



MINISTRY OF DEFENCE

Ministry of Defence

# Annual Report and Accounts Volume Two

# 2008-2009

**Departmental Resource Accounts  
and Annexes**



# **Ministry of Defence Annual Report and Accounts**

## **Volume Two 2008-09**

including the Annual Performance Report and  
Consolidated Departmental Resource Accounts

For the year ended 31 March 2009

Resources Accounts presented to the  
House of Commons pursuant to section 6(4) of the  
Government Resources and Accounts Act 2000.

Departmental Report presented to the  
House of Commons by Command of Her Majesty.  
Resource Accounts and Departmental Report presented to  
the House of Lords by Command of Her Majesty

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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. The Defence Plan 2008 sets out the top level objectives for the Defence Board's strategic management of the Department as:

- Achieve success in the military tasks we undertake, at home and abroad.
- Be ready to respond to the tasks that might arise.
- Build for the future.

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

## Departmental Boundary<sup>1</sup>

As at 31 March 2009, the Department consisted of 8 (2007-08: 9) Top Level Budget (TLB) Holders. Merging the Army's Adjutant General's Command and Land Command to form Land Forces reduced the number of TLBs by one. The TLBs are responsible for providing forces and support services required for a modern defence force and are detailed in Note 2 to the accounts – Analysis of Net Resource Outturn. Within the TLBs, there were 38 (2007-08: 49) reporting entities, known as management groupings, recording accounting balances and transactions and producing detailed management accounting information as part of in-year financial management, and planning and budgeting processes. Accounting transactions are attributed to the management group level for in-year management purposes but reporting for the annual financial accounts is now normally completed only at TLB level.

There are 6 on-vote Defence Agencies (listed in Note 37 – Entities within the Departmental Boundary), a reduction of two from 2007-08 following the removal of agency status on 1 April 2008 from the Defence Analytical Services Agency and the Defence Medical Education and Training Agency. Defence Agencies publish their own accounts. All on-vote Agencies are also management groupings. Further information relating to the Defence Agencies can be found at Annex B to the Annual Report and Accounts.

Also included within the Departmental Boundary are Advisory Non-Departmental Public Bodies (NDPBs) sponsored by the Department; these are listed at Note 37.

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

There are 4 (2007-08: 5) Executive Defence Agencies established as Trading Funds, and owned by the Secretary of State for Defence, at 31 March 2009. In May 2007, the MOD announced the creation of a new organisation to provide a maintenance, repair, overhaul and upgrade capability in support of the Armed Forces. Formed by merging ABRO with the retained Defence Aviation Repair Agency business units and some other defence engineering activities, the Defence Support Group began operating as a Trading Fund with effect from 1 April 2008. The Trading Funds produce their own accounts and fall outside the Departmental Boundary. Further details are provided in: Note 15 – Financial Assets, Note 32 – Related Party Transactions and at Annex B.

The Department also sponsors 5 Executive Non-Departmental Public Bodies which publish their own accounts. They receive Grants-in-Aid from the MOD and fall outside the Departmental Boundary. Further details are at Note 32 – Related Party Transactions.

The Oil and Pipelines Agency, NAAFI and the Fleet Air Arm Museum are Public Corporations; they also fall outside the Departmental Boundary.

### **Pension Liabilities**

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

<http://www.mod.uk/DefenceInternet/AboutDefence/WhatWeDo/Personnel/Pensions/ArmedForcesPensions/>

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

[http://www.civilservice-pensions.gov.uk/facts\\_and\\_figures.aspx](http://www.civilservice-pensions.gov.uk/facts_and_figures.aspx)

<http://www.dcsf.gov.uk/aboutus/reports/>

<http://www.nhsbsa.nhs.uk/pensions>

Other employees are members of smaller pension schemes e.g. schemes for Locally Employed Civilians in Germany, Cyprus and Gibraltar and the Merchant Navy Ratings Pension Fund; estimates of the liabilities for these schemes are included in the figure for Provisions for Liabilities and Charges (see Note 20).

Employer's contributions payable to the Armed Forces, Civil Service, NHS, Teachers' and other pension schemes have been charged to the Operating Cost Statement. Further information on the various pension schemes can be found in the Remuneration Report and at Note 9 – Staff Numbers and Costs.

### **Future Developments**

The MOD has comprehensive efficiency and change programmes that extend right across the Department and affect every employee. The details of many of these programmes are set out in the sections on Finance & Value for Money and Change in the Annual Performance Report, which forms the first part of the MOD Annual Report and Accounts.

MOD's programme of efficiency and business change includes extensive organisational restructuring and rationalisation that is likely to reduce further the number of on-vote Agencies.



One of the principal areas of change, being taken forward in response to the Capability Review of the MOD, is being managed under the Streamlining programme. The programme will simplify the Department's organisation and work, ensuring the MOD is focused on strategic tasks and better able to respond to priorities. Streamlining will release more resources to the front line by reducing MOD's Head Office in London, both in cost and number of staff, by 25%. Further information on the MOD's actions in response to the Capability Review can be found in the Annual Performance Report which forms the first part of the Annual Report and Accounts.

The Army's new single Command and TLB, Land Forces, was formed on 1 April 2008 by merging Land Command and the Adjutant General's Command. Collocation to the new Headquarters Land Forces is expected to take place in the second half of 2010.

In accordance with HM Treasury's timetable for the introduction of International Financial Reporting Standards (IFRS) across the Public Sector, for Financial Year 2008-09, the Department has prepared and published UK GAAP-compliant (as adapted for the Public Sector) accounts. In addition, 'shadow' financial statements based on IFRS as adapted and interpreted by HM Treasury in the Government Financial Reporting Manual (FReM) will be produced in September 2009. The latter will be subject to NAO review but not published. For 2009-10 onwards, the Department will prepare IFRS-based accounts.

## Management

The Ministers who had responsibility for the Department and the composition of the Defence Board during the year ended 31 March 2009 are shown on pages 164 and 166.

## Fixed Assets

Intangible and tangible fixed assets are accounted for by Single Balance Sheet Owners based on the category of asset managed:

- Land and Buildings – Defence Estates
- Single Use Military Equipment, Plant & Machinery, Transport and IT & Communications – Defence Equipment and Support

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

## Research and Development

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

In accordance with Statement of Standard Accounting Practice (SSAP)13, "Accounting for Research and Development" (as adapted for the public sector by the FReM, paragraphs 5.3.6 to 5.3.8), amounts spent on research are not capitalised, and certain development expenditure is expensed. The amounts are included at Note 10a – Other Administration Costs and Note 10b – Other Programme Costs.

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

## Net Expenditure

The Operating Cost Statement shows net expenditure of £36,717,605,000 which has been charged to the General Fund. Cash voted by Parliament for the Provision of Defence Capability (RfR 1), Operations and Peace-Keeping (RfR 2) and War Pensions Benefits (RfR 3) amounting to £36,551,725,000 has been credited to the General Fund.

## Dividends

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

## Payments to Suppliers

The Department's invoices, with the exception of some payments to suppliers made by units locally, are paid through the Financial Management Shared Service Centre (FMSSC). In the period 1 April 2008 to 31 March 2009, the FMSSC paid 99.84% of all correctly submitted invoices within 11 calendar days. This contributed to the Department's overall performance of 98% over the 30 calendar day cycle ensuring a high level of compliance with its statutory obligation under the Late Payment of Commercial Debts (Interest) Act 1998; commercial debt interest paid during this period amounted to £9,700 (2007-08: £9,956). Additionally, following the announcement by the Prime Minister in October 2008 of the intention for Government Departments to pay Small and Medium Enterprise suppliers within 10 days, the FMSSC has been monitoring performance during the final quarter of the year. The target is 90% for all UK invoices and this was achieved in March with a performance of 90.7%.

## Departmental Reporting Cycle

The MOD's main Departmental Report presented to Parliament each year is the *Ministry of Defence Annual Performance Report* which forms the first part of the Annual Report and Accounts and sets out the MOD's performance over the year, and developments since the year end where appropriate, against the objectives stated in the Statement of Net Operating Costs by Departmental Strategic Objectives and set out in the *Defence Plan (Including the Government's Expenditure Plans 2008-2012)*. The MOD's financial performance is also reported to Parliament in the explanatory memoranda to the Main and Supplementary Estimates, and in the *Public Expenditure Outturn White Paper*. In-year performance against Public Service Agreement and Efficiency targets and Departmental Strategic Objectives is formally reported to Parliament during the year in the Autumn and Spring Performance Reports. Copies of the Defence Plan can be found at the website:

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

## Administration Cost Regime

From 1 April 2008, the Operating Cost Statement has been analysed into Programme and Administration costs. This is as a result of the Comprehensive Spending Review settlement 2007, which introduced the requirement for an Administration budget and separate disclosure of Administration costs. The Department's Administration Cost Regime separately identifies costs, other than the costs of direct frontline service provision or support activities, as Administration. In order to simplify the process two different approaches were applied for determining the Administration cost boundaries; whole budget areas or expenditure against certain accounting codes. Each TLB has agreed its own basis for allocating costs to Administration; an approach that reflects the varying nature of the activities carried out by TLBs.

## Financial Instruments

As directed by HM Treasury, these financial statements adopt: Financial Reporting Standard (FRS) 23, 'The effects of changes in foreign exchange rates', FRS 25, 'Financial instruments: disclosure and presentation', FRS 26, 'Financial instruments: recognition and measurement' and FRS 29, 'Financial Instruments: disclosures', implementing the revised foreign currency and new financial instrument accounting requirements with effect from 1 April 2008.

The MOD holds financial instruments, mainly to finance its operations and to manage some of the currency risks arising from those operations; in addition various trade and other debtors and creditors arise directly from operations. The Department uses derivative financial instruments, in the form of forward currency contracts, to manage exposure to market risks from changes in foreign exchange rates; it does not hold or issue derivative financial instruments for trading purposes. Transactions in derivative financial instruments are undertaken to manage the risks arising from underlying business activities.

The Department's funding, liquidity and cash flow risks are managed, based on consideration of the cash flows from operations (including non-operating Appropriations-in-Aid), by a centralised treasury function whose primary role is the forecasting of cash requirement, management of the Supply funding and supply of funds to business areas across the Department. The Defence Operating Board sets the policy for the centralised treasury function and it is subject to controls set out in Managing Public Money and Departmental regulations (Joint Service Publications) as well as additional controls and monitoring by HM Treasury.

The Department has entered into forward currency contracts for the US Dollar and the Euro designed to mitigate 83% of the risk that Request for Resources 1 (RfR1) – Provision of Defence Capability cash flows will be affected by changes in exchange rates. As a result MOD's exposure to foreign currency risk arises mainly on: residual exposure in RfR1; RfR2 – Operations and Peace-Keeping expenditure and exposure in other currencies. The value of the forward currency contracts is detailed at Note 28 – Financial Instruments to the accounts; the contracts were not hedging relationships in accordance with FRS 26.

The Department is subject to some credit risk or credit related losses. The maximum credit risk exposure is represented by the amounts reported under the relevant Balance Sheet headings; some more detailed analysis of debtors is provided at Notes 17 – Debtors and 28.3 (credit risk).

## 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.

# Management Commentary

## Performance

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

The Performance Report uses the Defence Balanced Scorecard structure to:

- describe Defence strategies, objectives and activities, and how they are managed and delivered in the legislative, regulatory and external environments in which MOD operates, in particular in the sections on Current Operations, Readiness, Policy, Safety, Security & Business Continuity and Estate;
- provide a forward looking view of performance and development for the reporting year, with sections on Future Personnel, Change, and Future Capabilities; and
- set out information on the availability and use of resources, covering: People, Finance and Value for Money, Estate, Military Equipment Procurement and Reputation.

The Annual Performance Report also describes some of the risks and uncertainties which might affect performance. The Statement on Internal Control describes the Department's risk and control framework.

## Environmental, Social, Community, Employee and Other Matters

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

- **Social and Community Issues** – included in the sections: Current Operations e.g. Crisis Response Operations and Military Aid to the Civil Authorities and under Resources e.g. Defence in the Community.
- **Environmental** – included in the section on Enabling Processes under Sustainable Development. The MOD owns a large, varied and complex estate, with most of the UK's indigenous habitat types, exceptional biodiversity and some of the finest archaeology in the country. Further information on how the MOD is undertaking its responsibility for stewardship of the estate in the UK and overseas including links to *Sanctuary*, the annual MOD Conservation magazine, can be found at: <http://www.defence-estates.mod.uk/conservation/index.php>
- **Employees** – information is provided in the following sections: People, Future Personnel, Safety and Security & Business Continuity. Information on policy and numbers of disabled staff can be found in the People section. The MOD publishes details of its management of civilian sick absence, quarterly on its website – details can be found at: <http://www.mod.uk/DefenceInternet/AboutDefence/CorporatePublications/PersonnelPublications/Welfare/SicknessAbsenceAnnouncement.htm>
- **Performance Indicators** – these are included at the start of each section of the Performance Report. Additional information can be found in *Defence Plans* available on the website: <http://www.mod.uk/DefenceInternet/AboutDefence/CorporatePublications/BusinessPlans/DefencePlans/>

- **Contractual Arrangements** – some of the Department’s major contractual commitments are detailed in Note 27 to the accounts – Private Finance Initiative (PFI) Commitments, and in the sections in the Performance Report on Finance and Value for Money. In 2008-09 the Defence Science and Technology Laboratory, the UK Hydrographic Office, the Met Office, and Defence Support Group were Executive Defence Agencies financed by Trading Fund; they provided essential services to the Department. Further information on Trading Funds is at Annex B to the Annual Report and Accounts. Details of significant contracts relating to the management of the Defence Estate are included in the Estate section of the Performance Report.
- **Spending Review** – the financing implications of significant changes following the Department’s Comprehensive Spending Review settlement are set out in *Defence Plan 2008 Including the Government’s Expenditure Plans 2008-2012*, which, with the MOD Annual Report and Accounts, comprise the MOD’s Departmental Report. These reports and other business plans are available at: [www.mod.uk/DefenceInternet/AboutDefence/CorporatePublications/](http://www.mod.uk/DefenceInternet/AboutDefence/CorporatePublications/)
- **Contingent Liabilities** – Details of Contingent Liabilities disclosed under FRS 12 and additional liabilities included for Parliamentary Reporting and Accountability are at Notes 29 and 30 to these accounts.

### Personal Data Related Incidents

The following tables set out details of the Department’s personal data related incidents during 2008-09. An incident is defined as a loss, unauthorised disclosure or insecure disposal. Protected personal data is information that links an identifiable living person with information about them which, if released, would put the individual at risk of harm or distress; the definition includes sources of information that because of the nature of the individuals or the nature, source or extent of the information, is treated as protected personal data by the Department.

**Table 1: Summary of Protected Personal Data Related Incidents Formally Reported to the Information Commissioner's Office in 2008-09**

The Department's Chief Information Officer has responsibility for setting strategy, policy and standards relating to information and for ensuring appropriate governance and monitoring. A risk based information assurance process is in place, taking account of an independent review by Sir Edmund Burton and Cabinet Office guidance.

Month of Incident	Nature of Incident	Nature of Data Involved	Number of People Potentially Affected	Notification Steps
April 2008	Unencrypted laptop stolen from secured Government premises.	Personal records (not sensitive personal data as defined by the Data Protection Act).	300	Individuals notified.
May 2008	USB memory stick lost outside secured government premises.	Exercise Instruction and some personal information.	90	None.
June 2008	Loss of laptops from secured contractor premises.	Laptops fully encrypted so no risk of compromise.	N/A	N/A
August 2008	Computer server suffered catastrophic failure, back up failed.	Medical records.	1150 individuals (servicemen and their dependants).	Individuals notified, records re-created manually.
September 2008	Discovery that a server was missing following closure of secured Government premises.	Name, address details, and service number or National Insurance number and medical records.	7000 – 200 of which were active records.	Police notified.
September 2008	Discovery of theft of 3 USB Portable Hard Drives from secured Government premises.	Name, service number, date of birth, performance reports, next of kin. Limited sensitive personal information.	All RAF Service personnel who served between 2002-2008 and some of their next of kin.	Individuals about whom sensitive personal information may have been held notified. Helpline established to answer other enquiries. Police notified.
October 2008	Unencrypted laptop stolen from Government premises.	Photographs and limited personal details – name, service number, platoon and company details.	450 students.	Parents / Guardians notified. Police notified.
October 2008	Discovery of possible theft of Portable Hard Disk from secured contractor premises.	Name, date of birth, address, passport number, next of kin, bank account details, National Insurance number.	Estimated at 1.7 million.	APACS contacted with details of 16,000 bank accounts that could have been affected. Police notified. Helpline established to answer enquiries.
Further action on information risk.		The Department has made good progress implementing the recommendations from the Burton Report. 41 of the 51 recommendations have been achieved. Significant progress has been made against the remaining 10. The Information Commissioner's Office (ICO) and Sir Edmund Burton share the view that the outstanding recommendations all involve a longer term programme of change to fully implement.		

**Table 2: Summary of Other Protected Personal Data Related Incidents in 2008-09**

Incidents deemed by the Data Controller not to fall within the criteria for report to the Information Commissioner's Office but recorded centrally within the Department are set out in the table below. Small, localised incidents are not recorded centrally and are not cited in these figures.

Category	Nature of Incident	Total
I	Loss of inadequately protected electronic equipment, devices or paper documents from secured Government premises.	6
II	Loss of inadequately protected electronic equipment, devices or paper documents from outside secured Government premises.	15
III	Insecure disposal of inadequately protected paper documents.	-
IV	Unauthorised disclosure.	-
V	Other.	4

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

	2008-09 £M		Restated 2007-08 £M	
	Estimate	Outturn	Estimate	Outturn
<b>Net Resources Outturn (Estimates)</b>	<b>39,120</b>	<b>36,962</b>	38,042	<b>36,267</b>
<i>Adjustments to include:</i>				
Consolidated Fund Extra Receipts in the OCS	-	(245)	-	(63)
Other adjustments				
<b>Net Operating Cost (Accounts)</b>	<b>39,120</b>	<b>36,717</b>	38,042	<b>36,204</b>
<i>Adjustments to remove</i>				
gain on derivative financial instruments	-	(118)	-	-
voted expenditure outside the budget	(4)	(31)	(4)	(4)
<i>Adjustments to include:</i>				
Consolidated Fund Extra Receipts	-	245	-	63
resource consumption of non-departmental bodies	9	133	15	15
Other adjustments	1	47	-	-
<b>Resource Budget Outturn (Budget)</b>	<b>39,126</b>	<b>36,993</b>	38,053	<b>36,278</b>
<i>of which</i>				
Departmental Expenditure Limits (DEL)	38,071	36,779	36,940	35,768
Annually Managed Expenditure (AME)	1,055	214	1,113	510

### Financial Position

The Statement of Parliamentary Supply – Summary of Resource Outturn compares Estimates and Outturn (Net Total Resources). A detailed explanation of the variances against the Departmental Expenditure Limits is set out in the Finance section of the Annual Performance Report.

Request for Resources (RfR) 1, Provision of Defence Capability, provides for expenditure primarily to meet the MOD's operational support and logistics services costs and the costs of providing the equipment capability required by defence policy. Within RfR1, Appropriations-in-Aid are shown as the lower of actual Outturn or the Estimate. Appropriations-in-Aid in excess of the Estimate are shown at Note 5, and these will be surrendered to the Consolidated Fund. RfR1 is made up of three different controls:

- Resource Departmental Expenditure Limit (DEL), which consists of items such as pay, equipment support costs, fuel and administrative expenses, as well as non cash items such as depreciation, cost of capital and movements in the level of provisions;

- Annually Managed Expenditure (AME), which covers programmes that are demand-led, or exceptionally volatile in a way that could not be controlled by the Department, and where the programmes are so large that the Department could not be expected to absorb the effects of volatility in its programme, for example movements in nuclear provisions; and
- Non Budget costs, items of expenditure which are subject to Parliamentary but not Treasury control, and therefore outside DEL and AME. The majority of the costs relate to changes in the discount rates for pensions and other long term liabilities.

The net outturn for Total Resources is £36,962,297,000 against an Estimate of £39,120,152,000; an underspend of £2,157,855,000.

The net outturn for RfR1, Provision of Defence Capability is £33,097,064,000 against an Estimate of £34,637,300,000; an underspend of £1,540,236,000.

RfR2, Operations and Peace-Keeping, shows a net outturn of £2,865,462,000 against an Estimate of £3,467,762,000; an underspend of £602,300,000.

RfR3, War Pensions Benefits shows a net outturn of £999,771,000 against an Estimate of £1,015,090,000; an underspend of £15,319,000. This RfR provides for the payment of war disablement and war widows' pensions in accordance with relevant legislation; this is all AME. The costs of administering war pensions are borne by RfR1.

The non-operating Appropriations-in-Aid were £439,521,000; £61,473,000 lower than the Estimate of £500,994,000.

The Net Administration Costs were £2,279,884,000; £14,212,000 lower than the Estimate of £2,294,096,000.

The Net Cash Requirement shows an outturn of £36,430,918,000 against an Estimate of £36,551,725,000.

### Other Areas

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

The Department undertakes a professional revaluation of its land and building fixed assets every five years. The process is managed as a five year rolling programme; further details of the revaluation programme are at Note 14.1 – Quinquennial Revaluation to the accounts.

### Directorships and Significant Interests

Details of directorships and other significant interests held by Ministers are set out in The Register of Lords' Interests and The Register of Members' Interests which are available on the UK Parliament website at: <http://www.publications.parliament.uk/pa/ld/ldreg.htm> for Ministers in the Lords and at: <http://www.publications.parliament.uk/pa/cm/cmregmem/memi02.htm> for Ministers in the Commons.



Details of Related Party transactions, including those arising as a result of the interests of Ministers or Board members are listed at Note 32 – Related Party Transactions. During 2008-09 there were no transactions requiring disclosure. The MOD works closely with many organisations, especially in the charitable sector, and this can include representation on governing bodies, for example: The Secretary of State for Defence is trustee of Greenwich Hospital, Mrs Brennan is a trustee of the Imperial War Museum and General Dannatt is a trustee of Help for Heroes. The Department provides guidance, which reflects the Charity Commission's guidance on conflicts of interest for charity trustees, to individuals who hold appointments in outside organisations where a conflict of interest might arise, or be perceived to arise.

### **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 180 to 198. The audit fee is disclosed in Note 10a – Other Administration Costs.

### **Statement as to Disclosure of Information to Auditors**

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

*Sir Bill Jeffrey*  
**Accounting Officer**

**6 July 2009**

# Remuneration Report

## Remuneration Policy

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

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

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

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

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

Further information about the work of the Review Body can be found at [www.ome.uk.com](http://www.ome.uk.com).

There is an established departmental procedure for the appointment of all Non-Executive Directors (NEDs). This requires a visibly fair and open recruitment and selection process, with appointment on merit, thus mirroring the Civil Service Commissioners' Recruitment Code for permanent employees to the Civil Service. NEDs appointed to the Defence Board receive a Letter of Appointment setting out, amongst other things, details of the agreed remuneration.

## Performance and Reward

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

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

Up to seventy percent of the SCS population will receive a performance bonus. Bonuses will be awarded to those judged to have made the highest in-year contribution to the MOD's business objectives taking into account personal capability objectives and evidence of how individuals may have applied and supported diversity in their work. The ceiling for the bonus payments is 8.6% (2007-08 7.6%) of the SCS paybill.

All senior (2-star and above) military officers (except for the Chief of the Defence Staff (CDS), Legal Branch 2-star officers, medical and dental officers and those in the Chaplaincy branches) are paid under the Performance Management and Pay System (PMPS). Depending on their performance and position on the pay scale, individuals can be awarded a double increment, a single increment or no increment, and progress accordingly up the incremental pay range for their rank. The average value of one incremental rise under the PMPS is 2.6% of salary (2007-08: 2.6%). The award of increments is recommended by the Senior Officers' Remuneration Committee, chaired by the Department's Permanent Under-Secretary.

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

### Senior Managers' Contracts

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

Unless otherwise stated below, the officials covered by this report hold appointments which are open-ended, and to which a notice period of 3 months would usually apply. Early termination, other than for misconduct, would result in the individual receiving compensation as set out in the Civil Service Compensation Scheme.

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

NEDs are not employees and, therefore, do not have a contractual relationship with the Department; they are appointees who receive a Letter of Appointment setting out: their role, period of appointment, standards and details of remuneration.

The Chief Scientific Adviser was recruited on a three year fixed term appointment. Conditions covering termination of employment are set out in the contract document.

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

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

### Management

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

*Secretary of State for Defence*

The Right Honourable John Hutton MP

(appointed 4 October 2008, replacing The Right Honourable Des Browne MP).

*Minister of State for the Armed Forces*  
The Right Honourable Bob Ainsworth MP  
(appointed 30 June 2007).

*Parliamentary Under-Secretary of State for Defence (Minister for Defence Equipment and Support)*  
Mr Quentin Davies MP  
(appointed 5 October 2008, replacing The Right Honourable the Baroness Ann Taylor of Bolton).

*Parliamentary Under-Secretary of State for Defence (Minister for International Defence and Security)*  
The Right Honourable the Baroness Ann Taylor of Bolton  
(appointed as Minister for International Defence and Security on 4 October 2008; previously Minister for Defence Equipment and Support, appointed 8 November 2007).

*Parliamentary Under-Secretary of State for Defence (Minister for Veterans)*  
Mr Kevan Jones MP  
(appointed 5 October 2008, replacing Mr Derek Twigg MP).

### **Recent Ministerial Changes**

In June 2009: The Right Honourable Bob Ainsworth MP was appointed as Secretary of State for Defence, Bill Rammell MP was appointed as Minister of State for the Armed Forces and Lord Drayson was appointed as Minister of State for Strategic Defence Acquisition Reform.

### **During the year the following served as members of the Defence Board:**

*Permanent Under-Secretary of State*  
Sir Bill Jeffrey KCB  
(appointed 21 November 2005).

*Chief of the Defence Staff*  
Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF  
(appointed 28 April 2006).

*First Sea Lord and Chief of the Naval Staff*  
Admiral Sir Jonathon Band GCB ADC  
(appointed 7 February 2006).

*Chief of the General Staff*  
General Sir Richard Dannatt GCB CBE MC ADC Gen  
(appointed 29 August 2006).

*Chief of the Air Staff*  
Air Chief Marshal Sir Glenn Torpy GCB CBE DSO ADC BSc(Eng) FRAeS RAF  
(appointed 13 April 2006).

*Vice Chief of the Defence Staff*  
General Sir Timothy Granville-Chapman GBE KCB ADC Gen  
(appointed 22 July 2005).

*Second Permanent Under-Secretary of State*  
Mrs Ursula Brennan  
(appointed 22 October 2008 replacing Sir Ian Andrews CBE TD).

*Chief of Defence Materiel*  
General Sir Kevin O'Donoghue KCB CBE  
(appointed 1 January 2005).

*Chief Scientific Adviser*  
Professor Mark Welland FRS FREng  
(appointed 7 April 2008 replacing Professor Sir Roy Anderson who served until 30 September 2007).

*Director General Finance*  
Mr Jonathan Thompson IPFA  
(appointed 5 January 2009 replacing Mr Trevor Woolley CB).

*Non-Executive Directors*

Mr Paul Skinner, Chairman of Rio Tinto plc and Rio Tinto Limited  
(appointed 1 June 2006).

Mr Ian Rushby, Chair of the Defence Audit Committee.  
(appointed 29 January 2007).

Mrs Priscilla Vacassin, Group Human Resources Director, Prudential plc  
(appointed 1 September 2007).

## Ministerial Salaries, Allowances and Taxable Benefits

(This section has been subject to audit)

	2008 – 09 Salary* £	2008 – 09 Benefits-in-kind (to nearest £100)*	2007 – 08 Salary* £	2007 – 08 Benefits-in-kind (to nearest £100)*
<b>Secretary of State for Defence:</b>				
The Rt Hon John Hutton MP (from 4 October 2008)	38,546	Nil	Nil	Nil
<i>Full year equivalent salary</i>	78,356			
The Rt Hon Des Browne MP (to 3 October 2008)	39,810	Nil	77,884**	Nil
<i>Full year equivalent salary</i>	78,356			
<b>Minister of State for the Armed Forces:</b>				
The Rt Hon Bob Ainsworth MP (from 30 June 2007)	40,646	Nil	30,456**	Nil
<i>Full year equivalent salary</i>			40,646**	
<b>Parliamentary Under-Secretary of State for Defence (Minister for Defence Equipment and Support):</b>				
Mr Quentin Davies MP†† (from 5 October 2008)	Nil	Nil	Nil	Nil
<b>Parliamentary Under-Secretary of State for Defence (Minister for International Defence and Security):</b>				
The Rt Hon the Baroness Ann Taylor of Bolton† (Defence Minister from 8 November 2007)	109,983	Nil	43,192**	Nil
<i>Full year equivalent salary</i>			108,736**	
<b>Parliamentary Under-Secretary of State for Defence (Minister for Veterans):</b>				
Mr Kevan Jones MP†† (from 5 October 2008)	Nil	Nil	Nil	Nil
Mr Derek Twigg MP (to 5 October 2008)	15,840	Nil	30,665**	Nil
<i>Full year equivalent salary</i>	30,851			

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

\*\*Prior year figures have been restated to include the effect of the back-dated pay rises and, in the case of Baroness Taylor the retrospective payment of taxable allowances.

† For the period 8 November 2007 to 3 October 2008, Baroness Taylor held the post of Minister for Defence Equipment and Support.

†† Mr Kevan Jones MP and Mr Quentin Davies MP do not draw the £30,937 Ministerial salary to which they are entitled.

Ministers who, on leaving office, have not attained the age of 65 and are not appointed to a relevant Ministerial or other paid office within three weeks, are eligible for a severance payment of one quarter of the annual salary being paid. Two payments were made in 2008-09 (2007-08 – one).

## Ministerial Salary

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

The figures above are based on payments made by the Department and thus recorded in these accounts. In respect of Ministers in the House of Commons, the Department bears only the cost of the additional Ministerial remuneration; the salary for their services as an MP – £63,291 pa with effect from 1 April 2008 (£61,820 pa with effect from 1 November 2007; £61,181 pa with effect from 1 April 2007)<sup>2</sup> and various allowances to which they are entitled, are borne centrally. The arrangements for Ministers in the House of Lords are different in that they do not receive a salary but rather an additional remuneration, which cannot be quantified separately from their Ministerial salaries. This total remuneration, as well as the allowances to which they are entitled, is paid by the Department and shown in full above.

## Benefits-in-Kind for Ministers

Ministers' private use of official cars is exempt under the rules governing the definition of taxable benefits-in-kind. Where Ministers are provided with living accommodation and a taxable benefit-in-kind arises, its value is calculated in accordance with HM Revenue & Customs regulations.

## Ministerial Pensions

*(This section has been subject to audit)*

Figures for **2008-09 in bold**. The real increase in the value of the accrued pension compared to the 2007-08 value, is shown *in italics* (in bands of £2,500).

	Total Accrued Pension at Retirement as at 31 Mar 09 £000	CETV* at 31 Mar 08 or Date of Appointment if Later £000	CETV at 31 Mar 09 or on Cessation of Appointment if Earlier £000	Real Increase in CETV £000
<b>Secretary of State for Defence:</b>				
The Rt Hon John Hutton MP (from 4 October 2008)	<b>10-15</b> <i>0-2.5</i>	<b>152</b>	<b>168</b>	<b>14</b>
The Rt Hon Des Browne MP (to 3 October 2008)	<b>5-10</b> <i>0-2.5</i>	<b>109**</b>	<b>121</b>	<b>7</b>
<b>Minister of State for the Armed Forces:</b>				
The Rt Hon Bob Ainsworth MP	<b>10-15</b> <i>0-2.5</i>	<b>137**</b>	<b>158</b>	<b>9</b>
<b>Parliamentary Under-Secretary of State for Defence (Minister for Defence Equipment &amp; Support):</b>				
Mr Quentin Davies MP (from 5 October 2008)	<b>Nil</b>	<b>Nil</b>	<b>Nil</b>	<b>Nil</b>
<b>Parliamentary Under-Secretary of State for Defence (Minister for International Defence Security):</b>				
The Rt Hon the Baroness Ann Taylor of Bolton	<b>0-5</b> <i>0-2.5</i>	<b>5**</b>	<b>36</b>	<b>23</b>
<b>Parliamentary Under-Secretary of State for Defence and Minister for Veterans:</b>				
Mr Kevan Jones MP (from 5 October 2008)	<b>Nil</b>	<b>Nil</b>	<b>Nil</b>	<b>Nil</b>
Mr Derek Twigg MP (to 5 October 2008)	<b>0-5</b> <i>0-2.5</i>	<b>40**</b>	<b>45</b>	<b>3</b>

\*CETV – Cash Equivalent Transfer Value.

\*\* The factors used to calculate the CETVs were updated in October 2008 to comply with The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008 and as a result the figures for the 31 Mar 08 have changed from those published in the 2007-08 accounts.

Pension benefits for Ministers are provided by the Parliamentary Contributory Pension Fund (PCPF). The scheme is made under statute (the regulations are set out in Statutory Instrument SI 1993 No 3253, as amended). Ministers who are Members of Parliament may also accrue an MP's pension under

<sup>2</sup> The annual salary was increased from £60,675 to £61,181 with effect from 1 April 2007, and to £61,820 with effect from 1 November 2007 on 24 January 2008.

the PCPF; this pension is not included in the table above. The accrued pension quoted is the pension the Minister is entitled to receive when they reach the age of 65, or immediately on ceasing to be an active member of the scheme if they are already 65.

The arrangements for Ministers provide benefits on an 'average salary' basis, taking account of all service as a Minister. The accrual rate has been 1/40th since 15 July 2002 (or 5 July 2001 for those that chose to backdate the change). Ministers, in common with all other members of the PCPF, can opt for a 1/50th accrual rate and a lower rate of employee contribution.

Benefits for Ministers are payable at the same time as MPs' benefits become payable under the PCPF or, for those who are not MPs, on retirement from Ministerial office from age 65. Pensions are increased annually in line with changes in the Retail Prices Index. Members pay contributions of 6% of their Ministerial salary if they have opted for the 1/50th accrual rate or 10% if they have opted for the 1/40th accrual rate. There is also an employer contribution paid by the Exchequer representing the balance of cost as advised by the Government Actuary. This is currently 26.8% of the Ministerial salary.

### **The Cash Equivalent Transfer Value (CETV)**

This is the actuarially-assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. It is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme 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 in accordance with The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations and do not take account of any actual or potential reduction to benefits resulting from Lifetime Allowance Tax which may be due when pension benefits are taken.

### **The Real Increase in the Value of the CETV**

This is effectively the element of the increase in accrued pension funded by the Exchequer. It excludes increases due to inflation and contributions paid by the Minister and is calculated using common market valuation factors for the start and end of the period.

