Scrutiny Management Committee

REVIEW OF THE PRESENTATION OF THE STATES OF GUERNSEY ANNUAL ACCOUNTS

JUNE 2017

CONTENTS

"During the last political term, the Public Accounts Committee raised concerns on more than one occasion, both publicly and privately to the then Treasury & Resources Department, that the States of Guernsey's annual accounts had not made significant progress to comply with the International Public Sector Accounting Standards (IPSAS) and highlighted its disappointment at the presentation of the accounts themselves.

The Committee utilised the extensive commercial and financial experience of its Members, to put forward suggestions where improvements could be made to the public facing document.

The recommendations detailed in this report are the culmination of the work of the PAC's Audit Panel and the Financial Scrutiny Panel of the Scrutiny Management Committee and would I believe provide additional financial transparency for the States of Guernsey.

Early sight of this report was provided to Policy and Resources Committee in January and the Scrutiny Management Committee welcomes the inclusion of some of its recommendations in the current set of accounts. However, it hopes that all of the report's recommendations will be wholly embraced by the Policy and Resources Committee.

In closing, I believe that by improving the external communication of the information within the accounts, a greater number of the public would be afforded the opportunity to understand the Island's finances."

Mrs Gill Morris
Financial Scrutiny Panel Lead
Scrutiny Management Committee

1. Executive Summary

1.1. The previous Public Accounts Committee (PAC) reviewed the annual accounts and budget of the States of Guernsey to meet its mandated responsibility to ensure that management of the States' financial affairs met the highest operational standards.

1.2. Throughout the previous political term, the then PAC consistently expressed its desire to improve the overall clarity of the annual accounts. It decided to undertake a comparative review of similar jurisdictions and UK government departments to identify examples of best practice in the production of those entities' annual accounts.

1.3. A number of positive themes arose throughout the accounts reviewed. Taken together, they highlighted how complex organisations such as the States of Guernsey, can produce annual accounts that are clear and concise, but also include relevant detailed information.

1.4. The SMC completed this review and are pleased to note that following early sight of the report to Policy and Resources Committee, some steps have already been taken to improve the presentation of the 2016 accounts, in particular:

i) the removal of the individual departmental financial detail from the main report to the appendices of the accounts;

ii) the improved States Treasurer's Report narrative which includes additional information on the investment strategy and the States of Guernsey bond issue;

iii) the inclusion of an additional disclosure detailing the potential effects of moving towards the International Public Sector Accounting Standards (IPSAS) on the financial statements;

iv) the change to include each Committee's mandated responsibilities in the individual narratives; and

v) a new Appendix which reports all health service related expenditure in a consolidated statement

1.5. The PAC and subsequently the Scrutiny Management Committee (SMC), which assumed the role of the PAC, believe that the current Policy and Resources Committee can further improve the presentation of the accounts and therefore enhance the openness and transparency of the States' financial reporting, by fully considering the suggestions within this report.

2. Background

2.1. The PAC's responsibilities in relation to the oversight of the spending of public funds were formally laid down by the States of Deliberation in 2004. These responsibilities have now been assumed by the SMC.

2.2. These were: "*To ensure that proper scrutiny is given to the States' assets, expenditure and revenues to ensure that States' bodies operate to the highest standards in the management of their financial affairs.*"

2.3. The PAC complied with a portion of these responsibilities by reviewing the annual accounts and budget of the States of Guernsey (SOG) through its Audit Panel (the Panel), which benefitted greatly from the considerable current commercial and financial experience of its members.

2.4. The Committee believed that the overall clarity of the content within these important government documents was poor.

2.5. The complex nature of the current presentation of the accounts was seen as unnecessary and since the beginning of the previous term, the Panel sought to persuade the then Treasury and Resources Department (T&R) to revise the format and presentation of the annual accounts, to improve the clarity of the financial information.

2.6. This issue of unnecessary complexity was raised annually from 2013 within the PAC Chairman's annual statement to the Assembly during the accounts and budget debates and also in the Panel's meetings with the States Treasurer.

2.7. During the Budget debate in October 2014, the T&R Minister acknowledged the PAC's frustrations and confirmed that his department would welcome recommendations to assist them in improving the presentation of the accounts.

2.8. This prompted the PAC through the Panel, to undertake a more formal review of how similar jurisdictions and other large organisations produce their annual accounts. By examining how these entities delivered their annual reporting, the PAC hoped that it would be able to provide T&R with recommendations that should be helpful and constructive.

2.9. The SMC Members have since reviewed the report and the research material and agree fully with the suggested recommendations.

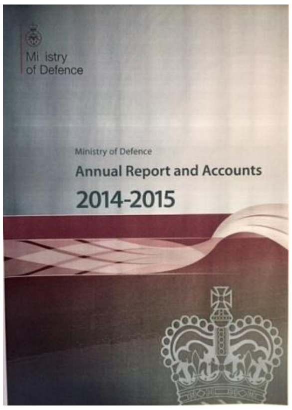
3. Findings

3.1. Whilst the Panel considered the accounts of multiple organisations, the review gave main consideration to the annual accounts of comparable jurisdictions and UK governmental departments and in particular:

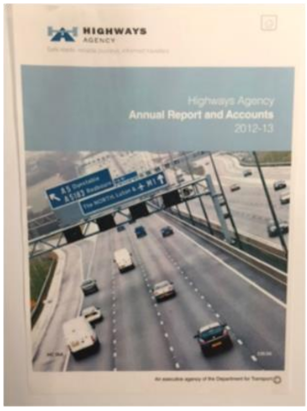
The States of Jersey

The Isle of Man Government

The UK Ministry of Defence



The UK Highways Agency



For full reports of the above, see appendices.

Best Practice

3.2. A number of common positive themes arose throughout the accounts reviewed and all demonstrated how organisations similar in scale and complexity to the SOG can produce annual accounts that are clear and concise, whilst still including detailed pertinent information.

3.3. Information which appears in the accounts reviewed, but not currently in the SOG accounts included:

(i) **Post Balance Sheet events**
Also referred to as subsequent events, these are events occurring after the date of the balance sheet, but prior to the date that the balance sheet is actually released. Items if significant will likely require a disclosure in the notes of the financial statements.

(ii) **Detailed statement of accounting policies**
The first note or footnote in a company's financial statements should disclose the significant accounting policies of the organisation; for example, how and when revenues are recognized, how property is depreciated and how inventory and income taxes are accounted for.

(iii) **Investment Strategies**
This is the opportunity for the organisation to present its strategies and long term aims for each of its investment funds.

(iv) **Fixed Assets**
Fixed assets are an organisation's tangible, noncurrent assets that are used in its business operations. A common example of fixed assets is an organisation's buildings and equipment. The word *fixed* indicates that these assets will not be used up, consumed, or sold in the current accounting year. The amount of a company's fixed assets is normally reported in the noncurrent (or long-term) asset section of the balance sheet under the header *Property, plant and equipment*.

3.4. In addition to the above, a statement of Internal Control and Governance should be included which describes the effectiveness of internal controls within an organisation and is personally signed by the relevant Accounting Officer/s.

3.5. The Internal Control statement included within the SOG's accounts is extremely short on detail and appears to be unchanged since 2008. This is disappointing when compared with the States of Jersey's Governance Framework detail for example, which occupies 28 pages.

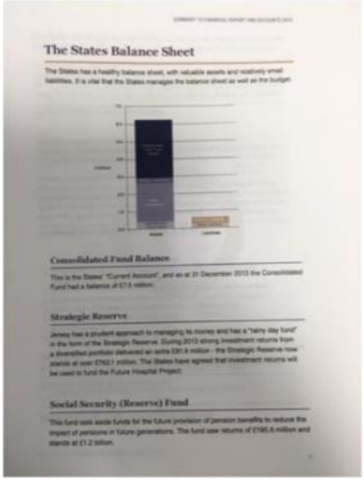
3.6. In the majority of the accounts reviewed, a detailed statement of Accounting Officer's responsibilities is also included. Currently, this is covered in one paragraph in the SOG's offering. It is hoped that following the machinery of government changes and the appointment of departmental/committee Accounting Officers, this will become more detailed.

3.7. UK central government departments also prepare a 'Statement of Parliamentary Supply' explaining their expenditure against the funds voted by Parliament. This statement is integral to the department's financial governance and something which their external auditor gives an opinion on within the annual audit of the department's accounts.

Including all of the above in the SOG accounts, would strengthen the governance and financial management surrounding the end of year process and provide more relevant information than is currently being published.

Innovation

3.8. In addition to the standard governance statements mentioned previously, the annual reports reviewed also provided innovative additions that the SOG should consider for the future:



The States of Jersey

Produces a clear and concise visually interesting summary in addition to the full accounts, written in plain English, explaining how the States of Jersey is attempting to balance its books. It also highlights with photographs, some of the capital expenditure undertaken within the fiscal year, or due to be undertaken in the coming year.

The full annual accounts include any changes made to the investment funds in the year, with a graph of the performance of the Common Investment Fund included, along with a forecast for the coming year.

Senior roles within the States are identified, with accompanying detailed pay costs for senior staff.

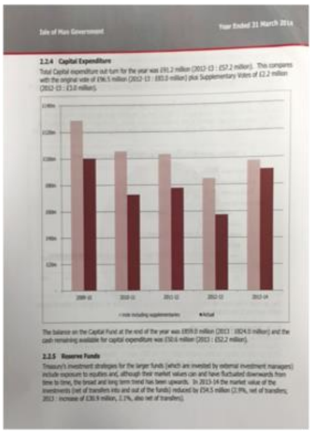
There is also a multiple page overview of the Scrutiny and Risk Management function within the States of Jersey. This explains the remits of the Audit Committee, Internal Audit, the Public Accounts Committee, Scrutiny Panels and the Chairmen's Committee along with any hearings undertaken and reports published.

The information above is publicised with a very clear and informative Press Release from the Jersey Treasury and Resources Department.

Isle of Man Government

Produces detailed Government accounts as per the States of Guernsey. However, they are written in a much more understandable language and include an introduction which explains what the different sections comprise of.

The IOM Bond Issue details the specific purposes that the amounts 'loaned on' are for, with interest rates charged and anticipated repayment dates.

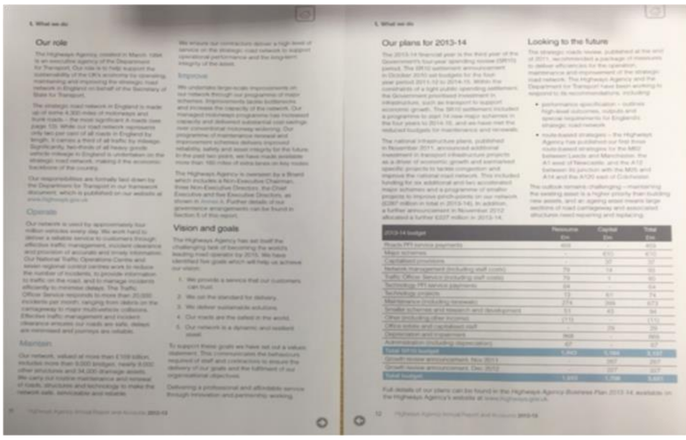


There is a summary of all invested funds, details of the income and expenditure of each fund and when, why and how the fund was established.

It also includes the annual Capital Expenditure with the overall amount approved and actual spend, explained graphically.

There is also a summary of current assets/liabilities by each Department/Committee included.

UK Highways Agency
These accounts include an interesting overview of the Purpose and Benefits of the organisation. The goals of the organisation are clearly detailed.


Our role

Our plans for 2013-14

Looking to the future

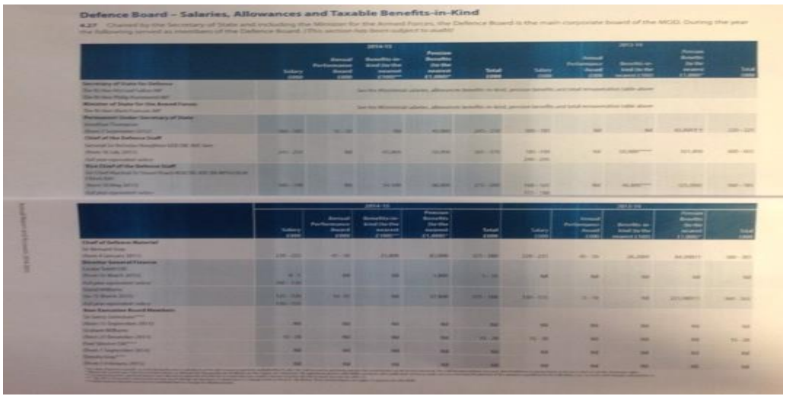
Vision and goals

There is a simple summary of income and expenditure with detailed notes available in the appendix.

An overview of Internal Audit and Risk Management and Assurance is also included.

UK Ministry of Defence
Notes to the accounts are detailed but clear, as are the numbers, with only six pages of actual figures required.

Departmental priorities with current ongoing projects are detailed.


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

There are also breakdowns of the Defence Board salaries, in addition to Ministerial salaries and allowances.

All of the above could significantly improve the presentation of the accounts of the SOG by enhancing the openness and transparency of the States' financial reporting.

4. Accounting Standards

4.1. In March 2012, the States resolved and agreed funding of £1.3m to initiate a programme intended to lead to the introduction of recognised Accounting Standards[1]. The implementation of this extant resolution would result in a robust and tested accounting framework, which is essential to effectively budget, report and plan in a sophisticated financial environment such as the States of Guernsey.

4.2. Such a framework not only facilitates these activities, but enables stakeholders, both internal and external, to evaluate how effectively and efficiently the States has performed. It enables year on year comparison and, because the recommended framework is recognised externally, also enables comparisons across similar jurisdictions. It also, importantly, allows the true cost of services delivered to be determined through the recognition of the existence and continued use of our valuable assets.

4.3. At the time of writing, the SOG accounts still do not fully adhere to current accounting standards. Despite attestations by the then T&R Department to the former PAC in this regard in the last term, the move to modern financial reporting standards is being fulfilled very slowly.

4.4. The SMC in common with its predecessor, believe it is essential that this work is undertaken to improve the overall clarity of the SOG accounts. To that end in July 2015, the previous PAC Chairman laid a successful amendment to the Second Policy Letter of the States Review Committee to insert a further proposition as follows:

"To agree that the accounts of the improved committee system shall be prepared under recognised Accounting Standards and that the Treasury & Resources Department shall formally commence the phased implementation of recognised Accounting Standards, as resolved by the States in March 2012, with effect from 1 January 2016."

4.5. The initial funding to enable this change to take place, was made available from the Fundamental Spending Review Fund and the SMC note that in the 2017 Budget there are still substantial funds allocated for *'the introduction of resource accounting and budgeting'*. Therefore, the SMC would hope that this transition is undertaken as expeditiously as possible.

[1] An accounting standard is a guideline for financial accounting and sets out how an organisation should prepare and present its business income and expense, assets and liabilities. The Generally Accepted Accounting Principles (GAAP) is comprised of a large group of individual accounting standards which apply to financial reporting worldwide.

5. Recommendations

1) **The governance and financial management surrounding the end of year process should be strengthened by the inclusion of the following in the States of Guernsey's annual accounts:**

   (i) A Statement of Parliamentary Supply;
   (ii) Any post Balance Sheet events;
   (iii) A detailed statement of accounting policies;
   (iv) The Investment Strategies of the States of Guernsey funds;
   (v) A statement of Internal Control/Governance;
   (vi) A detailed statement of Committees' Accounting Officers responsibilities;
   (vii) Fixed Assets.

2) **In order to enhance the openness and transparency of the States' financial reporting, the following should be included as a minimum by the 2016 accounts:**

   (i) An overview of the Purpose and Benefits of each new Committee following the machinery of government changes;
   (ii) Individual Committee priorities with current ongoing projects;
   (iii) The annual Capital Expenditure with the overall amount approved and actual spend explained (represented graphically);
   (iv) Any substantive changes made regarding investment funds in the year, with a performance graph, along with a forecast for the coming year;
   (v) Details of the Bond Issue including: the specific purposes of the amounts 'loaned on', interest rates charged and anticipated repayment dates;
   (vi) An overview of the Financial Scrutiny, Internal Audit, and Risk Management functions within the States of Guernsey;
   (vii) Senior roles within the States identified, with accompanying detailed pay costs (over 80k per annum).

States of Jersey

SUMMARY OF FINANCIAL REPORT AND ACCOUNTS 2013

TREASURY & RESOURCES

Overall Position for 2013 – Income and Expenditure

The States ended the year in a good position. Whilst income was lower than budgeted, expenditure was also less than approved.

General Revenue Income

General Revenue Income policy is set via the States Annual Budget, and covers the main sources of States Income such as Taxes and Duty.

Budget 2013	**Actual 2013**	**1.4%**
£646.0 million	**£636.7 million**	less than the 2013 Budget

Departments' Near Cash Revenue Expenditure

The majority of day-to-day expenditure is made through Departments, as approved in the Medium Term Financial Plan.

MTFP 2013 Approval £626.2 million	**Actual 2013 £636.2 million**	**3.5%** Less than the Final Approved Budget
Additional Allocations £32.8 million		

Capital Expenditure

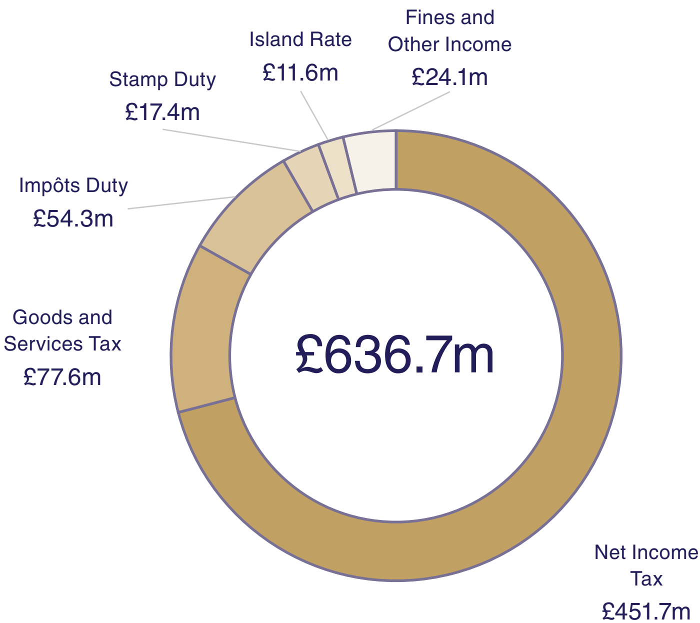
Capital Expenditure is that which enhances assets held by the States for delivery of services, e.g. property and equipment.

Consolidated Fund	**Actual 2013 £43.2 million**	**£101.1** million for future years
Trading Operations	**Actual 2013 £8.3 million**	**£43.6** million for future years

Whilst Capital Projects may span a number of years, the whole budget is allocated at the beginning of the Project. This means an element of Capital Approvals will be outstanding at the end of every year.

2013 General Revenue Income

General Revenue Income in 2013 was £8 million (1.4%) less than budgeted – mostly due to lower than budgeted Stamp Duty (£7.2 million) and lower than expected Tax revenues (£3.3 million), offset by better than budgeted Fines and Other Income (£3.5 million).



Personal Income Tax

A maximum of 20% standard rate with marginal relief to protect lower income earners.

Company Tax

Companies pay tax under the 0/10 Regime: 10% for Financial Services Companies and 0% for all other non-financial service entities and 20% for property companies and utilities.

Goods and Services Tax

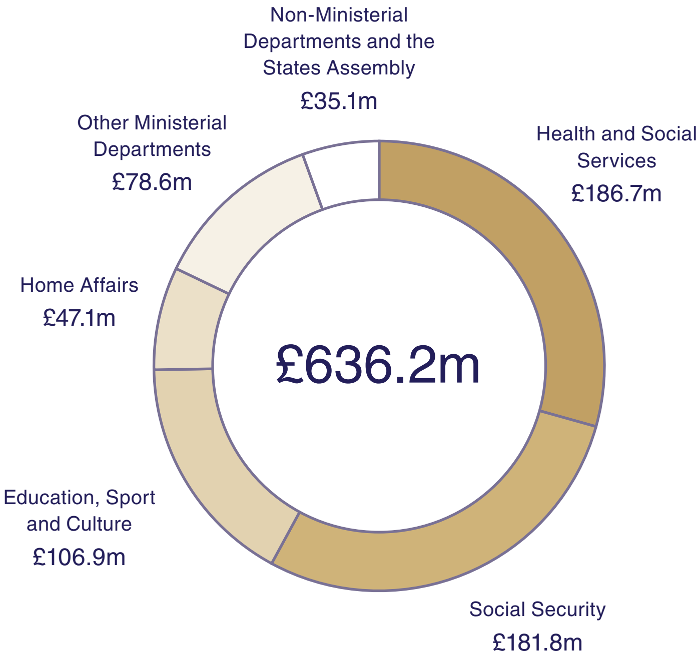
A consumption tax of 5% on imports and supplies made in Jersey. The underlying principles are that the tax is low, broad and simple.

Impôts

Impôts duties are duties charged on goods as they are imported to the Island. The duties apply to a range of commodities including alcohol, tobacco and fuel.

2013 Departmental Revenue Expenditure

Departments spent £636.2 million to provide services to the public – that equates to £15,300 per household.



Health and Social Services
£186.7 million

Promotes health and social wellbeing for the whole community, providing prompt services to all and protecting the interests of the frail and the vulnerable.

Social Security
£181.8 million

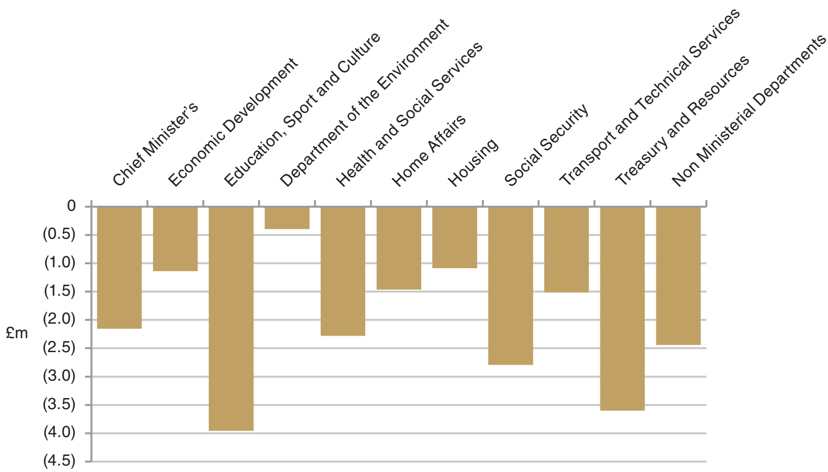
Responsible for the administration of contributions and benefits, the Health and Safety Inspectorate, and a number of employment services.

Education, Sport and Culture
£106.9 million

Provides educational, sporting and cultural opportunities for the people of Jersey, supporting Jersey's commitment to encourage lifelong learning and enabling everyone to realise their potential.

2013 Underspends

As a result of States-wide, careful management of spending, Departments spent £22.8 million less than the total approved amount for 2013. This means that some of this funding can be carried forward by Departments into 2014.



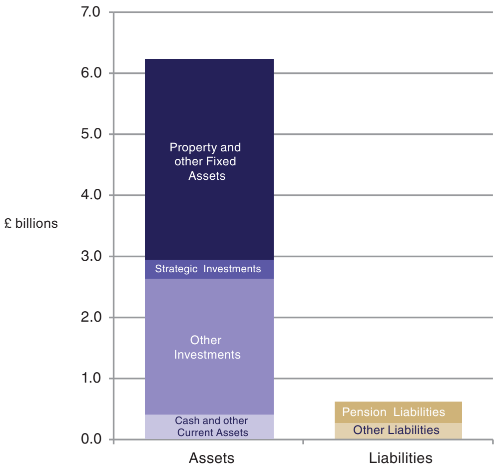
Contingencies of £20.7 million were also maintained during the year.

Carry forwards to 2014

£19.9 million (3.2% of 2013 original departmental budget) of the departmental underspending has been carried forward to fund service priorities. £18.3 million will also be retained as a contingency.

The States Balance Sheet

The States has a healthy balance sheet, with valuable assets and relatively small liabilities. It is vital that the States manages the balance sheet as well as the budget.



Consolidated Fund Balance

This is the States' "Current Account", and as at 31 December 2013 the Consolidated Fund had a balance of £7.5 million.

Strategic Reserve

Jersey has a prudent approach to managing its money and has a "rainy day fund" in the form of the Strategic Reserve. During 2013 strong investment returns from a diversified portfolio delivered an extra £91.9 million - the Strategic Reserve now stands at over £743.1 million. The States have agreed that investment returns will be used to fund the Future Hospital Project.

Social Security (Reserve) Fund

This fund sets aside funds for the future provision of pension benefits to reduce the impact of pensions in future generations. The fund saw returns of £195.6 million and stands at £1.2 billion.

Managing the Balance Sheet

Balance Sheet: Key Initiatives

Some of the key initiatives that the States is taking to manage the balance sheet better include:

- The Effective Management of the Property Portfolio through Jersey Property Holdings.
- Strategic land development through SOJDC.
- Incorporation proposals for Housing and Harbours and Airport.
- Optimising the shareholder value from the States' ownership of utilities.
- Maximising our return on investments in particular the Strategic Reserve and Social Security Reserve.
- Maximising Pension Fund investments and managing future liabilities through planned revisions to the Schemes.

Housing Incorporation

Following a States decision in May 2012, and approvals of relevant legislation in 2013, the Housing Transformation project will go ahead and this means the Housing Department will move to a Company limited by guarantee in 2014. The new housing association will be responsible for the management of all directly provided social housing for the States of Jersey.

The housing association will make a contribution to the States similar to that from the current Housing Department, and so there won't be a significant impact on net expenditure of the States.

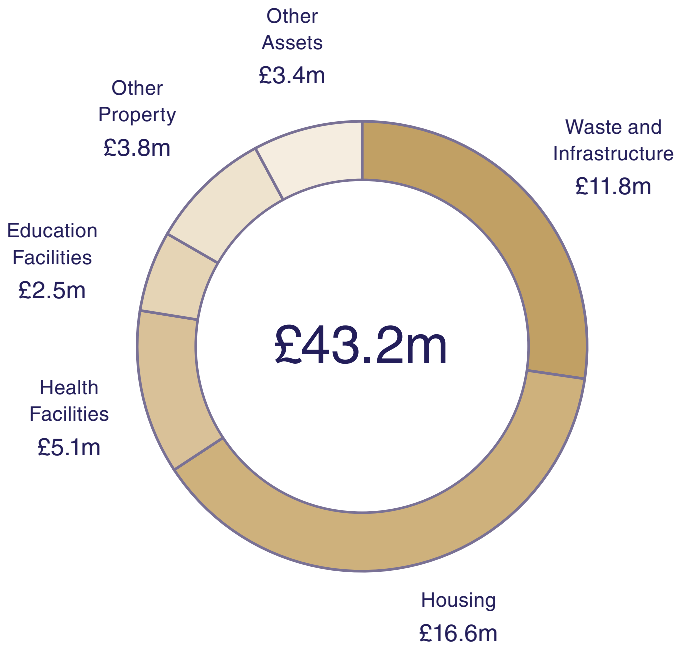
Ports of Jersey Incorporation

Harbours and Airports have now moved from two separate teams to one integrated group. A proposal will be made to incorporate these two separate entities into a new Ports Authority that will move outside the States and become a Strategic Investment wholly owned by the States.

As Harbours and Airports are already obliged to be self-funding the outcome of the incorporation process will not have a significant impact on net expenditure of the States.

2013 Capital Expenditure

A key part of managing the balance sheet is investing in the Assets that the States uses to provide operational services to Islanders. The capital programme recognises the need to invest in the States Assets, and the valuable stimulation that this provides to the Islands' economy. During 2013 amounts were spent on a diverse range of projects:



As well as works on the Island's Infrastructure and Social Housing, major schemes in the year included works on Phillips Street Shaft, the new school in St Martin, refurbishment of Clinique Pinel and improvements to the Prison.

Trading Operations also spent £8.3 million on various projects.

PLANNED PRISON IMPROVEMENTS – STORE ROOM

THE NEW ROLL-ON/ROLL-OFF RAMP IN TRANSIT FROM THE NETHERLANDS

Capital Expenditure – Long term planning

The 2014 Budget Statement included three major projects with individually identified funding sources:

- The Future Hospital – to be funded through returns on the Strategic Reserve.
- Social and affordable Housing –using Jersey's strong balance sheet to borrow funds for the longer term at record low rates of interest.
- Liquid Waste Strategy – using a combination of existing capital budgets, the main capital programme and investment from the Currency Fund.

In addition, the draft 2012-2032 Long Term Capital Plan was published as part of the Medium Term Financial Plan, as has subsequently been updated and extended to 2037. This plan looks ahead to the long term pressures within capital, and includes projects such as:

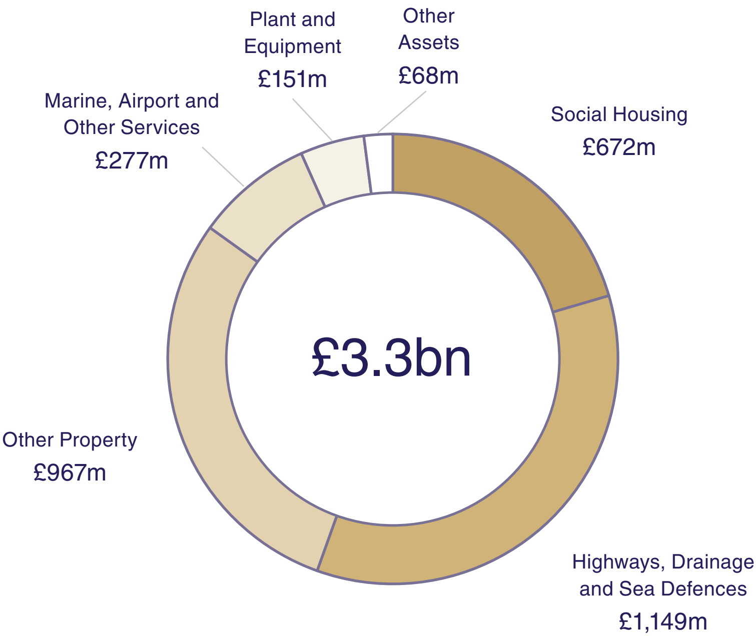
- TTS Infrastructure and Solid Waste Maintenance
- Development and refurbishment of a number of schools
- Redevelopment of Sports Facilities
- Improvements to the Prison, and relocation of Police, Fire and Ambulance Headquarters
- Office Rationalisation

These projects will be funded from a mixture of tax receipts and other funding sources.

States Assets

Property, Plant and Equipment

The States holds Assets to be used in providing services. During the year the States' Property and other Assets were revalued in line with accounting requirements to £3.3 billion.



Depreciation

Depreciation is an amount that represents the cost of "using up" fixed assets – spreading their cost over their useful life. In 2013 depreciation of £52.8 million was charged (including amounts in Trading Operations).

Pension Schemes

The States operates two main pension schemes:

- Public Employees' Contributory Retirement Scheme (PECRS)
- Teachers' Superannuation Fund (JTSF).

These funds are valued in two ways:

- The Actuarial Valuation allows assessment of the sustainability of the scheme, and is carried out every 3 years.
- The IAS 19 (Accounting) Valuation is a snapshot of the current position and assumes a highly conservative investment return which is not reflective of the returns expected from the Fund.

Under an Actuarial Valuation, the ability of the employer and employee contributions to continue to support the benefits is taken into consideration, including the employer's commitment to repay the pre-1987 debt.

Future payments are disregarded under the prescribed method for calculating an IAS 19 Valuation, and so is a less appropriate measure of the long term the long-term sustainability of the Pension Fund.

The current position of each scheme under both methods is given below:

Method	PECRS	JTSF
Actuarial (2010)	£40.6 million surplus	No surplus or deficit
IAS 19 (2013)	£766.9 million deficit	£299.0 million deficit

Whilst the IAS 19 valuation shows deficits in each scheme, the Actuarial Valuations, which provides a more realistic assessment of the long-term sustainability of the Fund, shows a surplus for PECRS, and that the JTSF has neither a surplus or deficit. The surplus in PECRS will be used in accordance with the Scheme Regulations.

Pension Review

Why is review necessary?

- People are living for longer, and drawing on the fund for longer. In 1980 a man retiring at age 60 could expect to live until he was 76, now he can expect to live until 87.
- Investments haven't grown fast enough to generate the required returns, together with the contributions, to fund the pensions.
- The way that we work and live has changed: flexible hours, part-time jobs and different life styles.

The current scheme is no longer sustainable and affordable.

What Principles have been applied

The scheme must be:

- Sustainable (for at least the next 25 years)
- Affordable (for members, employers and the taxpayer)
- Fair (for all members)

What is being proposed?

- Career Average Revalued Earning (CARE) Scheme – for every £66 earned £1 will be added to a members pension pot.
- Additional employee contributions – up to 8% for Non-Uniform employees and 10.1% for Uniform employees – phased in.
- Normal retirement age linked to Jersey state pension age for non-uniform employees, and increased from age 55 to age 60 for Uniform employees.
- Changes to rules to recognise changes to the way we live, for example, recognising co-habiting or civil partners as well as spouses.
- Risk sharing between employer and employees – including a contribution cap for employees, employers and tax payers.

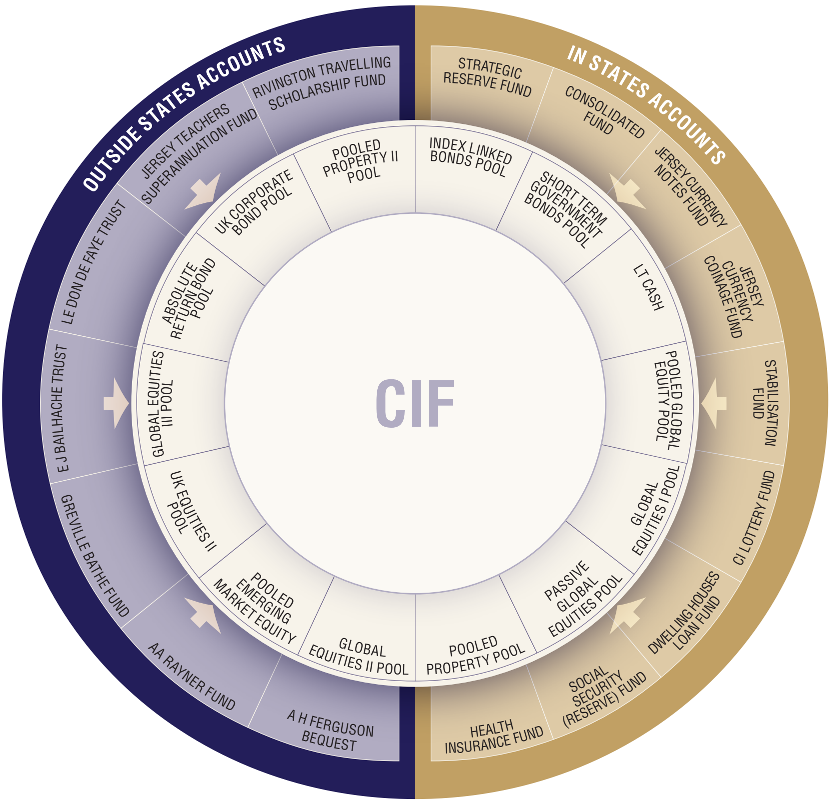
More details can be found on www.gov.je/pensionreview

States' Investment Strategy

The States of Jersey invests any amounts that either aren't immediately needed, or can't be used due to the purpose of the Fund that they have been allocated to. These investments are managed in line with Investment Strategies designed to support the Fund's aims, for example by focusing on income generation or capital maintenance.

The States operates a Common Investment Fund (CIF) to enable States Funds (both in the Accounts and outside of them) to pool resources and benefit from greater investment opportunities, economies of scale and improve risk management.

The Common Investment Fund currently operates fourteen Investment Pools, and has 16 Participant Funds.



Changes to the Investment Strategy

During the year the States has changed both individual funds Investment Strategies and the underlying Pools operated in the CIF to improve the investment options available to Participant Funds. Some of the more substantial changes were:

Consolidated Fund

During the year, improved cash management has allowed a higher proportion of the Consolidated Fund to be invested on a longer term basis, in a balanced portfolio of non-cash assets which are likely to generate higher returns.

Corporate Bond Pools

During the year the corporate bond pools were restructured, replacing long and short term corporate bond pools with a UK corporate bond pool and a global "Absolute Return" bond pool. These new pools allow the investment managers to better pursue the participants Investment Strategy.

Alternative Investment Classes

Investment Strategies also allow Funds to investment in "Alternative Investment Classes", and during 2013 a Property Investment Pool was set up within the CIF, the first Pool to offer this type of investment.

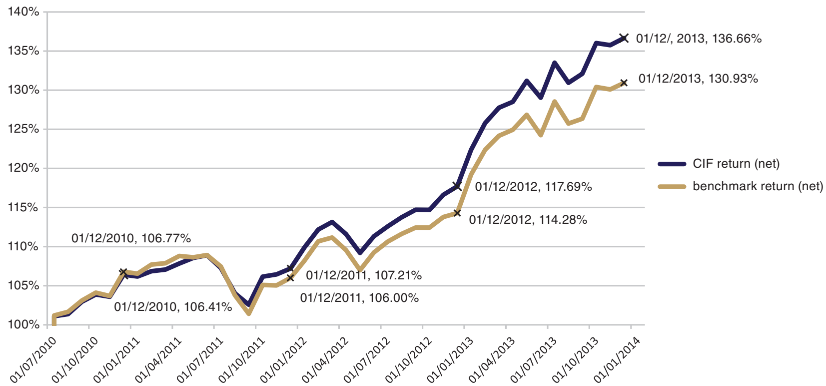
In addition, the Currency Fund has issued Infrastructure Investments totalling £14.9 million outside of its CIF investments. These Investments generate a return to the States whilst supporting the development of the Island's Infrastructure.

The Common Investment Fund – 2013 Performance

The Common Investment Fund allows States Funds to benefit from economies of scale and a range of diversified investment opportunities that increase returns and manage exposure to risk.

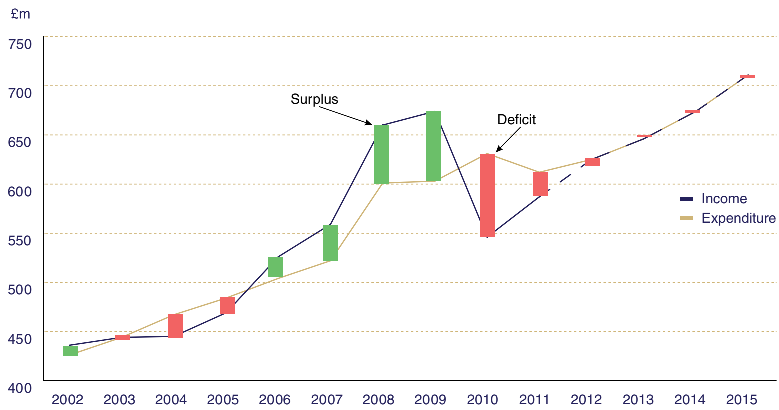
During the year the CIF generated significant income for the States of Jersey; earning net income of £251.0 million in total, representing a return on capital of around 15.9% – exceeding industry wide benchmarks by 1.3%.

The diagram below shows the performance of the CIF, compared to the benchmarks since it was established in 2010.



Not only does the CIF allow Special Funds maximise returns, it provides the opportunity for Trust and Bequest funds under the administration of the Treasury to benefit as well, giving them more money to spend on their charitable causes.

Looking Forward: Forecast Financial Position to 2015



The graph shows a return to broadly balances income and expenditure in 2013 to 2015 and this is based on the following principles.

Balancing Tax and Spending

Resource Principles

- Be prudent, taking account of the uncertain economic and financial outlook.
- Identify and implement all possible savings and efficiencies. (For 2013 and beyond we will optimise methods of service delivery and provide value for money).
- No additional spend unless matched by savings or income.
- Maintain balanced budgets over the medium term for current expenditure and achieve an appropriate balance between taxation and spending over the course of the economic cycle.
- Actively manage the Balance Sheet as well as the Budget by maximising investment returns within agreed levels of risk.
- Plan our expenditure on capital and infrastructure over the long term and consider carefully the appropriate sources of funding for major projects, including borrowing.

The States also have a number of principles that underpin the system of taxation:

- Taxation must be necessary, justifiable and sustainable.
- Taxes should be low, broad and simple.
- Everyone should make an appropriate contribution to the cost of providing services, while those on the lowest incomes are protected.
- Taxes must be internationally competitive.
- Taxation should support economic development and social policy, where possible.

States of Jersey

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GD 0055/14

Isle of Man Government

Reiltys Ellan Vannin

Isle of Man Government Accounts

For the year ended 31 March 2014

Laid before Tynwald by the Treasury

The Treasury
Finance Division

Price: £9.20

GD 0055/14

ISLE OF MAN GOVERNMENT ACCOUNTS

For the Year Ended 31 March 2014

LAID BEFORE TYNWALD BY THE TREASURY

CONTENTS

1 Explanatory foreword

1.1 Introduction

The purpose of this foreword is to offer interested parties a comprehensive guide to the most significant matters reported in these Accounts. This book is known as the "Dark Blue Book" and the pages which follow are the Audited Isle of Man Government Accounts for the year ended 31 March 2014.

1.2 Accounting Changes

The Isle of Man Government introduced the Audit Act 2006 and Accounts and Audit Regulations 2013 (Statutory Document SD No 0054/13) for accounting and financial reporting effective from the year ended 31 March 2014 and requires the Accounts to be prepared in accordance with the Isle of Man Statement of Recommended Practice 2007 *Accounting for entities subject to the Audit Act 2006* ("the SORP") and Audit Directions 2008.

The Accounts are prepared in respect of 'Central Government' (comprising Departments, Offices and revenue funded Statutory Boards of Isle of Man Government, as in previous years) and also in respect of the Isle of Man Government Group Accounts (comprising Central Government plus the three non-Revenue Funded Statutory Boards) and companies owned by Central Government. The Accounts for 2013-14 have been produced on the same basis as 2012-13 Accounts.

1.3 Financial Commentary

The financial commentary is intended to provide a quick guide to the Government's annual transactions and its year end position. The graphs included within the commentary add further information and give a visual impression of the relative sizes of the Income and Expenditure Account's components.

1.4 Statement of Responsibilities

This sets out the respective responsibilities for preparing the Accounts.

1.5 Statement on Internal Control

This is a statement by the Chief Financial Officer describing the Government's arrangements for ensuring strong governance and internal control, the progress made in addressing issues identified by this process previously and areas where improvements are planned.

1.6 Independent Auditor's Report

The Independent Auditor reports on whether, in his opinion, the Accounts have been properly prepared in accordance with the Accounts and Audit Regulations 2013 and comply with the requirements of all other enactments applicable to the Accounts.

1.7 Income and Expenditure Account

The Income and Expenditure Account shows in summary form all of the Government's annual income and expenditure, in accordance with the SORP and United Kingdom Accounting Standards, and the consequent surplus or deficit which has arisen during the year. It reports the cost for the year of the major services undertaken by the Government and compares that cost with the finance provided by Treasury income.

The income and expenditure for the year has been presented in accordance with the source of the voted income and the Government Department responsible for the expenditure.

1.8 Statement of Total Movement on the General Revenue Account Balance

This shows the surplus or deficit on the Income and Expenditure Account adjusted for the additional amounts which are required by statute and non-statutory proper practices to be charged and credited to the General Revenue Account in determining the movement on the General Revenue Account balance for the year. Examples of such transactions include adjustments in respect of fixed assets and pension, and transfers from the Net General Revenue Account to other external and internal reserve funds which are not included within the Income and Expenditure Account.

1.9 Statement of Total Recognised Gains and Losses

The Statement of Total Recognised Gains and Losses shows all gains and losses recognised by Government during the year which are not reflected in operating performance within the Income and Expenditure Account, such as revaluation of property.

1.10 Balance Sheet

This statement is fundamental to understanding Government's year end financial position as it reflects the balances in the Accounts of the Treasury. It does not generally attempt to place market values on the assets, although the value of Long Term Investments and certain Fixed Assets are revalued from their original cost. The amount of "Total Net Assets" does not reflect any liability associated with the National Insurance Fund Investments (future social security obligations).

1.11 Notes to the Accounts

The Notes to the Accounts record additional information that is either required to explain the summary information provided in the Accounts, or assist in explaining other information contained within the Accounts. The Notes include details of further information, the remuneration statement and any specific required year end information, including:

- Accounting Policies: this statement explains the basis upon which the figures in the Accounts have been prepared. The Accounts can only be properly appreciated if the policies which have been followed in dealing with material items are explained.
- Analysis of Treasury Income: detailed analysis of Custom and Excise, Income Tax and Other Treasury Income which are included in summary form in the Income and Expenditure Account.
- Investments and Internal Reserves: detailed analysis of Government's Funds including balances brought forward, movements during the year, the balances carried forward and the associated year end market values.
- Employee Pension Liabilities: estimated liabilities in respect of employee pension schemes (as opposed to state benefit pension commitments) together with movements during the year and key assumptions used to prepare the estimates.

1.12 Analysis of Expenditure of Department and Other Bodies

These statements provide a more detailed analysis of the income and expenditure of the individual Departments and other heads of expenditure which appear in summary form in the Income and Expenditure Account. The Central Government General Revenue budget is prepared on a different basis from the requirements of United Kingdom Accounting Standards, which is appropriate and necessary for reporting purposes. These statements show net expenditure against the approved revenue budget and a reconciliation to the figures presented in the Income and Expenditure Account.

1.13 Consolidated Loans Fund

Certain expenditure of a long term nature is funded from the Consolidated Loans Fund, enabling the expenditure to be defrayed against the General Revenue budget over a number of years. These statements provide details of funding made available to Departments during the year, how this funding has been financed and details of advances and repayments made during the year. Aggregate balances for loans made to external bodies are also presented.

1.14 Additional Information

There are two other annual publications which provide more financial information in support of these Accounts.

Of these, the prime reference document is the "Detailed Government Accounts" (the "Light Blue Book") which is not audited and is published informally as a source of management information within three months of the end of the accounting year. It contains the more detailed version of the Government's Accounts, published to the nearest Pound and one of its functions is that it is used to compile the Dark Blue Book which is published to the nearest thousand Pounds. The Light Blue Book also contains some additional information, comment and explanation about specific accounts including the purpose of the various General Revenue and non-General Revenue funds and how they are operated.

The other publication is the "Accounts and Financial Information" (the "Orange Book") which contains details of Trust Accounts and other third party statements.

S Clague, FCA
Chief Accountant
Treasury, Finance Division
24 September 2014

2 Financial Commentary

2.1 Introduction

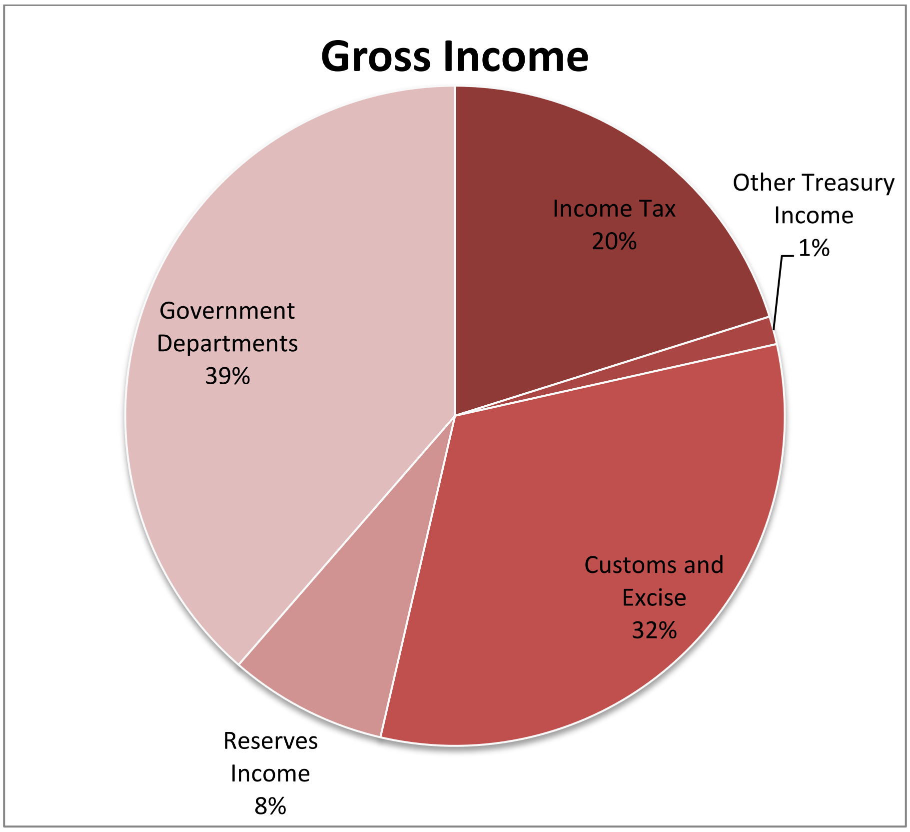
The financial commentary is intended to provide a quick guide to the Government's annual transactions and its year end position. The graphs included within the commentary add further information and give a visual impression of the relative sizes of the Income and Expenditure Account's components.

The commentary is split between Central Government Accounts (comprising Departments, Boards and Offices funded from the General Revenue Account) and Group Accounts (which also include the three non-revenue funded Statutory Boards and seven companies owned by Central Government).

2.2 Central Government

2.2.1 Income

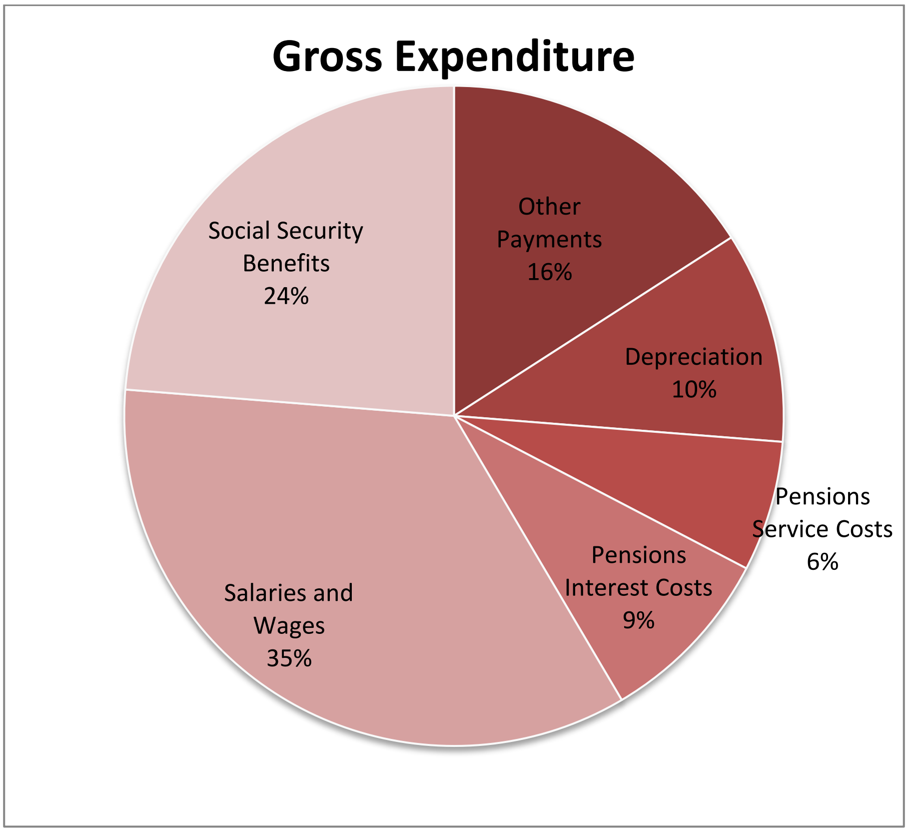
Gross income from all sources at £969.4 million (2013 : £908.0 million) was generally in line with the various estimates for Departments and Other Bodies. The increase over the previous year (£61.4 million) was due to increased Customs income (up £18.2 million), Income Taxes (up £7.6 million), Reserves income (up £10.4 million) and increases in Department receipts (up £27.9 million). This was mitigated by lower other Treasury income (down £2.7 million).



2.2.2 Expenditure

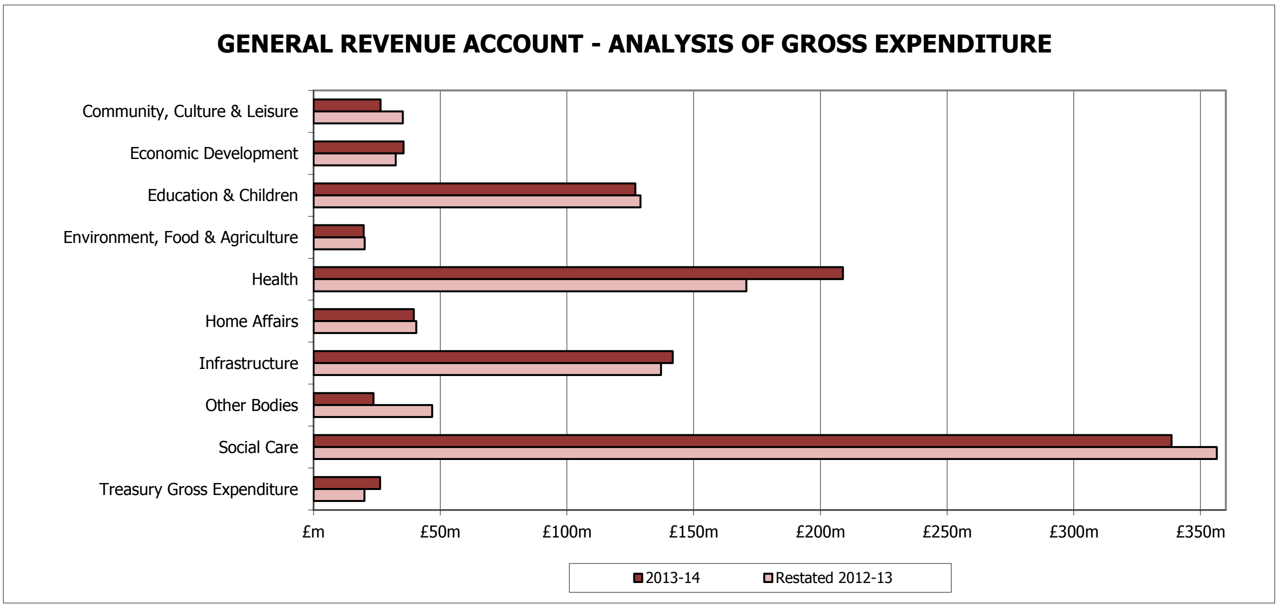
Gross expenditure for 2013-14 was £1,086.6 million and net expenditure was £117.2 million. These figures include pension interest costs of £97.0 million (2012-13 : £85.0 million; see 7.20) that reflect the estimated impact of inflation on existing pension liabilities between the annual actuarial valuations of the pension scheme liabilities.

Gross expenditure for 2013-14 of £1,086.6 million (2013 : £1,075.9 million) was £10.7 million higher than 2012-13 due to increases in general gross expenditure being partially offset by a reduction in fixed assets adjustments of £20.2 million and pensions adjustments of £2.0 million. The increase in gross income resulted in net expenditure of £117.2 million (2013 : £165.9 million).



All Departments stayed within their original expenditure votes for the year with the exception of the Department of Health that obtained a supplementary vote of £2.1 million in respect of pay awards. The Department of Infrastructure will require an additional vote to apply excess receipts to meet excess expenditure. No other Departments will require further supplementary revenue votes in respect of gross or net expenditure.

Expenditure within these Accounts is higher than gross expenditure within the Detailed Government Accounts published earlier in the year (GD 0036/14) due to the inclusion of depreciation charges and actuarial pension costs (as opposed to net pension payments made). Depreciation charges exceed their loan charge equivalents due to the revaluation of significant fixed asset groups above their historical costs.



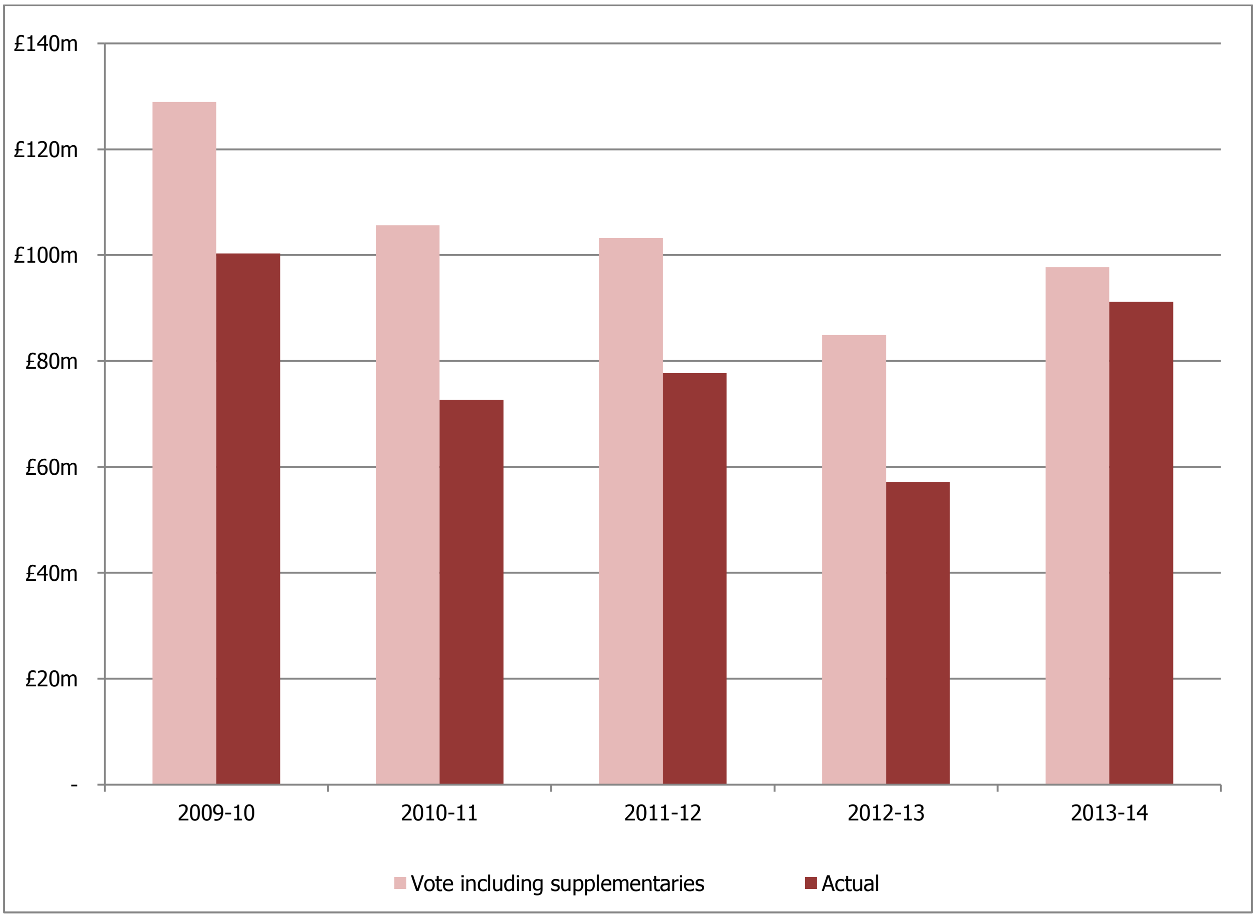
The decrease in the expenditure of the Department of Social Care is due in part to the transfer of mental health services to the Department of Health.

2.2.3 Transfers to Reserve Funds

The deficit for the year prior to transfers to or from Treasury reserves and funds of £117.2 million (2012-13 : £167.9 million) was reduced by a £31.6 million transfer from the Reserve Fund (2012-13 : £47.0 million) to £85.6 million (2012-13 : £118.9 million). There were transfers to other reserves totalling £8.0 million during the year (2012-13 : £32.0 million). The retained balance on the General Revenue Account increased by £6.8 million (2013 : reduced by £22.2 million) to £41.3 million.

2.2.4 Capital Expenditure

Total Capital expenditure out-turn for the year was £91.2 million (2012-13 : £57.2 million). This compares with the original vote of £96.5 million (2012-13 : £83.0 million) plus Supplementary Votes of £2.2 million (2012-13 : £3.0 million).

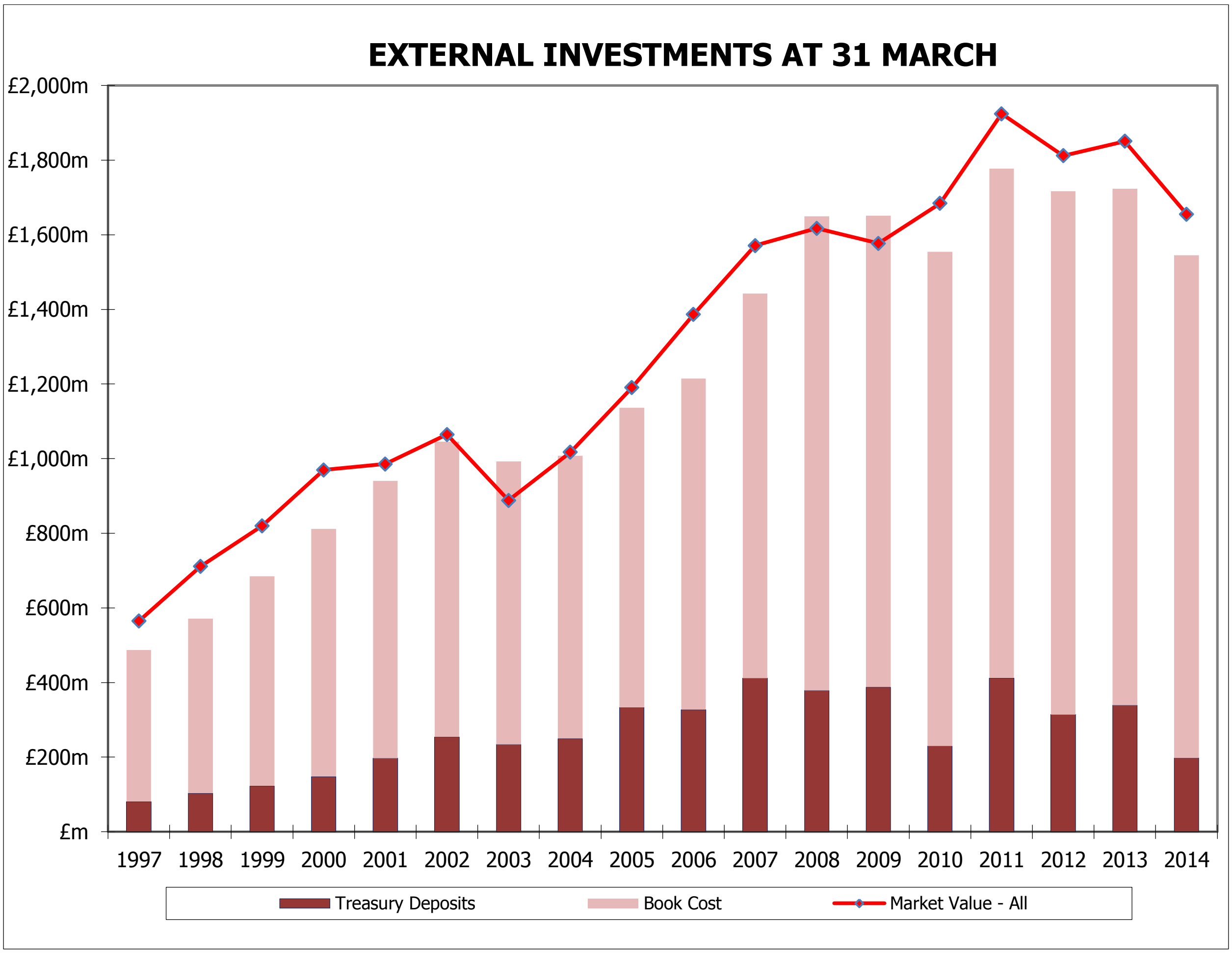


The balance on the Capital Fund at the end of the year was £859.0 million (2013 : £824.0 million) and the cash remaining available for capital expenditure was £50.6 million (2013 : £52.2 million).

2.2.5 Reserve Funds

Treasury's investment strategies for the larger funds (which are invested by external investment managers) include exposure to equities and, although their market values can and have fluctuated downwards from time to time, the broad and long term trend has been upwards. In 2013-14 the market value of the investments (net of transfers into and out of the funds) reduced by £54.5 million (2.9%, net of transfers; 2013 : increase of £30.9 million, 2.1%, also net of transfers).

Treasury Deposits decreased by £141.2 million (2012-13 : increase of £25.3 million) due to reduction in balances due to HM Revenue and Customs.



2.2.6 Other Balances

The value of fixed assets decreased by £159.6 million to £2,263.2 million (2013 : £2,422.8 million) principally due to depreciation charges for the year. Long term debtors increased by £36.4 million to £536.2 million (2013 : £499.8 million) predominantly due to refinancing a £35.0 million loan to the Manx Electricity Authority from the Consolidated Loans Fund.

Credit balances reduced by £49.5 million to £70.0 million (2013 : £119.5 million) due to increased working capital balances.

The pension liability in respect of Government pension schemes increased during the year by £27.0 million to £2,318.0 million (2013 : £2,291.0 million), principally due to experience gains of £175.0 million significantly offsetting changes to assumptions applied to actuarial calculations (£94.0 million) and the assumed interest charge on previous pension liabilities (£97.0 million). The United Kingdom's Government Actuary's Department has estimated that a reduction in the discount rate (in excess of Consumer Price Index inflation) of 0.5% will lead to an increase in pension liabilities of £230.0 million.

The value of internal investments decreased by £13.1 million (2012-13 : increase of £16.9 million, both net of expenditure and transfers) as a result of expenditure reimbursed from the funds exceeding transfers from the General Revenue Account to the reserve funds during the year. The balance on the General Revenue Adjustments Account decreased by £152.3 million to £284.7 million (2013 : £437.0 million) as a consequence of the increase in the value of fixed assets.

2.3 Group Accounts

2.3.1 Contribution from Statutory Boards

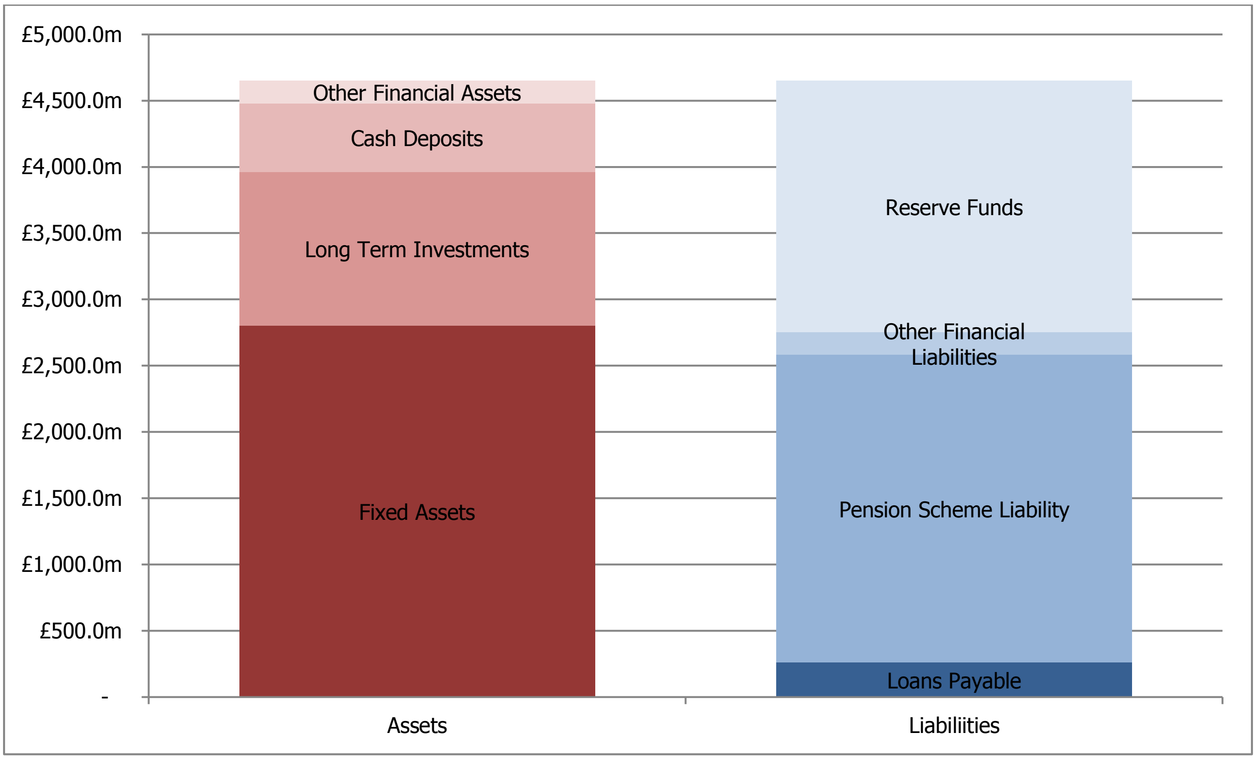
The operational surplus for the three non-revenue funded Statutory Boards and owned companies was £12.8 million (2013 : surplus of £16.7 million). However, the surplus reduces to a net deficit for the three non-revenue funded Statutory Boards and owned companies of £4.8 million (2012-13 : £1.3 million) when net interest charges of £15.7 million (2012-13 : £18.0 million) are included, predominantly in respect of the Manx Electricity Authority (£14.0 million, 2012-13 : £16.1 million).

2.3.2 General Revenue Account and Other Balances

The results of the three non-revenue Statutory Boards and owned companies do not affect the balance on the Government's General Revenue Account as they are not funded and do not contribute directly to the General Revenue Account (with the exception of the annual dividend to Treasury from the Isle of Man Post Office, which is included with Treasury income).

During the year the aggregate balance on the reserves held by the three non-revenue funded Statutory Boards and owned companies reduced from £10.3 million to £8.8 million due to the retained losses at the Manx Electricity Authority.

The group balance sheet can be summarised as follows:



S Clague, FCA
Chief Accountant
Treasury, Finance Division

3 Statement of Responsibilities for the Statement of Accounts

The Treasury's Responsibilities

The Treasury is required to:

- Make arrangements for the proper administration of its financial affairs and to secure that one of its Officers has the responsibility for the administration of those affairs. That Officer is the Chief Financial Officer.
- Manage its affairs to secure economic, efficient and effective use of resources and safeguard its assets.
- Approve the Statement of Accounts.

The Chief Financial Officer's Responsibilities

The Chief Financial Officer is responsible for the preparation of the Treasury's Statement of Accounts in accordance with applicable laws and regulations.

The Audit Act 2006 requires the Chief Financial Officer to prepare Accounts for each financial year, which meet the requirements of the Accounts and Audit Regulations 2013. The regulations require the Chief Financial Officer to prepare the Accounts in accordance with United Kingdom Accounting Standards and in accordance with proper practices as set out in the Isle of Man Statement of Recommended Practice 2007, *Accounting for entities subject to the Audit Act 2006*.

The Statement of Accounts are required by law to give a true and fair view of the financial position of the Isle of Man Government at the accounting date (31 March), and its income and expenditure for the year then ended.

In preparing this Statement of Accounts, the Chief Financial Officer has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that are reasonable and prudent; and
- complied with the Accounts and Audit Regulations 2013 and the SORP.

The Chief Financial Officer has also:

- kept proper accounting records which are up to date;
- taken reasonable steps for the prevention and detection of fraud and other irregularities;
- ensured that the Statement of Accounts presents fairly the financial position of the Isle of Man Government at 31 March 2014, and its income and expenditure for the year ended 31 March 2014.

Certificate

I certify that the Statement of Accounts give a true and fair view of the income and expenditure of Isle of Man Government for the year ended 31 March 2014 and the financial position of Isle of Man Government as at 31 March 2014.

M Couch PhD
Chief Financial Officer
Treasury Department
24 September 2014

4 Statement on Internal Control Year ended 31 March 2014

4.1 Scope of Responsibility

The Chief Financial Officer is appointed in accordance with the Treasury Act 1985 as the principal financial adviser to the Treasury; and acts as the Accounting Officer of the Department. The Chief Financial Officer is responsible for ensuring that Government business is conducted within an adequate system of internal control so as to give a reasonable assurance that public money is safeguarded, properly accounted for, and used economically, efficiently and effectively.

In discharging this responsibility, the Chief Financial Officer has received Statements on Internal Control or Assurance Certificates from the Accounting Officers of all parts of Government (being the designated bodies set out in the extract reproduced in the appendix); who have provided assurance that they, and their relevant financial and senior officers, have taken responsibility for having in place proper arrangements for the governance of their affairs and the stewardship of the resources at their disposal. This requirement is set out in the Isle of Man Government's Corporate Governance Principles and Code of Conduct prescribed by the Council of Ministers, and specified by the Direction of the Treasury through the Audit Act 2006.

In essence, the Statement on Internal Control can be seen as a means of measuring and evidencing the health of the Government in the context of the obligations above and, by doing so, then setting out an appropriate programme of development and improvement for the subsequent year.

4.2 The Risk Management and Control Framework

The Government operates a control environment based upon the Civil Service Regulations, the Financial Regulations, a framework of functions and responsibilities delegated to individual officers within detailed job descriptions, codes of conduct and an internal reporting mechanism within each designated body through the relevant senior management teams to the Accounting Officer.

These foundations set the overall framework for internal control, and the particular responsibilities of the Ministers, Members, Accounting Officers, departmental committees, and officers in respect of the:

- accomplishment of established goals and objectives;
- compliance with policies, plans, procedures, the law, and other regulations;
- reliability and integrity of management information;
- economical and efficient use of all resources; and
- safeguarding of all assets.

Individual responsibility and accountability for internal control is wholly vested with each individual Accounting Officer.

In accordance with the Audit Act 2006 Government maintains a system of Internal Audit which operates in accordance with the Government Internal Audit Standards.

4.3 Review of Effectiveness

The Government's systems of internal control are designed to manage rather than eliminate the risk of failing to achieve objectives: they can only provide reasonable and not absolute assurance. Accordingly, reasonable assurance is given that, except for the matters listed below, the Government's corporate governance arrangements are adequate and operate effectively.

The review of the effectiveness of the Government's internal controls is informed by the work of the management of designated bodies, the Treasury Internal Audit Division, the public auditors and by other external inspection bodies. The established audit committees of the Manx Electricity Authority, Isle of Man Post Office, Isle of Man Water and Sewerage Authority, and Financial Supervision Commission, further enhance control assurance in those organisations. The Statement on Internal Control or Assurance Certificate produced by each designated body is then used as a basis for this Government-wide Statement on Internal Control.

To inform my review of effectiveness, I have considered the views of Accounting Officers and senior managers across Government, who have completed questionnaires which review internal control, risk management and corporate governance arrangements. In providing their assurances, the Accounting Officers and managers have given specific consideration to each of the following operating risks within their areas of responsibility:

- Business Continuity;
- Performance Management;
- Financial Management & Compliance;
- Procurement Information Management;
- Value For Money;
- Human Resources;
- Change Management;
- Health & Safety;
- Environment; and
- Corporate Governance

An assurance certificate for each designated body has been produced, derived from the self-review questionnaires completed for each of its functional areas, and covering each of the specific operating risks listed above. These returns have not identified any material areas of weakness in the Isle of Man Government system of internal control.

I am informed by the Chief Internal Auditor that the results of the work undertaken during the 2013-14 internal audit programme provide adequate assurance on the overall adequacy and effectiveness of the Government's framework of governance, risk management and control; with the exception of the following concerns:

- cost improvement, especially financial planning strategy and the process of allocating reducing resources to priority areas of work; and
- some aspects of governance in the Department of Health.

In other cases where control weaknesses were identified, follow-up reviews indicated that suitable action had been taken by management to strengthen relevant internal controls.

4.4 External Reviews

In addition to the internal review process described above, the Government is subject to external review and assessment. Assurance is taken from these external reviews in respect of our adherence to and compliance with applicable international standards.

Government and its operations and governance are also subject to the parliamentary scrutiny of Tynwald. Accordingly, I have given appropriate consideration to any significant issues arising in Tynwald; and in particular to the work of the Standing Committee on Public Accounts.

Potentially significant issues which I consider to be relevant to this statement include:

- the governance arrangements associated with the use of the National Insurance Fund to meet administrative expenses;
- the application of the Financial Regulations to the Treasury, which is the Department which produces them; and
- the governance arrangements associated with payments made under the Enterprise Act 2008.

4.5 Planned Areas for Review

A continuous review of effectiveness is the responsibility of each Accounting Officer; as informed by the Internal Audit Division of Treasury, external auditors, third party review and self-assessment. Each Accounting Officer must produce and put into effect plans to address control weaknesses when they arise (including those highlighted above) and must ensure continuous improvement of the systems and procedures in place.

M Couch PhD
Chief Financial Officer
Treasury Department

Appendix (i) – Outline and definition of relevant Departments, Statutory Boards, Authorities and Bodies

The Isle of Man Corporate Governance Principles and Code of Conduct apply to all "designated bodies" and "departments of Government" within the meaning of the Treasury Act 1985. **In this Code they are all referred to as "departments".** The following are "designated bodies":

- **all departments** (Department of Community, Culture and Leisure, Department of Economic Development, Department of Education and Children, Department of the Environment, Food and Agriculture, Department of Health, Department of Home Affairs, Department of Infrastructure, Department of Social Care, and Treasury, that is the bodies established by the Government Departments Act 1987);
- **all Statutory Boards** (the Communications Commission, Financial Supervision Commission, Gambling Supervision Commission, Insurance and Pensions Authority, Office of Fair Trading, Public Service Pensions Authority; Isle of Man Post Office, Isle of Man Water and Sewerage Authority and the Manx Electricity Authority, that is the bodies to whom the Statutory Boards Act 1987 applies);
- **any other body or authority** (other than a local authority), for example Manx National Heritage, constituted by any enactment for any purposes involving the expenditure of public moneys or the receipt of public moneys for the purposes of that body or authority or for the public revenue; and
- **any other body designated** as such for the purposes of the Treasury Act 1985 by order of the Council of Ministers.

For the purposes of this document, the term "department of Government" includes the Chief Secretary's Office, Attorney General's Chambers, General Registry, Office of Human Resources, Office of the Data Protection Supervisor, Industrial Relations Service, Road Traffic Licensing Committee and Veterans' Welfare Service, which are not "designated bodies".

5 Report of the Independent Auditors, KPMG Audit LLC, to the Treasury Department of Isle of Man Government

5.1 Introduction

We have audited the consolidated financial statements of the Isle of Man Government and the Statutory Boards ("the Group") for the year ended 31 March 2014 which comprise the Income and Expenditure Account, the Statement of Total Movement on the General Revenue Account Balance, the Statement of Total Recognised Gains and Losses, the Balance Sheet, the Cash Flow Statement and the related notes to the Statement of Accounts. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (as modified by any Directions issued by Treasury under Section 13 of the Audit Act 2006).

This report is made solely to the Treasury, in accordance with Section 4 of the Audit Act 2006. Our audit work has been undertaken so that we might state to the Treasury those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Treasury, for our audit work, for this report, or for the opinions we have formed.

5.2 Respective responsibilities of Treasury and Auditors

As explained more fully in the Responsibilities Statement set out on page 11, the Chief Financial Officer is responsible for the preparation of financial statements that give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's ("APB's") Ethical Standards for Auditors.

5.3 Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by Treasury; and the overall presentation of the financial statements.

We report to you our opinion as to whether the Accounts give a true and fair view in accordance with United Kingdom Accounting Standards (as modified by any Directions issued by Treasury under Section 13 of the Audit Act 2006, are properly prepared in accordance with the Accounts and Audit Regulations 2013 made under the Audit Act 2006), and comply with the requirements of any other statutory provision applicable to them.

We review whether the Statement of Internal Control prepared by the Treasury reflects compliance with the Accounts and Audit Regulations 2013 made under the Audit Act 2006. We report if the statement is misleading or inconsistent with other information we are aware of from our audit of the accounts. We are not required to consider, nor have we considered, whether the Statement on Internal Control covers all risks and controls.

5.4 Opinion on the Financial Statements

In our opinion the financial statements set out on pages 17 to 57:

- give a true and fair view of the state of the Isle of Man Government's affairs as at 31 March 2014 and of its deficit for the year then ended; and
- have been properly prepared in accordance with UK Accounting Standards as modified by any Directions issued by Treasury under section 13 of the Audit Act 2006 and the Accounts and Audit Regulations 2013.

5.5 Matters on Which we are Required to Report by Exception

In accordance with Section 6 of the Audit Act 2006, we are required to include a statement in our audit report providing particulars of any payments or transactions identified which we believe are contrary to law. As stated in Note 7.22.2 of the financial statements, a legal opinion received by the Government's Acting Attorney General in June 2014 concluded that it was more likely than not that two loans totalling £1.75 million made to the Sefton Group plc under the Enterprise Act 2008 were ultra vires. We note that following further legal opinion, these two loans were replaced with a new loan made by Treasury under the provisions of the Financial Provisions and Currency Act 2011 in order to rectify the position. We also understand that, following a subsequent review by the Department of Economic Development of all outstanding loans made under the Enterprise Act 2008, steps were taken to rectify an additional facility of £60,000 made to another party.

KPMG Audit LLC

KPMG Audit LLC
Chartered Accountants
Heritage Court
41 Athol Street
Douglas
Isle of Man IM99 1HN
24 September 2014

6 Statement of Accounts

6.1 Income and Expenditure Account – Summary

	Original	Adjustments				Revised
	Net Expenditure	Fixed Assets	Pensions	Other	Consolidation	As Adjusted
A	B	C	D	E	F	G
	£000's	£000's	£000's	£000's	£000's	£000's
Treasury Department						
Customs and Excise	**312,000**	-	-	(640)	-	**311,360**
Income Tax	**196,116**	-	-	(853)	-	**195,263**
Other Treasury Income	**13,264**	-	-	(1,981)	-	**11,283**
Treasury Reserves Income	**-**	-	-	75,236	-	**75,236**
Treasury Gross Expenditure	**(28,765)**	5,773	(2,985)	(277)	8,214	**(18,040)**
Total Treasury	**492,615**	**5,773**	**(2,985)**	**71,485**	**8,214**	**575,102**
Other Departments						
Community, Culture & Leisure	**(15,689)**	(3,379)	(2,986)	-	-	**(22,054)**
Economic Development	**(10,747)**	(662)	(2,127)	-	-	**(13,536)**
Education & Children	**(94,235)**	(17,456)	(13,535)	-	-	**(125,226)**
Environment, Food & Agriculture	**(14,303)**	(2,414)	(1,413)	-	-	**(18,130)**
Health	**(139,725)**	(8,621)	(19,641)	-	-	**(167,987)**
Home Affairs	**(29,823)**	(1,036)	(7,705)	-	-	**(38,564)**
Infrastructure	**(36,059)**	(50,479)	(6,654)	3,404	-	**(89,788)**
Social Care	**(125,477)**	(7,548)	(6,211)	224	-	**(139,012)**
	(466,058)	**(91,595)**	**(60,272)**	**3,628**	**-**	**(614,297)**
Other bodies						
Executive Government	**(37,147)**	-	73,340	-	-	**36,193**
Manx National Heritage	**(3,717)**	58	(683)	-	-	**(4,342)**
Road Transport Licensing Committee	**(76)**	-	(18)	-	-	**(94)**
Statutory Boards (Revenue Funded)	**1,889**	-	(1,485)	-	-	**404**
	(39,051)	**58**	**71,154**	**-**	**-**	**32,161**
Expenses of the Legislature	**(4,358)**	340	(898)	-	-	**(4,916)**
	(4,358)	**340**	**(898)**	**-**	**-**	**(4,916)**
Net Voted (Expenditure)/Income	**(16,852)**	**(85,424)**	**7,000**	**75,113**	**8,214**	**(11,950)**
Statutory Boards (Non-Revenue Funded)						
Isle of Man Post Office	**-**	-	-	-	1,242	**1,242**
Isle of Man Water & Sewerage Authority	**-**	-	-	-	1,155	**1,155**
Manx Electricity Authority	**-**	-	-	-	3,076	**3,076**
	-	**-**	**-**	**-**	**5,473**	**5,473**
Owned Companies						
Laxey Glen Mills Limited	**-**	-	-	-	(8)	**(8)**
Radio Manx Limited	**-**	-	-	-	(859)	**(859)**
	-	**-**	**-**	**-**	**(867)**	**(867)**
Interest payable and similar charges	**-**	-	(97,000)	-	(20,368)	**(117,368)**
Interest and investment income	**-**	-	-	-	2,643	**2,643**
Total	**(16,852)**	**(85,424)**	**(90,000)**	**75,113**	**(4,905)**	**(122,069)**
Statement of Total Movement in General Revenue Account Balance						
Depreciation and impairment of fixed assets	**-**	103,953	-	-	-	**103,953**
Net (gain) or loss on disposal of fixed assets	**-**	(2,991)	-	-	-	**(2,991)**
Net charges made for retirement benefits in accordance with FRS17	**-**	-	90,000	-	-	**90,000**
Other adjustments	**-**	-	-	(942)	-	**(942)**
Loan Charges for Capital Financing	**-**	43,855	-	-	-	**43,855**
Net Capital Expenditure charge in-year to the General Revenue Adjustment Account	**-**	(59,390)	-	-	-	**(59,390)**
Net transfer to earmarked reserves	**-**	-	-	(50,571)	4,905	**(45,666)**
(Decrease)/Increase in General Revenue Account	**(16,852)**	3	-	23,600	-	**6,750**

All results derive from continuing activities. The Notes on pages 24 to 57 form part of these Accounts.

Notes:

i. Column B shows the amounts originally reported on page 15 of the Detailed Government Accounts (GD 0036/14) in June 2014, showing 'Surplus transferred to Net General Revenue Account' of a deficit of £16.85 million.

ii. Column C shows the adjustments applied to Department expenditure in respect of fixed assets.

iii. Column D shows the adjustments applied to Department expenditure in respect of pension costs.

iv. Column E shows the adjustments applied to Department net expenditure in respect of other adjustments required to comply with United Kingdom Accounting Standards. The main adjustments are recognising total income from Government reserves and inclusion of certain amounts which will be repayable (debts) to Government.

v. Column F shows the adjustments in respect of the additional bodies included with the audited Government Accounts and adjusts gross expenditure where one part of Government is paying another part of Government (eg. the grant paid by the Department of Infrastructure to the Isle of Man Water & Sewerage Authority), to avoid double counting of income and expenditure.

vi. Column G shows the adjusted amounts presented in the Group Income and Expenditure Account shown on page 19.

vii. The adjustments shown in Columns C, D, E and F are reversed in the Statement of Total Movement on the General Revenue Account Balance on page 19 of the audited Government Accounts, to result in the 'Increase/(decrease) in General Revenue Account balance', the resultant deficit, for the year of £16.85 million.

6.2 Income and Expenditure Account – Group

	Note	Group 2013-14 Gross Expenditure £000's	Group 2013-14 Gross Income £000's	Group 2013-14 Net Expenditure £000's	Group 2012-13 Net Expenditure £000's
Treasury Department					
Customs and Excise	*7.2.1*	-	311,360	**311,360**	293,087
Income Tax	*7.2.2*	-	195,263	**195,263**	187,680
Other Treasury Income	*7.2.3*	-	11,283	**11,283**	13,979
Treasury Reserves Income	*7.2.4*	-	75,236	**75,236**	64,829
Treasury Gross Expenditure	*7.3.2*	(18,040)	-	**(18,040)**	(19,284)
Total Treasury		**(18,040)**	**593,142**	**575,102**	**540,291**
Other Departments					
Community, Culture & Leisure	*7.3.2*	(26,454)	4,400	**(22,054)**	(30,806)
Economic Development	*7.3.2*	(35,573)	22,037	**(13,536)**	(15,104)
Education & Children	*7.3.2*	(126,985)	1,759	**(125,226)**	(127,330)
Environment, Food & Agriculture	*7.3.2*	(19,830)	1,700	**(18,130)**	(18,645)
Health	*7.3.2*	(208,878)	40,891	**(167,987)**	(130,680)
Home Affairs	*7.3.2*	(39,608)	1,044	**(38,564)**	(39,578)
Infrastructure	*7.3.2*	(141,739)	51,951	**(89,788)**	(87,550)
Social Care	*7.3.2*	(338,576)	199,564	**(139,012)**	(163,193)
		(937,643)	**323,346**	**(614,297)**	**(612,886)**
Other bodies					
Executive Government	*7.3.2*	(4,727)	40,920	**36,193**	11,135
Manx National Heritage	*7.3.2*	(5,170)	828	**(4,342)**	(4,247)
Road Transport Licensing Committee	*7.3.2*	(143)	49	**(94)**	(76)
Statutory Boards (Revenue Funded)	*7.3.2*	(8,441)	8,845	**404**	(2,032)
		(18,481)	**50,642**	**32,161**	**4,780**
Expenses of the Legislature	*7.3.2*	(5,146)	230	**(4,916)**	(5,082)
		(5,146)	**230**	**(4,916)**	**(5,082)**
Net Voted Income		**(979,310)**	**967,360**	**(11,950)**	**(72,897)**
Statutory Boards (Non-Revenue Funded)					
Isle of Man Post Office		1,242	-	**1,242**	2,248
Isle of Man Water & Sewerage Authority		1,155	-	**1,155**	(120)
Manx Electricity Authority		3,076	-	**3,076**	5,538
		5,473	**-**	**5,473**	**7,666**
Owned Companies					
Isle of Man Film Limited		-	-	**-**	-
Isle of Man Limited		-	-	**-**	-
Isle of Man National Transport Limited		-	-	**-**	-
Laxey Glen Mills Limited		(8)	-	**(8)**	(33)
Radio Manx Limited		(859)	-	**(859)**	(844)
		(867)	**-**	**(867)**	**(877)**
Surplus before Interest		**(974,704)**	**967,360**	**(7,344)**	**(66,108)**
Interest payable and similar charges		(117,368)	-	**(117,368)**	(107,506)
Interest and investment income		-	2,643	**2,643**	2,388
(Deficit) for the year	*7.3.1*	**(1,092,072)**	**970,003**	**(122,069)**	**(171,226)**

All results derive from continuing activities. The Notes on pages 24 to 57 form part of these Accounts.

6.3 Income and Expenditure Account – Central Government

		Central Government			
		2013-14			2012-13
	Note	**Gross Expenditure £000's**	**Gross Income £000's**	**Net Expenditure £000's**	**Net Expenditure £000's**
Treasury Department					
Customs and Excise	*7.2.1*	-	311,360	**311,360**	293,087
Income Tax	*7.2.2*	-	195,263	**195,263**	187,680
Other Treasury Income	*7.2.3*	-	13,283	**13,283**	15,979
Treasury Reserves Income	*7.2.4*	-	75,236	**75,236**	64,829
Treasury Gross Expenditure	*7.3.2*	(26,254)	-	**(26,254)**	(20,134)
Total Treasury		**(26,254)**	**595,142**	**568,888**	**541,441**
Other Departments					
Community, Culture & Leisure	*7.3.2*	(26,454)	4,400	**(22,054)**	(30,806)
Economic Development	*7.3.2*	(35,573)	22,037	**(13,536)**	(15,104)
Education & Children	*7.3.2*	(126,985)	1,759	**(125,226)**	(127,330)
Environment, Food & Agriculture	*7.3.2*	(19,830)	1,700	**(18,130)**	(18,645)
Health	*7.3.2*	(208,878)	40,891	**(167,987)**	(130,680)
Home Affairs	*7.3.2*	(39,608)	1,044	**(38,564)**	(39,578)
Infrastructure	*7.3.2*	(141,739)	51,951	**(89,788)**	(96,568)
Social Care	*7.3.2*	(338,576)	199,564	**(139,012)**	(163,193)
		(937,643)	**323,346**	**(614,297)**	**(621,904)**
Other bodies					
Executive Government	*7.3.2*	(4,727)	40,920	**36,193**	11,135
Manx National Heritage	*7.3.2*	(5,170)	828	**(4,342)**	(4,247)
Road Transport Licensing Committee	*7.3.2*	(143)	49	**(94)**	(76)
Statutory Boards (Revenue Funded)	*7.3.2*	(8,441)	8,845	**404**	(2,032)
		(18,481)	**50,642**	**32,161**	**4,780**
Expenses of the Legislature	*7.3.2*	(5,146)	230	**(4,916)**	(5,082)
		(5,146)	**230**	**(4,916)**	**(5,082)**
Net Voted Income		**(987,524)**	**969,360**	**(18,164)**	**(80,765)**
Surplus before Interest		**(987,524)**	**969,360**	**(18,164)**	**(80,765)**
Interest payable and similar charges		(99,055)	-	**(99,055)**	(87,134)
Interest and investment income		-	-	**-**	-
(Deficit) for the year	*7.3.1*	**(1,086,579)**	**969,360**	**(117,219)**	**(167,899)**

All results derive from continuing activities. The Notes on pages 24 to 57 form part of these Accounts.

