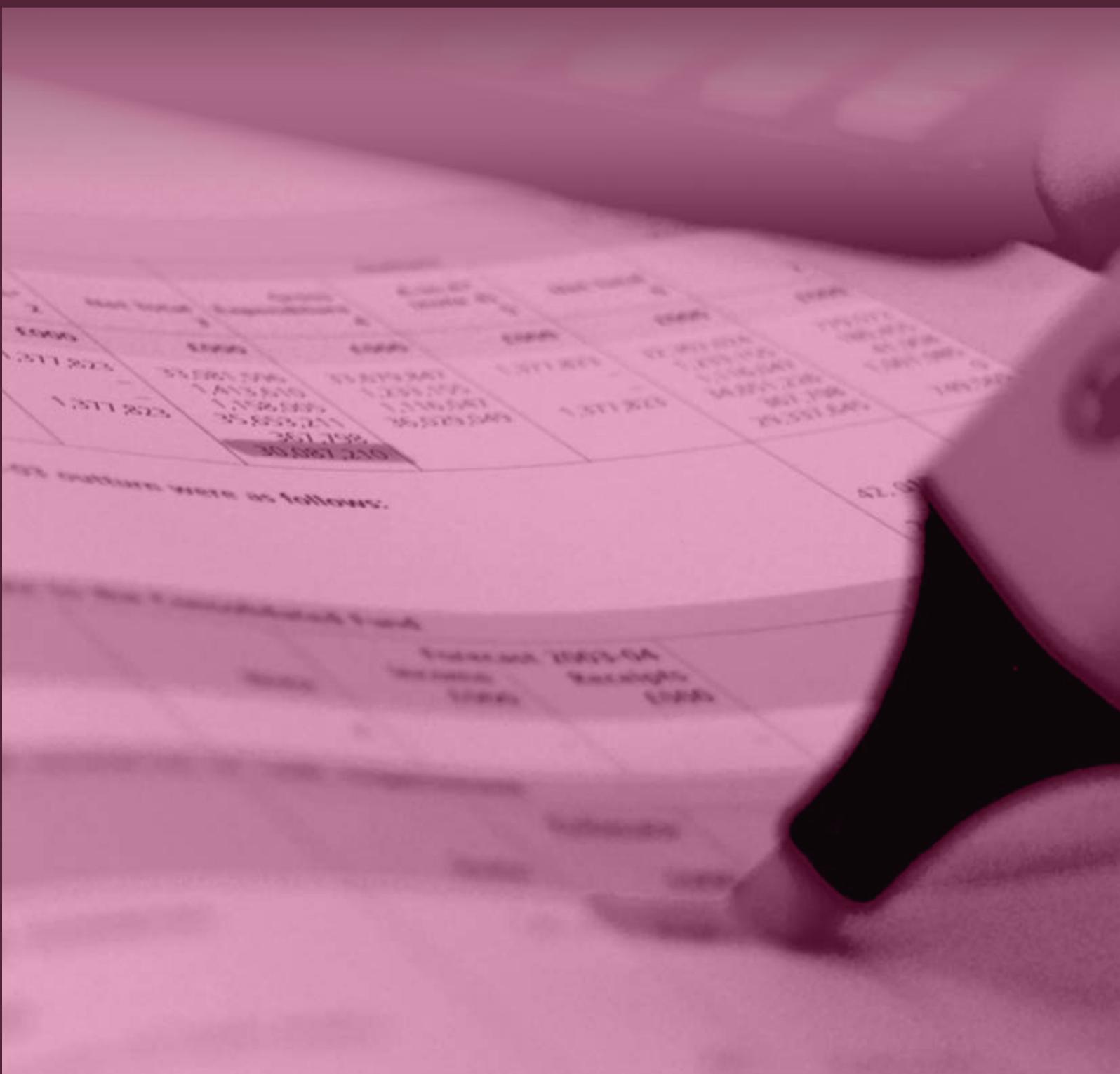


# Departmental Resource Accounts 2006-07

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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 Boundary<sup>1</sup>

At 31 March 2007, the Department consisted of 12 (2005-06:13) Top Level Budget (TLB) Holders; the merger of the Commander in Chief Fleet and 2nd Sea Lord organisations on 1 April 2006 created a single Naval TLB. The TLBs are responsible for providing forces and support services required for a modern defence force and are detailed in Note 2 to the accounts – Analysis of Net Resource Outturn. Within the TLBs, there were 57 (2005-06: 55) reporting entities, known as management groupings, recording accounting balances and transactions and producing detailed management accounting information as part of in-year financial management and planning and budgeting processes. One of the aims of the Department's Simplify and Improve initiative is to reduce the workload on finance staff. Consequently, whilst accounting transactions are still attributed to the management group level for in-year management purposes, reporting for the annual financial accounts is now normally completed only at TLB level.

There are 17 on-vote Defence Agencies (listed in Note 35), a reduction of 3 from 2005-06 following the removal of agency status on 1 April 2006 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' TLBs. 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 the Defence Transport and Movements Agency, which form part of larger management groupings. Further information relating to the Defence Agencies can be found at Annex E to the Annual Report and Accounts.

Also included within the Departmental Boundary are Advisory Non-Departmental Public Bodies (NDPBs) sponsored by the Department; these are listed at Note 35 – Entities within the Departmental Boundary.

There are 5 (2005-06: 5) Executive Defence Agencies established as Trading Funds, and owned by the Secretary of State for Defence, at 31 March 2007. These Trading Funds produce their own accounts and fall outside the Departmental Boundary. Further details are at: Note 15 – Investments, Note 32 – Related Party Transactions and at Annex E. On 22 May 2007 the MoD announced the decision to merge two of the Trading Funds, ABRO and the Defence Aviation Repair Agency, with effect from April 2008, to form a new defence support group providing a maintenance repair, overhaul and upgrade capability in support of the Armed Forces.

The Department also sponsors 5 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.

<sup>1</sup> The Departmental Boundary in this context relates to the boundary of the Departmental Resource Accounts.

The Oil and Pipelines Agency and the Fleet Air Arm Museum are Public Corporations sponsored by the Department, which fall 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.

## **Pension Liabilities**

The transactions and balances of the Armed Forces Pension Scheme (AFPS) (including the Gurkha Pension Scheme, the Non-Regular Permanent Staff Pension Scheme, and the 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:  
<http://www.official-documents.gov.uk/document/hc0506/hc15/1508/1508.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 NHS Superannuation Scheme and the Teachers' Pension 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/](http://www.civilservice-pensions.gov.uk/)  
[www.dfes.gov.uk/aboutus/reports/](http://www.dfes.gov.uk/aboutus/reports/)  
[www.nhspa.gov.uk/site/index.cfm](http://www.nhspa.gov.uk/site/index.cfm)

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.

In July 2006, Ministers announced plans to establish a new organisation, Defence Equipment & Support (DE&S), to carry out integrated defence equipment procurement and support. DE&S will be formed by merging the activities carried out by the Defence Procurement Agency and the Defence Logistics Organisation. As part of the re-organisation, agency status will be removed from: the Disposal Services Agency, the Defence Procurement Agency, the Defence Communications Services Agency, the British Forces Post Office and the Defence Transport and Movements Agency, with effect from 1 April 2007.

Progress on the collocation and rationalisation of the operational command headquarters and the personnel & training headquarters of the Services has continued. The collocation of the RAF's Strike and Personnel and Training Commands, in October 2006, was followed by their merger to form a single Air Command with its Headquarters at RAF High Wycombe, on 1 April 2007. 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. GOC Northern Ireland ceases to be a TLB Holder from 1 April 2007.

The process of organisation review continues to identify opportunities to reduce the number of on-vote Agencies. Agency status will be removed from: the Defence Bills Agency, Defence Estates and the Duke of York's Royal Military School with effect from 1 April 2007. The merger of the Veterans Agency and the Armed Forces Personnel Administration Agency to form the Service Personnel and Veterans Agency (SPVA), with effect from 1 April 2007, will also reduce the number of Agencies. MoD's programme of efficiency and business change including extensive organisational restructuring and rationalisation is likely to reduce the number of Agencies still further.

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. Roll-out of JPA to the RAF in April 2006 was followed by the RN in November 2006 and the Army at the end of March 2007.

The Defence Resource Management Programme (DRMP) aims to simplify and improve current financial processes, structures and systems to reduce costs and improve decision-making. As part of the Programme, the Financial Management Shared Service Centre (FMSSC), which took over the responsibilities of the Defence Bills Agency, was formally established in April 2007. The FMSSC is also responsible for fixed asset processing, cash and banking services and the preparation of the annual accounts. During 2007, the FMSSC will undertake changes to accounts payable processes and systems as part of the DRMP.

## Management

The Ministers who had responsibility for the Department and the composition of the Defence Management Board (DMB) during the year ended 31 March 2007 are shown on pages 202 to 203 in the Remuneration Report.

## Fixed Assets

During 2006 the intangible and tangible fixed assets and related provisions, contingent liabilities and reserves, held on individual TLB Fixed Asset registers, were 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
- Equipment Related Assets Under Construction – Defence Procurement Agency

Changes in fixed asset values during the year are summarised at 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 single use military equipment and on the improvement of the effectiveness and capability of existing single use military 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 £33,948,669,000 which has been charged to the General Fund. Cash voted by Parliament for the provision of Defence Capability (RfR 1), Conflict Prevention (RfR 2) and War Pensions Benefits (RfR 3) amounting to £31,683,881,000 has been credited to the General Fund (Note 21).

## Dividends

Details of 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 2006-07, the DBA met its target by paying 99.95% 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 £8,603 (2005-06: £14,709) and included interest paid by units locally of £23 (2005-06: £48).

## 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. The latest copy of *The Government's Expenditure Plans: Ministry of Defence* can be found at the website:

<http://www.mod.uk/DefenceInternet/AboutDefence/CorporatePublications/BusinessPlans>

## 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 at 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 to the Annual Report and Accounts.

## 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: Current Operations e.g. Crisis Response Operations and Military Aid to the Civil Authorities and Wider Government, e.g. Defence in the Wider Community and Young People: Building Skills and Raising Expectations.
- **Environmental** – aspects are included in the Sustainable Development sections under Estate and Wider Government and in the essay on Defence and Climate Change. The MoD owns a large, varied and complex estate, with most of the UK's indigenous habitat types, exceptional biodiversity and some of the finest archaeology in the country. Further information on how the MoD is undertaking its responsibility for stewardship of the estate in the UK and overseas including links to, *Sanctuary*, the annual MoD Conservation magazine can be found at the MoD Conservation Office website:  
<http://www.defence-estates.mod.uk/conservation/index.php>
- **Employees** – information is provided in the sections: Manpower, Personnel Management, Health and Safety and Future Personnel Plans and in the essay on Joint Personnel Administration. 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](http://www.mod.uk/DefenceInternet/AboutDefence/CorporatePublications/BusinessPlans) and in the Summary of Progress 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 2006-07 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 2006-07 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.

### Reconciliation of Resource Expenditure Between Estimates, Accounts and Budgets

	2006-07 £M		2005-06 £M	
	Estimate	Outturn	Estimate	Outturn
<b>Net Resources Outturn (Estimates)</b>	<b>34,824</b>	<b>34,005</b>	<b>36,839</b>	<b>34,862</b>
<i>Adjustments to include:</i>				
Consolidated Fund Extra Receipts in the OCS	-	(56)	-	(468)
Other adjustments				
<b>Net Operating Cost (Accounts)</b>	<b>34,824</b>	<b>33,949</b>	<b>36,839</b>	<b>34,394</b>
<i>Adjustments to remove:</i>				
voted expenditure outside the budget	(4)	12	(2,349)	(1,060)
<i>Adjustments to include:</i>				
other Consolidated Fund Extra Receipts	-	56	-	468
resource consumption of non departmental public bodies	16	16	24	24
unallocated Resource Provision	220	-	-	-
<b>Resource Budget Outturn (Budget)</b>	<b>35,056</b>	<b>34,033</b>	<b>34,514</b>	<b>33,826</b>
<i>of which</i>				
Departmental Expenditure Limits (DEL)	34,104	33,451	33,727	32,937
Annually Managed Expenditure (AME)	952	582	787	889

## Financial Position

The Statement of Parliamentary Supply – Summary of Resource Outturn on Page 223 compares Estimate and Outturn (net total resources). A detailed explanation of the variances against the Departmental Expenditure Limit is shown in paragraphs 285 to 286 within Finances in the Performance Report.

Request for Resources (RfR) 1, Provision of Defence Capability, provides for expenditure primarily to meet the MoD'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 5, and these will be surrendered to the Consolidated Fund. This RfR is made up from three different controls:

- Resource Departmental Expenditure Limit (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 (AME), 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 for Total Resources is £34,004,995,000 against an Estimate of £34,824,389,000; an underspend of £819,394,000.

The net outturn for RfR1, Provision of Defence Capability is £31,518,502,000 against an Estimate of £32,349,202,000; an underspend of £830,700,000. The variance against the Estimate results from an underspend of £148,322,000 against Resource DEL; an underspend of £666,526,000 in Annually Managed Expenditure (AME); and an underspend of £15,852,000 in Non Budget.

RfR2, Conflict Prevention, shows a net outturn of £1,448,420,000 against an Estimate of £1,427,526,000; an overspend of £20,894,000. This excess relates to non-cash costs, such as depreciation charges for military equipment and the firing of guided weapons, missiles and bombs in Afghanistan, which were higher than forecasted at the time the Estimates were prepared.

RfR3, War Pensions Benefits shows a net outturn of £1,038,073,000 against an Estimate of £1,047,661,000; a small underspend of £9,588,000. This RfR provides for the payment of war disablement and war widows' pensions in accordance with relevant legislation, this is all AME. The costs of administering war pensions are borne by RfR1.

The non-operating Appropriations in Aid show a net outturn of £498,287,000 against an Estimate of £556,152,000, which assumed higher fixed asset disposals in 2006-07.

The Net Cash Requirement shows a net outturn of £31,454,292,000, against an Estimate of £33,746,251,000; an underspend of £2,291,959,000.

## 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 Departmental Performance Report.

The Department is required to have a professional revaluation of its land and building 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](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 217 to 222. 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**

**16 July 2007**

# 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](http://www.ome.uk.com).

There is an established departmental procedure for the appointment of all Non-Executive Directors (NED). 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. NEDs appointed to the Defence Management Board (DMB) receive a Letter of Appointment setting out, amongst other things, details of remuneration.

## Performance and Reward

The basic salary and annual increases of the civilian members of the 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 six and a half percent (2005-06 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 (PMPS). 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 average value of one incremental rise under the PMPS is 2.4% of salary. 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, 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](http://www.civilservicecommissioners.gov.uk).

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

For the NEDs appointed to the DMB, 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.

NEDs 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: their role, period of appointment, standards and any remuneration.

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

The Chief of the Defence Staff, Vice Chief of the Defence Staff and Single-Service Chiefs of Staff 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 Des Browne MP was appointed as Secretary of State for Defence on 6 May 2006; prior to this, the Secretary of State for Defence was The Right Honourable Dr John Reid MP.

### *Minister of State for the Armed Forces*

The Right Honourable Adam Ingram MP.

### *Minister of State for Defence Equipment and Support*

Lord Drayson.

### *Parliamentary Under Secretary of State for Defence and Minister for Veterans*

Derek Twigg MP was appointed as Parliamentary Under Secretary of State for Defence and Minister for Veterans on 7 September 2006.

The following also served as the Parliamentary Under Secretary of State for Defence and Minister for Veterans during the financial year: Tom Watson MP, 6 May 2006 to 5 September 2006, prior to 6 May 2006 the Minister was Don Touhig MP.

### *Recent ministerial changes*

On 29 June 2007, The Right Honourable Bob Ainsworth MP was appointed as Minister of State for the Armed Forces, replacing The Right Honourable Adam Ingram MP.

The composition of the Defence Management Board (DMB), as at 31 March 2007 was:

*Permanent Under Secretary of State*

Bill Jeffrey CB  
(appointed 21 November 2005).

*Chief of the Defence Staff*

Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF  
(appointed 28 April 2006, vice, General Sir Michael Walker GCB CMG CBE ADC Gen).

*First Sea Lord and Chief of the Naval Staff*

Admiral Sir Jonathon Band KCB ADC  
(appointed 7 February 2006).

*Chief of the General Staff*

General Sir Richard Dannatt KCB CBE MC ADC Gen  
(appointed 29 August 2006, vice, General Sir Mike Jackson GCB CBE DSO ADC Gen).

*Chief of the Air Staff*

Air Chief Marshal Sir Glenn Torpy KCB CBE DSO ADC BSc(Eng) FRAeS RAF  
(appointed 13 April 2006, vice, Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF).

*Vice Chief of the Defence Staff*

General Sir Timothy Granville-Chapman GBE KCB ADC Gen  
(appointed 22 July 2005).

*Second Permanent Under Secretary of State*

Sir Ian Andrews CBE TD  
(appointed 4 March 2002).

*Chief of Defence Procurement*

Sir Peter Spencer KCB  
(appointed 1 May 2003).

*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 CB  
(appointed to the DMB 24 June 2004).

*Non-Executive Directors*

Charles Miller Smith, Chairman of Scottish Power (appointed 20 May 2002).  
Philippa Foster Back OBE, Director of the Institute of Business Ethics (appointed 24 July 2002)\*.  
Paul Skinner, Chairman of Rio Tinto plc and Rio Tinto Limited (appointed 1 June 2006).  
Ian Rushby, Group Vice President and General Auditor of BP (appointed 29 January 2007).

\*Chairman of the Defence Audit Committee.

## Ministerial Salaries, Allowances and Taxable Benefits

(This section has been subject to audit)

	2006 – 07 Salary* £	2006 – 07 Benefits-in-kind (to nearest £100)*	2005 – 06 Salary* £	2005 – 06 Benefits-in-kind (to nearest £100)*
<b>Secretary of State for Defence:</b>				
The Rt Hon Des Browne MP (from 6 May 2006) <i>Full year equivalent salary</i>	68,642 75,963	Nil		
The Rt Hon Dr John Reid MP (to 5 May 2006) <i>Full year equivalent salary</i>	7,321 75,651	Nil	67,653 74,902	Nil
<b>Minister of State for the Armed Forces:</b>				
The Rt Hon Adam Ingram MP	39,405	Nil	38,854	Nil
<b>Minister of State for Defence Equipment and Support:</b>				
Lord Drayson †	Nil	Nil	Nil	Nil
<b>Parliamentary Under Secretary of State for Defence and Minister for Veterans:</b>				
Derek Twigg MP (from 7 Sep 2006) <i>Full year equivalent salary</i>	17,002 29,909	Nil		
Tom Watson MP (from 6 May 2006 to 5 Sep 2006) <i>Full year equivalent salary</i>	9,942 29,786	Nil		
Don Touhig MP (to 5 May 2006) <i>Full year equivalent salary</i>	2,883 29,786	Nil	26,320 29,491	Nil

\*Disclosures cover the period during which individuals served as Ministers in the MoD.

† Lord Drayson does not receive the Ministerial salary of £80,970 to which he is entitled.

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 of one quarter of the annual Ministerial salary being paid. Two payments were made in 2006-07 (2005-06 – One).

### Ministerial Salary

'Salary' includes: gross salary; performance pay or bonuses; overtime; London weighting or London allowances; recruitment and retention allowances; private office allowances; ex-gratia payments 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 – £60,277 pa with effect from 1 November 2006 (£59,686 pa with effect from 1 April 2006; £59,095 pa with effect from 1 April 2005) 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 would therefore, normally, be 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. Where Ministers are provided with living accommodation and a taxable benefit-in-kind arises, its value is calculated in accordance with HM Revenue & Customs regulations.

## Ministerial Pensions

(This section has been subject to audit)

Figures for **2006-07 in bold**. The real increase in the value of the accrued pension compared to the 2005-06 value, is shown in italics (in bands of £2,500).

