

DEPARTMENTAL RESOURCE ACCOUNTS

2004-05

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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 to act as a force for good by strengthening international peace and stability.

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

Departmental Boundary

At 31 March 2005 the Department consisted of the 12 (2003-04:11) Top Level Budget (TLB) Holders detailed in Note 27 to the financial statements, responsible for providing forces and support services required for a modern defence force. Within these TLBs there were 69 (2003-04: 72) reporting entities known as management groupings. There are 26 (2003-04: 30) on-vote Defence agencies listed in Note 31. All on-vote agencies are also management groupings, except for the Defence Procurement Agency (a TLB) and the Disposal Services Agency (part of a management grouping). Also included within the Departmental Boundary are Advisory Non-Departmental Public Bodies (NDPB) sponsored by the Department listed in Note 31. Defence Agencies also publish their own financial statements.

The five (2003-04: five) Defence Executive Agencies established as Trading Funds and owned by the Department at 31 March 2005 fall outside the Departmental Boundary and are detailed in Note 10. The six Executive NDPBs and one Public Corporation listed in Note 11 are sponsored by the Department and fall outside the Departmental Boundary. The accounts of these bodies are published separately.

QinetiQ Holdings Limited (hereafter referred to as "QinetiQ") is a Self-Financing Public Corporation, incorporated in the United Kingdom, which falls outside the Departmental Boundary. The Navy, Army and Air Force Institutes (NAAFI) is also outside the Departmental Boundary.

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

Future Developments

Plans have progressed to co-locate the operational Command headquarters and the personnel & training headquarters for each of the three Services. In addition, the Royal Navy will merge their FLEET and 2nd Sea Lord TLBs. The new RN headquarters in Portsmouth will be operational by April 2006; the main part of the RAF co-location of Strike and Personnel & Training Commands at High Wycombe will be complete by October 2006; and the Army's LAND and Adjutant General Commands plan to co-locate progressively by March 2009.

From 1 April 2005, agency status was removed from six on-vote agencies. These were the Warship Support Agency, The Medical Supplies Agency, the Defence Dental Agency, the Queen Victoria School, the Defence Geographic and Imagery Intelligence Agency and the Defence Intelligence and Security Centre. In addition, Defence Estates took on dual status as both an agency and a Top Level budget. The Disposal Services Agency merged with the DLO's Head of Specialisation (Disposal Sales) and the enhanced organisation moved from under the ownership of MoD Centre to the Defence Logistics Organisation.

Fixed Assets

Changes in fixed assets during the year are summarised in Notes 8, 9 and 10 to the financial statements.

Research and Development

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

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

Development expenditure is included in Intangible Assets, where appropriate, and shown in Note 8.

Net Expenditure

The Operating Cost Statement shows net expenditure of £32,410,138,000 which has been charged to the General Fund. Cash voted by Parliament and drawn down for the provision of Defence Capability (RfR 1), Conflict Prevention (RfR 2) and War Pensions and Allowances (RfR 3) amounting to £29,497,000,000 has been credited to the General Fund (Note 18).

Operating and Financial Review

The Operating and Financial Review is included on pages 131 to 132.

Management

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

Secretary of State for Defence

The Right Honourable Geoffrey Hoon, MP

Minister of State for the Armed Forces

The Right Honourable Adam Ingram, MP

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

The Lord Bach of Lutterworth

Parliamentary Under Secretary of State for Defence and Minister for Veterans

Ivor Caplin, MP

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

The Right Honourable Dr John Reid MP was appointed as Secretary of State for Defence on 6 May 2005.

Lord Drayson was appointed as Parliamentary Under Secretary of State for Defence and Minister for Defence Procurement on 9 May 2005.

Don Touhig MP was appointed as Parliamentary Under Secretary of State for Defence and Minister for Veterans on 9 May 2005.

Composition of Defence Management Board (DMB), during the year ended 31 March 2005:

Permanent Under Secretary of State

Sir Kevin Tebbit KCB CMG

Chief of the Defence Staff

General Sir Michael Walker GCB CMG CBE ADC Gen

First Sea Lord and Chief of the Naval Staff

Admiral Sir Alan West GCB DSC ADC

Chief of the General Staff

General Sir Mike Jackson GCB CBE DSO ADC Gen

Chief of the Air Staff

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

Vice Chief of the Defence Staff

Air Chief Marshal Sir Anthony Bagnall KCB OBE FRAeS RAF

Second Permanent Under Secretary of State

Ian Andrews CBE TD

Chief of Defence Procurement

Sir Peter Spencer KCB ADC

Chief of Defence Logistics

Air Chief Marshal Sir Malcolm Pledger KCB OBE AFC BSc FRAeS RAF (to 31 December 2004)

General Sir Kevin O'Donoghue KCB CBE (appointed 1 January 2005)

Chief Scientific Adviser

Professor Sir Keith O'Nions FRS (to 9 July 2004)

Professor Roy Anderson FRS (appointed 1 October 2004)

Finance Director

Trevor Woolley (appointed to the Defence Management Board 24 June 2004)

Non-Executive members

Charles Miller Smith, Chairman of Scottish Power

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

* Chairman of the Defence Audit Committee.

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

The Methodology of Senior Appointments

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

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

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

Elements of Remuneration

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

Emoluments for senior military officers, at two-star rank and above, are based on rank and rates of pay are recommended annually by the SSRB.

Performance and Reward

Civilian members of the Defence Management Board (DMB) do not participate in any incentive/performance schemes. Their basic salary and annual increases, which could include a bonus payment, are performance related and are set by the Permanent Under Secretaries Remuneration Committee.

Pay and management arrangements for members of the Senior Civil Service (SCS) (one-star to three-star) reward individuals for delivery and personal achievement. These arrangements include:

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

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 under which they can be awarded a double increment, a single increment or no increment depending on their performance. The award of increments is recommended by the MoD Remuneration Committee, chaired by the Department's Permanent Under Secretary.

Pension Liabilities

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

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

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

Employees

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

Payments to Suppliers

The Department's bills, with the exception of some payments to suppliers by units locally and outside Great Britain, are paid through the Defence Bills Agency (DBA). In 2004-05 the DBA met its target by paying 99.98% of all correctly submitted bills within eleven calendar days, ensuring that the Department is in compliance with its statutory obligation under the Late Payment of Commercial Debts (Interest) Act 1998. Commercial debt interest paid by units locally during the year amounted to £63 (2003-2004: £336).

Environmental Protection Policy

The Ministry of Defence acts as a force for good in the world, by enabling a climate that supports the pursuit of sustainable development objectives. The MoD is an operational government department and is required to manage its sustainable development aspects and impacts alongside Defence imperatives. Ensuring a better quality of life for everyone now and for future generations to come lies at the heart of the Government's Sustainable Development Strategy. The MoD is committed to these objectives in pursuit of core business.

It is the Department's intention to comply with the Government's strategy for sustainable development and to take into consideration environmental and socio-economic factors in the development of policies, projects, acquisition programmes and training activities. A Sustainable Development Steering Group has been set up to oversee the development and implementation of a Departmental Sustainable Development Strategy. A report on the Department's performance against core sustainable development indicators will be published annually.

The Department will comply with the Environmental Protection Act 1990 and Environment Act 1995 and other relevant statutory provisions and any additional requirements arising from international treaties and protocols to which the UK is a signatory. Where the Department has been granted specific exemptions, disapplications or derogations from legislation, international treaties and protocols, Departmental Standards and arrangements will be introduced which are, as far as reasonably practical, at least as good as those required by the legislation. Any powers not to apply legislation on the grounds of national security will be invoked only when such action is absolutely essential for the maintenance of operational capability.

Departmental Report

The MoD's Departmental Report which is presented to Parliament each year comprises the "Ministry of Defence Performance Report 2004-05" and "The Government's Expenditure Plans 2004-05: Ministry of Defence". The Departmental Report sets out the performance of the MoD against the objectives stated in Schedule 5 and also includes developments since the year-end, where appropriate. The Departmental Performance Report forms the first Section of the Annual Report and Accounts.

Financial Instruments

The Department does not trade or enter into any speculative transactions in foreign currencies. Forward contract commitments entered into to cover future expenditure in foreign currencies are stated in Note 28.

Provision of Information and Consultation with Employees

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

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 137 to 138. The audit fee is disclosed in Note 3.

Kevin Tebbit

Accounting Officer **26 September 2005**

OPERATING AND FINANCIAL REVIEW

Operating Review

The operating review of the Department's performance is covered by the Departmental Annual Performance Report which forms the first section of the Annual Report and Accounts. The Performance Report is structured against the Balanced Scorecard that the Defence Management Board uses to assess and manage the Department's performance. The Finance section of the Performance Report covers the Department's management of financial resources and reports on the outcome for the year against Parliamentary Controls.

The Armed Forces continued to achieve a high degree of success against the policy and military objectives set for all Operations overseas in 2004-05, including in Iraq, Afghanistan and the Balkans, in response to crisis in Cote D'Ivoire, and on Tsunami relief around the Indian Ocean. They contributed to six United Nations peacekeeping missions, in Cyprus, the Democratic Republic of Congo, Georgia, Liberia, Sierra Leone, and Sudan. A minimum nuclear deterrent capability was maintained throughout the year. The security of the UK's Overseas Territories, including the Sovereign Base Areas in Cyprus, the Falkland Islands, and Gibraltar, was maintained. Continuing support was provided to the civil authorities at home, including in Northern Ireland, in responding to civil emergencies, in the routine provision of Search and Rescue and of Fisheries Protection services, and in the investigation and disposal of suspected explosive devices. Defence continued to contribute in 2004-05 to the Government's conflict prevention work under the Defence Diplomacy Programme and through the Joint Africa and Global Conflict Prevention Pools by providing support to a number of conflict prevention initiatives across Africa, the Middle East, Central America and Asia including widespread support to Security Sector Reform, provision of training to the Iraqi Security Forces and new Afghan National Army and provision of international training in Europe and Africa in military peace support operations. Of the Department's seven Public Service Agreement targets, three have been met, two partly met, one remains on course and one has yet to be assessed.

Financial Review

For the second year running the Department has received a clean audit opinion on its Accounts. This is a significant achievement considering the complexity of the Department's business, and the background against which it has been achieved. The Department moved from a myriad of financial systems to a single platform for accounting operations: Oracle 11i, to reduce the cost of operation and to provide consistency across the Department. The TLB re-structuring, which is under way to reduce costs and improve efficiency has also been challenging. The Department has also stayed within the resources allocated to it under each of the three "Requests for Resources" agreed in the Supplementary Estimates.

The two main areas which have had a significant impact on the results for the year have been the rolling programme of professional valuations of certain fixed assets, and the early retirement provisions which had to be set up during the year. The professional valuation of the Department's Estate has resulted in a significant increase in the overall Balance Sheet values, and led to impairments of a number of properties, which have been charged to the Operating Cost Statement. Details of both these items are given in the notes to the Accounts.

At 1 April 2004, the intangible and tangible fixed assets were reclassified in accordance with the requirements of HM Treasury. The main change under the new classifications has been the introduction of a category for Single Use Military Equipment; this includes all Fighting Equipment, Plant, Machinery and Vehicles, IT & Communication Equipment, and Capital Spares which are deemed not to have a dual military and civilian role.

Net Resource Outturn

The total Net Resource Outturn was £1,019M below the Estimate. Schedule 1 provides a summary explaining the reasons for the underspend, which is mainly due to lower than forecast non-cash costs. Of the total underspend, the provision for Defence Capability (Request for Resources 1) accounted for £955M, Conflict Prevention (Request for Resources 2) accounted for £12M, and War Pensions and Allowances (Request for Resources 3) £52M.

The Net Resource Outturn of £32,641M was £2,010M below last year. The reduction is made up of £2,319M in respect of the unwinding of provisions which arose in 2003-04 due to a change in HM Treasury Discount Rate on 1 April 2003 from 6% to 3.5%; this was offset by an overall increase in staff costs of £560M, mainly due to early retirement and redundancy provisions set up during the year. The early retirement and redundancy programme is part of the Department's commitment to reduce civilian posts by 10% by end of March 2008, together with reductions in military personnel, as announced by the Secretary of State in the 2004 Spending Review.

Net Cash Requirement

The net cash utilised in the year was £29,624M and was £187M below the Estimate. The underspend was mainly due to the timing of debtor payments and supplier invoicing which are difficult to forecast accurately.

Financial Position

The net asset value at 31 March 2005 was £85,645M, an increase over last year of £4,498M.

The increase in value of net assets is largely due to an increase in fixed assets of £5,285M, mainly resulting from the QQR, offset by increases in creditors and provisions for liabilities and charges of £885M: the latter amount includes a new liability of £348M in respect of the on-balance sheet PFI for the Main Building redevelopment and provisions set up for the early retirement and redundancy programmes.

Cash Flow

The amount drawn from the Consolidated Fund was £29,497M. This amount was mainly utilised in financing operating activities (£23,011M) and net capital expenditure (£6,246M). Closing cash and bank balances were £438M (2003-04 £313M).

Other areas

The Department's Accounts include a note (Note 29) on Losses and Special Payments. The nature of the losses and special payments, as defined in Government Accounting, vary from year to year depending on the circumstances arising and decisions made by the Department during the year. The value of losses and special payments reported in year show a significant reduction from last year. Improvement in this area is continuing, with control and procedures set up to minimise them where possible. 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 Resource Section of the Departmental Performance Report.

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

STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

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

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

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

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

- observe the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards, as set out in the *Resource Accounting Manual*, have been followed, and disclose and explain any material departures in the accounts;
- prepare the accounts on a going-concern basis.

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

STATEMENT ON INTERNAL CONTROL

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 2004/05, 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 6 executive Non-Departmental Public Bodies (NDPB) and 1 Public Corporation with delegated responsibilities. Included within the TLBs are 26 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 responsible¹. The MoD Trading Funds fall outside the Departmental Accounting Boundary and their Chief Executives are Accounting Officers in their own right. They therefore publish their own SICs together with their Annual Accounts. Given their close integration into the Department's business, and their extensive use of Departmental personnel and assets, their Chief Executives also provide to me the SIC prepared for their annual Accounts. Although sponsored by the Department, the 6 NDPBs and Public Corporation also fall outside the Departmental Boundary and their accounts are also published separately. The NDPBs operate within a financial memorandum agreed between their respective Boards of Trustees and the Department. The Public Corporation (Oil and Pipelines Agency) has a Board of Directors on which the Department is represented.

Ministers are involved in the delivery of outputs, including the management of risks to delivery, through the Defence Council which is chaired by the Secretary of State for Defence and includes all the senior executive members of the Defence Management Board. Ministers also chair a variety of internal Boards which review the performance of the Trading Funds, the primary on-vote Agencies and other elements of MoD business such as Environment and Safety, and Estates. In particular, all 5 Trading Funds (the Defence Aviation Repair Agency, the Army Base Repair Organisation, the Defence Science and Technology Laboratory (Dstl), the UK Hydrographic Office, and the Met Office) together with the Defence Procurement Agency (DPA) report to Advisory Boards chaired by MoD Ministers². Ministers are consulted on all key decisions affecting defence, including major investment decisions and on operational matters. The Chief of Defence Staff is 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 risks to successful outcomes.

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 only provide 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 2005 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. Risk forms an integral element of the Defence Management Board's performance reviews. Guidance on the Department's

¹For the Defence Procurement Agency, which is both an agency and a Top Level Budget, this is discharged by submission of the Statement on Internal Control prepared for its own annual Accounts.

²Until 27 July 2004 the Met Office reported to the UK Met Board chaired by the 2nd PUS.

approach to risk is detailed in a Joint Service Publication³, which is periodically reviewed and updated. This sets out the Department's corporate governance and risk management policy statement and strategy to be cascaded down through TLB Holders, and provides extensive guidance to staff on definitions, criteria and methods available for risk assessment and management. It is made available to all personnel in either hard copy or via the Department's intranet. Individual training, at both awareness and practitioner level, is available to all staff via the Department's in-house training provider.

A network of Risk Improvement Managers across the Department enhances the sharing of best practice by working with management at all levels to improve risk management in their area, facilitating learning from others across the Department, and drawing on the work carried out in the context of the Government-wide programme to improve the handling of risks to Government objectives.

4. The risk and control framework

The Department's Performance Management System provides the strategic framework for the consideration of risks within the Defence Balanced Scorecard and lower level scorecards, offering a starting point for the identification, evaluation, control and reporting of risk against a balanced assessment of Departmental objectives. Key Departmental objectives, performance indicators and targets are defined annually by the Defence Management Board (DMB) and cascaded to TLB Holders through Service Delivery Agreements. Performance is monitored and discussed quarterly at DMB and lower level management board meetings, including explicit consideration of key risks.