6.4 Statement of Total Movement on the General Revenue Account Balance

	Note	Group		Central Government	
		2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
Amounts included in the Income and Expenditure Account but required to be excluded when determining the movement on the General Revenue Account balance for the year					
Depreciation and amortisation of fixed assets		**103,953**	**106,233**	103,953	106,233
Net (gain) on disposal of fixed assets		**(2,991)**	**(2,536)**	(2,991)	(2,536)
Net charges made for retirement benefits in accordance with FRS17	*7.20*	**90,000**	**92,000**	90,000	92,000
Other adjustments		**(942)**	**(6,919)**	(942)	(6,919)
		190,020	**188,778**	190,020	188,778
Amounts not included in the Income and Expenditure Account but required to be included when determining the movement on the General Revenue Account balance for the year					
Loan Charges for Capital Financing		**43,855**	**38,632**	43,855	38,632
Net Capital Expenditure charge in-year to the General Revenue Adjustment Account		**(59,390)**	**(35,661)**	(59,390)	(35,661)
		(15,535)	**2,971**	(15,535)	2,971
Transfers that are required to be taken into account when determining the movement on the General Revenue Account balance for the year					
Net transfer to earmarked reserves		**(45,666)**	**(42,652)**	(50,516)	(45,979)
		(45,666)	**(42,652)**	(50,516)	(45,979)
Net additional amount required to be credited to the General Revenue Account balance		**128,819**	**149,097**	**123,969**	**145,770**
(Deficit) for the year on the Income and Expenditure Account	*6.2,6.3*	**(122,069)**	**(171,226)**	(117,219)	(167,899)
Increase/(decrease) in General Revenue Account balance for the year		**6,750**	**(22,129)**	**6,750**	**(22,129)**
General Revenue Account balance brought forward	*7.19.1*	**34,531**	**56,660**	34,531	56,660
General Revenue Account balance carried forward	*7.19.1*	**41,281**	**34,531**	**41,281**	**34,531**

The Notes on pages 24 to 57 form part of these Accounts.

6.5 Statement of Total Recognised Gains and Losses

	Note	Group		Central Government	
		2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
Increase/(decrease) in General Revenue Account balance for the year	*6.4*	**6,750**	**(22,129)**	6,750	(22,129)
Unrealised (loss)/gain on long term investments	*7.9.3*	**(11,207)**	**49,756**	(11,207)	49,756
Surplus on revaluation of fixed assets	*7.7.4*	**(18,849)**	**3,023**	(18,849)	3,023
Actuarial gains/(losses) on pension fund assets and liabilities	*7.20.8*	**77,727**	**(238,191)**	81,000	(237,000)
Total recognised gains/(losses) for the year		**54,421**	**(207,541)**	**57,694**	**(206,350)**

The Notes on pages 24 to 57 form part of these Accounts.

6.6 Balance Sheet

	Note	Group		Central Government	
		2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
Long Term Assets					
Fixed Assets	*7.7*	**2,778,380**	**2,945,884**	2,263,165	2,422,811
Long Term Investments	*7.9*	**1,156,107**	**1,241,964**	1,156,107	1,241,964
Long Term Debtors	*7.11*	**19,492**	**20,481**	536,157	499,794
		3,953,979	**4,208,329**	**3,955,429**	**4,164,569**
Current Assets					
Stocks and Work in Progress	*7.12*	**10,804**	**10,732**	4,085	4,133
Debtors and Prepayments	*7.13*	**139,884**	**69,760**	139,563	66,284
Short Term Deposits	*7.14*	**230,488**	**367,651**	198,034	339,263
Cash at Bank and in Hand	*7.15*	**289,420**	**250,729**	243,231	201,252
		670,596	**698,872**	**584,913**	**610,932**
Current Liabilities					
Creditors	*7.16.1*	**(79,447)**	**(132,941)**	(61,725)	(112,552)
Bank Overdrafts and Loans Payable	*7.15*	**(8,394)**	**(42,158)**	(8,297)	(6,946)
		(87,841)	**(175,099)**	**(70,022)**	**(119,498)**
Net Current Assets		**582,755**	**523,773**	**514,891**	**491,434**
Long Term Liabilities					
Loans Payable	*7.17*	**(263,035)**	**(263,165)**	(260,000)	(260,000)
Pension Scheme Liability	*7.20.3*	**(2,319,941)**	**(2,296,234)**	(2,318,000)	(2,291,000)
Other Creditors	*7.16.2*	**(83,039)**	**(89,198)**	(32,301)	(33,733)
		(2,666,015)	**(2,648,597)**	**(2,610,301)**	**(2,584,733)**
Total Net Assets		**1,870,719**	**2,083,505**	**1,860,019**	**2,071,270**
Represented by					
Net General Revenue Account	*7.19.1*	**41,281**	**34,531**	41,281	34,531
General Revenue Adjustments Account	*7.19.2*	**286,630**	**438,923**	284,709	437,028
Hospital Estates Development Fund	*7.9.3*	**44,339**	**46,271**	44,339	46,271
Manx Currency Account	*7.9.3*	**76,366**	**77,301**	76,366	77,301
Media Development Fund	*7.9.3*	**34,466**	**40,003**	34,466	40,003
National Insurance Fund	*7.9.3*	**727,207**	**705,875**	727,207	705,875
Public Service Employees Pension Reserve	*7.9.3*	**237,316**	**250,766**	237,316	250,766
Reserve Fund	*7.9.3*	**334,481**	**386,505**	334,481	386,505
Internal Funds and Reserves	*7.19.5*	**88,633**	**103,330**	79,854	92,990
		1,870,719	**2,083,505**	**1,860,019**	**2,071,270**

The Notes on pages 24 to 57 form part of these Accounts.

These Accounts were approved by the Treasury on 24 September 2014 and signed on its behalf by:

.... **Hon. W E Teare ACIB, MHK**, Minister for the Treasury

.... **M Couch PhD**, Chief Financial Officer

6.7 Cash Flow Statement

		Group		Central Government	
	Note	2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
Net Cash (Outflow) from Operating Activities	*7.24*	**(145,603)**	**(36,350)**	**(182,804)**	**(69,832)**
Returns on investments and servicing of finance					
Interest received		**1,980**	**2,305**	14,187	14,529
Interest paid		**(18,339)**	**(19,918)**	(14,163)	(14,163)
Investment income		**80,759**	**75,176**	80,759	75,176
		64,400	**57,563**	**80,783**	**75,542**
Capital expenditure					
Payments to acquire tangible fixed assets		**(52,978)**	**(58,636)**	(32,503)	(41,069)
Repayments		**(15,273)**	**(4,251)**	(15,473)	(4,491)
Income from disposal of tangible fixed assets		**11,527**	**22,896**	11,431	21,200
Deferred income received - customers' contributions		**721**	**359**	-	-
		(56,003)	**(39,632)**	**(36,545)**	**(24,360)**
Management of liquid resources					
Net purchases of investments		**72,965**	**(38,466)**	72,965	(38,466)
		72,965	**(38,466)**	**72,965**	**(38,466)**
Financing					
Repayment of loan		**(74,550)**	**-**	(35,000)	-
New loan finance arranged		**38,635**	**7,754**	-	-
Repayment of lease finance		**(3,289)**	**(3,071)**	-	-
		(39,204)	**4,683**	**(35,000)**	**-**
(Decrease) in cash	*7.25*	**(103,445)**	**(52,202)**	**(100,601)**	**(57,116)**

The Notes on pages 24 to 57 form part of these Accounts.

7 Notes to the Statement of Accounts

7.1 Accounting Policies

7.1.1 Basis of Preparation

The Statement of Accounts has been prepared under the historical cost convention and in accordance with United Kingdom Accounting Standards, unless otherwise stated.

The Accounts have been drawn up in accordance with the Isle of Man Statement of Recommended Practice 2007, *Accounting for entities subject to the Audit Act 2006*, issued by Treasury. This SORP is recognised under the Audit Act 2006 and the Accounts and Audit Regulations 2013 as representing proper accounting practices.

7.1.2 Restatement

There have been no significant changes to the accounting policies for 2013-14. Further details of the amendments and presentational changes have been included in Note 7.28.

7.1.3 Tangible Fixed Assets

Recognition

Expenditure on the acquisition, creation or enhancement of tangible fixed assets has been capitalised on an accruals basis. Where such expenditure is less than a specified de minimis level it is not capitalised but is charged to the Income and Expenditure Account in the year in which it is incurred. Capital expenditure incurred on fixed assets that does not materially add to the value of those assets is written off to the Income and Expenditure Account.

Depreciation

Depreciation is provided on all assets with a finite useful life, other than freehold land. Where depreciation is provided for, assets are depreciated by applying the straight line method to Balance Sheet values over periods reflecting their estimated useful lives. The following estimated useful lives are applied:

	Years
Land and Buildings	
Land (freehold)	None
Buildings (freehold)	10-50 years
Land and Buildings (leasehold)	Over period of lease
Vehicles, Plant and Equipment	
Vehicles	4-7 years
Plant – short term	5-10 years
Plant – long term	20-25 years
Infrastructure Assets	
Coastal Defences	60 years
Distribution networks	40-60 years
Highways	20-30 years
Railway Permanent Way	20-40 years

Assets during the course of construction are not depreciated until commissioned.

Revaluation

Long term assets and assets without a relevant purchase cost have been valued by suitably qualified valuers within Government. Any gain on revaluation has been applied to the General Revenue Adjustments Account. Where valuers are unable to provide a definitive value, for example due to the non-existence of comparable assets or any active market for sale of the assets, the value is determined by the Treasury Department on a best estimate basis, taking into account factors such as replacement costs. Revaluation of fixed assets takes place across each Government Department, on a Department by Department basis, on a five year cycle such that each department's fixed assets are revalued every five years.

Depreciation is calculated from the date of valuation based on the remaining economic useful life of the asset.

Impairment

The value at which each category of assets is included in the Balance Sheet is reviewed at the end of each year. Where values have changed materially in the year, the valuations are adjusted to reflect the change. When a major change in asset values is due to a consumption of economic benefits (such as physical damage), the impairment loss is recognised in the Income and Expenditure Account.

Disposals

Income from the disposal of fixed assets is accounted for on an accruals basis. The difference between the sale proceeds and current carrying value of the asset disposed (ie. the gain or loss on disposal) is applied to the Income and Expenditure Account.

7.1.4 Intangible Fixed Assets

Recognition

Expenditure on the acquisition, creation or enhancement of intangible fixed assets has been capitalised on an accruals basis. Where such expenditure is less than a specified de minimis level it is not capitalised but is charged to the Income and Expenditure Account in the year in which it is incurred. Capital expenditure incurred on intangible fixed assets that does not materially add to the value of those assets is written off to the Income and Expenditure Account.

Amortisation

Amortisation is provided on all assets with a finite useful life. Where amortisation is provided for, assets are amortised by applying the straight line method to Balance Sheet values over periods reflecting their estimated useful lives.

The following estimated useful lives are applied:

	Years
Software	3 years
Licences	3 years, or period of licence

Impairment

The value at which each category of assets is included in the Balance Sheet is reviewed at the end of each year. Where values have changed materially in the year, the valuations are adjusted to reflect the change. When a major change in asset values is due to a consumption of economic benefits, the impairment loss is recognised in the Income and Expenditure Account.

7.1.5 Leases

Finance leases

The Government has acquired a variety of assets ranging from vehicles to computer equipment by means of leases. These transfer the risks and rewards of ownership without transferring title of the assets.

Assets acquired under finance leases are capitalised and included in the Balance Sheet except for leases that are in secondary rental periods, where there are no future obligations of material significance. Assets acquired under finance leases are depreciated over the lease period if this is shorter than their estimated useful life.

Operating leases

Operating leases are those leases that do not transfer the risks and rewards of ownership to the Government. Rentals payable, net of benefits received or receivable (such as cash incentives or rent free periods), are charged to the Income and Expenditure Account and transactions are disclosed as a Note to the Accounts.

7.1.6 Investments

Long term investments held comprise assets managed by external investment managers in respect of specific Government reserve funds and are stated at market value. The market values of listed investments comprise mid-market prices; the market value of unlisted investments is determined by Treasury's investment managers.

Investment interest is recognised on a time proportion basis in the year that it is earned. Unrealised gains and losses on investments are applied to the specific reserves the assets relate to and are not included within the Income and Expenditure Account.

Investments in companies (registered either in the Isle of Man or in the United Kingdom) are held at the lower of cost and net realisable value.

7.1.7 Accruals of Income and Expenditure

The Accounts of Government are maintained on an accruals basis; activity is accounted for in the year that it takes place, not simply when cash payments are made or received. In particular:

- Direct and indirect taxes are accounted for as income during the year in which the assessments are raised and issued;
- Fees, charges and rents due from customers are accounted for as income at the date the Government provides the relevant goods or services;
- Employee costs are charged as expenditure when they are due rather than paid;
- Supplies are recorded as expenditure when they are consumed – where there is a gap between the date supplies are received and their consumption, they are carried as stocks in the Balance Sheet.
- Capital works are charged as expenditure or capitalised as tangible fixed assets, as appropriate, when they are completed, before which they are carried as works in progress in the Balance Sheet.
- Interest receivable is accounted for in the year to which it relates, on a basis that reflects the overall effect on the investment.
- Where income and expenditure has been recognised but cash has not been received or paid, a debtor or creditor for the relevant amount is recorded in the Balance Sheet. Where it is doubtful that debts will be settled, the balance of debtors is written down and a charge made to the Income and Expenditure Account for the income that might not be collected.
- Income and expenditure are credited and debited to the relevant account, unless they properly represent capital receipts or capital expenditure. These accruals are largely based on known commitments and can be assessed accurately. Where estimates are made, they are based on historical records, precedence and officers' knowledge and experience. In all cases the Government adopts a prudent approach to avoid overstating its resources.

Income and expenditure amounts for a year are credited or charged to the Income and Expenditure Account. The surplus of income over expenditure for a year, or deficit where expenditure exceeds income, where income and expenditure is calculated using the same basis as used by the Government Budget is credited or charged to Net General Revenue Account. Net income and expenditure adjustments arising from the requirements of United Kingdom Accounting Standards are credited or charged to the General Revenue Adjustment Account.

7.1.8 Value Added Tax

Value Added Tax on expenditure is included in the Income and Expenditure Account, whether of a capital or revenue nature, only to the extent that it is irrecoverable.

7.1.9 Stock and Work in Progress

Stocks and work in progress have been valued at the lower of cost and net realisable value.

7.1.10 Cash and Liquid Resources

Cash balances comprise balances in Government bank accounts, short term deposits and cash instruments, whether held directly by Treasury or by external investment managers.

Liquid resources include investments held by external investment managers and include equities, fixed interest securities and other traded financial instruments. These assets are generally held for long term investment purposes.

7.1.11 Foreign currency Translation

Income and expenditure arising from a transaction in foreign currency is translated into Sterling at the exchange rate in operation on the date on which the transaction occurred. Where rates do not fluctuate significantly, an appropriate average rate is used as an approximation. Where a transaction is to be settled at a contracted rate, the contract rate is used. Monetary assets and liabilities held in a foreign currency at the Balance Sheet date are translated by using the closing rate or any fixed rate imposed by the relevant transactions.

Differences on translation of balances from foreign currencies to Sterling relating to Government income and expenditure are applied to the Income and Expenditure Account. Generally, transactions and balances are denominated in Sterling and differences arising on translation to Sterling are negligible.

Differences arising on financial assets denominated in non-Sterling currencies held by external investment managers are applied to the reserve funds that the underlying assets relate to.

7.1.12 Pension Costs

Government operates a number of defined benefit schemes. In accordance with Financial Reporting Standard 17, "Retirement Benefits", the full service cost for the year, adjusted for any changes to the scheme, is charged to the Income and Expenditure Account. A charge equal to the expected increase in the present value of the scheme liabilities as a result of the scheme liabilities being one year closer to settlement and a credit reflecting the long term expected return on assets based on the market value of the scheme assets at the beginning of the year, are included in the Income and Expenditure Account.

The Balance Sheet records, as an asset or liability (as appropriate), the difference between the market value of the scheme assets and the present value of the accrued scheme liabilities. The difference between the expected return on assets and that actually achieved in the period is recognised in the Statement of Total Recognised Gains and Losses.

Actuarial valuations of the Central Government pension schemes have been obtained for the years ended 31 March 2013 and 31 March 2014 in order to provide an estimate of scheme liabilities for the Balance Sheet. Income and expenditure for 2012-13 and 2013-14 has been calculated based on these scheme valuations.

7.1.13 Reserves

Reserves include earmarked reserves set aside for specific policy purposes and balances which represent resources set aside for purposes such as general contingencies and cash flow management. The Government maintains the following significant reserves:

- Manx Currency Account – to provide asset backing for Manx Currency issued by the Treasury under the Currency Act 1992;
- National Insurance Fund – to meet certain on-going social security liabilities for payment of contributory benefit liabilities;
- Public Service Employees' Pension Reserve – to meet the emerging pensions liability in respect of public sector pensions; and
- Reserve Fund – set up to act as a buffer against the potential risks of increased expenditure to be charged to future years' Accounts.

7.1.14 Provisions

The Government maintains provisions for bad and doubtful debts, which are held against its arrears of major income sources.

7.1.15 Exceptional Items, Extraordinary Items and Prior Year Adjustments

Exceptional items and extraordinary items are included in the cost of the relevant service or on the face of the Income and Expenditure Account, as appropriate. Prior year adjustments arising from natural corrections associated with estimates used in the Accounts are accounted for in the year in which they are recognised. Material adjustments arising from changes in accounting policies or fundamental errors are accounted for by restating preceding year comparative figures and opening balances on reserves. Appropriate disclosures are made where relevant.

7.1.16 Contingent Assets and Liabilities

Contingent assets and liabilities are not recognised in the Accounts. Material contingent assets are disclosed in notes to the Accounts if the inflow of a receipt or economic benefit is probable. Material contingent liabilities are disclosed in Notes if there is a possible obligation which may require a payment or a transfer of economic benefits. The nature and estimated financial effect of each item are disclosed.

No provision for threatened or pending legal actions outstanding against the Isle of Man Government is made in these Accounts as the likelihood of these actions giving rise to material liabilities is considered remote.

7.1.17 Events after the Balance Sheet date

Post Balance Sheet events, whether favourable or unfavourable, that affect the conditions existing at the Balance Sheet date are adjusted in the Accounts and disclosures. For events occurring after the Balance Sheet date relating to conditions that arose after that date, adjustments are not made in the Accounts but details are disclosed in a note to the Balance Sheet. These principles apply up to the date when the Accounts are authorised for issue.

The responsibilities of Government are such that significant areas of new expenditure are frequently identified, although the actual expenditure is subject to approval by Tynwald. No attempt has been made to disclose or account for material items of new expenditure which arise in the period between the year end and the date of signing the Accounts and which relate to circumstances in existence at year end. Such items are accounted for in the year in which the Vote is approved.

7.1.18 Basis of Consolidation

Central Government Accounts

The Central Government Accounts show the transactions and balances for Central Government as a single entity, as defined by the Accounts and Audit Regulations 2013. This comprises all Government Departments, the revenue funded Statutory Boards (being the Office of Fair Trading, the Financial Supervision Commission, the Gambling Supervision Commission, the Insurance and Pensions Authority and the Communications Commission), Offices of Government and the Legislature, the Road Transport Licensing Committee and Manx National Heritage.

Transactions and balances relating to the Consolidated Loans Fund are eliminated on consolidation in the Central Government Accounts as these are, in effect, loans from Treasury to other Government Departments.

Group Accounts

The Group Accounts incorporate the Accounts of Central Government, the three non-Revenue Funded Statutory Boards and companies owned by Central Government or the Statutory Boards. The three non-Revenue Funded Statutory Boards are:

- Isle of Man Post Office;
- Isle of Man Water and Sewerage Authority; and
- Manx Electricity Authority.

The transactions and balances of Depositors' Compensation Schemes (initiated under the Banking Business (Compensation of Depositors) Regulations 1991 and the Compensation of Depositors Regulations 2008) are not consolidated within the Group Accounts on the basis the assets managed under these schemes relate to third parties. Amounts due from or to such schemes are included within Government debtors and creditors.

Accounting Year

The Accounting Year used for reporting purposes is the twelve months ending 31 March each year, as defined in the Accounts and Audit Regulations 2013. The Accounts for the Isle of Man Post Office are completed each year on the basis of working weeks. No adjustment is made to the transactions and balances for Isle of Man Post Office on the basis the difference in year end is only a few days and the impact of the different dates used is not material.

Elimination of Transactions and Balances on Consolidation

The following transactions and balances are eliminated on consolidation:

- Year end debtor and creditor balances between Central Government and the three Statutory Boards and owned companies;
- Year end debtor and creditor balances between Central Government and Isle of Man Film Limited and Laxey Glen Mills Limited;
- Transactions relating to the contribution to Government from the Isle of Man Post Office;
- Transactions relating to interest on the Bonds issued by Treasury on behalf of the Isle of Man Water and Sewerage Authority and the Manx Electricity Authority;
- Transactions relating to the subvention paid to Radio Manx Limited by Central Government and revenue transactions relating to the contribution to Government from Laxey Glen Mills Limited; and
- Share capital (including Share Premium) in owned companies.

7.2 Analysis of Treasury Income

Treasury income comprises four main areas – income from Income Tax, income from Customs duties, Other Treasury Income and Treasury Reserves Income. Further details of this income are set out below:

7.2.1 Customs and Excise

	Group		Central Government	
	2013-14 £'000s	2012-13 £'000s	2013-14 £'000s	2012-13 £'000s
Duties In Common With The UK				
Beer	**626**	**600**	626	600
Spirits	**11**	**16**	11	16
Wine	**40**	**41**	40	41
Tobacco	**442**	**500**	442	500
Hydrocarbon Oils	**30,266**	**30,591**	30,266	30,591
Miscellaneous Road Fuels	**5**	**5**	5	5
	31,390	**31,753**	31,390	31,753
Consumer Taxes				
Value Added Tax	**364,686**	**598,036**	364,686	598,036
Customs Duties	**-**	**(30)**	-	(30)
	364,686	**598,006**	364,686	598,006
Isle Of Man Duties				
Betting Duty	**626**	**23**	626	23
On Line Gambling	**4,164**	**3,718**	4,164	3,718
Air Passenger Duties	**4,491**	**4,157**	4,491	4,157
	9,281	**7,898**	9,281	7,898
Customs Receipts From UK				
Customs Receipts From UK	**(224,501)**	**(323,512)**	(224,501)	(323,512)
Credit/(Provision) For Repayment Back From/(To) UK HMRC	**129,970**	**(21,738)**	129,970	(21,738)
	(94,531)	**(345,250)**	(94,531)	(345,250)
Other Receipts				
Other Receipts	**534**	**680**	534	680
	534	**680**	534	680
Total	**311,360**	**293,087**	**311,360**	**293,087**

Notes:

- Income reported in the Detailed Government Accounts (GD 0036/14) was £312.0 million (2012-13 : £296.0 million). The differences between these figures and those above arise from movements on debtor balances not included within the Detailed Government Accounts, which are prepared on a cash basis for Customs income.

7.2.2 Income Tax

	Group		Central Government	
	2013-14	**2012-13**	**2013-14**	**2012-13**
	£'000s	**£'000s**	**£'000s**	**£'000s**
Resident Tax	**54,242**	**56,667**	54,242	56,667
Company Tax	**17,199**	**10,807**	17,199	10,807
Non Resident Tax	**2,902**	**5,217**	2,902	5,217
ITIP	**118,077**	**111,634**	118,077	111,634
Sub Contractors	**2,739**	**3,064**	2,739	3,064
EU Savings Directive	**106**	**284**	106	284
Other	**(2)**	**7**	(2)	7
Total	**195,263**	**187,680**	**195,263**	**187,680**

Notes:

- Income reported in the Detailed Government Accounts (GD 0036/14) was £196.1 million (2012-13 : £186.0 million). The differences between these figures and those above arise from movements on debtor balances not included within the Detailed Government Accounts, which are prepared on a cash basis for Income Tax income.

7.2.3 Other Treasury Income

	Group		Central Government	
	2013-14	**2012-13**	**2013-14**	**2012-13**
	£'000s	**£'000s**	**£'000s**	**£'000s**
Philatelic Profits Contribution	**-**	**-**	2,000	2,000
Fines and Fixed Penalties	**603**	**913**	603	913
Interest on Investments	**10,070**	**12,153**	10,070	12,153
Miscellaneous income	**610**	**913**	610	913
Total	**11,283**	**13,979**	**13,283**	**15,979**

Notes:

- Central Government income reported in the Detailed Government Accounts (GD 0036/14) was £13.3 million (2012-13 : £15.2 million). The differences between these figures and those above arise from accounting for the contribution from the Isle of Man Post Office on an accruals basis (whereas in the Detailed Government Accounts this is recorded on a cash basis) and Interest on Investments above has been reduced by the 1.4% provision (2012-13 : 2.1%) against the KSFIOML general revenue cash deposit of £2.7 million (as described in Note 7.14).

7.2.4 Treasury Reserves Income

	Group		Central Government	
	2013-14 £'000s	2012-13 £'000s	2013-14 £'000s	2012-13 £'000s
Investment Income	**32,315**	**34,127**	32,315	34,127
Net Profit on Sale of Investments	**38,010**	**28,744**	38,010	28,744
Sales of Properties	**3,691**	**1,916**	3,691	1,916
Other Receipts	**1,220**	**42**	1,220	42
Total	**75,236**	**64,829**	**75,236**	**64,829**

Notes:

i. Treasury Reserves Income relates to receipts, income and realised investment income in respect of Treasury's external and internal reserve funds. This income does not form part of the Government Net General Revenue Account and is transferred to the reserve funds to which it relates in the Statement of Total Movement on the General Revenue Account Balance.

ii. The impairment charge in respect of amounts advanced to the Depositors' Compensation Scheme for Kaupthing Singer & Friedlander (Isle of Man) Limited has been applied against Treasury Reserves Income (see Note 7.13.1).

7.3 Deficit for the Year

7.3.1 Deficit for the Year

The deficit for the year is arrived at after charging:

		Group		Central Government	
	Note	2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
Auditors' remuneration	*7.6*	**156**	**167**	96	120
Depreciation	*7.7*	**125,123**	**125,747**	103,862	106,160
Amortisation	*7.7*	**91**	**73**	91	73
Pension costs	*7.20*	**167,917**	**144,330**	167,000	143,000
Gain on disposal of fixed assets	*7.7*	**2,991**	**2,536**	2,991	2,536
Rentals payable under leases		**10,430**	**9,431**	6,509	6,509

Notes:

i. Auditors' remuneration excludes amounts paid in respect of Depositors' Compensation Schemes and other entities outside the scope of the group consolidation.

7.3.2 Department Expenditure

An analysis of Department Expenditure is included at Section 8. The analysis has been extracted from the Detailed Government Accounts (GD 0036/14). The following adjustments have been applied to reflect different basis of preparation:

		Group		Central Government	
		2013-14 £'000s	**2012-13 £'000s**	**2013-14 £'000s**	**2012-13 £'000s**
Total Revenue Expenditure, per Section 8		**(538,232)**	**(534,319)**	(538,232)	(534,319)
UK Accounting Standards Adjustments					
Fixed Assets Adjustments		**(85,424)**	**(106,667)**	(85,424)	(106,667)
Pension Adjustments		**6,999**	**(7,000)**	6,999	(7,000)
Other		**3,351**	**5,646**	3,351	5,646
Consolidation Adjustments					
Treasury/DOI - Grant to IOMWSA		**7,364**	**9,018**	-	-
Treasury - Manx Radio Subvention		**850**	**850**	-	-
Net Voted Expenditure		**(605,092)**	**(632,472)**	**(613,306)**	**(642,340)**
Treasury Income	*7.2*	**593,142**	**559,575**	595,142	561,575
Net Voted Income		**(11,950)**	**(72,897)**	**(18,164)**	**(80,765)**

Other adjustments include the reversal of lease costs paid by the Department of Infrastructure in respect of the Energy from Waste plant (the financing cost is included within Interest Payable and Similar Charges), the movement on House Purchase Assistance Schemes' balances for the Department of Social Care and the movement on the value of the strategic oil reserve (which is excluded from the Detailed Government Accounts).

7.4 Staff Remuneration

Numbers of employees and Members whose remuneration of £50,000 or greater is included in these Accounts as at 31 March for each year:

	Group		Central Government	
Remuneration Band	**2013-14**	**2012-13**	**2013-14**	**2012-13**
£325,000 to £349,999	**1**	**-**	1	
£250,000 to £274,999	**2**	**3**	2	3
£225,000 to £249,999	**3**	**-**	3	-
£200,000 to £224,999	**11**	**8**	11	8
£175,000 to £199,999	**19**	**22**	19	22
£150,000 to £174,999	**23**	**18**	23	18
£125,000 to £149,999	**26**	**21**	25	20
£100,000 to £124,999	**37**	**42**	35	40
£75,000 to £99,999	**112**	**100**	105	90
£50,000 to £74,999	**672**	**641**	610	586

Notes:

i. The above figures include gross pay amounts as remuneration (including compensation payments made in connection with their employment) but exclude employers' contributions (for example, employers' pension contributions).

ii. The figures are based on the total remuneration for an individual employee regardless of how many posts that individual may have held. For example, where an individual was employed by two different Departments for two different tasks, the employee is classified above based on their amalgamated remuneration for both posts.

7.5 Financial Commitments

7.5.1 Operating Leases

	Group		Central Government	
	2013-14 £'000s	**2012-13 £'000s**	**2013-14 £'000s**	**2012-13 £'000s**
<1 year	**5,784**	**6,396**	5,683	6,254
1 to 2 years	**5,603**	**5,749**	5,543	5,683
2 to 5 years	**15,626**	**16,523**	15,446	16,457
After 5 years	**37,718**	**42,250**	37,718	42,250

7.5.2 Other Financial Commitments

The charges paid by the Manx Electricity Authority in respect of the Gas Interconnector and the Spur Pipeline are invoiced in Euros. During the year the Manx Electricity Authority entered into forward contracts to purchase Euros, at exchange rates of Sterling to Euro, in a predefined range between 1.23 and 1.38 in order to hedge the foreign currency exchange exposure until April 2015. The total value of this commitment at 31 March 2014 was €10.8 million (2013 : €21.6 million) which equates to a maximum commitment of £8.8 million (2013 : £17.5 million).

During the year the Authority entered into a number of contracts to purchase gas at a pre-determined price for delivery between April 2014 and March 2017 (2013 : between April 2013 and April 2016), in order to hedge against gas price volatility. At 31 March 2014 the amount of these commitments was £33.9 million (2013 : £28.5 million).

7.6 External Audit Fees

	Group		Central Government	
	2013-14 £000's	**2012-13 £000's**	**2013-14 £000's**	**2012-13 £000's**
Fees payable with regard to external audit services carried out by the appointed auditors	**156**	**167**	96	120
Fees payable with regard to other services carried out by the appointed auditors	**294**	**294**	294	294

Following a tender process, the External Auditor (KPMG Audit LLC) was appointed for a 3-year term commencing 1 April 2010, with an option for a further extension for a further two years. The figures above relate solely to KPMG Audit LLC. KPMG Audit LLC was the incumbent external auditor immediately prior to the tender process.

An associated company, KPMG LLC, is appointed as Scheme Agent of the Banking Business (Compensation of Depositors) Regulations 1991 and the Compensation of Depositors Regulations 2008 by the Financial Supervision Commission. The above figures with regard to other services include payments made to KPMG LLC in respect of these Regulations. The transactions and balances of the depositors' compensation schemes, including the fees above, are not consolidated into these Accounts.

As part of a separate tender process another firm, Grant Thornton Limited (previous firms, including PKF (Isle of Man) LLC), were appointed auditors of Local Authority and related accounts. Grant Thornton Limited is also the appointed external auditor of Laxey Glen Mills Limited and PricewaterhouseCoopers LLC is the appointed external auditor of Radio Manx Limited.

7.7 Fixed Assets

	Note	Group		Central Government	
		2013-14	**2012-13**	**2013-14**	**2012-13**
		£000's	**£000's**	**£000's**	**£000's**
Tangible Fixed Assets	*7.7.1*	**2,778,324**	**2,945,749**	2,263,109	2,422,676
Intangible Fixed Assets	*7.7.2*	**56**	**135**	56	135
Total		**2,778,380**	**2,945,884**	**2,263,165**	**2,422,811**

7.7.1 Tangible Fixed Assets – Group

	Group			
	Freehold Land & Buildings	**Vehicles, Plant & Equipment**	**Infra-structure assets**	**Total**
	£'000s	**£'000s**	**£'000s**	**£'000s**
Cost or Valuation				
As at 1 April 2013	1,352,178	415,020	1,862,906	**3,630,104**
Additions	7,520	14,571	15,071	**37,162**
Revaluations	(46,883)	6,181	(33,677)	**(74,379)**
Disposals	(892)	(9,430)	-	**(10,322)**
As at 31 March 2014	**1,311,923**	**426,342**	**1,844,300**	**3,582,565**
Accumulated Depreciation				
As at 1 April 2013	170,342	216,578	297,435	**684,355**
Charge for year	47,866	22,674	54,583	**125,123**
Revaluations	6,593	2,121	(6,542)	**2,172**
Disposals	(184)	(7,225)	-	**(7,409)**
As at 31 March 2014	**224,617**	**234,148**	**345,476**	**804,241**
Net Book Value				
As at 31 March 2014	**1,087,306**	**192,194**	**1,498,824**	**2,778,324**
As at 1 April 2013	1,181,836	198,442	1,565,471	**2,945,749**

Included within tangible fixed assets at 31 March 2014 is freehold land amounting to £55.5 million (2013 : £55.5 million) which has not been depreciated.

The net book value of fixed assets held under finance leases and hire purchase contracts was £71.5 million (2013 : £74.9 million). Depreciation of £2.6 million (2012-13 : £2.6 million) was charged in the year on these assets.

7.7.2 Tangible Fixed Assets – Central Government

	Central Government			
	Freehold Land & Buildings £'000s	Vehicles, Plant & Equipment £'000s	Infra-structure assets £'000s	Total £'000s
Cost or Valuation				
As at 1 April 2013	1,284,416	157,728	1,418,084	**2,860,228**
Additions	7,370	12,690	110	**20,170**
Revaluations	(46,647)	4,772	(30,624)	**(72,499)**
Disposals	(753)	(2,745)	-	**(3,498)**
As at 31 March 2014	**1,244,386**	**172,445**	**1,387,570**	**2,804,401**
Accumulated Depreciation				
As at 1 April 2013	151,366	101,220	184,966	**437,552**
Charge for year	46,296	13,367	44,199	**103,862**
Revaluations	5,548	712	(4,089)	**2,171**
Disposals	(45)	(2,248)	-	**(2,293)**
As at 31 March 2014	**203,165**	**113,051**	**225,076**	**541,292**
Net Book Value				
As at 31 March 2014	**1,041,221**	**59,394**	**1,162,494**	**2,263,109**
As at 1 April 2013	1,133,050	56,508	1,233,118	**2,422,676**

Included within tangible fixed assets at 31 March 2014 is freehold land amounting to £53.1 million (2013 : £53.2 million) which has not been depreciated.

The net book value of fixed assets held under finance leases and hire purchase contracts was £21.7 million (2013 : £24.0 million). Depreciation of £2.3 million (2012-13 : £2.3 million) was charged in the year on these assets.

As at 31 March 2014, tangible fixed assets with a net book value of £250.8 million (2013 : £257.5 million) had been revalued.

7.7.3 Intangible Fixed Assets

	Group	Central Government
	Intangible Assets £'000s	**Intangible Assets £'000s**
Cost or Valuation		
As at 1 April 2013	325	325
Additions	14	14
Disposals	(23)	(23)
As at 31 March 2014	**316**	**316**
Accumulated Amortisation		
As at 1 April 2013	190	190
Charge for year	91	91
Disposals	(21)	(21)
As at 31 March 2014	**260**	**260**
Net Book Value		
As at 31 March 2014	**56**	**56**
As at 1 April 2013	135	135

7.7.4 Valuations

Many of the Group's land and buildings, including both freehold and leasehold assets, have been revalued during the last three years on the basis of existing use by qualified valuers. The valuations were undertaken in accordance with the Appraisal and Valuation Manual of the Royal Institution of Chartered Surveyors in the United Kingdom by the Treasury's Valuation Office. Many of the group's infrastructure assets have been revalued during the last three years on the basis of existing use by appropriate experts.

Any surpluses that arise are credited to the General Revenue Adjustment Account. Any impairment in value is charged to the General Revenue Adjustment Account where it reflects the reversal of a previous valuation gain. Where no such gain exists, impairment losses are charged to the Net General Revenue Account.

Depreciation is being charged based upon the revalued amounts and revised estimated useful economic life of the buildings.

7.8 Capital Commitments

The estimated commitments for capital expenditure that had started, or legal contracts entered into, as at 31 March 2014 was £8.6 million (2013 : £9.9 million) for the Group and £14.3 million (2013 : £7.1 million) for Central Government. This amount predominantly relates to capital schemes approved by Tynwald which were in the course of construction at the year end. Further details of approved Capital Schemes are set out in the Isle of Man Budget 2014-15 (GD 0001/14).

7.9 Long Term Investments

7.9.1 Investments

The market value and classification of the Long Term Investments held is as follows:

	Market Value 31 March 2014 £'000s	Book Value 31 March 2014 £'000s	Market Value 31 March 2013 £'000s	Book Value 31 March 2013 £'000s
Property	**890**	**408**	1,100	408
Investment in Films	**15,488**	**15,488**	15,517	15,517
United Kingdom Fixed Interest	**275,430**	**261,490**	306,491	275,504
United Kingdom Equities	**379,868**	**329,068**	457,168	407,465
Overseas Fixed Interest	**109,008**	**99,500**	91,257	85,399
Overseas Equities	**299,194**	**267,915**	280,324	248,801
Other Investments	**76,229**	**77,485**	90,107	91,226
Total	**1,156,107**	**1,051,354**	**1,241,964**	**1,124,320**

7.9.2 Balances on Externally Managed Funds

The investments relate to six externally managed funds. In addition to the investments above, the external Investment Managers and Treasury also hold cash balances in respect of these funds, details of which are set out below:

	Market Value 31 March 2014 £'000s	Book Value 31 March 2014 £'000s	Market Value 31 March 2013 £'000s	Book Value 31 March 2013 £'000s
Long Term Investments	**1,156,107**	**1,051,354**	1,241,964	1,124,320
Cash & Cash Instruments	**237,710**	**233,574**	195,773	193,380
Cash funds held by Treasury	**63,082**	**63,080**	73,271	73,271
Total	**1,456,899**	**1,348,008**	**1,511,008**	**1,390,971**

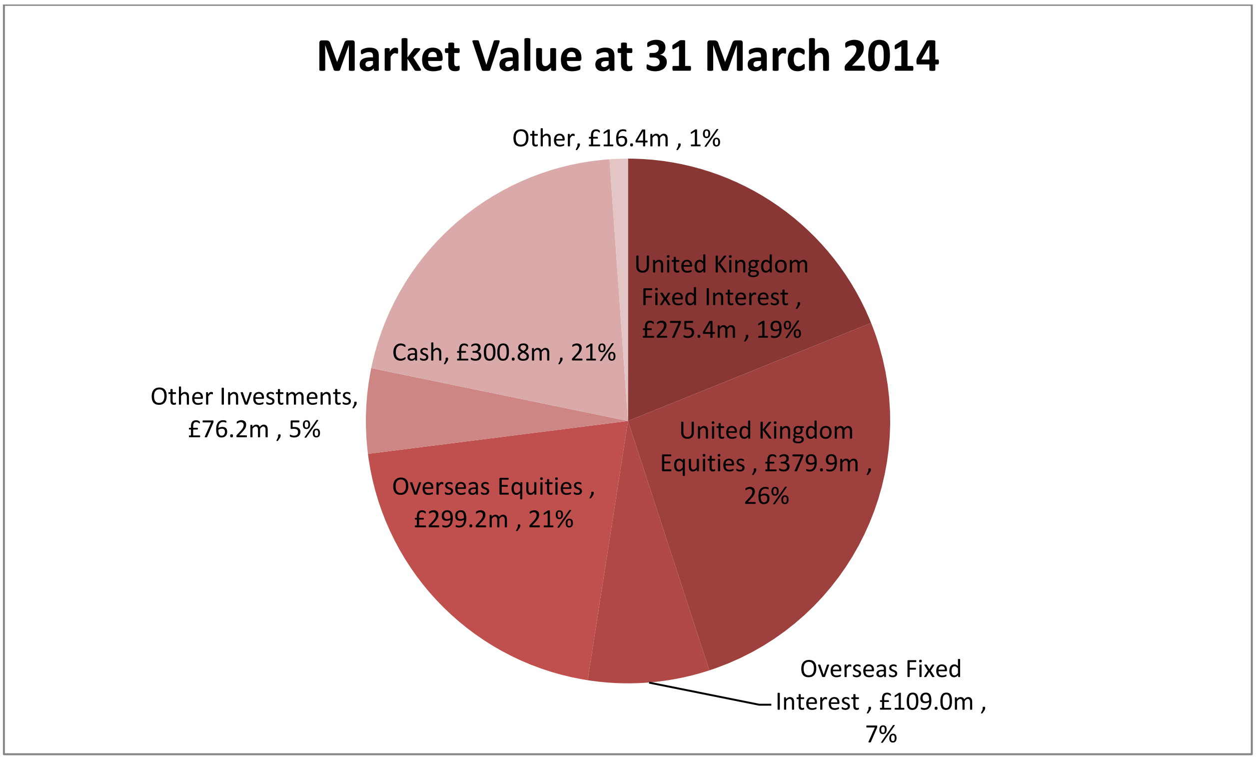
Included within 'Cash & Cash Instruments' above are deposits totalling £8.0 million which were placed with Kaupthing Singer & Friedlander (Isle of Man) Limited ("KSFIOML"). KSFIOML is in liquidation, further details of which are given at Note 7.13.1. A provision of 1.4% (2013 : 2.1%) is recognised at 31 March 2014 against the £8.0 million of reserve fund deposits.

The deposits of £8.0 million relate to the following reserve funds:

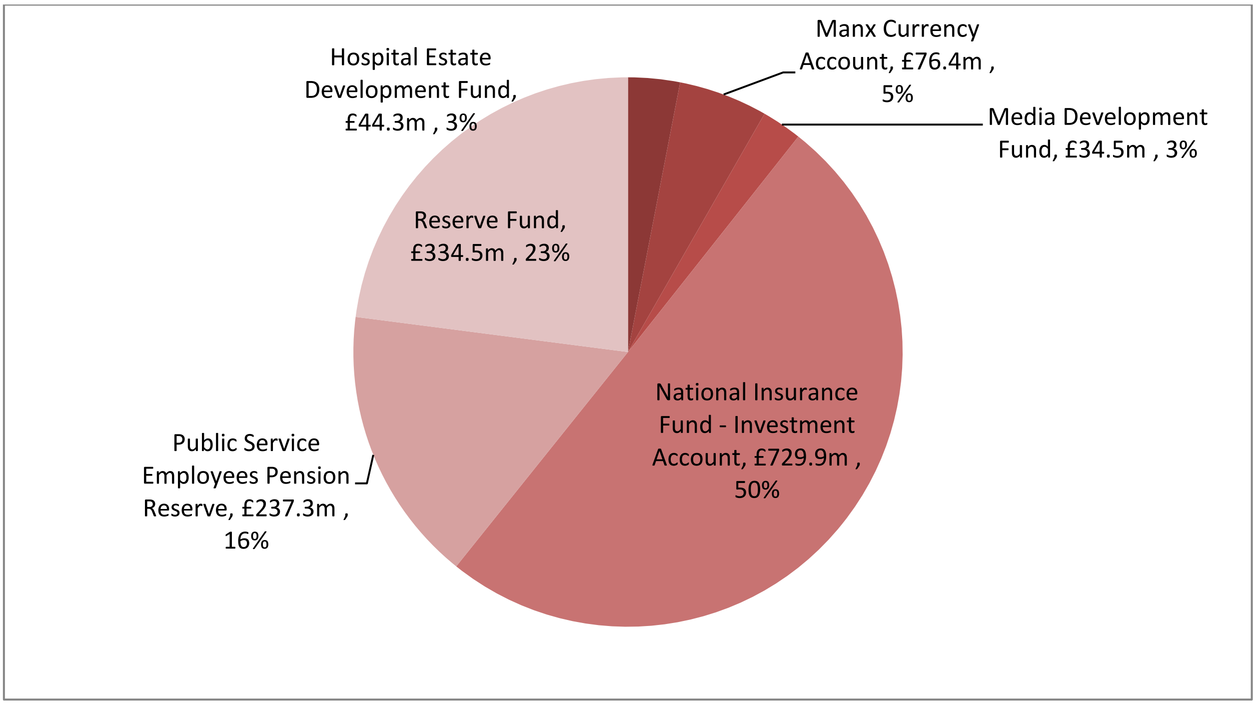
Reserve or Fund	Deposit Outstanding £000's	Provision Recognised at 31 March 2014 £000's	Provision Recognised at 31 March 2013 £000's
Reserve Fund	5,000	70	105
Public Service Employees' Pension Reserve	2,000	28	42
Hospital Estate Development Fund	1,000	14	21
Total	**8,000**	**112**	**168**

In addition to the £8.0 million deposited, a further £2.7 million was deposited in respect of Treasury cash balances (see Note 7.14).

The total market value of externally managed reserve fund assets held at 31 March 2014 can be shown by asset type as follows:



The assets are allocated across the externally managed reserve funds as follows:



7.9.3 Movements on Externally Managed Funds

An analysis of the fund balances and movements during the year is set out below:

Invested Fund	Balances Brought Forward 1 April 2013 £'000s	Income			Unrealised gain/(loss) on Investments £'000s	Expenditure Expenses, Transfers to Internal Accounts £'000s	Balances Carried Forward 31 March 2014 £'000s
		Contributions Seizures & Other £'000s	Investment Income £'000s	Net Profit on Sale of Investments £'000s			
Hospital Estate Development Fund	46,271	-	973	1,092	(1,660)	2,337	44,339
Manx Currency Account	77,300	(274)	1,102	643	(1,206)	1,199	76,366
Media Development Fund	40,003	112	3	-	(1)	5,651	34,466
National Insurance Fund - Investment Account	710,162	-	14,379	23,027	(4,029)	13,608	729,931
Public Service Employees Pension Reserve	250,767	-	5,520	12,059	(5,658)	25,372	237,316
Reserve Fund	386,505	-	9,926	10,408	1,347	73,705	334,481
Total	**1,511,008**	**(162)**	**31,903**	**47,229**	**(11,207)**	**121,872**	**1,456,899**

Notes:

i. The market values and book cost of each of the externally managed funds as at 31 March 2014 is shown below:

	Market Value 31 March 2014 £'000s	Book Value 31 March 2014 £'000s	Market Value 31 March 2013 £'000s	Book Value 31 March 2013 £'000s
Hospital Estate Development Fund	**44,339**	**43,419**	46,271	43,697
Manx Currency Account	**76,366**	**75,513**	77,301	75,243
Media Development Fund	**34,466**	**34,466**	40,003	40,003
National Insurance Fund - Investment Account	**729,931**	**674,407**	710,162	650,610
Public Service Employees Pension Reserve	**237,316**	**217,170**	250,766	224,979
Reserve Fund	**334,481**	**303,033**	386,505	356,439
Total	**1,456,899**	**1,348,008**	**1,511,008**	**1,390,971**

ii. The National Insurance Fund comprises an externally invested National Insurance Investment Account and an internally managed National Insurance Operating Account. The balances on these two funds are as follows:

	31 March 2014 £'000s	31 March 2013 £'000s
Operating Account	**(2,724)**	(4,287)
Investment Account	**729,931**	710,162
Total	**727,207**	**705,875**

iii. The face value of the Manx Currency in circulation at 31 March 2014 was £72.3 million (2013 : £72.7 million). At this date the Currency Account Surplus, being the amount by which the Manx Account (above) exceeds the face value of Manx Currency in circulation, was £3.2 million (2013 : £2.6 million).

7.10 Government Owned Companies

7.10.1 Central Government

The Isle of Man Government hold all the shares in the following six companies, the accounts of which have been consolidated with the Government's Group Accounts in accordance with the Accounts and Audit Regulations 2013:

Company	Principal activity	Country of Incorporation	Proportion of voting rights and shares held
Isle of Man Film Ltd	Film investment	Isle of Man	100%
Isle of Man Film (DOI) Ltd	Film investment	Isle of Man	100%
Isle of Man Ltd	Dormant	United Kingdom	100%
Isle of Man National Transport Ltd	Dormant	Isle of Man	100%
Laxey Glen Mills Ltd	Flour milling	Isle of Man	100%
Radio Manx Ltd	Commercial radio	Isle of Man	100%

The Accounts of all six of the Companies are required to be laid before Tynwald annually. Further details of the companies' activities during the year are set out below:

Isle of Man Film Ltd ("IOMFL")

IOMFL made investments in film productions on behalf of Government and remits receipts from film sales to the Media Development Fund.

Isle of Man Film (DOI) Ltd is a wholly-owned subsidiary of IOMFL and makes investments in a film production on behalf of IOMFL and is a subsidiary of IOMFL.

Laxey Glen Mills Ltd ("LGML")

Government provides subsidies to LGML in respect of flour sales, advances funds for LGML to purchase grain and provides grants to pay bonuses to growers.

Radio Manx Ltd ("RML")

Government provides an annual subvention to RML. In addition, Government organisations purchase services from and sell services to RML on an arm's length basis.

Isle of Man International Business School (Dissolved, "IOMIBS")

IOMIBS was Registered Charity that had not traded since 2005 and had no assets or liabilities. The company was dissolved on 18 July 2013 following the merger of the International Business School with the Isle of Man College of Further and Higher Education.

7.10.2 Group Accounts

In addition to the above, the Manx Electricity Authority hold all the shares in the following three companies, the accounts of which have been consolidated with the Government's Group Accounts, on the basis that they are consolidated within the Manx Electricity Authority's own Group Accounts:

Company	Principal activity	Country of Incorporation	Proportion of voting rights and shares held
Manx Cable Company Limited	Electricity cable link	Isle of Man	100%
PGT Limited	Dormant	Isle of Man	100%
e-llan Communications Limited	Wholesale telecom services	Isle of Man	100%

The Isle of Man Post Office hold shares in the following company, the accounts of which have not been consolidated with the Government's Group Accounts, on the basis that its transactions and balances are not material:

Company	Principal activity	Country of Incorporation	Proportion of voting rights and shares held
Isle of Man Business Park (No4) Management Company Limited	Property management	Isle of Man	40%

7.11 Long Term Debtors

Long Term Debtor balances comprise loans schemes funded by the Consolidated Loans Fund. An analysis of the closing balances on these schemes is shown below:

	Group		Central Government	
	2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
Loan Schemes				
Agricultural Holdings Scheme 1978	**321**	**398**	321	398
Agricultural Holdings Scheme 2000	**644**	**676**	644	676
Agricultural Credits Acts 1924-66	**40**	**45**	40	45
Fishing Industry	**273**	**317**	273	317
Building By Private Enterprise Schemes 1968/74	**3**	**5**	3	5
House Purchase Assistance Schemes	**19,477**	**19,253**	19,477	19,253
House Purchase Schemes	**95**	**148**	95	148
House Purchase & Refurbishment Scheme 1991	**1,235**	**1,409**	1,235	1,409
Royal British Legion Housing Association	**343**	**355**	343	355
Sports Club Improvement Scheme	**1**	**3**	1	3
Local Authorities	**1,992**	**2,112**	1,992	2,112
	24,424	**24,721**	**24,424**	**24,721**
Loans to Statutory Boards				
Manx Electricity Authority	**-**	**-**	360,059	325,934
Isle of Man Water & Sewerage Authority	**-**	**-**	167,405	164,973
e-llan Loan (MEA)	**-**	**-**	200	240
Total Loans Outstanding	**24,424**	**24,721**	**552,088**	**515,868**
Due within 12 months	**(4,932)**	**(4,239)**	(15,931)	(16,073)
Total	**19,492**	**20,482**	**536,157**	**499,795**

7.12 Stocks and Work in Progress

	Group		Central Government	
	2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
Raw Materials and Consumables	**8,327**	**8,045**	1,739	1,619
Work in Progress	**1,463**	**1,627**	1,463	1,627
Goods for Resale	**1,014**	**1,060**	883	887
Total	**10,804**	**10,732**	**4,085**	**4,133**

7.13 Debtors and Prepayments

		Group		Central Government	
		2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
Trade Debtors and Prepayments		**23,771**	**32,676**	14,037	18,822
Taxation Debtors		**26,375**	**27,868**	26,375	27,868
Loan Schemes	*7.11*	**4,932**	**4,239**	15,931	16,073
Other Debtors		**84,806**	**4,977**	83,220	3,521
Total		**139,884**	**69,760**	**139,563**	**66,284**

Taxation Debtors include amounts in respect of direct and indirect taxation where assessments have been raised and are expected to be paid. Income Tax assessments which are under review and for which the assessed value may change are excluded from the Taxation Debtors amount as the amount and timing of payment is uncertain.

Other Debtors for 2013-14 include an amount of £65.2 million payable by the United Kingdom's HM Revenue & Customs ("HMRC"). As at 31 March 2013 the Isle of Man Government owed HMRC £64.7 million. The difference in the balance arises from a change in the value of local collections in the Isle of Man.

7.13.1 Kaupthing Singer & Friedlander (Isle of Man) Limited

Included within Trade Debtors and Prepayments for both the Group and Central Government is an amount of £2.8 million (2013 : £4.1 million) in respect of the Kaupthing Singer & Friedlander (Isle of Man) Limited ("KSFIOML") Early Payment Schemes and Depositors' Compensation Schemes. A provision of £1.1 million (2013 : £3.9 million) has been applied against this balance to give a net balance of £1.7 million (2013 : £0.2 million).

On 9 October 2008 the Isle of Man Court made a Provisional Liquidation Order in relation to KSFIOML. On 27 May 2009 a Winding Up Order was passed by the Isle of Man High Court. The company's affairs are being wound up on the basis it could not repay its debts as they fall due. In February 2014 the Joint Liquidators of KSFIOML provided an update on the status of the liquidation and estimated total dividends to ordinary unsecured creditors will be between 98.6 pence in the pound and 99.2 pence in the pound (98.6%-99.2%; estimate at the time of the 2012-13 Accounts were prepared was 97.9%-99.0%).

Where balances within these Accounts are exposed to KSFIOML, provisions have been applied based on an outcome of 98.6 pence in the pound (1.4% provision required) (2013 : 97.9 pence in the pound, provision of 2.1%).

In May 2009 the Depositors' Compensation Scheme was activated in respect of KSFIOML. The Compensation of Depositors Regulations 2008 were approved by Tynwald in October 2008 and provided for compensation up to a maximum of £50,000 per individual depositor, per deposit taker, and up to £20,000 for certain other depositors, such as companies and trusts. The compensation is funded from distributions from the liquidation of KSFIOML, annual levies charged to other Isle of Man deposit takers and a contribution from the Isle of Man Government, Treasury Department.

In July 2009 Tynwald authorised Treasury to expend a maximum of £193 million during 2009-10 and 2010-11 to provide funding to the Depositors' Compensation Scheme so that compensation could be paid out in full to depositors prior to the scheme receiving liquidation distributions and levies. A transfer from the Reserve Fund not exceeding £193 million was also approved to meet the anticipated expenditure of the scheme.

Previously (in January 2009 and February 2009) Tynwald had approved two Early Payment Schemes and authorised the advancing of certain payments to depositors. The activation of the Depositors' Compensation Scheme effectively replaced the Early Payment Schemes, with amounts advanced by Treasury under the Early Payments Schemes becoming amounts due to Treasury from the Depositors' Compensation Scheme. By 31 March 2014 the total amount advanced by Treasury under all KSFIOML schemes was £214.4 million (2013 : £214.4 million) with £211.6 million (2013 : £210.3 million) having been repaid to give an outstanding balance of £2.8 million at 31 March 2014 (2013 : £4.1 million).

The eventual cost to Government under the regulations will be the cost of compensation paid against deposits in excess of £20,000 (up to the maximum of £50,000) less liquidation distributions against these deposits. This cost is currently estimated at £1.1 million (2013 : £3.9 million) based on an estimated final distribution of 98.6 pence in the pound and this is currently applied against General Revenue. During 2010-11 an amount of £3.9 million was transferred from the Reserve Fund to General Revenue to meet the cost of the provision with £2.7 million being released back to the Reserve Fund in 2013-14.

7.14 Short Term Deposits

Short term deposits comprise fixed term cash deposits placed by Treasury and Statutory Boards on wholesale money markets through local banks and deposits in short notice local bank accounts.

Included within these short term deposits (Group and Central Government) are deposits totalling £2.7 million which were placed at Kaupthing Singer & Friedlander (Isle of Man) Limited ("KSFIOML"). KSFIOML is in liquidation, further details of which are given at Note 7.13.1. A provision of £0.1 million (1.4%; 2013 : £0.1 million, 2.1%) has been recognised at 31 March 2014 against the £2.7 million of general revenue deposit placed.

In addition to the £2.7 million deposited, a further £8.0 million was deposited in respect of externally managed reserve funds (see Note 7.9.2).

7.15 Cash

	Group		**Central Government**	
	2013-14 £000's	**2012-13 £000's**	**2013-14 £000's**	**2012-13 £000's**
Cash re: external funds	**299,955**	**262,338**	299,955	262,338
Cash re: loans fund	**50,623**	**52,155**	50,623	52,155
Other cash balances	**(61,158)**	**(63,764)**	(107,347)	(113,241)
Cash at Bank and in Hand	**289,420**	**250,729**	**243,231**	**201,252**
Bank Overdrafts and Loans Payable	**(8,394)**	**(42,158)**	(8,297)	(6,946)
Total	**281,026**	**208,571**	**234,934**	**194,306**

The above represents cash held in Government bank accounts and cash held by the Government's External Investment Managers (see Note 7.9 Long Term Investments). In addition, Treasury also places short term cash deposits on wholesale money markets (see Note 7.14).

Cash balances in respect of the Consolidated Loans Fund (Capital cash balance) is funded from General Revenue and are therefore shown as both a positive (in respect of the Consolidated Loans Fund) and a negative (overdrawn, in respect of General Revenue) cash balance with 'Other cash balances' above.

Bank Overdrafts and Loans Payable includes £nil (2013 : £35 million) due to Barclays Private Clients International Limited by the Manx Cable Company Limited, a wholly owned subsidiary of the Manx Electricity Authority. The loan was repaid in July 2013, and was at an interest rate of 6.11%, which was fixed for the period of the loan.

The Treasury reviews its banking arrangements annually and currently has operational overdraft facilities in place with the Isle of Man Bank Limited to an aggregate value of £10.0 million (2013 : £10.0 million).

7.16 Creditors and Third Party Funds

7.16.1 Current Liabilities

		Group		Central Government	
	Note	**2013-14 £000's**	**2012-13 £000's**	**2013-14 £000's**	**2012-13 £000's**
Trade creditors		**32,411**	**29,493**	23,679	20,236
Finance debt	*7.18*	**4,956**	**4,647**	1,432	1,349
Accruals		**30,048**	**23,057**	26,365	17,855
Provision for repayment to UK HMRC		**-**	**64,725**	-	64,725
Other creditors		**12,032**	**11,019**	10,249	8,387
Total		**79,447**	**132,941**	**61,725**	**112,552**

7.16.2 Long Term Liabilities

		Group		Central Government	
	Note	**2013-14 £000's**	**2012-13 £000's**	**2013-14 £000's**	**2012-13 £000's**
Deferred income		**12,022**	**11,771**	-	-
Trade creditors		**288**	**628**	-	-
Provisions		**1,150**	**1,250**	-	-
Finance debt	*7.18*	**69,579**	**75,549**	32,301	33,733
Total		**83,039**	**89,198**	**32,301**	**33,733**

7.17 Loans Payable

7.17.1 Central Government

The external debt of Government (other than temporary borrowing by way of Bank overdraft) comprises Bonds issued under the Isle of Man Loans Act 1958-74.

Loans payable comprise £260 million (2013 : £260 million) in respect of loans issued from the Consolidated Loans Fund to the Manx Electricity Authority (£185 million, 2013 : £185 million) and the Isle of Man Water and Sewerage Authority (£75 million, 2013 : £75 million). These amounts relate to amounts raised by Treasury through a Bond Issue on behalf of these two Statutory Boards, the proceeds of which were then loaned to the Statutory Boards.

The Bonds have the following details:

Statutory Board	Amount	Interest rate	Maturity Date
Isle of Man Water and Sewerage Authority	£75 million	5.625% (fixed)	29 March 2030
Manx Electricity Authority	£185 million	5.375% (fixed)	14 August 2034

7.17.2 Group Accounts

Loans payable includes £3.2 million (2013 : £3.2 million) due to three local authorities (2013 : three) by the Isle of Man Water and Sewerage Authority. The loans were transferred from the Department of Transport to the Isle of Man Water and Sewerage Authority as part of the Government restructuring referred to in Note 7.22.1. The three loans (2013 : eight loans) have various maturity dates, the longest being in 2037, and are at fixed interest rates of between 4.68% and 6.36%.

7.18 Finance Debt

	Group		Central Government	
	2013-14 £000's	**2012-13 £000's**	**2013-14 £000's**	**2012-13 £000's**
Falling due within 1 year	**4,956**	**4,647**	1,432	1,349
Falling due after 1 year	**69,579**	**75,549**	32,301	33,733
Total	**74,535**	**80,196**	**33,733**	**35,082**

7.18.1 Central Government

At 31 March 2014 there was one material finance lease in existence in respect of the Energy from Waste ("EfW") Plant in Braddan, which was the subject of a sale and lease back agreement. During the year to 31 March 2014 the annual rental of £3.4 million (2012-13 : £3.4 million) was charged to the Income and Expenditure Account of the Department of Infrastructure. That amount is payable until the final payment which is due on 28 September 2028.

The finance liability represents the present value of expected future capacity payments discounted at an interest rate of 6.2% per annum. This amount has been included in fixed assets and is depreciated over 20 years.

7.18.2 Group Accounts

In 2002, the Manx Electricity Authority entered into contractual arrangements to obtain capacity on the natural gas inter-connector between the United Kingdom and the Republic of Ireland and to construct a spur pipeline to connect the Isle of Man to the inter-connector. These contractual arrangements were entered into by the Manx Electricity Authority in order to bring natural gas to the Isle of Man to supply the Manx Electricity Authority and other third party users.

The Isle of Man Pipeline Connection Agreement relates to the use of the spur pipeline linking the Moffat Distribution System and the west coast of the Isle of Man. Under the terms of the agreement, the Manx Electricity Authority pays the operator for the construction costs of the spur pipeline until 30 September 2023.

The finance liability represents the present value of expected future capacity payments discounted at an interest rate of 5.5% per annum. This amount has been included in fixed assets and is depreciated over 60 years. Operating and maintenance charges also arise under the spur inter-connector Agreement and are charged to the profit and loss account.

The amounts due under this agreement are payable in Euros (€). The future commitment in Euros has been translated at the year end exchange rate resulting in an unrealised exchange loss of £1.0 million (2013 : £0.7 million).

7.19 Movements on Reserves

7.19.1 Net General Revenue Account

The movement on the General Revenue Account is shown in the Statement of Total Movement on the Net General Revenue Account Balance (Section 6.4).

7.19.2 General Revenue Adjustments Account

	Group		Central Government	
	2013-14 £000's	**2012-13 £000's**	**2013-14 £000's**	**2012-13 £000's**
Balance brought forward	**438,923**	**815,407**	437,028	813,576
Fixed assets adjustments	**(123,792)**	**(32,847)**	(123,792)	(32,847)
Pensions adjustments	**(27,000)**	**(343,000)**	(27,000)	(343,000)
Other	**(1,501)**	**(637)**	(1,527)	(701)
Total	**286,630**	**438,923**	**284,709**	**437,028**

Adjustments which are required to comply with United Kingdom Accounting Standards and are applied to the Income and Expenditure Account but not included in the Government's budget are applied to the General Revenue Adjustments Account and not the Net General Revenue Account. Further details of the adjustments are given in Note 7.2 and Note 7.3.

7.19.3 External Funds and Reserves

The Government has six externally managed funds and reserves. These are reserves where the invested assets relating to each reserve are managed by external investment managers. Details of balances and movements on externally managed funds and reserves are provided in Note 7.9.

7.19.4 Internal Funds – Central Government

Internal Revenue Fund or Reserve	Balances Brought Forward 1 April 2013 £'000s	Contributions Seizures & Other £'000s	Investment Income £'000s	Transfers to Other Funds £'000s	Expenses, Other Expenses £'000s	Balances Carried Forward 31 March 2014 £'000s
Agricultural Development Fund	4,384	1,700	19	-	1,790	4,313
Economic Development Fund	16,926	-	157	3,000	-	14,083
Government Energy Initiatives Capital Fund	2,360	57	9	-	128	2,298
Government Marketing Initiatives Fund	6,053	-	26	-	966	5,113
Health Inspection Fund	-	2,100	-	-	-	2,100
Housing Reserve Fund	11,532	6,691	48	-	6,133	12,138
ICT Fund	6,482	683	27	-	3,653	3,539
Insurance Fund	2,626	2,500	9	-	2,675	2,460
Land & Property Acquisition Reserve	11,404	459	45	-	9,850	2,058
Legal Costs Reserve	7,529	3,700	31	-	3,395	7,865
Medical Indemnity Fund	6,640	650	27	-	595	6,722
Restructuring Fund	9,765	500	40	-	1,619	8,686
Seized Assets Fund	1,109	1,220	8	-	36	2,301
Town & Village Centre Regeneration Fund	6,180	3,000	25	-	3,027	6,178
Total	**92,990**	**23,260**	**471**	**3,000**	**33,867**	**79,854**

The internally managed funds are funds allocated from General Revenue to provide funding for a specific purpose. The assets invested for each fund comprise cash deposits based with local banks and are not separately identifiable from other General Revenue cash deposits.

Details of each fund, including a brief description of the purpose of each fund, can be found in Section 4 of the Detailed Government Accounts (GD 0036/14).

7.19.5 Internal Funds – Group Accounts

	Balances Brought Forward 1 April 2013 £'000s	Income: Contributions Seizures & Other £'000s	Income: Realised and Unrealised Income £'000s	Expenditure: Internal Transfers and Other Expenses £'000s	Balances Carried Forward 31 March 2014 £'000s
Treasury funds					
Internally managed funds	92,990	23,260	471	(36,867)	79,854
Other funds					
Isle of Man Post Office					
Fixed Asset Reserve	9,767	-	-	(203)	9,564
Revenue and general reserve	1,000	(30)	-	30	1,000
Development Reserve	3,568	-	-	3,446	7,014
Isle of Man Water & Sewerage Authority					
Capital and retained reserves	64,757	6,193	-	-	70,950
Manx Electricity Authority					
Reserves	(69,664)	(10,993)	-	-	(80,657)
Owned Companies					
Reserves	912	(4)	-	-	908
Total	**103,330**	**18,426**	**471**	**(33,594)**	**88,633**

7.20 Pensions

7.20.1 Overview

The Isle of Man Government operates a number of pensions for staff employed under a variety of pay agreements. These schemes apply to personnel in the various Departments, Boards and Offices within the scope of the Central Government Accounts. The schemes are administered by the Pensions Division of the Office of Human Resources.

Two of these schemes, the Civil Service and Whitely Council schemes, also apply to the Isle of Man Water and Sewerage Authority and the Manx Electricity Authority. The transactions and balances in respect of these schemes, including those relating to the Isle of Man Water and Sewerage Authority and the Manx Electricity Authority, are included within the Central Government figures below.

Whilst the Treasury has established a reserve fund to address the emerging pension liability, these schemes are accounted for as unfunded schemes as the Public Service Employees' Pension Reserve is not exclusively used to meet pension scheme liabilities and its assets are not allocated to specific schemes.

The schemes operated by Central Government comprise the following:

- Government Unified Scheme
- *Electricity Board (Officers of Boards) 1960 (closed scheme)*
- *Electricity Board Manual Workers Scheme 1976 (closed scheme)*
- *Judicial Pension Scheme 1992 (closed scheme)*
- Judicial Pension Scheme 2004
- *Manx Electricity Authority Local Government Scheme Optants (closed scheme)*
- *Police Pension Regulations 1991 (closed scheme)*
- Police Pension Regulations 2010
- *Superannuation Manual Workers (No 1) Pension Scheme 1973 (closed scheme)*
- *Superannuation Manual Workers (No 2) Pension Scheme (closed scheme)*
- *Superannuation (Traffic Wardens) Scheme 1989 (closed scheme)*
- Teachers Superannuation Order 2007
- Tynwald Members Pension Schemes 1985 and 1995

The Isle of Man Post Office operates a separate defined benefit scheme, the transactions and balances of which are included in the Group figures below. The scheme is a funded scheme, contributions to which are determined by a firm of independent Actuaries employed by the Trustees.

The scheme operated by the Isle of Man Post Office is as follows:

- The Isle of Man Post Office Superannuation Scheme.

7.20.2 Assumptions Used

The financial assumptions used to calculate scheme liabilities under Financial Reporting Standard number 17 issued by the United Kingdom Accounting Standards Board ("FRS 17") are as follows:

	Group		**Central Government**	
	2013-14	**2012-13**	**2013-14**	**2012-13**
Discount rate	**4.31%**	**4.41%**	4.30%	4.40%
Salary increase rate	**4.16%**	**4.70%**	4.20%	4.50%
Rate of revaluation in deferment	**2.25%**	**3.70%**	n/a	n/a
Pension increase rate	**2.19%**	**2.15%**	2.20%	2.05%
Expected return on scheme assets	**6.00%**	**7.35%**	n/a	n/a
Price inflation rate - Consumer Price Index (CPI)	**2.20%**	**2.50%**	2.20%	1.85%

Assumptions regarding life expectancy of members are based on published statistics and mortality tables.

The expected return on scheme assets is determined as the best estimate of returns expected over the period from dividends, interest and capital gains, taking into account the expected returns for individual asset categories.

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice.

7.20.3 Amounts Recognised in the Balance Sheet

The fair value of the scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the Scheme's liabilities, which are derived from cash flow projections over long periods and thus inherently uncertain, were as follows:

	Group		Central Government	
	2013-14 £000's	**2012-13 £000's**	**2013-14 £000's**	**2012-13 £000's**
Equities	**41,808**	**40,273**	-	-
Property	**8,763**	**8,305**	-	-
Bonds	**10,119**	**10,495**	-	-
Other	**3,496**	**3,433**	-	-
Fair value of scheme assets	**64,186**	**62,506**	**-**	**-**
Present value of funded liabilities	**(2,384,127)**	**(2,358,740)**	(2,318,000)	(2,291,000)
Net pension liability	**(2,319,941)**	**(2,296,234)**	**(2,318,000)**	**(2,291,000)**

The schemes do not invest in the sponsor's own financial instruments, including property or other assets owned by the sponsor.

7.20.4 Changes in Present Value of the Funded Liabilities

	Group		Central Government	
	2013-14 £000's	**2012-13 £000's**	**2013-14 £000's**	**2012-13 £000's**
At beginning of period	**2,358,740**	**2,007,831**	2,291,000	1,948,000
Current service cost	**71,601**	**59,330**	70,000	58,000
Employee contributions	**18,479**	**14,461**	18,000	14,000
Interest cost	**100,221**	**88,089**	97,000	85,000
Actuarial (gains)/losses	**(85,430)**	**241,994**	(81,000)	237,000
Benefits paid	**(79,484)**	**(52,965)**	(77,000)	(51,000)
At end of period	**2,384,127**	**2,358,740**	**2,318,000**	**2,291,000**

7.20.5 Changes in Fair Value of the Scheme Assets

	Group		Central Government	
	2013-14 £000's	**2012-13 £000's**	**2013-14 £000's**	**2012-13 £000's**
At beginning of period	**62,507**	**55,727**	-	-
Expected return on assets	**3,904**	**3,575**	-	-
Sponsor contributions	**937**	**905**	-	-
Employee contributions	**479**	**461**	-	-
Actuarial (gains)/losses	**(1,148)**	**3,803**	-	-
Benefits paid	**(2,484)**	**(1,965)**	-	-
At end of period	**64,195**	**62,506**	**-**	**-**

7.20.6 Amounts Recognised in the Income and Expenditure Account

	Group		Central Government	
	2013-14 £000's	**2012-13 £000's**	**2013-14 £000's**	**2012-13 £000's**
Current service cost	**71,601**	**59,330**	70,000	58,000
Interest on scheme liabilities	**100,221**	**88,089**	97,000	85,000
Expected return on scheme assets	**(3,905)**	**(3,575)**	-	-
Total expense	**167,917**	**143,844**	**167,000**	**143,000**

7.20.7 Effect of FRS17 on Net Expenditure

	Group		Central Government	
	2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
Total income as reported	**970,003**	**908,349**	970,003	908,349
Total expenditure as reported	**(1,092,072)**	**(1,077,561)**	(1,086,579)	(1,073,846)
Less FRS17 charge	**70,664**	**58,425**	70,000	58,000
Restated expenditure pre FRS17	**(1,021,408)**	**(1,019,136)**	**(1,016,579)**	**(1,015,846)**
Restated operating surplus pre FRS17	**(51,405)**	**(110,787)**	**(46,576)**	**(107,497)**
Interest earned	**2,643**	**2,388**	-	-
Less FRS17 adjustment	**96,316**	**84,514**	97,000	85,000
Restated interest income pre FRS17	**98,959**	**86,902**	**97,000**	**85,000**
Restated surplus/(deficit) pre FRS17	**47,554**	**(23,885)**	**50,424**	**(22,497)**

7.20.8 Amounts Recognised in the Statement of Total Recognised Gains and Losses

	Group		Central Government	
	2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
Actual return less expected return on scheme assets	**(1,157)**	**3,803**	-	-
Experience gains and losses arising on scheme liabilities	**(174,104)**	**60,976**	(175,000)	61,000
Change in assumptions underlying present value of scheme liabilities	**97,534**	**171,030**	94,000	176,000
Net actuarial gains recognised in the period	**(77,727)**	**235,809**	**(81,000)**	**237,000**

7.20.9 Cumulative Net Actuarial Gains Recognised in the Statement of Total Recognised Gains and Losses

	Group		Central Government	
	2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
At beginning of period	**578,532**	**342,723**	578,000	341,000
Actuarial gain/(loss) on pension scheme	**(77,727)**	**235,809**	(81,000)	237,000
At end of period	**500,805**	**578,532**	**497,000**	**578,000**

Cumulative net actuarial gains/(losses) for Central Government have been determined as the amounts recognised in the statement of total recognised gains and losses since the period ended 31 March 2010. Cumulative net actuarial gains/(losses) for other Group entities have been determined as the amounts recognised in the statement of total recognised gains and losses since the period ended 31 March 2004, based on FRS17 applicable during those years.

The net actuarial gain for Central Government for 2013-14 comprises an experience gain of £175 million reduced by £94 million for changes in assumptions underlying the present value of scheme liabilities. The experience gain broadly reflects a gain from salary increases over the year from 31 March 2013 to 31 March 2014 of around £50 million and a further gain of around £125 million resulting from using updated membership data.

7.20.10 Historical Information

	Group				
	2014	2013	2012	2011	2010
	£'000s	£'000s	£'000s	£'000s	£'000s
Present value of scheme Liabilities	(2,384,127)	(2,358,740)	(2,007,831)	(1,859,606)	(2,033,286)
Fair value of scheme assets	64,186	62,506	55,727	52,462	49,369
Net scheme deficit	**(2,319,941)**	**(2,296,234)**	**(1,952,104)**	**(1,807,144)**	**(1,983,917)**
Experience adjustments on scheme liabilities	(174,104)	60,976	56,270	37,392	808
Experience adjustments on scheme assets	(1,157)	3,803	477	329	10,806

	Central Government				
	2014	2013	2012	2011	2010
	£'000s	£'000s	£'000s	£'000s	£'000s
Present value of scheme Liabilities	(2,318,000)	(2,291,000)	(1,948,000)	(1,807,000)	(1,980,000)
Fair value of scheme assets	-	-	-	-	-
Net scheme deficit	**(2,318,000)**	**(2,291,000)**	**(1,948,000)**	**(1,807,000)**	**(1,980,000)**
Experience adjustments on scheme liabilities	(175,000)	61,000	56,000	37,000	-
Experience adjustments on scheme assets	-	-	-	-	-

Further information in respect of the experience gain for 2013-14 is included at Note 7.20.9.

7.21 Contingent Liabilities

Specific guarantees or potential liabilities at 31 March 2014 totalled £219.9 million (2013 : £210.5 million), as set out below:

	Group		Central Government	
	2013-14	2012-13	2013-14	2012-13
	£'000s	£'000s	£'000s	£'000s
Local Authority Borrowing	**207,987**	**197,511**	207,987	197,511
Medical Indemnity Fund	**8,792**	**10,130**	8,792	10,130
Insurance Fund	**2,474**	**2,432**	2,474	2,432
Economic Development Fund	**410**	**310**	410	310
Student Loans	**284**	**134**	284	134
Total	**219,947**	**210,517**	**219,947**	**210,517**

i. This statement records Government's identified potential liabilities and specific guarantees, and references the sums available to meet those potential claims.

ii. Local Authority Borrowing relates to Letters of Comfort issued by Treasury to Bankers in relation to authorised Local Authority borrowing to a value of £256.2 million at 31 March 2014 (2013 : £240.3 million).

iii. The Medical Indemnity Fund and Insurance Fund amounts relate to notified insurance claims. The amounts represent the maximum anticipated liability for these incidents, although it is still to be determined if Government has a liability in each case. The amount payable will depend on the final agreement of the liability for each claim with the claimant and the claims will be paid, if required, following this agreement.

iv. The Economic Development Fund amounts relate to guarantees issued from the Economic Development Fund.

v. The Department of Education and Children and the Treasury have signed an agreement with the Isle of Man Bank Limited to indemnify the bank for losses in respect of graduate loans issued by the bank. The maximum amount guaranteed under this facility is £10.0 million (2013 : £10.0 million).

7.22 Post Balance Sheet Events

The following Post Balance Sheet Events have been considered when preparing these Accounts. The events are not considered to require any adjustment to be made to the Accounts.

7.22.1 Government Restructuring

In January 2014 a restructuring of Government Departments was approved by Tynwald. Key changes announced were the creation of a Cabinet Office (principally comprising of the Chief Secretary's Office and Office of Human Resources from Executive Government, together with the Information Systems Division of the Department of Economic Development), the merging of the Department of Health and Department of Social Care (with Social Security transferring to the Treasury) and the dissolution of the Department of Community, Culture and Leisure. Furthermore, a further shared service initiative was announced by Government to centralise additional common functions across Government.

In addition, the Isle of Man Water and Sewerage Authority and Manx Electricity Authority have been combined into a single authority, the Manx Utilities Authority.

These changes all take effect from 1 April 2014 and therefore fall outside the scope of these accounts, which have been prepared up until 31 March 2014.

7.22.2 Loan Made to the Sefton Group plc

During 2012 and 2013 the Department of Economic Development advanced two loans to the Sefton Group plc under the Enterprise Act 2008 ("EA2008"). The balances on these two loans were included within debtor balances. In June 2014 a legal opinion was received by the Government's Acting Attorney General in connection with these loans. The legal opinion concluded that the Sefton Group plc was not an eligible business in respect of EA2008 and therefore it was more likely than not that the loans were ultra vires.

In July 2014 agreement was reached with the Sefton Group plc and the outstanding loan balance due to the Department of Economic Development was replaced by a new loan made by the Treasury under the Financial Provisions and Currency Act 2011. No adjustment has been made within these Accounts in respect of this matter, which is now considered to be on an appropriate legal basis.

7.23 Related Party Transactions

The Government is required to disclose material transactions with related parties, that is bodies or individuals, that have the potential to control or influence Government Departments, Boards and Offices, or to be controlled or influenced by the same.

Disclosure of these transactions allows the readers to assess the extent to which the Government might have been constrained in its ability to operate independently or might have secured the ability to limit another party's ability to bargain freely with the Government. Due to the nature of Isle of Man Government's business, the main related parties considered are Members of Tynwald Court and senior management of Government.

No material transactions or balances were identified for the financial year (2012-13 : none).

The Government has interests in companies and the relevant disclosures can be found in Note 7.10.

Details of the remuneration paid to Members of Tynwald Court is published by the Clerk of Tynwald's Office and can be accessed via the Tynwald website at http://www.tynwald.org.im/memoff/remall/Pages/default.aspx. In addition, Members of Tynwald are required to register certain interests in the Register of Members' Interests, a copy of which can be inspected at the Tynwald Library.

7.24 Reconciliation of Net Cash Flow from Operating Activities

	Group		Central Government	
	2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
Surplus Before Interest	**(7,344)**	**(66,108)**	(18,164)	(80,765)
Net transfer to earmarked reserves	**(45,666)**	**(42,652)**	(50,516)	(45,979)
Operating (Deficit)	**(53,010)**	**(108,760)**	**(68,680)**	**(126,744)**
Depreciation and amortisation charges	**127,063**	**127,147**	104,719	106,199
Deferred income release	**(470)**	**(461)**	-	-
Net transfer to/from external reserves	**(88,295)**	**(86,691)**	(83,487)	(83,364)
(Gain)/loss on sale of fixed assets	**(3,758)**	**(3,401)**	(3,690)	(2,536)
(Gain)/loss on sale of investments	**(904)**	**689**	-	-
Defined benefit scheme - current service cost in excess of contributions	**(6,336)**	**7,425**	(7,000)	7,000
Movements in working capital:				
- Decrease/(increase) in stocks	**25**	**383**	171	(350)
- (Increase)/decrease in debtors	**(69,461)**	**1,643**	(73,927)	2,525
- (Decrease)/increase in creditors	**(50,457)**	**25,676**	(50,910)	27,438
Net cash (outflow) from operating activities	**(145,603)**	**(36,350)**	**(182,804)**	**(69,832)**

7.25 Reconciliation of Movement in Cash and Net Cash

7.25.1 Reconciliation of Net Cash Flow to Movement in Cash

	Group		Central Government	
	2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
(Decrease)/increase in cash in the period	**(103,445)**	**(52,202)**	(100,601)	(57,116)
Repayment of bank loans	**39,550**	**3,165**	-	-
Loans advanced	**(670)**	**(3,731)**	-	-
Repayment of finance lease debt	**4,635**	**4,348**	1,349	1,270
Movement in net cash in the period	**(59,930)**	**(48,420)**	**(99,252)**	**(55,846)**
Unrealised gain/(loss) on currency revaluation	**1,013**	**(676)**	-	-
	(58,917)	**(49,096)**	**(99,252)**	**(55,846)**
Opening net cash	**232,861**	**281,957**	238,487	294,333
Closing net cash	**173,944**	**232,861**	**139,235**	**238,487**

7.25.2 Analysis of Net Cash

	Group		Central Government	
	2013-14 £000's	2012-13 £000's	2013-14 £000's	2012-13 £000's
Short term deposits	**230,488**	**367,651**	198,034	339,263
Cash at bank and in hand	**289,420**	**250,729**	243,231	201,252
Total cash	**519,908**	**618,380**	**441,265**	**540,515**
Bank overdraft	**(8,394)**	**(42,158)**	(8,297)	(6,946)
Loans payable	**(263,035)**	**(263,165)**	(260,000)	(260,000)
Finance debt	**(74,535)**	**(80,196)**	(33,733)	(35,082)
Net cash	**173,944**	**232,861**	**139,235**	**238,487**

7.26 Analysis of Change in Net Cash

7.26.1 Group Accounts

	Group		
	At 1 April 2013 £000's	Cash flow £000's	At 31 March 2014 £000's
Short term deposits	367,651	(137,163)	**230,488**
Cash at bank and in hand	250,729	38,691	**289,420**
Total cash	**618,380**	**(98,472)**	**519,908**
Bank overdraft	(42,158)	33,764	**(8,394)**
Loans payable	(263,165)	130	**(263,035)**
Finance debt	(80,196)	5,661	**(74,535)**
Net cash	**232,861**	**(58,917)**	**173,944**

7.26.2 Central Government

	Central Government		
	At 1 April 2013 £000's	Cash flow £000's	At 31 March 2014 £000's
Short term deposits	339,263	(141,229)	**198,034**
Cash at bank and in hand	201,252	41,979	**243,231**
Total cash	**540,515**	**(99,250)**	**441,265**
Bank overdraft	(6,946)	(1,351)	**(8,297)**
Loans payable	(260,000)	-	**(260,000)**
Finance debt	(35,082)	1,349	**(33,733)**
Net cash	**238,487**	**(99,252)**	**139,235**

7.27 Analysis of Change in Liquid Resources

	Group and Central Government			
	At 1 April 2013 £000's	Cash flow £000's	Non-Cash Change £000's	At 31 March 2014 £000's
Long Term Investments	1,241,964	(72,965)	(12,892)	**1,156,107**

7.28 Comparative Amounts

No changes to comparative amounts (transactions for the year 2012-13 and balances as at 31 March 2013) have been applied to these accounts to match the disclosure and accounting treatment in the current year.

8 Analysis of Expenditure of Department and Other Bodies

8.1 Overview

Detailed information in respect of Central Government income and expenditure is reported in the Detailed Government Accounts (GD 0036/14). The Detailed Government Accounts are prepared on the same basis as the Government Budget for the year, which is intended to present income and expenditure figures which are consistent year on year and represent an accurate presentation of the costs of the major services provided by Government through funds voted by Tynwald. As the annual audited Accounts are required to be prepared in accordance with the Audit Act 2006, which requires United Kingdom Accounting Standards to be applied, differences between income and expenditure figures reported in the Detailed Government Accounts and the annual audited Accounts arise.

The approved budget comprises amounts authorised by Tynwald at the time the original budget was presented for approval together with any subsequent approvals authorised by Tynwald or Treasury up to the date when the Detailed Government Accounts were prepared. Any subsequent approvals or transfers (virements) are not included.

8.2 Reconciliation of Department Expenditure

The following table shows net expenditure by Department for 2013-14 as reported in the Detailed Government Accounts and the adjustments applied to re-state the net expenditure figures to the required United Kingdom Accounting Standards basis. Fixed assets adjustments relate to the capitalisation of expenditure, application of depreciation and elimination of loan charges. Pension adjustments apply the current service cost for the year apportioned to Departments based on actual salary costs and eliminate the cost of pensions paid. Other adjustments include the reversal of lease costs paid by the Department of Infrastructure in respect of the Energy from Waste plant (the financing cost is included within Interest Payable and Similar Charges), the movement on House Purchase Assistance Schemes' balances for the Department of Social Care and the movement on the value of the strategic oil reserve (which is excluded from the Detailed Government Accounts).

	2013-14				
	As Reported £'000s	Fixed Assets Adjustments £'000s	Pension Adjustments £'000s	Other £'000s	As Adjusted £'000s
Expenditure – Voted Services					
Community, Culture & Leisure	**15,689**	3,379	2,986	-	**22,054**
Economic Development	**10,747**	662	2,127	-	**13,536**
Education & Children	**94,235**	17,456	13,535	-	**125,226**
Environment, Food & Agriculture	**14,303**	2,414	1,413	-	**18,130**
Health	**139,725**	8,621	19,641	-	**167,987**
Home Affairs	**29,823**	1,036	7,705	-	**38,564**
Infrastructure	**36,059**	50,479	6,654	(3,404)	**89,788**
Social Care	**125,477**	7,548	6,211	(224)	**139,012**
Treasury (Gross Expenditure)	**28,765**	(5,773)	2,985	277	**26,254**
	494,823	**85,822**	**63,257**	**(3,351)**	**640,551**
Other bodies					
Executive Government	**37,147**	-	(73,340)	-	**(36,193)**
Manx National Heritage	**3,717**	(58)	683	-	**4,342**
Road Transport Licensing Committee	**76**	-	18	-	**94**
Statutory Board (Revenue Funded)	**(1,889)**	-	1,485	-	**(404)**
	39,051	**(58)**	**(71,154)**	**-**	**(32,161)**
Expenses of the Legislature	**4,358**	(340)	898	-	**4,916**
Total Voted Expenditure	**538,232**	**85,424**	**(6,999)**	**(3,351)**	**613,306**

The following table shows net expenditure by Department for 2012-13 as reported in the Detailed Government Accounts and the adjustments applied to re-state the net expenditure figures to the required United Kingdom Accounting Standards basis. Similar adjustments have been applied as in the preceding table (for 2013-14).