## Defence Board – Salaries, Allowances and Taxable Benefits-in-Kind

(This section has been subject to audit)

	2008 – 09 Salary* £000	2008 – 09 Benefits-in-kind (to nearest £100)**	2007 – 08 Salary* £000	2007 – 08 Benefits-in-kind (to nearest £100)**
<b>Permanent Under-Secretary of State</b> Sir Bill Jeffrey KCB	185-190	29,100	180-185	29,700
<b>Chief of the Defence Staff</b> Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF	230-235	38,600	220-225	37,000
<b>First Sea Lord and Chief of the Naval Staff</b> Admiral Sir Jonathon Band GCB ADC	170-175	28,500	165-170	27,900
<b>Chief of the General Staff</b> General Sir Richard Dannatt GCB CBE MC ADC Gen	165-170	27,900	170-175	26,800
<b>Chief of the Air Staff</b> Air Chief Marshal Sir Glenn Torpy GCB CBE DSO ADC BSc(Eng) FRAeS RAF	165-170	27,900	160-165	26,800
<b>Vice Chief of the Defence Staff</b> General Sir Timothy Granville-Chapman GBE KCB ADC Gen	170-175	28,500	160-165	27,300
<b>Second Permanent Under-Secretary of State</b> Mrs Ursula Brennan (from 22 October 2008) <i>Full year equivalent salary</i>	65-70 155-160	4,100	Nil	Nil
Sir Ian Andrews CBE TD (to 21 October 2008) <i>Full year equivalent salary</i>	85-90 150-155	2,700	145-150	8,100
<b>Chief of Defence Materiel</b> General Sir Kevin O'Donoghue KCB CBE	165-170	Nil	160-165	Nil
<b>Chief Scientific Adviser</b> Professor Mark Welland FRS FREng (from 7 April 2008) <i>Full year equivalent salary</i>	135-140 140-145	23,500	Nil	Nil
<b>Director General Finance</b> Mr Jonathan Thompson IPFA (from 5 January 2009) <i>Full year equivalent salary</i>	40-45 170-175	Nil	Nil	Nil
Mr Trevor Woolley CB (to 4 January 2009) <i>Full year equivalent salary</i>	105-110 135-140	Nil	130-135	Nil
<b>Non-Executive Directors</b>	Fees		Fees	
Mr Paul Skinner	20-25	Nil	20-25	Nil
Mr Ian Rushby	25-30	Nil	25-30	Nil
Mrs Priscilla Vacassin (from 1 September 2007) <i>Full year equivalent</i>	20-25	Nil	10-15 20-25	Nil

\*Salary includes gross salary, performance pay (paid in 2008-09 but based on performance in an assessment period ended prior to the start of the financial year) and taxable allowances paid.

The payment of legitimate expenses e.g. travel and subsistence, is not part of salary and is not disclosed.

\*\*Benefits-in-kind figures for civilian members of the Defence Board represent the taxable benefit attributed to individuals where an official car is available for private use (the benefit accrues even if the individual chooses not to make use of the car). For Service members of the Board, the benefits-in-kind are the taxable benefits relating to the occupation of Official Service Residences. The Department has an arrangement with HM Revenue and Customs (HMRC) under which MOD pays the tax liability that would normally be paid by the individual on the benefits-in-kind; this tax liability is included in the figures in the table.



## Defence Board – Pension Benefits

(This section has been subject to audit)

2008-09 figures are in **bold**. The real increase in the pension, from 2007-08, and where applicable the real increase in the lump sum payment, are shown in *italics*.

	Total Accrued Pension at Retirement as at 31 Mar 09 £000	CETV at 31 Mar 08 or Date of Appointment if Later £000	CETV at 31 Mar 09 or on Cessation of Appointment if Earlier £000	Real Increase or (Decrease) in CETV £000
<b>Permanent Under-Secretary of State</b> Sir Bill Jeffrey KCB	Pension <b>80-85</b> <i>0-2.5</i> Lump Sum <b>240-245</b> <i>0-2.5</i>	<b>1,830*</b>	<b>1,895</b>	<b>4</b>
<b>Chief of the Defence Staff</b> Air Chief Marshal Sir Jock Stirrup GCB AFC ADC DSc FRAeS FCMI RAF	Pension <b>125-130</b> <i>2.5-5</i> Lump Sum <b>375-380</b> <i>10.5-12.5</i>	<b>2,438</b>	<b>2,552</b>	<b>77</b>
<b>First Sea Lord and Chief of the Naval Staff</b> Admiral Sir Jonathon Band GCB ADC	Pension <b>90-95</b> <i>2.5-5</i> Lump Sum <b>280-285</b> <i>7.5-10</i>	<b>1,836</b>	<b>1,915</b>	<b>52</b>
<b>Chief of the General Staff</b> General Sir Richard Dannatt GCB CBE MC ADC Gen	Pension <b>80-85</b> <i>0-2.5</i> Lump Sum <b>250-255</b> <i>0-2.5</i>	<b>1,668</b>	<b>1,696</b>	<b>16</b>
<b>Chief of the Air Staff</b> Air Chief Marshal Sir Glenn Torpy GCB CBE DSO ADC BSc(Eng) FRAeS RAF	Pension <b>80-85</b> <i>2.5-5</i> Lump Sum <b>245-250</b> <i>7.5-10</i>	<b>970</b>	<b>1,820</b>	<b>642</b>
<b>Vice Chief of the Defence Staff</b> General Sir Timothy Granville-Chapman GBE KCB ADC Gen	Pension <b>90-95</b> <i>2.5-5</i> Lump Sum <b>275-280</b> <i>7.5-10</i>	<b>1,548</b>	<b>1,735</b>	<b>57</b>
<b>Second Permanent Under-Secretary of State</b> Mrs Ursula Brennan (from 22 October 2008)	Pension <b>60-65</b> <i>2.5-5</i> Lump Sum <b>190-195</b> <i>12.5-15</i>	<b>1,195</b>	<b>1,351</b>	<b>100</b>
Sir Ian Andrews CBE TD† (to 21 October 2008)	Pension <b>55-60</b> <i>0-(2.5)</i> Lump Sum <b>130-135</b> <i>(5)-(7.5)</i>	<b>1,147*</b>	<b>1,164</b>	<b>(39)</b>

	Total Accrued Pension at Retirement as at 31 Mar 09 £000	CETV at 31 Mar 08 or Date of Appointment if Later £000	CETV at 31 Mar 09 or on Cessation of Appointment if Earlier £000	Real Increase or (Decrease) in CETV £000
<b>Chief of Defence Materiel</b> General Sir Kevin O'Donoghue KCB CBE	Pension <b>85-90</b> 0-2.5 Lump Sum <b>265-270</b> 5-7.5	<b>1,554</b>	<b>1,720</b>	<b>37</b>
<b>Chief Scientific Adviser</b> Professor Mark Welland FRS FREng (from 7 April 2008)	Pension <b>0-5</b> 2.5-5 Lump Sum <b>Nil</b>	<b>Nil</b>	<b>42</b>	<b>37</b>
<b>Director General Finance</b> Mr Jonathan Thompson IPFA (from 5 January 2009)	Pension <b>25-30</b> 0-2.5 Lump Sum <b>Nil</b>	<b>310</b>	<b>320</b>	<b>9</b>
Mr Trevor Woolley CB (to 4 January 2009)	Pension <b>50-55</b> 0-2.5 Lump Sum <b>150-155</b> 0-2.5	<b>955*</b>	<b>1,046</b>	<b>3</b>
<b>Non-Executive Directors</b>				
Mr Paul Skinner	N/A	N/A	N/A	N/A
Mr Ian Rushby	N/A	N/A	N/A	N/A
Mrs Priscilla Vacassin	N/A	N/A	N/A	N/A

\*The factors used to calculate the CETVs were updated in October 2008 to comply with The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008 and as a result the figures for 31 Mar 08 have changed from those published in the 2007-08 accounts.

†Sir Ian Andrews left the Department under Compulsory Early Retirement Terms on 30 March 2009. Total compensation paid was: a lump sum compensation payable at date of leaving of £123,016; an annual compensation payment of £66,565 payable until the age of 60; and an annual compensation payment of £8,343 payable from the age of 60.

††Clarification of differences between these disclosures and similar information published by the individual's previous Department is continuing.

## Civil Service Pensions

Pension benefits are provided through the Civil Service pension arrangements. From 30 July 2007, civil servants may be in one of four defined benefit schemes; either a 'final salary' scheme (classic, premium, or classic plus) or a 'whole career' scheme (nuvos). Classic, premium and classic plus are now closed to new members. These statutory arrangements are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under nuvos, classic, premium, and classic plus are increased annually in line with changes in the Retail Prices Index (RPI). Recent entrants to premium (after 1 October 2002) and nuvos (from 30 July 2007) may choose between membership of the scheme or joining a good quality 'money purchase' stakeholder pension with a significant employer contribution (partnership pension account). The accrued pensions quoted above are the pensions the members are entitled to receive when they reach 60 (nuvos 65), or immediately on ceasing to be an active member of the scheme if they are already 60 (nuvos 65).

Employee contributions are set at the rate of 1.5% of pensionable earnings for classic and 3.5% for premium, classic plus and nuvos. Benefits in classic accrue at the rate of 1/80th of pensionable earnings for each year of service; in addition, a lump sum equivalent to three years' pension is payable on retirement. For premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service; unlike classic, there is no automatic lump sum. Classic plus is essentially a hybrid with benefits in respect of service before 1 October 2002 calculated broadly as per classic and benefits for service from October 2002 calculated as in premium. In nuvos a member

builds up a pension based on pensionable earnings during their period of scheme membership. At the end of the scheme year (31 March) the member's earned pension account is credited with 2.3% of their pensionable earnings in that scheme year and the accrued pension is uprated in line with RPI. In all cases members may opt to give up (commute) pension for a lump sum up to the limits set by the Finance Act 2004.

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

Further details about the Civil Service pension arrangements can be found at the website [www.civilservice-pensions.gov.uk](http://www.civilservice-pensions.gov.uk).

### **Armed Forces Pension Scheme (AFPS)**

From 6 April 2005, a new Armed Forces Pension Scheme (known as AFPS 05) was introduced for all new members of the Armed Forces; those in service before this date have been given the opportunity to transfer, from AFPS 75, to the new scheme. Both schemes are defined benefit, salary-related, contracted out, occupational pension schemes. The AFPS is non-contributory for members; the cost of accruing benefits is met by the employer at rates approximately equivalent to 36.3% (Officers) and 21.8% (Other Ranks) of pensionable pay for regular personnel. Members are entitled to a taxable pension for life and a tax-free pension lump sum if they leave the Armed Forces at or beyond either the Early Departure Point or the Immediate Pension Point. If a scheme member leaves before these points, they will be entitled to a preserved pension and related lump sum.

Further details about Armed Forces Pensions can be found at the website [www.mod.uk/DefenceInternet/AboutDefence/WhatWeDo/Personnel/SPVA/Pensions.htm](http://www.mod.uk/DefenceInternet/AboutDefence/WhatWeDo/Personnel/SPVA/Pensions.htm)

### **Cash Equivalent Transfer Value**

A Cash Equivalent Transfer Value (CETV) is the actuarially-assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies. The figures include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the AFPS or Civil Service pension arrangements. They also include any additional pension benefit accrued to the member as a result of their purchasing additional pension benefits at their own cost. CETVs are calculated in accordance with The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations and do not take account of any actual or potential reduction to benefits resulting from Lifetime Allowance Tax which may be due when pension benefits are taken.

### **Real Increase in CETV**

This reflects the increase in CETV effectively funded by the employer. It does not include the increase in accrued pension due to inflation or contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

*Sir Bill Jeffrey*  
**Accounting Officer**

**6 July 2009**

## Statement of Accounting Officer's Responsibilities

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

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

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

- observe the Accounts Direction issued by HM Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards, as set out in the *Government Financial Reporting Manual*, have been followed, and disclose and explain any material departures in the accounts; and
- prepare the accounts on a going-concern basis.

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

# 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 Defence policies, aims and objectives, whilst safeguarding the public funds and Departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in *Managing Public Money*.

During the 2008-09 financial year the Department's outputs were delivered through four Trading Fund Agencies, five Executive Non-Departmental Public Bodies (NDPBs), two Public Corporations and eight Top Level Budgets (TLBs).

- The four MOD Trading Funds (The Defence Support Group (DSG), the Defence Science and Technology Laboratory (Dstl), the UK Hydrographic Office, and the Met Office) fall outside the Departmental Accounting Boundary and their Chief Executives are Accounting Officers in their own right. Given their close integration into the MOD's business, potential impact on MOD outputs and their extensive use of Departmental personnel and assets, their Chief Executives provide to me their Statement on Internal Control prepared for their Annual Accounts. In addition, a departmental representative sits on their Management Boards, whilst Ministers, supported by an Owners Board, are responsible for setting the Trading Funds top level objectives, approving major business decisions including their Corporate Plans and setting annual key targets.
- The five NDPBs (Royal Marines Museum, Royal Naval Museum, Royal Navy Submarine Museum, National Army Museum, and Royal Air Force Museum) and two Public Corporations, although sponsored by the Department, also fall outside the Departmental Boundary and their accounts are published separately. The NDPBs and one Public Corporation (the Fleet Air Arm Museum) each operate within a financial memorandum agreed between their respective Boards of Trustees and the MOD. The remaining Public Corporation (Oil and Pipelines Agency) has a Board of Directors on which the MOD is represented.
- The Armed Forces Pension Scheme (AFPS) and the Armed Forces Compensation Scheme (AFCS) are administered by the Service Personnel and Veterans Agency (SPVA). Payments to eligible individuals under AFPS and AFCS fall outside the Departmental Accounting Boundary and have separate, published accounts for which I am also the Accounting Officer. The administration costs of both schemes and employer's contributions are within the scope of the Departmental boundary and fall within the Central Top Level Budget.

Top Level Budget Holders operate within a framework of responsibilities delegated by me. To assist me in assessing the adequacy of control arrangements across the Department, they submit to me an annual statement of assurance, endorsed by their Audit Committee and Management Board. Included within the Top Level Budgets are six 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. The Top Level Budget Holders are responsible for setting the operating framework of the Agencies in their area through a Framework Document, for agreeing performance targets and for monitoring progress.

- Defence Equipment and Support TLB
  - Defence Storage and Distribution Agency
  
- Central TLB
  - Defence Vetting Agency
  - MOD Police and Guarding Agency
  - People, Pay and Pensions Agency
  - Service Personnel and Veterans Agency
  
- Land Command TLB
  - Service Children's Education

Command and administration of the Armed Forces is vested in the Defence Council by Letters Patent, chaired by the Secretary of State for Defence, and beneath that in the Service Boards, chaired by a Minister. Membership of the Defence Council comprises all Defence Ministers and the executive members of the Defence Board. The Chief of the Defence Staff is the Government's and the Secretary of State's principal advisor on military operations and is responsible for the maintenance of military operational capability and for the preparation and conduct of military operations, including managing the risks to successful outcomes. The Chiefs of Staff Committee is chaired by the Chief of the Defence Staff and is the main forum in which the collective military advice of the Chiefs is obtained on operational issues. The individual Service Chiefs also advise the Chief of the Defence Staff, the Secretary of State and, when required, the Prime Minister on the operational employment of their Service.

A Defence Ministerial Committee was established in April 2008, which brings together Ministers with the Department's most senior officials, to ensure that Ministers collectively are engaged more regularly on decisions affecting Defence.

The Defence Board, which I chair, ensures that the Strategy for Defence and the Defence Plan are carried out by using a corporate governance system, which has two inter-related elements, performance management processes and assurance processes. The Board comprises senior executive members of the Department and at least two external independent members. Appropriate decisions of, and direction from, the Defence Board are executed by the Defence Operating Board which was created in 2008. The Defence Operating Board also sees actions through, returning to the Defence Board as necessary.

## **2. The purpose of the system of internal control**

Defence is a complicated business, which is supported and run by a large complex organisation. It is important, therefore, to have the appropriate governance systems in place to best manage the risks that we face.

The system of internal control is designed to manage risk to a reasonable level. Internal control is based on processes 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 MOD for the year ended 31 March 2009 and up to the date of approval of the Annual Report and Accounts, and accords with HM 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. Guidance on the Department's approach to risk is detailed in a Joint Service Publication (JSP). This guidance is

cascaded down through Top Level Budget Holders and is available to all staff on the MOD's intranet. Individual training is available to all staff via the Department's in-house training provider.

#### 4. The risk and control framework

The Department's Performance Management System provides the overall framework for the consideration of risks using a Defence Balanced Scorecard for the identification, evaluation, control and reporting of risk against a balanced assessment of Departmental objectives. The Defence Plan and Top Level Budget Holder plans cascade key Departmental objectives, performance indicators and targets defined by the Defence Board each year. Performance management processes ensure that managers and commanders at all levels of Defence deliver the business requirements placed on them. These requirements take two forms: meeting objectives and targets which cascade from those set out in the Defence Plan; and complying with legal and regulatory requirements, and other binding policies, standards and rules as set by Process Owners on behalf of the Defence Board.

The Defence Board has identified and categorised the top strategic risks facing the Department into seven realms and reviews them during quarterly performance reviews. This provides a tool for top down ownership and direct leadership by the Defence Board. Lower level management boards also regularly review key risks.

The Department's risk appetite varies according to the area of Defence business. Military operations are inherently risky and the risk appetite is determined through the advice given to Ministers on operations. Every effort is made to provide personnel and assets with proper protection through planning, equipment and training, although we ultimately rely on the judgment of Force Commanders to manage the risks individually. On the non-operational side the Defence Board now receives regular Security, Business Continuity and Health & Safety reports and there is now a downward trend in non-operational injuries and fatalities. The Department's planning process assesses any gaps against Planning Assumptions, and limits and controls are placed on individual investment projects as part of the Department's Investment Approval process and the total number of projects.

The Defence Audit Committee, chaired by an external independent member of the Defence Board, reviews the Department's risk-based approach to internal control and provides independent advice to the Defence Board and me as Accounting Officer. The Committee adopts a strategic approach challenging the overall risk identification and assessment processes, pulling together all the strands of independent assurance. It co-ordinates the activities of internal audit, and draws on annual reports from pan-Departmental Process Owners and specialist assurance sources.

Each Top Level Budget Holder is supported by an Audit Committee, chaired by a non-executive member and at which representatives from the internal and external auditors are present. Like the Defence Audit Committee, these committees focus their activities to provide advice on wider-business risk and assurance processes.

A cascaded system is in place for ensuring that Business Continuity plans are present and tested on a regular basis from verifiable self-assessments<sup>3</sup>, including by independent audits. MOD used for the first time this year an assessment questionnaire that addressed all elements essential to an effective Business Continuity Management system. Top Level Budgets and Trading Funds were required to provide single, consolidated responses and this data was used to support the annual Business Continuity report to the Defence Audit Committee. Independent audit data was provided by Defence Internal Audit (DIA) and Director Defence Security Assurance Services (DSAS) in the form of feedback garnered from their audits of business continuity during 2008.

<sup>3</sup> TLBs and TFs were requested to provide assessments approved by their respective Audit Committee or responsible Board Members.

An effective governance structure and performance management system is in place to address the risks arising from the introduction of the general right of access to information from January 2005 under the Freedom of Information Act.

An annual risk-based programme of internal audit is provided by Defence Internal Audit, who are the primary source of independent assurance, which is complemented by the activity of the Directorate of Operational Capability, to provide independent military operational audit and assurance to the Secretary of State, the Chief of the Defence Staff and the Defence Audit Committee.

Annual Reports that provide measurable performance indicators and assessments of the Health of Financial Systems are provided by all Top Level Budget Holders and key functional specialists. This underpins the assurance I am required to give on the effectiveness of the Department's financial systems.

The Department's external audit function is provided on behalf of Parliament by the Comptroller and Auditor General, supported by staff from the National Audit Office (NAO). NAO see all Defence Audit Committee and TLB Audit Committee papers and attend their meetings. There was no relevant audit information which the NAO were not already aware of. Additionally, I held periodic private discussions with Internal Audit and with non-executive members of the Defence Audit Committee.

## 5. Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review is informed by a report from Defence Internal Auditors, by assurance reviews by Top Level Budget Holders and by Process Owners who have responsibility for the development and maintenance of the internal control framework. I have also taken account of comments made by the external auditors in their management letter and other reports and have been advised by the Defence Board and the Defence Audit Committee.

A number of steps have been taken during 2008-09 to maintain and improve the effectiveness of the system of internal control. These include:

- The Defence Board directed that the processes for identifying and reporting strategic risk using the Defence Balanced Scorecard and the guidance to staff on risk management both be reviewed to ensure they remain fit for purpose. This work will report in the autumn of 2009.
- In July the Defence Board directed a review to take forward work to simplify, improve and where possible streamline the Department's assurance processes. Work is now being taken forward to strengthen the role and responsibility of Process Owners within the Department and increase the level of confidence I and the Defence Board can have that performance and compliance management are being properly conducted across Defence, and that risks are being effectively identified and managed. Its principles have widespread support across the Department, but the continuing pressure on resources and substantial organisational change programmes we have in hand will continue to pose a significant challenge to deliver. Meeting this will require effective integration of governance and assurance as a fundamental element of the wider Business Improvement Strategy.
- I have designated a Chief Information Officer who is Information Management Process Owner with responsibility for setting strategy, policy and standards relating to information and for ensuring appropriate governance and monitoring are in place. This followed an independent review by Sir Edmund Burton to investigate the circumstances that led to the loss of personal data from a service recruitment database in January 2008, and to consider the broader MOD approach to data protection. He concluded<sup>4</sup> that MOD policies and procedures are generally fit for purpose and cited examples of good practice by the Department, but also identified a number

<sup>4</sup> "Report into the Loss of MOD Personal Data", Sir Edmund Burton, dated 30 April 2008



of areas where we needed to do better in protecting personal data. Good progress has been made in implementing the recommendations as required by the Information Commissioner's Enforcement Notice<sup>5</sup>. An extensive programme of work is also being taken forward to implement the Data Handling review and significant progress has been made. But risks remain and achieving the changes in behaviour that we need across Defence will require sustained effort over the long term. Enablers are now in place and the emphasis is now to drive the Information Assurance Change Programme to embed processes, practices and, above all, the necessary behaviour essential to routine, good Information Assurance.

- In January 2009 I appointed a new Director General of Finance who is a qualified accountant. He is a member of the Defence Council, the Defence Ministerial Committee, the Defence Board and the Investment Approvals Board. He attends the Defence Operating Board as required and is the Process Owner for financial management. Amongst other things he is responsible for ensuring that my financial, regularity and proprietary responsibilities as Accounting Officer are translated into appropriate organisational arrangements.
- In March 2009 the Cabinet Office published the second Capability Review of the MOD, providing a further assessment of the Department's leadership, strategy and delivery capability. The report acknowledged the significant progress made by the Department since the first review in 2007, but highlighted the need for more work and the Department has committed to actions to achieve further progress. In particular, we seek to inject more pace into implementation of review findings and to develop a robust overarching strategy for the Department. The Director General Strategy post was created on 1 September 2008 and the overarching strategy for the Department is now being developed.

## 6. Significant Internal Control Issues

### a. Joint Personnel Administration

The National Audit Office, in providing a qualified audit opinion arising from a limitation in audit scope for the MOD's 2007-08 Resource Accounts, made a number of recommendations about the Joint Personnel Administration which covered its support to Departmental financial and manpower accounting processes. We are addressing these issues through the Payroll and Allowances Control Framework Project, the JPA Finance "Get Well" project and through the implementation of the various recommendations made in the Barr report (an external review of JPA). SPVA continues to work closely with the NAO with regards to the on-going improvements.

Overall good progress was made on JPA during the year but the improved information which has resulted has increased concern about the complexity of the underlying military pay process in individual services including how elements of expenses might be open to abuse. I recognise that significantly more needs to be done on rectification and improvement and controls in the system and that this is likely to take at least a further 12 months. A programme of further work is underway under the direction of the Defence Operating Board which will address among other things the complexity and adequacy of controls.

<sup>5</sup> Data Protection Act 1998: Supervisory Powers of the Information Commissioner – Enforcement Notice dated 14 July 2008

#### b. BOWMAN

Deficiencies were identified by Land Forces TLB in the information available on asset management systems, both to the balance sheet owner in the Defence Equipment and Support TLB and to Land Forces TLB, on BOWMAN operational tactical communications system.

Significant progress has been made over the past two years to improve the visibility of assets and 89% of BOWMAN radios can now be accounted for at any one time. It is estimated that a large proportion of the remainder are in the repair loop. Further improvement is challenging given that the equipment is designed to be easily transported and is widely dispersed and heavily used on current operations. However, work is in hand through two new management systems to deliver future improvements in deployed logistics.

#### c. Stock Management

The Department remains concerned about stock management processes and systems because of the number of different lines of stock and locations at which they are held. The networked systems comprise a number of both aging and new systems and the complexities within them create a risk of error. The introduction of the Defence Stock Accounting Collation System did not resolve as many stock control issues in year as anticipated but is now better placed to meet the identified needs of stakeholders next year.

We are planning to rationalise and consolidate the stock systems IT architecture, which comprises some 37 systems as quickly as possible. The Department is in the process of appointing a systems integration partner to begin the work early in 2010. However, rationalisation and integration will take time. In addition an end to end process owner review of stock systems and control procedures is being undertaken by the Chief of Defence Materiel and steps are underway to improve the understanding and compliance with our standing processes. In the interim I have also sought assurances that in 2009-10 internal controls are strengthened, specifically management checks over the processes, whilst the longer term plan is developed.

#### d. MERLIN and MAESTRO Asset Systems

Discrepancies have been identified in the annual census exercise which is used to verify assets held on the MERLIN and MAESTRO inventory systems. Problems with the completeness and accuracy of the census returns have been identified. These inventory systems are not used to record all fixed asset movements, but are largely used for wheeled and tracked vehicles and certain grouped assets. Although any discrepancy is unwelcome, placed alongside the scale of operational deployments and the need to move assets quickly, this represents 1.3% of the total tangible fixed asset base for the Department. I have initiated work to improve the procedures for the census process to ensure all returns are completed and included in the annual report.

*Sir Bill Jeffrey*  
**Accounting Officer**

**6 July 2009**

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

I certify that I have audited the financial statements of the Ministry of Defence for the year ended 31 March 2009 under the Government Resources and Accounts Act 2000. These comprise the Statement of Parliamentary Supply, the Operating Cost Statement and Statement of Recognised Gains and Losses, the Balance Sheet, the Cash Flow Statement and the Statement of Net Operating Costs by Departmental Strategic Objectives and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

### **Respective responsibilities of the Accounting Officer and auditor**

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

The Ministry of Defence's Votes A is presented annually to Parliament to seek statutory authority for the maximum numbers of personnel to be maintained for service within the armed forces. The Accounting Officer is responsible for reporting the maximum numbers maintained for service.

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

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000. I report to you whether, in my opinion, the information which comprises the Management Commentary, included in the Annual Report, is consistent with the financial statements. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I also report to you my opinion on whether or not the approved Estimates (Votes A) have been exceeded.

In addition, I report to you if the Department has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by HM Treasury regarding remuneration and other transactions is not disclosed.

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

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

### **Basis of audit opinions**

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence

relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Department's circumstances, consistently applied and adequately disclosed.

I planned my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error, and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. However, the evidence available to me was limited due to a failure to maintain adequate accounting records and supporting evidence for military payroll costs and to operate adequate stocktaking and fixed asset verification procedures, meaning I was unable to obtain sufficient appropriate audit evidence to support:

- the recovery of specialist pay, allowances and expenses made to military personnel that are the subject of a qualification of my audit opinion on regularity;
- income arising from accommodation and food charges deducted from pay to military personnel, which has been recorded in the accounts at £83 million; and
- the existence and valuation of certain stock and fixed assets which are recorded in the accounts at £6.6 billion.

In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

### Qualified Opinion Arising from Limitations in Audit Scope

- Except for the financial effects of any adjustments which might have been determined to be necessary had I been able to obtain sufficient appropriate audit evidence over the recovery of overpayments, income arising from deductible accommodation and food charges, certain fixed assets and stock, **in my opinion:**
  - the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by HM Treasury, of the state of the Department's affairs as at 31 March 2009, and the net cash requirement, net resource outturn, net operating cost, net operating costs applied to departmental strategic objectives, recognised gains and losses and cash flows for the year then ended; and
  - the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000.
- In respect of the limitation on my work relating to recoverable overpayments, income arising from deductible accommodation and food charges, and to stock and fixed assets:
  - I have not obtained all the information and explanations that I considered necessary for the purposes of my audit; and
  - Proper accounting records have not been maintained.
- **In my opinion**, information which comprises the Management Commentary, included within the Annual Report, is consistent with the financial statements

## Qualified Opinion on Regularity

- In the year to 31 March 2009 the Ministry of Defence paid £1,083 million of specialist pay, allowances and expenses to military personnel, of which £268m was paid incorrectly or where entitlement could not be demonstrated. Such overpayments were, by definition, paid without appropriate authority, and accordingly I have concluded that this expenditure has not been applied to the purposes intended by Parliament and is not in conformity with the authorities which govern it.
- **In my opinion**, except for £268m of payments of specialist pay, allowances and expenses paid to military personnel incorrectly or where the evidence supporting their entitlement is not available, 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.

## Qualified Opinion on Votes A

The Ministry of Defence's Votes A is presented annually to Parliament to seek statutory authority for the maximum numbers of personnel to be maintained for service within the armed forces. Note 38 to the accounts states the maximum numbers maintained during 2008-09 for the Naval, Army and Air Force Services in all active and reserve categories were within the numbers voted by Parliament, with the exception of the Army Service Reserve Forces and the Royal Naval Reserve List 7 where the maximum numbers maintained have not been disclosed because the Ministry of Defence has not been able to obtain the relevant information. My role is to inform Parliament whether or not the approved Estimates (Votes A) have been exceeded.

However, with respect to the Army Service Reserve Forces and Naval Service Reserve Forces, the evidence available to me to confirm whether the approved Estimates (Votes A) have been exceeded is limited because the Ministry of Defence has not compiled the relevant information throughout the period. Owing to the nature of the Ministry of Defence's records, I was unable to obtain sufficient appropriate audit evidence regarding numbers maintained in the Army Service Reserve Forces and Naval Service Reserve Forces by using other audit procedures.

In respect of the limitation on my work relating to the numbers of Army Service Reserve Forces and Naval Service Reserve Forces, proper accounting records have not been maintained.

**In my opinion**, except for the Naval Service Reserve Forces and Army Service Reserve Forces, the numbers provided for in the Estimate have not been exceeded.

## Report

My report on pages 183 to 198 provides further detail of my qualified audit opinions on the financial statements and on Votes A.

*Amyas CE Morse*

**Comptroller and Auditor General**

**15 July 2009**

National Audit Office  
151 Buckingham Palace Road  
Victoria  
London SW1W 9SS

# Comptroller and Auditor General's Report on the 2008-09 Resource Accounts of the Ministry of Defence

## Introduction

1. The Ministry of Defence (the Department) Resource Accounts for 2008-09 report net expenditure of some £37 billion. This includes payroll costs for the Armed Forces of £8.9 billion, which are reported under Requests for Resources 1 and 2<sup>6</sup>. The financial statements also report assets of some £122 billion mainly consisting of land, buildings, fighting equipment and stores together with gross liabilities of some £15 billion consisting of, for example, creditors and provisions.

## The purpose of my report

2. This Report explains the basis for the qualification of my audit opinion. It also provides an update on the actions taken by the Department to address the issues identified by my predecessor in his Report on the 2007-08 Resource Accounts<sup>7</sup>.
3. The Department is addressing the issues identified in this Report, but there remains significant further work to be done to ensure that a robust control environment is re-established. I have provided a number of recommendations intended to assist the Department. Some of the issues identified will take a considerable amount of effort and time to address effectively.

## My obligations as Auditor

4. Under the Government and Resources Act 2000 (the Act) I am required to examine and certify all Departmental Resource Accounts. International Standards on Auditing (UK and Ireland) require me to obtain evidence to give reasonable assurance that the Department's financial statements are free from material misstatement. In forming my opinion I examine, on a test basis, evidence supporting the disclosures in the financial statements and assess the significant estimates and judgements made in preparing them. I also consider whether the accounting policies are appropriate, consistently applied and adequately disclosed. I am also required to satisfy myself that, in all material respects, the expenditure and income shown in the resource accounts have been applied to the purposes intended by Parliament and conform to the authorities that govern them.
5. Votes A for the Ministry of Defence is presented annually to Parliament to seek statutory authority for the maximum numbers of personnel to be maintained by the armed forces. Note 38 to the accounts discloses the number voted by Parliament and the maximum numbers maintained during 2008-09 for the Royal Navy, Army and Royal Air Force in all active and reserve categories. My role is to inform Parliament whether or not the approved Estimates (Votes A) have been exceeded.

## Audit opinion

### **Qualified opinion due to material error in military specialist pay, allowances and expenses paid via the JPA system and a limitation of scope due to the inadequacy of evidence to support certain income, expenditure and balances in the financial statements.**

6. I have qualified my regularity opinion on the Department's 2008-09 financial statements because a material value of payments of specialist pay, allowances and expenses made via the Joint Personnel Administration (JPA) system have been made to individuals who are not entitled to them, or to individuals where the evidence supporting their entitlement is not available (paragraphs 10 to 16 below).

<sup>6</sup> A further Request for Resources, RFR 3: war pensions payments, is not the subject of this report.

<sup>7</sup> HC 850 2007-08 Ministry of Defence Resource Accounts 2007-08. In my predecessor's report, he placed a limit on the scope of his audit opinion in relation to expenditure of around £920 million on allowances paid to military personnel.

7. I have limited the scope of my “true and fair” opinion on the Department’s 2008-09 financial statements because the Department was unable to provide me with evidence to support the:
  - (i) recovery of overpayments of specialist pay, allowances and expenses associated with the payments noted above;
  - (ii) level of income recognised by recovering the costs of certain accommodation and food charges from the pay of Service personnel (paragraphs 17 to 18 below), and
  - (iii) value of certain fixed assets and stock balances reported within the financial statements (paragraphs 30 to 63 below).
8. I was also unable to obtain sufficient evidence to support the accuracy of service personnel numbers in relation to the number of reserves for the Royal Navy and the Army and therefore I am unable to report to Parliament whether or not the approved Estimates (Votes A) have been exceeded (paragraphs 19 to 20 below).
9. In respect of the Department’s Resource Accounts for 2007-08, my predecessor limited the scope of his opinion on the accounts because of weaknesses in the JPA system<sup>8</sup>. A number of the concerns raised in my Report build on similar concerns raised by my predecessor.

### **Qualifications of my opinion in respect of military specialist pay, allowances and expenses**

10. This section of my Report describes in more detail the reasons for the qualifications of my opinion in respect of military pay transactions processed via the JPA system (paragraphs 11 to 21). It also provides further information on weaknesses in military HR processes and the Department’s efforts to date to remedy the weaknesses highlighted in my predecessor’s Report (paragraphs 22 to 27). Finally, I draw attention to areas for further action (paragraphs 28 to 31):

#### ***Material error in payments of military specialist pay, allowances and expenses***

11. The framework of Service personnel HR policies, regulation and administration is collectively known as Joint Personnel Administration (JPA). The Department, the Services’ Principal Personnel Officers, Front Line Commands and the Service Personnel and Veterans Agency (SPVA) all contribute to JPA in order to support the administration of approximately 192,000 Regular and 90,000 Reserve members of the Armed Forces. JPA depends on a software package that provides a wide range of processes including the payroll function, centralised records of service and the management of assignments and training. During 2008-09, the JPA payroll system was used to administer around £8.9 billion of staff costs for Service personnel.
12. A fundamental tenet of the JPA system is that input is carried out mainly by self-service users and Human Resources (HR) clerks both in Units and Manning Branches and is subject to only very limited further checks. Because of this the Department relies heavily upon the accurate input of information to provide the correct pay and allowances to Service personnel. In addition Service personnel are able to submit their own expenses claims and payment is normally made without further checks. The Department has a range of detective controls in place but these will not prevent error occurring or detect all errors that have been made.
13. In the absence of adequate input controls over the processing of military pay, allowances and expenses, my staff carried out testing of a sample of basic salaries, allowances and expenses paid via the JPA system.

