	
Chief of Defence Procurement Sir Robert Walmsley KCB FEng FIEE	**62** *61*	**130-135** *115-120*	**1-1.5** *1-1.5*	**5-10** *5-10*	**43,200** *31,800*	
Chief of Defence Logistics Air Chief Marshal Sir Malcolm Pledger KCB OBE AFC BSc FRAeS RAF	**54**	**65-70**	**13-13.5**	**60-65**	**Nil**	**2 Sep 2002**
Chief of Defence Logistics General Sir Sam Cowan KCB CBE ADC Gen	**61** *60*	**50-55** *120-125*	**0-0.5** *1-1.5*	**60-65** *60-65*	**Nil** *Nil*	***1 Sep 2002***
Chief Scientific Adviser Professor Sir Keith O'Nions FRS	**58** *57*	**135-140** *120-125*	**1-1.5** *1.5-2*	**35-40** *35-40*	**27,700** *19,700*	
Non-executive member of the DMB Charles Miller Smith (Chairman of Scottish Power)	**63**	**15-20** **Fees**				**29 May 02**
Non-executive member of the DMB Philippa Foster Back (Director of the Institute of Business Ethics)	**48**	**10-15** **Fees**				**10 July 02**

Salary includes gross salary, performance pay and allowances paid.

Benefits-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.

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

Pensions

2.4 The Civil Service Pension Scheme (CSP) 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 CSP 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 CSP accounts are also available on the web at www.civilservice-pensions.gov.uk.

For 2002-03, employers' contributions of £211,677,542 in respect of civilian staff were payable to the OPG (2001-02: £210,648,857) at one of the four rates in the range of 12 to18.5 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 CSP are to be reviewed every four years following a full scheme valuation by the Government Actuary.

For Service personnel, employers' contributions of £1,146,025,835 (2001-02: £1,094,449,935) were also made to the AFPS based on rates determined by the Government Actuary plus £4,842,554 (2001-02: £3,592,982) 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 2002-03 are included within the amount of £211,677,542 shown in Note 2.4 above.

3. Other Operating Costs

	2002-03 £000	Restated (Note 26) 2001-02 £000
Operating expenditure:		
– Fuel	184,665	159,980
– Stock consumption	1,222,151	1,293,656
– Surplus arising on disposal of stock (net)	(14,388)	(53,186)
– Provisions to reduce stocks to net realisable value	111,125	439,186
– Stocks written off – net of write-ons	321,811	215,072
– * Movements: includes personnel travelling, subsistence/relocation costs and movement of stores and equipment	505,272	718,262
– Utilities	223,048	234,492
– Property management	1,453,041	1,221,595
– Hospitality and entertainment	7,320	7,198
– Accommodation charges	320,557	338,239
– Equipment support costs	3,135,174	2,419,281
– (Decrease)/increase in nuclear and other decommissioning provisions (Note 16)	1,635,223	137,811
– IT and telecommunications	628,447	527,095
– Professional fees	468,201	559,169
– Other expenditure	1,870,940	1,738,584
– Research expenditure and expensed development expenditure	977,707	1,003,298
Depreciation and amortisation:		
– Intangible assets (Note 7)	1,256,067	1,015,592
– Tangible owned fixed assets (Note 8)	5,766,924	5,139,386
– Donated assets depreciation – release of reserve	(48,845)	(42,255)
– Tangible fixed assets held under finance leases (Note 8)	7,309	7,797
Impairment on fixed assets (Notes 7 & 8):		
– Quinquennial valuation	3,855,123	–
– Other	1,534,601	1,249,948
Impairment – donated assets release of reserve	(1,500)	–
(Surplus)/Deficit arising on disposal of tangible and intangible fixed assets:		
– Tangible and Intangible fixed assets	(44,219)	11,666
– Donated assets – release of reserve	(1,041)	(50,845)
– Loss on sale of shares in QinetiQ†	8,397	–
Fixed assets written off/(written on) – net	101,604	74,923
Write down of the value of investment in QinetiQ	219,886	–
Capital project expenditure written off	584,928	12,537
Bad debts written off	14,709	1,794
(Decrease)/increase in bad debts provision	(5,523)	1,827
Rentals paid under operating leases	311,003	199,023
Auditors' remuneration – audit work only	3,405	4,170
Grants-in-Aid	49,128	46,208
Exchange differences on foreign currencies: net deficit/(surplus)	12,276	(7,964)
War Pensions and Allowances	1,166,265	1,237,056
Total Other Operating Costs	**27,840,791**	19,860,595

* In 2002-03, civilian short-term detached duty costs, amounting to £236,797,000, were included in Other Expenditure; in prior years, these were included within movements.

† Loss on sale of shares in QinetiQ Holdings Limited to The Carlyle Group:

	£000
Value of shares sold	47,824
Net proceeds	39,427
Loss on sale	8,397

The net proceeds represent a proportion of the agreed debt and cash free enterprise value of the business. See Note 9 for details on loan repayments.

4. Operating Income

	2002-03 £000	2001-02 £000
External customers		
Rental Income – property	54,020	46,003
Other	1,115,777	970,795
Other Government Departments and Trading Funds		
Rental income – property	2,058	2,507
Dividends received from Trading Funds (Note 9)	8,587	7,431
Other	177,258	168,946
	1,357,700	**1,195,682**
Of which:		
Appropriations-in-Aid	1,334,286	1,176,897
CFER – Payable to the Consolidated Fund	23,414	18,785
	1,357,700	**1,195,682**
Appropriation-in-Aid shown on Schedule 1 is the lower of the amounts shown in the Estimate and the Outturn:		
Outturn:		
– Operating Income (see above)	1,334,286	1,176,897
– 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	44,112	42,132
– Profit on disposal of stock (net) (Note 3)	14,388	53,186
– Profit on disposal of tangible and intangible fixed assets (net) (Note 3)	45,260	39,179
– Foreign exchange gains	11,721	5,122
	1,449,767	**1,351,417**
Estimate:		
Appropriation-in-Aid as shown in the Spring Supplementary Estimate	1,695,949	1,308,607
Excess Appropriation-in-Aid payable to the Consolidated Fund as CFERs	**–**	42,810

5. Net Interest Payable

	2002-03 £000	2001-02 £000
Interest receivable:		
– Bank interest	(3,643)	(5,742)
– Loans to Trading Funds	(7,119)	(4,300)
– Loans to a Self Financing Public Corporation – QinetiQ	(5,054)	(6,719)
	(15,816)	(16,761)
Interest payable:		
– Bank interest	6	–
– Loan interest	3,612	3,693
– Unwinding of discount on provision for liabilities and charges (Note 16)	247,703	232,636
– Finance leases and PFI contracts	31,026	10,117
– Commercial debt	1	135
	282,348	246,581
Net interest payable	**266,532**	229,820

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

	2002-03 £000	Restated (Note 26) 2001-02 £000
Net operating cost (Schedule 2)	41,793,591	33,475,629
– Add income scored as Consolidated Fund Extra Receipts and included in operating income and interest	39,197	77,943
– Adjustment in respect of Machinery of Government changes	–	(34,901)
– Proceeds on part disposal of QinetiQ included in operating costs	39,427	–
– Prior year adjustment (Note 26)	141,469	–
Net resource outturn	**42,013,684**	33,518,671

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

	£000
Cost or Valuation	
At 1 April 2002	23,151,930
Additions	1,756,327
Disposals	(2,353)
Impairment	(39,724)
Revaluations	(147,096)
Other movements	(965,986)
At 31 March 2003	23,753,098
Amortisation	
At 1 April 2002	(3,624,708)
Charged in year	(1,256,067)
Impairment	20,990
Disposals	2,353
Revaluations	66,417
Other movements	475,525
At 31 March 2003	(4,315,490)
Net Book Value:	
At 31 March 2003	**19,437,608**
At 1 April 2002	19,527,222

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. Intangible assets include development expenditure in respect of fixed assets in use and assets in the course of construction where the first delivery into operational use of the asset type has taken place;

iii. Additions on intangible and tangible fixed assets (Note 8) include accruals amounting in total to £2,066,322,000 (2001-02: £1,690,228,000); and

iv. Other movements comprise reclassifications to tangible fixed assets and transfer to operating costs.