	2012-13				
	As Reported £'000s	**Fixed Assets Adjustments £'000s**	**Pension Adjustments £'000s**	**Other £'000s**	**As Adjusted £'000s**
Expenditure – Voted Services					
Community, Culture & Leisure	**17,441**	10,663	2,702	-	**30,806**
Economic Development	**13,528**	(248)	1,824	-	**15,104**
Education & Children	**95,793**	20,455	11,082	-	**127,330**
Environment, Food & Agriculture	**14,971**	2,478	1,196	-	**18,645**
Health	**124,845**	(8,330)	14,165	-	**130,680**
Home Affairs	**30,864**	2,013	6,701	-	**39,578**
Infrastructure	**33,038**	61,844	5,090	(3,404)	**96,568**
Social Care	**139,683**	18,512	7,343	(2,345)	**163,193**
Treasury (Gross Expenditure)	**17,992**	(436)	2,475	103	**20,134**
	488,155	**106,951**	**52,578**	**(5,646)**	**642,038**
Other bodies					
Executive Government	**36,957**	3	(48,095)	-	**(11,135)**
Manx National Heritage	**3,694**	(41)	594	-	**4,247**
Road Transport Licensing Committee	**63**	-	13	-	**76**
Statutory Board (Revenue Funded)	**880**	39	1,113	-	**2,032**
	41,594	**1**	**(46,375)**	**-**	**(4,780)**
Expenses of the Legislature	**4,570**	(285)	797	-	**5,082**
Total Voted Expenditure	**534,319**	**106,667**	**7,000**	**(5,646)**	**642,340**

8.3 Department Net Expenditure and Approved Budget

BUDGET 2013-14 Net Expenditure £'000s		ACTUAL 2013-14 Gross Expenditure £'000s	Gross Income £'000s	Net Expenditure £'000s	ACTUAL 2012-13 Net Expenditure £'000s
	DEPARTMENT OF COMMUNITY, CULTURE & LEISURE				
	Public Transport Directorate				
8,031	Operations	7,706	-	**7,706**	8,092
3,578	Engineering	3,873	-	**3,873**	3,608
(4,967)	Income	-	4,399	**(4,399)**	(4,469)
1,976	Administration & Commercial	2,036	-	**2,036**	2,428
8,618	**sub-total**	13,615	4,399	**9,216**	9,659
900	**Corporate Services**	716	-	**716**	857
900	**sub-total**	716	-	**716**	857
	Culture and Leisure Directorate				
1,735	Facility Support	1,698	-	**1,698**	1,832
329	Manx Welcome Centre	310	-	**310**	286
2,041	Sports And Recreation	1,889	-	**1,889**	2,442
2,072	Arts And Entertainment	1,860	-	**1,860**	2,365
6,177	**sub-total**	5,757	-	**5,757**	6,925
15,695	**Total**	**20,088**	**4,399**	**15,689**	**17,441**
	DEPARTMENT OF ECONOMIC DEVELOPMENT				
942	Chief Executive's Office	2,047	1,096	**951**	900
3,051	Training Employment Skills	3,436	321	**3,115**	3,083
2,650	Economic Development Group	2,484	96	**2,388**	2,610
3,500	Financial Assistance Scheme	3,000	(26)	**3,026**	2,810
(172)	Ship Registry	2,476	3,317	**(841)**	(498)
(736)	Aircraft Registry	2,423	4,659	**(2,236)**	(421)
8,326	Information Systems Division	8,394	-	**8,394**	9,444
5,537	Tourism	7,964	1,989	**5,975**	5,528
(10,310)	Companies Registry	560	10,585	**(10,025)**	(9,927)
12,788	**Total**	**32,784**	**22,037**	**10,747**	**13,528**
	DEPARTMENT OF EDUCATION & CHILDREN				
22,513	Primary Education	22,408	-	**22,408**	21,727
26,579	Secondary Education	26,734	-	**26,734**	26,229
9,285	Isle Of Man College	9,155	-	**9,155**	9,085
13,599	Universities etc. Awards	14,249	13	**14,236**	11,725
50	Works And Estates	50	-	**50**	4,456
708	Meals & Milk Service	1,861	1,379	**483**	637
1,088	Youth And Community Service	965	33	**932**	1,083
3,707	Educational Improvement Service	3,527	88	**3,439**	3,578
8,494	Services For Children	8,407	21	**8,386**	8,427
8,314	Central	8,637	226	**8,412**	8,846
94,337	**Total**	**95,994**	**1,760**	**94,235**	**95,793**

BUDGET 2013-14 Net Expenditure £'000s		ACTUAL 2013-14 Gross Expenditure £'000s	ACTUAL 2013-14 Gross Income £'000s	ACTUAL 2013-14 Net Expenditure £'000s	ACTUAL 2012-13 Net Expenditure £'000s
	DEPARTMENT OF ENVIRONMENT, FOOD & AGRICULTURE				
1,001	Corporate Services	1,160	175	**985**	963
8,582	Agriculture	8,776	305	**8,471**	8,927
892	Fisheries	1,061	186	**875**	1,084
1,905	Forestry, Amenity	3,019	874	**2,145**	2,023
1,267	Environmental	1,254	77	**1,177**	1,236
656	Government Laboratory	733	83	**650**	738
14,303	**Total**	**16,003**	**1,700**	**14,303**	**14,971**
	DEPARTMENT OF HEALTH				
-	**Core Services**				
304	Chief Executive's Office	245	(1)	**246**	226
3,738	Chief Operating Officer's Office	3,160	179	**2,981**	2,935
-	Estates Directorate	19	-	**19**	5,652
4,771	Finance Directorate	2,990	2	**2,988**	3,811
1,582	Public Health Directorate	1,269	1	**1,268**	1,218
10,395	**sub-total**	7,683	181	**7,502**	13,842
-	**Hospital & Specialist Services**				
81,187	Noble's Hospital Unit	88,701	2,910	**85,791**	80,761
4,033	Ramsey & District Community Hospital	4,093	31	**4,062**	3,926
14,265	UK Referrals And Patient Transport	15,641	-	**15,641**	14,292
15,463	Mental Health Services	15,652	3	**15,649**	-
114,948	**sub-total**	124,087	2,944	**121,143**	98,979
-	**Primary Health Care**				
7,904	Primary Health Community Services	8,081	170	**7,911**	7,558
2,960	Isle Of Man Ambulance Service	3,161	21	**3,140**	3,010
35,908	Primary Health Practitioner Services	35,924	1,291	**34,633**	34,405
347	Prison Health Service	395	-	**395**	372
1,633	Management And Administration	1,286	-	**1,286**	1,411
48,752	**sub-total**	48,847	1,482	**47,365**	46,766
-	**NHS Contributions**				
(36,285)	Social Security Administration Act 1992	1	36,286	**(36,285)**	(34,742)
137,810	**Total**	**180,618**	**40,893**	**139,725**	**124,845**
	DEPARTMENT OF HOME AFFAIRS				
1,066	Chief Executive's Office	1,225	119	**1,106**	1,058
220	Civil Defence	221	2	**219**	241
4,837	Fire & Rescue Service	4,974	40	**4,934**	4,927
8,451	Prison & Probation	8,466	90	**8,376**	8,513
1,461	Communications	1,945	486	**1,459**	1,849
13,949	Constabulary	14,035	306	**13,729**	14,276
29,983	**Total**	**30,866**	**1,043**	**29,823**	**30,864**

BUDGET 2013-14 Net Expenditure £'000s		ACTUAL 2013-14 Gross Expenditure £'000s	Gross Income £'000s	Net Expenditure £'000s	ACTUAL 2012-13 Net Expenditure £'000s
	DEPARTMENT OF INFRASTRUCTURE				
17,522	Operations	57,276	39,149	**18,127**	8,221
6,097	Airport	11,819	4,936	**6,883**	6,325
(409)	Harbours	4,929	5,497	**(568)**	(445)
1,002	Highways	14,384	13,502	**882**	1,739
8,640	Properties And Estates	12,096	3,462	**8,634**	4,902
674	Planning And Building Control	1,566	1,092	**474**	598
2,542	Corporate Services	1,664	73	**1,591**	2,683
-	Water & Sewerage Authority Grant	36	-	**36**	9,018
-	Inter Divisional Recharges	(15,760)	(15,760)	**-**	-
36,068	**Total**	**88,010**	**51,951**	**36,059**	**33,038**
	DEPARTMENT OF SOCIAL CARE				
2,642	**Core Services**	4,512	2,148	**2,364**	1,749
-	**Social Services Division**	-	-	**-**	-
19,169	Children Service Area	16,390	5	**16,385**	17,585
25,958	Adult Services Area	28,750	4,718	**24,032**	23,636
-	Mental Health Services	-	-	**-**	14,792
47,769	**sub-total**	49,652	6,871	**42,781**	57,762
	National Insurance Benefits				
(4,054)	National Insurance Operating Account	187,272	187,272	**-**	(2,871)
4,054	National Insurance Investment Account	-	-	**-**	2,871
79,720	**Non-Contributory Benefits**	78,461	-	**78,461**	77,090
79,720	**sub-total**	265,733	187,272	**78,461**	77,090
	Housing Division				
(1,002)	Housing Administration	3,400	5,422	**(2,022)**	(1,212)
6,257	Local Authorities Housing Deficiency	6,257	-	**6,257**	6,043
5,255	**sub-total**	9,657	5,422	**4,235**	4,831
132,744	**Total**	**325,042**	**199,565**	**125,477**	**139,683**
	TREASURY				
4,271	Corporate Strategy Division	4,410	-	**4,410**	5,043
2,116	Customs And Excise Division	2,023	-	**2,023**	2,081
508	Economic Affairs Division	491	-	**491**	461
4,211	Finance Division	4,196	-	**4,196**	4,297
4,543	Income Tax Division	4,431	-	**4,431**	4,416
526	Internal Audit Division	407	-	**407**	486
11,339	Treasury Grants	11,545	-	**11,545**	-
1,250	Lottery Distributions	1,262	-	**1,262**	1,205
28,764	**Total**	**28,765**	**-**	**28,765**	**17,989**

BUDGET 2013-14 Net Expenditure £'000s		ACTUAL 2013-14 Gross Expenditure £'000s	Gross Income £'000s	Net Expenditure £'000s	ACTUAL 2012-13 Net Expenditure £'000s
	OTHER BODIES				
	Executive Government				
5,575	Administration	6,455	1,215	**5,240**	5,323
6,716	Administration of Justice	11,785	5,130	**6,655**	7,465
22,850	Pensions	57,427	34,574	**22,853**	21,769
2,400	Miscellaneous Statutes & Charges	2,400	1	**2,399**	2,400
37,541	**Total**	78,067	40,920	**37,147**	36,957
3,838	**Manx Museum & National Trust**	4,545	828	**3,717**	3,694
3,838	**Total**	4,545	828	**3,717**	3,694
125	**Road Transport Licensing Committee**	124	48	**76**	63
125	**Total**	124	48	**76**	63
	Statutory Boards (Revenue Funded)				
(344)	Communications Commission	419	1,303	**(884)**	(526)
-	Financial Supervision Commission	3,464	3,464	**-**	1,860
(1,622)	Gambling Supervision Commission	648	2,041	**(1,393)**	(1,388)
-	Insurance And Pensions Authority	1,768	1,979	**(211)**	242
706	Office Of Fair Trading	657	58	**599**	692
-	Public Sector Pensions Authority	-	-	**-**	-
(1,260)	**Total**	6,956	8,845	**(1,889)**	880
542,736	**Government Total**	907,859	373,985	**533,874**	529,749
5,127	**Expenses Of The Legislature**	4,589	230	**4,358**	4,570
547,863	**Total Revenue Expenditure**	**912,448**	**374,215**	**538,232**	**534,319**

9 Consolidated Loans Fund

9.1 Overview

Detailed information in respect of Central Government capital income and expenditure is reported in the Detailed Government Accounts (GD 0036/14). The Consolidated Loans Fund provides funding to Departments and other bodies where expenditure will be incurred over a number of years. Its operation is governed by the Isle of Man Loans Act 1974 and it provides a mechanism for allocating funding and funding costs to Departments.

The funding for the Consolidated Loans Fund is currently provided by the Capital Fund (an internal fund) and Fixed Rate Bonds issued by Treasury on behalf of the Isle of Man Water and Sewerage Authority and the Manx Electricity Authority. Many of the transactions of the Consolidated Loans Fund are between the Treasury and other Government Departments and other bodies and are therefore eliminated on consolidation. The following section summarises information provided within the Detailed Government Accounts and is prior to consolidation adjustments.

9.2 Consolidated Loans Fund Balance Sheet

	Central Government	
	2013-14 £'000s	**2012-13 £'000s**
Assets		
Advances to Borrowing Accounts:-		
Fixed Assets - Central Government	1,246,923	1,189,715
Loans to Statutory Boards	491,506	491,506
Long Term Loans	4,947	5,467
Cash at Bank	50,623	52,155
Total	**1,793,999**	**1,738,843**
Liabilities		
Loans Outstanding:-		
Bond Issues	260,000	260,000
Capital Fund	858,986	823,962
Capital Discharged	675,013	654,881
Total	**1,793,999**	**1,738,843**

Notes:

i. Fixed Assets represent gross expenditure on assets purchased from Capital Financing. Long Term Loans are shown net of repayments.

ii. Capital expenditure in 2013-14 totalled £91.2 million, including £35.0 million advanced to the Manx Electricity Authority to repay an external loan (2012-13 : £57.2 million, no similar advance).

iii. The Bond issues referred to above were made by the Treasury on behalf of the Manx Electricity Authority (£185 million, 2013 : £185 million) and the Isle of Man Water and Sewerage Authority (£75 million, 2013 : £75 million). These amounts relate to amounts raised by Treasury through a Bond Issue on behalf of these two Statutory Boards, the proceeds of which were then loaned to the Statutory Boards through the Consolidated Loans Fund.

iv. Apart from the earmarked Bond issues, all of Government Departments' current capital financing requirements is met from internal resources, and all other external debt has been repaid. The sources of funding for Government's on-going capital programme were the interest on the Capital Fund, Departmental principal repayments, Capital Receipts and contributions from the Housing Reserve Fund and the Land and Property Acquisition Reserve.

v. Net interest of £0.0 million (2012-13 : £0.4 million) was paid to the Capital Fund during the year, at a rate of 0.00% (2012-13 : 0.04%).

vi. Capital Discharged represents the accumulated payments that have been made out of revenue to pay for capital expenditure, as follows:

	Central Government	
	2013-14	2012-13
	£'000s	£'000s
Advances to Borrowing Accounts:-		
Fixed Assets	1,738,429	1,681,221
Long Term Loans	4,947	5,467
Capital Discharged	(675,013)	(654,881)
Net Advances Outstanding	**1,068,363**	**1,031,807**

9.3 Consolidated Loans Fund Interest Transactions

	Central Government	
	2013-14	2012-13
Income	£'000s	£'000s
Investment Interest	24	366
Bond Interest recharged to IOMWSA	4,219	4,219
Bond Interest recharged to MEA	9,944	9,944
Total income	**14,187**	**14,529**
Expenditure		
Interest on Bond Issues	14,163	14,163
Interest on Capital Fund	24	366
Total expenditure	**14,187**	**14,529**
Net income/expenditure	-	-

Notes:

i. The balance on the Interest Transactions Accounts represents net interest charged to Borrowing Accounts in the year ended 31 March 2014 at an average rate of 0.00% (2012-13 : 0.00%).

ii. Interest on the MEA Bond Issue (£9.9 million, 2012-13 : £9.9 million) was charged in full to the MEA during the year (2012-13 : £9.9 million charged to MEA).

iii. The Bond Issues referred to above were made by the Treasury on behalf of the Manx Electricity Authority and the Isle of Man Water and Sewerage Authority.

9.4 Summary of Capital Advances

DEPARTMENT	Advances Outstanding at 1st April 2013 £'000s	Advances		Repayments			Advances Outstanding at 31st March 2014 £'000s
		Year 2013-14 £'000s	Total to 31st March 2014 £'000s	Advances Repaid 2013-14 £'000s	Capital Receipts etc 2013-14 £'000s	Total Repaid to 31st March 2014 £'000s	
Community, Culture and Leisure	55,645	5,464	100,794	2,647	5	42,337	58,457
Economic Development	2,618	219	31,972	561	200	29,896	2,076
Education and Children	97,431	5,013	171,408	3,920	-	72,884	98,524
Environment, Food and Agriculture	11,419	1,911	32,651	501	677	20,499	12,152
Health	123,224	2,136	211,630	5,322	930	92,522	119,108
Home Affairs	47,783	2,064	77,244	1,432	261	29,090	48,154
Infrastructure	140,349	23,472	357,026	6,977	9,975	210,157	146,869
Social Care	31,068	6,624	187,124	894	6,133	156,459	30,665
Treasury	12,864	1	138,185	774	-	126,094	12,091
Executive Government	-	-	402	-	-	402	-
Manx National Heritage	11,117	557	23,738	739	-	12,803	10,935
Expenses of the Legislature	6,783	-	10,257	341	-	3,815	6,442
Borrowing Authorities							
Isle of Man Post Office	-	-	900	-	-	900	-
Isle of Man Water & Sewerage Auth'ty	165,572	5,081	218,295	2,648	5,173	55,463	162,832
Manx Electricity Authority	325,934	38,635	409,739	4,511	-	49,681	360,058
TOTAL	**1,031,807**	**91,177**	**1,971,365**	**31,267**	**23,354**	**903,002**	**1,068,363**

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Mi istry
of Defence

Ministry of Defence

Annual Report and Accounts

2014-2015

Ministry of Defence
Annual Report and Accounts
2014-15

For the year ended 31 March 2015

Accounts presented to the
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Government Resources and Accounts Act 2000

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Annual Report and Accounts presented to
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This publication is available at www.gov.uk/government/publications

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Contents

Preface

The Defence Vision:

Our vision is to deliver versatile, agile and battle-winning Armed Forces, working effectively with each other, directed and supported by a professional Ministry of Defence, with people ready to lead, accept responsibility and spend wisely, protecting our security in a changing world.

Defence Priorities

Our priorities for 2014-15 reflect the Defence Vision. They were:

- to succeed in Afghanistan;
- to continue to fulfil our standing commitments;
- to succeed in other operations we are required to undertake;
- to transform Defence by:
  - restructuring the Armed Forces and their capabilities;
  - implementing the new Defence Operating Model;
  - delivering Defence in the most effective, efficient and sustainable way.

Defence Responsibilities

- defending the UK and its overseas territories
- providing strategic intelligence
- providing nuclear deterrence
- supporting civil emergency organisations in times of crisis
- defending our interests by projecting power strategically and through expeditionary interventions
- providing a defence contribution to UK influence
- providing security for stabilisation

This report is structured in line with the above responsibilities and priorities.

Strategic Report:

Chapter 1 Operations and Other Major Responsibilities – details our work on operations in Afghanistan, and on wider operational commitments. It explains how we fulfil our Standing Commitments, including strategic intelligence, nuclear deterrent, defence against direct threats to the UK and its overseas territories, counter-terrorism, and military aid to the civil authorities. It captures our work in providing the defence contribution to the UK's influence throughout the world by succeeding in other operations we are required to undertake at home and overseas, by providing a contribution to UK exports through our work with the Department of Business, Innovation and Skills (BIS), by defending UK interests through projecting power strategically and through expeditionary operations, by providing security for stabilisation, and providing a defence contribution in support of other government departments.

Chapter 2 Transforming and Delivering Defence – details our work in restructuring the Armed Forces including implementing the Armed Forces Covenant, progression of the new employment model for Armed Forces personnel, transforming the role of Reserves and further progress towards the Future Force 2020 structure. It captures our progress in implementing the Defence Operating Model and in delivering Defence in the most effective, efficient, and sustainable way by meeting benchmarking, efficiency, and Government sustainability development targets.

Accountability:

Chapter 3 Directors' Report – includes the Departmental Accounting Boundary, Directorships, and Significant Interests.

Chapter 4 Remuneration Report – includes Remuneration Policy; Performance and Reward; Senior Managers' Contracts and Management; Ministerial and Defence Board Salaries, Taxable Benefits and Pension Benefits; and Armed Forces and Civil Service Pensions.

Chapter 5 Governance Statement – includes Statement of Accounting Officers Responsibilities and Departmental Governance Statement.

Annual Accounts:

Chapter 6 Certificate of the Comptroller and Auditor General – includes Scope and Audit Opinion.

Chapter 7 Report of the Comptroller and Auditor General – a detailed report on Audit findings.

Chapter 8 Financial Statements – financial tables summarising income and expenditure and asset movement.

Chapter 9 Notes to the Accounts – supports the financial statements and provides detail on financial risk, investments, and Departmental Group break-down including losses and special payments.

Supplementary Information:

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Annex B Accountability to Parliament

Annex C Trading Funds Performance

Annex D Fraud

Annex E Sustainability

Annex F Statement of Approved Maximum Armed Forces Numbers

Foreword by Secretary of State for Defence

The Ministry of Defence exists to keep the United Kingdom safe and protect our national interests overseas. As the Secretary of State for Defence, my top priority is ensuring the success of our Armed Forces on operations and our readiness to respond in an increasingly dangerous world.

The actions of ISIL pose a direct threat to the safety of the British people and it is in our national interest that the UK is playing a full part in the global coalition to dismantle and destroy this terrorist organisation using all the resources at our disposal. The House of Commons last year gave its overwhelming backing to our Armed Forces helping the Government of Iraq to protect civilians and restore its territorial integrity, including the use of UK air strikes against ISIL in Iraq. This strong support for specific and specialist UK military help to the Iraqi Government, as part of a wider international strategy, marked a clear contrast with the decision taken in 2013 in relation to Syria. That widespread backing underpins the excellent work of our Armed Forces in helping Iraqis in the fight against ISIL.

Beyond Iraq, Britain has been able to play an active role across the world because we have a £34 billion a year defence budget. That means we can respond quickly and at scale to events: sending our flagship, HMS Bulwark, to the Mediterranean, where it has rescued more than two thousand people in operations off Italy; having RAF Typhoon aircraft patrol over the Baltic against Russian provocation; and providing disaster relief to Nepal, using RAF aircraft to transport humanitarian aid and deploying British Army Gurkhas in direct support roles on the ground.

At the end of 2014, the UK's involvement in combat operations in Afghanistan came to an end. I pay tribute to the 453 UK Service personnel who lost their lives and to those who have suffered serious injury throughout this campaign. The sacrifice of our servicemen and women has helped to prevent terrorist attacks in the UK and has brought greater stability to Afghanistan. The UK is continuing to support the people of Afghanistan through institutional development, including helping train the leaders of tomorrow via our role in the Afghan National Army Academy.

In meeting the needs of Future Force 2020, we are continuing to invest in the best equipment for our forces; the equipment plan will continue to grow by 1% above inflation every year. HMS Queen Elizabeth, the first of our two new aircraft carriers, was launched last summer and last autumn we placed the biggest contract for the Army in 30 years for 589 Scout armoured vehicles, which will provide a step-change in capability for the Army. In December, Typhoon tranche 3 was released into service; and over the next 10 years we plan to invest £11.1Bn in our helicopter fleet.

Our people are at the heart of all that we do, so I am pleased that all 407 local Authorities have now signed a Community Covenant as part of the Armed Forces Covenant; and that the Armed Forces Help-to-Buy scheme has so far helped over 4500 Service Personnel to join or stay on the property ladder, under the New Employment Model.

The MOD has continued to drive through the structural and organisational changes recommended by Lord Levene in his Defence Reform report and I am pleased that his most recent review of our progress highlighted just how much has changed for the better. Moving forward we will embed the reforms already made, build on our progress so far, and view efficiency as a continuous process, as part of getting best value for money for Defence.

All this forms the background to the Strategic Defence and Security Review that is now in progress and which will put Defence in the best position to tackle the challenges of the next few years.

Michael Fallon

Introduction from the Chief of Defence Staff and Permanent Secretary

Our priorities during 2014-15 have continued to be: to succeed in Afghanistan and in other operations; to meet our standing commitments; and to transform how we deliver Defence. As well as the successful transition in Afghanistan, this year our Armed Forces have also contributed to the UK response to a number of world events. And we have continued to drive towards our Future Force 2020 and implement the long-term transformational changes needed to the MOD itself.

Our operational focus has been on contributing to the international coalition to combat the threat from ISIL. We are making a critical contribution to the coalition with our advanced Intelligence, Surveillance, Target Acquisition, and Reconnaissance (ISTAR) capabilities; and since September 2014 the UK has been conducting air strikes on ISIL targets in Iraq using Tornado GR4 aircraft based in Cyprus. We have also responded to Russia's illegal aggression in Eastern Ukraine by deploying military training teams to develop the resilience of Ukraine's Armed Forces and help reduce casualties, as well as gifting a number of items of non-lethal equipment. In response to NATO's assurance measures, the UK deployed four Typhoons to augment the Baltic Air Policing Mission and will do so again in 2015.

Over the past year, the MOD and the Armed Forces have also responded to a diverse range of global issues: providing vital medical support to the Ebola crisis in West Africa; providing disaster relief in the aftermath of the Nepal earthquake; and assisting in the search for the missing MH370 aircraft in the Indian Ocean.

In October 2014, UK combat operations in Afghanistan came to an end. Our role is now focused on providing mentorship and training through the development of the Afghan National Army Officers Academy. We thank all the servicemen and women who served there during the eight years of operations and pay tribute to those who lost their lives or were seriously injured.

There have been important changes this year to the way we deliver key parts of Defence. The improvements we have made to our financial management resulted in a significant increase in our delegations from HM Treasury and this in turn has allowed us to increase the delegations to the four Commands in support of their greater role in capability management. On 1 April 2014, the Defence Equipment and Support organisation became an arms-length body of the MOD, in its new role as a Bespoke Trading Entity. And in September, we strengthened the executive management team of the Defence Infrastructure Organisation with the arrival of Capita as our private sector business partner. The UK hosted the NATO Summit in Wales, which occurred at an important time given the geo-strategic security situation in Europe. NATO leaders agreed a package of decisions that will see NATO adapt to ensure it can continue to play an important role in European Security in the coming years.

In December 2014, Lord Levene conducted his third review of our progress in implementing his 2011 Defence Reform report and we are pleased that he has praised 'a sea change in attitudes' in the Department. We are also pleased that the MOD has been able to publish its Annual Report and Accounts promptly this year and that last year's much improved audit opinion has been sustained.

Looking forward, we are now involved in the Strategic Defence and Security Review, which provides the five-yearly opportunity to reflect on Defence's contribution to our national security and will shape the MOD objectives and plans for the coming years.

We remain immensely proud of the men and women of the Armed Forces and Civil Service for their contributions to protecting the security and interests of the UK at home and abroad.

Indicators

The indicators below reflect two changes. Many of the indicators that the MOD has reported against since 2010 were closely linked to combat operations in Afghanistan. Following changes under the delegated operating model, some previously reported indicators can no longer be calculated. The Department is currently reviewing past and potential future indicators with the aim of moving to a new performance framework once the SDSR has concluded.

Indicators	FY 2014-15	FY 2013-14	Comment
Average percentage by which the cost of the Department's Equipment Programme (EP) varies compared to forecasts in year	-0.28%	-0.22%	*This figure is the average percentage by which the forecast costs of the Department's largest equipment procurement projects have varied over the year. This year the figure is negative, meaning that the forceast cost of these projects has fallen on average by 0.28%.*
Direct personnel costs, per Service person	£52,106	£52,553	*This shows the average costs of each of the Armed Forces personnel who have been employed on a full time basis over the financial year.*
Number of Service and MOD civilian personnel deployed on operations under the Command of Chief of Joint Operations (CJO)	4,311	8,529	*This is the total number of personnel deployed on CJO operations as at 31 March 2015. The significant reduction reflects the end of combat operations in Afghanistan.*
Percentage of Service Personnel that are medically deployable	89.80%	90.50%	*This is the total percentage of UK Armed Forces personnel (full time trained and serving against requirement) who have a Medical Deployability Status grading as Medically Fully Deployable or Medically Limited Deployable as at 1 April 2015.*
Percentage of Service Personnel (split by Officers and Other Ranks (OR)) who are satified with Service life in general	59% / 46%	58% / 48%	*Taken from the Armed Forces Continuous Attitude Survey. The drop in OR satisfaction is likely to be the continued effect of pay restraint and redundancy implementation.*
Overall public favourability of the UK Armed Forces	91%	85%	*The 2014-15 figure is taken as at 31 January 2015.*

The main body of the Annual Report and Accounts includes statistical information on the following themes:

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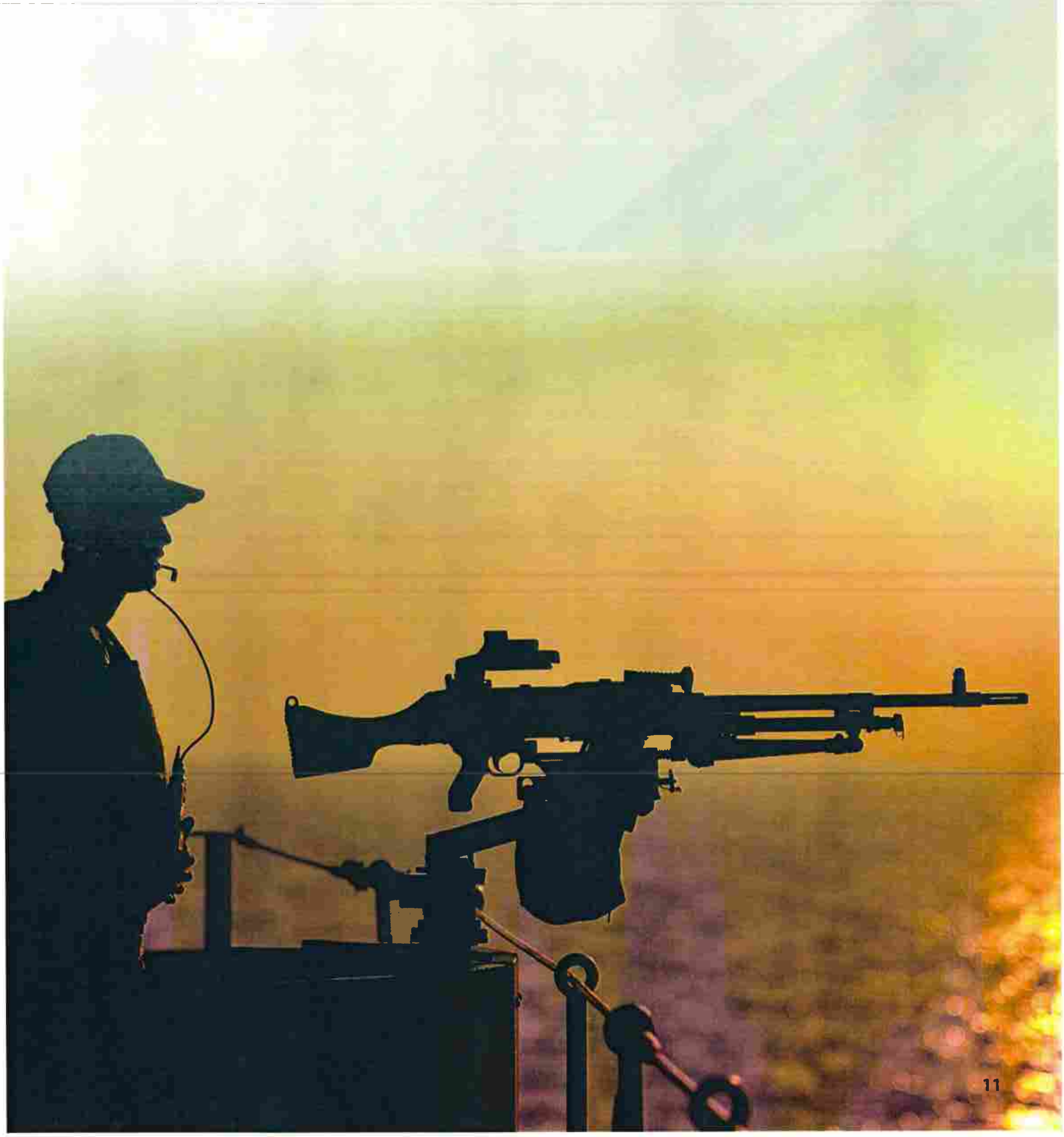
Chapter 1: Operations and Other Major Responsibilities

1.1 Operations



Afghanistan / Pakistan

Afghanistan overview

1.1.1 UK combat forces left Helmand Province on 27 October 2014. The Afghan National Defence and Security Forces (ANDSF) now lead in providing security across the country. As the ANDSF have grown in capability, the role of UK troops in Afghanistan has evolved from leading combat operations to training, advising, and assisting their Afghan counterparts as part of the NATO Resolute Support Mission. Together, we have helped reduce the threat of terrorism from the region and establish the foundations of a country that can govern its own lands and secure its own future.

1.1.2 The UK has played a substantial role in the progress made so far. When operations began in 2001, the Afghan security forces did not exist. Today they are leading operations, protecting the population and taking on the Taliban. Democracy has begun to take root with ordinary Afghans able to cast their vote for the country's next President. According to a recent international survey, the majority of Afghans believe their country is heading in the right direction, with good security cited as one of the main reasons[1].

UK contributions

1.1.3 The progress made by the ANDSF has enabled us to reduce our military footprint in Afghanistan from 5,200 at the start of 2014 down to around 470 at the start of 2015, when all British combat troops had departed Afghanistan. As the nature of the mission has changed from combat operations to an advisory role, and the Afghans have taken the lead responsibility for security across the country, we have been able to close all British bases in Central Helmand, of which we had 137 at the height of our engagement. Camp Bastion, our final base in Helmand, was closed on 27 October 2014.

1.1.4 The redeployment of our equipment presented a massive challenge both in terms of scale and complexity. Camp Bastion alone covered an area approximately the size of Reading. In total, 3,465 vehicles and pieces of major equipment were redeployed in good order from Afghanistan as well as the equivalent of 4,728 twenty-foot shipping containers of materiel. This achievement is testament to the diligence of all involved in the process of drawing down our presence in Afghanistan.

1.1.5 The UK is now contributing to the NATO-led Resolute Support Mission, which commenced on 1 January 2015 and is training and advising the ANDSF as they shoulder the responsibility for the security of their nation. The Mission does not involve international troops being deployed in a combat role. The UK's main role is one of institutional development, specifically continuing to take the lead in mentoring at the Afghan National Army Officer (ANA) Academy, as well as mentoring key positions in the Afghan Security Ministries.

1.1.6 In September 2014, the Officer Academy held its first graduation. The first 249 officers graduated and are now leading ANA troops in the field, a landmark moment for the Afghans. There are currently around 820 male officer cadets in training. The Academy is also training 41 female officer cadets alongside the males. The first 14 females graduated on 16 June 2015. Together, they will form the next generation of military leaders. This will be the UK's enduring legacy to the ANA.

1.1.7 <u>Casualties</u>: Five UK Service Personnel were killed in Afghanistan between April 2014 and March 2015. This occurred in a single helicopter crash on 26 April near Kandahar. The total number of deaths from the start of operations in October 2001 stands at 453.

ANDSF progress

1.1.8 The ANDSF now lead on all security operations, and carry out over 90% of their training independently of NATO. They demonstrated their capability to conduct large-scale and complex security operations by preventing disruption during both rounds of the 2014 Presidential elections. Their operational successes have improved their confidence and capability and enabled them to secure the key populated areas of Afghanistan.

1.1.9 The ANDSF have nearly achieved their surge strength target size of 352,000 Army, Air Force, and Police personnel. At the end of 2014, the Afghan National Army successfully developed sufficient medical capabilities to take over the responsibility for all its casualties, including those with life-threatening injuries. Challenges remain though, particularly at the institutional level, including budgeting, logistics, acquisition & Human Resources management. The UK and NATO is supporting capacity building of the security ministries under Resolute Support Mission (RSM) to address these challenges.

1 2014 Asia Foundation Survey, November 2014.

Wider development in Afghanistan

1.1.10 President Ashraf Ghani Ahmadzai, was inaugurated on 29 September 2014. This was only made possible through the millions of Afghans who turned out to vote, and the security provided by the Afghan Security Forces that gave them the confidence to do so. The UK remains committed to working with President Ghani, his Chief Executive Officer, Dr Abdullah and the National Unity Government to help improve the lives of all Afghans. The first act of the new Government was to sign security agreements with the US and international community which enabled the follow-on NATO Resolute Support Mission to commence.

1.1.11 In addition to the security gains, Afghan life expectancy has risen dramatically and over 6 million children are now in school, compared to just 2 million a decade ago under the Taliban. Around a third of the children in school today are girls, where previously they were denied this basic right. 60% of the local population can access a public health facility within walking distance of their home, compared to 9% in 2002. There has been a 20% rise in household incomes since 2010, and tax revenues have increased eightfold since 2004.

1.1.12 The insurgency is still capable of launching high profile and mass casualty attacks. Ultimately, a political settlement between the Afghan Government and the Taliban offers the best prospect of a sustainable peace in Afghanistan and the UK will continue to support the efforts of the Afghan Government to achieve this important objective.

Soldiers of 5 RIFLES on patrol in Afghanistan

Pakistan

1.1.13 President Ghani has made concerted efforts to improve relations with Pakistan, which will be a critical partner for Afghanistan in improving security in the region and facilitating peace talks with the Afghan Taliban. This is one of the reasons why the UK maintains a close and wide-ranging relationship with Pakistan, principally through regular Ministerial and military-to-military contacts. We continue to provide training and support to Pakistan's Armed Forces, particularly with regard to their capacity to tackle and defeat improvised explosive devices (IED); Pakistan faces a severe threat from IED attacks perpetrated by terrorist groups. The UK is delivering a counter-IED programme to assist Pakistan in establishing a multi-agency capability for tackling IEDs. In January 2015, we agreed to gift £1m worth of surplus counter-IED equipment.

Africa

Sierra Leone – Ebola

1.1.14 Working closely with partners across government, including the Department for International Development (DfID) and the Foreign and Commonwealth Office (FCO), the MOD supported the UK's response to the Ebola crisis in West Africa following a formal request for assistance from the Government of Sierra Leone and the World Health Organisation. By supporting the Government of Sierra Leone's efforts to fight Ebola, we also helped keep Britain safe from the disease.

Medics onboard RFA Argus supporting the fight against Ebola training in the ship's High Dependancy Unit

1.1.15 At its height, the deployment included 811 personnel, RFA ARGUS, three Merlin helicopters, and a network of liaison officers. In total we deployed over 1300 personnel. These personnel provided direct medical care, support to command and control, engineering support and other specialist skills. Military advisors supported national and regional emergency response centres which managed and coordinated treatment beds and laboratory testing capabilities, helped to deliver safe burials and conducted contract tracing. Royal Engineers managed the construction of six Ebola treatment centres across the country, one of which included a specialist unit for treating healthcare workers. This was operated by military clinicians, supported by the Canadian Armed Forces, and played a critical role in the recruitment and retention of healthcare workers and international partners fighting Ebola in Sierra Leone. We established an Ebola training academy and trained over 4000 Sierra Leonean healthcare workers. The academy also delivered a train-the-trainer capability to ensure local sustainability of the training. RFA Argus was deployed as a base for three Royal Navy Merlin helicopters which provided logistical support and influence. Additionally, we deployed a network of liaison officers around the world to ensure a coordinated response to the region, including to the UN Mission for Ebola Emergency Response in Ghana.

Somalia

1.1.16 The MOD continued to contribute to the UK Government's Somalia strategy during 2014-15. We have expanded efforts to improve the capacity of the African Union's peace support mission in Somalia, including through the provision of training across east Africa to the troop contributing countries of the African Union Mission in Somalia (AMISOM). We also supported Somali efforts to establish national Armed Forces both through bilateral advice and assistance and by participating in multilateral engagement such as the EU training mission. Additionally, we have provided military personnel to the United Nations Mission in Somalia (UNSOM) in order to provide policy advice to the Federal Government of Somalia and AMISOM on peace-building and state-building.

Nigeria

1.1.17 The abduction of over 200 schoolgirls from Chibok in north-east Nigeria in April 2014 brought into sharp relief the threat posed by the Boko Haram insurgency and led to the MOD providing military support to the Nigerian government, initially to help search for the schoolgirls and subsequently to contribute to the broader struggle against Boko Haram.

1.1.18 MOD established an Intelligence Fusion Cell, based in Abuja, in order to draw together the product from Intelligence, Surveillance, and Reconnaissance (ISR) assets, as well as other sources of information in order to build a credible, fused intelligence picture to assist the Nigerian authorities. UK personnel together with their Nigerian counterparts and international partners, helped draw together and analyse the available information from across the international community to support Nigerian efforts to find the schoolgirls.

1.1.19 Between May and July 2014 a Sentinel aircraft was deployed to Accra, Ghana, from where it flew surveillance missions over Nigeria to provide information to the Intelligence Fusion Cell. Three Tornado GR4s in the surveillance role also deployed to the region from August to October 2014. Following cessation of this deployment the MoD has continued to provide Commercial Satellite Imagery in support of the Nigerian government.

1.1.20 Additionally, following a request from France, the MOD deployed staff officers to contribute to the French-led Centre for Coordination and Liaison (CCL) based in N'Djamena, Chad. The CCL is designed to improve the regional response to the Boko Haram insurgency. UK continues to provide support through the provision of individual augmentees in Nigeria and Chad.

Libya

1.1.21 The MOD provided a wide range of capacity building support to Libya during 2014. The Defence Advisory and Training Team as part of the Libya Security Justice and Defence programme, provided military advisers into the Libyan Ministry of Defence and the single services on institutional reform; advice and guidance on Arms and Ammunition control, storage and disposal; Explosive Ordinance Disposal training among others. In August 2014, following the deterioration of the security situation in Libya, Defence assisted in the evacuation of 203 British nationals and eligible persons from Libya, aboard HMS Enterprise to Malta, and the closure of the British Embassy, there are no British military personnel in Libya. In June 2014, around 325 Libyan General Purpose Force trainees arrived in the UK to start basic training at Bassingbourn military camp. In November 2014 the remaining Libya General Purpose Force trainees completed their training and were returned to Libya. There were a number of disciplinary issues with the Libyan trainees, some of whom were charged by the police with criminal offences. The Defence Secretary said in the House of Commons that it is regrettable that there were disciplinary issues and that the MOD was grateful for the support received from the local community, the Cambridge Constabulary, and other Government Departments throughout the training programme. The UK remains committed to supporting the Libyan people but has no plans for further General Purpose Force training in the UK. Supporting progress towards a UN mediated ceasefire and a stable political settlement in Libya, is the UK's immediate priority. The UK Special Envoy to the Libyan Political Transition, Jonathan Powell, is working to support UN efforts to mediate between key political and military leaders.

Central African Republic (CAR)

1.1.22 In April to June 2014 the MOD provided additional military air transport support to the French-led mission in the CAR. As part of this effort the UK also helped deploy Estonian military vehicles and Georgian personnel and equipment, the latter in close co-operation with Sweden as part of the launch of EUFOR RCA[2]. EUFOR RCA was the EU's Mission to the Central African Republic to provide temporary support in achieving a safe and secure environment in the Bangui area, with a view to handing over to African partners. After 11 months of intensive operations EUFOR RCA completed its Mission on 15 March 2015.

South Sudan

1.1.23 The UK also provides military personnel to the United Nations Mission in South Sudan (UNMISS).

1.1.24 In support of the UN Mission in South Sudan a C-130 aircraft deployed to the country on 26 March 2015 in order to provide the UN with much needed air transport support. The aircraft flew 11 missions between Juba and Malakal, moving freight and vehicles before it returned to the UK on 12 April 2015.

Middle East / Near East

1.1.25 We continue to maintain significant maritime and air capabilities in the Gulf to underpin our enduring contribution to Gulf Security, alongside international partners. The UK has strong defence links with the region, and maintaining these links remains a key part of our renewed commitment to the region. The Gulf states are key partners in the fights against terrorism and the proliferation of nuclear weapons. They face a real and growing threat from terrorism and we continue to work closer together to combat that threat. The basing agreement with Bahrain, signed at the Manamah Dialogue in December 2014, has further served to reiterate our commitment and reassure the Gulf states.

Two fully armed RAF Tornados from RAF Marham transit the Mediterranean Sea en-route to Libya

Iraq / Syria

1.1.26 The UK is playing a major role in the global coalition to support the Iraqi Government and the moderate Syrian Opposition to defeat ISIL.

1.1.27 In August 2014, UK C130 Aircraft conducted seven humanitarian aid drops onto the Sinjar mountains in Iraq to provide relief to displaced Yazidis. In September 2014, the UK began strike operations against ISIL in Iraq, having deployed six Tornado GR4 aircraft to RAF Akrotiri in the UK Sovereign Base Areas in Cyprus. We have increased our efforts to match coalition requirements as they have evolved and as our resources have become available. This has included the deployment of an additional two Tornado GR4s and Intelligence, Surveillance, Target Acquisition, and Reconnaissance (ISTAR) capabilities such as RIVET JOINT, E3-D SENTRY, and REAPER remotely-piloted aircraft. As of 30 March 2015, we had conducted 201 strikes against targets in Iraq, second only to the United States, with our contribution acknowledged by collation partners.

1.1.28 In addition to ISTAR and strike capabilities, we have provided equipment and training to Iraq and are contributing to the coalition's Building Partner Capacity (BPC) programme. We have trained over 1,000 Peshmerga in Infantry and Heavy Machine Gun skills. We have supported the delivery of nearly 400 tonnes of equipment and ammunition. As a world leader in countering improvised explosive devices (C-IED) we are leading the coordination and development of the coalition's C-IED training programme, including through the provision of C-IED training at the BPC site in Erbil, which has now begun. The UK now has approximately 500 military personnel supporting operations against ISIL, including over 140 in Iraq.

1.1.29 As of 31 March 2015, the UK and coalition activity has contributed to a halt in ISIL's advances, and the start of ground operations by local forces to retake areas of Iraq from under ISIL control. Thousands of Iraqi Security Forces are being trained by the coalition to prepare them for future operations against ISIL.

1.1.30 The UK has also deployed the first UK personnel to deliver what will be a substantial contribution to the planned US-led programme to train Syrian moderates at regional training centres starting in FY 2015-16.

2 European Union Force République centrafricaine.

RAF Reaper remotely piloted air system used in locating ISIL positions

Rest of World

1.1.31 Following Cyclone Pam hitting the Pacific Islands on 11-14 March 2015, the MOD sent a C-17 aircraft to support humanitarian relief efforts in response to a DFID request. The C-17 was in the Pacific between 18-26 March 2015 during which time it delivered: 24.8 tonnes of DFID aid to Vanuatu; rescue/support vehicles; equipment to support the Australian Crisis Task Force, and 87 pallets of stores provided by World Vision and Oxfam.

1.1.32 During March and April of 2014 the UK deployed HMS Echo and HMS Tireless to aid the international search for the missing Malaysian Airline flight, MH370.

An Australian Maritime Patrol Aircraft flys over the Royal Navy survey vessel HMS Echo during the search for the Malaysian airliner Flight MH370 in the Indian Ocean

1.1.33 In May 2014, MOD provided a C-130 Hercules for four days to assist the US Coastguard in the search for the missing yacht – the Cheeki Rafiki.

Cheeki Rafiki's upturned hull

1.1.34 Between 16 and 30 January 2015, a C-130 aircraft has been deployed out of Punta Arenas to drop fuel onto the Antarctic ice cap in support of the British Antarctic Survey (BAS) . There were successful drops on five days, delivering a total of 176 drums of fuel to BAS stations at Fossil Bluff and Rothera Skiway. The aircraft arrived back in the UK on 1 February 2015.

1.1.35 Following the earthquake in Nepal on 25 April 2015, Defence deployed one C130 Hercules and two C-17 transport aircraft and 252 personnel, including 13 Royal Gurkha Rifles, 90 Queen's Gurkha Engineers and 6 Gurkha medics to the region, to support relief efforts. This was in addition to the 67 members of the British Gurkhas Nepal garrison already in Nepal. The aircraft have moved over 144 tonnes of humanitarian aid and evacuated 33 people from Nepal, while the Gurkhas conducted patrols and surveys, helped the relief effort by running water purification equipment, and distributed over 2000 temporary shelters and over 2700 aid packs (including food, mattresses and blankets) to Gurkha communities. The Gurkha Engineers and medics have remained in Nepal to support a request from the Gurkha Welfare Trust for assistance for Gurkha families, soldiers and veterans.

Counter-Narcotics

1.1.36 Defence has continued to support UK Government and international efforts to tackle the threat from illicit drugs. The Royal Navy has operated with US and other international partners to arrest the flow of drugs from Latin America through the Caribbean, and across the Atlantic to UK and Europe. The Navy has seized or disrupted over 2 tonnes of illicit cocaine and marijuana in the region, worth in excess of £80 million had those drugs reached the streets of UK. The Navy has also achieved good counter narcotics effect in the Indian Ocean, operating under the multi-national maritime coalition Combined Task Force 150. The MOD works closely in support of the National Crime Agency, as UK's lead on countering narcotics and other illicit trafficking activity worldwide. We have also continued to mentor the Afghan forces in order to develop capacity to take the lead in conducting counter narcotics operations, and tackle the narcotics threat within, and emanating from, their country.

Seized drug bales are stacked on the deck of HMS Argyll following a successful counter-narcotics operation in the Caribbean

Counter-Piracy

1.1.37 Defence continued to support international counter-piracy efforts in the Indian Ocean. The co-ordinated international military effort and the widespread use of self-defence measures and armed onboard protection teams by merchant vessels have continued to suppress levels of pirate activity. But while pirate activity levels have remained low, piracy off the coast of Somalia continues to pose a threat to shipping. In March 2015 two Iranian fishing vessels were seized in Somali territorial waters, but these are considered to be acts of maritime criminality rather than acts of piracy. Throughout 2014 the UK provided the European Union's Counter-Piracy Mission (Operation ATALANTA) with its Operational Commander and the multinational Operational Headquarters at Northwood. In addition the UK also provided the Deputy Commander to the US-led Combined Maritime Forces based in Bahrain.

Counter-piracy troops intercept a suspected Somali pirated vessel

NATO/EU

1.1.38 The MOD has continued to support NATO and EU operations. During the summer of 2014, RAF Typhoon aircraft deployed to Lithuania to take part in the enhanced Baltic Air Policing mission. Aircraft from Poland, Denmark and France, also deployed in the region. This enhanced posture was part of the NATO assurance measures in response to Russian aggression in Crimea and wider Ukraine. In Bosnia Herzegovina, the MOD has continued to assist EU operations in building and maintaining a safe and secure environment through the deployment of a ground Intelligence, Surveillance, and Reconnaissance Task Force. Maritime forces have operated in the Baltic and the Mediterranean in support of NATO assurance and maritime security tasking.

United Kingdom (UK)

Defence of UK Airspace, Waters, and UK Overseas Territories

1.1.39 In 2014-15 we continued to defend UK airspace with an integrated Air Defence system that included Quick Reaction Alert Typhoon aircraft, Voyager tankers, and air surveillance and control facilities. We also provided such capabilities to police NATO airspace alongside our allies. We provided Royal Navy assets to defend our territorial waters and overseas territories, and to maintain our Continuous At Sea Deterrent. The Police and maritime authorities have primacy in protecting the coastline of the UK, but Defence maintains forces to provide support to these authorities if required. We remained fully and demonstrably committed to the defence of UK Territories in the South Atlantic. UK forces continued to defend the right of the Falkland Islands to determine their own political future and to maintain their way of life against whatever threats may arise. The MOD has continued to employ Quick Reaction Alert Typhoon aircraft, maintain the permanent deployment of HMS CLYDE and provide SAR cover in the Falklands. In Gibraltar, the Royal Navy Gibraltar Squadron is responsible for the demonstration of UK sovereignty, challenging any unlawful incursions into British Gibraltar Territorial Waters.

Military Aid to the Civil Authorities

1.1.40 The Home Secretary is responsible for the safety and security of the UK and its citizens. Under the Civil Contingencies Act 2004, lead Government departments are allocated to deal with the most likely high-impact, disruptive events. The MOD is not the lead for any civil contingency, but if required can provide support through the Military Aid to the Civil Authorities process. We provided military aid to the civil authorities on over 85 occasions in 2014-15. These ranged from the provision of logistics support to the Police and ambulance services; having personnel trained and on call to deliver fuel in the event of strike action by tanker drivers; assisting the Department for Communities and Local Government during fire service strike action, and providing ambulance drivers, navigators, and support staff to the Department of Health during industrial action. During 2014-15 we also provided security and support to the Commonwealth Games and the NATO Summit.

Fisheries Protection

1.1.41 The Fishery Protection Squadron support the Marine Management Organisation with fishery patrols. In 2014-15 the Squadron boarded 565 fishing vessels, seven of which were detained at a UK port for further investigation, and detected many fishing infringements. We continue to work with other EU member states to develop joint operations and to improve the efficiency and effectiveness of their own patrols.

Search and Rescue (SAR)

1.1.42 The MOD Search and Rescue service exists to help military aircrew in difficulty. It also contributes to the UK's integrated national SAR framework. Helicopter cover for most of the UK and a large area of the surrounding sea was provided 24 hours a day by the Royal Air Force (RAF) and Royal Navy from eight helicopter bases, although these bases will cease operations throughout 2015 as SAR transitions to the Maritime and Coastguard Agency. Throughout 2014-15, SAR was also operated from a further four bases under contract to the Maritime Coastguard Agency.

1.1.43 The RAF also maintained three RAF mountain rescue teams in the north of the UK, who are expert in dealing with aircraft crashes and SAR in remote areas. The UK Aeronautical Rescue Coordination Centre (ARCC) at RAF Kinloss co-ordinated the response of all UK SAR aircraft and mountain rescue teams, and hosted the UK Mission Control Centre for the global satellite-based distress beacon detection system. The ARCC will transition to the Maritime and Coastguard Agency by 31 March 2016. In 2014-15 Defence SAR services were called out 1,842 times (1,852 times in 2013-14) in the UK and came to the aid of 1,531 people (1,555 people in 2013-14). Statistics on Defence SAR incidents, callouts and people moved can be found at: https://www.gov.uk/government/statistics/military-search-and-rescue-monthly-statistics-2015

Explosives Ordnance Disposal (EOD)

1.1.44 The MOD provides 24 hours-a-day EOD support to the police in the UK. This includes the provision of operational scientific expertise to deal with complex devices. Routine co-ordination of EOD tasking was conducted by the Joint Service EOD Operations Centre at Didcot, which allocates Royal Navy, Army or RAF teams as necessary. EOD teams responded to 468 Improvised Explosive Device Disposal incidents in 2014-15 (695 in 2013) and 1923 Conventional Munitions Disposal Incidents (1750 in 2013).

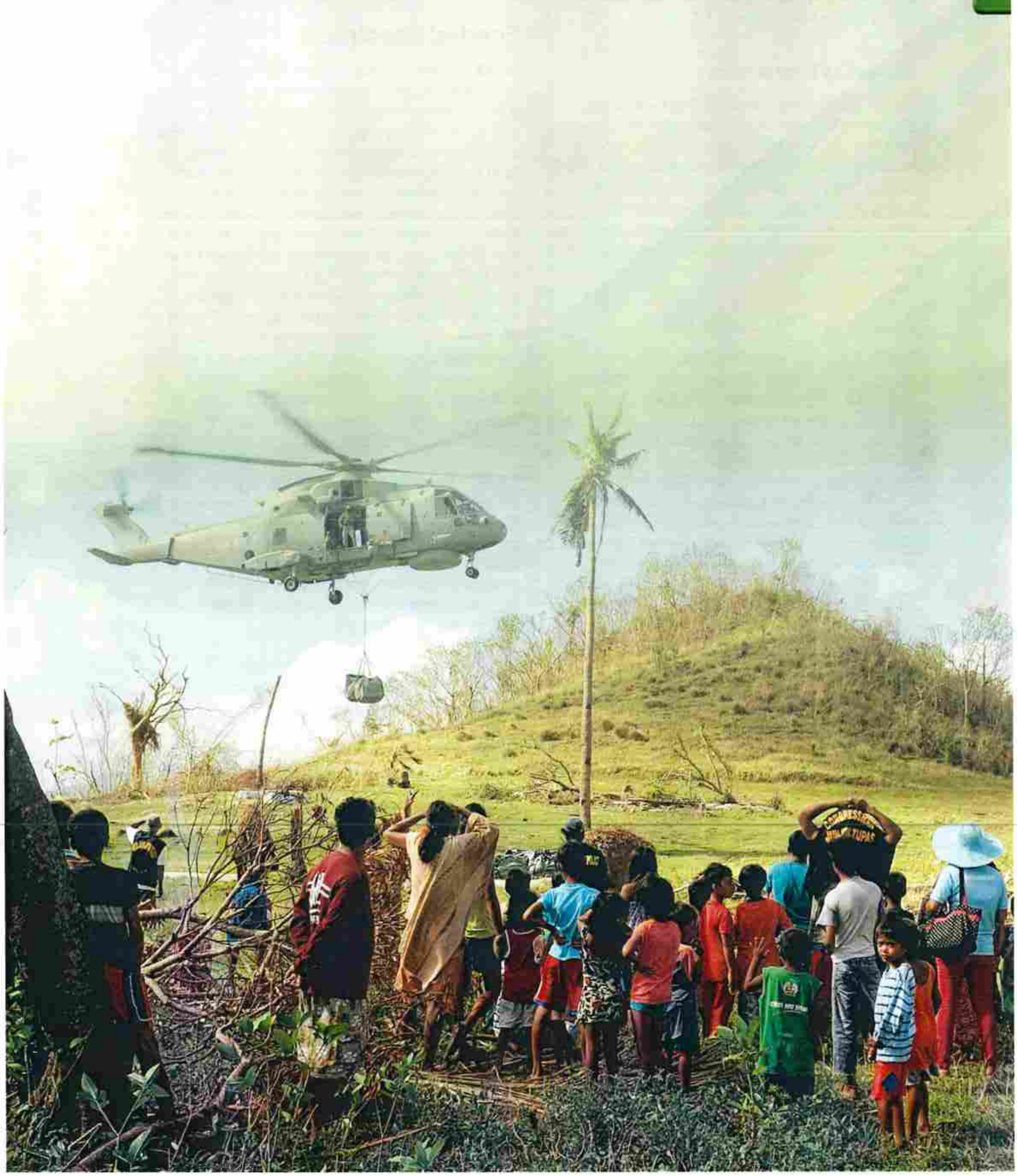
Funded Readiness

1.1.45 As well as succeeding in the operations that we undertake, an enduring priority for the MOD is to maintain a range of forces ready to deal with events that may emerge. In 2014-15 we maintained a graduated readiness system to ensure that the right force elements (typically ships, ground force sub-units, and aircraft) are ready to deploy to conduct the range of missions that may be required by the Government. Through its Defence Plan and Annual Budget Cycle process, the MOD Head Office sets requirements for the Front Line Commands in terms of the force elements and the readiness levels at which they need to be held, and allocates the resources to achieve this. These requirements are underpinned by specific direction on manning levels, equipment, logistic support, and training, both for individuals and the collective training that units do together to ensure they can fight effectively as part of a larger force.

1.1.46 The last year has seen a growing contribution to NATO. In addition to commanding the Maritime High Readiness Force in 2016, UK will provide the framework nation in 2017 of the newly established NATO very high readiness force; our other NATO commitments include support for the Baltic air policing patrols and a British presence on a number of naval task groups.

1.1.47 UK's ability to conduct Contingent Operations beyond Afghanistan continue to grow in line with the Defence Plan. Our contingent forces have been deployed and sustained on a number of tasks world wide, from Ukraine to West Africa, Defence's ability to deploy forces at short notice have had tangible positive effects through out the world. This includes the recent announcement that military forces have deployed off the coast of Libya to assist in the EU's humanitarian operation to save African migrants from drowning and to Nepal to assist in Earthquake disaster relief. The growth of UK's contingency capability continues to develop and mature through developing a coherent national capability and also in developing international partnerships both through existing treaties and new bi-lateral defence relationship.

1.2 Other Major Responsibilities



Nuclear Deterrence

1.2.1 The nuclear deterrent provides the ultimate guarantee of the UK's national security and represents a vital contribution to the defence of NATO.

1.2.2 The Royal Navy's Vanguard class submarines have sustained Operation RELENTLESS, continuing their mission of deterrent patrols which has been uninterrupted since 1968. The third submarine of the class, HMS VIGILANT, returned to operations after her successful overhaul, nuclear refuelling, and a demonstration firing of an instrumented Trident D5 Missile. HMS VENGEANCE, the fourth submarine, is now undergoing her overhaul in Devonport.

1.2.3 Work on the assessment phase for the Successor submarine programme continues in advance of a Main Gate decision planned for 2016. The main purpose of this work is to refine the design of the submarine and mature the costs of the detailed acquisition arrangements for these submarines, which are planned to bear the deterrent mission from 2028.

The Trident nuclear submarine HMS Victorious

International Defence Engagement

International Defence Engagement Strategy and Funding

1.2.4 Over the second year of the **International Defence Engagement Strategy** (IDES), MOD has developed regional and country strategies, including a standardised means to measure impact against objectives. The single Services and Joint Forces Command have each introduced internal structures to manage better Defence Engagement (DE) activity. The Army has continued to increase regional engagement through its Adaptable Brigades and work continues to give DE a more prominent position in Military Activity planning and programming.

1.2.5 In the final year of the Conflict Pool we have continued to work on conflict prevention, capacity building and security sector reform projects. Of the £240M of programmable Conflict Pool resources available to fund this kind of activity in 2014-15, MOD led on projects totalling some £60M, including responses to crises in Central African Republic, Nigeria, Iraq, and Ukraine as directed by the National Security Council. We also prepared for transition to the new Conflict, Stability and Security Fund (CSSF) arrangements which began in April 2015.

Capacity Building and International Defence Training

1.2.6 During 2014-15, MOD has provided over three thousand education and training places in UK domestic and overseas institutions to international military and civilian officials from almost one hundred countries.

1.2.7 As part of capacity building, training teams have delivered training in twenty countries enhancing knowledge and leadership, professionalism and understanding, promoting governance and international law. Following the ground breaking Managing Defence in the Wider Security Context course delivered in Burma in early 2014 – the first Defence Engagement course since independence in 1947 – the training team returned a year later to continue to support accountability, transparency, rule of law, and human rights.

1.2.8 The MOD's Defence Assistance Fund supported bilateral relationship building, funding defence education in support of security sector reform and capacity building; short-term training teams; staff talks, and exchange visits. In addition the Defence Engagement Provision provided resources to help to implement the IDES across Defence and with partners across government, funding both capital and programme activity, and including capacity building support to Ukraine and Georgia agreed at the NATO Summit in Wales.

Multilateral Engagement

NATO

1.2.9 NATO remains the cornerstone of UK Defence and security, and provides political and military structures through which the UK engages with Allies and Partners.

1.2.10 The NATO Summit in Wales (4-5 September 2014) saw the Alliance demonstrate solidarity at a time of diverse security challenges on NATO's eastern and southern borders. The best response to these remains through unity and the implementation of the Summit deliverables, including the Readiness Action Plan (RAP), the Defence Investment Pledge, enhancing relationships with key partners, Defence Capacity Building, and the Armed Forces Declaration.

1.2.11 Allies and NATO are working to ensure that the agreements from Wales are implemented in full and that we demonstrate clear progress ahead of the next Summit in Warsaw in 2016. The UK is at the forefront of this. On 5 February 2015 Defence Ministers met in Brussels and noted good progress in implementing Wales Summit outcomes.

1.2.12 The RAP will shape the future posture of NATO in response to the 21st Century security challenges facing the Alliance. The key components include continuation of Assurance Measures through regular training and exercising in Eastern Allied countries and the establishment of the 'Spearhead' element of the adapted NATO Response Force – known as the Very High Readiness Joint Task Force (VJTF). NATO is expected to declare full implementation of the RAP at the Warsaw Summit.

1.2.13 The UK has played a leading role in the development of, and contributions to, the RAP, being the first nation to volunteer as lead – or framework nation for the VJTF, a role we will assume in 2017. The UK contribution to NATO Assurance Measures was over 3,000 personnel in 2014 and will increase to over 4,000 UK personnel exercising in the territory of Eastern NATO allies in 2015. For a four month period in 2014, four RAF Typhoons operated in support of the Baltic Air Policing Mission.

1.2.14 We continued to promote and implement NATO reform, working with Allies to maximise NATO's effectiveness and to modernise its structures, capabilities and partnerships; as well as ensure the Alliance continues to deter threats effectively and succeed in military operations when and where needed.

RAF welcomed to Amari Airbase taking its turn in NATO's standing Baltic Air Policing patrols

Arms Control and Counter-Proliferation

1.2.15 The National Security Risk Assessment identified that the consequences from hostile acts by terrorists and states would be greatly magnified if weapons of mass destruction, advanced military technologies, and the systems used to deploy them, reached the wrong hands. The following paragraphs summarise MOD's contribution in 2014-2015 to meeting the Government's wider arms control and counter-proliferation objectives.

1.2.16 MOD continued to provide expertise to strengthen the **Chemical Weapons Convention** and the **Biological and Toxin Weapons Convention**. A priority has been to support the international community in the removal from Syria of the chemicals in its declared stockpile and their subsequent destruction. Some 200 tonnes of precursor chemicals were brought to UK for destruction in commercial facilities, and these were mostly destroyed by August 2014, under contracts placed by MOD. MOD also continued to work with FCO and international partners to ensure full declaration and destruction of Syria's entire chemical weapons programme, including providing training to support the missions of the Organisation for the Prohibition of Chemical Weapons in Syria.

HMS Montrose part of the International mission to eliminate the chemical weapons programme of the Syrian Arab Republic

1.2.17 MOD continued to work closely with international partners to strengthen international cooperation in the field of **biological security**, and continued to implement a variety of projects to strengthen biological security, primarily in Central Asia, the Caucasus, the Middle East, and North Africa. MOD also worked closely with Home Office, Department of Health, and others to support development of the UK's BioSecurity strategy, and the UK's contribution to the security elements of the International Global Health Security Agenda.

1.2.18 MOD worked closely with FCO to prepare for the 2015 **Nuclear Non-Proliferation Treaty**

Review Conference, in particular in ensuring progress against obligations under the 2010 Action Plan. MOD completed a key element of its programme of reductions by reducing the number of operationally available Trident nuclear warheads to no more than 120. MOD is also continuing work to reduce the total UK nuclear weapon stockpile from a maximum of 225 to no more then 180 by the mid-2020's. MOD provided technical input to the Chinese-led P5 initiative to agree nuclear definitions in order to provide a basis for further cooperation and transparency. MOD continued to lead HMG's contribution to the UK Norway Initiative on the verification of nuclear warhead dismantlement, agreeing a joint work plan to 2015.

1.2.19 MOD continued to fulfil its obligations as the National Authority responsible for the UK's commitment to the **Comprehensive Test Ban Treaty**, supporting the Comprehensive Test Ban Treaty Organisation (CTBTO) in Vienna. MOD played a key role in supporting the CTBTO's Integrated Field Exercise in 2014. MOD continued to coordinate across Government to develop a sovereign Technical Nuclear Forensics capability to collect, analyse, and attribute origin of recovered fissile material.

1.2.20 Working closely with the FCO, MOD provided technical support to four sessions of expert discussions in Geneva on the possible scope of a **Fissile Material Cut-off Treaty**, with the aim of informing future negotiation in the United Nations Conference on Disarmament, and ensuring that UK equities will be protected under any such Treaty.

1.2.21 MOD continued to implement key politically and legally binding **Conventional Arms Control agreements** on behalf of the UK. During the year, MOD hosted fourteen verification missions, which checked the UK's compliance with the Conventional Arms Control agreements; and led or participated in thirty verifications missions in other countries.

1.2.22 The **Arms Trade Treaty**, which obliges all signatory states to apply common criteria for assessing the export of conventional arms, entered into force on 24 December 2014. MOD continued to work with Government colleagues towards the goal of universalisation of the treaty and to support States who may need assistance to implement it.

1.2.23 MOD continued to provide expertise to strengthen the four **export control regimes** (Missile Technology Control Regime, Nuclear Suppliers Group, Australia Group, and Wassenaar Arrangement) to reduce the threat to UK national interests, including UK forces operating abroad, from the proliferation of weapons of mass destruction, their delivery systems, and advanced conventional weapons.

1.2.24 The Government's policy is to promote responsible Defence exports – ensuring we support the prosperity agenda, consistent with our obligations under Treaties, Regimes, and the Consolidated EU and National Arms Criteria. **The MOD Form 680 procedure**, for which the MOD is the authority, assists in supporting the Government's policy on responsible exports. It is a security procedure to assess the release of equipment or information (including technology or software) with a classification of OFFICIAL-SENSITIVE or above by companies to foreign entities. This could be for various purposes, including marketing campaigns or research, before an actual export of a physical good. It does not constitute an export approval or an HMG indication of a likely export licence approval. HMG's target is to clear 60% of MOD Form 680 applications in 30 working days; the MOD continued to exceed the target, processing 67% of applications in 30 working days during 2014, compared with 63% in the previous year.

United Nations

1.2.25 The MOD supported six **United Nations** (UN) peacekeeping operations in 2014-15, 50% more than in 2013-14. The UK deployed approximately 280 military personnel on UN missions; the largest UN deployment continued to be in Cyprus. We also maintained our commitment to UN-mandated peace support operations.

1.2.26 We provided three officers to the UN Headquarters in New York and maintained a Defence section in the UK Mission to the United Nations. We contributed to extensive multilateral capacity building in Africa through a combination of short-term training teams, British peace support training teams and British military advisory training teams. MOD continued to support United Nations Security Council Resolution 1325 on Women, Peace, and Security by its actions within the UK National Action Plan and promoted wider Government objectives on the Prevention of Sexual Violence Initiative.

Soldiers receiving their blue berets before deploying on a United Nations peacekeeping mission to Cyprus

Common Security and Defence Policy (CSDP)

1.2.27 The UK remained focused on fostering close cooperation between the **EU** and NATO and continued to emphasise the need for CSDP activity to be complementary to that of NATO wherever possible, to avoid any duplication or decoupling.

1.2.28 The Prime Minister has highlighted three areas where the UK could press for CSDP to add value – EU-NATO partnership; the Comprehensive Approach; and responding to Hybrid attacks recognising the commitments made at the Wales NATO Summit. Similarly we have shown our support towards the EU's comprehensive approach through encouraging progress on strategic communications and participating on the EU Battlegroup concept.

1.2.29 The UK continued to provide the standby Operational Headquarters at Northwood, commanding Op ATALANTA, the EU's counter-piracy operation off the Horn of Africa. We have also contributed to other EU-led military operations, in Bosnia and Herzegovina, Mali, and Somalia.

Bilateral Engagement

Key Allies

1.2.30 The depth of our defence relationship with the **United States (US)** was underlined by the Secretary of State's visit in March 2015 – the first foreign Defence Minister to meet the new Secretary for Defense, Ash Carter, in Washington since he assumed the role.

1.2.31 On operations, we demonstrated our continued value as the US's foremost military ally, staying closely aligned throughout the drawdown in Afghanistan and transition to operation Resolute Support. We coordinated during coalition operations against ISIL, while tackling the Ebola crisis and providing non-lethal support to Ukraine.

1.2.32 Our current portfolio of capability collaboration remains on track. In February 2015 the RAF's 17 Sqn (R) stood-up at Edwards Air Force Base in California to start independent UK testing and evaluation to bring the F35B Lightning II into service. In December 2014 an updated version of the 1958 Mutual Defense Agreement was signed by the President and our Prime Minister.

1.2.33 We continued to deepen and broaden defence cooperation with **France** under the 2010 Lancaster House Treaties and made good progress, implementing the goals set at the January 2014 Brize Norton Summit. We worked closely together in preparation for the successful September 2014 NATO Wales Summit and on implementation of its outcomes. We continued to support each other on operations. We further developed our ability to deploy a Combined Joint Expeditionary Force. We took forward together a range of equipment programmes, including in November 2014 placing the joint £120M two-year feasibility phase contract for the Future Combat Air System (FCAS) and committing jointly to invest £500M on a new naval missile system. Additionally, there were successful commemorations of previous occasions when we fought together in a common cause, including the D Day 70th Anniversary in Normandy in June 2014.

Europe

1.2.34 Following the 2011 announcement that UK troops will be withdrawn from **Germany** by 2020, we have continued to enhance our bilateral defence relationship through Structured Dialogue at Senior level and significant Ministerial engagement.

1.2.35 As a consequence of the ongoing Ukraine crisis, Defence engagement with **Russia** continued to be restricted to areas where we have Treaty obligations, and for certain commemorative events.

1.2.36 Following Russia's illegal annexation of Crimea and continued Russian-backed aggression in Eastern Ukraine, Defence engagement with **Ukraine** has increased over the year including an uplift in routine activities such as support on defence reform, strategic communications and procurement training.

1.2.37 Moreover, from February 2015, the MOD has provided Short-Term Training Teams in Ukraine to help build the resilience of the Ukrainian Armed Forces and improve their deterrent effect. This support has included Infantry, intelligence, and medical training.

1.2.38 Continuing the work of the 2011 Military Treaty between the **UK** and **Turkey**, in March 2015 VCDS hosted high-level staff talks in London that demonstrated the close working relationship that has developed.

1.2.39 In January 2015 a Memorandum of Understanding between the UK and the Republic of **Ireland** has been signed to ensure greater defence collaboration in the future. This will help to enhance cooperation in exercises, training, peacekeeping and crisis management operations.

1.2.40 In the Western Balkans we have maintained our contribution to EUFOR Op ALTHEA – the EU CSDP mission to **Bosnia & Herzegovina** operating under Berlin Plus arrangements. The UK contributed an Intelligence Surveillance Reconnaissance Taskforce to Op Althea from July 2014 to March 2015 following the civil unrest in February 2014.

1.2.41 The UK has continued to engage closely with the strategically important Nordic-Baltic region. The **Northern Group**[3] (a UK initiative) a valuable forum for consultation and co-operation. The six partner nations[4] that signed a Letter of Intent with the UK at the NATO Summit in Wales to develop the **Joint Expeditionary Force (JEF)** all come from within the Northern Group. The JEF (due to be fully operational by 2018) is a pool of high-readiness, adaptable forces that is designed to enhance the UK's ability to respond rapidly to crises, either nationally, or on behalf of international institutions such as the UN, NATO, or the EU.

Middle East and North Africa

1.2.42 The regional focus was on efforts to contain and counter ISIL. This was achieved through strong Defence Engagement with **Kuwait** and continued development of our standing in **Iraq**. **Jordan** and **Lebanon** are important to regional stability and so we focused on capacity building to assist in border security.

3 Established in 2010, the Northern Group is an informal grouping of 12 nations (Denmark, Estonia, Finland, Germany, Iceland, Latvia, Lithuania, the Netherlands, Norway, Poland, Sweden and the UK) which aims to promote more coherent, efficient and effective defence and security co-operation in Northern Europe.

4 The six partner nations of the Joint Expeditionary Force (JEF) include Denmark, Estonia, Latvia, Lithuania, the Netherlands and Norway.

1.2.43 In **Saudi Arabia**, **Oman**, **Qatar**, Kuwait, and **Bahrain** we maintained a comprehensive network of Defence Attachés and Loan Service Personnel. We continued to support broader HMG intent. In December 2014 we signed the Bahraini Naval Basing agreement to build a permanent operating capability in the region.

1.2.44 The 2014 COUGAR Naval Task Group deployment East of Suez demonstrated our maritime reach and ability to contribute to security in the Middle East. We continued to provide aircraft deployments to the region, basing in the **United Arab Emirates**, with potential further facilities in Bahrain.

1.2.45 North Africa is challenged by instability and extremism. We developed our relationships there through capacity building, Counter-Terrorism (CT) projects, and Defence exercises. With instability in **Libya** and absence of political settlement, we strengthened her neighbours to mitigate the growing threat from extremism and used Defence Engagement activity to complement the work of the CT community and OGDs Significant programmes of activity have been planned and conducted in **Algeria** and **Egypt**, as well as substantial Army-sponsored exercises in **Morocco**.

Africa

1.2.46 Following the kidnapping of the Chibok school girls (14 April 2014), the MOD committed to providing surveillance assets (for a limited period); assessed imagery; and, support to an intelligence fusion cell. The UK committed to a further package of support to **Nigeria**. Subsequently, we have been delivering an enhanced programme of training and military capacity building, including to Nigeria troops deployed against Boko-Haram, coordinated by an expanded resident training team. In response to the increased regional threat posed by Boko-Haram, we have also deployed military experts to support the development of regional intelligence sharing and a Multinational Joint Task Force.

1.2.47 In **Somalia**, we maintained our commitment to the **African Union's** peace support mission, which regained territory from Al Shabab. We expanded our efforts to develop a Somalia National Army through increased bilateral and multilateral engagement. Our resident training team in East Africa took on new co-ordination responsibilities in support of the UK Government's Somalia strategy, whilst sustaining its regional upstream capacity building efforts.

1.2.48 From August 2015, our resident training team in **Sierra Leone** became increasingly involved in the UK response to the Ebola crisis with its security sector reform programme necessarily in abeyance. In **Mali**, Defence continued to provide a strong contribution to the EU Training Mission. Our **South Africa** resident training team continued to provide battlegroup training for **Malawi** ahead of deployment to the UN Mission in the **Democratic Republic of Congo** and delivered training and advice for the UN Mission HQ in Goma.

Latin America and the Caribbean

1.2.49 The Defence Section in **Mexico** re-opened this year and has started to support wider UK strategies in the region. We continued to build on strong relations with **Brazil, Chile, Colombia, Paraguay,** and **Uruguay** with a variety of Defence Engagement activities. In the **Caribbean**, support to the fight against organised crime and in reducing the effects of natural disasters has continued.

South Asia

1.2.50 The October 2014 visit by the Defence Secretary to India for a WW1 commemoration event was the highlight of a re-energised Defence relationship with **India.** Further Ministerial and Chiefs' visits, PUS-level talks, and regular military interaction made for a busy engagement programme.

1.2.51 We continued to provide a highly influential Defence education package to **Bangladesh.** In **Nepal** we will celebrate in 2015 200 years of our relationship. In March 2015 the Defence Secretary met **Sri Lanka**'s new President.

Asia Pacific

1.2.52 In continuance of the trend reported last year, the Department has strengthened Defence Engagement effort in the Asia Pacific region, reflecting HMG's wider policy of prioritising effort in the region. There have been numerous events and Defence Engagement programmes run throughout the year, ranging from participation in staff talks, through the provision of training teams to joint exercises in the region, as well as an extensive flow of foreign military students from the Asia Pacific to training in the UK. We have held staff talks and strategic dialogues with numerous countries in the region, including a Strategic Dialogue with China, and inaugural Defence Policy talks with **New Zealand**. A critical element of the Australia-UK Ministerial (AUKMIN) Defence talks focused on opportunities for collaborating on Defence Engagement in the Asia Pacific region.

1.2.53 In SE Asia we have continued to engage through our involvement in the Five Power Defence Arrangements and associated exercises. Additionally, the Five-Eyes community held a series of high-level staff talks in the region, including Chiefs of Defence Staffs talks following the Shangri-La Dialogue. Defence has been at the forefront of our relations with Thailand following the coup there, both in terms of relaying UK Government messages and encouraging reform and reconciliation. Particularly noteworthy have been inaugural Defence and Foreign Minister "2+2" talks between the UK and Japan, the UK's largest ever participation in exercise ULCHI FREEDOM GUARDIAN on the Korean Peninsula, the MOD's efforts to support the search for MH370 (which included the deployment of both HMS ECHO and the nuclear submarine HMS TIRELESS to the Indian Ocean), MOD support to the relief effort in Vanuatu, an expanded and strengthened programme of engagement with China, our continued efforts to further HMG's wider democracy and human rights objectives in Burma through our unique engagement with and education of the Burmese military, and the renewal of the agreement that governs the presence of British forces in Brunei.

Defence Exports

1.2.54 This year we have continued to provide Department-wide support to the UK Defence and Security industry. With the support of DE&S and the Frontline Commands we have developed and refined our exportability policy in order to implement the recommendations in the "National Security Through Technology"[5] White Paper.

1.2.55 The UK Trade and Investment Defence and Security Organisation (UKTI DSO), part of the Department for Business, Innovation and Skills, is responsible for promoting defence exports within Government. MOD has worked closely with DSO to provide MOD expertise and equipment, including the training, support and know-how of the UK's Armed Forces to help deliver success in UK Defence export campaigns.

1.2.56 Our Armed Forces continued to deliver and build upon UK Defence Engagement activity and have provided military support to key Defence export markets including capability demonstrations and evaluations, for example of Watchkeeper. This is in addition to the broader support provided by the UKTI DSO dedicated Export Support Team. MOD support to the Farnborough International Airshow on 14 – 20 July 2014 represented a key opportunity

5 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/27390/cm8278.pdf

to support UK industry engagement with a wide range of overseas delegations.

Sea Ceptor missile system

1.2.57 Exports have provided new opportunities for collaboration with other nations: an example was New Zealand's purchase of the Sea Ceptor missile system. This high performance missile was developed for the UK Royal Navy and is a key demonstration of exportability and interoperability.

1.2.58 MOD Ministers, Single Service Chiefs of Staff, and senior MOD officials continued to support Defence exports as part of their international engagement activity. The Minister for Defence Equipment Support and Technology has continued to support UK industry at trade exhibitions in the UK and overseas, notably at IDEX and Langkawi International Maritime and Aerospace Exhibition.

Chapter 2:

Transforming and Delivering Defence

2.1 Transforming Defence – Organisation and Environments

Defence Reform – Transforming the Department

2.1.1 The process of transforming the Department has continued during the year, following the achievement of Full Operating Capability for the new **Defence operating model** on 1 April 2014. The operating model was implemented in response to Lord Levene's 2011 Defence Reform review[6] and is described in detail in "How Defence Works", which is available on gov.uk[7]. In autumn 2014, Lord Levene conducted his third annual review of progress on implementing Defence Reform, which was published to Parliament by the Secretary of State in December. Lord Levene praised the *"fundamental transformation the Ministry of Defence has undergone in the last four years"*.

2.1.2 In addition to the structural and process changes recommended in the Defence Reform review, we have implemented a new internal control framework, which came into effect on 1 April 2014. There are 18 **Defence Authorities** responsible for managing corporate-level risks and ensuring that key Defence activities are carried out on a coherent and consistent basis across Defence. They are also responsible for ensuring that the overall framework strikes the best balance within the delegated model between corporate needs and TLB freedoms.

2.1.3 We have continued to work on improving the **leadership, behaviours and ways of working** which support the effective operation of the delegated model.

2.1.4 The focus of organisational reform during this year has moved to the next phase, which is the transformation in the delivery of the key enabling services across Defence, in particular the management of acquisition, infrastructure, and shared services.

2.1.5 The establishment of the new role of **Director General Head Office and Commissioning Services** (DG HO&CS) in April 2014 brought together the Top-Level Budget Holder responsibilities for Head Office and Corporate Services and for the Defence Infrastructure Organisation. DG HO&CS is responsible for driving further improvements in the management of the Head Office, corporate services, infrastructure, and acquisition. The purpose of Commissioning Services is to ensure that the key enabling services (e.g. DIO, DE&S, and DBS) are fit for purpose in delivering against the requirements set by Commands and are managed as part of the wider-Defence system, exploiting synergies to deliver better value for Defence.

2.1.6 In parallel with the establishment of Defence Equipment and Support as a Bespoke Trading Entity in April 2014, the Department also developed a new **Acquisition System Operating Model (ASOM)**, which sets out how Defence acquires the equipment, logistic support, and information systems needed by the Armed Forces. The ASOM is in line with the Levene principle of delegating responsibility for capability budgets to the Front Line Commands. It was launched on 1 April 2015 and a new Acquisition System Authority has been set up to support the Defence Authority for the Acquisition System to embed and sustain the change and to provide assurance to the Defence Board that the system is operating effectively.

2.1.7 Following contract award in July 2014, Capita/URS/PA Consulting became the Strategic Business Partner responsible for the operation of the **Defence Infrastructure Organisation** from September 2014. As part of implementing these new arrangements, the Defence Infrastructure System Programme will continue to support the transition by identifying how to improve the interface between DIO, other delivery agencies, and their customers to ensure greater Defence-wide clarity; how best TLBs could be incentivised to achieve better value for money; and what changes are required to the infrastructure system to manage the relationship with DIO if it subsequently becomes an arms-length body.

2.1.8 The contract with Serco for the strategic management of **Defence Business Services** (DBS) expires at the end of FY 2015-16. The department has recently announced that, at that point, the management of DBS will be brought back "in house" whilst it considers and evaluates options for the longer term delivery of services presently provided by DBS.

Maritime Environment

2.1.9 In the **maritime environment**, the programme to restore the Navy's carrier strike has progressed well. The first of the new aircraft carriers, HMS Queen Elizabeth, was officially named by Her Majesty the Queen on 4 July 2014. Sea trials will begin in 2017, and flying from HMS Queen Elizabeth will start in 2018, with an extensive trials programme for the new F35B Lightning II aircraft. The Prime Minister announced[8], on 5 September 2014, that the carrier, HMS Prince of Wales, will also be brought into service on completion so that the UK *"will always have one carrier available, 100 percent of the time"*.

6 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/388383/Levene_Third_Annual_Review_5_December_20140001.pdf

7 https://www.gov.uk/government/publications/how-defence-works-the-defence-operating-model

8 https://www.gov.uk/government/speeches/nato-summit-2014-pm-end-of-summit-press-conference

2.1.10 The surface fleet saw the decommissioning of HMS Illustrious, the last of the Invincible Class aircraft carriers, with the Landing Platform Helicopter HMS Ocean taking on the role as the nation's helicopter carrier following a £65 million refit. Meanwhile further progress on the Type 26 Global Combat Ship has led to investment in essential long-lead items for the ship's shore testing facilities. Following the first steel being cut in October 2014, the first of the new Offshore Patrol Vessels, HMS Forth, is expected to be handed over to the Royal Navy in 2017. The second will be named HMS Medway and the third HMS Trent. An upgrade programme for the Royal Navy's Spearfish heavyweight torpedoes carried by the Astute, Vanguard, and Trafalgar Class submarines was announced in December 2014.

HMS Monmouth is pictured with the Indian aircraft carrier INS Vikramaditya during the vessels' transit through the English Channel

Land Environment

2.1.11 In the **land environment,** Army 2020 is the significant transformational programme for the British Army. Restructuring under this programme is near completion, with 3rd (UK) Division and Force Troops Command reaching full operating capability and 1st (UK) Division achieving initial operating capability during the year. We are also making progress in working towards required levels of readiness for Army 2020, with a deployability test exercise involving 1,650 personnel and 570 vehicles. We also approved a programme of work to bring the necessary equipment fleets up to full fitness for deployment, as well as provisioning for their sustainment once deployed.

2.1.12 An important achievement this year was the order of 589 Scout vehicles. This vehicle will deliver a step change in versatility and agility as well as provide vastly enhanced capability for our future needs. We also ordered the first tranche of new 40mm cannons that will provide the Scout and Warrior infantry fighting vehicle programmes with cutting edge, class-leading firepower. In addition, we successfully deployed the Watchkeeper tactical unmanned aerial system to Afghanistan in an operational role, as well as upgrading the Puma helicopter fleet and greatly enhancing our heavy lift capability through the delivery of the first six of 14 state of the art Chinook Mk 6 aircraft. Finally, we accepted into service the Land Environment Air Picture Provision system. As part of its development, in September 2014 it successfully deployed to Celtic Manor to provide air security to the NATO summit in Wales.

2.1.13 An important aspect of Army 2020 is the Army Basing Programme, and as part of Phase 1 of this programme we successfully completed 30 unit moves and/or functional re-roling of units within the UK; and one unit move to the UK from Germany. We have begun work to deliver Phase 2 of this programme; which will include a number of intra-UK moves and the return of a further 14 units from Germany. We remain on track to bring all UK military units back from Germany by 2020.

A soldier with 1st Battalion The Royal Regiment of Fusiliers taking part in live-firing training exercise

Air and Space Environment

2.1.14 In the air and space environment, Typhoon force transition was completed with 6 Squadron and 1(F) Squadron relocating to RAF Lossiemouth, and being joined by 2 Squadron which was stood-up as a Typhoon Squadron in January 2015. Typhoon was also cleared to use the Paveway IV bomb during trials in Spring 2015. Our Lightning II acquisition remains on track, with three aircraft delivered to date; these are currently based at Eglin Air Force Base in Florida. A further one will be received early in 2016, and a contract for the next four has been signed. This forms part of our plan initially to procure fourteen aircraft over the coming four years while putting in place the necessary support arrangements and infrastructure. The overall number of Lightning II aircraft that we will purchase has yet to be confirmed. Lightning II Initial Operating Capability is planned for 2018, when flying trials aboard the carrier HMS Queen Elizabeth will also begin delivering a Carrier Strike Capability by the end of 2020.

2.1.15 The RAF has taken delivery of three A400M Atlas transport aircraft. Following a tragic accident on 9 May 2015, involving a pre-delivery A400M aircraft operated by Airbus Defence and Space (ADS), the UK and other nations paused flying of their A400M aircraft, whilst an investigation uncovered the accident sequence and identified the root cause. Checks on all delivered aircraft did not find any other instances of the fault and robust mitigation actions have been put into place to prevent a re-occurrence. Additional training has also been instigated for RAF crews. At an A400M Air System Safety Working Group on 15 June 2015, Air Officer Commanding 2-Group, the RAF Operational Duty Holder (ODH), having formally considered evidence presented by the Type Airworthiness Authority (TAA), concluded that it was safe to resume RAF A400M flying, which recommenced on 16 June 2015. A total of 22 A400M Atlas aircraft will be procured. Delivery of Voyager strategic air transport and air-to-air refuelling aircraft continued under a PFI arrangement, with up to eleven aircraft now available. Our C-17 strategic air transport capability was enhanced with the addition of a secure, long range communications capability and its clearance in the combat offload role. This allows palletised loads to be offloaded immediately after landing without the need for ground handling personnel or equipment, thus enabling its rapid turnaround both to maximise the tempo of its operations and minimise its exposure to potential threats.

2.1.16 A contract has been awarded to deliver modernisation and rationalisation of our air traffic management system under Project Marshall. The UK's Air Surveillance and Control System (ASACS) is also being extended to 2020 through the replacement of the computer system at two control centres. Three new TPS-77 air defence radars have been acquired, mitigating the adverse effect of wind farms on radar performance, and will be brought into service later this year.

2.1.17 The National Space Security Policy[9] raised the profile of space security challenges and we took a leading role in addressing these issues across Government.

A RAF Atlas A400M transport aircraft flying over Bristol

9 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/307648/National_Space_Security_Policy.pdf

Joint Environment

2.1.18 In the Joint environment Joint Forces Command (JFC) continued to support our front line fighting services with its management of cross-cutting capabilities, such as Defence-wide intelligence, information, healthcare, cyber, logistics, education and training, and conceptual and doctrinal development. JFC also commands the Permanent Joint Headquarters, the overseas Permanent Joint Operating Bases and the United Kingdom's Special Forces and they, collectively, have been at the forefront of operations over the past year.

2.1.19 A new Joint Force Development organisation was established in September 2014, bringing together the Development, Concepts and Doctrine Centre, the Defence Academy and the Directorate of Joint Warfare. The new structure provides a single focus for the development of future joint operations from concepts to delivery.

2.1.20 In late 2014 we supported wider Government efforts, led by the Department for International Development, to combat the outbreak of the Ebola virus in West Africa.

2.1.21 By the end of the year we had successfully completed the drawdown from Afghanistan and oversaw the closure of Camp Bastion in Helmand Province.

2.1.22 In September 2014, the Joint Force Intelligence Group at Wyton achieved full operating capability and matured into a powerful, cross-government, multi-source intelligence hub. Over the same period we have initiated a transformation of the Department's delivery of information systems and services under the direction of a Chief Information Officer with over-arching responsibility for policy, procurement, delivery, and operations.

2.1.23 We made significant progress in the development of the Joint Expeditionary Force, since reaching initial operating capability a year ago. As a direct result of the NATO Summit in Wales, we welcomed officers from partner nations into the planning staffs from early 2015, helping to turn the concept into reality.

2.1.24 We have brought responsibility for delivering healthcare services for military personnel across Defence under the single direction of the Surgeon General. Work is now in hand to establish sustainable approach to delivery in close partnership with the National Health Service.

2.2 Transforming Defence – People

Future Reserve 2020

2.2.1 Two years after publishing the Reserves' White Paper[10], 39 of the 40 deliverables have either been achieved or are on track for delivery. The outstanding issue, development of the Army's Recruiting Partnering Project, continues to show progress, albeit more slowly than desired. The governance of FR20 underwent a substantial review in late summer 2014 and was restructured to recognise the shift in priority to the single Services for the delivery of the programme's outcomes.

2.2.2 More effective use of the nation's volunteer Reserves has been enabled by the commencement of the Defence Reform Act in October 2014 and the subsequent establishment of four standing call out orders against which the Services can mobilise Reserves. Beyond routine activity, recent mobilisation of Reserves has included support to Operations GRITROCK (Ebola) and SHADER (Iraq). Amendments to the Reserve Forces (Call-Out and Recall) (Financial Assistance) Regulations 2005 came into force on 27 March 2015. The role of the Reserves' External Scrutiny Team was formalised in the last Parliament and its third report is expected in June 2015.

2.2.3 The services are exceeding their targets for Trained Strength (TS) and volunteer Reserve forces continue to grow. The Maritime Reserve (MR) has recruited 860 against the FY 2014-15 target of 740 and has a TS of 1,980 against the FY 2014-15 target of 1,790. The Army Reserve Development Programme (ARDP) has recruited 4,480[11] against the FY 2014-15 target of 4,900 and has a TS of 21,030 against a target of 19,900. The Royal Air Force Reserve (RAF(Res)) has recruited 740 against the FY 2014-15 target of 600 and has a TS of 1,620 against the FY 2014-15 target of 1,400[12].

2.2.4 Reserve recruitment and marketing strategies have been reviewed in order to increase the level of understanding of Reserves amongst the recruitment target audiences and wider society, whilst better promoting the Reserves' offer. Progress has also been made in debunking some of the myths surrounding Reserve service through wider engagement, particularly at local and regional levels.

2.2.5 Considerable headway has been made in improving the recruiting experience for candidates. On-line applications are now standard; medical and security clearance processes have been simplified to remove delays; there are better communications between candidates and recruiters, along with more support for candidates from their chosen unit, throughout the recruiting process. As a result, time taken from application to enlistment is reducing significantly in most cases.

2.2.6 The offer to Reserves is generally accepted as the best ever, with paid leave now in force and pension entitlements coming into effect for periods of training as well as mobilisation from 1 April 2015. Occupational Health provision has been improved as has the availability and quality of welfare support. Terms and conditions of service have been improved and additional benefits, such as extending entitlement to the Armed Forces Railcard to Reserves, have been delivered. The 2015 Reserves Continuous Attitude Survey was launched on 5 January 2015, and the results were published on 11 June 2015.

2.2.7 From 1 April 2015, people on Jobseeker's Allowance or Income Support who sign up to be reserves will be able to train for up to a total of 43 days in their first year without having to sign off. Armed Forces Employability Pathways (AFEP) are being rolled out nationally. Under this scheme job seekers who are eligible, suitable and interested in the Armed Forces will be directed and screened, by Job Centre Plus and the Work Programme, onto military insight courses. These are followed by opportunities for pre-employment training and/or work experience with civilian employers.

