

Departmental Resource Accounts

2005-06

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THE 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 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 act as a force for good by strengthening international peace and stability. This is achieved by working together to produce battle-winning people and equipment that are:

- fit for the challenge of today,
- ready for the tasks of tomorrow, and
- capable of building for the future.

Further definition of the Departmental Objectives in terms of outputs is given in the Statement of Operating Costs by Departmental Aim and Objectives and in its supporting Note to the Accounts – Note 24.

Departmental Boundary¹

At 31 March 2006, the Department consisted of 13 (2004-05:12) Top Level Budget (TLB) Holders (detailed in Note 2 to the accounts – The Analysis of Net Resource Outturn) responsible for providing forces and support services required for a modern defence force. Within these TLBs, there were 55 (2004-05: 69) reporting entities known as management groupings; the reduction is a result of the ongoing process of reform of the finance function: the ‘Simplify and Improve’ initiative.

There are 20 on-vote Defence Agencies (listed in Note 36), a reduction of 6 from 2004-05 following the removal of agency status on 1 April 2005 from: the Warship Support Agency, the Medical Supplies Agency, the Defence Dental Agency, Queen Victoria School, the Defence Geographic and Imagery Intelligence Agency and the Defence Intelligence and Security Centre. Defence Agencies publish their own accounts. All on-vote agencies are also management groupings, except for the Defence Procurement Agency and Defence Estates which are TLBs, and the Disposal Services Agency and Naval Recruiting and Training Agency, which form part of larger management groupings. Further information relating to the Defence Agencies can be found at Annex E.

Also included within the Departmental Boundary are Advisory Non-Departmental Public Bodies (NDPBs) sponsored by the Department; these are listed at Note 36.

There are 5 (2004-05: 5) Executive Defence Agencies established as Trading Funds, and owned by the Secretary of State for Defence, at 31 March 2006. These Trading Funds produce their own accounts and fall outside the Departmental Boundary. Further details are at Note 15 – Investments and Note 32 – Related Party Transactions.

The Department also sponsors 6 Executive Non Departmental Public Bodies (NDPBs), which are self accounting and produce their own accounts. They receive Grants-in-Aid from the MoD and fall outside the Departmental Boundary. Further details are at Note 32 – Related Party Transactions.

The Oil and Pipelines Agency is a Public Corporation sponsored by the Department, which falls outside the Departmental Boundary

On 10 February 2006, QinetiQ Group plc was successfully floated on the London Stock Exchange, via an Initial Public Offering (IPO). The IPO completed the process of transforming the MoD in-house research and development organisation into an international defence technology and security company. QinetiQ Group plc is outside the Departmental Boundary; details of the MoD’s remaining shareholding in the company are set out at Note 15 – Investments and Note 32 – Related Party Transactions.

With effect from 1 April 2005, the provisions for civil nuclear liabilities were transferred to the Nuclear Decommissioning Authority; sponsored by the Department of Trade and Industry. The effect of this ‘Machinery of Government Change’ has been reflected by re-stating the relevant opening balances and prior year operating cost statement. Further details are at Note 33 – Restatement of Balance Sheet and Operating Cost Statement at 31 March 2005.

¹The Departmental Boundary in this context relates to the boundary of the Departmental Resource Accounts.

Pension Liabilities

The transactions and balances of the Armed Forces Pension Scheme (AFPS) (including the Non-Regular Permanent Staff Pension Scheme, the Army Careers Officers Pension Scheme and the new Reserve Forces Pension Scheme) and the Armed Forces Compensation Scheme are not consolidated in these financial statements. The report and accounts of the AFPS are prepared separately; further information is available on the Website:

www.official-documents.co.uk/document/hc0506/hc02/0286/0286.asp.

The Department's share of the transactions and balances of other pension schemes to which employees belong (e.g. under Civil Service Pension (CSP) arrangements, the Department of Health, Social Services and Public Safety Superannuation Scheme and the Teachers' Superannuation Scheme) is also not consolidated in these accounts; separate accounts are prepared for the schemes and details can be found on the following websites:

www.civilservice-pensions.gov.uk/scheme_information/facts_and_figures/index.asp

www.dfes.gov.uk/aboutus/reports/

www.official-documents.co.uk/document/hc0506/hc04/0492/0492.asp

Further information on the various pension schemes can be found in the Remuneration Report and at Note 9 – Staff Numbers and Costs.

Future Developments

The Department has comprehensive efficiency and change programmes that extend right across the Department and affect every employee. The details of many of these programmes are set out in the section on Efficiency and Change in the Annual Performance Report, which forms the first part of the MoD Annual Report and Accounts.

Progress on the collocation of the operational Command headquarters and the personnel & training headquarters of the three Services has continued. The Fleet and 2nd Sea Lord organisations merged on 1 April 2006 and collocated in a unified Headquarters in Portsmouth, creating a single Naval Top Level Budget. The first stage of the collocation of the headquarters of Strike Command and RAF Personnel and Training Command at High Wycombe will be complete by October 2006. Project Hyperion is taking forward the re-organisation of the Army's Land and Adjutant General Commands with progressive collocation to a new Land Forces Headquarters planned to be completed by March 2009.

The process of organisation review continues to identify opportunities to reduce the number of on vote Agencies. With effect from 1 April 2006, agency status was removed from: the Naval Recruiting and Training Agency, the Army Training and Recruiting Agency and the RAF Training Group Defence Agency as these training organisations became an integral part of their respective Services' Top Level Budgets. The MoD currently has in hand a major programme of efficiency and business change including extensive organisational restructuring and rationalisation. As a result of this and other factors, the number of agencies is likely to continue to reduce in the future.

The Joint Personnel Administration (JPA) will modernise the personnel management and administration of the Armed Forces by harmonising and simplifying a range of personnel policies and processes and by introducing new information systems. JPA began its roll-out, to the RAF, in April 2006.

The Defence Resource Management Programme aims to simplify and improve current financial processes, structures and systems to reduce costs and improve decision-making. As part of the Programme, a Shared Service Centre for accounts receivable was established in December 2005 and extended to cover fixed asset processing in April 2006.

From April 2006, all intangible and tangible fixed assets and related provisions and reserves will be transferred to Single Balance Sheet Owners based on the category of asset managed:

- Land and Buildings – Defence Estates
- Single Use Military Equipment – Defence Logistics Organisation
- Plant & Machinery – Defence Logistics Organisation
- Transport – Defence Logistics Organisation
- IT & Communications – Defence Communication Services Agency
- Assets Under Construction (excluding Land & Buildings) – Defence Procurement Agency

Management

The Ministers who had responsibility for the Department during the year and the composition of the Defence Management Board (DMB) during the year ended 31 March 2006 are shown on pages 171 to 172 in the Remuneration Report.

Fixed Assets

Changes in fixed asset values during the year are summarised in Notes 13, 14 and 15 (Intangible Assets, Tangible Fixed Assets and Investments) to the accounts. Note 1 – Statement of Accounting Policies provides details of the accounting policies relating to fixed assets.

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 effectiveness and capability of existing fighting equipment.

In accordance with SSAP13, “Accounting for Research and Development” (as adapted for the public sector by HM Treasury’s Financial Reporting Manual (FRM), paragraphs 5.3.6 to 5.3.8), amounts spent on research are not capitalised, and certain development expenditure is expensed. The amounts are included at Note 10 – Other Operating Costs.

Capitalised development expenditure is included in Intangible Assets, where appropriate, and shown in Note 13.

Net Expenditure

The Operating Cost Statement shows net expenditure of £34,393,535,000 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 Benefits (RfR 3) amounting to £31,262,178,000 has been credited to the General Fund (Note 21).

Dividends

Details of any dividends and loan interest received on investments can be found at Notes 11, 12 and 15 (Income, Net Interest Payable and Investments) to the accounts.

Payments to Suppliers

The Department’s bills, with the exception of some payments to suppliers by units locally, are paid through the Defence Bills Agency (DBA). In 2005-06, the DBA met its target by paying 99.99% 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 during the year amounted to £14,708.89 and included interest paid by units locally of £48 (2004-05: £63).

Departmental Reporting Cycle

The MoD’s main Departmental Report presented to Parliament each year comprises the Ministry of Defence Annual Performance Report (which forms the first section of the Annual Report and Accounts and sets out the MoD’s performance, against the objectives stated in the Statement of Operating Costs by Departmental Aim and Objectives, over the year and developments since the year end, where appropriate) and The Government’s Expenditure Plans: Ministry of Defence, which sets out planned expenditure over the following year. The MoD’s financial performance is also reported to Parliament in the explanatory memorandum to the Main Estimates, and in the Public Expenditure Outturn White Paper. Performance against Public Service Agreement and Efficiency targets is reported to Parliament during the year in the Autumn Performance Report and The Government’s Expenditure Plans: Ministry of Defence.

Post Balance Sheet Events

A Ministerial announcement on 10 May 2006, set out the outcome of the work on the composition and location of the post-normalisation garrison in Northern Ireland. This included the associated timelines for further base closures and announced the start of consultation with the trades unions on the future requirement for civilian staff for a peacetime garrison.

On 3 July 2006, the Secretary of State announced publication of the MoD's "Enabling Acquisition Change" report. This included a recommendation that the Defence Procurement Agency and the Defence Logistics Organisation should be merged to create a new organisation whose core function is delivery of equipment and support operations to the Front Line. It is the intention that the majority of the recommendations in the report will be implemented by April 2007, although the bedding in of the new intergrated procurement and support organisation will not be complete until April 2008.

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 – Financial Instruments.

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 TUs. Additional information on communication, internal and external, is provided in the Reputation section of the Annual Performance Report which forms the first part of this Annual Report and Accounts.

MANAGEMENT COMMENTARY

Performance

The Annual Performance Report forms the first part of the MoD Annual Report and Accounts and provides the detailed information set out, as best practice, in the Accounting Standards Board's (ASB's) Reporting Statement: Operating and Financial Review.

The Performance Report uses the Defence Balanced Scorecard structure to:

- describe Defence strategies, objectives and activities, and how they are managed and delivered in the legislative, regulatory and external environments in which we operate;
- provide a forward looking view of performance and development for the reporting year, with sections on Current and Future Operations as well as Future Capabilities;
- set out information on the availability and use of resources, covering: finance, manpower and estate as well as aspects such as reputation and the Wider Markets Initiative.

The Annual Performance Report also describes some of the risks and uncertainties which might affect performance.

The Statement on Internal Control describes the Department's risk and control framework and its relationship to the Performance Management System. The Departmental approach to Performance Management is detailed in Annex D.

Environmental, Social, Community, Employee and Other Matters

The preface to the Annual Report and Accounts summarises senior managers' views of how the document sets out the Department's work to realise the Defence Vision, highlighting all relevant matters. Some specific aspects mentioned in the ASB's Reporting Statement that are covered by the Performance Report are:

- **Social and Community Issues** – included in the sections on: Current Operations e.g. Crisis Response Operations and Military Aid to the Civil Authorities; Wider Government e.g. Defence in the Wider Community and Young People: Building Skills and Raising Expectations; and the essay on Defence Youth Policy.
- **Environmental** – aspects are included in the Sustainable Development sections under Estate and Wider Government. Defence Estates also produce an annual publication about conservation of the natural and historic environment on the Defence Estate. The publication, Sanctuary, illustrates how the MoD is undertaking its responsibility for stewardship of the estate in the UK and overseas through its policies and their subsequent implementation; the latest publication is available on the website: www.defence-estates.mod.uk/publications/sanctuary/sanctuary2005.pdf.
- **Employees** – information is provided in the sections on: Manpower, Personnel Management, Health and Safety and Future Personnel Plans and the essays on Diversity and the Care of Injured Personnel. Information on policy and numbers of disabled staff can be found in the Manpower section and at Annex F – Government Standards.
- **Performance Indicators** – these are included at the start of each section of the Performance Report where the Objective, Public Service Targets, Performance Measures and the Assessment against the measures are set out. Additional information can be found in the MoD Departmental Plan 2005-2009 available on the Website: www.mod.uk/DefenceInternet/AboutDefence/CorporatePublications/BusinessPlans and in the Summary of performance against SR2004 Public Service Agreement Objectives and Targets at the beginning of the Performance Report.
- **Contractual Arrangements** – some of the Department's major contractual commitments are detailed in Note 27 to the accounts – Private Finance Initiative (PFI) Commitments. The Defence Science and Technology Laboratory, the UK Hydrographic Office, the Met Office, the Defence Aviation Repair Agency and ABRO are Executive Defence Agencies financed by Trading Fund; they provide essential services to the Department. Further information on Trading Funds is at Annex E to the Annual Report and Accounts. Details of significant contracts relating to the management of the Defence Estate are included in the Estate section of the Performance Report.

- **Spending Review** – the financing implications of significant changes following the Department's Spending Review are set out in The Government's Expenditure Plans 2005-06 to 2007-08: Ministry of Defence which, with the MoD Annual Report and Accounts, comprise the MoD's Departmental Report. The Government's Expenditure Plans 2005-06 to 2007-08: Ministry of Defence and the MoD Investment Strategy are available on the websites:
<http://www.mod.uk/DefenceInternet/AboutDefence/CorporatePublications/BusinessPlans/GovernmentExpenditurePlans>
and
<http://www.mod.uk/DefenceInternet/AboutDefence/CorporatePublications/PolicyStrategy/DefenceDepartmentalInvestmentStrategy.htm>
- **Contingent Liabilities** Details of Contingent Liabilities disclosed under Financial Reporting Standard (FRS) 12 and additional liabilities included for Parliamentary Reporting and Accountability are at Notes 29 and 30 to these accounts.

Financial Position

The Statement of Parliamentary Supply – Summary of Resource Outturn on Page 187 compares Estimate and Outturn (net total resources). A detailed explanation of the variances against the Departmental Expenditure Limit is shown in paragraphs 263-264 within Resources in the Performance Report.

Request for Resources (RfR) 1, Provision of Defence Capability, provides for expenditure primarily to meet the Ministry of Defence's operational support and logistics services costs and the costs of providing the equipment capability required by defence policy. Within RfR1, the Estimate and Outturn for Operating Appropriations in Aid are shown as equal amounts. Any Appropriations in Aid in excess of the estimate are shown at Note 6, and these will be surrendered to the Consolidated Fund. This RfR is made up from three different controls:

- Resource DEL, which consists of items such as pay, equipment support costs, fuel and administrative expenses, as well as non cash items such as depreciation, cost of capital and movements in the level of provisions;
- Annually Managed Expenditure, which covers programmes that are demand-led, or exceptionally volatile in a way that could not be controlled by the Department, and where the programmes are so large that the Department could not be expected to absorb the effects of volatility in its programme, such as movements in nuclear provisions; and
- Non Budget costs, items of expenditure which are subject to Parliamentary but not Treasury control, and therefore outside DEL and AME. The majority of the costs relate to changes in the discount rates for pensions and other long term liabilities.

The net outturn is £32,737,691,000 against an Estimate of £34,664,525,000, a variance of £1,926,834,000 underspent. The variations were underspends of £374,656,000 against Resource DEL, £263,013,000 in AME, and £1,289,165,000 in Non Budget. The principal explanations for the underspend were reviews of fixed assets, capital spares and stock, resulting in lower depreciation and other impairment charges. The underspend in AME was due principally to the transfer of civil nuclear liabilities to the newly formed Nuclear Decommissioning Authority, and that in Non Budget to the lower than expected charges when the discount rate was changed, and again the transfer of nuclear liabilities to the Nuclear Decommissioning Authority.

RfR2, Conflict Prevention, shows net outturn of £1,055,848,000 against an Estimate of £1,101,276,000, a variance of £45,428,000. A contingency of £69,000,000 was included in the Spring Supplementary Estimate for reasons of prudence as the often rapidly changing operational situation means that costs are difficult to forecast. In the event, only a proportion of this contingency was needed.

RfR3, War Pensions Benefits shows net outturn of £1,068,595,000 against an Estimate of £1,072,972,000, an underspend of £4,377,000. This RfR provides for the payment of war disablement and war widows' pensions in accordance with relevant legislation, and this is all Annually Managed Expenditure. The costs of administering war pensions are borne by RfR1.

The non-operating Appropriations in Aid show a net outturn of £374,320,000 against an overly ambitious Estimate of £607,041,000.

The Net Cash Requirement shows a net outturn of £30,603,297,000 against an Estimate of £31,501,992,000, an underspend of £898,695,000. This is because the creditors at the end of the year were higher than had been forecast at the time the Spring Supplementary Estimate was submitted, and there was £146,000,000 of contingency in RfR2, for resource costs and urgent operational requirements, that in the event was not required.

Other Areas

The Department's Accounts include a note (Note 31) on Losses and Special Payments. The nature of the losses and special payments, as defined in Government Accounting, varies from year to year depending on the circumstances arising and decisions made by the Department during the year. Cases brought forward from last year are shown separately in order properly to identify the cases arising during the year. Further details on this Statement are included in the Resources Section of the Annual Performance Report.

The Department is required to have a professional revaluation of its tangible fixed assets every five years, and manages this process through a rolling programme. The current revaluation programme is due to complete in 2007-08 and is currently under review to ensure that it is being carried out effectively and at minimum cost.

Details of directorships and other significant interests held by Ministers are set out in The Register of Lords' Interests and The Register of Members' Interests which are available on the UK Parliament website:

http://www.parliament.uk/about_commons/register_of_members_interests.cfm

Details of directorships and other significant interests held by Defence Management Board members are included at Note 32 – Related Party Transactions.

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 185 to 186. The audit fee is disclosed in Note 10 – Other Operating Costs.

Statement as to Disclosure of Information to Auditors

So far as I, the Accounting Officer, am aware, there is no relevant audit information of which the Department's auditors are unaware, and I have taken all the steps that I ought to have taken to make myself aware of any relevant audit information and to establish that the Department's auditors are aware of that information.

Bill Jeffrey
Accounting Officer

11 July 2006

REMUNERATION REPORT

Remuneration Policy

The Review Body on Senior Salaries provides independent advice to the Prime Minister and the Secretary of State for Defence on the remuneration of senior civil servants and senior officers of the Armed Forces.

The Review Body also advises the Prime Minister from time to time on the pay, pensions and allowances of Members of Parliament; on Peers' allowances; and on the pay, pensions and allowances of Ministers and others whose pay is determined by the Ministerial and Other Salaries Act 1975.

In reaching its recommendations, the Review Body has regard to the following considerations:

- the need to recruit, retain and motivate suitably able and qualified people to exercise their different responsibilities;
- regional/local variations in labour markets and their effects on the recruitment and retention of staff;
- Government policies for improving the public services including the requirement on departments to meet the output targets for the delivery of departmental services;
- the funds available to departments as set out in the Government's departmental expenditure limits; and
- the Government's inflation target.

The Review Body takes account of the evidence it receives about wider economic considerations and the affordability of its recommendations.

Further information about the work of the Review Body can be found at www.ome.uk.com.

There is an established departmental procedure for the appointment of all Non-Executive Directors. This requires a visibly fair and open recruitment and selection process with appointment on merit, thus mirroring the Civil Service Commissioners' Recruitment Code for permanent employees to the Civil Service.

For the Non-Executive Directors appointed to the Defence Management Board, the Department has employed recruitment consultants to search for suitable candidates based upon a specification drawn up by senior officials. Short listed candidates are then interviewed by a selection panel (Permanent Under Secretary and Chief of the Defence Staff) with the successful candidate chosen on merit and appointed to the Board for a period of three years.

Performance and Reward

The basic salary and annual increases of the civilian members of the Defence Management Board (DMB), which could include a bonus payment, are performance related and are set by the Permanent Secretaries Remuneration Committee and the MoD's Main Pay Committee.

Pay and management arrangements for members of the Senior Civil Service (SCS) reward individuals for delivery and personal achievement. These arrangements include an objective-setting regime complementary to the Department's performance management system and a performance-related incremental pay system.

Up to two thirds of the SCS population will receive a bonus with the highest level of award limited to the top ten percent assessed as making the greatest contribution; the ceiling for the bonus payments is five percent of the SCS paybill.

All senior military officers (except for Legal Branch 2-star officers, medical and dental officers and those in the Chaplaincy branches) are paid under the Performance Management and Pay System. Depending on their performance, individuals can be awarded a double increment, a single increment or no increment and progress accordingly up the incremental pay range for their rank. The award of increments is recommended by the Senior Officers' Remuneration Committee, chaired by the Department's Permanent Under Secretary.

Whilst Non-Executive remuneration is not directly linked to performance, in part to avoid any suggestion that an employee/employer relationship exists, Non-Executive Directors' (NED) performance should nevertheless be reviewed annually. The aim of any review is to consider the impact of the NED on the performance of the board, recognise the contribution of the NED and identify ways this could be improved, and provide feedback.

Senior Managers' Contracts

Civil Service appointments are made in accordance with the Civil Service Commissioners' Recruitment Code, which requires appointments to be on merit on the basis of fair and open competition but also includes the circumstances when appointments may otherwise be made. Further information about the work of the Civil Service Commissioners can be found at www.civilservicecommissioners.gov.uk.

Unless otherwise stated below, the officials covered by this report hold appointments which are open-ended until they reach the normal retiring age of 60. Early termination, other than for misconduct, would result in the individual receiving compensation as set out in the Civil Service Compensation Scheme.

The Chief of Defence Procurement (CDP) and the Chief Scientific Adviser (CSA) are recruited on three year fixed term appointments. The conditions covering the termination of their employment are set out in their contract documents. The contract for CDP has been renewed for a further two years and now ends in 2008.

Non-Executive Directors are not employees and, therefore, do not have a contractual relationship with the Department but rather are appointees who receive a Letter of Appointment setting out amongst others: their role, period of appointment, standards and any remuneration.

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.