<sup>8</sup> HC 850 2007-08 Ministry of Defence Resource Accounts 2007-08.

14. My examination of the sample revealed that 14.7 percent of the transactions tested contained an error in the payment. These errors amounted to some 10.1 per cent by value of the sample. I have therefore concluded that this represents material error in the population as a whole. The key errors on which I am reporting relate to:

- errors in the payment of specialist pay;
- incorrect payment of allowances to Service personnel due to incorrect input of data, and
- failure to provide supporting documentation to validate the payment of allowances or expense claims as required by departmental regulations.

I found no material error in relation to basic pay for service personnel.

15. From the random sample of payments tested by my staff, an estimate of error is provided below.

Area	Amount paid £	Overpayments £	Underpayments £	Net most likely error £	Gross most likely error £
Specialist pay	235,000,000	74,718,637	7,557,341	67,161,296	82,275,978
Allowances	560,000,000	99,044,121	56,273,559	42,770,562	155,317,680
Expenses	288,000,000	30,582,873	261,671	30,321,202	30,844,544
Total	1,083,000,000	204,345,631	64,092,571	140,253,060	268,438,202

16. I consider this level of error to be material to the account and therefore I have qualified my regularity opinion in this respect. I have also qualified my “true and fair” opinion on the basis that the Department is unable to estimate the level of any recoveries of these overpayments.

***Limitation on the scope of my audit opinion in respect of income recovered via the military pay process and for the purposes of my report on Votes A***

17. I have limited the scope of my opinion due to the inadequacy of evidence to support the completeness of approximately £83 million of income relating to charges made to personnel. Particular areas were deductions from pay for occupying single service accommodation and for food.

18. Given the absence of adequate input controls over the processing of charges for occupying single service accommodation and other deductions made directly from pay, my staff were unable to take assurance from management’s own monitoring controls and, because of the limitations of management information, my staff were also unable to carry out reliable analytical procedures. As a result:

- individual Top Level Budget<sup>9</sup> (TLB) holders were unable to reconcile or confirm the completeness of deductions from pay for which they hold budgetary responsibility back to JPA to enable correction of mis-postings, and
- I was unable to establish the appropriateness of amounts recovered for the current and prior years.

19. I was also unable to obtain sufficient evidence to support the accuracy of certain categories of Service personnel numbers reported to Parliament as part of Votes A as shown in Note 38 to the Resource Accounts. The Army have been unable to provide the maximum number of Service Reserves as monthly figures for Reserves have not been collated during the year. The Royal Navy

<sup>9</sup> Top Level Budget holders are the main budget holders within the Department. There are currently 8 TLBs: Navy, Army, RAF, DE&S, SIT, Central, CJO, DE.



have also been unable to provide numbers for the Royal Naval Reserve "List 7". Whilst they have been able to provide maximum numbers for the Royal Fleet Reserve (Marines), the Royal Naval Reserve and the Royal Marines Reserve they have been unable to provide evidence to fully support the figures that have been disclosed.

20. The evidence available to me to support the figures stated for the maximum numbers maintained was not sufficient to enable me to report to Parliament whether or not the approved Estimates (Votes A) have been exceeded.
21. There were no other procedures available to me to carry out an audit of these areas and I have therefore limited the scope of my opinion in this regard.

### Development of the JPA system

22. In my predecessor's Report on the Department's Resource Accounts for 2007-08, he described the difficulties surrounding the implementation and operation of the new JPA project. That Report detailed a number of significant weaknesses in the JPA system, which was undermining its effectiveness in delivering the capability which had been originally intended. His Report also detailed concerns about the lack of controls within the system to prevent and identify errors and about the number of cases where incorrect information was held within the system.
23. He drew attention to the Department's review of the JPA system<sup>10</sup>, reported in May 2008, which noted key issues in the implementation of JPA and lessons to be learned. This report also included a recommendation to carry out a further review to assess the gap between desired capabilities for JPA against the actual capabilities and how to get to the desired end.
24. In May 2009, the Department produced this further "stocktake"<sup>11</sup> report which provided an updated assessment of the key gaps between what the JPA system was intended to deliver and what the system actually delivers. In response to this latest report, the Service Personnel Board is developing a road map to enable further changes to be made to enable the desired outcomes to be achieved as far as possible.
25. Key areas in which the Department has identified that performance does not yet match aspirations include:
  - the JPA system is extremely complex and subject to continuous change both to improve performance and to allow the services to provide a better pay and allowances framework. There are still some 400 "extensions" to the system which provide variations to the functionality of the original off-the-shelf package which is the foundation for JPA. Analysis by SPVA who are responsible for the operation of JPA has found that some 25% of these have a high impact on complexity and support to the system. Their work has usefully identified those which are both complex and less stable which should in turn assist when further updates are planned;
  - there remains frustration at the lack of immediate access to JPA terminals. Inadequate access undermines a key part of the vision for the JPA system which was for individuals to take responsibility for the maintenance of their own personnel data through self-service. Although there is an expectation that internet access will improve overall access, there are network and capacity issues still to be addressed and financial constraints are likely to limit the potential for significant improvement;
  - Reserve Forces, in particular, suffer from a lack of access to the system and their pay, allowances and expenses often do not fit easily into existing processes as the system was not originally designed for this part of the Service personnel population;

<sup>10</sup> The Barr report

<sup>11</sup> As recommended by the Barr Report

- data quality is poor in a number of important areas such as the location of personnel, leave, nationality and “whether trained”<sup>12</sup>. The key to improving this is believed to be a change in culture to promote participation and responsibility and simplification of some of the most complex rules which themselves give rise to error;
  - management information, for example for location, nationality and annual leave is considered by users to be inaccurate or out-of-date. This is inhibiting effective personnel management in the widest sense. Most importantly, the information does not facilitate budget holders’ monitoring of expenditure, with the associated opportunity to identify potential errors, and
  - key users are developing parallel systems, having to perform additional validation or take other necessary action to compensate for weaknesses in the JPA system. For example, the Defence Analytical Services Agency (DASA) corrects data from JPA to produce its own statistics for reports to the Armed Forces Pay Review Body, and is also considering whether to request the removal of the National Statistics’ status<sup>13</sup> accorded to its manpower reports for Reserve Forces and Cadets (TSP 07) because of the unreliability of data from the JPA system.
26. System improvements are being made and the reporting capability has also been enhanced. Important developments include the proposal to set up a joint board to be responsible for data management and policy and the establishment of an Army data management organisation to lead their work to improve and maintain JPA data quality. The Stocktake report also proposes an enhanced management information tool (Oracle OBIEE+) to supersede the current tool (Discoverer) which provides an important opportunity for improvement. All of the potential improvements these changes may bring have, in some cases, yet to be seen as there is an inevitable time-lag until the impact can be fully assessed.
27. Despite the weaknesses in the JPA system, the Army has recently reported that the reputation of the system is improving<sup>14</sup>. Whilst I welcome these efforts to improve the quality of Army data, mitigating actions like those taken by the Army will undoubtedly undermine the achievability of the efficiency savings originally intended to flow from the implementation of the JPA project.

### Further issues for consideration

28. I welcome the improvements taking place and the further work planned by the Department as a result of the recent “stocktake” report. However as the Department recognises, several step changes are still required before the end-to-end military pay process including JPA can be considered fit for purpose.
29. Important issues also remain which I do not consider have been sufficiently addressed by the work carried out to date. Key areas where further consideration is required include:
- **ensuring the accuracy of the personnel data held on the JPA system.** The issue of incorrect data in the JPA system is fundamental both to financial reporting and to the personnel management process and is acknowledged to be a widespread problem which needs urgent and sustained action. One consequence of the poor quality of data held on the JPA system is that the Department is unable to use this system to report robust information to Parliament on numbers of Service personnel against the estimates allowed under Votes A;
  - **ensuring appropriate quality control over input to the JPA system.** Responsibilities in respect of the quality of input need to be clear and TLBs need to ensure, through appropriate training and review, that HR clerks at Units are inputting data accurately. This may involve a review of the resources currently devoted to this role;

<sup>12</sup> “trained” is an important statistic as it enables management to identify the level of available forces for operations.

<sup>13</sup> The status of data as a National Statistic is only accorded to data that meets strict quality criteria set by the Office for National Statistics..

<sup>14</sup> Annual report of the Army

- **reduction in errors in specialist pay, allowances and expenses.** With the lack of basic input controls, the Department needs to consider more specifically how to reduce the level of input error in relation to basic pay, allowances and expenses to an acceptable level. The Department intends to introduce some input checks in July 2009 and this should lead to improved control. However, I do not believe that these control enhancements, even if accompanied by improved training and promotion of a culture of taking responsibility for accurate use of the JPA system, will be sufficient to reduce error to the necessary extent;
- **adequacy of controls to deter and detect fraud.** The Defence Fraud Analysis Unit has drawn attention to the growth of suspected frauds in respect of payments made via the JPA system. The Department has a number of compliance checks in place in relation to expenses including a random sample of 5 per cent of expense claims and there are plans to use analytical tools to target checking on unusual transactions.
- **ensuring that access is possible for all types of users.** There is a concern that the Department is rolling out further applications onto the Department's main IT platform<sup>15</sup>, without the necessary associated development of IT capacity. This will have an impact on all applications, including the JPA system, and will inevitably have implications for the reliability and accessibility of the JPA system. Lack of reliability and appropriate access could have an adverse impact on the Department's ability to enforce compliance with individuals' responsibilities, which could fundamentally undermine the rationale for the introduction of the JPA system;
- **facilitating budgetary control for TLB Holders.** The Department needs to continue efforts to ensure that management information is provided to the TLBs to enable them to operate budgetary control effectively, for example by supporting accessible and prompt analysis of variances to allow any necessary remedial action to be taken by the TLBs. Some budgetary reports have been made available since early 2009 but it is too early to assess whether these meet budget holders' needs;
- **revisiting the potential for harmonisation of pay and conditions of service.** The complexity of allowances and expenses means that, even with appropriate training, there remains a high risk of HR clerks or other personnel making mistakes. There is a continuing tension between the argument for simplification and harmonisation, particularly in view of the impact the current systems have for the complexity and risks of the JPA system, and the argument that the system should not be allowed to shape rules and regulations that may be required to meet specific Service personnel and business needs;
- **identification of the full cost of operation of the JPA system.** There is a general aim for the JPA system to reduce administration costs but there is a risk that efficiency savings from implementation of the JPA system may be leading to increased costs elsewhere within the Department and Services;
- **strong project management over the transfer to Oracle.** The complexity of the JPA system, with its added extensions, means that early preparations need to be made if the application is to be moved onto Oracle Fusion as support for the current application is forecast to end sometime after 2012 once Oracle have completed their product switch to Fusion. The "stocktake"<sup>16</sup> report notes that a decision will be required by mid 2010 to upgrade or not, although no specific recommendations are made in the report on how this project will be managed and resourced;
- **sufficiency of evidence to support deductions for accommodation, food and other charges through the JPA system.** Responsibility for accommodation charges and food lies with Defence Estates (DE) and Defence Equipment and Support (DE&S) respectively. Deductions are made from

<sup>15</sup> Commonly referred to as DII(F): Defence Information Infrastructure (Future)

<sup>16</sup> Paragraph 3.15

pay based on input into JPA by Units who are also responsible for ensuring credit is given for periods when personnel are not due to make payment, for example, if they are away on exercise or deployment. DE and DE&S have no means by which they can assess whether the income due is complete.

### **Limitation of the scope of my opinion in respect of assets**

30. In this part of my Report, I explain further the reasons for the limitation of the scope of my audit opinion due to the inability of the Department to provide adequate evidence to support certain fixed asset and stock balances within the financial statements (paragraphs 31 to 63). I also provide information on the Department's approach to the management and valuation of assets (paragraphs 31 to 47) and describe in more detail the specific concerns around the management of, and accounting for, certain military equipment including, but not limited to, BOWMAN communications equipment (paragraphs 48 to 63).

#### ***Limitation on the scope of my opinion in respect of assets***

31. I have limited the scope of my opinion in relation to around £6.6 billion of asset values reported within fixed assets and stock in the financial statements, due to insufficient evidence to support the existence of:

- certain inventory and stock items stored principally by the Defence Storage and Distribution Agency (DSDA); and
- certain military equipment including BOWMAN radios and associated equipment.

32. Each year, my staff review the results of the Department's stock counts and carry out a programme of independent counts to gain assurance over the accuracy of inventory accounting records. My staff also monitor the extent to which inventory owners have validated the movements and balances reported through the general ledger.

33. My staff carried out focussed testing of the inventory at various DSDA sites including Donnington, which holds inventory with an estimated net book value of £1.0 billion. This testing identified the greatest level of inaccuracy with 76 out of a total of 345 lines of stock counted being found to be inaccurately reported in the inventory accounting systems comprising 36 surpluses and 40 deficiencies. DSDA were unable to provide comprehensive explanations of the causes of the high discrepancies detected during the audit.

34. As described below, the Department has processes for assessing the completeness and accurate reporting of all fixed assets. The annual process for certain fixed assets including vehicles and certain grouped assets has revealed a significant increase in the levels of discrepancies being reported noting both surpluses and deficiencies.

35. In relation to BOWMAN assets in particular, the monitoring, tracking and accounting for assets has proved difficult for the Department for a number of reasons, which I explain further below. As a result of these difficulties, systems have only been able to accurately report on the existence and location of between 80-97 per cent of expected numbers of BOWMAN radios and associated equipment. By the year end the Department's most realistic assessment provided a visibility level of 89 per cent of the BOWMAN assets believed to be in service. At this level some £155m of such assets reported in the Departmental Resource Accounts could not be fully accounted for.

36. The level of control exercised by the Department is inadequate and the level of evidence required in order for me to provide an opinion on the existence and completeness of the relevant assets underpinning the values reported in the financial statements (and the associated expenditure in the Operating Cost Statement) has not been available. There were no other procedures available to me to carry out an audit of these balances and I have therefore limited the scope of my opinion in this regard.

### **The Department's approach to inventory management**

37. The Department's Resource Accounts for 2008-09 disclose a net book value of some £14.1 billion of fixed assets and stock, comprising raw materials and consumables of £6.2 billion and capital spares of £7.9 billion. There are a wide variety of assets reported under these categories as the Department holds over 1.4 million different lines of stock. These range from items of fighting equipment and significant capital spares, such as aircraft engines, to consumable items such as batteries.

38. The Department stores inventory items at a number of sites in the United Kingdom, the largest depots being in Donnington and Bicester. A programme of continuous stocktaking is performed to ensure that the inventories accurately record the levels of stock held. Because of the nature of continuous stocktaking it is important that errors are investigated and the impact assessed in case systemic issues are found.

39. The aim of stocktaking in the Department is:

- to provide assurance on the information necessary about stock levels to ensure reliable logistics support to meet operational tasks;
- to verify the validity, completeness and accuracy of accounting records to demonstrate and provide adequate assurance regarding the validity of the asset values reported in the Department's Resource Accounts; and
- to provide assurance to the inventory owners that their stockholdings are being properly safeguarded and accounted for by the custodians, for example by allowing trends of discrepancies to be monitored in order to deter, prevent and detect possible theft and fraud.

40. The Department's policy is to ensure that all inventories are subject to a full stocktake during a four-year stocktaking cycle. The key elements of this cycle are:

- each year a minimum of 70% of the total value of inventories held is checked;
- every line item is checked at least once every 4 years;
- items categorised as high risk are verified annually;
- additional checks are carried out on sensitive items;
- 2% of checks are re-performed, and
- there are additional management checks on the effectiveness and efficiency of the cyclical stocktaking procedures.

41. In addition to the physical counting and checking of inventories performed by custodians at stores, the owners of inventories are also required to review and validate stock movements and balances reported to them through the general ledger.

### **Weaknesses in inventory management**

42. The Department's stock systems are highly complex, because of the number of different lines of stock and locations at which they are held. The networked systems comprise a range of data feeds, incorporating a number of both new and legacy systems.
43. The complexities within the stock systems create a significant risk of error, and unintended consequences can occur as a result of minor changes or actions in one system. It is therefore critical that data from systems is fully reconciled in order to ensure that it is being accurately passed from warehouses and deployed systems to the general ledger which, in turn, supports the valuation of these stocks in the financial statements.
44. In 2008-09, the results of daily stocktakes across the depots operated by DSDA have shown a deterioration in the accuracy of reported stock holdings. The level of reported errors varied significantly, revealing high levels of discrepancies between the inventories counted in the stores and the amounts recorded on the underlying inventory accounting systems. The increase in discrepancies suggests that the systems for recording the receipt, holding and issue of inventory items may not be working as intended. In some areas the difficulties reconciling data held on warehouse systems to the data held on central stock accounting systems further weakens inventory management.
45. Particularly high discrepancies were found during the audit of inventories held at DSDA. As DSDA holds the majority of the Department's inventory (approximately 66 per cent), the impact of these errors on the reliability of underlying stock accounting records is considerable. In addition, insufficient management checks were performed by DSDA for the first nine months of 2008-09.
46. Many inventory owners were also unable to confirm or support the balances and movements reported in their own records. Difficulties encountered included:
- incorrect data entries by local inventory staff at storage depots and warehouses;
  - unexplained adjustments made to inventory balances by the central stock accounting team to correct system-generated errors;
  - reallocation of ownership of inventory items to owners who were unfamiliar with the stock concerned;
  - changes in personnel due to restructuring and relocation, which resulted in a lack of inventory management and accounting expertise within the owning units;
  - closure, in December 2007, of the depot at Stafford with stores being transferred mainly to Donnington and Dulmen in Germany. Stores were not checked on leaving Stafford and it has taken time to check these into their new locations.

### **Action taken by the Department**

47. The Department recognises that, in part, the issues that have arisen relate to system problems in the end-to-end logistics process and have taken urgent and extensive steps to improve materiel and stocktaking procedures including:
- setting up a campaign to be led by the Chief of Defence Materiel as the logistics process owner to address the wider end-to-end logistics issues which have led partly to the discrepancies and issues found;

- the creation of a Stock Integration Plan inventory action team of 24 staff to review processes and perform checks across all DSDA sites;
- in DSDA, management and re-performance checks have been re-established since January 2009, and
- further work is continuing to reconcile legacy stores and stock systems.
- planning to engage a single partner to help introduce a common process architecture, in order to rationalise the number of inventory systems.

## Military equipment

48. All assets, except land and buildings, are managed by DE&S. Once assets are issued to units in the front line commands, the units as the “custodians” have responsibility for monitoring and controlling the physical condition of the assets and for reporting losses, returns and impairments. Transactions affecting the Fixed Asset Registers are processed by a third organisation, the Fixed Asset Processing Centre (FAPC) which processes information affecting Fixed Asset Registers and generates the relevant accounting information for the DE&S.

49. Two of the Fixed Asset Registers maintained by the FAPC form the Managed Equipment Fixed Asset Registers (MEFAR). The MEFARs record assets with a net book value of some £6.1 billion and are used to record the values of certain managed equipment such as wheeled and tracked vehicles, firearms, grouped assets and encrypted communication equipment.

50. Information on managed equipment assets is input to the MEFAR using data fed from a number of subsidiary systems, for example:

- Data for wheeled and tracked vehicles is input by extracting data from a system known as MERLIN;
- Grouped assets such as rifles are fed into the MEFAR from an inventory management system known as MAESTRO;
- The number and value of BOWMAN communications assets is supplied to the MEFAR by the lead Integrated Project Team.

The verification of assets held on the MEFAR is performed through specific census checks in the case of MERLIN, MAESTRO and BOWMAN assets.

### **Weaknesses in the management of equipment recorded through MERLIN and MAESTRO**

51. The Department conducts the census of MERLIN and MAESTRO assets by issuing returns to asset “custodians” usually military units who check the location and condition of the assets. The Department collates this information and produces an Annual Report summarising the results of the exercise and this forms a key part of its assurance that these assets are recorded accurately and completely. Surpluses and deficiencies should be investigated and the relevant accounting action taken.

52. For 2008-09, the number and value of discrepancies reported through the census checks has increased significantly compared to previous years. The levels of returns made and discrepancies noted for each census of the MAESTRO and MERLIN equipment are provided below:

Year	% census complete	MAESTRO net discrepancies	MERLIN net discrepancies	Total value of discrepancies
2009	MAESTRO-85%; MERLIN-85%	£721m	£356m	£1077m
2008	MAESTRO-100%; MERLIN- 91%	£5m	£391m	£396m
2007	MAESTRO-100%; MERLIN- 98%	£176m	£82m	£258m

53. The increase in reported discrepancies indicates that the data in the MEFAR is not accurate or complete and that the corresponding asset values included in the financial statements may be misstated. However where assets have been passed between units there may be offsetting surpluses and deficiencies.

### **Action by the Department**

54. The Department is reviewing the latest MERLIN/MAESTRO Census report and will carry out further work to establish the causes of the growing discrepancies noted and decide what further action is necessary. Causes are thought to include:

- new codes for a large quantity of equipment have been introduced in the past year and at the time of the Census these had not been removed from MAESTRO, although the Department has informed me that the majority of these have now been removed, and
- a wide range of equipment has been moved to operational units without the relevant changes being recorded on MAESTRO. However, with the low level of returns from operational units, surpluses which might have offset the deficiencies noted elsewhere are not known.

55. The Department has recognised that in part the issues raised arise from the management and timing of their Census as well as the current operational tempo of front line units and they have taken steps to improve their procedures as follows, by;

- Changing the timing of the MERLIN and MAESTRO Census to allow units to be hastened on a more regular basis during the Census process to ensure that their returns are completed and included in the annual report;
- improving the cleansing of unit details on MAESTRO to ensure that all units included in the next Census are 'live' and are correctly addressed;
- continuing to invest in new integrated logistic information systems which will initially support and eventually replace the Census requirement.

### **Weaknesses in the management of BOWMAN communications equipment**

56. BOWMAN is a tactical communications system integrating digital voice and data technology to provide secure radio, intercom and tactical internet services in a modular and fully integrated system. The net book value of BOWMAN assets recorded in the Department's Resource Accounts for 2008-09 is £1.3 billion which relates to approximately 35,800 radio sets and associated cabling and other equipment. Examination of the Department's fixed asset records by my staff identified that the entries in respect of BOWMAN communication equipment were not fully supported.

57. The monitoring, tracking and accounting for BOWMAN assets has proved difficult for the Department for a number of reasons, most significantly:

- DE&S, the users (chiefly the Army, but also the other Services) and the provider have different systems for recording BOWMAN equipment;
- to manage operational needs a Whole Fleet Management approach has been taken so that radios are swapped extensively, sometimes in-theatre, without all procedures necessarily being followed. Discrepancies can therefore not always be investigated;
- the planned information system to support BOWMAN was withdrawn in 2005 as it was considered too expensive and not sufficiently flexible for the high volume of transactions that would be necessary to maintain visibility;



- the reported population of radios recorded on the various systems shifts and a stable population is therefore not available with significant quantities of equipment in transit at any moment in time, and
- equipment was initially issued without NATO Stock Numbers, without which the equipment was not able to be properly recorded on existing reporting systems;

58. As a result of the above, existing reporting systems have only been able to accurately report on the existence and location of between 80-97% of expected numbers of BOWMAN radios and associated equipment. By the year end it was only possible, on the basis of their most realistic estimate, to confirm the existence of approximately 89% of the BOWMAN assets believed to be in service. At this level some £155m of such assets reported in the Departmental Financial Statements could not be accounted for. The Department estimates that at 31 March 2009 a significant proportion of these were in the repair loop.

59. The actual number and value of BOWMAN assets in service at 31 March 2009 is uncertain because:

- information originally provided by the BOWMAN project team on the value and volume of BOWMAN assets issued has been revised several times;
- the most likely estimate of the level of visibility requires information from a number of sources and includes further estimates;
- the data on BOWMAN assets has not been revised to take account of items which have been destroyed or impaired. At least £2 million of equipment is believed to have been destroyed but authoritative documentation to support this estimate is unavailable; and
- not all BOWMAN assets issued were included within the MEFAR further restricting the Department's ability to track and monitor these assets. Following my review, some 5000 BOWMAN radio sets with an estimated value of £178 million have now been recorded on the MEFAR.

60. This is important as accurate information is needed to obtain a complete picture of where radios are, to ensure the most effective deployment and to ensure that modifications to, and updating of, hardware and software are carried out efficiently and comprehensively so that effective communications can be maintained.

61. During my staff's review of the management and control of BOWMAN assets, a number of other weaknesses were identified in financial control and management information, most significantly:

- the contract did not require the contractor to provide for good quality data and regular management information required to account for the BOWMAN assets issued. For example, it can be difficult to distinguish between items repaired and re-issued and those being issued as new equipment;
- the contractor maintains a supply of stocks and spares which were not included in the MEFAR at the year-end (estimated to be approximately 1400 radio sets valued at around £50 million);
- the MEFAR aggregates thousands of individual line items under 15 main items of account and does not hold serial numbers or up-to-date locations for the equipment issued. This hampers physical verification of the equipment;
- the Department's work has been focused on the high value equipment such as radio sets which are classified as 'P' class assets. There is also however some £200 million of other assets where the policy for tracking and accounting for them has not yet been decided; and

- the Department has not carried out impairment reviews of BOWMAN assets to identify any which may have been damaged and or unusable. As at 31 March 2009 the Department estimated that some 2000 radio sets were under repair at the year end.

### **Action by the Department**

62. The Department has taken steps to address the issue of tracking, monitoring and accounting for BOWMAN assets. Actions taken include:

- establishment of a high level Asset Management Steering Group, including key stakeholders, to develop a programme to stabilise, consolidate, resolve and enact BOWMAN policy and process changes with the aim of developing and implementing an effective system for the management of BOWMAN equipment;
- HQ Land Forces will continue their major BOWMAN census across all Army units including those deployed on operations and issue better guidance and directions for BOWMAN asset management;
- Development and roll-out of the BOWMAN Asset and Configuration Management System (BACMS) and enhancement of the future Joint Asset Management and Engineering Solutions (JAMES) system along with a number of other initiatives which will enable serial number tracking and accounting for BOWMAN assets;
- introduction in 2008-09 of an asset tracking system called UNICOM Out of Barracks. This system has now been rolled out further so that there is improved tracking of BOWMAN assets in operational theatres;
- continuing with a full inventory census designed to identify all BOWMAN assets;
- establishing a dedicated asset manager role within the relevant DE&S project team and beginning an exercise to improve its record-keeping of assets owned by the Department but utilised by contractors at their own premises by arranging 'audit visits' to its prime contractor and its sub-contractors; and
- deployment of additional staff resources to the BOWMAN project team to expedite resolution of the issues identified.

63. The contractor has responded positively and has provided some management information as requested. Additional management information is also now being provided on a routine basis.

### **Recommendations for further action**

64. I welcome the action already taken by the Department and note its future plans in respect of the areas of weakness highlighted in my and my predecessor's Reports. However, my audit has identified a number of areas of concern.

65. While the Department may have already instigated some of these actions, I detail below my recommendations for further improvements to the Department's procedures.

## The military pay process

### *On ensuring that accurate data is held within the JPA system*

- The Department should establish a task force to systematically correct pay and personnel records. There have been some improvements seen, and more are planned, but a systematic cleansing exercise should be undertaken with clear targets for the required levels of accuracy to be obtained and deadlines for the completion of this work;
- Particular attention should be paid to ensuring that the Department can meet its statutory requirements for reporting to Parliament on Votes A manning levels;

### *On access to the JPA system*

- A formal review should be undertaken of the existing levels of access to the JPA system and whether they are sufficient to allow the processes to be operated as intended. Where access is insufficient, alternative arrangements should be introduced;
- The ability of the Department's main IT platform to support the JPA system going forward should be reconsidered in light of the other applications which are also dependent on this IT platform;

### *On military pay process controls:*

- The Department should complete the review of controls begun last year to identify those that are key and to consider if further controls are needed. This review should take account of the need to reduce the level of error and fraud in relation to basic pay, allowances and expenses to an acceptable level and should ensure that there is a proper balance between preventative and detective controls. More specifically:
  - consideration should be given to activating the JPA system's capacity to allow line managers to see each expense claim at the time it is input. Whilst they would not be required to authorise the claim, this would provide visibility of the claims being made and would provide an early alert on incorrect or ineligible claims;
  - as recommended in my predecessor's report, the Department should revisit the level of payments above which a manual check is made. The current level is all net payments over a set limit of £10,000;
  - the monthly 5% check on expenses should be reviewed in order to determine whether there needs to be an increase in the % level of checks;
  - the data mining techniques currently being developed should be considered for wider use by budget holders to assist in targeting their checks on the amounts with most risk which are being charged to their budgets;
- the Department should introduce a more formal system to monitor the effectiveness of preventative and detective controls and a mechanism to enable enhancement of training and/or controls in areas where errors are being identified;
- reporting of allegations of fraud and misuse of JPA and any underlying trends as well as the subsequent outcomes should be enhanced and formalised;
- the responsibilities of all parties, for example the TLBs, should be clear and agreed, and
- the adequacy of resources available should be reassessed in the light of the evolving control environment;

#### *On the provision of management information*

- the management information available should be reviewed to ensure it meets the requirements of all stakeholders including budget holders on whom the Department is relying for checks on out-turn most notably the TLBs;

#### *On achieving the JPA vision:*

- the Department should revisit the timetable for harmonisation of pay and allowances to ensure the results are achievable and consistent with its ability to amend the JPA system to cope with the resultant changes;
- Service Personnel have a wide range of abilities, education and needs. The Department should consider the range of support needed both at the existing call centre and in Units is sufficient to ensure Service personnel receive their entitlements;
- the Department needs to begin its assessment on whether to upgrade to Oracle 12 and make the necessary preparations to review the current extensions to the COTS product or make provision for further maintenance costs from 2012 onwards;

### **Inventory management**

- the Department should analyse the reasons for the increasing discrepancies in stock counts and introduce appropriate additional controls to ensure that stock systems are sufficiently robust and efficient to support operational requirements, ensure efficient stock management and provide sufficiently accurate information for financial reporting requirements;
- a review should be carried out to confirm and clarify ownership of systems and to identify ways to ensure existing systems and any new systems are comprehensive and meet the identified needs of key stakeholders;
- a review should be carried out to examine the interfaces between the various stock systems, including the MEFAR, to ensure that an appropriate programme of reconciliations is conducted which will confirm the completeness of records and the robustness of data underpinning the figures in the Department's Resource Accounts;
- all stakeholders including the FAPC should be consulted as part of these reviews and before any major changes to the current systems are introduced, and
- where there are significant changes in key experienced personnel whether due to rationalisation or other factors, the Department should put in place strategies which support knowledge and skills transfer;

### **Assets accounted for using the MERLIN/MAESTRO systems**

- The Department should complete the census exercise and investigate surpluses and deficiencies to ensure that its records can be updated;
- review the timing of the census exercise and consider if it could be carried out more effectively to allow the Department time to be able to investigate any reported deficiencies and for these to be reflected in the financial statements.

## **BOWMAN communications equipment**

- the stocktake of BOWMAN equipment should be completed to establish as accurate a record as possible and missing equipment should be formally written off;
- procedures should be developed to recognise the different types of equipment to enable more effective asset management;
- working with the Army and their contractor, the Department should review the procedures for accounting for BOWMAN assets including purchases, issues, assets in the repair loop, losses, write-offs and assets in transit. These procedures should be designed to provide the robust management information required for operational deployment, stewardship and financial reporting;
- establishing the levels of visibility required using an effective management information system and mapping out how to achieve this with appropriate allocation of responsibilities and deadlines;
- as costs have not been updated since 2006, the Unit Production Cost (UPC) of each BOWMAN asset should be reviewed to ensure that the value of BOWMAN assets reported in the Department's Resource Accounts is materially correct; and

### **More widely:**

- the Department should ensure that no further equipment is issued without NATO stock numbers, where this is the key identifier to enable effective management of the assets, and
- the Department should review other key equipment lines to ensure that the bespoke inventory systems provide adequate records to support operational, stewardship and financial reporting requirements.

66. I shall continue to work with the Department as it seeks to resolve the significant problems it is experiencing with the implementation of the JPA system and its inventory management systems and will provide an update on the progress made in my Report on the 2009-10 Resource Accounts.

*Amyas CE Morse*

**Comptroller and Auditor General**

**15 July 2009**

National Audit Office  
151 Buckingham Palace Road  
Victoria  
London SW1W 9SS

# Statement of Parliamentary Supply

## Summary of Resource Outturn 2008- 09

Request for Resources	Note							2008-09	2007-08
		Estimate			Outturn			Net Total Outturn Compared to Estimate Saving / (Excess)	Restated** Total Outturn
		Gross Expenditure £000	A in A* £000	Net Total £000	Gross Expenditure £000	A in A* £000	Net Total £000		
1	2	36,060,788	1,423,488	34,637,300	34,520,552	1,423,488	33,097,064	1,540,236	33,056,870
2	2	3,495,852	28,090	3,467,762	2,893,552	28,090	2,865,462	602,300	2,196,037
3	2	1,015,090	-	1,015,090	999,771	-	999,771	15,319	1,014,130
<b>Total Resources</b>	3a	<b>40,571,730</b>	<b>1,451,578</b>	<b>39,120,152</b>	<b>38,413,875</b>	<b>1,451,578</b>	<b>36,962,297</b>	<b>2,157,855</b>	<b>36,267,037</b>
<b>Non-Operating Cost A in A*</b>	7			<b>500,994</b>			<b>439,521</b>	<b>61,473</b>	<b>1,201,329</b>

\* Appropriations-in-Aid (A in A)

\*\*Restated for the effect of a Machinery of Government change (see Note 35 to the accounts).

## Net Cash Requirement

	Note	Estimate £000	Outturn £000	2008-09	2007-08
				Net Total Outturn compared to Estimate Savings/ (Excess) £000	Restated* Total Outturn £000
<b>Net Cash Requirement</b>	<b>4</b>	<b>36,551,725</b>	<b>36,430,918</b>	<b>120,807</b>	<b>33,485,637</b>

\* Restated for the effect of a Machinery of Government change (see Note 35 to the accounts).

## Summary of Income Payable to the Consolidated Fund

(In addition to Appropriations-in-Aid, the following income relates to the Department and is payable to the Consolidated Fund (cash receipts being shown in *italics*)).

	Note	Income £000	Forecast 2008-09	Outturn 2008-09	
			Receipts £000	Income £000	Receipts £000
<b>Total</b>	<b>5</b>	<b>-</b>	<b>-</b>	<b>301,956</b>	<b>301,956</b>

The notes on pages 204 to 268 form part of these accounts

## Statement of Parliamentary Supply

The Estimates figures are the revised figures agreed as a result of the Spring Supplementary Estimate. The Net Resource Outturn is £36,962M against an Estimate of £39,120M.