The Department's risk appetite is determined through the advice on operations given to Ministers, through decisions taken as part of the Department's annual planning round including assessing any gaps against Planning Assumptions as set out in the Defence White Paper, 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 (DMB), which meets approximately monthly to manage the plans, performance and strategic direction of the Department, comprising the senior members of the Department and two external independent members.
- A Defence Audit Committee (DAC), chaired by an external independent member of the DMB, which has adopted a risk-based approach to internal control and is placed at the heart of the assurance process, co-ordinating the activities of internal audit, and drawing on reports from specialist assurance sources, including:
 - the Defence Environment and Safety Board
 - the Departmental Security Officer
 - Defence Internal Audit, including the Defence Fraud Analysis Unit
 - the Director General Financial Management

³JSP 525 Corporate Governance and Risk Management 2nd Edition May 2004.

- the Director of Operational Capability
 - the Science and Technology Director
 - the National Audit Office
- A Departmental risk register, supported by operational-level risk registers, which complements the Defence Balanced Scorecard. The Departmental risk register has been reviewed and endorsed by both the DAC and the DMB.
- Through TLB Holders, a cascaded system for ensuring compliance with legal and statutory regulations. Each TLB holder is supported by an Audit Committee, including and, in all but one case⁴, chaired by non-executive directors and at which representatives from the internal and external auditors are present. Like the DAC these committees focus their activities to provide advice on wider-business risk and assurance processes.
- A developing Business Management System through which responsibility for the effective and efficient operation of the key pan-Departmental processes, such as Planning and Human Resources (military and civilian), including the identification of risks within these processes and the maintenance of effective controls to manage them, is assigned to functional heads or process owners. Process Owners report directly to the Defence Management Board.
- Through TLB Holders, a cascaded system for ensuring that business continuity plans are in place, and that these plans are tested on a regular basis. Following a revamp of the Department's business continuity management policy⁵, an in-year review by the Directorate General of Safety and Security was undertaken to ascertain how the policy is being adopted across the Department, what improvements are planned and to identify specific areas of risk and the measures being taken to mitigate those risks. The review revealed that all business continuity plans currently in place had been at minimum desktop tested and that there are no significant internal control problems.
- An annual risk-based programme of internal audit provided by Defence Internal Audit (DIA), who are the primary source of independent assurance, which is complemented by the activity of the Directorate of Operational Capability (DOC), which provides independent operational audit and assurance to the Secretary of State and the Chief of Defence Staff. On the basis of the audit work conducted during the year, DIA offered Substantial Assurance that the systems of internal control, risk management and governance reviewed are operating effectively.
- Annual Reports providing measurable performance indicators and more subjective assessments on the Health of Financial Systems from all TLB Holders and key functional specialists. Improvements have continued to be made to our financial control during the year. The Department has delivered its outputs within the resources voted by Parliament and the Treasury's expenditure limits despite the additional workload generated by Operation TELIC and the migration to a new accounting system.
- Centres of Excellence in key areas – including Change, Equipment and Estates, integrating Office of Government Commerce (OGC) processes, tools and structures into existing Departmental management and control processes – to ensure that high-risk mission-critical projects and programmes carried out by the Department do not suffer from any of the common causes of failure identified by the OGC and the National Audit Office.
- A dedicated team to co-ordinate, and appropriate mechanisms to strengthen, the management of scientific risks, particularly to Service personnel health, and in health, safety and environmental matters.
- An effective governance structure and performance management system that addresses the risks arising from the introduction of the general right of access to information from January 2005 under the Freedom of Information Act.

Kevin Tebbit

Accounting Officer 26 September 2005

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

⁵Revised policy and guidance issued in Joint Service Policy 503 Business Continuity Management, 2nd Edition, published May 2003, and Defence Council Instruction (General) 160/03 dated 20 June 2003.

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

I certify that I have audited the financial statements on pages 139 to 146 under the Government Resources and Accounts Act 2000. These financial statements have been prepared under the historical cost convention as modified by the revaluation of certain fixed assets and stock and the accounting policies set out on pages 147 to 198.

Respective responsibilities of the Accounting Officer and Auditor

As described on page 133, the Accounting Officer is responsible for the preparation of the financial statements in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder and for ensuring the regularity of financial transactions. The Accounting Officer is also responsible for the preparation of the other contents of the Annual Report and Accounts. My responsibilities, as independent auditor, are established by statute and I have regard to the standards and guidance issued by the Auditing Practices Board and the ethical guidance applicable to the auditing profession.

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

I read the other information contained in the Annual Report and Accounts, including the Annual Performance 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.

I review whether the statement on pages 134 to 136 reflects the Department's compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered whether the Accounting Officer's Statement on Internal Control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the Department's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

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

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

Opinion

In my opinion:

- the financial statements give a true and fair view of the state of affairs of the Ministry of Defence at 31 March 2005 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the year then ended, and have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by Treasury; and
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.

John Bourn
Comptroller and Auditor General

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

28 September 2005

SCHEDULE 1

Summary of Resource Outturn for the year ended 31 March 2005

	Estimate			Outturn			Net Total Outturn compared to Estimate Savings/ (Excess)
	Gross Expenditure	A-in-A *	Net Total	Gross Expenditure	A-in-A * (note 4)	Net Total	
	1 £000	2 £000	3 £000	4 £000	5 £000	6 £000	
Request for resources 1 (RfR 1)	32,806,571	1,258,309	31,548,262	31,851,150	1,258,309	30,592,841	955,421
Request for resources 2 (RfR 2)	949,884	—	949,884	938,181	—	938,181	11,703
Request for resources 3 (RfR 3)	1,161,221	—	1,161,221	1,109,521	—	1,109,521	51,700
Total resources	34,917,676	1,258,309	33,659,367	33,898,852	1,258,309	32,640,543	1,018,824
Non operating cost A-in-A			287,435			287,435	—
Net cash requirement			29,811,461			29,624,275	187,186
Outturn in Respect of Prior Year The corresponding figures for 2003-04 Outturn were as follows:							
Total Resources							34,651,226
Non operating cost A-in-A							367,798
Net cash requirement							29,337,645
* Appropriation-in-Aid (A-in-A)							
Summary of Income payable to the Consolidated Fund							
	Note	Forecast 2004-05		Outturn 2004-05			
		Income £000	Receipts £000	Income £000	Receipts £000		
Total	4	—	—	383,612	283,612		

The notes on pages 147-198 form part of these financial statements.

Reconciliation of resources to cash requirement				
	Note	Estimate £000	Outturn £000	Savings/ (Excess) £000
Net total resources	Sch 2	33,659,367	32,640,543	1,018,824
Capital:				
*Purchase of fixed assets:				
– RfR 1	8/9	6,697,715	6,895,537	(197,822)
– RfR 2	8/9	223,151	173,842	49,309
– RfR 1 Capitalised provisions	8/9	—	22,937	(22,937)
– Investments		—	—	—
Non operating cost A-in-A:				
Proceeds on sale of fixed assets	8/9/3	(193,193)	(366,912)	173,719
Proceeds on redemption of shares	Sch 4	(54,301)	(48,543)	(5,758)
Excess non-operating costs Appropriation-in-Aid payable to the Consolidated Fund		—	153,207	(153,207)
Repayment of loans made to the Trading Funds and QinetiQ	10	(39,941)	(25,187)	(14,754)
Repayment of Loans from the National Loans Fund	Sch 4	—	1,599	(1,599)
Accruals adjustments:				
Non-cash transactions-				
Included in operating costs	Sch 4	(6,513,094)	(7,012,404)	499,310
Included in net interest payable	6	(2,025,252)	(289,956)	(1,735,296)
Capitalised provisions shown above		—	(22,937)	22,937
		(8,538,346)	(7,325,297)	(1,213,049)
Cost of capital charge	18	(2,586,125)	(2,857,714)	271,589
		(11,124,471)	(10,183,011)	(941,460)
*Changes in working capital other than cash, excluding movements on creditors falling due after one year	Sch 4	83,106	168,222	(85,116)
* Increase in creditors falling due after one year		—	(357,508)	357,508
*Use of provisions for liabilities and charges	17	560,028	522,959	37,069
Adjustment for movements on cash balances in respect of collaborative projects	14	—	26,590	(26,590)
Net cash requirement	Sch 4	29,811,461	29,624,275	187,186

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

Explanation of variation between Estimate and Outturn (net total resources)

Planned RfR 1 expenditure for 2004-05 was set out in the *Ministry of Defence: The Government's Expenditure Plans 2004/05 to 2005/06*, and in the Main, Winter and Spring Supplementary Estimates voted by Parliament. Total Defence expenditure in 2004-05 was contained within voted provision, with an overall Net Resource under spend of £1,019M, net of £230M Consolidated Fund Extra Receipts.

The biggest single variance lies within the Defence Procurement Agency, and is attributable in part to an indirect resource provision of £500M for Typhoon development costs requested in Estimates, which were deemed not to be required in the current year. £208M relates to a change in the method of calculating nuclear provisions, and accounting adjustments were made for £66M of capital spares, which the department assumed would be written off, but which were recovered for future use.

Air Officer Commanding-in-Chief RAF Personnel and Training Command made a provision of £148M for the costs of service personnel redundancies, which also explains £27M of the Adjutant General's variance.

The remaining variances are all below 10% against Estimates and arise principally from the impact of revaluations of fixed assets.

As in previous years, resources have been reallocated and redistributed between TLB holders as and when required in order to optimise the use of those resources in the generation of military capability and its effective use on operations. This normal process explains apparent in-year shortfalls and excesses shown against some of the TLB holders. These offset each other, with no material impact on the Department's Total Resources.

The Department is also voted additional resources (RfR 2) to cover the net additional costs of Operations. Overall Expenditure was £938M as against £950M requested in the Spring Supplementary Estimates. There is a small under spend on War Pensions under RfR 3 of £52M. This relates to smaller actual pension payments than originally forecast, and requested, in Estimates.

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

It is difficult to forecast cash movements precisely, as the timing of debtor payments and supplier invoicing cannot be predicted accurately. In the event, net cash outflow from the Department was marginally (0.63%) lower than that forecast when the Spring Supplementary Estimates were prepared.

The Request for Resources (RfR) represents:

- RfR 1: Provision for Defence Capability
- RfR 2: Conflict Prevention
- RfR 3: War pensions and Allowances

SCHEDULE 2

Operating Cost Statement for the year ended 31 March 2005

	Note	2004-05 £000	2003-04 £000
Staff costs	2	10,995,642	10,435,157
Other operating costs	3	19,700,190	20,126,927
Gross operating costs		30,695,832	30,562,084
Operating income	5	(1,416,807)	(1,412,306)
Net operating cost before interest		29,279,025	29,149,778
Net interest payable	6	273,399	2,611,043
Cost of capital charge	18	2,857,714	2,769,726
Net operating cost		32,410,138	34,530,547
Net resource Outturn	7	32,640,543	34,651,226

	Note	2004-05 £000	2003-04 £000
Net gain on revaluation of fixed assets and stocks	19	(4,521,891)	(2,473,614)
Receipts of donated assets and (gain)/loss on revaluation	19	(440,664)	32,702
Recognised gains during the year		(4,962,555)	(2,440,912)

The results shown above are in respect of continuing activity.

The notes on pages 147-198 form part of these financial statements.

SCHEDULE 3

Balance Sheet as at 31 March 2005

	Note	31 March 2005		31 March 2004	
		£000	£000	£000	£000
Fixed Assets					
Intangible assets	8	22,647,823		20,186,743	
Tangible fixed assets	9	69,634,594		66,737,257	
Investments	10	<u>347,108</u>		<u>420,838</u>	
			92,629,525		87,344,838
Current Assets					
Stocks and work-in-progress	12	6,095,363		6,318,224	
Debtors	13	2,870,899		2,675,419	
Cash at bank and in hand	14	<u>438,411</u>		<u>312,564</u>	
			9,404,673		9,306,207
Creditors: amounts falling due within one year	15	<u>6,075,613</u>		<u>5,662,598</u>	
Net current assets			<u>3,329,060</u>		<u>3,643,609</u>
Total assets less current liabilities			95,958,585		90,988,447
Creditors: amounts falling due after more than one year	16	809,896		451,649	
Provisions for liabilities and charges	17	<u>9,503,208</u>		<u>9,389,690</u>	
			10,313,104		9,841,339
Net assets			<u>85,645,481</u>		<u>81,147,108</u>
Taxpayers' equity					
General fund	18		64,906,908		64,028,508
Revaluation reserve	19		18,719,510		15,396,444
Donated assets reserve	19		2,019,063		1,722,156
			<u>85,645,481</u>		<u>81,147,108</u>

Kevin Tebbit
Accounting Officer

26 September 2005

SCHEDULE 4

Cash Flow Statement

For the year ended 31 March 2005

	Note	2004-05 £000	2003-04 £000
Net cash outflow from operating activities before interest	A	23,011,015	23,110,005
Returns on investments and servicing of finance	B	(44,735)	(7,225)
Net capital expenditure and financial investment	C	6,246,193	5,977,172
Payments to the Consolidated Fund		157,081	279,587
Financing from the Consolidated Fund	14	(29,497,000)	(29,257,550)
Repayment of loans from the National Loans Fund		1,599	1,375
(Increase)/Decrease in cash at bank and in hand	14	(125,847)	103,364
Notes to the cash flow statement:			
A. Net cash outflow from operating activities before interest			
Net operating cost before interest	Sch 2	29,279,025	29,149,778
Non-cash transactions:			
– Depreciation and amortisation charges	3	(6,106,056)	(5,719,358)
– Impairment in value of fixed assets	3	238,174	(299,009)
– Provisions to reduce value of stock to its net realisable value	3	(227,498)	72,345
– Stocks written off – net	3	(703,558)	(528,120)
– Auditors' remuneration	3	(3,300)	(3,150)
– Surplus/(deficit) arising on disposal of tangible fixed assets	3	53,620	71,725
– Fixed Assets written off – net	3	85,648	(26,017)
– Capital project expenditure written off	3	(25,851)	(268,310)
– Movement in provisions for liabilities and charges (excluding capitalised provisions)	17	(323,583)	(424,701)
		<u>(7,012,404)</u>	<u>(7,124,595)</u>
Dividends received from Trading Fund and QinetiQ	5	28,387	8,902
Adjustments for movements in working capital other than cash			
– Increase/(decrease) in stocks/WIP		288,489	757,323
– Increase/(decrease) in debtors		95,461	83,431
– (Increase)/decrease in creditors		(60,092)	(206,831)
		<u>323,858</u>	<u>633,923</u>
Paid against provisions for liabilities and charges		392,149	441,997
		<u>23,011,015</u>	<u>23,110,005</u>
B. Returns on investments and servicing of finance			
Dividends received from Trading Funds and QinetiQ	5	(28,387)	(8,902)
Interest received		(25,145)	(28,125)
Interest paid		298,753	2,639,007
Deduct: Unwinding of discount on provisions for liabilities and charges	6	(289,956)	(2,609,205)
		<u>8,797</u>	<u>29,802</u>
		<u>(44,735)</u>	<u>(7,225)</u>
C. Analysis of capital expenditure and financial investment			
Acquisition of fixed assets		6,586,835	6,467,310
Proceeds on disposal of tangible fixed assets		(266,912)	(481,298)
Proceeds of redemption of Redeemable Preference Shares in QinetiQ		(48,543)	—
		<u>6,271,380</u>	<u>5,986,012</u>
Repayment of loans made to the Trading Funds and QinetiQ	10	(25,187)	(28,040)
Loans made to Trading Funds	10	—	19,200
		<u>6,246,193</u>	<u>5,977,172</u>

The notes on pages 147-198 form part of these financial statements.