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 2002	16,861,829	43,595,115	6,491,507	1,587,909	18,005,193	13,984,112	100,525,665
Additions	95,870	42,171	45,189	95,886	467,232	3,985,652	4,732,000
Capitalised provisions	(10,061)	–	–	–	–	–	(10,061)
Donations	10,540	–	430	9,511	–	–	20,481
Impairment	(1,927,304)	(2,185,096)	(302,476)	(118,773)	(101,739)	(17,822)	(4,653,210)
Disposals	(267,559)	(48,564)	(45,831)	(6,413)	(1,031,008)	(75,536)	(1,474,911)
Revaluations	1,333,015	(875,149)	864,871	(274,262)	129,620	(2,113)	1,175,982
Other movements	(15,899)	1,522,301	(213,651)	(67,433)	1,478,514	(5,363,212)	(2,659,380)
At 31 March 2003	16,080,431	42,050,778	6,840,039	1,226,425	18,947,812	12,511,081	97,656,566
Depreciation							
At 1 April 2002	(2,513,754)	(16,314,230)	(2,349,284)	(760,033)	(10,447,529)	–	(32,384,830)
Charged in year	(610,574)	(2,835,481)	(441,859)	(184,117)	(1,702,201)	–	(5,774,232)
Impairment	24,247	(336,943)	101,446	8,744	(515,274)	–	(717,780)
Disposals	33,237	8,967	36,366	4,697	1,031,089	–	1,114,356
Revaluations	1,379,458	2,276,427	(189,046)	360,621	(71,536)	–	3,755,924
Other movements	949,291	1,677,377	298,281	157,442	(287,859)	–	2,794,532
At 31 March 2003	(738,095)	(15,523,883)	(2,544,096)	(412,646)	(11,993,310)	–	(31,212,030)
Net Book Value:							
At 31 March 2003	**15,342,336**	**26,526,895**	**4,295,943**	**813,779**	**6,954,502**	**12,511,081**	**66,444,536**
At 1 April 2002	14,348,075	27,280,885	4,142,223	827,876	7,557,664	13,984,112	68,140,835

Note:

i. Additions on intangible assets (Note 7) and tangible fixed assets include accruals amounting in total to £2,066,322,000 (2001-02: £1,690,228,000);

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; and

iii. Fixed Assets as at 31 March 2003 include capitalised provisions at cost of £321,000,000.

8.1 The net book value of tangible fixed assets by each major class of asset includes an amount of £115,389,000 (2001-02: £94,098,000) in respect of assets held under finance leases and PFI contracts. 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 2003	**41,708**	**42,305**	**77,560**	**5,437**	**–**	**–**	**167,010**
At 1 April 2002	30,828	15,389	80,272	4,793	–	–	131,282
Accumulated Depreciation:							
At 31 March 2003	**(1,719)**	**(20,511)**	**(27,429)**	**(1,962)**	**–**	**–**	**(51,621)**
At 1 April 2002	–	(9,324)	(26,258)	(1,602)	–	–	(37,184)

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 2003	**13,967,993**	**215,304**	**54,147**	**1,767,858**	**16,005,302**
At 1 April 2002	13,624,574	256,379	59,671	1,985,400	15,926,024

The net book values at 31 March 2003 and 1 April 2002 include assets in the course of construction of £662,966,000 and £1,577,948,000 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 1999	535,207
2001-2002	696,405
2002-2003	13,880,528

8.4 Quinquennial Revaluation

8.4.1 All categories of fixed assets, except Intangibles, ACOC and Capital Spares, were subject to a quinquennial revaluation with an effective valuation date of 1 April 2002. The Valuations for Land & Buildings and Fighting Equipment were applied to Fixed Asset Registers (FAR) and reflected in the financial statements in 2002-03. The valuations for Plant, Machinery and Vehicles and IT & Communications would not be incorporated in the FAR until 1 April 2003. However, for the purposes of these financial statements, the impact of the valuation of these assets has been reflected in the accounts by way of an adjusting post Balance Sheet event, after making appropriate adjustments to uplift the 1 April 2002 values by a Valuation Office Agency supplied uplift factor for the period up to 31 March 2003.

8.4.2 Operational land and buildings were valued by two firms of external professional valuers: the Valuation Office Agency valued the UK estate and the Overseas estate was valued by ATIS REAL Weatheralls, whose valuers are members of the Royal Institution of Chartered Surveyors (RICS). These valuations were undertaken in accordance with the RICS Appraisal and Valuation Manual and were on the basis of the existing use value to the Department and did not take account of alternative use value. Because of the specialised nature of the Departmental estate, the great majority of assets were thus valued on the Depreciated Replacement Cost basis.

8.4.3 Surplus land and buildings were valued by qualified internal Defence Estates staff, on the basis of Open Market Value.

8.4.4 Fighting equipment was valued, on a Depreciated Replacement Cost basis, by Advantage Technical Consulting, HVR Consulting Services Ltd and LSC Group.

8.4.5 Plant, Machinery & Vehicles and IT & Communications were both valued on a Depreciated Replacement Cost basis by the Valuation Office Agency, whose valuers are members of the Royal Institution of Chartered Surveyors.

8.4.6 The net effect of the professional valuation on the asset values is shown below by individual asset category. A decrease in valuation of an asset is set off against the revaluation reserve in the first instance, and any excess write down is charged to the Operating Cost Statement as an Impairment in accordance with accounting policy in Note 1.

i. The net increase on the Land & Buildings carrying value was £455 million. Impairment charged to the Operating Cost Statement was £1,595 million;

ii. The net decrease on the Fighting Equipment carrying value was £919 million. Impairment charged to the Operating Cost Statement was £2,131 million;

iii. The net increase on the Plant, Machinery & Vehicles carrying value was £136 million. Impairment charged to the Operating Cost Statement was £98 million; and

iv. The net increase on the IT & Communications carrying value was £18 million. Impairment charged to the Operating Cost Statement was £31 million.