Senior Military members of the Management Board hold appointments which are competed for by the 3 Services. Once selected for the appointment, they will usually hold the post for between 3 and 4 years.

Management

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

Secretary of State for Defence

The Right Honourable Dr John Reid MP was appointed as Secretary of State for Defence on 6 May 2005; prior to this, the Secretary of State for Defence was The Right Honourable Geoffrey Hoon MP.

Minister of State for the Armed Forces

The Right Honourable Adam Ingram MP.

Parliamentary Under Secretary of State for Defence and Minister for Defence Procurement

Lord Drayson was appointed as Parliamentary Under Secretary of State for Defence and Minister for Defence Procurement on 10 May 2005, replacing The Lord Bach of Lutterworth.

Parliamentary Under Secretary of State for Defence and Minister for Veterans

Don Touhig MP was appointed as Parliamentary Under Secretary of State for Defence and Minister for Veterans on 10 May 2005, replacing Ivor Caplin MP.

Recent Ministerial Changes

On 6 May 2006, The Right Honourable Des Browne MP was appointed as Secretary of State for Defence, replacing The Right Honourable Dr John Reid MP, and Tom Watson MP was appointed Parliamentary Under Secretary of State for Defence and Minister for Veterans, replacing Don Touhig MP.

The composition of the Defence Management Board (DMB), as at 31 March 2006 was:

Permanent Under Secretary of State

Bill Jeffrey CB

(appointed 21 November 2005, following the retirement of Sir Kevin Tebbit KCB CMG).

Chief of the Defence Staff

General Sir Michael Walker GCB CMG CBE ADC Gen

(appointed 2 May 2003).

First Sea Lord and Chief of the Naval Staff

Admiral Sir Jonathon Band KCB ADC

(appointed 7 February 2006, replacing Admiral Sir Alan West GCB DSC ADC).

Chief of the General Staff

General Sir Mike Jackson GCB CBE DSO ADC Gen

(appointed 1 February 2003).

Chief of the Air Staff

Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF

(appointed 1 August 2003).

Vice Chief of the Defence Staff

General Sir Timothy Granville-Chapman KCB CBE ADC Gen

(appointed 22 July 2005, replacing Air Chief Marshal Sir Anthony Bagnall KCB OBE FRAeS RAF).

Second Permanent Under Secretary of State

Ian Andrews CBE TD

(appointed 4 March 2002).

Chief of Defence Procurement

Sir Peter Spencer KCB

(appointed 1 May 2003 and re-appointed, for a 2 year period, on 1 May 2006).

Chief of Defence Logistics

General Sir Kevin O'Donoghue KCB CBE

(appointed 1 January 2005).

Chief Scientific Adviser

Professor Sir Roy Anderson FRS

(appointed 1 October 2004).

Finance Director

Trevor Woolley

(appointed to the Defence Management Board 24 June 2004).

Non-Executive Directors

Charles Miller Smith, Chairman of Scottish Power.

*Philippa Foster Back OBE, Director of the Institute of Business Ethics.

*Chairman of the Defence Audit Committee.

Recent Changes to the Defence Management Board

Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF was appointed

Chief of the Defence Staff on 28 April 2006.

Air Chief Marshal Sir Glenn Torpy KCB CBE DSO ADC BSc(Eng) FRAeS RAF was appointed

Chief of the Air Staff on 13 April 2006.

Paul Skinner, Chairman of Rio Tinto plc and Rio Tinto Ltd was appointed Non Executive Director on 1 June 2006.

Ministerial Salaries, Allowances and Taxable Benefits

(This section has been subject to audit)

	2005-06	2005-06	2004-05	2004-05
	Salary* £	Benefits- in-kind (to nearest £100)	Salary £	Benefits- in-kind (to nearest £100)
<i>Secretary of State for Defence:</i>				
The Rt Hon Dr John Reid MP (from 6 May 05)	67,653	Nil		
<i>Full year equivalent salary</i>	74,902			
The Rt Hon Geoffrey Hoon MP (to 6 May 05)	7,450	700	72,862	7,300
<i>Full year equivalent salary</i>	74,902			
<i>Minister of State for the Armed Forces:</i>				
The Rt Hon Adam Ingram MP	38,854	Nil	37,796	Nil
<i>Parliamentary Under Secretary of State and Minister for Defence Procurement:</i>				
Lord Drayson (from 10 May 05) †	Nil	Nil		
The Lord Bach of Lutterworth (to 9 May 05) ††	10,983	Nil	97,608	Nil
<i>Full year equivalent salary</i>	102,138			
<i>Parliamentary Under Secretary of State for Defence and Minister for Veterans:</i>				
Don Touhig MP (from 10 May 05)	26,320	Nil		
<i>Full year equivalent salary</i>	29,491			
Ivor Caplin MP (to 9 May 05)	3,171	Nil	28,688	Nil
<i>Full year equivalent salary</i>	29,491			

*Ministers who moved to different Departments were paid by MoD up to the end of the month in which they left; their new Department commenced paying them thereafter. Salary disclosures only cover the period during which individuals served as Ministers within the MoD.

† Lord Drayson does not receive the ministerial salary of £69,138 to which he is entitled.

†† Lords Ministers' Night Subsistence paid to The Lord Bach of Lutterworth was £3,548 in 2005-06 (2004-05: £30,353) and is included in the salary figures disclosed.

Ministers who, on leaving office, have not attained the age of 65 and are not appointed to a relevant Ministerial or other paid office within three weeks, are eligible for a severance payment. One payment was made in 2005-06 (2004-05 – Nil).

Ministers' Salary

'Salary' includes: gross salary; performance pay or bonuses; overtime; reserved rights to London weighting or London allowances; recruitment and retention allowances; private office allowances and any other allowance to the extent that it is subject to UK taxation.

The figures above are based on payments made by the Department and thus recorded in these accounts. In respect of Ministers in the House of Commons, the Department bears only the cost of the additional Ministerial remuneration; the salary for their services as an MP – £59,095 pa with effect from 1 April 2005 (£57,485 pa with effect from 1 April 2004) and various allowances to which they are entitled are borne centrally. The arrangements for Ministers in the House of Lords are 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 normally paid by the Department and is therefore shown in full above.

Benefits-in-kind for Ministers

Ministers' 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 and the value of the benefit is calculated in accordance with HM Revenue & Customs regulations. The value of the accommodation is exempt from tax but a taxable benefit is calculated in respect of the ancillary services (e.g. maintenance and utilities) provided; the value of the benefit is limited to 10% of Ministerial salary.

Ministerial Pensions

(This section has been subject to audit)

Figures for **2005-06 in bold**. The real increase in the value of the accrued pension compared to the 2004-05 value, is shown in italics (in bands of £2,500).

	Total Accrued Pension at Retirement as at 31 Mar 06 £000	CETV* at 31 Mar 05 or Date of Appointment if Later £000	CETV at 31 Mar 06 or on Cessation of Appointment if Earlier £000	Real Increase in CETV £000
<i>Secretary of State for Defence:</i>				
The Rt Hon Dr John Reid MP (from 6 May 05)	10-15	141	181	28
The Rt Hon Geoffrey Hoon, MP (to 6 May 05)	10-15 <i>0-2.5</i>	101**	102	1
<i>Minister of State for the Armed Forces:</i>				
The Rt Hon Adam Ingram MP	5-10 <i>0-2.5</i>	95**	119	17
<i>Parliamentary Under Secretary of State and Minister for Defence Procurement:</i>				
Lord Drayson (from 10 May 05)†	Nil	Nil	Nil	Nil
The Lord Bach of Lutterworth (to 9 May 05)	5-10 <i>0-2.5</i>	101	103	1
<i>Parliamentary Under Secretary of State for Defence and Minister for Veterans:</i>				
Don Touhig MP (from 10 May 05)	0-5	41	50	5
Ivor Caplin MP (to 9 May 05)	0-5 <i>0-2.5</i>	21	22	0

† Lord Drayson is not a member of the Parliamentary Contributory Pension Fund.

* CETV – Cash Equivalent Transfer Value.

** The factors used to calculate the CETV were revised on 1 April 2005 on the advice of the scheme's actuary. The CETV figures for 31 March 2005 have been recalculated using the new factors and in two cases this has led to changes to the figures published last year.

Pension benefits for Ministers are provided by the Parliamentary Contributory Pension Fund (PCPF). The scheme is statutory based (made under Statutory Instrument SI 1993 No 3253, as amended).

Those Ministers who are Members of Parliament are also entitled to an MP's pension under the PCPF. The arrangements for Ministers provide benefits on an 'average salary' basis with either a 1/50th or 1/40th accrual rate, taking account of all service as a Minister. The accrual rate has been 1/40th since 15 July 2002 but Ministers, in common with all other members of the PCPF, can opt to increase their accrual rate from 5 July 2001, or retain the 1/50th accrual rate and the lower rate of employee contribution.

Benefits for Ministers are payable at the same time as MPs' benefits become payable under the PCPF or, for those who are not MPs, on retirement from Ministerial office on or after age 65. Pensions are increased annually in line with changes in the Retail Prices Index. Members pay contributions of 6% of their Ministerial salary if they have opted for the 1/50th accrual rate, and 9% if they have opted for the 1/40th accrual rate. There is also an employer contribution paid by the Exchequer representing the balance of cost. This is currently 24% of the Ministerial salary.

The Cash Equivalent Transfer Value (CETV)

This is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. It is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme when the member leaves a scheme and chooses to transfer the pension benefits they have accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total Ministerial service, not just their current appointment as a Minister. CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries.

The Real Increase in the Value of the CETV

This reflects the increase in CETV effectively funded by the employer. It takes account of the increase in accrued pension due to inflation, contributions paid by the Minister (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

Defence Management Board – Salaries, Allowances and Taxable Benefits in Kind

(This section has been subject to audit)

	2005-06	2005-06	2004-05	2004-05
	Salary* £000	Benefits- in-kind (to nearest £100)	Salary £000	Benefits- in-kind (to nearest £100)
Permanent Under Secretary of State Bill Jeffrey CB (from 21 Nov 05) <i>Full year equivalent salary</i>	55-60 <i>155-160</i>	10,800		
Permanent Under Secretary of State Sir Kevin Tebbit KCB CMG (to 11 Nov 05)** <i>Full year equivalent salary</i>	115-120 <i>180-185</i>	25,500	170-175	32,600
Chief of the Defence Staff General Sir Michael Walker GCB CMG CBE ADC Gen	200-205	38,000	185-190	33,400
First Sea Lord and Chief of the Naval Staff Admiral Sir Jonathon Band KCB ADC (from 7 Feb 06) <i>Full year equivalent salary</i>	20-25 <i>140-145</i>	3,900		
First Sea Lord and Chief of the Naval Staff Admiral Sir Alan West GCB DSC ADC (to 6 Feb 06) <i>Full year equivalent salary</i>	120-125 <i>145-150</i>	23,400	135-140	22,100
Chief of the General Staff General Sir Mike Jackson GCB CBE DSO ADC Gen	170-175	28,100	160-165***	22,500
Chief of the Air Staff Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF	145-150	27,600	135-140	22,300
Vice Chief of the Defence Staff General Sir Timothy Granville-Chapman KCB CBE ADC Gen (from 22 Jul 05) <i>Full year equivalent salary</i>	95-100 <i>140-145</i>	18,400		

	2005-06	2005-06	2004-05	2004-05
	Salary* £000	Benefits- in-kind (to nearest £100)	Salary £000	Benefits- in-kind (to nearest £100)
Vice Chief of the Defence Staff Air Chief Marshal Sir Anthony Bagnall KCB OBE FRAeS RAF (to 21 July 05) <i>Full year equivalent salary</i>	45-50 <i>145-150</i>	8,500	140-145	24,800
Second Permanent Under Secretary of State Ian Andrews CBE TD	135-140	25,700	130-135	29,000
Chief of Defence Procurement Sir Peter Spencer KCB	135-140	29,400	125-130	31,100
Chief of Defence Logistics General Sir Kevin O'Donoghue KCB CBE <i>Full year equivalent salary</i>	135-140	Nil	30-35 <i>110-115</i>	Nil
Chief Scientific Adviser Professor Sir Roy Anderson FRS <i>Full year equivalent salary</i>	135-140	18,900	60-65 <i>125-130</i>	10,900
Finance Director Trevor Woolley <i>Full year equivalent salary</i>	125-130	Nil	80-85 <i>105-110</i>	Nil
Non-Executive Directors	Fees		Fees	
Charles Miller Smith	25-30	Nil	25-30	Nil
Philippa Foster Back OBE	25-30	Nil	25-30	Nil

* Salary includes gross salary, performance pay and allowances paid.

** Sir Kevin Tebbit received a payment from the Civil Service Compensation Scheme.

*** The prior year salary figure has been restated.

Benefit in kind figures for civilian members of the DMB represent the value obtained from the private use of official cars. For Service members of the DMB, the benefit in kind represents the value obtained from the use of Official Service Residences. The Department has an arrangement with the HM Revenue and Customs where MoD pays the tax liability that would ordinarily be paid by the individual on the benefit in kind. The tax liability consists of income tax and, where applicable, employees' National Insurance Contributions. This tax liability is included in the figures disclosed to arrive at the full value of the benefit to the individual.

Defence Management Board – Pension Benefits

(This section has been subject to audit)

2005-06 figures are in bold. The real increase in the pension, from 2004-05, and where applicable the real increase in the lump sum payment, are shown in italics.

	Total Accrued Pension at Retirement as at 31 Mar 06 £000	CETV at 31 Mar 05 or Date of Appointment if Later* £000	CETV at 31 Mar 06 or on Cessation of Appointment if Earlier £000	Real Increase or (Decrease) in CETV £000
Permanent Under Secretary of State Bill Jeffrey CB (from 21 Nov 05)	Pension 65-70 <i>2.5-5</i> Lump Sum 195-200 <i>7.5-10</i>	1,125	1,212	69
Permanent Under Secretary of State Sir Kevin Tebbit KCB CMG (to 11 Nov 05)	Pension 75-80 <i>0-2.5</i> Lump Sum 225-230 <i>5-7.5</i>	1,317	1,388	41
Chief of the Defence Staff General Sir Michael Walker GCB CMG CBE ADC Gen	Pension 100-105 <i>2.5-5</i> Lump Sum 300-305 <i>5-10</i>	1,533	1,604	52
First Sea Lord and Chief of the Naval Staff Admiral Sir Jonathon Band KCB ADC (from 7 Feb 06)	Pension 70-75 Lump Sum 215-220	1,418	1,434	10
First Sea Lord and Chief of the Naval Staff Admiral Sir Alan West GCB DSC ADC (to 6 Feb 06)	Pension 70-75 <i>2.5-5</i> Lump Sum 215-220 <i>10-12.5</i>	1,331	1,405	69
Chief of the General Staff General Sir Mike Jackson GCB CBE DSO ADC Gen	Pension 70-75 <i>0-2.5</i> Lump Sum 220-225 <i>5-7.5</i>	1,134	1,161	30
Chief of the Air Staff Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF	Pension 70-75 <i>2.5-5</i> Lump Sum 215-220 <i>10-12.5</i>	1,382	1,462	68

	Total Accrued Pension at Retirement as at 31 Mar 06 £000	CETV at 31 Mar 05 or Date of Appointment if Later* £000	CETV at 31 Mar 06 or on Cessation of Appointment if Earlier £000	Real Increase or (Decrease) in CETV £000
Vice Chief of the Defence Staff General Sir Timothy Granville-Chapman KCB CBE ADC Gen (from 22 Jul 05)	Pension 70-75 Lump Sum 210-215	1,241	1,184	45
Vice Chief of the Defence Staff Air Chief Marshal Sir Anthony Bagnall KCB OBE FRAeS RAF (to 21 Jul 05)	Pension 70-75 <i>0-2.5</i> Lump Sum 215-220 <i>0-2.5</i>	1,188	1,182	(7)
Second Permanent Under Secretary of State Ian Andrews CBE TD	Pension 50-55 <i>2.5-5</i> Lump Sum 125-130 <i>5-7.5</i>	686	789	73
Chief of Defence Procurement Sir Peter Spencer KCB	Pension 5-10 <i>0-2.5</i> Lump Sum N/A	47	75	33
Chief of Defence Logistics General Sir Kevin O'Donoghue KCB CBE**	Pension 65-70 <i>10-12.5</i> Lump Sum 205-210 <i>30-32.5</i>	1,104	1,298	190
Chief Scientific Adviser Professor Sir Roy Anderson FRS	Pension 0-5 <i>0-2.5</i> Lump Sum N/A	12	39	32
Finance Director Trevor Woolley	Pension 40-45 <i>0-2.5</i> Lump Sum 130-135 <i>5-7.5</i>	581	641	31
Non-Executive Directors Charles Miller Smith Philippa Foster Back OBE	N/A N/A	N/A N/A	N/A N/A	N/A N/A

* The CETV as at 31 Mar 05 for members of the Principal Civil Service Pension Scheme has been recalculated on the advice of the Scheme Actuary.

** The prior year calculation of pension was incorrect. The comparison above reflects the increase in pension and lump sum in relation to the correctly calculated 2004-05 figures.

Principal Civil Service Pension Scheme (PCSPS)

Pension benefits are provided through the Civil Service pension arrangements. From 1 October 2002, civil servants may be in one of three statutory based 'final salary' defined benefit schemes (classic, premium, and classic plus). The schemes are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under classic, premium, and classic plus are increased annually in line with changes in the Retail Prices Index. New entrants after 1 October 2002 may choose between membership of premium or joining a good quality 'money purchase' stakeholder arrangement with a significant employer contribution (partnership pension account).

Employee contributions are set at the rate of 1.5% of pensionable earnings for classic and 3.5% for premium and classic plus. Benefits in classic accrue at the rate of 1/80th of pensionable salary for each year of service. In addition, a lump sum equivalent to three years' pension is payable on retirement. For premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike classic, there is no automatic lump sum although members may give up (commute) some of their pension to provide a lump sum. Classic plus is essentially a variation of premium, but with benefits in respect of service before 1 October 2002 calculated broadly in the same way as in classic.

The partnership pension account is a stakeholder pension arrangement. The employer makes a basic contribution of between 3% and 12.5% (depending on the age of the member) into a stakeholder pension product chosen by the employee from a selection of approved products. The employee does not have to contribute but, where they do make contributions, the employer will match these up to a limit of 3% of pensionable salary (in addition to the employer's basic contribution). Employers also contribute a further 0.8% of pensionable salary to cover the cost of centrally-provided risk benefit cover (death in service and ill health retirement).

Further details about the Civil Service pension arrangements can be found at the website www.civilservice-pensions.gov.uk.

Armed Forces Pension Scheme (AFPS)

From 6 April 2005, a new Armed Forces Pension Scheme (known as AFPS 05) was introduced for all new members of the Armed Forces; those in service before this date have been given the opportunity to transfer, from AFPS-75, to the new scheme. Both schemes are defined benefit, salary-related, contracted out, occupational pension schemes. The AFPS is non-contributory for members; the costs of benefits accruing for each year of service are met by the employer at an 'all ranks' rate approximately equivalent to 31% of total pay. Members are entitled to a taxable pension for life and a tax-free pension lump sum if they leave the Armed Forces at or beyond either the Early Departure Point or the Immediate Pension Point. If a scheme member leaves before these points, they will be entitled to a preserved pension and related lump sum.

Further details about Armed Forces Pensions can be found at the website www.mod.uk/DefenceInternet/AboutDefence/Issues/Pensions/

Cash Equivalent Transfer Value

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies. The pension details include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the AFPS or Civil Service pension arrangements and for which a transfer payment commensurate with the additional pension liabilities being assumed has been received. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost.

CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries. The factors used to calculate the CETV for members of the PCSPS were revised on 1 April 2005 on the advice of the Scheme Actuary. The CETV figures for 31 March 2005 have been recalculated using the new factors (in some cases this has led to changes to the figures published last year) and restated on the same basis as the CETV figures for 31 March 2006.

Real Increase in CETV

This reflects the increase in CETV effectively funded by the employer. It takes account of the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

Bill Jeffrey
Accounting Officer

11 July 2006

STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

Under the Government Resources and Accounts Act 2000, HM Treasury has directed the Ministry of Defence to prepare for each financial year resource accounts detailing the resources acquired, held or disposed of during the year and the use of resources by the Department during the year.

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

In preparing the accounts, the Accounting Officer is required to comply with the requirements of the *Government Financial Reporting Manual* and in particular to:

- observe the Accounts Direction issued by HM Treasury, including 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 *Government Financial Reporting Manual*, have been followed, and disclose and explain any material departures in the accounts;

and

- prepare the accounts on a going-concern basis.

HM Treasury has appointed the Permanent Head of Department as Accounting Officer of the Department. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the 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

1. Scope of responsibility

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.

During the Financial Year 2005/06, the Department's outputs were delivered through 13 Top Level Budget areas, each managed by a military or civilian Top Level Budget (TLB) Holder, together with 5 Trading Fund Agencies. The Department also has 6 executive Non-Departmental Public Bodies (NDPB) and 1 Public Corporation with delegated responsibilities. Included within the TLBs are 20 on-vote Defence Agencies whose Chief Executives are responsible for producing annual accounts which are laid before Parliament but which also form part of the Departmental Resource Accounts. TLB Holders operate within a framework of responsibilities delegated by me. To assist me in assessing the adequacy of control arrangements across the Department, TLB Holders submit to me an annual statement of Assurance, endorsed by their Audit Committee and Management Board, also covering the Agencies for which they are responsible². Both the Veterans' Agency (VA) and Armed Forces Pensions Administration Agency (AFPAA) are administered within the Central TLB. The VA manages the War Pensions and Benefit Programme (WPB), and AFPAA the Armed Forces Pensions and Compensation scheme (AFPS/AFCS). The Agencies' Chief Executives are directly accountable for the delivery of these services. The 5 MoD Trading Funds (the Defence Aviation Repair Agency, ABRO, the Defence Science and Technology Laboratory (Dstl), the UK Hydrographic Office, and the Met Office) fall outside the Departmental Accounting Boundary and their Chief Executives are Accounting Officers in their own right. They therefore publish their own SICs together with their Annual Accounts. Given their close integration into the Department's business, and their extensive use of Departmental personnel and assets, their Chief Executives also provide to me the SIC prepared for their annual Accounts. Although sponsored by the Department, the 6 NDPBs and Public Corporation also fall outside the Departmental Boundary and their accounts are also published separately. The NDPBs operate within a financial memorandum agreed between their respective Boards of Trustees and the Department. The Public Corporation (Oil and Pipelines Agency) has a Board of Directors on which the Department is represented.