	Note	2004-05 £000	2003-04 £000
Analysis of Financing			
Parliamentary Funding from the Consolidated Fund (Supply)	14	29,497,000	29,257,550
(Increase)/decrease in cash at bank and in hand during the year	14	(125,847)	103,364
Consolidated Fund Extra Receipts (CFERs) received and not paid over	4	369,096	222,659
Consolidated Fund Extra Receipts (CFERs) received in prior year paid over		(222,659)	(134,737)
Grant undrawn/(drawn) in the previous year and paid by/(to) the Consolidated Fund during the year		80,095	(105,291)
Adjustment for movements on cash balances in respect of collaborative projects		26,590	(5,900)
Net cash requirement	Sch 1	<u>29,624,275</u>	<u>29,337,645</u>
Amount of grant actually issued to support the net cash requirement = £29,497,000,000.00			

SCHEDULE 5

Resources By Departmental Aim And Objectives for the year ended 31 March 2005

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:

	2004-05			2003-04		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
Objective 1: Achieving success in the tasks we undertake	3,725,324	(335,767)	3,389,557	3,818,272	(336,995)	3,481,277
Objective 2: Being ready to respond to the tasks that might arise	25,950,299	(1,016,681)	24,933,618	27,796,553	(1,019,105)	26,777,448
Objective 3: Building for the future	3,041,800	(64,359)	2,977,441	3,211,981	(56,206)	3,155,775
	<u>32,717,423</u>	<u>(1,416,807)</u>	<u>31,300,616</u>	<u>34,826,806</u>	<u>(1,412,306)</u>	<u>33,414,500</u>
Paying war pensions and allowances	1,109,522	—	1,109,522	1,116,047	—	1,116,047
Total	<u>33,826,945</u>	<u>(1,416,807)</u>	<u>32,410,138</u>	<u>35,942,853</u>	<u>(1,412,306)</u>	<u>34,530,547</u>

See additional details in Note 26.

The notes on pages 147-198 form part of these financial statements.

NOTES TO THE ACCOUNTS

1 Statement of Accounting Policies

Introduction

1.1 These financial statements have been prepared in accordance with the generic Accounts Direction issued by HM Treasury under reference DAO(GEN)01/05 on 16 February 2005 and comply with the requirements of HM Treasury's Resource Accounting Manual (RAM). In order to reflect the particular circumstances of the Department, the following exception to the RAM has been made:

The Operating Cost Statement is not segmented into programme and non-programme expenditure, as agreed with HM Treasury.

Accounting Convention

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

Basis of preparation of Departmental Resource Accounts

1.3 These financial statements comprise the consolidation of the Department, its Defence Supply Financed Agencies and those Advisory NDPBs sponsored by the Department which are not self-accounting. The Defence Agencies and the Advisory NDPBs sponsored by the Department are listed in Note 31.

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

1.5 The Department's interest in QinetiQ, a Self-Financing Public Corporation, is included in the financial statements as a fixed asset investment.

1.6 The Armed Forces Pension Scheme (AFPS) is not consolidated within these financial statements. Separate accounts are prepared by the AFPS.

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

Net Operating Costs

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

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

Fixed Assets

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

- Land (by region and type);
- Buildings – Dwellings (UK and specific overseas indices);
- Buildings – Non Dwellings (UK and specific overseas indices);
- Single Use Military Equipment – Sea Systems;
- Single Use Military Equipment – Air Systems;
- Single Use Military Equipment – Land Systems;
- Plant and Machinery;
- Transport – Fighting Equipment;
- Transport – Other;
- IT and Communications Equipment – Office Machinery and Computers; and
- IT and Communications Equipment – Communications Equipment.

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

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

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

Intangible Assets

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

1.15 Development costs are capitalised where they contribute towards defining the specification of an asset that will enter production. Development costs not capitalised are charged to Other Operating Costs. The development costs are amortised over the planned operational life of that asset type, e.g. class of ship or aircraft, on a straight-line basis. Amortisation commences when the asset type first enters operational service within the Department. If it is decided to withdraw the whole or a significant part of an asset type early, then a corresponding proportion of any remaining unamortised development costs is written off to the Operating Cost Statement along with the underlying tangible fixed assets. For the purposes of development costs, a significant withdrawal of assets is deemed to be 20% or greater of the total of the asset class.

Tangible Fixed Assets

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

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

	Category	Years
Land and Buildings	Land Buildings, permanent Buildings, temporary Leasehold	Indefinite, not depreciated Useful economic life 5 – 20 Shorter of expected life and lease period
Single Use Military Equipment (including GWMB)		Useful economic life (on a pooled basis for GWMB)
Plant, Machinery and Transport	Plant and Machinery Specialised Vehicles (includes non-fighting vessels and aircraft) Other standard vehicles	5 – 15 Useful economic life 3 – 5
IT and Communications Equipment	Computers Satellites Communications Equipment	3 – 7 Useful economic life Useful economic life
Operational Heritage Assets *		As other tangible fixed assets
Capital Spares	Items of repairable material retained for the purpose of replacing parts of an asset undergoing repair, refurbishment, maintenance, servicing, modification, enhancement or conversion.	Useful economic life (on a pooled basis, consistent within the life of the prime equipment supported)

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

Donated Assets

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

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

Impairment

1.20 The charge to the Operating Cost Statement in respect of impairment arises on the decision to sell a fixed asset and take it out of service; on transfer of a fixed asset into stock; on reduction in service potential and where the application of MHCA indices causes a downward revaluation below the historical cost and which is deemed to be permanent in nature. Impairment also includes the cost of capital spares that are embodied into a fixed asset, as part of a major refit and overhaul, but which cannot be capitalised in accordance with FRS 15. Any reversal of an impairment cost is recognised in the operating cost statement to the extent that the original charge, adjusted for subsequent depreciation, was recognised in the Operating Cost Statement. The remaining amount is recognised in the revaluation reserve.

Disposal of Tangible Fixed Assets

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

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

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

are transferred to stock at their NRA and shown under assets declared for disposal. Any write down on transfer is included in the Operating Cost Statement under Impairment.

1.24 Disposals exclude fixed assets written off and written on. These items are included within Other Movements in Notes 8 and 9.

Leased Assets

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

Private Finance Initiative (PFI) Transactions

1.26 Where the substance of the transaction is that the risks and rewards of ownership remain with the Department, the assets and liabilities are reported on the Department's Balance Sheet. Unitary charges in respect of on-balance sheet PFI deals are apportioned between reduction in the capital obligation and charges to the Operating Cost Statement for service performance and finance cost. Where the risks and rewards are transferred to the private sector the transaction is accounted for in the Operating Cost Statement through service charges in accordance with FRS 5 and Treasury Guidance.

1.27 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

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

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

Stocks and Work-in-Progress

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

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

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

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

Provisions for Liabilities and Charges

1.34 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.

1.35 Provisions are charged to the Operating Cost Statement unless they have been capitalised as part of the cost of the underlying facility where the expenditure provides access to current and future economic benefits. In such cases the capitalised provision will be depreciated as a charge to the Operating Cost Statement over the remaining estimated useful economic life of the underlying asset. All long-term provisions are discounted to current prices by use of HM Treasury's Test Discount Rate which was 3.5% (unchanged from 2003-04) for the financial year 2004-05. The discount is unwound over the remaining life of the provision and shown as an interest charge in the Operating Cost Statement.

Reserves

1.36 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.

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

Pensions

1.38 Present and past employees are mainly covered by the Civil Service Pension (CSP) arrangements for civilian personnel and the AFPS for Service personnel. There are separate scheme statements for the AFPS and CSP as a whole.

1.39 Both pension schemes are contracted out, unfunded, defined benefit pay as you go occupational pension schemes, although they are being accounted for as if they were defined contribution schemes in accordance with the HM Treasury RAM. The employer's charge is met by payment of an ASLC, which is calculated based on a percentage of pensionable pay. The ASLC represents an estimate of the cost of providing future superannuation protection for all personnel currently in pensionable employment. In addition, civilian personnel contribute 1.5% of salary to fund a widow/widower's pension if they are members of Classic and 3.5% if they are members of Premium. The Department's Balance Sheet will only include a creditor in respect of pensions to the extent that the contributions paid to the pension funds in the year fall short of the ASLC and widow/widower's pension charges due.

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

1.41 The Department operates a number of small pension schemes for civilians engaged at overseas locations. These schemes have been accounted for in accordance with the application of SSAP 24 – *Accounting for Pension Costs*, as set out in the HM Treasury RAM. Since 1 April 2003 they have been accounted for in accordance with FRS 17 – *Retirement Benefits*. Prior year's figures have not been restated as any adjustments would not be material.

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

Early Departure Costs

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

Cost of Capital Charge

1.44 A charge, reflecting the cost of capital utilised by the Department, is included in the Operating Cost Statement and credited to the General Fund. The charge is calculated using the HM Treasury standard rate for financial year 2004-05 of 3.5% (2003-04: 3.5%) in real terms on all assets less liabilities except for:

Donated assets and cash balances with the Office of HM Paymaster General (OPG), where the charge is nil.

Liabilities for the amounts to be surrendered to the Consolidated Fund and for amounts due from the Consolidated Fund, where the charge is nil.

Assets financed by grants, where the charge is nil.

Additions to heritage collections where the existing collection has not been capitalised, where the charge is nil.

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

Foreign Exchange

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

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

2 Staff Numbers and Costs

2.1 The average number of whole-time equivalent persons employed during the year was: Service 210,180 (2003-04: 213,600) and Civilian 97,540 (2003-04: 96,040). [Source: Defence Analytical Services Agency]. The Civilian total includes staff on maternity leave, career breaks and secondment to non-MoD bodies, and employed at United States Air Force bases in the United Kingdom. Comparative figures have been amended accordingly from 92,720 to 96,040.

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

	2004-05	2003-04
	£000	£000
Salaries and Wages	8,470,881	8,332,356
Social Security costs	619,673	609,865
Pension costs (see Note 2.4)	1,486,848	1,442,696
Redundancy and severance payments	418,240	50,240
	<u>10,995,642</u>	<u>10,435,157</u>
Made up of:		
Service	8,047,195	7,973,835
Civilian	2,948,447	2,461,322
	<u>10,995,642</u>	<u>10,435,157</u>

2.3 For the year ended 31 March 2005 the salary, pension entitlements and the value of any taxable benefits-in-kind for Ministers in respect of their services to the Department are detailed below and should be read in conjunction with the following notes.

Ministerial Salaries and Allowances

† The presentation below is based on payments made by the Department and thus recorded in these Accounts. In respect of Ministers in the House of Commons, Departments bear only the cost of the additional Ministerial remuneration. The salary for their services as an MP £57,485 pa with effect from 1 April 2004 (2003-04 £56,358 pa with effect from 1 April 2003), and various allowances to which they are entitled are borne centrally by the House of Commons. However, the arrangements for Ministers in the House of Lords 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 paid by the Department and is therefore shown in full in the figures below.

** Lords Ministers' Night Subsistence paid to The Lord Bach of Lutterworth was £30,353 in 2004-05 (2003-04: £27,866). These figures are included in the salary figures disclosed. No Minister received payment of the London Supplement allowance this year.

Ministers who have not attained the age of 65, and who are not re-appointed to a relevant Ministerial or other paid office within three weeks, are eligible for a severance payment. No payments were made in 2004-05 (2003-04: One).

Ministerial Pensions

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

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

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

The Cash Equivalent Transfer Value (CETV)

This is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. It is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement 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 takes account of the increase in accrued pension 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.

Benefits-in-kind for Ministers

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

Ministers:

Figures for 2004-05 in bold, 2003-04 in italics.

	Salary (as defined below)	Taxable Benefits- in-kind	Total Accrued Pension at retirement as at 31 March 2005	CETV at 31 March 2004	CETV at 31 March 2005	Real increase in CETV as funded by employer
	£000	(to nearest £100)	£000	£000	£000	£000
<i>Secretary of State for Defence:</i>						
The Right Honourable Geoffrey Hoon, MP †	70-75 <i>70-75</i>	7,300 <i>7,100</i>	5-10 <i>5-10</i>	78	93	6
<i>Minister of State for the Armed Forces:</i>						
The Right Honourable Adam Ingram MP †	35-40 <i>35-40</i>	Nil <i>Nil</i>	5-10 <i>5-10</i>	66	80	6
<i>Parliamentary Under Secretary of State and Minister for Defence Procurement:</i>						
The Lord Bach of Lutterworth † **	95-100 <i>90-95</i>	Nil <i>Nil</i>	5-10 <i>5-10</i>	78	101	12
<i>Parliamentary Under Secretary of State for Defence and Minister for Veterans:</i>						
Ivor Caplin MP †	25-30 <i>20-25</i>	Nil <i>Nil</i>	0-5 <i>0-5</i>	14	21	3

Salary includes gross salary, performance pay and allowances paid.

Defence Management Board:

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

Figures for 2004-05 in bold, 2003-04 in italics.

	Salary (as defined below)	Taxable Benefits- in-kind (to nearest £100)	Accrued Pension at retirement as 31 March 2005	CETV at 31 March 2004	CETV at 31 March 2005	Real increase in CETV
	£000	£100	£000	£000	£000	£000
<i>Permanent Under Secretary of State</i> Sir Kevin Tebbit KCB CMG	170-175 <i>165-170</i>	32,600 <i>33,000</i>	Pension 70-75 Lump sum 210-215	1,223	1,285	(5)
<i>Chief of the Defence Staff</i> General Sir Michael Walker GCB CMG CBE ADC Gen	185-190 <i>165-170</i>	33,400 <i>27,900</i>	Pension 90-95 Lump sum 280-285	1,487	1,533	33
<i>First Sea Lord and Chief of the Naval Staff</i> Admiral Sir Alan West GCB DSC ADC	135-140 <i>125-130</i>	22,100 <i>21,300</i>	Pension 65-70 Lump sum 200-205	1,287	1,331	45
<i>Chief of the General Staff</i> General Sir Mike Jackson GCB CBE DSO ADC Gen	150-155 <i>135-140</i>	22,500 <i>22,200</i>	Pension 70-75 Lump sum 210-215	1,104	1,134	26
<i>Chief of the Air Staff</i> Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF	135-140 <i>85-90</i>	22,300 <i>14,800</i>	Pension 65-70 Lump sum 200-205	1,254	1,382	130
<i>Vice Chief of the Defence Staff</i> Air Chief Marshal Sir Anthony Bagnall KCB OBE ADC FRAeS RAF	140-145 <i>130-135</i>	24,800 <i>22,900</i>	Pension 70-75 Lump sum 210-215	1,255	1,188	28
<i>Second Permanent Under Secretary of State</i> Ian Andrews CBE TD	130-135 <i>125-130</i>	29,000 <i>28,300</i>	Pension 40-45 Lump sum 115-120	641	686	Nil
<i>Chief of Defence Procurement</i> Sir Peter Spencer KCB	125-130 <i>105-110</i>	31,100 <i>29,000</i>	Pension 0-5	26	56	26
<i>Chief of Defence Logistics</i> Air Chief Marshal Sir Malcolm Pledger KCB OBE AFC BSc FRAeS RAF (Until 31 December 2004)	95-100 <i>125-130</i>	Nil <i>Nil</i>	Pension 65-70 Lump sum 195-200	1,278	1,295	27
General Sir Kevin O'Donoghue KCB CBE (From 1 January 2005)	30-35 <i>Nil</i>	Nil <i>Nil</i>	Pension 70-75 Lump sum 210-215	1,378**	1,378	-10
<i>Chief Scientific Adviser</i> Professor Sir Keith O'Nions FRS (Until 9 July 2004)	35-40 <i>145-150</i>	6,900 <i>25,700</i>	Pension 40-45 Lump sum 120-125	723	746	6
Professor Roy Anderson FRS (From 1 October 2004)	60-65 <i>Nil</i>	10,900 <i>Nil</i>	N/A	N/A	15	N/A

	Salary (as defined below) £000	Taxable Benefits- in-kind (to nearest £100)	Accrued Pension at retirement as 31 March 2005 £000	CETV at 31 March 2004 £000	CETV at 31 March 2005 £000	Real increase in CETV £000
<i>Finance Director</i> Trevor Woolley (From 24 June 2004)	80-85* <i>Nil</i>	Nil <i>Nil</i>	Pension 40-45 Lump sum 120-125	510‡	581	31
<i>Non-executive member of the DMB</i> Charles Miller Smith (Chairman of Scottish Power)	25-30 25-30 <i>Fees</i>					
<i>Non-executive member of the DMB and Chair of the Defence Audit Committee</i> Philippa Foster Back † (Director of the Institute of Business Ethics)	25-30 35-40 <i>Fees</i>					

The CETV values for 31 March 2004 have been updated since the 2003-04 Annual Report and Accounts.

† Mrs Foster Back's fees are £25,000 per annum. Fees for 2003-04 include an increase payable from July 2002.

* The Finance Director was appointed to the Board on 24 June 2004.

** At 31 December 2004.

‡ At 24 June 2004.

Salary includes gross salary, performance pay and allowances paid.

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

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

Pensions

2.4 The CSP scheme is an unfunded multi-employer defined benefit scheme but the Ministry of Defence is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out at 31 March 2003 for the CSP. Details can be found in the resource accounts of the scheme which are published and laid before the House of Commons. The CSP accounts are also available on the web at www.civilservice-pensions.gov.uk.