9. Investments

	Trading Funds Public Dividend Capital £000	Loans £000	Other Investments £000	QinetiQ £000	Total £000
At 1 April 2002	164,849	60,366	1	445,830	671,046
Movements during year:					
QinetiQ:					
Write down of investment				(219,886)	(219,886)
Book value of shares sold to The Carlyle Group (see Note 3)				(47,824)	(47,824)
ABRO vested as a Trading Fund:					
Public Dividend Capital	19,405				19,405
Loans set up on vesting		32,314			32,314
New loans		15,000			15,000
DARA – new loan		19,200			19,200
Repayment of Loans:					
–QinetiQ				(49,900)	(49,900)
–DARA		(2,115)			(2,115)
–UK Hydrographic Office		(279)			(279)
–DSTL		(2,128)			(2,128)
–ABRO		(5,155)			(5,155)
At 31 March 2003	**184,254**	**117,203**	**1**	**128,220**	**429,678**

Public Dividend Capital and Loans at 31 March 2003 were held in the following Trading Funds:

	Public Dividend Capital £000	Loans £000	Interest Rate % p.a. £000	
DSTL	50,412	3,192	8.375	
The Met Office	58,867	–	–	
The UK Hydrographic Office	13,267	11,982	8.375	
DARA	42,303	59,870	4.882	
ABRO Loan 1	19,405	30,159	5.625	
ABRO Loan 2	–	12,000	5.375	
	184,254	117,203		

Analysis of loans repayable by instalments:

	Due within one year £000	Due after one year £000	Total £000
DSTL	2,128	1,064	3,192
The UK Hydrographic Office	303	11,679	11,982
DARA	4,840	55,030	59,870
ABRO Loan 1	2,154	28,005	30,159
ABRO Loan 2	3,000	9,000	12,000
	12,425	104,778	117,203

At 31 March 2003, the loan made to QinetiQ Group Limited, a subsidiary undertaking of QinetiQ, amounted to £50,100,000 (31 March 2002: £100,000,000) and the book value of investment in QinetiQ amounted to £78,120,001.

On 28 February 2003, QinetiQ Group Limited repaid £100 million of the loan. The repayment was in the form of a cash repayment of £40 million and an issue of a loan note ('the Acquila / Chertsey loan note') by QinetiQ Group Limited of £60 million. The loan note is repayable from the net proceeds of disposals of certain identified assets. The loan note was interest free to 30 June 2003, thereafter interest will be charged at rates relating to LIBOR until 28 August 2004. Since the creation of the loan note an amount of £9,900,000 has been repaid, being the proceeds of disposal of one of the identified assets.

As at 31 March 2003, the loans repaid by QinetiQ and subsidiary undertakings, representing the partial original asset value of the business since its formation on 1 July 2001, amounted to £99,900,000. Cash received on part disposal of the shares to The Carlyle Group during 2002-03 amounted to £39,427,000.

9.1 Other Investments

Investments, including 'Golden' shares, were held in the following at 31 March 2003 and 31 March 2002:

	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

Shareholding in QinetiQ

The Department holds 5 classes of shares in QinetiQ. A brief summary of the financial and voting rights of each class are detailed below in order of their ranking in accordance with the Articles of Association of QinetiQ.

Convertible 'A' ordinary (3,773,481 shares of 1p each – 49% of class)

Voting Rights – holders of these shares are entitled to receive notice of, attend, speak and vote at general meetings of the company.

Dividends – none to be paid until Preference Shares have been redeemed in full along with any accrued Preference Dividend.

Convertible 'B' ordinary (285,833 shares of 1p each – 49% of class)

Dividend and Voting rights as per 'A' Ordinary shares.

Convertible Preferred (3,752,686 shares of 1p each – 100% of class)

Voting rights – this class of shareholder is not entitled to receive notice of, nor attend, speak or vote at general meetings of the company.

Dividends – until conversion each Convertible Preferred share in issue will be entitled to the same dividend as paid on each 'A' Ordinary Share.

Redeemable Cumulative Preference (70,308,000 shares of £1 each – 62.5% of class)

Voting rights – preference shareholders are not entitled to receive notice of, nor attend, speak or vote at general meetings of the company.

Dividend – to be paid at the rate of 9% per annum on the nominal value of the preference shares held.

Dividends will not be paid, but will accrue until the preference shares are redeemed at the Sale, Listing or the Winding up of the company. At 31 March 2003, the dividend accrued on these shares amounted to £527,300, which will be recognised in the Operating Cost Statement in the year in which it is received, in accordance with accounting policy in Note 1.9.

Special Rights Redeemable of £1 each – the one 'Special Share', which is held by MOD

The Special Shareholder has the right to require the Company to implement and maintain a regime which protects the defence and security interests of the nation. Voting Rights – the Special Shareholder must receive notice of, and may attend and speak at general company and share class meetings, but carries no voting rights, except to enforce certain aspects of the compliance regime.

Preferential 'Golden' Shares at £1 each (1 share QinetiQ Group plc, 1 share QinetiQ Limited)

The Preferential 'Golden' Shareholder has the right to require the Company to implement and maintain a regime which protects the defence and security interests of the nation. Voting Rights – the Special Shareholder must receive notice of, and may attend and speak at general company and share class meetings, but carries no voting rights, except to enforce certain aspects of the compliance regime.

Dividends – the Special Shareholder has no right to share in the capital or profits of the company other than – in the event of a liquidation – to be repaid the capital paid up in respect of the special share before other shareholders receive any payment.

QinetiQ also issued other classes of shares on its formation, which are not shown above. These shares were issued to the employees of the company.

9.2 Net assets

The reported net assets, after deducting loans due to MOD, of the investments held at 31 March 2003 and 31 March 2002 were:

	31 March 2003 £000	31 March 2002 £000
The UK Hydrographic Office	40,853	36,634
The Met Office	159,498	165,848
Defence Aviation Repair Agency (DARA)	59,099	51,758
Defence Science and Technology Laboratory (DSTL)	140,500	128,000
QinetiQ (2002: QinetiQ Group plc)	140,000	312,500
Army Base Repair Organisation (ABRO)	43,707	–
Total	583,657	694,740

During the year, a dividend of £6,000,000 was received from DSTL and a dividend of £2,587,166 (2001-02: £2,430,775) was received from The UK Hydrographic Office in respect of the financial year ended 31 March 2002. These are included within operating income. No dividend was received from The Met Office, Defence Aviation Repair Agency, QinetiQ and ABRO.

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
BAe Systems Marine (Holdings) Limited, Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hants, EU14 6YU	1470151

10. Related Party Transactions

10.1 The Defence Science and Technology Laboratory, The UK Hydrographic Office, The Met Office, the Defence Aviation Repair Agency and the Army Base Repair Organisation 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 arms 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: £527,578 (2001-02: £528,325)
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: £4,747,800 (2001-02: £4,684,103)
No Departmental representation.

Royal Air Force Museum

Grant-in-Aid: £6,060,731 (2001-02: £5,992,022)
No Departmental representation.

Royal Marines Museum

Grant-in-Aid: £654,601 (2001-02: £655,784)
Director 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: £882,286 (2001-02: £875,359)
Naval Base Commander Portsmouth and Chief of Staff (Warfare) CinCFleet are members of the Board of Trustees.

Royal Navy Submarine Museum

Grant-in-Aid: £488,008 (2001-02: £485,303)
Rear Admiral 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: £1,523,000 (2001-02: £1,412,800) VAT recovery £266,525 (2001-02: £247,200).
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. Mr Charles Miller Smith is Chairman of Scottish Power. These entities are therefore related parties of the Ministry of Defence.

The payments made to these entities were:

		£000
Imperial War Museum	Various transactions	19
Scottish Power	Various transactions	5,222

During the year there were 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; and

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.