	Total Accrued Pension at Retirement as at 31 Mar 07	CETV* at 31 Mar 06 or Date of Appointment if Later	CETV at 31 Mar 07 or on Cessation of Appointment if Earlier	Real Increase in CETV
	£000	£000	£000	£000
<b>Secretary of State for Defence:</b>				
The Rt Hon Des Browne MP (from 6 May 2006)	<b>5-10</b> <i>0-2.5</i>	<b>49</b>	<b>63</b>	<b>7</b>
The Rt Hon Dr John Reid MP (to 5 May 2006)	<b>10-15</b> <i>0-2.5</i>	<b>181</b>	<b>197</b>	<b>14</b>
<b>Minister of State for the Armed Forces:</b>				
The Rt Hon Adam Ingram MP	<b>5-10</b> <i>0-2.5</i>	<b>119</b>	<b>146</b>	<b>18</b>
<b>Minister of State for Defence Equipment and Support:</b>				
Lord Drayson †	Nil	Nil	Nil	Nil
<b>Parliamentary Under Secretary of State for Defence and Minister for Veterans:</b>				
Derek Twigg MP (from 7 Sep 2006)	<b>0-5</b> <i>0-2.5</i>	<b>21</b>	<b>24</b>	<b>2</b>
Tom Watson MP (from 6 May 2006 to 5 Sep 2006)	<b>0-5</b> <i>0-2.5</i>	<b>8</b>	<b>9</b>	<b>1</b>
Don Touhig MP (to 5 May 2006)	<b>0-5</b> <i>0-2.5</i>	<b>50</b>	<b>51</b>	<b>1</b>

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

\* CETV – Cash Equivalent Transfer Value.

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). Ministers who are Members of Parliament may also accrue an MP's pension under the PCPF; this pension is not included in the table above. The accrued pension quoted is the pension the Minister is entitled to receive when they reach the age of 65, or immediately on ceasing to be an active member of the scheme if they are already 65.

The arrangements for Ministers provide benefits on an 'average salary' basis, taking account of all service as a Minister. The accrual rate has been 1/40th since 15 July 2002 (or 5 July 2001 for those that chose to backdate the change). Ministers, in common with all other members of the PCPF, can opt for a 1/50th accrual rate and a 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 from 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 10% 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 26.8% 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 is the increase in accrued pension due to the Department's contributions to the PCPF and excludes increases due to inflation and contributions paid by the Minister, and is calculated using 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)

	2006 – 07 Salary* £000	2006 – 07 Benefits-in-kind (to nearest £100)**	2005 – 06 Salary* £000	2005 – 06 Benefits-in-kind (to nearest £100)**
<b>Permanent Under Secretary of State</b> Bill Jeffrey CB (from 21 Nov 05) <i>Full year equivalent salary</i>	175-180	29,600	55-60  155-160	10,800
<b>Chief of the Defence Staff</b> Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF (from 28 Apr 06) <i>Full year equivalent salary</i>	190-195  205-210	32,200		
<b>Chief of the Defence Staff</b> General Sir Michael Walker GCB CMG CBE ADC Gen (now The Lord Walker of Aldringham) (to 27 Apr 06) <i>Full year equivalent salary</i>	15-20  215-220	Nil	200-205	38,000
<b>First Sea Lord and Chief of the Naval Staff</b> Admiral Sir Jonathon Band KCB ADC (from 7 Feb 06) <i>Full year equivalent salary</i>	155-160	26,000	20-25  140-145	3,900
<b>Chief of the General Staff</b> General Sir Richard Dannatt KCB CBE MC ADC Gen (from 29 Aug 06) <i>Full year equivalent salary</i>	100-105  170-175	10,900		
<b>Chief of the General Staff</b> General Sir Mike Jackson GCB CBE DSO ADC Gen (to 28 Aug 06) <i>Full year equivalent salary</i>	70-75  180-185	14,700	170-175	28,100
<b>Chief of the Air Staff</b> Air Chief Marshal Sir Glenn Torpy KCB CBE DSO ADC BSc(Eng) FRAeS RAF (from 13 Apr 06) <i>Full year equivalent salary</i>	140-145  145-150	24,100		
<b>Chief of the Air Staff</b> Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF (to 12 Apr 06) <i>Full year equivalent salary</i>	5-10  155-160	900	145-150	27,600
<b>Vice Chief of the Defence Staff</b> General Sir Timothy Granville-Chapman GBE KCB ADC Gen (from 22 Jul 05) <i>Full year equivalent salary</i>	150-155	25,500	95-100  140-145	18,400
<b>Second Permanent Under Secretary of State</b> Sir Ian Andrews CBE TD	145-150	Nil	135-140	25,700

	<b>2006-07</b>	<b>2006-07</b>	<b>2005-06</b>	<b>2005-06</b>
	<b>Salary*</b>	<b>Benefits-</b>	<b>Salary*</b>	<b>Benefits-</b>
	<b>£000</b>	<b>in-kind (to</b>	<b>£000</b>	<b>in-kind (to</b>
		<b>nearest</b>		<b>nearest</b>
		<b>£100)**</b>		<b>£100)**</b>
<b>Chief of Defence Procurement</b> Sir Peter Spencer KCB***	140-145	36,800	135-140	29,400
<b>Chief of Defence Materiel</b> General Sir Kevin O'Donoghue KCB CBE	145-150	Nil	135-140	Nil
<b>Chief Scientific Adviser</b> Professor Sir Roy Anderson FRS	145-150	22,100	135-140	18,900
<b>Finance Director</b> Trevor Woolley CB	130-135	Nil	125-130	Nil
<b>Non-Executive Directors</b>	Fees		Fees	
Charles Miller Smith	25-30	Nil	25-30	Nil
Philippa Foster Back OBE	25-30	Nil	25-30	Nil
Paul Skinner (from 1 Jun 06)	20-25	Nil		
<i>Full year equivalent</i>	25-30			
Ian Rushby (from 29 Jan 07)	0-5	Nil		
<i>Full year equivalent</i>	25-30			

\*Salary, in bands of £5,000, includes gross salary, performance pay (paid in-year but based on performance in an assessment period ended prior to the start of the financial year) and allowances paid.

\*\* Benefits-in-kind figures for civilian members of the DMB represent the taxable benefit attributed to the private use of official cars. For Service members of the DMB, the benefits-in-kind are the taxable benefits relating to the occupation of Official Service Residences. The Department has an arrangement with HM Revenue and Customs where MoD pays the tax liability that would ordinarily be paid by the individual on the benefits-in-kind; this tax liability is included in the figures in the table.

\*\*\* Sir Peter Spencer received a payment as compensation for Compulsory Early Retirement.

## Defence Management Board – Pension Benefits

(This section has been subject to audit)

**2006-07 figures are in bold.** The real increase in the pension, from 2005-06, and where applicable the real increase in the lump sum payment, are shown in italics.

	<b>Total</b>	<b>CETV at</b>	<b>CETV at</b>	<b>Real Increase</b>
	<b>Accrued</b>	<b>31 Mar 06</b>	<b>31 Mar 07 or</b>	<b>or (Decrease)</b>
	<b>Pension at</b>	<b>or Date of</b>	<b>on Cessation of</b>	<b>in CETV</b>
	<b>Retirement</b>	<b>Appointment if</b>	<b>Appointment</b>	
	<b>as at</b>	<b>Later</b>	<b>if Earlier</b>	
	<b>31 Mar 07</b>			
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Permanent Under Secretary of State</b> Bill Jeffrey CB	Pension <b>70-75</b> 2.5-5 Lump Sum <b>210-215</b> 7.5-10	<b>1,583*</b>	<b>1,725</b>	<b>66</b>
<b>Chief of the Defence Staff</b> Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF (from 28 Apr 06)	Pension <b>105-110</b> 27.5-30 Lump Sum <b>315-320</b> 82.5-85	<b>1,462</b>	<b>2,061</b>	<b>565</b>

	<b>Total Accrued Pension at Retirement as at 31 Mar 07</b>	<b>CETV at 31 Mar 06 or Date of Appointment if Later</b>	<b>CETV at 31 Mar 07 or on Cessation of Appointment if Earlier</b>	<b>Real Increase or (Decrease) in CETV</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Chief of the Defence Staff</b> General Sir Michael Walker GCB CMG CBE ADC Gen (now The Lord Walker of Aldringham) (to 27 Apr 06)	Pension <b>100-105</b> 0-2.5 Lump Sum <b>305-310</b> 2.5-5	<b>1,604</b>	<b>1,641</b>	<b>32</b>
<b>First Sea Lord and Chief of the Naval Staff</b> Admiral Sir Jonathon Band KCB ADC	Pension <b>80-85</b> 5-7.5 Lump Sum <b>240-245</b> 15-17.5	<b>1,434</b>	<b>1,568</b>	<b>127</b>
<b>Chief of the General Staff</b> General Sir Richard Dannatt KCB CBE MC ADC Gen (from 29 Aug 06)	Pension <b>70-75</b> 2.5-5 Lump Sum <b>220-225</b> 12.5-15	<b>1,440</b>	<b>1,525</b>	<b>100</b>
<b>Chief of the General Staff</b> General Sir Mike Jackson GCB CBE DSO ADC Gen (to 28 Aug 06)	Pension <b>75-80</b> 0-2.5 Lump Sum <b>230-235</b> 2.5-5	<b>1,161</b>	<b>1,191</b>	<b>15</b>
<b>Chief of the Air Staff</b> Air Chief Marshal Sir Glenn Torpy KCB CBE DSO ADC BSc(Eng) FRAeS RAF (from 13 Apr 06)	Pension <b>65-70</b> 15-17.5 Lump Sum <b>205-210</b> 47.5-50	<b>530</b>	<b>743</b>	<b>173</b>
<b>Vice Chief of the Defence Staff</b> General Sir Timothy Granville-Chapman GBE KCB ADC Gen	Pension <b>75-80</b> 5-7.5 Lump Sum <b>235-240</b> 17.5-20	<b>1,184</b>	<b>1,298</b>	<b>96</b>
<b>Second Permanent Under Secretary of State</b> Sir Ian Andrews CBE TD	Pension <b>50-55</b> 2.5-5 Lump Sum <b>130-135</b> 0-2.5	<b>947*</b>	<b>1,025</b>	<b>44</b>
<b>Chief of Defence Procurement</b> Sir Peter Spencer KCB	Pension <b>5-10</b> 0-2.5 Lump Sum <b>N/A</b>	<b>104*</b>	<b>145</b>	<b>32</b>
<b>Chief of Defence Materiel</b> General Sir Kevin O'Donoghue KCB CBE	Pension <b>75-80</b> 5-7.5 Lump Sum <b>230-235</b> 15-17.5	<b>1,298</b>	<b>1,314</b>	<b>106</b>

	<b>Total Accrued Pension at Retirement as at 31 Mar 07</b>	<b>CETV at 31 Mar 06 or Date of Appointment if Later</b>	<b>CETV at 31 Mar 07 or on Cessation of Appointment if Earlier</b>	<b>Real Increase or (Decrease) in CETV</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Chief Scientific Adviser</b> Professor Sir Roy Anderson FRS	Pension 0-5 0-2.5 Lump Sum N/A	53*	93	33
<b>Finance Director</b> Trevor Woolley CB	Pension 45-50 0-2.5 Lump Sum 135-140 0-2.5	740*	771	5
<b>Non-Executive Directors</b>				
Charles Miller Smith	N/A	N/A	N/A	N/A
Philippa Foster Back OBE	N/A	N/A	N/A	N/A
Paul Skinner	N/A	N/A	N/A	N/A
Ian Rushby	N/A	N/A	N/A	N/A

\*The factors used to calculate the CETV for members of the PCSPS were revised for 2006-07, following advice from the Cabinet Office. The figures for 31 March 2006 have been recalculated using the new factors and this has led to changes to the figures published last year.

## Civil Service Pensions

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). The accrued pension quoted is the pension the member is entitled to receive when they reach 60, or immediately on ceasing to be an active member of the scheme if they are already 60.

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 as per 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. 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](http://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 cost of accruing benefits are met by the employer at rates approximately equivalent to 36.3% (Officers) and 21.8% (Other Ranks) of pensionable 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/](http://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.

## **Real Increase in CETV**

This reflects the increase in CETV effectively funded by the employer. It does not include the increase in accrued pension due to inflation, or 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**

**16 July 2007**

# 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 2006-07, the Department's outputs were delivered through 12 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 5 executive Non-Departmental Public Bodies (NDPB) and two Public Corporations with delegated responsibilities. Included within the TLBs are 17 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 responsible<sup>2</sup>. Both the Veterans' Agency (VA) and Armed Forces Personnel Administration Agency (AFPAA) (which merged on 1 April 2007) are administered within the Central TLB. The VA manages the War Pensions Benefits Programme. AFPAA manages the pay and provides administrative support for Service personnel. It also manages the Armed Forces Pensions and Compensation schemes (AFPS/AFCS), for which I am also Accounting Officer, which are accounted for separately to the main Departmental Resource Accounts. The Agencies' Chief Executives are directly accountable for the delivery of all 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 Statements on Internal Control 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 Statement on Internal Control prepared for their annual Accounts. Although sponsored by the Department, the 5 Non Departmental Public Bodies and 2 Public Corporations also fall outside the Departmental Boundary and their accounts are also published separately. The NDPBs and one Public Corporation (the Fleet Air Arm Museum) each operate within a financial memorandum agreed between their respective Boards of Trustees and the Department. The other 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 their routine oversight of the Department. They also chair a variety of internal Boards which review the performance of the Trading Funds, the primary on-vote Agencies, including during 2006-07 the Defence Procurement Agency and Defence Estates which were also TLBs. In particular, all 5 Trading Fund Agencies 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. Command and administration of the Armed Forces is vested in the Defence Council by Letters Patent, chaired by the Secretary of State for Defence, and beneath that in the Service Boards, chaired by a Minister. Membership of the Defence Council comprises all Defence Ministers and the executive members of the Defence Management Board. 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.

<sup>2</sup> For the Defence Procurement Agency and Defence Estates, which were both agencies and Top Level Budgets in the year ending 31 March 2007, this was discharged by submission of the Statement on Internal Control prepared for their own annual Accounts.

## **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 2007 and up to the date of approval of the annual report and accounts, and accords with Treasury guidance.

## **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. The major strategic risks are regularly considered by the Defence Management Board and risk forms an integral element of the quarterly performance reviews. Guidance on the Department's approach to risk is detailed in a Joint Service Publication, 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 Top Level Budget 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 Defence Management Board manages the top level risks to the Department through a structured series of discussions of the major risks through the course of the year. The Department's Performance Management System provides the overall framework for the consideration of risks within the Defence Balanced Scorecard and lower level scorecards, providing a means 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 by the Defence Management Board for each year and cascaded to Top Level Budget Holders through Service Delivery Agreements. Performance is monitored and discussed quarterly at Defence Management Board and lower level management board meetings, including explicit consideration of key risks.

The Department has a high tolerance of risk which is based predominantly in its purpose, preparedness and willingness to undertake military operations with potentially fatal consequences for both adversaries and UK Service personnel. Risk appetite is determined through the advice given to Ministers on operations, through the 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 Defence Management Board and the Defence Audit Committee 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 twice a month to manage the plans, performance and strategic direction of the Department, comprising the senior members of the Department and at least two external independent members.
- A Defence Audit Committee, chaired by an external independent member of the Defence Management Board, which reviews the Department's risk-based approach to internal control. The Committee itself has also adopted a risk based approach in its assurance work 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 (including Scientific risks);
  - the Chief of Defence Material (formerly the Chief of Defence Logistics) for the logistics process;
  - the Finance Director for departmental financial and planning systems;
  - the Deputy Chief of the Defence Staff (Personnel) for Service personnel processes;
  - the Personnel Director for civilian personnel processes;
  - the Director General Media and Communication for communications processes;
  - the Director General Security and Safety as the Departmental Security Officer, for security and business continuity;
  - the Director General of Defence Acquisition Policy for acquisition processes;
  - the Director of Operational Capability;
  - Defence Internal Audit, including the Defence Fraud Analysis Unit;
  - the Director of Internal Management Consultancy; and
  - the National Audit Office.
- A Strategic Risk Register and a Departmental risk register, supported by operational-level risk registers, which complement the Defence Balanced Scorecard. Departmental risks are routinely reviewed by the Defence Management Board in the context of its regular reviews of Departmental programmes. The Departmental risk management process has been reviewed and approved by the Defence Audit Committee.
- Through Top Level Budget 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 case<sup>3</sup>, chaired by non-executive directors and at which representatives from the internal and external auditors are present. Like the Defence Audit Committee these committees focus their activities to provide advice on wider-business risk and assurance processes.
- A Business Management System, with responsibility for the effective and efficient operation of the key pan-Departmental processes, such as Finance 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 Defence Management Board.
- Through Top Level Budget Holders, a cascaded system for ensuring that business continuity plans are in place, and that these plans are tested on a regular basis.

<sup>3</sup> Reflecting the particular circumstances in Northern Ireland, the General Officer Commanding Northern Ireland Top Level Budget Audit Committee was chaired by the Civil Secretary, but contained two Non-Executive Directors with direct access to the Management Board and the TLB Holder. On 1 April 2007 the TLB was absorbed into the Land TLB and the separate Audit Committee disestablished.

- An annual risk-based programme of internal audit provided by Defence Internal Audit, who are the primary source of independent assurance, which is complemented by the activity of the Directorate of Operational Capability, 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, Defence Internal Audit 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 on behalf of Parliament by the Comptroller and Auditor General, supported by staff from the National Audit Office (NAO). The Accounting Officer and NAO staff see all Defence Audit Committee 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 with non-executive members of the Defence Audit Committee. The NAO see all relevant Top Level Budget 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 Top Level Budget Holders and key functional specialists. Improvements have continued to be made to our financial control during the year, although longstanding difficulties with the Oracle fixed asset accounting module, exacerbated by the migration of the Defence Logistic Organisation's Managed Equipment Fixed Asset Register onto Oracle, generated some temporary difficulties in processing fixed asset data during the year. These were successfully resolved, and the Department has a programme of work to prevent their recurrence. The Department has delivered its outputs within the resources voted by Parliament notwithstanding the pressure generated by the high level of operations.
- The Department remained within the Treasury's Total Departmental Expenditure Limit. However, the high level of operations has resulted in a small excess (1.4%) on Request of Resources 2, due to the higher than expected non-cash costs (mainly depreciation charges), in part as the result of increased firing of Hellfire missiles in Afghanistan. Although there was no breach of the Net Cash Requirement, the consequence of the excess is a technical qualification of the Accounts. Whilst the National Audit Office has acknowledged that policy and guidance is sound, the Department has put in place a series of measures to prevent this reoccurring.
- Significant developments in Business Continuity Management, in particular the further development of effective policy and processes to ensure that Business Continuity is an integral part of the planning and management processes undertaken across all areas of Department. Significant improvements in this area have been made in the course of the year.
- The Department has designed and implemented a number of changes to its processes as it implements the Defence Acquisition Change Programme. This has ranged from the development of new Through Life Capability Management processes, new planning and approvals processes and, the merger of the Defence Procurement Agency and Defence Logistics Organisation Top Level Budgets in April 2007 to form the new integrated procurement and support Organisation: Defence Equipment and Support. It has been an achievement to deliver all this change within 12 months
- 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.

## Significant Internal Control Issues

### Joint Personnel Administration

During the past year the Armed Forces Personnel Administration Agency achieved three extremely significant milestones by rolling out the Joint Personnel Administration (JPA) system to the Royal Air Force (RAF) from April 2006, the Royal Navy (RN) from November 2006, and the Army from the end of March 2007. Initial teething problems with RAF specialist pay and expenses were overcome and the first RN payroll in November 2006 was successful. There are now no systemic problems with the delivery of RAF and RN pay and allowances. However, following RAF go-live a number of concerns about JPA support to Departmental financial and manpower accounting processes, and some weaknesses in AFPAA internal controls were identified. These have had a temporary impact on the Department's ability to exercise full financial control and increased the risk to the timeliness and quality of the Departmental Resource Accounts. Following identification of these issues mitigation plans were put into effect and action taken to resolve them such that full financial control had been re-established before year end. AFPAA (now the Service Personnel Veterans Agency) continues to work with the MoD finance community to resolve the outstanding issues.