Ministers are involved in the delivery of outputs, including the management of risks to delivery, through the Defence Council which is chaired by the Secretary of State for Defence and includes all the senior executive members of the Defence Management Board (DMB). Ministers also chair a variety of internal Boards which review the performance of the Trading Funds, the primary on-vote Agencies, including the Defence Procurement Agency (DPA) and Defence Estates (DE) which are also TLBs, and other elements of MoD business such as change, Acquisition and Environment and Safety. In particular, all 5 Trading Funds report to Advisory Boards chaired by MoD Ministers. Ministers are consulted on all key decisions affecting Defence, including major investment decisions and on operational matters. The Chief of Defence Staff is the Government's and the Secretary of State's principal advisor on military operations and is responsible for the maintenance of military operational capability and for the preparation and conduct of military operations, including managing the risks to successful outcomes. The Chiefs of Staff Committee is chaired by the Chief of Defence Staff and is the main forum in which the collective military advice of the Chiefs is obtained on operational issues. The individual Service Chiefs also advise the Chief of Defence Staff, the Secretary of State and, when required, the Prime Minister on the operational employment of their Service.

2. The purpose of the system of internal control

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 provide only reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of Departmental policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place in the Department for the year ended 31 March 2006 and up to the date of approval of the annual report and accounts, and accords with Treasury guidance.

²For the Defence Procurement Agency and Defence Estates, which are both agencies and Top Level Budgets, this is discharged by submission of the Statement on Internal Control prepared for their own annual Accounts.

3. Capacity to handle risk

Active management of risk is fundamental to the effective achievement of Defence objectives, and is central to the way business is conducted within the Department. It informs operational decision making, contingency planning, investment decisions and the financial planning process. Risk forms an integral element of the DMB's performance reviews. Guidance on the Department's approach to risk is detailed in a Joint Service Publication³, which is periodically reviewed and updated. This sets out the Department's corporate governance and risk management policy statement and strategy to be cascaded down through TLB Holders, and provides extensive guidance to staff on definitions, criteria and methods available for risk assessment and management. It is made available to all personnel in either hard copy or via the Department's intranet. Individual training, at both awareness and practitioner level, is available to all staff via the Department's in-house training provider.

4. The risk and control framework

The Department's Performance Management System provides the strategic framework for the consideration of risks within the Defence Balanced Scorecard and lower level scorecards, offering a starting point for the identification, evaluation, control and reporting of risk against a balanced assessment of Departmental objectives. Key Departmental objectives, performance indicators and targets are defined annually by the DMB and cascaded to TLB Holders through Service Delivery Agreements. Performance is monitored and discussed quarterly at DMB and lower level management board meetings, including explicit consideration of key risks. The Department's risk appetite is determined through the advice on operations given to Ministers, through decisions taken as part of the Department's bi-annual planning round including assessing any gaps against Planning Assumptions, and demonstrated through the limits and controls placed on individual investment projects as part of the Department's Investment Approval process and the total number of projects.

5. Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within the Department who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the DMB and the Defence Audit Committee (DAC) and a plan to address weaknesses and ensure continuous improvement of the system is in place.

The following processes are in operation in order to maintain and review the effectiveness of the system of internal control:

- A Defence Management Board, which meets approximately monthly to manage the plans, performance and strategic direction of the Department, comprising the senior members of the Department and two external independent members.
- A Defence Audit Committee, 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 pan-Departmental process owners and specialist assurance sources, including:
 - 2nd Permanent Under Secretary, as the Chair of the Defence Environment and Safety Board
 - the Chief of Defence Logistics
 - the Finance Director
 - the Deputy Chief of the Defence Staff (Personnel)
 - the Civilian Personnel Director
 - the Science and Technology Director
 - the Director General Media and Communication

³Joint Service Publication 525.

- the Director General Security and Safety as the Departmental Security Officer
 - the Director of Defence Acquisition
 - the Director of Operational Capability
 - Defence Internal Audit, including the Defence Fraud Analysis Unit
 - the National Audit Office
- A Departmental risk register, supported by operational-level risk registers, which complements the Defence Balanced Scorecard. Departmental risks are routinely reviewed by the DMB in the context of its regular reviews of Departmental programmes.
 - Through TLB Holders, a cascaded system for ensuring compliance with legal and statutory regulations. Each TLB holder is supported by an Audit Committee, including and, in all bar one case⁴, chaired by non-executive directors and at which representatives from the internal and external auditors are present. Like the DAC these committees focus their activities to provide advice on wider-business risk and assurance processes.
 - A new Business Management System, with responsibility for the effective and efficient operation of the key pan-Departmental processes, such as Planning and Human Resources (military and civilian), including the identification of risks within these processes and the maintenance of effective controls to manage them, assigned to functional heads or process owners. Process Owners are responsible directly to the DMB.
 - 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 annual risk-based programme of internal audit provided by Defence Internal Audit (DIA), who are the primary source of independent assurance, which is complemented by the activity of the Directorate of Operational Capability (DOC), which provides independent operational audit and assurance to the Secretary of State and the Chief of Defence Staff. On the basis of the audit work conducted during the year, DIA offered Substantial Assurance that the systems of internal control, risk management and governance reviewed are operating effectively across the Department.
 - The Department's external audit function is provided by the Comptroller and Auditor General, supported by staff from the National Audit Office (NAO). The Accounting Officer and NAO staff see all DAC papers and attend its meetings, and there was no relevant audit information that the NAO were not already aware. Additionally the Accounting Officer held periodic private discussions with Internal Audit, and the NAO see all relevant Top Level Budget (TLB) papers and attend TLB Audit Committee meetings.
 - Annual Reports providing measurable performance indicators and more subjective assessments on the Health of Financial Systems from all TLB Holders and key functional specialists. Improvements have continued to be made to our financial control during the year. The Department has delivered its outputs within the resources voted by Parliament despite the additional workload generated by Operations. The Department remained within the Treasury's Total Departmental Expenditure Limit but, owing to an accounting adjustment that arose from review after the year end, the specific Departmental Capital Expenditure Limit was exceeded.
 - Centres of Excellence in key areas – including Change, Equipment and Estates, integrating Office of Government Commerce (OGC) processes, tools and structures into existing Departmental management and control processes – 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 OGC and the National Audit Office.
 - A dedicated team to co-ordinate, and appropriate mechanisms to strengthen, the management of scientific risks, particularly to Service personnel health, and in health, safety and environmental matters.
 - An effective governance structure and performance management system that addresses the risks arising from the introduction of the general right of access to information from January 2005 under the Freedom of Information Act.

Bill Jeffrey
Accounting Officer

11 July 2006

⁴The General Officer Commanding Northern Ireland (GOCNI)'s Audit Committee is chaired by the TLB Civil Secretary, but contains two Non-Executive Directors with direct access to the Management Board and TLB Holder.

THE CERTIFICATE OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSE OF COMMONS

I certify that I have audited the financial statements of the Ministry of Defence for the year ended 31 March 2006 under the Government Resources and Accounts Act 2000. These comprise the Statement of Parliamentary Supply, the Operating Cost Statement and Statement of Recognised Gains and Losses, the Balance Sheet, the Cashflow Statement and the Statement of Operating Costs by Departmental Aim and Objectives and the related notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Accounting Officer and auditor

The Accounting Officer is responsible for preparing the Annual Report and the financial statements in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions made thereunder and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's Responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000. I also report 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 to you if, in my opinion, the Annual Report is not consistent with the financial statements, if the Department has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by HM Treasury regarding remuneration and other transactions is not disclosed.

I review whether the statement on pages 182 to 184 reflects the Department's compliance with HM Treasury's guidance on the Statement on Internal Control, and I report if it does not. I am not required to consider whether the Accounting Officer's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Department's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are most 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 and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

Opinions

In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by HM Treasury, of the state of the Department's affairs as at 31 March 2006 and the net cash requirement, net resource outturn, resources applied to objectives, recognised gains and losses and cashflows for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000; 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.

I have no observations to make on these financial statements.

John Bourn

Comptroller and Auditor General

12 July 2006

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

STATEMENT OF PARLIAMENTARY SUPPLY

Summary of Resource Outturn 2005-06

Request for Resources	Note	Estimate			Outturn			2005-06	2004-05
		Gross Expenditure	A-in-A *	Net Total	Gross Expenditure	A-in-A *	Net Total	Net Total Outturn compared to Estimate Savings/(Excess)	Outturn Restated
		£000	£000	£000	£000	£000	£000	£000	£000
1	2	36,011,095	1,346,570	34,664,525	34,084,261	1,346,570	32,737,691	1,926,834	30,514,128
2	2	1,101,276	–	1,101,276	1,055,848	–	1,055,848	45,428	938,181
3	2	1,072,972	–	1,072,972	1,068,595	–	1,068,595	4,377	1,109,521
Total resources	3	38,185,343	1,346,570	36,838,773	36,208,704	1,346,570	34,862,134	1,976,639	32,561,830
Non operating cost A-in-A				607,041			374,320	232,721	287,435

* Appropriation-in-Aid (A-in-A)

The prior year costs have been restated to reflect the transfer of responsibility for certain nuclear decommissioning from the MoD to the Nuclear Decommissioning Authority. Movements are detailed at Note 33.

Net Cash Requirement 2005-06

Net Cash Requirement	Note	Estimate	Outturn	2005-06	2004-05
				Net Total Outturn compared to Estimate Savings/(Excess)	Outturn
				£000	£000
	4	31,501,992	30,603,297	898,695	29,624,275

Summary 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 being shown in italics)).

Total	Note	Forecast 2005-06		Outturn 2005-06	
		Income	Receipts	Income	Receipts
		£000	£000	£000	£000
	5	–	–	468,599	<i>470,388</i>

The notes on pages 193 to 245 form part of these accounts

Further analysis of the variances between Estimate and Outturn is at Note 2 and a summary of the overall financial position, including an explanation of the main variances identified above, is provided both in the Management Commentary and the following paragraphs. A detailed explanation of the Department's financial performance in relation to HM Treasury's Departmental Expenditure Limits is included within Resources in the Performance Report.

RfR 1, Provision of Defence Capability, provides for expenditure primarily to meet the Ministry of Defence's operational support and logistics services costs and the costs of providing the equipment capability required by Defence policy. Within RfR1, the Estimate and Outturn for Operating Appropriations in Aid are shown as equal amounts. Any Appropriations in Aid in excess of the Estimate are shown at Note 6, and these will be surrendered to the Consolidated Fund.

The net outturn is £32,737,691,000 against an Estimate of £34,664,525,000, a variance of £1,926,834,000 underspent. Principal explanations for the underspend were reviews of fixed assets, capital spares and stock resulting in lower depreciation and other impairment charges. The underspend in nuclear provisions was due principally to the transfer of nuclear liabilities to the newly formed Nuclear Decommissioning Authority, and a lower than expected charge for the unwinding of the discount on provisions, following the discount rate change from 3.5% to 2.2%.

RfR2, Conflict Prevention, shows net outturn of £1,055,848,000 against an Estimate of £1,101,276,000, a variance of £45,428,000. A contingency of £69,000,000 was included in the Spring Supplementary Estimate for reasons of prudence as the often rapidly changing operational situation means that costs are difficult to forecast. In the event, only a proportion of this contingency was needed.

RfR3, War Pensions Benefits shows net outturn of £1,068,595,000 against an Estimate of £1,072,972,000 an underspend of £4,377,000. This RfR provides for the payment of war disablement and war widows' pensions in accordance with relevant legislation. The costs of administering war pensions are borne by RfR1.

The non-operating Appropriations in Aid show a net outturn of £374,320,000 against an overly ambitious Estimate of £607,041,000.

The Net Cash Requirement shows net outturn of £30,603,297,000 against an Estimate of £31,501,992,000, an underspend of £898,695,000. This is because the creditors at the end of the year were higher than had been forecast at the time the Spring Supplementary Estimate was submitted, and there was £146,000,000 of contingency in RfR2, for resource costs and urgent operational requirements, that in the event was not required.

OPERATING COST STATEMENT

for the year ended 31 March 2006

	Note	2005-06 £000	2004-05 Restated £000
Staff costs	9	11,254,851	10,995,642
Other operating costs	10	20,171,162	19,595,404
Gross operating costs		31,426,013	30,591,046
Operating income	11	(1,390,997)	(1,416,807)
Net operating cost before interest		30,035,016	29,174,239
Net interest payable	12	1,252,150	131,294
Cost of capital charge	21	3,106,369	3,025,892
Net operating cost		34,393,535	32,331,425
Net resource Outturn	3	34,862,134	32,561,830

The prior year costs have been restated to reflect the transfer of responsibility for certain nuclear decommissioning from the MoD to the Nuclear Decommissioning Authority. Movements are detailed at Note 33.

Statement of Recognised Gains and Losses

for the year ended 31 March 2006

	Note	2005-06 £000	2004-05 £000
Net gain on revaluation of fixed assets and stocks	22	(2,425,832)	(4,521,891)
Net gain on revaluation of investments	22	(242,590)	–
Receipts of donated assets and (gain)/loss on revaluation	22	(111,753)	(440,664)
Recognised gains for the financial year		(2,780,175)	(4,962,555)
Prior year adjustment	33	(4,348,036)	
Recognised gains since the last Annual Accounts		(7,128,211)	

The notes on pages 193 to 245 form part of these accounts.

BALANCE SHEET

as at 31 March 2006

	Note	31 March 2006		31 March 2005	
		£000	£000	£000	Restated £000
Fixed Assets					
Intangible assets	13	22,982,695		22,647,823	
Tangible fixed assets	14	71,774,958		69,608,889	
Investments	15	514,132		347,108	
			95,271,785		92,603,820
Current Assets					
Stocks and work-in-progress	16	6,052,227		6,095,363	
Debtors	17	2,921,155		2,849,378	
Cash at bank and in hand	18	1,018,245		438,411	
			9,991,627		9,383,152
Creditors: amounts falling due within one year	19	6,449,389		6,000,880	
Net current assets			3,542,238		3,382,272
Total assets less current liabilities			98,814,023		95,986,092
Creditors: amounts falling due after more than one year	19	1,057,601		809,895	
Provisions for liabilities and charges	20	6,274,944		5,182,680	
			7,332,545		5,992,575
Net assets			91,481,478		89,993,517
Taxpayers' equity					
General fund	21		72,490,177		69,254,944
Revaluation reserve	22		16,635,683		18,719,510
Donated assets reserve	22		2,113,028		2,019,063
Investment reserve	22		242,590		–
			91,481,478		89,993,517

The balances at 31 March 2005 have been restated to reflect the transfer of responsibility for certain nuclear decommissioning from the MoD to the Nuclear Decommissioning Authority. Movements are detailed at Note 33.

Bill Jeffrey
Accounting Officer

11 July 2006

The notes on pages 193 to 245 form part of these accounts.

CASH FLOW STATEMENT

for the year ended 31 March 2006

		2005-06	2004-05
	Note	£000	Restated £000
Net cash outflow from operating activities	23.1	(23,865,060)	(22,966,281)
Capital expenditure and financial investment	23.2	(6,222,278)	(6,246,193)
Payments of amounts due to the Consolidated Fund		(736,501)	(237,175)
Financing	23.4	31,403,673	29,575,496
Increase in cash at bank and in hand	23.5	579,834	125,847

The notes on pages 193 to 245 form part of these accounts.

STATEMENT OF OPERATING COSTS BY DEPARTMENTAL AIM AND OBJECTIVES

for the year ended 31 March 2006

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:

	2005-06			2004-05		
	Gross £000	Income £000	Net £000	Gross Restated £000	Income £000	Net Restated £000
Objective 1: Achieving success in the tasks we undertake	3,984,890	(420,801)	3,564,089	3,725,324	(335,767)	3,389,557
Objective 2: Being ready to respond to the tasks that might arise	27,526,586	(925,270)	26,601,316	25,950,299	(1,016,681)	24,933,618
Objective 3: Building for the future	3,204,461	(44,926)	3,159,535	2,963,087	(64,359)	2,898,728
	<u>34,715,937</u>	<u>(1,390,997)</u>	<u>33,324,940</u>	<u>32,638,710</u>	<u>(1,416,807)</u>	<u>31,221,903</u>
Paying war pensions and allowances	1,068,595	–	1,068,595	1,109,522	–	1,109,522
Total	<u>35,784,532</u>	<u>(1,390,997)</u>	<u>34,393,535</u>	<u>33,748,232</u>	<u>(1,416,807)</u>	<u>32,331,425</u>

See additional details in Note 24.

The prior year costs have been restated to reflect the transfer of responsibility for certain nuclear decommissioning from the MoD to the Nuclear Decommissioning Authority. Movements are detailed at Note 33.

The notes on pages 193 to 245 form part of these accounts.

NOTES TO THE ACCOUNTS

1 Statement of Accounting Policies

Introduction

1.1 These financial statements have been prepared in accordance with the generic Accounts Direction issued by HM Treasury under reference DAO(GEN)01/06 on 16 January 2006 and comply with the requirements of HM Treasury's Financial Reporting Manual (FReM). In order to reflect the particular circumstances of the Department, the following exceptions to the FReM have been made:

The Operating Cost Statement is not segmented into programme and non-programme expenditure, with the agreement of HM Treasury.

The FReM's requirement for Departments to prepare accounts that present the transactions and flows for the financial year and the balances at the year end between "core" department and the consolidated group in respect of the Operating Cost Statement (and supporting notes) and Balance Sheet (and supporting notes) has not been applied. With the agreement of HM Treasury, the agencies falling within the Departmental Boundary are on-vote and embedded within the Departmental chain of command; they are, therefore, treated as an integral part of the "core" Department. So, throughout these accounts, the consolidated figures for the Ministry of Defence (including its on-vote agencies) are deemed to be those for the "core" Department.

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 Supply Financed 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 36.

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, formerly a Self-Financing Public Corporation, is included in the financial statements as a fixed asset investment.

1.6 The Armed Forces Pension Scheme (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 Financial Reporting Standard (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 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 Revenue and Customs. Surpluses and deficits on disposal of fixed assets and stock are included within Note 10 – Other Operating Costs.

1.9 Income from services provided to third parties is included in operating income, net of related VAT.

Fixed Assets

1.10 Through the application of the Modified Historical Cost Accounting Convention (MHCA), the Department's fixed assets are expressed at their current value to the Department. The Department achieves this through the application of prospective indices which are produced by the Defence Analytical Services Agency. These indices are applied to the fixed assets, falling within the categories listed below, at the start of each financial year and look ahead to the subsequent balance sheet date. With the exception of Land and Buildings, the indices are also adjusted to reflect the actual change in prices in the prior year as compared to the earlier prediction.

- Land (by region and type);
- Buildings – Dwellings (UK and specific overseas indices);
- Buildings – Non Dwellings (UK and specific overseas indices);
- Single Use Military Equipment – Sea Systems;
- Single Use Military Equipment – Air Systems;
- Single Use Military Equipment – Land Systems;
- Plant and Machinery;
- Transport – Fighting Equipment;
- Transport – Other;
- IT and Communications Equipment – Office Machinery and Computers; and
- 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 under construction are valued at cost and are subject to indexation. On completion, they are released from the project account into the appropriate asset category.

1.13 The Department's policy on the capitalisation of subsequent expenditure under FRS15 is to account separately 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 is 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 net book value of the underlying asset class.

1.16 On the grounds of materiality, the Department has not fully complied with the FReM emissions cap and trade scheme accounting requirements. Instead of registering an asset and liability in respect of its holding of allowances and obligation to deliver allowances, the Department has simply reflected purchases and sales of allowances as an

expense and income respectively in the Operating Cost Statement. All other costs associated with the scheme, such as compliance checking, are also charged to the Operating Cost Statement.

Tangible Fixed Assets

1.17 The useful economic lives of tangible fixed assets are reviewed annually and adjusted where necessary. The capitalisation threshold is normally £10,000. The £10,000 threshold is applied when deciding whether to register an asset on the Fixed Asset Register (FAR). The decision to record an asset on a FAR normally takes place at the point when the asset is initially acquired.

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

	Category	Years
Land and Buildings	Land Buildings, permanent Buildings, temporary Leasehold	Indefinite, not depreciated Useful economic life 5 – 20 Shorter of expected life and lease period
Single Use Military Equipment (including GWMB)		Operational life (on a pooled basis for GWMB)
Plant, Machinery and Transport	Plant and Machinery Specialised Vehicles (includes non-fighting vessels and aircraft) Other standard vehicles	5 – 15 Operational life 3 – 5
IT and Communications Equipment	Computers Satellites Communications Equipment	3 – 7 Operational life Operational 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.	Operational life (on a pooled basis, consistent within the life of the prime equipment supported)

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

Donated Assets

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

1.20 A donated assets reserve represents the value of the original donation, additions, any subsequent 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

1.21 The charge to the Operating Cost Statement in respect of impairment arises on the 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 depreciated 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, adjusted for subsequent depreciation, was recognised in the Operating Cost Statement. The remaining amount is recognised in the revaluation reserve.