For 2004-05, employers' contributions of £240,854,000 in respect of civilian staff were payable to the Office of the Paymaster General (OPG) (2003-04: £218,459,000) at one of the four rates in the range of 12 /18.5 per cent of pensionable pay, based on salary bands. Rates will remain the same for the next year, subject to revalorisation of the salary bands. Employer contributions to the PCSPS are to be reviewed every four years following a full scheme valuation by the Government Actuary.

For Service personnel, employers' contributions of £1,245,994,000 (2003-04: £1,224,237,000) were also made to the AFPS based on rates determined by the Government Actuary. The applicable rates were 33.8% of pensionable pay for officers and 18.2% for other ranks.

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

2.5 Certain other employees are covered by other schemes such as the NHS Superannuation Scheme and the Teachers' Superannuation Scheme. Contributions to these schemes in 2004-05 are included within the amount of £240,854,000 shown in Note 2.4 above.

Cash Equivalent Transfer Values

2.6 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 CETV figures, and from 2003-04 the other pension details, include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the CSP arrangements and for which the Civil Service Pension Scheme has received a transfer payment commensurate to the additional pension liabilities being assumed. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost. CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries. The calculations involve the application to projected pension values of a number of factors, including related to market conditions, which change with individuals' ages, particularly near retirement.

Real increase in CETV

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

3 Other Operating Costs

	2004-05	2003-04
	£000	£000
Operating expenditure:		
– Fuel	181,373	161,329
– Stock consumption	1,136,329	1,059,775
– Surplus arising on disposal of stock (net)	(25,214)	(29,456)
– Provisions to reduce stocks to net realisable value	227,498	(72,345)
– Stocks written off (net)	703,558	528,120
– Movements: includes personnel travelling, subsistence/relocation costs and movement of stores and equipment	422,769	491,226
– Utilities	241,111	220,327
– Property management	1,509,085	1,393,283
– Hospitality and entertainment	6,450	7,991
– Accommodation charges	340,113	422,888
– Equipment support costs	3,623,327	3,804,132
– Increase/(Decrease) in nuclear and other decommissioning provisions (note 17)	(211,238)	154,509
– IT and telecommunications	678,250	737,717
– Professional fees	565,138	549,048
– Other expenditure	2,148,897	2,032,368
– Research expenditure and expensed development expenditure	996,421	1,011,213
Depreciation and amortisation:		
– Intangible assets (Note 8)	1,023,665	902,707
– Tangible owned fixed assets (Note 9)	5,128,204	4,838,283
– Donated assets depreciation – release of reserve	(49,473)	(46,625)
– Tangible fixed assets held under finance leases (Note 9)	3,660	24,993
Impairment on fixed assets (Notes 8 & 9)		
– Arising on Quinquennial valuation (net of reversal of impairments of £349M)	110,000	—
– Arising on Other items **	(335,339)	299,010
Impairment – donated assets release of reserve	(12,835)	(1)
(Surplus) arising on disposal of tangible and intangible fixed assets		
– Tangible and Intangible fixed assets	(52,079)	(68,676)
– Donated assets – release of reserve	(1,541)	(3,049)
Fixed assets written off/(written on) – net	(85,648)	26,017
Capital project expenditure written off	25,851	268,310
Bad debts written off	(5,411)	27,491
Increase in bad debts provision	920	(2,939)
Rentals paid under operating leases	228,515	214,328
Auditors' remuneration – audit work only *	3,300	3,150
Grants-in-Aid	63,079	54,790
Exchange differences on foreign currencies: net deficit/(surplus)	14,728	(622)
War Pensions and Allowances	1,096,727	1,117,635
Total Other Operating Costs	19,700,190	20,126,927

Note:

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

** Figure for 2004-05 includes some £520M of capital spares coming into the supply system, mainly from the cannibalisation of Tornado and Harrier aircraft, previously impaired.

4 Analysis of income payable to the Consolidated Fund

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

	2004-05 Forecast		2004-05 Outturn	
	Income £000	Receipts £000	Income £000	Receipts £000
Operating income and receipts – excess A-in-A	—	—	215,889	215,889
Non operating income and receipts – excess A-in-A	—	—	153,207	53,207
Subtotal	—	—	369,096	269,096
Other operating income and receipts not classified as A-in-A	—	—	14,516	14,516
Other non-operating income and receipts not classified as A-in-A	—	—	—	—
Other amounts collectable on behalf of the Consolidated Fund	—	—	—	—
	—	—	383,612	283,612

5 Operating Income

	2004-05 £000	2003-04 £000
External customers		
Rental Income – property	54,618	54,717
Other	1,142,142	1,171,897
Other Government Departments, Trading Funds and QinetiQ		
Rental income – property	2,680	4,974
Dividends received from Trading Funds (Note 10)	28,387	8,902
Other	188,980	171,816
	1,416,807	1,412,306
Of which:		
Appropriations-in-Aid	1,402,595	1,378,937
CFER – Payable to the Consolidated Fund	14,212	33,369
	1,416,807	1,412,306
Appropriation-in-Aid shown on Schedule 1 is the lower of the amounts shown in the Estimate and the Outturn:		
Outturn:		
– Operating Income (see above)	1,402,595	1,378,937
Included in other operating costs:		
– Refunds of formula based VAT recovery	71,603	46,766
– Foreign exchange gains	—	37,435
	1,474,198	1,463,138
Estimate:		
Appropriation-in-Aid as shown in the Spring Supplementary Estimate:	1,258,309	1,377,823
Excess Appropriation-in-Aid payable to the Consolidated Fund as CFERs	215,889	85,315

6 Net Interest Payable

	2004-05	2003-04
	£000	£000
Interest receivable:*		
– Bank interest	(18,529)	(20,006)
– Loans to Trading Funds	(5,523)	(6,637)
– Loan to a Self Financing Public Corporation – QinetiQ	(1,109)	(1,346)
– Other interest receivable	(2)	(137)
	(25,163)	(28,126)
Interest payable:		
– Bank interest	25	164
– Loan interest	3,417	3,536
– Unwinding of discount on provision for liabilities and charges (Note 17)	289,956	2,609,205
– Finance leases and PFI contracts	5,164	26,264
– Late payment of Commercial debts	—	—
	298,562	2,639,169
Net interest payable	273,399	2,611,043

* Interest receivable of which payable to Consolidated fund of £304,000.

7 Reconciliation of Net Operating Cost to Control Total and Net Resource Outturn

	2004-05	2003-04
	£000	£000
Net operating cost (Schedule 2)	32,410,138	34,530,547
– Add income scored as Consolidated Fund Extra Receipts and included in operating income and interest (inc. excess operating Appropriation-in-Aid) (Note 4)	230,405	120,679
Net resource Outturn	32,640,543	34,651,226

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

8 Intangible Assets

	Single Use Military Equipment	Others	Total
	£000	£000	£000
Cost or Valuation			
At 1 April 2004	20,933,708	3,991,110	24,924,818
Additions	1,561,224	18,660	1,579,884
Impairment	(2,446)	(8,104)	(10,550)
Revaluations	589,037	7,235	596,272
Other movements	4,911,391	(3,559,935)	1,351,456
At 31 March 2005	<u>27,992,914</u>	<u>448,966</u>	<u>28,441,880</u>
Amortisation			
At 1 April 2004	(4,568,373)	(169,702)	(4,738,075)
Charged in Year	(998,276)	(25,389)	(1,023,665)
Impairment	(253)	2,884	2,631
Revaluations	(115,607)	(1,479)	(117,086)
Other movements	(31,349)	113,487	82,138
At 31 March 2005	<u>(5,713,858)</u>	<u>(80,199)</u>	<u>(5,794,057)</u>
Net Book Value:			
At 31 March 2005	<u>22,279,056</u>	<u>368,767</u>	<u>22,647,823</u>
At 1 April 2004	<u>16,365,335</u>	<u>3,821,408</u>	<u>20,186,743</u>

Note:

- i) Intangible asset valuations are based on the actual costs incurred over time, where available, or derived by applying a ratio to the tangible fixed asset valuations based on the historical relationship between development and production costs. The intangible asset valuations were indexed using the appropriate Gross Domestic Product (GDP) deflator to determine the opening balance sheet valuation;
- ii) Intangible assets include development expenditure in respect of fixed assets in use and assets under construction where the first delivery into operational use of the asset type has taken place;
- iii) Additions on intangible and tangible fixed assets (Note 9) include accruals amounting in total to £2,246,205,000 (2003-04: £2,204,303,000); and
- iv) Other movements comprise reclassifications to tangible fixed assets and transfers to operating costs.

9 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
Cost or Valuation									
At 1 April 2004 (Restated)	2,049,604	14,457,359	58,346,879	7,840,074	3,975,618	1,229,336	12,599,701	577,509	101,076,080
Additions	7,617	381,801	434,349	123,990	72,680	134,466	3,789,444	545,148	5,489,495
Capitalised provisions	—	20,887	2,050	—	—	—	—	—	22,937
Donations	—	1,906	—	205	—	—	—	—	2,111
Impairment	50,511	(273,778)	864,164	(46,192)	501	(65,604)	(10,315)	(1,578)	517,709
Disposals	(5,531)	(290,817)	(758,828)	(59,631)	(5,599)	(47)	—	—	(1,120,453)
Revaluations	336,489	3,519,357	1,200,163	(28,685)	(223,732)	25,941	216,285	5,917	5,051,735
Other movements	400,269	(183,117)	(1,945,583)	(1,386,629)	4,731,821	143,435	(4,879,640)	(385,280)	(3,504,724)
At 31 March 2005	<u>2,838,959</u>	<u>17,633,598</u>	<u>58,143,194</u>	<u>6,443,132</u>	<u>8,551,289</u>	<u>1,467,527</u>	<u>11,715,475</u>	<u>741,716</u>	<u>107,534,890</u>
Depreciation									
At 1 April 2004 (Restated)	(208,867)	(998,337)	(26,995,079)	(4,193,193)	(1,609,954)	(333,393)	—	—	(34,338,823)
Charged in year	(51,806)	(549,374)	(3,590,135)	(317,146)	(430,380)	(193,023)	—	—	(5,131,864)
Impairment	(13,969)	(16,965)	(239,754)	(17,770)	325	3,682	—	—	(284,451)
Disposals	2,664	32,244	713,716	53,777	3,181	38	—	—	805,620
Revaluations	(78,250)	(529,769)	(452,699)	112,672	205,759	(27,861)	—	—	(770,148)
Other movements	1,807	60,475	2,985,690	1,393,052	(2,737,760)	116,106	—	—	1,819,370
At 31 March 2005	<u>(348,421)</u>	<u>(2,001,726)</u>	<u>(27,578,261)</u>	<u>(2,968,608)</u>	<u>(4,568,829)</u>	<u>(434,451)</u>	<u>—</u>	<u>—</u>	<u>(37,900,296)</u>
Net Book Value:									
At 31 March 2005	<u>2,490,538</u>	<u>15,631,872</u>	<u>30,564,933</u>	<u>3,474,524</u>	<u>3,982,460</u>	<u>1,033,076</u>	<u>11,715,475</u>	<u>741,716</u>	<u>69,634,594</u>
At 1 April 2004 (Restated)	<u>1,840,737</u>	<u>13,459,022</u>	<u>31,351,800</u>	<u>3,646,881</u>	<u>2,365,664</u>	<u>895,943</u>	<u>12,599,701</u>	<u>577,509</u>	<u>66,737,257</u>

Note:

- i) Additions on intangible assets (note 8) and tangible fixed assets include accruals amounting in total to £2,246,205,000 (2003-04: £2,204,303,000);
- ii) Other movements comprise reclassifications between tangible fixed asset categories, intangible assets, assets under construction, stock and transfers to operating costs; and
- iii) Fixed Assets as at 31 March 2005 include capitalised provisions at cost of £245,382,000 (2003-2004: £222,519,000).

9.1 The net book value of tangible fixed assets by each major class of asset includes an amount of £660,800,000 (2003-04 £329,852,000) in respect of assets held under finance leases and PFI contracts. Detail by asset category is as follows:

	Dwellings £000	Other Land and Buildings £000	Plant and Machinery £000	Fighting equipment transport £000	Other Transport £000	IT and Comms equipment £000	Total £000
Gross Cost:							
At 31 March 2005	28,204	450,358	95,915	51,814	47,907	62,792	736,990
At 1 April 2004 (restated)	4,040	98,564	45,665	130,804	41,598	64,797	385,468
Accumulated Depreciation:							
At 31 March 2005	4,382	11,324	4,388	44,716	3,867	7,865	76,542
At 1 April 2004 (restated)	—	8,046	4,794	42,377	176	223	55,616

9.2 Restatement of Fixed Assets at 1 April 2004

	Net Book Value 1 April 2004 £000	Reclassification £000	Restated 1 April 2004 £000
Land & Buildings	15,299,759	(15,299,759)	—
Dwellings		1,840,737	1,840,737
Other Land and Buildings		13,459,022	13,459,022
Fighting Equipment	27,156,996	(27,156,996)	—
Single Use Military Equipment (SUME)		31,351,800	31,351,800
Plant, Machinery & Vehicles	3,453,060	(3,453,060)	—
Plant and Machinery		3,646,881	3,646,881
Transport		2,365,664	2,365,664
IT & Comms Equipment	895,943	—	895,943
Capital Spares	6,754,289	(6,754,289)	—
Assets Under Construction	13,177,210	(13,177,210)	—
Assets Under Construction (SUME)		13,346,377	13,346,377
Assets Under Construction (Other)		(169,167)	(169,167)
	<u>66,737,257</u>	<u>—</u>	<u>66,737,257</u>

9.3 Capital Spares movement in Fixed Assets

	SUME £000	Transport £000	Plant & Machinery £000	Total £000
Cost or Valuation At 1 April 2004	18,294,289	29,960	485,127	18,809,376
Additions	407,243	37,158	13,274	457,675
Impairment	769,954	(344)	(9)	769,601
Disposals	(692,389)	—	(6,065)	(698,454)
Revaluations	404,809	1,743	3	406,555
Other	(193,141)	320,783	(55,290)	72,352
At 31 March 2005	18,990,765	389,300	437,040	19,817,105
Depreciation: At 1 April 2004	(11,747,617)	(7,049)	(300,421)	(12,055,087)
Charged in year	(1,127,753)	(23,558)	(21,458)	(1,172,769)
Impairment	(253,257)	—	174	(253,083)
Disposals	690,278	—	—	690,278
Revaluations	(252,222)	—	(2,040)	(254,262)
Other	425,956	(163,881)	1,409	263,484
At 31 March 2005	(12,264,615)	(194,488)	(322,336)	(12,781,439)
Net Book Value At 31 March 2005	6,726,150	194,812	114,704	7,035,666
At 1 April 2004	6,546,672	22,911	184,706	6,754,289

Note:

In previous years, Capital Spares were shown as a separate category in the Tangible Fixed Assets Table. From 1 April 2004, capital spares have been reclassified to comply with HM Treasury's RAM, and are now included within the various categories shown in the top Table above. However, in order to maintain comparability with figures for prior years, movements on capital spares are disclosed separately in the table shown above.

9.4 Analysis of Land and Buildings:

	Freehold £000	Long lease £000	Short lease £000	Beneficial Use* £000	Total £000
Net Book Value: At 31 March 2005	16,665,120	248,469	50,232	2,001,336	18,965,157
At 1 April 2004 (restated)	13,895,883	261,029	70,985	1,704,157	15,932,054

The net book values at 31 March 2005 and 1 April 2004 include assets under construction of £842,748,000 and £632,295,000 respectively

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

9.5 2004 – 05 Quinquennial Revaluation

- i) All categories of fixed assets, except Intangibles, Assets under Construction and Capital Spares, are subject to a quinquennial revaluation, which is being conducted on a rolling basis and is due to complete by 31 March 2007. During 2004-05 as the first part of this programme, 50% of land and buildings were re-valued by three external organisations: the Valuation Office Agency who dealt with the UK estate; Atisreal (previously known as Weatheralls) who valued the first tranche of the overseas estate with the remainder being assigned to GVA Grimley. 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.
- ii) The remaining 50% of land and buildings were re-valued by qualified Defence Estates (DE) staff using an uplift factor that took account of designated use and known regional market trends. In addition, surplus land and buildings were valued internally by DE on the basis of market value. The effective date of all re-valuations was 1 April 2005, but the impact of the revaluations has been reflected in these accounts by way of an adjusting post Balance Sheet event.
- iii) A small percentage of plant and machinery was professionally re-valued on a depreciated replacement cost basis in 2004-05 by the Valuation Office Agency valuers: the net increase in net book value from these valuations (£125M) is reflected in these accounts. Impairments of £57M have been charged to the Operating Cost Statement and reversals of impairments of £2M credited to the Operating Cost Statement.
- iv) The net increase on the Land and Buildings carrying value was £2,821M. Impairments charged to the Operating Cost Statement were £402M. Impairments that originated in the 2002-03 quinquennial review of asset values have been reversed through the Operating Cost Statement in 2004-05 to the sum of £347M.