*Bill Jeffrey*  
**Accounting Officer**

**16 July 2007**

# 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 2007 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. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

## Respective responsibilities of the Accounting Officer and auditor

The Accounting Officer is responsible for preparing the Annual Report, which includes the Remuneration 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 and the part of the remuneration report to be audited 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 report to you whether, in my opinion, certain information given in the Annual Report, which comprises a Management Commentary, is consistent with the financial statements. 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.

In addition, I report to you 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 Internal Control reflects the Department's compliance with HM Treasury's guidance, and I report if it does not. I am not required to consider whether this statement covers 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 certificate 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 opinions

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.

## Votes A

The Ministry of Defence's Votes A is presented annually to Parliament to seek statutory authority for the maximum numbers of personnel to be maintained for service with the armed forces. Note 36 to the Accounts shows that the maximum numbers maintained during 2006-07 for the Naval, Army and Air Force Services in all active and reserve categories were within the numbers voted by Parliament. My role is to inform Parliament whether or not the approved Estimates (Vote A) have been exceeded. My staff have reviewed the information supporting actual numbers provided in the note to the financial statements and I am content that the numbers provided for in the Estimates have not been exceeded.

## Opinions

### Audit Opinion

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 2007, and the net cash requirement, net resource outturn, net operating cost, operating costs 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
- information given within the Annual Report, which comprises a Management Commentary, is consistent with the financial statements.

### Qualified Audit Opinion on Regularity arising from expenditure in excess of amounts authorised

As explained more fully in the attached report, Parliament authorised a Request for Resources for the Ministry of Defence relating to Conflict Prevention in the Appropriation Acts 2006 and 2007. A net total provision of £1,427,526,000 was authorised, and against this authorised limit, the Ministry of Defence incurred net resource expenditure of £1,448,420,000 as shown in the Summary of Resource Outturn in the Resource Accounts for 2006-07, and have thus exceeded the authorised limit.

In my opinion, with the exception for net resource expenditure of £20,894,000 in excess of the amount authorised for the Request for Resources 2: Conflict Prevention, referred to in my Report, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Details of this matter are explained more fully in my Report below.

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

**18 July 2007**

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

## Excess Vote

### Introduction

1. The principal activity of the Ministry of Defence (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 (Departmental Annual Report, 2006-2007).
2. For 2006-07, the Department had three Requests for Resources by which it was voted resources by Parliament. These were:
  - Request for Resources 1: Provision of Defence Capability. This covers expenditure primarily to meet the Department's operational support and logistics services costs and the costs of providing the equipment capability required by defence policy.
  - Request for Resources 2: Conflict Prevention. This accounts for conflict prevention and peacekeeping activities and includes the additional costs of current operations being undertaken not only in Iraq and Afghanistan but in other parts of the world such as the Balkans and Africa.
  - Request for Resources 3: War Pensions Benefits. This Request for Resources provides for the payment of war disablement and war widows' pensions in accordance with relevant legislation.
3. This report describes the background and circumstances leading to the qualification of my audit opinion on the Ministry of Defence's 2006-07 Resource Accounts.

### Purpose of Report

4. In 2006-07 the Department expended more resources than Parliament had authorised on Request for Resources 2. In so doing, the Department breached Parliament's control of expenditure and incurred what is termed an "excess" for which further parliamentary authority is required. I have qualified my opinion on the Department's 2006-07 Resource Accounts in this regard.
5. The purpose of this Report is to explain the reasons for this qualification and to provide information on the causes, extent and nature of the breach to inform Parliament's further consideration.

### My responsibilities with regard to the breach of regularity

6. As part of my audit of the Department's financial statements, I am required to satisfy myself that, in all material respects, the expenditure and income shown in the Resource Accounts have been applied to the purposes intended by Parliament and conform to the authorities which govern them; that is they are "regular". In doing so I have had regard to Parliamentary authority and in particular the supply limits Parliament has set on expenditure.
7. By incurring expenditure that is unauthorised and is thus not regular, the Department have breached Parliament's controls.

### Background to the excess

8. Parliament authorises and sets limits on departmental expenditure on two bases – 'resources' and 'cash'. Such amounts are set out in Supply Estimates for which Parliament's approval is given in Annual Appropriation Acts.
9. By this means Parliament has authorised three Requests for Resources for the Department. For each Request for Resources, Parliament thereby authorises amounts for current (rather than capital) expenditure which are net of forecast income, known as "operating Appropriations in Aid". Parliament also sets limits on the amount of operating Appropriations in Aid that can be applied towards meeting expenditure. The amounts authorised therefore represent a limit on the net current expenditure that may be incurred under each Request for Resources.

## Limits

**10.** The limits described above for the Department were set out in the Main Supply Estimates for 2006-07 (HC1035, 2005-06), as amended by the Winter and Spring Supplementary Estimates (HC2 & HC293, 2006-07). The limit for Request for Resources 2 was set at net expenditure of £1,427,526,000 together with a limit on Appropriations on Aid of £15,557,000. These limits were authorised in the Appropriation Act (No 2) 2006 and 2007. The breach reported below is against this limit. The Net Cash Requirement for the Department was not breached.

## Breach of limit on Request for Resources 2

**11.** The Statement of Parliamentary Supply for the accounts shows net expenditure on Request for Resources 2 of £1,448,420,000 which is £20,894,000 (1.44 per cent) in excess of the amount authorised. Operating income authorised to be appropriated in aid of expenditure on this Request for Resources was limited to £15,557,000. This amount was wholly earned and applied. The Department also earned during the year from these income sources an additional £5,047,000.00. This is shown as excess Appropriations in Aid on Note 5 on page 53 of the accounts. It is proposed to ask Parliament to increase the limit on Appropriations in Aid by this amount to allow it to be applied towards meeting the excess on this Request for Resources, and to authorise the balance of £15,847,000 as additional use of resources by an Excess Vote.

## Details and causes

**12.** The rest of my report covers:

- the costs attributable to Request for Resources 2;
- forecasting of costs ;
- the resulting requests for Resources by the Department;
- causes of the excess and action proposed by the Department.

*The costs attributable to Request for Resources 2*

**13.** Broadly, Request for Resources 2 comprises the additional costs of current operations throughout the world over and above that which would have been borne under normal conditions. This Request for Resources therefore for example includes:

- stocks consumed in operational theatres for example fuel, food and munitions;
- the costs of additional equipment support eg servicing of vehicles;
- additional pay such as the operational bonus to which military personnel are entitled. The standard pay costs of military and civilian personnel serving in operational theatres are included within RfR1.
- costs such as depreciation and cost of capital charges relating to assets and equipment in use on operations which under Government Accounting rules are sometimes called "non-cash costs".

**14.** The costs allocated to Request for Resources 2 are reduced to recognise that some activities that would normally have taken place such as training and exercises will not have been carried out and therefore some costs will not have been incurred. These "savings" have therefore been deducted from the total costs recognised. Receipts recognised under Request for Resources 2 include repayments by, for example, other government departments or for supplies made available to allies in operational theatres.

*Estimating and recording costs for Request for Resources 2*

- 15.** The Department employs a comprehensive methodology to record the income and expenditure attributable to Request for Resources 2. This process initially takes the information provided through the Department's main financial systems and allocates this to the different Requests for Resources. The apportionment of the net additional costs to Request for Resources 2 is complex and requires judgement. The Department has issued detailed guidance to staff to assist the process and the results are reviewed for completeness and consistency.
- 16.** The nature of the operations whose resources are attributed to Request for Resources 2 makes it difficult to anticipate the final costs as the tempo of operations inevitably fluctuates. Some of the costs of operations are able to be assessed with a high degree of accuracy, for example the additional costs of equipment support and additional personnel costs as well as the costs of activities foregone. However other significant costs such as the levels of stock consumption will depend in part on information provided by personnel in operational theatres and this increases the complexity of the reporting process where there may be more urgent operational priorities.

*The resulting requests for Resources by the Department*

- 17.** Because of the factors outlined above, the Department provided Parliament with a Request for Resources in the main Estimates voted on in May only in respect of operations in the Balkans; for 2006-07 this was £27 million (net). The bulk of its forecast expenditure, including that for Iraq and Afghanistan, for the year in question was provided part way through the year via the Winter Supplementary Estimates (net additional funding of £1.04 billion) made in November 2006. This was 3 months in advance of their request in the previous year. The Department provided a final request for additional resources (of £340m) in the Spring Supplementary estimates approved by Parliament in February 2007. As in previous years, this included a transfer from Request for Resources 1 to Request for Resources 2 for items such as depreciation and cost of capital which the Department can only assess later in the year.
- 18.** As noted in its Annual Report for 2005-06, the Department included in its 2005-06 Spring Supplementary Estimate a contingency of some £69 million to ensure it had sufficient funding to cater for the potential impact of a rapidly changing operational situation. In the event only a proportion of the contingency was utilised and the Department completed the year with a net surplus on Request for Resources 2 of some £45 million. In 2006-07 no contingency was made following discussions between the Department and Treasury.

**Causes of the excess and actions taken or proposed to be taken by the Department to help prevent a recurrence**

- 19.** The excess on Request for Resources 2 was primarily the result of operational activity in both Afghanistan and Iraq being substantially higher than originally forecast. The unpredictability in activity levels is a significant cause of the underlying difficulties in forecasting Request for Resources 2 and in particular gave rise to additional depreciation and cost of capital charges<sup>4</sup>. The main items were the firing (and consequent accelerated depreciation) of more Hellfire missiles than expected, particularly in Afghanistan, and the incomplete capture of depreciation costs associated with the operational use of capital spares.
- 20.** The Department is undertaking a detailed review of the treatment of asset depreciation and stock consumption in operations, focusing particularly on Urgent Operational Requirements, in order to understand the origin of the issues which gave rise to the excess. It will take account of the results of this exercise when preparing the 2007-08 Supply Estimates. The policy and guidance is sound, but the Department should take steps to improve the application of the process in operational situations.

<sup>4</sup> In February 2007, in the Spring Supplementary, an increase was approved by Parliament of £42 million for cost of capital and depreciation associated with equipment procured under Urgent Operational Requirement arrangements. Actual expenditure under this category was some £60 million.

**21.** The Department has already identified some useful improvements in both the forecasting and the accounting for Request for Resources 2:

- The relevant guidance to its major departmental groupings<sup>5</sup> and budget holders will be reissued, and the importance of accounting properly for even urgent requirements will be stressed;
- There will be an increased focus on accurate forecasting at the mid-year point, in time for Spring Supplementary Votes;
- At the mid year point, the Department will carry out a robust review of stock and spares consumption charged to Request for Resources 2, and the depreciation of equipment damaged or destroyed in conflict, and of weapons fired, to ensure that the accounting is accurate and provides a firm base for forecasts; the department has invited my staff to review this exercise with them.

## Summary and Conclusions

**22.** The Department has incurred an excess vote on Request for Resources 2 due to the factors outlined above for which it now plans to seek Parliamentary approval. The Department is putting into place procedures that will address the weaknesses that have been identified to minimise the possibility of an excess occurring in the future.

John Bourn

**Comptroller and Auditor General**

National Audit Office

157-197 Buckingham Palace Road

Victoria

London SW1W 9SP

**18 July 2007**

<sup>5</sup> These are called "Top Level Budgets or TLBs".

# Statement of Parliamentary Supply

## Summary of Resource Outturn 2006-07

Request for Resources	Note	Estimate			Outturn			2006-07 Net Total Outturn compared to Estimate Savings/ (Excess)	2005-06 Total Outturn
		Gross Expenditure	A in A *	Net Total	Gross Expenditure	A in A *	Net Total		
		£000	£000	£000	£000	£000	£000	£000	
1	2	33,827,383	1,478,181	32,349,202	32,996,683	1,478,181	31,518,502	830,700	32,737,691
2	2	1,443,083	15,557	1,427,526	1,463,977	15,557	1,448,420	(20,894)	1,055,848
3	2	1,047,661	-	1,047,661	1,038,073	-	1,038,073	9,588	1,068,595
<b>Total resources</b>	<b>3</b>	<b>36,318,127</b>	<b>1,493,738</b>	<b>34,824,389</b>	<b>35,498,733</b>	<b>1,493,738</b>	<b>34,004,995</b>	<b>819,394</b>	<b>34,862,134</b>
<b>Non operating cost A in A</b>				<b>556,152</b>			<b>498,287</b>	<b>57,865</b>	<b>374,320</b>

\*Appropriation in Aid (A in A)

## Net Cash Requirement 2006-07

	Note	Estimate		Outturn		2006-07 Net Total Outturn compared to Estimate Savings/ (Excess)	2005-06 Total Outturn
		£000	£000	£000	£000		
<b>Net Cash Requirement</b>	<b>4</b>	<b>33,746,251</b>	<b>31,454,292</b>	<b>2,291,959</b>	<b>30,603,297</b>		

## 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)).

	Note	Forecast 2006-07		Outturn 2006-07	
		Income	Receipts	Income	Receipts
		£000	£000	£000	£000
<b>Total</b>	<b>5</b>	<b>-</b>	<b>-</b>	<b>56,326</b>	<b>56,326</b>

The notes on pages 229 to 279 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.

Request for Resources (RfR) 1, Provision of Defence Capability, provides for expenditure primarily to meet the MoD'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 5, and these will be surrendered to the Consolidated Fund.

The net outturn for Total Resources is £34,004,995,000 against an Estimate of £34,824,389,000; an underspend of £819,394,000. The variance against the Supply Estimate results from an underspend of £127,428,000 against Resource DEL; an underspend of £676,114,000 in Annually Managed Expenditure (AME); and an underspend of £15,852,000 in Non Budget.

The principal explanations for the underspend in RfR1 of £830,700,000 is due to an underspend in AME of £666,526,000 arising from a review of nuclear provisions, in preparation for the quinquennial review of liabilities by the Nuclear Installations Inspectorate during 2007-08. There is an underspend within Resource DEL of £148,322,000.

RfR2, Conflict Prevention, shows a net outturn of £1,448,420,000 against an Estimate of £1,427,526,000; an overspend of £20,894,000. The excess relates to non-cash costs, such as depreciation charges for military equipment and the firing of guided weapons, missiles and bombs in Afghanistan, which were higher than forecasted at the time of the Estimates were prepared.

RfR3, War Pensions Benefits shows a net outturn of £1,038,073,000 against an Estimate of £1,047,661,000; a small underspend of £9,588,000. This RfR provides for the payment of war disablement and war widows' pensions in accordance with relevant legislation, this is all AME. The costs of administering war pensions are borne by RfR1.

The non-operating Appropriations in Aid show a net outturn of £498,287,000 against an Estimate of £556,152,000, which assumed higher fixed asset disposals in 2006-07. This is made up principally of £105,000,000 lower than expected actual capital receipts within the Defence Procurement Agency; and £53,000,000 higher than expected capital receipts within the Defence Logistics Organisation.

The Net Cash Requirement shows a net outturn of £31,454,292,000, against an Estimate of £33,746,251,000; an underspend of £2,291,959,000. This results from planned working assumptions made in the Spring Supplementary Estimates that did not materialise.

# Operating Cost Statement

for the year ended 31 March 2007

	Note	2006-07 £000	2005-06 £000
Staff costs	9	11,204,262	11,254,851
Other operating costs	10	20,764,796	20,171,162
Gross operating costs		<b>31,969,058</b>	<b>31,426,013</b>
Operating income	11	(1,429,392)	(1,390,997)
<b>Net operating cost before interest</b>		<b>30,539,666</b>	<b>30,035,016</b>
Net interest payable	12	167,096	1,252,150
Cost of capital charge	21	3,241,907	3,106,369
<b>Net operating cost</b>		<b>33,948,669</b>	<b>34,393,535</b>
<b>Net resource outturn</b>	3	<b>34,004,995</b>	<b>34,862,134</b>

## Statement of Recognised Gains and Losses

for the year ended 31 March 2007

	Note	2006-07 £000	2005-06 £000
Net gain on revaluation of intangible fixed assets	22	(602,077)	(312,151)
Net gain on revaluation of tangible fixed assets	22	(2,629,943)	(1,888,608)
Net (gain)/loss on revaluation of stock	22	385,024	(225,073)
Net (gain)/loss on revaluation of investments	22	9,991	(242,590)
Receipts of donated assets and gain on revaluation	22	(59,233)	(111,753)
Net gain on change in the discount rate of pension scheme	21	(50,600)	-
<b>Recognised gains for the financial year</b>		<b>(2,946,838)</b>	<b>(2,780,175)</b>
Prior year adjustment*			(4,348,036)
<b>Recognised gains since the last Annual Accounts</b>			<b>(7,128,211)</b>

\* Gain arising from the transfer of civil nuclear liabilities to the Nuclear Decommissioning Authority on 1 April 2005. Further details can be found in the *Ministry of Defence Report and Accounts 2005-06*.

The notes on pages 229 to 279 form part of these accounts.

# Balance Sheet

as at 31 March 2007

	Note	31 March 2007		31 March 2006	
		£000	£000	£000	£000
<b>Fixed Assets</b>					
Intangible assets	13	24,162,622		22,982,695	
Tangible fixed assets	14	74,600,538		71,774,958	
Investments	15	500,062		514,132	
			<b>99,263,222</b>		<b>95,271,785</b>
<b>Current Assets</b>					
Stocks and work-in-progress	16	5,321,394		6,052,227	
Debtors	17	3,237,419		2,921,155	
Cash at bank and in hand	18	473,676		1,018,245	
		<b>9,032,489</b>		<b>9,991,627</b>	
Creditors: amounts falling due within one year	19	6,738,594		6,449,389	
<b>Net current assets</b>			<b>2,293,895</b>		<b>3,542,238</b>
<b>Total assets less current liabilities</b>			<b>101,557,117</b>		<b>98,814,023</b>
Creditors: amounts falling due after more than one year	19	975,146		1,057,601	
Provisions for liabilities and charges	20	5,771,881		6,274,944	
			<b>6,747,027</b>		<b>7,332,545</b>
<b>Net assets</b>			<b>94,810,090</b>		<b>91,481,478</b>
<b>Taxpayers' equity</b>					
General fund	21		75,434,183		72,490,177
Revaluation reserve	22		17,129,769		16,635,683
Donated assets reserve	22		2,013,539		2,113,028
Investment reserve	22		232,599		242,590
			<b>94,810,090</b>		<b>91,481,478</b>

Bill Jeffrey  
Accounting Officer

16 July 2007

The notes on pages 229 to 279 form part of these accounts.

# Cash Flow Statement

for the year ended 31 March 2007

	Note	2006-07 £000	2005-06 £000
Net cash outflow from operating activities	23.1	(24,671,233)	(23,865,060)
Capital expenditure and financial investment	23.2	(6,767,865)	(6,222,278)
Payments of amounts due to the Consolidated Fund		(119,654)	(736,501)
Financing	23.4	31,014,183	31,403,673
Increase/(decrease) in cash at bank and in hand	23.5	(544,569)	579,834

*The notes on pages 229 to 279 form part of these accounts.*

# Statement of Operating Costs by Departmental Aim and Objectives

for the year ended 31 March 2007

## 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:

	Gross £000	Income £000	2006-07 Net £000	Gross £000	Income £000	2005-06 Net £000
<b>Objective 1:</b> Achieving success in the tasks we undertake	4,014,273	(303,275)	3,710,998	3,984,890	(420,801)	3,564,089
<b>Objective 2:</b> Being ready to respond to the tasks that might arise	27,373,390	(1,081,131)	26,292,259	27,526,586	(925,270)	26,601,316
<b>Objective 3:</b> Building for the future	2,952,325	(44,986)	2,907,339	3,204,461	(44,926)	3,159,535
	<u>34,339,988</u>	<u>(1,429,392)</u>	<u>32,910,596</u>	<u>34,715,937</u>	<u>(1,390,997)</u>	<u>33,324,940</u>
Paying war pensions benefits	1,038,073	-	1,038,073	1,068,595	-	1,068,595
<b>Total</b>	<u>35,378,061</u>	<u>(1,429,392)</u>	<u>33,948,669</u>	<u>35,784,532</u>	<u>(1,390,997)</u>	<u>34,393,535</u>

See additional details in Note 24.