Disposal of Tangible Fixed Assets

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

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

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

1.25 Disposals exclude fixed assets written off and written on. These items are included within Other Movements in Notes 13 and 14 (Intangible and Tangible Fixed Assets).

Leased Assets

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

Private Finance Initiative (PFI) Transactions

1.27 Where the substance of the transaction is that the risks and rewards of ownership remain with the Department, the assets and liabilities are reported on the Department's Balance Sheet. Unitary 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.

1.28 Where assets are transferred to the Private Sector Provider, and the consideration received by the Department is in the form of reduced unitary payments, the sales value is accounted for as a prepayment. This prepayment is then reduced (charged to the Operating Cost Statement) over the course of the contract as the benefits of the prepaid element are utilised.

Investments

1.29 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. In the case of Trading Funds and other public bodies/corporations not consolidated into the Department's resource accounts, the value of loans, public dividend capital and other interests held by the Department are recorded at historic cost. In February 2006, QinetiQ Group plc became a listed company. The MoD's investment in QinetiQ Group plc is now recorded at market value. Details on the QinetiQ Group plc investment are given in Note 15. 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.

1.30 Joint Ventures would be 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 would be shown on the face of the Balance Sheet. The Operating Cost Statement would include the Department's share of the investee's turnover. The Department currently has no Joint Ventures.

Stocks and Work-in-Progress

1.31 Stock is valued at current replacement cost, or historic 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.

1.32 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.

1.33 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.

1.34 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

1.35 Provisions for liabilities and charges have been established under the criteria of FRS 12 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.

1.36 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 using the rate advised by HM Treasury. The rate for financial year 2005-06 is 2.2% (3.5% for 2004-05). The discount is unwound over the remaining life of the provision and shown as an interest charge in the Operating Cost Statement.

Reserves

1.37 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.

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

1.39 The Investment Reserve represents the value of the Departmental investment in QinetiQ Group plc on flotation, and the subsequent movement in market valuation as at 31 March 2006.

Pensions

1.40 Present and past employees are mainly covered by the Civil Service pension arrangements for civilian personnel and the AFPS for Service personnel. There are separate scheme statements for the AFPS and Civil Service pensions as a whole.

1.41 Both the AFPS and the main Civil Service pension schemes are unfunded defined benefit pension schemes, although the Department accounts for the schemes in its accounts as if they were defined contribution schemes in accordance with the HM Treasury FReM. The employer's charge is met by payment of a superannuation contribution adjusted for past experience (SCAPE), formerly known as an accruing superannuation liability charge (ASLC), which is calculated based on current pay of serving personnel. The SCAPE 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 SCAPE and widow/widower's pension charges due. Money purchase pensions delivered through employer-sponsored stakeholder pensions have been available as an alternative to all new Civil Service entrants since October 2002.

1.42 The pension schemes undergo a reassessment of the SCAPE 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 are charged to the Operating Cost Statement.

1.43 The Department operates a number of small pension schemes for civilians engaged at overseas locations. Since 1 April 2003, they have been accounted for in accordance with FRS 17 – *Retirement Benefits*.

1.44 The disclosures required under FRS 17 are included in the Remuneration Report.

Early Departure Costs

1.45 The Department provides in full for the cost of meeting pensions up to normal retirement age in respect of military and civilian personnel early retirement programmes and redundancies announced in the current and previous years. Pensions payable after normal retirement age are met by the Armed Forces Pension Scheme for military personnel and the Civil Service pension arrangements for civilian personnel.

Cost of Capital Charge

1.46 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 2005-06 of 3.5% (2004-05: 3.5%) 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.

1.47 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

1.48 Transactions that are denominated in a foreign currency are translated into Sterling using the General Accounting Rate 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.

1.49 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. Analysis of Net Resource Outturn

Request for Resources 1: Provision of Defence Capability	2005-06				2004-05		
	Other Current Expenditure	Grants	Operating Appropriation -in-Aid	Total Net Resource Outturn	Total Net Resource Estimate	Total Net Outturn Compared With Estimate	Total Net Resource Outturn Restated
	£000	£000	£000	£000	£000	£000	£000
TLB HOLDER							
Commander-in-Chief Fleet	3,610,461	–	(16,826)	3,593,635	3,601,440	7,805	3,571,021
General Officer Commanding (Northern Ireland)	580,639	–	(1,131)	579,508	587,276	7,768	626,427
Commander-in-Chief Land Command	5,829,642	130	(196,210)	5,633,562	5,548,474	(85,088)	5,340,560
Commanding-in-Chief RAF Strike Command	4,071,158	–	(27,662)	4,043,496	4,044,594	1,098	3,502,913
Chief of Joint Operations	605,655	–	(27,226)	578,429	536,080	(42,349)	499,452
Chief of Defence Logistics	8,044,821	772	(305,560)	7,740,033	8,224,444	484,411	7,412,637
2nd Sea Lord/Commander-in-Chief Naval Home Command	814,472	3,223	(39,960)	777,735	747,520	(30,215)	762,524
Adjutant General's Command	1,971,534	15,662	(38,572)	1,948,624	1,942,270	(6,354)	1,788,072
Air Officer Commanding-in-Chief Personnel & Training Command	1,058,556	7,235	(158,662)	907,129	862,304	(44,825)	1,127,137
Central	2,625,112	158,814	(295,053)	2,488,873	2,681,190	192,317	2,405,077
Defence Estates *	1,298,979	–	(233,000)	1,065,979	1,147,560	81,581	746,444
Defence Procurement Agency **	2,885,790	–	(6,707)	2,879,083	4,238,067	1,358,984	1,995,350
SIT (Science, Innovation, Technology)	497,948	3,658	(1)	501,605	503,306	1,701	506,109
Total (RFR 1)	33,894,767	189,494	(1,346,570)	32,737,691	34,664,525	1,926,834	30,283,723
Excess Operating Appropriations in Aid ***							215,889
Items treated as CFERs to be allocated ***							14,516
Total (RFR 1)	33,894,767	189,494	(1,346,570)	32,737,691	34,664,525	1,926,834	30,514,128

* Defence Estates is a new TLB created from a Management Group within Central TLB

** Defence Procurement Agency prior year figure restated to reflect the transfer to the Nuclear Decommissioning Authority

*** For 2005-06 these items are reported within the appropriate TLB Total Net Resources

Request for Resources 2: Conflict Prevention	2005-06				2004-05		
	Other Current Expenditure	Grants	Operating Appropriation -in-Aid	Total Net Resource Outturn	Total Net Resource Estimate	Total Net Outturn Compared With Estimate	Total Net Resource Outturn Restated
	£000	£000	£000	£000	£000	£000	£000
Programme Expenditure: Sub-Saharan Africa*	36,419	–	–	36,419	30,520	(5,899)	–
Programme Expenditure: Rest of the World*	73,552	–	–	73,552	82,220	8,668	133,176
Peace Keeping: Rest of the World	945,877	–	–	945,877	988,536	42,659	805,005
Total (RFR 2)	1,055,848	–	–	1,055,848	1,101,276	45,428	938,181

* 2004-05 Programme Expenditure was not disclosed by geographic area within the Estimates or Outturn.

Request for Resources 3: War Pensions Benefits	2005-06				2004-05		
	Other Current Expenditure	Grants	Operating Appropriation -in-Aid	Total Net Resource Outturn	Total Net Resource Estimate	Total Net Outturn Compared With Estimate	Total Net Resource Outturn Restated
	£000	£000	£000	£000	£000	£000	£000
War Pensions Benefits Programme costs	-	1,064,862	-	1,064,862	1,068,466	3,604	1,101,504
War Pensions Benefits Programme costs – Far Eastern Prisoners of War	-	3,730	-	3,730	4,500	770	8,010
War Pensions Benefits Programme costs – British Limbless ex-Servicemen's Association	-	3	-	3	6	3	7
Total (RFR 3)	-	1,068,595	-	1,068,595	1,072,972	4,377	1,109,521

	2005-06				2004-05		
	Other Current Expenditure	Grants	Operating Appropriation -in-Aid	Total Net Resource Outturn	Total Net Resource Estimate	Total Net Outturn Compared With Estimate	Total Net Resource Outturn Restated
	£000	£000	£000	£000	£000	£000	£000
Total Net Resource Outturn	34,950,615	1,258,089	(1,346,570)	34,862,134	36,838,773	1,976,639	32,561,830

Provision of Defence Capability (RfR1)

2.1 Principal explanations for the underspend on RfR1 were reviews of fixed assets, capital spares and stock resulting in lower depreciation and other impairment charges. The underspend in AME was due principally to the transfer of nuclear liabilities to the newly formed Nuclear Decommissioning Authority, and that in Non Budget to the lower than expected charges when the discount rate was changed, and again the transfer of nuclear liabilities to the Nuclear Decommissioning Authority. A detailed explanation of the variances against the Departmental Expenditure Limit is shown in paragraphs 263-264 within Resources, in the Performance Report.

Conflict Prevention (RfR2)

2.2 The following table shows the conflict prevention costs summarised by each of the Operations, and compared against the Estimate (voted funding) for the year.

Operation	2005-06		2004-05	
	Resource Costs	Capital Costs	Total	Outturn
	£000	£000	£000	£000
Peace Keeping Expenditure				
Afghanistan	148,117	51,231	199,348	67,034
Iraq	797,760	159,838	957,598	909,930
Programme Expenditure				
Balkans	62,679	174	62,853	86,560
Global pool *	10,873	-	10,873	
African pool *	36,419	-	36,419	48,499
Total RfR2	1,055,848	211,243	1,267,091	1,112,023
Total Estimate	1,101,276	329,997	1,431,273	1,173,035
Difference – savings/(excess)	45,428	118,754	164,182	61,012

*2004-05 African and Global Pool Expenditure was not disclosed by geographic area within the Estimates or Outturn

A breakdown of cost for the three main Operations is shown in the following table, alongside the Departmental Allocation for the year and the Outturn for 2004-05.

	Total Outturn 2005-06								
	Iraq			Afghanistan			Balkans		
	Total	Total	Outturn	Total	Total	Outturn	Total	Total	Outturn
	Outturn	Allocation	2004-05	Outturn	Allocation	2004-05	Outturn	Allocation	2004-05
£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Resource Cost (by area)									
Direct costs									
Service manpower	80,237	80,278	115,590	7,575	7,172	14,898	11,509	11,640	15,960
Civilian manpower	14,213	11,688	13,889	1,627	1,116	996	4,949	7,336	7,614
Infrastructure costs	81,407	84,082	87,550	10,522	25,663	7,197	12,633	13,954	15,912
Equipment support	220,232	243,097	198,273	24,399	14,832	6,488	7,840	7,339	4,399
Other costs and services	111,186	103,984	110,169	37,595	46,070	19,863	11,824	16,935	32,480
Income	10,054	3,812	2,110	7,792	5,917	(2,054)	2,369	(9,209)	(8,681)
Stock consumption	218,920	202,936	156,280	57,171	33,918	10,178	9,332	8,566	7,642
Contingency	–	55,000	–	–	14,000	–	–	–	–
Indirect costs									
Stock write-off	51	44	1,559	(2)	(2)	9	–	–	–
Provisions	1,560	3,000	6,192	–	–	–	(437)	87	299
Depreciation and amortisation (inc Urgent Operational Requirements – UORs)	33,611	15,577	41,270	1,255	1,596	177	2,376	6,944	8,608
Fixed asset write-off	21,848	30,000	8,000	–	–	–	–	–	–
Cost of capital	4,441	4,594	6,186	183	162	185	284	408	444
Total	797,760	838,092	747,068	148,117	150,444	57,937	62,679	64,000	84,677
Capital Cost (by area)									
Capital addition including UORs and Recuperation)	159,838	199,944	162,862	51,231	53,053	9,097	174	–	2,430
Net Book Value of fixed asset disposals	–	–	–	–	–	–	–	–	(547)
Contingency	–	60,000	–	–	17,000	–	–	–	–
Total	159,838	259,944	162,862	51,231	70,053	9,097	174	–	1,883
Total by Operation	957,598	1,098,036	909,930	199,348	220,497	67,034	62,853	64,000	86,560

2.3 In accordance with the accounting principles agreed with HM Treasury, the Department has identified the costs of operations on the basis of net additional costs. Expenditure such as wages and salaries for permanently employed personnel are not included as these costs would have been incurred in the normal course of business. Costs of activities such as training and exercises which would have been incurred, but which have been cancelled due to operational commitments, have been deducted.

Negative numbers are shown in brackets. However, when comparing outturn against Estimate, excesses are shown in brackets.

The “positive income” figures in the operational costs represent income foregone (loss of receipts) as a result of those operations. The major loss of receipt falls into two areas: those from the Sultan of Brunei in respect of withdrawal of the services of the Gurkha Regiment whilst it was deployed in Afghanistan and the loss of anticipated messing charges for those military personnel based in the UK and Germany that were deployed to Iraq.

2.4 Comments on Major Changes in Cost

Between 2004-05 and 2005-06:

- The reduction in service manpower costs in 2005-06, in both Iraq and Afghanistan, is the result of managing existing resources to reduce the requirement for Territorial Army support.
- The increase in equipment support and stock consumption costs in 2005-06 in Afghanistan is the result of the planned expansion of operations into Helmand province.
- The increase in stock consumption costs in 2005-06 in Iraq is the result of increased use of armament stores and fuel.

Between 2005-06 Outturn and Estimate:

- The increase in depreciation and amortisation costs in Iraq between the sum allocated and final Outturn is the result of depreciation of Urgent Operational Requirements (UORs) which are purchased for specific operational purpose and often have short life spans.
- The Request for Resources is based upon forecast costs two third of the way through the financial year. Due to the often rapidly changing operational situation it is prudent to include a contingency figure within the request; this is based on prior year's outturn and UOR costs which give an indication of potential short notice operational equipment requirements.
- When the capital Estimate was prepared, it was based on UORs that had been financially approved. Not all UORs were subsequently delivered prior to the end of the financial year, resulting in an underspend against capital costs.

War Pensions Benefits – Programme Costs (RfR3)

2.5 The Chief Executive of the Veterans Agency is not a Top Level Budget Holder, but exercises all the responsibilities for the programme costs. There was an underspend of £4,377,000 against this RfR.

3. Reconciliation of Net Resource Outturn to Net Operating cost

	2005-06		2004-05
	Outturn	Supply Estimate	Outturn Restated
	£000	£000	£000
Net Resource Outturn (Statement of Parliamentary Supply)	34,862,134	36,838,773	32,561,830
– Less income scored as Consolidated Fund Extra Receipts and included in operating income and interest (inc. excess operating Appropriation-in-Aid) (Note 5)	(468,599)		(230,405)
Net Operating Cost	34,393,535	36,838,773	32,331,425

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. Net operating cost is the total of expenditure and income appearing in the Operating Cost Statement. The Outturn against the Estimate is shown in the Statement of Parliamentary Supply.

4. Reconciliation of Resources to Cash Requirement

	Note	Estimate £000	Outturn £000	Savings/ (Excess) £000
Resource Outturn	2	36,838,773	34,862,134	1,976,639
Capital:				
*Purchase of fixed assets:				
– RfR 1	13/14	7,058,578	6,906,906	151,672
– RfR 2	13/14	329,997	211,243	118,754
– RfR 1 Capitalised provisions	13/14	–	43,178	(43,178)
– Investments	15	–	6,000	(6,000)
Non operating cost A-in-A:				
Proceeds on sale of fixed assets	10/13/14	(510,000)	(299,317)	(210,683)
Proceeds on redemption of shares	23.2	(27,857)	(21,766)	(6,091)
Repayment of loans made to the Trading Funds and QinetiQ	15	(69,184)	(53,237)	(15,947)
Accruals adjustments:				
Non-cash transactions-				
Included in operating costs	23.1	(8,725,882)	(7,276,465)	(1,449,417)
Included in net interest payable	12	(2,318,484)	(1,211,110)	(1,107,374)
Capitalised provisions shown above			(43,178)	43,178
		(11,044,366)	(8,530,753)	(2,513,613)
Cost of capital charge	23.1	(2,284,067)	(3,106,369)	822,302
*Changes in working capital other than cash, excluding movements on creditors falling due after one year		414,788	399,153	15,635
* Increase in creditors falling due after one year			(247,705)	247,705
*Use of provisions for liabilities and charges	20	795,330	374,039	421,291
Adjustment for movements on cash balances in respect of collaborative projects	23.5		59,791	(59,791)
Net cash requirement	23.5	31,501,992	30,603,297	898,695

* Stated to include accruals within the movements in the year

5. 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 being shown in italics).

	2005-06 Forecast		2005-06 Outturn	
	Income	Receipts	Income	Receipts
	£000	£000	£000	£000
Operating income and receipts – excess A-in-A Request for Resources 1	–	–	76,272	<i>76,272</i>
Operating income and receipts – excess A-in-A Request for Resources 2	–	–	16,062	<i>16,062</i>
Other operating income and receipts not classified as A-in-A	–	–	20,283	<i>20,283</i>
Subtotal operating income and receipts payable to the Consolidated Fund	–	–	112,617	<i>112,617</i>
Other amounts collectable on behalf of the Consolidated Fund (QinetiQ sale CFER)	–	–	355,982	<i>357,771</i>
Total income payable to the Consolidated Fund	–	–	468,599	<i>470,388</i>

6. Reconciliation of income recorded within the Operating Cost Statement to operating income payable to the Consolidated Fund

	Note	2005-06 £000	2004-05 £000
Operating Income		1,390,997	1,416,807
Income included within other operating costs			
– Refunds of formula based VAT recovery		31,669	71,603
– Foreign exchange gains		9,711	–
– Other		(11)	–
Interest Receivable		26,821	304
Gross Income		1,459,187	1,488,714
Income authorised to be appropriated in aid		(1,346,570)	(1,258,309)
Operating Income payable to the Consolidated Fund	5	112,617	230,405

7. Non-Operating income – Excess A in A

	2005-06 £000	2004-05 £000
Principal repayments of voted loans	53,237	25,187
Proceeds on disposal of fixed assets	321,083	415,455
Non-operating income – excess A-in-A	–	153,207

8. Non-Operating income not classified as A in A

	Income £000	Receipts £000
The Department has no non-operating income not classified as A-in-A	–	–

9. Staff Numbers and Costs

9.1 The average number of full-time equivalent persons employed during the year was: Service 203,290 (2004-05: 210,180) and Civilian 95,750 (2004-05: 96,780^a). Source: Defence Analytical Services Agency.

	Permanent Staff	Temporary Staff	Armed Forces	Ministers	2005-06 Total	2004-05 Total
Analysis of Staff Numbers	94,626	1,120	203,290	4	299,040	306,960

In order to align with the total pay costs incurred during the year, shown below, the calculation of the average number of staff uses monthly statistics to identify an average employed for the year. The staff numbers quoted reflect the numbers of personnel employed in organisations within the Departmental Boundary for the Annual Accounts (see page 163) and therefore exclude those within the Trading Funds. The numbers reported within the Performance Report include employees in the MoD Trading Funds. More information on the Department's staff numbers, and the statistical calculations used, is available on the website: <http://www.dasa.mod.uk>.

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

	2005-06 £000	2004-05 £000
Salaries and Wages	8,603,882	8,470,881
Social Security costs	644,726	619,673
Pension costs	1,751,740	1,486,848
Redundancy and severance payments	254,503	418,240
	11,254,851	10,995,642
Made up of:		
Service	8,262,776	8,047,195
Civilian	2,992,075	2,948,447
	11,254,851	10,995,642

Principal Civil Service Pension Scheme

9.3 The Principal Civil Service Pension Scheme (PCSPS) is an unfunded multi-employer defined benefit scheme. The Ministry of Defence is unable to identify its share of the underlying assets and liabilities. The Scheme Actuary (Hewitt Bacon Woodrow) valued the scheme as at 31 March 2003. Details can be found in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice-pensions.gov.uk).

9.4 For 2005-06, total pension contributions of £345,182,000 were payable in respect of the various schemes in which MoD civilian staff were members. Contributions to the PCSPS in the year were £309,639,000 (2004-05: £240,854,000) at rates in the range of 16.2 to 25.6 percent of pensionable pay, based on salary bands (the rates in 2004-05 were between 12% and 18.5%); the scheme actuary reviews employer contributions every four years. From 2006-07, the salary bands will be revised and the rates will be in a range between 17.1% and 26.5%. The contribution rates are set to meet the cost of the benefits accruing, to be paid when the member retires, not the benefits paid during the period to existing pensioners.

9.5 Employees can opt to open a partnership pension account, a stakeholder pension with an employer contribution. Employer contributions are age-related and range from 3% to 12.5% of pensionable pay. Employers also match employee contributions up to 3% of pensionable pay. In addition, employer contributions of 0.8% of pensionable pay were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service and ill health retirement of these employees.

^aThe 2004-05 average full-time equivalent civilian staff number has been restated following the identification of an error in the classification of personnel employed within one of the MoD Trading Funds. The consequence is a reduction in the average number of civilian personnel for 2004-05 from 97,540 shown in the 2004-05 Annual Report and Accounts to 96,780.

Armed Forces Pension Scheme

9.6 From 6 April 2005, the new Armed Forces Pension Scheme (known as AFPS 05) was introduced for all new members of the Armed Forces; those in service before this date have been given the opportunity to transfer to the new Scheme. The AFPS is an unfunded, non-contributory, defined benefit, salary-related, contracted out, occupational pension scheme. A formal valuation of the AFPS was carried out as at 31 March 2005 by the scheme's actuary, the Government Actuary's Department. Scheme members are entitled to a taxable pension for life and a tax-free pension lump sum if they leave the Regular Armed Forces at or beyond normal retirement age; those who have at least two years service who leave before age 55 will have their pensions preserved until age 65. Pensions may be payable to the spouse, civil partner, partner or to eligible children. Death-in-service lump sums are payable subject to nomination. There are no attributable ill-health benefits under the AFPS 05; these will be considered under the War Pensions Scheme (WPS) or the new Armed Forces Compensation Scheme (AFCS).