2.2.8 Polling carried out quarterly throughout the year has shown a steady improvement in favourability and positive attitudes towards the reserves. Set piece events such as: Reserves Day (former Uniform to Work Day), International Women's Day, and Skills' Week all highlighted the volunteer reserves' contribution to Defence and the benefits that reserve service can offer.

Reservists conducting their Cold Weather Warfare Course (CWWC) in Norway

10 Reserves in the Future Force 2020: Valuable and Valued, dated Jul 13.
11 In addition to WMS related inflow the Army achieved non-WMS inflow of 730 against an assumption of 225. Overall inflow into the Army Reserve Group A in FY 2014-15 was 5210.
12 Against targets laid out in the Defence Secretary's Written Ministerial statement, dated 19 Dec 13.

Maritime Reserve

2.2.9 Significant progress has been made in delivering the estate betterment programme: the Prime Minister opened a new facility in Edinburgh; a visit by HRH Duke of York marked the completion of the £1.2M upgrade to HMS PRESIDENT (London); and HMS HIBERNIA (N Ireland) celebrated the completion of a £1M refurbishment project. Work is in hand to complete a further four projects by March 2016. All units have benefitted from upgrades to IT, fitness suites, and appearance. Pairing arrangements between Maritime Reserve units and ships are paying dividends for all parties. The training pipeline is being streamlined to reduce the time taken for a Reservist to join the Trained Strength.

Army Reserve

2.2.10 Recruitment into the Army Reserve continues to improve and trained strength remains ahead of target; this has been delivered through a programme of continuous improvement focused on the candidate experience and journey, combined with close mentoring and assistance of candidates through the application process and throughout initial training. The recent Reserve Officer Career Review examined how we could improve the reserve officer experience. Wider capability improvement continues with the fielding of modern dismounted close combat equipment, routine access to more complex equipment (for example Challenger 2 Tanks), streamlining of special-to role training, and the delivery of demanding training opportunities at home and overseas alongside Regulars.

2.2.11 In the fight against Ebola, the medical reserve has proved invaluable, in Afghanistan a reserve infantry platoon serves as part of the regular-led Kabul Security Force; and reserves continue to provide a routine and prominent contribution to the UK element of UN Forces in Cyprus. Playing an important part in Defence Engagement and capacity building overseas, Reserves have recently deployed on Short-Term Training Teams in Nigeria. The Army has introduced the accreditation of military skills into recognised civilian academic and vocational qualifications and has made it easier for Reservists to access the MOD's Standard Learning Credits scheme.

Royal Air Force Reserve (RAF(Res))

2.2.12 Recruiting of direct entrants was particularly strong this year with a high number of ex-Regular, trained entrants recruited – aided in part by the introduction of an ex-Regular financial incentive. The Reserves' Continuous Attitude Survey showed that the RAF Reserves were well-motivated and felt well-integrated with their Regular colleagues. The utility of the component continues to be demonstrated by healthy mobilisation statistics, with up to 190 reservists mobilised at any one time during the year for tasks as diverse as: force protection in Afghanistan; support to Intelligence outputs and Defence exercises; support to ceremonial events; and most recently to deployments on Operations GRITROCK and SHADER.

Joint Forces Command

2.2.13 Recruiting into the Cyber Reserve has reached its targets for FY 2014-15 with a healthy rate of applications and inflow being sustained. Recruiting into the Defence Medical Services Reserves improved significantly in FY 2014-15. This was principally a benefit of a flourishing relationship with the NHS, which has acknowledged the benefits it accrues from Defence in terms of leadership and medical trauma skills. At the highest level, the MOD and Departments of Health across the four home nations are collaborating to ensure an effective proposition for the military component of the national health sector workforce.

Armed Forces Covenant

2.2.14 The Armed Forces Covenant sets out the moral obligation the nation owes to our Armed Forces personnel, Veterans, and their families. Its key principles are that the Armed Forces Community should face no disadvantage compared to other citizens in the provision of public and commercial goods and services, and that special consideration is appropriate in some cases, especially for those who have given most, such as the injured and the bereaved.

2.2.15 The Armed Forces Act 2011 places a statutory obligation on the Secretary of State to report to Parliament each year on the Armed Forces Covenant. The 2014 Covenant Annual Report was published in December 2014 and can be found on the internet[13]. It focused on those areas that have the greatest effect on the Armed Forces Community – healthcare, education, housing, and the operation of inquests. It noted:

- the completion of the £138 million Midlands medical accommodation project, a world-class centre of excellence for the training and delivery of Defence Medical Services;

13 https://www.gov.uk/government/publications/armed-forces-covenant-annual-report

- our change in policy so that, from April 2015, service widows, widowers and surviving civil partners will be able to retain their pensions for life, including if they subsequently remarry;

- that £17.4 million had been allocated through the Department of Education to support the needs of some 58,000 pupils from service families;

- the increase in the MOD Education Support Fund to £6 million per year and its extended timeline to 2017-18, to help schools who support children from service families as personnel drawdown from Germany and rebasing takes place in the UK;

- the introduction of the Forces Help-to-Buy Scheme to make it easier for Armed Forces personnel to get on to or stay on the property ladder. The scheme has already allocated around £45 million to help over 4,500 Service Personnel;

- that we had committed £40 million to support 16 new accommodation projects that will help Veterans across Great Britain; and

- that we had sponsored career assistance programmes designed for service partners which had already supported over 250 spouses.

2.2.16 The 2014 Covenant Annual Report also reflected the full breadth of Covenant-related work, on which we continue to make good progress. All 407 Local Authorities in Great Britain have now signed a Community Covenant. The aim of the Community Covenant is to encourage local people to support members of the Armed Forces Community in their area and develop greater public understanding of the issues that affect them. In the coming year the MOD will work more closely with Local Authorities to help spread best practice, and improve the services they provide for the Armed Forces Community.

2.2.17 The Corporate world has been increasingly keen to show its support for the Armed Forces Community. The Corporate Covenant, introduced in 2013, enables businesses and charities to make specific pledges of support for the Armed Forces Community across a range of employment and service issues. As noted above, more than 550 Corporate Covenants have been signed by big and small organisations alike. Westminster Security, a London-based security and investigation company became the 500th organisation to sign. In 2014 we launched the Defence Relationship Management organisation to provide a dedicated team to co-ordinate and develop our engagement with employers, and they took on the lead for the Corporate Covenant in November 2014.

2.2.18 The Government's commitment to ensuring that the Armed Forces Community is recognised and supported continues to be demonstrated by the financial support it provides to Service charities and other good causes. Over the past four years it has allocated over £150M including: £30M for a Community Covenant Grant scheme; £35M for a grant scheme which was allocated to 96 projects during 2013-15; £20M to improve the infrastructure in support of childcare provision for Service families; and a further £21M from 2014 for key World War 1 and 2 commemorations, Veterans with Service-related hearing issues, and to help the Ghurkha trust set up a third care home for Ghurkhas in Nepal. During the year we announced all but one of the 16 successful applications for the £40M Veterans' accommodation fund. The Chancellor has allocated a further £10M per annum from 2015-16 in perpetuity to support the delivery of Armed Forces Covenant commitments as well as a separate £25M, which will be available over the next five years in support of healthcare for Aged Veterans. An additional £50M of LIBOR funding in support of military charities and other good causes was announced during the Budget in March 2015, including £10M for regimental charities on the basis of need arising from the Afghanistan campaign.

The Prime Minister speaking at the Armed Forces Covenant Celebration on 17 July 2014

New Employment Model (NEM) Programme

2.2.19 The New Employment Model (NEM) Programme was announced as part of the Strategic Defence and Security Review (SDSR) October 2010, and is a wide ranging review of Service Personnel Terms and Conditions of Service.

2.2.20 The NEM is a strategic programme looking out to 2020 and beyond. It will update the current package of Terms and Conditions of Service (TACOS), which is costly, complex, and does not align sufficiently with the expectations of Service Personnel and their families, as evidenced by recent trends in the Armed Forces and Families' Continuous Attitude Surveys. It aims to maximise recruitment and retention effect within available resources, recycle efficiencies, and produce a modernised offer that better supports lifestyle choice and reduces the impact of service life on individuals and their families.

2.2.21 The NEM sets a direction of travel towards a modernised 'offer', with a rolling programme of implementation due to be complete by 2017, with transition continuing to the nominal end-of-life of the programme in 2020. The result will be a measured shift, over time, in the nature of the overall employment offer, delivered in an affordable and realistic way, whilst maintaining the confidence of existing personnel.

2.2.22 Some changes have already been introduced, around allowances and the introduction of a three-year Forces Help-to-Buy pilot scheme, providing an interest-free loan to Service Personnel. Over the past year NEM has also continued to develop policy over four broad areas: Pay and Allowances; Accommodation; Training and Education; and Career Structures and Career Management.

2.2.23 Accommodation The three year "Forces Help to Buy" pilot was introduced on 1 April 2014 and offers Regular personnel loans of up to 50% salary, capped at £25,000, interest-free and repayable over a 10-year period. The scheme has proven popular in the first year and supported 3,046 Service Personnel to join or stay on the property ladder. A total of £45.5M has been advanced, averaging approximately £15,000 per claim. A further 1,526 applications have been fully approved by MOD and are expected to receive support in the coming months as property purchases complete. Additionally, those individuals leaving the Service as a result of the recent redundancies had the opportunity to apply for an advance of their lump sum payment to enable them to buy a home before leaving Service.

2.2.24 On 24 October 2014 the MOD announced, through a Written Ministerial Statement, the introduction of a new charging system for Service Family Accommodation from 1 April 2016. This replaces the current grading system with a fairer, more transparent, simplified, and modern approach. The new system will still consider condition, size, and location of the property, but will use modern, objective assessments - for example, condition will be assessed against the Department for Communities and Local Government's 'Decent Homes Standard'. A survey programme is underway to provide underpinning data to allow every property's accommodation charge to be accurately reassessed against the new criteria. Accommodation charges will continue to be subsidised by the Department and, as now, the Armed Forces Pay Review Body will make recommendations to the Department on the level of charges that should be applied.

2.2.25 Responsibility for the Partner Employment Project has now transferred from NEM to the Families and Veterans' Welfare team, with provision being established within the MOD Career Transition Partnership contract re-let in October 2015 for spouses of Service Personnel to obtain employment readiness training.

2.2.26 Pay Reform The NEM continues to develop a new pay model, which will be simpler, more efficient, and enable better targeting of reward to recognise higher value trades. The new pay model will provide Service Personnel with greater pay predictability and remove some of the unpopular and divisive features of the current pay model (Pay 2000). Importantly, it will retain the fundamental characteristics of rank-based pay progression, consistent with the base-fed nature of military personnel structures. Progress over the last year has included Defence Board agreement of the fundamental structure of the model, which is now being developed in greater detail. Significant progress has also been made to gather additional Job Evaluation evidence to enable and support subsequent decisions on pay treatment for the different trades of Ratings and Other Ranks. Meanwhile, Defence Statistics have developed bespoke tools to assure cost modelling and affordability. Introduction of the new pay model is planned for 1 April 2016.

2.2.27 Training & Education The New Employment Model is examining a number of different ways to deliver training more effectively and efficiently. Training, education, skills, and personal development will remain an extremely important part of Service life and one aspect that makes a career in the Services an attractive proposition. Through-career training and education is being reviewed to ensure that we offer Service Personnel the best opportunities for career development.

2.2.28 We are developing proposals for a consolidated Personal Development Pathway (PDP), which eventually will link life skills, through career training, and resettlement training into a planned and coherent structure. Through-life training and education will be reviewed to ensure that they offer Service Personnel the best opportunities for career development. The PDP aims to equip personnel early on and through their career with skills that can be used within Service and which have a career focus to help prepare for a successful second profession in civilian life. A review of Enhanced Learning Credits and Standard Learning Credits schemes is underway to support through life learning and encourage Service Personnel to manage their current and future personal development.

2.2.29 In order to provide more stability for Service Personnel, we will try, where possible and appropriate, to reduce time spent away from home on courses by expanding the amount of career training that can be delivered at regional centres, home units, or via distance learning/e-learning. This should allow Service Personnel to spend more time at their home base rather than being away from their family on courses. This will be achieved by reviewing courses to determine whether elements of them can be distributed away from centralised residential training schools, in tandem with this we are developing a means for Service Personnel to record time spent on authorised study via Joint Personnel Administration.

2.2.30 Terms of Service NEM introduced a set of simplified engagement structures from 1 April 2015, which aims to be more attractive to new joiners and provide more organisational agility to respond to changes in manpower requirements of the Armed Forces. Aligned around the new Armed Forces Pension Scheme 2015, the new engagements will see new joiners offered, in most cases, an initial period of no less than twelve years. Where there is a Service need, and individuals wish to continue to serve, they will be offered Service to twenty years, or to age 40 whichever is the later. Further Service extensions of service, up to age 60, are possible subject to there being a Service need. Each Service has bespoke mechanisms for transitioning Service personnel to the new structures which align to the needs of the individual Service.

2.2.31 NEM is developing a common set of tri-Service career management principles and whilst career management processes remain the preserve of the Services, the adoption of an agreed set of principles supports our aspiration to make career management more transparent and standardised across the Services. It is planned to introduce these new arrangements from 2016.

2.2.32 The programme is also scoping the opportunity for focused career and professional development of officers from OF3 upwards. This focus will improve Operational capability by ensuring that specialist and professional development is managed to enhance the alignment of skills, training and experience with specific roles as they proceed through their career. We plan to implement changes from 2017.

2.2.33 Reserves' Terms and Conditions of Service (TACOS) Defence is committed to the principle that Conditions of Service for Regulars and Reserves should be broadly equivalent for comparable levels of commitment, and any difference in treatment would need to be justified against Service requirement. Consideration of Reserve forces is now an aspect of every component, with several strands of work specific to the Reserves being undertaken under the NEM umbrella including:

a. A review of the non-specialist monetary cap on the Reservists' Award (payable when Reserves are called into permanent service). The maximum permissible value has been reduced and the new cap was introduced from 1 April 2015.

b. Changes to the Conditions of Service for those undertaking an Additional Duties Commitment to enable their participation in long training courses or exercises. These changes came into effect from 1 April 2015.

c. A review of the Reserve Training Bounty payment is underway. Options to re-structure the payment better to support the future Reserve training requirement will be considered by the Armed Forces Pay Review Body as part of their 2015-16 programme of work.

Armed Forces Remuneration

Armed Forces Pay

2.2.34 In their annual report published on 12 March 2015, the Armed Forces' Pay Review Body (AFPRB) recommended that Service Personnel should receive a 1% pay award from 1 April 2015. The Government accepted this recommendation in full. The Government also accepted in full the AFPRB targeted increases aimed at supporting retention within specific cadres.

2.2.35 Service Personnel are not affected by wider Public Sector incremental pay reforms and so, subject to satisfactory performance, all Service Personnel who are not at the top of their pay range will continue to receive an increment in pay each year in addition to any annual pay award recommended by the AFPRB.

Development of the new Armed Forces Pay Model

2.2.36 As discussed in the New Employment Model section, the MOD continues to develop a new Armed Forces Pay model.

Armed Forces Allowances

2.2.37 The Department has achieved the planned saving of £250M per year on Service allowances through measures introduced following the 2010 Strategic Defence and Security Review (SDSR). The effectiveness of the allowance package to meet the needs of Service Personnel, including the Reserve cadres, is monitored regularly and the priority for policy review is set jointly by the Services and central policy staffs. The priority for 2014-15 was to assess, and then address, the perceived dis-incentives to Service Personnel serving in overseas posts. Evidence showed that, for many Service Personnel, overseas service was not considered to be valued and the associated domestic upheaval, including the impact on spousal employment, made volunteering for overseas service less attractive. This could have affected our ability to select the right Service Person to support our Defence Engagement priorities. A package of measures to enhance the overseas offer was developed and considered by the Defence Board, who approved funding for it. These measures were introduced on 1 April 2015.

Armed Forces Pension Schemes

2.2.38 A new Armed Forces Pension Scheme (AFPS) was introduced on 1 April 2015. The scheme, known as the AFPS15, delivers on the recommendations set out in Lord Hutton's Independent Public Service Pensions Commission[14] to reform public service pension schemes and ensure that they are more affordable and sustainable in the long-term. This Career Average Re-valued Earnings (CARE) scheme replaces all current schemes with benefits protected for those transferring.

2.2.39 From 1 April 2015, members of the Part-Time Volunteer Reserve (PTVR) will be enrolled into AFPS 15. All Service, including paid attendance-based training and periods of mobilised service, will be pension earning and enrolment in a single scheme should make transition between Regular and Reserve service much easier. The only significant difference will be that Reserves will not qualify for an Early Departure Payment or Resettlement Grant.

2.2.40 As part of Lord Hutton's recommendations, to provide protection to the taxpayer against changes in scheme costs, the Government has introduced a cost cap mechanism as part of their wider Public Sector Pensions reform. If the cost of a scheme determined at a future actuarial valuation differs from the employer cost cap by more than 2% of pay, then action must be taken to bring the cost back to this level. The Government Actuary's Department, acting as the Scheme Actuary, has determined the cost cap for AFPS15 to be 34.6% of pensionable pay. The detail behind both this result and the Employer contribution rate (also known as the SCAPE rate) can be found in the valuation reports published in March 2015. The valuation reports can be found at: https://www.gov.uk/government/publications/actuarial-valuation-of-the-armed-forces-pension-scheme

2.2.41 Also, from 1 April 2015, a Scheme Advisory Board and a Pension Board have been established and are responsible for ensuring that all Armed Forces Pension Schemes are managed and administered efficiently, effectively, and transparently. The Scheme Advisory Board has the authority to recommend changes to scheme rules; the Pension Board is responsible for assisting the Scheme Manager (the Secretary of State) to comply with the scheme regulations and other legislation relating to the governance and administration of the scheme. A Shadow Pension Board took place on 4 February 2015 and the first Pension Board meeting took place on 5 May 2015. The Pension

14 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207720/hutton_final_100311.pdf

Board is led by a Non-Executive Director Chair, Mr Robert Branagh, and has seven employer and seven employee representatives.

Armed Forces Compensation Scheme

2.2.42 The Armed Forces Compensation Scheme (AFCS) continues to provide no-fault compensation for members of the Armed Forces, including Reserves, where illness, injury, or death is caused by Service.

2.2.43 The medical and scientific aspects are scrutinised by the Independent Medical Expert Group (IMEG), an advisory Non-Departmental Public Body, ensuring the Scheme reflects contemporary understanding. Their third report was published in March 2015 and includes consideration of infectious diseases, mesothelioma, non-freezing cold injury, outcome after amputation, compensation aspects of combat-related complex lower limb injuries, and recognised diseases, including diabetes mellitus, testicular cancer, and the leukaemias. The conclusions and recommendations are an important part of ensuring that the Scheme remains equitable and supports Service Personnel. It can be found at: IMEG Reports.

Training and Education

2.2.44 The Nation faces a critical skills shortfall, particularly in Engineering, but in many other disciplines too. This presents a Strategic Workforce Challenge for Defence and so the Department is developing measures to improve the recruiting, development, and retention of skilled personnel in order to address its Manning Pinch Points. Although Financial Retention Initiatives may address problems in the short-term, a longer term plan involving industry, academia, and OGDs is needed and so the Department is considering solutions as wide-ranging as lateral entry into the Armed Forces and is actively developing an Enterprise Approach with industry to tackle the issue systematically across all Lines of Development.

Soldiers receiving a briefing from an author as part of their educational development

2.2.45 In addressing the increased importance of skills in the workforce, the Government has raised targets for Apprenticeships. In response, the MoD is developing a Skills Communications Strategy to align, coherently and deliberately, our main outputs with our organisational objectives enabling all four Services to exploit the skills agenda messaging. It guides our culture to communicate effectively both internally and externally about the skills required of our civilian and military personnel, the development opportunities available, and the skills that personnel acquire during their time in Defence. It is driven by the heuristic context of **Attract, Recruit, Train, Develop, Retain** and **Transition** framework with a main effort on **Attract (external)** and **Retain (internal)**.

2.2.46 In response to a series of reports and studies by Ofsted, the House of Commons Defence Committee, Lord Lingfield's review into the professionalisation of Further Education, and a series of research projects on behalf of Defence, we are now committing significant resource to up-skill our Trainers. The purpose of this, is to ensure that Defence Trainers can meet the challenges presented by the modern learner, either in a formal or informal learning environment. Trainers will have a much wider range of skills at their disposal, with emphasis on modern techniques, an increased use of learning technologies, critical self-reflection, and the ability to undertake CPD.

Welfare

2.2.47 Support to our wounded personnel and bereaved families continues to be a key priority. We commissioned an End-to-End study into Defence **Casualty and Compassionate** processes, which is due to report later this year. We also commissioned a study to provide a framework for assuring welfare support to our **Reserve Forces** personnel. We have continued to support a number of charities who contribute to Service Personnel welfare, particularly at Christmas time.

2.2.48 Our **MoneyForce** programme (MoneyForce.org.uk), developed in partnership with The Royal British Legion with funding from Standard Life Charitable Trust, continues to provide benefit in improving knowledge about personal finance, and we introduced the **HomeFinder** tool to highlight considerations when purchasing property. The **Defence Discount Service** contract has been extended for a further year and the scheme continues to grow at a monthly rate of c.1600, providing benefits to serving and retired personnel. We are also introducing an Armed Forces **Credit Union** scheme in Summer this year to allow our personnel access to safe and affordable loans.

2.2.49 The **Defence Recovery Capability** was reviewed in June 2014, one year after reaching full operating capability. The single Service delivery models were deemed appropriate and **Ofsted** was commissioned to develop an independent 3rd Party Assurance Framework; the pilot project reported in April 2015 and Ofsted will commence a formal assurance programme in November 2015.

2.2.50 We continued to support the Department of Health, NHS (England), and the Service Charities on Veterans' health issues, including attendance at the quarterly **Health Partnership Working Group**, chaired by Armed Forces' charities A national shared **Vision for Veterans** has also been agreed by Government, Devolved Administrations, Local Authorities, and the charitable sector, to agree principles for support within the Armed Forces Covenant framework.

2.2.51 Projects to understand better the **mental health** of **Reserve** personnel, including post-deployment, were commissioned in 2014; these will report in 2016.

2.2.52 In August 2014 a Tri-Service Working Group was created to identify key policy and behavioural changes to support a **reduction in alcohol misuse** in the Armed Forces. An Alcohol intervention pathway is being developed.

2.2.53 As the Defence Authority for Health, CDP directed the development of a **Defence People Health Strategy and Plan** to establish and sustain a through-life process that creates a healthy culture, fosters wellbeing and mitigates risks to health; this was published in April 2015.

2.2.54 We are trialling a **Partner Employment Project** over two years from October 2015 to support spousal and partner employment.

2.2.55 Research to understand better the needs of **geographically dispersed families** in partnership with Dstl, Armed Forces Families Federations, and the Forces in Mind Trust is ongoing.

Manpower

Manning Levels

2.2.56 Overall manning levels for the Armed Forces are published regularly by UK Defence Statistics and can be found at https://www.gov.uk/government/organisations/ministry-of-defence/about/statistics

Redundancy

2.2.57 As part of the SDSR 2010 reductions, each Service was required to reduce their headcount. Under the Armed Forces Redundancy Programme (AFRP) around 11,340 Armed Forces personnel had left MOD by 31 March 2015 under Tranches 1, 2, 3 and 4. The remaining personnel from Tranche 4, comprising those who did not apply for redundancy, left the MOD on 11 June 2015. There is no requirement for a further tranche of redundancy to meet the SDSR 10 personnel targets. Further details on redundancy numbers can be found at https://www.gov.uk/government/organisations/ministry-of-defence/about/statistics

Voluntary Outflow (VO)

2.2.58 Voluntary Outflow (VO) is defined as 'all exits from Trained personnel which are generated by the individual before their time expiry date'. The VO rate for Officers across the Services has decreased between 31 March 2014 to 31 March 2015, decreasing from 4.5% to 4.4%, and increased from 5.4% to 5.5% amongst Other Ranks in the same period. Overall Voluntary Outflow figures for the Armed Forces are published by UK Defence Statistics, and can be found at https://www.gov.uk/government/collections/uk-armed-forces-monthly-manning-statistics-index

Recruiting

2.2.59 Delivery of recruiting success continues to be challenging within the current, less permissive, recruiting environment, which has been generated by the continuing economic upturn, withdrawal from operations, and uncertainty over redundancies and conditions of service. Additionally, the delay in the delivery of the new recruiting Information Communications Technology support to all three Services through the Army Recruiting Partnering

Project (RPP) contract has further complicated delivery of processes. These factors, combined with a forecast demographic decline in the 16-25 year old population mean that the challenges of recruiting to sustain the Regular Forces and to grow the Reserve Forces to the numbers required remain considerable.

2.2.60 Overall, RN and RAF Regular recruiting is forecast to achieve targets within tolerable risk levels (circa 90%), albeit with some specific shortages – principally engineering branches and trades. Army Regular recruiting is forecasting a 20% (2199) shortfall in soldier entrants and the focus for 2015-16 will be to address this shortfall. Overall, there has been an improvement over 2013-14 Reserves recruiting performance, where Regular re-joiners have boosted Reserves recruiting numbers significantly. Active national recruiting campaigns, sponsorships, and new media partnerships have largely been successful in increasing recruiting activity throughout the year.

Operational Pinch Points (OPPs)

2.2.61 The MOD is committed to publishing data on Operational Pinch Points (OPPs), which is defined as a branch specialisation, sub-specialisation, or area of expertise where the shortfall in trained strength (Officers or Other Ranks) is such that it has a measurable, detrimental impact on current, planned, or contingent operations. OPPs may result from adherence to single Service harmony guidelines, under-manning, and/or levels of commitment that exceed the resourced manpower ceiling for the trades or areas of expertise involved.

2.2.62 The management and mitigation of OPPs is a priority, with the focus being on incentivising personnel to join (and/or retrain) and remain within pinch point trades. OPPs are managed by the single Services. Personnel in OPPs are always excluded from Redundancy. The position as of 1 April 15 is set out at Table 2.2.1. This table excludes information that might jeopardise operational security.

Naval Service

2.2.63 As at 1 April 2015, the number of Naval Service OPPs was 20. Critical OPPs are centred on General Service and Submarine Engineering capabilities, and Nuclear Watchkeepers. Insufficient supply of engineering skills in the wider economy has created a highly competitive market for the Naval Service, impacting on Engineering recruitment and retention. This challenge is compounded by the long training pipeline associated with this cadre, as well as operational and platform demands. A significant range of financial and non-financial initiatives is having impact in temporarily reducing VO rates for some OPPs, but delivering the Future Navy Campaign Plan is key to mitigating these issues in the long term.

Army

2.2.64 As at 1 April 2015, the Army had 2 OPPs, a reduction of 23 from last year. The 2 OPPs that remain are due to the demand from Op GRITROCK for Infection Prevention Control Nursing Officers, and insufficient Para-trained OR2 in the Royal Artillery to meet Air Assault Task Force in role demand. Mitigation measures are in place to reduce further the number of pinch points and the performance of these is measured through the Manning Balance Working Group.

RAF

2.2.65 As at 1 April 2015, the number of RAF OPPs was 19. The OPPs are in part caused by the current high levels of commitment, in particular in specialist cadres. In some cases there is a shortage of personnel, particularly pilots, engineers, logisticians, and intelligence personnel. Each of these OPPs is monitored closely and subject to the application of manning levers including extensions of service, retention incentives, and offers of permanent commissions. Furthermore, all of the identified OPPs are utilising Reserves to mitigate manpower shortfalls. Consequently, the overall impact is being mitigated successfully.

Table 2.2.1 – Operational Pinch Points

Naval Service Operational Pinch Point Groups 1 April 2015		Liability	Shortfall	% Shortfall
1	Above Water Warfare specialist – Rank: Leading Hand	130	20	15%
2	Above Water Tactical specialist – Rank: Leading Hand	160	35	20%
3	Weapon Engineer Officer (Submarines) – Rank: Lieutenant	90	~	~
4	Marine Engineer General Service – Rank: Leading Hand	515	35	~
5	Weapon Engineer General Service – Rank: Leading Hand	355	70	20%
6	Medical Technician (Operating Department Practitioner) – Rank: Leading Hand to Chief Petty Officer	25	~	25%
7	Submarine Coxswain – Rank: Chief Petty Officer	25	~	~
8	Strategic Weapons Systems Engineers – Rank: Leading Hand to Warrant Officer 1	255	90	35%
9	Seaman specialist – Rank: Able Rate	410	30	~
10	Marine Engineer General Service: Rank: Chief Petty Officer	400	85	20%
11	Medical Assistant (Submarines) – Rank: Senior Rates	40	~	10%
12	Chef – Rank: Able Rate to Leading Hand	500	10	~
13	Hydrographic Services – Rank: Leading Hand	25	10	40%
14	Mine Warfare – Rank: Leading Hand to Petty Officer	155	40	25%
15	Tactical Weapon Systems engineer – Rank: Petty Officer to Chief Petty Officer	285	115	40%
16	Underwater Warfare specialist – Rank: Able Rate to Petty Officer	300	95	30%
17	Submarine Sonar specialist (SSM) – Rank: Able Rate	155	~	~
18	Marine Engineer General Service – Rank: Petty Officer	560	240	45%
19	Weapon Engineer General Service – Rank: Petty Officer	375	140	40%
20	Nuclear Watchkeepers – Rank: Petty Officer to Warrant Officer 1	590	115	20%

Army Operational Pinch Point Groups 1 April 2015		Liability	Shortfall	% Shortfall
1	Royal Artillery – Para Trained Gunner – Rank: OR2	135	20	15%
2	QARANC Infection Prevention Control Nursing Officer	15	10	45%

RAF Operational Pinch Point Groups 1 April 2015		Liability	Shortfall	% Shortfall
1	Intelligence Branch – Rank: OF2	180	35	20%
2	Logistics (Supply) – Rank: OR2-4	1520	90	~
3	RAF Regiment Officer – Rank: OF2	200	~	~
4	Logistics (Driver) – Rank: OR2-4	805	35	~
5	RAF Police – Rank: OR1-7	1060	120	10%
6	RAF Regiment Gunner – Rank: OR1-3	1610	150	10%
7	Medic – Rank: OR1-6 and 9	545	65	10%
8	Logistics (Catering) – Rank: OR1-9	430	45	10%
9	Intelligence Analyst – Rank: OR1-7	765	60	10%
10	Logistics Branch – Rank: OF2	490	65	15%
11	Pilot – Rank: OF2-3	1750	280	15%
12	Engineer (Comms & Electrical) – Rank: OF2	330	20	~
13	Fire Fighter – Rank: OR1-2	445	10	~
14	General Technician (Electrical) – Rank: OR1-7	475	95	20%
15	Logistics (Chef) – Rank: OR1-6	495	100	20%
16	Engineer (Aero Systems) – Rank: OF2	315	45	15%
17	Intelligence Analyst Voice – Rank: OR1-9	170	25	15%
18	General Technician (Mechanical) – Rank: OR1-7)	840	140	20%
19	Information Communications Technician – Rank: OR1-7	2370	215	10%

Notes:
* Figures have been rounded to 5 in order to prevent unnecessarily obscuring the data. However, to prevent disclosure any numbers less than 5 are shown as '~'.
* Where rounding has been used, totals and sub-totals have been rounded separately and so may not equal the sums of their rounded parts. Shortfall figures are calculated as at 01 April 2015.
* Liability set at different points in the year, Naval Service liability data is at 1 February 2015 and Army and RAF liability data is at 1 January 2015.

Table 2.2.2 – Breaches of Harmony Guidelines by Service

	Apr 11	Jul 11	Oct 11	Jan 12	Apr 12	Jul 12	Oct 12	Jan 13	Apr 13	Jul 13	Oct 13	Jan 14	Apr 14	Jul 14	Oct 14	Jan 15	Apr 15
Naval Service Harmony	0.8	0.6	0.7	0.7	0.5	0.6	0.7	1.0	0.9	0.8	0.6	0.7	0.7	0.7	0.5	0.4	0.4
Army Harmony	5.2	5.0	5.2	5.0	5.5	5.3	5.7	5.2	5.1	4.7	5.1	4.9	3.9	3.8	3.8	3.3	3.0
RAF Harmony	2.7	2.8	3.0	3.1	3.2	3.1	3.4	3.7	3.6	3.5	3.7	4.0	1.4	1.4	1.5	1.5	1.3

Percentages have been calculated from unrounded data.
Figures are for Trained UK Regular Forces, and therefore exclude Gurkhas, Full Time Reserve Service Personnel and mobilised reservists.
Until April 2014 for the RAF, percentages are calculated as a proportion of average strength for the 24 month period. From April 2014 percentages are calculated in the same way as the Naval Service and Army.

Harmony

2.2.66 As at 1 April 2015, the proportion of Service Personnel in breach of harmony guidelines was 0.4% for the Naval Service, 3.0% for the Army and 1.3% for the RAF. The nature of short-term operational and force structure requirements is such that it is unlikely that the Armed Forces would be able to reach a point where no one is in breach of harmony guidelines; the best we can achieve is to reduce the number of unnecessary breaches to a minimum whilst still meeting our operational and force structure requirements. The levels of harmony breaches are shown in Table 2.2.2.

Harmony Definitions

2.2.67 For the **Naval Service**, personnel on trained strength are considered to be in breach of harmony guidelines on a particular date if they have spent more than 660 days away from home during the preceding 36 month period.

2.2.68 Until April 2014, **Army Personnel** on trained strength are considered to be in breach of harmony in the final month of the specified reporting period if they have spent more than 415 days in the 30 month period preceding. From April 2014 Army Personnel on trained strength are considered to be in breach of harmony in the final month of the specified reporting period if they have spent more than 498 days in the 36 month period preceding.

2.2.69 Until April 2014, **RAF Personnel** on trained strength are considered to be in breach of harmony if they have spent more than 280 days in the 24 months. From April 2014, RAF Personnel on trained strength are considered to be in breach of harmony in the final month of the specified reporting period if they have spent more than 468 days in the 36 month period preceding.

Service Complaints

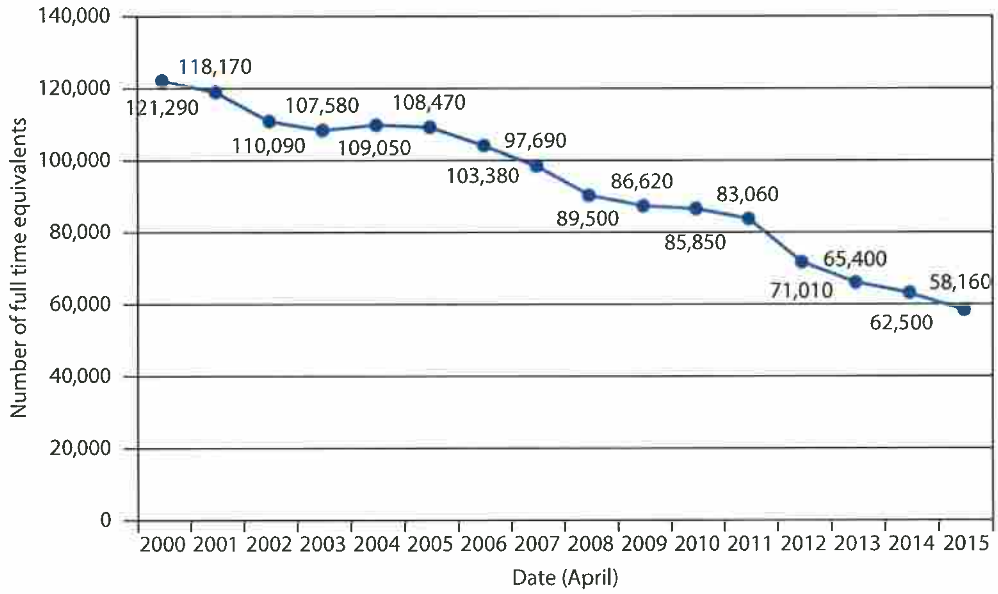
2.2.70 The post of Service Complaints Commissioner (SCC) was created by the Armed Forces Act 2006 with a remit which covers any complaint made after 1 January 2008. The Commissioner's role is to provide a rigorous and independent oversight of how the complaints system is working and to report to Ministers and to Parliament. The Commissioner also provides an alternative point of contact for Service Personnel, or someone acting on their behalf, such as a member of their family, a friend, or MP to raise concerns.

2.2.71 In June 2014, the MOD introduced the Armed Forces (Service Complaints and Financial Assistance) Bill; this received Royal Assent in March 2015. The new Act will simplify the complaints process and change the Commissioner's role to that of a Service Complaints Ombudsman with associated extended powers. The MOD is working with the SCC to understand fully the staffing and resource implications of the new legislation for the Ombudsman's office and considering the transitional arrangements to the new system

Civilian Workforce Numbers and Civilian contributions

2.2.72 Defence outputs are now delivered on a "whole force" basis. "Whole force" means we look at people holistically: military personnel – Regular and Reservists, Civil Servants, contractors and other civilians (such as Locally Employed Civilians), all contributing to the most cost-effective delivery of Defence outputs. The approach ensures that we maximise the effectiveness of an agile and affordable Departmental workforce. Civilians make up as essential component of Defence capability, supporting, and delivering Defence outputs within allocated resources. Over recent years we have, where possible and appropriate, deliberately civilianised tasks previously undertaken by (more expensive in per capita terms) military personnel.

Figure 2.2.1 – MOD Workforce – Level 0 Full Time Equivalent Numbers



2.2.73 The total civilian workforce fell by about 4,340 during the year, to around 58,160 on 1 April 2015. This represents a total reduction since 1 April 2010 of around 27,690 (see figure 2.2.1).

2.2.74 MOD civilians play a vital role directly supporting the success of military operations. They deploy alongside the military to operational theatres, and undertake a range of important roles in support of the mission. Throughout FY 2014-15 approximately 75 civilians deployed in support of operations in Afghanistan, and around 30 staff deployed to posts in the broader Middle East and Africa. During this financial year the number of deployable roles, which include policy advisors, finance and commercial staffs, intelligence analysts, and scientific advisers, has fluctuated between 8 and 20, depending on operational requirements. A marked achievement this year has been the end of the civilian contribution to Operation HERRICK and the transition to Operation TORAL in Afghanistan. In addition to deployments, there were approximately 200 MOD civilian visits to operational theatres in FY 2014-15. Visitors carry out work to meet urgent operational requirements, such as conducting vital maintenance on equipment.

2.2.75 Depending on the location and nature of their role, civilians must undertake appropriate training either through Reinforcements Training and Mobilisation Centre Chilwell or the "SAFE" course delivered by Pilgrims PLC. While in theatre, deployees and their families have welfare support available to them via the Employee Wellbeing Service. An allowance package recognises the long hours and difficult conditions of the civilian work force. Like their military colleagues, civilians complete a mandatory decompression programme prior to returning home; for Afghanistan this includes a structured programme in Cyprus and post-tour leave, allowing a period for rest and personal reflection before returning to "normal life". Advice is also available to line managers on how to assist deployees returning to work. Deployees have the opportunity to reflect on their experiences at bi-annual returnees' days and receptions hosted by PUS. The contribution that civilians make to operations in Afghanistan is recognised through the award of the Operational Service Medal, and the Accumulated Service Medal in appropriate circumstances.

2.2.76 At home in the UK too, provision of direct support to current and contingent military operations takes precedence over all other work. As part of the arrangements for crisis management, the Defence Board vests authority in a small team (Defence Main Effort Civilian – DMEC) to divert civilians to priority posts to help meet surge requirements in a range of UK-based roles in support of various crises. From offensive operations in the Middle-East to humanitarian assistance in response to Ebola, civilian manpower resources are diverted to support the Government's priorities, including ensuring that the Cabinet, military commanders, and senior officials are fully supported with appropriate policy advice and briefing at all stages of a crisis.

2.2.77 In enabling emerging MOD priorities to be promptly and effectively resourced, DMEC is also charged with sourcing additional civilian staff to meet surge requirements on wider Defence

Board priorities. This capacity to 'flex' the workforce temporarily has seen many high priority, non-operational programmes or teams supported through the diversion of 'surge' civilian personnel resources. Projects such as the Future Reserves programme, Strategic Capability reviews, the New Employment Model, as well as various current and planned efficiency reviews, have been rapidly resourced with the right skills to enable delivery against urgent Defence objectives.

Civilian Recruitment

2.2.78 The restrictions on the external recruitment to the Civil Service, which were first imposed in 2010, remain in place. They continue to affect civil service recruitment, with only limited exceptions for frontline and business critical staff, requiring approval from Director Resources (Senior Civil Servants) or Agency Chief Executives, and with Top-Level Budget Holders accountable to the Defence Board. The DE&S Bespoke Trading Entity has delegated authority to recruit to fill posts directly, determine their tenure and other conditions of appointment. To meet it's business need DE&S is exempt from Cabinet Office controls on external recruitment.

2.2.79 The intake to the Department (excluding Trading Funds) in 2014-15 was **3,490,** compared with 3,050 in 2013-14. Non-Industrial intake increased from 2,590 to **3,120** while Industrial intake decreased from 460 to **370.**

2.2.80 In accordance with our obligations to the Civil Service Commissioners' Recruitment Principles Table 2.2.3 shows the use of permitted exceptions to the principles of fair and open competitions and selection on merit in 2014-15.

Table 2.2.3 – Permitted exceptions to the Civil Service Commissioners Recruitment Principles

Exception	Non-Industrial	Industrial
Short – term appointments up to a maximum of 2 years to meet short term needs	139	6
Appointments of people with highly specialised skills and experience for up to 2 years	0	0
Inward secondments of up to 2 years	10	0
Reappointment of former Civil Servants	2	0
Transfer of an organisation into the Civil Service (inward TUPE)	26	0
Transfers of individuals into the Civil Service (e.g. COSOP)	0	0

Diversity and Inclusion

2.2.81 Defence views diversity and inclusion within its workforce as fundamental to the delivery of its outputs. While there is already significant activity to progress diversity and inclusion within the Armed Forces and MOD Civil Service, this has not delivered the traction and consistency that is required and the demographics of the workforce remain misaligned with that of UK society. The Defence Diversity and Inclusion Programme (DDIP) has been established as a Defence Board priority to cover all areas of Defence including both service and civilian personnel, to identify the interventions necessary and coordinate delivery to create the substantial changes required. The DDIP has overseen and validated self-assessments by all of the Top-Level Budgets and Trading Funds against a Diversity Maturity Model, which describes where Defence would ideally be as a mature, diverse and inclusive organisation. Out of this work, actions are being taken forwards against four key workstrands: leadership and culture; external engagement; recruitment; retention and progression. As a highlight, this year has seen the three single Services achieve top 100 rankings in Stonewall's Work Equality Index, which indicates that progress is being made.

High-Paid Off-Payroll Appointments

2.2.82 The tables below provide information on the MOD's most highly paid off-payroll appointments as required following the outcome of the Chief Secretary to the Treasury's Review of the Tax Arrangements of Senior Public Appointees (published on 23 May 2012).

Table 2.2.4 – For all off-payroll engagements as of 31 March 2015, for more than £220 per day and that last for longer than six months

	Main Department	Arms Length Bodies (Note 1)
No. of existing engagements as of 31 March 2015	273	
Of which		
No. that have existed for less than one year at time of reporting.	165	
No. that have existed for between one and two years at time of reporting.	59	
No. that have existed for between two and three years at time of reporting.	12	
No. that have existed for between three and four years at time of reporting.	7	
No. that have existed for four or more years at time of reporting.	30	

Notes: (1) The MOD's three Trading Funds (the Defence Support Group, the Defence Science and Technology Laboratory and the UK Hydrographic Office) are outside the MOD's Departmental Accounting Boundary and are reporting their High-Paid Off-Payroll Appointments in their own Annual Reports and Accounts.
(2) All the MOD's High-Paid Off-Payroll appointees have been requested to provide assurance that they paid the right amount of tax and National Insurance contributions in 2014-15.

Table 2.2.5 – For all new off-payroll engagements, or those that reached six months in duration, between 1 April 2014 and 31 March 2015, for more than £220 per day and that last for longer than six months

	Main Department	Arms Length Bodies (Note 3)
No. of new engagements, or those that reached six months in duration, between 1 April 2014 and 31 March 2015	**352**	
No. of the above which include contractual clauses giving the Department the right to request assurance in relation to income tax and National Insurance obligations	236	
No. for whom assurance has been requested	326 (Note 1)	
Of which...		
No. for whom assurance has been received	125	
No. for whom assurance has not been received	201 (Note 2)	
No. that have been terminated as a result of assurance not being received.	0	

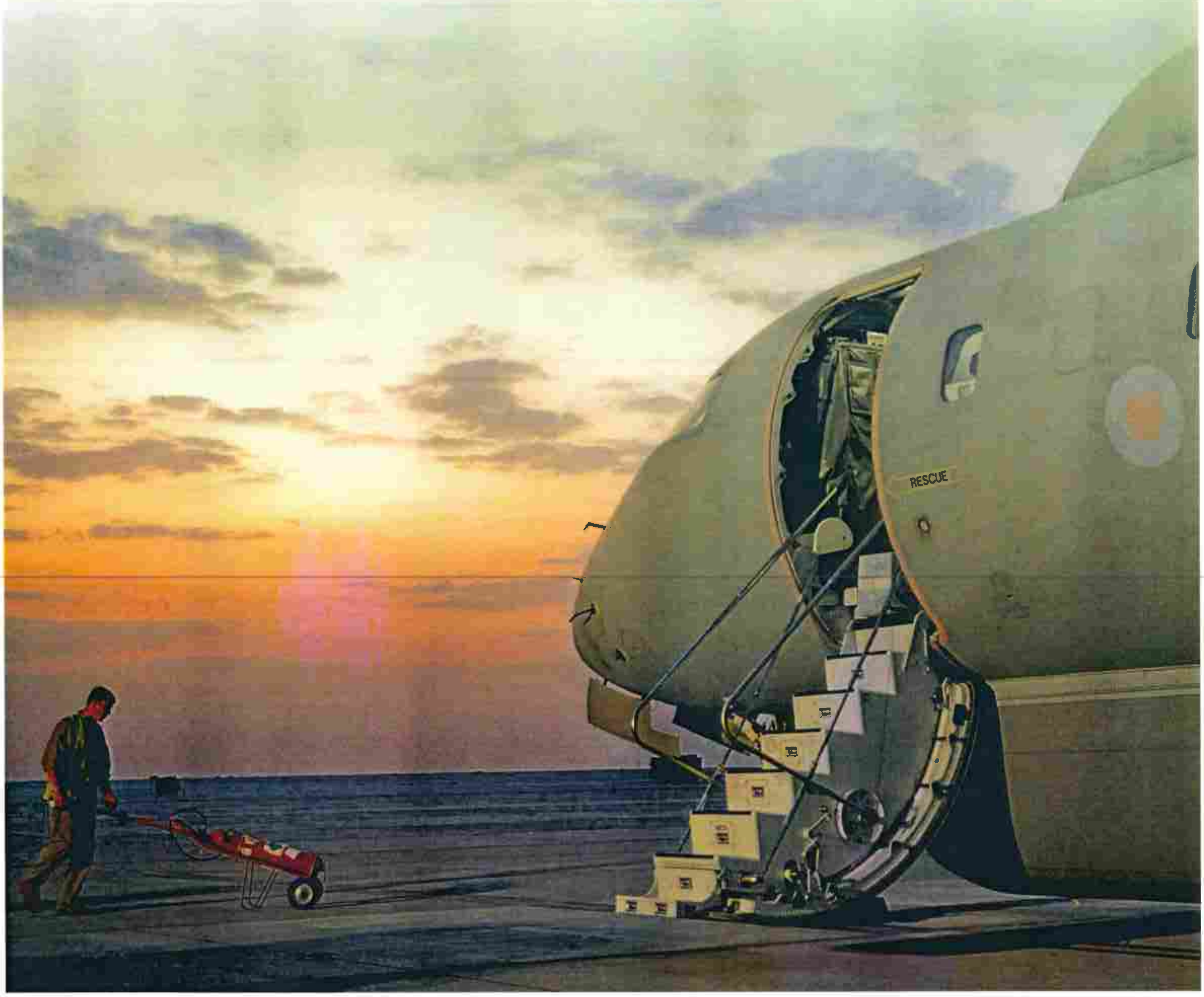
Notes: (1) Assurance has been sought for all High-Paid Off-Payroll appointments that the individual appointees paid the right amount of tax and National Insurance contributions in 2014-15 except where they were also in scope of governance in 2013-14 and either (a) provided satisfactory assurance and left post early in the 2014-15 financial year or (b) were referred to HM Revenue & Customs for failing to provide satisfactory assurance and have left the Department. In the interests of good governance, we have also sought assurance from appointees engaged under legacy contracts which have not been amended to include a specific assurance clause.
(2) Assurance is sought on a rolling basis. Where satisfactory assurance is not forthcoming, the Department will terminate contracts and refer the appointees involved to HM Revenue & Customs. If such action is necessary, this will be completed over the summer.
(3) The MOD's three Trading Funds (the Defence Support Group, the Defence Science and Technology Laboratory and the UK Hydrographic Office) are outside the MOD's Departmental Accounting Boundary and are reporting their High-Paid Off-Payroll Appointments in their own Annual Reports and Accounts.

Table 2.2.6 – For any off-payroll engagements of board members, and/or, senior officials with significant financial responsibility, between 1 April 2014 and 31 March 2015

	Main Department	National Museum of the Royal Navy	National Army Museum	Royal Air Force Museum	Single Source Regulatory Office
No. of off-payroll engagements of board members, and/or, senior officials with significant financial responsibility, during the financial year.	2 (Note 1)	0	0	0	0
No. of individuals both on and off payroll that have been deemed "board members, and/or, senior officials with significant financial responsibility", during the financial year.	16 (Note 2)	3	6	0	0

Notes: (1) Both off-payroll engagements are Non-Executive Board Members of the Defence Board. They are deemed to be off payroll as they elected to waive their annual fee in 2014-15.
(2) This figure comprises the eleven members of the Defence Board (two Ministers, five executive members and the four Non-Executive Board Members in appointment in 2014-15) and five officials with significant financial responsibility (the Top Level Budget Holders).
The MOD's three Trading Funds (the Defence Support Group, the Defence Science and Technology Laboratory and the UK Hydrographic Office) are outside the MOD's Departmental Accounting Boundary and are reporting their High-Paid Off-Payroll Appointments in their own Annual Reports and Accounts.

2.3 Delivering Defence



Defence Budget and Spending

Management Commentary

2.3.1 The Government's Spending Review 2010 announced the Defence spending plans and budgets for 2011-12 to 2014-15 , and the MOD Main Estimate in April 2014 set out the plans for 2014-15. The Supplementary Estimate (SE) in January 2015 updated these plans, as an additional £200M relating to previous underspends was provided by HM Treasury, along with various transfers of funding between MOD and other Government departments.

2.3.2 The following table and accompanying commentary explains the main variances to the detailed plans published in the SE. *(Due to rounding, totals may not equal the sums of their rounded parts).*

				£M
Total Departmental Variance	2,371 underspend			
This figure includes all Departmental Budgets and can be broken down into the relevant areas as follows				
Core Departmental Spending Variance		2,202		
Near Cash Variances (*see 1 below*)			147	
Cash Resource DEL				136
Capital DEL				11
Ring Fenced (Non Cash) Resource DEL (*see 2 below*)			1,263	
Annually Managed Expenditure (AME) – Total (*see 3 below*)			792	
Resource AME				732
Capital AME				60
Operational Spend (*see 4 below*)		169		

Commentary

(1) This represents a final variance to outturn of -0.4% against the near cash SE, which amounted to £33.8bn and can be found at Note 2 to the accounts. This has been a successful outcome against a challenging set of circumstances and reflects the strong financial discipline across the department. The near cash variances by Commodity Block can also be found at Note 2 to the accounts.

(2) This underspend was largely due to significant impairment reversals, creating a negative charge against budgets, and the write-on of additional assets. This variance does not impact on Defence spending power as it is a non-cash accounting adjustment.

(3) This underspend was due to negative charges to budgets created by impairment reversals. The Capital AME underspend was driven by a favourable movement on provisions that had previously been provided for by the department. This variance does not impact on Defence spending power as it is a non-cash accounting adjustment.

(4) The Department is voted resources to cover the net additional costs of Operations and Peacekeeping Programme Expenditure . This expenditure does not include costs that the Department would have incurred in any case, for example the salaries of Service personnel. The Department makes provision to ensure that there are sufficient funds to cover the potential costs of all operations and therefore underspends are not uncommon. This underspend is largely a reflection of the drawdown during this financial year of forces in Afghanistan, with Operation HERRICK ending in December 2014.

Table 2.3.1 – Net Additional Cost of Operations (£m)

	Afghanistan			Wider Gulf			DMAP			Counter ISIL			Conflict Pool			Total		
	Allocation	Outturn	Outturn	Allocation	Outturn	Outturn	Allocation	Outturn	Outturn	Allocation	Outturn	Outturn	Allocation	Outturn	Outturn	Allocation	Outturn	Outturn
	2014-15	2014-15	2013-14	2014-15	2014-15	2013-14	2014-15	2014-15	2013-14	2014-15	2014-15	2013-14	2014-15	2014-15	2013-14	2014-15	2014-15	2013-14
Personnel	112.90	88.51	120.52	3.00	2.08	2.17	2.10	0.92	-	-	-	-	-	20.06	19.94	118.00	111.58	142.63
Infrastructure	110.00	82.13	147.26	4.00	0.55	14.81	1.00	3.84	0.01	-	-	-	-	2.78	1.97	115.00	89.29	164.04
Inventory/ Other Consumption	174.00	145.82	394.61	3.00	0.19	0.97	10.00	14.31	0.07	16.00	-0.26	-	-	1.61	-2.34	203.00	161.66	393.3
Equipment Support	134.00	156.15	332.14	9.00	10.32	12.88	5.00	0.85	-	20.00	17.08	-	-	0.33	-3.38	168.00	184.73	341.64
Research & Development	12.00	11.47	17.14	-	-	-	-	-	-	-	-	-	-	-		12.00	11.47	17.14
Other Costs	154.10	121.57	212.85	1.00	1.69	6.03	6.90	3.56	0.06	-	-	-	-	30.88	33.79	162.00	157.70	252.72
Receipts and Other Income	-50.00	-40.91	-26.79	-	-	-	-	-	-	-	-	-	-	-0.14	-0.34	-50.00	-41.06	-27.1
Cash Release of Provision	4.00	2.87	2.98	-	-	-	-	-	-	-	-	-	-	-	-	4.00	2.87	2.98
Total Cash Resource	651.00	567.61	1200.70	20.00	14.84	36.88	25.00	23.48	0.13	36.00	16.81	-	61.39	55.52	49.65	793.39	678.26	1287.35
Total Non Cash Resource	344.80	317.26	550.37	-	-	-	-	-	-	5.00	5.09	-	-	-	-	349.81	322.35	550.37
Total Resource	995.80	884.88	1751.06	20.00	14.84	36.88	25.00	23.48	0.13	41.00	21.90	-	61.39	55.52	49.65	1143.20	1000.61	1837.72
Total Capital Costs	26.00	8.93	122.63	5.00	-	2.97	-	-	-	5.00	-	-	-	-	-	41.00	8.93	125.6
Total Annually Managed Expenditure	22.00	69.88	3.17	0.00	-	-	-	-	-	-	-	-	-	-	-	22.00	69.88	3.17
Total Costs	**1043.80**	**963.69**	**1876.87**	**25.00**	**14.84**	**39.85**	**25.00**	**23.50**	**0.13**	**46.00**	**21.90**	-	**61.39**	**55.52**	**49.65**	**1206.20**	**1079.42**	**1966.49**

Notes:
DMAP: Deployed Military Activity Pool - In 2014-15 a £25M allocation from the HMT Special Reserve was made available in addition to the MOD funding of the same amount.
The DMAP is a joint HM Treasury and MOD initiative to make available resources to fund the initial and short term costs of any unforeseen military activities, as authorised by the National Security Council.
In 2014, the DMAP has funded military activity in support of the search for the missing Nigerian schoolgirls, NATO reassurance measures, and elements of countering ISIL activity in Iraq and Syria.
The Conflict Pool is transferred annually from DFID on a block Resource basis as reflected in the published Estimates.

Table 2.3.2 – Reconciliation of Resource Expenditure Between Estimates, Budgets and Accounts

	2014-15 £000	2013-14 £000
Net Resource Outturn (Estimates)	**36,969,344**	37,411,572
Prior period adjustments	-	-
Net Resource Budget Outturn	**36,969,344**	37,411,572
of which:		
Departmental Expenditure Limits (DEL)	**35,105,038**	36,448,453
Annually Managed Expenditure AME)	**1,864,306**	963,119
	36,969,344	37,411,572
Adjustments:		
Adjustment for changes to discount rates included in resource outturn but not passing through net operating costs	**(43,798)**	(32,547)
Adjustment for Service Concession Arrangements treated as on-SoFP for Accounts but treated as off-SoFP for Estimates and Budgets	**66,527**	109,635
Income in respect of donated assets treated as Capital income	**(6,957)**	(4,300)
Loss / (gain) on foreign exchange contracts in respect of Capital purchases	**67,090**	20,675
Adjustment for impairments and impairment reversals included in resource outturn but not passing through Net Operating Cost	-	(15,404)
Add Capital grants included in operating costs but excluded from resource outturn	**2,414**	2,527
Equity Withdrawal from investments in Trading Funds - recorded as income in Operating Costs and capital in the SoPS	**(213,842)**	-
Net Operating Cost (Accounts)	**36,840,778**	37,492,158

Table 2.3.3 – Total departmental spending , 2008-09 to 2017-18

	2008-09 Outturn	2009-10 Outturn	2010-11 Outturn	2011-12 Outturn	2012-13 Outturn	2013-14 Outturn	2014-15 Outturn	2015-16 Plans	2016-17 Plans	£'000 2017-18 Plans
Resource DEL										
Provision of Defence Capability Service Personnel Costs	8,082,458	8,534,221	9,016,445	9,822,628	9,400,516	9,046,632	7,878,834	8,788,394	-	-
Provision of Defence Capability Civilian Personnel Costs	627,152	776,422	1,353,353	214,603	200,829	192,110	1,937,614	984,885	-	-
Provision of Defence Capability Infrastructure costs	4,532,692	4,575,357	4,130,436	4,365,665	4,428,812	4,545,389	4,576,992	4,478,611	-	-
Provision of Defence Capability Inventory Consumption	1,922,549	1,851,181	1,560,057	1,740,806	1,749,176	1,765,487	1,661,847	1,721,904	-	-
Provision of Defence Capability Equipment Support Costs	5,417,481	6,066,863	5,721,074	5,625,988	5,161,399	6,065,557	6,343,245	6,463,365	-	-
Provision of Defence Capability Other Costs and Services	1,379,233	1,310,353	2,590,215	1,339,556	1,500,622	1,790,894	1,804,274	1,405,591	-	-
Provision of Defence Capability Receipts and other Income	-1,698,504	-1,744,595	-1,780,177	-1,283,873	-1,248,867	-1,169,263	-1,091,806	-968,617	-	-
Provision of Defence Capability Depreciation and Impairments Costs [1]	6,388,871	7,901,575	10,626,669	9,291,756	8,958,447	8,911,222	8,187,241	8,490,988	-	-
Provision of Defence Capability Cash Release of Provisions Costs	316,031	273,437	242,598	176,464	203,010	175,030	201,855	234,220	-	-
Provision of Defence Capability Research and Development Costs	-	-	-	833,485	944,069	971,008	1,000,606	1,017,214	-	-
Provision of Defence CapabilityAdministration Civilian Personnel Costs	1,947,330	1,929,833	1,355,224	2,673,630	2,134,313	2,112,064	371,688	400,900	-	-
Provision of Defence Capability Administration Other Costs and Services	-	-	-	18,316	44,548	17,139	463,849	496,860	-	-
Operations Service Personnel Staff Cost	174,953	187,477	204,898	278,285	197,449	108,909	85,480	13,000	-	-
Operations and Peacekeeping Civilian Personnel Staff Costs	56,804	60,870	23,043	25,570	22,421	13,777	6,036	4,000	-	-
Operations Infrastructure Costs	367,614	366,443	312,144	214,071	164,921	162,069	86,516	30,000	-	-
Operations Inventory Consumption	910,319	719,429	786,590	794,614	562,911	395,649	160,055	65,000	-	-
Operations Equipment Support Costs	847,896	806,205	629,133	630,108	427,032	345,016	184,400	70,000	-	-
Operations Other Costs and Services	136,399	155,714	560,059	492,251	378,161	218,930	126,827	50,000	-	-
Operations Receipts and other Income	-28,090	-58,486	-33,245	-42,806	-27,686	-26,764	-40,914	-2,000	-	-
Operations Depreciation and Impairment Costs [1]	358,109	385,679	308,591	532,998	499,275	550,366	322,349	-	-	-
Operations Cash Release of Provisions Costs	-	7,379	11,093	2,827	1,976	2,980	2,869	-	-	-
Operations Research and Development Costs	-	-	-	-	-	17,137	11,475	-	-	-
Conflict Pools Resource Costs	-	-	59,705	46,212	44,009	49,648	55,518	-	-	-
Non Departmental Public Bodies Costs	238,811	193,386	186,203	186,791	126,833	187,466	130,021	192,143	-	-
Defence Capability Admin Serivce Pers Costs	736,361	735,986	670,788	-	-	-	623,716	601,600	-	-
IFRS/PFI and other costs	-	-117,360	-	-	-	-	-	-	-	-
Defence Capability DE&S DEL Costs	-	-	-	-	-	-		1,211,203	-	-
War Pension Benefits Programme Costs	-	-	-	-	-	-		812,411	-	-
Conflict,Stability and Security Fund	-	-	-	-	-	-		59,300	-	-
Cash Release of Provisions Admin Costs	-	-	-	-	-	-	14,451	20,280	-	-
Total Resource DEL	**32,714,469**	**34,917,369**	**39,034,896**	**37,979,945**	**35,874,176**	**36,448,452**	**35,105,038**	**36,641,252**	-	-
Resource AME										
Provision of Defence Capability Depreciation and Impairment Costs [1]	352,890	838,438	7,098,741	509,557	1,062,365	-208,143	450,416	1,209,412	-	-
Provision of Defence Capability Provisions Costs	441,309	548,128	17,925	-467,009	307,375	141,371	679,896	255,258	-	-
Provision of Defence Cash Release of Provisions Costs	-316,031	-273,437	-242,598	-342,499	-237,141	-200,392	-216,306	-254,500	-	-
Movement On Fair Value of Financial Instruments	-1,177,064	202,354	50,481	347,133	-182,527	368,147	42,768	300,000	-	-
Operations Depreciation and Impairment Costs [1]	-	-	-	-	-	-	10,757	-	-	-
Operations Provisions	-324	7,168	39,575	6,799	10,884	6,152	61,995	-	-	-
Operations Cash Release of Provisions Costs	-	-7,379	-11,093	-2,827	-1,976	-2,980	-2,869	-	-	-
War Pensions Benefits Programme costs	1,000,400	980,294	935,066	915,683	907,817	858,964	837,649	-	-	-
Total Resource AME	**301,180**	**2,295,566**	**7,888,097**	**966,837**	**1,866,797**	**963,119**	**1,864,306**	**1,510,170**	-	-
Total Resource Budget	**33,015,649**	**37,212,935**	**46,922,993**	**38,946,782**	**37,740,973**	**37,411,571**	**36,969,344**	**38,151,422**	-	-
Capital DEL										
Provision of Defence Capability Other Costs and Services	1,603	-1,695	-	25,000	-	-		-	-	-

£'000	2008-09 Outturn	2009-10 Outturn	2010-11 Outturn	2011-12 Outturn	2012-13 Outturn	2013-14 Outturn	2014-15 Outturn	2015-16 Plans	2016-17 Plans	2017-18 Plans
Provision of Defence Capability Capital Single Use Military Equipment	4,517,457	4,488,004	4,851,719	4,828,748	4,395,170	4,455,379	4,870,897	2,900,000	-	-
Provision of Defence Capability Other Capital (Fiscal)	3,361,494	3,197,059	3,432,350	3,536,232	3,008,738	3,037,505	3,210,988	4,358,691	-	-
Provision of Defence Capability Fiscal Assets / Estate Disposal	-87,324	-16,386	-32,154	-149,657	-63,685	-43,573	-250,881	-488,709	-	-
Provision of Defence Capability New Loans and Loan Repayment	-101,127	-55,176	-71,903	-5,469	-5,519	-5,573	-56,626	-4,032	-	-
Operations Capital Single Use Military Equipment	1,148,685	807,357	598,026	454,911	372,970	72,533	17,908	30,000	-	-
Operations Other Capital (Fiscal)	77,057	728,431	485,571	322,068	132,636	53,070	-8,978	-	-	-
Conflict Pools Resource Costs	-	-	694	-	-	-	-	-	-	-
Non Departmental Public Bodies Costs	-	-	851	2,223	3,029	2,527	2,414	16,559	-	-
Defence Capability DE&S DEL Costs	-	-	-	-	-	-		10,797	-	-
Total Capital DEL	**8,917,845**	**9,147,594**	**9,265,154**	**9,014,056**	**7,843,339**	**7,571,868**	**7,785,722**	**6,823,306**	-	-
Capital AME										
Provision of Defence Capability Provisions Costs	75,868	-4,690	-	-9,615	-35,352	-128,612	50,559	-	-	-
Provision of Defence Capability AME Capital Fiscal	-	9,773	-	-	-	-		-	-	-
Total Capital AME	**75,868**	**5,083**	-	**-9,615**	**-35,352**	**-128,612**	**50,559**	-	-	-
Total Capital Budget	**8,993,713**	**9,152,677**	**9,265,154**	**9,004,441**	**7,807,987**	**7,443,256**	**7,836,281**	**6,993,306**	-	-
Total departmental spending [2]	35,529,058	37,994,285	38,116,370	37,176,648	35,210,412	35,214,346	35,834,862	34,399,316	-	-
Of which:										
Total DEL	34,327,836	36,734,428	37,355,234	37,156,539	34,258,805	34,539,843	34,381,170	34,398,558	-	-
Total AME	1,201,222	1,259,857	761,136	20,109	951,607	674,503	1,453,692	758	-	-

1 Includes impairments.
2 Total departmental spending is the sum of the resource budget and the capital budget less depreciation. Similarly, total DEL is the sum of the resource budget DEL and capital budget DEL less depreciation in DEL, and total AME is the sum of resource budget AME and capital budget AME less depreciation in AME.

Table 2.3.4 – Outturn year, 2014-15

£'000	2014-15 Original Plans		2014-15 Adjusted Plans†		2014-15 Final Plans		2014-15 OUTTURN	
Outturn year, 2014-15	Resource	Capital	Resource	Capital	Resource	Capital	Resource	Capital
Spending in Departmental Expenditure Limits (DEL)								
Voted expenditure	**36,436,498**	**7,506,926**	**36,436,498**	**7,506,926**	**36,646,516**	**7,834,578**	**35,105,038**	**7,785,722**
Of which:								
Provision of Defence Capability Service Personnel Costs	8,816,134	-	8,816,134	-	8,008,573	-	7,878,834	-
Provision of Defence Capability Civilian Personnel Costs	454,277	-	454,277	-	1,910,379	-	1,937,614	-
Provision of Defence Capability Infrastructure costs	4,482,642	-	4,482,642	-	4,589,453	-	4,576,992	-
Provision of Defence Capability Inventory Consumption	1,835,871	-	1,835,871	-	1,725,871	-	1,661,847	-
Provision of Defence Capability Equipment Support Costs	6,441,312	-	6,441,312	-	6,351,312	-	6,343,245	-
Provision of Defence Capability Other Costs and Services	1,907,141	-	1,907,141	-	1,664,604	-	1,804,274	-
Provision of Defence Capability Receipts and other Income	-1,114,126	-	-1,114,126	-	1,114,126	-	-1,091,806	-
Provision of Defence Capability Depreciation and Impairments Costs	9,449,975	-	9,449,975	-	9,449,975	-	8,187,241	-
Provision of Defence Capability Cash Release of Provisions Costs	241,911	-	241,911	-	221,911	-	201,855	-
Provision of Defence Capability Capital Single Use Military Equipment	-	3,656,000	-	3,656,000	-	4,756,157	-	4,870,897
Provision of Defence Capability Other Capital (Fiscal)	-	4,344,823	-	4,344,823	-	3,548,583	-	3,210,988
Provision of Defence Capability Fiscal Assets / Estate Disposal	-	-342,000	-	-342,000	-	-342,000	-	-250,881
Provision of Defence Capability New Loans and Loan Repayment	-	-177,468	-	-177,468	-	177,468	-	-56,626
Provision of Defence Capability Research and Development Costs	1,041,647	-	1,041,647	-	1,018,647	-	1,000,606	-
Provision of Defence CapabilityAdministration Civilian Personnel Costs	1,844,102	-	1,844,102	-	388,000	-	371,688	-
Provision of Defence Capability Administration Other Costs and Services	22,104	-	22,104	-	488,701	-	463,849	-
Operations Service Personnel Staff Cost	55,025	-	55,025	-	90,000	-	85,480	-
Operations and Peacekeeping Civilian Personnel Staff Costs	6,803	-	6,803	-	28,000	-	6,036	-
Operations Infrastructure Costs	62,134	-	62,134	-	115,000	-	86,516	-
Operations Inventory Consumption	170,525	-	170,525	-	203,000	-	160,055	-
Operations Equipment Support Costs	199,402	-	199,402	-	168,000	-	184,400	-
Operations Other Costs and Services	133,313	-	133,313	-	162,000	-	126,827	-
Operations Receipts and other Income	-9,264	-	-9,264	-	-50,000	-	-40,914	-
Operations Depreciation and Impairment Costs	152,810	-	152,810	-	349,810	-	322,349	-
Operations Cash Release of Provisions Costs	2,926	-	2,926	-	4,000	-	2,869	-

Outturn year, 2014-15	2014-15 Original Plans Resource	2014-15 Original Plans Capital	2014-15 Adjusted Plans† Resource	2014-15 Adjusted Plans† Capital	2014-15 Final Plans Resource	2014-15 Final Plans Capital	2014-15 OUTTURN Resource	2014-15 OUTTURN Capital
								£'000
Operations Capital Single Use Military Equipment	-	13,296	-	13,296	-	25,000	-	17,908
Operations Other Capital (Fiscal)	-	9,861	-	9,861	-	11,000	-	-8,978
Operations Research and Development Costs	522	-	522	-	12,000	-	11,475	-
Conflict Pools Resource Costs	64,405	-	64,405	-	61,390	-	55,518	-
Non Departmental Public Bodies Costs	174,907	2,414	174,907	2,414	178,016	2,414	130,021	2,414
Defence Capability Admin Serivce Pers Costs	-	-	-	-	602,000	-	623,716	-
Cash Release of Provisions Admin Costs	-	-	-	-	20,000	-	14,451	-
Total Spending in DEL	**36,436,498**	**7,506,926**	**36,436,498**	**7,506,926**	**36,646,516**	**7,823,686**	**35,105,038**	**7,785,722**
Spending in Annually Managed Expenditure (AME)								
Voted expenditure	**3,421,374**	**-**	**3,421,374**	**-**	**2,596,783**	**110,000**	**1,864,306**	**50,559**
Of which:								
Provision of Defence Capability Depreciation and Impairment Costs	1,949,205	-	1,949,205	-	939,205	-	450,416	-
Provision of Defence Capability Provisions Costs	541,177	-	541,177	-	716,177	110,000	679,896	50,559
Provision of Defence Cash Release of Provisions Costs	-241,911	-	-241,911	-	-241,911	-	-216,306	-
Movement On Fair Value of Financial Instruments	299,271	-	299,271	-	299,271	-	42,768	
Operations Depreciation and Impairment Costs	5,573	-	5,573	-	10,000	-	10,757	-
Operations Provisions	-2,926	-	-2,926	-	16,000	-	61,995	-
Operations Cash Release of Provisions Costs	-4,000	-	-4,000	-	-4,000	-	-2,869	-
War Pensions Benefits Programme costs	874,985	-	874,985	-	862,041	-	837,649	-
Total Spending in AME	**3,421,374**	**-**	**3,421,374**	**-**	**2,596,783**	**110,000**	**1,864,306**	**50,559**
Total	**39,857,872**	**7,506,926**	**39,857,872**	**7,506,926**	**39,243,299**	**7,933,686**	**36,969,344**	**7,836,281**
Of which:								
Voted expenditure	39,857,872	7,506,926	39,857,872	7,506,926	39,243,299	7,933,686	36,944,484	7,836,281

† Figures for Adjusted Plans have been adjusted for machinery of government changes effected during 2014 to reflect the Final Plans structure where applicable.

Table 2.3.5 – Administration budget, 2008-09 to 2017-18

	2008-09 Outturn	2009-10 Outturn	2010-11 Outturn	2011-12 Outturn	2012-13 Outturn	2013-14 Outturn	2014-15 Outturn	2015-16 Plans	2016-17 Plans	2017-18 Plans
										£'000
Resource DEL										
Provision of Defence CapabilityAdministration Civilian Personnel Costs	1,947,330	1,929,833	1,355,224	2,673,630	2,134,313	2,112,064	371,688	400,900	-	-
Provision of Defence Capability Administration Other Costs and Services	-	-	-	18,316	44,548	17,139	463,849	496,860	-	-
Non Departmental Public Bodies Costs	238,811	193,386	186,203	-	-	-	-	-	-	-
Defence Capability Admin Serivce Pers Costs	736,361	735,986	670,788	-	-	-	623,716	601,600	-	-
Cash Release of Provisions Admin Costs	-	-	-	-	-	-	14,451	20,280	-	-
Total administration budget	**2,922,502**	**2,859,205**	**2,212,215**	**2,691,946**	**2,178,861**	**2,129,203**	**1,473,704**	**1,519,640**	**-**	**-**

Table 2.3.6 – Assets and Liabilites

	2007-08 outturn £m	2008-09 outturn £m	2009-10 outturn £m	2010-11 outturn £m	2011-12 outturn £m	2012-13 outturn £m	2013-14 outturn £m	2014-15 outturn £m	2015-16 Plans £m
Assets and liabilities in the Statement of Financial Position at year end:									
Assets									
Non-current assets	111,376	119,142	121,827	116,863	120,890	119,495	118,067	121,676	115,667
Property, plant and equipment	82,434	89,877	91,653	88,300	92,070	91,519	92,331	95,426	96,857
Intangible assets	26,718	27,959	29,134	27,529	27,851	27,418	24,918	25,567	18,116
Financial Assets	256	217	158	147	142	136	103	77	78
Receivables due after more than one year	1,968	1,088	883	887	828	422	715	607	616
Current assets	8,581	11,027	11,086	11,306	10,647	12,416	10,534	10,792	10,522
Liabilities									
Current Liabilities	-8,840	-9,078	-9,278	-10,252	-10,920	-10,800	-9,558	-10,428	-10,584
Non-current liabilities	-10,252	-11,045	-11,103	-11,025	-10,730	-10,610	-10,894	-11,726	-11,902
Capital employed within main department	100,866	110,045	112,533	106,892	109,887	110,500	108,149	110,313	103,703
NDPB total assets less liabilities	613	608	819	842	743	758	760	923	819
Total capital employed in dept'l group	**101,478**	**110,653**	**113,352**	**107,734**	**110,630**	**111,258**	**108,909**	**111,236**	**104,522**

Defence Equipment and Support

2.3.3 DE&S was launched as a Bespoke Trading Entity on 1 April 2014. The change in status and associated new management freedoms which were delegated at the time, marked the start of a three-year timeline of transition and transformation. During the first transition year, DE&S has focused on harnessing its freedoms and flexibilities through the design and development of the tools and processes required to upskill staff and transform the organisation.

2.3.4 A new governance regime has been established and embedded, including the recruitment of a highly experienced Chairman and Non-Executive Directors who are providing challenge and support to the DE&S Executive. On 25 March 2015, the Department announced that Tony Douglas has been appointed as the Chief Executive to DE&S, he will assume this role towards the end of 2015. DE&S has put in place new Command Acquisition and Support Plans with each of its military Customers which capture formally what is required of DE&S and drive improved performance.

Defence Equipment and Support, Bristol

2.3.5 DE&S has also brought in highly specialised private sector expertise through a series of contracts known as Managed Service Providers (MSPs). A key aspect of the DE&S transformation programme; the MSPs are providing support in clearly defined areas of the business, namely Project Delivery and Human Resources. Following a robust commercial competition, which was held over the course of 2014, the Project Delivery and Human Resources contracts were awarded in November 2014 to Bechtel/CH2M HILL and PwC respectively. The MSPs are helping DE&S with organisation design, development of business transformation plans and in driving the necessary organisational and cultural change to deliver enduring improvements in the delivery of the Equipment and Support plans.

2.3.6 DE&S had intended to award a third and final MSP contract this year, focussed on Management Information and Information Technology. Following a re-examination of the requirement and current financial context, DE&S has decided not to proceed with the competition at this point and will instead, address its requirements by making further use of in-house capabilities and by drawing on the lessons learnt from the MSPs working in DE&S now. DE&S will continue to monitor progress and will examine at a later date, whether there is a need for a new commercial competition to address any residual Management Information and Information Technology requirements.

Value of New Equipment Delivered

2.3.7 A major priority for the Department this year has been to continue to deliver equipment to the Armed Forces. The DE&S organisation delivered new equipment valued at £5.36Bn, which includes £13.97M of Urgent Operational Requirements (UORs). Further details on UORs are provided in paragraph 2.3.21 below.

2.3.8 Total programmed capital expenditure (including PFI assets) for DE&S in 2014-15 was £8.07Bn. Capital expenditure covers money spent on acquisition less any capital receipts.

2.3.9 With managing ownership responsibility for military equipment, at the end of Financial Year 2014-15, DE&S was responsible for £56.38Bn of capital assets. This was a decrease of £0.587Bn over the course of the year. Depreciation of assets on operations was £333M. Items of equipment procured through the UOR process were depreciated in the same way as other assets, but the expected life was adjusted to reflect the harsh environment in which they operated. DE&S also owns the majority of non-property assets and equipment under construction, which increased by £1.53Bn (8.5%) from £18Bn to £19.53Bn during the year.

Key Achievements by Service

For the Royal Navy:

- Significant progress continues to be made with the Queen Elizabeth (QE) Class Aircraft Carrier project. In July 2014, Her Majesty the Queen officially named HMS QUEEN ELIZABETH at a ceremony in Rosyth. Shortly after, the ship was floated out of the dock and is now alongside for the test, integration and commissioning stage of her programme. In October 14, she was supplied with shore-based High Voltage

(HV) electricity for the first time, enabling the on-board systems to be brought to life and tested ahead of autonomous power from the ship's generators coming on-stream in 2015. The first main blocks (Lower Block 02 and 03) of the second ship, HMS PRINCE OF WALES, arrived in Rosyth during August 2014, with the assembly phase beginning on 9 September. There are now over 20,000 tonnes of HMS PRINCE OF WALES in the dry dock at Rosyth, which means she is over 30% complete. On 5 September 2014 the Prime Minister announced that HMS PRINCE OF WALES will enter service with the Royal Navy. A work has started to prepare Portsmouth Naval Base for the arrival of the ships and through-life support. A Review Note on Long Lead Support Activity (Spares and Risk Mitigation) was approved by the Investment Approvals Committee on 17 March 2015. The Main Gate Business case for Support will be submitted in 2016.

HMS Queen Elizabeth following her naming ceremony conducted at Rosyth Dockyard

- ARTFUL, the third Astute submarine, was launched in May 2014 and completed her initial dive in October 2014. A set of work streams known as Project Tensor have been initiated that focus on increasing the efficiency of both the overall BAES submarine enterprise, as well as the individual Successor and Astute programmes. It will provide an opportunity to inject independent challenge to the current programmes with the aim of securing contracts for Astute Boats 5, 6 and 7.

Britain's third £1 billion Astute Class nuclear submarine, Artful, lowered into the water at Barrow-in-Furness, in Cumbria

- In May 2014 the Merlin Mk2 Anti-Submarine & Anti-Surface Warfare helicopter achieved its In-Service Date early. Eventually a total of thirty of these aircraft will be delivered to the Royal Navy after undergoing a £800+M capability upgrade to their warfare mission systems and software, with new glass-cockpit technology and updates to the Merlin Training Facility. The Merlin Mk2 helicopters operate globally and will operate from the Royal Navy's next generation Queen Elizabeth class aircraft carriers, as well as on-board Royal Navy frigates, destroyers, and support ships.

Flight deck of the new Merlin Mk 2 helicopter with touch screen displays

- A £270M contract was placed with BAE Systems in December 2014 for the Demonstration and Manufacture of the Spearfish Upgrade project. The Spearfish Torpedo has been in-service since 1994 and the mid-life update will sustain a credible and safe weapon for future submarine operations. The scope of the project includes digitisation of the weapon, the provision of a new insensitive munition warhead to replace the current ageing warhead, changes to the fuel system, and the introduction of a new communications link.

- Significant progress has been made on the Military Afloat Reach and Sustainability Tanker project, which will deliver four new double-hulled tankers to support the Royal Navy on operations around the world from 2016. Cut Steel for the First of Class RFA TISDESPRING was achieved in June 2014, signalling the beginning of the build phase. Keel Lay was achieved in December 2014 as well as the Cut Steel for the second tanker, RFA TIDERACE. In January 2015 a contract worth £15M was placed with A&P Group Ltd (Falmouth) for Customisation, Capability, and Assessment Trials to be undertaken in the UK prior to entry into service, as well as support in-service for all four new Tankers to 2018.

- A Firm Price contract for £348M was placed in August 2014 with BAE Systems for the build and initial support of three new River Class Offshore Patrol Vessels (RCOPVs). The new OPVs will provide valuable capability to the Royal Navy, but their construction is also crucial in securing the skills and demonstrating the new production processes needed to build the Type 26 Global Combat Ship. The official steel cutting for Ship 01, held on 10 October 2014, marked the start of the build programme. Also announced at the same time were the names of the three ships; the first being HMS FORTH, the second HMS MEDWAY, and the third HMS TRENT. The build of HMS FORTH is progressing well and is on target to meet the Contract Acceptance Date of April 2017.

- Over the last 6 months of the Assessment Phase, the Type 26 Global Combat Ship (T26 GCS) programme has adopted a collaborative and incremental approach with industry that draws on key lessons to ensure the ship design is sufficiently mature, the supply chain is fully mobilised to de-risk material supply, and risks assessed before awarding the build contract. The MOD made a significant commitment to the T26 GCS programme with the Prime Minister's announcement of the Demonstration Phase contract, worth £859M, on 20 February 2015. The Demonstration Phase commenced on 1 April 2015.

- The Successor programme is now more than half way through its Assessment Phase. Two major Design maturity milestones have been achieved – Preliminary Design Review (PDR) and the Reactor Critical Design Review (CDR) – both within weeks of planning dates set almost 4 years ago. These were key enablers for entry into Stage 2 (spatial) design. In October 2014, General Dynamics Electric Boat was awarded an $83M contract by the US Department of Defense for the first tranche of Missile Tubes that are being procured as part of the collaborative Common Missile Compartment (CMC) programme with the US. Work on improving infrastructure in Barrow is progressing well and is currently focussed on new facilities in the Central Yard at Barrow to improve outfitting, finishing, and logistics, as well as early implementation steel work in the New Assembly Shop. A number of long lead materials have been ordered, including the weapons handling and launch system, gearbox components, and associated equipment.

- In Summer 2014, contracts worth a total of £150M were signed for Future Anti-Surface Guided Weapon (Light) system and its integration onto the Wildcat Helicopter. These complex weapons will use sophisticated laser beam riding technology to neutralise small fast inshore attack craft. They will be carried by the Royal Navy's new Wildcat helicopters, providing them with unparalleled defensive surface warfare capabilities.

- In March 2015, a helicopter support contract worth £580M was awarded to AgustaWestland, which will provide in-service support to the whole Royal Navy Merlin helicopters fleet over the next five years. This new contract delivers more than £140M savings over the next five years. At the same time, the contract will sustain more than 1,000 jobs across the UK.

- In March 2015, a £40M Letter of Offer and Acceptance (LOA) was signed with the US Department of Defense for the procurement of a number of Tomahawk Land Attack Missile (TLAM) Block IV All Up Rounds from the US inventory. TLAM provides the UK with a proven, highly effective, all-weather, long-range subsonic cruise missile precision strike capability that is launched from UK Trafalgar and Astute Class submarines. It has a range in excess of 1000 miles and can be used to attack a wide variety of fixed land targets, such as air defence and command and control and communications sites, even in high-threat environments.

- In October 2014, the MOD awarded two contracts to support the management of the UK's Naval Bases and maintain and repair the Royal Navy's warships. These contracts, which have a combined value of £3.2Bn, represent a new approach to contracting for support services at the Naval Bases, known as the Maritime Support Delivery Framework (MSDF). This new, modern commercial and financial strategy replaced the previous contracts with one wider contracting framework designed to incentivise industry to transform and rationalise to meet the needs of the Royal Navy.

For the Army:

- In September 2014, the Scout Specialist Vehicle (Scout SV) project awarded a contract to General Dynamics UK for production of the fleet of 589 vehicles with deliveries starting in 2017, ready for deployment in 2020. Marking continued progress, the project has also held its second anchor milestone, with verification trials commencing later this year. As the Army's top equipment priority, Scout SV is central to the delivery of the Army 2020 Armoured Infantry Brigade capability. Scout SV will provide the Army's first comprehensively digitised vehicle, providing a persistent all-weather ground surveillance capability and a powerful information processing hub applicable to a broad range of future operations; and matched with high levels of physical protection and tactical mobility.

Prototype of the Scout Specialist Vehicle (SV) which is part of the Future Rapid Effect System (FRES)

- Warrior Capability Sustainment Programme (WCSP) has passed two Anchor Milestones since March 2014. Unit Zero Unmanned Firing in July 2014 and Unit Zero Manned Firing in February 2015. The programme is progressing towards its FV520/521 System Critical Design Review. Under WCSP, vehicles will be fitted with an upgraded turret including a new weapon system, and an enhanced electronic architecture. The upgraded vehicles will be the cornerstone of the Armoured Infantry Brigade of the future until 2040.

- The Multi Role Vehicle – Protected (MRV-P) and Combat Water Supply Systems (CWSS) Projects gained Initial Gate acceptance in March 2015. Work can now commence to provide the Army's future capability for contingent operations. MRV-P will provide a protected deployable platform for all Force Elements in a wide range of environments for 25 years from 2020. CWSS is a Tri-Service project including the Sourcing, Treating, Testing, Storage, Distribution and Issue of potable water on operations.

- A contract was placed in August 2014 for conversion of the Army's fleet of Cougar vehicles. The work allows Mastiff and Ridgeback vehicles, procured over the duration of operations in Afghanistan, to be retained as part of the core Equipment Programme. The platforms will be upgraded and converted to suit the Army's needs for contingent operations from 2020, improving supportability and providing greater coherency across the fleet.

- In December 2014 the Land Ceptor (Future Local Area Air Defence System (Land)) Design and Manufacture contract at some £228M was placed with MBDA. This was achieved 7 months earlier than originally planned and will advance the delivery of capability by at least a year.

- Watchkeeper deployed to Operation HERRICK to provide Intelligence, Surveillance, Targeting Acquisition, and Reconnaissance (ISTAR) support to UK forces during a period of transition as they completed the final phases of withdrawal from Camp Bastion and Helmand in late 2014. The advanced radar on Watchkeeper provided Coalition forces with a step-change in organic and persistent surveillance capability. Watchkeeper was operated from Camp Bastion alongside the existing UOR, HERMES 450, with both systems operating under the command of 47th Regiment Royal Artillery and as part of the Theatre UAS Battery Royal Artillery, until the closure of Camp Bastion.

Watchkeeper – Unmanned Aerial Vehicle (UAV), which supports all three services

- In February 2015, the transition of the support service to KBR for the new Joint Operational Fuel System concluded. The service encompasses technical support and post-design services for the storage, issue, maintenance, and repair of a range of expeditionary fuel-handling equipments and spares provisioning. The £28M, five year contract provides a one-stop shop for the provision of a deployable fuel-handling capability across the land environment, required extensively on operations, and increasingly as mitigation for shortfalls in permanent fuels installations.

For the RAF:

- In December 2014, Typhoon Tranche 3 Release to Service was declared. The 40 Tranche 3a aircraft will be delivered to the RAF by 2018, and along with the 67 Tranche 2 aircraft, will be the core of the Typhoon fleet through to its out-of-service date.

- The UK placed an order for a further four F-35 Lightning II aircraft in November 2014. At 31 March 2015, the UK had taken delivery of three F-35 Lightning II aircraft, with five aircraft in manufacture and assembly. The UK Lightning II Test and Evaluation Squadron (TES) 17(R) formally stood up at Edwards Air Force Base in California in January 2015. UK Pilot and Aircraft Maintainer training is making good progress as we look to build the UK Lightning II Force.

One of the first UK Lightning II F35-B aircraft is pictured during a trials flight

- The Voyager Private Finance Initiative capability is now providing a strong and high-profile level of service to the Armed Forces and to coalition partners, particularly with the deployment on Operation SHADER breaking records for fuel offload. The TriStar fleet has now been disposed of and the HS125 fleet retired from long and distinguished RAF service in March 2015. The C-130K variant of Hercules, which were retired from service in October 2013, have been offered for disposal via the Disposal Services Authority. Negotiations continue and we expect a sale via a Canadian government agency to be announced formally soon.

- The first three A400M Atlas tactical transport aircraft, from an order of 22, have been delivered; two are undertaking training and operational sorties, the third is being retrofitted with the UK Defensive Aids system. An innovative industry-led, output-based support service, drawing on the efficiencies of commercial aviation maintenance, has been established at RAF Brize Norton to provide all lines of maintenance for the fleet. The A400M Training Service is also progressing well; the first full flight simulator has been accepted, and pilot conversion training is now being carried out at RAF Brize Norton.

- In January 2015, the Chinook Mk6 was delivered into service on time, less than three years after the main contract was signed with Boeing. A total of 14 Mk6 helicopters have been ordered to enhance the RAF's existing heavy-lift helicopter capability, at a cost of almost £1Bn. This delivery will bring the overall number of UK Chinooks to 60 by the end of 2015.

- In November 2014, an £800M contract for the development of a new electronic radar system for Typhoon was awarded. The contract marks the next stage in the full development of an Active Electronically Scanned Array (AESA) radar capability for Typhoon. The introduction of an AESA radar will support new mission capabilities for Typhoon, through simultaneous multirole air-to-air and air-to-ground tracking of targets with increased fidelity and range, whilst utilising the Radio Frequency spectrum for Electronic Warfare.

- Airseeker is the UK's new Signals Intelligence System, replacing the capability previously delivered by the Nimrod R1. It is being procured through a Foreign Military Sales arrangement with the US Government and is being supported under a Cooperative Programme underpinned by a Sustainment and Follow-on Development Memorandum of Understanding. The first of three RC-135W 'Rivet Joint' aircraft was delivered to the UK ahead of schedule in November 2013, deploying operationally to Theatre in July 2014 and completing a successful 6-month operational deployment at the end of 2014. The Airseeker Initial Operating Capability was declared in December 2014. The second aircraft is ahead of schedule for delivery in August 2015.

A RAF A400M Atlas aircraft at RAF Brize Norton

- The Typhoon Phase 1 Enhancement package Release to Service was declared, as planned, in July 2014. The package, which forms part of the Future Capability Programme, delivers precision bombing capability through integration of the Paveway IV bomb and Laser Designator Pod. It also includes upgrades for the aircraft's Defensive Aid Sub-System and the latest interoperability updates.

- In December 2014, a £420M amendment to the Chinook Through-Life Contract Support contract was signed to cover in-service support for the next five years. As a result of MOD and supply chain efficiencies and continuous improvements, we have been able to reduce the cost of supporting Chinook by more than £150M over the next five years. In October 2014, a £150M contract for the development and manufacture stages of a Digital Automatic Flight Control System (DAFCS) for Chinook was signed, which will provide improved handling qualities and mitigate operating risks in degraded visual environments. The contract deliverables will ensure the Chinook remains at high levels of availability, readiness, and safety.