10 Investments

	Public Dividend Capital £000	Trading Funds Loans £000	Other Investments £000	QinetiQ £000	Total £000
At 1 April 2004	184,254	112,577	1	124,006	420,838
Movements during year:					
Redemption of shares				(48,543)	(48,543)
Repayment of Loans					
– DARA		(21,640)			(21,640)
– UK Hydro Office		(329)			(329)
– DSTL		(1,064)			(1,064)
– ABRO		(2,154)			(2,154)
At 31 March 2005	184,254	87,390	1	75,463	347,108
At 1 April 2004	184,254	112,577	1	124,006	420,838

Public Dividend Capital and Loans at 31 March 2005 were held in the following Trading Funds:

	Public Dividend Capital	Loans	Interest Rate
	£000	£000	% p.a.
DSTL	50,412	—	8.375
Met Office	58,867	—	—
The UK Hydrographic Office	13,267	11,350	8.375
DARA	42,303	50,190	4.882
ABRO	19,405	25,850	5.375 - 5.625
	184,254	87,390	

Analysis of loans repayable by instalments:

	Due within one year	Due after one year	Total
	£000	£000	£000
The UK Hydrographic Office	300	11,050	11,350
DARA	4,840	45,350	50,190
ABRO	2,154	23,696	25,850
	7,294	80,096	87,390

At 31 March 2005, the loan made to QinetiQ Group Limited, a subsidiary undertaking of QinetiQ, amounted to £45,886,000 (31 March 2004: £45,886,000) and the book value of investment in QinetiQ amounted to £29,577,000. The loan note is repayable from the net proceeds of disposals of certain identified assets. The loan note was interest free until 30 June 2003. Interest has been charged at rates relating to LIBOR until 28 August 2004, thereafter the loan has been interest-free.

As at 31 March 2005, the loans repaid by QinetiQ and subsidiary undertakings, representing the partial original asset value of the business since its formation on 1 July 2001, amounted in total to £104,114,000 (2003-04: £104,114,000). The cash received on the part disposal of the shares to The Carlyle Group during 2002-03 amounted to £39,427,000 and cash received on the partial redemption of the Redeemable Preference Shares during 2004-05 amounted to £48,542,000.

10.1 Other Investments:

Investments, including “Golden” shares, were held in the following at 31 March 2005 and 31 March 2004:

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

Preferential “Golden” Shares at £1 each	
Devonport Royal Dockyard Limited	1 Share
Rosyth Royal Dockyard Limited	1 Share
Atomic Weapons Establishment plc	1 Share
Atomic Weapons Establishment Pension Trustees Limited	1 Share
QinetiQ Group plc	1 Share
QinetiQ Limited	1 Share
BAE Systems Marine (Holdings) Ltd (formerly VSEL Limited)	1 Share

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

Shareholding in QinetiQ

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

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

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

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

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

Dividend and Voting rights as per “A” Ordinary shares.

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

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

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

Redeemable Cumulative Preference (21,765,524 shares of £1 each – 58% of class)

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

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

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

In June 2004, the Department received £48,542,475 on the partial redemption of some of these shares at its nominal value of £1 and a dividend up to the date of redemption of £5,759,382.

Special Rights Redeemable of £1 each – the one “Special Share”, which is held by MoD

The Special Shareholder has the right to require the Company to implement and maintain a regime which protects the defence and security interests of the nation.

Voting Rights – The Special Shareholder must receive notice of, and may attend and speak at general company and share class meetings, but carries no voting rights, except to enforce certain aspects of the compliance regime.

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

The Preferential “Golden” Shareholder has the right to require the Company to implement and maintain a regime which protects the defence and security interests of the nation.

Voting Rights – The Special Shareholder must receive notice of, and may attend and speak at general company and share class meetings, but carries no voting rights, except to enforce certain aspects of the compliance regime.

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

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

10.2 Net assets

The reported net assets, after deducting loans due to MoD, of the investments held at 31 March 2005 and 31 March 2004 were:

	31 March 2005	31 March 2004
	£million	£million
The UK Hydrographic Office	43.2	48.7
The Met Office	175.8	167.8
Defence Aviation Repair Agency (DARA)	76.9	67.2
Defence Science and Technology Laboratory (Dstl)	198.9	176.5
QinetiQ	214.1	225.2
Army Base Repair Organisation (ABRO)	53.5	57.3
Total	762.4	742.7

During the year, dividends were received from Dstl of £3,000,000 (2003-04: £6,000,000), The Hydrographic Office of £19,627,477 (2003-04: £2,902,359) and QinetiQ of £5,759,382 (2003-04: nil) in respect of the year ended 31 March 2004. These are included within operating income. No dividend was received from The Met Office, Defence Aviation Repair Agency and ABRO.

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

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

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

Company	Registration Number
Devonport Royal Dockyard Limited, Devonport Royal Dockyard, Devonport, Plymouth PL1 4SG	02077752
Rosyth Royal Dockyard Limited, Rosyth Royal Dockyard, Rosyth, Fife KY11 2YD	SC101959
Atomic Weapons Establishment plc, AWE Aldermaston, Reading, Berkshire RG7 4PR	02763902
Atomic Weapons Establishment Pension Trustees Limited, AWE Aldermaston, Reading, Berkshire RG7 4PR	02784144
QinetiQ Group PLC, 85 Buckingham Gate, London SW1E 6PD	4154556
QinetiQ Limited, 85 Buckingham Gate, London SW1E 6PD	3796233
BAe Systems Marine (Holdings) Limited, Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hants, EU14 6YU	1470151

11 Related Party Transactions

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

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

Fleet Air Arm Museum

Grant-in-Aid: £564,448 (2003-2004: £550,323)

Commodore Naval Aviation (Deputy Chairman), Commanding Officer HMS Heron (RNAS Yeovilton), Commanding Officer HMS Seahawk (RNAS Culdrose), Director Logistics (Rotary Wing), and Assistant Director Joint Manoeuvre, Director of joint Capability are members of the Board of Trustees.

National Army Museum

Grant-in-Aid: £5,151,170 (2003-2004: £4,413,460)

No Departmental representation.

Royal Air Force Museum

Grant-in-Aid: £7,026,895 (2003-2004: £6,810,815)

No Departmental representation.

Royal Marines Museum

Grant-in-Aid: £704,839 (2003-2004: £688,061)

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

Royal Naval Museum

Grant-in-Aid: £1,143,901 (2003-2004: £962,120)

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

Royal Navy Submarine Museum

Grant-in-Aid: £649,314 (2003-2004: £509,332)

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

Oil and Pipelines Agency

Agency Fees: £1,625,000 (2003-2004: £1,600,000)

VAT recovery £284,375 (2003-2004: £280,000).

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

Other

Ian Andrews CBE TD, Second Permanent Under Secretary of State, is a trustee of the Imperial War Museum. Mr Charles Miller Smith is Chairman of Scottish Power. These entities are therefore related parties of the Ministry of Defence.

The payments made to these entities were:

		£000
Imperial War Museum	Various transactions-Payments	16
	Various transactions-Receipts	10
Scottish Power	Various transactions-Payments	1,731

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

Note:

- i) The Department also pays a number of grants to other bodies outside the Departmental Boundary. These include Grants-in-Aid to the Royal Hospital Chelsea and the Commonwealth War Graves Commission; and
- ii) The museums are designated NDPBs under the National Heritage Act 1983. Each NDPB is required to produce annual accounts in accordance with the Charities (Accounts and Reports) Regulations 1995 (Statutory Instrument 1995 No. 2724). The Oil and Pipelines Agency is a corporate body established under the Oil and Pipelines Act 1985.

Joint Ventures

11.2 The Department does not have any Joint Ventures.

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

12 Stocks and Work in Progress

	31 March 2005	31 March 2004
	£000	£000
Work in progress	28,861	60,058
Raw materials and consumables	6,064,180	6,255,211
Assets declared for disposal	2,322	2,955
	<u>6,095,363</u>	<u>6,318,224</u>

13 Debtors

	31 March 2005	31 March 2004
	£000	£000
Amounts falling due within one year		
Trade debtors	142,708	133,695
Deposits and advances	53,186	39,437
Value Added Tax	277,354	244,920
Amounts owed by other Government Departments	59,788	68,252
Amounts owed by Local Authorities	2,375	—
Amounts owed by National Health Trusts	10,136	—
Amounts owed by entities in which the Department has a participating interest	38,637	7,446
Other debtors	220,348	209,570
Prepayments and accrued income	809,263	1,224,380
	1,613,795	1,927,700
Amounts falling due after one year		
Trade debtors	7,235	50,254
Other debtors	96,949	88,948
Prepayments and accrued income	1,092,105	608,457
Amounts owed by other Government Departments	60,514	—
Amounts owed by entities in which the Department has a participating interest	301	60
	1,257,104	747,719
Total Debtors	2,870,899	2,675,419

Note:

- i) Other debtors include loans for house purchase and other loans made to staff amounting to £85,299,668 (2003-04: £91,317,714). The number of staff with house purchase loans was 12,558 (2003-04: 13,927); and
- ii) Prepayments falling due after one year include an amount of £358M 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. In 2003-04, the amount was shown under amounts falling due within one year.

14 Cash at Bank and in Hand

	31 March 2005	31 March 2004
	£000	£000
At 1 April	312,564	415,928
Net Cash Inflow/(Outflow):		
Received from Consolidated Fund	29,497,000	29,257,550
Utilised	(29,371,153)	(29,360,914)
Increase/(decrease) during year	125,847	(103,364)
At 31 March	438,411	312,564
Represented by:		
Balances at the OPG	277,775	279,166
Commercial Banks and Cash in Hand	160,636	33,398
	438,411	312,564
The balance at 31 March comprises:		
Consolidated Fund Extra Receipts received during the year and due to be paid to the Consolidated Fund (Note 15)	369,096	222,659
Amounts due from the Consolidated Fund for supply	(127,275)	(80,095)
Net amount due to the Consolidated Fund	241,821	142,564
Amounts held in respect of Collaborative Projects (see note below)	196,590	170,000
Total	438,411	312,564

Note:

The cash at bank balance includes £196,590,000 (2003-04: £170,000,000) of sums advanced by foreign governments to the Department on various collaborative projects where the United Kingdom is the host nation. Advances made by foreign governments for the procurement of defence equipment on their behalf are also included in this amount. The corresponding liability for these advances is shown under creditors due within one year.

15 Creditors: amounts falling due within one year

	31 March 2005	31 March 2004
	£000	£000
Trade creditors	688,539	472,930
Payments received on account	22,115	7,979
Other taxation and social security	215,375	203,939
Other creditors	344,645	357,592
Accruals and deferred income	4,223,012	4,216,352
Obligations under finance leases	4,914	4,853
Obligations under PFI contracts	16,409	10,418
Payable to the Consolidated Fund	241,821	142,564
Amounts owed to other Government Departments	14,144	5,281
Amounts owed to Local Authorities	1,216	—
Amounts owed to National Health Trusts	14,485	—
Amounts owed to entities in which the Department has a participating interest	287,243	239,091
Loans	1,695	1,599
Total creditors due within one year	6,075,613	5,662,598

Note:

Amounts payable to the Consolidated Fund comprise:

	31 March 2005	31 March 2004
	£000	£000
CFERs received during the year	—	19
Excess Operating Appropriation-in-Aid	215,889	85,315
Excess Non-Operating Appropriation-in-Aid	153,207	137,325
	369,096	222,659
Amount in respect of supply to be set off against CFER liability (Note iii)	(127,275)	(80,095)
Net amount payable to Consolidated Fund	241,821	142,564

Note:

- i) Loans are from the National Loans Fund in respect of the Armed Forces Housing Loans. These are fully repayable between years 2012 and 2028, with the last instalment due on 20 February 2028. Interest on the loans is payable at rates ranging from 4.25% to 7% per annum.
- ii) Included in other creditors are amounts advanced by foreign governments to the Department in respect of various collaborative projects where the United Kingdom is the host nation and for the procurement of defence equipment on their behalf of £196,590,000 (2003-04 – £170,000,000).
- iii) The amount comprises amounts drawn down from the Consolidated Fund of £29,497,000,000 less Net Cash Requirement (Schedule 1) of £29,624,275,000.

16 Creditors: amounts falling due after more than one year

	2004-05	2003-04
	£000	£000
Other creditors	96,942	96,897
Accruals and deferred income	558	2,655
Obligations under finance lease:		
– Amounts payable between one and two years	4,771	5,372
– Amounts payable between two and five years	3,248	8,413
– Amounts payable over five years	2,488	6,528
Obligations under PFI contracts:		
– Amounts payable between one and two years	25,175	16,884
– Amounts payable between two and five years	44,953	43,837
– Amounts payable over five years	581,629	219,215
Amounts owed to entities in which the Department has a participating interest	—	21
Loans:		
– Amounts payable between one and two years	1,797	2,527
– Amounts payable between two and five years	6,064	8,500
– Amounts payable over five years	42,271	40,800
Total creditors due after more than one year:	809,896	451,649

17 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 2004	7,818,769	184,904	310,947	1,075,070	9,389,690
Increase in Provision	202,539	8,943	248,878	349,162	809,522
Unwinding of discounting	265,591	2,509	3,682	18,174	289,956
Amounts released	(415,752)	(6,968)	(6,858)	(56,709)	(486,287)
Reclassifications	—	(72,337)	—	72,686	349
Amounts capitalised	22,937	—	—	—	22,937
Utilised in year	(282,919)	(6,168)	(89,027)	(144,845)	(522,959)
At 31 March 2005	7,611,165	110,883	467,622	1,313,538	9,503,208

Analysis of amount charged / (credited) to Operating Cost Statement	2004-05	2003-04
	£000	£000
Charged/(credited) to:		
Property management	6,066	—
Staff costs	407,621	40,379
Nuclear and Other Decommissioning provisions	(211,238)	154,509
War Pensions and Allowances	(10,355)	866
Other costs	131,141	228,947
Net interest (receivable)/payable	289,956	2,609,205
	613,191	3,033,906
Made up of:		
Increase	809,522	490,111
Release	(486,287)	(65,410)
	323,235	424,701
Unwinding of discount *	289,956	2,609,205
Net increase in provisions	613,191	3,033,906

* The 2003-04 charge for the unwinding of discount was higher due to the change in discount factor from 6% to 3.5% in that year.

Nuclear Decommissioning

17.1 Nuclear decommissioning provisions relate principally to the cost of facility decommissioning and the treatment and storage of nuclear waste arising at British Nuclear Fuel plc (BNFL) sites, operations at United Kingdom Atomic Energy Authority (UKAEA) sites, 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.

17.2 On 1 April 2005, the Nuclear Decommissioning Authority (NDA), a newly formed organisation which sits within the Department of Trade and Industry, took over the responsibility for certain nuclear clean up issues. As a result, the MoD liabilities at 1 April 2005 relating to civil nuclear sites and the associated value of provisions and funding for decommissioning costs were transferred to NDA. The liabilities for the decommissioning of other MoD sites, and for the disposal of submarine waste, have been retained by MoD.

Liabilities have arisen since the late 1940's and will continue well into the future as a result of ongoing production and operations associated with the manufacture and reprocessing of Special Nuclear Materials (SNM).

The majority of the liability is historic and relates to facilities used for the production of SNM by BNFL and its predecessor the UKAEA. The Atomic Weapons Establishment is the other main source of MoD's liabilities.

The liabilities include the costs associated with decommissioning and care and maintenance of redundant facilities including submarines (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 £23,149,585,000 (2003-2004: £23,387,678,000).

The estimate of £7,607,136,000 (2003-2004: £7,818,769,000) at 31 March 2005 represents the liabilities discounted at 3.5% and expressed in 2004/05 money values.

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

	31 March 2005	1 April 2004
	£Bn	£Bn
Up to 3 years	0.1	1.5
From 4 – 10 years	0.3	2.1
Beyond 10 years	7.2	4.2
Total	7.6	7.8

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

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

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

Other Decommissioning and Restoration

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

Early Retirement Pensions

17.4 Where the Department implements an early retirement scheme, provision is made for future liability payable to civilian early retirees. During the year, a provision was set up in the Central TLB of £188M for the early retirement scheme announced in 2004-05. Provisions include those arising from the "80:20

Scheme" under which 20% of the cost was borne by the Department and 80% was borne by the Civil Superannuation Vote. This scheme was terminated in 1997 and the full cost of the obligations are now payable by CSP.