9.7 AFPS 05 includes an Early Departure Payment for those who leave before age 55 providing they have at least 18 years service and are at least 40 years of age. The Early Departure Payment Scheme pays a tax-free lump sum and income of between 50% and 75% of preserved pension between the date of the individual's departure from the Armed Forces and age 55. The income rises to 75% of preserved pension at age 55 and is index linked. At age 65, the Early Departure payments stop and the preserved pension and preserved pension lump sum are paid.

9.8 For 2005-06 total employers' pension contributions payable were £1,406,558,000. This figure includes £1,404,451,000 payable to the AFPS, (2004-05 £1,245,994,000) based on rates determined by the Government Actuary. For 2005-06, the rates were 34.3% of total pay (33.8% for 2004/05) for officers and 21.3% (18.2% for 2004/05) for other ranks. The contribution rates reflect benefits as they are accrued, not costs actually incurred in the period, and reflect past experience of the scheme. Further information on the Armed Forces Pension Scheme and the Armed Forces Compensation Scheme can be found at the website: www.mod.uk/DefenceInternet/AboutDefence/Issues/Pensions/.

Other Pension Schemes

9.9 The Armed Forces Pension Scheme incorporates three smaller pension schemes: the Non-Regular Permanent Staff Pension Scheme (NRPS), the Army Careers Officers Pension Scheme (ACOPS) and the new Reserve Forces Pension Scheme (RFPS). The membership of these schemes is 0.48% of the AFPS total membership and the employers' contributions are included in the AFPS figure at note 9.8.

9.10 Certain other employees are covered by schemes such as the Department of Health, Social Services and Public Safety Superannuation Scheme and the Teachers' Superannuation Scheme. The figure for total employers' pension contributions at note 9.4 includes contributions in respect of these schemes.

10. Other Operating Costs

	2005-06	2004-05
	£000	Restated £000
Operating expenditure:		
– Fuel*	369,463	238,579
– Stock consumption	1,038,865	1,079,123
– Surplus arising on disposal of stock (net)	(16,372)	(25,214)
– Provisions to reduce stocks to net realisable value	(165,851)	227,498
– Stocks written off (net)	758,698	703,558
– Movements: includes personnel travelling, subsistence/relocation costs and movement of stores and equipment**	820,690	710,644
– Utilities	291,347	241,111
– Property management	1,747,294	1,509,085
– Hospitality and entertainment	5,364	6,450
– Accommodation charges	307,138	340,113
– Equipment support costs	3,614,442	3,623,327
– Increase/(Decrease) in nuclear and other decommissioning provisions (Note 20)***	(94,964)	(316,024)
– IT and telecommunications	755,249	678,250
– Professional fees	552,917	565,138
– Other expenditure	1,736,028	1,861,022
– Research expenditure and expensed development expenditure	994,480	996,421
Depreciation and amortisation:		
– Intangible assets (Note 13)	1,314,570	1,023,665
– Tangible owned fixed assets (Note 14)	5,236,589	5,128,204
– Donated assets depreciation – release of reserve	(57,991)	(49,473)
– Tangible fixed assets held under finance leases (Note 14)	4,685	3,660
Impairment on fixed assets (Notes 13 & 14):		
– Arising on Quinquennial valuation	254,156	110,000
– Arising on Other items	182,344	(335,339)
Impairment – release of reserve	(23,696)	(12,835)
(Surplus) arising on disposal of tangible and intangible fixed assets		
– Tangible and Intangible fixed assets	(458,384)	(52,079)
– Donated assets – release of reserve	(20,975)	(1,541)
Fixed assets (written on) – net	(301,805)	(85,648)
Investment writedown on share conversion	4,774	–
Capital project expenditure write off/(write on)	(22,145)	25,851
Bad debts written off	8,398	(5,411)
Increase in bad debts provision	1,439	920
Rentals paid under operating leases	192,488	228,515
Auditors' remuneration – audit work only ****	3,500	3,300
Grants-in-Aid	61,087	63,079
Exchange differences on foreign currencies: net deficit/(surplus)	8,207	14,728
War Pensions Benefits	1,069,133	1,096,727
Total Other Operating Costs	20,171,162	19,595,404

* The prior year figure for Fuel has increased by £57,205,547 to reflect a more accurate disclosure of all expenditure on fuel (excluding utilities). A corresponding reduction is shown in Stock Consumption.

** The prior year figure for Movements has increased by £287,874,734 to reflect a more accurate disclosure of all personnel movements. A corresponding reduction is shown in Other Expenditure.

*** The prior year figure for the movement in nuclear decommissioning provision has increased by £104,768,000 following the transfer to the Nuclear Decommissioning Authority.

**** Auditors' remuneration: No charge is made for non-audit work carried out by the auditors.

11. Income

	RfR 1	RfR2	2005-06	2004-05
			£000	£000
			Total	Total
Income Source				
External Customers				
Rental income – property	49,444		49,444	54,618
Receipts – personnel	55,171		55,171	52,798
Receipts – sale of fuel	56,559		56,559	57,406
Receipts – supplies and services	176,466		176,466	174,177
Receipts – personnel related	175,369		175,369	168,626
Receipts – provision of families accommodation	180,779		180,779	178,319
Receipts – NATO/UN/US Forces/Foreign Governments	300,341	16,062	316,403	347,745
Other	193,634		193,634	180,328
Other Government Departments, Trading Funds and QinetiQ				
Rental income – property	440		440	2,680
Receipts – personnel related	3,281		3,281	17,662
Reverse tasking	26,384		26,384	28,473
Dividends from Investments (Note 15.4)	39,387		39,387	28,387
Income from provision of goods and services	113,218		113,218	122,773
Other	4,462		4,462	2,815
	1,374,935	16,062	1,390,997	1,416,807

12. Net Interest Payable

	2005-06	2004-05
	£000	Restated £000
Interest receivable:*		
– Bank interest	(21,553)	(18,529)
– Loans to Trading Funds	(4,664)	(5,523)
– Loan to a Self Financing Public Corporation – QinetiQ**	(603)	(1,109)
– Other interest receivable	(1)	(2)
	(26,821)	(25,163)
Interest payable:		
– Bank interest	18	25
– Loan interest	3,348	3,417
– Unwinding of discount on provision for liabilities and charges (Note 20)***	1,211,110	147,851
– Finance leases and PFI contracts	64,480	5,164
– Late payment of Commercial debts	15	–
	1,278,971	156,457
Net interest payable	1,252,150	131,294

* Interest receivable of which £765,000 is payable to Consolidated Fund (£304,000 in 2004-05).

** for the period to Feb 06 prior to flotation.

*** The increase in the unwinding of the discount is as a result of the change in discount rate from 3.5% to 2.2% with effect from 1 Apr 05

The prior year figure for unwinding of discount on provisions for liabilities and charges has decreased by £142,106,000 following the transfer to the Nuclear Decommissioning Authority.

13. Intangible Assets

	Single use Military Equipment £000	Others £000	Total £000
Cost or Valuation			
At 1 April 2005	27,992,914	448,966	28,441,880
Additions	1,350,720	199,248	1,549,968
Impairment	(7,201)	(23,313)	(30,514)
Revaluations	366,104	13,838	379,942
Other movements	(1,295,504)	371,802	(923,702)
At 31 March 2006	28,407,033	1,010,541	29,417,574
Amortisation			
At 1 April 2005	(5,713,858)	(80,199)	(5,794,057)
Charged in Year	(1,270,657)	(43,913)	(1,314,570)
Impairment	(5,549)	8,201	2,652
Revaluations	(64,536)	(3,256)	(67,792)
Other movements	677,057	61,831	738,888
At 31 March 2006	(6,377,543)	(57,336)	(6,434,879)
Net Book Value:			
At 31 March 2006	22,029,490	953,205	22,982,695
At 1 April 2005	22,279,056	368,767	22,647,823

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 under construction where the first delivery into operational use of the asset type has taken place;
- iii) Additions on intangible and tangible fixed assets (Note 14) include accruals amounting in total to £2,514,869,000 (2004-05: £2,246,205,000); and
- iv) Other movements comprise reclassifications to tangible fixed assets and transfers to operating costs.

14. Tangible Fixed Assets

	Dwellings £000	Other Land and Buildings £000	Single Use Military Equipment (SUME) £000	Plant and Machinery £000	Transport £000	IT and Comms Equipment £000	Assets under Construction (SUME) £000	Assets under Construction (Others) £000	Total £000
Cost or Valuation									
At 1 April 2005 Restated	2,838,959	17,607,893	58,143,194	6,443,132	8,551,289	1,467,527	11,715,475	741,716	107,509,185
Additions	611	30,194	401,991	63,878	12,580	180,401	4,253,950	624,576	5,568,181
Capitalised provisions	–	25,370	17,808	–	–	–	–	–	43,178
Donations	12,331	37,887	–	5,188	–	–	–	–	55,406
Impairment	(9,716)	(154,946)	68,954	(28,026)	(293,063)	(207,807)	(3,692)	(1,193)	(629,489)
Disposals	(1,619)	(198,477)	(1,067,310)	(26,694)	(8,385)	(65)	–	–	(1,302,550)
Revaluations	160,068	1,021,504	1,929,311	85,843	(187,937)	(38,354)	152,589	12,771	3,135,795
Other movements	389,104	(861,726)	1,073,283	(664,226)	136,560	65,986	(3,523,988)	(314,738)	(3,699,745)
At 31 March 2006	3,389,738	17,507,699	60,567,231	5,879,095	8,211,044	1,467,688	12,594,344	1,063,132	110,679,961
Depreciation									
At 1 April 2005	(348,421)	(2,001,726)	(27,578,261)	(2,968,608)	(4,568,829)	(434,451)	–	–	(37,900,296)
Charged in year	(86,044)	(609,794)	(3,446,561)	(391,890)	(471,923)	(235,062)	–	–	(5,241,274)
Impairment	4,636	23,014	119,082	17,863	7,328	48,925	–	–	220,848
Disposals	251	4,874	1,066,598	26,652	7,196	65	–	–	1,105,636
Revaluations	(38,954)	(237,772)	(1,198,983)	(35,943)	295,761	25,050	–	–	(1,190,841)
Other movements	(8,510)	857,172	1,960,312	746,954	431,325	113,671	–	–	4,100,924
At 31 March 2006	(477,042)	(1,964,232)	(29,077,813)	(2,604,972)	(4,299,142)	(481,802)	–	–	(38,905,003)
Net Book Value: At 31 March 2006	2,912,696	15,543,467	31,489,418	3,274,123	3,911,902	985,886	12,594,344	1,063,132	71,774,958
At 1 April 2005	2,490,538	15,606,167	30,564,933	3,474,524	3,982,460	1,033,076	11,715,475	741,716	69,608,889

Note:

- i) Additions on intangible assets (Note 13) and tangible fixed assets include accruals amounting in total to £2,514,869,000 (2004-05: £2,246,205,000).
- ii) Other movements comprise reclassifications between tangible fixed asset categories, intangible assets, assets under construction, stock and transfers to operating costs.
- iii) The prior year cost for other Land and Buildings has been reduced by £25,705,000 to reflect the transfer of a capitalised provision to the Nuclear Decommissioning Authority.
- iv) Fixed Assets as at 31 March 2006 include capitalised provisions at cost of £195,698,000 (Restated 2004-2005: £219,677,000).

14.1 The net book value of tangible fixed assets by each major class of asset includes an amount of £522,190,000 (2004-05 £660,448,000) in respect of assets held under finance leases and PFI contracts. Detail by asset category is as follows:

	Dwellings	Other Land and Buildings	Plant and Machinery	Fighting Equipment Transport	Other Transport	IT and Comms Equipment	Total
	£000	£000	£000	£000	£000	£000	£000
Gross Cost:							
At 31 March 2006	31,479	341,841	102,534	84,993	8,077	54,913	623,837
At 1 April 2005	28,204	450,358	95,915	51,814	47,907	62,792	736,990
Accumulated Depreciation:							
At 31 March 2006	8,438	15,480	9,014	57,250	2,395	9,070	101,647
At 1 April 2005	4,382	11,324	4,388	44,716	3,867	7,865	76,542

14.2 Analysis of Land and Buildings

	Freehold	Long lease	Short lease	Beneficial Use*	Total
	£000	£000	£000	£000	£000
Net Book Value:					
At 31 March 2006	17,072,700	267,245	63,041	2,090,735	19,493,722
Restated At 1 April 2005	16,639,415	248,469	50,232	2,001,336	18,939,452

*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.

The net book values at 31 March 2006 and 1 April 2005 include assets under construction of £1,037,559,000 and £842,748,000 respectively.

The balance as at 1 April 05 for Freehold has been reduced by £25,705,000 following the transfer of a capitalised provision to the Nuclear Decommissioning Authority.

14.3 2005 – 06 Quinquennial Revaluation

- All categories of fixed assets, except Intangibles, Assets under Construction and Capital Spares, are subject to a quinquennial revaluation, which is being conducted on a rolling programme. During 2005-06, 22% of Land and Buildings were re-valued by two external organisations: the Valuation Office Agency, who dealt with the UK estate, and GVA Grimley, who were responsible for the overseas estate. These valuations were undertaken in accordance with the Royal Institute of Chartered Surveyors Appraisal and Valuation Manual and were on the basis of the existing use value to the Department. Due to the specialised nature of the Departmental estate, the majority of assets were valued using the Depreciated Replacement Cost method.
- As a result of the valuations undertaken in 2005-06, the net increase to Land and Buildings was £269,423,000. Impairments charged to the Operating Cost Statement were £87,882,000. Impairments incurred as a result of the 2002-03 quinquennial review have been reversed through the Operating Cost Statement in 2005-06 to the sum of £10,008,000.
- 70% of Plant and Machinery, IT and Transport was professionally re-valued on a Depreciated Replacement Cost basis in 2005-06 by the Valuation Office Agency valuers: the net decrease in net book value from these valuations (£56,188,000) is reflected in these accounts. Impairments of £162,232,000 have been charged to the Operating Cost Statement.
- Much of the overseas Plant and Machinery, IT & Communications Equipment and Transport were valued by GVA Grimley during 2005-06. The movement in the net book value of assets valued was a decrease of £10,908,000. Impairments charged to the Operating Cost Statement are £5,656,000. Impairments that originated in the 2002-03 quinquennial review have been reversed through the Operating Cost Statement in 2005-06 to the sum of £5,610,000.

15. Investments

	Trading Funds		Other Investments	QinetiQ	Total
	Public Dividend Capital	Loans			
	£000	£000	£000	£000	£000
Balance at 1 April 2005	184,254	87,390	1	75,463	347,108
Additions					
Met Office		6,000			6,000
Disposals (share conversions and shares sold in the Initial Public Offering (IPO))				(28,329)	(28,329)
Loan Repayments					
QinetiQ				(45,886)	(45,886)
Defence Aviation Repair Agency (DARA)		(4,840)			(4,840)
UK Hydrographic Office (UKHO)		(357)			(357)
ABRO		(2,154)			(2,154)
Revaluations				242,590	242,590
Balance at 31 March 2006	184,254	86,039	1	243,838	514,132
Balance at 1 April 2005	184,254	87,390	1	75,463	347,108

Public Dividend Capital and Loans at 31 March 2006 were held in the following Trading Funds:

	Public Dividend Capital	Loans	Interest Rates
	£000	£000	% p.a.
Defence Science Technology Laboratory (Dstl)	50,412	–	
Met Office	58,867	6,000	4.45
UK Hydrographic Office	13,267	10,993	8.375
Defence Aviation Repair Agency	42,303	45,350	4.20 – 5.00
ABRO	19,405	23,696	5.625
Balance at 31 March 2006	184,254	86,039	

Analysis of loans repayable by instalments:

	Due within one year	Due after one year	Total
	£000	£000	£000
Met Office	1,100	4,900	6,000
UK Hydrographic Office	387	10,606	10,993
Defence Aviation Repair Agency	4,840	40,510	45,350
ABRO	2,154	21,542	23,696
Balance at 31 March 2006	8,481	77,558	86,039

15.1 Investment in QinetiQ Group plc.

	£000	Total £000
Balance at 1 April 2005		75,463
Repayment of Long Term Loan		(45,886)
Balance After repayment of Long Term Loan		29,577
Disposals		
Redemption of Preferences Shares	(21,766)	
Write-down on share conversions	(4,774)	(26,540)
Balance after share redemption and conversions		3,037
Book Value of the shares sold in the IPO		(1,789)
Value of the remaining shareholding before revaluations		1,248
Revaluations		
Revaluation of the remaining shares to the IPO market price of 200p per share		248,522
Balance of investment at the IPO market price		249,770
Write-down in the value of the shares to a market price of 195.25p as at 31 March 06		(5,932)
Balance at 31 March 2006		243,838

As part of the process of preparing for the Initial Public Offering (IPO) in QinetiQ Group plc, and in accordance with the company's Articles of Association, the outstanding loan with MoD (£45,886,023) was repaid. This reduced MoD's investment from £75,463,551 (at 1 April 2005) to an investment valued at £29,577,528 and consisting of various types of shares.

This investment was further reduced on the redemption, by MoD, of its Redeemable Cumulative Preference Shares for £21,765,524 leaving an investment that consisted of a mixture of Ordinary and Convertible Shares (with a book value of £7,812,004). The Company then undertook a series of share redemptions, conversions and bonus issues, in accordance with the Articles of Association, which resulted in MoD holding 303,770,800 of the new class of Ordinary Shares with a nominal value of £3,037,708. The book value of MoD's investment was written-down to this amount prior to the IPO.

On 10 February 2006, MoD sold 178,885,355 of its shares, for 200p per share, as part of the IPO. The book value of the shares sold was £1,788,853.55. The balance of the shareholding (124,885,445 shares) had a book value of £1,248,854.45 (£3,037,708.00 – £1,788,853.55). This remaining shareholding was revalued, at 200p per share (a total valuation of £249,770,890 as at 10 February 2006, an increase in the book value of the investment of £248,522,035.55).

Fees associated with the sale of shares (e.g. stamp duty and commission paid) were £10,617,824.75 and are included as Professional Fees under Other Operating Costs. (Further details of Other Operating costs can be found at Note 10 to the accounts).

The total raised from the IPO was £357,770,710 (178,885,355 shares sold at 200p per share). This amount has been treated as a Consolidated Fund Extra Receipt which was payable, in full, to HM Treasury.

On 31 March 2006, the 124,885,445 shares held were valued at 195.25p per share: a reduction in the total value of the investment, compared to the 200p per share value on flotation, of £5,932,058.64. The Department's remaining shareholding in QinetiQ Group plc is 124,885,445 (19.3%) Ordinary Shares (nominal value 1p each) which, at 31 March 06, were valued at a market price of 195.25p per share; a total market value of £243,838,831.36. Holders of Ordinary Shares in QinetiQ Group plc are entitled to receive notice of, attend, speak and vote at general and extraordinary meetings of the company and have one vote for every share owned.

The Department also holds one Special Share in QinetiQ Group plc, and one Special Share in each of two of its subsidiary companies, QinetiQ Holdings Limited and QinetiQ Limited. The Special Shares can only be held by the Crown and give the Government the right to: implement and operate the Compliance System, prohibit or restrict QinetiQ from undertaking activities which may lead to an unmanageable conflict of interest that would be damaging to the defence or security interests of the United Kingdom, and to veto any transaction which may lead to unacceptable ownership of the company. The Special Shareholder must receive notice of, and may attend and speak at, general and extraordinary meetings. The Special Shares carry no voting rights, except to enforce certain aspects of the compliance regime. The shareholder has no right to share in the capital or profits of the company other than – in the event of liquidation – to be repaid the capital paid up in respect of the shares before other shareholders receive any payment.

15.2 Other investments.

Investments, including Special Shares, were held in the following at 31 March 2006:

7.5% Non-cumulative Irredeemable Preference Shares at £1 each	
Chamber of Shipping Limited	688 Shares
British Shipping Federation Limited	55,040 Shares

Preferential Special Shares at £1 each	
Devonport Royal Dockyard Limited	1 Share
Rosyth Royal Dockyard Limited	1 Share
AWE plc	1 Share
AWE Pension Trustees Limited	1 Share
QinetiQ Group plc	1 Share
QinetiQ Holdings Limited	1 Share
QinetiQ Limited	1 Share
BAE Systems Marine (Holdings) Limited	1 Share

Non Preferential Shares of £1 each	
International Military Services Limited	19,999,999 Shares

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.

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.