Joint Ventures and Collaborative Projects

10.2 European Transonic Windtunnel GmbH (ETW):

The Department has a 31% 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 £260,000 up to 31 March 2004, all of which 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 2003 £000	31 March 2002 £000
Work in progress	39,116	40,748
Raw materials and consumables	5,294,617	6,350,728
Assets declared for disposal	3,392	4,828
	5,337,125	6,396,304

12. Debtors

	31 March 2003 £000	Restated (Note 26) 31 March 2002 £000
Amounts falling due within one year		
Trade debtors	171,404	119,389
Deposits and advances	24,398	27,748
Value Added Tax	251,683	248,195
Amounts owed by other Government Departments	66,641	7,866
Amounts owed by entities in which the Department has a participating interest	10,517	10,520
Armed Forces Pension Scheme	–	7,976
Other debtors	211,480	275,788
Prepayments and accrued income	879,643	370,292
Amount due from Consolidated Fund	39,665	–
	1,655,431	1,067,774
Amounts falling due after one year		
Trade debtors	13,506	22,568
Other debtors	103,838	86,689
Prepayments and accrued income	428,451	80,210
Amounts owed by other Government Departments	299	–
Amounts owed by entities in which the Department has a participating interest	127	–
	546,221	189,467
Total Debtors	**2,201,652**	1,257,241

Notes:

i. Other debtors include loans for house purchase and other loans made to staff amounting to £97,554,131 (2001-02: £99,867,277). The number of staff with house purchase loans was 14,452 (2001-02: 14,766); and

ii. Prepayments include an amount of £343,500,000 paid into an Escrow account in respect of an adjudication decision where an appeal is pending.

13. Cash at Bank and in Hand

	31 March 2003 £000	Restated (Note 26) 31 March 2002 £000
At 1 April	631,681	302,775
Net Cash Inflow/(Outflow):		
Received from Consolidated Fund	27,136,321	26,568,984
Utilised	(27,352,074)	(26,240,078)
Increase/(decrease) during year	(215,753)	328,906
At 31 March	**415,928**	631,681
Represented by:		
Balances at the OPG	147,197	533,518
Commercial Banks and Cash in Hand	268,731	98,163
	415,928	631,681
The balance at 31 March comprises:		
Consolidated Fund Extra Receipts received during the year and due to be paid to the Consolidated Fund (Note 14)	134,737	69,430
Amounts issued from the Consolidated Fund for supply but not spent at the year end (included in Creditors)	144,956	380,656
Amount in respect of prior year payable to the Consolidated Fund	(39,665)	–
Net amount due to the Consolidated Fund	105,291	380,656
Amount in respect of Machinery of Government changes	–	(305)
Amounts held in respect of Collaborative Projects (see note below)	175,900	181,900
	415,928	631,681

Note:

The cash at bank balance includes £175,900,000 (2001-02: £181,900,000) 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 due within one year.

14. Creditors: amounts falling due within one year

	31 March 2003 £000	Restated (Note 26) 31 March 2002 £000
Trade creditors	608,803	427,277
Payments received on account	6,160	11,647
Other taxation and social security	164,041	158,851
Other creditors	400,635	425,114
Accruals and deferred income	3,736,625	3,091,302
Obligations under finance leases and PFI contracts	6,654	4,984
Payable to the Consolidated Fund	279,693	455,974
Amounts owed to other Government Departments	2,561	4,146
Amounts owed to undertakings in which the Department has a participating interest	177,303	81,490
Loans	1,375	1,424
	5,383,850	4,662,209

Note:

Amounts payable to the Consolidated Fund amounting to £279,692,811.63 (2001-02: £455,974,221.46) comprise:

	31 March 2003 £000	31 March 2002 £000
CFERs received during the year	1,110	4,063
CFER – proceeds on part sale of shareholding in QinetiQ	39,427	–
CFER – proceeds of certain fixed assets	44,300	–
CFER – loan repayments by QinetiQ	49,900	–
Excess Operating Appropriation-in-Aid	–	42,810
Excess Non-Operating Appropriation-in-Aid	–	22,557
	134,737	69,430
Amount repayable by Consolidated Fund in respect of prior year	(39,665)	–
CFERs accrued at year end	–	5,888
Amount drawn but not spent at the year end (Note iii)	144,956	380,656
Net amount payable to Consolidated Fund	240,028	455,974
Amount shown within debtors due within one year	39,665	–
	279,693	455,974

i. 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.

ii. Included in other creditors are amounts advanced by foreign governments to the Department 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 £175,900,000 (2001-02: £181,900,000).

iii. The amount comprises amount drawn down from the Consolidated Fund £27,136,321,000 less net cash requirement (Schedule 1) of £26,991,365,000.

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

	31 March 2003 £000	31 March 2002 £000
Other creditors	287,953	303,981
Accruals and deferred income	14,844	1,364
Obligations under finance leases and PFI contracts:		
– Amounts payable between one and two years	9,564	8,300
– Amounts payable between two and five years	21,972	16,676
– Amounts payable over five years	62,291	63,126
Loans: (Note 14)		
– Amounts payable between one and two years	1,599	1,509
– Amounts payable between two and five years	5,396	5,090
– Amounts payable over five years	46,431	48,335
Amounts owed to entities in which the Department has a participating interest	283	–
	450,333	448,381

16. Provisions for Liabilities and Charges

	Nuclear Decommissioning £000	Other Decommissioning & Restoration costs £000	Early Retirement Commitments £000	Other £000	Total £000
At 1 April 2002 (Restated Note 26)	3,887,957	143,970	163,594	916,896	5,112,417
Increase in Provision	1,755,329	30,548	239,507	320,075	2,345,459
Unwinding of discounting	227,362	4,140	3,346	12,855	247,703
Amounts released	(118,152)	(4,249)	(13,539)	(170,029)	(305,969)
Reclassifications	19,737	(19,877)	–	140	–
Amounts capitalised	(10,060)	–	–	–	(10,060)
Utilised in year	(232,421)	(9,731)	(31,615)	(121,556)	(395,323)
At 31 March 2003	**5,529,752**	**144,801**	**361,293**	**958,381**	**6,994,227**

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

	2002-03 £000	2001-02 £000
Charged/(credited) to:		
Staff costs	232,485	111,708
Movements	–	(1,518)
Nuclear and Other Decommissioning provisions	1,635,223	137,811
Other costs	171,782	278,737
Net interest (receivable)/payable	247,703	232,636
	2,287,193	759,374
Made up of:		
Increase	2,345,459	550,262
Release	(305,969)	(23,524)
	2,039,490	526,738
Unwinding of discount	247,703	232,636
Net increase in provisions	**2,287,193**	759,374

General

16.1 HM Treasury issued instructions to reduce the rate used for discounting the value of provisions from 6% to 3.5% to be effective from 1 April 2003. This has not affected the value of the provisions at the Balance Sheet date but this will have the effect of increasing the provisions at 1 April 2003 by £2,300 million and the operating costs in 2003-04 by the same amount.

16.2 The increase in the year in nuclear provisions of £1,755 million includes an amount of £1,124 million in respect of the MOD allocation of costs associated with BNFL, where a review of the company's strategy for solid Intermediate Level Waste (ILW) retrieval and change in methodology of certain other costs resulted in a significant increase in the estimates of nuclear decommissioning costs. The increase also includes an increase of £505 million in AWE estimates arising from the first quinquennial review as required by the Government White Paper 'Review of Radioactive Waste Management Policy: Final Conclusion' (Cm 2919).

16.3 Nuclear decommissioning provisions relate principally to the cost of facility decommissioning and the treatment and storage of nuclear waste arising at British Nuclear Fuel 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 1940's 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 £21,947,363,000 (2001-02: £16,622,092,000).