The notes on pages 229 to 279 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)12/06 on 19 December 2006 and comply with the requirements of HM Treasury's Financial Reporting Manual (FRoM), except where HM Treasury has approved the following departures to enable the Department to reflect its own particular circumstances:

The Operating Cost Statement is not segmented into programme and non-programme expenditure.

The FRoM'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. Since agencies falling within the Departmental Boundary are on-vote and embedded within the Departmental chain of command, HM Treasury permits them to be treated as an integral part of the "core" Department. Throughout these accounts, the consolidated figures for the Ministry of Defence (including its on-vote agencies) are deemed to represent those of the "core" Department.

The Department has not fully complied with the FRoM emissions cap and trade scheme accounting requirements on grounds of materiality. Rather than registering an asset and liability to reflect its holding of allowances and its obligation to pay for emissions discharged, the Department has reflected the purchase and sales of allowances as expenditure and income within the Operating Cost Statement. All other costs associated with the scheme, such as compliance checking, are also charged to the Operating Cost Statement.

Although FRS 15, as interpreted by the current FRoM, requires that all tangible fixed assets be subject to a quinquennial revaluation by external professional valuers, the 2007-08 FRoM permits entities to use the most appropriate valuation methodology available, including that of applying appropriate indices, to uplift non-property fixed assets to current values. Since it is considered that a truer and fairer representation of the values of the Department's non-property fixed assets may be achieved by using appropriately robust indices, rather than a mixture of indices and quinquennial professional revaluation, this approach has been applied to the 2006-07 accounts.

### 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 Non Departmental Public Bodies (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 35.

**1.4** Five of the Department's agencies are established as Trading Funds. As such, they fall outside Voted Supply and are subject to a different control framework. 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 within 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 Group plc, 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 for 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 are matched to any related income. Costs of contracted-out services are included net of recoverable 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 within operating income, net of related VAT. In accordance with FRS 21, as interpreted by the FReM, Trading Fund dividends are recognised as operating income on an accruals basis, whilst other dividends are recognised in the year in which they are declared.

## Fixed Assets

**1.10** The Department's fixed assets are expressed at their current value through the application of the Modified Historical Cost Accounting Convention (MHCA). Prospective indices, which are produced by the Defence Analytical Services Agency, are applied at the start of each financial year to the fixed assets which fall within the categories listed below. These indices, which look ahead to the subsequent Balance Sheet date, are also adjusted to reflect the difference between the actual change in prices in the prior year and 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** Property fixed assets are also subject to a quinquennial revaluation by external professional valuers in accordance with FRS 15, as interpreted by the FReM.

**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 period which differs from that of the overall 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.

**1.14** Subsequent expenditure is also capitalised, where it is deemed to enhance significantly the operational capability of the equipment, including extension of life, likewise when it is incurred to replace or restore a component of an asset that has been treated separately for depreciation purposes.

## Intangible Fixed Assets

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

**1.16** Development costs are capitalised where they contribute towards defining the specification of an asset that will enter production, and those not capitalised are charged to the Operating Cost Statement. Capitalised development costs are amortised, on a straight line basis, over the planned operational life of that asset type, e.g. class of ship or aircraft. 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 value of the underlying tangible fixed assets. For development costs, a significant withdrawal of assets is deemed to be 20% or greater of the net book value of the underlying asset class.

## Tangible Fixed Assets

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

**1.18** In these financial statements, Guided Weapons, Missiles and Bombs (GWMB) and Capital Spares are categorised as fixed assets and subject to depreciation. The depreciation charge in the Operating Cost Statement also includes the cost of GWMB fired to destruction. The principal asset categories and their useful economic lives, depreciated on a straight line basis, are:

	Category	Years
Land and Buildings	Land	Indefinite, not depreciated
	Buildings, permanent	40 – 50
	Buildings, temporary	5 – 20
	Leasehold	Shorter of expected life and lease period
Single Use Military Equipment (including GWMB)	Air Systems – Fixed Wing	13 – 35
	Air Systems – Rotary Wing	25 – 30
	Sea Systems – Surface Ships	24 – 30
	Sea Systems – Submarines	28 – 32
	Land Systems – Armoured Vehicles	25 – 30
	Land Systems – Small Arms	10 – 15
Plant and Machinery	Equipment	10 – 25
	Plant and Machinery	5 – 25
Transport	Air Systems – Fixed Wing	25 – 35
	Air Systems – Rotary Wing	15 – 32
	Sea Systems – Surface Ships	20 – 30
	Land Systems – Specialised Vehicles	15 – 30
	Land Systems – Other Standard Vehicles	3 – 5
IT and Communications Equipment	Other Machinery	3 – 10
	Communications Equipment	3 – 30
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	As life of prime equipment supported
Operational Heritage Assets *		As other tangible fixed assets

\*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** The Donated Assets Reserve represents the value of the original donation, additions and any subsequent professional revaluation and indexation (MHCA). 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 take a fixed asset out of service and sell it; on transfer of a fixed asset into stock; on reduction in service potential or where the application of MHCA indices causes a downward revaluation below the depreciated historical cost, which is deemed to be permanent in nature. Any reversal of an impairment cost is recognised in the Operating Cost Statement to the extent that the original charge, 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 write down in value to the net recoverable amount (NRA) charged to the Operating Cost Statement against impairment whilst any increase in value to the NRA is credited to the Revaluation Reserve. 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 NRA is charged to the Operating Cost Statement against impairment whilst any increase in value to the NRA is credited to the Revaluation Reserve. 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 costs 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 such 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 in accordance with FRS 5 and HM 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 (which are not consolidated into the Department's resource accounts), the value of loans and public dividend capital held by the Department is 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 of 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 recognised on the Department's Balance Sheet from the point of acquisition to the point of issue for use, consumption, sale, write-off or disposal. The point of consumption for Land stocks is the point at which stock is issued from depots. For Air stocks, the point of consumption is when stocks are issued from final depots such as an airbase, and for Naval stocks it is when the stock item is used.

**1.32** 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 Cost Statement on consumption, disposal and write-off.

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

**1.34** 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.

**1.35** Stocks written-off, included within Other Operating Costs, represent the book value of stock which has been scrapped, destroyed or lost during the year, and also adjustments to bring the book values into line with the figures recorded on the supply systems.

## Provisions for Liabilities and Charges

**1.36** 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.

**1.37** Provisions are charged to the Operating Cost Statement unless the expenditure provides access to current and future economic benefits, in which case the provision is capitalised as part of the cost of the underlying facility. In such cases, the capitalised provision will be depreciated and charged 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 2006-07 is 2.2% (2.2% for 2005-06). The discount is unwound over the remaining life of the provision and shown as an interest charge in the Operating Cost Statement.

## Reserves

**1.38** 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.

**1.39** 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 2007.

**1.40** The General Fund represents the balance of the Taxpayers' Equity.

## Pensions

**1.41** 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.

**1.42** Both the AFPS and the main Civil Service pension schemes are unfunded defined benefit pension schemes, although, in accordance with the HM Treasury FReM, the Department accounts for the schemes in its accounts as if they were defined contribution schemes. 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 on the basis of the 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.

**1.43** The pension schemes undergo a reassessment of the SCAPE contribution rates by the Government Actuary at four-yearly intervals. Provisions are made for costs of early retirement programmes and redundancies up to the minimum retirement age and are charged to the Operating Cost Statement.

**1.44** 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. The pension scheme liability is included within the total provisions reported at Note 20 – Provisions for Liabilities and Charges, and following a change in policy by HM Treasury, the gain on the change in the discount rate at 31 March 2007 is shown in the General Fund and the Statement of Recognised Gains and Losses. Gains or Losses arising from discount rate changes prior to 2006-07 have been charged to the Operating Cost Statement.

**1.45** The disclosures required under FRS 17 for the main pension schemes are included in: the Remuneration Report, Note 9 – Staff Numbers and Costs, and on the websites of the Civil Service Pension Scheme and the Armed Forces Pension Scheme (see Note 9 paragraphs 9.3 and 9.4).

## Early Departure Costs

**1.46** The Department provides in full for the cost of meeting pensions up to the minimum retirement age in respect of military and civilian personnel early retirement programmes and redundancies announced in the current and previous years. Pensions payable after the minimum 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

**1.47** 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 2006-07 of 3.5% (2005-06: 3.5%) in real terms on all assets less liabilities except for the following, where the charge is nil:

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

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

## Foreign Exchange

**1.49** 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.

**1.50** Overseas non-monetary assets and liabilities are subject to annual revaluation and are translated at the spot rate applicable at the Balance Sheet date. 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	2006-07						2005-06
	Other Current Expenditure	Grants	Operating Appropriation in Aid	Total Net Resource Outturn	Total Net Resource Estimate	Total Net Outturn Compared With Estimate	Restated Total Net Resource Outturn
	£000	£000	£000	£000	£000	£000	£000
<b>TLB HOLDER</b>							
Commander-in-Chief Fleet	2,192,016	3,040	(47,178)	<b>2,147,878</b>	2,143,658	(4,220)	2,184,168
General Officer Commanding (Northern Ireland)	391,298	-	(1,953)	<b>389,345</b>	410,242	20,897	478,933
Commander-in-Chief Land Command	4,426,743	128	(104,751)	<b>4,322,120</b>	4,310,881	(11,239)	4,254,179
Commanding-in-Chief RAF Strike Command	1,972,123	-	(47,895)	<b>1,924,228</b>	1,909,667	(14,561)	2,125,506
Chief of Joint Operations	427,663	-	(27,203)	<b>400,460</b>	366,411	(34,049)	382,295
Chief of Defence Logistics	13,183,008	1,432	(358,275)	<b>12,826,165</b>	13,374,460	548,295	13,067,529
Adjutant General's Command	1,596,989	15,834	(27,782)	<b>1,585,041</b>	1,571,725	(13,316)	1,745,550
Commander-in-Chief Personnel & Training Command	852,110	6,975	(97,173)	<b>761,912</b>	812,178	50,266	793,222
Central	2,371,221	171,587	(385,867)	<b>2,156,941</b>	2,214,473	57,532	2,303,380
Defence Estates	3,053,756	-	(358,479)	<b>2,695,277</b>	2,572,717	(122,560)	2,205,839
Defence Procurement Agency	1,806,149	-	(21,161)	<b>1,784,988</b>	2,135,391	350,403	2,695,495
SIT ( Science, Innovation, Technology)	520,719	3,892	(464)	<b>524,147</b>	527,399	3,252	501,595
<b>Total (RFR 1)</b>	<b>32,793,795</b>	<b>202,888</b>	<b>(1,478,181)</b>	<b>31,518,502</b>	<b>32,349,202</b>	<b>830,700</b>	<b>32,737,691</b>

From 1 April 2006, Commander-in-Chief Fleet and 2nd Sea Lord/Commander-in-Chief Naval Home Command TLBs have merged into one Naval TLB.

From 1 April 2006, Chief of Defence Logistics, the Defence Procurement Agency TLB and Defence Estates TLB became Single Balance Owners (SBSOs). All assets and associated OCS costs were transferred from TLBs to the SBSOs. Prior year figures have been restated to reflect these transfers.

Request for Resources 2: Conflict Prevention	2006-07						2005-06
	Other Current Expenditure	Grants	Operating Appropriation in Aid	Total Net Resource Outturn	Total Net Resource Estimate	Total Net Outturn Compared With Estimate	Restated Total Net Resource Outturn
	£000	£000	£000	£000	£000	£000	£000
Programme Expenditure: Sub-Saharan Africa*	29,538	-	-	<b>29,538</b>	31,486	1,948	30,355
Programme Expenditure: Rest of the World*	77,985	-	(9,914)	<b>68,071</b>	73,040	4,969	79,616
Peace Keeping: Rest of the World	1,356,454	-	(5,643)	<b>1,350,811</b>	1,323,000	(27,811)	945,877
<b>Total (RFR 2)</b>	<b>1,463,977</b>	<b>-</b>	<b>(15,557)</b>	<b>1,448,420</b>	<b>1,427,526</b>	<b>(20,894)</b>	<b>1,055,848</b>

\* prior year outturn figures restated to reflect correct attribution to geographical areas

Request for Resources 3: War Pension Benefits	2006-07						2005-06
	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
	£000	£000	£000	£000	£000	£000	£000
War Pensions Benefits Programme costs	-	1,036,803	-	1,036,803	1,046,661	9,858	1,064,862
War Pensions Benefits Programme costs – Far Eastern Prisoners of War	-	1,270	-	1,270	1,000	(270)	3,730
War Pensions Benefits Programme costs – British Limbless ex-Servicemen's Association	-	-	-	-	-	-	3
<b>Total (RFR 3)</b>	-	<b>1,038,073</b>	-	<b>1,038,073</b>	<b>1,047,661</b>	<b>9,588</b>	<b>1,068,595</b>

	2006-07						2005-06
	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
	£000	£000	£000	£000	£000	£000	£000
<b>Total Net Resource Outturn</b>	<b>34,257,772</b>	<b>1,240,961</b>	<b>(1,493,738)</b>	<b>34,004,995</b>	<b>34,824,389</b>	<b>819,394</b>	<b>34,862,134</b>

## Provision of Defence Capability (RfR1)

**2.1** The net outturn is £31,518,502,000 against an Estimate of £32,349,202,000; an underspend of £830,700,000.

The principal explanations for the underspend in RfR1 relate to capital spares and a reduction in Annually Managed Expenditure (£666,526,000) following a review of the value of nuclear provisions prior to the quinquennial review by the Nuclear Installation Inspectorate during 2007-08, which resulted in a significant release to the Operating Cost Statement. A detailed explanation of the variances against the Departmental Expenditure Limit is shown in paragraphs 285 to 286 within Resources, in the Performance Report.

## Conflict Prevention (RfR2)

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

Operation	Net Resource Outturn	Capital Costs	2006-07 Total	2005-06 Restated Outturn
	£000	£000	£000	£000
<b>Peace Keeping Expenditure</b>				
Afghanistan	564,096	178,208	742,304	199,348
Iraq	786,715	169,447	956,162	957,598
<b>Programme Expenditure</b>				
Balkans	55,878	543	56,421	62,853
Global pool*	12,193	-	12,193	16,937
African pool*	29,538	-	29,538	30,355
<b>Total RfR2</b>	<b>1,448,420</b>	<b>348,198</b>	<b>1,796,618</b>	<b>1,267,091</b>
Total Estimate	1,427,526	449,000	1,876,526	1,431,273
Difference – savings/(excess)	(20,894)	100,802	79,908	164,182

\* prior year outturn figures restated to reflect correct attribution to geographical areas

2.3 A breakdown of the net operating and capital costs for the three main Operations is shown in the following table, alongside the Departmental Allocation for the year and the Outturn for 2005-06.

	Iraq			Afghanistan			Balkans		
	Total Departmental Allocation 2006-07	Total Outturn 2006-07	Total Outturn 2005-06	Total Departmental Allocation 2006-07	Total Outturn 2006-07	Total Outturn 2005-06	Total Departmental Allocation 2006-07	Total Outturn 2006-07	Total Outturn 2005-06
	£000	£000	£000	£000	£000	£000	£000	£000	£000
<b>Operating Cost (by area)</b>									
Direct costs									
Service manpower	111,000	99,779	80,237	51,000	49,487	7,575	12,000	11,006	11,509
Civilian manpower	15,000	14,733	14,213	3,000	4,340	1,627	5,000	5,310	4,949
Infrastructure costs	89,000	83,136	81,407	99,000	100,928	10,522	12,000	12,853	12,633
Equipment support	214,000	206,065	220,232	122,000	111,739	24,399	6,000	5,557	7,840
Other costs and services	139,000	137,273	111,186	77,000	89,215	37,595	14,000	13,997	11,824
Income	5,000	4,720	10,054	4,000	(2,008)	7,792	(9,000)	(9,573)	2,369
Stock consumption	212,000	218,010	218,920	140,000	164,205	57,171	13,000	15,100	9,332
Indirect costs									
Stock write-off	-	238	51	-	-	(2)	-	-	-
Provisions	2,000	5,547	1,560	-	18	-	-	720	(437)
Depreciation and amortisation (inc Urgent Operational Requirements – UORs)	20,000	14,443	33,611	21,000	39,113	1,255	-	293	2,376
Fixed asset write-off	-	-	21,848	-	-	-	-	-	-
Cost of capital	-	2,771	4,441	(1,000)	2,500	183	-	147	284
<b>Total Operating Costs</b>	<b>807,000</b>	<b>786,715</b>	<b>797,760</b>	<b>516,000</b>	<b>559,537</b>	<b>148,117</b>	<b>53,000</b>	<b>55,390</b>	<b>62,679</b>

	Iraq			Afghanistan			Balkans		
	Total Departmental Allocation 2006-07	Total Outturn 2006-07	Total Outturn 2005-06	Total Departmental Allocation 2006-07	Total Outturn 2006-07	Total Outturn 2005-06	Total Departmental Allocation 2006-07	Total Outturn 2006-07	Total Outturn 2005-06
	£000	£000	£000	£000	£000	£000	£000	£000	£000
<b>Capital Cost (by area)</b>									
Capital addition (including UORs and Recuperation)	195,000	169,447	159,838	254,000	178,208	51,231	-	543	174
Net Book Value of fixed asset disposals	-	-	-	-	-	-	-	-	-
<b>Total Capital</b>	<b>195,000</b>	<b>169,447</b>	<b>159,838</b>	<b>254,000</b>	<b>178,208</b>	<b>51,231</b>	<b>-</b>	<b>543</b>	<b>174</b>
<b>Total by Operation</b>	<b>1,002,000</b>	<b>956,162</b>	<b>957,598</b>	<b>770,000</b>	<b>737,745</b>	<b>199,348</b>	<b>53,000</b>	<b>55,933</b>	<b>62,853</b>

The Net Operating Costs and Total by Operation in Table 2.3 include all income attributable to each Operation. The Net Resource Outturn by Operation in Table 2.2 excludes the excess Appropriations in Aid attributable to RFR2 and paid to the Consolidated Fund (see Note 5 – Analysis of income payable to the Consolidated Fund).

**2.4** 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 “negative income” figures represent income generated on operations (e.g. support to other nations in respect of catering and medical services).

## Major Changes in Operational Costs

**2.5** Explanation for the major movements in operational costs are:

Between 2005-06 and 2006-07:

The increase in service manpower costs in 2006-07 is the result of the new operational allowance paid to service personnel on operations with effect from 1 April 2006.

The overall increase in costs of operations in Afghanistan in 2006-07, particularly Urgent Operational Requirement (UOR) expenditure, is the direct result of the increased tempo of the operation in the Helmand Province in the south of the country.

Between 2006-07 Outturn and Estimate:

The excess in non-cash costs, such as depreciation charges for military equipment and the firing of guided weapons, missiles and bombs in Afghanistan were higher than forecasted at the time the Estimates were prepared. This is the direct result of the increased tempo of the operation in the Helmand Province in the south of the country.

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)

**2.6** The Chief Executive of the Veterans Agency is not a Top Level Budget Holder, but exercises all the responsibilities for the programme costs.