Special 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, c/o Babcock BES, Rosyth Business Park, Rosyth, Dunfermine, Fife KY11 2YD	SC101959
AWE plc, AWE Aldermaston, Reading, Berkshire RG7 4PR	02763902
AWE Pension Trustees Limited, AWE Aldermaston, Reading, Berkshire RG7 4PR	02784144
QinetiQ Group plc, 85 Buckingham Gate, London SW1E 6PD	04586941
QinetiQ Holdings Limited, 85 Buckingham Gate, London SW1E 6PD	04154556
QinetiQ Limited, 85 Buckingham Gate, London SW1E 6PD	3796233
BAE Systems Marine (Holdings) Limited, Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hants GU14 6YU	01957765

15.3 Net Assets of Trading Funds

The reported net assets, after deducting loans due to MoD, of the investments held in Trading Funds at 31 March 2006 and 31 March 2005 were:

	31 March 2006	31 March 2005
	£000	£000
UK Hydrographic Office	49,207	43,150
Met Office	188,293	175,753
Defence Aviation Repair Agency	82,904	76,877
Defence Science and Technology Laboratory	218,000	198,900
ABRO	47,598	53,496
Total	586,002	548,176

15.4 Dividends from Investments

The following dividends, shown as income in Note 11, were received in the accounting periods ended 31 March 2005 and 31 March 2006:

	31 March 2006	31 March 2005
	£000	£000
QinetiQ	6,091	5,759
UK Hydrographic Office	6,296	19,628
Met Office	Nil	Nil
Defence Aviation Repair Agency	12,000	Nil
Defence Science and Technology Laboratory	3,000	3,000
ABRO	12,000	Nil
Total	39,387	28,387

16. Stocks and Work in Progress

	31 March 2006	31 March 2005
	£000	£000
Work in progress	34,244	28,861
Raw materials and consumables	6,015,687	6,064,180
Assets declared for disposal	2,296	2,322
	6,052,227	6,095,363

17. Debtors

17.1 Analysis by type

	31 March 2006	31 March 2005
	£000	Restated £000
Amounts falling due within one year		
Trade debtors	177,539	211,854
Deposits and advances	54,355	53,186
Value Added Tax	320,544	277,354
Other debtors	275,363	187,263
Staff loans and advances	41,921	33,085
Prepayments and accrued income	506,324	636,303
Current part of PFI prepayment	156,716	193,229
	1,532,762	1,592,274
Amounts falling due after one year		
Trade debtors	28,000	49,693
Deposits and advances	26	–
Other debtors	2,431	97,250
Prepayments and accrued income	1,357,936	1,110,161
Total Debtors	1,388,393	1,257,104

Note:

- i) Other debtors include loans for house purchase and other loans made to staff amounting to £92,291,269 (2004-05: £85,299,668). The number of staff with house purchase loans was 11,712 (2004-05:12,558).
- ii) Prepayments falling due after one year include an amount of £391,000,000 in respect of an adjudication decision where an appeal is pending: the amount represents an amount paid into an Escrow Account in the financial year 2002-03 and interest earned on it since that date.
- iii) The prior year balance for prepayments and accrued income falling due within one year has been reduced by £21,521,000 following the transfer to the Nuclear Decommissioning Authority.

17.2 Intra-Government Balances

	Amounts falling due within one year		Amounts falling due after more than one year	
	£000		£000	
	2005-06	2004-05	2005-06	2004-05
Balances with other central government bodies	366,301	337,142	30,143	60,514
Balances with local authorities	1,433	2,375	–	–
Balances with NHS Trusts	12,864	10,136	–	–
Balances with public corporations and trading funds	7,576	38,637	–	301
<i>Subtotal: intra-government balances</i>	388,174	388,290	30,143	60,815
Balances with bodies external to government	1,144,588	1,203,984	1,358,250	1,196,289
Total debtors at 31 March	1,532,762	1,592,274	1,388,393	1,257,104

The 2004-05 “Amounts falling due within one year” balance with other central government bodies has been restated to include the VAT debtor.

18. Cash at Bank and in Hand

	2005-06	2004-05
	£000	£000
Balance at 1 April	438,411	312,564
Net Cash Inflow/(Outflow):		
Received from Consolidated Fund	31,262,178	29,497,000
Utilised	(30,682,344)	(29,371,153)
Increase during year	579,834	125,847
Balance at 31 March	1,018,245	438,411
The following balances at 31 March were held at:		
Office of HM Paymaster General	684,585	277,775
Commercial Banks and Cash in Hand	333,660	160,636
Balance at 31 March	1,018,245	438,411

Note:

The cash at bank balance includes £256,381,000 (2004-05: £196,590,000) 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.

19. Creditors

19.1 Analysis by type

	31 March 2006	31 March 2005
	£000	Restated £000
Amounts falling due within one year		
VAT	36,320	(13)
Other taxation and social security	240,255	215,375
Trade creditors	546,569	709,356
Other creditors (Note ii)	351,519	344,645
Payments received on account	25,920	22,115
Accruals and deferred income	4,465,599	4,444,563
Current part of finance leases	4,378	4,914
Current part of imputed finance lease element of on-balance sheet PFI contracts	15,168	16,409
Current part of NLF loans (Note i)	1,797	1,695
Amounts issued from the Consolidated Fund for supply but not spent at year end (Note iii)	658,881	(127,275)
Consolidated Fund extra receipts due to be paid to the Consolidated Fund – Received	102,983	369,096
	6,449,389	6,000,880
Amounts falling due after more than one year		
Other creditors	101,618	37,441
Accruals	176,686	558
Finance leases	2,639	10,507
Imputed finance lease element of on-balance sheet PFI contracts	642,523	651,757
NLF loans (Note i)	48,335	50,132
Loans – other	85,800	59,500
	1,057,601	809,895

The prior year balances for trade creditors and accruals and deferred income, have been reduced by £2,238,000 and £72,495,000 respectively, following the transfer to the Nuclear Decommissioning Authority.

Note:

- 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 £256,381,000 (2004-05 – £196,590,000).
- iii) The amount comprises amounts drawn down from the Consolidated Fund of £31,262,178,000 less Net Cash Requirement (Statement of Parliamentary Supply) of £30,603,297,000

19.2 Intra-Government Balances

	Amounts falling due within one year		Amounts falling due after more than one year	
	£000		£000	
	2005-06	2004-05	2005-06	2004-05
Balances with other central government bodies	806,936	257,762	134,135	50,132
Balances with local authorities	781	1,216	–	–
Balances with NHS Trusts	2,938	14,485	–	–
Balances with public corporations and trading funds	66,884	287,243	3,874	–
<i>Subtotal: intra-government balances</i>	<i>877,539</i>	<i>560,706</i>	<i>138,009</i>	<i>50,132</i>
Balances with bodies external to government	5,571,850	5,440,174	919,592	759,763
Total creditors at 31 March	6,449,389	6,000,880	1,057,601	809,895

The 2004-05 balances with other central Government bodies has been restated to include creditors with the Consolidated Fund and the National Loans Fund.

20. Provisions for Liabilities and Charges

	Nuclear Decom- missioning	Other Decom- missioning And Restoration Costs	Early Retirement Commit- ments	Other	Total
	£000	£000	£000	£000	£000
At 1 April 2005 (Restated)	3,290,637	110,883	467,622	1,313,538	5,182,680
Increase in Provision	112,306	32,016	172,185	293,767	610,274
Unwinding of discounting	1,114,871	4,002	26,329	65,908	1,211,110
Amounts released	(205,821)	(17,755)	(40,530)	(132,604)	(396,710)
Reclassifications	–	(2,699)	–	1,150	(1,549)
Amounts capitalised	43,178	–	–	–	43,178
Utilised in year	(55,683)	(8,876)	(99,095)	(210,385)	(374,039)
At 31 March 2006	4,299,488	117,571	526,511	1,331,374	6,274,944

The balance as at 1 April 2005 for nuclear decommissioning has been reduced by £4,320,528,000 following the transfer to the Nuclear Decommissioning Authority.

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

	2005-06	2004-05 Restated
	£000	£000
Charged/(credited) to:		
Property management	10,334	6,066
Staff costs	274,509	407,621
Nuclear and Other Decommissioning provisions	(95,111)	(316,024)
War Pensions Benefits	2,200	(10,355)
Other costs	21,632	131,141
Net interest (receivable)/payable	1,211,110	147,850
	1,424,674	366,299
Made up of:		
Increase	610,274	809,522
Release	(396,710)	(591,073)
	213,564	218,449
Unwinding of discount *	1,211,110	147,850
Net increase in provisions	1,424,674	366,299

* The 2005-06 charge for the unwinding of discount is higher due to the change in discount factor from 3.5% to 2.2% in this year.

The prior year costs for nuclear and other decommissioning provisions has increased by £104,786,000 and costs for net interest payable have decreased by £142,106,000 following the transfer to the Nuclear Decommissioning Authority.

Nuclear Decommissioning

20.1 Nuclear decommissioning provisions relate principally to the cost of facility decommissioning and the treatment and storage of nuclear waste arising from operations at MoD sites, operations of Royal Navy submarines and for the Departmental share of planning and constructing a national repository for the eventual disposal of that waste.

On 1 April 2005, the Nuclear Decommissioning Authority (NDA), a newly formed organisation sponsored by the Department of Trade and Industry, took over the responsibility for decommissioning and clear-up of civil nuclear sites. As a result, the MoD liabilities at 1 April 2005 relating to civil nuclear sites and the associated value of provisions and funding for decommissioning costs were transferred to the NDA. The liabilities for the decommissioning of other MoD sites and for the disposal of submarine waste have been retained by MoD. The MoD retains responsibility for the Atomic Weapons Establishment (AWE).

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 £9,753,827,000 (Restated 2004-2005: £9,127,164,000).

The estimate of £4,299,488,000 at 31 March 2006 represents £9,863,904,000 discounted at 2.2% to the balance sheet date and expressed in 2005-06 money values.

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

	31 March 2006 £000
Up to 3 years	311,855
From 4 – 10 years	864,766
Beyond 10 years	3,122,867
Total	4,299,488

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 Deep Waste Repository. Pending the current Government's consideration of a House of Lords Sub Committee report on the means of disposing of radioactive waste, the UK holders of such waste are working on the assumption that a repository will not be available earlier than 2040. This will necessitate the continued provision of interim storage.

During 2005-06, a formal review has been undertaken of the AWE nuclear provision incorporating an assessment of the risks and assumptions which underpin the provision calculations and the level of contingency within it. Progress made since 2000 against the original plans was also examined. The outcome of this review was the decision to retain the provision at the current level until the next quinquennial review due in 2007.

Other Decommissioning and Restoration

20.2 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. During 2005-06, a provision of £20,111,000 was created for environmental liabilities at the former Defence Evaluation and Research Agency (DERA) test ranges, currently operated by QinetiQ Group plc.

Early Retirement Pensions

20.3 Where the Department implements an early departure scheme, provision is made for future liability payable to civilian early retirees. During 2005-06, provisions were created for the early departure of civilian employees in Northern Ireland (£42,975,000) as a result of "normalisation", within the DLO (£80,682,000), and within the Central TLB (£10,222,000) to extend the Departmental scheme announced in 2004-05.

Other

20.4 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 created during 2005-06 include £153,044,000 arising from Army restructuring of the Home Service officers and soldiers of the Royal Irish Regiment following Northern Ireland normalisation, an increase of £66,756,000 for legal claims, and £13,560,000 for ABRO restructuring. The pension provision for locally employed personnel overseas has been increased by £46,290,000 on advice from the Government Actuary's Department. Existing provisions include those concerning an adjudication decision where an appeal is pending (£368,000,000).

21. General Fund

	2005-06	2004-05 Restated
	£000	£000
Balance at 1 April	69,254,944	68,129,653
Net Parliamentary Funding – Drawn Down	31,262,178	29,497,000
Year end adjustment – Supply Creditor/(Debtor) – current year	(658,881)	127,275
Net Transfer from Operating Activities – Net Operating Costs	(34,393,535)	(32,331,425)
– CFERs paid and repayable to Consolidated Fund	(470,388)	(383,612)
Non-cash charges:		
– Cost of Capital (OCS)	3,106,369	3,025,892
– Auditors' Remuneration (Note 10)	3,500	3,300
Transfer from Revaluation Reserve (Note 22)	4,450,319	1,094,062
Transfer from Donated Asset Reserve (Note 22)	(64,329)	92,799
Balance at 31 March	72,490,177	69,254,944

The prior year net operating costs transferred from operating activity have decreased by £78,714,000 following the transfer to the Nuclear Decommissioning Authority. The balance as at 1 April 2004 is also restated from £64,028,508,000 as a result of the transfer.

22. Reserves

	Revaluation Reserve £000	Donated Asset Reserve £000	Investment Reserve £000
At 1 April 2005	18,719,510	2,019,063	–
Arising on revaluation during the year (net)	2,425,832	56,346	–
Arising on revaluation on flotation of QinetiQ	–	–	248,522
Arising on valuation of year end market values	–	–	(5,932)
Additions during the year	–	55,407	–
Transfers and reclassifications	(59,340)	20,545	–
Transferred (to) / from Operating Cost Statement	–	(102,662)	–
Transferred (to) / from General Fund	(4,450,319)	64,329	–
At 31 March 2006	16,635,683	2,113,028	242,590

22.1 Following the Quinquennial Review of asset valuations during 2002, the MoD rebased the land and building assets with new gross costs and lives, within TLB asset registers. This resulted in a loss of direct linkage between individual assets and the revaluation reserve held on the Fixed Asset Registers (FARs). Off-line records continued to be maintained by TLBs.

22.2 The MoD estate was subject to a subsequent full professional revaluation review during 2004-05, and a further 22% review during 2005-06. The resultant movements in valuations were significantly reduced from those experienced in 2002. It is considered that future movements in the valuation of the estate will remain fairly constant and that the requirement for significant impairment reversals will not arise.

22.3 In preparation for the transfer of assets to Single Balance Sheet Owners from 1 April 2006 and the centralised processing of assets within the Shared Service Centre, and in light of the difficulties experienced in trying to maintain the off-line records, the unsupported revaluation reserve within the general ledger has been written-off to the general fund. The net transfer to the general fund is £2,898,000,000.

23. Notes to the Cash Flow Statement

23.1 Reconciliation of operating cost to operating cash flows

	Note	2005-06 £000	2004-05 Restated £000
Net operating cost	OCS	34,393,535	32,331,425
Non-cash transactions:			
– Depreciation and amortisation charges	10	(6,497,853)	(6,106,056)
– Impairment in value of fixed assets	10	(412,804)	238,174
– Provisions to reduce value of stock to its net realisable value	10	165,851	(227,498)
– Stocks written off – net	10	(758,698)	(703,558)
– Auditors' remuneration	10	(3,500)	(3,300)
– Surplus/(deficit) arising on disposal of tangible fixed assets	10	123,377	53,620
– Surplus/(deficit) arising on disposal of investments (QinetiQ)	10	355,982	–
– Fixed Assets written on – net	10	301,805	85,648
– Capital project expenditure written on/(off)	10	22,145	(25,851)
– Amounts written off investments	10	(4,774)	–
– Movement in provisions for liabilities and charges (excluding capitalised provisions)	20	(212,014)	(218,797)
– Unwinding of discount on provisions for liabilities and charges	20	(1,211,110)	(147,850)
– Cost of capital	21	(3,106,369)	(3,025,892)
		(11,237,962)	(10,081,360)
Increase/(decrease) in stocks/WIP		255,844	288,489
Increase/(decrease) in debtors		71,777	95,478
<i>Less movements in debtors relating to items not passing through the OCS</i>		–	–
(Increase)/decrease in creditors		(696,215)	(696,529)
<i>Less movements in creditors relating to items not passing through the OCS</i>		600,926	636,629
Use of provisions		477,154	392,149
Net cash outflow from operating activities		23,865,060	22,966,281

The prior year figure for the movement in provisions for liabilities and charges has decreased by £104,786,000 following the transfer to the Nuclear Decommissioning Authority.

23.2 Analysis of capital expenditure and financial investment

	Note	2005-06 £000	2004-05 Restated £000
Intangible fixed asset additions	13	1,549,968	1,579,884
Tangible fixed asset additions	14	5,568,181	5,489,495
Less movement on fixed asset accruals & creditors		(169,781)	(482,544)
Proceeds on disposal of tangible fixed assets		(299,316)	(266,912)
Proceeds of redemption of Redeemable Preference Shares in QinetiQ		(21,766)	(48,543)
Proceeds of Shares in QinetiQ		(357,771)	–
Loans made to Trading Funds	15	6,000	–
Repayment of loans made to the Trading Funds and QinetiQ	15	(53,237)	(25,187)
Net cash outflow from investing activities		6,222,278	6,246,193

23.3 Analysis of capital expenditure and financial investment by Request for Resources

	Capital expenditure £000	Loans etc £000	A in A £000	Net Total £000
Request for Resources 1	6,737,125	(47,237)	(321,082)	6,368,806
Request for Resources 2	211,243	–	–	211,243
Request for Resources 3	–	–	–	–
Paid to the Consolidated Fund Extra Receipts (QinetiQ flotation)	–	–	(357,771)	(357,771)
Net movements in debtors/creditors	169,781	–	–	169,781
Total 2005-06	7,118,149	(47,237)	(678,853)	6,392,059
Total 2004-05	7,092,316	(25,187)	(415,455)	6,651,674

23.4 Analysis of financing

	Note	2005-06 £000	2004-05 Restated £000
From the Consolidated Fund (Supply) – current year	21	31,262,178	29,497,000
From the Consolidated Fund (Supply) – prior year	21	127,275	80,095
Advances from the Contingencies Fund		1,839,814	–
Repayments to the Contingencies Fund		(1,839,814)	–
Repayment of loans from the National Loans Fund		(1,695)	(1,599)
Capital elements of payments in respect of finance leases and on-balance sheet PFI contracts		(10,385)	–
Loans – Other		26,300	–
Net financing		31,403,673	29,575,496

23.5 Reconciliation of Net Cash Requirement to increase in cash

	Note	2005-06 £000	2004-05 Restated £000
Net cash requirement		(30,603,297)	(29,624,275)
From the Consolidated Fund (Supply) – current year	23.4	31,262,178	29,497,000
From the Consolidated Fund Supply – prior year	23.4	127,275	80,095
Amounts due to the Consolidated Fund received and not paid	19	102,983	369,096
Amounts due to the Consolidated Fund received in the prior year and paid over		(369,096)	(222,659)
Movement on Collaborative balances		59,791	26,590
Increase in cash		579,834	125,847

24. Notes to the Statement of Operating Costs by Departmental Aim and Objectives

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:

	2005-06			2004-05		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
Operations	1,055,848	(16,062)	1,039,786	938,449	(268)	938,181
Other military tasks	1,751,704	(53,287)	1,698,417	1,849,803	(86,019)	1,763,784
Contributing to the community	566,648	(72,362)	494,286	457,294	(62,328)	394,966
Helping to build a safer world	610,690	(279,090)	331,600	479,778	(187,152)	292,626
Total	3,984,890	(420,801)	3,564,089	3,725,324	(335,767)	3,389,557

Costs are identified as follows:

- **Operations** comprises the additional costs incurred deploying the Armed Forces in military operations, e.g. in Iraq and Afghanistan, over and above the costs of maintaining the units involved at their normal states of readiness;
- **Other military tasks** include ongoing military commitments, e.g. to security in Northern Ireland and Overseas Commands, and the costs of identifying and countering the threat of terrorist attack on the UK mainland, and of maintaining the integrity of UK waters and airspace;
- **Contributing to the community** includes ongoing support activities, e.g. search and rescue, administration of cadet forces. In addition, it includes the costs of assistance to other Government Departments and agencies, e.g. in counter drugs operations;
- **Helping to build a safer world** includes the costs of Defence diplomacy undertaken to build confidence and security with our allies. It also includes the Department's support of wider British interests.

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

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

	2005-06			2004-05		
	Gross	Income	Net	Gross	Income	Net
	£000	£000	£000	£000	£000	£000
Royal Navy						
Aircraft carriers	363,720	(9,392)	354,328	362,268	(15,507)	346,761
Frigates and Destroyers	1,385,909	(30,940)	1,354,969	1,614,503	(66,014)	1,548,489
Smaller warships	424,510	(11,840)	412,670	509,040	(22,819)	486,221
Amphibious ships	296,158	(5,935)	290,223	348,724	(8,594)	340,130
Strategic sealift	43,742	(2,675)	41,067	40,097	(1,929)	38,168
Fleet support ships	347,915	(3,473)	344,442	413,254	(5,150)	408,104
Survey and other vessels	74,755	(2,389)	72,366	106,285	(3,797)	102,488
Naval aircraft	1,170,120	(31,482)	1,138,638	1,224,695	(31,763)	1,192,932
Submarines	3,441,777	(48,510)	3,393,267	2,351,571	(45,064)	2,306,507
Royal Marines	550,066	(10,153)	539,913	552,325	(12,555)	539,770
	8,098,672	(156,789)	7,941,883	7,522,762	(213,192)	7,309,570
Army						
Field units	8,696,394	(204,079)	8,492,315	7,683,884	(166,992)	7,516,892
Other units	2,204,945	(218,263)	1,986,682	1,927,205	(191,669)	1,735,536
	10,901,339	(422,342)	10,478,997	9,611,089	(358,661)	9,252,428
Royal Air Force						
Strike/attack and offensive support aircraft	1,832,257	(54,774)	1,777,483	2,424,992	(76,478)	2,348,514
Defensive and surveillance aircraft	2,409,986	(61,914)	2,348,072	2,303,701	(75,409)	2,228,292
Reconnaissance and maritime patrol aircraft	620,778	(15,043)	605,735	512,340	(23,002)	489,338
Tankers, transport and communications aircraft	1,304,193	(56,750)	1,247,443	1,064,852	(36,427)	1,028,425
Future capability	20,370	(372)	19,998	14,908	(314)	14,594
Other aircraft and RAF units	886,603	(36,854)	849,749	764,418	(48,798)	715,620
	7,074,187	(225,707)	6,848,480	7,085,211	(260,428)	6,824,783
Centre Grouping						
Joint and multinational operations	495,378	(21,187)	474,191	544,794	(21,333)	523,461
Centrally managed military support	491,589	(92,020)	399,569	437,110	(148,012)	289,098
Maintenance of war reserve stocks	465,421	(7,225)	458,196	749,333	(15,055)	734,278
	1,452,388	(120,432)	1,331,956	1,731,237	(184,400)	1,546,837
Total Objective 2	27,526,586	(925,270)	26,601,316	25,950,299	(1,016,681)	24,933,618

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, nuclear weapons systems and logistical support of nuclear propulsion, including nuclear decommissioning; (The costs of submarines reported in 2005-06 include the increased cost incurred following the change in the discount rate, from 3.5% to 2.2%, applied to the Department's provisions for nuclear decommissioning).