The estimate of £5,529,752,000 (2001-02: £3,887,957,000) at 31 March 2003 represents the liabilities discounted at 6% and expressed in 2002-03 money values.

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

	2003 £bn	2002 £bn
Up to 3 years	1.3	0.8
From 4 – 10 years	1.9	1.4
Beyond 10 years	2.3	1.7
Total	5.5	3.9

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 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

16.4 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 Commitments

16.5 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 are now payable by CSP.

Other

16.6 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

	2002-03 £000	Restated (Note 26) 2001-02 £000
Net Operating Cost for the year (Schedule 2)	(41,793,591)	(33,475,629)
Paid and payable to the Consolidated Fund	(317,780)	(516,136)
Parliamentary funding from the Consolidated Fund (Schedule 4)	27,136,321	26,568,984
Transfer to General Fund of realised element of:		
– Revaluation reserve (Note 18)	830,832	638,774
– Donated asset reserve (Note 18)	6,537	24,069
Non-cash charges:		
– cost of capital charge (Schedule 2)	5,074,726	5,124,775
– auditors' remuneration (Note 3)	3,405	4,170
Surplus arising on restructuring of DERA	–	297,066
Net increase/(decrease) in General Fund	(9,059,550)	(1,333,927)
General Fund at 1 April	74,504,706	75,991,550
	65,445,156	74,657,623
Restatement of opening General Fund at 31 March 2002 (Note 26)	–	(152,917)
General Fund at 31 March	**65,445,156**	74,504,706

18. Reserves

	Revaluation Reserve £000	Donated Asset Reserve £000
At 1 April 2002	10,549,019	1,347,597
Arising on revaluation during the year (net)	4,611,795	501,342
Additions during the year	–	20,480
Transfers and reclassifications	(148,348)	(169)
Transferred (to)/from Operating Cost Statement	–	(51,386)
Transferred (to)/from General Fund	(830,832)	(6,537)
At 31 March 2003	**14,181,634**	**1,811,327**

Note:

During the year Land and Buildings were valued by professional valuers and the new net book values were posted directly to fixed asset registers. However, as a result of adopting this treatment, the historical data in respect of the revaluation reserve for these assets could only be maintained at a disproportionate cost. The accounting treatment for future years is under review. This does not have any impact on the values at which Land and Buildings are stated in the Balance Sheet.

19. Capital Commitments

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

	31 March 2003 £000	31 March 2002 £000
Contracted but not provided for	**17,824,501**	17,532,005

20. Financial Commitments

Commitments under operating leases:

	Land and Buildings		Other	
	31 March 2003 £000	31 March 2002 £000	31 March 2003 £000	31 March 2002 £000
The Department was committed to making the following payments during the next year in respect of operating leases expiring:				
Within one year	6,284	8,205	12,844	9,268
Between two and five years	11,644	12,052	14,483	26,394
After five years	144,678	142,425	109,828	96,272
	162,606	162,682	**137,155**	131,934

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 £542,048,000 (2001-02: £538,023,000).

21.2 The payments which the Department is committed to make during the year 2003-04 are analysed below by time-bands specifying the period in which the individual commitment expires:

	31 March 2003 £000	31 March 2002 £000
In the 1st year	–	1,600
In the 2nd to 5th years	225,325	–
In the 6th to 10th years	126,969	336,807
In the 11th to 15th years	3,820	–
In the 16th to 20th years	15,830	75,383
In the 21st to 25th years	127,451	18,835
In the 26th to 30th years	75,531	85,914
In the 41st to 45th years	6,250	6,250

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

Project Description	Capital Value* £000	Contract Start/End Dates	
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 three 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
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 (of which £63.9 million relates to on-balance sheet)	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

Project Description	Capital Value £000	Contract Start/End Dates	
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 five years	2,600	Mar 2001	Mar 2006
Defence Electronic Commerce Services (DECS)	–	Jul 2000	Jul 2010
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: Provision of management, manning, operation and maintenance of Air Support Craft and Range Safety Craft	11,000	Dec 2001	Dec 2012
Astute Class Training: Provision of a training environment for crewmen and maintainers to upport Astute Class submarines for 30 years	41,000	Sep 2001	Sep 2031
Strategic Sealift (RoRo): Provision of strategic sealift services based on six RoRo ferries in support of Joint Rapid Reaction Force (JRRF) deployments	175,000	Jun 2002	Dec 2024
Field Electrical Power Supplies (FEPS): Provision of generator sets to support operational electrical requirements in the field	60,000	Jul 2002	Mar 2022
Material Handling Equipment: Provision of tri-service material handling equipment for Army, Navy and RAF storage depots	23,000	Aug 2002	Jul 2010

* 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 Command and 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 are as follows: Aquatrine Project A, Defence Sixth Form College and Pan Government Records Management and Archive Services (HAYES).

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

22. Contingent Liabilities Disclosed Under FRS 12

Contingent liabilities estimated at some £1,318,000,000 (2001-02: £550,000,000) were identified.

Indemnities issued to contractors and suppliers that were quantifiable as at 31 March 2003 amounted to £1,162,000,000.

23. Contingent Liabilities Not Required To Be Disclosed Under FRS 12 But Included For Parliamentary Reporting And Accountability

23.1 Quantifiable

MOD has entered into the following quantifiable contingent liabilities by offering guarantees, indemnities or by giving letters of comfort. None of these is a contingent liability within the meaning of FRS12 since the likelihood of a transfer of economic benefit in settlement is too remote.

	1 April 2002 £000	Increase in year £000	Liabilities crystalised in year £000	Obligation expired in year £000	31 March 2003 £000	Amount reported to Parliament by departmental minute £000
UNRESTRICTED						
Indemnities						
Residual liability for the remediation of unidentified contamination in parts of the former Rosyth Naval Base which has been sold to Rosyth 2000 plc.	Up to £1,000k				Up to £1,000k	n/a
Termination liabilities arising out of MOD's association with the Research Council under the Joint Grants Scheme.	£16,100k	£1,520k (1)	NIL	NIL	£17,620k	£17,520k
Liabilities arising from insurance risk of exhibits on loan to the Army, Navy and RAF Museums.	£1,452k	£47k (2)		£10 (2)	£1,489	Not known
RESTRICTED						
Details on restricted liabilities not given because they are sensitive due to commercial confidentiality, national security, or where public knowledge of a guarantee could prompt claims from third parties.						

Explanation of movements

1. Grants are replaced on an annual basis both 'in place' and 'committed by letter', hence liability fluctuates on an annual basis.
2. General reassessment of risk.

Reconciliation between disclosed amount and amount reported to Parliament

The last comprehensive valuations were as reported in the 2001-02 Treasury return.

23.2 Unquantifiable

MOD has entered into the following unquantifiable contingent liabilities by offering guarantees, indemnities or by giving letters of comfort. None of these is a contingent liability within the meaning of FRS12 since the likelihood of a transfer of economic benefit in settlement is too remote.

Unrestricted Indemnities

- Indemnity given in relation to the disposal of Gruinard Island in the event of claims arising from the outbreak of specific strains of anthrax on the Island.
- Indemnity to Devonport Royal Dockyards Ltd (DRDL) in respect of nuclear risks under the Nuclear Installations Act 1965.
- Indemnity to the Babcock Group in respect of nuclear risks under the Nuclear Installations Act 1965.
- Indemnities to Devonport Royal Dockyards Ltd (DRDL) and the Babcock Group in respect of non-nuclear risks resulting from claims for damage to property or death and personal injury to a third party.
- Product liability to British Aerospace in respect of work carried out by third party contractors on aircraft for which BAe are Design Authority and for which BAe, at MOD's request provide the third party contractor with design advice and verification.