- A £120M agreement was signed at the Farnborough International Air Show in July 2014 to integrate Storm Shadow missiles to Typhoon jets. Storm Shadow, which is already used by Tornado GR4s, provides a long-range-air-to-surface capability; and will be fitted onto Typhoon Tranche 2 and 3 aircraft ready for service with the RAF in 2018.

- A £165M contract for the Typhoon Phase 3 Enhancements programme was awarded in February 2015. The programme will deliver a number of upgrades to the UK's Typhoon mission and maintenance systems; including the integration of the Brimstone 2 weapon system onto the Tranche 2 and 3 platforms.

- In October 2014, £120M Defence co-operation contracts for the early phase of a joint development of Unmanned Combat Air System (UCAS) between the UK and French governments were awarded to UK and French industry. A UCAS capability would be able to undertake sustained surveillance, mark targets, gather intelligence, deter adversaries, and carry out strikes in hostile territory in the 2030+ timeframe. The contracts will underpin a two-year Future Combat Air System (FCAS) Feasibility Phase programme and will involve six industry partners exploring concepts and options for the potential collaborative acquisition of a UCAS in the future. The UK share of the contracts is £60M and UK companies that will benefit are BAE Systems, Rolls-Royce, and Selex ES.

- UK REAPER Aircraft were deployed directly from Afghanistan to the Middle East to support coalition force operations in Northern Iraq in October 2014. The first mission was flown on 22 October, five weeks after notification to deploy.

- In February 2015, the Puma Mk2 achieved its Initial Operating Capability early, delivering a step change in the capability over the Puma MK1. New improvements include a Digital Automatic Flying Control System; new, more powerful and fuel-efficient engines; a new digital glass cockpit; an enhanced secure communications suite; and improved ballistic protection. These all boost the aircraft's capability and make it safer for its crew and passengers.

Across Defence:

- The Chief of Defence Materiel's Inventory Management Strategy set the intent to achieve Inventory reductions against the Financial Year 2011-12 baseline, with a reduction of Inventory stock from £40.3Bn (Gross Book Value) to a strategic target of £30.8Bn and a reduction of Inventory purchasing of £561M per annum by 31 March 2016. Through robust governance, new management systems and improvement interventions, the Department has set demanding financial control targets for the management of the Defence Inventory. At the close of Financial Year 2014-15, the DE&S had delivered a stock reduction to £31.6Bn and a cumulative reduction in expenditure on Raw Materials and Consumables of £1.7Bn against the FY 2011-12 baseline. The DE&S is exceeding the Inventory purchasing reduction targets and is on track to deliver the Inventory stock target by 31 March 2016.

- On 28 October 2014, the Marshall Air Traffic Management Team signed a contract 12 months ahead of approval to update and sustain Military Air Traffic Management capability. The contract value is £1.7Bn over 22 years and encompasses more than 60 Defence locations in the UK, overseas and deployed. The service provision will be via an output-based, availability-driven contract with Aquila Air Traffic Management Services Ltd (a company jointly owned by National Air Traffic Services and Thales). The contract allows the MOD to continue to fulfil its legal obligation to ensure safe operation of aircraft, as well as enabling compliance with forthcoming changes to air traffic regulations and addressing future obsolescence through a capital refresh with modern technology. The contract will save some £1Bn compared to the contracts that it replaces, by streamlining 70 existing contracts into a single service provision contract with a streamlined supply chain.

- The UK is investing £11.1Bn in its helicopter fleet over the next 10 years. Initial Operating Capability (IOC) was declared in August 2014 for the Army Wildcat and in January 2015 for the Wildcat Helicopter Maritime Attack (Royal Navy version). The Wildcat represents a significant increase in capability over the existing Lynx aircraft, with more powerful and fuel efficient engines to provide improved performance and modern integrated avionics that enhance the aircraft's mission capability.

- 2014 saw the completion on time of a £206M MOD/BAES joint-funded five year programme to transform UK General Munitions production facilities as part of the Munitions Acquisition Supply Solution (MASS) contract. This included new factories at Washington (Newcastle upon Tyne) for forging, machining, and treatment of large-calibre mortars, artillery, and tank ammunition; and at Radway Green (Crewe) for small arms ammunition, replacing the old Royal Ordnance Factories. The new factories were formally opened by HRH The Princess Royal in 2012 and 2014 respectively. MASS is a long-term partnering agreement signed between the UK MOD and BAE Systems in 2008 covering the majority of the UK's Armed Forces General Munitions requirements. The modern, more efficient factories underpin keener prices to MOD and increasing BAES competitiveness in the world market.

- During Financial Year 2014/2015, and in line with the MOD's 2009 Rotary Wing Strategy, we have delivered a number of new helicopter capabilities to our Armed Forces: the RAF's Chinook Mk6, the Army and Royal Navy variants of the Wildcat helicopter, the RAF's Puma Mk2, and the Royal Navy's Merlin Mk2, having all achieved their respective Initial Operating Capability milestones, on time or early. The MOD is continuing to provide our Armed Forces with one of the most capable and technologically-advanced helicopter fleets in the world, ensuring our Armed Forces are agile and ready to deploy on operations around the world.

Major Projects Portfolio

2.3.10 On 25 June 2015, the MOD (along with all Government Departments) published its third report on the progress of projects in the Government's Major Projects Portfolio (GMPP) in support of the 2015 Major Projects Authority annual report. The publication is based on a snap-shot of performance in September 2014. The latest Major Project Authority's annual report and GMPP data is published[15] at gov.uk.

Urgent Operational Requirements (UOR)

2.3.11 The UOR process is used for the rapid purchase of or modification to equipment, in order to address urgent and unforeseen capability gaps in support of current or imminent military operations. Where a requirement meets these criteria and is specific to a particular operational theatre, it will be funded from the Government Special Reserve, rather than the Defence budget. Over £8.1Bn of expenditure has been approved through the UOR process since 2001, of which over £6.1Bn has been for emerging requirements for Afghanistan.

2.3.12 For 2014-2015, the Department agreed an estimate with HM Treasury for Reserve expenditure on UORs of up to £17M. The final outturn against this estimate, based on operational demand, was £13.97M. The difference reflects both the changing operational requirements of UK Forces in Afghanistan since the original estimate was put in place, and the Department's efforts actively to reduce the cost of UORs without compromising their urgency or quality. In 2014-15, the MOD successfully delivered 10 UORs.

2.3.13 UOR delivery performance exceeded targets with 100% of UORs meeting their Equipment Delivery Dates or being delivered early. This included enhanced Improvised Explosive Device (IED) detection and protection system, vehicle safety enhancements, and a capability to identify enemy locations.

2.3.14 During Financial Year 2014-2015, a number of business cases have been approved to bring Urgent Operational Requirements into the MOD Equipment Programme.

Logistics Management and Support to Operations

2.3.15 The successful redeployment from Op HERRICK was concluded on 23 November 2014. Redeployment began in October 2012 and saw 3,456 vehicles and other major equipments returned from operations in Afghanistan, concurrent with 4,728 Twenty-foot Equivalent Units (TEUs) of materiel. This complex logistic operation was a significant achievement that involved personnel from all three Services, MOD civilians, and commercial partners. The Chancellor of the Exchequer has written to The Secretary of State for Defence to compliment the Department on the achievement of delivering redeployment on-time and under cost. The recovered equipment and vehicles are now being reconditioned and readied for contingent operations.

15 https://www.gov.uk/government/publications/major-projects-authorityannual-report-2015

UK Aid being loaded onto a RAF Hercules aircraft ready to be air dropped over northern Iraq

Staff loading baggage and freight onto an C-17

2.3.16 The current tempo and complexity of operations sets a demanding requirement on logistic support and joint enablers. In Sierra Leone, working in support of DfID in response to the Ebola crisis in West Africa has been a unique challenge logistically, with the military inextricably linked to a civilian-led response, which has necessitated inter-agency solutions. Equally, counter-ISIL operations in Northern Iraq are placing demands on niche strike and ISR capabilities, each accompanied by bespoke logistic support arrangements, while our continued support to wider operations in the Middle East and Afghanistan continues.

2.3.17 The logistic challenge of the future will be to anticipate the breadth and complexity of the Joint Force's requirements and meet them through a range of joint and multi-national logistic capabilities, Host Nation Support, and contracting solutions. The UK's commitment to the NATO Very High Readiness Joint Task Force (VJTF) will focus logistic contingency planning throughout the remainder of the year.

Support Chain Operations and Movements

2.3.18 Defence Support Chain Operations and Movements (DSCOM) has enabled, in conjunction with PJHQ, Front Line Commands (FLC), and commercial contractors, various lines of communication in support of operations. The main effort has been in support of operations in Afghanistan and specifically Redeployment.

2.3.19 The Op HERRICK redeployment challenge was to transport 4,728 20 foot containers of materiel and 3,465 Vehicles and Major Equipments from a land-locked, war-torn country bordering both Iran and Pakistan. This was achieved in parallel with the NATO mission of developing the Afghan National Security Forces, closing the UK's 137 Main and Forward Operating Bases across Helmand, and protecting the key redeployment base at Camp Bastion.

2.3.20 As at 1 June 15, a small number of vehicles remain at SMC Marchwood awaiting minor mechanical rectification prior to final on-move. The ensuing delivery and receipt of these vehicles at the Strategic Base will mark the conclusion of Stage 3 and the successful completion of Op HERRICK Redeployment.

2.3.21 Learning the lessons from the UK's extraction from Iraq, the Department created a robust governance process to assess which items should return to the UK and which would be disposed of in Afghanistan. This process run by DSCOM and supported by PJHQ, the FLCs provided an accurate basis for booking movements assets and for determining the order in which vehicles and material should be withdrawn. This planning also ensured that the military operations that needed to continue in parallel were not adversely affected by the redeployment imperative.

2.3.22 A combination of military and commercial airlift and commercial ground and sea lift were utilised throughout, with no adverse financial implications identified. Op HERRICK Redeployment has been regarded as a success both financially and operationally. DSCOM will continue to support Ops TORAL and KIPION utilising the Broader Middle East Line of Communication.

2.3.23 DSCOM has also been involved in support to all contingency operations notably Ops GRITROCK and SHADER.

2.3.24 In addition, DSCOM's role as the coordination centre for DE&S has continued to develop with emphasis on the coordination of the Strategic Base in support of contingency outloads.

Equipment Disposals

2.3.25 Departmental equipment disposal receipts for FY 2014-15 totalled £32M, of which £29.21M was achieved through the Disposal Services Authority (DSA). This included over 10,000 declarations of surplus materiel measured at 80,000 tonnes with just 1% sent to landfill. Major activities include the announcement of the sale of Combat Vehicle Reconnaissance (Tracked) to Latvia; sales of ammunition to Estonia and New Zealand; the recycling of HMS Liverpool and Manchester; the conclusion of Disposal Service Authority's involvement in disposals resulting from the drawdown in Afghanistan; and the disposal of chemicals from Syria as part of UK Government's contribution to the international effort.

Defence Infrastructure

2.3.26 The MOD is one of the largest landowners in the United Kingdom, with an estate of some 230,000 hectares; about 2% of the UK mainland. Some 73,000 hectares of this comprise a varied built estate including naval bases, airfields, living accommodation for military personnel and their families, scientific facilities, storage and distribution centres, communications facilities, and offices, making the MOD one of the UK's largest property managers. Reflecting the long history of the Armed Forces, the estate contains 815 listed buildings and over 700 scheduled monuments. The rural estate comprises mainly training areas and ranges, on undeveloped land which in places is of particular environmental or archaeological significance. The MOD has rights to use a further 222,000 hectares in the UK, mainly for training. In addition, the MOD manages an overseas estate comprising the garrisons and training facilities in Germany, Cyprus, the Falkland Islands, and Gibraltar, as well as facilities on Ascension Island, in Belize, Brunei, Nepal, Singapore, and the United States. The Armed Forces regularly use major training facilities in Canada, Cyprus, Germany, Norway, and Kenya. As at March 2015, estate-related Defence assets were valued at some £29.7Bn.

Defence Infrastructure Organisation (DIO) Transformation

2.3.27 To deliver the mandated 2010 SDSR outcomes for DIO, the new Enhanced Operating Model organisation structure and business processes were further developed during the year, with an emphasis on simplifying the organisation and ensuring that cross-cutting processes are harmonised. The Infrastructure Management System (IMS) programme delivered Release 1 of its functionality on time and within budget in December 2014.

2.3.28 Following the introduction of the Strategic Business Partner (SBP) in September 2014, the focus of the ongoing transformation for 2015-17 will include continuous improvement of the operating model through building the capability and capacity of the business to deliver the operational End-to-End Review; the implementation of the Footprint Strategy; and potentially to move DIO to a different corporate structure in April 2017. It will also enable DIO to respond to changes resulting from the current Strategic Defence and Security Review and the Comprehensive Spending Review. This will require putting key enablers in place across People (delivering the workforce plan, talent management, skills improvement, staff engagement, behaviours and culture); Process (Programme and Project Management Improvement, end-to-end delivery processes, and Supplier Engagement); Technology (completing the deployment of IMS) and Data (Information Strategy, data analytics and insight). The activities listed here will facilitate and enable business change as the DIO adapts to changing requirements, as well as improving efficiency and agility of the organisation.

The Footprint Strategy for Defence

2.3.29 In 2010 the National Audit Office carried out a review of the Defence Estate concluding not only that substantial further reductions in cost should be sought, but also that a more robust and systematic approach to estate rationalisation was required. A Footprint Strategy for the future lay-down of the Defence Estate is being developed; and is due to conclude in February 2016. It reflects the revised Defence requirement under Future Force 2020 and includes the needs of both Regular and Reserve forces. It also considers military capability, efficiency, and wider value.

2.3.30 A significant part of the footprint is accommodation. During 2015-16 DIO's work on the Accommodation Strategy will continue to develop ways in which supply and demand can be modified, to underpin an accommodation offer which supports future requirements, is flexible, is socially relevant, and which can be provided in a financially sustainable way. This work builds on that undertaken by the Living Accommodation Strategy Review (LASR), which during 2014 established a baseline model of current accommodation supply and demand now and in 2020. It generated a baseline for the MOD accommodation estate and identified a substantial cost pressure in meeting the projected accommodation demand based on current standards and policies. Ongoing work between DIO and various stakeholders continues to identify and analyse ways to reduce the cost pressure through a range of mitigation measures and develop the longer-term accommodation in line with the New Employment Model Programme.

Army Basing Programme

2.3.31 The Army Basing Programme (ABP) is a key enabler of Army 2020. It enables Regular Army unit moves in support of the Army 2020 future operating model, designed around a Reaction Force that is ready for the most demanding scenarios and an Adaptable Force capable of engagement at home and overseas, both of which will be supported by specialist Force Troops. The ABP will provide a UK basing lay-down that best supports the generation of military capability in an effective and efficient way whilst honouring the SDSR commitment to return all personnel from Germany by 2020 and deliver significant savings to the Department.

2.3.32 30 unit moves and structural changes in support of Army 2020 took place in 2014 as part of the drawdown from Germany and UK rebasing and we have closed and handed back Hameln Station to the Federal authorities. These moves have laid the foundations to enable the first big tranche of unit moves from Germany to the UK during 2015, which will see 14 units comprising nearly 5,000 Service Personnel and their families relocate over the summer months. These moves will result in the closure and hand-back to the Federal authorities of our Stations at Hohne, Fallingbostel, Herford and Elmpt, comprising 13 barracks, two ranges, a supply depot and seven schools. By the end of 2014 Army personnel numbers in Germany had reduced from 20,000 in 2010 to 10,500, and by the end of 2015 this figure will have reduced further to 5,300. In addition to the unit moves out of Germany, 8 units will relocate within the UK, 10 other units will restructure and one new unit will be formed in the UK during 2015.

2.3.33 Further progress on the infrastructure has been made during FY 2014-15 with early enabling works having been delivered at a number of sites including Preston, Catterick, York, Donnington, Bulford, Tidworth, Larkhill and Aldershot. A large number of the ABP projects are now in Develop Preferred Option (DPO) stage where the detailed designs and estimates are developed prior to Main Gate Business Case submission. Detailed planning continues under DPO on all aspects of infrastructure delivery including engagement with relevant Local Authorities, the NHS and local communities, resulting in a number of planning applications being submitted. The first planning application at Ludgershall, one of three, is to build 900 homes on Salisbury Plain. An ABP open day was held in Jan 15 to show members of the public the plans for Service Family Accommodation on Salisbury Plain and take feedback. Detailed negotiations with Wiltshire Council proceed to agree the social infrastructure contribution that the 900 new homes will attract. Additionally a number of Service family homes have been purchased directly from the open market at Grantham, York, Newbury and Tidworth to meet the forecast demand for accommodation under the planned moves back to the UK.

Next Generation Estate Contracts

2.3.34 The Financial Year 2014-15 has seen the four Next Generation Estate Contracts (NGEC) come into service. The Scotland and Northern Ireland contract came into service on 1 November 2014 with the Central, South East and South West coming into service on 1 February 2015. The new contractor, CarillionAmey, is working closely with the DIO mobilisation teams to ensure that all systems necessary to run the contracts successfully are being put in place. The value of the savings achieved were in line with the expectations expressed in last year's report and provided significant saving over the previous Regional Prime Contracts.

Sustainability of the Estate

2.3.35 DIO is responsible for delivering a sustainable estate. To this end, the Sustainability Appraisal process has been strengthened, improving the sustainability and resilience of capital projects with a commitment to sustainable procurement embedded in the new NGEC, National Training Estate Prime (NTEP), and Housing Prime contracts. DIO has also continued to lead the way for MOD infrastructure energy efficiency and sustainable practices, including waste management, during 2014-15. Increased access to data, thanks to the ongoing roll-out of the IMS, and key initiatives such as Demand Reduction, Behaviour Change and the Water Consumption Reduction Programme, have contributed to improved performance versus the 2009-10 baseline for energy consumption and Greening Government commitment targets. Performance for the period is reported separately within the Sustainable MOD Annual Report 2014-15 compiled by the MOD Sustainable Development (SD) Team. In addition MOD is on track to meet the current UK targets for the condition of Sites of Special Scientific Interest (SSSI). This includes the England Biodiversity Strategy vision to have 50% of the total area of SSSI in a 'favourable' condition by 2020 while maintaining at least 95% in 'favourable' or 'recovering' condition, with all reaching favourable condition by 2061. Looking to the future, climate impact risk assessments were completed on MOD's 80 priority sites in line with the 2014-15 target. These will inform future infrastructure development and improve resilience. In addition, the DIO Future Procurement Group is embedding sustainability into future contracts. 74 MOD heritage assets are currently on the English Heritage 'At Risk' list, with six due to be removed later this year.

DIO Training Estate

2.3.36 The DIO Training Estate supplies the majority of the military training areas, ranges, and facilities for the Armed Forces in the UK, Germany, Canada, and Kenya and also supports the Army lead in Belize. The estate supports individual and collective training in support of operations and contingency readiness, as well as training for the Reserve forces, adventure training, cadets, and the test and evaluation community. Wider government use of the training estate includes the territorial and national constabularies, as well as support to UK operations and national events, such as the Commonwealth Games.

2.3.37 DIO conducts a continuous review of the estate. In 2014-15 we decided to dispose of Deverell Barracks in Catterick which will be released in Summer 2015. Current rationalisation plans should see an estimated 12.5% reduction in holdings across the DIO training estate by 2020. The DIO is incorporating the Training Estate strategic estate development planning, known as the Footsteps Strategy, into the Footprint Strategy (see 2.3.39). Footsteps is the means of working towards an affordable, sustainable, and agile training estate, of the right size and quality, in the right place, in support of endorsed operational capabilities. The strategy will deliver a 10-year development programme designed to inform lifecycle replacement, basing requirements, and the needs of the contemporary training environment.

2.3.38 The next generation National Training Estate Prime (NTEP) was successfully mobilised on 3 November 2014 across the UK training estate. Elements of NTEP delivery are being incrementally delivered in 2015, principally enhanced IT support systems for bookings and management of the estate.

Army Reservists from the Royal Wessex Yeomanry on exercise on Salisbury Plain training area

Overseas Estate

2.3.39 DIO deployed several civilian Commercial and Facilities Management staff to Op HERRICK in Afghanistan prior to the closure of Camp Bastion in October 2014. DIO employs Royal Engineer personnel, alongside its civilian staff and Industry Partners, to ensure it maintains the necessary infrastructure experience to remain at high readiness for deployment in support of expeditionary Air Operations. The surge effort for both Op SHADER, the British military intervention in Syria and Iraq, and Op GRITROCK, the humanitarian relief effort to West Africa operating out of Ascension Island, required a swift and substantial infrastructure response provided by DIO and its Industry Partner teams. DIO has also continued with a programme of significant investment in the South Atlantic to sustain the British military presence on the Falkland and Ascension Islands.

MOD Land Release

2.3.40 On 8 June 2011, the Government set a target for land owned by central Government that has the capacity to deliver 100,000 new homes to be released. As a major landowning department, the MOD agreed a target, to release land with the potential capacity to deliver over 37,634 new homes, by end of March 2015. MOD exceeded this target, releasing sale of land having the potential for 38,778 new homes, and land with the potential for 515 new homes transferred to the Homes and Communities Agency (HCA). The Government has also exceeded its target of delivering the capacity for 100,000 homes on public sector land by March 2015.

2.3.41 Disposal receipts for FY 2014-15 were some £117M.

Single Living Accommodation (SLA)

2.3.42 Delivery of modern appropriate SLA has continued this financial year through Defence-funded projects. Modern scales and standards cater for single and multi-occupancy living needs with single en-suite bed-sitting rooms configured in either six- or eight-person flats or hotel layout supported by additional communal space and utility rooms with laundry and kitchenette facilities for Junior Ranks; equally appropriate provision is made for SNCO and Officer Cadres. Project SLAM delivered a cumulative total in excess of 20,000 bedspaces by the end of FY 2013-14, with a further 2,020 bedspaces delivered during FY 2014-15.

Service Family Accommodation (SFA)

2.3.43 The MOD controls 65,000 SFA properties worldwide. Of these, some 49,500 properties are in the UK and some 14,500 properties are overseas; the majority in Germany (c6,900). SFA is owned in a variety of ways. In England and Wales, most properties are leased from Annington Homes Ltd (AHL); AHL owns 38,920 properties in England and Wales, all of which were purchased from the MOD in 1996 and leased back for a period of 199 years. Most of the properties in Scotland and Northern Ireland are owned by the MOD. In Germany almost all are leased either from the Federal Government or private owners, as is the case in smaller and more remote overseas locations. However, in the other overseas bases – such as Cyprus – most are MOD-owned. The draw-down of British Forces in Germany will require the progressive return of substantial numbers of properties to the Federal authorities or private landlords with some 1,500 returned in 2014 following the closure of the Rhine Military Complex. It is planned that a further 3,100 will be returned during 2015 following the closure of Hohne Garrison and Herford Station.

2.3.44 Standard for Condition is used to determine the overall physical state of SFA, with Standard 1 being the highest and Standard 4 the lowest. Some 99% of the UK housing stock is in Good Condition (that is Standard 1 and 2) and the few houses not in good condition are not allocated. From April 2016, in line with the introduction of the new Combined Accommodation Assessment System (a key element of the New Employment Model), the Department will utilise the Government's Decent Homes Standard (DHS) as the benchmark for the standard of SFA. No Service family will be allocated a house which does not meet the DHS.

2.3.45 A margin of empty properties is required to support the natural rotation and movement of reassigned personnel, in particular peak demand in the late summer before the new school year starts, as well as periodic repair and upgrade of properties. However, the impact of the Armed Forces Redundancy Programmes, the requirement to retain houses to support ongoing UK Basing plans, and constraints placed on disposals has meant that the proportion of empty properties in the UK has continued to rise. In March 2015, the figure was 21%. When all known UK Basing plan housing requirements, especially for Service Personnel returning from Germany, and planned disposals are taken into account, the SFA void rate adjusts downwards to c9%, against the agreed 10% target.

A service married quarters

2.3.46 £61m was allocated for the upgrade and improvement of UK property during 2014-15. This enabled some 185 properties to be upgraded to Standard 1 for Condition, with over 5,000 other SFA benefiting from further improvements such as new kitchens, bathrooms, double glazing and energy efficiency measures. In addition, DIO continued to fund a capital programme to purchase new SFA from housing developers to improve further the condition of the housing stock, reduce reliance on costly substitute accommodation rented from the private sector, and meet new housing requirements to support rebasing. DIO purchased a further 273 new properties across seven locations at a total cost of £69m. Over the past four years, this programme has delivered some 1,200 new SFA at a total cost of £271m. Plans for further purchases and builds of

SFA are well advanced to meet the overall basing requirement, including the unit moves in 2015 as part of the Army Basing Programme.

Defence Asset Sales

2.3.47 As part of the Strategic Defence and Security Review, the Prime Minister announced in Parliament on 19 October 2010 the Department's intention to dispose of assets which are surplus or which do not need to remain in public ownership to contribute to Defence. As a consequence, the Department announced plans to sell its interests in the Government Pipeline and Storage System (GPSS), and the land business of the Defence Support Group (DSG), and to grant a concession for the commercial operation of the Marchwood Military Port.

2.3.48 The MOD is close to completing the three major elements of this asset disposal work. The successful sale of the Defence Support Group land business to Babcock for £140 million completed on 31 March 2015. The Government Pipeline & Storage System was sold to Compañía Logística de Hidrocarburos of Spain for £82 million, completing on 30 April 2015. In February 2015, the MOD announced that Solent Gateway Limited had been selected as preferred bidder for the concession to manage, and exploit the commercial potential of, the Marchwood Sea Mounting Centre.

2.3.49 As part of the comprehensive spending review in 2010 the Government announced a target of 500MHz of public sector spectrum below 5GHz to be released by 2020. This Department has identified two bands of spectrum for release, a total of 190MHz of bandwidth. The spectrum will be transferred to Ofcom during 2015-16 prior to sale, as the Department is not permitted to sell the asset direct. The sale is expected to be complete in 2015-16. As there is currently no reliable estimate of the value of this resource, nor of the economic benefits arising from its disposal, the Department has not recognised this as an asset in its Statement of Financial Position.

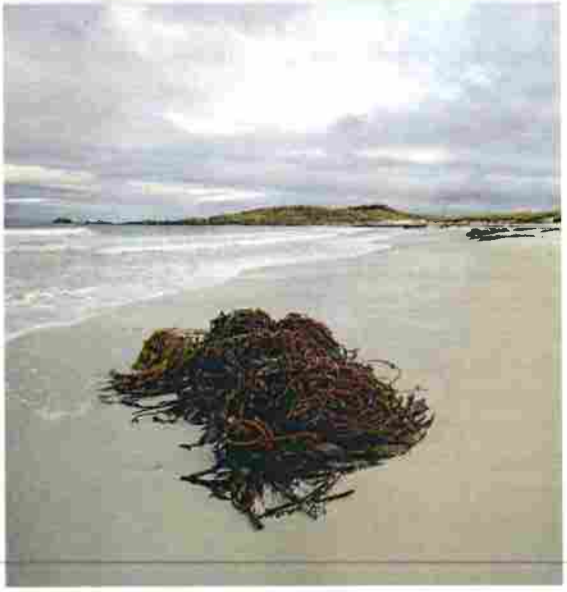
2.3.50 Old War Office Building was declared surplus to MOD requirements in Aug 2013 and prepared for marketing by mid 2014. A 250 year lease was offered for sale on the open market (with strict tenant obligations and restrictions in respect of planning, heritage and security) which attracted significant worldwide interest. Hinduja Group & OHLD were selected as the preferred purchaser (the purchase price remains commercially confidential). An Agreement for Lease was exchanged on 12 December 2014 with Lease completion expected in Q4 FY 2015-16.

Environmental, Social, Community, Employee and Other Matters

2.3.51 The *Business Plan 2012-15* summarises senior managers' views of how the Department's work will realise the Defence Vision, highlighting relevant matters. Specific aspects mentioned in the ASB's Reporting Statement that are available on MOD's section of the Gov.uk website are:

- Social and Community Issues – including sections covering current operations, cadet forces and support to Veterans.
- Environmental – 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 archaeological sites 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: https://www.gov.uk/defence-infrastructure-organisation-estate-and-sustainable-development

Protected areas of Stanley, Falkland Islands, which is home to a diverse range of wildlife



- Sustainability – the MOD's work to build security overseas is a key contributor to Sustainable Development. Internationally, MOD works with other government departments to prevent or contain violence, protect people and institutions, build capacity and improve security in some of the most poorly developed regions and countries in the world. This work is essential for preventing further conflict, strengthening international peace and creating the conditions for sustainable development overseas. Further information can be found at: https://www.gov.uk/defence-infrastructure-organisation-estate-and-sustainable-development

- Employees – personnel related information can be found at: https://www.gov.uk/government/organisations/ministry-of-defence/about/recruitment and statistical information including staff numbers can be found at: https://www.gov.uk/government/organisations/ministry-of-defence/about/statistics

- Performance Indicators – some details of MOD's performance are published as part of the Government's transparency initiative at: http://transparency.number10.gov.uk/

- Contractual Arrangements – the Department's capital commitments and commitments under leases and service concession arrangements are detailed in Notes 19, 20 and 21 to the accounts. During 2014-15 the Defence Science and Technology Laboratory, the UK Hydrographic Office and Defence Support Group were Trading Funds; they provided essential services to the Department.

- Expenditure – details of expenditure published under the Government's transparency agenda, including links to the data sets is available at: https://www.gov.uk/government/organisations/ministry-of-defence

- Spending Review 2010 – implications of significant changes following the Department's Comprehensive Spending Review settlement are set out in the *Business Plan 2012-15*.

- Contingent Liabilities – details of Contingent Liabilities disclosed under IAS 37 – Provisions, Contingent Liabilities and Contingent Assets, and additional liabilities included for Parliamentary Reporting and Accountability are at Note 22 to the accounts.

Devolution

2.3.52 Following the independence referendum in Scotland on 18 September 2014, the MOD has continued to work closely with the Scotland Office on plans for further devolution of powers to the Scottish Government while safeguarding Defence interests. There will also be new powers for Wales and Northern Ireland. Defence will remain a reserved responsibility of the UK Government, and the Armed Forces activities and military presence in England, Scotland, Wales and Northern Ireland ensure we provide the best levels of defence and security for all parts of the UK.

Pension Liabilities

2.3.53 The transactions and balances of the Armed Forces Pension Scheme (AFPS) (including the Gurkha Pension Scheme, the Non-Regular Permanent Staff Pension Scheme, the Reserve Forces Pension Scheme and other minor pension schemes covering locally employed personnel) and the Armed Forces Compensation Scheme are not consolidated in the financial statements. The funding for these schemes is voted separately by Parliament although the cost of administering the schemes fall to the MOD and is included in the accounts. The report and accounts of the AFPS are prepared separately and are available at:
http://www.official-documents.gov.uk/document/hc1213/hc00/0039/0039.asp
further information on Armed Forces pensions is available at
https://www.gov.uk/pensions-and-compensation-for-veterans

2.3.54 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 the accounts; separate accounts are prepared for the schemes and details can be found on the following websites:
http://www.civilservice.gov.uk/pensions
http://www.education.gov.uk/schools/careers/payandpensions
http://www.nhsbsa.nhs.uk/pensions

2.3.55 Other employees are members of smaller pension schemes e.g. schemes for Locally Employed Civilians in Germany, Cyprus and Gibraltar, the Merchant Navy Ratings Pension Fund, the Commonwealth War Graves Commission Superannuation Scheme and the Reserve Forces and Cadets Associations Pension Scheme; estimates of the assets and liabilities for these schemes are included in the financial statements and additional details are provided in Note 17 – Employee Benefits – Pensions.

2.3.56 Employer's contributions payable to the Armed Forces, Civil Service, NHS, Teachers' and other pension schemes have been charged to the Statement of Comprehensive Net Expenditure.

Further information on the various pension schemes can be found in the Remuneration Report and at Note 3 – Staff Numbers and Costs.

Payments to Suppliers

2.3.57 The Department's invoices, with the exception of some payments to suppliers made by units locally, are paid through the Defence Business Services (DBS) shared-service centre organisation. In the period 1 April 2014 to 31 March 2015, the DBS paid 99.99% of all correctly submitted invoices received at the shared-service centre within 11 calendar days. This contributed to the Department's overall performance of 100% 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. These calculations do not take into account, for certain invoices requiring signature by departmental staff, the time between the invoice arriving at the local MOD branch and the invoice being passed internally to the DBS shared-service centre for payment. Commercial debt interest of £8,000 was paid during this period (2013-14: £4,000). From May 2010 all Government Departments were asked to pay 80% of invoices from suppliers within 5 working days. The Department, including its Trading Funds, has achieved a performance of 93.94% against this target up to 31 March 2015.

IFRIC 4 – Determining Whether an Arrangement Contains a Lease

2.3.58 In preparing these accounts MOD has not complied with the Government Financial Reporting Manual (FReM), specifically the requirement to assess all its supplier arrangements to determine whether they are dependent on the use of specific assets and convey the right to use the assets. The assessments need to be made against criteria set out in the accounting standards as IFRIC 4 - Determining whether an Arrangement Contains a Lease. If these arrangements, particularly strategic procurement arrangements with key contractors, once reviewed, are considered to be finance leases, the assets and offsetting liabilities associated with the contracts would be brought into the MOD Accounts.

2.3.59 On the introduction of IFRS across Government in 2009-10, it was deemed too costly and time consuming to review MOD's contracts within the timescales for the 2009-10 Accounts. The review was then further deferred beyond 2011-12 when it became apparent that a large number of major contracts would have to be renegotiated as a result of the outcome of the SDSR. The Department has conducted a review, with support from an external accountancy consultant, of its most significant contract arrangements where IFRIC 4 is likely to apply. This has confirmed that the Department has a number of significant lease type arrangements which are not currently recognised and cannot be accurately quantified. As a result of the complex, resource intensive and costly practical issues identified by the review, the Department has decided not to apply IFRIC 4 to existing contracts on the grounds that it does not represent value for money and the Department is considering further work in respect of the application of IFRIC 4 to new contracts which should provide wider benefits through improved financial management around supplier assets. This position is supported by HM Treasury.

2.3.60 The Department has recently carried out a further piece of work, with external support, to look in detail at the challenges in managing the data, from an IFRIC 4 perspective, of assets used for new multiple contracts. The conclusion was that whilst it would be "technically possible to implement IFRIC 4 for new contracts, it would be practically extremely difficult" requiring significant changes to systems, processes and potentially the internal structure of the Department. The Department is currently considering the value for money implication of these conclusions.

2.3.61 The Comptroller and Auditor General's (C&AG's) opinion on the financial statements will be qualified for as long as non-compliance with IFRIC 4 is considered to have a material impact on the accounts. As a result of the decision not to implement IFRIC 4 for legacy contracts the MOD's accounts are expected to receive a qualified audit opinion for the foreseeable future.

Jon Thompson
Accounting Officer
08 July 2015

Chapter 3:
Directors' Report

Departmental Accounting Boundary

3.1 As at 31 March 2015, the Department consisted of 6 (2013-14: 7) Top Level Budget areas the reduction being due to the reorganisation of the former Defence Equipment and Support TLB by transferring responsibilities to the Front Line Commands and creating a Bespoke Trading Entity, the Defence Equipment and Support (Bespoke Trading Entity) – DE&S(BTE). The TLBs are responsible for providing forces and support services required for a modern Defence force. Within the TLBs, there were 37 (2013-14: 29) reporting entities, known as management groupings, producing detailed management accounting information as part of in-year financial management, planning and budgeting processes. Accounting transactions are recorded at management group level for in-year management purposes but reporting for the annual financial accounts is based on Departmental and TLB level returns.

3.2 The Departmental accounting boundary includes the Bespoke Trading Entity DE&S(BTE). several Non Departmental Public Bodies (NDPBs) including advisory NDPBs, and a number of other bodies classified to the public sector by the Office of National Statistics. For the accounting statements, DE&S (BTE) is included in the Core Department figures. The NDPBs and other bodies, referred to as arms-length bodies (ALBs), are added to the Core Department to form the Departmental Group. The complete list of arms-length bodies is at Note 27 – Entities Within the Departmental Boundary.

3.3 Throughout 2014-15, there were three MOD established Trading Funds. The Defence Support Group was sold on 31 March 2015; details of the sale are at Note 10 to the Accounts. The Trading Funds produce their own accounts and fall outside the Departmental Boundary. Further details are provided at Note 10 – Investments, Note 25 – Related Party Transactions and on the following websites: www.dstl.gov.uk for the Defence Science and Technology Laboratory (dstl) and www.ukho.gov.uk for the UK Hydrographic Office (UKHO).

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

Directorships and Significant Interests

3.5 Details of directorships and other significant interests held by Ministers are set out in The Register of Lords' Interests and The Register of Members' Financial 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/contents.htm for Ministers in the Commons.

3.6 In accordance with Cabinet Office guidance, MOD maintains a register of interest which records details of directorships and other significant interests held by senior managers in the Department. The Ministry of Defence Register of Interest is updated quarterly and a copy can be requested from HOCF-RegisterofInterest-mailbox@mod.uk.

3.7 Details of Related Party Transactions, including those arising as a result of the interests of Ministers or Defence Board members, are listed at Note 25 – Related Party Transactions. The MOD works closely with many organisations 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. The Department provides information (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.

Sickness Absence Data

3.8 Levels of sickness absence for civilian personnel employed by the Ministry of Defence, excluding Royal Fleet Auxiliary personnel and Locally Engaged Civilians, have fluctuated slightly throughout the year. The Department recorded 7.93 Average Working Days Lost (AWDL) per person for the 12 months ending 31 March 2015. This figure excludes DSG personnel for whom no complete data is available for the period due to the organisation's sale to Babcock. The MOD continues to review related policy and initiatives to ensure we proactively manage sickness absence and improve health and wellbeing at work. The highest causes of absence remain Mental health and Musculoskeletal disorders. This data has been processed according to Cabinet Office guidelines to allow more accurate comparison with Other Government Departments.

Personal Data Related Incidents

3.9 The following tables set out details of the Department's personal data related incidents during 2014-15. An incident is defined as a loss, unauthorised disclosure or insecure disposal of personal data. 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.

Summary of Protected Personal Data Related Incidents Formally Reported to the Information Commissioners Office (ICO) in 2014-15

The Department's Chief Information Officer (CIO) has responsibility for setting strategy, policy and standards relating to information and for ensuring appropriate governance and monitoring. The CIO also oversees a risk-managed information assurance process.

Month of Incident	Nature of Incident	Nature of Data Involved	Number of People Potentially Affected	Notification Steps
March 2014	Incorrect disposal of documents leading to potential external disclosure	Mixed Personal - exact details not known	Not known	ICO informed in May 2014
Further action on information risk:		The Department will continue to monitor and assess its information risks in order to identify and address any weaknesses and ensure continuous improvement of its systems.		

Summary of Other Protected Personal Data Related Incidents 2014-15

Incidents deemed by the Data Controller not to fall within the criteria for reporting 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.	1
II	Loss of inadequately protected electronic equipment, devices or paper documents from outside secured Government premises.	10
III	Insecure disposal of inadequately protected paper documents.	-
IV	Unauthorised disclosure.	36
V	Other.	3

Auditor

3.10 The financial statements of the Department (including DE&S (BTE)), five of its other ALBs (the National Army Museum, the National Museum of the Royal Navy, the RAF Museum, the Single Source Regulations Office and the Royal Hospital Chelsea) and the Armed Forces Pensions Scheme are audited by the Comptroller and Auditor General. The audit fees for this work are included at Note 5 to the accounts. The Department did not contract with its external auditor for any non-audit services.

Statement as to Disclosure of Information to Auditors

3.11 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.

Jon Thompson
Accounting Officer
08 July 2015

Chapter 4:
Remuneration Report

Remuneration Report

Remuneration Policy

4.1 The Review Body on Senior Salaries (SSRB) 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.

4.2 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).

4.3 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.

4.4 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.

4.5 There is an established Departmental procedure for the appointment of all Non-Executive Board Members (NEBMs). This requires a transparent recruitment and selection process, with appointment on merit, thus mirroring the Civil Service Commissioners' Recruitment Principles for permanent employees to the Civil Service. NEBMs appointed to the Defence Board receive a Letter of Appointment setting out, amongst other things, details of the agreed remuneration which is in line with the Bank of England's non-executive Directors of Court and in accordance with the *Corporate governance in central government departments: Code of good practice 2011 – Guidance Note.* NEBMs have the option to waive their remuneration.

Performance and Reward

4.6 Salary and reward for Permanent Secretaries is considered annually by the Permanent Secretaries' Remuneration Committee and, in common with that for other members of the Senior Civil Service (SCS), is subject to the rules and regulations imposed by the SSRB and the Cabinet Office. For the SCS below Permanent Secretary level, MOD implements its own pay and non-consolidated award arrangements within the Cabinet Office framework through an agreed pay strategy. Any non-consolidated award is based on a judgement of how well an individual has performed against their peers and awards are made to individuals judged to have made the highest in-year contribution to MOD's business objectives. There is no restriction on the nature of the contribution; the only requirement is that it benefits the Department or Defence more widely. Recommendations for awards – which are considered by moderation committees – must be linked to demonstrable evidence of delivery.

4.7 The Department also employs a number of members of the SCS on Fixed Term Appointments. These individuals are externally recruited to fill specific roles where the Department does not already have the necessary skills in-house. They are employed on individual contracts which allow them a base salary and the opportunity to earn performance related awards, specifically linked to business and corporate objectives. They are expected to deliver substantial benefits to the Department both in terms of outputs, delivering change programmes and skills transfer. As with the rest of the SCS the awards paid to those on Fixed Term Appointments are non-consolidated and non-pensionable and are subject to rigorous scrutiny.

4.8 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, time in rank and position on the pay scale, individuals can be awarded a single increment or no increment, and progress accordingly up the incremental pay scale for their rank. The average value of one incremental rise under the PMPS was 2.6% of salary in 2014-15 (2013-14: 2.6%).

4.9 Whilst Non-Executive remuneration is not directly linked to performance, in part to avoid any suggestion that an employee/employer relationship exists, NEBM performance is kept under review on at least an annual basis. The aim of the reviews, which are informal, is to consider the impact of individuals on the performance of the board, recognise the contribution of the NEBM and identify ways this could be improved, and provide feedback.

Senior Managers' Contracts

4.10 Recruitment into the Civil Service is regulated by The Constitutional Reform and Governance Act 2010 which established the Civil Service Commission and requires selection in accordance with Recruitment Principles, which require appointments to be on merit on the basis of fair and open competition, but also include the circumstances when appointments may otherwise be made. Further information about the work of the Civil Service Commission can be found at http://www.civilservicecommission.org.uk/

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

4.12 The lead NEBM appointment to the Defence Board was approved by the Prime Minister from a list of candidates recommended by the Cabinet Office. The appointment was for an initial period of three years, which was extended for a further three years to September 2017.

4.13 NEBMs 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.

4.14 The Chief of Defence Materiel was recruited on a four year fixed term appointment which has been extended for one year. Conditions covering termination of employment are set out in his contract of employment which requires the individual to provide notice of not less than 6 months. The contract also provides for the opportunity to earn a non-consolidated performance award.

4.15 The Chief of the Defence Staff and Vice Chief of the Defence Staff are appointed on the recommendation of the Secretary of State for Defence to the Prime Minister. Following the Prime Minister's agreement the final approval of the appointment lies with Her Majesty The Queen. Once selected the intention is that appointees hold the post for between 3 and 5 years.

Management

4.16 The following pages contain details of the pay, pensions and benefits-in-kind of individuals who served as Ministers or members of the Defence Board during the financial year. The disclosures cover only the periods individuals were Ministers or Board Members in the MOD i.e. if an individual moves Department during the year the disclosure covers only the remuneration earned to that date. The following pages also include details of pay multiples – the ratio between the highest paid Board member and the median remuneration of the workforce.

Ministerial Salaries, Allowances and Taxable Benefits

(This section has been subject to audit)

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

	2014-15				2013-14			
	Salary (£)	Benefits-in-kind (to the nearest £100)	Pension Benefits (to the nearest £1,000)*	Total (to the nearest £1,000)	Salary (£)	Benefits-in-kind (to the nearest £100)	Pension Benefits (to the nearest £1,000)*	Total (to the nearest £1,000)
Secretary of State for Defence								
The Rt Hon Michael Fallon MP								
(from 15 July 2014)	48,088	Nil	15,000	63,000	Nil	Nil	Nil	Nil
Full year equivalent salary	67,505							
The Rt Hon Philip Hammond MP**								
(to 14 July 2014)	19,417	Nil	7,000	27,000	68,169	Nil	25,000	93,000
Full year equivalent salary	67,505							
Minister of State for the Armed Forces								
The Rt Hon Mark Francois MP								
(from 7 October 2013)	31,680	Nil	11,000	43,000	32,344	Nil	16,000	49,000
Minister of State for Defence Personnel, Welfare and Veterans								
The Rt Hon Anna Soubry MP***								
(from 15 July 2014)	29,004	Nil	10,000	39,000	11,148	Nil	4,000	15,000
Full year equivalent salary	31,680				23,039			
Parliamentary Under-Secretary of State and Minister for Reserves								
Julian Brazier MP†								
(from 15 July 2014)	15,939	Nil	Not Available	Not Available	Nil	Nil	Nil	Nil
Full year equivalent salary	22,375							
Parliamentary Under-Secretary of State and Minister for Defence Equipment, Support and Technology (including Defence Exports)								
Philip Dunne MP								
(from 5 September 2012)	22,375	Nil	Nil	22,000	23,039	Nil	Nil	23,000
Parliamentary Under-Secretary of State for Defence (Minister for International Security Strategy)								
Dr Andrew Murrison MP**								
(to 14 July 2014)	6,436	Nil	3,000	9,000	23,039	Nil	8,000	31,000
Full year equivalent salary	22,375							
Parliamentary Under-Secretary of State and The Lords Spokesperson on Defence								
The Rt Hon The Lord Astor of Hever DL								
(from 26 May 2010)	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil

*The value of pension benefits accrued during the year is calculated as the real increase in pension multiplied by 20, plus the real increase in any lump sum less the contributions made by the individual. The real increase excludes increases due to inflation or any increases or decreases due to transfer of pension rights.
**The disclosures cover only the periods these individuals were Ministers in the MOD. The actual total salary paid by the Department (including the balance of pay for the month in which they transferred Departments) was: for Phillip Hammond £22,502 and for Dr Andrew Murrison £7,458.
*** Anna Soubry was appointed as Parliamentary Under-Secretary of State for Defence Personnel, Welfare and Veterans on 7 October 2013 and as Minister of State on 15 July 2014.
†The pension figures for Julian Brazier are not available and will be published in the 2015-16 accounts.

4.18 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 tax free severance payment of one quarter of the annual salary being paid. No payments were made in 2014-15 (2013-14 – None).

Ministerial Salary

4.19 'Salary' includes: gross salary; reserved rights to 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.

4.20 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 – £67,060 pa with effect from 1 April 2014 (£66,396 pa with effect from 1 April 2013) 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, if applicable would be shown in full above.

Ministers Benefits-in-Kind

4.21 The monetary value of benefits-in-kind covers any benefits provided by the Department and treated by HM Revenue and Customs as a taxable emolument.

Ministerial Pensions

(This section has been subject to audit)

4.22 The real increase in the value of the accrued pension compared to the 2013-14 value, is shown *in italics* (in bands of £2,500).

	Total Accrued Pension at Retirement as at 31 Mar 15 £000	CETV* at 31 Mar 14 or date of Appointment if Later £000	CETV* at 31 Mar 15 or on Cessation of Appointment if Earlier £000	Real Increase in CETV* £000
Secretary of State for Defence				
The Rt Hon Michael Fallon MP	**0 - 5**			
	0 - 2.5	**70**	**93**	**13**
The Rt Hon Philip Hammond MP	**5 - 10**			
	0 - 2.5	**103**	**112**	**5**
Minister of State for the Armed Forces				
The Rt Hon Mark Francois MP	**0 - 5**			
	0 - 2.5	**32**	**44**	**5**
Minister of State for Defence Personnel, Welfare and Veterans				
The Rt Hon Anna Soubry MP	**0 - 5**			
	0 - 2.5	**14**	**26**	**7**
Parliamentary Under-Secretary of State and Minister for Reserves				
Julian Brazier MP**		**Not Available**		
Parliamentary Under-Secretary of State and Minister for Defence Equipment, Support and Technology (including Defence Exports)				
Philip Dunne MP***	**Nil**	**Nil**	**Nil**	**Nil**
Parliamentary Under-Secretary of State for Defence (Minister for International Security Strategy)				
Dr Andrew Murrison MP	**0 - 5**			
	0 - 2.5	**13**	**16**	**1**
Parliamentary Under-Secretary of State and The Lords Spokesperson on Defence				
The Rt Hon The Lord Astor of Hever DL	**Nil**	**Nil**	**Nil**	**Nil**

*CETV – Cash Equivalent Transfer Value.
**The pension figures for Julian Brazier are not available and will be published in the 2015-16 accounts.
***Philip Dunne chose not to be covered by the Parliamentary Contributory Pension Fund (PCPF) during the reporting year.

4.23 Pension benefits for Ministers are provided by the 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 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.

4.24 The accrual rate for benefits 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. An additional 1/60th accrual rate option (backdated to 1 April 2008) was introduced from 1 January 2010.

4.25 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 revalued annually in line with changes in Pensions Increase legislation. From 1 April 2015 members pay contributions between 8.4% and 17.9% depending on their level of seniority and chosen accrual rate. In line with reforms to other public service pension schemes, it is intended to reform the Ministerial pension Scheme in 2015. The new scheme will be a Career Average pension scheme, have an accrual rate of 1.775%, revaluation based on the change in prices, a Normal Pension age equal to State pension age and a member contribution rate of 11.1%.

Recent Ministerial Changes

4.26 As part of the post-election Government reshuffle, a number of Ministerial changes and changes to Ministers' responsibilities have been made. Details are available at: https://www.gov.uk/government/organisations/ministry-of-defence

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

4.27 Chaired by the Secretary of State and including the Minister for the Armed Forces, the Defence Board is the main corporate board of the MOD. During the year the following served as members of the Defence Board. *(This section has been subject to audit)*

	2014-15					2013-14				
	Salary £000	**Annual Performance Award £000**	**Benefits-in-kind (to the nearest £100)****	**Pension Benefits (to the nearest £1,000)***	**Total £000**	Salary £000	Annual Performance Award £000	Benefits-in-kind (to the nearest £100)	Pension Benefits (to the nearest £1,000)*	Total £000
Secretary of State for Defence										
The Rt Hon Michael Fallon MP The Rt Hon Philip Hammond MP	See the Ministerial salaries, allowances benefits-in-kind, pension benefits and total remuneration table above									
Minister of State for the Armed Forces										
The Rt Hon Mark Francois MP	See the Ministerial salaries, allowances benefits-in-kind, pension benefits and total remuneration table above									
Permanent Under-Secretary of State										
Jonathan Thompson (from 3 September 2012)	180 - 185	15 - 20	Nil	49,000	245 - 250	180 - 185	Nil	Nil	43,000††	220 - 225
Chief of the Defence Staff										
General Sir Nicholas Houghton GCB CBE ADC Gen (from 18 July 2013)	245 - 250	Nil	65,000	58,000	365 - 370	185 -190	Nil	50,000****	361,000	600 - 605
Full year equivalent salary						240 - 245				
Vice Chief of the Defence Staff										
Air Chief Marshal Sir Stuart Peach KCB CBE ADC BA MPhil DLitt FRAeS RAF (from 10 May 2013)	185 - 190	Nil	54,100	38,000	275 - 280	160 - 165	Nil	46,800***	(25,000)	180 - 185
Full year equivalent salary						175 - 180				

	2014-15					2013-14				
	Salary £000	Annual Performance Award £000	Benefits-in-kind (to the nearest £100)**	Pension Benefits (to the nearest £1,000)*	Total £000	Salary £000	Annual Performance Award £000	Benefits-in-kind (to the nearest £100)	Pension Benefits (to the nearest £1,000)*	Total £000
Chief of Defence Materiel										
Sir Bernard Gray										
(from 4 January 2011)	220 - 225	45 - 50	23,800	83,000	375 - 380	220 - 225	45 - 50	26,200†	84,000††	380 - 385
Director General Finance										
Louise Tulett CBE										
(from 16 March 2015)	0 - 5	Nil	Nil	3,000	5 - 10	Nil	Nil	Nil	Nil	Nil
Full year equivalent salary	105 - 110									
David Williams										
(to 15 March 2015)	125 - 130	10 - 15	Nil	37,000	175 - 180	130 - 135	5 - 10	Nil	223,000††	360 - 365
Full year equivalent salary	130 - 135									
Non-Executive Board Members										
Sir Gerry Grimstone***										
(from 15 September 2011)	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Graham Williams										
(from 21 December 2011)	15 - 20	Nil	Nil	Nil	15 - 20	15 - 20	Nil	Nil	Nil	15 - 20
Paul Skinner CBE***										
(from 1 September 2014)	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Danuta Gray***										
(from 1 February 2015)	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil

*The value of pension benefits accrued during the year is calculated as the real increase in pension multiplied by 20, plus the real increase in any lump sum less the contributions made by the individual. The real increase excludes increases due to inflation or any increases or decreases due to transfer of pension rights.

**Where the current year's benefit-in-kind includes an element for the private use of official cars the figures are estimated. The agreement process with HMRC concludes after publication of the accounts and any necessary restatement of the amounts is published in the following year's accounts with changes indicated by a †.

***Sir Gerry Grimstone and Paul Skinner have elected to waive the £15,000 fee to which they are entitled. Danuta Gray has elected to waive fees due for 2014-15.

****The 2013-14 benefit in kind for the private use of official cars has been re-stated due to a change in the method of calculation. These revised figures are subject to agreement with HMRC.

†† Civilian pension benefits have been recalculated due to changes in inflation factors.

Defence Board Salary

4.28 Salary includes gross salary, taxable allowances and payment in lieu of untaken leave (if applicable). Any annual performance award paid is shown separately and is in respect of amounts paid in 2014-15 but based on performance in an assessment period ended prior to the start of the financial year. The payment of business expenses e.g. travel costs incurred on duty, is not part of salary and is not disclosed above.

Defence Board Benefits-in-Kind

4.29 For civilian members of the Board the figures for benefits-in-kind 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 military Board members the figures disclosed as benefits-in-kind combine the taxable value in respect of their occupation of official residences and the value attributed to individuals for their private use of official cars. For the disclosed benefits-in-kind the Department has arrangements under which MOD pays the tax liability that would normally be paid by the individual; this liability is included in the figures quoted.

Pay Multiples

(This section has been subject to audit)

4.30 The following table contains details of pay multiples – the ratio between the highest paid Board member and the median remuneration of the remaining workforce. Remuneration of the highest paid directors is based on annual equivalents, improving comparability from year to year where, for example, individuals serve for part of a year. A separate multiple has been calculated for the Armed Forces – comparing the Chief of the Defence Staff to the military pay median. The civilian multiple uses a median based on civil service pay i.e. it excludes staff who are paid under arrangements outside the Department's control, for example: medical personnel, fire fighters, police and teachers; it also excludes locally employed civilians overseas and agency staff covering permanent posts.

	2014-15	2013-14
Mid point of the £5,000 band for the annual equivalent remuneration of the highest earning military Board member in the table above.	£312,500	£302,500*
Median total remuneration of Armed Forces personnel	£33,130	£31,689
Ratio	9.4	9.5*
Mid point of the £5,000 band for the annual equivalent remuneration of the highest earning civilian Board member in the table above.	£297,500	£297,500
Median total remuneration of civilian staff	£28,285	£27,551
Ratio	10.5	10.8

*The benefit-in-kind attributable to the highest paid military director has been restated resulting in a change to the mid-point figure and therefore the ratio.

4.31 The military pay ratio has decreased due to the increase in the median of the rest of the Armed Forces. The decrease in the ratio has been partially offset by the increase in the mid-point figure for the highest paid military board member.

4.32 The civilian pay ratio has decreased due to a higher proportion of civilians in higher grades resulting in a higher median.

4.33 In 2014-15 the remuneration of civilian employees ranged from £15,468 to £272,490 and no (2013-14, none) civilian employees received remuneration in excess of the highest paid director.

Defence Board – Pension Benefits

(This section has been subject to audit)

4.34 Pension benefits for individuals who served on the Defence Board are set out below. The real increase in the pension, from 2013-14, and where applicable the real increase in the lump sum payment, are shown in *italics*.

	Total Accrued Pension at Retirement as at 31 Mar 15 £000	CETV at 31 Mar 14 or date of Appointment if Later £000	CETV at 31 Mar 15 or on Cessation of Appointment if Earlier £000	Real Increase in CETV £000
Secretary of State for Defence The Rt Hon Philip Hammond MP The Rt Hon Michael Fallon MP	See the Ministerial pensions table above			
Minister of State for the Armed Forces The Rt Hon Mark Francois MP	See the Ministerial pensions table above			
Permanent Under-Secretary of State Jonathan Thompson	Pension **45 -50** *2.5 - 5* Lump Sum **Nil**	613	685	33
Chief of the Defence Staff General Sir Nicholas Houghton GCB CBE ADC Gen	Pension **140 - 145** *2.5 - 5* Lump Sum **420 - 425** *7.5 - 10*	3,526*	3,717	94
Vice Chief of the Defence Staff Air Chief Marshal Sir Stuart Peach KCB CBE ADC BA MPhil DLitt FRAeS RAF	Pension **90 - 95** *0 - 2.5* Lump Sum **275 - 280** *2.5 - 5*	2,246*	2,369	60
Chief of Defence Materiel Sir Bernard Gray	Pension **20 - 25** *5 - 7.5* Lump Sum **Nil**	217	294	47
Director General Finance Louise Tulett CBE (from 16 March 2015)	Pension **15 - 20** *0 - 2.5* Lump Sum **50 - 55** *0 - 2.5*	342	345	2
David Williams (to 15 March 2015)	Pension **40 - 45** *0 - 2.5* Lump Sum **120 - 125** *5 - 7.5*	568	621	22
Non-Executive Board Members				
Sir Gerry Grimstone	N/A	N/A	N/A	N/A
Graham Williams	N/A	N/A	N/A	N/A
Paul Skinner CBE	N/A	N/A	N/A	N/A
Danuta Gray	N/A	N/A	N/A	N/A

* The factors used to calculate the CETV at the start of the year were updated resulting in revised figures to those published last year

Civil Service Pensions

4.35 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 Pensions Increase legislation. Members joining from October 2002 may opt for either the appropriate defined benefit arrangement or a 'money purchase' stakeholder pension with an 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).

4.36 Employee contributions are salary related and range between 1.5% and 6.85% of pensionable earnings for classic and 3.5% and 8.85% for premium, classic plus and nuvos. Employer contributions are calculated using four percentage rates (16.7%, 18.8%, 21.8% and 24.3%) of pensionable pay, based on four salary bands. Employer contributions are reviewed by the Schemes' actuary and as a result of the latest review the 2015-16 salary bands were revised and the percentage rates will be 20%, 20.9%, 22.1%, and 24.5% from 1 April 2015. Benefits in classic accrue at the rate of 1/80th of final pensionable earnings for each year of service; in addition, a lump sum equivalent to three years' initial 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 Pensions Increase legislation. 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.

4.37 The partnership pension account is a stakeholder pension arrangement. The employer makes a basic contribution, depending on the age of the member, of between 3% and 12.5% (from 1 October 2015 between 8% and 14.75%) into a stakeholder pension product chosen by the employee from a panel of three providers. 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).

4.38 Further details about the Civil Service pension arrangements can be found at the website www.civilservice.gov.uk/pensions . New Career Average pension arrangements will be introduced from 1 April 2015 and the majority of classic, premium, classic plus and nuvos members will join the new scheme. Further details of this new scheme are available at:
http://www.civilservicepensionscheme.org.uk/members/the-new-pension-scheme- alpha/

Armed Forces Pension Scheme (AFPS)

4.39 From 6 April 2005, the Armed Forces Pension Scheme known as AFPS 05 was introduced for all new members of the Armed Forces; those in service before this date have been given the opportunity to transfer, from AFPS 75, to the new scheme. Both schemes are defined benefit, salary-related, contracted out, occupational pension schemes. The AFPS is non-contributory for members; the cost of accruing benefits are met by the employer at rates of 42.6% for Officers and 30.6% for Other Ranks of pensionable pay for Regular personnel. These rates will change to 53.4% for Officers and 52% for Other Ranks from 1 April 2015. 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. A scheme member leaving before these points, is entitled to a preserved pension and related lump sum.

4.40 Further details about Armed Forces Pensions can be found at the website https://www.gov.uk/pensions-and-compensation-for-veterans

Cash Equivalent Transfer Value

4.41 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. For the senior civil servants and military members of the Defence Board 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 2008 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

4.42 This reflects the increase in CETV that is 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.

Jon Thompson
Accounting Officer
08 July 2015

Chapter 5:
Governance Statement

Statement of Accounting Officer's Responsibilities

Under the Government Resources and Accounts Act 2000 (the GRAA), HM Treasury has directed the Ministry of Defence to prepare, for each financial year, consolidated resource accounts detailing the resources acquired, held or disposed of and the use of resources, during the year by the Department (inclusive of its executive agencies) and its sponsored Non-Departmental and other arms-length bodies designated by order made under the GRAA by Statutory Instrument 2014 No. 3314 (together known as the 'Departmental Group', consisting of the Department and sponsored bodies listed at Note 27 to the accounts). 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 the Departmental Group and of the net resource outturn, application of resources, changes in taxpayers' equity and cash flows of the Departmental Group for the financial year.

In preparing the accounts, the Accounting Officer of the Department is required to comply with

the requirements of the *Government Financial Reporting Manual* and in particular to:

- observe the Accounts Direction issued by the Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- ensure that the Department has in place appropriate and reliable systems and procedures to carry out the consolidation process;
- make judgements and estimates on a reasonable basis, including those judgements involved in consolidating the accounting information provided by Non-Departmental and other arms-length bodies;
- 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 Jonathan Thompson, Permanent Under-Secretary (PUS) as Accounting Officer of the Ministry of Defence. The Accounting Officer of the Department has appointed some Chief Executives of its sponsored Non-Departmental and other arms-length bodies as Accounting Officers of those bodies. The Accounting Officer of the Department is responsible for ensuring that appropriate systems and controls are in place to ensure that any grants that the Department makes to its sponsored bodies are applied for the purposes intended and that such expenditure and the other income and expenditure of the sponsored bodies are properly accounted for, for the purposes of consolidation within the resource accounts. Under their terms of appointment, the Accounting Officers of the sponsored bodies are accountable for the use, including the regularity and propriety, of the grants received and the other income and expenditure of the sponsored bodies. 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 assets of the Department or Non-Departmental and other arms-length bodies for which the Accounting Officer is responsible, are set out in *Managing Public Money* published by HM Treasury.

Governance Statement

1. Introduction

This Governance Statement represents my assurance to Parliament that, as Accounting Officer, I am satisfied that the Department's system of internal control is effective.

I delegate responsibilities within the MOD to control the Department's business and meet the standards required by the relevant regulatory authorities. The systems used to do this give me insight into the business of the Department and its use of resources, and allow the Defence Board to make informed decisions about progress against Departmental objectives, and if necessary to steer performance back on track.

In implementing the recommendations of Lord Levene, the Department has undergone significant internal change since 2011. As previously reported, this has improved the Department's governance and risk management frameworks and management information systems. In recognition of this improvement, on

1 April 2014 I increased the delegations to the Top-Level Budget (TLB) Holders to include commitments to spend on equipment and support up to £250M. On the same date, HM Treasury increased the delegation to MOD to £600M, which I sub-delegate to the Director General Finance, specifically to set the financial delegation framework, but also as Chair of the Investment Approval Sub-Committee of the main Defence Board.

The Armed Forces

Command and administration of the Armed Forces is vested by Letters Patent in the Defence Council, chaired by the Secretary of State for Defence, and beneath that in the three Service Boards, each chaired by a Minister. Membership of the Defence Council comprises all Defence Ministers, the executive members of the Defence Board (DB) – that is the Permanent Under-Secretary (PUS), the Chief of the Defence Staff (CDS), the Vice-Chief of Defence Staff (VCDS), the Chief of Defence Materiel (CDM), and the Director General Finance (DG Finance) – together with the Chief of the Naval Staff (CNS), the Chief of the General Staff (CGS), the Chief of the Air Staff (CAS), and the Chief Scientific Advisor (CSA).

CDS is the professional head of the Armed Forces and principal military adviser to the Secretary of State and the government. His responsibilities include:

- leading defence (with me, the PUS);
- setting strategy for defence, including the future development of the Armed Forces (together with me, PUS and subject to Ministers' direction);
- the conduct of current operations (as strategic commander); and
- leading relationships with other countries' Armed Forces.

The Chiefs of Staff meetings are the principal means through which CDS gathers the collective military advice of the Service Chiefs. The Armed Forces Committee is the senior executive committee of the Armed Forces and assists CDS in leading and directing the Armed Forces.

The individual Service Chiefs also advise CDS, the Secretary of State, and when required the Prime Minister on the operational employment of the forces for which they are responsible.

2. Governance Framework

Organisational structure

The core financial structure of the department during 2014-15 comprised the six Top-Level Budget (TLB) organisations:

- Navy Command
- Army Command
- Air Command
- Joint Forces Command
- Defence Infrastructure Organisation
- Head Office and Corporate Services

and the Defence Equipment and Support organisation, which became an arms-length body on 1 April 2014. Between them, these seven organisations deliver the Department's principal outputs.

Each TLB organisation is headed by a TLB Holder, who operates within a framework of responsibilities delegated by me. To assist me in assessing the adequacy of control arrangements across the Department, they each submit an annual statement of assurance, endorsed by their Management Board and in most cases by their Audit Committee.

In addition, the Defence Departmental Group, under Managing Public Money, includes a number of other arms-length bodies and Trading Funds (see below).

Changes during the year

There were important changes to the organisational bodies within the Defence Departmental Group during the reporting year.

The principal change was the transition of the Defence Equipment and Support (DE&S) organisation to become an arms-length body of the MOD on 1 April 2014. As set out in its Framework Document[16], the DE&S is a Bespoke Trading Entity[17], which is a unique business model in Government that has been tailored to allow it to deliver cost-effectively the Department's ten-year equipment and support plans to their customers. Strategic governance is provided by the Owner's Council, chaired by the Minister for Defence Procurement; and by the DE&S Board, under the chairmanship of a lead Non-Executive Director, and four other NEDs, together with me, who provides a forum for independent, non-executive support and constructive challenge to CDM and his top executive team.

The DE&S Executive Board comprises CDM as Chief Executive, Director General Resources as Chief Finance Officer, and the Director General Commercial along with the Chiefs of Materiel for Fleet, Land, Air, and Joint Enablers, who lead the delivery of the programme in their respective areas. The Executive Board supports and advises CDM in the discharge of his delegations and responsibilities, to ensure the DE&S delivers its purpose to equip and support the UK's Armed Forces for operations now and in the future.

The other main status changes were:

- on 16 December 2014, the Department agreed to sell its interests in the Defence Support Group (DSG) to Babcock, who assumed operational responsibility on 1 April 2015, transferring 1982 civil servants under TUPE arrangements. The electronic component element of the business (Defence Electronic and Components Agency) has been retained and was brought back on-vote on 1 April 2015, resulting in 431 civil servants being back on-vote;

- on 14 July 2014, following the passing of the Defence Reform Act 2014 and Parliamentary approval of new Single Source Contract Regulations, the Single Source Regulations Office was established as an Executive Non-Departmental Public Body, sponsored by the MOD employing between 30 – 50 staff. Its principal aim is to ensure that the UK taxpayer receives value for money against single source contracts let on behalf of Defence, and

- on 23 February 2015, Leidos Europe Limited was announced as the preferred bidder to deliver Logistics & Commodities Services to Defence. In April 2015, the TU consultation document was released detailing the TUPE arrangements for the transfer of c.1600 MOD civilians to the new owner. This is followed by a three month consultation period leading to a planned employee transfer date of 1 August 2015.

Other important internal changes were:

- on 1 April 2014, the Service Personnel and Veterans Agency (SPVA), which administers the Armed Forces Pension Scheme and the Armed Forces Compensation Scheme, was incorporated into the Defence Business Services organisation. Payments to eligible individuals under the Armed Forces Pension Scheme and Armed Forces Compensation Scheme fall outside the Departmental Accounting Boundary and have separate, published Annual 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 Accounting Boundary and fall within the Head Office and Corporate Services TLB;

- a competition was held to introduce a strategic business partner for the Defence Infrastructure Organisation (DIO), to design and deliver a range of facilities in both its property and operational portfolio. The selected consortium, led by Capita and URS, began work on 1 September 2014, and

16 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/311029/20140513-des-framework-document-v1-May-2014.pdf
17 *Managing Public Money* (2013), Chapter-7.

- on 3 March 2015, Solent Gateway was announced as the preferred bidder to manage and develop the potential of the Marchwood Sea Mounting Centre.

Subsequent changes

There have also been some significant changes since the reporting year ended:

- on 1 April 2015, the Military Aviation Authority and the Defence Safety Environment Authority merged to form the Defence Safety Authority, giving a single MOD focus for Health, Safety and Environmental protection;
- on 30 April 2015, the Department completed the sale of its interests in the Government Pipeline and Storage System (GPSS) to Compañía Logística de Hidrocarburos, with 72 GPSS employees transferring under TUPE arrangements to work for the new owners. The Department has retained ownership of the six UK Oil Fuel Depots, which will continue to be operated and maintained by the residual Oil and Pipelines Agency; and
- in April 2015, the decision was taken that when the SERCO contract for the management of Defence Business Services comes to an end in March 2016, management responsibility will be brought back in-house.

Arms-length bodies

The Department is responsible for: the Defence Equipment and Support organisation; four Executive Non-Departmental Public Bodies (NDPBs); three Trading Fund Agencies; and one Public Corporation.

- The Defence Equipment and Support (DE&S) organisation became an arms-length body of the MOD on 1 April 2014. The DE&S Owner's Council is chaired by the Minister for Defence Procurement. The DE&S Board is chaired by a lead Non-Executive Director, alongside four Non-Executive colleagues, PUS, CDM, DG Resources and DCDS (Mil Cap). The DE&S is headed by the Chief of Defence Materiel, under a Chief Executive Letter of Delegation as Accounting Officer and a Letter of Authority from me. Under its new status, the CDM will produce for the first time this year a Governance Statement for the DE&S's own Annual Report and Accounts.
- The four Executive NDPBs – the National Museum of the Royal Navy, the National Army Museum, the Royal Air Force Museum, and the Single Source Regulations Office[18] – are sponsored by the Department and fall within the Departmental Accounting Boundary. They each operate within a financial memorandum agreed between their respective Boards and the MOD.
- The three MOD Trading Funds – The Defence Science and Technology Laboratory (Dstl), the UK Hydrographic Office, and the Defence Support Group[19] – 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 prepare Governance Statements for their Annual Accounts. Representatives from Head Office are members of their Audit Committees. In addition, a Departmental representative sits on the Trading Funds' Management Boards. Ministers, supported by an Owner's Council[20], are responsible for setting the Trading Funds' top-level objectives, approving major business decisions including their Corporate Plans, and setting annual key targets. The respective Audit Committee of each Trading Fund provides the Board and Accounting Officer with an Annual Report, which covers activity through-out the year and highlights any control risks and weaknesses found.
- The Public Corporation – the Oil and Pipelines Agency (OPA), which *inter alia* manages the Government Pipeline and Storage System (GPSS)[21] – is also sponsored by the Department, but this falls outside the Departmental Accounting Boundary and its Annual Accounts are published separately. The Public Corporation has a Board of Directors on which the MOD is represented. The Accounting Officer is

18 The Single Source Regulations Office was formed on 18 December 2014, see above.
19 The Defence Support Group ceased to exist as a Trading Fund on 31 March 2015, see above.
20 The Defence Support Group had an Owner's Advisory Council.
21 The Department has now sold its interest in the Government Pipeline and Storage System, see above.

their Chief Executive, who provides me with an annual assurance statement detailing the governance framework and internal control issues.

Defence Authorities

I have appointed 18 senior individuals as Defence Authorities, who are authorised to issue general direction concerning a specific aspect of the defence operating model – for example, human resources, procurement, IT, finance, health services, logistics, and security. Their remit is articulated in a Defence Directive in each case. Defence Authorities are accountable for the associated policies, processes, and internal controls and for ensuring that these are designed on a coherent and consistent basis and to a consistent standard across Defence, in order to manage corporate-wide risks and support effective delivery of Defence outputs. They are also responsible for monitoring performance and compliance across the whole organisation in respect of their areas of responsibility, including against relevant legislation and other external requirements, and for monitoring operating risks and escalating significant risks to the corporate-level risk system as necessary. As part of this, each Defence Authority is required to provide me with an annual assurance report. In parallel, Defence Authorities are responsible for the ongoing development and improvement of related functions and services, including the efficiency, effectiveness, and coherence of the underpinning processes. The Defence Authority structure for 2014-15 is listed in the table below.

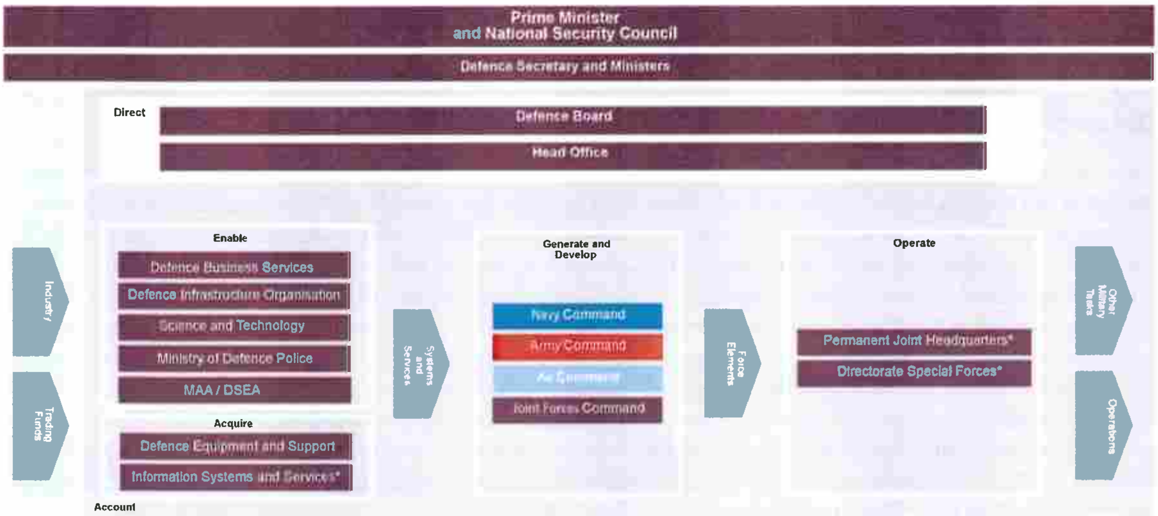
Function	Defence Authority
Acquisition System	Director General Head Office & Commissioning Services
Business Resilience	Director Business Resilience
Capability Coherence	Deputy Chief of Defence Staff (Military Capability)
Commercial	Director Commercial
Communications	Director Defence Communications
Corporate Design	Director Corporate Strategy
Cyber & C4ISR	Chief of Defence Intelligence
Financial Management & Approvals	Director General Finance
Health, Safety & Environmental Protection	Director Safety and Environment Authority*
Healthcare & Medical	Surgeon General
Information	Chief Information Officer
Logistics	Chief Executive of DE&S, supported by Assistant Chief of Defence Staff (Logistics Operations)
Operations	Assistant Chief of Defence Staff (Operations)
People	Chief of Defence Personnel
Public & Parliamentary Accountability	Secretary of State's Chief Of Staff
Security	Director Business Resilience
Statistics	Chief Statistician
Technical & Quality Assurance	DE&S Technical Director

* On 1 April 2015, the new Defence Safety Authority was established, headed by the Director-General Safety, under a charter from the Secretary of State.

The Defence Operating Model

The Defence Operating Model was initially introduced on 1 April 2013 and became fully operational on 1 April 2014. This is set out in more detail in the How Defence Works publication[22] and summarised in the diagram below.

22 https://www.gov.uk/government/publications/the-new-operating-model-how-defence-works



* *Within Joint Forces Command*

Quality Assurance of Analytical Models

As required by the MacPherson Review, our Governance Statement must confirm that we have an appropriate quality assurance framework for analytical models. As part of our annual assurance process we have asked the TLBs and Defence Authorities to confirm their quality assurance arrangements.

The Department has well established arrangements and we have continued to test and build on these in the last year. Notable progress includes:

- last July, we published a list of our 83 business critical models - making MOD a lead Department in responding to this suggestion of the MacPherson Review;

- in March, HM Treasury published their progress report on implementation - MOD was an active participant and our Cost Analysis and Assurance Service was given as an exemplar organisation; and

- in March, HM Treasury also published the *'Aqua Book: guidance on producing quality analysis for government'* – as acknowledged in the document itself, MOD staff were major contributors and ensured the rest of government benefits from our expertise.

This year, two independent reviews of our implementation (by the Defence Science Advisory Council and Defence Internal Audit) were undertaken. The Defence Internal Audit report has provided substantial assurance and confirmed that the Department has made good progress in implementing the recommendations of the MacPherson review and that there is now a clear focus on Quality Assurance. A number of recommendations were made by both the reviews to strengthen out current arrangements and these are being implemented.

3. The Defence Board

The Defence Board, chaired by the Secretary of State, is the senior corporate decision-making body in Defence for non-operational matters. It provides top-level leadership and direction in managing Defence with its main focus on strategy and plans for generating military forces, performance against those plans, and risk. It meets every month (except August) and considers a range of topics, as well as reviewing key performance indicators and resources at each meeting and risks quarterly. The Defence Board met eleven times during 2014-15, all members were in attendance with the exception of one meeting which took place without VCDS.

Members of the Defence Board during 2014-15

Rt Hon Phillip Hammond MP	Secretary of State for Defence (up to 14/07/14)
Rt Hon Michael Fallon MP	Secretary of State for Defence (wef 15/07/14)
Rt Hon Mark Francois MP	Minister of State for the Armed Forces*
Jonathan Thompson	Permanent Under-Secretary
Gen Sir Nicholas Houghton	Chief of the Defence Staff
Air Chief Marshal Sir Stuart Peach	Vice Chief of the Defence Staff
David Williams	Director General Finance (up to 15/03/15)
Louise Tulett	Director General Finance (wef 16/03/15)
Bernard Gray	Chief of Defence Materiel
Sir Gerry Grimstone	Lead Non-Executive Board Member
Graham Williams	Non-Executive Board Member
Paul Skinner	Non-Executive Board Member (wef 30/09/14)
Danuta Gray	Non-Executive Board Member (wef 17/03/15)

* The Minister of State deputises when the Secretary of State is not present. Since May 2015, the Minister of State for Defence Procurement, Phillip Dunne MP, has been the second Ministerial member of the Defence Board.

The Defence Board is supported by three sub-committees (see section 5 below).

4. The Board's Performance

Report on Board Effectiveness by the Lead Non-Executive Board Member

This is my fourth statement for the Departmental Annual Report since my appointment as the Lead Non-Executive for Defence in September 2011.

The Defence Board met formally on 11 occasions during the Financial Year, devoting time to the consideration of a wide range of strategic issues. It continues to be ably chaired by the Defence Secretary, and it sits at the centre of decision taking within the Department. The capability of the Board has been enhanced by the appointment of two further Non-Executive Members, Paul Skinner, who is also the chair of the DE&S organisation, and Danuta Gray, who will also chair the People Committee. Keeping to a balanced budget whilst delivering state-of-the-art military capability remained a key priority for the Board. Our role is to help ensure that the defence of the United Kingdom and our ability to project power as and when required by the National Security Council are in good shape, now and into the future.

The management of risk has been a particular focus for the Board this reporting year and it agreed to and approved a new risk framework which better aligns the key risks across the Department to allow for common themes to be easily identified and for a coordinated approach to be applied. It has also agreed its role in risk management and to the appointment of a MOD Chief Risk Officer to champion risk management activities and behaviours.

In addition to our regular work reviewing the delivery of capability and the operations of the Department, some of the subjects considered by the Board during the year included: Defence workforce challenges and specifically how to address the shortage of key skills within Defence, including engaging and being clear that a fundamental strategic shift was necessary on the Department's approach to people; the Annual Budgeting Cycle 15 and the importance of operating and delivering within the stipulated financial envelope; Health, Safety and Environmental Protection; the Defence Nuclear Programme; cyber security; and diversity and inclusion. It also considered and agreed PUS' approach to improving corporate governance within the Department. The Board's Away Day in November considered, in the context of the next Strategic Defence and Security Review (SDSR), the key issues that would need to be addressed, with the Board recently deciding to take monthly updates on developments in this area as the Review approached, and given its strategic importance.

The standard of Management Information and the quality of papers received by the Board continued to improve, and served to focus our attention on key issues, and speed up our decision-making. Corporate governance has being strengthened further throughout with the introduction of portfolio management where those responsible for equipment delivery, business change, or Science and Technology, for example, are held to account in much the same way as the TLBs. The Holding-to-Account process has also been extended to include Defence Authorities, in their capacity as leads for MOD corporate policy in their specific areas of Defence activity. It is important for these areas to deliver on their areas of responsibilities and for them to be held to account for their outputs. The Department currently has 18 Defence Authorities.

The Board has three sub-committees, chaired by members of the Defence Board: Investment Approvals, Audit, and People. The Board receives a report at each meeting from the chair of each committee. The Investment Approvals committee, chaired by the Director General Finance, is responsible for scrutinising and advising on all major investment decisions, and continues to provide timely and robust challenge. It is now supported by the Joint Requirements Oversight Committee (JROC), chaired by the Vice Chief of the Defence Staff, which has been set up to provide additional scrutiny and strongly challenge new capability requirements. The Audit Committee has had another good year under the chairmanship of Graham Williams. The Committee has continued to focus primarily on Defence's assurance processes, including the Holding to Account, internal audit and the Defence Board's strategic risk framework, conducting another thorough programme of work to support the Governance Statement that you will see elsewhere in the report. It has also taken on the role of providing assurance for the Armed Forces Pension Schemes (AFPS) Accounts. The People Committee did not meet this reporting year. With the appointment of Danuta Gray as chair, the intention is to reinvigorate the People Committee to play a more active role in the strategic 'people' issues as a sub-committee to the Defence Board. The Armed Forces Committee continues to function as a very effective body. Chaired by the Chief of the Defence Staff, and comprising the Vice Chief of the Defence Staff, the Single Service Chiefs, the Commander Joint Forces, Chief of Defence Materiel and Director General Head Office & Commissioning Services, assisted by the PUS, it ensures that a clear, coordinated military voice is heard at the Defence Board.

On the Board's Effectiveness, my review last year was very comprehensive and thorough, and I was ably assisted by Sam Laidlaw as the external independent source. The resulting 'Action Plan' detailed a series of measures on which improvements were necessary if the Board was to strengthen its effectiveness. The Board has continued to make good progress on implementing the Action Plan. Notably, the action to review the topmost architecture of the Department and clarify the role of the Armed Forces Committee was completed in the autumn of 2014. The Head Office Management Group has been enhanced to provide coordination in assuring the Defence Authorities and in the Holding to Account process; information flow between the Board, its sub-committees and the TLBs has improved; and, visibility of the Board has been strengthened as we continue holding our meetings in various locations around the Defence Estate, accompanied by Town Hall sessions with front-line staff, both military and civilian. The Secretary of State attaches high priority to ensuring that the Board is fully visible throughout Defence. Articles on the sessions are published on the MOD intranet site to feedback to those who were unable to be present. We will continue to explore what else we might do to further help improve the Board's visibility and get our message across to the Department.

The other notably successes include the appointment of two further Non-Executive member to the Defence Board, as I mentioned earlier. The addition of the 4th member also addressed the 'people' skills gap that was previously missing from the Board membership. The Board is more diverse as it now has two female members. Agenda setting routinely takes into account the issues on which the Board should focus to ensure strategic direction is provided in a timely fashion, but also includes items which members have specifically asked be brought to the Board. As an example the Board recently requested monthly discussions on SDSR 15 in the lead up to the Review.

The recommendation from the Cabinet Office on this year's review was for departments to undertake a 'light touch' review. My recommendation to the Defence Board, at our meeting in February 15, was to review the Action Plan from the review last year and to push forward with its implementation to demonstrate visible progress against it. During our discussion of the Action Plan, the Board agreed that improvements had been made in the quality of the Management Information, timeliness and quality of papers provided to it. However, it was clear that it saw this as no reason to be complacent and that the Department should drive further improvements in this area. Part of PUS' corporate governance review was for more Board exposure on the outcomes from the Holding-to-Account sessions in a bid to provide transparency, particularly for the Non-Executive Board Members. The Board therefore called for more to be done on providing better visibility to it on that process, and requesting that further work continue on the outstanding actions, particularly in further driving the requirement for a common approach and language *to risk management, Non-Executive Members induction, and the role of the People Committee. The Board also agreed that the Department had a good set of capable Non-Executive Directors who could be utilised to 'deep dive' issues on its behalf.*

I will again be overseeing the progression of work in these areas. We believe we are the most effective Departmental Board in Whitehall and increasingly stand comparison with the Boards running the UK's major businesses. We are determined to maintain this position as well as continuing to improve our effectiveness. We will make sure that our accountability continues to improve, unnecessary bureaucracy is reduced, and Defence is operated in the most effective and efficient way possible.

Sir Gerry Grimstone

5. Highlights of Board Committee Activities

The Defence Board is supported by three sub-committees.

Defence Audit Committee (DAC)

The Defence Audit Committee (DAC), is chaired by Mr Graham Williams, a Non-Executive Defence Board Member, and this reviews and challenges the adequacy of internal controls and processes and how risk is managed across Defence. The other members are also Non-Executives, who are not Defence Board members and are largely drawn from TLB audit committees. The DAC met seven times during 2014-15, all members were in attendance, except for two meetings where one member was absent.

A summary of each meeting is included in the Management Information pack to the Defence Board, in addition to the Chair of the DAC presenting regular oral updates.

The DAC dedicated a series of meetings to reviewing the 2014-15 Departmental Annual Reports and Accounts and were content that progress had been made against the control risks identified in the Governance Statement the previous year (financial skills gap in the DE&S, transforming Defence and the Materiel Strategy); but agreed that they remained relevant for inclusion in the 2014-15 Governance Statement to ensure that progress was maintained. Also included in the Statement were a number of other significant risks that the Committee identified were facing the Department including the need for the Department to have sufficient numbers of Suitably Qualified and Experienced Personnel, improved Information Systems and investment in fuels infrastructure.

The DAC also sought assurance that issues that had been raised on the Accounts, including the recording of DIO Assets Under Construction (AUC) and the tax arrangements for off-payroll staff, were satisfactorily resolved and that robust management information systems were put in place to ensure that these issues did not recur.

The Committee considered the Annual Fraud Report and the fraud risk assessment process and noted that good progress has been made, and that the fraud strategy has changed from being reactive, which focused just on investigations, to being more proactive, with a focus on fraud risks, prevention and detection. Data analytics are now being used to detect potential fraud and the TLBs are more engaged in the identification of fraud risks and assessment of controls. It also called for fraud matters to be included as a standing agenda item on TLB Audit Committees as they would be better able to assess the risks and offer advice to the TLB Holders.

In light of my review of the Departmental Corporate Governance, the DAC reviewed the way it was operating and its terms of reference, to improve its ability to support the Defence Board, and me as the Accounting Officer. The DAC's Forward Programme of business was aligned to better complement the introduction of a new assurance process for Defence Authorities and TLBs and to drive more rigour in the Holding-to-Account process. The Committee agreed that their involvement in this process would be assessed at the end of the annual cycle to see how well they had done.

The DAC considered a number of Defence Authority annual assurance reports including Commercial, Financial Management, Defence Personnel, nuclear security, general security, business resilience and cyber & C4ISR (Command, Control, Communication & Computers, Information, Surveillance, Reconnaissance). This was in addition to reviewing the annual assurance reports produced by the TLB holders; and the independent assurance provided by DIA. The DAC was clear that any report containing a limited assurance assessment should include a mitigation plan with actions, targets and a timeline explaining when substantial assurance would be achieved. It was not acceptable for Defence Authorities and TLBs to continue receiving limited assurance assessments over a number of years with no plans in place to improve their level of assurance.

The Committee was complimentary about the new risk framework, which included strategic risks that should be considered by the Defence Board as well as TLB and Defence Authority identified risks. They were also pleased with the work to develop and implement an integrated risk, control and assurance framework across the Department. Its successful implementation would assist the Committee to identify any potential gaps in the assurance process and enable them to better focus their efforts.

The DAC stressed the importance of ensuring that management actions on audits were completed and that any lack of progress identified by DIA through follow-up audits should be brought to the attention of the executive management and to the attention of the DAC. In particular, it called for greater management engagement in the progression of audit recommendations and reinforced the requirement for completion to be achieved in the agreed timeframes.

On wider issues, the DAC were given a presentation on the new acquisition system that will govern the relationship between the DE&S and the Front Line Commands through the delivery of the Command Acquisition Support Plans. The DAC stressed the importance of robust plans and Key Performance Indicators (KPIs); and the need for some of the KPIs to be generated by the customer. It was also important that the new system featured an effective arbitration process, with analysis being based on facts and evidence.

The DAC also agreed to take on the assurance and oversight role for the Armed Forces Pension Scheme Accounts (AFPS) and dedicated time to understand better the components of the Pension Scheme and the associated processes and procedures.

Overall, the Committee concluded that the Department had made some progress against control risks, however, there was more to do. The strengthening of corporate governance and the introduction of the new control framework was a move in the right direction which should lead to more stringent controls over processes and procedures, and ultimately improved assurance. It agreed that the new assurance process was more coherent, better structured and provided consistency across the Department. It called for a review of the process once the initial annual cycle had been completed so that any lessons learnt could be incorporated and further developments made to ensure that it continued to improve.

Investment Approvals Committee (IAC)

The Investment Approvals Committee (IAC), chaired by DG Finance, is responsible for considering major investment proposals on behalf of the Defence Board, forwarding advice to Ministers as necessary on expensive, complicated, innovative, risky, or novel and contentious investments. The IAC decides other cases itself or delegates those decisions to a level consistent with the value or nature of the proposal. The other members are VCDS, CDM, CSA, Director Commercial, and Director Central Legal Services. The IAC met ten times during 2014-15, with full attendance at six meetings and apologies from one member at each of the other four meetings. Approvals for investment decisions below £250M are given to the Director of Resources in each TLB (each of whom reports to DG Finance as well as to their TLB holder). Further sub-delegation of TLB approvals are referred to DG Finance for endorsement. TLBs are allowed, without referral, to sub-delegate expenditure below £10M to DE&S and Information Systems and Services (ISS).

DG Finance provided monthly oral updates to the Board on its work, in addition to the inclusion of a summary of IAC consideration in the monthly Management Information pack to the Defence Board.

The IAC considered a wide range of projects, including the Defence Infrastructure Organisation Transformation, A400M ATLAS Support Solution, Wildcat Infrastructure, Scout Specialist Vehicles, Offshore

Patrol Vehicles, MARSHALL Air Traffic Services, Defence Support Group Sale, Queen Elizabeth Class Infrastructure, and UK Military Flying Training System.

The IAC considered 114 investment approval cases for projects worth over £250M, including 24 Main or Initial Gate Business Cases. Of these Business cases, 9 were approved and 15 were approved with caveats. The remaining 89 cases considered by the IAC related to Review Notes and Information Notes submitted by project teams.

TLB delegated approvals are up to £250m Category B, Category C is £20m to £100m, and Category D is below £20m. TLBs sub-delegate to DE&S and ISS Equipment Plan approvals below £10m. TLB approval activity for 2014-15 is as follows:

	Approval Category		
TLB	B	C	D
Navy Command	4	22	6*
Army HQ	4	17	13*
Air Command	3	22	8*
JFC	8	24	20*
DIO	0	39	32
HOCS	0	1	3*

* Category D expenditure > £10m and < £20m.

People Committee

The People Committee, chaired by one of the Non-Executive Board Members, supports the Board in monitoring: the talent management processes, including senior promotions and appointments; workforce plans, including succession plans; and polices and processes relating to human capability, including culture and behaviours. The other members are PUS and CDS. The People Committee did not meet during 2014-15, as the Defence Board took a number of strategic papers on People issues and the Department was in the process of recruiting a new Non-Executive to lead the Committee, which it successfully did in March 2015.