- **Army – Field units** includes 1 (UK) Armoured Division, 3 (UK) Division, Joint Helicopter Command and Theatre troops;
- **Army – Other units** includes Regional Divisions and 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 Typhoon, 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 the development and use of geographic information.
- **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.

Objective 3: Building for the future

This objective comprises the following elements:

	2005-06			2004-05		
	Gross £000	Income £000	Net £000	Gross Restated £000	Income £000	Net Restated £000
Research	1,041,105	(159)	1,040,946	996,421	(318)	996,103
Equipment programme	2,163,356	(44,767)	2,118,589	1,966,666	(64,041)	1,902,625
Total	3,204,461	(44,926)	3,159,535	2,963,087	(64,359)	2,898,728

The prior year gross cost for the equipment programme has been reduced by £78,714,000 following the transfer to the Nuclear Decommissioning Authority.

- **Research** comprises the costs, including capital charges, of the Science, Innovation, Technology TLB, 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 Notes 13 and 14.

Attribution to Objectives

Gross expenditure of £27,929,750,000 (78.1%) (2004-05 – 72.8%) and Operating Income of £883,844,000 (63.5%) (2004-05 – 55.8%) were allocated to tasks, force elements or activities directly supporting the Objectives. The rest was 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:

	2005-06			2004-05		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
Support for Ministers and Parliament	19,155	(87)	19,068	15,830	(43)	15,787
Departmental corporate services	825,530	(280,807)	544,723	1,686,358	(263,904)	1,422,454
Strategic management	303,154	(7,208)	295,946	353,073	(2,214)	350,859

- **Support for Ministers and Parliament** includes 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, housing and medical care for service personnel, and costs of Departmental restructuring; and
- **Strategic management** comprises Departmental Head Office policy-making functions in strategic, personnel, scientific and medical matters.

The reduction in costs for Departmental Corporate Services in 2005-06 is due in part to the income on disposal from the flotation of QinetiQ (£355,982,000), the inclusion of the corporate civilian redundancy provision (£187,000,000) and the RAF Personnel and Training Command provision for military redundancy and restructuring (£148,000,000) in 2004-05 and the realignment of housing costs to all TLBs.

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 £72,541,390,000 (79.3%) support the military capability required to meet Objective 2. The remainder comprises assets wholly attributable to tasks within Objective 1 (£3,709,146,000 – 4.0%), and intangible assets, fighting equipment and other assets under construction, and assets related to equipment procurement within Objective 3 (£15,246,655,000 – 16.7%), and payment of War Pensions Benefits (-£15,711,000).

25. Capital Commitments

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

	31 March 2006 £000	31 March 2005 £000
Contracted but not provided for	18,906,646	20,446,744

26. Financial Commitments

Commitments under operating leases:

	Land and Buildings		Other	
	31 March 2006	31 March 2005 Restated	31 March 2006	31 March 2005
	£000	£000	£000	£000
The Department was committed to making the following payments during the next year in respect of operating leases expiring:				
Within one year	11,458	5,118	9,860	16,137
Between two and five years	14,811	10,382	167,785	145,328
After five years	155,575	148,623	755,075	642,446
	181,844	164,123	932,720	803,911

The prior year figures have been restated due to an omission in the 2004-05 Note in respect of operating leases in Germany.

The prior year "Other – after five years" figure has been restated to include the Strategic Sealift project.

Obligations under finance leases:

	2005-06	2004-05
	£000	£000
Rentals due within 1 year	4,378	4,914
Rentals due after 1 year but within 5 years	2,639	8,019
Rentals due thereafter	–	2,488
	7,017	15,421

The movement between 2004-05 obligations and the 2005-06 obligations is as a result of the reclassification of a finance lease to an operating lease.

27. Private Finance Initiative (PFI) Commitments

27.1 The payments made during the year in respect of on and off Balance Sheet PFI transactions were £869,512,000 (2004-05: £728,465,000).

27.2 The service payments which the Department is committed to make during the year 2006-07 are analysed below by time-bands specifying the period in which the individual commitment expires:

	31 March 2006	31 March 2005
	£000	£000
In the 2nd to 5th years	81,912	186,883
In the 6th to 10th years	236,188	117,687
In the 11th to 15th years	213,235	132,590
In the 16th to 20th years	54,519	54,447
In the 21st to 25th years	240,046	190,569
In the 26th to 30th years	11,600	86,967
In the 31st to 35th years	120,350	28,339

27.3 The following information is provided for those schemes assessed as off Balance Sheet:

Project Description	Capital Value*	Contract Start**/ End Dates	
	£000		
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	Nov 2009
Hazardous Stores Information System (HSIS): Provision of an information management service for hazardous stores safety datasheets with 2,000 users	1,000	Oct 1997	Oct 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 2012
Electronic Messaging Service: Interoperability of messaging services for the Army	33,000	Apr 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 the total amount, £64 million relates to on-balance sheet)	92,800	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	3,800	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.	5,000	Feb 1998	Aug 2018
RAF Mail: Provision of informal messaging services for the RAF	12,000	Nov 1998	Nov 2008

Project Description	Capital Value*	Contract Start**/ End Dates	
	£000		
Fire Fighting Training Units: Provision of fire fighting training for the Naval Recruiting and Training Agency (NRTA)	22,500	Apr 1999	Jan 2021
Light Aircraft Flying Training: Provision of flying training and support services for Air Experience Flying (AEF) and University Air Squadron (UAS) Flying Training	20,000	Apr 1999	Mar 2009
Tornado GR4 Synthetic Training Service: Provision of aircraft training service at RAF Marham and RAF Lossiemouth	61,700	Jun 1999	Jun 2031
Army Foundation College: Provision of teaching and training facilities for the further vocational education and military training of high-quality school leavers	73,400	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	15,100	Mar 1999	Jun 2025
Central Scotland Family Quarters: Provision of married quarters accommodation for 164 Service Families in Central Scotland	24,700	Aug 1999	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.	2,600	Mar 2001	Mar 2008
E3D Sentry Aircrew Training Service: E3D Sentry simulators instructors and maintainers at RAF Waddington	6,900	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	15,400	Jul 2000	Jul 2025
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	Mar 2028
Family quarters at Bristol / Bath / Portsmouth: Provision for married quarters accommodation for 317 service families	78,000	Nov 2001	Sep 2028
Defence Housing Executive Information Systems (DOMIS): Provision for a management information system for the Defence Housing Executive	11,600	Oct 2001	Sep 2010
Marine Support to Range and Aircrew Training: Provision of management, manning, operation and maintenance of Air Support Craft and Range Safety Craft	11,800	Dec 2001	Dec 2012
Astute Class Training: Provision of a training environment for crewmen and maintainers to support Astute Class submarines for 30 years	79,600	Sep 2001	Jan 2037
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
Material Handling Equipment: Provision of tri-service material handling equipment for Army, Navy and RAF storage depots	9,000	Aug 2002	Jul 2010
Aquatrine Project A: Provision of water and waste water services	154,000	Apr 2003	Nov 2028
Aquatrine Project B: Provision of water and waste water services	86,400	Sep 2004	Mar 2030
Aquatrine Project C; Provision of water and waste water services	363,600	Oct 2004	Mar 2030
Hayes Records and Storage: Pan-Government Records Management and Archive Services	11,100	Sep 2003	Sep 2028
Defence Sixth Form College: Development of a sixth form college to help meet the future recruitment requirements in the Armed Forces and MoD Civil Service	20,000	Jun 2003	Aug 2033
Colchester Garrison: Redevelopment, rebuilding and refurbishment to provide accommodation and associated services (messing, education, storage, workshops)	539,000	Feb 2004	Feb 2039
Skyenet 5: Range of satellite services, including management of existing Skynet 4 satellites	1,360,930	Oct 2003	Feb 2020
C Vehicles: Provision of Earthmoving and Specialist plant, Engineer Construction Plant and Material Handling Equipment and support services	114,436	Jun 2005	Jun 2021
Portsmouth 2 Housing: Provision of 148 Family Quarters in Portsmouth	27,092	Oct 2005	Oct 2030

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

** The date when the contracts were signed.

27.4 The following PFI projects are treated as on balance sheet. The service payment commitments for the year 2005-06 are included in the table shown at 27.2.

Project Description	Contract end date	Contract end date
Defence Helicopter Flying School: Provision of helicopter flying training services	Apr 1997	Mar 2012
RAF Lossiemouth Family Quarters: Redevelopment and reprovision of 279 family quarters	Jun 1998	Aug 2020
Joint Services Command and Staff College: Command and Staff College for military and civilian personnel	Jun 1998	Aug 2028
RAF Fylingdales: Provision of guaranteed power supply	Dec 1998	Dec 2023
Main Building Refurbishment: Redevelopment and management services for MoD Main Building	May 2000	May 2030
Naval Communications: Submarine fleet communications service	Jun 2000	Dec 2030
Defence Electronic Commerce Service: Strategic partnership to deliver e-business environment to share information between MoD and trading partners	Jul 2000	Jul 2010
Defence Animal Centre: Redevelopment of new office and residential accommodation, animal husbandry and training support	Aug 2000	Nov 2026
Heavy Equipment Transporters: Provision of vehicles to replace existing fleet and meet future requirements	Dec 2001	Jul 2024
Field Electrical Power Supplies: Provision of generator sets to support operational electrical requirements in the field	Jul 2002	Jun 2022
Devonport Armada Single Living Accommodation: Provision of Support Services and Fleet Accommodation Centre services at Devonport Naval Base	Jul 2004	Mar 2029
Project Allenby/Connaught: Rebuild, refurbishment, management and operation of facilities for service accommodation at Aldershot, Tidworth, Bulford, Warminster, Larkhill and Perham Down	Mar 2006	Mar 2041

* * The dates when the contracts were signed.

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

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 are as follows:

	Foreign currency US\$/Euro 000	Weighted average exchange rate (=£1)	31 March 2006 Sterling £000	31 March 2005 Sterling £000
			2006/2007 delivery	2005/2006 delivery
US Dollar	1,986,000	1.8426	1,077,839	892,182
Euro	1,524,000	1.3931	1,093,972	962,769
			2007/2008 delivery	2006/2007 delivery
US Dollar	1,813,000	1.7552	1,032,949	836,864
Euro	1,541,000	1.4197	1,085,456	990,699
Total			4,290,216	3,682,514

The 31 March 2006 mid-market closing rates for US Dollar and Euro were £/\$ 1.7346 and £/Euro 1.433 respectively.

Fair values

Financial assets

The Department's financial assets include investments in, and loans made to, MoD agencies funded through a Trading Fund and QinetiQ. The net assets of these bodies (excluding MoD loans) and the interest rates applicable to these loans are shown in Note 15. Other financial assets' fair values approximate to their book values.

Financial liabilities

The Department's liabilities include loans from the National Loans Fund, obligations under finance leases and PFI contracts and a loan from the Atomic Weapons Establishment amounting in total to £800,640,000 (2004-05: £794,914,000). The fair values of these liabilities will be different from their book values but since these represent only 4.8% of the gross liabilities and provisions, the impact on the Department's net assets will not be material. The fair values of provisions for liabilities and charges are not materially different to their book values, which are stated after discounting at the Treasury rate of 2.2%. Other liabilities' fair values approximate to their book values.

29. Contingent Liabilities and Contingent Assets Disclosed under FRS 12

29.1 Contingent Liabilities

Contingent liabilities estimated at some £1,575,055,000 (2004-05: £1,607,000,000) have been identified. This comprises site restoration liabilities of some £400,000,000 (2004-05: £400,000,000) relating to the British Army Training Units in Canada and indemnities, that are quantifiable, of £979,500,000 (2004-05: £1,036,000,000) granted to contractors and suppliers.

The Department holds a number of sites where it may be necessary to carry out remediation work in respect of contamination. It is not cost effective or practicable to identify all levels of contamination at individual sites nor to assess the likely cost of any remediation work necessary. As any liability cannot, therefore, be quantified it is not appropriate to include a provision in accordance with FRS 12.

The Department has identified a contingent liability for compensation payments arising from the underpayment of pensions under the Armed Forces Pension Scheme. The scope and scale of the underpayments are currently being assessed as part of a programme of work called Project Collins. The payment of compensation has not yet been agreed and the amounts involved (if any) will be dependent on a number of factors to be considered as part of the project. Until this work is completed, any potential liability cannot be quantified; so, a provision in accordance with FRS12 is not appropriate.

29.2 Contingent Assets

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 estimated to be valued at the time at £1 million. If confirmed as HMS Sussex, 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 Her Majesty's Government, and Odyssey for further archaeological exploration of the wreck of HMS Sussex and recovery of artefacts et cetera. Under the agreement, the net proceeds of the sale of coins and other marketable artefacts will be shared between the two parties. Insufficient certainty exists at present as to the presence or value of any potential recovery of artefacts to quantify the contingent asset.

30. Contingent Liabilities not required to be disclosed under FRS 12 but included for Parliamentary Reporting and Accountability

30.1 Quantifiable (Unrestricted)

The 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 2005	Increase in year	Liabilities crystallised in year	Obligation expired in year	31 March 2006	Amount reported to Parliament by Departmental minute
	£000	£000	£000	£000	£000	£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 1,000				1,000	1,000
Termination liabilities arising out of MoD's association with the Research Council under the Joint Grants Scheme.	10,035 (Note i)			(10,035)	–	10,035
Liabilities arising from insurance risk of exhibits on loan to the Army, Navy and RAF Museums.	2,125	601 (Note ii)			2,726	2,726

Explanation of movement

Note:

- The liability at 1 April 2005 has been restated to reflect a downward review of the obligation in 2004-05 by £7,585,000.
- Increase in the number of exhibits and indemnities issued through the Department for Culture, Media and Sport scheme.

Reconciliation between disclosed amount and amount reported to Parliament

The MoD conducts a review of its outstanding liabilities annually to ensure that all its liabilities have been properly recorded under the requirements of Resource Accounting and Government Accounting. Until 2003-04, unclassified liabilities which were reportable to Parliament under Government Accounting were published in the annual Supplementary Statement to the Consolidated Fund and National Loans Fund accounts. The Finance Act 2003 repealed the requirement for this publication. Restricted liabilities continue to be reported annually to Parliament.

30.2 Quantifiable (Restricted)

Details on restricted indemnities are not given because they are sensitive due to commercial confidentiality and/or national security.

30.3 Unquantifiable

The 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 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.

Restricted Indemnities

- Details on restricted liabilities are not given because they are sensitive due to commercial confidentiality and national security.

These liabilities are unquantifiable due to the nature of the liability and the uncertainties surrounding them.

31. Losses and Special Payments

CLOSED CASES: these comprise losses and special payments which have been formally signed off to date subsequent to a satisfactory completion of all the case work relating to the loss or special payment. Closed cases, therefore, include some cases which in the previous year were shown under Advance Notifications.	Arising in 2005-06 £000	Reported in 2004-05 as Advanced Notifications £000
Total (excluding gifts, special payments and War Pensions Benefits) under £250,000 each: 13,739 cases	14,602	
Total (excluding gifts, special payments and War Pensions Benefits) over £250,000 each: 13 cases (detailed below)	30,527	262,851
Bookkeeping losses and adjustments		
Clearance of obsolete balances for old, completed projects. Amounts written off. (DPA)	16,551	
Claims waived or abandoned		
Following an annual review of the Service Level Agreement, a claim for Service Level Failure Charges against EDS has been waived. Originally £660k, the sum has been reduced following finalisation of payment terms. (Central)		548
Stores and other losses		
An issue of 2 Power Units was made to 62 Stores Squadron in support of Operation TELIC. The unit subsequently raised a Discrepancy Report as a result of nil receipt. An in depth investigation has been able to track the issue into Theatre but the unit had subsequently returned to peacetime location. The stores have not been accounted for in Theatre and, therefore, formal write-off action is required with a conclusion that the stores have been lost in Theatre or used by other units but not accounted for. (DLO)	747	
HMS Penzance. Loss of Minesweeping and Dan laying stores whilst undertaking an exercise. The vehicle was lost owing to a lack of battery power which prevented the drag rope being released and the Emergency Release procedure being effective. During the run, the battery drain was excessive and unusually fast, given the demands placed on the vehicle. Full "on receipt" checks had been completed on 16 Mar 05. The vehicle operators took the correct actions when trying to surface the vehicle. (FLEET)	394	
Loss of TALON Satellite Communication equipment deployed to Operation TELIC. Remedial measures were taken and, since the incident, internal procedures for the issue and receipt of equipment have been reviewed. (LAND)	332	
Tornado engine spares destroyed by fire, caused by a short circuit in cabling in module repair bay at RAF Marham. Provision of an automatic fire detection system has been approved and should be installed during financial year 2006-07. (STC)		352
Fruitless Payments		
In the wake of Hurricane Katrina, which made landfall on the US Gulf coast states of Louisiana, Mississippi and Alabama on the 29th August 2005, the UK responded to an urgent US request on the 4th September 2005 to send 500,000 Operational Ration Packs (ORPs) to aid the relief effort. 475,185 ORPs were airlifted by the Defence Logistics Organisation to the US authorities at Little Rock Airbase between the 5th and 7th September 2005. The decision to gift the ORPs was made by the then PUS, a decision endorsed by the Treasury, and a departmental minute to that effect was laid before Parliament. The Treasury, however, directed that only the ORPs could be gifted and the transportation costs of £1,981,975 would have to be written off. Staff from the Department are in discussions with the Cabinet Office about putting in place a process that seeks to ensure that MoD would not be left to pick up the costs if a similar event occurs in the future. (DLO)	1,982	
Constructive Losses		
The Tornado F3 Mid-Life Fatigue Programme (MLFP) was designed to modify those parts of the aircraft structure that, on predicted usage, would reach a fatigue life limit prior to the fleet planned Out of Service Date (OSD). A study carried out concluded that those parts of the aircraft originally identified no longer had an impact on the aircraft's ability to reach OSD and so, to prevent further nugatory expenditure, the decision was taken in December 2003 to terminate the Tornado F3 MLFP. Negotiations were conducted with the prime contractor EADS to agree the level of consequential costs associated with the termination of the contract. Financial provision for the termination costs was made in the 2003-04 accounts and, following a contract amendment in February 2005, final payment of £10.521M was made in March 2005. (DLO)	10,521	
This constructive loss arose from the UK Government decision not to proceed into production for the medium range anti-tank guided weapons system (MR TRIGAT). There is also a loss (on which negotiations are continuing) in connection with the long range (LR TRIGAT) project (see Advance Notifications). (DPA)		105,343
Loss due to a new building at AWE that was not fit for purpose and cannot be utilised in any other capacity (total loss £148M):		
1) A loss of £83m has been incurred in respect of plant and equipment within the building. (DPA)		82,983
2) A loss of £65m has been incurred following the impairment of the building. (DPA)		64,672
A Post Project Evaluation was conducted during 2004-05 and a Learning from Experience day was held to ensure that lessons have been learnt and procedures have been changed in order to try to prevent any similar reoccurrence.		
A delay in the production of helicopter training course material resulted in courses not being run leading to a write-off of £8M. Lessons learnt include improvements to the design and acceptance processes for training material to avoid such delays in the future. (DPA)		8,369

CLOSED CASES (continued)	Arising in 2005-06 £000	Reported in 2004-05 as Advanced Notifications £000
The relocation of HMS OSPREY to RNAS Yeovilton involved the construction of a new office block for 847 Squadron. The roof of the building, which was completed in 1999, obscured the view of the end of the runway from the Aircraft Control Tower, causing a potential flight safety hazard. Re-design and construction of a new roof was required to address this. (FLEET)		584
Gifts		
Total under £250,000 each: 18 cases	265	
Total over £250,000 each: 5 cases (detailed below)	44,591	
Infrastructure and Police vehicles to the Government of Iraq. Details of the transfer were notified to the House of Commons in a Departmental Minute dated 9th January 2006. (CJO)	19,600	
Infrastructure, Vehicles and Communications equipment to the Government of Iraq. Details of the transfer were notified to the House of Commons in a Departmental Minute dated 12th October 2005. (CJO)	15,500	
MoD Pattern Room to the Royal Armouries Leeds. Details of the transfer were notified to the House of Commons in a Departmental Minute dated 14th June 2001. The effective date of transfer was September 2005. (DPA)	6,000	
Operational Ration Packs to the Government of the USA in aid of Hurricane Katrina. Details of the transfer were notified to the House of Commons retrospectively in a Departmental Minute dated 6th February 2006. The costs of transportation were written off as a fruitless payment. (DLO)	3,115	
Non-Lethal Equipment, EOD to the Government of Nepal. Details of the transfer were notified to the House of Commons in a Departmental Minute dated 13th July 2005. (Central)	376	
International Courtesy Rules		
Supplies and services provided on a reciprocal basis to Commonwealth and Foreign Navy vessels during visits to British Ports at Clyde, Portsmouth, Devonport and Gibraltar (Central)	1,723	
Transfer of properties below market value		
In December 2004, the MoD gained Parliamentary approval to gift some surplus land in Aldershot to the English Churches Housing Group to provide short-term accommodation units for Service leavers considered at risk of social exclusion immediately after discharge. The value of the land is £350k and the gifting took place during the year. (This was notified in FY 04/05 and reported as a gift in the annual accounts). (DE)	350	
Special Payments		
Total under £250,000 each: 606 cases (of which 2 cases were due to maladministration).	498	
Total over £250,000 each: 3 cases (detailed below)	575	85,076
During 2004-05, the Contractor refurbishing the Officer's Mess at RAF Valley entered a claim for prolongation and disruption of work after payment penalties for over-running the completion date were applied. The likely compensation was estimated at £445k and a provision was made in the accounts in March 2005. The eventual compensation was agreed at £575k and this amount was paid in full to the contractor during 2005-06. (PTC)	575	
HM Treasury agreed an ex-gratia payment of up to £84,500,000 to Swan Hunter subject to completion of certain contractual conditions relating to the construction of two Landing Ship Dock (Auxiliary). Total paid to 31 Mar 06 was £84.5m. The MoD originally placed a contract for four LSD(A). There is a possible claim for £63.8M for delay and dislocation costs relating to the other two ships (see Advance Notifications). (DPA)		84,500
This loss relates to a settlement payment made to a service provider as a result of a termination of contract due to technical reasons relating to Defence Information Infrastructure requirements. (DLO)		576