Restricted Indemnities

- Details on restricted liabilities are not given because they are sensitive due to commercial confidentiality and national security.
- Explanation as to why unquantifiable: These liabilities are unquantifiable due to the nature of the liability and the uncertainties surrounding them.

24. Post Balance Sheet Events

Recovery of HMS Sussex

A US salvage company, Odyssey Marine Exploration, has found what is believed to be the wreck of 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 is estimable until the initial 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 Ministry's voted funds.

25. 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:

	2002-03			2001-02		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
Operations	**1,117,429**	**–**	**1,117,429**	530,016	–	530,016
Other military tasks	**1,658,433**	**(52,743)**	**1,605,690**	1,580,360	(81,073)	1,499,287
Contributing to the community	**564,923**	**(59,129)**	**505,794**	401,834	(8,285)	393,549
Helping to build a safer world	**411,562**	**(165,811)**	**245,751**	331,916	(133,631)	198,285
Total	**3,752,347**	**(277,683)**	**3,474,664**	2,844,126	(222,989)	2,621,137

Costs are identified as follows:

- *Operations* comprises the additional costs incurred deploying the armed forces in military operations, e.g. in Iraq, 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; and
- *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 activities.

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:

	2002-03			2001-02		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
Royal Navy						
Aircraft carriers	**421,865**	**(5,550)**	**416,315**	329,911	(5,352)	324,559
Frigates and Destroyers	**3,080,057**	**(51,136)**	**3,028,921**	1,780,494	(54,518)	1,725,976
Smaller warships	**504,617**	**(17,923)**	**486,694**	356,593	(11,627)	344,966
Amphibious ships	**436,480**	**(6,763)**	**429,717**	304,272	(15,027)	289,245
Strategic sealift	**15,283**	**(655)**	**14,628**	53,556	(4,288)	49,268
Fleet support ships	**474,224**	**(13,110)**	**461,114**	400,564	(18,547)	382,017
Survey and other vessels	**232,336**	**(8,923)**	**223,413**	211,808	(6,470)	205,338
Naval aircraft	**1,246,648**	**(25,599)**	**1,221,049**	1,166,152	(31,385)	1,134,767
Submarines	**5,662,233**	**(73,110)**	**5,589,123**	3,334,008	(55,465)	3,278,543
Royal Marines	**481,415**	**(4,615)**	**476,800**	464,940	(20,715)	444,225
	12,555,158	**(207,384)**	**12,347,774**	8,402,298	(223,394)	8,178,904
Army						
Field units	**7,613,358**	**(231,653)**	**7,381,705**	7,170,124	(139,176)	7,030,948
Other units	**3,031,434**	**(184,282)**	**2,847,152**	2,789,561	(218,015)	2,571,546
	10,644,792	**(415,935)**	**10,228,857**	9,959,685	(357,191)	9,602,494
Royal Air Force						
Strike/attack and offensive support aircraft	**3,212,034**	**(74,360)**	**3,137,674**	3,517,065	(84,954)	3,432,111
Defensive and surveillance aircraft	**2,772,787**	**(50,136)**	**2,722,651**	1,653,404	(33,180)	1,620,224
Reconnaissance and maritime patrol aircraft	**737,534**	**(26,796)**	**710,738**	963,080	(39,475)	923,605
Tankers, transport and communications aircraft	**1,257,826**	**(46,723)**	**1,211,103**	1,088,635	(46,984)	1,041,651
Future capability	**312,281**	**(6,003)**	**306,278**	144,660	(2,530)	142,130
Other aircraft and RAF units	**1,131,165**	**(40,584)**	**1,090,581**	924,593	(34,802)	889,791
	9,423,627	**(244,602)**	**9,179,025**	8,291,437	(241,925)	8,049,512
Centre Grouping						
Joint and multinational operations	**628,716**	**(55,623)**	**573,093**	384,706	(34,181)	350,525
Centrally managed military support	**549,567**	**(80,464)**	**469,103**	473,244	(70,363)	402,881
Maintenance of war reserve stocks	**909,204**	**(12,990)**	**896,214**	N/A	N/A	N/A
	2,087,487	**(149,077)**	**1,938,410**	857,950	(104,544)	753,406
Total Objective 2	**34,711,064**	**(1,016,998)**	**33,694,066**	27,511,370	(927,054)	26,584,316

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 (e.g. 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; and
- *Maintenance of war reserve stocks* includes the holding costs and charges of munitions and other stocks, above the levels required for planned consumption. (Comparable figures are not available for 2001-02).

Objective 3: Building for the future

This objective comprises the following elements:

	2002-03			2001-02		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
Research	**972,089**	**–**	**972,089**	1,000,583	(333)	1,000,250
Equipment programme	**2,514,938**	**(60,547)**	**2,454,391**	2,078,176	(45,306)	2,032,870
Total	**3,487,027**	**(60,547)**	**3,426,480**	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; and
- *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.

Attribution to Objectives

Gross expenditure of £32,963 million (76.4%) (2001-02 – 71.7%) and Operating Income of £664 million (48.9%) (2001-02 – 52.9%) were allocated to tasks, force elements or activities directly supporting the Objectives. The remainder were apportioned in one of two ways:

i. 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:

ii. 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:

	2002-03			2001-02		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
Support for ministers and Parliament	**9,380**	**(3)**	**9,377**	5,392	–	5,392
Departmental corporate services	**1,164,202**	**(279,767)**	**884,435**	1,407,737	(239,868)	1,167,869
Strategic management	**507,630**	**(9,562)**	**498,068**	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, e.g. payment of bills, payroll administration, and housing and medical care for service personnel; and
- *Strategic management* comprises Departmental policy making functions in strategic, personnel, scientific and medical matters.

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 £61,986million (76.1%) support the military capability required to meet Objective 2. The remainder comprises assets wholly attributable to tasks within Objective 1 (£3,629 million – 4.4%), and intangible assets, fighting equipment and other assets in the course of construction, assets related to equipment procurement within Objective 3 (£15,853 million – 19.5%), and payment of War Pensions and Allowances (–£30.4m).

26. Restatement of Balance Sheet and Operating Cost Statement at 31 March 2002

26.1 The restatement of £152,917,000 arises due to a) Machinery of Government changes in respect of War Pensions and Allowances and b) bringing on to Balance Sheet the liabilities in respect of a number of overseas pension schemes in accordance with the requirements of SSAP24.

26.2 Machinery of Government changes – War Pensions and Allowances

Under merger accounting rules applicable to Machinery of Government changes, the Department's Balance Sheet and Operating Cost Statement have been restated. The summarised Balance Sheet at 31 March 2002 was as follows:

Net Assets	£000
Debtors	26,595
Cash at bank	(305)
Creditors	(37,738)
	(11,448)

The Operating Cost Statement for 2001-02 was restated to incorporate costs of War Pensions and Allowances amounting to £1,237,056,000.

26.3 Overseas Pension Schemes

As a result of the change referred to in Note 26.1 above, the opening balance of provision for liabilities and charges was increased by £141,469,000, of which £28,890,000 was allocated to Early Retirement Commitments and £112,579,000 to Other Provisions shown in Note 16. The General Fund was reduced by the same amount.