6. Compliance with Corporate Governance Code

I have reviewed the Department's compliance with the Code of Good Practice[23] and confirm that the Department complies with all of the requirements, with one exception. Section 5.9 of the Code requires that at least one Non-Executive Board Member should sit on the Audit Committee, in addition to the Chair. The Defence Audit Committee is chaired by one of the Non-Executive Board Members and the other three members are Non-Executive chairs of TLB audit committees. I believe that this membership provides a broad perspective of the Department's business, whilst maintaining the necessary independence of Audit Committee members.

7. The risk and control framework

Active management of risk is fundamental to the effective achievement of Defence objectives and central to the way business is conducted within the Department. It informs operational decision making, contingency planning, investment decisions, and the financial planning process. The Department's overall approach to risk management is summarised in *How Defence Works*[24]. The detailed guidance underpinning it is captured in the revised Joint Service Publication 892. The Defence Board receives a detailed quarterly risk report, which is focused on reporting the longer-term strategic risks facing defence and the shorter-term delivery risks to the current Defence Plan, as well as visibility of the key risks being managed by the TLB Holders and Defence Authorities. The complete list of risks is not published for reasons of national security but it includes these risks:

23 *Corporate governance in central government departments: Code of good practice 2011;* HMT/Cabinet Office, July 2011.
24 https://www.gov.uk/government/publications/the-new-operating-model-how-defence-works

- that we do not have the right numbers of people with the right skills;
- that we cannot attract and retain sufficient capable and motivated people;
- to the delivery of operational capability;
- that we have do not have adequate management information
- to our information, including from cyber attack; and
- from a disruptive event such as a flu epidemic or terrorist attack

The risk management framework is cascaded down through TLB Holders and available to all staff on the MOD's intranet. Individual training is available to all staff via the Civil Service Learning organisation and the Department's in-house training provider, the Defence Academy.

During the year the current risk management arrangements have been reviewed and a common risk framework designed. The common risk framework will be implemented during 2015-16 and will be fully operational by March 2016. As part of the framework, MOD has appointed a Chief Risk Officer at Director level to lead the implementation of the framework and champion risk management.

The Department's tolerance of risk varies between the different functions and areas of the defence enterprise. Military operations inherently involve taking risks. The level of risk that Ministers agree to accept is based on advice from senior military officers and civilian officials. Every effort is made to provide personnel and assets with proper protection through planning, equipment, and training, but we ultimately rely on the judgement of Force Commanders to manage the risks on a day–to-day basis. On non-operational activities, the Defence Board receives regular reports on Finance, Personnel, Equipment Plan (including Investment Approvals), ICT, Information Rights and Parliamentary Business, Security, Business Continuity, and Health & Safety matters, alongside more general performance reporting every month.

The Department implemented a revised annual assurance process covering the Defence Authorities and TLBs this year. The revised assurance process includes a standard reporting template supported by a questionnaire which covers key governance, risk management and internal control matters. The Defence Authority assurance reports are reviewed by the Head Office Management Group, which I chair, or other relevant 4* Boards. The TLB assurance reports are reviewed by their Audit Committees and also scrutinised as part of the TLB Holding-to-Account process. The Director of Audit, Risk and Assurance (DARA) reviews all the reports and provides a briefing note to me to aid the scrutiny process. In addition, DARA has produced an overall Departmental Assurance report for me and the DAC highlighting key internal control issues.

DARA is also leading the development of internal control and control frameworks for key processes to improve the overall control environment. Initially the work will focuss on finance processes and we plan to have a financial control and assurance framework developed by the end of this year. This framework will set out, for each finance process, the key risk and key controls along with plans to obtain assurance over the operation and effectiveness of the controls.

The DAC, reviews the Department's approach to internal control and provides independent advice both to the Defence Board and me, as the Accounting Officer. The views of the DAC are set out at section 5 above.

Most TLB Holders are supported by an Audit Committee or equivalent, which is chaired by a Non-Executive member and at which representatives from the internal and external auditors are present. Like the DAC, these committees focus their activities on providing advice on wider business risk and assurance processes. The DAC aims to meet the Chairs of the TLB Audit Committees at least once a year to seek their opinion on potential issues to be raised in this Governance Statement.

An annual risk-based programme of internal audit is provided by Defence Internal Audit, which is the primary source of independent assurance within MOD. The audit programme is comprehensive and covers the Department's strategic and operational risks and key operational processes.

Overall, the opinion provided by the Group Head of Internal Audit is 'limited assurance', the same as in the previous two years. In particular, Defence Internal Audit found as follows.

- Change continues across the Department, including: organisational, staff, and governance. Whilst the overall effect of change on the management and direction of Defence is positive, the challenge to operate steady state, day to day controls in some business areas in this environment requires more attention in order to maintain an effective control framework. Gapping and staff reductions had resulted in unforeseen risks and control weaknesses as activities were discontinued or tasks grouped together.

- Risk needed to be better analysed and understood. Moves to build a more effective enterprise wide risk management system are in hand and are a positive step forward in this respect.

- Improvements were required in elements of the organisational policy making and dissemination process. This reflects the still maturing Defence Authority role which is beginning to create better governance and central challenge to accepted practice. The absence of robust and reliable management information and feedback mechanisms still placed an over reliance on third line of defence assurance.

- Access to information of good quality continued to present a challenge to managers across the Department risking a reactive approach to events and unnecessary additional effort to avoid materialisation of risk.

- Problems identified by work the previous year on the ability to manage knowledge in a way which effectively supports the business had led to several initiatives, including a demonstrated top level commitment. However, weaknesses remained, including a lack of a knowledge management strategy and an unclear relationship between initiatives. As a consequence, the practical improvement could not yet be assessed.

- Similar to last year audits identified risks around commercial governance and assurance arrangements together with policy compliance. Steps were being taken to improve the overall commercial control framework and skills base.

- The in-built resilience of organisational structures was found to require improvement with resourcing being a recurring problem. There was a need to generate a deeper understanding of resilience risks.

More broadly, the Group Head of Internal Audit has noted an improvement over central governance arrangements and management implementation of actions arising from audits is showing an improving trend.

I also draw assurance from a number of other bodies on specific issues, many of which concern safety and security. These include the Defence Safety Authority (DSA)[25], the MOD Police Committee, and the Defence Security Assurance Services.

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. As part of the process, representatives from the National Audit Office see all DAC and TLB Audit Committee papers and attend their meetings.

Significant Control Risks

Update on Significant Control Risks reported last year

Defence Infrastructure Organisation – Assets under Construction

Last year I reported that the NAO identified concerns about the substantiation of the £2.7bn balance previously disclosed by the DIO as Assets under Construction (AuC). The DIO subsequently worked to resolve these issues, by reviewing its asset records and the available information in respect of AuC projects and completing the necessary accounting adjustments (including reporting bookkeeping losses of £394M). To

25 Formed on 1 April 2015, see above.

ensure this situation is not repeated, policy has been reinforced at organisational management reviews at all levels and in-year management instructions clarify senior finance staffs responsibility for ensuring completed capital works are reconciled against Property Change Forms/Asset Change Notifications. In addition, the Senior Leadership Team Meeting Chaired by Chief Executive DIO, receive monthly updates specifically on AUC as part of enhanced governance and monitoring process.

Tax Arrangements of Senior Public Sector Appointees

Last year I reported that the Department had established that it had misinterpreted the scope of the governance arrangements (introduced in 2012-13) covering those senior public appointments where the appointees are not engaged directly on departmental payrolls and who are earning over £220 a day for more than six months. As a consequence of this misinterpretation, the Department determined that it had omitted to seek assurance from 101 senior off-payroll appointees in 2012-13 that they were compliant with the tax legislation. We have regularised the position by securing retrospective assurance from all those senior off-payroll appointees who we subsequently identified should have been within scope and, where satisfactory assurance has not been forthcoming, we have referred the individual appointees (none of whom are still working in the Department) to HM Revenue & Customs in accordance with the Treasury guidance. The Chief Secretary to the Treasury imposed a financial sanction of £1 million on the Department for failing to seek assurance from senior off-payroll appointees in financial year 2012-13 that they were paying the right amount of tax and National Insurance.

To enable the Department to discharge its off-payroll obligations fully, we recently enhanced Departmental governance arrangements, including ensuring that off-payroll appointments are not normally made until a formal declaration of compliance with the tax legislation has been received from the prospective appointee. Assurance of compliance with the tax legislation will subsequently be sought in accordance with Treasury guidelines.

Management Information

Last year I reported concerns about the robustness of MOD's MI and information systems and the appointment of a Chief Information Officer (CIO) at Director General level and the establishment of new Information Board, which I chair, to drive improvement in our performance. Following an initial assessment of the scale of the challenge to our systems and networks, with consequential impacts on MI, I reported that it will take some years and investment to address this issue which has been built over a number of years.

During the year the CIO has continued to baseline the pan-Defence ICT portfolio and we now have a reasonable picture of the size and shape of the Defence ICT portfolio, increased visibility and understanding of the portfolio and the systemic issues that inhibit the effective exploitation of ICT. The base lining exercise has encountered many examples of the MI challenge. The pan-Defence ICT portfolio remains obscured by missing, inconsistent and often conflicting MI across many systems developed and implemented over several decades. This constrains effective and timely decision-making and adversely impacts our ability to proactively drive the overall portfolio. During 2015-16 we will continue to work to improve the quality of the data and drive a coherent approach to MI (both in terms of data and tools). CIO has appointed a new Head of Corporate and Management Information to drive this work and whose remit is much wider than ISS and will include the plethora of management information systems across Defence that hold data on people, projects, risks and costs that the ICT Portfolio relies on so heavily. The Defence Board reviews this situation quarterly with the CIO.

Significant Control Risks identified for the reporting year

Commercial awareness, skills and contract management

The MOD Commercial Capability Review conducted by the Cabinet Office and HM Treasury in 2014 highlighted the need to improve the commercial awareness of non-commercial colleagues (in particular military staff in key acquisition roles). The commercial function across the Department also suffers from a shortage of appropriately skilled professional people which is the most significant risk to delivery. There is a specific requirement to strengthen senior commercial skills, alongside a requirement to review the size, profile and experience of the entire commercial function.

I have agreed the recommendations, with the support of DG Commercial in DE&S and Director of Commercial and an implementation plan to ensure delivery against the Commercial Capability Review recommendations has been developed and a monthly progress report against this will be provided to the Cabinet Office. Work has already commenced. The restructuring and recruitment of new senior talent, for example, in the commercial aspects of Information Systems and Services has started. A Commercial Talent Development and Qualification Programme at 2* level is being developed which will provide a continuous programme of training and development to improve the capability of the commercial function.

We will continue our programme to deliver an increase in our contract management capability led by the newly appointed Director of Contract Management. The improvements to contract management will extend to beyond the commercial staff and deliver a more rigorous regime (processes and behaviours) for MOD contracts and a step improvement in operational governance of procurement.

Fuel Depots

Naval Oil Fuels Depots (OFD), part of the UK Strategic Base Infrastructure, are owned by the MOD but managed and operated by the Oil and Pipelines Agency (OPA). Progress on the renewal and renovation of our Oil Fuels Depot (OFD) asset portfolio has been slow to meet the Control of Major Accident Hazards (COMAH) standards. The Defence Board agreed in January this year to prioritise a further £83m in the Capital Infrastructure programme for ABC 15 and which has been welcomed by the Competent Authority. In addition the Board agreed that the Navy Command would become the lead TLB with responsibility for OFDs, from 1 April 2015. Our progress to deal with compliance actions in the OFDs has been substantial but further action is needed over several financial years.

Conclusion

The Department's corporate governance arrangements have evolved during the year in response to some major changes in the organisational bodies of the Defence Department Group. The overall trend is one of improvement and further bedding down of the governance arrangements.

The important changes during the year include the implementation of a robust assurance regime to provide me with assurance on the Department's overall arrangement over the effectiveness of governance, risk management and internal controls. Given the complexity and size of the Department it is not unexpected that these mechanisms will identify areas for improvement but I am satisfied that the mechanisms in place to manage risks are adequate.

Jon Thompson
Accounting Officer
08 July 2015

Chapter 6:
Certificate of the Comptroller And Auditor General

The Certificate of the Comptroller And Auditor General To The House Of Commons

I certify that I have audited the financial statements of the Department and of its Departmental Group for the year ended 31 March 2015 under the Government Resources and Accounts Act 2000. The Department consists of the core Department and its Agency. The Departmental Group consists of the Department and the bodies designated for inclusion under the Government Resources and Accounts Act 2000 (Estimates and Accounts) Order 2014. The financial statements comprise: the Department's and Departmental Group's Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity; and the related notes. I have also audited the Statement of Parliamentary Supply 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

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Accounting Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Government Resources and Accounts Act 2000. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Department's and the Departmental Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Accounting Officer; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

I am required to obtain evidence sufficient to give reasonable assurance that the Statement of Parliamentary Supply properly presents the outturn against voted Parliamentary control totals and that those totals have not been exceeded. The voted Parliamentary control totals are Departmental Expenditure Limits (Resource and Capital), Annually Managed Expenditure (Resource and Capital), Non-Budget (Resource) and Net Cash Requirement. I am also required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on regularity

In my opinion, in all material respects

- the Statement of Parliamentary Supply properly presents the outturn against voted Parliamentary control totals for the year ended 31 March 2015 and shows that those totals have not been exceeded; and

- the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Basis for Qualified Opinion on Financial Statements

I have qualified my opinion on the financial statements in two respects:

The Department does not hold records to enable compliance with the Financial Reporting Framework and account for the expenditure, assets and liabilities arising from certain contracts in accordance with International Accounting Standard 17, *Leases*. Consequently, I have concluded that the Ministry of Defence has omitted a material value of leased assets and lease liabilities from its Statement of Financial Position as at 31 March 2013, 31 March 2014 and 31 March 2015. This has also led to a material misstatement of the Statement of Comprehensive Net Expenditure for 2013-14 and 2014-15 and Statement of Parliamentary Supply for 2013-14 and 2014-15. I am unable to quantify the impact on the financial statements because the Ministry of Defence has not maintained the records or obtained the information required to comply with International Financial Reporting Standards in this respect.

In 2013-14 I qualified my opinion in respect of the inventory impairments of £860 million charged to the Statement of Comprehensive Net Expenditure as I was unable to obtain the necessary evidence to support the point at which impairments had occurred and consequently the amount that should have been charged in 2013-14. My opinion on the financial statements is also qualified in respect of the corresponding figures for the impairment charge in the 2013-14 Statement of Comprehensive Net Expenditure.

Qualified Opinion on Financial Statements

In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraph:

- the financial statements give a true and fair view of the state of the Department's and the Departmental Group's affairs as at 31 March 2015 and of the Department's and Departmental Group's net operating cost for the year then ended; and

- the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions issued thereunder

My report, which follows, provides further detail of my qualified audit opinions on the financial statements.

Opinion on other matters

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with HM Treasury directions made under the Government Resources and Accounts Act 2000; and

- the information given in the *Strategic Report*; Chapter Three: *Directors' Report;* details of Directors in Chapter: *Remuneration Report* and Annex E: *Sustainable Development* of the Annual Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I report by exception

In respect solely of the absence of accounting records held by the Department to support the proper application of IAS 17; described above:

- I have not received all the information and explanations that I considered necessary for the purposes of my audit; and

- proper accounting records have not been maintained.

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records and returns; or

- the Governance Statement does not reflect compliance with HM Treasury's guidance.

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 with the armed forces. As reported in Annex F of the Annual Report, the maximum numbers maintained during 2014-15 for the Naval, Army and Air Force Services in all active and reserve categories were within the numbers voted by Parliament. I obtain evidence sufficient to give reasonable assurance as to whether the Votes A Statement as presented in Annex F properly presents the maximum numbers maintained against voted Parliamentary control totals and whether those totals have not been exceeded

In my opinion the Votes A Statement properly presents the maximum numbers maintained against voted Parliamentary control totals for the year ended 31 March 2015 and that those totals have not been exceeded.

Sir Amyas C E Morse 13 July 2015

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

Chapter 7: Report of the Comptroller and Auditor General

Report of the Comptroller and Auditor General on the 2014-15 Accounts of the Ministry of Defence

Introduction

1. The Ministry of Defence's (the Department) principal activity is to provide 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 2014-15 the Departmental Group incurred £ 36.8 billion of net operating costs and held assets of £ 133.7 billion and gross liabilities of £ 22.4 billion.

2. The Department is required to prepare its financial statements in accordance with the Government Financial Reporting Manual (FReM) issued by HM Treasury. Under the FReM, the Department is required to apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector.

The purpose of my report

3. This report explains the basis for the qualification of my audit opinion on the Department's 2014-15 financial statements.

Accounting for lease type arrangements

Basis of my qualification

4. I have qualified my opinion for a sixth year because the Department is likely to have omitted a material value of leased assets and associated liabilities from its Statement of Financial Position. I cannot quantify the impact of these omissions on the accounts with certainty because, as a result of its accounting policies, the Department has not maintained the records, or obtained the information required to do so.

Accounting requirements

5. The FReM requires those preparing accounts to establish whether contracts contain lease-type arrangements and whether those are, in substance, either a finance or operating lease and account for these leases under International Accounting Standard (IAS) 17, *Leases*. A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. An operating lease is any other type of lease. The classification made by those preparing accounts could have a significant impact on the financial statements.

6. If the contract is classified as a finance lease then the value of assets used to deliver the service would be recognised in the Statement of Financial Position at the lower of fair value and the present value of the minimum lease payments due under the contract. A corresponding liability of the same value would also be recognised. If it is classified as an operating lease, no assets would be recognised and the payments made under the lease would be reflected in the Statement of Comprehensive Net Expenditure as spend is incurred.

7. I regard the accounting requirements for lease type arrangements as particularly relevant to the Department. The Department must enter into strategic arrangements with certain contractors to procure specialist defence platforms on a non-competitive basis. These arrangements may provide for the exclusive, or near exclusive, use of industrial assets and capability that have only limited use for other customers. Consequently, the contractual terms, which are covered by the government profit formula and its associated arrangements (GPFAA),[1] may result in the Department controlling a significant majority of the outputs of a supplier's assets. An example is where shipyards are used exclusively on defence contracts and the pricing of the contract recognises this by allowing the contractor to recover fixed costs other than through market rate or unit cost pricing. These arrangements may be considered to contain the characteristics of a finance lease as defined by IAS 17, Leases.

1 The GPFAA, also commonly referred to as the Yellow Book, is agreed by government and industry, as represented by the CBI, and is reviewed periodically by an independent review board.

Action by the Department

8. The Department assessed a number of contracts when IAS 17, Leases, was first adopted by the FReM in 2009-10. Based on the results, the Department believed that there may be a number of contracts that it would need to account for and disclose as leases. This review has continued and, to date, the Department has identified 25 contracts that demonstrate characteristics of a lease under IAS 17, Leases. Eight of these contracts were then assessed as being finance leases. If recognised, these would lead to assets with an estimated initial net book value (for seven of the eight contracts) of some £860 million being recognised in the Department's Statement of Financial Position. The exercise also identified a number of sites where multiple MoD platforms or contracts were being supplied. The Department's analysis confirms the material impact of not recognising leases although the quality of evidence is still insufficient for the purposes of my opinion.

9. In 2013-14, the Department concluded that it needed further management information and supplier engagement to complete its review and conclude on whether its current contracts meet the criteria of a lease under IAS 17, Leases. As disclosed in its Annual Report and Accounts, the Department has, in agreement with HM Treasury, decided not to obtain more detailed information on the grounds that doing so would not represent value for money. In 2014-15, the Department confirmed that it is possible to account for existing contracts in compliance with IAS 17, but this would create significant challenges for the Department. It would need to change its business systems and processes as well as wider interaction with its supplier base to obtain the necessary asset and liability information. Consequently, no conclusion can be drawn as to whether the existing contracts held represent leases and the financial impact of the omission of potential assets and liabilities cannot be determined with sufficient accuracy. This decision will have an ongoing impact on the audit opinion I am able to provide on the financial statements for the foreseeable future.

10. The Department is considering further work on applying IAS 17, Leases, to new contracts although it has not yet taken a formal decision on this matter. The International Accounting Standards Board (IASB) is responsible for setting IFRS, of which IAS 17, *Leases*, is a part. The IASB is currently undertaking a project to revise leasing accounting standards and it is expected that a new standard will be issued in late 2015. It is likely that this will see the accounting treatment of finance and operating leases aligned, so that all leases are recognised in the Statement of Financial Position and not just finance leases. This new standard may be adopted by the Financial Reporting Advisory Board (FRAB) which has responsibility for the FReM. If this standard is adopted then, in the future, the Department will have to adhere to these new requirements. The Department should therefore consider these developments in determining the further work required in respect of lease accounting.

Qualifications arising in 2014-15 relating to prior year comparative figures

11. In 2013-14 I qualified my opinion in respect of the inventory impairments of £860 million charged to the Statement of Comprehensive Net Expenditure. This was because I was unable to obtain the necessary evidence to support the point at which impairments had occurred and the validity of the charge made to the 2013-14 Statement of Comprehensive Net Expenditure. My opinion on the financial statements is also qualified in respect of the corresponding figures for the impairment charge in the 2013-14 Statement of Comprehensive Net Expenditure comparative figures. This qualification has no impact on the opinion given in respect of the charges made to the 2014-15 Statement of Comprehensive Net Expenditure

Sir Amyas C E Morse

Comptroller and Auditor General
National Audit Office
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13 July 2015

Chapter 8: Financial Statements

Statement of Parliamentary Supply

Summary of Resource and Capital Outturn 2014-15

		Estimate			Outturn			2014-15 Total Voted Outturn Compared to Estimate Saving / (Excess)	2013-14 Outturn
	Note	Voted £000	Non Voted £000	Total £000	Voted £000	Non Voted £000	Total £000	£000	£000
Departmental Expenditure Limit									
Resource	SoPS 2.1	36,646,516	-	36,646,516	35,105,038	-	35,105,038	1,541,478	36,448,453
Capital	SoPS 2.2	7,823,686	-	7,823,686	7,785,722	-	7,785,722	37,964	7,571,868
Annually Managed Expenditure									
Resource	SoPS 2.1	2,596,783	-	2,596,783	1,864,306	-	1,864,306	732,477	963,119
Capital	SoPS 2.2	110,000	-	110,000	50,559	-	50,559	59,441	(128,612)
Total		47,176,985	-	47,176,985	44,805,625	-	44,805,625	2,371,360	44,854,828
Total Resource	SoPS 3.1	39,243,299	-	39,243,299	36,969,344	-	36,969,344	2,273,955	37,411,572
Total Capital		7,933,686	-	7,933,686	7,836,261	-	7,836,261	97,405	7,443,256
Total		47,176,985	-	47,176,985	44,805,625	-	44,805,625	2,371,360	44,854,828

Net Cash Requirement 2014-15

	Note	Estimate £000	Outturn £000	2014-15 Outturn compared to Estimate: Savings/ (Excess) £000	2013-14 Outturn £000
Net Cash Requirement	SoPS 4	37,328,773	35,850,310	1,478,463	36,217,239

Administration Costs 2014-15

	Estimate £000	2014-15 Outturn £000	Outturn compared with Estimate £000	Restated 2013-14 Outturn* £000	Outturn as published in the 2013-14 Accounts £000
Administration Costs	1,498,701	1,473,704	24,997	1,503,653	2,129,203

* A new Administrative Cost Regime for 2014-15 onwards was agreed with HM Treasury. Prior period figures have been restated. Further details are at SoPS Note 3.2.

Further details of the Department's budget and expenditure are included in the Directors' Report.

Notes to the Statement of Parliamentary Supply (SoPS)

SoPS Note 1. Statement of Accounting Policies

The SoPS and supporting notes have been prepared in accordance with the 2014-15 Government Financial Reporting Manual (FReM) issued by HM Treasury. The policies contained in the FReM are consistent with the requirements set out in HM Treasury's 2014-15 Consolidated Budgeting Guidance and their Supply Estimates Guidance Manual.

SoPS 1.1 Accounting Convention

The SoPS and related notes are presented in the formats agreed between the MOD and HM Treasury and are consistent with agreed budgetary controls and the MOD's detailed Supply Estimates as approved by Parliament.

The budgeting system, and the consequential presentation of the Supply Estimates, the SoPS and related notes have different objectives to the Department's IFRS-based accounts. The system supports the achievement of macro-economic stability by ensuring that public expenditure is controlled, with relevant Parliamentary authority, in support of the Government's fiscal framework. It provides incentives to the MOD to manage spending well so as to protect our national interests and provide the UK's ultimate guarantee of security and independence while offering value for money to the taxpayer.

SoPS 1.2 Comparison with IFRS-based accounts

The following transactions are accounted for differently between the SoPS and the IFRS-based accounts. The SoPS figures are based on accounting treatments used to compile the National Accounts, which provide the aggregates used to monitor the mandate for fiscal policy and HM Treasury's objective for the management of the national debt. To meet the requirement for National Accounts the SoPS are compiled using the European System of Accounts; this differs from the International Financial Reporting Standards used when producing the financial accounts. The different accounting treatments used are set out below and in SoPS Note 3.1.

- movements in the value of local overseas pension scheme provisions, resulting from changes in discount rates are treated as movements through reserves under IFRS but are included in the outturn for SoPS.

- Equity Withdrawal from investments in Trading Funds are recorded as income in the Statement of Comprehensive Net Expenditure and Capital in the SoPS.

- adjustments are made in the IFRS accounts for certain Service Concession Arrangements treated as on Statement of Financial Position (SoFP) for IFRS but off-SoFP for SoPS.

- receipt of donated assets, donations treated as capital income, capital grant expenditure and the loss or gain on foreign exchange contracts in respect of capital purchases are treated as capital items in the SoPS. Under IFRS they score as income or expenditure in the Statement of Comprehensive Net Expenditure (SoCNE) with no distinction made between capital and revenue items.

- funding for Prior Period Adjustments (PPAs) resulting from an error in previous recording, or from an accounting policy change initiated by the MOD, needs to be voted on by Parliament in the current year, whereas in IFRS-based accounts (IAS 8) they are treated as adjustments to previous years. There have been no PPAs this year.

- receipts in excess of HMT agreement e.g. profit on disposal of assets, score outside budgets, and consequently outside the SoPS. IFRS-based accounts will record all of the income, regardless of the budgetary limit. There have been no receipts in excess of HMT limits this year; and

- provisions recognised in IFRS-based accounts are not recognised as expenditure for National Accounts purposes until the actual payment of cash (or accrual liability) is recognised. To meet the requirements of both resource accounting and National Accounts, additional entries are made in the SoPS across AME and DEL control totals; these do not effect the administration costs reported in the SoCNE. As the Administration control total is a sub-category of DEL, Administration and Programme expenditure reported in the SoPS will differ from that reported in the IFRS-based accounts. A reconciliation is provided in SoPS Note 3.2.

SoPS Note 2. Analysis of Net Resource and Capital Outturn

SoPS Note 2.1 – Analysis of Net Resource Outturn

Spending in Departmental Expenditure Limits (DEL) Voted Expenditure	Administration Expenditure £000	Programme Expenditure £000	Programme Income £000	Total Net Resource Outturn £000	Total Net Resource Estimate £000	Total Net Outturn Compared to Estimate £000	2014-15 Total Net Outturn Compared to Estimate Adjusted for Virements £000	2013-14 Total Net Resource Outturn* £000	2013-14 Total Net Resource Outturn as Published in the 2013-14 Accounts* £000
A. Provision of Defence Capability - Service Personnel Costs*	-	7,878,834	-	**7,878,834**	8,008,573	129,739	-	8,400,713	9,046,632
B. Provision of Defence Capability - Civilian Personnel Costs*	-	1,937,614	-	**1,937,614**	1,910,379	(27,235)	-	1,840,926	192,110
C. Provision of Defence Capability - Infrastructure Costs	-	4,576,992	-	**4,576,992**	4,589,453	12,461	**2,530**	4,545,389	4,545,389
D. Provision of Defence Capability - Inventory Consumption	-	1,661,847	-	**1,661,847**	1,725,871	64,024	**14,469**	1,765,487	1,765,487
E. Provision of Defence Capability - Equipment Support Costs	-	6,343,245	-	**6,343,245**	6,351,312	8,067	**8,067**	6,065,557	6,065,557
F. Provision of Defence Capability - Other Costs and Services*	-	1,804,274	-	**1,804,274**	1,664,604	(139,670)	-	1,413,547	1,790,894
G. Provision of Defence Capability - Receipts and Other Income	-	-	(1,091,806)	**(1,091,806)**	(1,114,126)	(22,320)	-	(1,169,263)	(1,169,263)
H. Provision of Defence Capability - Depreciation and Impairment Costs	-	8,187,241	-	**8,187,241**	9,449,975	1,262,734	**1,262,734**	8,911,223	8,911,223
I. Provision of Defence Capability - Cash Release of Provisions	-	201,855	-	**201,855**	221,911	20,056	**20,056**	175,030	175,030
N. Provision of Defence Capability - Research and Development Costs	-	1,000,606	-	**1,000,606**	1,018,647	18,041	**18,041**	971,008	971,008
Q. Operations - Service Personnel Staff Costs	-	85,480	-	**85,480**	90,000	4,520	**4,520**	108,909	108,909
R. Operations and Peacekeeping - Civilian Personnel Staff Costs	-	6,036	-	**6,036**	28,000	21,964	**21,964**	13,777	13,777
S. Operations - Infrastructure Costs	-	86,516	-	**86,516**	115,000	28,484	**28,484**	162,069	162,069
T. Operations - Inventory Consumption	-	160,055	-	**160,055**	203,000	42,945	**17,459**	395,649	395,649
U. Operations - Equipment Support Costs	-	184,400	-	**184,400**	168,000	(16,400)	-	345,016	345,016
V. Operations - Other Costs and Services	-	126,827	-	**126,827**	162,000	35,173	**35,173**	218,930	218,930
W. Operations - Receipts and Other Income	-	-	(40,914)	**(40,914)**	(50,000)	(9,086)	-	(26,764)	(26,764)
X. Operations - Depreciation and Impairment Costs	-	322,349	-	**322,349**	349,810	27,461	**27,461**	550,366	550,366

Spending in Departmental Expenditure Limits (DEL) Voted Expenditure	Administration Expenditure £000	Programme Expenditure £000	Programme Income £000	Total Net Resource Outturn £000	Total Net Resource Estimate £000	Total Net Outturn Compared to Estimate £000	2014-15 Total Net Outturn Compared to Estimate Adjusted for Virements £000	2013-14 Total Net Resource Outturn* £000	2013-14 Total Net Resource Outturn as Published in the 2013-14 Accounts* £000
Y. Operations - Cash Release of Provisions	-	2,869	-	**2,869**	4,000	1,131	**1,131**	2,980	2,980
AB. Operations - Research and Development Costs	-	11,475	-	**11,475**	12,000	525	**525**	17,137	17,137
AC. Conflict Pools Resource Costs	-	55,660	(142)	**55,518**	61,390	5,872	**5,872**	49,648	49,648
AD. Arm's Length Bodies Costs	-	130,021	-	**130,021**	178,016	47,995	**47,995**	187,466	187,466
Administration Costs									
O. Administration Costs - Civilian Personnel Costs*	371,688	-	-	**371,688**	388,000	16,312	**16,312**	441,139	2,112,064
P. Administration Costs - Other Costs and Services*	463,849	-	-	**463,849**	488,701	24,852	**3,136**	394,486	17,139
AE. Administration Costs - Service Personnel Costs*	623,716	-	-	**623,716**	602,000	(21,716)	**-**	645,919	-
AF. Administration Costs - Cash Release of Provisions*	14,451	-	-	**14,451**	20,000	5,549	**5,549**	22,109	-
Total Spending in DEL	**1,473,704**	**34,764,196**	**(1,132,862)**	**35,105,038**	**36,646,516**	**1,541,478**	**1,541,478**	36,448,453	36,448,453

* A new Administrative Cost Regime for 2014-15 onwards was agreed with HM Treasury. Prior period figures have been restated. Further details are at SoPS Note 3.2.

Spending in Annually Managed Expenditure (AME) Voted Expenditure	Administration Expenditure £000	Programme Expenditure £000	Programme Income £000	Total Net Resource Outturn £000	Total Net Resource Estimate £000	Total Net Outturn Compared with Estimate £000	2014-15 Total Net Outturn Compared to Estimate Adjusted for Virements £000	2013-14 Total Net Resource Outturn* £000
AG. Provision of Defence Capability - Depreciation and Impairment Costs	-	450,416	-	**450,416**	939,205	488,789	**488,789**	(208,143)
AH. Provision of Defence Capability - Provisions Costs	-	679,896	-	**679,896**	716,177	36,281	**10,676**	141,371
AI. Provision of Defence - Cash Release of Provisions Costs	-	(216,306)	-	**(216,306)**	(241,911)	(25,605)	**-**	(200,392)
AJ. Movement on the Fair Value of Financial Instruments	-	42,768	-	**42,768**	299,271	256,503	**208,620**	368,147
AK. Operations - Depreciation and Impairment Costs	-	10,757	-	**10,757**	10,000	(757)	**-**	-
AL. Operations - Provisions	-	61,995	-	**61,995**	16,000	(45,995)	**-**	6,152
AM. Operations - Cash Release of Provisions Costs	-	(2,869)	-	**(2,869)**	(4,000)	(1,131)	**-**	(2,980)
AN. War Pensions Benefits Programme costs	-	837,649	-	**837,649**	862,041	24,392	**24,392**	858,964
Total Spending in AME	**-**	**1,864,306**	**-**	**1,864,306**	**2,596,783**	**732,477**	**732,477**	963,119
Total Resource Outturn	**1,473,704**	**36,628,502**	**(1,132,862)**	**36,969,344**	**39,243,299**	**2,273,955**	**2,273,955**	37,411,572

SoPS Note 2.2 – Analysis of Net Capital Outturn

Capital Spending in Departmental Expenditure Limits (DEL)	Administration Expenditure £000	Programme Expenditure £000	Programme Income £000	Total Net Capital Outturn £000	Total Net Capital Estimate £000	Total Net Outturn Compared with Estimate £000	2014-15 Total Net Outturn Compared to Estimate Adjusted for Virements £000	2013-14 Total Net Capital Outturn £000
Capital - Voted Expenditure								
J. Provision of Defence Capability - Capital - Single Use Military Equipment (SUME)	-	4,870,897	-	**4,870,897**	4,756,157	(114,740)	-	4,455,379
K. Provision of Defence Capability - Other Capital (Fiscal)	-	3,260,988	(50,000)	**3,210,988**	3,548,583	337,595	**10,894**	3,037,505
L. Provision of Defence Capability - Fiscal Assets / Estate Disposal	-	-	(250,881)	**(250,881)**	(342,000)	(91,119)	-	(43,573)
M. Provision of Defence Capability - New Loans and Loan Repayments	-	(56,626)	-	**(56,626)**	(177,468)	(120,842)	-	(5,573)
Z. Operations Capital Single Use Military Equipment (SUME)	-	17,908	-	**17,908**	25,000	7,092	**7,092**	72,533
AA. Operations Other Capital (Fiscal)	-	(8,978)	-	**(8,978)**	11,000	19,978	**19,978**	53,070
AD. Arm's Length Bodies	-	2,414	-	**2,414**	2,414	-	-	2,527
Total Capital Spending in DEL	**-**	**8,086,603**	**(300,881)**	**7,785,722**	**7,823,686**	**37,964**	**37,964**	7,571,868

Capital Spending in Annually Managed Expenditure (AME)	Administration Expenditure £000	Programme Expenditure £000	Programme Income £000	Total Net Capital Outturn £000	Total Net Capital Estimate £000	Total Net Outturn Compared with Estimate £000	2014-15 Total Net Outturn Compared to Estimate Adjusted for Virements £000	2013-14 Total Net Capital Outturn £000
Capital - Voted Expenditure								
Provision of Defence Capability - Provisions Costs (release)	-	50,559	-	**50,559**	110,000	59,441	**59,441**	(128,612)
Total Capital Spending in AME	**-**	**50,559**	**-**	**50,559**	110,000	59,441	**59,441**	(128,612)
Total Capital Outturn	**-**	**8,137,162**	**(300,881)**	**7,836,281**	**7,933,686**	**97,405**	**97,405**	7,443,256

SoPS Note 3 Reconciliation of Outturn to Net Operating Cost and Administration Budget

SoPS Note 3.1. Reconciliation of Net Resource Outturn to Net Operating Cost

	Note	2014-15 Outturn £000	2013-14 Outturn £000
Net Resource Outturn (Statement of Parliamentary Supply)	SoPS 2	**36,969,344**	37,411,572
Adjustment for changes in discount rates not passing through net operating costs		**(43,798)**	(32,547)
Adjustment for Service Concession Arrangements treated as on-SoFP for Accounts but treated as off-SoFP for Estimates and Budgets and therefore excluded from the resource outturn but included in operating costs		**66,527**	109,635
Income in respect of donated assets treated as capital income		**(6,957)**	(4,300)
(Loss) / gain on foreign exchange contracts in respect of Capital purchases		**67,090**	20,675
Adjustment for impairments and impairment reversals included in resource outturn but not passing through Net Operating Cost	SoCiTE	**-**	(15,404)
Add capital grants included in operating costs but excluded from resource outturn	SoPS 2.2	**2,414**	2,527
Equity Withdrawal from investments in Trading Funds - recorded as income in Operating Costs and Capital in the SoPS		**(213,842)**	-
Net Operating Cost		**36,840,778**	37,492,158

SoPS Note 3.2 Outturn Against Administration Budget and Administration Net Operating Cost

	Note	2014-15 £000	2013-14 £000	Illustrative figures for the two financial years calculated on the, now replaced, basis that was first introduced in 2011-12: 2014-15 £000	2013-14 £000
Estimate - Administration Cost Limit		**1,498,701**	2,155,592		
Outturn - Administration Costs	SoPS 2.1	**1,473,704**	1,503,653 *	**2,148,198**	2,129,203
Less release of early retirement provisions	18	**(14,451)**	(22,109) *	**(17,039)**	(25,362)
Administration Net Operating Costs	SoCNE	**1,459,253**	1,481,544 *	**2,131,159**	2,103,841

* Restated for the change in Administration Cost Regime agreed with HM Treasury for 2014-15.

HM Treasury define Administration Budgets as covering costs other than the costs of direct frontline service provision; for example, activities such as provision of policy advice and business support services. Administration costs would usually include expenditure such as: employee costs – including pay, superannuation, training, travel and subsistence; accommodation, including rent, rates and maintenance; office services; contracted out services (for comparable services – e.g. consultancy) and relevant depreciation.

From Financial Year 2011-12 the Department and HM Treasury agreed a significant departure from the usual content of administration cost. The content was changed to only include the costs of civilian staff (pay, and superannuation), excluding: health care professionals and staff working in operational areas (including Royal Fleet Auxiliary personnel) such as Afghanistan plus the cost of external assistance (which for 2013-14 excluded external assistance arising from transformation). The Armed Forces were excluded from this revised Administration Cost Regime (ACR) as were the arms-length bodies. The cost of civilian redundancies, early release schemes and the movement on provisions was included.

As an action from Spending Review 13 the Department undertook a review of the content of its administrative cost and agreed a further revision with HM Treasury effective from Financial Year 2014-15. The review considered the type of work done by personnel and by areas of the Department. As a result the new content consists only of the pay and superannuation costs of civilian and military personnel considered to be performing an administrative function; plus the costs of professional fees and external assistance for the Department; and the costs of lump sum redundancy payments to military personnel and cash expenditure on civilian early release schemes.

The cost of the Defence Equipment and Support (DE&S) Bespoke Trading Entity (BTE) is excluded from all elements of the revised Administration cost. When HM Treasury consider the overall administration cost for the Department they also discuss DE&S BTE operating costs, recognising that they are a mix of administration and front line costs and are outside the latest agreed ACR.

SoPS Note 4 Reconciliation of Net Resource Outturn to Net Cash Requirement

	Notes	Estimate £000	Outturn £000	Net Total Outturn Compared with Estimate: Savings/ (Excess) £000
Net Resource Outturn	SoPS 2.1	39,243,299	36,969,344	2,273,955
Net Capital Outturn	SoPS 2.2	7,933,686	7,836,281	97,405
Adjustments for Arm's Length Bodies (ALBs):				
Remove voted outturn (Resource and Capital)		(180,430)	(132,435)	(47,995)
Add cash Grant in Aid and other Departmental expenditure on behalf of ALBs		179,615	174,567	5,048
Adjustments to remove non-cash items:				
Depreciation		(11,048,261)	(8,986,597)	(2,061,664)
New provisions and adjustments to previous provisions		(732,177)	(909,136)	176,959
Adjustment to reflect movement in working capital				
Increase / (Decrease) in Inventory		294,072	192,720	101,352
Increase / (Decrease) in Receivables		55,201	324,933	(269,732)
(Increase) / Decrease in Payables		1,337,857	173,873	1,163,984
Use of provisions		245,911	206,760	39,151
Net Cash requirement		**37,328,773**	**35,850,310**	**1,478,463**

Consolidated Statements of Comprehensive Net Expenditure (SoCNE)

for the year ended 31 March 2015

	Note	2014-15 Core Department & Agencies £000	2014-15 Departmental Group £000	2013-14 Restated Core Department & Agencies £000	2013-14 Restated Departmental Group £000
Administration Costs					
Staff costs*	3.2	995,404	995,404	1,087,058	1,087,058
Other administration costs*	4	463,849	463,849	394,486	394,486
Total administration costs		**1,459,253**	**1,459,253**	1,562,178	1,562,178
Programme Costs					
Staff costs*	3.2	9,954,261	10,041,615	10,398,472	10,484,540
Other programme costs*	5	26,822,698	26,805,953	26,810,473	26,771,863
Operating income	6	(1,353,302)	(1,466,043)	(1,200,667)	(1,245,789)
Net programme cost		**35,423,657**	**35,381,525**	36,008,278	36,010,614
Net operating cost	SoPS 3.1	**36,882,910**	**36,840,778**	37,489,822	37,492,158

Other Comprehensive Expenditure

	Note	2014-15 Core Department & Agencies £000	2014-15 Departmental Group £000	2013-14 Core Department & Agencies £000	2013-14 Departmental Group £000
Net (gain) / loss on revaluation of property, plant and equipment	SoCiTE	(3,581,898)	(3,599,351)	(794,504)	(806,499)
Net (gain) / loss on revaluation of intangible assets	SoCiTE	(274,665)	(274,665)	2,028,442	2,028,442
Net (gain) / loss on revaluation of assets held for sale	SoCiTE	92,831	90,206	54,166	54,166
Net (gain) / loss on revaluation of inventories	SoCiTE	61,509	61,509	(242,272)	(242,272)
Net (gain) / loss on pensions	SoCiTE	42,840	48,536	34,207	34,304
Impairments / (Impairment Reversals) not included in operating costs	SoCiTE	-	-	15,404	15,404
Transfer between reserves and asset (writes-on) / writes-off	SoCiTE	58,436	74,801	(13,570)	28,368
Total Other Comprehensive Expenditure		**(3,600,947)**	**(3,598,964)**	1,081,873	1,111,913
Total Net Comprehensive Expenditure		**33,281,963**	**33,241,814**	38,571,695	38,604,071

* A new Administrative Cost Regime for 2014-15 onwards was agreed with HM Treasury. Prior period figures have been restated. Further details are at SoPS Note 3.2.

Notes 1 to 28 which follow the Statements of Changes in Taxpayers' Equity form part of these accounts.

Consolidated Statements of Financial Position (SoFP)

as at 31 March 2015

	Note	31 March 2015 Core Department & Agencies £000	31 March 2015 Departmental Group £000	31 March 2014 Core Department & Agencies £000	31 March 2014 Departmental Group £000
Non-current assets					
Intangible assets	7	25,566,539	25,566,539	24,918,012	24,918,012
Property plant and equipment	8	95,426,411	96,234,020	92,330,873	93,091,214
Financial assets		76,559	76,559	103,102	103,102
Receivables due after more than one year	14	606,652	790,352	714,679	914,801
Total non-current assets		**121,676,161**	**122,667,470**	**118,066,666**	**119,027,129**
Current assets					
Financial assets held for sale	9.6	1	61,436	1	60,823
Non-current assets held for sale	12	179,300	179,300	51,575	51,575
Inventories	13	6,806,899	6,815,294	7,291,500	7,300,096
Trade and other receivables	14	2,371,225	2,398,353	2,201,126	2,210,261
Financial assets		292,114	292,114	58,448	58,448
Cash at bank and in hand	15	1,142,075	1,236,896	930,897	1,013,971
Total current assets		**10,791,614**	**10,983,393**	**10,533,547**	**10,695,174**
Total assets		**132,467,775**	**133,650,863**	**128,600,213**	**129,722,303**
Current liabilities					
Trade and other payables due within one year	16	(9,787,646)	(9,862,101)	(9,253,283)	(9,314,776)
Financial liabilities	9.6	(640,440)	(640,440)	(305,189)	(305,189)
Total current liabilities		**(10,428,086)**	**(10,502,541)**	**(9,558,472)**	**(9,619,965)**
Non-current assets plus net current assets		**122,039,689**	**123,148,322**	**119,041,741**	**120,102,338**
Non-current liabilities					
Provisions	18	(5,086,574)	(5,091,006)	(4,523,551)	(4,530,802)
Other payables	16	(6,639,724)	(6,821,356)	(6,370,087)	(6,541,013)
Total non-current liabilities		**(11,726,298)**	**(11,912,362)**	**(10,893,638)**	**(11,071,815)**
Assets less liabilities*		**110,313,391**	**111,235,960**	**108,148,103**	**109,030,523**
Taxpayers' equity and other reserves					
General fund	SoCiTE	86,946,475	86,946,475	86,509,376	86,509,376
Revaluation reserve	SoCiTE	23,366,916	23,366,916	21,638,727	21,638,727
Taxpayers Equity		**110,313,391**	**110,313,391**	**108,148,103**	**108,148,103**
Arm's Length Bodies restricted reserves	SoCiTE	-	154,523	-	172,285
Arm's Length Bodies unrestricted reserves	SoCiTE	-	768,046	-	710,135
Total Arm's Length Bodies' reserves		**-**	**922,569**	**-**	**882,420**
Total taxpayers' equity and other reserves		**110,313,391**	**111,235,960**	**108,148,103**	**109,030,523**

*The value of assets and liabilities accounted for under leases is understated because contracts, particularly strategic procurement arrangements with key contractors, have not been assessed under IFRIC 4; further details are at Notes 1.41 to 1.44 to the accounts.

Jon Thompson
Accounting Officer

08 July 2015

Notes 1 to 28 which follow the Statements of Changes in Taxpayers' Equity form part of these accounts.

Consolidated Statements of Cash Flows (SoCF)

for the year ended 31 March 2015

		2014-15		2013-14	
	Note	Core Department & Agencies £000	Departmental Group £000	Core Department & Agencies £000	Departmental Group £000
Cash flows from operating activities					
Net operating cost	SoCNE	36,882,910	36,840,778	37,489,822	37,492,158
Adjustments for non-cash transactions		(10,169,744)	(10,187,302)	(9,880,165)	(9,922,288)
Increase / (Decrease) in trade and other receivables	SoFP	62,072	63,643	(350,400)	(338,835)
Adjustment for movements on receivables relating to items not passing through operating costs		162,097	158,097	179,886	182,968
Movement in net inventories including provisions		192,720	195,127	87,036	87,085
(Increase) / Decrease in trade payables	SoFP	(804,000)	(827,668)	1,016,209	844,159
Adjustment for movements in payables relating to items not passing through operating costs		848,123	858,897	(221,436)	(52,265)
Dividends and Equity Repayments		97,119	102,619	46,091	47,891
Realised loss / (gain) on derivatives		234,030	234,030	38,896	38,896
Use of provisions	18	206,760	206,760	203,156	203,156
Net cash outflow from operating activities		**27,712,087**	**27,644,981**	**28,609,095**	**28,582,925**
Cash flows from investing activities					
Purchase of property, plant and equipment	8	7,867,091	7,927,950	7,620,247	7,630,458
Purchase of intangible assets	7	2,089,309	2,089,309	1,384,722	1,384,722
Adjustment for non cash movements relating to PPE and intangibles		(1,688,696)	(1,688,696)	(1,447,121)	(1,447,121)
Proceeds on disposal of property, plant and equipment		(149,251)	(149,251)	(141,179)	(141,179)
Dividends and Equity Repayments		(97,119)	(102,619)	(46,091)	(47,891)
Repayments from other bodies	10.1	(56,624)	(56,624)	(5,573)	(5,573)
Net cash outflow from investing activities		**7,964,710**	**8,020,069**	**7,365,005**	**7,373,416**
Cash flows from financing					
From the consolidated fund (Supply) - current year		(35,866,048)	(35,866,048)	(35,374,420)	(35,374,420)
From the consolidated fund (Supply) - prior year		(145,349)	(145,349)	-	-
Repayment of loans from the National Loans Fund	16	2,444	2,444	2,297	2,297
Capital element of payments in respect of finance leases and Service Concession Arrangements		231,033	231,033	240,842	240,842
Movement on collaborative projects		(110,055)	(110,055)	12,118	12,118
Net financing		**(35,887,975)**	**(35,887,975)**	**(35,119,163)**	**(35,119,163)**
Net increase / (decrease) in cash and cash equivalents in the period after adjustment for receipts and payments to the Consolidated Fund		**211,178**	**222,925**	**(854,937)**	**(837,178)**
Cash and cash equivalents at the beginning of the period	15	930,897	1,013,971	1,785,834	1,851,149
Cash and cash equivalents at the end of the period	15	1,142,075	1,236,896	930,897	1,013,971

Notes 1 to 28 which follow the Statements of Changes in Taxpayers' Equity form part of these accounts.

Consolidated Statements of Changes in Taxpayers Equity (SoCiTE)

For the period ended 31 March 2015

		Core Department and Agencies			Arms Length Bodies (ALBs)			Departmental Group
	Note	General Fund £000	Revaluation Reserve £000	Taxpayers Equity £000	Restricted Reserves £000	Unrestricted Reserves £000	Total of ALBs Reserves £000	Total Reserves £000
Balance at 31 March 2013		85,179,244	25,321,455	110,500,699	176,743	738,053	914,796	111,415,495
Parliamentary Funding - drawn down in-year		35,374,420	-	35,374,420	-	-	-	35,374,420
Parliamentary Funding - deemed funding		697,470	-	697,470	-	-	-	697,470
Parliamentary Funding - Supply Receivable	14.1	145,349	-	145,349	-	-	-	145,349
Non-cash charge - auditors remuneration	5	1,860	-	1,860	-	-	-	1,860
Net operating costs	SoCNE	(37,489,822)	-	(37,489,822)	-	(2,336)	(2,336)	(37,492,158)
Other net comprehensive expenditure:								
Net (loss) / gain on revaluation of property, plant and equipment	SoCNE	-	794,504	794,504	-	11,995	11,995	806,499
Net (loss) / gain on revaluation of intangible assets	SoCNE	-	(2,028,442)	(2,028,442)	-	-	-	(2,028,442)
Net (loss) / gain on revaluation of assets held for sale	SoCNE	-	(54,166)	(54,166)	-	-	-	(54,166)
Net (loss) / gain on revaluation of inventories	SoCNE	-	242,272	242,272	-	-	-	242,272
Net (loss) / gain on pensions	SoCNE	(34,207)	-	(34,207)	-	(97)	(97)	(34,304)
Impairments / (Impairment Reversals) not included in operating costs	SoCNE	-	(15,404)	(15,404)	-	-	-	(15,404)
Transfer between reserves and asset writes-on	SoCNE	2,635,062	(2,621,492)	13,570	(4,458)	(37,480)	(41,938)	(28,368)
Balance at 31 March 2014		**86,509,376**	**21,638,727**	**108,148,103**	**172,285**	**710,135**	**882,420**	**109,030,523**
Parliamentary Funding - drawn down in-year		35,866,048	-	35,866,048	-	-	-	35,866,048
Parliamentary Funding - Supply Payable	16	(420,983)	-	(420,983)	-	-	-	(420,983)
Non-cash charge - auditors remuneration	5	2,186	-	2,186	-	-	-	2,186
Net operating costs	SoCNE	(36,882,910)	-	(36,882,910)	6,667	35,465	42,132	(36,840,778)
Other net comprehensive expenditure:								
Net (loss) / gain on revaluation of property, plant and equipment	SoCNE	-	3,581,898	3,581,898	6,186	11,267	17,453	3,599,351
Net (loss) / gain on revaluation of intangible assets	SoCNE	-	274,665	274,665	-	-	-	274,665
Net (loss) / gain on revaluation of assets held for sale	SoCNE	-	(92,831)	(92,831)	-	2,625	2,625	(90,206)
Net (loss) / gain on revaluation of inventories	SoCNE	-	(61,509)	(61,509)	-	-	-	(61,509)
Net (loss) / gain on pensions	SoCNE	(42,840)	-	(42,840)	-	(5,696)	(5,696)	(48,536)
Transfer between reserves and asset writes-on	SoCNE	1,915,598	(1,974,034)	(58,436)	(30,615)	14,250	(16,365)	(74,801)
Balance at 31 March 2015		**86,946,475**	**23,366,916**	**110,313,391**	**154,523**	**768,046**	**922,569**	**111,235,960**

Notes 1 to 28 which follow the Statements of Changes in Taxpayers' Equity form part of these accounts.

Chapter 9:
Notes to the Accounts

Notes to the Accounts

1. **Statement of Accounting Policies**

Introduction

1.1 These financial statements have been prepared in accordance with the 2014-15 FReM issued by HM Treasury except that IFRIC 4 – Determining whether an Arrangement Contains a Lease, has not been applied. Further information on the reasons for this non-application and its impact on the financial statements are given in Notes 1.41 to 1.44 below. The accounting policies contained in the FReM apply IFRS as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be the most appropriate to the particular circumstances of the Department for the purpose of giving a true and fair view has been selected. The particular policies adopted by the Department are described below. They have been applied consistently in dealing with items that are considered material to the accounts and comply with the requirements of the FReM except where HM Treasury has approved the departures to enable the Department to reflect its own particular circumstances or the departures do not have a material impact on the financial statements. The departures are:

- 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, core Department and agencies and the consolidated group in respect of the Statement of Comprehensive Net Expenditure (and supporting notes) and the Statement of Financial Position (and supporting notes). The Department has chosen not to apply the three column approach to these financial statements following the creation of the Department's only Agency, Defence Equipment and Support (Bespoke Trading Entity). The Agency falling within the Departmental Boundary is on-vote and embedded within the Departmental chain of command. Throughout these accounts, the consolidated figures for the Ministry of Defence (including its on-vote agency) are represented as "Core Department and Agency". HM Treasury and the House of Commons Defence Committee have been made aware of the decision not to include a third column. The resource outturn for DE&S (BTE) is included as a separate line in Note 2.10 – Segmental Reporting.

- The Department has not fully complied with the FReM regarding the Carbon Reduction Commitment (CRC) Energy Efficiency Scheme and similar schemes' 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 Statement of Comprehensive Net Expenditure. All other costs associated with the scheme, such as compliance checking, are also charged to the Statement of Comprehensive Net Expenditure.

- On the grounds of materiality, the Department, in applying IFRIC 1 – Changes in Existing Decommissioning, Restoration and Similar Liabilities – uses the cost model rather than the revaluation model to measure changes in its capitalised asset provisions.

- On the grounds of materiality, HM Treasury has also agreed that the information normally required by the FReM on Fees and Charges disclosures (paragraph 5.4.16) is not required and the disclosure provided at Note 6.1 is sufficient.

- The Department currently departs from the FReM by accounting for its inventory under current cost. It has been agreed with HM Treasury this is an appropriate bases for valuation until the 2018-19 Financial Year when the valuation will change to the lower of cost and Net Realisable Value. Further details can be found in Note 1.54.

1.2 The Statement of Comprehensive Net Expenditure is analysed between administration and programme costs. As an action from Spending Review 13 the Department undertook a review of its Administrative Cost Regime (ACR) boundary and has agreed, with HM Treasury, a revised ACR details of which are at SoPS Note 3.2.

Segmental Reporting

1.3 The Departmental Group's reporting segments are based on the information that the Defence Board uses to make decisions about operating matters and resource allocation. Further details are at Note 2.

Accounting Convention

1.4 These financial statements have been prepared under the historical cost convention, modified to include the revaluation of intangible assets, property, plant and equipment assets and inventories.

Basis of Preparation of Department's Annual Accounts

1.5 These financial statements comprise the consolidation of the Department, its Advisory NDPBs and ALBs sponsored by the Department. The Advisory NDPBs and ALBs which are included in the accounting boundary of the Departmental Group are listed in Note 27. The departmental boundary is similar to the concept of a group under generally accepted accounting practice, but is based on control criteria used by the Office for National Statistics to determine the sector classification of the relevant sponsored bodies and requires the individual bodies to be designated for consolidation by order of HM Treasury under statutory instrument. Subsidiaries which are public corporations, or fall outside the central government classification for some other reason, have been excluded from the accounting boundary (unless they satisfy the criteria for consolidation as an associate or joint venture) except for some minor entities where inclusion does not have a material impact on the consolidated position and the work required to exclude them is therefore not justified.

1.6 The ALBs use categories for their costs, including the distinction between capital and revenue expenditure, which do not always align with MOD categories. As they are not material, the operating costs of the Department's ALBs are split into three categories for the purpose of consolidation – 'staff costs', 'depreciation' and 'other'. ALBs operate a lower capitalisation threshold for Property Plant and Equipment than the Department. On the grounds of materiality , all ALB Non Current Property, Plant and Equipment are consolidated into the accounts. The Department has two Trading Funds which produce their own accounts and, as they fall outside Voted Supply, the Department's interests are included in the financial statements as non-current financial assets. The Department's third Trading Fund (Defence Support Group) was sold in year.

Critical Accounting Judgements and Key Sources of Estimation Uncertainty

1.7 Preparation of the Department's Annual Accounts requires significant judgements and estimates to be applied in order to arrive at the value of Departmental assets and liabilities and likewise the amount of revenue and expenses to be reported during the accounting period. The key areas in which judgements and estimates have been used are described below.

Non-Current Assets

1.8 Intangible non-current assets and plant and equipment assets are expressed at their fair value through the application of indices produced by Defence Statistics; indices are also applied to property assets during periods between the quinquennial revaluations undertaken by external professional valuers.

1.9 The useful economic life of an equipment asset is assessed by reference to its estimated out of service date and for other assets on the basis of their estimated period of utility to the Department. There is an inherent uncertainty in estimating the annual depreciation charge and the carrying amount of a tangible non-current asset. For example an increase in the useful economic life will decrease the depreciation charged to the Statement of Comprehensive Net Expenditure during the year and increase the asset's carrying amount at financial year end.

1.10 The out of service date for tangible non-current assets is subject to change depending on factors such as strategic defence policy and predicted obsolescence. The economic lives of non-current assets are regularly reviewed and, where appropriate, revised to reflect changing circumstances such as decisions reflected in the latest finalised Annual Budget Cycle.

Inventories

1.11 Where inventories have become surplus, unserviceable, defective or obsolescent, an estimated financial provision is applied to their carrying value to reduce it to net realisable value. Details of inventories balances are given in Note 13.

Accruals

1.12 Where expenditure has been incurred but not invoiced an estimate is made of the amount to be accrued. It is key to retain evidence to support this estimate. This is particularly so in complicated contractual arrangements where it is necessary to present fairly the substance of the arrangement. Accruals are listed in Note 16.

Nuclear Decommissioning

1.13 Provisions have been made for the cost of decommissioning facilities and for the treatment, storage, and disposal of nuclear waste arising from operations at Rosyth and Devonport dockyards and at Atomic Weapons Establishment sites. Provisions are also included for the future cost of decommissioning operational nuclear submarines and likewise for the cost of decommissioning those which have reached their out of service date.

1.14 In calculating the provisions, an estimate has been made of the cash flows required to settle the obligations. Key assumptions in this estimate are the time period over which the provisions are estimated, the costs for the future storage and decommissioning of waste, the VAT rate and the discount rate used. While the discount rate applied to the future cash flows is subject to assumptions, the Department has used the discount rate mandated by HM Treasury. Details of how nuclear decommissioning provisions have been calculated are included in Note 18.

Changes During FY 2014-15 Which Have Affected the Preparation of These Annual Accounts

1.15 Changes in accounting policies, estimates and conventions in 2014-15 have not had a material impact on the accounts; the main change was:

- Implementation of the new Group accounting standards. The main changes are that departmental investments in associates and joint ventures outside the public sector should apply the equity accounting method and the removal of certain subsidiary companies of executive NDPBs whose accounts are consolidated into the Department's accounts.

Recent Changes to Regulations Affecting the Preparation of Future Annual Accounts

1.16 Changes in the 2015-16 FReM are not expected to have a material impact on the accounts; the main changes introduced are:

- IFRS 13 Fair Value. The main impact is likely to be for the valuation of surplus assets where there are no restrictions on sale where the valuation method will change from market value in existing use to a value based on highest and best use.

- Simplifying and Streamlining Central Government Annual Report and Accounts. The main changes are the introduction of three parts to the Annual Report and Accounts – the Performance Report; the Accountability Report and the Financial Statements.

Net Operating Costs

1.17 Costs are charged to the Statement of Comprehensive Net Expenditure in the period in which they are incurred and matched to any related income. Details of exit packages are included at Note 3 to the accounts. 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 HMRC. Surpluses and deficits on disposal of assets classified as held for sale and inventories declared for disposal are included at Note 5 Other Programme Costs.

1.18 Income from services provided to third parties is included within operating income, net of related VAT. In accordance with IAS 10, as interpreted by the FReM, Trading Fund dividends are recognised as operating income on an accruals basis, whilst other dividends are recognised in the year in which they are declared.

Non-Current Assets

1.19 The Department's capitalisation threshold is £25,000. Intangible and Property, Plant and Equipment assets are expressed at their fair value through the application of the Modified Historical Cost Accounting Convention (MHCA). Prospective indices, which are produced by Defence Statistics, are applied at the start of each financial year to the non-current assets which fall within the categories listed below. These indices look ahead to the Reporting Period date and include calculations to reflect the difference between the actual change in prices during the prior year and the prospective indices used for that year. In addition, where there is a material difference between the indices for year end and those used throughout the year, the MHCA calculations are performed again, using the up to date indices at the year end. The value of the overseas estate assets is similarly adjusted to take account of the year-end exchange rates. However, Non-Current Assets are not subject to indexation during the period the platform remains in production as the contract is deemed to reflect fair value. Categories of indices used are:

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

1.20 Property assets are also subject to a quinquennial revaluation by external professional valuers in accordance with IAS 16 – Property, Plant and Equipment, as interpreted by the FReM. Property assets are valued in one of two ways depending on their use. Non-specialist properties are valued at fair (i.e. market) value. For in-use non specialist properties, fair value is interpreted as market value for existing use. Specialist property for which there is no external market is valued at depreciated replacement cost. The majority of Service Families Accommodation is valued at depreciated replacement cost due to the positioning of housing in certain areas or as a result of the lack of an alternative market for certain holdings due to their remote geographic locations. Where market value for existing use is more appropriate, for example for small numbers of houses in a single location, this basis of valuation has been applied.

1.21 Non-Current Assets Under Construction are not subject to indexation where the contract payments capitalised during the period of construction are deemed to reflect fair value. On completion, balances are released from the project account into the appropriate asset category.

Intangible Non-Current Assets

1.22 Research costs are charged to the Statement of Comprehensive Net Expenditure in the period in which they are incurred.

1.23 Development costs are capitalised where the project is expected to result in an asset which will enter service. Those not capitalised are charged to the Statement of Comprehensive Net Expenditure.

1.24 After initial recognition, intangible non-current assets are revalued to fair value, using a market value where an active market exists. Where no market exists, indices are used to revalue the intangible asset to Depreciated Replacement Cost (DRC) or, if the asset is income generating, to value in use if lower than DRC. Intangible Non-Current Assets Under Construction are not subject to indexation where the contract payments capitalised during the period of construction are deemed to reflect fair value.

1.25 Capitalised development costs are amortised, on a straight line basis, over the planned operational life of the resultant asset, e.g. class of ship or aircraft. Amortisation commences when the asset type first enters operational service within the Department.

1.26 Externally purchased software including licences (other than for the operating system which is treated as part of the computer hardware and where appropriate capitalised as a tangible non-current asset) are capitalised where they contribute to the provision of services or other Departmental outputs for a period in excess of one year. Capitalised software is amortised, on a straight line basis, over the shorter of either the economic life or the licence period.

Property, Plant and Equipment Non-Current Assets

1.27 Property, Plant and Equipment assets are expressed at their fair value through the application of the Modified Historical Cost Accounting Convention (MHCA). Property, Plant and Equipment assets are indexed other than during the period where contract payments capitalised are deemed to already reflect fair value. There are assets with similar capabilities which have different values, reflecting the nature of the construction process. Some First of Class Non-Current Assets include one-off production set up costs which the subsequent platforms do not. Future platforms can also benefit from learning curve efficiencies.

1.28 The useful economic lives of property, plant and equipment non-current assets are reviewed annually and adjusted where necessary.

1.29 It is the Departmental capitalisation threshold which determines whether or not an asset is recorded on the Department's Non-Current Asset Register (NCAR); the threshold is £25,000. Where ALBs have used a lower capitalisation threshold, the assets have also been consolidated.

1.30 The Departmental threshold of £25,000 is not applied to individual capital spares and assembled Guided Weapons Missiles and Bombs (GWMB). Instead, for accounting purposes, these items are treated as pooled assets and included within the SUME category of non-current assets. GWMB and capital spares are depreciated and the depreciation charge in the Statement of Comprehensive Net Expenditure also includes the cost of GWMB fired to destruction.

1.31 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	Not depreciated unless it is held under a finance lease.
	Buildings (dwellings and non-dwellings):	
	– permanent	40 – 50
	– 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	Operational Heritage Assets are included within the principal asset category to which they relate.	As other non-current assets

Donated Assets

1.32 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.

1.33 Income to the value of the donated assets is recognised in the year of donation except where donation is subject to conditions. Where donation is subject to conditions income is deferred to the year in which the conditions are met.

Componentisation and Subsequent Expenditure

1.34 The Department's policy on componentisation (the recognition of the cost of replacing part of an asset) is as follows:

- Newly built property assets, with the exception of specialist assets, are not subject to componentisation at the point of initial capitalisation as the cost of any potential component is not significant to the total cost of the asset. Specialist assets such as runways are considered for componentisation.

- Where a property asset is refurbished or part of it replaced, the expenditure is recognised within the carrying amount of the overall asset. For assets above £500,000, the carrying amount of the part which is replaced is de-recognised. The Quinquennial Revaluation is used to adjust any short term valuation differences.

- Material expenditure on major refits and overhauls in the sea environment are accounted for separately when their value is consumed by the Department over a different period from the life of the corresponding core asset.

Impairment

1.35 Impairment charges to the Statement of Comprehensive Net Expenditure occur in circumstances which reduce the carrying amount of property, plant and equipment assets to their recoverable amount. All impairment losses (except for those arising from a clear consumption of economic benefit or loss of service potential) are written off against the Revaluation Reserve until the carrying amount of the asset reaches its depreciated historic cost. Impairment losses below this amount are charged to the net operating cost section of the Statement of Comprehensive Net Expenditure. Any reversal of an impairment charge is recognised in the Statement of Comprehensive Net Expenditure to the extent that the original charge was previously recognised there. Any remaining amount is recognised in the Revaluation Reserve.

1.36 All impairment losses arising from a clear consumption of economic value or loss of service potential are written off to the net operating cost section of the Statement of Comprehensive Net Expenditure. Any balance on the Revaluation Reserve (up to the level of the impairment) is transferred to the General Fund.

1.37 Capitalised development costs that are directly linked to a class of asset are impaired if the whole class of the associated tangible non-current asset is impaired. The magnitude of the impairment applied is in the same proportion as that applied to the underlying asset class.

Disposal of Tangible Non-Current Assets

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

1.39 Non-current assets are reclassified as held for sale if their carrying amount will be recovered principally through a sales transaction rather than through continuing use. For this to be the case, the asset must be available for immediate sale, subject only to terms that are usual and customary for the sale of such assets. The sale must also be highly probable, and expected to complete within one year.

1.40 When assets are classified as held for sale, they are re-classified as current assets and valued at the lower of their carrying amount and their fair value less costs to sell. No further depreciation is applied.

Leased Assets

1.41 Assets held under finance leases are capitalised as non-current assets and a corresponding liability recognised. The assets are depreciated over the shorter of the lease term and their estimated useful economic life. Payments are apportioned between reductions in the capital obligations included in payables and finance costs charged to the Statement of Comprehensive Net Expenditure. Expenditure under operating leases is charged to the Statement of Comprehensive Net Expenditure in the period to which the charge relates.

1.42 The Department may also enter into arrangements that do not take the legal form of a lease but which give the Department the right to use an asset in return for payment. IFRIC 4 – Determining whether an Arrangement Contains a Lease provides guidance on determining whether such arrangements contain leases. Where leases are identified, they should be classified as operating or finance leases in accordance with IAS 17 – Leases, and accounted for in accordance with the accounting policies set out in Note 1.41.

1.43 The Department has conducted a review, with support from an external accountancy consultant, of its most significant contract arrangements where IFRIC 4 is likely to apply. This has confirmed that the Department has a number of significant lease type arrangements which are not currently recognised and cannot be accurately quantified. As a result of the complex, resource intensive and costly practical issues identified by the review, the Department, with HM Treasury support, has decided not to apply IFRIC 4 to existing contracts on the grounds that it does not represent value for money. The Department is considering further work in respect of the application of IFRIC 4 to new contracts. As a result of the decision not to implement IFRIC 4 for legacy contracts MOD's accounts will continue to receive a qualified audit opinion for the foreseeable future.

1.44 The impact on the financial statements of not applying IFRIC 4 is that contractors' assets held under finance leases and the associated liabilities have been excluded from the Statement of Financial Position. Commitments under operating leases and finance leases have also been omitted from Notes 20.1 and 20.3.

Public Private Partnerships (PPP) including Private Finance Initiative (PFI) Arrangements

1.45 Where PPP including PFI arrangements fall within the scope of the IFRIC 12 – Service Concession Arrangements definition of Service Concession Arrangements, the infrastructure assets and liabilities are reported on the Department's Statement of Financial Position. Unitary charges are apportioned between reduction in the capital obligation and charges to the Statement of Comprehensive Net Expenditure for service performance and finance costs.

1.46 Where PPP including PFI arrangements are outside the scope of IFRIC 12 – Service Concession Arrangements, the arrangement is assessed to establish whether it contains a lease under IFRIC 4. If it does contain a lease, the lease is accounted for as either a finance or an operating lease in accordance with IAS 17. Where the arrangement does not contain a lease, the expenditure will be recognised as it falls due.

Financial Instruments

1.47 The Department has foreign currency forward purchase contracts, denominated in US Dollars and Euros, and fuel fixed price swap contracts denominated in US Dollars which are accounted for as derivatives and classified as Held For Trading financial instruments.

1.48 The foreign currency forward purchase contracts are measured at fair value with movements in fair value being charged or credited to the Statement of Comprehensive Net Expenditure. 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 Bank of England. The forward contracts will only have a fair value up to their date of settlement. Once each contract has been settled, the derivative is removed from the Department's Statement of Financial Position. The forward contracts were purchased from the Bank of England. Details of existing contracts are at Notes 9.9 to 9.11 to the accounts.

1.49 The Department uses fixed price swap contracts to manage its risk of fuel price movements in respect of aviation turbine fuel, marine gas oil, unleaded ground fuel and diesel ground fuel. The contracts are measured at fair value with movements in fair value being charged or credited to the Statement of Comprehensive Net Expenditure. The fair value is measured as the difference between the market rate for the four commodities at the date of valuation and the PLATTS rate stipulated in the contracts, multiplied by the contracted volumes, in the contracted currency. The market rate is determined by the latest average PLATTS index for the month. These values are converted to sterling using the closing mid-market rate obtained from the Bank of England. The swap contracts will only have a fair value up to their date of settlement. Once each contract is settled, it is removed from the Statement of Financial Position. Swap contracts are purchased by competitive tender using a panel of financial institutions (the latter chosen following a comprehensive assessment). The contracting process began in 2010-11 for supply in 2011-12 onwards for aviation and marine fuels. This was extended to the four fuels in 2013-14. Details of existing contracts are at Notes 9.12 and 9.13 to the accounts.

1.50 Public Dividend Capital is not treated as a financial instrument in the Department's financial statements and is reported at historic cost less any impairment. The Department's investments in special or 'golden' shares are not recognised on the Statement of Financial Position. The entities in which the Department holds special shares are listed at Note 10.7.

1.51 Receivables, including trade receivables, 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 receivables and loans which carry no rate of interest or a subsidised rate. However, the Department's receivables that are due within 1 year are not discounted on the grounds of materiality. Provisions are only made for specific bad debts.

1.52 Liabilities covering trade payables and accruals are classified as Payables and Accruals 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.

1.53 The Department has not made a provision for arrangements that fall within the scope of a financial guarantee contract on the grounds that there is a very low probability of a claim maturing.

Inventories

1.54 On transition from UK GAAP to IFRS, HMT confirmed that the introduction of IAS 2 (which requires Inventories to be held at the lower of cost or net realisable value) would not require any immediate changes in the MOD's accounting treatment of inventories. The Department and HM Treasury have discussed the continued appropriateness of valuing inventories at current cost and HM Treasury, as the Relevant Authority has confirmed an adaptation to the FReM – that the Department can continue with current replacement cost accounting for Inventories. It has also been agreed that the valuation basis for inventories will change to the lower of cost and net realisable value by Financial Year 2018-19. This is to allow time for changes to the financial systems to support an historic cost valuation in accordance with the FReM.

1.55 Inventories are recognised on the Department's Statement of Financial Position from the point of acquisition to the point of issue for consumption, sale, write-off or disposal.

1.56 Inventory which is expected to be used is valued at the cost of replacing the materiel – i.e. at current cost based on purchase price or estimated through indexation. However, where there is no expectation of consumption or sale in the ordinary course of business, the value is impaired to reduce it to Net Realisable Value.

1.57 Some items of inventory, for example munitions, have a limited shelf life and depreciation (on a straight line basis) is applied throughout the life of these items. When an item is consumed, written off or disposed of the remaining carrying value is charged to the Statement of Comprehensive Net Expenditure.

Cash and Cash Equivalents

1.58 The Department determines cash as cash in hand and demand deposits (repayable on demand) with any commercial bank or other financial institution. This includes gold coins and deposits denominated in foreign currencies after allowing for unpresented payments and uncleared deposits.

1.59 Cash equivalents are determined as short term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of change in value. Cash and cash equivalents in the Department's Statement of Financial Position comprise balances held by the Government Banking Service, commercial banks and cash in hand.

Provisions for Liabilities and Charges

1.60 Provisions for liabilities and charges have been established under the criteria of IAS 37 – Provisions, Contingent Liabilities and Contingent Assets and are based on realistic estimates of the expenditure required to settle legal or constructive obligations that exist at the Reporting Period date.

1.61 On initial recognition, provisions are charged to the Statement of Comprehensive Net Expenditure unless the expenditure will provide access to current and future economic benefits, in which case a capitalised asset provision is created. The carrying amount of any capitalised asset provision is depreciated and charged to the Statement of Comprehensive Net Expenditure over the remaining estimated useful economic life of the underlying asset. Provisions are discounted at rates advised by HM Treasury and three different rates are used for provisions depending on the time boundary they fall into. The pensions discount rate advised by HM Treasury is used for provisions relating to employee benefits. The discount is unwound over the remaining life of the provision and shown as an interest charge in the Statement of Comprehensive Net Expenditure.

Reserves

1.62 The Revaluation Reserve reflects the unrealised element of the cumulative balance of revaluation and indexation adjustments on non-current assets and inventories.

1.63 The General Fund represents the balance of the Taxpayers' Equity in the Core Department. Reserves relating to the ALBs are split into 'Restricted' and 'Unrestricted' reserves, where restricted reserve have limitations, e.g. covenants and other legal restrictions, on their use.

Pensions

1.64 Present and past employees are mainly covered by the Civil Service pension arrangements for civilian personnel and the AFPS for Service personnel with a small number, including those in ALBs, covered by other schemes (see Note 17). There are separate scheme statements for the AFPS and Civil Service pensions. Further details can be found at: www.civilservice-pensions.gov.uk and https://www.gov.uk/pensions-and-compensation-for-veterans

1.65 Both the AFPS and the main Civil Service pension schemes are unfunded defined benefit pension schemes although, in accordance with the HM Treasury FReM, the Department accounts for the schemes in its accounts as if they were defined contribution schemes. The employer's charge is met by payment of an estimated Superannuation Contribution Adjusted for Past Experience (SCAPE), which represents the cost of providing future superannuation protection for all personnel currently in pensionable employment. The Department's Statement of Financial Position will only include a payable in respect of pensions to the extent that the contributions paid to the pension funds in the year fall short of the SCAPE and employee contributions 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.

Early Departure Costs

1.66 The Department provides in full for the cost of meeting pensions up to the normal retirement age in respect of military and civilian personnel early retirement programmes. Early departure provisions under pension scheme rules are discounted at the pensions' discount rate, issued annually by HM Treasury, 1.3% as at 31 March 2015 (1.8% as at 31 March 2014). Pensions payable after the normal retirement age are met by the Armed Forces Pension Scheme for military personnel and, mainly, by the Principal Civil Service Pension Scheme for civilian personnel. However, any additional element payable beyond normal retirement age, which derives from the enhancement of reckonable service, continues to be met by the Department. Redundancies are provided for in full.

Foreign Currency

1.67 All transactions that are denominated in a foreign currency are translated into Sterling using the General Accounting Rate (GAR) prevailing at the date of each transaction. For each currency, the GAR is updated monthly based on spot rates. In respect of US Dollars and Euros the GAR is based on the average of the published spot rates 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 Reporting Period date and the exchange differences are reported in the Statement of Comprehensive Net Expenditure.

1.68 Overseas non-monetary assets and liabilities are subject to annual revaluation and are translated at the mid-market closing rate applicable at the Reporting Period date. Nuclear inventories are revalued using the GAR. Exchange differences are taken to the Revaluation Reserve.

VAT

1.69 The Department is registered for VAT and pays tax on its purchases in accordance with Value Added Tax Act 1994 (VATA94). As it is a non-business organisation, most of the VAT the Department incurs is non-recoverable and therefore a cost to the Department.

Third Party Assets

1.70 Third party assets are those for which the Department acts as custodian or trustee but in which neither the Department nor the government has a direct beneficial interest. As they are not public assets they are not recorded in the Statement of Financial Position.

Heritage Assets

1.71 Operational heritage assets are valued at fair value using the same methodology applied to other assets of the same general type. Non operational heritage assets are valued at fair value if information is available and if valuation is considered beneficial. Further details of heritage assets are at Note 26.

2. Segmental Analysis

2.1 The Department's organisational structure is set out in the Governance Statement and additional information is provided in *The New Operating Model: How Defence Works* available at: www.gov.uk/government/publications/the-new-operating-model-how-defence-works. The structure is the key factor in determining the reporting segments disclosed below.

2.2 The Royal Navy, the Army, and the Royal Air Force are supported by: Joint Forces Command – responsible for the planning and execution of joint operations outside the UK; Defence Equipment and Support (Bespoke Trading Entity) – responsible for procurement and support of equipment; the Defence Infrastructure Organisation – responsible for managing the Defence Estate and Head Office and Corporate Services – responsible for policy, strategy and corporate services such as payroll.

2.3 Forecasts of near cash expenditure against budgets (Resource and Capital) are regularly reviewed by the Defence Board when considering performance and resource allocation. The tables below set out the detail of this near cash net expenditure, by segment (where the Board consider the net expenditure at that level of detail), and analyse the net expenditure reviewed between Resource and Capital.

2.4 The Board also receives separate information on the total additional spend on Military Operations (Resource and Capital) – this information, in more detail than presented to the Board, is set out at SoPS Note 2 (each expenditure type is prefixed by 'Operations'). The Board also separately consider expenditure on War Pensions Benefits against the budget approved by Parliament (these details are set out at SoPS Note 2) and expenditure on the Equipment Plan. The Board review the Department's Net Cash Requirement – details of which are set out in the Statement of Parliamentary Supply and are not duplicated here.

2.5 The routine financial information considered by the Board does not include details of assets and liabilities and therefore does not form part of these disclosures. The Board do not receive information on the separate Administration Control Total and the figures presented to the Board do not include the full net expenditure of ALBs (they do include Grants in Aid and certain payments made on behalf of these bodies). Information on expenditure by geographical area or major customers is not routinely considered and is therefore not disclosed below.

2.6 Transactions between segments take two main forms:

- Costs such as payroll, equipment support, centralised contract costs, estate management, inventory consumption etc. are allocated to segments by the main accounting systems e.g. accounts payable, accounts receivable, civilian payroll, military payroll, inventory and Non-Current Asset registers.

- Costs incurred by one segment on behalf of another are subject to agreement and then transferred by a central accounts section to ensure the net effect on the Department's consolidated accounts remains correct.

2.7 DE&S(BTE) was new for 2014-15 and formed by bringing together internal sections and individuals whose costs for the previous year were an integral part of the previous DE&S. This integrated expenditure could not be separately identified without excessive cost. In accordance with IFRS 8, the table below sets out the Department's segmental information as if the reorganisation had not taken place.

Net Resource DEL Outturn	2014-15 £000	2013-14 £000
Outturn by Top Level Budget (reviewed as forecast against budget by the Board during the year)		
Royal Navy	2,347,969	2,270,922
Army	6,365,814	6,740,905
Royal Air Force	2,411,278	2,541,985
Joint Forces Command	1,876,347	1,523,486
Defence Equipment & Support	8,343,573	8,258,402
Defence Infrastructure Organisation	2,749,397	2,771,562
Head Office & Corporate Services	1,476,437	1,414,884
	25,570,815	25,522,146
Reconciliation to Operating Costs		
Net Resource Outturn for Cost of Operations (excluding depreciation, impairments and provisions) - reviewed by the Board as total forecast resource outturn against Estimate during the year	675,393	1,284,373
War Pensions Benefits (Annually Managed Expenditure) - reviewed by the Board as total forecast resource outturn against Estimate during the year	837,649	858,964
Sub total of Net Resource Outturn reviewed by the Board during the financial year	**27,083,857**	27,665,483
Balance of Net Resource Outturn not reviewed by the Board (depreciation, impairment, provisions, Annually Managed Expenditure, Centrally Managed Expenditure and ALB income and expenditure)	9,885,487	9,746,089
Total Resource Outturn (See SoPS Note 2)	**36,969,344**	37,411,572
Less: items included in Net Resource Outturn but not included in Net Operating Costs (see SoPS Note 3.1) and also excluding ALB income and expenditure	(86,434)	78,250
Total Departmental Operating Costs (see Statement of Comprehensive Net Expenditure)	**36,882,910**	37,489,822

Net Capital DEL Outturn	2014-15 £000	2013-14 £000
Outturn by Top Level Budget (reviewed by the Board)		
Royal Navy	13,818	2,413
Army	36,500	39,693
Royal Air Force	4,893	1,375
Joint Forces Command	7,028	10,502
Defence Equipment & Support	7,134,741	6,543,840
Defence Infrastructure Organisation	731,573	817,716
Head Office & Corporate Services	(221,265)	28,199
	7,707,288	7,443,738
Reconciliation to Capital Outturn		
Net Capital Outturn for Cost of Operations (excluding Annually Managed Expenditure) - reviewed by the Board as a total forecast figure against Estimate during the year	8,930	125,603
Sub total of Capital Outturn reviewed by the Board	**7,716,218**	7,569,341
Balance of Capital Outturn not reviewed by the Board (Capital AME, foreign exchange movements and ALB capital outturn)	120,063	(126,085)
Total Capital Outturn (See SoPS Note 2)	**7,836,281**	7,443,256

2.8 On 1 April 2014, as part of Defence Transformation, the DE&S (BTE) was established – a new segment for review by the Defence Board. The balance of the old DE&S segment's costs have, under the new delegated operating model for Defence, become the responsibility of the Front Line Commands.

2.9 DE&S (BTE) was set up to equip and support the UK's Armed Forces for operations now and in the future. The individual Services set the requirements and budgets, this gives them the flexibility to allocate funding where they consider it to be most critical. The work of DE&S (BTE) ranges from submarines, warships, aircraft and missiles, through to armoured vehicles, utility trucks, body armour and field kitchens. DE&S (BTE) manages: new equipment procurements; upgrades, updates and upkeep of equipment in service; and undertakes disposals and decommissioning.

2.10 The tables below set out the segmental information on the new organisational basis, as considered by the Defence Board. In this layout the new DE&S (BTE) organisation is separately identified, with the balance of the former DE&S segment shown as part of the reconciliations to the Statement of Comprehensive Net Expenditure and to the Capital Outturn at SoPS Note 2.

Net Resource DEL Outturn	2014-15 £000	2013-14* £000
Outturn by Top Level Budget (reviewed by the Board)		
Royal Navy	2,347,969	2,270,922
Army	6,365,814	6,740,905
Royal Air Force	2,411,278	2,541,985
Joint Forces Command	1,876,347	1,523,486
Defence Equipment & Support (Bespoke Trading Entity)	1,017,277	-
Defence Infrastructure Organisation	2,749,397	2,771,562
Head Office & Corporate Services	1,476,437	1,414,884
	18,244,519	17,263,744
Reconciliation to Operating Costs		
Net Resource Outturn for Cost of Operations (excluding depreciation, impairments and provisions) - reviewed by the Board as total forecast resource outturn against Estimate during the year	675,393	1,284,373
War Pensions Benefits (Annually Managed Expenditure) - reviewed by the Board as total forecast resource outturn against Estimate during the year	837,649	858,964
Sub total of Net Resource Outturn reviewed by the Board during the financial year	**19,757,561**	19,407,081
Balance of Net Resource Outturn not reviewed by the Board (depreciation, impairment, provisions, Annually Managed Expenditure, Centrally Managed Expenditure and ALB income and expenditure)	9,876,224	9,746,089
Balance of the Net Resource Outturn relating to the old DE&S organisation. This expenditure is not separately reviewed by the Board, it forms part of the Equipment Plan expenditure which the Board reviews by Service Command and Strategic Programme (see table below)	7,335,559	8,258,402
Total Resource Outturn (See SoPS Note 2)	**36,969,344**	37,411,572
Less: items included in Net Resource Outturn but not included in Net Operating Costs (see SoPS Note 3.1) and also excluding ALB income and expenditure	(86,434)	78,250
Total Departmental Operating Costs (see Statement of Comprehensive Net Expenditure)	**36,882,910**	37,489,822

*The 2013-14 information has been restated to reflect changes to the way the Board reviews performance and makes decisions on resource allocations between Segments following the establishment of the Defence Equipment & Support (Bespoke Trading Entity).

Net Capital DEL Outturn	2014-15 £000	2013-14* £000
Outturn by Top Level Budget (reviewed by the Board)		
Royal Navy	13,818	2,413
Army	36,500	39,693
Royal Air Force	4,893	1,375
Joint Forces Command	7,028	10,502
Defence Infrastructure Organisation	731,573	817,716
Head Office & Corporate Services	(221,265)	28,199
	572,547	899,898
Reconciliation to Capital Outturn		
Net Capital Outturn for Cost of Operations (excluding Annually Managed Expenditure) - reviewed by the Board as a total forecast figure against Estimate during the year	8,930	125,603
Sub total of Capital Outturn reviewed by the Board	**581,477**	1,025,501
Balance of Capital Outturn not reviewed by the Board (Capital AME, foreign exchange movements and ALB capital outturn)	120,063	6,417,755
Balance of the Net Capital Outturn relating to the old DE&S organisation. This expenditure is not separately reviewed by the Board; it forms part of the Equipment Plan expenditure which the Board reviews by Service Command and Strategic Programme (see table below)	7,134,741	
Total Capital Outturn (See SoPS Note 2)	**7,836,281**	7,443,256

*The 2013-14 information has been restated to reflect changes to the way the Board reviews performance and makes decisions on resource allocations between Segments following the establishment of the Defence Equipment & Support (Bespoke Trading Entity).

2.11 As set out in the accounting policies note (Note 1.1. – first bullet) the Department has not disclosed its Core Department expenditure separately. If it had, in the financial statements and related notes, the DE&S(BTE) expenditure would have been removed from the current 'Core Department and Agencies' column to create an extra column 'Core Department'. The additional detail would be most noticeable on the SoCNE and related notes as the DE&S(BTE) costs consist of: staff costs £649M and other operating costs £371M. These numbers for DE&S BTE are still subject to audit at the time of signing these accounts.

The Equipment Plan

2.12 In addition to reviewing the information above, the Defence Board also receive information on expenditure on the Equipment Plan. This is the expenditure which was previously included in the segmental analysis as DE&S and in the revised format above is included in the reconciling sections; it covers expenditure on equipment support and the procurement of Single Use Military Equipment and other equipment for Defence. The details are set out below and allow the Defence Board to make decisions about resource allocation to segments and to assess performance.

Equipment Plan	2014-15 £000
Outturn by Budget Area (reviewed by the Board)	
Strategic Programme	3,864,800
DE&S Corporate	42,200
Joint Forces Command	2,207,400
Royal Air Force	3,373,900
Royal Navy	3,373,300
Army	1,608,700
Total	**14,470,300**

3. Staff Numbers and Costs

3.1 The average number of full-time equivalent persons employed during 2014-15 and 2013-14 are set out in the following table.

	2014-15		2013-14	
	Core Department & Agencies	Departmental Group	Core Department & Agencies	Departmental Group
Civilian Staff				
Permanent staff	54,690	57,390	56,830	59,560
Temporary staff	160	227	160	226
Ministers and special advisers	8	8	8	8
Armed Forces	162,800	162,800	171,540	171,540
Totals	**217,658**	**220,425**	228,538	231,334

In order to align with the total pay costs incurred during the year, shown at paragraph 3.2 below, the calculation of the number of staff uses monthly statistics to identify an average number employed for the year. The figures reflect the number of personnel in organisations within the Departmental Boundary for the Annual Accounts and therefore exclude those in the Trading Funds. Locally Employed Civilians are included as permanent staff because the additional detail required to analyse the figures between permanent and temporary is not available. More information on the Department's staff numbers, and the statistical calculations used, is available on the website: http://www.dasa.mod.uk

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

	2014-15		2013-14	
	Core Department & Agencies £000	Departmental Group £000	Restated Core Department & Agencies £000	Restated Departmental Group £000
Staff costs - Administration*	995,404	995,404	1,087,058	1,087,058
Staff costs - Programme*	9,954,261	10,041,615	10,398,472	10,484,540
	10,949,665	**11,037,019**	11,485,530	11,571,598
Made up of:				
Salaries and wages	8,063,815	8,134,952	8,433,353	8,509,643
Social security costs	601,647	611,675	627,892	631,406
Pension costs	2,142,524	2,148,713	2,205,565	2,211,829
Redundancy and severance payments	141,679	141,679	218,720	218,720
	10,949,665	**11,037,019**	11,485,530	11,571,598
Paid to:				
Armed Forces	8,639,041	8,639,041	9,173,564	9,173,564
Civilian	2,310,624	2,397,978	2,311,966	2,398,034
	10,949,665	**11,037,019**	11,485,530	11,571,598

* A new Administrative Cost Regime for 2014-15 onwards was agreed with HM Treasury. Prior period figures have been restated. Further details are at SoPS Note 3.2.

Principal Civil Service Pension Scheme

3.3 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. An actuarial valuation of the PCSPS has been completed with an effective date of 31 March 2012 and can be found at http://www.civilservicepensionscheme.org.uk/about-us/scheme-valuations/

3.4 For the year to 31 March 2015, of the total pension contributions (including an estimate in respect of IAS 19 – Employee Benefits) for the Departmental Group in the table above, £283M (2013-14: £269M) were payable in respect of the various schemes in which civilian staff were members. Contributions to the PCSPS in the same period were £260M (2013-14: £260M) calculated using four percentage rates (16.7%, 18.8%, 21.8% and 24.3%) of pensionable pay, based on four salary bands. The salary bands and percentage contribution rates will change for 2015-16. The scheme's Actuary reviews employer contributions, usually, every four years following a full scheme valuation. 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.