The reconciliation between the Net Resource Outturn and Net Operating Cost is at Note 3a; the variance is £245M, consisting of income from Annington Homes, minor amounts of interest treated as Consolidated Fund Extra Receipts and excess A-in-A on Request for Resource (RfR) 1 - Provision of Defence Capability and RfR2 – Operations and Peace-Keeping which are due to be paid to the Consolidated Fund – additional detail is provided at Note 5 to the accounts.

The Net Cash Requirement outturn is £36,431M against the Estimate of £36,552M.

The analysis of the Net Resource Outturn by Request for Resource is at Note 2:

- RfR1 – Provision of Defence Capability. The total RfR1 Outturn is £33,097M against an estimate of £34,637M. The prior year figures have been restated to reflect the introduction of the Administration Cost Regime (ACR) and the formation of Land Forces.
  - The movement on derivatives resulting from the foreign exchange rate contracts is reflected in Central TLB and is the main cause of the large underspend against Estimate.
  - The underspend in Defence Equipment and Support is mainly due to less than expected indirect costs such as impairment, depreciation and writes off, in respect of equipment and stocks including capital spares.
  - The overspend in Defence Estates is a result of increased impairments to asset values as a result of adverse market conditions.
- RfR2 – Operations and Peace-Keeping. The total RfR2 Outturn is £2,865M against an Estimate of £3,468M. The analysis by theatre of operation and a detailed explanation of the movements between Estimate and Outturn and 2008-09 expenditure compared to 2007-08 expenditure is provided in the Annual Performance Report.
- RfR3 – War Pensions Benefits. The total RfR3 net resource outturn is £1,000M against the Estimate of £1,015M.

Non Operating Appropriations-in-Aid (A-in-A) £440M; consists of: loan repayments by Trading Funds £27M, repayment of Public Dividend Capital by DARA £38M and proceeds on the sale of fixed assets of £375M, (see Note 7 to the accounts).

Additional information on the Defence Budget and spending is provided in the Finance section of the Resources Chapter of the Annual Performance Report. The section includes information on: The Defence Budget; Parliamentary Controls; Net Additional Costs of Operations and Resources by Departmental Strategic Objectives; as well as: comparison of the Defence Budgetary Outturn against Departmental Expenditure Limits (DEL); Reconciliation of DEL and Estimates; and Reconciliation of Resource Expenditure to Estimates, Accounts and Budgets.

## Operating Cost Statement

for the year ended 31 March 2009

	Note	2008-09 £000	Restated 2007-08* £000
<b>Administration Costs</b>			
Staff costs	9.2	1,716,179	1,748,205
Other administration costs	10a	560,724	666,121
<b>Gross administration costs</b>		<b>2,276,903</b>	<b>2,414,326</b>
Operating income	11	-	-
<b>Net administration costs before interest</b>		<b>2,276,903</b>	<b>2,414,326</b>
Net interest payable	12	2,981	40,021
<b>Net administration costs</b>		<b>2,279,884</b>	<b>2,454,347</b>
<b>Programme Costs</b>			
Staff costs	9.2	10,006,779	9,725,774
Other programme costs	10b	22,125,236	21,919,309
<b>Gross programme costs</b>		<b>32,132,015</b>	<b>31,645,083</b>
Operating income	11	(1,479,061)	(1,394,394)
<b>Net programme cost before interest</b>		<b>30,652,954</b>	<b>30,250,689</b>
Net interest payable	12	159,258	127,783
Cost of capital charge	21	3,625,509	3,370,908
<b>Net programme cost</b>		<b>34,437,721</b>	<b>33,749,380</b>
<b>Net Operating Cost</b>		<b>36,717,605</b>	<b>36,203,727</b>
<b>Net resource outturn</b>	3a	<b>36,962,297</b>	<b>36,267,037</b>

\*The 2007-08 Operating Cost Statement and its relevant supporting notes have been restated for the effect of a Machinery of Government change and the introduction of the Administration Cost Regime (see Note 35 to the accounts).

## Statement of Recognised Gains and Losses

for the year ended 31 March 2009

	Note	2008-09 £000	2007-08 £000
Net (gain) on revaluation of intangible fixed assets	22	(895,569)	(1,653,255)
Net (gain) on revaluation of tangible fixed assets	22	(3,260,819)	(2,852,140)
Net (gain) on revaluation of stock	22	(36,541)	(83,884)
Net (gain) on revaluation of investments	22	(16,236)	(7,181)
Receipts of donated assets and (gain) on revaluation	22	(220,933)	(453,461)
Net loss on change in the discount rate of pension scheme	21	33,428	41,815
<b>Recognised gains for the financial year</b>		<b>(4,396,670)</b>	<b>(5,008,106)</b>

The notes on pages 204 to 268 form part of these accounts



# Balance Sheet

as at 31 March 2009

	Note	31 March 2009		Restated 31 March 2008*	
		£000	£000	£000	£000
<b>Fixed Assets</b>					
Intangible assets	13	27,947,841		26,692,246	
Tangible fixed assets	14	82,384,224		77,930,278	
Financial assets	15	217,201	<b>110,549,266</b>	256,265	<b>104,878,789</b>
Debtors: due after more than one year	17	1,443,038	<b>1,443,038</b>	1,967,906	<b>1,967,906</b>
<b>Current Assets</b>					
Financial assets held for sale	15	-		241,029	
Stocks and work-in-progress	16	6,221,007		5,288,755	
Debtors: due within one year	17	2,235,696		1,938,499	
Derivative financial instruments	28.6	1,110,800		451,542	
Cash at bank and in hand	18	913,570		513,852	
		10,481,073		8,433,677	
Creditors: amounts falling due within one year	19	(8,549,899)		(8,111,184)	
Derivative financial instruments		-		(191,538)	
<b>Net current assets</b>			<b>1,931,174</b>		<b>130,955</b>
<b>Total assets less current liabilities</b>			<b>113,923,478</b>		<b>106,977,650</b>
Creditors: amounts falling due after more than one year	19	(1,073,792)		(1,137,644)	
Provisions for liabilities and charges	20	(5,734,203)		(5,753,771)	
			<b>(6,807,995)</b>		<b>(6,891,415)</b>
<b>Net assets</b>			<b>107,115,483</b>		<b>100,086,235</b>
<b>Taxpayers' equity</b>					
General fund	21		82,154,818		76,897,678
Revaluation reserve	22		22,481,215		20,452,461
Donated assets reserve	22		2,479,450		2,496,316
Investment reserve	22		-		239,780
			<b>107,115,483</b>		<b>100,086,235</b>

\*The Balance Sheet, and the relevant supporting notes, as at 31 March 2008 have been restated to include disclosures required following adoption of Financial Reporting Standards (FRSs) 23,25,26 and 29 – implementing the foreign currency and financial instrument accounting requirements (see Note 34 to the accounts).

Sir Bill Jeffrey  
Accounting Officer

6 July 2009

The notes on pages 204 to 268 form part of these accounts

# Cash Flow Statement

for the year ended 31 March 2009

	Note	2008-09	Restated 2007-08*
		£000	£000
Net cash outflow from operating activities	23.1	(27,146,857)	(25,669,845)
Capital expenditure and financial investment	23.2	(8,571,939)	(6,990,157)
Payments of amounts due to the Consolidated Fund		(405,834)	(809,744)
Financing	23.4	36,524,348	33,509,922
Increase/(decrease) in cash at bank and in hand	23.5	<b>399,718</b>	40,176

\*The 2007-08 Cash Flow Statement and the relevant supporting notes to the accounts have been restated as a result of a Machinery of Government change (see Note 35 to the accounts).

# Statement of Net Operating Costs by Departmental Strategic Objectives

for the year ended 31 March 2009

## 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:

	2008-09			Restated 2007-08*		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
<b>Objective 1.</b> Achieve success in the military tasks we undertake, at home and abroad.	4,845,310	(323,945)	4,521,365	4,300,715	(253,151)	4,047,564
<b>Objective 2.</b> Be ready to respond to the tasks that might arise.	27,407,745	(1,065,303)	26,342,442	27,914,410	(1,112,020)	26,802,390
<b>Objective 3.</b> Build for the future	4,943,840	(89,813)	4,854,027	4,368,866	(29,223)	4,339,643
	<b>37,196,895</b>	<b>(1,479,061)</b>	<b>35,717,834</b>	36,583,991	(1,394,394)	35,189,597
Paying war pensions benefits	999,771	-	999,771	1,014,130	-	1,014,130
<b>Total</b>	<b>38,196,666</b>	<b>(1,479,061)</b>	<b>36,717,605</b>	37,598,121	(1,394,394)	36,203,727

\*The 2007-08 Statement of Net Operating Costs by Departmental Strategic Objective and its supporting note (Note 24) to the accounts have been restated to include the effects of a Machinery of Government change (see Note 35 to the accounts) and the introduction of the Non-Equipment Investment Programme as a separate objective (see Note 24 – Objective 3, to the accounts).

See additional details in Note 24.

*The notes on pages 204 to 268 form part of these accounts*

# Notes to the Accounts

## 1. Statement of Accounting Policies

### Introduction

1.1 These financial statements have been prepared in accordance with the generic Accounts Direction issued by HM Treasury (HMT) under reference DAO(GEN)07/08. They comply with the requirements of the FReM except where HMT has approved the following departures to enable the Department to reflect its own particular circumstances:

- The FReM's requirement for Departments to prepare accounts that present the transactions and flows for the financial year and the balances at the year end between "core" Department and the consolidated group in respect of the Operating Cost Statement (and supporting notes) and Balance Sheet (and supporting notes) has not been applied. Since agencies falling within the Departmental Boundary are on-vote and embedded within the Departmental chain of command, HMT permits them to be treated as an integral part of the "core" Department. Throughout these accounts, the consolidated figures for the Ministry of Defence (including its on-vote agencies) are deemed to represent those of the "core" Department;
- The Department has not fully complied with the FReM emissions cap and trade scheme accounting requirements on the grounds of materiality. Rather than registering an asset and a liability to reflect its holding of allowances and its obligation to pay for emissions, the Department has reflected the purchase and sale of allowances as expenditure and income within the Operating Cost Statement. All other costs associated with the scheme, such as compliance checking, are also charged to the Operating Cost Statement.
- On the grounds of materiality, HMT has also agreed that the information normally required by the FReM on Fees and Charges disclosures (paragraph 7.4.32) is not required and the disclosure provided at Note 11.1 is sufficient.

1.2 In accordance with HMT's timetable for the introduction of International Financial Reporting Standards (IFRS) across the Public Sector, for Financial Year 2008-09 the Department has prepared both UK GAAP compliant accounts and 'shadow' financial statements based on IFRS as adapted and interpreted by HMT in the FReM. The latter will be subject to NAO review but not published. For Financial Year 2009-10 onwards, the Department will prepare IFRS based accounts.

1.3 The Operating Cost Statement is analysed between administration and programme costs. Administration costs reflect the costs of running the Department. Programme costs reflect non-administration costs, including payments of grants and certain staff costs where they relate directly to service delivery. The classification of expenditure as administration or as programme follows the definition of administration costs set by HMT except in the following instances:

- All DE&S and DE staff costs are classified as administration costs.
- All depreciation and cost of capital costs are classified as programme costs.

These departures have been approved by HMT.

1.4 As directed by HMT and the Financial Reporting Advisory Board, these financial statements adopt, for the first time, Financial Reporting Standard (FRS) 23, 'The effects of changes in foreign exchange rates', FRS 25, 'Financial instruments: disclosure and presentation', FRS 26, 'Financial instruments: recognition and measurement' and FRS 29, 'Financial instruments: disclosures' in order to implement the revised foreign currency and new financial instrument accounting requirements. Opening balances have been restated to provide comparators. Further details are at Note 34 – Restatement of the Balance Sheet as at 31 March 2008.

### **Accounting Convention**

1.5 These financial statements have been 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**

1.6 These financial statements comprise the consolidation of the Department, its Defence Supply Financed Agencies and those Advisory Non-Departmental Public Bodies (NDPBs) sponsored by the Department, which are not self-accounting. The Defence Agencies and the Advisory NDPBs sponsored by the Department are listed in Note 37.

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

1.8 The Department's interest in QinetiQ Group plc, formerly a Self-Financing Public Corporation, was previously included in the financial statements as a fixed asset investment. At the start of the year, it was reclassified as a current asset - financial asset held for sale and subsequently sold in the year as detailed in Note 15.

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

1.10 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 sector to another, are accounted for using merger accounting in accordance with FRS 6 – Acquisitions and Mergers. The prior year Operating Cost Statement has been adjusted to reflect the transfer of the responsibilities of the Defence Exports Services Organisation, from MOD to UK Trade and Investment. Further details are at Note 35 – Restatement of the Operating Cost Statement as at 31 March 2008.

### **Net Operating Costs**

1.11 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 recoverable VAT. Other costs are VAT inclusive, although a proportion of this VAT is recovered via a formula agreed with HM Revenue and Customs. Surpluses and deficits on disposal of fixed assets and stock are included within Notes 10a – Other Administration Costs and 10b – Other Programme Costs.

1.12 Income from services provided to third parties is included within operating income, net of related VAT. In accordance with FRS 21 – Events After the Balance Sheet Date, as interpreted by the FRoM, Trading Fund dividends are recognised as operating income on an accruals basis, whilst other dividends are recognised in the year in which they are declared.

## Fixed Assets

1.13 The Department's fixed assets are expressed at their current value through the application of the Modified Historical Cost Accounting Convention (MHCA). Indices, which are produced by Defence Analytical Services and Advice, are applied at the start of each financial year to the fixed assets which fall within the categories listed below. These indices, which look ahead to the subsequent Balance Sheet date, are also adjusted to reflect the difference between the actual change in prices in the prior year and the earlier prediction. At the end of each reporting period, overseas Estate assets are revalued offline to take account of the year-end exchange rates. In addition, due to the exceptional circumstances surrounding the UK property market during 2008/09, UK Estate assets were revalued offline based upon revised 2008-09 indices provided by DASA at the end of the reporting period. Some details of the indices used are:

- 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.

1.14 Property fixed assets are also subject to a quinquennial revaluation by external professional valuers in accordance with FRS 15 – Tangible Fixed Assets, as interpreted by the FRoM.

1.15 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.

1.16 The Department's policy on the capitalisation of subsequent expenditure under FRS 15 is to account separately for material major refits and overhauls, when their value is consumed by the Department over a period which differs from that of the overall life of the corresponding core asset, and where this is deemed to have a material effect on the carrying values of a fixed asset and the depreciation charge.

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

### **Intangible Fixed Assets**

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

1.19 Development costs are capitalised where they contribute towards defining the specification of an asset that will enter production. Those not capitalised are charged to the Operating Cost Statement. Capitalised development costs are amortised, on a straight line basis, over the planned operational life of that asset type, e.g. class of ship or aircraft. Amortisation commences when the asset type first enters operational service within the Department. If it is decided to withdraw the whole class of an asset type early, then any residual unamortised development costs relating to that class are written off to the Operating Cost Statement, along with the value of the underlying tangible fixed assets.

### **Tangible Fixed Assets**

1.20 The useful economic lives of tangible fixed assets are reviewed annually and adjusted where necessary. The Departmental capitalisation threshold is generally £10,000 and it is this which determines whether or not an asset is recorded on the Department's Fixed Asset Register (FAR). An exception to this is the Managed Equipment FAR, where a capitalisation threshold of £5,400 is applied to the assets which are managed by DE&S Project Teams on behalf of the three services. Agencies may also apply a lower capitalisation threshold to those assets which form part of their Agency accounts balance sheet. The decision to record an asset on the FAR normally takes place at the point of initial acquisition.

1.21 The Departmental threshold of £10,000 is not applied to Capital Spares or assembled Guided Weapons Missiles and Bombs (GWMB). For accounting purposes, these items are treated as pooled assets and included within the Single Use Military Equipment category of tangible fixed assets.

1.22 GWMB and Capital Spares are categorised as tangible fixed assets and depreciated. The depreciation charge in the Operating Cost Statement also includes the cost of GWMB fired. The principal asset categories, together with their useful economic lives, are set out in the table below. All the assets are depreciated on a straight line basis.

	Category	Years
Land and Buildings	Land	Indefinite, not depreciated
	Buildings, permanent	40 – 50
	Buildings, temporary	5 – 20
	Leasehold	Shorter of expected life and lease period
Single Use Military Equipment (including GWMB)	Air Systems - Fixed Wing	13 – 35
	Air Systems – Rotary Wing	25 – 30
	Sea Systems – Surface Ships	24 – 30
	Sea Systems – Submarines	28 – 32
	Land Systems – Armoured Vehicles	25 – 30
	Land Systems – Small Arms	10 – 15
Plant and Machinery	Equipment	10 – 25
	Plant and Machinery	5 – 25
Transport	Air Systems – Fixed Wing	25 – 35
	Air Systems – Rotary Wing	15 – 32
	Sea Systems – Surface Ships	20 – 30
	Land Systems – Specialised Vehicles	15 – 30
	Land Systems – Other Standard Vehicles	3 – 5
IT and Communications Equipment	Office Machinery	3 – 10
	Communications Equipment	3 – 30
Capital Spares	Items of repairable material retained for the purpose of replacing parts of an asset undergoing repair, refurbishment, maintenance, servicing, modification, enhancement or conversion.	As life of prime equipment supported
Operational Heritage Assets *		As other tangible fixed assets

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

## Donated Assets

1.23 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.

1.24 The Donated Assets Reserve represents the value of the original donation, additions and any subsequent professional revaluation and indexation (MHCA). Amounts equal to the donated asset depreciation charge, impairment costs and any in-year surplus/deficit on disposal are released from this reserve to the Operating Cost Statement.

## Impairment

1.25 Impairment charges to the Operating Cost Statement occur in circumstances which include a decision to retire a fixed asset from service and dispose of it at below net book value; on reduction in service potential or where the application of MHCA indices causes a downward revaluation below the depreciated historical cost, and this is deemed to be permanent. For example, there will be a reduction in service potential if a specialist building is subsequently used for non-specialist purposes. Any reversal of an impairment charge is recognised in the Operating Cost Statement to the extent that the original charge, adjusted for subsequent depreciation, was previously recognised in the Operating Cost Statement. The remaining amount is recognised in the Revaluation Reserve.

## Disposal of Tangible Fixed Assets

1.26 Disposal of assets is handled principally by two specialist internal organisations: Defence Estates for property assets and the Disposal Services Authority for non-property assets.

1.27 Property assets identified for disposal are included at the open market value, with any write down in value to the net recoverable amount (NRA) charged to the Operating Cost Statement as an impairment. Any increase in value to the NRA is credited to the Revaluation Reserve. On subsequent sale, the surplus or deficit is included in the Operating Cost Statement under surplus/deficit on disposal of fixed assets.

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

## Leased Assets

1.29 Assets held under finance leases are capitalised as tangible fixed assets and depreciated over the shorter of the lease term or their estimated useful economic lives. Rentals paid are apportioned between reductions in the capital obligations included in creditors, and finance costs charged to the Operating Cost Statement. Expenditure under operating leases is charged to the Operating Cost Statement in the period in which it is incurred.

## Private Finance Initiative (PFI) Transactions

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

1.31 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.

## Financial Instruments

1.32 This is the first year that the Department has been required to account for financial instruments in accordance with FRS 25, 26 and 29. The Department's foreign currency forward contracts denominated in its major traded currencies, US Dollars and Euros, are derivatives and are classified as Held For Trading financial instruments.

1.33 The foreign currency forward purchase contracts are measured at fair value with movements in fair value being charged or credited to the Operating Cost Statement. The fair value is measured as the difference between the currency's closing mid market rate at the date of valuation (representing the spot rate) and the rate stipulated in the contract multiplied by the number of contracted units of currency. The Department obtains the closing mid market rate from the Financial Times. The forward contracts will only have a fair value up to their date of settlement. Once each contract has been



settled, it is removed from the Department's Balance Sheet. The forward contracts were purchased from the Bank of England. Details of existing contracts are at Note 28 to the accounts.

1.34 The Department's shareholding in QinetiQ was classified as an Available For Sale current asset. It was held at fair value (by valuing the shares at their quoted market price) with revaluations taken to the Investment Revaluation Reserve. On sale, the Investment Revaluation Reserve balance was released to the Operating Cost Statement. The Department's loans to Trading Funds are classified within Loans and Debtors; they are carried at historic cost, less any impairment. Public Dividend Capital is not treated as a financial instrument in the Department's accounts because of the statutory, rather than contractual, basis of the investment. The Department's investments in special or 'golden' shares are not recognised on the Balance Sheet. The entities in which the Department holds special shares are listed at Note 15.

1.35 Debtors, including trade debtors, staff loans and advances are classified as Loans and Receivables and are initially measured at fair value and subsequently at amortised cost. Discounting is relevant to those debtors and loans which carry no rate of interest or a subsidised rate. However, the Department's debtors that are due within 1 year are not discounted on the grounds of materiality. Provisions are only made for specific bad debts.

1.36 Liabilities covering trade creditors, accruals and loans are classified as Other Liabilities and are initially measured at fair value and subsequently at discounted cost. This applies to those liabilities carrying a nil or a subsidised rate of interest. On the grounds of materiality, the Department's liabilities falling due within 1 year are not discounted.

1.37 The Department has not made a provision for its arrangements that fall within the scope of a financial guarantee contract on the grounds that the amounts are unquantifiable.

### **Stocks and Work-in-Progress**

1.38 Stock is recognised on the Department's Balance Sheet from the point of acquisition to the point of issue for consumption, sale, write-off or disposal. The point of consumption for Land stocks is the point at which stock is issued from depots. For Air and Navy stocks, the point of consumption is when stocks are issued from final depots such as an air base or a ship's hold.

1.39 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 credited to the Operating Cost Statement on disposal and write-off.

1.40 External work in progress represents the ongoing work on production or repair contracts for external customers and is valued at the lower of current replacement cost and NRV.

1.41 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.

1.42 Stocks written-off, included within Other Operating Costs, represent the net realisable value of stock which has been scrapped, destroyed or lost during the year, and also adjustments to bring the book values into line with the figures recorded on the supply systems. Munitions are accounted for as stockpile goods and provision is made to reduce their cost to their residual value over the course of their shelf lives. Life provision is credited to the Operating Cost Statement on consumption, write off or disposal.

## Provisions for Liabilities and Charges

1.43 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.

1.44 Provisions are charged to the Operating Cost Statement unless the expenditure provides access to current and future economic benefits, in which case the provision is capitalised as part of the cost of the underlying asset. In such cases, the capitalised provision will be depreciated and charged to the Operating Cost Statement over the remaining estimated useful economic life of the underlying asset. All long-term provisions are discounted to current prices using the rate advised by HMT. The rate for financial year 2008-09 is 2.2% (2.2% for 2007-08). The discount is unwound over the remaining life of the provision and shown as an interest charge in the Operating Cost Statement.

## Reserves

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

1.46 The Investment Reserve represented the value of the Department's investment in QinetiQ Group plc on flotation, and the subsequent movement in market valuation until the date of disposal at which point it was released to the Operating Cost Statement.

1.47 The General Fund represents the balance of the Taxpayers' Equity.

## Pensions

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

1.49 Both the AFPS and the main Civil Service pension schemes are unfunded defined benefit pension schemes, although, in accordance with the FReM, the Department accounts for the schemes in its accounts as if they were defined contribution schemes. The employer's charge is met by a Superannuation Contribution Adjusted for Past Experience (SCAPE) payment, which 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, classic plus or nuvos. The Department's Balance Sheet will only include a creditor in respect of pensions to the extent that the contributions paid to the pension funds in the year fall short of the SCAPE and widow/widower's pension charges due. Money purchase pensions delivered through employer-sponsored stakeholder pensions have been available as an alternative to all new Civil Service entrants since October 2002.

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

1.51 The Department operates a number of small pension schemes for civilians engaged at overseas locations. Since 1 April 2003, they have been accounted for in accordance with FRS 17 – Retirement Benefits. The pension scheme liability is included within the total provisions reported at Note 20 – Provisions for Liabilities and Charges, and, following a change in policy by HMT, the gain on the change in the discount rate from 31 March 2007 is shown in the General Fund and the Statement of Recognised Gains and Losses. Gains or losses arising from discount rate changes prior to 2006-07 have been charged to the Operating Cost Statement.

1.52 The disclosures required under FRS 17 for the main pension schemes are included in: the Remuneration Report, Note 9 – Staff Numbers and Costs, (see paragraphs 9.3 and 9.4); and on the websites of the Civil Service Pension Scheme and the Armed Forces Pension Scheme. The smaller schemes referred to in Note 9 are not material and are not, therefore, disclosed separately.

### Early Departure Costs

1.53 The Department provides in full for the cost of meeting pensions up to the minimum retirement age in respect of military and civilian personnel early retirement programmes. Pensions payable after the minimum retirement age are met by the Armed Forces Pension Scheme for military personnel and the Civil Service pension arrangements for civilian personnel. Redundancies are provided for in full.

### Cost of Capital Charge

1.54 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 HMT standard rate for Financial Year 2008-09 of 3.5% (2007-08: 3.5%) in real terms on all assets less liabilities except for the following, where the charge is nil:

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

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

### Foreign Currency

1.56 During Financial Year 2008-09 the Department implemented FRS 23. All transactions that are denominated in a foreign currency are translated into Sterling using the General Accounting Rate (GAR) at the date of each transaction. For each currency, from 1 September 2008, the GAR is updated monthly based on spot rates; for US Dollars and Euros the GAR is based on the published spot rate in the week immediately preceding the new month. Exchange differences will arise when a currency transaction is settled at a GAR which differs from the rate used when the transaction was initially recorded. In addition, monetary assets and liabilities are translated at the mid-market closing rate applicable at the Balance Sheet date and the exchange differences are reported in the Operating Cost Statement. Prior to 1 September 2008, the GAR for the Department's major traded currencies, US Dollars and Euros, was based on the Department's foreign currency forward contract rates.

1.57 Overseas non-monetary assets and liabilities are subject to annual revaluation and are translated at the mid-market closing rate applicable at the Balance Sheet date. The exchange differences are taken to the Revaluation Reserve for Departmentally owned assets, or the Donated Asset Reserve for donated assets.

## 2. Analysis of Net Resource Outturn

Request for Resources 1: Provision of Defence Capability	2008-09							2007-08
	Admin- istration Cost £000	Other Current Expendi- ture £000	Grants £000	Operating Appropri- ation in Aid £000	Total Net Resource Outturn £000	Total Net Resource Estimate £000	Total Net Outturn Compared with Estimate £000	Restated Total Net Resource Outturn* £000
<b>TLB HOLDER / TLB</b>								
Navy Command	-	2,221,430	11,822	(48,507)	<b>2,184,745</b>	2,180,326	(4,419)	2,153,486
Land Forces**	-	6,791,269	77,635	(145,195)	<b>6,723,709</b>	6,744,153	20,444	6,390,877
Air Command	-	2,908,921	8,173	(183,997)	<b>2,733,097</b>	2,743,180	10,083	2,581,309
Chief of Joint Operations	-	457,513	8,150	(28,344)	<b>437,319</b>	396,351	(40,968)	467,197
Defence Equipment & Support	-	14,927,546	745	(331,934)	<b>14,596,357</b>	15,086,289	489,932	15,086,906
Central***	-	666,009	190,441	(313,871)	<b>542,579</b>	1,789,964	1,247,385	1,602,328
Defence Estates	-	3,470,663	-	(371,639)	<b>3,099,024</b>	2,895,437	(203,587)	1,783,931
SIT ( Science, Innovation, Technology)	-	496,037	4,314	(1)	<b>500,350</b>	507,504	7,154	536,489
Administration Costs	2,279,884	-	-	-	<b>2,279,884</b>	2,294,096	14,212	2,454,347
<b>Total (RfR 1)</b>	<b>2,279,884</b>	<b>31,939,388</b>	<b>301,280</b>	<b>(1,423,488)</b>	<b>33,097,064</b>	34,637,300	1,540,236	33,056,870

\*Restated to separately identify Administration Costs and to record a Machinery of Government change – see Note 35.

\*\*On 1 April 2008 the Land and Adjutant General's Commands merged to form a single Army TLB – Land Forces.

\*\*\*The outturn for Central TLB includes a £1.1Bn credit in respect of the movement on derivative financial instruments linked to contracts for the forward purchase of foreign currency.

Request for Resources 2: Operations and Peace- Keeping	2008-09*							2007-08
	Admin- istration Cost £000	Other Current Expendi- ture £000	Grants £000	Operating Appropri- ation in Aid £000	Total Net Resource Outturn £000	Total Net Resource Estimate £000	Total Net Outturn Compared with Estimate £000	Restated Total Net Resource Outturn £000
Programme Sub-Saharan Africa	-	-	-	-	-	-	-	24,719
Stabilisation Aid Fund	-	8,998	-	-	<b>8,998</b>	12,597	3,599	-
Programme Rest of the World	-	69,617	-	(2,137)	<b>67,480</b>	65,865	(1,615)	2,171,318
Peace-Keeping and Operations (Afghanistan and Iraq)	-	2,814,937	-	(25,953)	<b>2,788,984</b>	3,389,300	600,316	-
<b>Total (RfR 2)</b>	<b>-</b>	<b>2,893,552</b>	<b>-</b>	<b>(28,090)</b>	<b>2,865,462</b>	<b>3,467,762</b>	<b>602,300</b>	2,196,037

\*The sub-heads in the Estimate, against which this table sets out expenditure, have changed. The Stabilisation Aid Fund is new. Expenditure previously recorded against Programme Sub-Sahara is now included in Programme Rest of the World. Expenditure in Afghanistan and Iraq (previously recorded as Programme Rest of the World) is now recorded as Peace-Keeping and Operations.

Request for Resources 3: War Pensions Benefits	2008-09						2007-08	
	Admin- istration Cost £000	Other Current Expendi- ture £000	Grants £000	Operating Appropri- ation in Aid £000	Total Net Resource Outturn £000	Total Net Resource Estimate £000	Total Net Outturn Compared with Estimate £000	Restated Total Net Resource Outturn £000
War Pensions Benefits								
Programme Costs	-	-	999,271	-	999,271	1,014,590	15,319	1,013,740
War Pensions Benefits							-	
Programme Costs - Far Eastern Prisoners of War	-	-	500	-	500	500	-	390
<b>Total (RfR 3)</b>	-	-	<b>999,771</b>	-	<b>999,771</b>	1,015,090	15,319	1,014,130
<b>Total Resource Outturn</b>	<b>2,279,884</b>	<b>34,832,940</b>	<b>1,301,051</b>	<b>(1,451,578)</b>	<b>36,962,297</b>	39,120,152	2,157,855	36,267,037

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

	Outturn £000	Supply Estimate £000	Outturn compared with Estimate £000	Restated 2007-08 Outturn £000
Net Resource Outturn (Statement of Parliamentary Supply)	<b>36,962,297</b>	39,120,152	<b>2,157,855</b>	36,267,037
- Less income scored as Consolidated Fund Extra Receipts and included in operating income and interest (inc. excess operating Appropriation in Aid) (Note 5)	(244,692)	-	<b>244,692</b>	(63,310)
<b>Net Operating Cost</b>	<b>36,717,605</b>	39,120,152	<b>2,402,547</b>	36,203,727

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

### 3b. Outturn Against Final Administration Budget

	Budget £000	2008-09 Outturn £000	Outturn compared with Budget £000	Restated 2007-08 Outturn £000
Administration Costs Gross	2,294,096	2,279,884	14,212	2,454,347
Income allowable against the Administration Budget	-	-	-	-
<b>Net Administration Costs</b>	<b>2,294,096</b>	<b>2,279,884</b>	<b>14,212</b>	<b>2,454,347</b>

## 4. Reconciliation of Resources to Cash Requirement

	Note	Estimate £000	Outturn £000	Savings / (Excess) £000
Resource Outturn	2	39,120,152	<b>36,962,297</b>	2,157,855
<b>Capital:</b>				
Purchase of fixed assets:				
– RfR 1		8,815,058	<b>7,918,352</b>	896,706
– RfR 2	23.3		<b>1,226,957</b>	(1,226,957)
– RfR 1 Capitalised provisions	20		<b>22,640</b>	(22,640)
<b>Non operating cost A in A:</b>				
Proceeds on sale of fixed assets	7	(300,994)	<b>(176,958)</b>	(124,036)
Proceeds from the sale of QinetiQ shares net of amounts payable to the Consolidated Fund and net of cash deducted at source	7	(200,000)	<b>(197,619)</b>	(2,381)
Loan and PDC repayments by Trading Funds	7		<b>(64,944)</b>	64,944
<b>Accruals adjustments:</b>				
Non-cash transactions-				
Included in operating costs		(8,647,451)	<b>(5,918,186)</b>	(2,729,265)
Included in net interest payable	12		<b>(108,135)</b>	108,135
Capitalised provisions shown above			<b>(22,640)</b>	22,640
Cost of capital charge	23.1	(3,230,740)	<b>(3,625,509)</b>	394,769
Changes in working capital other than cash, excluding movements on creditors falling due after one year		710,257	<b>(27,215)</b>	737,472
Increase in creditors falling due after one year			<b>63,852</b>	(63,852)
Use of provisions for liabilities and charges	20	285,443	<b>316,031</b>	(30,588)
Loans to Trading Funds made in 2008-09	15.2		<b>25,879</b>	(25,879)
Adjustment for movements on cash balances in respect of collaborative projects	23.5		<b>36,116</b>	(36,116)
Net cash requirement		<b>36,551,725</b>	<b>36,430,918</b>	<b>120,807</b>

## 5. Analysis of income payable to the Consolidated Fund

In addition to Appropriations-in-Aid, the following income relates to the Department and is payable to the Consolidated Fund (cash receipts being shown in *italics*).

	2008-09 Forecast		2008-09 Outturn	
	Income £000	Receipts £000	Income £000	Receipts £000
Operating income and receipts – excess A in A Request for Resources 1	-	-	232,349	<i>232,349</i>
Operating income and receipts – excess A in A Request for Resources 2	-	-	10,446	<i>10,446</i>
Other operating income and receipts not classified as A in A	-	-	1,897	<i>1,897</i>
Subtotal operating income and receipts payable to the Consolidated Fund			244,692	<i>244,692</i>
Other amounts collectable on behalf of the Consolidated Fund	-	-	57,264	<i>57,264</i>
Total income payable to the Consolidated Fund			<b>301,956</b>	<b><i>301,956</i></b>

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

	Note	2008-09 £000	Restated 2007-08 £000
Operating Income	11	1,479,061	1,394,394
Income included within other operating costs			
- Refunds of formula based VAT recovery		83,614	36,080
- Foreign exchange gains		110,454	7,937
- Less discounts provided		(67)	(103)
Interest Receivable		23,208	28,410
Gross Income		<b>1,696,270</b>	<b>1,466,718</b>
Income authorised to be appropriated in aid		(1,451,578)	(1,403,408)
Operating Income payable to the Consolidated Fund	5	<b>244,692</b>	<b>63,310</b>

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

	2008-09 £000	2007-08 £000
Principal repayments of voted loans	64,944	9,949
Proceeds on disposal of fixed assets	374,577	1,191,380
Totals	439,521	1,201,329

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

	Income £000	Receipts £000
Cash receipts surrenderable to the Consolidated Fund	57,264	57,264

On 9 September 2008 the Department sold its remaining shareholding in QinetiQ plc. 124,885,445 shares were sold at 206 pence per share; a gross income of £257,264,016.70. HM Treasury agreed that £200M of the gross income could be treated as non-operating Appropriations-in-Aid; the balance of £57,264,016.70 was surrendered to the Consolidated Fund.