Other

17.5 Other provisions include costs arising from the disposal of fixed assets; redundancy and relocation costs associated with reorganisation and restructuring (including provisions set up during the year in respect of the Adjutant General (£27M) and Personnel and RAF Training Command (£148M)); and amounts payable under guarantees, litigation and contractual arrangements. Provisions include those concerning an adjudication decision where an appeal is pending.

18 Reconciliation of Net Operating Costs to changes in General Fund

	2004-05 £000	2003-04 £000
Net Operating Cost for the Year (Sch 2)	(32,410,138)	(34,530,547)
Paid and payable to the Consolidated Fund	(256,337)	(182,125)
Parliamentary funding from the Consolidated Fund (Sch 4)	29,497,000	29,257,550
Transfer to General Fund of realised element of:		
– Revaluation reserve (Note 19)	1,094,062	1,258,804
– Donated asset reserve (Note 19)	92,799	6,794
Non-cash charges:		
– cost of capital charge (Sch 2)	2,857,714	2,769,726
– auditors' remuneration (Note 3)	3,300	3,150
Net increase in General Fund	878,400	(1,416,648)
General Fund at 1 April	64,028,508	65,445,156
General Fund at 31 March	64,906,908	64,028,508

19 Reserves

	Revaluation Reserve £000	Donated Asset Reserve £000
At 1 April 2004	15,396,444	1,722,156
Arising on revaluation during the year (net)	4,521,891	438,552
Additions during the year	—	2,112
Transfers and reclassifications	(104,763)	12,891
Transferred (to) / from Operating Cost Statement	—	(63,849)
Transferred (to) / from General Fund	(1,094,062)	(92,799)
At 31 March 2005	18,719,510	2,019,063

20 Capital Commitments

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

	31 March 2005 £000	31 March 2004 £000
Contracted but not provided for	20,446,744	15,158,637

21 Financial Commitments

Commitments under operating leases:

	Land and Buildings		Other	
	31 March 2005	31 March 2004	31 March 2005	31 March 2004
	£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	215	7,883	3,227	15,178
Between two and five years	1,121	13,733	135,909	69,413
After five years	136,490	168,517	61,016	48,596
	137,826	190,133	200,152	133,187

22 Private Finance Initiative (PFI) Commitments

22.1 The payments made during the year in respect of on and off Balance Sheet PFI transactions were £728,465,000 (2003-04: £605,139,000).

22.2 The service payments which the Department is committed to make during the year 2005-06 are analysed below by time-bands specifying the period in which the individual commitment expires:

	31 March 2005	31 March 2004
	£000	£000
In the 2 nd to 5 th years	186,883	181,324
In the 6 th to 10 th years	117,687	94,986
In the 11 th to 15 th years	132,590	49,693
In the 16 th to 20 th years	54,447	34,312
In the 21 st to 25 th years	190,569	185,566
In the 26 th to 30 th years	86,967	54,252
In the 31 st to 35 th years	28,339	1,300
In the 36 th to the 40 th years	—	30,060

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

Project Description	Capital Value* £000	Contract Start**/End Dates	
Training, Administration and Financial Management Information System : Provision of training administration and financial management information systems to the Army Training and Recruiting Agency	41,000	Aug 1996	Aug 2007
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
Electronic Messaging Service: Interoperability of messaging services for the Army	33,000	Apr 1997	Apr 2007
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 : 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 £64M relates to on-balance sheet)	92,800	Jun 1998	Aug 2028
Attack Helicopter Training Service: Provision of full mission simulator, 3 field deployable simulators, ground crew, maintenance and armament training	165,000	Jul 1998	Sep 2027
Family Quarters Yeovilton: Provision of married quarters accommodation for 88 Service families at RNAS Yeovilton	8,200	Jul 1998	Jul 2028
RAF Lyneham Sewage Treatment: Refurbishment of existing sewage treatment facilities, serving a population of 7,000, to meet regulatory standards at RAF Lyneham	3,800	Aug 1998	Aug 2023
Tidworth Water and Sewerage: Pathfinder project providing water, sewerage and surface water drainage, serving a population of 12,000 military and dependants at Tidworth.	5,000	Feb 1998	Aug 2018
RAF Mail: Provision of informal messaging services for the RAF	12,000	Nov 1998	Nov 2008
Fire Fighting Training Units: Provision of fire fighting training for the Naval Recruiting and Training Agency (NRTA)	22,500	Apr 1999	Apr 2019
Light Aircraft Flying Training: Provision of flying training and support services for Air Experience Flying 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
Army Foundation College: Provision of teaching and training facilities for the further vocational education and military training of high-quality school leavers	73,400	Feb 2000	Dec 2029
RAF Cosford/RAF Shawbury Family Quarters: Provision of married quarters accommodation for 145 Service families at RAF Cosford and RAF Shawbury	15,100	Mar 1999	Jun 2025
Central Scotland Family Quarters: Provision of married quarters accommodation for 164 Service Families in Central Scotland	24,700	Aug 1999	Jan 2021
Tri-Service Material Handling Equipment: Provision of Tri-Service materials handling capability	35,000	Jun 2000	Jun 2010
Commercial Satellite Communication Service (INMARSAT): Provision of world-wide commercial satellite communication system for Royal Navy Ships to run for five years	2,600	Mar 2001	Mar 2006
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

Project Description	Capital Value* £000	Contract Start**/End Dates	
Family quarters at Bristol / Bath / Portsmouth: Provision for married quarters accommodation for 317 service families	78,000	Nov 2001	Sep 2028
Defence Housing Executive Information Systems : Provision for a management information system for the Defence Housing Executive	11,600	Oct 2001	Sept 2010
Marine Support to Range and Aircrew Training: Provision of management, manning, operation and maintenance of Air Support Craft and Range Safety Craft	11,800	Dec 2001	Dec 2012
Astute Class Training: Provision of a training environment for crewmen and maintainers to support Astute Class submarines for 30 years	79,600	Sep 2001	Jan 2037
Strategic Sealift (RoRo): Provision of strategic sealift services based on six RoRo ferries in support of Joint Rapid Reaction Force (JRRF) deployments	175,000	Jun 2002	Dec 2024
Material Handling Equipment: Provision of tri-service material handling equipment for Army, Navy and RAF storage depots	9,000	Aug 2002	Jul 2010
Provision for storage facilities	22,000	Apr 1996	Jan 2011
Aquatrine Project A: Provision of water and waste water services	154,000	Apr 2003	Nov 2028
Aquatrine Project B: provision of water and water services	86,400	Sep 2004	Mar 2030
Aquatrine Project C: provision of water and water services	363,600	Oct 2004	Mar 2030
Hayes Records and Storage: Pan-Government Records Management and Archive Services	11,100	Sep 2003	Sep 2028
Defence Sixth Form College: Development of a sixth form college to help meet the future recruitment requirements in the Armed Forces and MoD Civil Service	20,000	Jun 2003	Aug 2033
Colchester Garrison: Redevelopment, rebuilding and refurbishment to provide accommodation and associated services (messing, education, storage, workshops)	539,000	Feb 2004	Feb 2039
Skynet 5: Range of satellite services, including management of existing Skynet 4 satellites	1,079,000	Oct 2003	Feb 2018

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

**The dates when the contracts were signed.

The following PFI projects, where service delivery has commenced, are treated as on balance sheet and their service payment commitments for the year 2004-05 are included in the table shown above: Lossiemouth FQs; RAF Fylingdales; Defence Helicopter Flying School; Defence Animal Centre; Naval Communication; Provision of storage facilities; Main Building Redevelopment, part of the Joint Services Command and Staff College, Heavy Equipment Transporter, Field Electrical Storage Facilities, Defence Electronic Commerce Services and Devonport Armada Single Living Accommodation.

Since the year ended, the Department has signed a PFI deal for the provision of 'C' Vehicles (Earthmoving and Specialist Plant, Engineering Construction Plant and Material Handling Equipment) and support.

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

23 Contingent Liabilities and Contingent Assets Disclosed under FRS 12

Contingent Liabilities

Contingent liabilities estimated at some £1,607,000,000 (2003-04: £1,127,000,000) were identified. This mainly comprised possible environmental clean-up and site restoration liabilities of some £400,000,000 (2003-04: nil) relating to the British Army Training Units in Canada, and indemnities, that are quantifiable, of £1,036,000,000 (2003-04: £852,000,000) granted to contractors and suppliers.

The Department hold 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

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

A licensing agreement was signed on 27 September 2002 between the Disposal Services Agency of the Ministry of Defence, on behalf of Her Majesty's Government and Odyssey for further archaeological exploration of the wreck of HMS Sussex and recovery of artefacts et cetera. Under the agreement the net proceeds of the sale of coins and other marketable artefacts will be shared between the two parties. Insufficient certainty exists at present as to the presence or value of any potential recovery of artefacts to quantify the contingent asset.

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

24.1 Quantifiable

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

	1 April 2004	Increase in year	Liabilities crystallised in year	Obligation expired in year	31 March 2005	Amount reported to Parliament by departmental minute
UNRESTRICTED						
Indemnities						
Residual liability for the remediation of unidentified contamination in parts of the former Rosyth Naval Base which has been sold to Rosyth 2000 plc.	Up to £1,000k				Up to £1,000k	Not Known
Termination liabilities arising out of MoD's association with the Research Council under the Joint Grants Scheme.	£17,620k	NIL	NIL	NIL	£17,620k	£17,620k
Liabilities arising from insurance risk of exhibits on loan to the Army, Navy and RAF Museums.	£1,965k	£160k (Note1)	NIL	NIL	£2,125k	
RESTRICTED						
Details on restricted liabilities not given because they are sensitive due to commercial confidentiality, national security, or where public knowledge of a guarantee could prompt claims from third parties.						

Note 1: Explanation of movement

Increase due to a new exhibit on loan to the Army, Navy and RAF Museums and reassessment of indemnities.

Reconciliation between disclosed amount and amount reported to Parliament

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

24.2 Unquantifiable

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

Unrestricted Indemnities

- Indemnity given in relation to the disposal of Gruinard Island in the event of claims arising from the outbreak of specific strains of anthrax on the Island.

- Indemnity to Devonport Royal Dockyards Ltd (DRDL) in respect of nuclear risks under the Nuclear Installations Act 1965.
- Indemnity to the Babcock Group in respect of nuclear risks under the Nuclear Installations Act 1965.
- Indemnities to DRDL and the Babcock Group in respect of non-nuclear risks resulting from claims for damage to property or death and personal injury to a third party.
- Product liability to BAE SYSTEMS in respect of work carried out by third party contractors on aircraft for which BAE are Design Authority and for which BAE, at MoD's request, provide the third party contractor with design advice and verification.

Restricted Indemnities

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

25 Post Balance Sheet Events

The Treasury standard rate used for calculating the discounting of provisions was reduced from 3.5% to 2.2% with effect from 1 April 2005. The rate for calculating the cost of capital charge remains unchanged, at 3.5%. The effect of the reduction in the Treasury rate on the operating costs for 2005-06 would be to increase the unwinding of interest charge relating to the discounted provisions.

The Department transferred the responsibility for historic liabilities relating to the cleaning and decommissioning of civil nuclear sites to the Nuclear Decommissioning Authority on 1 April 2005.

26 Notes to Schedule 5

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

Objective 1: Achieving success in the tasks we undertake

This objective comprises the following:

	Gross	2004-05	Net	Gross	2003-04	Net
	£000	Income	£000	£000	Income	£000
		£000			£000	
Operations	938,449	(268)	938,181	1,236,721	(3,566)	1,233,155
Other military tasks	1,849,803	(86,019)	1,763,784	1,733,706	(74,893)	1,658,813
Contributing to the community	457,294	(62,328)	394,966	419,977	(59,784)	360,193
Helping to build a safer world	479,778	(187,152)	292,626	427,868	(198,752)	229,116
Total	3,725,324	(335,767)	3,389,557	3,818,272	(336,995)	3,481,277

Costs are identified as follows:

- *Operations* comprises the additional costs incurred deploying the armed forces in military operations, e.g. in Iraq, over and above the costs of maintaining the units involved at their normal states of readiness;
- *Other military tasks* 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; and
- *Helping to build a safer world* includes the costs of defence diplomacy undertaken to build confidence and security with our allies. It also includes the Department's support of wider British interests.

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

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

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

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

	Gross £000	2004-05 Income £000	Net £000	Gross £000	2003-04 Income £000	Net £000
Royal Navy						
Aircraft carriers	362,268	(15,507)	346,761	299,679	(6,880)	292,799
Frigates and Destroyers	1,614,503	(66,014)	1,548,489	1,744,387	(35,195)	1,709,192
Smaller warships	509,040	(22,819)	486,221	293,095	(9,139)	283,956
Amphibious ships	348,724	(8,594)	340,130	344,496	(5,581)	338,915
Strategic sealift	40,097	(1,929)	38,168	2,691	(70)	2,621
Fleet support ships	413,254	(5,150)	408,104	360,029	(12,507)	347,522
Survey and other vessels	106,285	(3,797)	102,488	160,030	(3,249)	156,781
Naval aircraft	1,224,695	(31,763)	1,192,932	1,429,942	(37,403)	1,392,539
Submarines	2,351,571	(45,064)	2,306,507	4,904,164	(42,492)	4,861,672
Royal Marines	552,325	(12,555)	539,770	617,431	(13,078)	604,353
	<u>7,522,762</u>	<u>(213,192)</u>	<u>7,309,570</u>	<u>10,155,944</u>	<u>(165,594)</u>	<u>9,990,350</u>
Army						
Field units	7,683,884	(166,992)	7,516,892	6,585,112	(212,672)	6,372,440
Other units	1,927,205	(191,669)	1,735,536	2,519,327	(169,006)	2,350,321
	<u>9,611,089</u>	<u>(358,661)</u>	<u>9,252,428</u>	<u>9,104,439</u>	<u>(381,678)</u>	<u>8,722,761</u>
Royal Air Force						
Strike/attack and offensive support aircraft	2,424,992	(76,478)	2,348,514	2,464,139	(57,067)	2,407,072
Defensive and surveillance aircraft	2,303,701	(75,409)	2,228,292	2,140,241	(28,380)	2,111,861
Reconnaissance and maritime patrol aircraft	512,340	(23,002)	489,338	370,066	(19,639)	350,427
Tankers, transport and communications aircraft	1,064,852	(36,427)	1,028,425	1,079,959	(40,135)	1,039,824
Future capability	14,908	(314)	14,594	345,722	(6,515)	339,207
Other aircraft and RAF units	764,418	(48,798)	715,620	784,155	(30,982)	753,173
	<u>7,085,211</u>	<u>(260,428)</u>	<u>6,824,783</u>	<u>7,184,282</u>	<u>(182,718)</u>	<u>7,001,564</u>
Centre Grouping						
Joint and multinational operations	544,794	(21,333)	523,461	341,411	(193,658)	147,753
Centrally managed military support	437,110	(148,012)	289,098	310,388	(73,987)	236,401
Maintenance of war reserve stocks	749,333	(15,055)	734,278	700,089	(21,470)	678,619
	<u>1,731,237</u>	<u>(184,400)</u>	<u>1,546,837</u>	<u>1,351,888</u>	<u>(289,115)</u>	<u>1,062,773</u>
Total Objective 2	<u>25,950,299</u>	<u>(1,016,681)</u>	<u>24,933,618</u>	<u>27,796,553</u>	<u>(1,019,105)</u>	<u>26,777,448</u>

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

- *Smaller warships* includes mine hunting and offshore patrol vessels;
- *Amphibious ships* includes assault ships providing platforms for landing craft and helicopters, and Royal Fleet Auxiliary landing support ships;
- *Strategic sealift* is the Roll-On Roll-Off ferry facility supporting the Joint Rapid Reaction Force;
- *Fleet support ships* includes Royal Fleet Auxiliary ships providing tanker and replenishment support to warships;
- *Survey and other vessels* includes ocean and coastal survey and ice patrol ships;
- *Naval aircraft* include Sea King, Lynx and Merlin helicopters deployed in anti-submarine, airborne early warning, Royal Marine support, and reconnaissance and attack roles;
- *Submarines* includes the operating costs of submarines and support of nuclear propulsion and weapons systems, including nuclear decommissioning;
(the costs of submarines reported in 2003-04 included the increased cost incurred by lowering from 6.5% to 3.5% in that year the discount rate applied to the Department's provisions for nuclear decommissioning).
- *Army – Field units* includes 1 (UK) Armoured Division, 3 (UK) Division, Joint Helicopter Command and Theatre troops;
- *Army – Other units* includes Regional Divisions and Land support and training;
- *Strike/attack and offensive support aircraft* includes Tornado GR1/GR1A/GR1B/GR4/GR4A, Joint Force Harrier and Jaguar aircraft deployed in strike/attack and offensive support roles;
- *Defensive and surveillance aircraft* includes Tornado F3 and Sentry AEW1 aircraft deployed in UK air defence, and NATO and UN peacekeeping commitments;
- *Reconnaissance and maritime patrol aircraft* includes Canberra and Nimrod R1 aircraft deployed on reconnaissance, and Nimrod MR2 aircraft on maritime patrol. (Tornado GR1A/4A included in *strike/attack and offensive support aircraft* also undertake reconnaissance roles);
- *Tankers, transport and communications aircraft* includes C17, Hercules, Tristar and VC10 aircraft providing air transport and air to air refuelling, and smaller transport aircraft (BAe 125/146 and Squirrel helicopters) used in a rapid communications role;
- *Future capability* includes primarily the preparatory costs for the introduction of the Typhoon aircraft;
- *Other aircraft and RAF units* includes ground forces (e.g. the RAF Regiment) and miscellaneous aircraft not included elsewhere;
- *Joint and multinational operations* includes Chief of Joint Operations HQ and the costs less receipts of UK participation in NATO;
- *Centrally managed military support* includes intelligence operational support and Special Forces; and
- *Maintenance of war reserve stocks* includes the holding costs and charges of munitions and other stocks, above the levels required for planned consumption.