3.5 Employees can opt to open a partnership pension account, a stakeholder pension with an employer contribution. Employer contributions of £1.7M (2013-14 £1.5M) were paid to one or more of the panel of three appointed stakeholder pension providers. Employer contributions are age-related and range from 3% to 12.5% (2013-14 from 3% to 12.5%) of pensionable pay. Employers also match employee contributions up to 3% of pensionable pay. In addition, employer contributions of £0.8M (2013-14 £0.2M) representing 0.8% of pensionable pay were payable to the PCSPS to cover the cost of future provision of lump sum benefits on death in service and ill health retirement of these employees.

Armed Forces Pension Scheme

3.6 The Armed Forces Pension Scheme 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 2014 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 60 or 65 depending on the scheme. 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).

3.7 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.

3.8 A new Armed Forces Pension Scheme will be introduced in April 2015. It will be known as the Armed Forces Pension Scheme 2015 (AFPS15). All Service personnel who are members of one of the Armed Forces Pension Schemes (e.g. AFPS 75, AFPS 05, FTRS 97 and RFPS) who will be serving beyond April 2015 will be automatically transferred to the new scheme unless they qualify for Transitional Protection. The Government has offerred Transitional Protection to those who are within 10 years of their respective scheme's Normal Pension Age on 1 April 2012. Further details of the new scheme are available at: https://www.gov.uk/pensions-and-compensation-for-veterans#armed-forces-pension-scheme-2015

3.9 For the year to 31 March 2015 total employer's pension contributions (including an estimate in respect of IAS 19 – Employee Benefits) payable to the AFPS were £1.9Bn (2013-14: £1.9Bn) based on employer's contribution rates determined by the Government Actuary. For 2014-15, the employer's contribution rates were 42.6% of pensionable pay for Officers (2013-14: 42.8%) and 30.6% of pensionable pay for Other Ranks (2013-14: 30.8%). These rates will change to 53.4% for Officers and 52% for Other Ranks from 1 April 2015. 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: https://www.gov.uk/pensions-and-compensation-for-veterans

Other Pension Schemes

3.10 The Armed Forces Pension Scheme incorporates a number of smaller schemes, including: the Non-Regular Permanent Staff Pension Scheme, the Gurkha Pension Scheme and the Reserve Forces Pension Scheme. The membership of these schemes is approximately 5% of the AFPS total membership and the employer's contributions to the schemes are included in the figure payable to the AFPS, at paragraph 3.9.

3.11 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 3.4 includes contributions in respect of these schemes. Some employees and former employees are members of other schemes, for example the Merchant Navy Ratings Pension Fund and schemes covering locally employed civilians in Germany, Cyprus and Gibraltar. Estimates of the liabilities for these schemes are included in the accounts and additional details are provided at Note 17 – Pensions.

Civil Service and Other Compensation Schemes – Exit Packages

3.12 The figures in the following table include redundancy and other departure costs paid in accordance with the provisions of the Civil Service Compensation Scheme (CSCS). Where the Department has agreed early retirements the costs are met by the MOD and not by the Civil Service Pension Scheme. The table includes 157 individuals who retired early on ill-health grounds during 2014-15 (2013-14 116); their total accrued pension liabilities for the year were £0.2M (2013-14 £0.3M).

3.13 For staff leaving under voluntary exit or voluntary redundancy terms the cost includes any top-up to compensation provided by the Department to buy out the actuarial reduction on an individual's pension as well as the compensation payment.

3.14 The table also includes the members of the Armed Forces released under schemes introduced as part of the SDSR. All Armed Forces redundancies are compulsory; the law does not provide for voluntary redundancy. While personnel are invited to apply for consideration, the Services may retain applicants, and make non-applicants redundant in their stead, in order to retain the right balance of skills and experience across the rank structures. Successful applicants are included in the table as 'other departures agreed'; non applicants are listed as compulsory.

Exit Package Cost Band	Number of Compulsory Redundancies*		Number of Other Departures Agreed*		Total Number of Exit Packages by Cost Band*	
	2014-15	2013-14	**2014-15**	2013-14	**2014-15**	2013-14
<£10,000	21	39	18	57	39	96
£10,000 - £25,000	256	233	501	1,992	757	2,225
£25,000 - £50,000	257	445	509	2,233	766	2,678
£50,000 - £100,000	113	166	184	1,050	297	1,216
£100,000 - £150,000	-	8	7	95	7	103
£150,000 - £200,000	-	-	2	17	2	17
£200,000 - £250,000	-	1	-	4	-	5
£250,000 - £300,000	-	-	-	3	-	3
£300,000 - £350,000	-	-	-	-	-	-
£350,000 - £400,000	-	-	-	-	-	-
£400,000 - £450,000	-	-	-	-	-	-
£450,000 - £500,000	-	-	-	-	-	-
Total Number of Exit Packages	**647**	892	**1,221**	5,451	**1,868**	6,343
	£M	£M	£M	£M	£M	£M
Total Resource Cost	**21.2**	32.7	**40.2**	199.8	**61.4**	232.5

*The 2014-15 figures exclude civilian exits from the Core Department - these details were not available at the date of publication and will be included in the 2015-16 accounts.

3.15 In addition to the exit packages detailed above the Department may occasionally make use of early release schemes to reduce the number of civilian staff who are not members of the CSCS, for example locally employed staff in Germany and Cyprus, teachers and nursing staff.

3.16 Members of the Armed Forces Pension Scheme who leave before the age of 55 may be entitled to an Early Departure Payment (EDP); these payments are not included above unless they are a result of SDSR redundancy schemes. Details of the EDP scheme are set out at Note 3.7 to the accounts.

4. Other Administration Costs

	2014-15		2013-14*	
	Core Department & Agencies £000	Departmental Group £000	Restated Core Department & Agencies £000	Restated Departmental Group £000
Professional fees, and external assistance on strategic, financial, IT, technical and organisational change & management, and legal support.	**463,849**	**463,849**	394,486	394,486
Total Other Administration Costs	**463,849**	**463,849**	394,486	394,486

* A new Administrative Cost Regime for 2014-15 onwards was agreed with HM Treasury. Prior period figures (£17.139M) have been restated. Further details are at SoPS Note 3.2.

5. Other Programme Costs

	2014-15 Core Department & Agencies £000	2014-15 Departmental Group £000	2013-14 Restated Core Department & Agencies £000	2013-14 Restated Departmental Group £000
Other Programme Costs – Non-Cash Expenditure				
Auditors' remuneration - audit work only†	2,186	2,186	1,860	1,860
Depreciation and amortisation:				
– Intangible assets	1,653,325	1,653,325	1,790,912	1,790,912
– Property, plant and equipment (PPE) owned assets*	6,154,625	6,167,939	5,915,480	5,934,369
– PPE held under finance leases	106,875	106,875	112,338	112,338
– PPE held under service concession arrangements	361,296	361,296	440,461	440,461
Impairment on non-current assets:				
– Arising on Quinquennial valuation	332,000	332,000	(78)	(78)
– Arising on Other items	107,968	107,968	917,728	917,728
Provisions to reduce inventory to net realisable value	259,822	259,822	253,080	253,080
Inventory write off / (on) - net	321,963	321,963	361,715	361,715
(Surplus) / deficit on disposal of property, plant and equipment and intangible assets	(61,880)	(61,880)	(90,743)	(90,743)
(Surplus) / deficit arising on disposal of inventory - net	(3,168)	(3,168)	(14,366)	(14,366)
Intangible and property, plant and equipment assets write off / (write on) - net	(1,022)	(1,022)	(233,723)	(233,723)
Capital project expenditure write off / (write on) - net	(13,689)	(13,689)	(12,176)	(12,176)
Bad debts written off	2,208	2,208	12,900	12,900
Increase/(Decrease) in bad debts provision	1,856	1,856	(5,975)	(5,975)
Increase/(Decrease) in nuclear provisions	371,471	371,471	(3,787)	(3,787)
Unwinding of discount on payables and receivables - net	91,283	91,283	69,515	69,515
Movement on Derivatives	282,055	282,055	409,497	409,497
Increase/(Decrease) in other provisions**	192,588	192,588	41,223	41,223
Other Programme Costs - Total Non-Cash Expenditure	**10,161,762**	**10,175,076**	9,965,861	9,984,750
Other Programme Costs				
Fuel	550,752	550,752	699,785	699,785
Inventory consumption	1,040,660	1,040,660	1,187,095	1,187,095
Movements. Including: personnel travelling, subsistence / relocation costs and movement of stores and equipment	644,682	644,682	664,025	664,025
Utilities	376,649	376,649	392,598	392,598
Property management**	1,325,449	1,325,449	1,462,988	1,462,988
Hospitality and entertainment	2,059	2,059	1,512	1,512
Accommodation charges	370,700	370,700	370,465	370,465
Equipment support costs	3,987,533	3,987,533	3,819,224	3,819,224
IT and telecommunications	1,271,108	1,271,108	1,242,870	1,242,870
Professional fees‡ †	253,775	253,775	102,208	102,208
Other expenditure*†	1,132,518	1,274,609	1,166,468	1,297,185
Research expenditure and expensed development expenditure	1,012,081	1,012,081	988,145	988,145
Service Concession Arrangements:				
– IT and telecommunications	356,181	356,181	352,748	352,748
– Property management	592,591	592,591	549,603	549,603
– Transport	51,592	51,592	51,070	51,070
– Equipment support	405,983	405,983	424,600	424,600
– Plant and Equipment	54,742	54,742	54,771	54,771
Payments under finance leases:				
– Equipment support	59,851	59,851	57,552	57,552
– Defence housing	65,694	65,694	65,517	65,517

	2014-15		2013-14	
	Core Department & Agencies £000	Departmental Group £000	Restated Core Department & Agencies £000	Restated Departmental Group £000
Contractor Logistic Support and Integrated Operational Support contracts for equipment support	1,379,678	1,379,678	1,439,069	1,439,069
Payments under operating leases - plant & equipment	42,333	42,333	37,948	37,948
Payments under operating leases - other	226,568	226,568	231,375	231,375
Grants-in-Aid	169,276	20,241	185,097	17,290
Other Grants to bodies within the accounting boundary	23,118	-	19,850	-
Exchange differences on foreign currencies: net deficit / (surplus)	19,184	19,184	31,217	31,217
Cost of: unwinding discounting and finance lease and other interest	408,530	408,533	387,848	387,289
War Pensions Benefits	837,649	837,649	858,964	858,964
Other Programme Costs - Sub Total	**16,660,936**	**16,630,877**	16,844,612	16,787,113
Total Other Programme Costs	**26,822,698**	**26,805,953**	**26,810,473**	**26,771,863**

* Expenditure by Arm's Length Bodies is classified as depreciation of PPE, interest paid or other expenditure.
** The 'Increase/(Decrease) in other provisions' has been separately disclosed for the first time. The costs were previously included as either Other Expenditure or Property Management the prior year comparator figures have been adjusted.
† In addition to the notional audit fee for the Department's audit (including in 2014-15 the cost of the audit of the Armed Forces Pension Scheme accounts (£158,400) and Defence Equipment and Support (BTE) accounts (£158,000) currently budgeted - the audit is ongoing at the time of signing these accounts with the forecast fee expected to be £226,000)), other programme costs for the Departmental Group includes, as Other Expenditure, the cash cost of the NAO's audit of: the National Museum of the Royal Navy, the National Army Museum, the RAF Museum, the Royal Hospital Chelsea, and for the first time in 2014-15, the Single Source Regulations Office: £133,000 in 2014-15 (2013-14 : £108,000).
† † A new Administrative Cost Regime for 2014-15 onwards has been agreed with HMT. Prior period figures have been restated Further details are at SoPS Note 3.2.

6. Income

	2014-15		2013-14	
	Core Department & Agencies £000	Departmental Group £000	Core Department & Agencies £000	Departmental Group £000
Rental income – property	26,875	26,875	25,922	25,922
Receipts – personnel	313,380	313,380	318,351	318,351
Receipts from sale of fuel	81,964	81,964	126,029	126,029
Donated Assets	6,598	6,598	4,300	4,300
Receipts – supplies and services	303,366	303,366	297,241	297,241
Receipts – NATO/UN/US Forces/Foreign Governments	245,883	245,883	285,594	285,594
Reverse tasking *	36,253	36,253	33,304	33,304
Dividends and other income from investments (Note 10.8)** †	97,119	102,619	46,091	47,891
Other income** ††	241,864	349,105	63,835	107,157
	1,353,302	**1,466,043**	1,200,667	1,245,789

* Receipts for invoiced goods and/or services supplied to the Trading Funds and QinetiQ Group plc by MOD.
** The income of Arm's Length Bodies is classified as dividends or other income.
† Includes, for 2014-15, a £50M equity withdrawal from UKHO and a £15M Super Dividend from DSG.
†† Includes for 2014-15 £163.8M (cash extraction £23.8M and sale proceeds £140M) from the sale of DSG.

Fees and Charges

6.1 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. Where a chargeable activity produces a tangible benefit to Defence, the Department has authority to abate charges below full costs.

7. Consolidated Departmental Group – Intangible Assets

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

	Note	Single Use Military Equipment £000	Software £000	AUC £000	Others £000	Total £000
Cost or Valuation†						
At 1 April 2013		24,258,286	5,317	7,520,608	7,898,394	39,682,605
Additions	i	646	5,917	1,377,887	272	1,384,722
Disposals		(371,449)	-	-	(130,509)	(501,958)
Impairments	ii	(6,170)	-	(1,999)	(2,013)	(10,182)
Revaluations	iii	(1,438,590)	111	(754,302)	(143,736)	(2,336,517)
Reclassifications	iv	623,170	(776)	(900,470)	473,443	195,367
At 31 March 2014		**23,065,893**	**10,569**	**7,241,724**	**8,095,851**	**38,414,037**
Additions	i	35,340	6,247	2,033,453	14,269	2,089,309
Disposals		(614,112)	-	-	(303,193)	(917,305)
Impairments	ii	(5,880)	-	236	(14,276)	(19,920)
Revaluations	iii	408,928	82	286	82,143	491,439
Reclassifications	iv	130,177	(919)	(1,568,177)	1,506,389	67,470
At 31 March 2015		**23,020,346**	**15,979**	**7,707,522**	**9,381,183**	**40,125,030**
Amortisation						
At 1 April 2013		(9,046,110)	(5,220)	-	(3,213,164)	(12,264,494)
Charged in Year		(1,285,814)	(1,438)	-	(503,660)	(1,790,912)
Disposals		346,643	-	-	97,773	444,416
Impairments	ii	1,240	-	-	(10,590)	(9,350)
Revaluations	iii	138,188	(70)	-	169,957	308,075
Reclassifications	iv	48,094	3	-	(231,857)	(183,760)
At 31 March 2014		**(9,797,759)**	**(6,725)**	**-**	**(3,691,541)**	**(13,496,025)**
Charged in Year		(1,123,648)	(2,119)	-	(527,558)	(1,653,325)
Disposals		498,820	-	-	296,658	795,478
Impairments	ii	2,221	-	-	10,336	12,557
Revaluations	iii	(174,954)	(77)	-	(41,743)	(216,774)
Reclassifications	iv	(62)	-	-	(340)	(402)
At 31 March 2015		**(10,595,382)**	**(8,921)**	**-**	**(3,954,188)**	**(14,558,491)**
Net Book Value						
At 1 April 2013		15,212,176	97	7,520,608	4,685,230	**27,418,111**
At 31 March 2014		13,268,134	3,844	7,241,724	4,404,310	**24,918,012**
At 31 March 2015		**12,424,964**	**7,058**	**7,707,522**	**5,426,995**	**25,566,539**
Of the total net book value as at 31 March 2015						
Core Department		12,424,964	7,058	7,707,522	5,426,995	25,566,539
ALBs		-	-		-	-
Total		**12,424,964**	**7,058**	**7,707,522**	**5,426,995**	**25,566,539**

Notes
i. Additions include accruals of £602M (2013-14: £563M). Information on Frascati compliant R&D expenditure can be found on the website: https://www.gov.uk/government/organisations/ministry-of-defence/about/statistics.
ii. Capitalised development costs directly linked to a class of asset are only impaired if the whole class of the associated non current asset is impaired e.g. when a whole class of asset is withdrawn from service.
iii. Revaluations include changes due to Modified Historic Cost Accounting through indexation. Departmental reviews have concluded that where the price inflation embedded within contracts for construction of buildings and equipment provides for a reasonable estimate of fair value during development and construction, the additional annual application of indexation is not required.
iv. Reclassifications include assets classified to or from property, plant and equipment.
† Intangible asset valuations are based on the actual costs incurred, or derived by applying a ratio to the property, plant and equipment asset valuations based on the historical relationship between development and production costs.

7.1 Movement in the revaluation reserve relating to intangible assets

	2014-15 £000	2013-14 £000
Balance - 1 April	3,145,757	5,609,326
Revaluation	274,665	(2,030,592)
Transfers / reclassifications	(479,699)	(13,529)
Realised reserve transferred to the General Fund	(261,201)	(419,448)
Balance - 31 March	**2,679,522**	3,145,757

7.2 Details of intangible assets with a net book value greater than £0.5Bn.

Description	Net Book Value 31 March 2015 £Bn	Remaining Useful Economic Life
Typhoon development costs	5.8	15 years
Merlin helicopter development costs	1.9	14 years 10 months
Type 45 destroyer development costs	1.4	23 years 11 months
Airbus A400M Atlas	0.8	34 years 8 months
Astute class submarine development costs	0.7	20 years
Lynx helicopter development costs	0.7	29 years 9 months

8. Consolidated Departmental Group – Property, Plant and Equipment

	Note	Land Dwellings £000	Land Other Buildings £000	Dwellings £000	Other 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 (Other) £000	Total £000
Cost or Valuation												
At 1 April 2013		2,016,380	5,349,446	9,818,267	18,380,209	74,276,131	4,614,690	16,939,745	4,529,825	12,080,364	5,425,411	153,430,468
Additions	i	37,557	24,804	141,558	140,739	379,279	89,005	600,225	312,853	3,247,512	2,656,926	7,630,458
Capitalised Provisions	ii	-	-	-	9,608	(138,136)	-	-	-	-	-	(128,528)
Donations	iii	-	-	-	-	3,761	650	-	-	-	-	4,411
Disposals		(31)	(3,446)	(27,825)	(234,789)	(3,634,514)	(214,786)	(1,140,997)	(275,405)	(174,073)	(94,081)	(5,799,947)
Impairments	iv	126,104	(10,000)	(66,229)	142,567	(176,099)	(16,496)	(59,781)	2,485	(119,341)	(17,082)	(193,872)
Reclassifications	v	(11,665)	(107,957)	216,428	(149,011)	2,291,165	93,766	368,994	97,410	(2,196,624)	(1,246,785)	(644,279)
Revaluations	vi	78,820	760,130	191,596	1,967,297	(513,621)	24,447	66,184	183,744	(516,316)	(95,104)	2,147,177
At 31 March 2014		**2,247,165**	**6,012,977**	**10,273,795**	**20,256,620**	**72,487,966**	**4,591,276**	**16,774,370**	**4,850,912**	**12,321,522**	**6,629,285**	**156,445,888**
Additions	i	3,626	41,196	121,686	142,097	1,092,994	24,358	676,992	238,689	2,921,904	2,664,408	7,927,950
Capitalised Provisions	ii	-	-	-	43,363	7,112	-	-	-	-	-	50,475
Donations	iii	-	-	-	-	6,913	125	-	-	-	(440)	6,598
Disposals		(4,214)	-	(28,781)	(459,266)	(3,873,848)	(390,115)	(1,035,038)	(264,920)	-	(156,137)	(6,212,319)
Impairments	iv	163,889	(16,216)	(65,935)	(302,850)	(665,759)	(95,340)	(24,487)	(23,966)	(17,446)	(19,495)	(1,067,605)
Reclassifications	v	(6,728)	(135,144)	(63,950)	410,401	1,372,072	(573,439)	723,218	36,892	(1,640,123)	(1,830,056)	(1,706,857)
Revaluations	vi	64,376	1,133,433	862,824	2,481,736	946,848	56,561	189,405	2,603	2,921	2,200	5,742,907
At 31 March 2015		**2,468,114**	**7,036,246**	**11,099,639**	**22,572,101**	**71,374,298**	**3,613,426**	**17,304,460**	**4,840,210**	**13,588,778**	**7,289,765**	**161,187,037**
Depreciation												-
At 1 April 2013		(50,775)	-	(2,050,030)	(7,753,605)	(38,550,310)	(2,562,622)	(8,174,458)	(2,011,226)	-	-	(61,153,026)
Charged in Year		(10,766)	(20,642)	(222,064)	(635,138)	(3,931,346)	(248,690)	(1,015,826)	(402,696)	-	-	(6,487,168)
Disposals		-	-	15,235	189,610	3,752,310	176,742	1,346,734	267,950	-	-	5,748,581
Impairments	iv	(3,916)	-	80,495	44,223	(722,991)	(855)	(2,401)	(17,997)	-	-	(623,442)
Reclassifications	v	44	2,972	54,068	95,287	331,437	(36,353)	(11,052)	64,656	-	-	501,059
Revaluations	vi	(1,008)	-	(110,729)	(1,039,602)	(43,368)	(1,429)	(23,152)	(121,390)	-	-	(1,340,678)
At 31 March 2014		**(66,421)**	**(17,670)**	**(2,233,025)**	**(9,099,225)**	**(39,164,268)**	**(2,673,207)**	**(7,880,155)**	**(2,220,703)**	**-**	**-**	**(63,354,674)**

	Note	Land Dwellings £000	Land Other Buildings £000	Dwellings £000	Other 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 (Other) £000	Total £000
Charged in Year		(12,405)	(17,287)	(255,626)	(691,358)	(4,019,714)	(215,774)	(987,424)	(436,522)	-	-	(6,636,110)
Disposals		148	-	(3,788)	455,378	3,172,188	381,407	981,928	242,315	-	-	5,229,576
Impairments	iv	(4,231)	-	(7,557)	(33,562)	673,773	3,599	7,388	18,504	-	-	657,914
Reclassifications	v	853	1,645	31,319	110,813	174,455	755,133	218,396	1,219	-	-	1,293,833
Revaluations	vi	(1,221)	-	(289,168)	(1,342,314)	(388,943)	(23,988)	(98,162)	240	-	-	(2,143,556)
At 31 March 2015		**(83,277)**	**(33,312)**	**(2,757,845)**	**(10,600,268)**	**(39,552,509)**	**(1,772,830)**	**(7,758,029)**	**(2,394,947)**	**-**	**-**	**(64,953,017)**
Net Book Value												
At 1 April 2013		1,965,605	5,349,446	7,768,237	10,626,604	35,725,821	2,052,068	8,765,287	2,518,599	12,080,364	5,425,411	92,277,442
At 31 March 2014		2,180,744	5,995,307	8,040,770	11,157,395	33,323,698	1,918,069	8,894,215	2,630,209	12,321,522	6,629,285	93,091,214
At 31 March 2015		**2,384,837**	**7,002,934**	**8,341,794**	**11,971,833**	**31,821,789**	**1,840,596**	**9,546,431**	**2,445,263**	**13,588,778**	**7,289,765**	**96,234,020**
Asset Financing												
Owned		305,932	6,551,248	3,502,616	10,705,227	31,814,423	1,444,209	8,051,584	1,284,426	13,588,778	7,260,755	84,509,198
Donated		97,598	340,263	84,071	121,665	7,366	16,720	-	(39)	-	-	667,644
Long Lease		6,221	24,496	12,847	42,580	-	-	-	-	-	-	86,144
Short Lease		50	14,593	189	21,447	-	-	-	-	-	-	36,279
Operating Lease (Lessor)		-	-	3,232	9,850	-	-	-	-	-	-	13,082
Finance Lease		1,854,494	-	3,942,486	-	-	-	62	-	-	-	5,797,042
Service Concession Arrangements		120,542	72,334	796,353	1,071,064	-	379,667	1,494,785	1,160,876	-	29,010	5,124,631
At 31 March 2015		**2,384,837**	**7,002,934**	**8,341,794**	**11,971,833**	**31,821,789**	**1,840,596**	**9,546,431**	**2,445,263**	**13,588,778**	**7,289,765**	**96,234,020**
Of the total net book value as at 31 March 2015												
Core Department		2,384,837	6,994,268	7,958,728	11,735,975	31,821,789	1,691,566	9,537,299	2,442,485	13,588,778	7,270,686	95,426,411
Arm's Length Bodies		-	8,666	383,066	235,858	-	149,030	9,132	2,778	-	19,079	807,609
Total		**2,384,837**	**7,002,934**	**8,341,794**	**11,971,833**	**31,821,789**	**1,840,596**	**9,546,431**	**2,445,263**	**13,588,778**	**7,289,765**	**96,234,020**

Notes
i. Additions include accruals of £2.3Bn (2013-14: £2.3Bn).
ii. Property, plant and equipment as at 31 March 2015 include capitalised provisions (gross cost) of £395M (2013-14: £345M).
iii. Donated Assets in use have been valued on the same basis as all other assets used by the Department.
iv. Assets are impaired for a variety of reasons e.g. loss, damage, obsolescence, abandonment of Assets Under Construction (AUC) and as part of the disposal process.
v. Includes assets reclassified to intangible assets of £67M, assets reclassified to Held for Sale of £307M.
vi. Revaluations include changes due to indexation, impairment and impairment reversals. Departmental reviews have concluded that where the price inflation embedded within contracts for construction of buildings and equipment provides for a reasonable estimate of fair value during development and construction, the additional annual application of indexation is not required. To ensure accurate fair values for AUC, MOD conducts fair value reviews annually on its AUC and on their reclassification to assets in use. Non-Current Assets are not subject to indexation during the period the platform remains in production and the contract is deemed to reflect fair value.

8.1 Land and Buildings, with the exception of AUC, are subject to quinquennial revaluation (QQR), conducted as a rolling programme with approximately 25% of the estate re-valued in each of the first 4 years allowing any residual work to take place in year 5. Financial year 2014-15 represents the second year of the current QQR4 programme. Valuations for the UK estate were performed by the Valuation Office Agency and for the overseas estate in-house by Defence Infrastructure Organisation personnel and reviewed by GVA plc. All valuations are undertaken in accordance with the Royal Institute of Chartered Surveyors Appraisal and Valuation Manual. Non-specialist properties are valued at fair value, interpreted as market value for existing use; Specialist properties, for which there is no external market, are valued at depreciated replacement cost.

8.2 Data from the 2014–15 quinquennial review resulted in a £707M increase in the value of Land and a £737M increase in the value of Buildings at Net Book Value. Valuations received during the year were effective 1 November 2014 and were applied to the asset registers during the financial year.

8.3 The net charge to the SoCNE in respect of impairments arising from the movement in values against Land and Buildings assets is £332M impairment write off. This is made up of: Land, £69M net impairment write off; Buildings, £263M net impairment write off. The figures include all Land and Building assets professionally valued during Financial Year 2014-15, including Donated, IFRIC 12 and IAS 17 leased assets.

9. Financial Instruments

9.1 IFRS 7 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.

9.2 The cash requirements of the Department are met mainly through the Supply funding process, financial instruments therefore 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.

9.3 The Department is subject to some credit risk. The carrying amount of receivables, which is net of impairment losses, represents the Department's maximum exposure to credit risk from these instruments. Trade and other receivables consist of a large number of diverse customers spread over a wide geographical area. Receivables 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 Department has cash balances with commercial banks in the Eurozone and is therefore exposed to credit risk in respect of these holdings. The cash balances are relatively small and are being managed in order to minimise the risk; in addition, wider corporate services development will see much of the activity on these accounts transferred to the Government Banking Service.

9.4 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 IAS 39.

Significant Accounting Policies

9.5 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

9.6 Details of the Financial Instruments, by category, are:

			31 March 2015		31 March 2014
	Note	Core Department & Agencies £000	Departmental Group £000	Core Department & Agencies £000	Departmental Group £000
Financial Assets					
Fair value through Net Operating Cost - Held for Trading	SoFP	292,114	292,114	58,448	58,448
Loans and receivables (including cash and cash equivalents)		2,205,429	2,318,213	1,876,480	1,984,239
Held for Sale		1	61,436	1	60,823
		2,497,544	**2,671,763**	1,934,929	2,103,510
Financial Liabilities					
Payables and accruals		(8,616,852)	(8,640,687)	(8,693,435)	(8,708,815)
Fair value through Net Operating Cost - Held for Trading	SoFP	(640,440)	(640,440)	(305,189)	(305,189)
		(9,257,292)	**(9,281,127)**	(8,998,624)	(9,014,004)

9.7 The net gains and losses, for the Departmental Group, taken through Net Operating Cost or Other Comprehensive Expenditure in respect of financial instruments are listed below:

	31 March 2015 Net Operating Cost £000	31 March 2015 Other Comprehensive Expenditure £000	31 March 2014 Net Operating Cost £000	31 March 2014 Other Comprehensive Expenditure £000
Financial Assets				
Fair value through Net Operating Cost - Held for Trading	282,055	-	409,497	-
Loans and receivables	(4,209)	-	1,290	-
Available for Sale	-	2,625	-	-
Financial Liabilities				
Payables and accruals	(3,841)	-	5,882	-
	274,005	**2,625**	416,669	-

Interest Rate Risk Management

9.8 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 Supply funding process.

Foreign Currency Risk

9.9 The Department undertakes certain transactions denominated in foreign currencies; as a result exposure to exchange rate fluctuations arises. Exchange rate exposure for the US Dollar and Euro are managed using forward purchase contracts with the Bank of England and covered 94% and 95% respectively of the in-year expenditure in US dollars and Euros.

9.10 The table below details the forward purchase currency contracts outstanding as at 31 March 2015:

	Average Contract Exchange Rates	Foreign Currency US $ '000 Euro € '000 31 March 2015	Contract Value 31 March 2015 £000	Financial Asset / (Liability) Fair Value 31 March 2015 £000	Financial Asset / (Liability) Fair Value 31 March 2014 £000
Delivery 2014-15					
US Dollars ($)		-	-	-	(93,068)
Euro (€)		-	-	-	(41,450)
Delivery 2015-16					
US Dollars ($)	1.59	2,798,000	1,756,337	128,219	(69,193)
Euro (€)	1.19	1,858,000	1,561,328	(216,997)	(27,720)
Delivery 2016-17					
US Dollars ($)	1.60	2,155,000	1,343,037	108,435	(33,569)
Euro (€)	1.18	1,082,000	915,414	(132,547)	(23,781)
Delivery 2017-18					
US Dollars ($)	1.59	1,123,000	704,148	52,234	-
Euro (€)	1.26	342,000	272,151	(24,702)	-
Total			**6,552,415**	**(85,358)**	(288,781)

9.11 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 by the Bank of England.

Fuel Price Risk

9.12 The Department undertakes substantial purchases of aviation and marine fuels. Exposure to fluctuations in the market prices of these commodities is managed using Swap contracts for forward deliveries. The Swap contracts are placed with a small range of major financial institutions.

9.13 The table below details the Swap contracts outstanding as at 31 March 2015:

	Average Price US$ / Tonne	Volume Tonnes	31 March 2015 US$000	Contract Value 31 March 2015* £000	Financial Asset / (Liability) Fair Value 31 March 2015* £000	Financial Asset / (Liability) Fair Value 31 March 2014* £000
Delivery 2014-15						
Aviation Turbine Fuel		-	-	-	-	(4,793)
Marine Gas Oil		-	-	-	-	719
Unleaded Ground Fuel		-	-	-	-	20
Diesel Ground Fuel		-	-	-	-	(55)
Delivery 2015-16						
Aviation Turbine Fuel	906	406,960	368,563	248,240	(92,703)	1,865
Marine Gas Oil	744	261,347	194,347	130,900	(38,650)	2,820
Unleaded Ground Fuel	841	2,280	1,917	1,291	(365)	75
Diesel Ground Fuel	808	40,838	33,003	22,229	(7,142)	536
Delivery 2016-17						
Aviation Turbine Fuel	826	307,645	254,185	171,204	(53,623)	4,210
Marine Gas Oil	731	195,605	142,946	96,279	(27,236)	2,791
Unleaded Ground Fuel	796	1,670	1,330	896	(218)	56
Diesel Ground Fuel	782	29,543	23,088	15,550	(4,636)	495
Delivery 2017-18						
Aviation Turbine Fuel	808	163,454	132,041	88,934	(26,463)	-
Marine Gas Oil	705	107,827	76,000	51,189	(13,128)	-
Unleaded Ground Fuel	772	811	626	422	(92)	-
Diesel Ground Fuel	746	14,523	10,834	7,297	(1,932)	-
			1,238,880	**834,431**	**(266,188)**	8,739

*US $ values have been converted to sterling using the mid market exchange rate as at 31 March.

Embedded Derivatives

9.14 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 Statement of Comprehensive Net Expenditure in accordance with IFRS 7. 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

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

- Financial assets at fair value through Statement of Comprehensive Net Expenditure: mid market rate at 31 March as published by the Bank of England.
- Loans and Receivables: Loans to MOD Trading Funds are valued at historical cost less any impairment, with the element due within one year treated as fair value. Receivables due in less than one year are valued at historic cost less any impairment. Receivables 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%.
- Financial assets held for sale are measured at fair value.
- Payables and accruals: Payables and accruals due in less than one year are valued at historic cost less any impairment. Payables and accruals due in more than one year are discounted using the higher of the interest rate intrinsic to the financial instrument, the HM Treasury rate of 2.2% or, where applicable, the discount rate applicable to pension scheme provisions. Loans payable with a market rate of interest are valued at cost.
- Financial liabilities at fair value through Statement of Comprehensive Net Expenditure: mid market rate at 31 March as published by the Bank of England.

9.16 Details of the financial instruments by valuation method are:

	31 March 2015		31 March 2014	
	Core Department & Agencies £000	Departmental Group £000	Core Department & Agencies £000	Departmental Group £000
Financial Assets				
Fair value	292,115	353,550	58,449	119,271
Historic cost	2,009,413	2,122,197	1,625,652	1,711,911
Discounted cost	196,016	196,016	250,828	272,328
	2,497,544	**2,671,763**	1,934,929	2,103,510
Financial Liabilities				
Fair value	(640,440)	(640,440)	(305,189)	(305,189)
Historic cost	(8,468,309)	(8,492,144)	(8,423,381)	(8,438,761)
Discounted cost	(148,543)	(148,543)	(270,054)	(270,054)
	(9,257,292)	**(9,281,127)**	(8,998,624)	(9,014,004)

10. Investments

10.1 Departmental Group – Investments in Public and Non-Public Sector Bodies

	Non-Current Assets - Financial Assets		
	Public Dividend Capital £000	Loans £000	Total £000
Balance at 1 April 2013	87,002	54,974	141,976
Repayments	-	(5,573)	(5,573)
Balance at 31 March 2014	**87,002**	**49,401**	**136,403**
Repayments:			
Defence Science and Technology Laboratory	-	(3,220)	(3,220)
UK Hydrographic Office	-	(6,783)	(6,783)
Defence Support Group	(23,323)	(23,298)	(46,621)
Balance at 31 March 2015	**63,679**	**16,100**	**79,779**

Sale of the Defence Support Group

10.2 In October 2010 following the Strategic Defence and Security Review it was announced that the Defence Support Group, a MOD owned Trading Fund providing military air and land equipment repair and overhaul, would be offered for sale. As part of work to achieve a successful sale the Department decided to retain part of the existing business – the Electronic Components Business Unit. The assets of this separate business function were transferred to the Department, at no cost, and from 1 April 2015 will be used by the Defence Electronics and Components Agency (DECA), a new on-vote Defence Agency, to deliver the function in the future. DECA will be included in the Department's 2015-16 Group Accounts as part of the Core Department and Agencies' consolidation.

10.3 Preparation for the sale of the remaining DSG business continued with the repayment, in full, of the original financing provided by the Department – Public Dividend Capital of £23.3M; and the outstanding balance on loans made by the Department, £23.3M. These repayments can be seen in the table at Note 10.1 above and are the most significant reason for the reduction in the value of the Core Department's Non-current Financial Assets figure on the Statement of Financial Position. In addition the remaining DSG land and building assets and residual liabilities (mainly taxation) were transferred to the Department and the MOD received a 'cash extraction' of £23.8M.

10.4 To enable the remaining DSG business to be disposed of to a third party it was transferred, on 31 March 2015, from DSG to an off the shelf incorporated entity – DSG Land Equipment Support Ltd (DLES) a company wholly owned by the MOD. The Department then immediately (31 March 2015) sold its entire shareholding in the company to Babcock Land Limited and received £140M in cash as consideration. The sale agreement allowed for adjustment to the proceeds to reflect the extent to which the value of the business assets transferred to Babcock Land Limited differed from that assumed at the time the price was agreed. This aspect of the sale is still subject to negotiation. The proceeds on the sale, the additional £23.8M cash extraction and dividend income of £15M received from DSG prior to the sale are included at Note 6 – Income.

10.5 Public Dividend Capital (PDC) and Loan Balances by Trading Fund

	Public Dividend Capital (PDC) 31 Mar 15 £000	Loan Balance Due Within One Year £000	Loan Balance Due After One Year £000	Total Balance of Loan due at 31 Mar 15 £000
Defence Science and Technology Laboratory	50,412	3,220	12,880	**16,100**
UK Hydrographic Office	13,267	-	-	-
Totals	**63,679**	**3,220**	**12,880**	**16,100**

10.6 Department's Share of Net Assets and Results of Trading Funds

	Net Assets (after loans due to MOD) 31 Mar 15 £000	Turnover £000	2014-15 Surplus / profit for the Year (before financing) £000	Net Assets (after loans due to MOD) 31 Mar 14 £000	Turnover £000	2013-14 Surplus / profit for the Year (before financing) £000
Defence Science and Technology Laboratory	412,611	652,962	30,303	380,286	660,404	20,075
UK Hydrographic Office	87,777	134,002	30,013	125,157	130,542	17,908
Defence Support Group	-	175,700	127,400	149,061	179,478	15,616
Total	**500,388**	**962,664**	**187,716**	**654,504**	**970,424**	**53,599**

Other Financial Assets

10.7 As at 31 March 2015, investments, including Special Shares, were held in the following:

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

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

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

10.8 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 and any remaining value distributed in accordance with the company's constitution. The Department has written down the value of the investment to nil.

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

10.10 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 International, 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, Cody Technology Park, Ively Road, Farnborough, Hampshire, GU14 0LX	04586941
QinetiQ Holdings Limited, Cody Technology Park, Ively Road, Farnborough, Hampshire, GU14 0LX	04154556
QinetiQ Limited, Cody Technology Park, Ively Road, Farnborough, Hampshire, GU14 0LX	03796233
BAE Systems Marine (Holdings) Limited, Warwick House, PO Box 87, Farnborough Aerospace Centre, Farnborough, Hants, GU14 6YU	01957765

Departmental Group – Dividends from Investments

10.11 The following dividends are shown as income in Note 6.

	2014-15 £000	2013-14 £000
Defence Science Technology Laboratory	12,700	11,000
UK Hydrographic Office*	69,419	28,091
Defence Support Group	15,000	7,000
Other	5,500	1,800
Total	**102,619**	47,891

*The figure for 2014-15 includes a £50M equity withdrawal from UKHO.

11. Departmental Group – Impairments 2014-15

Details of impairments and impairment reversals through Net Operating Costs and Other Comprehensive Expenditure, for the year, are:

	Net Operating Cost Impairment £000	Net Operating Cost Impairment Reversal £000	Other Comprehensive Expenditure Impairment £000	Other Comprehensive Expenditure Impairment Reversal £000
Intangibles	7,363	-	-	-
Land	160,300	(303,742)	-	-
Property	651,551	(241,647)	-	-
Single Use Military Equipment (SUME)	305,081	(313,096)	-	-
Plant & machinery	96,533	(4,793)	-	-
Transport	17,198	(99)	-	-
IT	5,619	(156)	-	-
Assets under construction	40,050	(3,109)	-	-
Assets held for sale	22,915	-	-	-
	1,306,610	**(866,642)**	-	-

12. Departmental Group – PPE Assets Held For Sale

The Department has the following non-current assets held for sale:

	Property £000	Plant and Equipment £000	Total £000
Balance as at 1 April 2013	31,803	9,705	41,508
Additions (transfers in)	203,859	2,688	206,547
Disposals	(42,579)	(6,516)	(49,095)
Revaluation	(148,654)	1,269	(147,385)
Balance as at 31 March 2014	**44,429**	**7,146**	**51,575**
Additions (transfers in)	224,547	82,599	307,146
Disposals	(85,506)	37	(85,469)
Revaluation	(93,932)	(20)	(93,952)
Balance as at 31 March 2015	**89,538**	**89,762**	**179,300**

Disposal of plant and equipment is managed through the Disposal Services Authority. Disposal of property is managed by Defence Infrastructure Organisation. Assets are held at the lower of market value or net book value with any movement in valuation taken to the revaluation reserve up to historic cost and then to Net Operating Cost as an impairment. Asset disposals include property assets overseas handed back to host nations , for which receipts are expected in future periods. Costs of impairing the assets to the net realisable value were charged to the operating costs statement and are included in Note 5 – Other Programme Costs.

13. Departmental Group – Inventories

To conduct its activities across the world, on operations and standing commitments, the Armed Forces require a wide range of supplies and spares for immediate and potential use. A large part of these supplies and spares are recorded on the inventory accounting systems and comprise over 750,000 different types and around 900 million items. The type and range of items accounted for include: Guided Weapons, Missiles and Bombs and significant equipment spares (e.g. aircraft engines), which are reported in the accounts at Note 8 as part of the Single Use Military Equipment figures; as well as raw materials and consumable items which are reported in the table below:

	31 March 2015 £000	31 March 2014 £000
Munitions	**1,417,931**	1,761,729
Clothing & textiles	**384,936**	396,293
Engineering & technical	**2,540,221**	2,656,965
General	**2,238,727**	2,154,776
Medical, dental & veterinary	**49,758**	48,767
Oil, fuel & lubricants	**175,326**	272,970
Inventory held by ALBs	**8,395**	8,596
Total	**6,815,294**	7,300,096

13.1 Where MOD has a Memorandum of Understanding with another country, inventory (including major components such as gas turbines and other supporting inventory) belonging to and held on behalf of that country is included in MOD's inventory systems. The assets may physically be at the contractor, in stores or both. The value of these items is not included in the figures above.

14. Trade Receivables and Other Current Assets

14.1 Analysis of receivables by type:

	31 March 2015		31 March 2014	
	Core Department & Agencies £000	Departmental Group £000	Core Department & Agencies £000	Departmental Group £000
Amounts falling due within one year:				
Trade receivables	298,711	309,733	198,398	199,173
Deposits and advances	83,128	83,128	5,861	5,861
Value Added Tax	573,317	576,848	520,789	521,209
Other receivables	379,903	387,114	223,323	226,108
Staff loans and advances*	66,415	66,655	53,739	53,989
Prepayments and accrued income	942,515	947,639	1,048,431	1,053,336
Current part of Service Concession Arrangement prepayment	27,236	27,236	5,236	5,236
Under issue of Supply from the Consolidated Fund	-	-	145,349	145,349
	2,371,225	**2,398,353**	2,201,126	2,210,261
Amounts falling due after one year:				
Trade receivables	71,338	71,338	103,755	103,755
Other receivables	103,591	103,591	87,858	109,358
Staff loans and advances*	93,249	93,249	70,988	70,988
Prepayments and accrued income	338,474	338,474	452,078	452,078
ALB Pension Assets	-	183,700	-	178,622
	606,652	**790,352**	714,679	914,801
Total Receivables	**2,977,877**	**3,188,705**	2,915,805	3,125,062

* Staff loans and advances includes loans for house purchase. The number of staff with house purchase loans was 15,777 (2013-14:14,839).

The Department holds cash in accounts with foreign governments due to contractual requirements to trade with defence contractors through foreign military sales. These have been recognised as prepayments.

14.2 Departmental Group – Additional analysis of receivables balances:

	Amounts falling due within one year		Amounts falling due after more than one year	
	31 March 2015 £000	31 March 2014 £000	31 March 2015 £000	31 March 2014 £000
Balances with other central government bodies	601,979	696,477	243	568
Balances with local authorities	336	273	2	3
Balances with NHS Trusts	1,286	4,317	1,453	-
Balances with public corporations and trading funds	27,083	31,281	71	-
Subtotal: intra-government balances	630,684	732,348	1,769	571
Balances with bodies external to government	1,767,669	1,477,913	788,583	914,230
Total Receivables	**2,398,353**	2,210,261	**790,352**	914,801

15. Cash and Cash Equivalents

	Core Department & Agencies £000	Departmental Group £000
Balance at 31 March 2014	930,897	1,013,971
Net change in cash and cash equivalents	211,178	222,925
Balance at 31 March 2015	**1,142,075**	**1,236,896**

The following balances were held at:	**31 March 2015 £000**	31 March 2014 £000
Government Banking Service	575,715	370,089
Commercial Banks and Cash in Hand	661,181	643,882
Totals	**1,236,896**	1,013,971

The commercial banks and cash in hand figure as at 31 March 2015 includes £721M (31 March 2014: £610M) 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 payables due within one year.

16. Trade Payables and Other Current Liabilities

16.1 Analysis of payables and other liabilities by type:

	31 March 2015		31 March 2014	
	Core Department & Agencies £000	Departmental Group £000	Core Department & Agencies £000	Departmental Group £000
Amounts falling due within one year:				
VAT	93,171	93,171	35,188	35,508
Other taxation and social security	191,406	193,068	183,226	184,501
Trade payables	468,122	475,157	535,897	540,202
Other payables*	1,813,519	1,816,691	1,906,795	1,907,615
Payments received on account	2,769	14,829	2,523	15,466
Accruals and deferred income	6,522,841	6,573,367	6,322,254	6,364,084
Current part of finance leases	8,351	8,351	8,458	8,458
Current part of imputed finance lease element of Service Concession Arrangement contracts	263,930	263,930	256,498	256,498
Current part of NLF loans**	2,554	2,554	2,444	2,444
Supply Payable***	420,983	420,983	-	-
	9,787,646	**9,862,101**	9,253,283	9,314,776
Amounts falling due after one year:				
Other payables	63,578	63,710	117,142	117,342
Accruals and deferred income	84,965	84,965	152,912	152,912
Finance leases	1,780,500	1,780,500	1,788,436	1,788,436
Imputed finance lease element of Service Concession Arrangement contracts	4,682,800	4,682,800	4,281,163	4,281,163
NLF loans**	27,881	27,881	30,434	30,434
ALB pension schemes' liabilities	-	181,500	-	170,726
	6,639,724	**6,821,356**	6,370,087	6,541,013
Total Payables	**16,427,370**	**16,683,457**	15,623,370	15,855,789

*Other payables 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 £721M (2013-14: £610M).
**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.
***Amounts received from the Consolidated Fund for supply but not spent as at 31 March 2015.

16.2 Departmental Group – Additional analysis of payables and other liabilities:

	Amounts falling due within one year		Amounts falling due after more than one year	
	31 March 2015 £000	31 March 2014 £000	31 March 2015 £000	31 March 2014 £000
Balances with other central government bodies	443,174	336,250	-	-
Balances with local authorities	4,162	842	-	-
Balances with NHS Trusts	1,047	3,023	-	-
Balances with public corporations and trading funds	191,000	216,885	-	-
Subtotal: intra-government balances	639,383	557,000	-	-
Balances with bodies external to government	9,222,718	8,757,776	6,821,356	6,541,013
Total Payables	**9,862,101**	**9,314,776**	6,821,356	6,541,013

17. Departmental Group – Employee Benefits – Pension Schemes

17.1 The Armed Forces and the majority of the Department's staff are members of one of the following pension schemes: The Armed Forces Pension Scheme, The Principal Civil Service Pension Scheme, The NHS Pension Scheme or the Teachers' Pension Scheme. The pension liabilities, any assets and the costs of running these schemes are not included in these accounts (with the exception of the costs of administrating the Armed Forces Pension Scheme which forms a part of the Department's expenditure). Separate accounts are published for these schemes, details can be found at:
https://www.gov.uk/pensions-and-compensation-for-veterans;
http://www.civilservice.gov.uk/pensions;
http://www.education.gov.uk/schools/careers/payandpensions; and
http://www.nhsbsa.nhs.uk/pensions.

17.2 Other employees are members of smaller pension schemes e.g. schemes for Locally Employed Civilians overseas. Estimates of the liabilities (and assets where applicable) for these schemes are included in the accounts as set out in the tables below.

17.3 Value of (liabilities) of schemes included in the accounts as part of the overall provision for liabilities and charges:

	2014-15 £000	2013-14 £000
United Kingdom Departments Gibraltar Pension Scheme (Unfunded)	**(299,500)**	(263,100)
Sovereign Base Administration Areas Pension Scheme Cyprus (Unfunded)	**(93,000)**	(75,900)
British Forces Cyprus Fire Service Pension Scheme (Unfunded)	**(43,000)**	(35,200)
Total	**(435,500)**	(374,200)

The Schemes were valued by the Government Actuary's Department as at 31 March 15

17.4 Value of assets and (liabilities) of schemes included in the accounts as part of the overall balances for receivables and payables:

	As at 31 March 2015			As at 31 March 2014		
	Assets £000	(Liabilities) £000	Surplus/ (Deficit) £000	Assets £000	(Liabilities) £000	Surplus/ (Deficit) £000
Reserve Forces and Cadets Associations Pension Scheme (Funded)*	**97,700**	**(86,100)**	**11,600**	96,622	(85,826)	10,796
Commonwealth War Graves Commission Superannuation Scheme (Funded)**	**86,000**	**(95,400)**	**(9,400)**	82,000	(84,900)	(2,900)
Total	**183,700**	**(181,500)**	**2,200**	178,622	(170,726)	7,896

* The latest valuation of the Reserve Forces and Cadets Association Pension Fund was completed as at 1 August 2012.
** The funded defined benefit scheme was closed to new members in 2012-13 and a new defined contribution scheme was opened. The latest valuation of the closed scheme was completed as at 28 February 2015.

17.5 The Department also makes payments to The Merchant Navy Rating Pensions Fund; a funded, multi-employer defined benefit scheme for which the Department can not reliably estimate its share of the assets and liabilities. The scheme is closed to new members and the payments are the Department's agreed long term contribution towards the overall scheme deficit. The liability for payments (£16M) are included in the accounts based on the latest actuarial valuation as at 31 March 2008.

17.6 The numbers of members in these smaller schemes are:

	Active	Pensioners	Deferred Pensioners
United Kingdom Departments Gibraltar Pension Scheme	589	1,569	308
Sovereign Base Administration Areas Pension Scheme Cyprus	332	151	-
British Forces Cyprus Fire Service Pension Scheme	115	69	-
Reserve Forces and Cadets Associations Pension Scheme	824	1,127	298
Commonwealth War Graves Commission Superannuation Scheme	190	408	169
Total	2,050	3,324	775

18. Provisions for Liabilities and Charges

18.1 Departmental Group – Provisions for Liabilities and Charges

	Nuclear Decommissioning £000	Other Decommissioning and Restoration Costs £000	Early Retirement Commitments £000	Other Provisions: Pension £000	Other Provisions: Legal £000	Other Provisions: Other £000	Total £000
At 1 April 2013	3,733,224	43,030	111,120	344,400	447,375	184,190	4,863,339
Increase in provisions in-year	218,294	196	32,175	9,962	131,195	105	391,927
Provisions written back and reclassifications	(201,139)	(3,610)	(5,958)	(12,300)	(83,565)	(162,980)	(469,552)
Provisions utilised in year	(66,519)	(1,997)	(25,362)	(12,962)	(91,034)	(5,498)	(203,372)
Unwinding of discount	32,728	(61)	3,545	45,100	(4,423)	99	76,988
Provisions capitalised	(128,528)	-	-	-	-	-	(128,528)
At 31 March 2014	**3,588,060**	**37,558**	**115,520**	**374,200**	**399,548**	**15,916**	**4,530,802**
Increase in provisions in-year	439,280	31,010	21,472	34,891	144,105	37,221	707,979
Provisions written back and reclassifications	(77,460)	(1,527)	(5,394)	(19,200)	(17,894)	(8,798)	(130,273)
Provisions utilised in year	(95,183)	-	(17,039)	(12,191)	(92,909)	(1,853)	(219,175)
Unwinding of discount	93,035	(50)	3,064	57,800	(2,586)	(65)	151,198
Provisions capitalised	50,475	-	-	-	-	-	50,475
At 31 March 2015	**3,998,207**	**66,991**	**117,623**	**435,500**	**430,264**	**42,421**	**5,091,006**

18.2 Analysis of expected timing of discounted cash flows

	Nuclear Decommissioning £000	Other Decommissioning and Restoration Costs £000	Early Retirement Commitments £000	Other Provisions £000	Total £000
Due within 1 year	151,708	16,669	31,760	160,104	360,241
Due over 1 year and less than 5 years	657,791	49,579	39,101	292,169	1,038,640
Due over 5 years	3,188,708	743	46,762	455,912	3,692,125
At 31 March 2015	**3,998,207**	**66,991**	**117,623**	**908,185**	**5,091,006**

Nuclear Decommissioning

18.3 Changes in the cost estimates of discharging the nuclear provisions (representing an increase or decrease in future decommissioning costs, less under or overspend of decommissioning delivered in year) are charged to the Statement of Comprehensive Net Expenditure. This charge includes the impact of restating liabilities from March 2014 values to current price levels. Actual costs incurred in discharging provisions in the year to 31st March 2015 have been charged against the provision.

18.4 In applying accounting policies it is necessary to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Where costs have been derived using a confidence model, the 50% value has been used as this represents most likely cost. Where costs have been calculated using a deterministic method the most likely value has been used as the basis for valuing the long term liability.

18.5 The nuclear provisions are based on the most recently available estimates discounted in line with HM Treasury guidance. The current discount rates are: a short term rate applicable to years 0-5 (-1.5%); a medium term rate for the period after 5 years and up to 10 years (-1.05%); and a long term rate for the period over 10 years (2.2%). These liabilities are necessarily based on assumptions around the processes and methods most likely to be used to discharge the obligations reflecting a combination of the latest technical knowledge available, the most up to date assumptions for the volume of waste to be decommissioned, the type of waste to be decommissioned (Low, Intermediate or High Level Waste), the timescales involved and the requirements of the existing regulatory regime, Government policy and commercial arrangements.

18.6 The uncertainties that surround nuclear provisions mean that quantifying the financial impact of changes to assumptions is very difficult. For example, in the strategic weapons area (which accounts for approximately a third of the nuclear decommissioning provision) a change in the discount rate of plus or minus 0.1% would result in a change in the value of the liability of between plus £23M and minus £22M.

18.7 For decommissioning operations with an end date, costs have been calculated to that date; for operations of an ongoing nature (e.g. storage of materials) costs have been calculated for a period of 150 years as the impact of discounting means that the discounted value of costs beyond this period are considered to be immaterial.

18.8 Nuclear decommissioning provisions relate principally to: the cost of decommissioning facilities and equipment, the treatment and storage of nuclear materials and waste, and the long term management of irradiated submarine fuel. These nuclear liabilities have arisen from operations at MOD sites and the operation of Royal Navy submarines. The liabilities include the costs associated with decommissioning including care and maintenance of redundant facilities (the conditioning, retrieval and storage of contaminated materials), and the procurement of facilities to handle the various waste streams. In September 2011 the Department published the initial version of its Nuclear Liabilities Management Strategy which sets the overall context for the establishment of decommissioning provisions. MOD is working closely with bodies such as the Nuclear Decommissioning Authority (NDA) to refine the assumptions underpinning its provisions. The following provides further details in respect of strategic weapons, submarines and nuclear propulsion provisions, which account for a significant element of the provision balances. The remaining nuclear decommissioning provisions are individually immaterial:

- MOD holds provisions for the decommissioning of facilities and materials relating to the nuclear warhead programme. The largest of which relates to AWE. A quinquennial review was carried out in 2012 to support the valuation of this provision and following the most recent annual review the carrying value was increased by £87M.

- Provisions are held for the decommissioning of all nuclear submarines. These provisions cover the safe storage and maintenance of the boats before they are processed through the Submarine Dismantling Project (SDP). An interim shortlist of sites for the SDP facility was announced in February 2014.

- The Department also holds provisions for the safe storage and management of irradiated fuel arising from the out of service submarines and for the decommissioning of sites used for this purpose. This includes the decommissioning of the Vulcan site which houses prototypes of nuclear propulsion plants operated by the Royal Navy.

18.9 The Department's nuclear decommissioning provisions are inter-linked and closely aligned. One of the key assumptions underpinning these provisions is the availability of the Geological Disposal Facility (GDF) as the end storage point for MOD's nuclear materials. The construction of the Facility is managed by the NDA and MOD is working with the Department of Energy and Climate Change (DECC) and the NDA to refine the assumptions and valuation of its liability for the GDF. There are significant uncertainties surrounding the GDF. MOD's provision aims to reflect NDA's current working assumptions, which continues to assume that the GDF will be available from around 2040. If the Facility is not available until after this period, additional storage costs would be incurred by MOD for a longer period. As the NDA assumptions have yet to be revalidated it is not possible to quantify the financial effect on MOD's provisions.

Other Decommissioning and Restoration

18.10 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 rates listed at paragraph 18.5.

Early Retirement Pensions

18.11 Prior to December 2010, for those employees covered by the Civil Service Compensation Scheme who retired early, the Department met the additional costs of benefits beyond the normal civil service pension scheme benefits 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 applicable to such provisions: 1.3% with effect from 31 March 2015 (1.8% from 31 March 2014). Following changes in December 2010, employees who retire early do so on a 'clean break' basis so no provision is required as there are no costs in future years. During 2014-15 increases of £1.5M were made to existing schemes and new provisions included £20M for planned early release of individuals from the Department Information Systems Service organisation. Early retirement / redundancy costs charged to provisions during the period amounted to £17M.

Other

18.12 Other provisions consist of: Pension, Legal and Other liabilities. Pension liabilities are in respect of three schemes for Locally Employed Civilians (the United Kingdom Departments Gibraltar Pension Scheme; the Sovereign Base Administration Areas Pension Scheme Cyprus; and the British Forces Cyprus Fire Service Pension Scheme). Legal liabilities include amounts payable under guarantees, litigation and contractual arrangements; some legal liabilities (where the probability of settlement against the Department is low) have been apportioned to contingent liabilities. Other provisions include provisions for costs on disposal of non-current assets and redundancy and relocation costs associated with restructuring.

19. Departmental Group – Capital Commitments

Capital commitments, for which no provision has been made in these financial statements, are:

	31 March 2015 £000	31 March 2014 £000
Intangible assets	3,245,488	2,785,099
Property, plant and equipment	16,610,592	11,733,171
	19,856,080	14,518,270

20. Departmental Group – Commitments Under Leases

The totals of future minimum lease payments under operating and finance leases for the periods: not later than one year; later than one year but less than five years and later than five years are set out below:

20.1 Operating leases:

Obligations under operating leases comprise:	31 March 2015 £000	Restated 31 March 2014* £000
Land		
Not later than one year	19,026	5,156
Later than one year and not later than five years	31,318	16,469
Later than five years	154,211	115,726
	204,555	137,351
Buildings		
Not later than one year	54,952	64,952
Later than one year and not later than five years	125,828	167,617
Later than five years	100,811	165,503
	281,591	398,072
Other		
Not later than one year	124,444	114,928
Later than one year and not later than five years	243,310	234,612
Later than five years	43,516	42,742
	411,270	392,282

20.2 Land Operating Lease commitments, as at 31st March 2015 include: The Royal Armoured Corps Gunnery School (£43M) in Dorset, Aldershot Health Centre (£43M), St. George's Court (£13M) in London, and Okehampton Training Camp (£13M) in Devon.

The most significant Buildings Operating Lease commitments, as at 31st March 2015 are Service Families Accommodation (£48M), Walker House (£17M) in Liverpool and Farnborough Airfield (£6M).

Other Operating Lease Commitments include Operational Support Vehicles (£233M), ScanEagle (£21M), Fuel Tankers (£10M) and the HMS Clyde charter arrangement (£10M); the remaining Operating Lease Commitments are less than £10M.

20.3 Finance leases:

Obligations under finance leases comprise:	31 March 2015 £000	31 March 2014 £000
Land		
Not later than one year	48,042	48,042
Later than one year and not later than five years	192,168	192,168
Later than five years	8,644,998	8,695,603
	8,885,208	8,935,813
Less interest element	(8,039,063)	(8,087,104)
	846,145	848,709
Buildings		
Not later than one year	47,848	47,848
Later than one year and not later than five years	191,392	191,392
Later than five years	8,612,649	8,658,184
	8,851,889	8,897,424
Less interest element	(8,006,609)	(8,054,455)
	845,280	842,969
Other		
Not later than one year	15,018	20,217
Later than one year and not later than five years	55,820	76,507
Later than five years	63,382	90,598
	134,220	187,322
Less interest element	(36,793)	(43,791)
	97,427	143,531

The most significant finance lease is the land and buildings lease with Annington Homes Ltd for homes for service personnel and their families.

21. Departmental Group – Commitments Under Service Concession Arrangements

21.1 All PPP / PFI arrangements have been assessed in accordance with IFRIC 12 – Service Concession Arrangements as adopted by HM Treasury. Any arrangements not fulfilling the criteria for IFRIC 12 have subsequently been assessed against IFRIC 4 (Determining whether an arrangement contains a lease) and IAS 17 (leases). The following arrangements fulfilled the criteria for IFRIC 12 and the assets have been accounted for as assets of the Department:

Project Description	Contract Start*	Contract End
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.	Jul-97	Dec-49
Medium Support Helicopter Aircrew Training Facility: Provision of 6 flight simulator training facilities, covering three different types of helicopter, at RAF Benson.	Oct-97	Oct-37
Hawk Synthetic Training Facility: Provision of replacement simulator training facilities at RAF Valley.	Dec-97	Dec-15
Veolia PFI (formerly Thames Water and Tidworth Water and Sewage): Pathfinder project providing water, sewerage and surface water drainage at Tidworth.	Feb-98	Aug-18
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.	Jun-98	Aug-28
RAF Lossiemouth Family Quarters: Redevelopment and re-provision of 279 Service family quarters.	Jun-98	Aug-20
Attack Helicopter Training Service: Provision of full mission simulator, 3 field deployable simulators, ground crew, maintenance and armament training.	Jul-98	Sep-17
Family Quarters Yeovilton: Provision of married quarters accommodation for 88 Service families at RNAS Yeovilton.	Jul-98	Jul-28
RAF Lyneham Sewage Treatment: Refurbishment of existing sewage treatment facilities, to meet regulatory standards at RAF Lyneham.	Aug-98	Aug-23
RAF Fylingdales: Provision of guaranteed power supply.	Dec-98	Mar-24
RAF Cosford/RAF Shawbury Family Quarters: Provision of married quarters accommodation for 145 Service families at RAF Cosford and RAF Shawbury.	Mar-99	Jun-25
Fire Fighting Training Units: Provision of fire fighting training for the Royal Navy.	Apr-99	Jan-21
Tornado GR4 Synthetic Training Service: Provision of aircraft training service at RAF Marham and RAF Lossiemouth.	Jun-99	Jun-31
Central Scotland Family Quarters: Provision of married quarters accommodation for 164 Service families in Central Scotland.	Aug-99	Jan-21
Army Foundation College: Provision of teaching and training facilities for the further vocational education and military training of high-quality school leavers.	Feb-00	Dec-29
Main Building Refurbishment: Redevelopment and management services for MOD Main Building.	May-00	May-30
E3D Sentry Aircrew Training Service: E3D Sentry simulators instructors and maintainers at RAF Waddington.	Jul-00	Dec-30
Lynx MK 7 and 9 Aircrew Training Service: Provision for simulator training facility for Lynx MK 7 and 9 helicopter aircrew.	Jul-00	Jul-25
Family quarters at Wattisham: Provision of married quarters accommodation for 250 Service families.	May-01	Mar-28
Astute Class Training: Provision of a training environment for crewmen and maintainers to support Astute Class submarines for 30 years.	Sep-01	Sep-37
Defence Housing Information Systems: Provision of a management information system for Defence Housing.	Oct-01	Sep-14
Family quarters at Bristol/Bath/Portsmouth: Provision of accommodation for 317 Service families.	Nov-01	Sep-28
Heavy Equipment Transporters: Provision of vehicles to replace existing fleet and meet future requirements.	Dec-01	Jul-24
Field Electrical Power Supplies: Provision of generator sets to support operational electrical requirements in the field.	Jun-02	Jun-22
Flight Simulation and Synthetic Trainers: Provision of a Flight Simulation and Synthetic Trainers Integrated Aircrew Synthetic Training Service.	Oct-02	Mar-17
Aquatrine Project A: Provision of water and waste water services.	Apr-03	Nov-28
Naval Communications: Submarine fleet communications service.	Jun-03	Dec-30
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.	Jun-03	Aug-28
Skynet 5: Range of satellite services, including management of existing Skynet 4 satellites.	Oct-03	Aug-22
Colchester Garrison: Redevelopment, rebuilding and refurbishment to provide accommodation and associated services (messing, education, storage, workshops).	Feb-04	Feb-39
Devonport Armada Single Living Accommodation: Provision of Support Services and Fleet Accommodation Centre services at Devonport Naval Base.	Jul-04	Mar-29
Aquatrine Project B: Provision of water and waste water services.	Sep-04	Mar-30
Aquatrine Project C: Provision of water and waste water services.	Oct-04	Mar-30

Project Description	Contract Start*	Contract End
C Vehicles: Provision of Earthmoving and Specialist Plant, Engineer Construction Plant and Material Handling Equipment and support services.	Jun-05	May-21
Portsmouth 2 Housing: Provision of 148 Family quarters in Portsmouth.	Oct-05	Oct-30
Project Allenby/Connaught: Rebuild, refurbishment, management and operation of facilities for Service accommodation at Aldershot, Tidworth, Bulford, Warminster, Larkhill and Perham Down.	Mar-06	Apr-41
Northwood: Rebuild, refurbishment, management and operation of facilities for the Permanent Joint Headquarters.	Jul-06	Oct-31
Combined Aerial Targets (CATS): Provision of aerial targets and associated ground equipment and support services.	Dec-06	Mar-28
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.	Dec-07	Nov-22
Future Strategic Tanker Aircraft (FSTA): FSTA is an innovative PFI programme that will provide modern air-to-air refuelling and passenger air transport capabilities.	Mar-08	Mar-35
UK Military Flying Training System: Advanced Jet Trainer, Ground Based Training Equipment Element: Management and provision of Fast Jet Phase IV training.	May-08	May-33
Corsham Development Project: Rebuild, refurbishment, management and operation of facilities at the Basil Hill site.	Aug-08	Jul-33

*Date when contract signed.

21.2 The substance of an arrangement accounted for under IFRIC 12 is that the Department has a finance lease with the provider with payments comprising an imputed finance lease charge, a repayment of capital and a service charge. Payments are accounted for within the Statement of Comprehensive Net Expenditure – Service Concession Arrangements (SCA) and charges for 2014-15 were £1.46Bn (2013-14: £1.43Bn). Total obligations under SCA (consisting of the minimum lease payments, interest and any minimum service charges) analysed by time periods are shown in the tables below:

Details of the imputed finance lease charges	31 March 2015 £000	31 March 2014 £000
Not later than one year	559,622	526,870
Later than one year and not later than five years	2,039,065	1,860,669
Later than five years	4,986,261	4,523,903
	7,584,948	6,911,442
Less interest element	(2,638,218)	(2,373,780)
Present value of obligations	**4,946,730**	4,537,662

Details of the minimum service charge	31 March 2015 £000	31 March 2014 £000
Not later than one year	1,265,121	1,353,239
Later than one year and not later than five years	3,887,245	4,063,095
Later than five years	9,149,174	10,310,016
	14,301,540	15,726,350

22. Departmental Group – Contingent Liabilities and Contingent Assets Disclosed Under IAS 37

Contingent Liabilities

22.1 The following quantifiable contingent liabilities have been identified:

Description	Liability as at 31 March 2015	Amount reported to Parliament by Departmental Minute
Restricted - not disclosed due to reasons of commercial confidentiality and / or national security	723,456	723,456
Indemnity to contractors for loss or damage to Offshore Patrol Vessels during construction and trials	282,000	282,000
Indemnity for possible damage to aircraft or hangars caused by contractors	172,000	172,000
Indemnity to contractors in respect of nuclear risks and decontamination	140,000	140,000
Indemnity to contractors for third party risks	140,000	140,000
Statutory liability for International Military Sales	100,000	100,000
Legal claims (personal)	43,346	43,346
Environmental clean up costs	39,802	39,802
Early termination of leases relating to property in Germany	30,000	30,000
Liability for redundancy following contractorisation	24,064	24,064
Indemnity for utilities and services following the sale of Service housing	17,031	17,031
Capital works on the Government of Gibraltar electricity network	3,858	3,858
Contractor claims relating to project deferment or termination	500	500
Total quantifiable contingent liabilities	**1,716,057**	**1,716,057**

The Department has the following unquantifiable liabilities in accordance with IAS 37.

- Indemnities to AWE Management Ltd for nuclear and non-nuclear risks.
- Indemnities to Rolls-Royce for risks associated with the handling of fissile materials and other non-nuclear risks.
- Standard shipbuilding indemnity in respect of Vanguard and Astute class submarines.
- Indemnity related to potential damages awarded following sale of electromagnetic spectrum.
- Potential further and higher education costs for service personnel under the Enhanced Learning Credit Scheme.
- Indemnity for early termination of the Forces Broadcasting Service contract.
- Indemnity for live firing of missiles at overseas ranges.
- Indemnities to the Government of Gibraltar related to transfer of electricity generation facilities
- Service Life Insurance – providing access to life insurance for service personnel. Details of the scheme and key features can be found at https://www.sli365.com.
- Guarantee to NAAFI that the Department will reimburse 90% of their additional costs arising from any changes in MOD's service requirements.
- The Department has a number of sites where it may be necessary to carry out decontamination work. As it is not practicable or cost effective to identify all contamination at those sites, any possible liability is not quantifiable, so possible site remediation exposure is recognised as an unquantifiable contingent liability.

- Strategic Weapons System Activities Future Delivery Project outsourced contract includes an indemnity for Non Nuclear events.
- Indemnity to contractors for potential third party risks arising from construction of the Queen Elizabeth carriers.
- Indemnity in respect of US Government owned equipment and related guided weapons' trials.
- Indemnity for non-nuclear events at HMNB Clyde.

Contingent liabilities not required to be disclosed under IAS 37

22.3 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 IAS 37 as the likelihood of a transfer of economic benefit in settlement is too remote.

Quantifiable – unrestricted

Unrestricted – Indemnities	1 April 2014 £000	Increase / (Decrease) in year £000	Liabilities crystallised in year £000	Obligation expired in year £000	31 March 2015 £000	Amount reported to Parliament by Departmental Minute £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 museums of the Royal Navy, Army and Royal Air Force	2,456	142	-	-	2,598	2,598
Indemnity to Help for Heroes and Royal British Legion should recovery centres have a change in use within ten years	4,889	-	-	-	4,889	4,889
Remediation costs associated with the discovery of unknown environmental contamination at the Fleetlands site	17,000	-	-	-	17,000	17,000
Government Pipeline and Storage System (GPSS) - compensation for loss of rights	5,456	-	-	-	5,456	5,456
Government Pipeline and Storage System (GPSS) - compensation to landowners	100	50	-	-	150	150
Potential redundancy costs for employees at the Defence College of Technical Training	-	1,900	-	-	1,900	1,900
Fair Deal for Staff Pensions: staff transfers from Central Government	-	187	-	-	187	187

Unquantifiable – unrestricted

22.4 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 IAS 37 as 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 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 residual 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.
- Indemnity for contractors under standard contract terms for Joint Operational Fuel Systems and F3EA (Find, Fix, Finish, Exploit, Analyse) contracts.
- Indemnities under standard terms to contractors for contractors' personnel on Government premises for United Kingdom Air Surveillance Command and Control System (UCCS), Flight Plan Distribution System (FPDS), Sensors Support Optimisation Project and the Puma Mark 2 Helicopter Interim Support Arrangement.
- Indemnity under standard terms to contractors for the CERBERUS project.
- Indemnity to contractors for the Data Link Processor System (DLPS) post design services contract.
- Indemnity to contractor for repair of specialist communication systems.
- The Department has offered an indemnity under standard terms to the operator of the Apache helicopter integrated operational support contract.
- Indemnity in respect of nuclear risk in support of framework contracts under Next Generation Estate Contracts.

Quantifiable and Unquantifiable – restricted

22.5 Details of restricted indemnities are not given due to reasons of commercial confidentiality and / or national security.

23. Financial Guarantee Contracts

The Department has entered into two financial guarantee contracts, neither of which is a contingent liability within the meaning of IAS 37 since the likelihood of transfer of economic benefit in settlement is too remote. The probability of payments under these guarantees is very low and the likely liability (fair value) as at year end is assessed as nil. Details of the guarantees are:

- Under the terms of the contract with TNT Ltd for the Government Records Management and Archive Service, MOD guarantees to pay the operator should any other government department fail to settle its outstanding invoices. The total value of invoices outstanding against all government departments as at 31 March 2015 was nil.
- MOD provides an indemnity to towage companies who are contracted to tow foreign warships in to UK ports, should the foreign nation default on payment of the invoice.

24. Departmental Group – Losses and Special Payments

24.1 Losses – Closed Cases

CLOSED CASES: these are losses that 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.	Arising in 2014-15 £000	Reported in 2013-14 as Advance Notifications £000
Total Losses (excluding gifts) under £300,000 each: 15,865 cases.	10,494	
Total Losses (excluding gifts) over £300,000 each: 19 cases (detailed below).	245,827	1,187,090
	256,321	1,187,090
Total Value of Closed Cases	1,443,411	
Details of the Closed Cases over £300,000 are:		
Bookkeeping Losses		
Write-off of unsupported balances. The loss consists of balances that could not be verified with the information available. This loss consists of three cases.	177,393	
	177,393	-
Stores Losses		
Loss of two Tornado aircraft after an accident over the Moray Firth.		23,502
Stores discrepancies identified during stock takes at RAF Marham and Gibraltar.	482	7,327
An RAF HS125 aircraft taken out of service early due to damage sustained during a hailstorm.		347
	482	31,176
Fruitless Payments		
Incorrect recording of Merlin aircraft component lives has resulted in a fruitless payment.		20,995
Ear Defence System found to be not fit for purpose on Operations.		5,769
Interest payment due to HM Revenue & Customs on a tax liability for Locally Employed Civilians.		1,260
HM Treasury has reduced the MOD's budget for 2015-16 as a result of the Department's cash forecasting performance during 2014-15.	1,537	
HM Treasury fine for failing to seek assurance from a number of high-paid off-payroll appointees in FY2012-13 that they were paying the correct tax and National Insurance.	1,000	
A reduction in requirements resulted in an order for Lynx Tail Rotor Drive shafts no longer being needed.	582	
	3,119	28,024
Constructive Losses		
Early withdrawal from service of the Harrier aircraft fleet.		1,120,917
Decision not to deploy Counter Improvised Explosive Device equipment due to changes in the threat has resulted in a constructive loss.	61,741	
Costs incurred in a failed attempt to host the Army Recruit Partnering Project on the MOD IT network.		6,973
Costs incurred on early termination of a contract.	1,886	
Cancellation of flights because a landing permit was not granted.	843	
	64,470	1,127,890
Claims waived or abandoned		
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.	363	
	363	-

24.2 Losses – Advance Notifications

ADVANCE NOTIFICATIONS: these are losses, which arose during 2014-15 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, and the exact amount thereof, has not yet been concluded. The amounts shown below are, therefore, estimates, and it is likely that the final value of these losses will differ when they are reported as closed cases in future years. Should the final value be less than £300,000, they will not be separately identified.	Arising in 2014-15 £000	Reported in 2013-14 as Advance Notifications £000
Total Advance Notifications over £300,000 each	**56,228**	**1,306,497**
	1,362,725	
Constructive Losses		
Early withdrawal from service of 4 Type 22 Frigates.		**416,369**
Reduction in the numbers of Challenger 2 tanks, Driver Training Tanks and Challenger Armoured Repair and Recovery Vehicles.		**253,810**
Reduction in the stockpile of Storm Shadow missiles.		**173,100**
Project Soothsayer: terminated contract.		**87,778**
Reduction in the number of Sentry Aircraft.		**64,050**
Reduction in holdings of the Multi Launch Rocket System due to a change in the operational environment.		**59,725**
Reduction of the AS90 Howitzer self-propelled guns due to a change in the operational environment.		**58,573**
Cancellation of the Queen Elizabeth Class aircraft carrier conversion programme, following the decision to revert to the Short Take Off and Vertical Landing (STOVL) variant of the Joint Strike Fighter Aircraft.		**54,484**
Payments for the early surrender of leases to landlords in Germany due to the early withdrawal of Forces from Germany.	**51,161**	
Following a capability review a decision was made that the Shielder Anti-Tank mine canisters and associated vehicles were no longer required.		**43,144**
Withdrawal from the Typhoon engine In Service Support System as a review determined that the majority of the system is no longer required.		**29,620**
Reduction in the number of reconnaissance vehicles - Combat Vehicle Reconnaissance (Tracked).		**22,965**
Mobile mine detection capability for Warrior vehicles that was deemed unsuitable.		**7,200**
Reduction in the number of Warrior Armoured Fighting Vehicles.		**5,456**
Costs incurred on early termination of a contract.	**1,324**	
MOD has terminated three contracts due to non-compliance issues with the contract specifications.		-
	52,485	**1,276,274**
Fruitless Payments		
Cost of equipment damaged in 2008 and the leased replacement capability		**30,223**
Interest payment due to HM Revenue & Customs on a Value Added Tax liability.	**2,249**	
Repairs to leased equipment.	**1,494**	
	3,743	**30,223**

24.3 During the year the Department conducted a review, involving HM Treasury, of its policy on reporting losses. The exercise helped clarify policy in a number of areas including the reporting of losses resulting from military operations and training for military operations where, in the past, it is likely disclosures in respect of these operational losses have not been complete. The Department's policy has been clarified and reissued for prospective application.

24.4 Special Payments – Closed Cases

CLOSED CASES: these are special payments that 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.	Arising in 2014-15 £000	Reported in 2013-14 as Advance Notifications £000
Total under £300,000 each: 84 cases.	1,502	
Total over £300,000 each: 335 cases (detailed below).	7,091	
	8,593	-
Total Value of Closed Cases	8,593	
Details of the closed cases over £300,000 are:		
Extra contractual payments to three contractors to settle legal challenges	6,398	
War Pensions Benefit cases		
The payments detailed below were for War Disability Pensions, and were made under the authority of Treasury Dispensing Instruments but outside the scope of the Service Pension order:		
(a) 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 number of cases in 2014-15 was 232.	353	
(b) Noise Induced Sensorineural Hearing Loss:		
During financial year 2014-15 100 payments were made.	340	
	7,091	-

24.5 Special Severance Payments

During the year 15 Special Severance Payments totalling £313,000 were made. Further details (to the nearest £1,000) are:

Maximum Payment	£115,000
Median Payment	£ 10,000
Minimum Payment	£ 3,000

24.6 Special Payments – Advance Notifications

ADVANCE NOTIFICATIONS: these are special payments, which arose during 2014-15 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, and the exact amount thereof, has not yet been concluded. The amounts shown below are, therefore, estimates, and it is likely that the final value of these losses will differ when they are reported as closed cases in future years. Should the final value be less than £300,000, they will not be separately identified.	Arising in 2014-15 £000	Reported in 2013-14 as Advance Notifications £000
Total Advance Notifications over £300,000 each	23,194	-
	23,194	
Payments to former and current Service Personnel who were incorrectly subjected to disciplinary action after receiving a police caution.	19,000	
Compensation payments to service personnel due to an anomaly in the legislation that did not allow for aggregation of service when calculating payments upon departure of service.	4,194	
	23,194	-

24.7 Gifts – Closed Cases

Gifts: that have been formally handed over to the recipient	Arising in 2014-15 £000	Reported in 2013-14 as Advance Notifications £000
Total under £300,000 each: 172 cases.	62	
Total over £300,000 each: 3 cases (detailed below).	2,636	450
	2,698	450
Total Value of Gifts	3,148	
Detail of the gifts over £300,000 are:		
Two separate gifts of infrastructure to Government of Islamic Republic of Afghanistan.	1,636	
Surplus Counter Improvised Explosive Device equipment to the Government of the Islamic Republic of Pakistan.	1,000	
50 Leyland DAF 4-ton trucks plus associated spares, Land Rover vehicle components and major assemblies to The Government of Uzbekistan.		450
	2,636	450

24.8 Gifts – Advance Notifications

	Arising in 2014-15 £000	Reported in 2013-14 as Advance Notifications £000
The net proceeds from the sale of three sites in Northern Ireland to the Northern Ireland Executive.		5,500
Military equipment to the Government of Iraq.	2,075	
Non-lethal equipment to the Government of Ukraine.	844	
Surplus Counter Improvised Explosive Device equipment to the Government of Iraq.	504	
Thermal imagery equipment and quad bikes to the Government of the Republic of Kazakhstan.	402	
	9,325	

25. Related Party Transactions

25.1 The Department owned three Trading Funds during the year reducing to two (The Defence Science and Technology Laboratory and the UK Hydrographic Office) on 31 March 2015 when the land business of the Defence Support Group was sold to Babcock Land Limited. Also, as part of the sale process, the Defence Electronic Components Agency was set up with effect from 1 April 2015 – further details of the sale are at Note 10. The Oil and Pipelines Agency and The Navy Army Air Force Institutes (NAAFI) are Public Corporations. The Trading Funds and the NAAFI 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 value of transactions with these and other related parties are set out below and balances with the Trading Funds (excluding loans and dividends, which are shown at Note 10) at year end, are in the following table:

Organisation	Receivables Balances £000	Payables Balances £000
Defence Science and Technology Laboratory	2,156	166,445
UK Hydrographic Office	2,432	-

Oil and Pipelines Agency (Public Corporation)

25.2 During the year MOD paid the agency fees (excluding VAT) of: £9.6M (2013-14: £8.6M). The Department is represented on the OPA Board – further details are at: https://www.gov.uk/government/organisations/oil-and-pipelines-agency

25.3 In May 2012 the Government announced its plan to create a set of transferrable rights in respect of the Government Pipeline and Storage System (GPSS). The sale of these rights is expected to be completed in 2015-16 and the GPSS is included in these accounts as Held for Sale.

Navy Army Air Force Institutes (NAAFI)

25.4 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. Further details of the activities of the NAAFI including membership of The Council can be found at http://www.naafi.co.uk. During 2014-15 there were no receipts from NAAFI (2013-14: £Nil); payments to NAAFI were £24M (2013-14: £22M). The Department has provided NAAFI with a guarantee that it will reimburse 90% of additional costs arising from any changes in MOD's service requirements.

Executive Non-Departmental Public Bodies (NDPBs)

25.5 The following are Executive NDPBs of the MOD. They are designated NDPBs under the National Heritage Act 1983 and produce their own annual accounts. The value of the NDPBs' income, expenditure, assets and liabilities are consolidated in the accounts as part of the Departmental Group. Further details of these organisations can be found at:

- The National Museum of the Royal Navy http://www.royalnavalmuseum.org/
- National Army Museum www.national-army-museum.ac.uk
- Royal Air Force Museum www.rafmuseum.org.uk

During the year the year Grants-in-Aid (GiA) were made to: The National Museum of the Royal Navy £3.3M; the National Army Museum £5.9M and the Royal Air Force Museum £8.3M.

25.6 The Single Source Regulations Office (SSRO) is an Executive NDPB of the Department established under the Defence Reform Act 2014 with the aim of ensuring value for money is obtained for the UK taxpayer in MOD expenditure on qualifying defence contracts, and that single source suppliers are paid a fair and reasonable price under those contracts. During the year the SSRO was paid GiA of £2.8M (which includes funding for the first part of 2015-16 of £1.2M paid on 31 March 2015); in addition, during the financial year MOD incurred £0.5M of expenditure on behalf of the SSRO. Further information on the organisation is at: https://www.gov.uk/government/organisations/single-source-regulations-office

Other

25.7 The Department also pays a number of grants and grants-in-aid to other bodies included in the Departmental Group e.g. the Reserve Forces and Cadets Associations (£95M), the Commonwealth War Graves Commission (£47M) and the Royal Hospital Chelsea (£12M), as well as grants-in-aid to bodies outside the accounting boundary e.g. the Marine Society & Sea Cadets (£11M) and the Gurkha Welfare Scheme (£2M).

25.8 The MOD has also had a number of transactions with other government departments and central government bodies. These are undertaken under normal trading circumstances, at arms length, and are included in MOD's net resource outturn.

25.9 No Minister or Board Member or other related party has undertaken any material transactions with the Department during the year.

Joint Ventures

25.10 The Department has not established any Joint Ventures. Some of the Trading Funds and NDPBs 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.

26. Heritage Assets

26.1 Heritage assets are tangible assets with historical, artistic, scientific, technological, geophysical or environmental qualities that are held and maintained principally for their contribution to knowledge and culture. They are preserved in trust for future generations because of their cultural, environmental or historical associations and include: historical buildings, archaeological sites, military and scientific equipment of historical importance, museum and gallery collections and works of art.

26.2 Heritage assets display the following attributes: their value to the Government and to the public in cultural, environmental, educational and historical terms is unlikely to be fully reflected in a financial value derived from a market price; established custom and, in many cases primary statute and trustee obligations, impose prohibitions or severe restrictions on disposal by sale; they are often irreplaceable and their value may increase over time, even if their physical condition deteriorates; they may require significant maintenance expenditure to enable them to be enjoyed by future generations; and their life may be measured in hundreds of years.

26.3 Heritage assets are categorised as either operational or non-operational. Non-operational heritage assets are those which are held primarily for the purpose described above e.g. archaeological sites. Operational heritage assets are those which, in addition to being held for their characteristics as part of the nation's heritage, are also used by the Department for other activities or to provide other services e.g. historical buildings used as office accommodation.

26.4 Operational heritage assets are usually valued using the same valuation methodologies as for other assets of that general type. Non-operational heritage assets are valued where this information can be obtained at a cost commensurate with the benefits to users of the Annual Accounts. Heritage assets are not separately disclosed in the SoFP as they are not considered material.

26.5 Details of the scale and scope of some of the heritage assets, held by the Department and its ALBs can be viewed on the following websites:
http://www.nmrn.org.uk
http://www.nam.ac.uk
http://www.rafmuseum.org.uk
http://www.chelsea-pensioners.co.uk/home
https://www.gov.uk/defence-infrastructure-organisation-estate-and-sustainable-development

26.6 The Department owns a range of non-operational heritage assets. 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. Assets may, for example, be valued when loaned to other organisations as occurred in 2012-13 when artefacts valued at £75M were loaned to the National Maritime Museum.

26.7 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
Records and artworks	London, Gosport, Stanmore	The Admiralty and Institute of Naval Medicine Libraries and the Air Historical Branch (RAF) comprise text and records of historical and research items. Although not open to the public, access is available on application.
Artefacts, records and artworks	Various locations	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. Further information is available at: http://www.armymuseums.org.uk
Battle of Britain Memorial Flight	RAF Coningsby	Further information is available at: http://www.raf.mod.uk/bbmf

27. Entities Within the Departmental Boundary

The entities within the boundary during 2014-15 were as follows:

Defence Equipment and Support (Bespoke Trading Entity)

Advisory Non-Departmental Public Bodies

Advisory Committee on Conscientious Objectors

Advisory Group on Military Medicine

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

Science Advisory Committee on the Medical Implications of Less Lethal Weapons

Veterans Advisory and Pensions Committees

Executive Non-Departmental Public Bodies

National Museum of the Royal Navy

National Army Museum

Royal Air Force Museum

Single Source Regulations Office

Other Bodies

Commonwealth War Graves Commission

Independent Monitoring Board for the Military Corrective Training Centre, Colchester

Royal Hospital, Chelsea

Territorial, auxiliary and volunteer reserve associations established under section 110 of the Reserve Forces Act 1996

Note: The Defence Electronic Components Agency was established on 1 April 2015 as an on-vote Agency and will be included in the 2015-16 Annual Report and Accounts.

28. Events After the Reporting Date

28.1 There are no events after the reporting date. These accounts have been authorised for issue by the Accounting Officer on the same date as the C&AG's Audit Certificate.

Supplementary Information

Annex A

Defence in the Public Eye

A.1 In 2014-15, we continued to work hard to ensure that Parliament, the public, the media, and other stakeholders understand our role, what we do, and why we do it. The results of independent public opinion polling conducted on our behalf show that the British population continues to be highly favourable towards the UK Armed Forces. The reputation of the MOD has continued to improve steadily and that of the individual Services remains at a high level.

A.2 The MOD has conducted surveys of public opinion on an annual or bi-annual basis since 1999. The Department switched to telephone-based methodology in spring 2012, which means that detailed comparison between the results of our surveys undertaken before and after the start of 2012 should not be made. We do, however, show historical data indicating clearly at which point the shift in methodology occurred.

Table A.1 – External opinion of the Armed Forces and MOD

Jan 2015*	May 2014*	March 2013*	March 2012*	March 2011	March 2010	March 2009
Favourable ratings for Armed Forces						
91%	86%	85%	85%	88%	82%	84%
Unfavourable ratings for the Armed Forces						
2%	2%	5%	4%	3%	4%	2%
Favourable ratings for the MOD						
70%	71%	69%	68%	57%	56%	55%
Unfavourable ratings for the MOD						
7%	7%	12%	13%	15%	11%	9%

* Methodology switched from face to face to telephone from March 2012.