## 9. Staff Numbers and Costs

9.1 The average number of full-time equivalent persons employed during the year was: Service 192,270<sup>17</sup> (2007-08: 193,610) and Civilian 78,550<sup>17</sup> (2007-08: 83,930). Source: Defence Analytical Services and Advice (DASA).

	Permanent Staff	Temporary Staff	Armed Forces	Ministers & Special Advisers	2008-09 Total	2007-08 Total
Analysis of Staff Numbers	77,883 <sup>17</sup>	660	192,270 <sup>17</sup>	7	270,820 <sup>17</sup>	277,540

In order to align with the total pay costs incurred during the year, shown below, the calculation of the average number of staff uses monthly statistics to identify an average number employed for the year. The staff numbers quoted reflect the number of personnel employed in organisations within the Departmental Boundary for the Annual Accounts (see page 152) and therefore exclude those in the Trading Funds. The staff numbers reported in the Performance Report include employees in the MOD Trading Funds. More information on the Department's staff numbers, and the statistical calculations used, is available on the website: <http://www.dasa.mod.uk/index.php?page=47&skipCheck=1>

<sup>17</sup> Figures are Full Time Equivalent (FTE), weighted averages for the financial year. The civilian figure includes an estimate of the Locally Employed Civilians (LEC) in Land Forces, based on the financial resources bid for LEC in 2008-09; the figure is provisional and subject to review. The Armed Forces figure uses data from the Joint Personnel Administration system and, due to ongoing validation, Army statistics from 1 April 2007, and Navy and RAF statistics from 1 May 2007 are provisional and subject to change.



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

	2008-09 £000	Restated 2007-08 £000
Staff costs – Administration	1,716,179	1,748,205
Staff costs – Programme	10,006,779	9,725,774
	<b>11,722,958</b>	<b>11,473,979</b>
Made up of:		
Salaries and wages	9,179,339	8,879,235
Social security costs	641,823	642,970
Pension costs	1,848,829	1,822,924
Redundancy and severance payments	52,967	128,850
	<b>11,722,958</b>	<b>11,473,979</b>
Paid to:		
Service	8,937,300	8,645,822
Civilian	2,785,658	2,828,157
	<b>11,722,958</b>	<b>11,473,979</b>

### Principal Civil Service Pension Scheme

9.3 The Principal Civil Service Pension Scheme (PCSPS) is an unfunded multi-employer defined benefit scheme. The Ministry of Defence is unable to identify its share of the underlying assets and liabilities. The Scheme Actuary Hewitt Associates reviewed the scheme as at 31 March 2007; details can be found at [www.civilservice-pensions.gov.uk](http://www.civilservice-pensions.gov.uk).

For 2008-09, total pension contributions of £343,612,000 were payable in respect of the various schemes in which MOD civilian staff were members. Contributions to the PCSPS in the same period were £316,980,000 (2007-08: £321,837,000) calculated using four percentage rates (17.1%, 19.5%, 23.2% and 25.5%) of pensionable pay, based on four salary bands. The scheme's Actuary reviews employer contributions, usually, every four years following a full scheme valuation. As a result of the latest review the 2008-09 salary bands were revised and the percentage rates will be 16.7%, 18.8%, 21.8% and 24.3% from 1 April 2009. The contribution rates are set to meet the cost of the benefits accruing, to be paid when the member retires, not the benefits paid during the period to existing pensioners.

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

### **Armed Forces Pension Scheme**

9.4 The Armed Forces Pension Scheme (known as AFPS 05) is an unfunded, non-contributory, defined benefit, salary-related, contracted out, occupational pension scheme. A formal valuation of the AFPS was carried out as at 31 March 2005 by the scheme's actuary, the Government Actuary's Department. Scheme members are entitled to a taxable pension for life and a tax-free pension lump sum if they leave the Regular Armed Forces at or beyond normal retirement age; those who have at least two years service who leave before age 55 will have their pensions preserved until age 65. Pensions may be payable to the spouse, civil partner, partner or to eligible children. Death-in-service lump sums are payable subject to nomination. AFPS 05 offers ill-health benefits if a career is cut short by injury or illness, irrespective of cause. Additionally, if the injury or illness is mainly attributable to service, compensation for conditions caused on or after 6 April 2005 will be considered under the Armed Forces Compensation Scheme (AFCS).

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

For 2008-09 total employer's pension contributions including those payable to the AFPS were £1,505,217,000 (2007-08 £1,461,908,000) based on employer's contribution rates determined by the Government Actuary. For 2008-09, the employer's contribution rates were 36.3% of pensionable pay for Officers and 21.8% of pensionable pay for Other Ranks. The contribution rates reflect benefits as they are accrued, not costs actually incurred in the period, and reflect past experience of the scheme. Further information on the AFPS and the AFCS can be found at the website: [www.mod.uk/DefenceInternet/AboutDefence/WhatWeDo/Personnel/Pensions/ArmedForcesPensions/](http://www.mod.uk/DefenceInternet/AboutDefence/WhatWeDo/Personnel/Pensions/ArmedForcesPensions/).

### **Other Pension Schemes**

9.5 The Armed Forces Pension Scheme incorporates the following schemes: the Non-Regular Permanent Staff Pension Scheme, the Gurkha Pension Scheme and the Reserve Forces Pension Scheme. The membership of these schemes is approximately 3% of the AFPS total membership and the employer's contributions to the schemes are included in the figure payable to the AFPS, at paragraph 9.4.

Certain other employees are covered by schemes such as the National Health Service Pension Scheme and the Teachers' Pension Scheme. The figure for total employers' pension contributions at paragraph 9.3 includes contributions in respect of these schemes. Some employees are members of other schemes, for example Locally Employed Civilians in Germany, Cyprus and Gibraltar and the Merchant Navy Ratings Pension Fund; estimates of the liabilities for these schemes are included in the figure for provisions for liabilities and charges.

## 10a. Other Administration Costs

	2008-09 £000	Restated 2007-08 £000
Operating expenditure:		
– Fuel	1,272	1,156
– Stock consumption	1,970	3,960
– (Surplus) / deficit arising on disposal of stock (net)	(17)	14
– Movements: includes personnel travelling, subsistence/relocation costs and movement of stores and equipment	95,342	92,260
– Utilities	44,432	37,916
– Property management	41,529	60,668
– Hospitality and entertainment	1,259	1,174
– Accommodation charges	35,892	48,472
– Equipment support costs	6,214	2,237
– IT and telecommunications	45,480	37,105
– Professional fees	171,851	131,453
– Other expenditure	96,230	191,661
– Research expenditure and expensed development expenditure	8,135	5,831
PFI Service Charges - property management	2,314	44,361
Increase in bad debts provision	-	(1)
Rentals paid under operating leases – Plant & Machinery	216	228
Rentals paid under operating leases – Other	4,510	2,659
Auditors' remuneration – audit work only	3,600	3,600
Grants-in-Aid	500	994
Exchange differences on foreign currencies: net deficit/(surplus)	(5)	373
<b>Total Other Administration Costs</b>	<b>560,724</b>	<b>666,121</b>

## 10b. Other Programme Costs

	2008-09 £000	Restated 2007-08 £000
Operating expenditure:		
– Fuel	693,688	535,874
– Stock consumption	1,179,308	1,067,422
– Surplus arising on disposal of stock (net)	(14,511)	(9,652)
– Movement on stock related provisions	(249,894)	137,193
– Stocks written off (net)	130,407	431,651
– Movements: includes personnel travelling, subsistence/relocation costs and movement of stores and equipment	879,680	765,835
– Utilities	345,057	268,986
– Property management	1,466,725	1,462,523
– Hospitality and entertainment	2,998	3,028
– Accommodation charges	440,444	394,378
– Equipment support costs	4,285,374	4,269,559
– Increase/(Decrease) in nuclear and other decommissioning provisions	(3,738)	233,751
– IT and telecommunications	806,778	618,127
– Professional fees	219,096	339,295
– Other expenditure	1,751,646	1,414,765
– Research expenditure and expensed development expenditure	1,106,692	945,726
PFI Service Charges:		
– IT and telecommunications	538,527	492,581
– Property management	481,847	381,570
– Transport	220,895	141,388
– Equipment support	177,154	166,084
– Plant and machinery	60,926	50,147
Depreciation and amortisation:		
– Intangible assets (Note 13)	1,287,081	1,196,571
– Tangible owned fixed assets (Note 14)	5,115,174	5,024,648
– Donated assets depreciation - release of reserve	(50,362)	(48,379)
– Tangible fixed assets held under finance leases (Note 14)	-	165
Impairment on fixed assets (Notes 13 & 14):		
– Arising on Quinquennial valuation	240,900	(46,207)
– Arising on Other items	469,878	43,251
Impairment – release of reserve	(168,366)	77,302
Surplus arising on disposal of tangible and intangible fixed assets	(58,009)	(682,647)
Surplus arising on disposal of QinetiQ shares	(253,457)	-
Contractor Logistic Support/Integrated Operational Support - Contract Costs*	374,680	-
Movement on Derivatives**	(1,176,730)	-
Fixed assets write off / (write on) – net	423,549	869,919
Capital project expenditure write off / ( write on) – net	32,706	19,238
Bad debts written off	6,940	29,607
Increase / (decrease) in bad debts provision	(4,197)	(1,223)
Rentals paid under operating leases		
– Plant & Machinery	54,092	27,204
– Other	89,380	121,853
Grants-in-Aid	134,712	127,273
Exchange differences on foreign currencies: net deficit/(surplus)	87,767	35,887
War Pensions Benefits	1,000,399	1,014,616
<b>Total Other Programme Costs</b>	<b>22,125,236</b>	<b>21,919,309</b>

\*Separately identified for the first time in 2008-09; previously included in various categories of other operating costs.

\*\*Recognised in 2008-09 as a result of the adoption, for the first time, of Financial Reporting Standards covering the disclosure, presentation, recognition and measurement of Financial Instruments. See also Note 28.

## 11. Income

Income Source	RfR 1	RfR2	2008-09	Restated
	£000	£000	Total £000	Total 2007-08 £000
<b>External Customers</b>				
Rental income – property	31,933	-	<b>31,933</b>	33,514
Receipts – personnel	26,036	-	<b>26,036</b>	61,740
Receipts – sale of fuel	107,838	-	<b>107,838</b>	100,963
Receipts – personnel related	125,583	-	<b>125,583</b>	119,288
Receipts – supplies and services	207,078	-	<b>207,078</b>	119,506
Receipts – provision of service accommodation	232,972	-	<b>232,972</b>	229,223
Receipts – NATO/UN/US Forces/Foreign Governments	290,931	38,536	<b>329,467</b>	367,962
Other	147,607	-	<b>147,607</b>	148,544
<b>Other Government Departments, Trading Funds and QinetiQ</b>				
Rental income – property	1,576	-	<b>1,576</b>	510
Receipts – personnel related	8,889	-	<b>8,889</b>	2,451
Reverse tasking *	25,809	-	<b>25,809</b>	31,663
Dividends from Financial Assets (Note 15.6)	57,414	-	<b>57,414</b>	39,555
Income from provision of goods and services	171,835	-	<b>171,835</b>	139,369
Other	5,024	-	<b>5,024</b>	106
	<b>1,440,525</b>	<b>38,536</b>	<b>1,479,061</b>	<b>1,394,394</b>

\* Receipts for invoiced goods and/or services supplied to the Trading Funds and QinetiQ Group plc by MOD.

### Fees and Charges

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

## 12. Net Interest Payable

	Administra- tion Cost £000	Programme Cost £000	Total 2008-09 £000	2007-08 £000
<b>Interest receivable:</b>				
– Bank interest	-	(20,007)	(20,007)	(24,063)
– Loans to Trading Funds	-	(3,201)	(3,201)	(4,347)
– Other interest receivable	-	-	-	-
	-	(23,208)	(23,208)	(28,410)
– Unwinding of discount on long term debtors and loans	(475)	(15,481)	(15,956)	-
<b>Total interest receivable</b>	<b>(475)</b>	<b>(38,689)</b>	<b>(39,164)</b>	<b>(28,410)</b>
<b>Interest payable:</b>				
– Bank interest	-	338	338	5,139
– Loan interest	-	3,006	3,006	3,136
– Unwinding of discount on provision for liabilities and charges (Note 20)	-	123,757	123,757	123,288
– Unwinding of discount on long term creditors	-	334	334	-
– Finance leases and PFI contracts	3,456	70,502	73,958	64,641
– Late payment of commercial debts	-	10	10	10
– Other interest payable	-	-	-	-
<b>Total interest payable</b>	<b>3,456</b>	<b>197,947</b>	<b>201,403</b>	<b>196,214</b>
<b>Net interest payable</b>	<b>2,981</b>	<b>159,258</b>	<b>162,239</b>	<b>167,804</b>

## 13. Intangible Assets

Intangible assets include development expenditure in respect of fixed assets in use and assets under construction.

	Single Use Military Equipment £000	Others £000	Total £000
<b>Cost or Valuation*</b>			
At 1 April 2008	31,304,474	2,819,369	34,123,843
Additions**	930,035	380,947	1,310,982
Disposals	(111,582)	(1,818)	(113,400)
Revaluations***	1,183,517	36,914	1,220,431
Reclassifications****	(810,740)	1,152,513	341,773
<b>At 31 March 2009</b>	<b>32,495,704</b>	<b>4,387,925</b>	<b>36,883,629</b>
<b>Amortisation</b>			
At 1 April 2008	(6,655,315)	(776,282)	(7,431,597)
Charged in Year	(1,007,605)	(279,476)	(1,287,081)
Disposals	110,060	2,780	112,840
Revaluations	(301,899)	(62,334)	(364,233)
Reclassifications	49,984	(15,701)	34,283
<b>At 31 March 2009</b>	<b>(7,804,775)</b>	<b>(1,131,013)</b>	<b>(8,935,788)</b>
<b>Net Book Value</b>			
<b>At 31 March 2009</b>	<b>24,690,929</b>	<b>3,256,912</b>	<b>27,947,841</b>
At 1 April 2008	24,649,159	2,043,087	26,692,246

\* 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.

\*\* Additions include accruals of £527,801,000 (2007-08: £395,583,000). Information on Frascati compliant R&D expenditure can be found on the DASA website: <http://www.dasa.mod.uk/index.php?page=47&skipCheck=1>

\*\*\* Revaluations include changes due to: Modified Historic Cost Accounting through indexation, impairment and impairment reversals. Intangible Assets are only impaired when the class of underlying fixed assets is changed e.g. when the assets are destroyed.

\*\*\*\* Reclassifications include assets classified to or from tangible fixed assets and transfers to or from operating costs.

## 14. Tangible Fixed Assets

	Dwellings £000	Other Land and Buildings £000	Single Use Military Equipment (SUME) £000	Plant and Machinery £000	Transport £000	IT and Communication Equipment £000	Assets under Construction (SUME) £000	Assets under Construction (Others) £000	Total £000
<b>Cost or Valuation</b>									
At 1 April 2008	4,305,819	21,296,301	68,480,197	3,360,605	10,660,475	1,945,460	11,133,403	3,833,557	125,015,817
Additions*	92,857	69,796	552,091	29,639	238,699	336,390	3,671,399	2,843,456	7,834,327
Donations	(56,489)	(2,771)	-	-	-	-	-	-	(59,260)
Disposals	-	(73,670)	(646,531)	(193,530)	(1,140,107)	(456,252)	-	-	(2,510,090)
Reclassifications	98,163	(282,389)	(265,736)	851,992	77,611	135,304	(1,681,215)	(1,323,526)	(2,389,796)
Revaluations	130,052	390,274	2,885,911	126,121	384,826	(118,109)	685,029	234,860	4,718,964
<b>As at 31 Mar 2009**</b>	<b>4,570,402</b>	<b>21,397,541</b>	<b>71,005,932</b>	<b>4,174,827</b>	<b>10,221,504</b>	<b>1,842,793</b>	<b>13,808,616</b>	<b>5,588,347</b>	<b>132,609,962</b>
<b>Depreciation</b>									
At 1 April 2008	(801,451)	(5,026,292)	(32,713,591)	(1,607,755)	(6,049,861)	(886,589)	-	-	(47,085,539)
Charged in Year	(110,899)	(693,570)	(3,350,631)	(254,159)	(556,296)	(149,619)	-	-	(5,115,174)
Disposals	-	-	528,869	168,476	1,091,705	207,692	-	-	1,996,742
Reclassifications***	49,572	603,838	1,147,187	(211,888)	318,819	(79,938)	-	-	1,827,590
Revaluations†	(79,147)	(301,338)	(1,207,770)	(93,857)	(188,308)	21,063	-	-	(1,849,357)
<b>As at 31 Mar 2009</b>	<b>(941,925)</b>	<b>(5,417,362)</b>	<b>(35,595,936)</b>	<b>(1,999,183)</b>	<b>(5,383,941)</b>	<b>(887,391)</b>	<b>-</b>	<b>-</b>	<b>(50,225,738)</b>
<b>Net Book Value</b>									
<b>As at 31 Mar 2009</b>	<b>3,628,477</b>	<b>15,980,179</b>	<b>35,409,996</b>	<b>2,175,644</b>	<b>4,837,563</b>	<b>955,402</b>	<b>13,808,616</b>	<b>5,588,347</b>	<b>82,384,224</b>
at 1 April 2008	3,504,368	16,270,009	35,766,606	1,752,850	4,610,614	1,058,871	11,133,403	3,833,557	77,930,278
<b>Asset Financing</b>									
Owned	2,777,063	13,406,342	35,409,996	2,070,165	4,765,029	919,511	13,801,217	5,591,148	78,740,471
Donated****	485,212	1,974,107	-	20,066	65	-	-	-	2,479,450
Long Lease	137,889	81,381	-	-	-	-	-	-	219,270
Short Lease	539	52,709	-	-	-	-	-	-	53,248
Operating Lease	-	9,261	-	-	-	-	-	-	9,261
Finance Lease	-	-	-	-	-	-	-	-	-
On Balance Sheet PFI	227,774	419,526	-	85,413	72,470	35,891	-	4,596	845,670
PFI Residual Interest	-	36,854	-	-	-	-	-	-	36,854
<b>As at 31 Mar 2009</b>	<b>3,628,477</b>	<b>15,980,180</b>	<b>35,409,996</b>	<b>2,175,644</b>	<b>4,837,564</b>	<b>955,402</b>	<b>13,801,217</b>	<b>5,595,744</b>	<b>82,384,224</b>
In -Year depreciation for assets held under PFI contracts	(7,405)	(11,390)	-	(5,515)	(11,467)	(2,070)	-	-	(37,847)

The figures for AUC SUME and AUC Other, as at 1 April 2008, have been adjusted to reflect a more accurate split; the figure for IT and Communication Equipment has been adjusted to resolve a rounding difference.

\* Additions of tangible fixed assets include accruals of £2,803,023,000 (2007-08: £2,810,543,000).

\*\* Fixed Assets as at 31 March 2009 include capitalised provisions at cost of £188,580,000 (2007-08: £177,730,000).

\*\*\* Includes assets reclassified to/from intangible assets and transfers to/from operating costs.

\*\*\*\* Donated Assets in use have been valued on the same basis as all other assets used by the Department.

† Revaluations include changes due to Modified Historic Cost Accounting through indexation, impairment and impairment reversals. Assets are impaired for a variety of reasons e.g. changes due to increased wear and tear as a result of operations. Land and buildings are subject to quinquennial revaluation; overseas assets are also subject to adjustments to reflect movements in the Euro to Sterling exchange rate. Revaluations to Land and Buildings as a result of indexation and exchange rate movements have resulted in an overall increase in value despite the significant downward movement resulting from the quinquennial revaluations (see note 14.1 below).



## 2008–09 Quinquennial Revaluation

14.1 All Land and Buildings with the exception of Assets Under Construction, are subject to a quinquennial revaluation (QQR), which is conducted over a rolling 5 year programme with approximately 25% of the estate being revalued in each of the first 4 years allowing for any residual work to take place in year 5. The valuations are performed by two external organisations: the Valuation Office Agency, who deal with the UK estate, and GVA Grimley, who cover the overseas estate. Valuations are undertaken in accordance with the Royal Institute of Chartered Surveyors Appraisal and Valuation Manual and are completed on the basis of the existing use value to the Department. Due to the specialised nature of the Departmental estate, the majority of assets are valued using the Depreciated Replacement Cost method.

14.2 Data from the 2008–2009 quinquennial review resulted in a £138M decrease in the value of Land and a £341.2M decrease in the value of Buildings; accruals have been posted to cover some outstanding valuations.

14.3 The net debit to the OCS in respect of impairments arising from the decreases in the value against both Land and Buildings is £240.9M. This is made up of: Land – Impairment Writes-Off £47.5M and Impairment Reversals £14.0M; Buildings – Impairment Writes-Off £214.2M and Impairment Reversals £6.8M.

## 15. Financial Assets

	Trading funds		Financial Assets Available for Sale	Total
	Public Dividend Capital	Loans		
	£000	£000	£000	£000
Balance at 1 April 2008	184,254	72,011	241,029	497,294
Additions / Transfers:				
Defence Science Technology Laboratory	-	21,500		21,500
Defence Support Group (DSG)*	23,323	33,283		56,606
Met Office	-	4,379		4,379
Repayments / Transfers:				
Defence Science Technology Laboratory	-	-		-
UK Hydrographic Office	-	(457)		(457)
Met Office	-	(2,663)		(2,663)
Defence Aviation Repair Agency (DARA)*	(42,303)	(35,670)		(77,973)
ABRO*	(19,405)	(19,388)		(38,793)
Defence Support Group (DSG)*		(1,664)		(1,664)
Revaluations			16,236	16,236
Sale of Shares			(257,264)	(257,264)
<b>Balance at 31 March 2009</b>	<b>145,869</b>	<b>71,331</b>	<b>1</b>	<b>217,201</b>
Balance at 1 April 2008	184,254	72,011	241,029	497,294

\*On 1 April 2008 DSG was formed from ABRO and elements of DARA; ABRO and DARA have ceased to exist.

## Public Dividend Capital (PDC) Balances

15.1 The sale of the Defence Aviation Repair Agency (DARA)'s Rotary Wing and Components business units to Vector Aerospace International Limited (VAIL) for £17M was successfully concluded on 1 April 2008. The businesses sited at Fleetlands and Almondbank undertake vital helicopter maintenance and repairs to MOD rotary aviation units. Faced with declining workloads as the number of aircraft leaving service increased, diversification of the businesses into the commercial sector represented the best long-term solution for Defence, the Armed Forces, and for the employees. Defence Support Group was formed by merging ABRO and the elements of DARA which remained after the sale. The Public Dividend Capital in Defence Support Group as at 31 March 2009 consists of the opening balances from ABRO (£19,405,000) and DARA (£42,303,000) less the repayment of PDC on 1 April 2008 of £38,385,000; a balance of £23,323,000. The details of PDC balances are set out in the following table:

	Public Dividend Capital (PDC) 31 March 2008 £000	Following Sale of the Rotary Wing Component - PDC Repayment Made on 1 April 2008 £000	Transfer of PDC on Formation of DSG on 1 April 2008 £000	Public Dividend Capital (PDC) Balances as at 31 March 2009 £000
Defence Science and Technology Laboratory	50,412	-	-	<b>50,412</b>
UK Hydrographic Office	13,267	-	-	<b>13,267</b>
Met Office	58,867	-	-	<b>58,867</b>
Defence Aviation Repair Agency	42,303	(38,385)	(3,918)	-
ABRO	19,405	-	(19,405)	-
Defence Support Group	-	-	23,323	<b>23,323</b>
<b>Totals</b>	<b>184,254</b>	<b>(38,385)</b>	<b>-</b>	<b>145,869</b>

## Reconciliation of Outstanding Loan Balances

15.2 The Loan to Defence Support Group is the total of the loans due from ABRO (£19,388,000) and DARA (£35,670,000) less repayment of loans by DARA (£21,775,000) and repayments made by the Defence Support Group (£1,664,000); an outstanding balance of £31,619,000. Details of the movements on the loan balances are set out in the following table:

	Loans 31 March 2008 £000	Loan Repayments Made on 1 April 2008 £000	Transfer of Loans on Formation of DSG on 1 April 2008 £000	Loans made during the year to 31 March 2009 £000	Repayments made during the year to 31 March 2009 £000	Loan Balances as at 31 March 2009 £000	Interest Rate % p.a.
Defence Science and Technology Laboratory	-	-	-	21,500	-	<b>21,500</b>	4.53
UK Hydrographic Office	10,184	-	-	-	(457)	<b>9,727</b>	8.375
Met Office	6,769	-	-	4,379	(2,663)	<b>8,485</b>	1.06 - 5.65
Defence Aviation Repair Agency	35,670	(21,775)	(13,895)	-	-	-	4.20 - 5.00
ABRO	19,388	-	(19,388)	-	-	-	5.625
Defence Support Group	-	-	33,283	-	(1,664)	<b>31,619</b>	4.6
<b>Totals</b>	<b>72,011</b>	<b>(21,775)</b>	<b>-</b>	<b>25,879</b>	<b>(4,784)</b>	<b>71,331</b>	

## Analysis of loans repayable by instalments

	Due Within One Year £000	Due After One Year £000	Total £000
Defence Science Technology Laboratory	-	21,500	21,500
UK Hydrographic Office	972	8,755	9,727
Met Office	4,935	3,550	8,485
Defence Support Group	1,664	29,955	31,619
<b>Balance at 31 March 2009</b>	<b>7,571</b>	<b>63,760</b>	<b>71,331</b>

## Shareholding in QinetiQ Group plc and Other Financial Assets

15.3 On the 9 September 2008 the Department sold its remaining shareholding in QinetiQ plc. 124,885,445 shares were sold at 206 pence per share; a gross income of £257,264,016.70. The cost of the sale, including the nominal value of the shares was approximately £3.8M and was met by the MOD. HM Treasury agreed that £200M of the gross income could be treated as non-operating Appropriations-in-Aid; the balance of £57,264,016.70 was surrendered to the Consolidated Fund (see Note 8).

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

## Other Financial Assets

15.4 As at 31 March 2009, investments, including Special Shares, were held in the following:

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

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

	<b>Non Preferential Shares of £1 each</b>
International Military Services Limited	19,999,999 Shares

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

The 7.5% Non-cumulative Irredeemable Preference Shares in Chamber of Shipping Limited and British Shipping Federation Limited are valued at 1p each reflecting the value at which shares would be recovered by the two companies should membership by the Department be ceded, as laid down in the Articles of Association of the respective companies.

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

Company	Registration Number
Devonport Royal Dockyard Limited, Devonport Royal Dockyard, Devonport, Plymouth PL1 4SG	02077752
Rosyth Royal Dockyard Limited, c/o Babcock BES, Rosyth Business Park, Rosyth, Dunfermline, Fife KY11 2YD	SC101959
AWE plc, AWE Aldermaston, Reading, Berkshire RG7 4PR	02763902
AWE Pension Trustees Limited, AWE Aldermaston, Reading, Berkshire RG7 4PR	02784144
QinetiQ Group plc, 85 Buckingham Gate, London SW1E 6PD	04586941
QinetiQ Holdings Limited, 85 Buckingham Gate, London SW1E 6PD	04154556
QinetiQ Limited, 85 Buckingham Gate, London SW1E 6PD	03796233
BAE Systems Marine (Holdings) Limited, Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hants, GU14 6YU	01957765

### Net Assets of Trading Funds

15.5 The reported net assets, after deducting loans due to MOD, of the investments held in Trading Funds at 31 March 2009 and 31 March 2008 were:

	31 March 2009 £000	31 March 2008 £000
Defence Science and Technology Laboratory	228,000	265,100
UK Hydrographic Office	47,055	42,294
Met Office	204,403	205,788
Defence Aviation Repair Agency	-	60,264
ABRO	-	46,197
Defence Support Group	71,021	-
<b>Total</b>	<b>550,479</b>	<b>619,643</b>

## Dividends from Investments

15.6 The following dividends are shown as income in Note 11.

	31 March 2009 £000	31 March 2008 £000
QinetiQ	2,643	5,724
Defence Science Technology Laboratory*	28,000	3,000
UK Hydrographic Office	4,394	7,854
Met Office*	17,177	11,077
Defence Aviation Repair Agency	-	4,200
ABRO	-	7,700
Defence Support Group	5,200	-
<b>Total</b>	<b>57,414</b>	<b>39,555</b>

\*The figures as at 31 March 2009 include Special Dividends of £25,000,000 from Dstl and £6,000,000 from Met Office.

## 16. Stocks and Work in Progress

	31 Mar 2009 £000	31 Mar 2008 £000
Work in progress – long term contract	53,615	124,773
Work in progress - other	43,126	4,599
Raw materials and consumables	6,119,600	5,158,447
Assets declared for disposal	4,666	936
	<b>6,221,007</b>	<b>5,288,755</b>

## 17. Debtors

### 17.1 Analysis by type

	31 Mar 2009 £000	Restated 31 Mar 2008 £000
<b>Amounts falling due within one year</b>		
Trade debtors	387,494	388,031
Deposits and advances	49,882	63,312
Value Added Tax	362,498	411,187
Other debtors	172,846	221,848
Staff loans and advances*	21,998	42,716
Prepayments and accrued income	1,213,551	735,092
Current part of PFI prepayment	27,427	76,313
	<b>2,235,696</b>	<b>1,938,499</b>
<b>Amounts falling due after one year</b>		
Trade debtors	403,621	576,148
Other debtors	8,280	41,162
Staff loans and advances*	65,853	52,982
Prepayments and accrued income	965,284	1,297,614
	<b>1,443,038</b>	<b>1,967,906</b>
<b>Total Debtors</b>	<b>3,678,734</b>	<b>3,906,405</b>

\* Staff loans and advances includes loans for house purchase. The number of staff with house purchase loans was 12,225 (2007-08:12,781).

### 17.2 Intra-Government Balances

	2008-09 £000	Restated 2007-08 £000	2008-09 £000	Restated 2007-08 £000
	Amounts falling due within one year		Amounts falling due after more than one year	
Balances with other central government bodies	405,392	470,202	-	331
Balances with local authorities	102,411	103,431	-	314
Balances with NHS Trusts	4,695	4,188	-	207
Balances with public corporations and trading funds	45,028	36,530	-	3
Subtotal: intra-government balances	557,526	614,351	-	855
Balances with bodies external to government	1,678,170	1,324,148	1,443,038	1,967,051
<b>Total Debtors at 31 March</b>	<b>2,235,696</b>	<b>1,938,499</b>	<b>1,443,038</b>	<b>1,967,906</b>

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

## 18. Cash at Bank and in Hand

	2008-09 £000	2007-08 £000
Balance at 1 April	513,852	473,676
Net Cash Inflow/(Outflow):		
Received from Consolidated Fund	36,551,725	33,622,000
Utilised	(36,152,007)	(33,581,824)
Increase / (decrease) during year	399,718	40,176
<b>Balance at 31 March</b>	<b>913,570</b>	<b>513,852</b>
The following balances were held at:		
Office of HM Paymaster General	560,944	339,757
Commercial Banks and Cash in Hand	352,626	174,095
<b>Balance at 31 March</b>	<b>913,570</b>	<b>513,852</b>

The cash at bank balance includes £203,296,000 (2007-08: £167,181,000) of sums advanced by foreign governments to the Department on various collaborative projects where the United Kingdom is the host nation. Advances made by foreign governments for the procurement of defence equipment on their behalf are also included in this amount. The corresponding liability for these advances is shown under creditors due within one year.

## 19. Creditors

### 19.1 Analysis by type

	31 Mar 2009 £000	Restated 31 Mar 2008 £000
<b>Amounts falling due within one year</b>		
VAT	15,301	55,465
Other taxation and social security	257,197	278,284
Trade creditors	447,919	499,999
Other creditors*	879,947	716,550
Payments received on account	4,922	13,413
Accruals and deferred income	6,551,023	6,176,337
Current part of finance leases	-	43
Current part of imputed finance lease element of on-balance sheet PFI contracts	27,847	22,401
Current part of NLF loans**	2,141	2,019
Amounts issued from the Consolidated Fund for supply but not spent	120,807	346,673
Consolidated Fund extra receipts due to be paid to the Consolidated Fund – Received	242,795	-
	<b>8,549,899</b>	<b>8,111,184</b>
<b>Amounts falling due after more than one year</b>		
Other creditors	70,094	263,364
Accruals and deferred income	66,072	75,346
Imputed finance lease element of on-balance sheet PFI contracts	895,355	754,522
NLF loans**	42,271	44,412
	<b>1,073,792</b>	<b>1,137,644</b>
<b>Total Creditors</b>	<b>9,623,691</b>	<b>9,248,828</b>

\* Other creditors includes amounts advanced by foreign governments to the Department in respect of various collaborative projects where the United Kingdom is the host nation and for the procurement of defence equipment on their behalf of £203,296,000 (2007-08: £167,181,000).

\*\* Under the Armed Forces (Housing Loans) Acts 1949, 1958 and 1965, £94M was borrowed from the National Loans Fund for the construction of married quarters over the period 1950/51 to 1967/68. These loans are fully repayable between 2012 and 2028, with the last instalment due on 20 February 2028. Interest on the loans is payable at rates ranging from 4% to 7% per annum.

## 19.2 Intra-Government Balances

	2008-09	2007-08	2008-09	Restated 31 Mar 2008
	Amounts falling due within one year		Amounts falling due after more than one year	
	£000	£000	£000	£000
Balances with other central government bodies	418,190	686,264	-	44,412
Balances with local authorities	7,542	332	-	-
Balances with NHS Trusts	11,625	12,924	-	-
Balances with public corporations and trading funds	138,800	135,189	-	-
Subtotal: intra-government balances	576,157	834,709	-	44,412
Balances with bodies external to government	7,973,742	7,276,475	1,073,792	1,093,232
<b>Total Creditors at 31 March</b>	<b>8,549,899</b>	<b>8,111,184</b>	<b>1,073,792</b>	<b>1,137,644</b>

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

## 20. Provisions for Liabilities and Charges

	Nuclear Decommissioning	Other Decommissioning and Restoration Costs	Early Retirement Commitments	Other	Total
At 1 April 2008	4,168,222	101,681	416,851	1,067,017	5,753,771
Increase in Provision	177,980	14,524	86,382	204,043	482,929
Unwinding of discounting	96,091	172	5,362	(11,296)	90,329
Amounts released	(181,777)	(23,816)	(55,434)	(38,408)	(299,435)
Amounts capitalised	22,640	-	-	-	22,640
Utilised in year	(55,180)	(16,514)	(116,172)	(128,165)	(316,031)
<b>At 31 March 2009</b>	<b>4,227,976</b>	<b>76,047</b>	<b>336,989</b>	<b>1,093,191</b>	<b>5,734,203</b>



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

	2008-09 £000	2007-08 £000
Charged/(credited) to:		
Property management	(9,292)	1,220
Staff costs	41,898	150,720
Nuclear and Other Decommissioning provisions	(3,797)	233,751
Other costs	154,685	23,138
Net interest (receivable)/payable	123,757	123,288
	<b>307,251</b>	<b>532,117</b>

	2008-09 £000	2007-08 £000
Made up of:		
Increase	482,929	835,722
Release	(299,435)	(426,893)
	183,494	408,829
Unwinding of discount	123,757	123,288
Net increase in provisions	<b>307,251</b>	<b>532,117</b>

## Nuclear Decommissioning

20.1 Nuclear decommissioning provisions relate principally to: the cost of facility decommissioning, the treatment and storage of nuclear waste arising from operations at MOD sites and operation of Royal Navy submarines and to the Departmental share of planning and constructing a national repository for the eventual disposal of that waste. MOD is also responsible for the Atomic Weapons Establishment (AWE).