Objective 3: Building for the future

This objective comprises the following elements:

	2004-05			2003-04		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
Research	996,421	(318)	996,103	1,007,082	(75)	1,007,007
Equipment programme	2,045,379	(64,041)	1,981,338	2,204,899	(56,131)	2,148,768
Total	3,041,800	(64,359)	2,977,441	3,211,981	(56,206)	3,155,775

- *Research* comprises the costs, including capital charges, of the Research Building Block, and research expenditure incurred by other TLBs; and
- *Equipment Programme* refers to the administration and programme costs, primarily of the Defence Procurement Agency, associated with specifying requirements for and procurement of fighting equipment and other assets. The values of fixed asset additions are shown in Note 9.

Attribution to Objectives

Gross expenditure of £24,626M (72.8%) (2003-04 – 75.6%) and Operating Income of £791M (55.8%) (2003-04 – 49.0%) 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:

	2004-05			2003-04		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
Support for Ministers and Parliament	15,830	(43)	15,787	18,971	(33)	18,938
Departmental corporate services	1,686,358	(263,904)	1,422,454	1,356,300	(91,033)	1,265,267
Strategic management	353,073	(2,214)	350,859	207,188	(11,911)	195,277

- *Support for Ministers and Parliament* includes provision of advice to Ministers and the costs, wherever incurred in the Department, of dealing with Parliamentary business;
- *Departmental corporate services* comprises internal support functions, e.g. payment of bills, payroll administration, housing and medical care for service personnel, and costs of Departmental restructuring; and
- *Strategic management* comprises Departmental Head Office policy making functions in strategic, personnel, scientific and medical matters.

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 £68,312M (79.8%) support the military capability required to meet Objective 2. The remainder comprises assets wholly attributable to tasks within Objective 1 (£3,844M – 4.4%), and intangible assets, fighting equipment and other assets under construction, and assets related to equipment procurement within Objective 3 (£13,513M – 15.8%), and payment of War Pensions and Allowances (-£24M).

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

	Other Current Expenditure	Grants	Operating Appropriation -in-Aid	2004-05 Total Net Resource Outturn	Total Net Resource Estimate	Outturn Compared With Estimate	2003-04 Total Net Resource Outturn
	£000	£000	£000	£000	£000	£000	£000
TLB HOLDER							
Commander-in-Chief Fleet	3,588,386	—	(17,365)	3,571,021	3,542,918	(28,103)	3,366,534
General Officer Commanding (N Ireland)	627,845	—	(1,418)	626,427	642,754	16,327	653,341
Commander-in-Chief Land Command	5,540,794	100	(200,334)	5,340,560	5,418,502	77,942	4,862,103
Air Officer Commanding-in-Chief RAF Strike Command	3,545,793	—	(42,880)	3,502,913	3,674,690	171,777	3,469,096
Chief of Joint Operations†	546,865	—	(47,413)	499,452	459,723	(39,729)	535,485
Chief of Defence Logistics	7,765,414	—	(352,777)	7,412,637	7,621,944	209,307	7,950,588
2nd Sea Lord/Commander-in-Chief Naval Home Command	805,237	205	(42,918)	762,524	717,142	(45,382)	696,635
Adjutant General	1,812,799	—	(24,727)	1,788,072	1,742,886	(45,186)	1,757,136
Air Officer Commanding-in-Chief RAF Personnel & Training Command	1,282,773	—	(155,636)	1,127,137	1,001,861	(125,276)	1,004,269
Central	3,499,827	158,758	(507,064)	3,151,521	3,044,064	(107,457)	2,648,786
Defence Procurement Agency	2,098,843	2,369	(27,149)	2,074,063	3,186,742	1,112,679	4,817,605
SIT (Science, Information,Technology)	502,952	3,157	—	506,109	495,036	(11,073)	419,767
Total (RfR 1)	31,617,528	164,589	(1,419,681)	30,362,436	31,548,262	1,185,826	32,181,345
Total (RfR 2) (Note 2)	938,181	—	—	938,181	949,884	11,703	1,233,155
Total (RfR 3) (Note 1)	1,109,521	—	—	1,109,521	1,161,221	51,700	1,116,047
Total	33,665,230	164,589	(1,419,681)	32,410,138	33,659,367	1,249,229	34,530,547
Income netted off against operating expenditure between TLB holders	(2,874)		2,874				
Items netted off against other operating costs but treated as Appropriation-in-Aid for Schedule 1 (note 4)	71,603		(71,603)				
Excess Operating Appropriation-in-Aid (RfR 1)			215,889	215,889		(215,889)	85,315
Items treated as CFERs to be allocated (RfR 1)	304		14,212	14,516		(14,516)	35,364
	33,734,263	164,589	(1,258,309)	32,640,543	33,659,367	1,018,824	34,651,226

Note 1: War Pensions and Allowances – Programme Costs

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

Note 2: Conflict Prevention (RfR2)

The analysis of the Conflict Prevention costs is as follows:

Operating Costs	
£000	
Operation	
Balkans	84,677
Afghanistan	57,937
Iraq	747,068
	<hr/>
Programme Expenditure	889,682
	48,499
	<hr/>
Total	938,181
	<hr/>

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

General

1. The MoD had £0.975Bn (2003-04: £1.539Bn), including £219M (2003-04: £334M) for capital expenditure, in voted provision for Operation TELIC in the Spring Supplementary Estimates 2004-05.
2. The resource outturn in 2004-05 for the operation was £0.747Bn (2003-04: £1.051Bn), which reflects the costs for the period to 31 March 2005.
3. The capital expenditure for Operation TELIC paid and accrued in the financial statements amounted to £163M (2003-04: £260M)
4. Full details of the Department's aims and performance assessment for Operation TELIC are provided in the Departmental Performance Report.

Assumptions

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

1. In accordance with the accounting principles agreed with HM Treasury, the Department has identified the costs of Operation TELIC on the basis of net additional costs. Expenditure such as wages and salaries are not included as they would have been incurred in any event, and the costs of activities such as training and exercises, which have been cancelled because of the operational commitment, have been deducted;
2. There have been no fixed asset impairments resulting from the operation in Iraq, though cost of equipment destroyed in the conflict is included. It is likely that repair and refurbishment costs will need to be incurred in the future in order to bring the equipment back into full operational use; these costs will be reflected in the Operating Cost Statement in the year in which they are incurred;
3. Stock consumption is charged at a gross cost and the related stock provision movements are shown under the stock provision line in the Operating Cost Statement.
4. Write offs of fighting equipment and GWMB, charged in the financial statements, are based on actual records.

28 Financial Instruments

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

Liquidity risk

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

Interest rate risk

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

Foreign currency risk

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

Currency	Foreign currency	Weighted average exchange rate	31 March 2005 Sterling	31 March 2004 Sterling
	US\$/Euro 000	(=£1)	£000	£000
2005-06 delivery (2004-05 delivery)				
US Dollar	1,558,000	1.7463	892,182	969,581
Euro	1,379,000	1.4323	962,769	947,173
2006-07 delivery (2005-06 delivery)				
US Dollar	1,566,000	1.8713	836,864	892,182
Euro	1,374,000	1.3869	990,699	891,949
Total			3,682,514	3,700,885

The 31 March 2005 mid-market closing rates for US Dollar and Euro were £/\$ 1.8896 and £/Euro 1.4540 respectively.

Fair Values

Financial assets

The Department's financial assets include investments and loans made in Trading Funds, MoD agencies funded through a Trading Fund and QinetiQ, a Self Financing Public Corporation. The net assets of these bodies (excluding MoD loans) and the interest rates applicable to these loans are shown in note 10. Other financial assets fair values approximate to their book values.

Financial liabilities

The Department's liabilities include loans from National Loans Fund, Obligations under finance leases and PFI contracts and a loan from Atomic Weapons Establishment amounting in total to £794.9M (2003 – 2004: £368.9M). The fair values of these liabilities will be different from their book values but since these represent only 4.8% of the gross liabilities and provisions, the impact on the Department's net assets will not be material. The fair values of provisions for liabilities and charges are not materially different to their book values which are stated after discounting at the Treasury rate of 3.5%. Other liabilities fair values approximate to their book values.

29 Losses and Special Payments

CLOSED CASES: these comprise losses and special payments which have been formally signed off to date subsequent to a satisfactory completion of all the case work relating to the loss or special payment. Closed cases would, therefore, include some cases which in the previous year were shown under Advance Notifications.	Arising in 2004-05	Reported in 2003-04 as Advance Notifications
	£000	£000
Total (excluding gifts, special payments and War Pensions Benefits) under £100,000 each: 14,167 cases	4,620	
Total (excluding gifts, special payments and War Pensions Benefits) over £100,000 each: 36 cases (detailed below)	75,892	321,820
Cash Losses		
British Defence Staff Washington: net write off to regularise the various control accounts used to manage US Government Foreign Military Sales to the UK. This was reported under Advance Notification in 2003-04. (Central)		8,332
A loss, as a result of an accounting error, of £567,000 occurred in July 1993 on a control account, set up during the Anglo/French agreement on the production of the Jaguar aircraft. An investigation has concluded that the balance on the account could not be supported. A loss of £199,000 reported in 2003-04 under Advance Notification represented the net loss on 4 control accounts relating to this agreement. (DLO)		567
A review of the Overseas Leave Travel Scheme and of the Welfare Warrants Scheme allowances has shown that an overpayment has arisen at a MoD establishment abroad. In 2003-04, the amount of the loss was estimated at £850,000 and included under Advance Notification. (PTC)		500
Bookkeeping losses and adjustments		
Clearance of obsolete balances for old, completed projects: Amounts written off. (DPA)	5,310	
Clearance of obsolete balances relating to earlier restructuring of account grouping. (DPA)	5,131	
Write-off balance relating to prior year deliveries of low value stock items previously classified as Assets Under Construction. (DPA)	121	
Claims waived or abandoned		
A claim for £160,000 has been abandoned against a company that went into liquidation in 2002. The claim arose from the subsequent deterioration of work completed by the company on the watertight hatches on a Royal Maritime Auxiliary Service Vessel. The MoD has sought re-dress through the Receivers' solicitors, but there is little in the way of company assets remaining to meet the MoD's legitimate claim. (DLO)	160	
Amounts owed by the Defence Evaluation and Research Agency (DERA), a MoD Trading Fund until 2001, in respect of postal services provided by the MoD during the period 1999-2000, was written off on the disestablishment of DERA and the establishment of Qinetiq, a self-financing public corporation and Dstl, a MoD Trading Fund. (DLO)	129	
Renegotiations in respect of the Hydrographic and Oceanographic Survey Vessels contract have resulted in a claim abandoned. In 2003-04, the loss was estimated at £1,034,000 and reported under Advance Notification. (DPA)		978
Stores and other losses		
In moving to a training camp in preparation for an exercise, 2 Warrior vehicles were involved in a collision. The accident was fully investigated and the findings resulted in the vehicle driver and commander being disciplined. (LAND)	500	
Defence Fire Service vehicle (RU 83 AA) was involved in an accident on its way to a fire in the Eastern Sovereign Base Area in Cyprus. Further investigation into the incident established that no negligence was involved. (CJO)	172	
Loss as a result of a fire on an AS90 (self-propelled artillery gun) during Ex Saif Sareea 2 (Oman). In 2003-04, the loss was estimated at £2,202,000 and shown under Advance Notification. (LAND)		1,942
Part of an accommodation block in Clive Barracks, Tern Hill was destroyed as a result of arson. The offender has been prosecuted and sentenced accordingly. In 2003-04, the loss was estimated at £500,000 and shown under Advance Notification. (LAND)		698
Communication equipment located on a remote site was stolen in 2001-02. A Board of Enquiry was held and the asset was written off. A contribution of £190,750 towards the loss was received from the Dutch Government. In 2003-04, the loss was estimated at £573,000 and included under Advance Notification. (CJO)		382
Accidental damage caused by fire to miscellaneous equipment during Op TELIC. In 2003-04, the case was still ongoing and the loss was estimated at £375,000 and reported under Advance Notification. (LAND)		373
Although no physical loss occurred, incomplete documentation on ammunition movements during an Operation in Afghanistan resulted in paper deficiencies in stock holdings. This loss was reported under Advance Notification in 2003-04. (LAND)		241
A fire involving stores, fuel products and munitions destroyed buildings, tents and other property during Operation TELIC. Investigations concluded that the accident was not attributable to a single individual or specific act of negligence. This loss was reported under Advance Notification in 2003-04. (LAND)		104

CLOSED CASES (continued)	Arising in 2004-05	Reported in 2003-04 as Advance Notifications
	£000	£000
Constructive Losses		
Constructive loss following a change in procurement strategy for the BOWMAN battlefield communications system. A change in the supplier resulted in nugatory expenditure of £51,000,000 which had to be written off. (DPA)	51,000	
Additional costs incurred resulting from the UK's decision in 2003 to withdraw from the Multi Role Armoured Vehicle programme. The total amount written off on the programme is £56,910,000, which includes £48,000,000 written off in 2003-04. (DPA)	8,910	
Cancellation of a classified programme on C130J as a savings measure. (DPA)	1,791	
There was a project delay as a result of defective GPS chips supplied by US Contractor Trimble Navigation in respect of the Storm Shadow missile project and hence a Variation of Price (VOP) clause was triggered resulting in the Agency incurring additional contract costs. The Agency is attempting to recover costs from the contractor (DPA)	1,763	
Loss in respect of expenditure associated with the implementation of an IT based output costing system, Metify Enterprise. The system could not be made to perform as expected and as the output costing processes developed it became clear that the design would no longer meet the DLO's evolving requirement for output costs or, subsequently, the emerging central requirement for pan MoD costing of Defence outputs. (DLO)	491	
Loss arose in respect of expenditure incurred in the development of a tool to further automate the DLO output costing process. This IS project was cancelled because it was not compatible with the centrally driven policy to simplify and improve financial processes. (DLO)	168	
The sum of £143,972 has been written off as a constructive loss, being food stocks disposed off as a result of the late cancellation of the annual winter deployment of the Royal Marines to Norway, who were required for initial deployment to Operation TELIC. (DLO)	144	
The programme to install a Control & Reporting Centre at RAF Neatishead was cancelled following the rationalisation of the Defence Estate (DPA)	102	
The loss case results from a settlement payment to Elonex as a result of a technical breach of contract. As part of the settlement with Elonex, it was agreed that the sum paid to them would not be disclosed. In 2003-04, the case was still ongoing, and the amount provided for was estimated to be £600,000 and was reported under Advance Notification. The amount cannot be disclosed due to legal reasons. (DLO)		
The Defence Stores Management Solution (DSMS) and two associated IT projects, Delivering The Requirement for Unit Material Management (DRUMM) and In-Transit (ITV), formed part of the DLO Business Change Programme. During development of DSMS, doubts surfaced about the programme's ability to deliver the expected benefits and its affordability leading to the programme and its associated projects, DRUMM and ITV, being suspended in 2002 to permit better solutions to be developed. Costs of £144,500,000 have now been formally written off for the three related projects: DSMS, DRUMM and ITV. In 2003-04, the DSMS loss alone of £118,000,000 was reported as an Advance Notification. (DLO)		144,500
Re-negotiation of a contract to reduce the number of Nimrod MRA4 required from 21 to 18 has resulted in a constructive loss. In 2003-04, an amount of £75,000,000 was reported under Advance Notification. (DPA)		74,880
The decision to cancel the Remote Ammunitioning Facility Tamar at Devonport Naval Base has resulted in a constructive loss of £25,000,000. The project was suspended in May 2002 following a Defence Ordnance Group study showing that the effects of potential ammunition explosions would be more localised than originally predicted and that a safe facility could be provided at the submarines' current berths within the Naval Base, without the need to construct a remote facility. The project was formally cancelled in December 2004 once Devonport had established confidence that the existing facilities could be used and the full costs of cancellation had become clearer. (DLO)		25,000
The Aircraft Computerised Equipment Support System project (Project ACCESS) was initiated, in 1996, to provide an on-aircraft logistics information system to analyse fleet support costs and activities for Army aircraft. The project was subsequently descope to cover the Apache helicopter only. A Strategic Options Study, involving all stakeholders, concluded that a more convergent Information System (IS) was required. It was therefore agreed by the Systems Management Board that further development of Project ACCESS should be cancelled, incurring a constructive loss. (DLO) In 2003-04, an amount of £18,000,000 was reported as an Advance Notification.		18,960
Cancellation of contract to deliver High G Force Centrifuge training project, due to the contractor's inability to deliver RAF Requirements. (DPA)		14,383
A loss of £12,896,000 was incurred as a result of the cancellation of the Harrier Night Bombing System (HNBS) project. With the introduction of Precision Guided Weapons, the appropriate authorities agreed that HNBS was no longer required and that further development should be cancelled. The gross value of the loss was £13,818,000 offset by a recovery of £922,000, resulting in a net loss of £12,896,000. (DLO)		12,896