### 3. Reconciliation of Net Resource Outturn to Net Operating Cost

	Outturn £000	Supply Estimate £000	2006-07 Outturn compared with Estimate £000	2005-06 Outturn £000
Net Resource Outturn (Statement of Parliamentary Supply)	34,004,995	34,824,389	819,394	34,862,134
— Less income scored as Consolidated Fund Extra Receipts and included in operating income and interest (inc. excess operating Appropriation in Aid) (Note 5)	(56,326)		56,326	(468,599)
<b>Net Operating Cost</b>	<b>33,948,669</b>	<b>34,824,389</b>	<b>875,720</b>	<b>34,393,535</b>

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	34,824,389	34,004,995	819,394
<b>Capital:</b>				
Purchase of fixed assets:				
— RfR 1	13/14	7,547,068	7,214,767	332,301
— RfR 2	13/14	449,000	348,198	100,802
— RfR 1 Capitalised provisions	13/14		12,843	(12,843)
— Investments	15		4,400	(4,400)
<b>Non operating cost A in A:</b>				
Proceeds on sale of fixed assets	10/13/14	(541,829)	(489,808)	(52,021)
Repayment of loans made to the Trading Funds	15	(14,323)	(8,479)	(5,844)
<b>Accruals adjustments:</b>				
Non-cash transactions-				
Included in operating costs	23.1	(7,708,802)	(6,430,478)	(1,278,324)
Included in net interest payable	12	(85,219)	(126,414)	41,195
Capitalised provisions shown above			(12,843)	12,843
		(7,794,021)	(6,569,735)	(1,224,286)
Cost of capital charge	23.1	(2,807,894)	(3,241,907)	434,013
Changes in working capital other than cash, excluding movements on creditors falling due after one year		1,499,047	(264,834)	1,763,881
Increase in creditors falling due after one year			82,454	(82,454)
Use of provisions for liabilities and charges	20	584,814	413,347	171,467
Adjustment for movements on cash balances in respect of collaborative projects	23.5		(51,949)	51,949
Net cash requirement	23.5	<b>33,746,251</b>	<b>31,454,292</b>	<b>2,291,959</b>

## 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).

	2006-07 Forecast		2006-07 Outturn	
	Income £000	Receipts £000	Income £000	Receipt £000 s
Operating income and receipts – excess A in A Request for Resources 1	-	-	34,608	<i>34,608</i>
Operating income and receipts – excess A in A Request for Resources 2	-	-	5,047	<i>5,047</i>
Other operating income and receipts not classified as A in A	-	-	16,671	<i>16,671</i>
Subtotal operating income and receipts payable to the Consolidated Fund	-	-	56,326	<i>56,326</i>
Other amounts collectable on behalf of the Consolidated Fund	-	-	-	-
Total income payable to the Consolidated Fund	-	-	56,326	<i>56,326</i>

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

	Note	2006-07 £000	2005-06 £000
Operating Income	11	1,429,392	1,390,997
Income included within other operating costs			
– Refunds of formula based VAT recovery		51,250	31,669
– Foreign exchange gains		39,230	9,711
– Other		(71)	(11)
Interest Receivable		30,263	26,821
Gross Income		<b>1,550,064</b>	<b>1,459,187</b>
Income authorised to be appropriated in aid		(1,493,738)	(1,346,570)
Operating Income payable to the Consolidated Fund	5	<b>56,326</b>	<b>112,617</b>

## 7. Non-Operating income – Excess A in A

	2006-07 £000	2005-06 £000
Principal repayments of voted loans	8,479	53,237
Proceeds on disposal of fixed assets	489,808	321,083
Non-operating income – excess A in A	-	-

## 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 198,090<sup>P</sup> (2005-06: 203,290) and Civilian 90,650 (2005-06: 95,750). Source: Defence Analytical Services Agency.

	Permanent Staff	Temporary Staff	Armed Forces	Ministers	2006-07 Total	2005-06 Total
Analysis of Staff Numbers	89,576	1,070	198,090	4	288,740	299,040

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 number employed for the year. The staff numbers quoted reflect the number of personnel employed in organisations within the Departmental Boundary for the Annual Accounts (see page 193) 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:

	2006-07 £000	2005-06 £000
Salaries and wages	8,728,349	8,603,882
Social security costs	641,539	644,726
Pension costs	1,761,944	1,751,740
Redundancy and severance payments	72,430	254,503
	<b>11,204,262</b>	<b>11,254,851</b>
Made up of:		
Service	8,422,935	8,262,776
Civilian	2,781,326	2,992,075
	<b>11,204,262</b>	<b>11,254,851</b>

### 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 at: [www.civilservice-pensions.gov.uk](http://www.civilservice-pensions.gov.uk).

For 2006-07, total pension contributions of £340,578,000 were payable in respect of the various schemes in which MoD civilian staff were members. Contributions to the PCSPS in the year were £323,481,000 (2005-06: £309,639,000) at four rates in the range of 17.1 to 25.5 percent of pensionable pay, based on salary bands (the rates in 2005-06 were between 16.2% and 24.6%)<sup>6</sup>. The scheme's Actuary reviews employer contributions every four years following a full scheme valuation. From 2007-08, the salary bands will be revised but the rates will remain the same. 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.

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.

<sup>P</sup> Denotes provisional. Due to Joint Personnel Administration being introduced to the RN and RAF during 2006, manpower numbers for the RN from November 2006, and the RAF from February 2007, are provisional and subject to review.

<sup>6</sup> The 2005-06 Annual Accounts quoted a rate of 25.6% which is only applicable to Prison Officers with Service prior to 1987; reference to this rate has been removed from the 2006-07 Accounts.

## Armed Forces Pension Scheme

**9.4** The Armed Forces Pension Scheme (known as AFPS 05) 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. AFPS 05 offers ill-health benefits if a career is cut short by injury or illness, irrespective of cause. Additionally, if the injury or illness is mainly attributable to service, compensation for conditions caused on or after 6 April 2005 will be considered under the Armed Forces Compensation Scheme (AFCS).

AFPS 05 members who leave before the age of 55 may be entitled to an Early Departure Payment, 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 Payment stops and the preserved pension and preserved pension lump sum are paid.

For 2006-07, total employers' pension contributions payable were £1,421,366,000. This figure includes £1,419,529,000 payable to the AFPS, (2005-06 £1,404,451,000) based on rates determined by the Government Actuary. For 2006-07, the rates were 34.3% of total pay or 36.3%<sup>7</sup> of pensionable pay (34.3% and 36.3% for 2005-06) for officers. The 2006-07 rates for other ranks were 21.3% of total pay or 21.8% of pensionable pay (21.3% and 21.8% for 2005-06). 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/WhatWeDo/Personnel/Pensions/ArmedForcesPensions/](http://www.mod.uk/DefenceInternet/AboutDefence/WhatWeDo/Personnel/Pensions/ArmedForcesPensions/).

## Other Pension Schemes

**9.5** The Armed Forces Pension Scheme incorporates the following schemes: the Non-Regular Permanent Staff Pension Scheme, the Gurkha Pension Scheme and the Reserve Forces Pension Scheme. The membership of these schemes is approximately 3.68% of the AFPS total membership and the employers' contributions to the schemes are included in the figure payable to the AFPS, at paragraph 9.4.

Certain other employees are covered by schemes such as the National Health Service Pension Scheme and the Teachers' Pension Scheme. The figure for total employers' pension contributions at paragraph 9.3 includes contributions in respect of these schemes.

<sup>7</sup> Joint Personnel Administration was introduced for the RAF and RN during 2006 and calculates SCAPE as a percentage of pensionable pay (this change will be effective for the Army in 2007). Note 9 includes all the percentage rates (including the previously unpublished pensionable pay rates for 2005-06) used to calculate the 2006-07 contributions.

**10. Other Operating Costs**

	2006-07	2005-06 Restated
	£000	£000
Operating expenditure:		
– Fuel	415,637	369,463
– Stock consumption	1,140,287	1,038,865
– Surplus arising on disposal of stock (net)	4,078	(16,372)
– Provisions to reduce stocks to net realisable value	90,771	(165,851)
– Stocks written off (net)	94,903	758,698
– Movements: includes personnel travelling, subsistence/relocation costs and movement of stores and equipment	774,031	728,875
– Utilities	319,591	291,347
– Property management *	1,257,963	1,366,781
– Hospitality and entertainment	4,337	5,364
– Accommodation charges *	465,946	443,917
– Equipment support costs	3,793,183	3,542,240
– Increase/(Decrease) in nuclear and other decommissioning provisions	(438,617)	(94,964)
– IT and telecommunications	718,780	642,546
– Professional fees	482,706	552,917
– Other expenditure	1,749,867	1,507,545
– Research expenditure and expensed development expenditure	987,649	994,480
– PFI service charges **		
IT and Telecommunications	424,930	307,269
Property Management	348,863	243,342
Transport	193,806	182,601
Equipment Support	121,454	123,619
Plant and Machinery	58,607	12,681
Depreciation and amortisation:		
– Intangible assets (Note 13)	1,152,633	1,314,570
– Tangible owned fixed assets (Note 14)	4,545,251	5,236,589
– Donated assets depreciation – release of reserve	(53,984)	(57,991)
– Tangible fixed assets held under finance leases (Note 14)	219	4,685
Impairment on fixed assets (Notes 13 & 14):		
– Arising on Quinquennial valuation	302,843	254,156
– Arising on Other items	4,682	182,344
Impairment – release of reserve	(131,820)	(23,696)
(Surplus) arising on disposal of tangible and intangible fixed assets		
– Tangible and Intangible fixed assets	(123,135)	(458,384)
– Donated assets – release of reserve	-	(20,975)
Fixed assets written off – net	730,325	(301,805)
Investment write down on share values	-	4,774
Capital project expenditure write off/(write on)	58,830	(22,145)
Bad debts written off	26,557	8,398
Increase/(decrease) in bad debts provision	4,298	1,439
Rentals paid under operating leases		
– Plant and Machinery	11,604	18,975
– Other	126,521	52,938
Auditors' remuneration – audit work only ***	3,600	3,500
Grants-in-Aid	61,319	61,087
Exchange differences on foreign currencies: net deficit/(surplus)	(2,293)	8,207
War Pensions Benefits	1,038,574	1,069,133
<b>Total Other Operating Costs</b>	<b>20,764,796</b>	<b>20,171,162</b>

\* The prior year figure for Property Management has been restated by a reduction of £136,779,000, and Accommodation charges has been increased by £136,779,000 to reflect a more accurate disclosure of expenditure.

\*\* PFI service charges have been separately disclosed. Prior year figures for Property Management (£243,734,000), IT and telecommunications (£112,703,000), Equipment Support (£72,202,000), Movements (£91,815,000), Other expenditure (£228,483,000) and Rentals paid under operating leases (£120,575,000) have been restated to reflect the PFI service charges previously disclosed within these headings and now disclosed separately.

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

## 11. Income

Income Source			2006-07	2005-06
	RfR 1	RfR2	£000 Total	£000 Total
<b>External Customers</b>				
Rental income – property	28,752		28,752	49,444
Receipts – personnel	62,077		62,077	55,171
Receipts – sale of fuel	105,592		105,592	56,559
Receipts – personnel related	152,332		152,332	175,369
Receipts – supplies and services	186,410		186,410	176,466
Receipts – provision of service accommodation	214,744		214,744	180,779
Receipts – NATO/UN/US Forces/Foreign Governments	294,139	20,604	314,743	316,403
Other	154,703		154,703	193,634
<b>Other Government Departments, Trading Funds and QinetiQ</b>				
Rental income – property	618		618	440
Receipts – personnel related	-		-	3,281
Reverse tasking*	29,275		29,275	26,384
Dividends from Investments (Note 15.4)	49,617		49,617	39,387
Income from provision of goods and services	130,072		130,072	113,218
Other	457		457	4,462
	<b>1,408,788</b>	<b>20,604</b>	<b>1,429,392</b>	<b>1,390,997</b>

\*Receipts for invoiced good and or services supplied to the Trading Funds and QinetiQ Group plc by MoD.

The introduction of Joint Personnel Administration has resulted in single and family accommodation receipts being attributed to Receipts – provision of service accommodation. The 2005-06 income was attributable to Rental Income – property, Receipts – personnel related and Receipts – provision of service accommodation.

## Fees and Charges

**11.1** Where the Department has spare capacity, it provides a range of services to external organisations. The majority of these services are in the form of military support to foreign governments and other government departments. Where appropriate, costs are recovered in accordance with HM Treasury's Fees and Charges Guide. On a smaller scale, the Department provides services to support charities, local community initiatives as well as commercial companies where there is a defence interest.

## 12. Net Interest Payable

	2006-07	2005-06
	£000	£000
<b>Interest receivable:*</b>		
– Bank interest	(25,705)	(21,553)
– Loans to Trading Funds	(4,556)	(4,664)
– Loan to a Self Financing Public Corporation – QinetiQ**	-	(603)
– Other interest receivable	(2)	(1)
	<b>(30,263)</b>	<b>(26,821)</b>
<b>Interest payable:</b>		
– Bank interest	148	18
– Loan interest	3,237	3,348
– Unwinding of discount on provision for liabilities and charges (Note 20)	126,414	1,211,110
– Finance leases and PFI contracts	67,551	64,480
– Late payment of Commercial debts	9	15
	<b>197,359</b>	<b>1,278,971</b>
<b>Net interest payable</b>	<b>167,096</b>	<b>1,252,150</b>

\*Interest receivable of which £831,000 is payable to the Consolidated Fund (£765,000 in 2005-06).

\*\*prior to flotation in February 2006

## 13. Intangible Assets

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.

	Single Use Military Equipment	Others	Total
	£000	£000	£000
Cost or Valuation*			
At 1 April 2006	28,407,033	1,010,541	29,417,574
Additions**	1,658,196	86,170	1,744,366
Impairment	(27,978)	(6,529)	(34,507)
Revaluations	773,533	21,357	794,890
Other movements***	(459,265)	(590,317)	(1,049,582)
<b>At 31 March 2007</b>	<b>30,351,519</b>	<b>521,222</b>	<b>30,872,741</b>
Amortisation			
At 1 April 2006	(6,377,543)	(57,336)	(6,434,879)
Charged in Year	(1,020,335)	(132,298)	(1,152,633)
Impairment	5,065	2,327	7,392
Revaluations	(185,057)	(7,756)	(192,813)
Other movements***	1,042,948	19,866	1,062,814
<b>At 31 March 2007</b>	<b>(6,534,922)</b>	<b>(175,197)</b>	<b>(6,710,119)</b>
<b>Net Book Value:</b>			
<b>At 31 March 2007</b>	<b>23,816,597</b>	<b>346,025</b>	<b>24,162,622</b>
At 1 April 2006	22,029,490	953,205	22,982,695

\* 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.

\*\* Additions on intangible and tangible fixed assets (Note 14) include accruals amounting in total to £2,666,839,000 (2005-06: £2,514,869,000).

\*\*\* Other movements comprise reclassifications to tangible fixed assets and transfers to operating costs.

## 14. Tangible Fixed Assets

	Dwellings	Other Land and Buildings	Single Use Military Equipment (SUME)	Plant and Machinery	Transport	IT and Comms Equipment	Assets under Construction (SUME)	Assets under Construction (Others)	Total
	£000	£000	£000	£000	£000	£000	£000	£000	£000
<b>Cost or Valuation</b>									
At 1 April 2006	3,389,738	17,507,699	60,567,231	5,879,095	8,211,044	1,467,688	12,594,334	1,063,132	110,679,961
Additions*	2,786	41,798	404,400	31,605	32,523	206,391	4,471,464	627,632	5,818,599
Capitalised provisions**	-	6,647	6,196	-	-	-	-	-	12,843
Donations	-	-	-	80	-	-	-	-	80
Impairment	(31,648)	(402,709)	275,448	(30,518)	2,011	(33,482)	(744)	(1,216)	(222,858)
Disposals	62	(327,696)	(233,848)	(115,998)	(496)	-	-	-	(677,976)
Revaluations	170,044	1,314,033	1,529,615	348,294	236,415	27,504	343,099	43,529	4,012,533
Other movements***	85,269	808,004	3,162,544	(1,213,675)	1,231,589	140,464	(5,041,939)	(306,410)	(1,134,154)
At 31 March 2007	3,616,251	18,947,776	65,711,586	4,898,883	9,713,086	1,808,565	12,366,214	1,426,667	118,489,028
<b>Depreciation</b>									
At 1 April 2006	(477,042)	(1,964,232)	(29,077,813)	(2,604,972)	(4,299,142)	(481,802)	-	-	(38,905,003)
Charged in year	(116,965)	(598,417)	(2,850,548)	(257,420)	(503,908)	(218,212)	-	-	(4,545,470)
Impairment	746	12,625	(119,894)	5,620	(1,854)	45,205	-	-	(57,552)
Disposals	-	-	232,394	78,655	254	-	-	-	311,303
Revaluations	(38,358)	(397,885)	(558,690)	(199,318)	(114,378)	(14,807)	-	-	(1,323,436)
Other movements***	(14,231)	(536,848)	906,769	728,043	(446,642)	(5,423)	-	-	631,668
At 31 March 2007	(645,850)	(3,484,757)	(31,467,782)	(2,249,392)	(5,365,670)	(675,039)	-	-	(43,888,490)
<b>Net Book Value: At 31 March 2007</b>	<b>2,970,401</b>	<b>15,463,019</b>	<b>34,243,804</b>	<b>2,649,491</b>	<b>4,347,416</b>	<b>1,133,526</b>	<b>12,366,214</b>	<b>1,426,667</b>	<b>74,600,538</b>
At 1 April 2006	2,912,696	15,543,467	31,489,418	3,274,123	3,911,902	985,886	12,594,334	1,063,132	71,774,958
<b>Asset Financing</b>									
Owned	2,458,134	13,263,800	34,243,804	2,516,766	4,290,412	1,090,951	12,366,214	1,426,667	71,656,748
Donated****	308,126	1,665,021	-	40,320	123	-	-	-	2,013,590
Long Lease	176,099	102,179	-	-	-	-	-	-	278,278
Short Lease	621	58,193	-	-	-	-	-	-	58,814
Operating Lease	-	8,489	-	-	-	-	-	-	8,489
Finance Lease	-	-	-	-	420	-	-	-	420
On-Balance Sheet PFI	27,421	343,147	-	92,405	56,461	42,575	-	-	562,009
PFI residual interest	-	22,190	-	-	-	-	-	-	22,190
<b>Net Book Value: At 31 March 2007</b>	<b>2,970,401</b>	<b>15,463,019</b>	<b>34,243,804</b>	<b>2,649,491</b>	<b>4,347,416</b>	<b>1,133,526</b>	<b>12,366,214</b>	<b>1,426,667</b>	<b>74,600,538</b>

\* Additions on intangible assets (Note 13) and tangible fixed assets include accruals amounting in total to £2,666,839,000 (2005-06: £2,514,869,000).

\*\* Fixed Assets as at 31 March 2007 include capitalised provisions at cost of £110,777,000 (2005-2006: £195,698,000).

\*\*\* Other movements comprise reclassifications between tangible fixed asset categories, intangible assets, assets under construction, stock and transfers to operating costs.

\*\*\*\* Assets have been valued on the same basis as all other properties used by the Department.

## 2006-07 Quinquennial Revaluation

**14.1** All Land and Buildings with the exception of Assets Under Construction, are subject to a quinquennial revaluation, which is being conducted on a rolling programme. During 2006-07, 25% 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 2006-07, the net increase to Land and Buildings assets was £137,555,000. Impairments charged to the Operating Cost Statement were £414,575,000. Impairments incurred as a result of previous quinquennial reviews have been reversed through the Operating Cost Statement in 2006-07 to the sum of £146,653,000. Net asset write-ons credited to the Operating Cost Statement were £38,897,000.

**14.2** Data from the 2005-06 quinquennial review (Land and Buildings) was included within the 2005-06 Annual Accounts, although not processed within the Fixed Asset Register. As a result of processing the data, there has been an increase in the net book values of Buildings (£44,623,000), and a reversal of impairments through the Operating Cost Statement in 2006-07 of £26,108,000. The net increase to Land assets was £25,236,000 and impairments charged to the Operating Cost Statement were £40,032,000. The reversal of previously impaired land assets was credited to the Operating Costs Statement in 2006-07 to the sum of £1,033,000. Release of reserve charges for the quinquennial revaluation of donated assets totalled £126,405,000.

**14.3** The 2007-08 Financial Reporting Manual permits entities to use the most appropriate valuation methodology available, including applying appropriate indices, to uplift non-property fixed assets to current values. This approach has been adopted by the Department for the 2006-07 accounts. However, a small proportion of Plant and Machinery had been professionally re-valued by the Valuation Office Agency prior to the decision to adopt the use of indices for non land and buildings assets, and these valuations have been included within the 2006-07 accounts.

The net book value decrease of the valuations for plant and machinery was £7,541,000. Impairments charged to the Operating Cost Statement were £26,954,000, and impairments incurred as a result of previous quinquennial reviews have been reversed through the Operating Cost Statement in 2006-07 to the sum of £4,924,000.