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

Calculation of the provision to cover the liabilities is based on schedules of information received by the MOD from major decommissioning contractors. These schedules are based on technical assessments of the processes and methods likely to be used 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 is sensitive to these factors and their likely effect on the calculation and amount of the liabilities is reviewed on an annual basis. For decommissioning operations with a finite end date costs have been calculated to the date; for operations of an ongoing nature (e.g. storage of materials) costs have been calculated for a period of 150 years.

The latest estimate of the undiscounted cost of dealing with the MOD's nuclear liabilities is £9,641,500,000 (2007-08: £9,221,769,000).

The estimate of £4,227,976,000 (2007-08: £4,168,222,000) at 31 March 2009 represents the liabilities discounted at 2.2% to the balance sheet date.

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

	31 March 2009 £000
Up to 3 years	336,555
From 4 to 10 years	1,093,110
Over 10 years	2,798,311
<b>Total</b>	<b>4,227,976</b>

In December 2007 the AWE Quinquennial Review (QQR) Submission Report was presented to the Nuclear Installations Inspectorate (NII). The resulting estimates incorporate risk and uncertainty appropriate to each type of expenditure and form the basis of the 2008-09 AWE decommissioning costs. The NII have not yet concluded their work on the QQR but have not identified any issues to date.

### Other Decommissioning and Restoration

20.2 Other decommissioning and restoration provisions relate primarily to contaminated sites where the Department has a constructive or a legal obligation to restore the sites for normal use. The estimated payments are discounted by the Treasury discount rate of 2.2% in real terms. During 2008-09 a new provision, for essential asbestos cleanup in the South East of the UK, was created. Existing provisions have been used to offset expenditure for the removal of residual military equipment from the Pacific Island of Kiritimati, cleanup of asbestos in Cyprus and mine stabilisation in Bath.

### Early Retirement Pensions

20.3 The Department meets the additional costs of benefits beyond the normal civil service pension scheme benefits in respect of employees who retire early by paying the required amounts annually to the pension schemes over the period between early departure and normal retirement date. The Department provides for this in full when the early retirement programme becomes binding by establishing a provision for the estimated payments discounted by the Treasury discount rate of 2.2% in real terms. During 2008-09 a new provision for PACE and Head Office Streamlining (£58,998,000) and project BORONA (£360,000) have been created. Increases of £27,024,000 were made to existing schemes. Early retirement/redundancy costs charged to provisions during the period amounted to £116,172,000.

### Other

20.4 The opening balance on Other provisions of £1,067,017,000 includes costs arising from the disposal of fixed assets; redundancy and relocation costs associated with reorganisation and restructuring (£81,420,000) and amounts payable under guarantees, litigation and contractual arrangements (£985,597,000). During 2008-09, provisions have been increased for legal claims (£94,700,000), an outstanding adjudication decision (£93,936,000) and Locally Employed Civilian pensions (£15,407,000). Costs charged to provisions during the period amounted to £128,165,000 and included £2,995,000 for Army and RAF manpower reductions following decisions on organisational change.

## 21. General Fund

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

	2008-09 £000	Restated 2007-08 £000
Balance at 1 April	76,897,678	75,664,782
Net Parliamentary Funding		
– Drawn Down	36,205,052	33,622,000
– Deemed	346,673	229,588
Year end adjustment		
– Supply Creditor	(120,807)	(346,673)
Net Transfer from Operating Activities		
– Net Operating Costs	(36,717,605)	(36,203,727)
– CFERs paid and payable to Consolidated Fund	(301,956)	(750,810)
Non-cash charges:		
– Cost of Capital (OCS)	3,625,509	3,370,908
– Auditors' Remuneration (Note 10)	3,600	3,600
– Change in the Discount Rate – Pension Provision (Note 20)	33,428	41,815
Transfer from Revaluation Reserve (Note 22)	2,164,175	1,266,589
Transfer from / (to) Donated Asset Reserve (Note 22)	19,071	(394)
<b>Balance at 31 March</b>	<b>82,154,818</b>	<b>76,897,678</b>

## 22. Reserves

	Revaluation Reserve £000	Donated Asset Reserve £000	Investment Reserve £000
At 1 April 2008	20,452,461	2,496,316	239,780
Arising on revaluation during the year (net)	4,192,929	280,193	16,236
Additions during the year	-	(59,260)	-
Transfers	-	-	-
Transferred to Operating Cost Statement	-	(218,728)	-
Transferred to General Fund	(2,164,175)	(19,071)	(256,016)
<b>At 31 March 2009</b>	<b>22,481,215</b>	<b>2,479,450</b>	-

## 23. Notes to the Cash Flow Statement

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

	Note	2008-09 £000	Restated 2007-08 £000
Net operating cost	OCS	<b>36,717,605</b>	36,203,727
Non-cash transactions:			
– Depreciation and amortisation charges	10b	<b>(6,351,893)</b>	(6,173,005)
– Impairment in value of fixed assets	10b	<b>(542,412)</b>	(74,346)
– Movement in stock related provisions	10b	<b>249,894</b>	(137,193)
– Stocks written off – net	10b	<b>(130,407)</b>	(431,651)
– Auditors' remuneration	10a	<b>(3,600)</b>	(3,600)
– Surplus arising on disposal of stock	10	<b>14,528</b>	9,638
– Surplus arising on disposal of tangible and intangible fixed assets	10b	<b>311,466</b>	682,647
– Fixed Asset write off – net	10b	<b>(423,549)</b>	(869,919)
– Capital project expenditure write off – net	10b	<b>(32,706)</b>	(19,238)
– Bad debts written off	10b	<b>(6,940)</b>	(29,607)
– Decrease in bad debts provision	10b	<b>4,197</b>	1,224
– Movement in the value of derivatives	10b	<b>1,176,730</b>	-
– Movement in provisions for liabilities and charges (excluding capitalised provisions)	20	<b>(183,494)</b>	(408,829)
Unwinding of discount on provisions for liabilities and charges	20	<b>(123,757)</b>	(123,288)
Net movement on unwinding of discount on long term debtors and liabilities		<b>15,622</b>	-
Cost of capital	21	<b>(3,625,509)</b>	(3,370,908)
		<b>(9,651,830)</b>	(10,948,075)
Increase / (decrease) in stocks/WIP		<b>603,971</b>	501,231
Increase / (decrease) in debtors		<b>(240,884)</b>	713,184
(Increase) / decrease in creditors		<b>(374,863)</b>	(1,540,776)
<i>Less movements in creditors relating for items not passing through the OCS</i>		<b>(444,896)</b>	640,212
Use of provisions		<b>863,688</b>	100,342
Movement in derivatives not passing through the OCS		<b>(325,934)</b>	-
<b>Net cash outflow from operating activities</b>		<b>27,146,857</b>	<b>25,669,845</b>

### 23.2 Analysis of capital expenditure and financial investment

	Note	2008-09 £000	2007-08 £000
Intangible fixed asset additions	13	<b>1,310,982</b>	1,755,558
Tangible fixed asset additions	14 & 20	<b>7,811,687</b>	6,707,037
Less movement on fixed asset accruals & creditors		<b>(112,875)</b>	(288,291)
Proceeds on disposal of tangible fixed assets		<b>(143,906)</b>	(1,174,198)
Net proceeds on disposal of shares in QinetiQ plc	15	<b>(254,884)</b>	-
Loans made to Trading Funds	15	<b>25,879</b>	-
Repayment of loans made to the Trading Funds and QinetiQ	15	<b>(64,944)</b>	(9,949)
<b>Net cash outflow from investing activities</b>		<b>8,571,939</b>	<b>6,990,157</b>

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

	Capital Expenditure £000	Loans Etc £000	A in A £000	Net Total £000
Request for Resources 1	7,782,837	(39,065)	(398,790)	7,344,982
Request for Resources 2	1,226,957	-	-	1,226,957
Request for Resources 3	-	-	-	-
Net movements in debtors/creditors	112,875	-	-	112,875
<b>Total 2008-09</b>	<b>9,122,669</b>	<b>(39,065)</b>	<b>(398,790)</b>	<b>8,684,814</b>
Total 2007-08	8,462,595	(9,949)	(1,174,198)	7,278,448

### 23.4 Analysis of financing

	Note	2008-09 £000	2007-08 £000
From the Consolidated Fund (Supply) – current year including deemed funding	21	<b>36,551,725</b>	33,622,000
Repayment of loans from the National Loans Fund		<b>(2,019)</b>	(1,904)
Capital elements of payments in respect of finance leases and on-balance sheet PFI contracts		<b>(25,358)</b>	(24,374)
Repayment of other loans		-	(85,800)
<b>Net financing</b>		<b>36,524,348</b>	<b>33,509,922</b>

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

	Note	2008-09 £000	Restated 2007-08 £000
Net cash requirement		<b>(36,430,918)</b>	(33,485,637)
From the Consolidated Fund (Supply) – current year including deemed funding	21,18	<b>36,551,725</b>	33,622,000
Amounts due to the Consolidated Fund received and not paid	19	<b>242,795</b>	-
Amounts due to the Consolidated Fund received in the prior year and paid over		-	(58,934)
Movement on Collaborative balances		<b>36,116</b>	(37,253)
<b>Increase / (decrease) in cash</b>		<b>399,718</b>	<b>40,176</b>

## 24. Notes to the Statement of Net Operating Costs by Departmental Strategic Objectives

The net costs of the Departmental Objectives are:

### Objective 1: Achieving success in the tasks we undertake, at home and abroad

	2008-09		Net £000	Restated 2007-08		
	Gross £000	Income £000		Gross £000	Income £000	Net £000
Operations	2,893,552	(38,536)	2,855,016	2,218,138	(22,101)	2,196,037
Other military tasks	937,669	(54,687)	882,982	1,207,830	(50,378)	1,157,452
Contributing to the community	467,633	(18,385)	449,248	468,887	(30,111)	438,776
Helping to build a safer world	546,456	(212,337)	334,119	405,860	(150,561)	255,299
<b>Total</b>	<b>4,845,310</b>	<b>(323,945)</b>	<b>4,521,365</b>	<b>4,300,715</b>	<b>(253,151)</b>	<b>4,047,564</b>

Operations comprises the additional costs incurred deploying the Armed Forces on military operations, e.g. in Iraq and Afghanistan, over and above the costs of maintaining the units involved at their normal states of readiness.

Other military tasks include ongoing military commitments, e.g. 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 and administration of cadet forces. In addition, it includes the costs of assistance to other Government Departments and agencies, e.g. in counter drugs operations.

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

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

The costs of delivering the military capability to meet this objective are analysed by the 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, the cost of Force Elements 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, costs also contain a share of the costs of: advising Ministers, accountability to Parliament and apportioned overheads for other Head Office functions and centrally provided services.

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

	2008-09			Restated 2007-08		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
<b>Royal Navy</b>						
Aircraft carriers	448,038	(10,345)	437,693	372,035	(9,824)	362,211
Frigates and Destroyers	1,781,407	(37,746)	1,743,661	1,476,283	(36,973)	1,439,310
Smaller warships	323,038	(7,180)	315,858	350,972	(13,117)	337,855
Amphibious ships	504,373	(13,754)	490,619	407,636	(8,811)	398,825
Strategic sealift	66,859	(2,419)	64,440	35,620	(2,088)	33,532
Fleet support ships	305,462	(6,579)	298,883	300,672	(6,182)	294,490
Survey and other vessels	184,447	(5,537)	178,910	150,740	(5,393)	145,347
Naval aircraft	1,183,981	(31,558)	1,152,423	1,105,507	(29,355)	1,076,152
Submarines	2,072,843	(36,274)	2,036,569	2,762,928	(47,519)	2,715,409
Royal Marines	620,710	(21,201)	599,509	530,285	(19,134)	511,151
	<b>7,491,158</b>	<b>(172,593)</b>	<b>7,318,565</b>	<b>7,492,678</b>	<b>(178,396)</b>	<b>7,314,282</b>
<b>Army</b>						
Field units	8,488,350	(291,215)	8,197,135	9,568,705	(293,695)	9,275,010
Other units	1,750,526	(151,500)	1,599,026	1,215,079	(131,419)	1,083,660
	<b>10,238,876</b>	<b>(442,715)</b>	<b>9,796,161</b>	<b>10,783,784</b>	<b>(425,114)</b>	<b>10,358,670</b>
<b>Royal Air Force</b>						
Combat aircraft	3,662,529	(116,378)	3,546,151	3,815,147	(87,096)	3,728,051
Intelligence, Surveillance, Target Acquisition and Reconnaissance aircraft	920,123	(20,879)	899,244	851,851	(22,566)	829,285
Tankers, transport and communications aircraft	910,063	(44,152)	865,911	1,053,352	(48,653)	1,004,699
Future capability	202,879	(2,892)	199,987	146,285	(3,429)	142,856
Other aircraft and RAF units	2,016,270	(208,125)	1,808,145	1,758,686	(269,228)	1,489,458
	<b>7,711,864</b>	<b>(392,426)</b>	<b>7,319,438</b>	<b>7,625,321</b>	<b>(430,972)</b>	<b>7,194,349</b>
<b>Centre Grouping</b>						
Joint and multinational operations	439,822	(35,264)	404,558	795,128	(24,444)	770,684
Centrally managed military support	666,083	(10,274)	655,809	680,234	(44,691)	635,543
Maintenance of war reserve stocks	859,942	(12,031)	847,911	537,265	(8,403)	528,862
	<b>1,965,847</b>	<b>(57,569)</b>	<b>1,908,278</b>	<b>2,012,627</b>	<b>(77,538)</b>	<b>1,935,089</b>
<b>Total Objective 2</b>	<b>27,407,745</b>	<b>(1,065,303)</b>	<b>26,342,442</b>	<b>27,914,410</b>	<b>(1,112,020)</b>	<b>26,802,390</b>

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

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

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

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

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

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

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

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

*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.

*Combat aircraft (formerly strike/attack and offensive support aircraft and Typhoon/Tornado F3 within defensive and surveillance aircraft)* includes Tornado GR4, Joint Force Harrier and Jaguar aircraft deployed in strike/attack and offensive support roles and Typhoon and Tornado F3 in air defence roles for the UK's standing commitments and contingent overseas operations. Typhoon has a multi-role capability since mid 2008.

*Intelligence, Surveillance, Target Acquisition and Reconnaissance (ISTAR) (formerly within defensive and surveillance aircraft and reconnaissance and maritime patrol aircraft)* includes Sentry AEW1, Sentinel and Nimrod aircraft deployed in UK contingent operations, NATO and UN Peace-Keeping commitments.

*Tankers, transport and communications aircraft* includes C-17, Hercules, Tristar and VC10 aircraft providing air transport and air to air refuelling, and smaller transport aircraft (BAe 125/146 and Squirrel/Agusta 109 helicopters) used in a rapid communications role.

*Future capability* includes the Joint Test and Evaluation Group and the development and use of geographic information.

*Other aircraft and RAF units* includes ground forces (e.g. the RAF Regiment), miscellaneous aircraft not included elsewhere and the RAF Logistics Hub and Air Traffic Services.

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

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

*Maintenance of war reserve stocks* includes the holding costs and charges of munitions and other stocks, above the levels required for planned consumption.

### Objective 3: Build for the future

This objective comprises the following elements:

Objective 3: Building for the Future	2008-09			Restated 2007-08		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
Research	1,112,555	(71)	1,112,484	973,182	(252)	972,930
Equipment Programme	1,973,072	(89,591)	1,883,481	1,847,828	(28,971)	1,818,857
Non Equipment Investment Programme	1,858,213	(151)	1,858,062	1,547,856	-	1,547,856
<b>Total</b>	<b>4,943,840</b>	<b>(89,813)</b>	<b>4,854,027</b>	<b>4,368,866</b>	<b>(29,223)</b>	<b>4,339,643</b>



Research comprises the costs, including capital charges, of the Science, Innovation, Technology TLB, and research expenditure incurred by other TLBs.

Equipment Programme refers to the administration and programme costs incurred by DE&S TLB, associated with specifying requirements for and procurement of fighting equipment and other assets. The values of fixed asset additions are shown in Notes 13 and 14.

Non-Equipment Investment Programme refers to the administration and programme costs associated with specifying requirements and delivering investment in defence estate and business infrastructure, enabling the military capability of the Armed Forces.

### Attribution to Objectives

Gross expenditure of £35,574,392,000 (94.3%) (2007-08 – 90.3%) and Operating Income of £1,201,085,000 (81.5%) (2007-08 – 86%) 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:

	2008-09			Restated 2007-08		
	Gross £000	Income £000	Net £000	Gross £000	Income £000	Net £000
Support for Ministers and Parliament	9,511	(201)	9,310	13,942	(399)	13,543
Departmental corporate services	1,049,795	(253,112)	796,683	1,199,671	(313,132)	886,539
Strategic Management	172,840	(5,449)	167,391	194,696	(6,636)	188,060
<b>Totals</b>	<b>1,232,146</b>	<b>(258,762)</b>	<b>973,384</b>	<b>1,408,309</b>	<b>(320,167)</b>	<b>1,088,142</b>

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

*Departmental corporate services* comprises internal support functions, e.g. payment of bills, payroll administration and medical care for service personnel, and costs of Departmental restructuring.

*Strategic management* includes: strategic, personnel, scientific and medical policy functions.

### 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 £84,369,236,000 (78.8%) support the military capability required to meet Objective 2. The remainder comprises assets wholly attributable to tasks within Objective 1 (£2,616,808,000 – 2.4%), and intangible assets, Single Use Military Equipment (SUME) and other assets under construction, and assets related to equipment procurement within Objective 3 (£20,147,771,000 – 18.8%), and payment of War Pensions Benefits (-£18,332,000).

## 25. Capital Commitments

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

	31 March 2009 £000	31 March 2008 £000
Contracted but not provided for	<b>21,793,987</b>	18,090,995

## 26. Financial Commitments

### 26.1 Commitments under operating leases:

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

	Land and Buildings		31 March 2009 £000	31 March 2008 £000
	31 March 2009 £000	31 March 2008 £000		
The Department was committed to making the following payments during the next year in respect of:				
Operating leases expiring within one year	6,938	14,455	44,941	38,045
Operating leases expiring between one and five years	12,718	18,017	95,036	118,991
Operating leases expiring after five years	177,619	166,158	2,856	7,072
	<b>197,275</b>	<b>198,630</b>	<b>142,833</b>	<b>164,108</b>

### 26.2 Obligations under finance leases:

Obligations under finance leases are as follows:

	31 March 2009 £000	31 March 2008 £000
Rentals due within one year	-	43
Rentals due after 1 year but within 5 years	-	-
Rentals due thereafter	-	-
	-	<b>43</b>

### 26.3 Obligations under Contractor Logistic Support (CLS) / Integrated Operational Support (IOS) Contracts:

CLS or IOS contracts are intended to provide a complete logistic, engineering and technical support service that delivers agreed platform or major system availability (or capacity) to an agreed cost. The Department's commitments under CLS/IOS contracts are set out below:

	31 March 2009 £000	31 March 2008 £000
Payments due within one year	85,551	115,798
Payments due after 1 year but within 5 years	682,893	702,543
Payments due thereafter	611,126	681,772
	<b>1,379,570</b>	<b>1,500,113</b>

## 27. Private Finance Initiative (PFI) Commitments

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

27.1 The total amount charged in the Operating Cost Statement in respect of off-balance sheet PFI transactions and the service element of on-balance sheet PFI transactions was £1,481,663,000 (2007-08: £1,276,131,000); and the payments to which the Department is committed during 2009-10, analysed by the period during which the commitment expires, are as follows:

	31 March 2009 £000	31 March 2008 £000
Expiry within 1 year	35,148	15,064
Expiry within 2 to 5 years	261,746	286,469
Expiry within 6 to 10 years	70,511	289,078
Expiry within 11 to 15 years	407,017	135,850
Expiry within 16 to 20 years	96,553	55,162
Expiry within 21 to 25 years	169,760	228,259
Expiry within 26 to 30 years	75,694	24,540
Expiry within 31 to 35 years	169,078	208,726

## Off-Balance Sheet

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

Project Description	Capital Value* £000	Prepayment 31 Mar 09 £000	Contract Start **	Contract End
Training, Administration and Financial Management Information System: Provision of training administration and financial management information systems to the Army Recruiting and Training Division	36,000	-	Aug 1996	Nov 2009
Hazardous Stores Information System: Provision of an information management service for hazardous stores safety datasheets with 2,000 users.	1,000	-	Oct 1997	Oct 2008
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	200,000	-	Jul 1997	Jul 2012
Medium Support Helicopter Aircrew Training Facility: Provision of 6 flight simulator training facilities, covering three different types of helicopter, at RAF Benson	114,000	11,134	Oct 1997	Oct 2037
Hawk Synthetic Training Facility: Provision of replacement simulator training facilities at RAF Valley	19,000	371	Dec 1997	Dec 2015
Joint Services Command and Staff College (JSCSC): Design and delivery of a new tri-Service Command and Staff Training College infrastructure and supporting services, including single residential accommodation and married quarters. (a further £58,188,000 is shown as on-balance sheet in the table at Note 27.3 below )	29,008	-	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 2017
Family Quarters Yeovilton: Provision of married quarters accommodation for 88 Service families at RNAS Yeovilton	8,200	-	Jul 1998	Jul 2028
RAF Lyneham Sewage Treatment: Refurbishment of existing sewage treatment facilities, serving a population of 7,000, to meet regulatory standards at RAF Lyneham	3,809	-	Aug 1998	Aug 2023
VIOLA PFI (formerly Thames Water and Tidworth Water and Sewage): Pathfinder project providing water, sewerage and surface water drainage, serving a population of 12,000 military and dependants at Tidworth	5,000	-	Feb 1998	Aug 2018
RAF Mail: Provision of informal messaging services for the RAF	12,000	-	Nov 1998	Nov 2011
Fire Fighting Training Units: Provision of fire fighting training for the Royal Navy	22,500	-	Apr 1999	Jan 2021
Light Aircraft Flying Training: Provision of flying training and support services for Air Experience Flying and University Air Squadron Flying Training	20,000	-	Apr 1999	Mar 2009
Tornado GR4 Synthetic Training Service: Provision of aircraft training service at RAF Marham and RAF Lossiemouth	61,700	4,184	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	15,083	-	Mar 1999	Jun 2025
Central Scotland Family Quarters: Provision of married quarters accommodation for 164 Service families in Central Scotland	24,713	1,632	Aug 1999	Jan 2021
Tri-Service Material Handling Equipment: Provision of Tri-Service materials handling capability	35,000	-	Jun 2000	Jun 2010
E3D Sentry Aircrew Training Service: E3D Sentry simulators instructors and maintainers at RAF Waddington	6,929	316	Jul 2000	Dec 2030
Lynx MK 7 and 9 Aircrew Training Service: Provision for simulator training facility for Lynx MK 7 and 9 helicopter aircrew	15,436	128	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	Prepayment 31 Mar 09 £000	Contract Start**	Contract End
Family quarters at Bristol/Bath/Portsmouth: Provision of accommodation for 317 Service families	78,010	3,892	Nov 2001	Sep 2028
Defence Housing Information Systems: Provision of a management information system for Defence Housing	11,600	-	Oct 2001	Sep 2010
Marine Support to Range and Aircrew Training: Provision of management, manning, operation and maintenance of Air Support and Range Safety Craft	11,850	-	Dec 2001	Mar 2012
Astute Class Training: Provision of a training environment for crewmen and maintainers to support Astute Class submarines for 30 years	79,600	-	Sep 2001	Jan 2037
Strategic Sealift (RoRo): Provision of strategic sealift services based on six RoRo ferries in support of Joint Rapid Reaction Force deployments	167,872	-	Jun 2002	Dec 2024
Material Handling Equipment: Provision of Tri-Service material handling equipment for Army, Navy and RAF storage depots	5,952	-	Aug 2002	Jul 2010
Aquatrine Project A: Provision of water and waste water services	154,032	81,155	Apr 2003	Nov 2028
Aquatrine Project B: Provision of water and waste water services	48,450	28,257	Sep 2004	Mar 2030
Aquatrine Project C: Provision of water and waste water services	174,000	59,155	Oct 2004	Mar 2030
Hayes Records and Storage: Pan-Government Records Management and Archive Services	11,000	-	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	141,154	Feb 2004	Feb 2039
Skynet 5: Range of satellite services, including management of existing Skynet 4 satellites	1,360,930	-	Oct 2003	Feb 2020
C Vehicles: Provision of Earthmoving and Specialist plant, Engineer Construction Plant and Material Handling Equipment and support services	703,000	32,094	Jun 2005	Jun 2021
Portsmouth 2 Housing: Provision of 148 Family quarters in Portsmouth	27,092	7,325	Oct 2005	Oct 2030
Future Strategic Tanker Aircraft (FSTA): FSTA is an innovative PFI programme that will provide modern air-to-air refuelling and passenger air transport capabilities	2,688,000	-	Mar 2008	Mar 2035

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

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

## On-Balance Sheet

27.3 The following PFI projects are treated as on-balance sheet. The service payment commitments for the year 2008-09 are included in the table shown at 27.1.

Project Description	Capital Value* £000	Net Book Value 31 Mar 09 £000	Contract Start **	Contract End
Defence Helicopter Flying School: Provision of helicopter flying training services	93,027	17,954	Apr 1997	Mar 2012
RAF Lossiemouth Family Quarters: Redevelopment and re-provision of 279 Service family quarters	24,745	23,744	Jun 1998	Aug 2020
Joint Services Command and Staff College: Command and Staff College for military and civilian personnel (also see JSCSC – Off Balance Sheet)	58,188	76,992	Jun 1998	Aug 2028
RAF Fylingdales: Provision of guaranteed power supply	7,486	2,687	Dec 1998	Dec 2023
Main Building Refurbishment: Redevelopment and management services for MOD Main Building	347,914	207,219	May 2000	May 2030
Defence Electronic Commerce Service: Strategic partnership to deliver e-business environment to share information between MOD and trading partners	6,511	406	Jul 2000	Jul 2010
Defence Animal Centre: Redevelopment of new office and residential accommodation, animal husbandry and training support	10,047	14,437	Aug 2000	Nov 2026
Heavy Equipment Transporters: Provision of vehicles to replace existing fleet and meet future requirements	58,000	43,889	Dec 2001	Jul 2024
Field Electrical Power Supplies: Provision of generator sets to support operational electrical requirements in the field	73,410	64,420	Jun 2002	Jun 2022
Naval Communications: Submarine fleet communications service	58,491	39,407	Jun 2003	Dec 2030
Devonport Armada Single Living Accommodation: Provision of Support Services and Fleet Accommodation Centre services at Devonport Naval Base	44,513	37,109	Jul 2004	Mar 2029
Project Allenby/Connaught: Rebuild, refurbishment, management and operation of facilities for Service accommodation at Aldershot, Tidworth, Bulford, Warminster, Larkhill and Perham Down	1,300,000	209,185	Mar 2006	Apr 2041
Northwood: Rebuild, refurbishment, management and operation of facilities for the Permanent Joint Headquarters	161,521	79,022	Jul 2006	Oct 2031
Provision of Marine Services: Provision of marine services at UK Dockyard Ports at Portsmouth, Devonport and Clyde and support to military exercises, training and deep water trials, worldwide	90,565	29,199	Dec 2007	Dec 2022
Corsham Development Project: rebuild, refurbishment, management and operation of facilities of the Basil Hill site	111,398	-	Aug 2008	Jul 2033
UK Military Flying Training System: Advanced Jet Trainer, Ground Based Training Equipment Element	59,230	-	May 2008	May 2033

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

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

Imputed finance lease obligations under on-balance sheet PFI contracts comprises:	31 March 2009 £000	31 March 2008 £000
Rentals due within 1 year	27,848	22,401
Rentals due after 1 year but within 5 years	118,732	82,935
Rentals due thereafter	776,623	671,587
	<b>923,203</b>	<b>776,923</b>
Less interest element	73,959	60,857
	<b>849,244</b>	<b>716,066</b>

## 28. Financial Instruments

28.1 FRS 29 Financial Instruments – Disclosures, requires the Department to provide disclosures in respect of the role of financial instruments on performance during the period, the nature and extent of the risks to which the Department is exposed and how these risks are managed. For each type of risk arising from financial instruments, the Department is also required to provide summary quantitative data about its exposure to the risk at the reporting date.

28.2 As the cash requirements of the Department are met through the Estimates process, financial instruments play a more limited role in creating risk than would apply to a non-public sector body of a similar size. The majority of financial instruments relate to contracts for non-financial items in line with the Department's expected purchase and usage requirements and the Department is therefore exposed to little liquidity or cash flow risk.

28.3 The Department is subject to some credit risk. The carrying amount of debtors, which is net of impairment losses, represents the Department's maximum exposure to credit risk. Trade and other debtors consist of a large number of diverse customers spread over a diverse geographical area. Debtors are impaired where there is sufficient knowledge to indicate that recovery is improbable including the probability that customers will enter bankruptcy or financial reorganisation, that the customer is facing financial difficulties or that economic conditions are likely to lead to non-payment. The following analysis provides details of debtors beyond their due date and the impairments made:

Trade Debtors Beyond the Due Date	0 - 3 Months	3 - 6 Months	6 - 12 Months	Over 12 months
	£000	£000	£000	£000
Trade Debtors beyond the due date - not impaired	59,363	22,818	14,838	9,749
Trade Debtors beyond the due date - impaired	(181)	(842)	(1,394)	(8,393)
Total Debtors beyond the due date	59,182	21,976	13,444	1,356

The impairments represent 1.4% of trade and other debtors (2007-08: 1.3%).

28.4 The Department is subject to exchange rate risk and enters into forward purchase contracts for Euros and US Dollars to mitigate against the risk that cash inflows and outflows will be affected by changes in exchange rates; foreign currency forward contracts were not in hedging relationships in accordance with FRS 26. £2,304M of expenditure is undertaken in foreign currencies which are not funded through the forward purchase contracts.

### Significant Accounting Policies

28.5 Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial instrument are disclosed in Note 1 to the financial statements.

## Categories of Financial Instruments

28.6 Details of the Financial Instruments, by category, were:

	Note	Carrying Value 31 March 2009 £000	Carrying Value 31 March 2008 £000
<b>Financial Assets</b>			
Fair value through OCS – Held for Trading	BS	1,110,800	451,542
Loans and Debtors (including cash and cash equivalents)		2,198,610	2,055,473
Available for Sale	15	1	241,029
		<u>3,309,411</u>	<u>2,748,044</u>
<b>Financial Liabilities</b>			
Creditors and accruals		(7,986,875)	(7,717,540)
Fair value through OCS – Held for Trading	BS	-	(191,538)
		<u>(7,986,875)</u>	<u>(7,909,078)</u>

28.7 The net gains and losses taken through the Operating Cost Statement and Reserves in respect of financial instruments are listed below:

	OCS £000	Reserves £000
<b>Financial Assets</b>		
Fair value through OCS – Held for Trading	(1,176,730)	-
Loans and Debtors	(15,957)	-
Available for Sale	(253,457)	239,780
<b>Financial Liabilities</b>		
Creditors and accruals	334	-
	<u>(1,445,810)</u>	<u>239,780</u>

## Interest Rate Risk Management

28.8 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. Departmental cash requirements are met through the Parliamentary Estimates process.

28.9 The following table details the Department's remaining contractual maturity for its non-derivative financial liabilities. The table is based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Department can be required to pay.

31 March 2009	Less than 1 Year £000	1-5 Years £000	5+ Years £000	Total £000
Non-interest bearing	(7,806,298)	(138,837)	(151)	(7,945,286)
Fixed interest rate instruments	(2,141)	(9,392)	(32,879)	(44,412)
	<u>(7,808,439)</u>	<u>(148,229)</u>	<u>(33,030)</u>	<u>(7,989,698)</u>



28.10 The following table details the Department's expected maturity for its non-derivative financial assets. The table is based on the undiscounted contractual maturities of the financial assets including interest that will be earned on those assets.

31 March 2009	Less than 1 Year £000	1-5 Years £000	5+ Years £000	Total £000
Non-interest bearing	735,956	474,273	25,910	1,236,139
	735,956	474,273	25,910	1,236,139

### Foreign Currency Risk

28.11 The Department undertakes certain transactions denominated in foreign currencies. Hence exposures to exchange rate fluctuations arise. Exchange rate exposures for the US Dollar and Euro are managed utilising forward purchase contracts with the Bank of England covering 83% of the in-year planned expenditure (Request for Resources 1 (RfR1) – Provision of Defence Capability).

28.12 The table below details the forward purchase currency contracts outstanding at the year end:

	Average	Foreign Currency	Contract Value	Financial Asset / (Liability)	Financial Asset / (Liability)
	Contract	US \$ '000	31 March 2009	Fair Value 31 March 2009	Fair Value 31 March 2008
	Exchange	Euro € '000			
	Rates	31 March 2009	£000	£000	£000
<b>Delivery 2009-10</b>					
US Dollars (\$)	1.84	1,328,000	721,119	205,350	(52,943)
Euro (€)	1.40	1,634,000	1,169,140	344,384	133,579
<b>Delivery 2010-11</b>					
US Dollars (\$)	1.88	919,000	487,944	153,189	(25,554)
Euro (€)	1.39	1,087,000	784,205	222,649	82,414
<b>Delivery 2011-12</b>					
US Dollars (\$)	1.90	445,000	234,187	76,264	(10,288)
Euro (€)	1.38	540,000	391,219	108,965	39,300
Total			3,787,814	1,110,801	166,508

28.13 The fair value of the financial asset/liability arising from the forward purchase contracts is determined using the mid-market rate for 31 March published in the Financial Times.

28.14 Pending a review of the appropriateness of forward purchase currency contracts, no new contracts were entered into during 2008-09. The Department recommenced the forward purchase programme, in May 2009, with new contracts for delivery in the period 2009-10 to 2012-13.

### Foreign Currency Sensitivity Analysis

28.15 The following table details the Department's sensitivity to a 10% increase/decrease in Sterling against the US Dollar and Euro for capital and operating expenditure. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the year end for a 10% change in foreign currency rates. A negative number below indicates a reduction in net operating costs where Sterling has strengthened 10% against the relevant currency.

	Sterling Rate Strengthens by 10%		Sterling Rate Weakens by 10%	
	US \$	Euro (€)	US \$	Euro (€)
	Currency Impact	Currency Impact	Currency Impact	Currency Impact
	31 March 2009 £000	31 March 2009 £000	31 March 2009 £000	31 March 2009 £000
Operating Cost Statement (gain) / loss	(13,241)	(36,204)	16,183	44,249

28.16 The following table details the Department's sensitivity to a 10% strengthening in Sterling against the US Dollar and the Euro in respect of the forward purchase contracts:

	Sterling Rate Strengthens by 10%
	31 March 2009 £000
Financial Asset (decrease)	(445,376)
Operating Cost Statement loss	445,376

### Embedded Derivatives

28.17 Derivatives embedded in other financial instruments or host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not measured at fair value with changes in fair value recognised in the operating cost statement in accordance with FRS 26. The Department operates a commercial framework whereby it does not currently hold financial risks of this nature and places restrictions on doing so in the future.