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

	2002-03						Restated 2001-02
	Other Current Expenditure £000	Grants £000	Operating Appropri-ation -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
TLB HOLDER							
Commander-in-Chief Fleet	5,013,333	–	(14,991)	**4,998,342**	5,863,220	864,878	3,853,623
General Officer Commanding (N Ireland)	719,734	–	(2,280)	**717,454**	765,891	48,437	614,235
Commander-in-Chief Land Command	5,707,428	132	(224,459)	**5,483,101**	5,651,602	168,501	4,941,240
Air Officer Commanding-in-Chief RAF Strike Command	4,864,850	–	(35,709)	**4,829,141**	5,108,198	279,057	4,128,259
Chief of Joint Operations†	719,496	–	(40,507)	**678,989**	541,170	(137,819)	448,514
Chief of Defence Logistics	11,455,941	886	(273,084)	**11,183,743**	12,174,776	991,033	8,700,505
2nd Sea Lord/Commander-in-Chief Naval Home Command	783,302	–	(43,178)	**740,124**	723,588	(16,536)	683,528
Adjutant General	1,780,857	–	(32,124)	**1,748,733**	1,781,173	32,440	1,684,726
Air Officer Commanding-in-Chief RAF Personnel and Training Command	1,243,355	–	(156,774)	**1,086,581**	1,098,384	11,803	929,901
Central	3,106,794	137,474	(477,379)	**2,766,889**	2,988,606	221,717	2,600,514
Defence Procurement Agency	5,118,403	1,721	(36,955)	**5,083,169**	5,033,081	(50,088)	2,709,591
Major customers' research budgets*	414,578	–	–	**414,578**	416,840	2,262	414,153
Total (RFR 1)	40,928,071	140,213	(1,337,440)	**39,730,844**	42,146,529	2,415,685	31,708,789
Total (RFR 2) (Note 2)	1,117,429	–	–	**1,117,429**	1,155,834	38,405	530,016
Total (RFR 3) (Note 1)	1,165,411	–	–	**1,165,411**	1,186,720	21,309	1,237,056
Total	43,210,911	140,213	(1,337,440)	**42,013,684**	44,489,083	2,475,399	33,475,861
Income netted off against operating expenditure between TLB holders	(3,154)	–	3,154				
Items netted off against other operating costs but treated as Appropriation in Aid for Schedule 1 (Note 4)	115,481		(115,481)				
Excess Operating Appropriation-in-Aid							42,810
	43,323,238	140,213	(1,449,767)	**42,013,684**	44,489,083	2,475,399	33,518,671
				Sch 1	**Sch 1**		**Sch 1**

† *Chief of Joint Operations* includes a prior year charge of £141,469,000 (see Note 26).
* Major customers' research budgets is not a Top Budget (TLB) Holder.

Note 1: **War Pensions and Allowances – Programme Costs**
The Chief Executive of the Veterans Agency is not a Top Level Budget Holder, but exercises all the responsibilities for the programme costs.

Note 2: **Conflict Prevention (RFR2)**
The analysis of the Conflict Prevention costs is as follows:

Operations	Operating Costs £000
BOSNIA	78,898
KOSOVO	86,995
AFGANISTAN (*includes VERITAS, FINGAL and JACANA)	235,959
GULF	39,384
IRAQ	629,532
MACEDONIA	57
	1,070,825
Programme Expenditure	46,604
TOTAL	1,117,429

The Department's cost of operation in Iraq (Operation TELIC) forms the main component of the above costs. Further details and assumptions used in arriving at these figures are as set out below:

General

1. The MOD had £1bn, including £400m for capital expenditure on Urgent Operational Requirements (UOR), in voted provision for Operation TELIC in the Spring Supplementary Estimates 2002-03. The resource outturn in 2002-03 for the operation was £629 million, which reflects the costs for the period to 31 March 2003, including military action that began on the night 19/20 March;

2. The capital expenditure on UORs for Operation TELIC paid and accrued in the financial statements amounted to £218 million; and

3. Full details of the Department's aims and performance assessment for Operation TELIC are provided in the Departmental Performance Report with further information in the 'Iraq First Reflections Report', which was published in July 2003.

Assumptions

The following assumptions have been used in arriving at the net resource outturn figures for Operation TELIC:

1. In accordance with the accounting principles agreed with HM Treasury, the Department has identified the costs of Operation TELIC on the basis of net additional costs. Expenditure such as wages and salaries are not included as they would have been incurred in any event, and the costs of activities such as training and exercises, which have been cancelled because of the operational commitment, have been deducted;

2. There have been no fixed asset impairments resulting from the operation in Iraq, though cost of equipment destroyed in the conflict during 2002-03 is included. It is likely that repair and refurbishment costs will need to be incurred in the future in order to bring the equipment back into full operational use; these costs will be reflected in the Operating Cost Statement in the year in which they are incurred;

3. Stock consumption was calculated using the best estimate of stock remaining in theatre at 30 June 2003, and making the necessary adjustments to this figure for issues of additional stock in the three months to 30 June 2003 and for stock consumed pre and post 31 March 2003 based on the level of activity during that period; and

4. Write offs of fighting equipment and GWMB, charged in the financial statements, are based on actual records.

28. 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 2003 Sterling £000	31 March 2002 Sterling £000
US Dollar	1,330,000	1.5281	870,378	633,777
Euro	1,090,000	1.5650	696,466	593,273
The 31 March 2003 mid-market closing rates for US Dollar and Euro were £/$1.5807 and £/Euro 1.4486 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 approximates to their book values.

Financial liabilities

The Department's liabilities include loans from National Loans Fund and Obligations under finance leases and PFI contracts amounting in total to £155.3 million (2002: £149.4 million). The fair values of these liabilities will be different from their book values but since these represent only 1.2% of the gross liabilities and provisions, the impact on the Department's net assets will not be material. The fair value of provisions for liabilities and charges are not materially different to their book values which are stated after discounting at the Treasury rate of 6%. Other liabilities fair values approximate to their book values.