## 15. Investments

	Trading Funds		Other Investments	QinetiQ Group plc	Total
	Public Dividend Capital	Loans			
	£000	£000			
Balance at 1 April 2006	184,254	86,039	1	243,838	514,132
Additions:					
Met Office		4,400			4,400
Loan Repayments:					
UK Hydrographic Office		(388)			(388)
Met Office		(1,097)			(1,097)
Defence Aviation Repair Agency		(4,840)			(4,840)
ABRO		(2,154)			(2,154)
Revaluations				(9,991)	(9,991)
<b>Balance at 31 March 2007</b>	<b>184,254</b>	<b>81,960</b>	<b>1</b>	<b>233,847</b>	<b>500,062</b>
Balance at 1 April 2006	184,254	86,039	1	243,838	514,132

Public Dividend Capital and Loans at 31 March 2007 were held in the following Trading Funds:

	Public Dividend Capital	Loans	Interest Rates
	£000	£000	% p.a.
Defence Science Technology Laboratory	50,412	-	
UK Hydrographic Office	13,267	10,605	8.375
Met Office	58,867	9,303	4.45 – 5.65
Defence Aviation Repair Agency	42,303	40,510	4.20 – 5.00
ABRO	19,405	21,542	5.625
<b>Balance at 31 March 2007</b>	<b>184,254</b>	<b>81,960</b>	

Analysis of loans repayable by instalments:

	Due within one year	Due after one year	Total
	£000	£000	£000
UK Hydrographic Office	421	10,184	10,605
Met Office	2,534	6,769	9,303
Defence Aviation Repair Agency	4,840	35,670	40,510
ABRO	2,154	19,388	21,542
<b>Balance at 31 March 2007</b>	<b>9,949</b>	<b>72,011</b>	<b>81,960</b>

During the year two new loans totalling £4,400,000 were made, both to the Met Office, at an interest rate of 5.65% per annum. The loans are repayable over three years, with the final instalments due in January 2010.

A Civil Network Loan of £2,400,000 was made to fund the cost of restructuring the regional infrastructure. Civil forecasting services were centralised onto two sites, Exeter and Aberdeen, delivering substantial efficiencies. The loan was required to fund staff exit and transfer costs and investment in new infrastructure and IT.

A Commercial Loan of £2,000,000 was made in support of the commercial strategy. It was used to enhance the Met Office's commercial capability by increasing the staff skill base, improving basic internal commercial processes and rationalising product and service offerings.

## Investment in QinetiQ Group plc

**15.1** On 1 April 2006, the Department's shareholding in QinetiQ Group plc, 124,885,445 (19.3%) Ordinary Shares (nominal value 1p each), were valued at 195.25p per share; a total value of £243,838,831.36. The market price of the shares had fallen to 187.25p per share on 31 March 2007; a reduction in the total market value of £9,990,835.60 to £233,847,995.76.

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.

## Other Investments

**15.2** As at 31 March 2007, investments, including Special Shares, were held in the following:

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, Dunfermline, 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

## Net Assets of Trading Funds

**15.3** The reported net assets, after deducting loans due to MoD, of the investments held in Trading Funds at 31 March 2007 and 31 March 2006 were:

	31 March 2007	31 March 2006
	£000	£000
Defence Science and Technology Laboratory	242,600	218,000
UK Hydrographic Office	51,315	46,907*
Met Office	198,700	182,293*
Defence Aviation Repair Agency	89,085	82,904
ABRO	49,953	47,598
<b>Total</b>	<b>631,653</b>	<b>577,702</b>

\* Balance restated.

## Dividends from Investments

15.4 The following dividends, shown as income in Note 11.

	31 March 2007	31 March 2006
	£000	£000
QinetiQ	4,309	6,091
Defence Science and Technology Laboratory	6,000	3,000
UK Hydrographic Office	9,171	6,296
Met Office *	18,937	Nil
Defence Aviation Repair Agency	6,000	12,000
ABRO	5,200	12,000
<b>Total</b>	<b>49,617</b>	<b>39,387</b>

\* Dividends in respect of financial years 2004-05, 2005-06 and 2006-07.

## 16. Stocks and Work in Progress

	31 March 2007	31 March 2006
	£000	£000
Work in progress	11,670	34,244
Raw materials and consumables	5,309,724	6,015,687
Assets declared for disposal*	-	2,296
	<b>5,321,394</b>	<b>6,052,227</b>

\* Assets have been declared for disposal as part of the DSDA Rationalisation Programme, however the Net Book Value of these assets cannot easily be identified.

## 17. Debtors

### 17.1 Analysis by type

	31 March 2007	31 March 2006
	£000	£000
<b>Amounts falling due within one year</b>		
Trade debtors	233,860	177,539
Deposits and advances	28,207	54,355
Value Added Tax	317,118	320,544
Other debtors	213,501	275,363
Staff loans and advances*	46,072	41,921
Prepayments and accrued income	633,614	506,324
Current part of PFI prepayment	41,647	156,716
	<b>1,514,019</b>	<b>1,532,762</b>
<b>Amounts falling due after one year</b>		
Trade debtors	286,160	28,000
Other debtors	3,165	2,457
Staff loans and advances*	51,843	50,371
Prepayments and accrued income**	1,382,232	1,307,565
	<b>1,723,400</b>	<b>1,388,393</b>
<b>Total Debtors</b>	<b>3,237,419</b>	<b>2,921,155</b>

\* Staff loans and advances includes loans for house purchase. The number of staff with house purchase loans was 12,167 (2005-06:11,712).

\*\* Prepayments falling due after one year include an amount of £407,000,000 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.

**17.2 Intra-Government Balances**

	Amounts falling due within one year		Amounts falling due after more than one year	
	2006-07	2005-06	2006-07	2005-06
Balances with other central government bodies	374,454	366,301	14,873	30,143
Balances with local authorities	949	1,433	-	-
Balances with NHS Trusts	5,770	12,864	787	-
Balances with public corporations and trading funds	24,040	7,576	-	-
<i>Subtotal: intra-government balances</i>	<i>405,213</i>	<i>388,174</i>	<i>15,660</i>	<i>30,143</i>
Balances with bodies external to government	1,108,806	1,144,588	1,707,740	1,358,250
<b>Total Debtors at 31 March</b>	<b>1,514,019</b>	<b>1,532,762</b>	<b>1,723,400</b>	<b>1,388,393</b>

The table above provides an analysis of the balances in Table 17.1 by customer type.

**18. Cash at Bank and in Hand**

	2006-07	2005-06
	£000	£000
Balance at 1 April	1,018,245	438,411
Net Cash Inflow/(Outflow):		
Received from Consolidated Fund	31,025,000	31,262,178
Utilised	(31,569,569)	(30,682,344)
Increase/(decrease) during year	(544,569)	579,834
<b>Balance at 31 March</b>	<b>473,676</b>	<b>1,018,245</b>
The following balances at 31 March were held at:		
Office of HM Paymaster General	157,237	684,585
Commercial Banks and Cash in Hand	316,439	333,660
<b>Balance at 31 March</b>	<b>473,676</b>	<b>1,018,245</b>

The cash at bank balance includes £204,434,000 (2005-06: £256,381,000) 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 2007	31 March 2006
	£000	£000
<b>Amounts falling due within one year</b>		
VAT	47,131	36,320
Other taxation and social security	234,373	240,255
Trade creditors	880,088	546,569
Other creditors*	266,872	351,519
Payments received on account	14,940	25,920
Accruals and deferred income	5,003,057	4,465,599
Current part of finance leases	2,595	4,378
Current part of imputed finance lease element of on-balance sheet PFI contracts	18,391	15,168
Current part of NLF loans**	1,904	1,797
Amounts issued from the Consolidated Fund for supply but not spent ***	229,588	658,881
Consolidated Fund extra receipts due to be paid to the Consolidated Fund – Received	39,655	102,983
	<b>6,738,594</b>	<b>6,449,389</b>
<b>Amounts falling due after more than one year</b>		
Other creditors	12,186	101,618
Accruals	190,579	176,686
Finance leases	43	2,639
Imputed finance lease element of on-balance sheet PFI contracts	640,107	642,523
NLF loans**	46,431	48,335
Loans – other	85,800	85,800
	<b>975,146</b>	<b>1,057,601</b>

\* Other creditors includes 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 £204,434,000 (2005-06 – £256,381,000).

\*\* 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% to 7% per annum.

\*\*\* The amount comprises amounts drawn down and deemed drawn down from the Consolidated Fund for 2006-07 less the Net Cash Requirement for 2006-07.

### 19.2 Intra-Government Balances

	Amounts falling due within one year		Amounts falling due after more than one year	
	£000		£000	
	2006-07	2005-06	2006-07	2005-06
Balances with other central government bodies	481,008	806,936	132,231	134,135
Balances with local authorities	448	781	-	-
Balances with NHS Trusts	10,782	2,938	-	-
Balances with public corporations and trading funds	104,919	66,884	-	3,874
<i>Subtotal: intra-government balances</i>	<i>597,157</i>	<i>877,539</i>	<i>132,231</i>	<i>138,009</i>
Balances with bodies external to government	6,141,437	5,571,850	842,915	919,592
<b>Total Creditors at 31 March</b>	<b>6,738,594</b>	<b>6,449,389</b>	<b>975,146</b>	<b>1,057,601</b>

The table above provides an analysis of the balances in Table 19.1 by contractor type.

**20. Provisions for Liabilities and Charges**

	Nuclear Decommissioning	Other Decommissioning And Restoration Costs	Early Retirement Commitments	Other	Total
	£000	£000	£000	£000	£000
At 1 April 2006	4,299,488	117,571	526,511	1,331,374	6,274,944
Increase in Provision	273,595	13,943	102,251	174,554	564,343
Unwinding of discounting	90,840	1,956	9,422	74,795	177,013
Amounts released	(712,207)	(23,969)	(18,404)	(89,335)	(843,915)
Reclassifications	(798)	11,438	(58,588)	47,948	-
Amounts capitalised	12,843	-	-	-	12,843
Utilised in year	(53,118)	(12,948)	(116,357)	(230,924)	(413,347)
<b>At 31 March 2007</b>	<b>3,910,643</b>	<b>107,991</b>	<b>444,835</b>	<b>1,308,412</b>	<b>5,771,881</b>

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

	2006-07	2005-06
	£000	£000
Charged/(credited) to:		
Property management	(8,724)	10,334
Staff costs	68,826	274,509
Nuclear and Other Decommissioning provisions	(438,612)	(95,111)
War Pensions Benefits	1,000	2,200
Other costs	97,938	21,632
Net interest (receivable)/payable	126,414	1,211,110
	<b>(153,158)</b>	<b>1,424,674</b>
Made up of:		
Increase	564,343	610,274
Release	(843,915)	(396,710)
	(279,572)	213,564
Unwinding of discount	126,414	1,211,110
Net increase in provisions	<b>(153,158)</b>	<b>1,424,674</b>

The unwinding of the discount charge for Other Liabilities includes the change in discount rate from 2.8% to 1.8% applied to the Locally Engaged Civilian Pension Schemes. The charge arising from the change in rate has been taken to the General Fund (Note 21).

## 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. MoD is also responsible for the Atomic Weapons Establishment (AWE).

MoD liabilities relating to civil nuclear sites and the associated value of provisions and funding for decommissioning costs at 1 April 2005 (£4,320,528,000) were transferred to the newly formed Nuclear Decommissioning Authority sponsored by the Department of Trade and Industry.

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 £8,385,008,000 (2005-2006: £9,753,827,000).

The estimate of £3,910,643,000 (2005-06: £4,299,488,000) at 31 March 2007 represents the liabilities discounted at 2.2% to the balance sheet date and expressed in 2006-07 money values.

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

	<b>31 March 2007</b>
	<b>£000</b>
Up to 3 years	319,790
From 4 – 10 years	819,435
Beyond 10 years	2,771,418
<b>Total</b>	<b>3,910,643</b>

During 2006-07, schedule and cost estimates have been reviewed and updated in preparation for the quinquennial review that is to take place with the Nuclear Installations Inspectorate during 2007-08. The resulting estimates incorporate risk and uncertainty appropriate to each type of expenditure and take into account progress made to date since the original estimates made in 2000. The provision has been reduced as a result of this review.

## 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. The estimated payments are discounted by the Treasury discount rate of 2.2% in real terms. During 2006-07 provisions have been created for Land Quality Assessments in respect of chemical weapon agent contamination (£5,807,000) and for the removal of asbestos (£3,914,000). Provisions for decommissioning work at RRH Portreath (£15,022,000) and at vacated London sites (£4,853,000) have been released to the Operating Cost Statement following a review of the requirement.

## Early Retirement Pensions

**20.3** The Department meets the additional costs of benefits beyond the normal civil service pension scheme benefits in respect of employees who retire early by paying the required amounts annually to the pension schemes over the period between early departure and normal retirement date. The Department provides for this in full when the early retirement programme becomes binding by establishing a provision for the estimated payments discounted by the Treasury discount rate of 2.2% in real terms. During 2006-07, provisions were created to increase the early departure scheme for civilian employees in Northern Ireland as a result of "normalisation", announced in 2005-06 (£24,682,000), within RAF Strike Command (£6,750,000) for redundancies within the DLO (£13,783,000) and within Central TLB (£18,264,000) to extend the Departmental scheme announced in 2004-05. Provisions were released to the Operating Cost Statement for specific redundancies no longer required (£4,819,000) and following the review of a specific early retirement scheme (£6,742,000).

## 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. During 2006-07, provisions have been created for an increase in legal claims (£70,980,000), and the pension provision for locally employed personnel overseas has been increased by £6,630,000 on advice from the Government Actuary's Department and by £50,600,000 as a result of the change in the Treasury discount rate from 2.8% to 1.8% for pensions. A further increase in provisions has been created for potential claims by contractors (£21,043,000). Following a review of the requirement, provision of £51,604,000 have been released to the Operating Cost Statement in respect of Army and RAF restructuring programmes, and of £25,453,000 in respect of Trading Fund restructuring. Existing provisions include those concerning an adjudication decision where an appeal is pending (£376,860,000).

## 21. General Fund

The General Fund represents the total assets less liabilities of each of the entities within the accounting boundary, to the extent that the total is not represented by other reserves and financing items.

	2006-07	2005-06
	£000	£000
Balance at 1 April	72,490,177	69,254,944
Net Parliamentary Funding		
– Drawn Down	31,025,000	31,262,178
– Deemed	658,881	-
Year end adjustment		
– Supply (Creditor)/Debtor – current year	(229,588)	(658,881)
Net Transfer from Operating Activities		
– Net Operating Costs	(33,948,669)	(34,393,535)
– CFERs paid and repayable to Consolidated Fund	(56,326)	(470,388)
Non-cash charges:		
– Cost of Capital (OCS)	3,241,907	3,106,369
– Auditors' Remuneration (Note 10)	3,600	3,500
– Change in the Discount Rate-Pension Provision (Note 20)	(50,600)	-
Transfer from/(to) Revaluation Reserve (Note 22)	2,321,586	4,450,319
Transfer from/(to) Donated Asset Reserve (Note 22)	(21,785)	(64,329)
<b>Balance at 31 March</b>	<b>75,434,183</b>	<b>72,490,177</b>

## 22. Reserves

	Revaluation Reserve	Donated Asset Reserve	Investment Reserve
	£000	£000	£000
At 1 April 2006	16,635,683	2,113,028	242,590
Arising on revaluation during the year (net)	2,846,996	59,153	(9,991)
Additions during the year	-	80	-
Transfers and reclassifications	(31,324)	5,297	-
Transferred (to) / from Operating Cost Statement	-	(185,804)	-
Transferred (to) / from General Fund	(2,321,586)	21,785	-
<b>At 31 March 2007</b>	<b>17,129,769</b>	<b>2,013,539</b>	<b>232,599</b>

## 23. Notes to the Cash Flow Statement

### 23.1 Reconciliation of operating cost to operating cash flows

	Note	2006-07	2005-06
		£000	£000
Net operating cost	OCS	33,948,669	34,393,535
Non-cash transactions:			
– Depreciation and amortisation charges	10	(5,644,119)	(6,497,853)
– Impairment in value of fixed assets	10	(175,705)	(412,804)
– Provisions to reduce value of stock to its net realisable value	10	(90,771)	165,851
– Stocks written off – net	10	(94,903)	(758,698)
– Auditors' remuneration	10	(3,600)	(3,500)
– Surplus/(deficit) arising on disposal of stock	10	(4,078)	16,372
– Surplus/(deficit) arising on disposal of tangible fixed assets	10	123,135	123,377
– Surplus/(deficit) arising on disposal of investments (QinetiQ)	10	-	355,982
– Fixed Assets written on/(off) – net	10	(730,325)	301,805
– Capital project expenditure written on/(off)	10	(58,830)	22,145
– Amounts written off investments	10	-	(4,774)
– Bad debts written off	10	(26,557)	(8,398)
– Bad debts provision	10	(4,298)	(1,439)
– Movement in provisions for liabilities and charges (excluding capitalised provisions)	20	279,573	(212,014)
– Unwinding of discount on provisions for liabilities and charges	20	(126,414)	(1,211,110)
– Cost of capital	21	(3,241,907)	(3,106,369)
		(9,798,799)	(11,231,427)
Increase/(decrease) in stocks/WIP		169,875	239,473
Increase/(decrease) in debtors		347,119	81,614
(Increase)/decrease in creditors		(206,751)	(696,215)
<i>Less movements in creditors relating to items not passing through the OCS</i>		<i>(76,237)</i>	<i>600,926</i>
Use of provisions		287,357	477,154
<b>Net cash outflow from operating activities</b>		<b>24,671,233</b>	<b>23,865,060</b>

### 23.2 Analysis of capital expenditure and financial investment

	Note	2006-07	2005-06
		£000	£000
Intangible fixed asset additions	13	1,744,366	1,549,968
Tangible fixed asset additions	14	5,818,599	5,568,181
Less movement on fixed asset accruals & creditors		(301,213)	(169,781)
Proceeds on disposal of tangible fixed assets		(489,808)	(299,316)
Proceeds of redemption of Redeemable Preference Shares in QinetiQ		-	(21,766)
Proceeds of Shares in QinetiQ		-	(357,771)
Loans made to Trading Funds	15	4,400	6,000
Repayment of loans made to the Trading Funds and QinetiQ	15	(8,479)	(53,237)
<b>Net cash outflow from investing activities</b>		<b>6,767,865</b>	<b>6,222,278</b>

**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	6,913,554	(4,079)	(489,808)	6,419,667
Request for Resources 2	348,198			348,198
Request for Resources 3				
Net movements in debtors/creditors	301,213			301,213
<b>Total 2006-07</b>	<b>7,562,965</b>	<b>(4,079)</b>	<b>(489,808)</b>	<b>7,069,078</b>
<b>Total 2005-06</b>	<b>7,118,149</b>	<b>(47,237)</b>	<b>(678,853)</b>	<b>6,392,059</b>

**23.4 Analysis of financing**

	Note	2006-07 £000	2005-06 £000
From the Consolidated Fund (Supply) – current year	21	31,025,000	31,262,178
From the Consolidated Fund (Supply) – prior year	21	-	127,275
Advances from the Contingencies Fund		-	1,839,814
Repayments to the Contingencies Fund		-	(1,839,814)
Repayment of loans from the National Loans Fund		(1,797)	(1,695)
Capital elements of payments in respect of finance leases and on-balance sheet PFI contracts		(9,020)	(10,385)
Loans – Other		-	26,300
<b>Net financing</b>		<b>31,014,183</b>	<b>31,403,673</b>

**23.5 Reconciliation of Net Cash Requirement to increase/(decrease) in cash**

	Note	2006-07 £000	2005-06 £000
Net cash requirement		(31,454,292)	(30,603,297)
From the Consolidated Fund (Supply) – current year	23.4	31,025,000	31,262,178
From the Consolidated Fund Supply – prior year	23.4	-	127,275
Amounts due to the Consolidated Fund received and not paid	19	39,655	102,983
Amounts due to the Consolidated Fund received in the prior year and paid over		(102,983)	(369,096)
Movement on Collaborative balances		(51,949)	59,791
<b>Increase/(decrease) in cash</b>		<b>(544,569)</b>	<b>579,834</b>

## 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:

	2006-07			2005-06		
	Gross	Income	Net	Gross	Income	Net
	£000	£000	£000	£000	£000	£000
Operations	1,463,977	(20,604)	1,443,373	1,055,848	(16,062)	1,039,786
Other military tasks	1,611,502	(86,229)	1,525,273	1,751,704	(53,287)	1,698,417
Contributing to the community	421,920	(25,357)	396,563	566,648	(72,362)	494,286
Helping to build a safer world	516,874	(171,085)	345,789	610,690	(279,090)	331,600
<b>Total</b>	<b>4,014,273</b>	<b>(303,275)</b>	<b>3,710,998</b>	<b>3,984,890</b>	<b>(420,801)</b>	<b>3,564,089</b>

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.