### Fair Value of Financial Instruments

28.18 The carrying values of financial assets and financial liabilities are determined as follows:

- Financial assets at fair value through operating cost statement: mid market rate at 31 March as published in the Financial Times.
- Loans and debtors: Loans to MOD Trading Funds are valued at historical cost less any impairment. Debtors due in less than one year are valued at historic cost less any impairment. Debtors due in more than one year are discounted using either the higher of the interest rate intrinsic to the financial instrument or the HM Treasury rate of 2.2%.
- Available for sale assets: QinetiQ shares are measured using the quoted price. Other assets available for sale are measured at book value.
- Creditors and accruals: Creditors and accruals due in less than one year are valued at historic cost less any impairment. Creditors and accruals due in more than one year are discounted using either the higher of the interest rate intrinsic to the financial instrument or the HM Treasury rate of 2.2%. Loans payable with a market rate of interest are valued at cost.
- Financial liabilities at fair value through operating cost statement: mid market rate at 31 March as published in the Financial Times.

28.19 Details of the financial instruments by valuation method are:

	Carrying Value 31 March 2009 £000	Carrying Value 31 March 2008 £000
<b>Financial Assets</b>		
Fair value	1,110,800	692,570
Historic cost	1,720,858	1,384,122
Discounted cost	477,753	671,352
	<u>3,309,411</u>	<u>2,748,044</u>
<b>Financial Liabilities</b>		
Fair value	-	(191,538)
Historic cost	(7,850,709)	(7,378,830)
Discounted cost	(136,166)	(338,710)
	<u>(7,986,875)</u>	<u>(7,909,078)</u>

### Financial Guarantee Contracts

28.20 The Department has entered into the following financial guarantee contracts as defined in FRS 26:

Guarantee	Maximum Liability at 31 March 2009 £000	Probability	Fair value at 31 March 2009 £000
Guarantee to contractor for the provision of Government Records and Storage Facility.	296	Very Low	-
Indemnity to towage companies hired to tow foreign warships in UK ports.	-	Very Low	-

## 29. Contingent Liabilities and Contingent Assets Disclosed under FRS 12

### Contingent Liabilities

29.1 Contingent liabilities estimated at some £1,444,215,000 (2007-08: £1,698,012,000) have been identified. The balance comprises mainly of site restoration liabilities of some £400,000,000 (2007-08: £400,000,000) relating to training areas in Canada and quantifiable indemnities of £705,993,000 (2007-08: £999,548,000) granted to contractors and suppliers. The reduction in the amount of quantifiable liabilities is mainly the result of the change, following a review, of a £400,000,000 liability from quantifiable to unquantifiable.

The Department has 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 be quantified it is not appropriate to include a provision in accordance with FRS 12.

The Department signed a contract in May 2007 for Service Life Insurance which will enable Service personnel to access life insurance throughout their Service career. As at 31 March 2009 MOD's contribution to payments against qualifying policies amounted to £492,000. The amount for 2009-10 will show payments for policies falling due in 2009 but at this time the extent of the liability cannot be known. This unquantified liability has been reported to Parliament. A maximum theoretical

liability of £4bn has also been reported to Parliament. Details of the scheme and key features can be found at: <http://www.servicelifeinsurance.co.uk/>

### Contingent Assets

29.2 A US salvage company, Odyssey Marine Exploration, has found what is believed to be the wreck of the British warship 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 the 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 Authority of the Ministry of Defence, on behalf of Her Majesty's Government, and Odyssey for further archaeological exploration of the wreck and recovery of artefacts et cetera. Full responsibility for the project, including the sale of the artefacts has been transferred to the Department. Proceeds from the sale of any artefacts will be surrendered to HM Treasury.

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

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

### Quantifiable (Unrestricted)

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

	1 April 2008	Increase in year	Liabilities crystallised in year	Obligation expired in year	31 March 2009	Amount reported to Parliament by Departmental Minute
UNRESTRICTED – Indemnities	£000	£000	£000	£000	£000	£000
Residual liability for the remediation of unidentified contamination in parts of the former Rosyth Naval Base which has been sold to Rosyth 2000 plc.	Up to 1,000				Up to 1,000	1,000
Liabilities arising from insurance risk of exhibits on loan to the Army, Navy and RAF Museums.	2,630			30	2,600	
Remediation costs associated with the discovery of unknown environmental contamination at the Fleetlands site.		14,000			14,000	Above 3,000 and up to 17,000

### Quantifiable (Restricted)

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

### **Unquantifiable (Unrestricted)**

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

- 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.
- Indemnities to the Babcock Group in respect of nuclear risks under the Nuclear Installations Act 1965.
- Indemnities to the Babcock Group in respect of non-nuclear risks resulting from claims for damage to property or death and personal injury to a third party.
- Indemnity to Rolls-Royce Power for the non-insurance of the Rolls-Royce Core Factory and the Neptune Test Reactor facility for death and personal injury to a third party.
- Indemnity for residual commercial contracts claims liabilities arising from the disbanding of DERA as a MOD Trading Fund and the formation of QinetiQ on 1 July 2001.
- Indemnity for residual employee disease liability arising from the disbanding of DERA as a MOD Trading Fund and the formation of QinetiQ on 1 July 2001.
- Indemnity for public liability arising from the disbanding of DERA as a MOD Trading Fund and the formation of QinetiQ on 1 July 2001.
- Indemnity for environmental losses incurred by QinetiQ arising from certain defined materials at specific properties before the formation of QinetiQ on 1 July 2001.

### **Unquantifiable (Restricted)**

30.4 Details of restricted liabilities are not given because they are sensitive due to commercial confidentiality and for national security.

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

## 31. Losses and Special Payments

<b>CLOSED CASES: these are losses and special payments which have been formally signed off following completion of all the relevant case work. Closed cases include some cases which in previous years were shown as Advance Notifications.</b>	<b>Arising in 2008-09 £000</b>	<b>Reported in 2007-08 as Advance Notifications £000</b>
Total (excluding gifts, special payments and War Pensions Benefits) under £250,000 each: 11,154 cases	<b>14,116</b>	
Total (excluding gifts, special payments and War Pensions Benefits) over £250,000 each: 21 cases (detailed below)	<b>101,378</b>	<b>88,101</b>
Totals	<b>115,494</b>	<b>88,101</b>
<b>Total Value of Closed Cases – Arising in 2008-09 and Reported in 2007-08 as Advance Notifications</b>	<b>203,595</b>	
Details of the 21 Closed Cases over £250,000 each are:		
<b>Cash Losses</b>		
A serious fraud, linked to the purchase of airline tickets, was discovered in January 2008 by International Military Advisory Training Team (IMATT) staff. The fraud was perpetrated by a locally employed civilian in Sierra Leone and totalled \$827,729 (approx £430K). (Central)	<b>430</b>	
<b>Bookkeeping losses and adjustments</b>		
Write-off of unsupported balances following the 2008-09 asset verification exercise. The loss consists of assets not verified due to physical loss or an inability to verify with the information available. (DE&S)	<b>43,411</b>	
Write-off of an unsupported legacy balance formerly held in the Defence Procurement Agency prior to merger into DE&S. (DE&S)	<b>6,256</b>	
Write-off of an unsupported legacy balance formerly held in the Defence Logistics Organisation prior to merger into DE&S. (DE&S)	<b>1,920</b>	
<b>Losses arising from failing to make adequate charges</b>		
Mill Hill Garrison Pre-School Playgroup was allowed to trade from MOD property for the period April 1995 to March 2005 without paying rent. (Land)		<b>305</b>
<b>Losses of pay, allowances and superannuation benefits</b>		
The Infantry Financial Retention Incentive, introduced in 2007, was paid in error to a number of infantry personnel. (Land)		<b>8,834</b>
Overpayments of salary to Ministry of Defence Police officers between 1998 and 2008 due to a miscalculation of the rate for pension contributions. (Central)		<b>1,250</b>
275 occurrences of overpayment of civilian salaries and expenses between April 2008 and March 2009. (Central)	<b>331</b>	
Service Personnel Veterans Agency write-off of balance on legacy Control Account. (Central)	<b>329</b>	
<b>Stores Losses</b>		
Loss of stock at 34 Field Hospital. The loss represents a write-off of stock, which was disposed of in accordance with regulations, but not recorded in the accounts. (Land)		<b>1,726</b>
Loss of equipment at 34 Field Hospital. The loss represents a write-off of equipment which was not recorded in the accounts. (Land)		<b>628</b>
<b>Fruitless Payments</b>		
A claim on the MOD relating to delay and dislocation costs for two Landing Ship Dock (Auxiliary). Slippage in the construction programme caused delay in supplying design information and equipment to a contractor. (DE&S)		<b>53,836</b>
Technical difficulties and cost constraints led to the decision to cancel the Military Flying Management Information System project. (DE&S)		<b>8,695</b>
Costs incurred by MOD as a result of the Department's failure to supply surplus Nimrod MR2 (Spey) engines to Rolls Royce (RR) for refurbishment within the contractually agreed period. The Rolls Royce claim was based on the additional costs incurred in providing the contracted level of engine availability with a smaller pool of spare engines. (DE&S)		<b>953</b>
Write-off for the cost associated with work undertaken at RAF Brize Norton. Defence Estates and Royal Air Force Infrastructure Branch had instructed the contractor to use slurry seal as a surfacing material. The resurfacing began to fail after a few months and, as a result, the slurry seal was abandoned and Marshall Asphalt laid instead. (DE)		<b>876</b>
The repair costs to the Type 45 Long Range Radar Antenna which was damaged during installation. (DE&S)		<b>697</b>

<b>CLOSED CASES (continued)</b>	<b>Arising in 2008-09 £000</b>	<b>Reported in 2007-08 as Advance Notifications £000</b>
Return of funds to the Department of Community and Local Government (DCLG). This was in respect of monies paid over by DCLG in 2004-05 to the Defence Diversification Agency, (DDA), which was at the time part of the MOD, to enable DDA to deliver a technology-based business development project in the north-east of England on behalf of the DCLG. Insufficient evidence regarding monies claimed by DDA during the life of the project was retained on MOD files to enable the money to be reclaimed from the European Regional Development Fund. The monies were therefore returned by the MOD. (Central)	410	
A food component was withdrawn from Operational Ration Packs following discovery in tests that deterioration of the product's packaging could, over time, compromise the safety of the contents. The Contractor has accepted liability in principle for this defect and, subject to being able to develop a replacement product that is fit for purpose, has agreed to supply a replacement, at no cost to MOD. (DE&S)		315
<b>Constructive Losses</b>		
Abandonment of four incomplete permanent structures following Iraq drawdown. (CJO)	48,291	
<b>Claims waived or abandoned</b>		
Under the Service Provision Agreement between the Service Personnel and Veterans Agency (SPVA) and Electronic Data Services (EDS), a Failure Charge can be deducted from the monies payable to EDS where performance against a specified and agreed Service Level has not been achieved. The Failure Charge can be abated if Delivery Failure is adjudged to be a consequence of circumstances outside EDS' control. During the Financial Year 2007-08, the total calculated adjusted sum under the Service Provision Agreement was £9,253,000. (Central)		9,253
A claim abandoned in respect of outstanding debts owed to MOD by Air Luxor, an airline which has ceased trading. (Air £621k and CJO £112k)		733
<b>Total of the 21 cases listed above</b>	<b>101,378</b>	<b>88,101</b>
<b>International Courtesy Rules</b>		
Supplies and services provided on a reciprocal basis to Commonwealth and Foreign Navy vessels during visits to British Ports at Clyde, Portsmouth, Devonport and Gibraltar. (Central)	2,138	
<b>Special Payments</b>		
Total under £250,000 each: 101 cases	1,032	
Total over £250,000 each: 3 cases (detailed below)		10,874
Totals	<b>1,032</b>	<b>10,874</b>
<b>Total Value of Special Payments – Arising in 2008-09 plus Cases Reported in 2007-08 as Advance Notifications</b>		<b>11,906</b>
Details of the 3 Special Payments over £250,000 each are:		
Ex-gratia element of Northern Ireland Royal Irish Regiment redundancy payment relating to Normalisation arrangements in the Province. This represents payments made during 2008-09. (Land)		2,492
Ex-gratia element of the Northern Ireland civilian redundancy payment relating to Normalisation arrangements in the Province. This represents payments made during 2008-09. (Land and DE)		7,882
Armed Forces Memorial. The Armed Forces Memorial, located at the National Memorial Arboretum, Staffordshire, is dedicated to members of the UK Armed Forces killed on duty or as a result of terrorist action. In a Ministerial announcement on 5 June 2008 the Department announced a Special Payment to cover an estimated £500k shortfall in the final construction cost. (Central)		500
Totals		<b>10,874</b>
<b>Gifts</b>		
Total under £250,000 each: 19 cases	421	
Total over £250,000 each: 0 cases	0	
Total	<b>421</b>	
<b>War Pensions Benefits (WPB):</b>		
<b>Claims Abandoned-WPB</b>		

<b>CLOSED CASES (continued)</b>	<b>Arising in 2008-09 £000</b>	<b>Reported in 2007-08 as Advance Notifications £000</b>
Irrecoverable overpayments of war pensions relating to 2,583 cases have been written off.	443	
Totals	443	
<b>Special Payments-WPB</b>		
Total number of payments made during the year was 449 at a total cost of £2,190,816. These payments were for War Disability Pensions, and were made under the authority of Treasury Dispensing Instruments but outside the scope of the Service Pension order. These relate to the following payments:		
(a) Far Eastern Prisoners of War Ex-gratia payments		
In the 2000 pre-Budget speech, the Chancellor of the Exchequer announced that ex-gratia awards of £10,000 would be paid to surviving members of British groups held prisoner by the Japanese during the Second World War or their surviving spouses, including the Gurkhas from November 2003. Although the majority of cases have been paid in previous financial years, 66 claims were processed and paid in financial year 2008-09.	660	
(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. The total number of cases in 2008-09 was 201.	983	
(c) Noise Induced Sensorineural Hearing Loss		
During financial year 2008-09 173 payments were made.	481	
(d) Crown Agents Supplementation payments		
Crown Agents Financial Services make payments to ex-members of the colonial forces who are resident in the UK and who have been awarded a disablement pension by the colonial government. The payment is a supplementation amount that increases the disablement pension to the rate equivalent to a UK war pension.		
The Veterans Agency re-imburses Crown Agents Financial Services for these payments. During financial year 2008-09, the total number of cases was 9.	67	
Totals	2,191	

<b>ADVANCE NOTIFICATIONS: these are losses and special payments, which arose during 2008-09 and prior years, but where the cases have not yet been formally signed off because all the work necessary to establish the validity of the loss or special payment, and the exact amount thereof, has not yet been concluded. The amounts shown below are, therefore, estimates, and it is likely that, in many instances, the final value of these losses and special payments will differ when they are reported as closed cases in future years. Should the final value be less than £250,000, they will not be separately identified.</b>	<b>Arising in 2008-09 £000</b>	<b>Reported in 2007-08 as Advance Notifications £000</b>
<b>Notified in prior years</b>		
The value of 8 Chinook Mk3 helicopters has been written down under prudent accounting practices while the MOD establishes a way forward for the programme. The write down has arisen because, although the terms of the contract had been met, the helicopters do not currently meet the operational requirement and could not acquire Military Aircraft Release. The MOD intends to convert the Mk3 airframes to a modified Mk2 standard as a way forward, with a revaluation exercise of the 8 aircraft at the point of asset delivery. Whilst the value of the loss reported in the accounts is currently an estimate, the final write-off case, expected to be completed in 2009-10, will report the actual recalculated value of the loss. (DE&S)		205,000
A potential claim against a contractor on the Airborne Stand-Off Radar programme has been abandoned resulting in a loss, although other benefits have been secured in compensation. (DE&S)		28,000
Cancellation of the Alternative Launcher Drive System programme has resulted in a potential write-off. (DE&S)		4,000
A contractor is claiming extra costs resulting from the late delivery of unusable Global Positioning System chips in respect of the Storm Shadow missile programme, purchased via Foreign Military Sales. A related write-off of £1.8M for Variation of Price was recorded in the 2004-05 accounts. (DE&S)		4,000
The payment of staff from public funds within a non-public organisation covering the period April 1999 to March 2009 – The British Mohnese Sailing Club. (Land)		1,795
The payment of staff from public funds within a non-public organisation covering the period April 1999 to March 2009 – The British Dümmersee Yacht Club. (Land)		1,611



<b>ADVANCE NOTIFICATIONS (continued)</b>	<b>Arising in 2008-09 £000</b>	<b>Reported in 2007-08 as Advance Notifications £000</b>
Minimum Drawing Rate (MDR) overpayments due to Joint Personnel Administration automation problems. (Central)		700
In September 2006, four Sea King Gnome 1T engines were transported from Rolls Royce East Kilbride to HMS Sultan using the Defence Storage and Distribution Agency. On arrival at HMS Sultan they were found to have been transported in the incorrect orientation, additionally one had suffered impact damage. All four engines had to be returned to the workshop for a full strip and overhaul at a total cost of £0.5M. (DE&S)		500
A potential loss has been identified in respect of an overpayment made to a MOD contractor. Whilst repayment is being actively pursued, there is no assurance that the overpayment can be recovered owing to the statute of limitation restrictions. (Central)		372
<b>Notified during the year</b>		
<b>Constructive Losses</b>		
As a result of the Dublin Diplomatic Conference it was agreed to cease the use, development, production and transfer of Cluster Munitions, including the Extended Range Bomblet Shell (ERBS) L20A1 shell, resulting in a Constructive Loss. (DE&S)	55,700	
Following an accident on HMS Tireless the Board of Inquiry recommended that all Self Contained Oxygen Generators be withdrawn from service and replaced with a new design. 8,103 units are to be disposed of. (DE&S)	3,626	
<b>Fruitless Payments</b>		
In May 2009 a contractor successfully challenged the Department's interpretation of contract terms via adjudication. As a result MOD was ordered to pay sums withheld, and interest thereon. (DE)	2,154	
<b>Claims waived or abandoned</b>		
Under the Service Provision Agreement between the Service Personnel and Veterans Agency (SPVA) and Electronic Data Services (EDS), a Failure Charge can be deducted from the monies payable to EDS where performance against a specified and agreed Service Level has not been achieved. The Failure Charge can be abated if Delivery Failure is adjudged to be a consequence of circumstances outside EDS' control. During the Financial Year 2008-09, the total calculated adjusted sum under the Service Provision Agreement was £5,471,000. (Central)	5,471	
Totals	<b>66,951</b>	<b>245,978</b>
<b>Total Value of Advance Notifications – Arising in 2008-09 plus Reported and Arising in Prior Years</b>	<b>312,929</b>	
<b>Gifts</b>		
<b>Notified during the year</b>		
Gifts of buildings, fixtures and fittings in Basra, Iraq.	457	

## 32. Related Party Transactions

32.1 The Defence Science and Technology Laboratory, the UK Hydrographic Office, the Met Office, and the Defence Support Group operate as Executive Defence Agencies financed by Trading Fund. The Navy Army Air Force Institutes (NAAFI), the Oil and Pipelines Agency and the Fleet Air Arm Museum are Public Corporations.

The Trading Funds, the Oil and Pipelines Agency, NAAFI and the Fleet Air Arm Museum are regarded as related parties outside the Departmental Boundary with which the Department has had material transactions. Transactions are carried out on terms which are contracted for on an arms-length basis, and are subject to internal and external audit. The values of transactions with some of these organisations are set out below and balances with the Trading Funds at year end, are in the following table:

Organisation	Debtor Balances £000	Creditor Balances £000
Defence Science and Technology Laboratory	7,070	95,349
UK Hydrographic Office	5,527	2,265
Met Office	11,213	8,075
Defence Support Group	21,107	27,892

### Oil and Pipelines Agency (Public Corporation)

Agency Fees (excluding VAT): £2,100,000 (2007-08: £1,800,000)

Director Finance Defence Equipment & Support (DE&S), Commercial Director DE&S and the Head of Business Support group MOD are members of the Board of Directors.

### Navy Army Air Force Institutes (NAAFI)

The NAAFI Council acts as the most senior NAAFI body responsible for approving the policy and direction of NAAFI's business. The rules governing the NAAFI Council and its proceedings are laid out in NAAFI's Memorandum and Articles of Association. The Council's membership consists of: Deputy Chief of Defence Staff (Personnel) (President); 2nd Sea Lord, Adjutant General, Air Member for Personnel, Director Service Personnel Policy, Chief of Joint Operations, DE&S – Head of Commercial Command and Centre; as well as the Chairman and Deputy Chairman of NAAFI. During 2008-09 receipts from NAAFI were £164,000; payments to NAAFI were £18,208,000.

### Fleet Air Arm Museum (Public Corporation)

Grant-in-Aid: £631,000 (2007-08: £614,000)

Assistant Chief of Staff (Carrier Strike Aviation), CINCFLEET, Whale Island; Assistant Director Joint Manoeuvre, MOD, London; Director Operations, DG Helicopters, DE&S; Commanding Officer of the Naval Transition Team; Commanding Officer RNAS Culdrose and Commanding Officer RNAS Yeovilton are members of the Board of Trustees.

## **Executive Non-Departmental Public Bodies (NDPBs)**

32.2 The following are Executive NDPBs of the MOD. They are designated NDPBs under the National Heritage Act 1983 and produce their own annual accounts, in accordance with the Charities (Accounts and Reports) Regulations 2005, on an accruals basis, and are regarded as related parties. During the period 1 April 2008 to 31 March 2009, each Executive NDPB had a material transaction with the Department, as listed below:

### **National Army Museum**

Grant-in-Aid: £5,735,000 (2007-08: £5,489,000)

The Department is not represented on the Board.

### **Royal Air Force Museum**

Grant-in-Aid: £7,989,000 (2007-08: £7,019,000)

The Department is not represented on the Board.

### **Royal Marines Museum**

Grant-in-Aid: £783,000 (2007-08: £765,000)

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

### **Royal Naval Museum**

Grant-in-Aid: £1,045,000 (2007-08: £873,000)

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

### **Royal Navy Submarine Museum**

Grant-in-Aid: £591,000 (2007-08: £576,000)

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

## **Other**

32.3 The Department also pays a number of grants to other bodies outside the Departmental Boundary. These include Grants-in-Aid to: the Council of Reserve Forces and Cadets Associations (CRFCA), the Commonwealth War Graves Commission, the Royal Hospital Chelsea, the Marine Society & Sea Cadets, the Gurkha Welfare Scheme and Skill Force.

In addition, the MOD has had a number of transactions with other government departments and central government bodies. Most of the transactions have been with: the Foreign & Commonwealth Office, the Government Communications Headquarters, the Home Office, the Learning and Skills Council, the United Kingdom Trading and Investment Department, the Treasury Solicitor, the Cabinet Office, the Department for Work and Pensions, the Department for Environment Food and Rural Affairs, the National Assembly for Wales, HM Revenue and Customs and the Department for International Development.

## **Joint Ventures**

32.4 There are no Joint Ventures within the Departmental accounting boundary. Some of the Trading Funds have set up Joint Ventures and the Department is involved in collaborative projects with various foreign countries for the development and production of Single Use Military Equipment.

## 33. Events After the Balance Sheet Date

33.1 The financial statements included in the Annual Report and Accounts were authorised for issue on 6 July 2009.

33.2 MOD has terminated the Soothsayer contract. Any settlement reached between MOD and Lockheed Martin, or any damages awarded in favour of or against MOD in arbitration proceedings which may need to be reported on, will be included in the Annual Report and Accounts for 2009-10.

## 34. Restatement of the Balance Sheet as at 31 March 2008

The FReM does not require the restatement of comparative information as a result of adopting Financial Reporting Standards (FRS) 23, 25, 26 and 29 – implementing the foreign currency and financial instrument accounting requirements – for the first time. The effects of the following adjustments have been made to the published Balance Sheet, as at 31 March 2008, to improve the quality of the figures as comparators:

	Published Balance Sheet as at 31 March 2008		Restate Long Term Debtors	Remove General Bad Debt Provision	Discount Long Term Debtors & Creditors	Disclose Derivative Financial Instruments	Reclassify Shares as Available for Sale	Restated Balance Sheet as at 31 March 2008	
	£000	£000						£000	£000
<b>Fixed Assets</b>									
Intangible Assets	26,692,246							26,692,246	
Tangible Fixed Assets	77,930,278							77,930,278	
Financial Assets	497,294					(241,029)		256,265	104,878,789
Debtors: due after more than one year	1,977,080		7,107		(16,281)				1,967,906
		107,096,898							
<b>Current Assets</b>									
Financial Assets Available for Sale	-						241,029	241,029	
Stocks and work-in-progress	5,288,755							5,288,755	
Debtors: due within one year	1,945,139		(7,107)	467				1,938,499	
Derivative financial instruments	-					451,542		451,542	
Cash at bank and in hand	513,852							513,852	
	7,747,746							8,433,677	
Creditors: amounts falling due within one year	(8,111,184)							(8,111,184)	

	Published Balance Sheet as at 31 March 2008		Restate Long Term Debtors	Remove General Bad Debt Provision	Discount Long Term Debtors & Creditors	Disclose Derivative Financial Instruments	Reclassify Shares as Available for Sale	Restated Balance Sheet as at 31 March 2008	
	£000	£000						£000	£000
Derivative financial instruments	-					(191,538)		<b>(191,538)</b>	
<b>Net Current Assets</b>		<b>(363,438)</b>							<b>130,955</b>
<b>Total assets less current liabilities</b>		<b>106,733,460</b>							<b>106,977,650</b>
Creditors: amounts falling due after more than one year	(1,143,332)				5,688			<b>(1,137,644)</b>	
Provisions for liabilities and charges	<u>(5,753,771)</u>							<b><u>(5,753,771)</u></b>	
		<b>(6,897,103)</b>							<b>(6,891,415)</b>
<b>Net Assets</b>		<b><u>99,836,357</u></b>							<b><u>100,086,235</u></b>
<b>Taxpayers Equity</b>									
General fund		76,647,800		467	(10,593)	260,004			<b>76,897,678</b>
Revaluation reserve		20,452,461							<b>20,452,461</b>
Donated assets reserve		2,496,316							<b>2,496,316</b>
Investment reserve		239,780							<b>239,780</b>
		<b><u>99,836,357</u></b>							<b><u>100,086,235</u></b>

## 35. Restatement of the Operating Cost Statement as at 31 March 2008

On 1 April 2008 the responsibilities of the Defence Exports Services Organisation, to promote defence related trade, transferred from MOD to UK Trade and Investment part of the Department for Business Enterprise and Regulatory Reform. The effect of the transfer on MOD's Operating Cost Statement for the year ended 31 March 2008 is set out below with the movements also included as changes to the comparator figures in the Operating Cost Statement and the relevant notes to the accounts:

	Published 2007-08 Operating Cost Statement Analysed Between Administration and Programme Costs	Transfer of Defence Export Services Organisation	Restated Operating Cost Statement as at 31 March 2008
<b>Administration Costs</b>			
Staff costs	1,759,135	(10,930)	1,748,205
Other administration costs	675,846	(9,725)	666,121
<b>Gross administration costs</b>	<b>2,434,981</b>	<b>(20,655)</b>	<b>2,414,326</b>
Operating income	-	-	-
<b>Net administration costs before interest</b>	<b>2,434,981</b>	<b>(20,655)</b>	<b>2,414,326</b>
Net interest payable	40,021	-	40,021
<b>Net administration costs</b>	<b>2,475,002</b>	<b>(20,655)</b>	<b>2,454,347</b>
<b>Programme Costs</b>			
Staff costs	9,725,774	-	9,725,774
Other programme costs	21,919,309	-	21,919,309
<b>Gross programme costs</b>	<b>31,645,083</b>	<b>-</b>	<b>31,645,083</b>
Operating income	(1,395,770)	1,376	(1,394,394)
<b>Net programme cost before interest</b>	<b>30,249,313</b>	<b>1,376</b>	<b>30,250,689</b>
Net interest payable	127,783	-	127,783
Cost of capital charge	3,370,908	-	3,370,908
<b>Net programme cost</b>	<b>33,748,004</b>	<b>1,376</b>	<b>33,749,380</b>
<b>Net Operating Cost</b>	<b>36,223,006</b>	<b>(19,279)</b>	<b>36,203,727</b>
<b>Net resource outturn</b>	<b>36,286,316</b>		<b>36,267,037</b>

## 36. Non-Operational Heritage Assets

36.1 The Department owns a range of non-operational heritage assets from historically significant defence equipment, through archive information, to museum and art collections. In accordance with the FReM, non-operational heritage assets are valued except where the cost of obtaining a valuation for the asset is not warranted in terms of the benefits it would deliver or where it is not possible to establish a sufficiently reliable valuation.

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

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

Item	Location	Description
HMS Victory	Portsmouth	HMS Victory is the world's oldest commissioned warship and is most famous for her role as Lord Nelson's Flagship at the Battle of Trafalgar. HMS Victory is open to the public, details are available at: <a href="http://www.hms-victory.com">www.hms-victory.com</a>
Army Historic Aircraft Flight	Middle Wallop	Formed in 1977, the flight consists of seven aircraft and makes public appearances between May and September.
Battle of Britain Memorial Flight	RAF Coningsby	The Memorial Flight operates eleven mainly World War II aircraft that appear at several hundred public events each year and can also be viewed at their hangar at RAF Coningsby. Further information is available at: <a href="http://www.bbmf.co.uk/index.html">www.bbmf.co.uk/index.html</a>
Pickling Pond	HMNB Portsmouth	Pickling or mast ponds enabled long lengths of timber to be soaked before being used to build ships; well-seasoned planks would not split or shrink in the water.
Enigma Machine	RAF Cosford	Cryptographic equipment captured during WW2 and used at Bletchley Park to assist in the breaking of German signal traffic.
Artefacts, records and artworks	Various locations	Over one hundred Regimental and Corps Museums and collections exist across the country. Ownership of the buildings and contents of the museums varies between the MOD, local authorities and regimental associations. The museums, which are open to the public, trace the history of the regiments and comprise displays of uniforms, weapons, medals and records. Further information is available at: <a href="http://www.army.mod.uk/events/museums/default.aspx">http://www.army.mod.uk/events/museums/default.aspx</a>
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 19 <sup>th</sup> 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. Further information is available at: <a href="http://www.mod.uk/DefenceInternet/AboutDefence/WhatWeDo/DefenceEstatesandEnvironment/MODArtCollection">www.mod.uk/DefenceInternet/AboutDefence/WhatWeDo/DefenceEstatesandEnvironment/MODArtCollection</a>
Records and artworks	London, Gosport, Stanmore	The Admiralty and Institute of Naval Medicine Libraries and the Air Historical Branch (RAF) comprise text and records of historical and research items. Although not open to the public, access is available on application.

## 37. Entities within the Departmental Boundary

The entities within the boundary during 2008-09 were as follows:

### **Executive Agencies**

Defence Storage and Distribution Agency  
Defence Vetting Agency  
Ministry of Defence Police and Guarding Agency  
People, Pay and Pensions Agency  
Service Children's Education  
Service Personnel and Veterans Agency

### **Advisory Non-Departmental Public Bodies**

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

Stakeholder Advisory Group - Op Telic Health Research Programme Review Board

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



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

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

38.2 Votes A numbers represent uppermost limits for Service manpower; they neither predict actual strengths nor act as a control over numbers in the Services. Votes A includes a contingency margin to cover unforeseen circumstances. Manpower levels are monitored routinely, and if it is anticipated that the numbers could be breached, then a Supplementary Estimate may be required to increase the limit.

38.3 The tables included below compare, for each service, the numbers voted by the House of Commons with the maximum numbers maintained and the date at which this peak occurred. The aggregate maximum numbers maintained may not equal the sum of Officers plus Men and Women as these categories peak at different times of the year. The “Men and Women” categories represent the Services’ Ratings and Other Ranks.

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

		Numbers voted by the House of Commons	Maximum Numbers Maintained	Peak Dates
<b>NAVAL SERVICE</b>				
Royal Navy	Officers	7,230	6,680	April 2008
	Men and Women	26,050	24,230	April 2008
	Aggregate	33,280	30,910	April 2008
Royal Marines	Officers	900	840	February 2009
	Men and Women	7,090	6,910	October 2008
	Aggregate	7,990	7,730	December 2008
<b>ARMY SERVICE</b>				
Army	Officers	16,380	14,710	June 2008
	Men and Women	102,020	91,340	March 2009
	Aggregate	118,400	105,900	March 2009
Gurkhas	Officers	170	160	April 2008
	Men and Women	4,300	3,980	February 2009
	Aggregate	4,470	4,120	February 2009
<b>AIR FORCE SERVICE</b>				
Royal Air Force	Officers	10,150	9,720	February 2009
	Men and Women	35,980	33,790	May 2008
	Aggregate	46,130	43,390	April 2008

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

		Numbers voted by the House of Commons	Maximum Numbers Maintained	Peak Dates
<b>NAVAL SERVICE</b>				
Royal Fleet Reserve (Navy)	Officers	5,500	4,199	April 2008
	Men and Women	4,200	3,024	April 2008
	Aggregate	9,700	7,223	April 2008
Royal Fleet Reserve (Marines)	Officers	410	382	April 2008
	Men and Women	1,300	1,178	April 2008
	Aggregate	1,710	1,560	April 2008
Royal Naval Reserve	Officers	960	849	April 2008
	Men and Women	1,450	1,330	February 2009
	Aggregate	2,410	2,140	February 2009
Royal Marines Reserve	Officers	110	53	April 2008
	Men and Women	960	844	August 2008
	Aggregate	1,070	897	August 2008
Royal Naval Reserve List 7	Officers	900	Not Available*	
<b>ARMY SERVICE</b>				
Army Reserve	Officers	11,000	Not Available*	
	Men and Women	26,000	Not Available*	
	Aggregate	37,000	Not Available*	
Territorial Army	Officers	7,500	Not Available*	
	Men and Women	39,500	Not Available*	
	Aggregate	47,000	Not Available*	
<b>AIR FORCE SERVICE</b>				
Royal Air Force Reserve	Officers	4,250	3,719	October 2008
	Men and Women	9,000	6,250	April 2008
	Aggregate	13,250	9,963	April 2008
Royal Aux Air Force	Officers	400	317	August 2008
	Men and Women	2,300	1,335	March 2009
	Aggregate	2,700	1,585	August 2008

38.6 Maximum numbers of personnel to be maintained for service as Special Members of the Reserve Forces:

		Numbers voted by the House of Commons	Maximum Numbers Maintained	Peak Dates
<b>NAVAL SERVICE</b>				
Royal Naval Reserve	Officers	479	140	June 2008
	Men and Women	660	106	December 2008
	Aggregate	1,139	245	June 2008
<b>ARMY SERVICE</b>				
Territorial Army	Officers	1,000	Not Available*	
	Men and Women	5,000	Not Available*	
	Aggregate	6,000	Not Available*	
<b>AIR FORCE SERVICE</b>				
Royal Air Force Reserve	Officers	100	62	April 2008
	Men and Women	250	78	January 2009
	Aggregate	350	139	May 2008

The Armed Forces figure uses data from the Joint Personnel Administration system and is subject to validation; as a result, Army statistics from 1 April 2007, and Navy and RAF statistics from 1 May 2007 are provisional and subject to change

Figures for Regular Forces are rounded to the nearest 10; for Reserve Forces the figures are not rounded.