29. Losses and Special Payments

Losses Statement	£000
Total (12,765 cases)	131,084
Details (cases over £100,000)	
Cash Losses	
The department has incurred a loss of £9,841,351.23 through adverse exchange rate movements resulting from its handling of Foreign funds deposited in respect of a collaborative project.	9,841
Claims Waived or Abandoned	
During the year an amount owing from a trading company became irrecoverable and was written off. A bad debt provision had been created in the 1999/2000 accounts against this amount. The amount of the write-off was £235,000 but in addition Defence Estates was liable for a further £350,000 for costs and compensation.	585
Stores and other Losses	
During a live firing exercise where a large number of units were participating, an armoured fighting vehicle caught fire. There were no casualties, but the vehicle was completely destroyed to the value of £1,812,106.50. Investigations were carried out in accordance with the relevant regulations, but the outcome could not conclusively determine the cause of the fire. Various recommendations are now being implemented.	1,812
A loss of £230,116.72 has been incurred as a result of an Armoured Fighting Vehicle suffering repairable fire damage whilst in transit from docks to the unit lines. A thorough investigation including a Board of Inquiry was undertaken. No serious equipment failure was found, and nobody was held culpable.	230
In September 1998 a road traffic accident occurred involving two Drops Vehicles and Trailers whilst on exercise. The driver of the trailer at the rear fell asleep and rammed the trailer in front. This resulted in damage estimated at £153,791.52. Steps have been taken to prevent a recurrence.	154
239 International Standard Organisation (ISO) containers were discovered missing following a DCMS audit on an Operation. A thorough investigation including a Board of Inquiry was undertaken. Nobody was found culpable, there is no suggestion of Fraud or Theft. None of the items have been recovered to date and the loss has now been written off. Measures have been put in place to help prevent a recurrence.	149
A stores loss of £140,192.19 has been incurred as a result of the misplacement of two turning gears held in store while awaiting the refit of a ship. Despite extensive investigations they could not be located and have to be re-provisioned. New business control mechanisms have been implemented to reduce the risk of a similar occurrence.	140
Other Notes	
There were 30 instances of supplies and services being provided on a reciprocal basis to Commonwealth and Foreign Navy vessels during visits to British naval ports totalling £302,312.72.	302
There have been 4 instances where buildings have been sold to the tenants at a discount totalling £193,065.	193
Constructive Losses	
Following the decision to withdraw the Sea Harrier FA2 aircraft from service, the contracts to integrate the Joint Tactical Information Distribution System (JTIDS) on to Sea Harrier were terminated. This resulted in a constructive loss of £77,763,169.30.	77,763
A constructive loss of £4.185m covers the design costs for housing in a UK province at two sites where due to reductions in troop numbers, new housing was no longer required.	4,185
Following a decision in 2002 to revise the operational role of Harrier GR9 aircraft a constructive loss of £2,741,844.88 was incurred. It was judged no longer cost effective to integrate the Storm Shadow missile on the aircraft. Integration work ceased in May 2002.	2,742
The Successor Identification Friend or Foe equipment supplier prime contract was placed with a contractor in December 2000, which included the requirement to fit SIFF to over 20 platform-types, including the Augusta 109A/AM helicopter fleet. During subsequent de-risking trials in 2002, it was discovered that expensive and time consuming modification to the Augusta 109A/AM cockpit layout would be required to make the helicopter suitable for SIFF installation. In view of the fact that the Augusta 109A/AM 'Out of Service Date' had also been brought forward from 2010 to 2006, it was decided that this modification would not be cost effective given the limited return of service that would have resulted and that costs of £0.247m incurred to date should be written off as a constructive loss.	247

Losses Statement	£000
Gifts	
100 Paveway 3 precision guided bombs were gifted to a Foreign Government. Details of the transfers were notified to the House of Commons in a Departmental Minute dated 4 February 1999.	15,628
Three non-core MOD sites in Northern Ireland were gifted to the Office of the First Minister/Deputy First Minister of the Northern Ireland Executive. Details of the transfers were notified to the House of Commons retrospectively in a Departmental Minute dated 23 June 2003.	6,377
Special payments	
Total (1,327 cases)	129,118
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 £1,175 million.	121,333
An Extra-contractual payment was made to a contractor for additional costs incurred to modify government furnished equipment required for the modification of an electronic repair vehicle.	284
During the construction of an antenna there was a civil disturbance. This resulted in the contract being cancelled and the contractor incurring costs over which he had no control. It was agreed to make an extra-contractual payment to meet these costs.	262
Retrospective Notifications	
Retrospective notification of a write-off of £984.997m incurred as a result of the withdrawal from service of the JP233 Weapons system. In 1998, UK Government deposited the UK Instrument of the Ottawa Convention ratification with the UN Secretary General, indicating its firm commitment to the withdrawal and destruction of all British Forces Anti-Personnel Landmines (APL). The JP233 was classified as an APL and was therefore subject to the terms of the Ottawa Convention and the UK Landmines Act. Accordingly, in order to comply with the Assistant Chief of the Air Staff unequivocal directive, JP233 was withdrawn from service and disposal action was initiated.	984,997
Retrospective notification of the constructive loss expenditure of £28.9m incurred between April 2000 and March 2001 as a result of the write-off of LITS OM. There were significant technical problems with developments of the LITS OM application and it was decided that the functionality should be pursued on a DLO wide basis through the Purchase to Payment project, which is currently being implemented.	28,900
Cancellation of the production of the 25mm Aden Gun as the result of an LTC 98/99 Alternative Assumption resulted in fruitless payment of £1,404,152.28.	1,404
A fire at a RAF station has resulted in a stores loss of £170,712.65.	171
Advance Notifications	
Previously notified	
An alleged fraud at an MOD establishment during 1990 to 1995 may give rise to a loss in excess of £100,000. Audit and MOD Police investigations are proceeding and it is not possible to provide an accurate assessment of the value at this time.	
Closure of a storage depot has resulted in a possible stores loss. The total figure is not yet known.	
A vehicle was destroyed by fire when it rolled out of control down a hillside resulting in a possible stores loss.	
Communications equipment, located on a remote hilltop site, was stolen resulting in a possible stores loss.	
Delays in the production of helicopter training courseware has resulted in a possible write-off.	
A possible constructive loss has arisen due to the decision not to proceed into production for either MR or LR TRIGAT.	
A depletion and disposal of surplus stock, has arisen out of the Strategic Defence Review and the formation of the Defence Logistics Organisation. It is not possible at this time to separate out figures for the formal categories of the reduction but, when the value has been determined, it will be noted in the Resource Account in a future year.	
The decision to cancel a contract for an automated Electronic Warfare system has resulted in a possible write-off. The actual cost of termination cannot be quantified at this time but will feature in the account of a future year.	
The decision to terminate a programme for a highly mobile, manned reconnaissance vehicle resulted in a possible constructive loss.	
Not previously notified	
DSMS formed part of the DLO Business Change Programme. During development doubts surfaced about the programme's ability to deliver the expected benefits and its affordability leading to the programme being suspended and a potential constructive loss of £118m. Work is still going on to finalise the case which is expected to be formally reported in 2003-04.	
A message handling system that was not fit for purpose and gave concerns over obsolescence has resulted in a possible fruitless payment.	
A review of the accounting treatment of the D154 facility at Devonport has been conducted. The revised treatment changes the basis of valuation by basing the scale of the asset on the planned workload. The impact of this change in accounting treatment is a write down of £287m, which is expected to be formally reported as a Constructive Loss in 2003-04. The Department's investment in the D154 Project is classified as a prepayment in accordance with FRS5.	
Re-negotiation of a contract for a reconnaissance aircraft project has resulted in a possible claim being abandoned.	
Advance notification of a possible extra contractual payment due to a company seeking compensation for dislocation costs for the delay to its build programme.	

30. Non-Operational Heritage Assets

30.1 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.

30.2 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 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	London, Taunton	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.

31. Entities within the Departmental Boundary

The entities within the boundary during 2002-03 were as follows:

Executive Agencies

Armed Forces Personnel Administration Agency
Army Personnel Centre
Army Training and Recruitment 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)

32. Votes A Statement – Statement of Approved Maximum Armed Forces Numbers

32.1 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.

32.2 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 and Women for NAVAL SERVICE	46,025	41,631	1 April 2002
Officers, Men and Women for ARMY SERVICE	128,195	119,944	1 March 2003
Officers, Men and Women for AIR FORCE SERVICE	57,415	53,271	1 March 2003

32.3 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	15,354	1 Oct 2002
Special Members of the Reserve Naval Forces	250	75	1 Feb 2003 1 March 2003
Reserve Land Forces	84,000	74,016	1 April 2002
Special Members of the Reserve Land Forces	6,000	–	–
Reserve Air Forces	23,050	18,558	1 April 2002
Special Members of the Reserve Air Forces	550	46	1 April 2002 1 May 2002 1 June 2002 1 Oct 2002