With effect from April 2006, intangible and tangible fixed assets were transferred from TLBs to Single Balance Sheet Owners (SBSOs). The related operating costs (e.g. depreciation and cost of capital charge) have been apportioned to outputs by the SBSOs using the percentage of costs attributed to the Management Grouping in 2005-06 as a basis for the apportionment. Where Front Line TLBs had previously allocated some asset costs directly to final outputs, the methodology used in 2006-07 has resulted in some variances in costs attributed to final outputs from those reported in 2005-06. Restructuring within RAF Strike Command resulted in a more accurate alignment of costs to outputs.

The complexity of the cost apportionment model used to calculate costs by Departmental Objective, prevents the prior year figures being restated using the 2006-07 methodology.

The total comprises the full costs, including support services, of force elements grouped under the following headings:

	2006-07			2005-06		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
<b>Royal Navy</b>						
Aircraft carriers	348,985	(10,050)	338,935	363,720	(9,392)	354,328
Frigates and Destroyers	1,667,001	(58,421)	1,618,580	1,385,909	(30,940)	1,354,969
Smaller warships	403,709	(13,386)	390,323	424,510	(11,840)	412,670
Amphibious ships	349,766	(10,823)	338,943	296,158	(5,935)	290,223
Strategic sealift	46,738	(684)	46,054	43,742	(2,675)	41,067
Fleet support ships	375,291	(8,996)	366,295	347,915	(3,473)	344,442
Survey and other vessels	97,893	(3,759)	94,134	74,755	(2,389)	72,366
Naval aircraft	1,117,280	(34,106)	1,083,174	1,170,120	(31,482)	1,138,638
Submarines	2,286,998	(82,943)	2,204,055	3,441,777	(48,510)	3,393,267
Royal Marines	577,469	(20,530)	556,939	550,066	(10,153)	539,913
	<b>7,281,130</b>	<b>(243,698)</b>	<b>7,037,432</b>	<b>8,098,672</b>	<b>(156,789)</b>	<b>7,941,883</b>
<b>Army</b>						
Field units	9,143,183	(311,830)	8,822,353	8,696,394	(204,079)	8,492,315
Other units	1,993,020	(109,495)	1,883,525	2,204,945	(218,263)	1,986,682
	<b>11,127,203</b>	<b>(421,325)</b>	<b>10,705,878</b>	<b>10,901,339</b>	<b>(422,342)</b>	<b>10,478,997</b>
<b>Royal Air Force</b>						
Strike/attack and offensive support aircraft	2,156,574	(89,446)	2,067,128	1,832,257	(54,774)	1,777,483
Defensive and surveillance aircraft	1,691,662	(67,060)	1,624,602	2,409,986	(61,914)	2,348,072
Reconnaissance and maritime patrol aircraft	635,269	(22,436)	612,833	620,778	(15,043)	605,735
Tankers, transport and communications aircraft	1,262,576	(51,779)	1,210,797	1,304,193	(56,750)	1,247,443
Future capability	45,837	(1,566)	44,271	20,370	(372)	19,998
Other aircraft and RAF units	1,489,798	(62,572)	1,427,226	886,603	(36,854)	849,749
	<b>7,281,716</b>	<b>(294,859)</b>	<b>6,986,857</b>	<b>7,074,187</b>	<b>(225,707)</b>	<b>6,848,480</b>

	2006-07			2005-06		
	Gross	Income	Net	Gross	Income	Net
	£000	£000	£000	£000	£000	£000
<b>Centre Grouping</b>						
Joint and multinational operations	448,581	(23,744)	424,837	495,378	(21,187)	474,191
Centrally managed military support	447,486	(80,637)	366,849	491,589	(92,020)	399,569
Maintenance of war reserve stocks	787,274	(16,868)	770,406	465,421	(7,225)	458,196
	<b>1,683,341</b>	<b>(121,249)</b>	<b>1,562,092</b>	<b>1,452,388</b>	<b>(120,432)</b>	<b>1,331,956</b>
<b>Total Objective 2</b>	<b>27,373,390</b>	<b>(1,081,131)</b>	<b>26,292,259</b>	<b>27,526,586</b>	<b>(925,270)</b>	<b>26,601,316</b>

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 attributed to submarines in 2005-06 include the increased cost (£1,085,000,000) 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 GR4, 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. The improved alignment of costs in 2006-07 including the allocation of the RAF Logistics Hub and Air Traffic Services to Other aircraft and RAF units has resulted in the major year on year variance.
- **Reconnaissance and maritime patrol aircraft** includes Canberra and Nimrod R1 aircraft deployed on reconnaissance, and Nimrod MR2 aircraft on maritime patrol. (Tornado GR4 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/Augusta 109 helicopters) used in a rapid communications role.
- **Future capability** includes the Joint Test and Evaluation Group (for 2006-07) and 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 and for 2006-07, the RAF Logistics Hub and Air Traffic Services.

- **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.
- **Maintenance of war reserve stocks** includes the holding costs and charges of munitions and other stocks, above the levels required for planned consumption. Costs for 2006-07 include the accelerated write-off of dumb munitions (£112,000,000).

### Objective 3: Building for the future

This objective comprises the following elements:

	2006-07			2005-06		
	Gross	Income	Net	Gross	Income	Net
	£000	£000	£000	£000	£000	£000
Research	1,026,433	(104)	1,026,329	1,041,105	(159)	1,040,946
Equipment programme	1,925,892	(44,882)	1,881,010	2,163,356	(44,767)	2,118,589
<b>Total</b>	<b>2,952,325</b>	<b>(44,986)</b>	<b>2,907,339</b>	<b>3,204,461</b>	<b>(44,926)</b>	<b>3,159,535</b>

- **Research** comprises the costs, including capital charges, of the Science, Innovation, Technology TLB, and research expenditure incurred by other TLBs.
- **Equipment Programme** refers to the administration and programme costs, primarily of the Defence Procurement Agency, associated with specifying requirements for and procurement of fighting equipment and other assets. The values of fixed asset additions are shown in Notes 13 and 14.

### Attribution to Objectives

Gross expenditure of £30,442,213,000 (86.0%) (2005-06 – 78.1%) and Operating Income of £1,059,149,000 (74.1%) (2005-06 – 63.5%) were allocated to tasks, force elements or activities directly supporting the Objectives. The rest was apportioned in one of two ways:

- by means of cost attributions to “customer” Management Groupings, using local output costing systems to identify the full local costs of services provided. Cost attributions from suppliers are analysed onward to final outputs on advice from the recipients. If specific advice is not given, attributed costs are assumed to follow the same pattern as locally incurred expenditure;
- as an element of central overhead, shared among objectives in proportion to all other attributions. The force elements etc. described above receive a share of the expenditure and income components of these overheads, on the basis of their net costs.

The central overheads comprised:

	2006-07			2005-06		
	Gross	Income	Net	Gross	Income	Net
	£000	£000	£000	£000	£000	£000
Support for Ministers and Parliament	15,062	(19)	15,043	19,155	(87)	19,068
Departmental corporate services	1,170,115	(309,963)	860,152	825,530	(280,807)	544,723
Strategic Management	240,183	(1,822)	238,361	303,154	(7,208)	295,946

- **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 and medical care for Service personnel, and costs of Departmental restructuring. Costs attributed to corporate services in 2005-06 included the surplus on the sale of shares in QinetiQ Group plc (£355,982,000).
- **Strategic management** includes policy-making functions in strategic, personnel, scientific and medical matters.

## Capital employed

The deployment of the Department's capital in support of its objectives does not follow the pattern of operating costs. Net assets totalling £76,629,869,000 (80.8%) support the military capability required to meet Objective 2. The remainder comprises assets wholly attributable to tasks within Objective 1 (£2,207,816,000 – 2.3%), and intangible assets, fighting equipment and other assets under construction, and assets related to equipment procurement within Objective 3 (£15,987,751,000 – 16.9%), and payment of War Pensions Benefits (-£15,346,000).

## 25. Capital Commitments

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

	31 March 2007	31 March 2006
	£000	£000
Contracted but not provided for	<u>17,849,412</u>	<u>18,906,646</u>

## 26. Financial Commitments

### 26.1 Commitments under operating leases:

Commitments under operating leases to pay rentals during the year following the year of these accounts are given in the table below, analysed according to the period in which the lease expires.

	Land and Buildings		Other	
	31 March 2007	31 March 2006	31 March 2007	31 March 2006
	£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	8,984	11,458	84,439	9,860
Between two and five years	11,298	14,811	104,359	167,785
After five years	156,482	155,575	688,573	755,075
	<u>176,764</u>	<u>181,844</u>	<u>877,371</u>	<u>932,720</u>

### 26.2 Obligations under finance leases:

Obligations under finance leases are as follows.

	31 March 2007	31 March 2006
	£000	£000
Rentals due within 1 year	2,595	4,378
Rentals due after 1 year but within 5 years	43	2,639
Rentals due thereafter	-	-
	<u>2,638</u>	<u>7,017</u>

## 27. Private Finance Initiative (PFI) Commitments

### Charge to the Operating Cost Statement and future commitments

27.1 The total amount charged in the Operating Cost Statement in respect of off-balance sheet PFI transactions and the service element of on-balance sheet PFI transactions was £1,147,660,000 (2005-06: £869,512,000); and the payments to which the Department is committed during 2007-08, analysed by the period during which the commitment expires, is as follows.

	31 March 2007	31 March 2006
	£000	£000
Expiry within 1 year	11,028	1,875
Expiry within 2 to 5 years	172,654	81,912
Expiry within 6 to 10 years	178,205	236,188
Expiry within 11 to 15 years	335,233	213,235
Expiry within 16 to 20 years	67,317	54,519
Expiry within 21 to 25 years	219,874	240,046
Expiry within 26 to 30 years	21,213	11,600
Expiry within 31 to 35 years	171,964	120,350

### Off Balance Sheet

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

Project Description	Capital Value*	Prepayment 31 March 2007	Contract Start **	Contract End
	£000	£000		
Training, Administration and Financial Management Information System: Provision of training administration and financial management information systems to the Army Recruiting and Training Division	36,000	-	Aug 1996	Nov 2009
Hazardous Stores Information System: 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: 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
Medium Support Helicopter Aircrew Training Facility: 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
Thames Water (formally known as Tidworth Water and Sewage): 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
Fire Fighting Training Units: Provision of fire fighting training for the Royal Navy	22,500	-	Apr 1999	Jan 2021
Light Aircraft Flying Training: Provision of flying training and support services for Air Experience Flying and University Air Squadron 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

<b>Project Description</b>	<b>Capital Value*</b> <b>£000</b>	<b>Prepayment 31 March 2007</b> <b>£000</b>	<b>Contract Start **</b>	<b>Contract End</b>
Army Foundation College: Provision of teaching and training facilities for the further vocational education and military training of high-quality school leavers	73,400	44	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 Information Systems: Provision of a management information system for Defence Housing	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 deployments	173,150	-	Jun 2002	Dec 2024
Material Handling Equipment: Provision of tri-service material handling equipment for Army, Navy and RAF storage depots	7,820	-	Aug 2002	Jul 2010
Aquatrine Project A: Provision of water and waste water services	154,000	89,840	Apr 2003	Nov 2028
Aquatrine Project B: Provision of water and waste water services	86,400	30,802	Sep 2004	Mar 2030
Aquatrine Project C: Provision of water and waste water services	363,600	64,248	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	150,567	Feb 2004	Feb 2039
Skyenet 5: Range of satellite services, including management of existing Skynet 4 satellites	1,360,930	112,117	Oct 2003	Feb 2020
C Vehicles: Provision of Earthmoving and Specialist plant, Engineer Construction Plant and Material Handling Equipment and support services	703,000	37,187	Jun 2005	Jun 2021
Portsmouth 2 Housing: Provision of 148 Family Quarters in Portsmouth	27,092	7,981	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.

## On Balance Sheet

**27.3** The following PFI projects are treated as on balance sheet. The service payment commitments for the year 2007-08 are included in the table shown at 27.1.

<b>Project Description</b>	<b>Capital Value*</b> <b>£000</b>	<b>Net Book Value</b> <b>31 March 2007</b> <b>£000</b>	<b>Contract</b> <b>Start**</b>	<b>Contract</b> <b>End</b>
Defence Helicopter Flying School: Provision of helicopter flying training services	93,027	26,866	Apr 1997	Mar 2012
RAF Lossiemouth Family Quarters: Redevelopment and re-provision of 279 family quarters	24,745	27,421	Jun 1998	Aug 2020
Joint Services Command and Staff College: Command and Staff College for military and civilian personnel (also see JSCSC – Off Balance Sheet)	64,000	72,983	Jun 1998	Aug 2028
RAF Fylingdales: Provision of guaranteed power supply	7,486	3,839	Dec 1998	Dec 2023
Main Building Refurbishment: Redevelopment and management services for MoD Main Building	347,914	233,772	May 2000	May 2030
Naval Communications: Submarine fleet communications service	58,491	44,676	Jun 2000	Dec 2030
Defence Electronic Commerce Service: Strategic partnership to deliver e-business environment to share information between MoD and trading partners	11,410	1,200	Jul 2000	Jul 2010
Defence Animal Centre: Redevelopment of new office and residential accommodation, animal husbandry and training support	10,047	14,430	Aug 2000	Nov 2026
Heavy Equipment Transporters: Provision of vehicles to replace existing fleet and meet future requirements	58,000	50,744	Dec 2001	Jul 2024
Field Electrical Power Supplies: Provision of generator sets to support operational electrical requirements in the field	73,410	67,949	Jun 2002	Jun 2022
Devonport Armada Single Living Accommodation: Provision of Support Services and Fleet Accommodation Centre services at Devonport Naval Base	44,513	18,129	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	1,117,332	-	Mar 2006	Apr 2041
Northwood: Rebuild, refurbishment, management and operation of facilities for the Permanent Joint Headquarters	161,500	-	Jul 2006	Oct 2031

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

\*\* The date when the contracts were signed.

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

	<b>31 March 2007</b> <b>£000</b>	<b>31 March 2006</b> <b>£000</b>
Imputed finance lease obligations under on-balance sheet PFI contracts comprises:		
Rentals due within 1 year	18,391	15,167
Rentals due after 1 year but within 5 years	90,521	82,448
Rentals due thereafter	549,585	560,075
	<b>658,497</b>	<b>657,690</b>
Less interest element	7,366	14,013
	<b>651,131</b>	<b>643,677</b>

## 28. Financial Instruments

**28.1** 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

**28.2** 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

**28.3** 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

**28.4** The Department enters into forward purchase contracts with the Bank of England to cover the majority of its foreign exchange requirements. The Department has changed its policy for the Forward Purchase contracts to extend the purchase period up to five years thereby benefiting from the increased certainty of longer term future rates. The details of the outstanding foreign currency contracts are as follows:

Currency	Foreign currency	Weighted average exchange rate	31 March 2007 Sterling	31 March 2006 Sterling
	US\$/Euro 000	(=£1)	£000	£000
US Dollar	2,258,250	1.79	2007/2008 delivery 1,263,836	2006/ 2007 delivery 1,077,839
Euro	1,957,000	1.43	1,365,429	1,093,972
US Dollar	2,073,000	1.81	2008/2009 delivery 1,145,771	2007/ 2008 delivery 1,032,949
Euro	2,126,000	1.42	1,498,720	1,085,456
US Dollar	1,328,000	1.84	2009/2010 delivery 721,119	-
Euro	1,634,000	1.40	1,169,141	-
US Dollar	919,000	1.88	2010/2011 delivery 487,944	-
Euro	1,087,000	1.39	784,205	-
US Dollar	445,000	1.90	2011/2012 delivery 234,187	-
Euro	540,000	1.38	391,219	-
Total			<b>9,061,571</b>	<b>4,290,216</b>

The 31 March 2007 mid-market closing rates for US Dollar and Euro were £/\$ 1.9614 and £/Euro 1.4735 respectively.

## Fair values

### *Financial assets*

**28.5** The Department's financial assets include investments in, and loans made to, MoD Trading Funds and QinetiQ Group plc. The net assets of these bodies (excluding MoD loans), the interest rates applicable to these loans and the market value of the shareholding in QinetiQ are shown in Note 15. Other financial assets' fair values approximate to their book values.

### *Financial liabilities*

**28.6** 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 £795,271,000 (2005-06: £800,640,000). The fair values of these liabilities will be different from their book values but since these represent only 5.9% 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

### Contingent Liabilities

**29.1** Contingent liabilities estimated at some £1,474,972,000 (2005-06: £1,575,055,000) have been identified. The balance primarily comprises of site restoration liabilities of some £400,000,000 (2005-06: £400,000,000) relating to the British Army Training Units in Canada and indemnities, that are quantifiable, of £886,800,000 (2005-06: £979,500,000) 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.

### Contingent Assets

**29.2** 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. Full responsibility for the project, including the sale of the artefacts has been transferred to the Department. Proceeds from the sale of any artefacts will be surrendered to HM Treasury.

The Department will be responsible for the preservation of any part of the wreck brought up as part of the salvage effort.

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

#### Quantifiable (Unrestricted)

**30.1** 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 2006	Increase in year	Liabilities crystallised in year	Obligation expired in year	31 March 2007	Amount reported to Parliament by Departmental Minute
UNRESTRICTED – Indemnities	£000	£000	£000	£000	£000	£000
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				Up to 1,000	
Liabilities arising from insurance risk of exhibits on loan to the Army, Navy and RAF Museums.	2,726		(191)		2,535	

#### Quantifiable (Restricted)

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

#### Unquantifiable (Unrestricted)

**30.3** 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 possibility of a transfer of economic benefit in settlement is too remote.<sup>8</sup>

- 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.
- Indemnity to Rolls Royce Power for the non insurance of the Rolls Royce Core Factory and the Neptune Test Reactor facility for death and personal injury to a third party.
- Indemnity for residual commercial contracts claims liabilities arising from the disbanding of DERA as a MoD Trading Fund and the formation of QinetiQ on 1 July 2001.
- Indemnity for residual employee disease liability arising from the disbanding of DERA as a MoD Trading Fund and the formation of QinetiQ on 1 July 2001.
- Indemnity for public liability arising from the disbanding of DERA as a MoD Trading Fund and the formation of QinetiQ on 1 July 2001.

#### Unquantifiable (Restricted)

- 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.

<sup>8</sup> A contract was signed in May 2007 for Service Life Insurance which will enable Service personnel to access life insurance cover throughout their service career. Reported to Parliament, this is an unquantifiable liability for the MoD.