\*At the date of publication figures for Army Reserve Forces and RN List 7 were not available.

# Annexes

# Annex A

## Accountability to Parliamentary

**A.1** Ministers have accounted to Parliament during 2008-09 on all aspects of the Ministry of Defence's business. 4,443 Parliamentary Questions were tabled, Defence Ministers participated in 19 debates on Defence issues in the House of Commons and five in the House of Lords and responded to nine Adjournment Debates in Westminster Hall. Ministers made five oral statements to the House of Commons and two to the House of Lords. They also made 107 written statements to the House of Commons and the House of Lords. Details are published in Hansard.

### Ministerial Correspondence

**A.2** During 2008-09, Defence Ministers received 5,498 items of correspondence from other Members of Parliament of which 4,212 (85%) were answered within a target of 15 working days.

Table A.1 – Parliamentary Session 2007-08 Reports (Government Responses are listed in brackets after the report they relate to)

Report	Title	Publication Date
Eleventh Report HC 885 (HC 1072)	Ministry of Defence Main Estimates 2008-09	7 July 2008
Twelfth Report HC 254	Scrutiny of Arms Export controls (2008), UK Strategic Export Controls Annual Report 2006, Quarterly Reports for 2007, licensing policy and review of export control legislation	17 July 2008
Thirteenth Report HC 535 (HC 1087)	The contribution of Unmanned Aerial Vehicles to ISTAR capability	5 August 2008
Fourteenth Report HC 424 (HC 1074)	Recruiting and retaining Armed Forces personnel	30 July 2008
Fifteenth Report HC 982 (HC 1073)	UK operations in Iraq and the Gulf	22 July 2008

### Evidence to House of Commons Defence Committee (HCDC)

**A.3** Since 1 April 2008 the Ministry of Defence has also given evidence to the House of Commons Defence Committee on a number of occasions covering a wide range of issues, and the Government has responded to a number of the Committee's reports. All Committee publications, including published evidence given to the Committee, are available at: [http://www.parliament.uk/parliamentary\\_committees/defence\\_committee/defence\\_committee\\_reports\\_and\\_publications.cfm](http://www.parliament.uk/parliamentary_committees/defence_committee/defence_committee_reports_and_publications.cfm)

Reports published during this reporting period are listed in Table A.2.

Table A.2 – Parliamentary Session 2008-09 Reports (Government Responses are listed in brackets after the report they relate to)

Report	Title	Publication Date
First Report HC 52 (HC 301)	Winter Supplementary Estimates 2008-09	15 December 2008
Second Report HC 106	The work of the Committee 2007-08	14 January 2009
Third Report (HC 107)	Defence Equipment 2009	26 February 2009
Fourth Report HC 301	Spring Supplementary Estimate 2008-09	9 March 2009
Fifth Report HC 214	MOD Annual Report and Accounts 2007-08	30 March 2009

**A.4** The Defence Committee also undertook a number of visits to military establishments both in the UK and overseas as part of its inquiries, as shown in Table A.3.

Table A.3

Date of Visit	Establishment	Related Inquiry
12 May 2008	St Georges Court (AFC)	Recruiting and retaining Armed Forces personnel
19 May 2008	HMS Raleigh	Recruiting and retaining Armed Forces personnel
19 May 2008	ATE Bassingbourn	Recruiting and retaining Armed Forces personnel
23-26 Jun 2008	Bahrain and Iraq	UK operations in Iraq and the Gulf
6-11 Jul 2008	Pakistan and Afghanistan	On going inquiry into UK Operations in Afghanistan
15-16 Oct 2008	Defence Academy, Shrivenham	General visit
1 Oct 2008	Defence Equipment and Support, Abbey Wood	Defence Equipment 2009
2 Oct 2008	Centre for Counter Terrorism, DSTL Porton Down	UK National Security and Resilience
3-4 Dec 2008	Faslane & Govan	Defence Equipment 2009

## Evidence to Select Committees of the House of Commons and House of Lords

**A.5** Since 1 April 2008 the Ministry of Defence has also given written and oral evidence on various issues to the following Select Committees of the House of Commons and House of Lords: All Committee publications, including published evidence given to the Committee, are available at: <http://www.parliament.uk/business/committees.cfm>

Evidence given during this reporting period is listed below in Table A.4 below.

Table A.4 – Parliamentary Session 2007-08 Reports (Government Responses are listed in brackets after the report)

Select Committee	Subject	Publication Date
Environment, Food and Rural Affairs Committee HC49 (HC 901)	Flooding	7 May 2008
Scottish Affairs Committee HC 305 (HC1098)	Employment and Skills for the Defence industry in Scotland	23 June 2008
Welsh Affairs Committee HC870	The Provision of Cross-Border Health services for Wales: Interim Report	10 July 2008
Environment, Food and Rural Affairs Committee HC 656	Draft Marine Bill: Coastal Access Provisions	22 July 2008
Culture, Media and Sport Committee HC 693	Draft Cultural Property (Armed Conflicts) Bill	22 July 2008
Joint Committee on Human Rights HL 157/HC527	UN Convention Against Torture: Discrepancies in Evidence Given to the Committee About the Use of Prohibited Interrogation Techniques in Iraq	27 July 2008
Joint Committee on the draft Marine Bill HL 159/HC 552	Draft Marine Bill	30 July 2008
Environment, Food and Rural Affairs Committee HC 544 (HC 155)	The Potential of England's Rural Economy	29 October 2008

Table A.5 – Parliamentary Session 2008-09 Reports

House of Lords Communications Committee (HL7)	Government Communications	26 January 2009
House of Commons Innovation, Universities Science & Skills Committee HC50-I	Engineering: turning ideas into reality.	27 March 2009

## The Public Accounts Committee

**A.6** The Permanent Under Secretary has given evidence to the Public Accounts Committee (PAC) on five occasions during 2008-09. The PAC published three reports relating to hearings which took place in financial year 2007-08 and four reports relating to hearings which took place in financial year 2008-09. The Government has issued four responses to PAC reports in financial year 2008-09. Table A.6 shows this activity.

**A.7** All departments are now required to publish their progress made against the implementation of agreed PAC recommendations. Details in regard to the MOD can be found on the MOD website at [www.mod.uk](http://www.mod.uk).

Table A.6 – Parliamentary Session 2007-08 Reports (Government Responses, when they have been published, are listed in brackets after the report)

Subject	Evidence sessions & publication dates	Reference
The Privatization of QinetiQ	PAC report issued on 10 June 2008. Government's response issued on 16 October 2008.	HC 151 (Cm 7453)
Leaving the Services	PAC report issued on 18 July 2008. Government's response issued on 16 October 2008.	HC 351 (Cm 7453)
Major Projects Report 2007	PAC report issued on 22 July 2008. Government's response issued on 16 October 2008.	HC 433 (Cm 7453)
Defence Information Infrastructure	Oral evidence given by Sir Bill Jeffrey KCB, Permanent Under Secretary, Mr John CT Taylor, Chief Information Officer and Mr Bob Quick OBE, Defence Information Infrastructure (DII) Integrated Project Team Leader, Ministry of Defence, 22 October 2008. PAC report issued on 15 January 2009. Government response issued on 26 March 2009.	HC100 (Cm 7568)
Chinook Mark III	Oral evidence given by Sir Bill Jeffrey KCB, Permanent Secretary for Defence, General Sir Kevin O'Donoghue KCB CBE, Chief of Defence Materiel and Lt Gen Andrew Figgures CBE, Deputy Chief of Defence Staff (Equipment Capability) Ministry of Defence, 18 June 2008. PAC report issued on 5 March 2009.	HC247
The United Kingdom's Future Nuclear Deterrent Capability	Oral evidence given by Sir Bill Jeffrey KCB, Permanent Under Secretary of State, Dr Paul Hollinshead Bsc (Hons), PhD, MBA, OBE, Director Strategic Requirement, Mr Guy Lester, Director General Equipment, and Rear Admiral A D H Mathews CB, Director General Submarines, Ministry of Defence, 19 November 2008. PAC report issued on 19 March 2009. Government response issued on 20 May 2009.	HC250
Type 45 Destroyer	Oral evidence given by Sir Bill Jeffrey, Permanent Under Secretary, Dr Andrew Tyler, Chief Operating Officer, Defence Equipment and Support, and Rear Admiral Paul Lambert CB, Deputy Chief of Defence Staff Designate (Equipment Capability), Ministry of Defence, 23 March 2009.	
Major Projects Review 2008	Oral evidence given by Sir Bill Jeffrey KCB, Permanent Under Secretary, General Sir Kevin O'Donoghue KCB, CBE, Chief of Defence Materiel, and Lieutenant General Andrew Figgures CBE, Deputy Chief of Defence Staff (Equipment Capability), Ministry of Defence, 19 January, 2009. PAC report issued on 12 May 2009.	

## Complaints to the Parliamentary Ombudsman

**A.8** In response to a recommendation from the Public Accounts Committee in 2009 departments are required to publish information on complaints on the department by the Parliamentary Ombudsman. The MOD has a robust process for dealing with complaints of maladministration including, if it becomes necessary, for an independent internal review. During the year no complaints have been referred to our internal review body, nor have we been made aware of any complaints being referred to the Parliamentary and Health Service Ombudsman.

**A.9** The MOD treats any complaint seriously and has procedures for managing and responding to any complaints received, internally or from the public. Separate procedures exist for complaints about low flying aircraft. In addition, members of the Armed Forces are able to raise complaints via the Service Complaints Commissioner. Information about the Service Complaints Commissioner can be found at paragraph 3.48 within Section D – People.



# Annex B

## Defence Agencies, Trading Funds and Non Departmental Public Bodies

### Defence Agency Performance

#### Agencies

**B.1** There are a number of agencies within Defence delivering specialist services to Defence and other customers. Some are embedded within and funded through Top Level Budgets. These are known as on-vote agencies. Others operate as off-vote agencies and are known as Trading Funds. These are outside the Top Level Budgets structure and are self-financing through the sale of goods and services to Defence, other Government departments and commercial customers. Although Trading Funds operate at arm's length on a day-to-day basis, they remain part of Defence.

Table B.1 – Defence Agency Performance

Name	Overall performance Number and % of targets achieved <sup>1</sup>			Year on year performance – number and % of targets met which were directly comparable with the previous year		Performance relative to target against comparable Key Targets in 07/08 (better/same/ worse)
	08/09	07/08	06/07	08/09	07/08	
Defence Storage and Distribution Agency	<b>3/5</b> <b>60%</b>	3/5 60%	6/6 100%	<b>3/5</b> <b>60%</b>	3/5 60%	2/2/1
Defence Vetting Agency	<b>8/9</b> <b>89%</b>	6/9 66%	8/9 89%	<b>7/9</b> <b>78%</b>	5/8 63%	5/1/3
MOD Police and Guarding Agency	<b>11/18</b> <b>61%</b>	4/8 50%	4/10 40%	<b>4/7</b> <b>57%</b>	3/7 43%	4/1/2
People, Pay and Pensions Agency	<b>3/6</b> <b>50%</b>	14/21 66%	8/9 89%	<b>1/1</b> <b>100%</b>	3/3 100%	0/0/1
Service Children's Education	<b>30/44</b> <b>68%</b>	21/34 62%	25/30 83%	<b>23/32</b> <b>72%</b>	18/29 62%	15/3/14
Service Personnel and Veterans Agency	<b>17/21</b> <b>81%</b>	8/12 67%	16/17 94% <sup>2</sup>	<b>12/15</b> <b>80%</b>	3/4 75%	12/1/2

Notes:

<sup>1</sup> Where there are multiple elements to a target, these have been counted separately.

<sup>2</sup> Combined total for Armed Forces Personnel and Administration Agency and Veterans Agency which merged to form the Service Personnel and Veterans Agency on 1 April 2007.

**B.2** The Secretary of State for Defence has ultimate responsibility for agencies and is accountable to Parliament for their activities. In practice, this responsibility is delegated to one of the other Defence Ministers, or through a Defence Minister to a senior military officer or official, who acts as the owner. The owner is usually assisted by an Owner's Advisory Board or Owner's Council. Table B.1 shows each agency's performance against their overall performance targets.

**B.3** Each agency is headed by a Chief Executive, who is responsible for its day-to-day management and those Chief Executives of agencies within Top Level Budgets receive formal delegations through the normal Top Level Budget mechanism and are accountable through the Top Level Budget structure. The Chief Executive of an agency is also responsible for ensuring the regularity and propriety of expenditure, adequacy of financial systems, prudent and economical administration and effective use of resources within the agency. Chief Executives of agencies within Top Level Budgets are accountable on these matters to the Permanent Under Secretary as the Departmental Accounting Officer.

## Organisational changes

**B.4** On 1 April 2008 agency status was removed from the Defence Analytical Services Agency and the Defence Medical Education and Training Agency.

**B.5** The MOD is examining how the business models of the Met Office, Defence Storage and Distribution Agency and the Oil and Pipelines Agency to see if they can be developed to deliver greater value as part of the Government's Organisation Efficiency Programme (OEP). MOD is additionally reviewing the Defence Support Group's business and boundary with the Defence Storage and Distribution Agency.

## Further Information

**B.6** Further information on each agency can be found on their respective websites, details of which can be found in Table B.2 below.

Table B.2 – Defence Agency Websites

Name	Website
Defence Storage and Distribution Agency	<a href="http://www.mod.uk/DefenceInternet/MicroSite/DES/OurTeams/DGJointSupplyChain/DefenceStorageAndDistributionAgencydsda.htm">http://www.mod.uk/DefenceInternet/MicroSite/DES/OurTeams/DGJointSupplyChain/DefenceStorageAndDistributionAgencydsda.htm</a>
Defence Vetting Agency	<a href="http://www.mod.uk/DefenceInternet/AboutDefence/WhatWeDo/SecurityandIntelligence/DVA/">http://www.mod.uk/DefenceInternet/AboutDefence/WhatWeDo/SecurityandIntelligence/DVA/</a>
MoD Police and Guarding Agency	<a href="http://www.MOD.uk/DefenceIntranet/AboutDefence/WhatWeDo/SecurityandIntelligence/MDPGA">http://www.MOD.uk/DefenceIntranet/AboutDefence/WhatWeDo/SecurityandIntelligence/MDPGA</a>
People, Pay and Pensions Agency	<a href="http://www.MOD.uk/DefenceIntranet/MicroSite/PPPA">http://www.MOD.uk/DefenceIntranet/MicroSite/PPPA</a>
Service Children's Education	<a href="http://SCEschools.com/new">http://SCEschools.com/new</a>
Service Personnel and Veterans Agency	<a href="http://www.veterans-uk.info/">http://www.veterans-uk.info/</a>

## Trading Funds

**B.7** Details of the overall performance against targets, for MOD Trading Funds, can be found in Table B.3.

Table B.3 – Trading Fund Performance

Name	Overall performance Number and % of targets achieved			Year on year performance – number and % of targets met which were directly comparable with the previous year			Performance relative to target against comparable Key Targets in 07/08 (better/same/ worse)
	08/09	07/08 <sup>1</sup>	06/07 <sup>1</sup>	08/09 <sup>1</sup>	07/08 <sup>1</sup>	06/07 <sup>1</sup>	
<b>DSG</b>	<b>5/5</b> <b>100%</b>	n/a	n/a	n/a	n/a	n/a	n/a
<b>Dstl</b>	<b>4.5/5</b> <b>90%</b>	6.5/8 81%	5/6 83%	<b>3/3</b> <b>100%</b>	3/4 75%	4/5 80%	1/2/0
<b>Met Office</b>	<b>3/4</b> <b>75%</b>	4/4 100%	4/4 100%	<b>2/3</b> <b>67%</b>	2/2 100%	2/2 100%	0/1/2
<b>UKHO</b>	<b>4/4</b> <b>100%</b>	3/6 50%	3/6 100%	<b>4/4</b> <b>100%</b>	3/3 100%	3/5 60%	4/0/0

<sup>1</sup> DSG was vested on 1 April 2008. It does not have any comparable data for previous years.

## Defence Support Group

**B.8** In its first operating year, the Defence Support Group (DSG) concentrated on stabilising and transforming its businesses to deliver the performance targets. With turnover of £227M, DSG gave a significant price rebate to its customers and still delivered a profit of £9.6M along with a dividend of £5.2M to its owner. DSG achieved all five Key Targets (KTs), which is significant given the pace of change employees were embracing in the first operating year. More accurate financial reporting now gives management the assurance and confidence in the performance figures and DSG is on track to deliver even greater benefits.

**B.9** DSG is now on an ambitious transformation journey under the banner of DART – DSG Achieving Rapid Transformation. This programme impacts on all areas of DSG and it will deliver the efficiencies and benefits that merger aims to provide. DSG is now established on foundations that provide the stability to consolidate and build upon all the positive actions put in place during the past year. As an MOD asset, DSG must continue delivering best value for defence, if it is to remain an in-house provider of skilled maintenance, repair, overhaul and upgrade services to the UK's Armed Forces.

## Defence Science & Technology Laboratory (Dstl)

**B.10** Dstl's core role is to deliver independent, objective, research, scientific and engineering advice, analysis and support to the MOD and UK Armed Forces. Its mission is to create the winning edge for the UK Armed Forces and Government through the best use of science and technology. It works collaboratively with the wider defence science and technology base, at home and abroad. The impact Dstl has on customers most important issues, from policy thinking and military capability development to major acquisition programmes, and support to operational theatres and headquarters, is reflected in consistently high levels of customer satisfaction.

**B.11** During 2008-09 Dstl deployed 38 scientific advisers and analysts in support of operations TELIC and HERRICK. On the technology axis, building on high-quality scientific research, Dstl has exploited its knowledge in support of the PARSIFAL accelerated development programme. This advanced armour protection has already been credited for saving the lives of soldiers on operations in Afghanistan and Iraq.

**B.12** This year all financial targets in terms of cash flow management and the continuing affordability of internal investments associated with the i-lab site rationalisation and change programme, now in its final delivery phase with all new buildings completed on time, were achieved. Turnover rose from £378.9M in 2007-08 to £404.7M, an increase of 6.8%. Group turnover amounted to £405.2M. Dstl's profit for the financial year fell as planned from £18.9M in 2007-08 to a loss of £2.1M. Return on Capital Employed (ROCE) fell from 5.5% to -1.2% over the same period. These falls arose from the costs of staff relocation, non-capital expenditure associated with the i-lab programme and a significant increase in the price of utilities.

**B.13** Ploughshare Innovations Ltd (PIL), a wholly owned subsidiary of Dstl, has made good progress in the exploitation of Dstl's Intellectual Property (IP) and, despite the impact of the economic downturn, has placed new licences for life-saving vaccine technologies in the market and, overall, maintained its level of income from licensed IP and royalties. PIL also launched two new spin-out companies and completed successful funding rounds for three existing spin-outs.

## Met Office

**B.14** The Met Office is a leading weather and climate service. Its vision is to be recognised as the best weather and climate service in the world. This will be achieved by continuing to deliver a first-rate public service and an exceptional commercial performance.

**B.15** Turnover in 2008-09 was £184.8M compared to £176.6M in 2007-08, with growth in both Government and commercial revenue streams. The upward trend in commercial revenue has continued during 2008-09 rising to £29.4M. Business profitability amounted to £7.5M in 2008-09 exceeding the target of £7M. In line with the continued improvement in our performance, dividends paid to the MOD have increased for the fifth year in a row to £17.2m in 2008-09 from £11.1m in 2007-08.

**B.16** Three out of four Key Performance Targets (KPT) were achieved. The Forecasting Accuracy KPT was narrowly missed because of a failure of one element, which measures skill in predicting whether precipitation will occur in selected locations.. The overall accuracy of Met Office forecasts continues to improve.

**B.17** The Met Office Corporate Plan for the period 2009 to 2013 outlines broad strategic objectives and plans for achieving them to meet the Top Level Objectives set by Government. Future success will be built on excellence in five key areas: science, technology, operations, customer service and outstanding people.

## UK Hydrographic Office (UKHO)

**B.18** UKHO's vision is "to remain the world leader in the supply of marine navigational information and services" and has the following digital vision to help project the organisation into its digital future: "UKHO will be the market leader in sales of carriage compliant navigational products and provide value added services". The products and services supplied to Defence, primarily the Royal Navy, are crucial to the conduct of operations globally. UKHO also plays a central role in support of the Maritime and Coastguard Agency in discharging the UK's Treaty obligations under the UN Safety of Life at Sea convention. In addition, UKHO has established a significant commercial business, supplying navigational charts, publications and other services to mariners throughout the world.

**B.19** The UKHO enjoyed a successful year. All four Key Targets were fully achieved whilst turnover increased by 14.8% to £108.3M, with sales growth achieved in both the commercial and Defence sectors. This gave a profit on ordinary activities of £12.9M; and a net profit of £7.6M after provision for an exceptional charge of £5.1M for redundancy costs linked to the rationalisation programme started last year.

## Non Departmental Public Bodies

**B.20** The department sponsors five executive and twelve advisory Non-Departmental Public Bodies, two Public Corporations, a Stakeholder Advisory Board and an Independent Monitoring Board. Details of their funding from the Defence Budget can be found in Notes 32.1 and 32.2 of the Resource Accounts section of this report. More detailed information on these and the other bodies sponsored by the department can be found at the MOD website at [www.mod.uk](http://www.mod.uk) and also on their respective websites, details of which are below, with the exception of the Oil and Pipelines agency. The Principal Service Museums are the repositories of world-class collections of objects and artefacts relating to the heritage of the Armed Forces. Discussion is still ongoing regarding the classification of a number of other bodies with links to the Department.

## National Museum of the Royal Navy

**B.21** The Navy Board identified the need for a single national museum for the Royal Navy that would provide a focus for the unique heritage and reputation of the Service, and which would embrace the four existing naval service museums (RN Museum, RN Submarine Museum, RM Museum and the Fleet Air Arm Museum). The creation of this new body, the National Museum of the Royal Navy, is now becoming a reality; the National Museum of the Royal Navy is incorporated as a limited company and registered as a Charity. While the existing museums will continue to retain a strong individual identity, increasingly the National Museum of the Royal Navy will provide the overarching national and strategic context and direction. From 1 April 2009 the funding that has been provided by Grant in Aid to the existing naval service museums will be channelled through the National Museum of the Royal Navy, for which the newly-appointed Director General is the Accounting Officer.

## Public Corporations

### Oil and Pipelines Agency

**B.22** The Oil and Pipelines Agency was set up under The Oil and Pipelines Act 1985 and is responsible for managing the Government Pipeline and Storage System (GPSS). It oversees all aspects of the operation and maintenance of the pipeline and storage facilities, ensuring that UK military requirements for aviation fuel are met. The agency also generates income from the system, mainly receipts from the use of the pipeline and storage facilities by the United States Air Force and commercial operators. The agency employs 23 people.

### Annual Public Appointment Plan

**B.23** The Committee on Standards in Public Life recommended in its Tenth Report that departments produce annual plans setting out policy and practice relating to public appointments. The MOD's Annual Public Appointment Plan includes diversity figures and targets that previously included in the now discontinued Cabinet Office publication *Delivering Diversity in Public Appointments*.

### Policy

**B.24** The MOD is committed to following the Code of Practice of the Commissioner for Public Appointments. All MOD Non-Departmental Public Bodies, Public Corporations and Independent Monitoring Boards are encouraged to follow the Code of Practice whether or not an appointment is Ministerial and therefore formally within the remit. In practice, the majority of MOD public appointments are Ministerial. The department is fully committed to improving diversity throughout its workforce and this is reflected in our approach to filling public appointments. MOD public appointments are made entirely on merit. Remuneration is based on the sum needed to attract suitably qualified candidates and to reflect the time commitment and regularity of work involved in the position.

## Report on Achievement of Objectives

**B.25** The diversity targets to be achieved in making public appointments to MOD Non-Departmental Public Bodies, Public Corporation and Independent Monitoring Board during the period of this Annual Report and the actual figures achieved by our public appointees to Non-Departmental Public Bodies are shown in Table B.4. Recruitment activity for all our public appointments is now supported by the People Pay and Pensions Agency. This could benefit our public appointments by widening the field of potential candidates, and particularly by helping to identify the best ways to communicate with minority groups. Within the overriding principle of selection based on merit, we aim to improve the representation of women, people from minority ethnic backgrounds and people with disabilities within our public appointments to MOD Non-Departmental Public Bodies, Public Corporations and Independent Monitoring Boards. Our policy is in line with the Government's long-term objectives of equal representation of men and women, pro-rata representation of people from minority ethnic backgrounds and the increased participation of people with disabilities. We also promote the benefits of diversity within their membership.

Table B.4 – Diversity Targets for Public Bodies, Public Corporation and Independent Monitoring Board

		2008-09	2009-10
Women	Target	35%	35 %
	Achieved	16%	
Ethnic minorities	Target	4.5%	4.5 %
	Achieved	0.5%	
Disabled People	Target	6%	6%
	Achieved	8.5%	

Table B.5 – MOD Non-Department Public Bodies and Public Corporation websites

Museum	Website
Royal Marines Museum	<a href="http://www.royalmarinesmuseum.co.uk/index2.html">http://www.royalmarinesmuseum.co.uk/index2.html</a>
Royal Navy Submarine Museum	<a href="http://www.rnsubmus.co.uk/">http://www.rnsubmus.co.uk/</a>
Royal Naval Museum	<a href="http://www.royalnavalmuseum.org/">http://www.royalnavalmuseum.org/</a>
National Museum of the Royal Navy	<a href="http://www.royalnavy.mod.uk/history/">http://www.royalnavy.mod.uk/history/</a>
National Army Museum	<a href="http://www.national-army-museum.ac.uk/">http://www.national-army-museum.ac.uk/</a>
Royal Air Force Museum	<a href="http://www.rafmuseum.org.uk/">http://www.rafmuseum.org.uk/</a>
Public Corporation	Website
Fleet Air Arm Museum	<a href="http://www.fleetairarm.com/">http://www.fleetairarm.com/</a>

## Websites

**B.26** The websites in Table B.5 contain further information on their respective owner, with the exception of the National Museum of the Royal Navy which does not have a dedicated website as of yet and links to the main Royal Navy website, and the Oil and Pipelines Agency which has no plans to have a website. Further information on the Oil and Pipelines Agency can be found on the main MOD website.

# Annex C

## Government Standards

### Fraud

**C.1** During the year the department's Defence Irregularity Reporting Cell recorded a total of 1,055 (664 in 2007-08) reported suspicions of irregularity, including fraud, theft and corruption with an estimated value of £6.52M (£14.61M in 2007-08). The reported total is part of a rising trend experienced over the last three years. The introduction of the cell is likely to have influenced this rise since it has improved the internal reporting process, providing for whistle-blowing disclosure and increasing the information passed to Defence Police authorities. Techniques such as data matching and the wider adoption of best practice in some local business areas have also served to identify suspicions that might previously have gone unrecorded. In this context the increase in reported suspicions over the total for 2007-08 is largely accounted for by concerns related to travel, subsistence and allowances. These include, however, a number of long standing but only newly identified and reported cases. Information on the outcomes of disciplinary and criminal proceedings is now increasingly being made available through the Defence Irregularity Reporting Cell. The department is using this information to identify the level of adherence to its stated policy of zero tolerance of fraud, theft and corruption. The awareness training programme by Defence Fraud Analysis Unit made 74 presentations at a range of locations to 3,189 Crown Servants in the year.

### Bill Payment

**C.2** The department's invoices, with the exception of some payments to suppliers by units locally, are paid through the Financial Management Shared Service Centre (FMSSC) in Liverpool. During 2008-09 the FMSSC paid 99.84% of all correctly submitted invoices within eleven calendar days, contributing to the Department's compliance with its statutory obligation under the Late Payment of Commercial Debts (Interest) Act 1998. Additionally, following the announcement by the Prime Minister in October 2008 of the intention for Government Departments to pay Small and Medium Enterprise suppliers within 10 days, the FMSSC has been monitoring performance during the final quarter of the year. The target is 90% for all UK invoices and this was achieved in March with a performance of 90.7%. Table C.1 shows MOD, and agencies, bill paying performance.

Table C.1 – Agencies Bill Paying Performance

	2008-09		2007-08		2006-07	
	Target	Achieved	Target	Achieved	Target	Achieved
<b>FMSSC</b>	Pay 99.9% of correctly presented invoices within 11 days	99.84% No of invoices: 5,086,563 Value: £25.96Bn	Pay 99.9% of correctly presented invoices within 11 days	99.8% No of invoices – 4,785,227 Value: £22.69Bn	Pay 99.9% of correctly presented invoices within 11 days	99.9% No of invoices – 5,268,462 Value: £20.79Bn
<b>Dstl</b>	Pay 98% of correctly presented invoices within 30 days	99.25% No of invoices – 28,079 Value: £291.31M	98%	98.06% No of invoices – 26,355 Value: £301.67M	98%	98.23% No of invoices – 32,893 Value: £204.13M
<b>Met Office</b>	Pay 99% of correctly presented invoices within 30 days	99.03% No of invoices – 12,697 Value: £90.978M	99%	99.2% No of invoices – 13,073 Value: £83.2M	99%	99.55% No of invoices – 12,722 Value: £68,774M
<b>UK Hydro-graphic Office</b>	Pay 99% of correctly presented invoices within 30 days	98.8% No of invoices – 11,236 Value: £58.4M	98%	98.9% No of invoices – 19,507 Value: £57M	100%	98.8% No of invoices – 12,998 Value: £48.6M
<b>DSG</b>	Pay 99% of correctly presented invoices within 30 days	95% No of invoices – £78,190 Value: £106.786Bn	N/a	N/a	N/a	N/a

## Open Government – Freedom of Information

**C.3** In 2008-09, the MOD again received more Freedom of Information requests than any other central Government department, totalling 2,732, or approximately 7% of all requests received by Whitehall. The next comparable number was 2,492 received by the Ministry of Justice. The MOD continues to have a good record on timeliness and openness in respect to its responses to Freedom of Information requests, with 70% of requests being answered within the 20 working day statutory time limit, and 63% being answered in full. MOD refused only 13% of requests in full, on the grounds that information was exempt from disclosure under the provisions of the FOI Act 2000. Our internal operating procedures continue to be improved as our familiarity with the Act increases. Formal training, seminars and workshops establish and maintain the necessary levels of expertise in business units. In-house guidance has been continuously improved and updated to reflect the evolving views of the Information Commissioner, the Information Tribunal, and policy developments issued by the Ministry of Justice. A revised and expanded publication scheme, was introduced on time, on 1 January 2009, in line with the model defined by the Information Commissioner under his Development and Maintenance Initiative.



Table C.2 – Requests for information under the Freedom of Information Act in Financial Year 2008-09

Category	MOD performance	Total for Central Government Departments
Number of requests received	2,732	36,748
Of these:		
% of requests within 20 working days	70%	82%
% of requests answered 'in time' <sup>1</sup>	79%	87%
Total of 'resolvable requests' <sup>2</sup>	2,351	27,114
Of these:		
% of resolvable requests answered in full	63%	57%
% of resolvable request refused in full	13%	20
% of resolvable requests refused in part	6%	12%
% of resolvable requests yet to receive a response at the time these statistics were collected	18%	11%

Notes:

1. In time means that an extension to the timescale for response has been applied during the initial 20-working day period, under the terms of section 10 of the FOI Act 2000.

2. Resolvable requests are those to which a substantive response can be given, and excludes lapsed or on-hold requests, or those where the information is not held or where clarification was required.

## Asbestos Contaminated Files

**C.4** Work to re-establish access to the information contained in records affected by asbestos contamination in the Old War Office Building, London was completed in March 2008. Following successful scanning, the original files were destroyed in accordance with both security and health and safety regulations. The backlog of FOI requests that had been frustrated because of the asbestos contamination has now been cleared.

## Files to the National Archive

**C.5** In 2008-09 the routine review and transfer of records to The National Archives (TNA) resulted in around 15,000 files being reviewed and about 2,800 have been released for general access. In addition, MOD has continued to support TNA in dealing with FOI requests for files that are held by TNA but not available to the public.

## Commercial Sponsorship in MOD

**C.6** A sponsorship return satisfies the Cabinet Office requirement to publish details of individual commercial sponsorship deals that are valued in excess of £5,000 ex VAT and where they supplement Government funding of any departmental core business.

Table C.3 – Commercial Sponsorship

Activity	TLB	Individual Sponsors	Company Contribution £ EX VAT	
HMS Albion	<b>Naval Command</b>	Land Rover UK	11,481	
HMS Ark Royal		Land Rover/Jaguar	8,642	
HMS Bulwark		Land Rover UK	11,481	
HMS Illustrious		Land Rover UK	11,831	
HMS Ocean		Land Rover UK	6,562	
Royal Navy Presentation Team		Jaguar Cars	6,392	
RNAS Culdrose Air Day 2007		Lockheed Martin	22,127	
		Augusta Westland	5,106	
RNAS Yeovilton		Jaguar Cars	9,749	
Fly Navy 100		BVT/ACA	40,000	
		Lockheed Martin	20,000	
HMS Daring Commissioning		Thales	7,000	
		MBDA	5,000	
	Rolls Royce	6,000		
	CONVERTEAM UK	5,000		
	BVT	10,000		
	ASTRUIM	7,000		
DAAvn Helicopter Display Team – The Blue Eagles	<b>Land Command</b>	ORIS(UK) Ltd	49,000	
		Mercedes Benz UK	234,000	
		BAE Systems	12,500	
		Mitsubishi Motors	18,700	
		The Bulletin – in-house publication		
		2009 Chinook Display Team	Boeing	10,000
		Corps Recruiting Team	Volkswagen (UK)	56,720
		Goat Mascot Vehicle	Brains Brewery	18,240
		D Inf Parachute Display Team – The Red Devils	Gencon	11,000
			Oakley	22,000
Seat Sport UK	60,000			
Suunto	5,000			
Exercise Jurassic Shark 2	Selex Galileo	10,000		
RMAS Digitisation Project	Towergate Insurance and Mr Paul Dean	15,000		
RMAS Boxing Competition	RBS Holts Bank	7,250		
RMAS Polo Club	Al Attiyah family	10,000		
8 Regt RLC Skiing Training	QinetiQ	9,000		
	RBS	8,000		
Gutersloh Half Marathon	Landrover	8,500		
RAF Aerobatic Display Team – The Red Arrows	<b>Air Command</b>	Breitling	16,000	
		BAE Systems	80,000	
		Leeds Commercial	6,500	
		Hatched Brands	18,000	

Activity	TLB	Individual Sponsors	Company Contribution £ EX VAT
		Thales	8,000
Battle of Britain Memorial Flight		BAE Systems	20,000
		Rolls Royce	10,000
		Land Rover	8,700
		John Merry	11,300
Typhoon Display Team		BMW	39,000
RAF Falcons Parachute Display Team		Peli Products (UK)	60,000
LED Screen for the 90 <sup>th</sup> Anniversary of the WW1 Armistice	<b>Central</b>	ADI Group	10,000
Contribution to Annual formal dinner		Fujitsu Services	6,500
<b>Total</b>			<b>£1,052,281</b>

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