CLOSED CASES (continued)

	Arising in 2005-06 £000	Reported in 2004-05 as Advanced Notifications £000
War Pensions Benefits (WPB):		
Claims Abandoned-WPB		
Irrecoverable overpayments of war pensions relating to 2,785 cases amounting to £506,421 (2004-05: 2,147 cases amounting to £836,000) were written off. These represent overpayments of pensions which occur due to a number of reasons outside of the Agency's control; this represented 0.05% of the total war pension payments budget of £1.07Bn. All overpayments are recorded as amounts outstanding and action is taken to recover these amounts. In the 2005-06 financial year, over £1.6M of overpayments were recovered. However, where the overpayment was found to be irrecoverable, the decision was taken to waive the amount owed.	506	
Special Payments-WPB		
Total number of payments made during the year were 943 (2004-05: 1,626) and amounted to £5,815,084 (2004-05: £12,120,619). These payments were for War Disability Pensions, and were made under the authority of Treasury dispensing instruments but outside the scope of the Service Pension order. These relate to the following payments:		
(a) Far Eastern Prisoners of War Ex-gratia payments		
In the 2000 pre-budget speech, the Chancellor of the Exchequer announced that ex-gratia awards of £10,000 would be paid to surviving members of British groups held prisoner by the Japanese during the Second World War or their surviving spouses.		
Although the large majority of cases have been paid in previous financial years, 63 claims were processed and paid in the 2005-06 financial year. The total payment amounted to £630,000.	630	
Following a Judicial Review announced in November 2003, the scheme was expanded to allow payments to qualifying Gurkhas in Nepal. In the 2005-06 financial year, 90 successful claims were processed totalling £900,000. A further £2.2 million was charged to the Operating Cost Statement by way of provision to reflect the likely payments in the 2006-07 financial year.	3,100	
(b) Empire Air Training Scheme Pensions		
These Payments relate to members of the Royal Australian Air Force who were trained under the Empire Air Training Scheme and were subsequently selected for service in the RAF. The British Government agreed in June 1942 that it would contribute towards pensions in respect of disablement or death due to the service with the RAF.		
In 2005-06 the total number of cases were 335 (2004-05: 380 cases) and the cost amounted to £1,466,066 (2004-05: £1,625,924).	1,466	
(c) Noise Induced Sensorineural Hearing Loss		
In 2005-06, 219 cases (2004-05: 246 cases) were paid under the Dispensing Instruments and the total amount payable was £523,676 (2004-05: £558,470). The figure was arrived at through a scan of the War Pensions Computer System (WPCS).	524	
(d) Crown Agents Supplementation payments		
Crown Agents Financial Services make payments to ex-members of the colonial forces who are resident in the UK and who have been awarded a disablement pension by the colonial government. The payment is a supplementation amount that increases the disablement pension to the rate equivalent to a UK war pension.		
The Veterans Agency re-imburses Crown Agents Financial Services for these payments. In 2005-06, the total number of cases was 16 (2004-05: 19 cases) and the amount payable was £95,340 (2004-05: £126,224).	95	

ADVANCE NOTIFICATIONS: these comprise losses and special payments, which arose during 2005-06 and prior years, but where the cases have not yet been formally signed off to date. A formal sign off cannot take place until all the work necessary to establish the validity of the loss or special payment, and the exact amount thereof, has been satisfactorily concluded. The amounts shown below are, therefore, only the best estimates, and are reflected in these accounts where appropriate. It is likely that, in many instances, the final value of these losses and special payments will differ from the estimates below when they are reported as closed in future years. Should the final value be less than £250,000, they will not be separately identified.

	Arising in 2005-06 £000	Reported and arising in prior years £000
Notified in prior years		
This constructive loss arose from the UK Government decision not to proceed into production for the long range anti-tank guided weapons system (LR TRIGAT). (DPA)		205,000
The value of 8 Chinook Mk3 helicopters has been written down by £205m under prudent accounting practices while the MoD establishes a way forward for the programme. The write down has arisen because, although the terms of the contract had been met, the helicopters do not currently meet the operational requirement and could not acquire Military Aircraft Release. (DPA)		205,000
Slippage in the construction programme for two Landing Ship Dock (Auxiliary) caused delay in supplying design information and equipment to a contractor. This resulted in a claim on the MoD relating to the associated delay and dislocation costs. (DPA)		63,800
The extended range ordnance modular charge system (ERO/MCS) was cancelled due to technical difficulties with the MCS that could not be resolved. This produced an estimated constructive loss. In 2003-04 the loss was estimated at £34.5m. (DPA)		32,798
Uncleared balances in respect of Income Tax and National Insurance balances to be written off in the books of the Armed Forces Personnel Administration Agency (AFPAA). (Central)		1,479
A food component was withdrawn from Operational Ration Packs (ORP) following discovery in tests that deterioration of the product's packaging could over time compromise the safety of the contents. The Contractor accepted liability in principle for this defect and agreed to supply a replacement product utilising an alternative packaging arrangement, at no cost to MoD, subject to being able to develop a replacement product that could be warranted fully fit for purpose. This development work is continuing and, if successful, will substantially mitigate the overall loss to the Department brought about by a combination of loss of use of the original product and the cost of its removal/destruction. (DLO)		1,400
Metropole Building re-wire project. Bad Debt provision for legal dispute between MoD and former contractor which remains unresolved. Case is currently with the Treasury Solicitor and negotiations are ongoing. (Central)		500
A constructive loss arose in respect of the Voice Monitoring and Analysis Facility (VMAF) due to several factors including a limited capability and a change in policy placing the onus on contractors to provide their own capability testing. Changes in procurement policy will ensure that losses of a similar nature do not occur again. (DLO)		434

ADVANCE NOTIFICATIONS (continued)

	Arising in 2005-06	Reported and arising in prior years
	£000	£000
Notified during the year		
Bookeeping Losses and Adjustments		
A detailed reconciliation of the Fixed Asset Register with the General Ledger for the Central Top Level Budget is underway, and this advance notification represents the maximum value of the bookkeeping adjustment that may have to be made. This unreconciled balance has arisen over a period of several years. The issue will be fully resolved during 2006-07, as part of the transfer of assets and balances to the Single Balance Sheet Owners. (Central)	9,367	
In preparation for the implementation of the Order to Cash system a reconciliation was undertaken of debtor balances. This highlighted a number of problems where prepaid amounts were duplicated against income and debtor balances and balances could not be reconciled. The duplications have now been reconciled to the current Defence Bills Debtor balance, and the adjustment should be written off as a book-keeping loss. Work is on-going to try to reconcile other balances – however, there may be a need to write off the final unreconciled amounts. The figure quoted is the best estimate of the amount that may be written off. (Central)	6,175	
Claims waived or abandoned		
A potential claim against a contractor on the ASTOR programme has been abandoned resulting in a loss, but other benefits have been secured in compensation. (DPA)	28,000	
A commercial compensation package agreed as a result of slippage to the delivery dates by the contractor and the unavailability of components for the COBRA programme has resulted in a potential write-off. (DPA)	548	
Service Level Failure Charges against EDS waived. Final amount is expected to be agreed by September 2006. (AFPAA). (Central)	1,022	
Stores and other losses		
Item of aircraft spares transferred from the Westlands Managed store in RNAS Culdrose to HMS WESTMINSTER conducting RP1 in Rosyth Naval Base. There is a clear audit trail confirming receipt by Ship's staff in Rosyth. However, on running a weekly Issue Transaction Summary (ITS) (Stores equivalent of a bank statement listing all issues to a unit from external sources), the item had not been brought to Ship's charge and cannot be located. (FLEET)	630	
Constructive losses		
A potential loss arose as the result of the UK Government decision to reduce the number of Nimrod MRA4 procured from 18 to 12. (DPA)	32,600	
Cancellation of the Alternative Launcher Drive System (ALDS) programme has resulted in a potential write-off. (DPA)	4,000	
A constructive loss arose as a result of a settlement between the Agency and a manufacturer for the provision of Manportable Remote Control Vehicles (MRCVs). (DPA)	1,117	
An agreement was breached with a Contractor that required contracts for nuclear cores to be placed within a certain timeframe rendering MoD liable to pay default costs. (DPA)	562	
Special Payments		
A contractor is claiming extra costs resulting from the late delivery of unusable Global Positioning System chips in respect of the Storm Shadow missile programme, purchased via Foreign Military Sales. However, the MoD is attempting to re-claim from the supplier of the Government Furnished Equipment via the US courts. A related write off of £1.8M for Variation of Price (VoP) was recorded in the 2004-05 accounts. (DPA)	4,000	
There is a possible extra contractual payment of £3.8m resulting from the late supply of Government Furnished Equipment to the TITAN & TROJAN project. (DPA)	3,800	
There is a possible ex-gratia payment in settlement of the Armoured Vehicle Training Service PFI procurement strategy. (DPA)	2,900	
Following the closure of the last RAF base in Germany (RAF Brüggen), it was decided that the UK would withdraw from the Central European Pipeline System. This resulted in payments of £2.069M during FY 2005-06, to ensure that the UK has no further involvement or liability in respect of the Central European Pipeline System. (DLO)	2,069	

32. Related Party Transactions

32.1 The Defence Science and Technology Laboratory, the UK Hydrographic Office, the Met Office, the Defence Aviation Repair Agency and ABRO operate as Executive Defence Agencies financed by Trading Fund.

The Initial Public Offering for QinetiQ Group plc completed the transformation of the MoD's in-house research and development organisation into an international defence technology and security company. MoD retains a 19.3% shareholding in the company and also holds a Special Share; further details can be found at Note 15 – Investments, to these accounts. The MoD also appoints a Non-Executive Director to QinetiQ's Board; the appointment is currently held by Mr Colin Balmer. (Until 18 Jan 06, the appointment was held by Mr Trevor Woolley – MoD's Finance Director).

The Navy Army Air Force Institutes (NAAFI) and the Oil and Pipelines Agency are Public Corporations.

The Trading Funds, QinetiQ, the Oil and Pipelines Agency and NAAFI 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.

Oil and Pipelines Agency (Public Corporation)

Agency Fees: £1,747,000 (2004-2005: £1,625,000)

VAT recovery £305,725 (2004-2005: £284,375).

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

32.2 The following are Executive NDPBs of the MoD. They are designated NDPBs under the National Heritage Act 1983 and produce their own annual accounts, in accordance with the Charities (Accounts and Reports) Regulations 1995, on an accruals basis, and are regarded as related parties. During the year, each Executive NDPB had a material transaction with the Department, as listed below:

Fleet Air Arm Museum

Grant-in-Aid: £579,036 (2004-2005: £564,448)

Assistant Chief of Staff Aviation, CinCFleet, Whale Island; Assistant Director Joint Manoeuvre, MoD, London; Director Logistics (Rotary Wing) RNAS Yeovilton; Commanding Officer RNAS Culdrose and Commanding Officer RNAS Yeovilton are members of the Board of Trustees.

National Army Museum

Grant-in-Aid: £4,871,546 (2004-2005: £5,151,170)

The Department is not represented on the Board.

Royal Air Force Museum

Grant-in-Aid: £7,104,192 (2004-2005: £7,026,895)

The Department is not represented on the Board.

Royal Marines Museum

Grant-in-Aid: £783,252 (2004-2005: £704,839)

Director Royal Marines and Regimental Sergeant Major, Royal Marines Corps are members of the Board of Trustees.

Royal Naval Museum

Grant-in-Aid: £1,025,044 (2004-2005: £1,143,901)

Naval Base Commander Portsmouth and Chief of Staff (Warfare) CinCFleet were members of the Board of Trustees during the financial year.

Royal Navy Submarine Museum

Grant-in-Aid: £548,317 (2004-2005: £649,314)

Rear Admiral Submarines is a member of the Board of Trustees.

Other

32.3 Mr Ian Andrews, Second Permanent Under Secretary of State, is a trustee of the Imperial War Museum. Mr Charles Miller Smith, a Non-Executive Director on the Defence Management Board, is also the Chairman of Scottish Power. The Imperial War Museum and Scottish Power are therefore regarded as related parties of the Ministry of Defence and transactions between the organisations during the year were:

		£000
Imperial War Museum	Various transactions-Payments	48
	Various transactions-Receipts	12
Scottish Power	Various transactions-Payments	1,825

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

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, Skill Force and the Commonwealth War Graves Commission.

In addition, the MoD has had a number of transactions with other government departments and central government bodies. Most of the transactions have been with: the Foreign & Commonwealth Office, the Cabinet Office, HM Revenue & Customs, the Department for International Development, the Home Office, the Treasury Solicitor, the Office of Communications, the National School of Government and the Department for Work and Pensions.

Joint Ventures

32.4 Within the Departmental accounting boundary, see page 163 for further information, the Department does not have any Joint Ventures. Some of the Trading Funds have set up Joint Ventures and the Department is involved in collaborative projects with various foreign countries for the development and production of fighting equipment.

33. Restatement of Balance Sheet and Operating Cost Statement at 31 March 2005

The transfer of responsibility for the decommissioning costs for civil nuclear sites, from the MoD to the Nuclear Decommissioning Authority (NDA), is a Machinery of Government change. In accordance with the HM Treasury's Financial Reporting Manual, the transfer is accounted for under merger accounting rules, requiring the restatement of the opening Balance Sheet and prior year's Operating Cost Statement, Cash Flow Statement, Statement of Operating Costs by Departmental Aim and Objectives and associated Notes to the Accounts.

Balance Sheet	Published Balance at 31 March 2005	Transfer to the NDA	Restated Balance at 31 March 2005
	£000	£000	£000
Fixed Assets			
Intangible Assets	22,647,823	–	22,647,823
Tangible Fixed Assets – capitalised provision	69,634,594	(25,705)	69,608,889
Investments	347,108	–	347,108
Current Assets			
Stocks and work-in-progress	6,095,363	–	6,095,363
Debtors – prepayment	2,870,899	(21,521)	2,849,378
Cash at bank and in hand	438,411	–	438,411
Creditors: amounts falling due within one year	6,075,613	(74,733)	6,000,880
Creditors: amounts falling due after more than one year	809,896	–	809,896
Provisions for liabilities and charges	9,503,208	(4,320,528)	5,182,680
Net assets	<u>85,645,481</u>	<u>4,348,036</u>	<u>89,993,517</u>
Taxpayers' equity			
General fund	64,906,908	4,348,036	69,254,944
Revaluation reserve	18,719,510	–	18,719,510
Donated assets reserve	2,019,063	–	2,019,063
	<u>85,645,481</u>	<u>4,348,036</u>	<u>89,993,517</u>

Operating Cost Statement	Published 2004-05 £000	Movements arising from the transfer to NDA £000	Restated 2004-05 £000
Staff costs	10,995,642	–	10,995,642
Other operating costs	19,700,190	(104,786)	19,595,404
Gross operating costs	30,695,832	(104,786)	30,591,046
Operating income	(1,416,807)	–	(1,416,807)
Net operating cost before interest	29,279,025	(104,786)	29,174,239
Net interest payable	273,399	(142,106)	131,294
Cost of capital charge	2,857,714	168,178	3,025,892
Net operating cost	<u>32,410,138</u>	<u>(78,714)</u>	<u>32,331,425</u>

34. Post Balance Sheet Events

Subsequent to the year end, a Ministerial announcement on 10 May 2006 set out the outcome of the work on the composition and location of the post-normalisation garrison in Northern Ireland, associated time-lines for further base closures, and announced the start of consultation with the trade unions on the future requirement for civilian support staff for the peacetime garrison.

On 3 July 2006, the Secretary of State announced publication of the MoD's "Enabling Acquisition Change" report. This included a recommendation that the Defence Procurement Agency and the Defence Logistics Organisation should be merged to create a new organisation whose core function is delivery of equipment and support operations to the Front Line. It is the intention that the majority of the recommendations in the report will be implemented by April 2007, although the bedding in of the new integrated procurement and support organisation will not be complete until April 2008.

35. Non-Operational Heritage Assets

35.1 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's Financial Reporting Manual (FReM), non-operational heritage assets are valued except where the cost of the valuation outweighs the benefits that the knowledge of the valuation would deliver or where 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.

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

Item	Location	Description
HMS Victory	Portsmouth	HMS Victory is the world's oldest commissioned warship and is most famous for her role as Lord Nelson's Flagship at the Battle of Trafalgar. HMS Victory is open to the public, details are available at: http://www.hms-victory.com
Army Historic Aircraft Flight	Middle Wallop	Formed in 1977, the flight consists of seven aircraft and makes public appearances between May and September. Further information can be found at: http://www.deltaweb.co.uk/haf/index.htm
Battle of Britain Memorial Flight	RAF Coningsby	The Memorial Flight operates 11 mainly World War II aircraft that appear at several hundred public events each year and can also be viewed at their hangar at RAF Coningsby. Further information is available at: http://www.deltaweb.co.uk/bbmf/history.html
Enigma Machine	RAF Cosford	Cryptographic equipment captured during WW2 and used by Bletchley Park to assist in the breaking of German signal traffic.
MoD Art Collection	Various locations	The MoD Art Collection comprises approximately 800 works of fine art and 250 antiques such as clocks and furniture. Many other miscellaneous items, such as photographs and manuscripts are contained in the archive. At the core of the collection are works commissioned by (and bequeathed to) the Admiralty during the 19th century, and those given to the Admiralty and to the War Office by the War Artists Commission at the end of the Second World War. Items from the MoD art collections are displayed in conference rooms and senior officers' accommodation throughout the Defence estate. The most important items are on permanent public display in the National Maritime Museum and on temporary loan to many other public museums and galleries.
Records and artworks	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	Over one hundred Regimental and Corps Museums and collections 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. Further information is available at: http://www.army.mod.uk/museums/index.htm

36. Entities within the Departmental Boundary

The entities within the boundary during 2005-06 were as follows:

Executive Agencies

Armed Forces Personnel Administration Agency
 Army Training and Recruiting Agency
 British Forces Post Office
 Defence Analytical Services Agency
 Defence Bills Agency
 Defence Communication Services Agency
 Defence Estates
 Defence Medical Education Training Agency
 Defence Procurement Agency
 Defence Storage and Distribution Agency
 Defence Transport and Movements Agency
 Defence Vetting Agency
 Disposal Services Agency
 Duke of York's Royal Military School
 Ministry of Defence Police and Guarding Agency
 Naval Recruiting and Training Agency
 Pay and Personnel Agency
 RAF Training Group Defence Agency
 Service Children's Education
 Veterans Agency

Advisory Non-Departmental Public Bodies

Advisory Committee on Conscientious Objectors
 Advisory Group on Medical Countermeasures
 Animal Welfare Advisory Committee
 Armed Forces Pay Review Body
 Central Advisory Committee on War Pensions
 Dartmoor Steering Group
 Defence Nuclear Safety Committee
 Defence Scientific Advisory Council
 National Employer Advisory Board
 Nuclear Research Advisory Council
 Review Board for Government Contracts
 War Pensions Committees

Independent Monitoring Board – Independent Board of Visitors for Military Corrective Training Centre

Other Entities

The Reserve Forces and Cadet Associations (formerly TAVRA)

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

37.1 Votes A provide the formal mechanism by which Parliament sets limits for and monitors the maximum numbers of personnel retained for service in the Armed Forces. They are presented to the House shortly before the start of each financial year (late February), and form part of the Parliamentary Supply process.

37.2 Votes A numbers represent uppermost limits for Service manpower; they neither predict actual strengths nor act as a control over numbers in the Services. The Vote includes a contingency margin to cover unforeseen circumstances. Manpower levels are monitored routinely, and if it is anticipated that the numbers could be breached, then a Supplementary Estimate may be required to increase the limit. There was no requirement to raise a Supplementary estimate in 2005-06.

37.3 The tables included below compare, for each service, the numbers voted by the House of Commons with the maximum numbers maintained and the date at which this peak occurred.

37.4 Maximum numbers of personnel to be maintained for Service with the Armed Forces:

	Numbers voted by the House of Commons	Maximum numbers maintained	Peak Dates
Officers, Men & Women for NAVAL SERVICE	44,180	39,943	1 Apr 2005
Officers, Men & Women for ARMY SERVICE	128,945	116,812	1 Apr 2005
Officers, Men & Women for AIR FORCE SERVICE	56,140	51,992	1 Apr 2005

37.5 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	17,200	14,712	1 Apr 2005
Reserve Land Forces	84,000	70,650	1 Nov 2005
Reserve Air Forces	23,050	14,164	1 Apr 2005

37.6 Maximum numbers of personnel to be maintained for service as special members with the Reserve Forces:

	Numbers voted by the House of Commons	Maximum numbers maintained	Peak Dates
Special Members of the Reserve Naval Forces	300	182	1 Jan 2006
Special Members of the Reserve Land Forces	6,000	112	1 Oct 2005
Special Members of the Reserve Air Forces	550	88	1 Nov 2005