### 31. Losses and Special Payments

<b>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.</b>	<b>Arising in 2006-07</b>	<b>Reported in 2005-06 as Advance Notifications</b>
	<b>£000</b>	<b>£000</b>
Total (excluding gifts, special payments and War Pensions Benefits) under £250,000 each: 11,212 cases	14,935	
Total (excluding gifts, special payments and War Pensions Benefits) over £250,000 each: 26 cases (detailed below)	94,384	281,120
<b>Losses of pay, allowances and superannuation benefits</b>		
An administrative error arising from the introduction of the Army Pay system in December 2000 led to the overpayment of £2.9M of public money to 428 soldiers during the period February to December 2006. (Central)	2,900	
<b>Bookkeeping losses and adjustments</b>		
Bookkeeping Losses: £37M relates to the write-off of legacy project balances and £4.0M of this relates to the write off of residual balances post migration to the Single Balance Sheet Owners. This loss represents four cases. (DPA)	44,933	
The write-off of unsupported asset balances within TLBs following the migration of assets to the single Balance Sheet Owners. This loss represents three cases. (DLO, STC and CJO)	41,169	
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. The balances have now been reconciled to the current Defence Bills Debtor balance, and the adjustment written off as a bookkeeping loss. This loss represents three cases. (Central)		6,175
A detailed reconciliation of the Fixed Asset Register with the General Ledger for the Central Top Level Budget was undertaken prior to the transfer of assets and balances to the Single Balance Sheet Owners. The write-off is in respect of the final un-reconciled balance which had arisen over a period of several years. (Central)		4,515
A bookkeeping adjustment within the General Ledger to reconcile with the fully supported cash and bank Control Accounts. There has been no physical loss of cash. (Central)	2,329	
<b>Losses arising from failure to make adequate charges</b>		
The costs of maintenance work incurred on hirings for the Rhine and European Group Support Unit in Naples which should have been charged to individual landlords during the period 1999 to March 2005. (Central)	2,037	
<b>Claims waived or abandoned</b>		
A commercial compensation package agreed as a result of slippage in the delivery dates by the Contractor and the unavailability of components for the Counter-Battery Radar programme has resulted in a write-off. (DPA)		540
Metropole Building re-wire project. The loss arising from a legal dispute between MoD and a former contractor. (Central)		1,400
Following an annual review of the Service Level Agreement, a claim for Service Level Failure Charges against EDS waived (Armed Forces Personnel Administration Agency – AFPA). (Central)		1,096
<b>Stores and other losses</b>		
Item of aircraft spares transferred from the Westlands Managed store in RNAS Culdrose to HMS WESTMINSTER at Rosyth Naval Base: whilst there is a clear audit trail confirming receipt by Ship's staff in Rosyth, the item had not been brought to Ship's charge and cannot be located. (FLEET)		630
<b>Constructive Losses</b>		
Delays in Phase 1 projects at the Defence Academy resulted in a constructive loss. (Central)	532	
The cancellation of Civil Pallet Conversion Kits within the A400M aircraft procurement programme. (DPA)	484	
This constructive loss arose from the UK Government decision not to proceed into production for the long range anti-tank guided weapons system. (DPA)		194,820
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. The MoD was able to recover £10.3M through a negotiated settlement package. (DPA)		37,047
A loss arose as the result of the UK Government decision to reduce the number of Nimrod MRA4 procured from 18 to 12. (DPA)		32,550
A constructive loss arose as a result of a settlement between the Department and a manufacturer for the provision of Manportable Remote Control Vehicles. (DPA)		1,354
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
A constructive loss arose in respect of the Voice Monitoring and Analysis Facility 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 should ensure that losses of a similar nature do not occur again. (DLO)		431

<b>CLOSED CASES: (continued)</b>	<b>Arising in 2006-07</b>	<b>Reported in 2005-06 as Advance Notifications</b>
	<b>£000</b>	<b>£000</b>
<b>Gifts</b>		
Total under £250,000 each: 35 cases	316	
Total over £250,000 each: 7 cases (detailed below)	23,694	
3 Infrastructure Projects and Equipment to the Iraqi Government. Details of the transfer were notified to the House of Commons in a Departmental Minute dated 18 April 2006. (CJO)	20,363	
110 Landrovers to the Lebanese Armed Forces. Details of the transfer were notified to the House of Commons in a Departmental Minute dated 9 October 2006. (Central)	1,000	
Non-lethal military equipment to the Government of Nepal. Details of the transfer were notified in a Departmental Minute dated 12 February 2007. (Central)	850	
Cash gift to the Afghan Government to equip Afghan Territorial Force in Helmand Province. Details of the transfer were notified to the House of Commons in a Departmental Minute dated 30 October 2006. (CJO)	500	
Non-lethal military equipment for the Palestinian Presidential Guard. Details of the transfer were notified in a Departmental Minute dated 8 February 2007. (Central)	376	
Camp Smitty and Camp Driftwood Infrastructure to the Government of Iraq. Details of the transfer were notified to the House of Commons in a Departmental Minute dated 21 June 2006. (CJO)	314	
Camp Abu Naji (Maysan) Infrastructure to the Government of Iraq. Details of the transfer were notified to the House of Commons in a Departmental Minute dated 28 June 2006. (CJO)	291	
<b>International Courtesy Rules</b>		
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)	1,027	
<b>Special Payments</b>		
Total under £250,000 each: 136 cases	274	
Total over £250,000 each: 8 cases (detailed below)	68,912	9,449
The contract for the Landing Ship Dock (Auxiliary) incurred additional expenditure of £32M for 2006-07. The second ship built at Swan Hunter, RFA Lyme Bay, is nearing completion by BAE Systems. (DPA)	32,000	
Ex-gratia element of Northern Ireland Royal Irish Regiment redundancy payment relating to Normalisation arrangements in the Province. This represents 1,531 payments made during 2006-07. A provision has been made for further payments during 2007-08, which is disclosed as an Advance Notification. (AG)	26,894	
In November 2001 proceedings were brought against the MoD by a contractor for non-compliance with certain terms of their commercial Marketing Agreement. A number of preliminary issues were determined by the Arbitrator at an interim Arbitration hearing in July 2002. The Arbitrator declared in favour of the MoD on some issues and in favour of the contractor on others. A final settlement was agreed in 2006. (DLO)	5,508	
Ex-gratia element of the Northern Ireland civilian redundancy payment relating to Normalisation arrangements in the Province. This represents 215 payments made during 2006-07. A provision has been made for future payments which is disclosed as an Advance Notification. (GOCNI and Central)	3,010	
Payment to the Armed Forces Memorial Trust, for the memorial to be erected at the National Memorial Arboretum in Staffordshire, to commemorate all members of the Armed Forces who have lost their lives on duty since the end of the Second World War. (Central)	1,500	
An extra contractual payment resulting from the late supply of Government Furnished Equipment to the TITAN & TROJAN project. (DPA)		4,465
An ex-gratia payment in full and final settlement of the Armoured Vehicle Training Service cancelled PFI programme. (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 (CEPS). This resulted in payments of £2.1M during FY 2005-06, to ensure that the UK has no further involvement or liability in respect of the CEPS. (DLO)		2,084

<b>CLOSED CASES: (continued)</b>	<b>Arising in 2006-07</b>	<b>Reported in 2005-06 as Advance Notifications</b>
	<b>£000</b>	<b>£000</b>
<b>War Pensions Benefits (WPB):</b>		
<b>Claims Abandoned-WPB</b>		
Irrecoverable overpayments of war pensions relating to 2,623 cases amounting to £631,177 (2005-06: 2,785 cases amounting to £506,421) were written off. These represent overpayments of pensions which occur for a number of reasons outside of the MoD's control; this represented 0.04% of the total war pension payments budget of £1.037 billion. All overpayments are recorded as amounts outstanding and action is taken to recover these amounts. In financial year 2006-07, over £1.9M of overpayments were recovered. Where the overpayment was found to be irrecoverable, the decision was taken to waive the amount owed.	631	
<b>Special Payments-WPB</b>		
Total number of payments made during the year were 885 (2005-06: 943) and amounted to £5,215,885 (2005-06: £5,815,084). 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 majority of cases have been paid in previous financial years, 186 claims were processed and paid in financial year 2006-07. The total payment amounted to £1,860,000.	1,860	
Following a Judicial Review announced in November 2003, the scheme was expanded to allow payments to qualifying Gurkhas in Nepal. Within financial year 2006-07, 63 successful claims were processed. The total payment amounted to £630,000. A further £1,000,000 was charged to the Operating Cost Statement by way of a provision to reflect the likely payments in financial year 2007-08.	1,630	
(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 2006-07 the total number of cases were 306 (2005-06: 335 cases) and the cost amounted to £1,110,189 (2005-06: £1,466,066).	1,110	
(c) Noise Induced Sensorineural Hearing Loss		
During financial year 2006-07, 217 cases (2005-06: 219 cases) were paid under the Dispensing Instruments and the total amount payable was £538,337 (2005-06: £523,676).	538	
(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. During financial year 2006-07, the total number of cases was 13 (2005-06: 16 cases) and the amount payable was £77,358 (2005-06: £95,340).	77	

<b>ADVANCE NOTIFICATIONS: these comprise losses and special payments, which arose during 2006-07 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.</b>	<b>Arising in 2006-07</b>	<b>Reported and arising in prior years</b>
	<b>£000</b>	<b>£000</b>
<b>Notified in prior years</b>		
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. The MoD intends to convert the MK3 airframes to a modified MK2 standard as a way forward, with a revaluation exercise of the 8 aircraft at the point of asset delivery. (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. Following review, the potential loss has been reduced. (DPA)		53,836
A potential claim against a contractor on the Airborne Stand-Off Radar programme has been abandoned resulting in a loss, but other benefits have been secured in compensation. (DPA)		28,000
Cancellation of the Alternative Launcher Drive System programme has resulted in a potential write-off. (DPA)		4,000
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 was recorded in the 2004-05 accounts. (DPA)		4,000
Uncleared balances in respect of Income Tax and National Insurance balances to be written off in AFPAA's books. (Central)		1,479
A food component was withdrawn from Operational Ration Packs 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 MoD brought about by a combination of loss of use of the original product and the cost of its removal/destruction. (DLO)		1,400
<b>Notified during the year</b>		
<b>Cash Loss</b>		
A potential loss has been identified in respect of an overpayment made to an MoD contractor. Whilst repayment is being actively pursued, there is no assurance that the overpayment can be recovered owing to the statute of limitation restrictions. (Central)	372	
<b>Losses arising from failure to make adequate charges</b>		
The Payment of staff from public funds within a non-public organisation covering the period April 1999 to March 2007 – The British Mönnessee Sailing Club. (Land)	1,264	
The Payment of staff from public funds within a non-public organisation covering the period April 1999 to March 2007 – The British Dömmessee Yacht Club. (Land)	1,225	
Mill Hill Garrison Pre-School Playgroup, a private enterprise, was allowed to trade from MoD property for the period April 1995 to March 2005 without due rent being raised. (Land)	267	
<b>Bookkeeping losses and adjustments</b>		
A bookkeeping loss arising from the write-off of unsupported asset balances as a result of the 2006-07 asset verification exercise. (DE and DLO)	21,135	
A bookkeeping loss has arise in respect of the write-off of an unsubstantiated debtor balance. The write-off has been accounted for during 2006-07. (DLO)	12,893	
A bookkeeping loss has arisen in respect of the write-off of a number of unsubstantiated Control Account Balances. The loss has been accounted for during 2006-07 and comprises erroneous balances on five Control Accounts that are believed to have been caused by system errors, spread over a period of four years. There has been no physical loss of cash. (DLO)	7,180	
<b>Claims waived or abandoned</b>		
Service Level Failure Charges against EDS waived in respect of 2006-07 – (AFPAA). (Central)	3,456	
<b>Stores Losses</b>		
The Cadet Hut, Kings School Winchester was destroyed by fire. (Land)	252	

<b>ADVANCE NOTIFICATIONS: (continued)</b>	<b>Arising in 2006-07</b>	<b>Reported and arising in prior years</b>
	<b>£000</b>	<b>£000</b>
<b>Constructive Loss</b>		
As a result of the UK's interpretation of the Oslo Declaration on dumb cluster munitions, the Multiple Launch Range System containing the M26 bomblet was declared as out of service by the secretary of State for Defence on 20 March 2007. The announcement also resulted in the withdrawal of the BL755 Air to Ground unguided Cluster Bomb. Although plans were in place to dispose of the munitions, the revised out of service date has resulted in a write-off of £112m (£101m for M26 and £11m for BL755). (DLO)	112,000	
A contract for an Integrated Biological Detection System was not progressed as a result of production delays and a strategic decision to reduce the numbers of systems required. (DPA)	25,916	
The Nuclear, Biological and Chemical Battlefield System Application Project, was cancelled by mutual agreement with the Contractor. Technical difficulties in pre-existing software introduced significant risks into the project which threatened its future success. (DPA)	14,165	
A MoD funded project to be conducted by the US Government, will now not go ahead as it relied on the finalisation of another US project which has been cancelled. This decision was outside of the management control of the MoD. The disclosure is for the full loss although there remains a possibility that some of the loss may be mitigated through an alternative use of the facilities raised in preparation for the original trial. (SIT)	794	
A loss arising from the decision to close a 5 year old Sullage Treatment Plant as result of a lack of a technical solution to suppress gas emissions, the need to replace corroded sullage vessels and a re-appraisal of the overall operational and financial effectiveness of the plant in light of changed circumstances. Construction costs of £1.3m have been offset by a recovery from the construction company who accepted liability of £0.6m in respect of the corroded sullage vessels. (DLO)	700	
During the deployment of UK forces to Iraq, arrangements were made by several seagoing units to hire and load shipping containers. The hire and lease should have been agreed through the Defence Container Management Service. On completion of the hire agreement the containers were not returned directly to the sub-contractor. All containers were taken off hire in August 2005. Partial write off action was taken in October 2006 (£0.2M). Work is continuing to progress additional write off action for approximately £0.2M. (FLEET)	420	
During 2005, the MoD entered into a contract for the lease of 1,410 Airwave Radios, with the requirement for 210 being deferred until 2006-07. The final 210 radios were not required and contract termination costs have been incurred. (Central)	348	
<b>Fruitless Payments</b>		
The estimated repair costs to the Type 45 Long Range Radar Antenna which was damaged during installation. (DPA)	700	
On 11 September 2006 4 Sea King Gnome 1T engines were transported from Rolls Royce East Kilbride to HMS Sultan using the Defence Storage and Distribution Agency. On arrival at HMS Sultan they were found to have been transported in the incorrect orientation, additionally one had suffered impact damage. All 4 engines had to be returned to the workshop for a full strip and overhaul at a total cost of £0.5M.		
<b>Special Payments</b>		
Ex-gratia element of Northern Ireland Royal Irish Regiment redundancy payment relating to Normalisation arrangements in the Province. This represents payments due to be made during 2007-08. Payments made during 2006-07 are disclosed as a Closed Case. (AG)	41,020	
Ex-gratia element of the Northern Ireland civilian redundancy payments relating to Normalisation arrangements in the Province. This represents payments due to be made in the period 2007-2010. Payments made during 2006-07 are disclosed as a Closed Case. (GOCNI and DE)	14,112	

## 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.

The Navy Army Air Force Institutes (NAAFI), the Oil and Pipelines Agency and, following reclassification, the Fleet Air Arm Museum, are Public Corporations. The Trading Funds, QinetiQ Group plc, the Oil and Pipelines Agency, NAAFI and the Fleet Air Arm Museum 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 (excluding VAT): £1,730,000 (2005-2006: £1,747,000)

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

### Fleet Air Arm Museum (Public Corporation)

Grant-in-Aid: £593,724 (2005-2006: £579,036)

Assistant Chief of Staff Aviation, CinCFleet, Whale Island; Assistant Director Joint Manoeuvre, MoD, London; Director Operations, DG Helicopters, DE&S; Commanding Officer RNAS Culdrose and Commanding Officer RNAS Yeovilton are members of the Board of Trustees.

### Executive Non Departmental Public Bodies (NDPBs)

**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:

#### National Army Museum

Grant-in-Aid: £5,292,879 (2005-2006: £4,871,546)

The Department is not represented on the Board.

#### Royal Air Force Museum

Grant-in-Aid: £6,774,110 (2005-2006: £7,104,192)

The Department is not represented on the Board.

#### Royal Marines Museum

Grant-in-Aid: £740,788 (2005-2006: £783,252)

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

## Royal Naval Museum

Grant-in-Aid: £895,502 (2005-2006: £1,025,044)

Naval Base Commander Portsmouth and the Naval Secretary, CinCFleet, Whale Island were members of the Board of Trustees during the financial year.

## Royal Navy Submarine Museum

Grant-in-Aid: £561,997 (2005-2006: £548,317)

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

## Other

**32.3** Sir 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	164
	Various transactions-Receipts	2
Scottish Power	Various transactions-Payments	1,283

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 193 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 single use military equipment.

## 33. Events After the Balance Sheet Date

The financial statements included in the Annual Report and Accounts were authorised for issue (defined as the date of dispatch to HM Treasury) by the Accounting Officer on 23 July 2007.

### 34. Non-Operational Heritage Assets

**34.1** 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 (FRM), non-operational heritage assets are valued except where the cost of obtaining a valuation for the asset is not warranted in terms of the benefits it 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.

**34.2** 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: <a href="http://www.hms-victory.com">www.hms-victory.com</a>
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: <a href="http://www.deltaweb.co.uk/haf/index.htm">www.deltaweb.co.uk/haf/index.htm</a>
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: <a href="http://www.bbmf.co.uk/index.html">www.bbmf.co.uk/index.html</a>
Pickling Pond	HMNB Portsmouth	Pickling or mast ponds enabled long lengths of timber to be soaked before being used to build ships; well seasoned planks would not split or shrink in the water.
Enigma Machine	RAF Cosford	Cryptographic equipment captured during WW2 and used at 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, Gosport, Stanmore	The Admiralty and Institute of Naval Medicine Libraries and the Air Historical Branch (RAF) 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: <a href="http://www.army.mod.uk/museums/index.htm">www.army.mod.uk/museums/index.htm</a> .

### **35. Entities within the Departmental Boundary**

The entities within the boundary during 2006-07 were as follows:

#### **Executive Agencies**

Armed Forces Personnel Administration 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  
People, Pay and Pensions 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  
Defence Nuclear Safety Committee  
Defence Scientific Advisory Council  
National Employer Advisory Board  
Nuclear Research Advisory Council  
Review Board for Government Contracts  
War Pensions Committees

Stakeholder Advisory Group – Op Telic Health Research Programme Review Board

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

### 36. Votes A Statement – Statement of Approved Maximum Armed Forces Numbers

**36.1** 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.

**36.2** 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.

**36.3** 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. The aggregate maximum numbers maintained may not equal the sum of Officers plus Men and Women as these categories peak at different times of the year. The 'Men and Women' categories represent the Service's Ratings and Other Ranks

**36.4** 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
<b>Naval Service</b>	Officers	8,280	7,670	May 2006
	Men and Women	33,770	31,730	April 2006
	Aggregate	42,050	39,390	April 2006
<b>Army Service</b>	Officers	16,425	15,190	June 2006
	Men and Women	110,520	99,750	April 2006
	Aggregate	126,945	114,835	April 2006
<b>Air Force Service</b>	Officers	11,180	10,313	April 2006
	Men and Women	40,930	38,416	April 2006
	Aggregate	52,110	48,729	April 2006

**36.5** 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
<b>Naval Service</b>	Officers	8,280	7,327	April 2006
	Men and Women	8,420	6,871	November 2006
	Aggregate	16,700	14,191	May 2006
<b>Army Service</b>	Officers	18,500	15,270	January 2007
	Men and Women	65,500	55,850	January 2007
	Aggregate	84,000	71,120	January 2007
<b>Air Force Service</b>	Officers	5,400	4,135	July 2006
	Men and Women	17,650	9,954	June 2006
	Aggregate	23,050	14,053	July 2006

**36.6** 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
<b>Naval Service</b>	Officers	720	111	March 2007
	Men and Women	1,300	104	March 2007
	Aggregate	2,020	215	March 2007
<b>Army Service</b>	Officers	1,000	-	-
	Men and Women	5,000	106	October 2006
	Aggregate	6,000	106	October 2006
<b>Air Force Service</b>	Officers	150	52	March 2007
	Men and Women	400	45	March 2007
	Aggregate	550	97	March 2007

Due to a new personnel administration system (Joint Personnel Administration) being introduced to the Royal Navy and Royal Air Force during 2006-07, the numbers maintained for the Royal Navy from November 2006 and the Royal Air Force from February 2007 are provisional and subject to review.