CLOSED CASES (continued)	Arising in 2004-05 £000	Reported in 2003-04 as Advance Notifications £000
Increased development costs, payable to the contractor, relating to the Brimstone project arising from the non-availability of trial platforms because of increased operational priorities arising from operations in Iraq. This loss was reported under Advance Notification in 2003-04. (DPA)		9,165
The loss was incurred through the procurement of new aircraft lifts that were to be fitted to Royal Naval Aircraft Carriers. A more cost effective solution was found as a result of increased technical knowledge and the lifts were therefore not required. There have been various expressions of interest in buying the aircraft lifts from the MoD, but none of these has resulted in a sale. In 2003-04, the loss was estimated at £6,500,000 and included as an Advance Notification. (DLO)		6,221
A loss has been incurred by the cancellation of the Oasis Stores and Engineering Enhancement (OSEE) Project. The development of the IT project was subject to delays and was not deemed fit for purpose in its current form when trials were undertaken in mid 2002. At the same time, a review of DLO projects found that OSEE did not meet the new recommended criteria for the continuation of IT projects. The project was therefore cancelled. There has been some mitigation of the loss through an arrangement to purchase licences for a different product in use in the MoD. In 2003-04, the loss was estimated at £1,500,000 and included as an Advance Notification. (DLO)		1,255
This loss is a result of the MoD's decision to terminate a contract in respect of project PASCO: a project intended to provide a Defence Messaging Handling System for the Navy. This loss was reported under Advance Notification in 2003-04 and covers the training costs incurred.(DLO)		290
A stores loss was incurred between the end of September and the beginning of October 2002, as a result of the incorrect scrapping of 45 Lynx Metal Rotor Blades which, although they have subsequently been recovered, has left the blades beyond economical repair. In 2003-04, the case was still ongoing and the loss was estimated at £151,000 and reported under Advance Notification. (DLO)		153
Gifts		
Total: 29 cases amounting to £35,967,000		
Military equipment to the Iraqi Interim Government, of which some equipment is deliverable after 31 March 2005.	27,300	
Non-lethal military equipment to the Government of Sierra Leone. Delivery of equipment started in 2004-05 and is due to complete in 2006-07.	4,476	
Non-lethal military equipment to the Government of Nepal	3,530	
Non-core MoD site in Aldershot to the English Churches Housing Group	350	
Messerschmitt 163B-1 (KOMET) formally gifted to the Imperial War Museum. The Messerschmitt was captured equipment, previously on permanent loan to the Imperial War Museum.	120	
International Courtesy Rules		
Supplies and services provided on a reciprocal basis to Commonwealth and Foreign Navy vessels during visits to British Ports at Clyde, Portsmouth, Devonport and Gibraltar (Central)	1,511	
Transfer of properties below Market value		
Defence Munitions Dean Hill Salisbury was closed down. Certain properties at this site were purchased by sitting tenants under the provisions of the 1985 Housing Act; the remaining properties with sitting tenants were sold to a Housing Association.	919	
Special Payments		
Total : 199 cases amounting to £16,860,000		
Ex gratia payments as approved by HM Treasury arising as a consequence of the cancellation of the Airfield Support Service Project. (DLO)	9,637	
Extra-Contractual payment to contractor following cancellation of a construction contract for accommodation of personnel at a MoD establishment. The payment represents additional costs incurred by the preferred bidder prior to the cancellation of the contract. (STC)	987	
Ex-gratia payments were made on account to British Nuclear Fuels plc and the United Kingdom Atomic Energy Authority towards the cost of treating and disposing of nuclear wastes and decommissioning plant at British Nuclear Fuels plc sites. Total paid to date is £1.503Bn. (DPA)		162

CLOSED CASES (continued)	Arising in 2004-05 £000	Reported in 2003-04 as Advance Notifications £000
War Pensions Benefits (WPB):		
Claims Abandoned-WPB		
Irrecoverable overpayments of war pensions relating to 2,147 cases amounting to £836,000 (2003-04: 1836 cases amounting to £613,680) were written off. These represent overpayments of pension which occur due to a number of reasons outside of the Agency's control; this represented 0.1% of the total war pension payments budget of £1.1Bn. All overpayments are recorded as amounts outstanding and action is taken to recover these amounts. In the 2004-05 financial year over £1.3M of overpayments were recovered. However, where the overpayment was found to be irrecoverable, the decision was taken to waive the amount owed. Included in the total figure of claims abandoned was an overpayment amounting to £132,000 due to failure in advising the Department of change in marital status of a war widow. The claim was abandoned after review of the circumstances of the case.	836	
Special Payments-WPB		
Total number of payments made during the year were 1,626 (2003-04: 1,029) and amounted to £12,120,619 (2003-04 £5,496,146). These payments comprise payments of war Disability Pension which 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.		
Following a Judicial Review, announced in November 2003, the scheme was expanded to allow payments to qualifying Ghurkhas in Nepal. In the 2004-05 financial year, 500 successful claims were processed totalling £5,000,000. A further £3,000,000 was charged to the Operating Cost Statement by way of provision to reflect the likely payments in the 2005/06 financial year.	8,000	
Although the large majority of cases have been paid in previous financial years 181 claims were processed and paid in the 2004-05 financial year. The total payment amounted to £1,810,000.	1,810	
(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.	1,626	
In 2004-05, there were 380 cases (2003-04: 420 cases) and the cost amounted to £1,625,924.00 (2003-04: £1,625,926)		
(c) Noise Induced Sensorineural Hearing Loss pensions		
In 2004-05, 246 cases (2003-04: 260 cases) were paid under the Dispensing Instruments and the total amount payable was £558,470 (2003-04: 551,826). The figure was arrived at through a scan of the War Pensions Computer System.	558	
(d) Crown Agents Supplementation payments		
Crown Agents Financial Services, make payments to ex-members of the colonial forces who are resident in the UK and who have been awarded a disablement pension by the colonial government. The payment is a supplementation amount that increases the disablement pension to the rate equivalent to a UK war pension.		
The Veterans Agency re-imburses Crown Agents Financial Services for these payments. In 2004-05, there were 19 cases (2003-04: 28 cases) and the amount payable was £126,224 (2003-04: 108,395).	126	

ADVANCE NOTIFICATIONS: these comprise losses and special payments, which arose during 2004-05 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 £100,000 they will not be separately identified.

Arising in
2004-05

Reported
and arising
in prior
years

£000

£000

Notified in prior years

This constructive loss arose from the UK Government decision not to proceed into production for either long range or medium range anti-tank guided weapons system. (DPA)

314,000

The value of 8 Chinook Mk3 helicopters has been written down by £205m under prudent accounting practices while the MoD establishes a way forward for the programme. The write down has arisen because, although the terms of the contract had been met, the helicopters do not currently meet the operational requirement and could not acquire Military Aircraft Release. (DPA)

205,000

A loss of £65,000,000 has been incurred following the impairment of an Operational building. (DPA)

65,000

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. In 2003-04, an amount of £40,000,000 was included in Advance Notification as an estimate of the likely amount of the claim. (DPA)

63,800

The extended range ordnance/ modular charge system (ERO/MCS) was cancelled because the contractor encountered technical difficulties with the MCS that could not be resolved. This produced an estimated constructive loss. In 2003-04, the loss was estimated at £34,540,000. (DPA)

32,798

A delay in the production of helicopter training course materiel has resulted in a potential write-off. The loss was estimated at £8,500,000. (DPA)

8,369

This loss relates to a settlement payment made to a service provider as a result of a termination of contract due to technical reasons relating to Defence Information Infrastructure requirements. (DLO)

850

The relocation of HMS OSPREY to RNAS Yeovilton involved the construction of a new office block for 847 Squadron. The roof of the building, which was completed in 1999, obscured the view of the end of the runway from the Aircraft Control Tower, causing a potential flight safety hazard. Re-design and construction of a new roof was required to address this. Previous year estimate amount was £618,000, actual value is £584,000. (FLEET)

584

Loss of £515,000 on disposal by sale of Scammell Commander assets to the Jordanian Armed Forces. This figure includes the net loss of approximately £162,000 disclosed in 2003-04. which related to the assets transferred at that time.(DLO)

515

Metropole Building re-wire project (fraud), an alleged fraud during 1990-1995 which is in the process of being settled. (Central)

500

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. (DLO)

434

A stores loss of £148,000 occurred in February 2001 and has resulted in the write-off of two C130J right-hand main undercarriage shock struts. The faulty struts were mislaid between the unit staffs and the Contractor Interim Logistics Support Team at RAF Lyneham. A Unit Inquiry (UI) was convened between January and April 2002. (DLO)

148

ADVANCED NOTIFICATIONS (continued)	Arising in 2004-05 £000	Reported in 2003-04 as Advance Notifications £000
Notified during the year		
Cash Losses		
Uncleared balances in respect of Income Tax and National Insurance balances written off in the books of the Armed Forces Personnel Administration Agency. (Central)	1,479	
A cash loss of £166,000 has been incurred as the result of the Navy Days 2004 Event which took place in Devonport Naval Base during August 2004. A forecast of income and expenditure for Navy Days 2004 assumed a break-even position with 60,000 visitors attending. Although good control of expenditure against budget was exercised, income was lower than anticipated mainly due to reduced visitor numbers (46,000). (DLO)	166	
Claims waived or abandoned		
A claim arising against EDS, under a Service Provision Agreement between the company and the Armed Forces Personnel Administration Agency, waived during the year (Central).	660	
Stores and other losses		
A food component was withdrawn from Operational Ration Packs (ORP) following discovery in tests that deterioration of the product's packaging could over time compromise the safety of the contents. The Contractor accepted liability in principle for this defect and agreed to supply a replacement product utilising an alternative packaging arrangement, at no cost to MoD, subject to being able to develop a replacement product that could be warranted fully fit for purpose. This development work is continuing and if successful will substantially mitigate the overall loss to the Department brought about by a combination of loss of use of the original product and the cost of its removal/destruction. (DLO)	1,400	
Tornado engine spares destroyed by fire, caused by short circuit in cabling in module repair bay at RAF Marham. (STC)	352	
Constructive loss		
A loss of £82,000,000 has been incurred in respect of plant and equipment. (DPA)	82,000	
A potential loss following the termination of a contract for 4.5kw generators as a result of contractor non-performance. (DPA)	306	
Special Payments		
HM Treasury has agreed an ex-gratia payment of up to £84,500,000 to Swan Hunter subject to completion of certain contractual conditions relating to the construction of two landing Ship Dock (Auxiliary) LSD(A). Total paid to date is £38,000,000. (DPA)	38,000	
Containers carrying supplies in support of Exercise Torpedo Focus (ETP) were found to be contaminated on arrival at the US port of disembarkation. Entry to the US was refused until bio-diversity standards were met by isolating the containers and fumigating them. (STC)	212	

30 Non-Operational Heritage Assets

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

- a) The cost of the valuation outweighs the benefits that the knowledge of the valuation would deliver; or
- b) it is not possible to establish a sufficiently reliable valuation.

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

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

Item	Location	Description
HMS Victory	Portsmouth	HMS Victory is a 100 gun, first rate ship of the line, most famous for her role as Lord Nelson's Flagship at the Battle of Trafalgar. Victory was commissioned into the fleet in 1778 and serves today as flagship to 2nd Sea Lord/Commander-in-Chief Naval Home Command. Open to the public since 1928, Victory now attracts around 400,000 visitors a year.
Army Historic Aircraft Flight	Middle Wallop	Formed in the late 1980s, the flight consists of 7 aircraft and makes about 15 public appearances between May and September.
Historic Gun Collection	DSDC Donnington	The museum currently holds a collection of 749 small arms of British and foreign origin together with a small number of larger weapons.
Battle of Britain Memorial Flight	RAF Coningsby	Formed in 1973 the Memorial Flight operates 11 mainly World War II aircraft that appear at several hundred airshows, public events and state occasions each year. Memorial Flight aircraft can also be viewed by the public at their hangar at RAF Coningsby.
MoD Art Collection	Various locations	The MoD Art Collection comprises approximately 800 works of fine art and 250 antiques such as clocks and furniture. Many other miscellaneous items, such as photographs and manuscripts are contained in the archive. At the core of the collection are works commissioned by (and bequeathed to) the Admiralty during the 19th century, and those given to the Admiralty and to the War Office by the War Artists Commission at the end of the Second World War. Items from the MoD art collections are displayed in conference rooms and senior officers' accommodation throughout the defence estate. The most important items are on permanent public display in the National Maritime Museum and on temporary loan to many other public museums and galleries.
Records and artworks	London, Taunton	The Admiralty and Institute of Naval Medicine Libraries and the Air Historical Branch (London) comprise text and records of historical and research items. Although not open to the public, access is available on application.
Artefacts, records and artworks	Various locations	Over one hundred Regimental and Corps Museums and collections exist across the country. Ownership of the buildings and contents of the museums varies between the MoD, local authorities and regimental associations. The museums, which are open to the public, trace the history of the regiments and comprise displays of uniforms, weapons, medals and records.

31 Entities within the Departmental Boundary

The entities within the boundary during 2004-05 were as follows:

Executive Agencies

Armed Forces Personnel Administration Agency
Army Training and Recruitment Agency
British Forces Post Office
Defence Analytical Services Agency
Defence Bills Agency
Defence Communication Services Agency
Defence Dental Agency
Defence Estates
Defence Geographic and Imagery Intelligence Agency
Defence Intelligence and Security Centre
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
Medical Supply Agency
Ministry of Defence Police and Guarding Agency
Naval Recruiting and Training Agency
Pay and Personnel Agency
Queen Victoria School
RAF Training Group Defence Agency
Service Children's Education
Veterans Agency
Warships Support Agency

Advisory Non-Departmental Public Bodies

Advisory Committee on Conscientious Objectors
Advisory Group on Medical Countermeasures
Animal Welfare Advisory Committee
Armed Forces Pay Review Body
Central Advisory Committee on War Pensions
Dartmoor Steering Group
Defence Nuclear Safety Committee
Defence Scientific Advisory Council
National Employers' Liaison Committee
Nuclear Research Advisory Council
Review Board for Government Contracts
War Pensions Committees
Independent Monitoring Board
Independent Board of Visitors for Military Corrective Training Centre

Other Entities

The Reserve Forces and Cadet Associations (formerly TAVRA)

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

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

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

	Numbers voted by the House of Commons	Maximum numbers maintained	Peak Dates
Officers, Men & Women for NAVAL SERVICE	45,325	40,882	1 April 2004
Officers, Men & Women for ARMY SERVICE	128,195	120,278	1 April 2004
Officers, Men & Women for AIR FORCE SERVICE	57,415	53,957	1 April 2004

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

	Numbers voted by the House of Commons	Maximum numbers maintained	Peak Dates
Reserve Naval and Marine Forces	18,000	15,334	1 April 2004
Special Members of the Reserve Naval Forces	300	177	1 January 2005
Reserve Land Forces	84,000	69,825	1 May 2004
Special Members of the Reserve Land Forces	6,000	111	1 March 2005
Reserve Air Forces	23,050	15,424	1 April 2004
Special Members of the Reserve Air Forces	550	86	1 March 2005