Figure A.1 – External opinion of the Armed Forces and MOD 2006-15

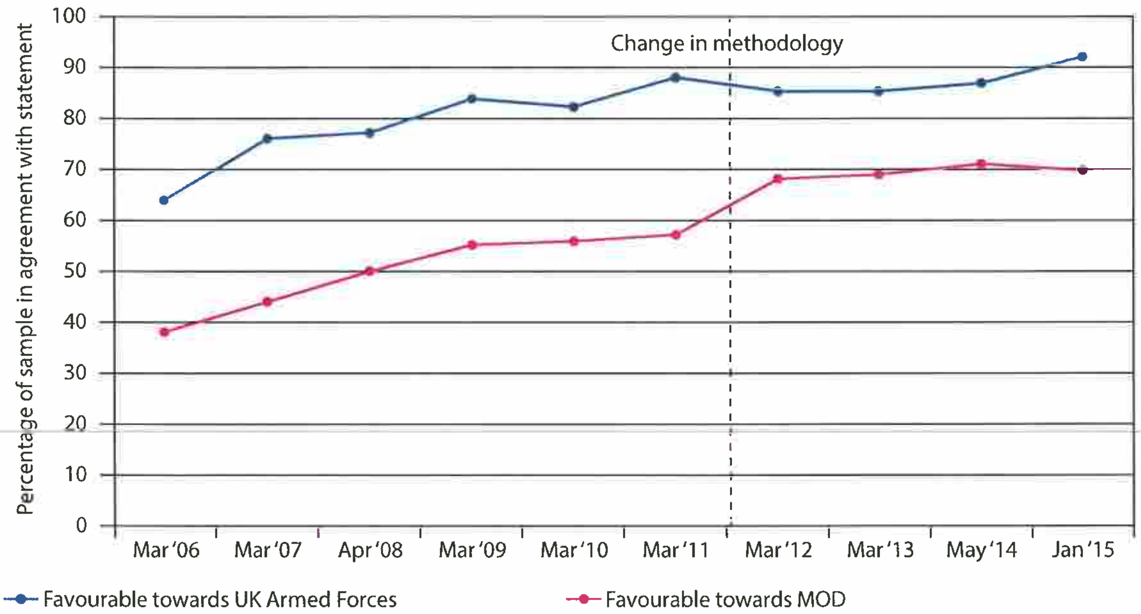
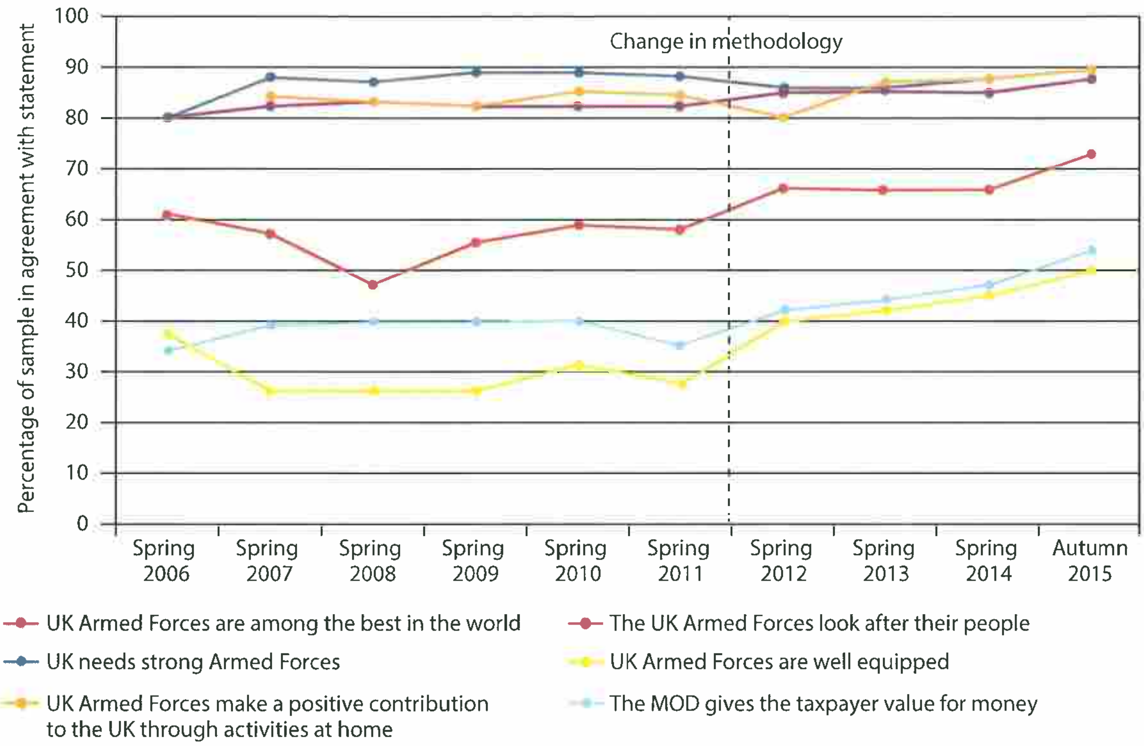


Table A.2 – External Opinion Survey Headlines

Armed Forces	January 2015	May 2014
Favourable towards Armed Forces	91%	86%
UK Armed Forces are among the best in the world	88%	84%
UK needs strong Armed Forces	89%	87%
UK Armed Forces look after their people	73%	65%
UK Armed Forces make a positive contribution to the UK through their activities at home	89%	87%

Ministry of Defence	January 2015	May 2014
UK Armed Forces are well equipped	50%	45%
Favourable towards MOD	70%	71%
MOD gives the taxpayer value for money	53%	47%

Figure A.2 – External Opinion Survey Polling Results, 2006-15



Reputation among Service and Civilian Personnel

A.3 We also carry out an annual survey to determine the views of our own people – Service and civilian – on Defence issues and the Armed Forces. Changes in the wording of response options for the 2014 survey, to align better with the external MOD and Armed Forces public reputation survey[1], means that direct comparisons with polling undertaken prior to 2014 should not be made. A minor change to the weighting strata was made in 2015.

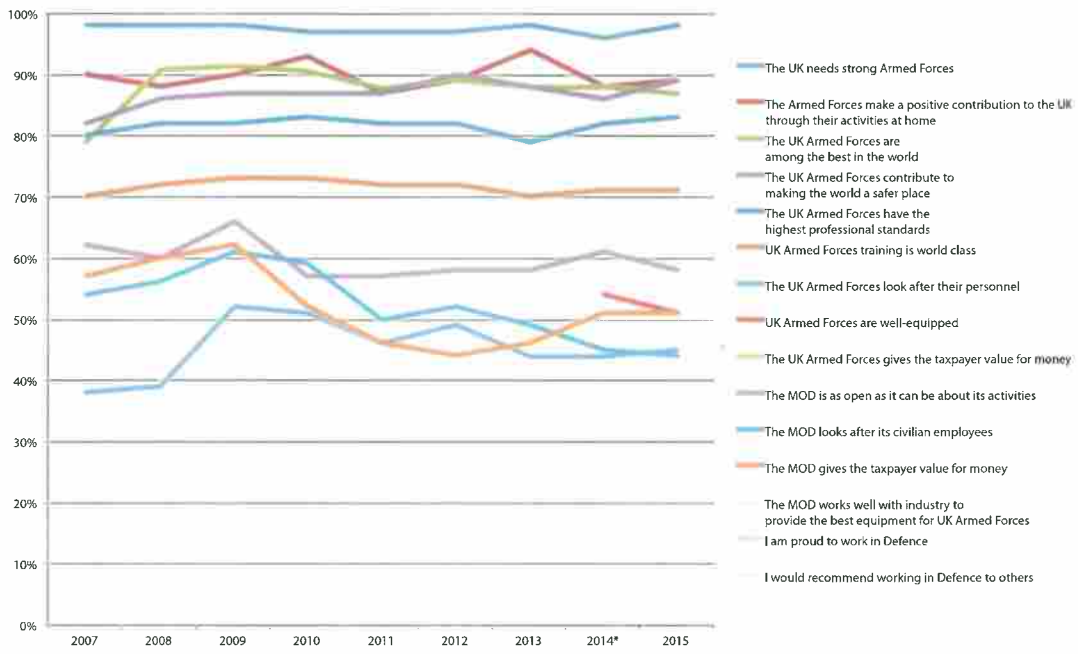
A.4 Our most recent poll conducted in spring 2015 showed that the majority (89%) of our people agree that the UK Armed Forces make a positive contribution to the UK through their activities at home which aligns with the public at 89% agreement.

Table A.3 – Internal Opinion Survey headlines (% Agree)

UK Armed Forces	Spring 2015	Spring 2014*
UK needs strong Armed Forces	**98%**	96%
UK Armed Forces contribute to making the world a safer place	**89%**	86%
UK Armed Forces are among the best in the world	**87%**	88%
UK Armed Forces are well equipped	**51%**	54%
UK Armed Forces have the highest professional standards	**83%**	82%
UK Armed Forces look after their personnel	**45%**	44%
UK Armed Forces training is world class	**71%**	71%
UK Armed Forces gives the taxpayer value for money *(New question for 2015)*	**65%**	N/A
UK Armed Forces make a positive contribution to the UK through their activities at home	**89%**	88%
MOD is as open as it can be about its activities	**58%**	61%
MOD gives the taxpayer value for money	**51%**	51%
MOD looks after its civilian employees	**44%**	45%
MOD works well with industry to provide the best equipment for the UK Armed Forces *(New question for 2015)*	**36%**	N/A
I am proud to work in Defence *(New question for 2015)*	**79%**	N/A
I would recommend working in Defence to others *(New question for 2015)*	**58%**	N/A

1 Responses were altered from Agree/Disagree to Strongly agree, Tend to agree, Strongly disagree, Tend to disagree.

Figure A.3 – Internal polling results, 2007-2015 (% Agree)



*Responses were altered from Agree/Disagree to Strongly agree/Tend to agree/Strongly disagree/Tend to disagree in 2014.

Annex B

Accountability to Parliament

B.1 Ministers have accounted to Parliament during the financial year 2014-15 on all aspects of the Ministry of Defence's business. A total of 2,630 Parliamentary Questions were tabled. Defence Ministers participated in 15 debates on Defence issues in the House of Commons, 10 in the House of Lords, and responded to six Adjournment Debates in Westminster Hall. Ministers made three oral statements to the House of Commons and two to the House of Lords. They also made 82 Written Ministerial Statements to the House of Commons and the House of Lords. Details are published in Hansard.

Ministerial Correspondence

B.2 From 1 April 2014 to 31 March 2015, Defence Ministers received 3,755 items of correspondence from Members of Parliament, Peers and some members of the public to which a Ministerial response was deemed appropriate. Of these, 2,556 (68%) were answered within the target of 20 working days.

Evidence to the Defence Select Committee

B.3 Since 1 April 2014, the Ministry of Defence has given evidence to the Defence Select 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/business/committees/committees-a-z/commons-select/defence-committee/publications/

B.4 Reports published during this reporting period are listed below.

Table B.1 – Parliamentary Session 2014-15: MOD responses to reports published in the previous parliamentary session

Report	Title	Publication Date
HC 525	Deterrence in the Twenty-First Century: Government Response to the Committee's Eleventh Report of Session 2013-14	7 July 2014
HC 526	Afghanistan – Camp Bastion Attack: Government Response to the Committee's Thirteenth Report of Session 2013-14	7 July 2014
HC 548	UK Armed Forces Personnel and the Legal Framework for Future Operations: Government Response to the Committee's Twelfth Report of Session 2013-14	11 July 2014
HC 581	Intervention: Why, When and How? Government Response to the Committee's Fourteenth Report of Session 2013-14	29 July 2014
HC 582	Afghanistan: Government Response to the Committee's Fifteenth Report of the Session 2013-14	29 July 2014
HC 611	Remote Control: Remotely Piloted Air System – current and future UK use: Government Response to the Committee's Tenth Report of Session 2013-14	29 July 2014
HC 387	Future Army 2020: Government Response to the Committee's Ninth Report of the Session 2013-14	12 September 2014

Table B.2 – Financial Year 2014-15: Defence Select Committee Reports (Government Responses, if published, are listed in brackets after the report to which they relate)

Report	Title	Publication Date
HC 469 (HC 681)	The Ministry of Defence Main Estimates 2014-15	4 July 2014
HC 358 (HC 755)	Towards the Next Defence and Security Review: Part Two – NATO	31 July 2014
HC 508 (HC 900)	Armed Forces (Service Complaints and Financial Assistance) Bill	23 October 2014
HC 527 (HC 953)	The Armed Forces Covenant in Action Part 5: Military Casualties, a review of progress	30 October 2014
HC 832	Pre-Appointment Hearing for the Service Complaints Commissioner	28 November 2014
HC 690 (HC 1126)	The Situation in Iraq and Syria and the response to al-Dawla al-Islamiya fi al-Iraq al-Sham (DAESH)	5 February 2015
HC 896	Ministry of Defence Annual Report and Accounts 2013-14	11 March 2015
HC 512	Re-thinking defence to meet new threats	24 March 2015
HC 1127	Towards the Next Strategic Defence and Security Review: Part Three	25 March 2015
HC 682	Decision-making in Defence Policy	26 March 2015

B.5 The Defence Committee also visited the Armed Forces in the UK and overseas as part of its inquiries, as shown in Table B.3.

Table B.3 – Visits by the Defence Committee to UK Armed Forces

Date of Visit	Establishment	Related Inquiry
1 May 2014	Portsmouth Fleet Diving Squadron	General visit
19-20 May 2014	SHAPE and NATO HQ	General visit
8-10 December 2014	Iraq	The Situation in Iraq and Syria and the Threat Posed by Islamic State in Iraq and the Levant (ISIL)
25-30 January 2015	Falkland Islands	General visit
9-11 February 2015	Cyprus	General visit

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

B.6 Since 1 April 2014, 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/committees-a-z/#E

Table B.4 Parliamentary Session 2014-15: Reports/evidence

Select Committee	Subject	Publication Date
Joint Committee on the National Security Strategy	First Report of the Committee Session 2013-14	24 July 2014
House of Lords Select Committee on Soft Power and the UK's Influence	Government Response to the House of Lords Select Committee on Soft Power and the UK's Influence Report HL 150 of Session 2013-14, Persuasion and Power in the Modern World (Cm 8879)	17 June 2014
House of Lords Select Committee on the Arctic	Report of Session 2014-15, Responding to a Changing Arctic	27 February 2015
Public Administration Select Committee	Leadership for the long term: Whitehall's capacity to address future challenges, Third Report of Session 2014-15	9 March 2015

B.7 Other Select Committees also visited the Armed Forces in the UK as part of their inquiries, as shown in Table B.5.

Table B.5 Other Select Committee Visits to the Armed Forces

Date of Visit	Select Committee	Establishment	Related Inquiry
4 December 2014	Public Administration Select Committee	Development, Concepts and Doctrine Centre	Leadership for the long term: Whitehall's capacity to address future challenges

Annex C

Trading Fund Performance

Defence Support Group (DSG)

C.1 The DSG Trading Fund provided the MOD with secure access to assured onshore capacity and capability for the through life maintenance, repair, overhaul, upgrade and procurement support services for defence equipment. During the year the MOD completed the sale of the DSG Land business to the Babcock International Group. The MOD also confirmed the retention of DSG's Electronics and Components Business Unit (ECBU), which includes activities undertaken at DSG Sealand and Stafford and other military locations around the country, in the MOD ownership as a new executive agency called the Defence Electronics and Components Agency (DECA). DECA was established on 1 April 2015.

C.2 Besides managing the issues surrounding sale and separation, the business produced a strong trading performance during the year with turnover of £175.7M. Reducing costs contributed to the business producing a net profit, before interest and dividend, of £14.7M against a plan of £10.7M. The Return on Capital Employed was 8.8%.

C.3 DSG's role in Camp Bastion was pivotal in providing support to the front line, as well as redeploying equipment to the UK in readiness for the conclusion of deployed operations in Afghanistan. DSG Bastion contributed cost avoidance savings in excess of £120M to MOD since 2009 with over 2000 pieces of equipment regenerated and over 11,000 pieces of equipment calibrated. Almost 500 DSG employees volunteered to deploy over the course of the project with over 100 for two or more tours. DSG personnel have now returned to the UK with many working on the Herrick Exchange Point facilities at Warminster and Lyneham.

C.4 More information can be obtained from the DSG Annual Report and Accounts on the DSG website. https://www.gov.uk/government/publications/defence-support-group-annual-report-and-accounts-2014-to-2015

UK Hydrographic Office (UKHO)

C.5 UKHO are a world leader in the supply of hydrographic information and data services. Commercial business, marketed under the ADMIRALTY brand, represents 90.3% of its total revenue and are financially self-supporting.

C.6 The products and services we supply to Defence are crucial to the conduct of operations globally and support the National Security Strategy. UKHO also support the Maritime and Coastguard Agency in discharging the UK's obligations for national charting under the United Nation's (UN) International Convention for the Safety of Life at Sea (SOLAS), 1974, to which the UK is a signatory.

C.7 UKHO plays a key role in support of Defence operations and has delivered against all its targets and also delivered ad hoc maritime geospatial data to support changing operational needs.

C.8 The safety and quality of ADMIRALTY brand products and services in support of the mariner at sea is deeply embedded in the culture and ethos of the UKHO, and its leadership and technical ability in this niche, but vital, field for Defence, safety and international trade, is hard won and internationally recognised.

C.9 In addition to having another strong year of delivery against plans, UKHO have increased profitability despite increasing pressure on margins. UKHO sales are linked to the health of the global shipping market and trading conditions remain challenging. As a result, UKHO turnover was only slightly up on the previous year at £134.0M (+2.7%) however, exceeding its target again to reduce costs has resulted in a Profit on Ordinary Activities of £32.0m, up 46.7%. Return on Capital Employed was 30.2% against a target of 9%. All five key targets for the UKHO, encompassing Safety, Defence, Finance, cost reduction and strategic plan delivery, were achieved. The mandation of digital navigation is reaching an ever increasing percentage of UKHO's core commercial market; this is starting to erode the overall margin and maintaining profitability is a key focus for Board and Management.

C.10 More information can be obtained from the UKHO Annual Report and Accounts on the UKHO website https://www.gov.uk/government/publications/the-united-kingdom-hydrographic-office-annual-report-and-accounts-2014-to-2015

Defence Science and Technology Laboratory (Dstl)

C.11 The purpose of Dstl, the MOD's Science and Technology (S&T) organisation, is to maximise the impact of S&T for the defence and security of the UK. It provides the Government with an extensive portfolio of scientific and technical support, which is delivered both from professional in-house expertise and by working with others across industry, academia, wider government laboratories, and international agencies.

C.12 Through this collaborative work, Dstl have continued to deliver successful programmes and projects that have had significant impact for customers across the defence and security sector at home and abroad, such as this year's scientific support to combating the outbreak of the Ebola virus in West Africa. On behalf of the MOD, Dstl also lead the formulation, management, and delivery of the MOD S&T Programme. This year, 59 per cent of this programme was delivered by Dstl's industry and academic partners in line with targets set by the MOD.

C.13 Dstl produced a strong trading performance during the year, with turnover of £653 million (2013-14: £661m) and net profit of £30 million (2013-14: £26 million). It delivered a Return on Capital Employed of 7.7 per cent.

C.14 This year, Dstl also launched an Easy Access Intellectual Property (IP) scheme that will develop closer relationships with academia and industry in order to get Dstl technology into the hands of those best placed to exploit it. Additionally, the Dstl Centre for Defence Enterprise (CDE) continued to encourage small- and medium-sized enterprises (SMEs) to enter the defence supply chain. More than two-thirds of this year's CDE contracts went to SMEs and innovators within academia.

C.15 More information can be obtained from the Dstl Annual Report and Accounts 2014-15 at www.gov.uk/dstl

Annex D

Fraud

D.1 The MOD has a zero tolerance to fraud, corruption, bribery, and theft, along with a clear process on how to report suspicions. All suspicions are investigated and appropriate action is taken. The Fraud Defence Board provides strategic direction and oversight of the Fraud Defence unit. There has been a significant change in our approach to managing the risk of fraud over the last two years, from being a very reactive function, which focused on suspected fraud and investigations, to a much more proactive approach which looks at fraud in terms of detection and prevention. Our proactive approach deploys a risk-based approach to identifying the risk of fraud and ensures appropriate controls are in place to manage the risk and increasing use of data analytics to detect fraud. The level of the effectiveness of the MOD's risk-based approach is measured by an industry standard risk maturity model. This measures the quality of the fraud risk management activities and the extent to which they are embedded within the organisation. Activities advance to date includes:

- The delivery of fraud risk workshops and assessments with Royal Navy, Army, Royal Air Force, Joint Forces Command, Defence Infrastructure Organisation and Defence Business Services;
- The successful delivery of a fraud analytics pilot;
- Increase in awareness and skills activities including bespoke training sessions.

Transparency

D.2 The MOD has continued to meet its Transparency Agenda corporate commitments and has worked towards embedding transparency into the department's normal working business, such as publishing Senior Officials' travel and expenses data to schedule. The transparency team have also worked to source and publish datasets of public interest, such as Historical Monuments, Sites of Special Scientific interest, and further Energy consumption data.

D.3 MOD supported the Cabinet Office in updating the National Information Infrastructure and will continue to work with them to align its principles with the next MOD Open Data Strategy. The Open Data Strategy will aim to identify further datasets of interest to the public through meetings with stakeholders.

MOD Freedom of Information performance in 2014-15

Category	MOD performance
Number of requests received	3,517
Of these:	
% of requests responded to within 20 working days	83%
% of requests answered 'in time'[2]	86%
Total of 'resolvable requests'[3]	2,688
Of these:	
% of resolvable requests answered in full	52%
% of resolvable request refused in full	27%
% of resolvable requests refused in part	12%
% resolvable requests yet to receive a response at the time these statistics were collected	9%

D.4 In 2014-15, the MOD received 3,517 requests for information under the Freedom of Information Act 2000, a 4% decrease over the previous year. 83% of requests received a substantive response within the

2 Requests answered within the 20 working day limit or using a permitted extension. 'Permitted extensions' are those where the 20 working day deadline for response under FOIA is extended to allow for consideration of the balance of the public interest.
3 'Resolvable requests' are all those where it is possible to make a substantive decision on whether to release the requested information. They exclude requests where the information requested was not held and where it is necessary to provide advice and assistance in order to clarify a request.

20 working day statutory time limit set out in the legislation and 86% of requests were handled in time, in accordance with the timescales recommended in the Information Commissioner's guidance. These figures demonstrate that despite the pressures of other defence business, the department continues to achieve a good level of performance in this area of its business. 52% of 'resolvable' requests were answered in full. MOD refused 27% of requests in full and 12% in part, on the grounds that information was exempt from disclosure under the provisions of the FOI Act 2000.

D.5 FOI is an important element of MOD business. Formal training, seminars and workshops establish and maintain the necessary levels of expertise in business units. In-house guidance is regularly updated to reflect the evolving views of the Information Commissioner, the Information Tribunal, and policy developments issued by the Ministry of Justice.

Corporate Memory – The National Archieves

D.6 2014-15 saw the routine review and transfer of records to The National Archives (TNA) resulting in around 10,000 files being identified and selected for permanent preservation, which were made publicly available at TNA from Q1 2015. MOD continues to comply with its obligations under the Public Records Act and, due to a change in the Act that replaces the 30 Year Rule with a 20 Year Rule, has increased the resources available for reviewing and transferring files to TNA. In addition, MOD has continued to support TNA in dealing with Freedom of Information requests for files that are held by TNA, but not available to the public.

Commercial Sponsorship Within The MOD During 2014-15

D.7 The sponsorship return satisfies the Cabinet Office requirement to publish details of commercial sponsorship deals with a value of £5,000 or greater, excluding VAT, where they supplement Government funding of Departmental core business.

Activity	TLB	Individual Sponsors	Company Contribution £ EX VAT
Battle of Britain Memorial Flight	Air Command	Santander UK PLC	16,800
Battle of Britain Memorial Flight	Air Command	BAE Systems	120,000
Battle of Britain Memorial Flight	Air Command	Blackbrookes LLP	10,290
Battle of Britain Memorial Flight	Air Command	Pullman Wincanton	8,900
Battle of Britain Memorial Flight	Air Command	Land Rover	33,350
Royal Air Force Acrobatic Team	Air Command	Leeds Commercial	26,000
Royal Air Force Acrobatic Team	Air Command	XS Creativity	2,500
Royal Air Force Acrobatic Team	Air Command	Ping	9,800
Royal Air Force Acrobatic Team	Air Command	Coffee Real	6,600
Royal Air Force Acrobatic Team	Air Command	W L Gore and Associates UK Ltd	52,000
Royal Air Force Acrobatic Team	Air Command	Barbour	6,700
Royal Air Force Acrobatic Team	Air Command	Land Rover	156,000
Royal Air Force Acrobatic Team	Air Command	Grant	12,000
Royal Air Force Acrobatic Team	Air Command	Alexandre (BMB Menswear)	40,000
Royal Air Force Acrobatic Team	Air Command	Breitling	48,000
Royal Air Force Acrobatic Team	Air Command	M2c2 (Morrison Mc Connell)	8,000
Royal Air Force Acrobatic Team	Air Command	Applewhites	8,000
Royal Air Force Acrobatic Team	Air Command	Pitscards	4,000
Royal Air Force Acrobatic Team	Air Command	Rolls Royce	8,500

Activity	TLB	Individual Sponsors	Company Contribution £ EX VAT
Royal Air Force Acrobatic Team	Air Command	Connect Colour	26,000
Royal Air Force Acrobatic Team	Air Command	Grenson	2,000
Royal Air Force Acrobatic Team	Air Command	Bose	11,100
Royal Air Force Acrobatic Team	Air Command	BAE Systems	300,000
Tucano Display Team	Air Command	Breitling	8,000
Tutor Display Team	Air Command	Squadron Prints Ltd	1,000
Tutor Display Team	Air Command	BAE Systems	3,000
Tutor Display Team	Air Command	Selex ES	20,000
Tutor Display Team	Air Command	Rolls Royce	3,250
Tutor Display Team	Air Command	Goretex	2,000
Tutor Display Team	Air Command	Breitling UK Ltd	8,000
Tutor Display Team	Air Command	Breitling UK Ltd	11,200
Sponsorship of a Cadet Unit	Army	The Honourable Artillery Company	228,760
Loan of vehicle to Chinook Display Team	Army	Range Rover	7,932
Loan of vehicle to HMS Ocean	Navy Command	Land Rover	5,625
Loan of vehicle to RNAS Yeovilton	Navy Command	Jaguar XJ 3.0D Portfolio lwb Auto	5,451
Loan of vehicle to HMS Bulwark	Navy Command	Land Rover	10,423
RNAS Culdrose Airday 2014	Navy Command	Lockheed Martin UK Ltd	20,000
RNAS Culdrose Airday 2014	Navy Command	Augusta Westland	5,000
RNAS Culdrose Airday 2014	Navy Command	Thales UK Ltd	5,000
Sanctuary Magazine	DIO	Williams Lea	533
Sanctuary Magazine	DIO	Aspire Defence Ltd	500
Sanctuary Magazine	DIO	Babcock International Group	2,500
Sanctuary Magazine	DIO	CarillionAmey	2,000
Sanctuary Magazine	DIO	Kelda Water Services (Defence)	1,000
Sanctuary Magazine	DIO	Landmarc Support	1,500
Sanctuary Magazine	DIO	QinetiQ Ltd	1,000

Annex E
Sustainability

E.1 The Sustainable MOD Strategy provides direction on what Defence must do to become increasingly sustainable. Whilst MOD sustainability activities contribute to the sustainability agenda and to wider Government commitments, the focus of the Department is increasingly on those activities that better embed sustainability principles in support of wider Defence outputs and objectives.

E.2 During 2014-15, we have refreshed our Departmental sustainability strategy to focus better on the material sustainability issues for the Department and embed sustainability principles to maximise benefits for Defence and set out our future priorities.

E.3 To support the Department's sustainability agenda, changes have been made to its governance structures. During 2014 the Director General of Head Office and Commissioning Services became the MOD sustainability champion and lead for the sustainable MOD agenda. He is supported in this role by a senior departmental steering group. This senior level group is in turn supported by a number of working groups that focus on sustainability and energy programmes and projects.

E.4 The MOD has continued to contribute to the Greening Government Commitments and targets. Overall, performance against the targets has been mixed, with some targets exceeded, and significant challenges affecting performance of others. The Department has exceeded the consumption reduction targets in both estate water demand and paper use. Other target areas such as waste reduction have been affected by operational activity, Defence reform, and major business change programmes such as rebasing the Army from Germany. These activities are generating short term peaks in asset disposals and alterations to estate infrastructure hence increases in waste generation.

E.5 Further details of the Department's sustainability activities and performance against the Greening Government Commitment targets will be published within The Sustainable MOD Annual Report available at the end of July 2015. The report can be viewed at https://www.gov.uk/government/publications/sustainable-mod-annual-report-2014-to-2015

E.6 During 2015-16 our focus will be on continuing to drive improvements against energy efficiency, reducing water demand, improving waste management and sustainable procurement within the Greening Government framework; and the development of a five year plan to deliver against our Sustainable MOD Strategy.

Annex F

Statement of Approved Maximum Armed Forces Numbers

F.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 (mid February), and form part of the Parliamentary Supply process.

F.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.

F.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.

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
Naval Service				
Royal Navy	Officers	6,450	6,020	June 2014
	Men and Women	20,240	19,520	April 2014
	Aggregate	26,690	25,520	April 2014
Royal Marines	Officers	920	840	September 2014
	Men and Women	7,500	7,010	April 2014
	Aggregate	8,420	7,810	April 2014
Army Service				
Army	Officers	14,260	13,270	June 2014
	Men and Women	97,020	80,670	April 2014
	Aggregate	111,280	93,870	April 2014
Commonwealth, Colonial, etc, troops abroad and Gurkhas	Officers	140	120	March 2015
	Men and Women	3,760	3,150	April 2014
	Aggregate	3,900	3,260	April 2014
Air Force Service				
Royal Air Force	Officers	8,340	7,880	May 2014
	Men and Women	28,850	27,380	April 2014
	Aggregate	37,190	35,230	April 2014

		Numbers voted by the House of Commons	Maximum Numbers Maintained	Peak Dates
Reserve Naval and Marine Forces				
Royal Fleet Reserve(Naval Officers and Ratings)	Officers	4,960	3,460	May 2014
	Men and Women	10,580	3,240	March 2015
	Aggregate	15,540	6,630	June 2014
Royal Fleet Reserve (Marine Officers and Marines)	Officers	470	270	September 2014
	Men and Women	2,610	1,160	May 2014
	Aggregate	3,080	1,430	May 2014
Royal Naval Reserve	Officers	1,200	840	March 2015
	Men and Women	1,980	1,490	March 2015
	Aggregate	3,180	2,330	March 2015
Royal Marines Reserve	Officers	70	60	March 2015
	Men and Women	920	720	February 2015
	Aggregate	990	780	February 2015
Royal Naval Reserve (List 7)	Officers	950	900	December 2014
Reserve Land Forces				
Army Reserve	Officers	11,300	9,490	June 2014
	Men and Women	26,770	21,870	April 2014
	Aggregate	38,070	31,340	April 2014
Territorial Army	Officers	9,110	4,600	March 2015
	Men and Women	46,150	25,850	March 2015
	Aggregate	55,260	30,440	March 2015
Reserve Air Forces				
Royal Air Force Reserve	Officers	5,000	3,930	May 2014
	Men and Women	10,100	7,670	April 2014
	Aggregate	15,100	11,550	April 2014
Royal Auxiliary Air Force	Officers	530	330	March 2015
	Men and Women	2,490	1,820	March 2015
	Aggregate	3,020	2,160	March 2015

		Numbers voted by the House of Commons	Maximum Numbers Maintained	Peak Dates
Special Members of The Reserve Naval Forces				
Royal Naval Reserve	Officers	780	650	March 2015
	Men and Women	1,620	1,190	February 2015
	Aggregate	2,400	1,840	March 2015
Special Members of The Reserve Land Forces				
Territorial Army	Officers	20	~	July 2014
	Men and Women	180	90	May 2014
	Aggregate	200	90	May 2014
Army Reserve	Officers	10	0	*
	Men and Women	20	0	*
	Aggregate	30	0	*
Special Members of The Reserve Air Forces				
Royal Air Force Reserve	Officers	100	60	March 2015
	Men and Women	210	100	March 2015
	Aggregate	310	160	March 2015

Figures for Maximum Numbers Maintained have been rounded to the nearest 10, with numbers ending in 5 being rounded to the nearest multiple of 20 to prevent systematic bias.

Totals and sub-totals have been rounded separately and so may not equal the sum of their rounded parts.

~ denotes 5 or fewer.

* strength has been zero for the whole time period.

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HIGHWAYS AGENCY

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Contents

Highlights

Our two M25 widening schemes, between junctions 16 and 23 in Hertfordshire and junctions 27 and 30 in Essex, were both fully opened to traffic in May in advance of the London 2012 Games. The two schemes add an additional lane to both motorway carriageways, delivering much needed extra capacity on one of Europe's busiest motorways.

The Canford Bottom scheme completed in June, improving one of the busiest junctions on the A31 near Wimbourne in Dorset. By opening ahead of the London 2012 Games, it provided better access to the Weymouth and Portland sailing venue.

Accelerated delivery and pinch-point schemes to support economic growth. We forged ahead with detailed design on this programme of more than 100 projects to ease traffic flow at bottlenecks. Our first pinch-point scheme was completed at Penzance in Cornwall in March 2013 – improvements to the A30 Newtown roundabout relieve congestion and support the local economy.

Adverse weather – the Highways Agency met significant challenges from the weather, including floods during the wettest spring for more than 100 years, one of the wettest weeks in the last 50 years in November 2012, and the coldest March since 1962.

M4 Boston Manor Viaduct is a critical structure on our network, linking Heathrow Airport, the Thames Valley and the West of England to the capital. During five months of intensive work, we completed technically advanced strengthening work to this 50-year-old structure, just in time for London to host the 2012 Olympic Games.

London 2012 Games co-ordination – we kept the network running smoothly:

- We had close and successful operational relationships with Olympic and Paralympic stakeholders through the London Transport Co-ordination Centre, as well as at venues.
- An effective 24/7 operation was in place at our National Traffic Operations Centre and in all regions where events took place.
- The Games Lane on the eastbound M4 operated when most of the Games family arrived between 16 July and 4 August, and again between 22 and 29 August – keeping traffic moving into London.

Reduced the impact of incidents – collisions and incidents cause delays for other road users. Our CLEAR initiative sets out how different responders to incidents on the strategic road network will work together to prioritise investigation, repair and reopening. CLEAR is a joint initiative between the Highways Agency, the Department for Transport and the Home Office, along with the police, fire and ambulance services.

Safety milestones

- Our roads maintenance contractor, EnterpriseMouchel, achieving three million injury-free hours at work in our central southern England area.
- 1,000 days since our technology maintenance contractor, Amey, suffered a reportable injury.
- Our M6 managed motorway scheme between junctions 5 and 8 achieving 500,000 hours without a reportable incident.

Awards

Our A3 Hindhead project won the Project, Programme and Portfolio Management Award at this year's Civil Service Awards. The £371 million improvement project, which completed the dual carriageway from London to Portsmouth by bypassing Hindhead village, was recognised for engaging with the local community to preserve and enhance the environmentally sensitive Surrey Hills site. Ben Catchesides, of our intelligent transport systems research group, was also recognised for introducing improved technologies for inductive loops, which are sensors in the road that record traffic data.

Our M4 junctions 19 to 20 and M5 junction 15 to 17 managed motorways scheme near Bristol achieved a Considerate Constructors Scheme gold standard award.

M53 Bidston Moss viaduct strengthening scheme in Merseyside won a Construction News Award. The Bidston Moss project also won a Structural Steel Design Award for excellence in design using steel.

The Highways Magazine Award for Environmental Sustainability in the Highways Sector was awarded for our East and South East asset management framework.

The first 12 graduates, including two from the Highways Agency, were awarded diplomas and postgraduate certificates in strategic leadership at the Highways Agency/Roffey Park Roads Academy – our innovative route to masters level management development.

Foreword by the Chairman

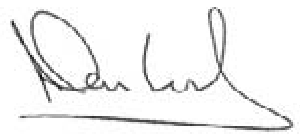
The Highways Agency performed well over the last year, maintaining the motorway and trunk road network in good condition, and focusing effort on managing congestion and incidents. Through an exceedingly wet year, the Highways Agency had to deal with a series of floods that affected some trunk roads on the South Coast and in the North East – a reminder once again of the importance of our climate change adaptation plans that seek to make the road network more resilient in the face of extreme weather events.

The Government's spending review in 2010 set some ambitious goals for the Highways Agency to reduce the cost of maintaining and improving the network. Over the past year we have successfully completed the final steps to secure those cost savings, with mobilisation of two new Asset Support Contracts for road maintenance, and renegotiation of most of the other maintenance contracts to a new specification. The collaborative approach with our supply chain has also delivered capital savings in excess of our targets.

I am pleased to note that the Highways Agency's performance and positive economic impact has again been recognised through the announcement by the Government of substantial additional investment across the strategic road network.

As Chairman, I have continued to strengthen the governance of the Highways Agency and the Board membership, including the appointment of Simon Murray as Non-Executive Director and, at the end of the year, two new Executive Director appointments. This refreshed Board is equipped with the skills and experience needed to take forward the Government's plans for roads reform – delivering a step up in investment in the strategic road network.

I and my fellow Directors now look forward to the conclusion of the Government's roads feasibility study, announced by the Prime Minister last year, and then implementing those conclusions alongside the recommendations of my earlier strategic roads review.



Alan Cook
Chairman

Chief Executive's overview

The last year has been one where the Highways Agency's motorway and trunk road network has been under great pressure – supporting London as host city for the 2012 Olympic and Paralympic Games, keeping traffic moving through a winter of prolonged flooding, and ice and snow conditions, and most importantly in keeping business, commerce and communities connected across the country.

There is a legacy from the London 2012 Games – greatly enhanced working relationships with police forces, with emergency services, and with key transport authorities in planning for major events, and quickly clearing incidents that restrict or block key routes.

Across the Highways Agency, we are committed to the role of the motorway and trunk road network in supporting the development that is essential for the country's economic prosperity. We have focused our resource to respond quickly to planning applications that affect the road network, and to work closely with developers at the early stages of their planning. Coupled with an ambitious programme of more than 100 medium-size improvement projects targeted at relieving congestion pinch-points, we are making a huge effort to enable that economic growth.

Any business like the Highways Agency depends on the professionalism and dedication of its people – our own staff and our contractors' employees. Their commitment to operating, maintaining and improving the strategic road network is outstanding, and I would like to record my appreciation for all that they have achieved over the last year.

Our road network in England is one of the safest in the world – for road users and for road workers. But despite our significant commitment to improving safety, sometimes things go wrong. In 2011-12, 251 people died and 1,578 were seriously injured on our road network. While this is one of the lowest totals for many years, it remains a heavy toll.

We were all deeply saddened by the fatal injuries sustained by a road worker in Kent in October 2012, who was undertaking routine repairs, and the loss of one of our traffic officers – John Walmsley – on the M25 in September 2012. Both of these tragic deaths serve as a reminder of the hazards faced by our staff and our suppliers everyday on the road network, and strengthen our resolve to create a wholly accident and incident-free working environment.

So 2012-13 was a year of highs and lows for the Highways Agency. It takes real teamwork to deliver the successes and just as much teamwork to manage through the challenges. At the Highways Agency we are lucky to have great people who have a real commitment to the strategic road network and to delivering a good service to all who use or rely on our roads. The response from all those working in the sector to loss of life and serious injury is an enduring example of such teamwork and I again record my appreciation for all that they have done during another demanding year.

Graham Dalton
Chief Executive

1. What we do

Our role

The Highways Agency, created in March 1994, is an executive agency of the Department for Transport. Our role is to help support the sustainability of the UK's economy by operating, maintaining and improving the strategic road network in England on behalf of the Secretary of State for Transport.

The strategic road network in England is made up of some 4,300 miles of motorways and trunk roads – the most significant A roads (see page 13). While our road network represents only two per cent of all roads in England by length, it carries a third of all traffic by mileage. Significantly, two-thirds of all heavy goods vehicle mileage in England is undertaken on the strategic road network, making it the economic backbone of the country.

Our responsibilities are formally laid down by the Department for Transport in our framework document, which is published on our website at www.highways.gov.uk

Operate

Our network is used by approximately four million vehicles every day. We work hard to deliver a reliable service to customers through effective traffic management, incident clearance and provision of accurate and timely information. Our National Traffic Operations Centre and seven regional control centres work to reduce the number of incidents, to provide information to traffic on the road, and to manage incidents efficiently to minimise delays. The Traffic Officer Service responds to more than 20,000 incidents per month, ranging from debris on the carriageway to major multi-vehicle collisions. Effective traffic management and incident clearance ensures our roads are safe, delays are minimised and journeys are reliable.

Maintain

Our network, valued at more than £109 billion, includes more than 9,000 bridges, nearly 9,000 other structures and 34,000 drainage assets. We carry out routine maintenance and renewal of roads, structures and technology to make the network safe, serviceable and reliable.

We ensure our contractors deliver a high level of service on the strategic road network to support operational performance and the long-term integrity of the asset.

Improve

We undertake large-scale improvements on our network through our programme of major schemes. Improvements tackle bottlenecks and increase the capacity of the network. Our managed motorways programme has increased capacity and delivered substantial cost savings over conventional motorway widening. Our programme of maintenance renewal and improvement schemes delivers improved reliability, safety and asset integrity for the future. In the past two years, we have made available more than 160 miles of extra lanes on key routes.

The Highways Agency is overseen by a Board which includes a Non-Executive Chairman, three Non-Executive Directors, the Chief Executive and five Executive Directors, as shown in Annex A. Further details of our governance arrangements can be found in Section 5 of this report.

Vision and goals

The Highways Agency has set itself the challenging task of becoming the world's leading road operator by 2015. We have identified five goals which will help us achieve our vision:

1. We provide a service that our customers can trust.
2. We set the standard for delivery.
3. We deliver sustainable solutions.
4. Our roads are the safest in the world.
5. Our network is a dynamic and resilient asset.

To support these goals we have set out a values statement. This communicates the behaviours required of staff and contractors to ensure the delivery of our goals and the fulfilment of our organisational objectives.

Delivering a professional and affordable service through innovation and partnership working.

Our plans for 2013-14

The 2013-14 financial year is the third year of the Government's four-year spending review (SR10) period. The SR10 settlement announcement in October 2010 set budgets for the four-year period 2011-12 to 2014-15. Within the constraints of a tight public spending settlement, the Government prioritised investment in infrastructure, such as transport to support economic growth. The SR10 settlement included a programme to start 14 new major schemes in the four years to 2014-15, and we have met the reduced budgets for maintenance and renewals.

The national infrastructure plans, published in November 2011, announced additional investment in transport infrastructure projects as a driver of economic growth and earmarked specific projects to tackle congestion and improve the national road network. This included funding for six additional and two accelerated major schemes and a programme of smaller projects to improve pinch-points on our network (£287 million in total in 2013-14). In addition, a further announcement in November 2012 allocated a further £227 million in 2013-14.

Looking to the future

The strategic roads review, published at the end of 2011, recommended a package of measures to deliver efficiencies for the operation, maintenance and improvement of the strategic road network. The Highways Agency and the Department for Transport have been working to respond to its recommendations, including:

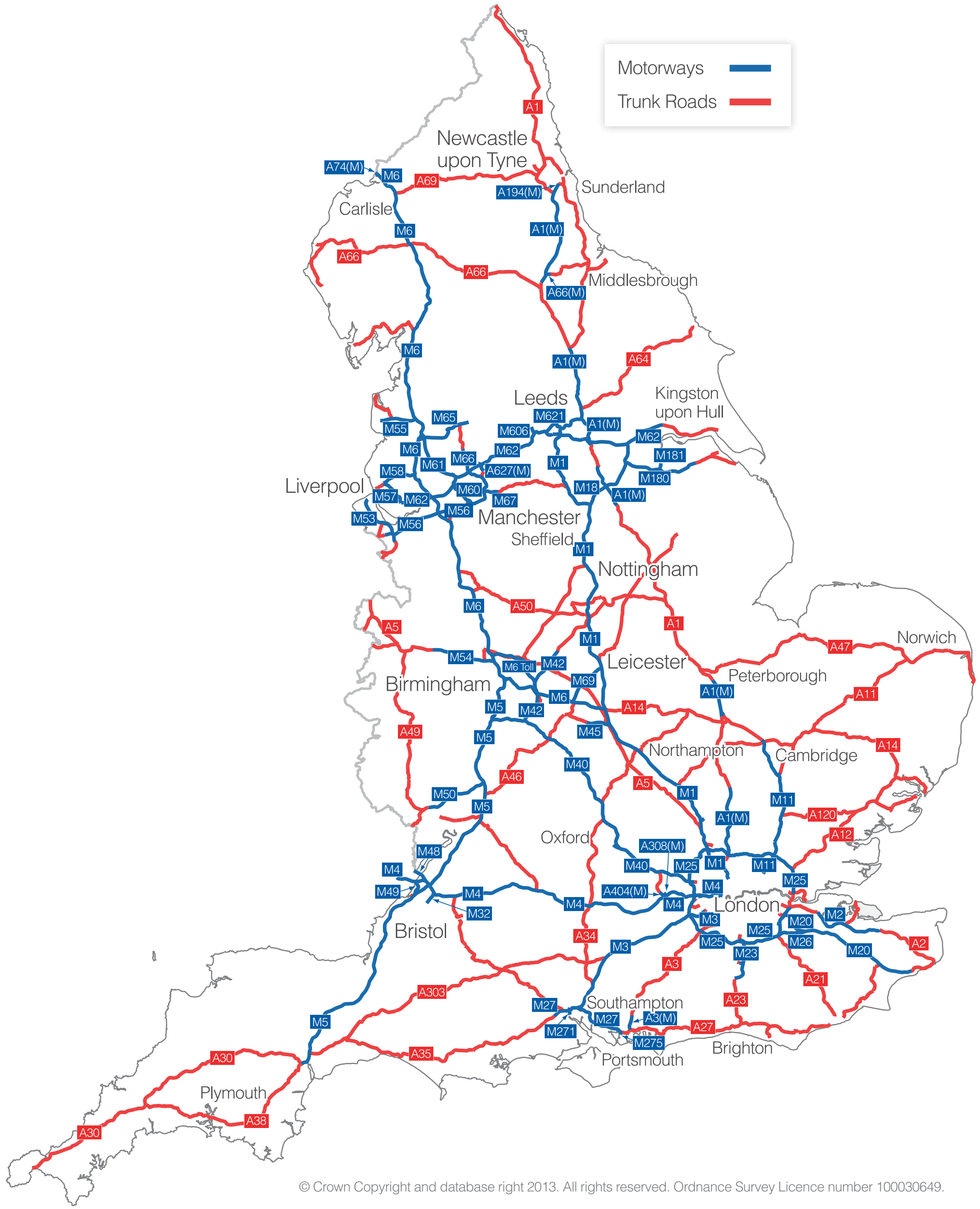
- performance specification – outlines high-level outcomes, outputs and special requirements for England's strategic road network
- route-based strategies – the Highways Agency has published our first three route-based strategies for the M62 between Leeds and Manchester, the A1 west of Newcastle, and the A12 between its junction with the M25 and A14 and the A120 east of Colchester.

The outlook remains challenging – maintaining the existing asset is a higher priority than building new assets, and an ageing asset means large sections of road carriageway and associated structures need repairing and replacing.

2013-14 budget	Resource £m	Capital £m	Total £m
Roads PFI service payments	459	-	459
Major schemes	-	610	610
Capitalised provisions	-	37	37
Network management (including staff costs)	79	14	93
Traffic Officer Service (including staff costs)	79	1	80
Technology PFI service payments	64	-	64
Technology projects	13	61	74
Maintenance (including renewals)	274	399	673
Smaller schemes and research and development	51	43	94
Other (including other income)	(11)	-	(11)
Office estate and capitalised staff	-	29	29
Depreciation and impairment	868	-	868
Administration (including depreciation)	67	-	67
Total SR10 budget	**1,943**	**1,194**	**3,137**
Growth review announcement, Nov 2011	-	287	287
Growth review announcement, Dec 2012	-	227	227
Total budget	**1,943**	**1,708**	**3,651**

Full details of our plans can be found in the *Highways Agency Business Plan 2013-14*, available on the Highways Agency's website at www.highways.gov.uk

Our strategic road network



2. Our Performance in 2012-13

1. Overview

The *Highways Agency Business Plan 2012-13*, which was agreed with the Department for Transport, set 12 key performance measures for the Highways Agency (summarised in Annex B) covering:

- Delivering a reliable network
- Minimising delays due to incidents
- Delivering safe roads for road users, our workforce and suppliers' staff
- The development and construction of major roads projects
- Customer satisfaction, measured through comprehensive road user surveys
- Minimising our carbon emissions
- Maintaining the condition of the road network
- Using our resources efficiently and effectively

Nine of the measures show performance has improved or is broadly similar to 2011-12. However, a deterioration in journey reliability, incident clearance and customer satisfaction demonstrate that the Highways Agency continues to operate in a very challenging environment.

There is a positive position to report on the financial aspects of managing the strategic road network. The Highways Agency has lived within its budget and the cost of operating and maintaining our network has reduced when compared to 2011-12. Our major construction schemes and programme of road improvements have been delivered below target cost and ahead of schedule.

The condition of the network has improved marginally despite the slightly reduced spend on maintenance and the adverse weather. However, the asset is subject to increasing stress with more emergency work on structures required and imminent end-of-life issues on a significant proportion of carriageways.

Journey reliability has deteriorated over the year due, to a large extent, to the adverse weather over the winter months, in particular the flooding that occurred in early 2013. In total, 77.6 per cent of journeys were 'on time' compared to 83.9 per cent in 2011-12. This has had a consequent impact on customer satisfaction levels, with a 0.75 per cent reduction to 90.73 per cent satisfaction.

Of our motorways, the M25 continues to score lowest in satisfaction scores. We continue to take forward various actions across many activities such as managing roadworks, engagement with our maintenance contractors, and analysis and follow-up of Highways Agency Information Line (HAIL) enquiries with the objective of improving satisfaction.

We have invested time and resource in new ways of working, aimed at shortening the time it takes to clear incidents. The Collision, Lead, Evaluate, Act, Reopen (CLEAR) initiative is a good example of this. However, while the overall number of incidents has fallen slightly, there is an increasing proportion of incidents with a duration in excess of two hours. This can be partly attributed to flooding and snow, which puts additional pressure on our operations. The average time to clear incidents on motorways has increased from 26 to 28 minutes (rolling year basis). We continue to look at more innovative ways to reduce incident times where possible, without compromising safety.

On safety, road user fatalities continue to reduce in number, as do the accident frequency rates for road workers. Final verified figures for 2012 are due for release in July 2013, after publication of this report. Results of performance in this area will be published on the Highways Agency's website.

We continue to make good progress in reducing our carbon emissions. We achieved a 6 per cent reduction in carbon dioxide emissions in 2012-13. While a proportion of this reduction is due to a change to Defra's greenhouse gas emission factor for electricity, there has been a substantial reduction in energy consumed. However, we have now completed all the easily obtainable savings and, going forward, further reductions will be much harder to achieve.

2. Financial outturn

Living within our means

Following the Government's spending review in 2010 (SR10), we were set the challenge of continuing to effectively manage the delivery of our roads programme, remaining focused on our priorities, while driving out costs to deliver within funding levels that reduce from £2.6 billion in 2010-11 to £2.0 billion in 2014-15 (excluding depreciation and annually managed expenditure). Three key programme areas were identified where we committed to lower levels of funding and the SR10 assumed these reductions:

- **Major schemes** – where we agreed to start a defined programme of 14 schemes by 2014-15 within a funding envelope that delivered at least 20 per cent efficiencies. We are currently anticipating over-delivery of these efficiencies over the SR10 period.
- **Traffic management** – where we committed to a broad range of operational improvements to our Traffic Officer Service and other traffic management functions while also cutting costs by 20 per cent by the end of 2013-14. We are on schedule to deliver this.
- **Maintenance** – where we expect to reduce annual spending from an average of more than £900 million to an average of about £700 million over the four-year SR10 period. As new contracts are awarded we are achieving this level of saving.

In addition, the SR10 set the Highways Agency a challenging 30 per cent reduction to its administration budget. With early decisions around estates and information technology, the Highways Agency is ahead of schedule to meet these reductions by the end of the SR10 period.

Our financial performance in 2012-13

Our total budget for 2012-13 was £3,813 million and was divided into DEL and AME:

- Departmental expenditure limit (DEL) budgets, which are the firm budgets (resource and capital) set in SR10 and supplemented by the autumn statements.
- Annual managed expenditure (AME) budgets, which apply to items that are volatile and which the Highways Agency could not be expected to absorb within the firm DEL plans.

	Actual £m	Budget £m	Variance £m
Resource DEL (excluding depreciation)	996	1,038	41
Resource DEL depreciation	858	914	56
Resource AME	390	827	437
Total net operating cost [1]	**2,245**	**2,779**	**534**
Capital DEL [2]	963	1,034	71
Capital AME	(61)	0	61
Total capital	**902**	**1,034**	**132**
Total budget	**3,147**	**3,813**	**666**

[1] Net operating costs include £24 million of EU grants for capital projects and exclude a write-back of £83 million relating to the M25 gain-share receivable (see below). These items are treated differently in the accounts and are excluded from the statement of comprehensive net expenditure which therefore shows lower net operating costs.

[2] Net capital expenditure in the accounts is £843 million, £83 million less than capital DEL. The £83 million relates to a gain-share receivable by the Highways Agency following the completion of the M25 widening project. For budgeting purposes, this is treated as a consolidated fund extra receipt.

During 2012-13 we:

- **completed 752 lane miles of carriageway resurfacing**
- **made more than 7,000 inspections across our structural assets and undertook 880 maintenance interventions**
- **carried out 2,200 maintenance interventions on our technology assets**
- **replaced more than 28,000 individual technology components – replacing in full 708 signs and signals and 42 miles of the digital communications network**
- **installed 8,140 new technology assets including 1,290 signs and signals, more than 28 miles of new communication cabling infrastructure and more than 50,000 technology components.**

A segmental analysis of our 2012-13 expenditure is included at Note 2 to the accounts.

The most significant segments are:

- **Maintenance** – The infrastructure of the strategic road network is one of the single most valuable public assets, and the maintenance of it consumed a high proportion of the Highways Agency's spend in 2012-13 (more than 37 per cent of the total DEL expenditure excluding depreciation).

  The work includes replacing and maintaining surfaces, bridges and other structures (780 renewal schemes were delivered in the year). It also includes the associated upkeep of fencing, drainage, lighting and signage, and the cost of keeping the network open in winter.
- **Public Finance Initiative (PFI)** – The Highways Agency has 12 PFI contracts, 11 of which are for the design, build, finance and operation of sections of the network including the 30-year M25 widening and maintenance contract. The expenditure is included in the major improvements segment and details of these contracts are included in Note 18 of the accounts.

  Approximately 52 per cent of the Highways Agency's resource DEL expenditure (excluding depreciation) relates to the service payments on these contracts.
- **Major Capital Improvements** – During 2012-13, £462 million was invested in major projects on the strategic road network, including the completion of major investments on the M25 and the M1.

  New schemes were started on the M6, the A453 widening, the M1, the A11 and the M25. Further details of all these schemes can be found in Section 5 (Improving the network).

Resource DEL (excluding depreciation)

The positive variance of £41 million (4 per cent) compared to budget reflects:

- higher savings from the implementation of new operating models in the Traffic Officer Service
- reduced costs for traffic management activity
- savings in the delivery of smaller local schemes
- lower than anticipated inflation resulting in payments on PFI contracts below initial forecast
- generation of more income than originally expected.

Resource DEL depreciation

The final depreciation charge of £821 million against the infrastructure asset was three per cent lower than budgeted. As well as the level of expenditure on capital renewals, the depreciation charge is impacted by the condition of road surfaces and indexation of the network valuation. Both of these factors are difficult to predict accurately in advance and both have moved in a way that generates a favourable variance. In addition, during the year, the Highways Agency has undertaken a detailed review of the standard costs and dimensions for structures to ensure a robust and auditable position. This work has resulted in a small decrease in the value of structures and an associated decrease in the depreciation charge.

Resource AME

The main item within this budget is the non-cash write-down of the infrastructure asset to reflect the difference between the actual cost of construction and the standard replacement cost. Further details of this valuation policy can be found in Note 1.4 of the accounts. The level of write-down is very dependent on the volume and type of schemes undertaken by the Highways Agency. The under spend of £437 million, which had been forecast from early in the year, reflects the difference between the prudent assumptions used at the time of deriving the AME write-down budget and the actual capital investment programme for 2012-13 that was subsequently agreed as part of the SR10 settlement.

Capital budget

The positive variance on the capital investment programme is mainly due to:

- over-delivery of efficiencies on major projects
- changes to the profiling of activity on major projects
- additional efficiency savings from capital renewal activities where the full programme has been delivered at lower cost.

Prompt Payment Initiative (PPI)

The Highways Agency has a PPI target to pay 98 per cent of all supplier invoices within terms (usually 30 days) and a further target to pay 80 per cent of all invoices within five working days. During the year the Highways Agency paid 99.77 per cent (2011-12: 99.62 per cent) of all invoices within terms and 94.10 per cent (2011-12: 92.79 per cent) within five working days.

Payments to Small and Medium Enterprises (SMEs)

The Highways Agency continues to make a key contribution to the Government agenda to accelerate cash flow and give certainty of payment timing through our supply chain. While the Highways Agency's direct spend with SMEs is relatively small (around three per cent of expenditure), a significant proportion of our expenditure ends up with SMEs via our main contractors.

It is the Highways Agency's policy to introduce project bank accounts (PBAs) on all new large contracts. These accounts enable subcontractors and suppliers to draw payment at the same time as the main contractor is paid, and offer us much more transparency over expenditure with SMEs. Over the next three years, we will see more than £2.5 billion of payment passing through PBAs, which will account for more than 70 per cent of the Government target for PBA spend and benefit hundreds of SME suppliers working on Highways Agency projects.

We are working to collate data to monitor this SME spend. Initial indications suggest that at least 28 per cent of the Highways Agency's expenditure (excluding PFI payments) flows to SMEs spread across the country.

3. Olympics and Paralympics

Delivery for the London 2012 Games

The Highways Agency was a key delivery partner for London 2012 Games. Our job was to support the success of the Games by keeping traffic on the strategic road network moving and co-ordinating with other transport network operators. Operational relationships with Olympic and Paralympic stakeholders through the London Transport Co-ordination Centre were a real success.

Preparation for the Games

The Highways Agency delivered a number of planned improvements on schedule ahead of the Olympics in July:

- The A31 Canford Bottom junction in Dorset used to experience significant congestion at peak times and weekends. Work was undertaken to remove this bottleneck on the route to the Games sailing regatta at Weymouth and Portland. The scheme was completed ahead of schedule.
- Major projects to add capacity on the M25 between junctions 16 and 23 and between junctions 27 and 30 were both completed ahead of schedule and well in time for the Olympics.
- The Games Lane on the M4 was delivered to a challenging timetable. The Highways Agency successfully operated this lane, helping to get the Olympic family, including athletes and officials from Heathrow Airport, into central London and to the Olympic Village. The M4 Games Lane was a success, with good compliance observed.

In addition, the Highways Agency had to respond promptly to a major issue on Boston Manor Viaduct – located on the M4 between junctions 2 and 3 – when cracks were discovered in the structure.

M4 Boston Manor Viaduct

In early July 2012, Boston Manor Viaduct – which carries the M4 in west London – was closed for emergency repairs after a crack was found in a highly stressed zone above the 0.6-mile-long structure's bridge supports. Previous repair work had been taking place since April after a routine inspection found cracks in the structure in the spring of 2012, but by preventing heavy vehicles from using the viaduct, we had kept the road open to 90 per cent of all traffic.

After intricate engineering work, with our contractors working night and day, the M4 was reopened just a few days later with a weight restriction in place. This allowed for the smooth transport of athletes and officials, arriving at Heathrow Airport, to and from the Olympic Village.

Repair work on the mid-1960s structure continued throughout the summer and was eventually completed in October 2012, allowing the weight restriction to be removed for up to 100,000 vehicles that use that section of the M4 every day.

Operations for the London 2012 Games

The Highways Agency devised and implemented detailed operational plans to actively support the London 2012 Games, from when the torch relay first arrived in Cornwall on 18 May until when the last Paralympian left Heathrow Airport on 14 September. Our plans were developed in close consultation with Olympic Delivery Authority, the London operating committee and Transport for London. We focused on the two key transport objectives of supporting the success of the Games while keeping England moving. Action we took included:

- significantly extending our traffic officer patrols and recovery services along the route to Weymouth
- pre-positioned resources where they could most effectively support the Games and worked closely with venues such as Lea Valley, Eton Dorney and the football stadiums – with our staff joining venue transport teams to ensure success
- responding swiftly to clear significant incidents threatening access to Games venues across the country by operating a round-the-clock command structure during the Games, with volunteers working night shifts to make this happen
- staffing a 24/7 Highways Agency desk at the Olympic Transport Co-ordination Centre in London. Our traffic officers, vehicle recovery service, incident support units and police partners were all on heightened readiness to respond to incidents
- making full use of fixed and portable variable message signs and regularly updating our Traffic England website to ensure accurate and targeted messages for those planning journeys
- contributing strongly to Transport for London's travel demand management campaign, with direct messages on our electronic motorway signs near venues and around London.

Case study

The Highways Agency supported a number of staff who volunteered to be Games Makers. **Julie Smith was one of London 2012's 70,000 Games Makers, supporting the Haiti team during the Paralympics:**

"My role was to be the link between LOCOG and the Haiti delegation during the Paralympics. This involved jobs ranging from doing the paperwork and escorting athletes and officials on sightseeing trips, to cheering them on at their events and generally, being their friend, sister and "mamma".

"Like when one of my athletes, Josué Cajuste, got a new leg. Josué was born with one leg shorter than the other with his foot at about knee-height. He has therefore spent 29 years on crutches, with a huge, debilitating limp.

"In the village there was a German company, OttoBock, which repaired wheelchairs, prosthetics and orthotics. We asked their advice on what we could do in the future for Josué, so we could work on fundraising for him. The next day they rang to ask us to bring him in to see them. They'd made him a leg. Within two days he had gained four metres on his personal best in the javelin!

Julie was a National Paralympic Committee assistant for the Haiti team

"I learned loads from these guys – they were all here to achieve personal bests with had a desire to compete, just like anyone else. In the village, disabilities genuinely didn't matter. Everyone helped each other, regardless of nationality or background.

"So, as I stood at the closing ceremony among dignitaries, receiving standing ovations for being a Games Maker, with tears rolling down my cheeks, I knew I would never forget this unbelievable opportunity."

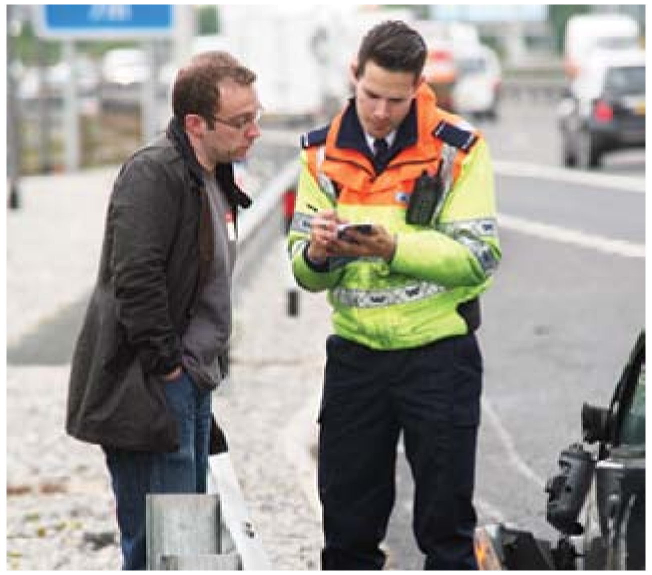
4. Operating the network

With more than four million customers a day, operating England's strategic road network is a 24/7 business. Our National Traffic Information Service supports our National Traffic Operations Centre and seven regional control centres – these manage around 3,250 variable message signs and more than 1,600 closed-circuit televisions. Through these, the Highways Agency focuses on:

- keeping the road network open by responding rapidly to incidents
- providing up-to-date information to customers.

Managing incidents

The Highways Agency responds to more than 6,000 carriageway impact incidents a month. These are typically breakdowns in a live lane, clearance of debris, or road traffic collisions. Incident duration is monitored closely and the Highways Agency strives to minimise the impact of all incidents on road users.



The Department for Transport's Business Plan, updated in 2012, formally set the objective of implementing measures to reduce the congestion and costs associated with motorway closures following incidents. One action taken to address this was establishing the Collision, Lead, Evaluate, Act, Reopen (CLEAR) joint initiative between the Highways Agency, the Department for Transport, Association of Chief Police Officers, Chief Fire Officers Association, and Association of Ambulance Chief Executives.

These organisations, together with the Vehicle Operators Services Agency (VOSA), have endorsed and progressed the CLEAR initiative's 10-point action plan, in many cases exceeding the requirements. The objectives of the plan have been achieved and a final report has been produced.

The 10-point plan set out actions related to incident analysis, developing understanding, creating a bank of case study incidents, reviewing the Road Death Investigation Manual, promoting and reviewing multi-agency and police training, exploring technology to improve incident clearance, and monitoring performance.

The three themes prioritised for action were the clarification of roles and responsibilities of incident responders, the use of new technology, such as laser scanners, and a focus on incident prevention initiatives for heavy goods vehicles.

This has led to significant achievements. There has been closer joint-working and co-operation between incident responders, and the use of laser scanners has led to incident scenes being surveyed more quickly. These save an average of 40 minutes during the investigation time for motorway incidents.

Other significant achievements have been an insight into longer duration incidents, the production and dissemination of a booklet and training film focusing on roles and responsibilities, a review of the Road Death Investigation Manual 2013, wider use of technology, such as towing load cells to clear the carriageway quickly, and incident screens to stop rubbernecking. In addition VOSA is continuing to take action on non-compliant heavy goods vehicles.

Continuing actions include further data gathering, analysis and reporting of incident durations, the piloting and roll out of new incident management technology, and embedding CLEAR principles in operational guidance. More importantly all stakeholders are committed to learn from best practice and to develop the joint working and cooperation that embodies CLEAR to reduce the impact of incidents on road users.

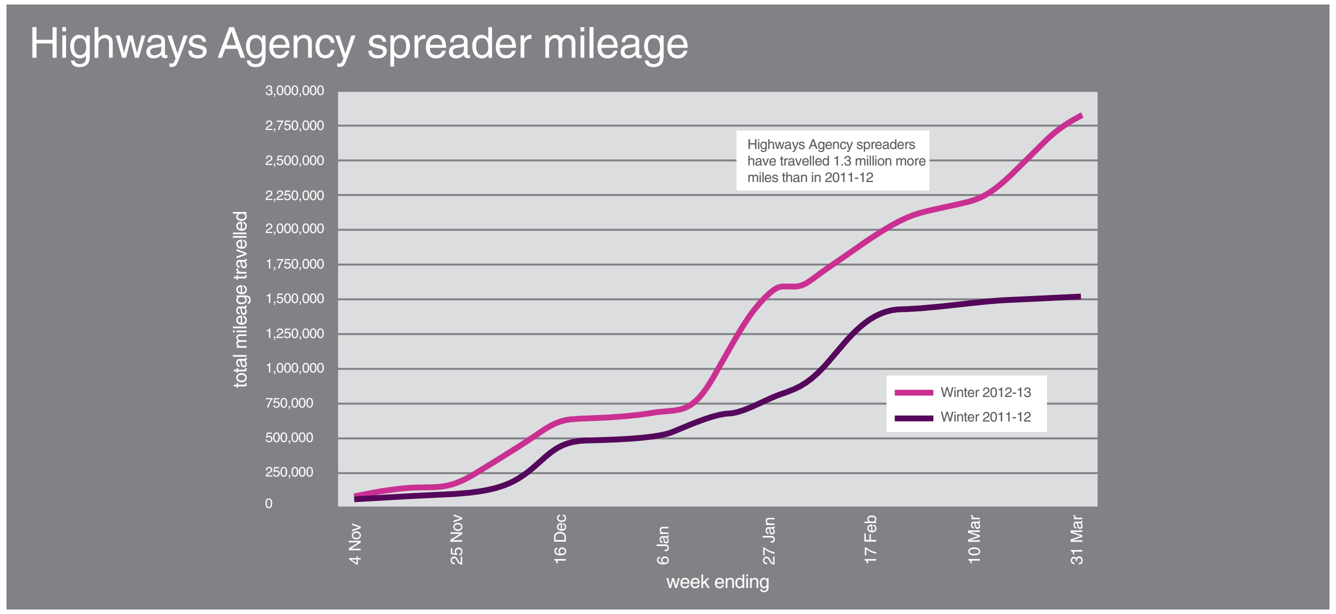
Weather – flooding and snow

Severe weather events can be challenging for England's transport network and 2012-13 saw significant and prolonged snow and rainfall, which required the Highways Agency to respond. The Highways Agency has developed severe weather plans specifically tailored to the local requirements in each of our regions. New guidance for contractors this year included advice on treating the network in extreme cold conditions.

The Highways Agency launched a comprehensive winter communication campaign in October 2012, which ran in unison with the Cabinet Office's *Get ready for Winter* and Scotland's *Ready Scotland* campaigns, to encourage drivers and passengers to be informed and be prepared when considering their journey.

The Highways Agency also distributed its campaign toolkit to more than 300 partners and worked closely with more than 100 key partners – including the AA and RAC, the Institute of Advanced Motorists, and trade bodies including the Road Haulage Association and the Freight Transport Association, as well as local authorities, airports, shopping centres and fuel companies. By working in partnership with them, we have delivered our winter messages through their own communication channels. Campaign information was also displayed on Highways Agency information points at 100 motorway service areas, ports and airports.

The Highways Agency has its own modern fleet of 437 winter service vehicles. With the addition of vehicles owned and operated by our contractors, more than 500 winter service vehicles are available for use on England's motorway and trunk road network.



During a winter season, the Highways Agency's winter fleet typically covers around 1.5 million miles while treating our network. In 2012-13 this increased to more than 2.75 million miles in response to the higher frequency of cold weather events in the final quarter of the year. The Highways Agency also introduced its new weather information service, which takes data from more than 200 weather stations on the strategic road network, together with forecast information that is used by operational teams.

Severe weather updates on social media

The Highways Agency winter driving information is now on Facebook and Twitter. We can be followed on Twitter at @winterhighways

This channel provides road users with seasonal advice, the latest weather and 'gritting' news, as well as updates on any major incidents on our network and weather warnings from the Met Office. We have an index of more detailed traffic information for Highways Agency motorways and major A roads and eight regional feeds on our website.

Like us on Facebook

The Highways Agency's Facebook page provides information about how we help to keep the motorways and major A roads clear during the winter, along with advice and information. As well as updates on our timeline, there are also useful Facebook apps to choose from…

- Weather Watch – latest information from Met Office colleagues based in our National Traffic Operations Centre
- Live flood alerts – an interactive map in association with the Environment Agency
- Winter kit – reminders about what you should keep in your car during severe weather
- Traffic on Twitter – all our Twitter traffic feeds in one place
- Links to our YouTube and Flickr pages, providing photos and videos

In September 2012 stretches of the road network around the A1 at Catterick and near Morpeth in Northumberland, and the A66 to the east of the A1, were closed due to flooding. The A19, which acts as the strategic diversion route for the A1 through North Yorkshire and Durham, was also down to one lane in places and nearly closed. The flooding happened after what the Met Office described as the most intense September storm for 30 years, with up to 100mm of rain falling locally within 24 hours on ground that was saturated by the wettest summer for 100 years. Much of the region received at least a month's rain in just three or four days.

Four days of around-the-clock efforts to clear floodwater from our strategic road network ensued. Work to clear the floodwater included:

- a Jetvac cleaner that can suck up 3,000 litres of water at a time
- deploying a sweeper – a vehicle with automated brushes and vacuum
- pumps – including a high-volume pump provided and operated by the West Yorkshire Fire and Rescue Service, which pumped 15 million litres (equivalent to six Olympic swimming pools) of water over 30 hours.

This equipment was used at the main trouble spots as rain continued to fall, compounding the original incidents.

We trialled the use of the Environment Agency's flood forecasting system in one of our regions. Our severe weather plans include an assessment and mapping of flooding risks which are recorded in our schedule of vulnerable locations.

Adapting to climate change

Over the longer term, the Highways Agency is having to adapt to operating within a changing climate and ensuring that its road network is dynamic and resilient. The Highways Agency has assessed the potential risks that climate change poses to the ongoing operation, maintenance and improvement of our road network. We are factoring in anticipated climatic changes into the delivery of our business and developing appropriate management and mitigation solutions to remove or reduce these risks. These risks are recorded in the Highways Agency's climate change risk assessment, which has been published on our website.

We use the latest scenarios from the UK Climate Impacts Programme to further inform our work on adaptation, as well as contribute to internal guidance to ensure that the changing climate is factored into our new advice, technical standards and specifications.

Informed travellers

Road users are at the heart of everything we do. We support the public in using our network by providing them with information to:

- enable them to plan their journeys
- inform road users what to expect during their journey.

We do this through our National Traffic Information Service, which supports our National Traffic Operations Centre and seven regional control centres. We also have a uniformed Traffic Officer Service which operates from our regional centres. Traffic officers patrol the key parts of the strategic road network, helping road users first hand by managing incident clearance and making sure that risks to the travelling public are minimised.

Provision of tourist signs

Tourist signs have a role to play in informing travellers. Their provision balances road safety with the strategic needs of the tourism industry and how this can support economic growth.

In response to valid criticism, including indications that the costs of signs was disproportionately high, the Highways Agency has worked closely with other Government bodies, for example the Department for Culture, Media and Sport and Visit England, as well as key tourism stakeholders to consider options for revised criteria for the provision of tourist signs on the strategic road network, and to provide a more streamlined process to deliver new signs. A new process has been launched and costs are now much clearer and proportionate.

Road user satisfaction survey

We carry out regular road users satisfaction surveys to develop a detailed understanding of customer experiences when using the strategic road network, and gathering their views on our services. The data collected from these surveys allows the Highways Agency to provide services which are cost effective and targeted to the needs of road users.

The surveys provide national and regional data, enabling us to highlight regional differences in perceptions. In 2012-13, 91 per cent of road users were satisfied with their most recent journey on the strategic road network. This is measured across the following five areas:

- Safety
- Routine maintenance
- Journey time reliability
- Information provision
- Roadworks

As well as finding out about the last journey made on the road network, we ask road users about driving in severe weather conditions, the Traffic Office Service, variable message signs and general satisfaction with the Highways Agency. The results from the surveys, together with feedback received through the Highways Agency Information Line and correspondence, help us to improve our understanding of the needs of our customers, which in turn helps us to communicate more effectively and improve the services we provide.

Stakeholder engagement

We engage with our stakeholders on a daily basis, often at project level with local stakeholders.

We manage our relationships with key strategic stakeholders through an account management system and 'memorandums of understanding' to develop reciprocal partnerships that assist in the delivery of the Highways Agency's business objectives.

At present we have three national committees – National Road User Committee, National Environment Committee and in 2012 we created a Vulnerable Road User Committee. All three committees allow the Highways Agency to consult, inform and learn from specific groups of stakeholders, ensuring that the interests and opinions of stakeholders are heard and that we better understand organisational and members' needs.

The committees meet twice a year, chaired by Highways Agency senior managers, allowing us to continue to develop strategic partnerships with stakeholders. We worked in partnership with the committees and their members to deliver the *Make Time for Winter* partnership marketing campaign.

In addition to the committees, we also work to establish partnerships with organisations that have an active interest in managing the roads and traffic information. This includes developing and maintaining partnership agreements with local authority partners, strategic traffic generators and other highways authorities.

We explore joint working opportunities to co-ordinate the communication of driving and safety campaign messages. The Highways Agency has been working closely with cycling stakeholders to develop a programme of interventions to improve safety and accessibility, and to encourage cycling as a form of transport. This has been targeted at locations on the strategic road network where we can provide a connection between housing and services, and where there are safety or perceived safety issues which may discourage them from making the journey by bike.

Through liaising with cycling stakeholders, we identified that highway engineers need to consider the requirements of cyclists during scheme design, and we are addressing this by developing a training package.

5. Improving the network

Enabling growth

Over the four years of the Government's spending review period (SR10), the Highways Agency is planning to invest £2.3 billion on major roads improvements, including £1.4 billion to start 14 new schemes. This new investment is a key enabler for economic growth. In addition, the Government's National Infrastructure Plan, published in November 2011, announced additional investment in transport infrastructure projects as a further driver for economic growth. This earmarked specific projects to tackle congestion, including a programme of investment in pinch-point schemes.

Three major schemes completed in 2012-13:

M25 junctions 16 to 23 – We successfully completed the construction work to add a fourth lane in each direction of the north-western section of the M25, between the M40 and A1(M). After just under three years of work, the whole length (more than 22 miles) was open to 70mph traffic more than eight weeks ahead of schedule and well in time for the London 2012 Olympics in July. The project included reconfiguring nine junctions, widening a viaduct and demolishing and reinstalling a footbridge. In total 81 gantries were installed, including the longest spanning gantry in the UK – across 10 lanes – to allow the introduction of variable speed limits above this section of the M25.

M25 design, build, finance and operate (DBFO) contract

The M25 DBFO scheme comprised the upgrade of the M25 to dual four-lane controlled motorway standard and the refurbishment of Hatfield Tunnel.

The project materials strategy focused on the use of recycled materials. Inert demolition waste from other sites was used to produce recycled aggregate, along with waste glass from domestic recycling; in total 92 per cent of aggregate was recycled.

Innovative pile design reduced the amount of steel required by 30 per cent. By using this innovation and 100 per cent recycled steel, 55,000 tonnes of carbon dioxide equivalent of greenhouse gas emissions were avoided across the project.

Lighting can be turned off on the main carriageway, but remains switched on at junctions. This allows potential energy savings in the future operational life of the motorway. The design of new tunnel equipment includes features such as variable lighting levels, which can reduce driver stress, as well as energy consumption.

Wildlife protection included a capture programme which saw 2,500 newts and reptiles moved to new habitats. Additionally two otter holts were constructed. Following a captive breeding programme more than 200 water voles were successfully released into new habitats. Other measures to protect wildlife included the provision of artificial hibernacula and log piles for great crested newts, reptiles and invertebrates, the management of retained scrub for reptiles, and the provision of bird and bat boxes.

The scheme received a number of awards:

- Winner of a CEEQUAL Outstanding Achievement Award 2013 for Project Management.
- Winner of a CEEQUAL Outstanding Achievement Award 2013 for Land Use.
- Highly Commended CEEQUAL Outstanding Achievement Award 2013 for Material Use.
- Considerate Constructors Scheme silver certificate for 'performance beyond compliance'.

M25 junctions 27 to 30 – This scheme involved widening the north-eastern section of the M25 between the M11 and A13 from three to four lanes in each direction (over 16 miles). It was opened to traffic in May 2012, more than six weeks ahead of schedule and well in time for the London 2012 Olympics. This extra capacity has improved journey time reliability, reduced congestion and improved motorway safety. The scheme also incorporates improved driver information and low noise surfacing.

More than 4,800 personnel worked on this project, accumulating a total of more than four-and-a-half million working hours.

M1 junctions 10 to 13 – This scheme involved introducing the first section of managed motorway technology on the M1 between Luton and Milton Keynes (over 14 miles). Work commenced in December 2009 and the first section became operational in July 2012. Overhead electronic signals display variable mandatory speed limits, and message signs indicate when drivers can use the hard shoulder as an extra lane. In December 2012, testing began on the newly installed managed motorway systems between junctions 11 and 13 and became operational in early 2013.

Four major new schemes commenced during 2012-13:

Project	Purpose	Benefits	Completion Expected
M6 junctions 5 to 8 (Birmingham Box phase 3)	To increase capacity by introducing managed motorway technology on the M6 between junction 5 at Castle Bromwich and junction 8	Relieve congestion and smooth the flow of the traffic, improving safety and journey times over this very busy section of the M6 – supporting economic development in the region	2014-15
A453 widening (M1 J24 to A52 Nottingham)	Upgrade of the section of the A453 between the M1 (junction 24) near East Midlands Airport and the A52 in Nottingham	Improve safety, reduce congestion and provide more reliable journeys for travellers and businesses in the region	Summer 2015
A11 Fiveways to Thetford	To upgrade the last remaining single carriageway section on the strategic M11/A11 route to Norwich to dual carriageway standard	Improve congestion problems, particularly during holiday periods	December 2014
M25 junctions 23 to 27 managed motorway	To increase capacity by introducing managed motorway technology on the northern section of the M25 between the A1(M) and the M11	The project will relieve congestion and smooth the flow of traffic, improving safety and journey times; this will also support economic development in the region	Spring 2015

Pinch-point programme

The pinch-point programme, announced in the Chancellor's 2011 autumn statement, is part of the Government's growth initiative with funding of £217 million allocated for the period 2011-12 to 2014-15. The programme was designed to deliver small-scale improvements to the strategic road network to stimulate local economic growth, relieve congestion and improve safety.

The first tranche of the programme, comprising eight schemes, was announced in July 2012, with a total cost of £18.5 million. The second tranche of 57 schemes, with an investment total of £169 million, followed in October 2012. The third and final tranche was announced in April 2013.

We worked with many local enterprise partnerships and local highway authorities to identify these schemes. They will promote economic growth by improving access to nearby development sites and have the potential to help facilitate the creation of more than 300,000 new jobs and 150,000 new homes.

The programme includes an £11 million scheme to widen and improve junction 4 of the M5 near Bromsgrove, with significant benefits for Longbridge – former home of the MG Rover manufacturing plant. With support from the local authority and enterprise partnerships, it will form part of a development plan that aims to create around 10,000 jobs in the West Midlands.

Our first pinch-point scheme was completed at Penzance in Cornwall in March 2013. The £128,000 scheme involved widening the A30 westbound approach to provide two lanes coming on to Newtown roundabout. This meant a dedicated lane for A30 westbound traffic, separating it from local traffic. Work also included improving the access to a bus stop as well as pedestrian crossing points. Meanwhile we have completed design for many more pinch-point programme projects.

Efficiency in the delivery of major projects – preparing for accelerated delivery

The roads sector has been challenged to deliver major projects faster to help support economic growth. Four schemes have been selected to be part of an accelerated pilot project – three managed motorway projects (M1 junctions 28 to 31, M6 junctions 10a to 13, M3 junctions 2 to 4a) must achieve on-site completion by spring 2015 with the fourth pilot project, A160 Immingham, to complete by autumn 2016.

To support this challenging programme, an accelerated delivery team has been created with a dedicated core team of industry leaders. They have been selected to work with the four project teams to enable and facilitate faster delivery, together with creating the future template for accelerated delivery to apply to the rest of the roads programme.

The Delivery Hub

The Delivery Hub was set up in 2012. The Hub is a team made up of Highways Agency employees, delivery partners, designers and consultants that has been brought together to help facilitate at least a 20 per cent efficiency target across the roads programme by supporting all major project schemes. Its aim is to develop and embed new ways of working across organisations and projects; by doing so it intends to fully exploit a programme management approach in order to drive continuous improvements in the efficiency and effectiveness of project delivery.

Category management

Significant progress has been made with embedding category management across the Highways Agency and our supply chain. The gantries and carriageway (aggregate, surfacing and concrete) enabled frameworks are already directly supporting the delivery of forecasted savings on the cost of delivering our major projects programme, which is exceeding the 20 per cent savings target agreed with ministers. Further opportunity will soon be realised through the introduction of an enabled temporary traffic management framework. Category management is playing a key role in driving cultural change in the industry and unlocking value through our supply chain.

Localism and promoting economic development

Following the introduction of the Localism Act 2011, we have been working closely with local authorities as they progress their local development plans. We continue to work with developers, local planning authorities and local enterprise partnerships to facilitate growth, while fulfilling our responsibilities for the strategic road network. This includes working closely with partners on enterprise zones. Our programme of major and small schemes will improve the performance of the network and encourage economic growth.

Planning

In our role as delivery partner, we engage with developers, planners, enterprise partnerships and local authorities to support the timely delivery of local and national growth objectives. We continue to identify opportunities to improve our network for the safe movement of people and goods around the country. We will be working with the Department for Transport to issue new planning guidance that better reflects our economic role and responsibility, and emphasises the important contribution that the road network plays in enabling and sustaining economic activity.

In 2012-13 we received 2,762 planning applications, responding to 99.62 per cent within statutory deadlines. This has resulted in social and economic benefits including developments costing some £13 million, with retail or residential rental values of £5 million, 78,000 new homes, and thousands of new jobs.

In December 2012 the Highways Agency launched four new planning protocols. These provide clarity about how we work with local authorities and developers to support the delivery of projects, in turn generating economic growth while still ensuring the safe and effective operation of the strategic road network.

www.highways.gov.uk/publications/planning-protocols-for-planning-and-development

The new planning protocols cover:

- the local planning process
- local development orders and neighbourhood development orders
- the planning application process
- the section 278 agreement process where the Highways Agency is commissioned by developers to construct small links to the network.

We have also launched the Highways Agency's planning improvement plan – our commitment to continue challenging and improving how we perform in supporting the Government's economic growth agenda. Actions are identified against 11 key areas and we will be submitting a report on our progress against each of them twice-yearly to the Department of Communities and Local Government, the Department for Business, Innovation and Skills and HM Treasury. The first report on our progress was submitted in January 2013.

The delivery of the actions within the plan involves colleagues across the Highways Agency, demonstrating a joined-up approach towards supporting the national growth agenda.

6. Maintaining the network

Maintenance of the strategic road network continues to be our core responsibility. It covers a wide range of essential activities that are required to keep the road network safe and maintained at an optimum level:

- **Routine maintenance** – such as clearing debris, litter and hazardous defects, treating ice and snow, clearing drains, and cleaning and replacing signs.

- **Roads renewals** – including new road surfaces, and other roadworks such as footways, cycle tracks, safety fences and drains.
- **Structures renewals** – for example the repair and rebuilding of bridges and underpasses, tunnels and gantries.
- **Technology renewals** – including repair of variable message signs, cameras, emergency telephones and equipment in control centres.

Maintenance of the road network consumes a high proportion of the Highways Agency's spend – around a third of the budget in 2012-13. The service is delivered by our 12 area-based contractors.

Litter

Since April 2011, the *Bag it. Bin it!* campaign has seen the amount of litter on the Highways Agency's roads reduce by an estimated 25 per cent – but road workers still collect more than 180,000 sacks of rubbish every year. Safety for both road users and road workers is a top priority, and clearing litter from along the carriageway can put workers at risk.

Litter isn't just unsightly – it can cause accidents, block drains and present a danger to wildlife. The Highways Agency estimates that it costs £10 million of taxpayers' money each year to collect litter from motorways. This money could be far better spent on priorities such as road safety improvements.

The Highways Agency works closely with Defra and Keep Britain Tidy to support the Love Where You Live campaign. As part of the *Bag it. Bin it!* campaign, which ran during February 2013, the Highways Agency used electronic roadside messages and Twitter channels to remind road users to take their litter with them and dispose of it safely.

Asset support contracts

The first asset support contract (ASC) for the operational maintenance of the strategic road network started in July 2012, with Atkins/Skanska managing the road network in Area 2, covering Somerset, Avon, Wiltshire and Gloucestershire. The second ASC started in November 2012, with Balfour Beatty Mott McDonald taking responsibility for Area 10, covering Cheshire, Merseyside, Greater Manchester and parts of Lancashire.

The third ASC was awarded to EnterpriseMouchel in June 2013, covering Area 3 in central southern England. The remaining area-based maintenance contracts will all move to ASCs by 2016.

The new style ASCs will gradually replace the existing arrangements, known as managing agent contractor (MAC) contracts. They will form the basis of the delivery of operational maintenance and the identification and delivery of renewal and improvement work across England's motorway and trunk road network.

The new contracts will deliver efficiencies through the inclusion of new operational requirements for asset maintenance and achieve better value for money.

These new requirements are outcome-based and less prescriptive about how and when work is delivered, without compromising safety. They set out the outcomes and deliverables we require, together with any mandated processes and procedures which must be adopted. The contractor now has more flexibility to decide how the required outcomes are to be achieved – encouraging innovation and continuous improvement.

The provision of technology maintenance is also changing as part of the switch to the ASC. Regional technology maintenance contracts are new region-based contracts that are responsible for routine technology maintenance work and repairs, such as to traffic light signals and traffic monitoring equipment.

Delivering efficiency – the 'lean' journey

The adoption of lean principles as a means of developing a continuous improvement culture in the Highways Agency and its supply chain started in 2009. Since then, 240 improvement projects have been started and 115 completed, generating planned savings of nearly £90 million.

Among these projects have been successes such as the use of collaborative planning and lean visual management to reduce timescales on the repairs to M4 Boston Manor Viaduct, and using collaborative planning on the renewals programme in Area 9 (in the West Midlands) to deliver £6 million savings on the overall programme.

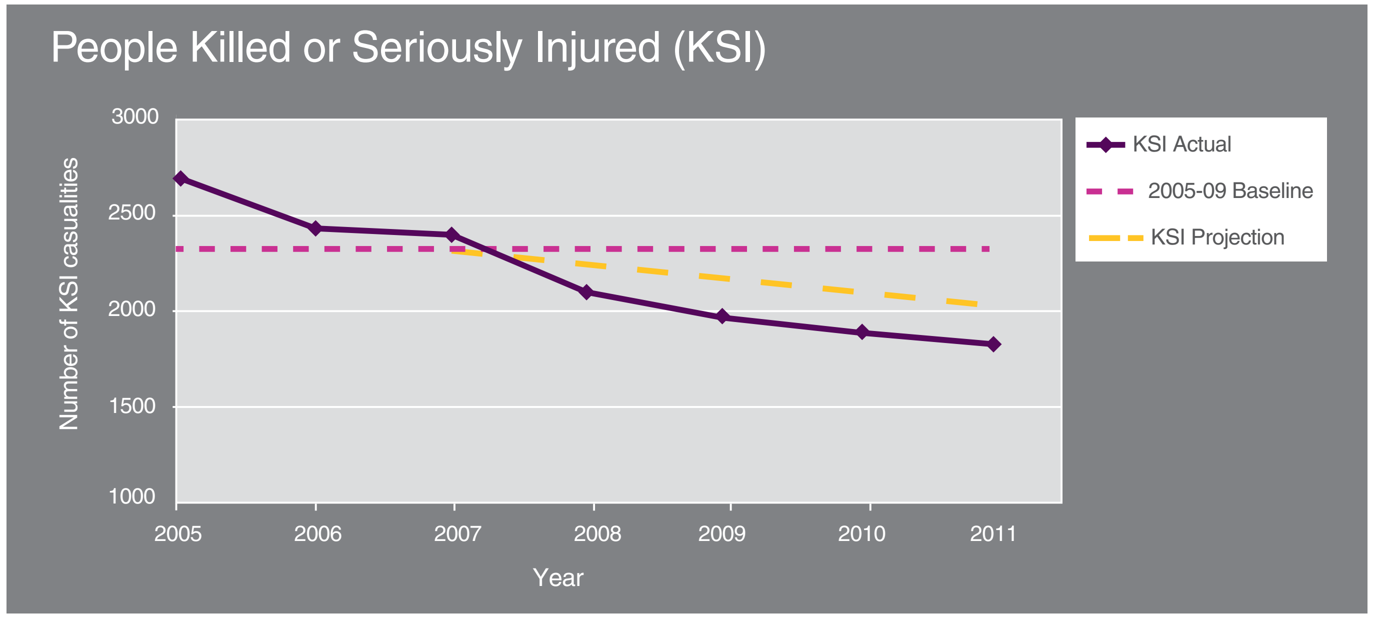
Since 2009, 270 individuals – from the Highways Agency and its supply chain – have received lean training, with 84 people having undertaken training towards practitioner level during 2012.

The delivery partners' lean group in the Delivery Hub are working at programme level to give savings during pre-construction for all major road schemes, including a new process aimed at reducing delivery times by up to six months.

From 2013, lean is being used to seek efficiencies within the Highways Agency's cross-cutting and end-to-end processes – such as the approvals process. In total 12 projects are under way as part of the first wave, with more to come, especially in terms of on-road traffic management.

Lean is also recognised as a key enabler for supporting the Highways Agency's change initiative – an internal organisational change programme – by managing a series of lean improvement projects.

7. Road safety



Safe roads and casualty reduction

The number of people killed or seriously injured on the strategic road network has continued on a downward trend.

The Highways Agency has worked closely with the Department for Transport to develop the future performance specification for road safety, reducing the number of avoidable incidents that will enable us to further improve safety.

We have now rolled out regional safety reports, which summarise the safety performance of regional routes and planned local-level interventions, and ensure compliance with the EU directive for road safety infrastructure management.

Through collaboration with the Conference of European Directors of Roads' road safety panel, as well as the devolved administrations within the UK, we have been able to oversee a cost-neutral implementation of the directive. A further benefit from this closer working approach has been to influence a number of cross-European joint research topics that will be of mutual benefit, as well as to provide a more cost-effective approach for looking at a road safety research programme.

In November 2012, we published the highways standard for the assessment of safety risk on the strategic road network. This provides an overview of the Highways Agency's safety risk management framework and sets the context within which safety risk management decisions are taken across all the populations affected by the road network.

This year our vehicle restraints team has worked closely with the British Standards Committee on amendments to the European standard for road restraint systems. The team has also worked closely with the Construction Products Regulations to ensure mandatory compliance with European Union regulations for vehicle restraint products installed in the UK; they now need to be CE marked to meet the requirements of the EU directive.

8. Collaboration

The Highways Agency continues to benefit from a number of collaborative working arrangements:

CHARM

Over the past four years, the Highways Agency and its Dutch equivalent, Rijkswaterstaat, have worked together to share knowledge and approaches to solving common problems. This relationship is embedded in a joint 'memorandum of agreement'. A programme of collaborative activities has been established, overseen by a joint programme team.

CHARM (Common Traffic Model Highways Agency, Rijkswaterstaat and Mobility and Works) is one of the key traffic technology delivery projects, which aims to investigate and address the current constraints that impact on traffic management technology. The objective is to define a new generation of technologies for traffic control centre use, and to identify the options available for potential future procurement.

The project is part-funded by a grant of €2.8 million from the European Union.

European collaborative research

Following completion of the European-sponsored ERA-NET ROAD project the Highways Agency has continued to collaborate on research with other European national road administrations. We do this through the Conference of European Directors of Roads (CEDR) and separate collaborative agreements, identifying common needs and taking forward co-funded research programmes. This initiative enables the Highways Agency to benefit from exchanging knowledge, peer reviews, performance benchmarking, and gaining value for money through cost sharing.

Participation in the Road Safety at the Heart of Road Design programme has helped the Highways Agency to benchmark its approach to the EU directive on Road Infrastructure Safety Management.

The 2010 asset management programme, which is almost complete, provides a wider understanding of asset management from the road user's perspective. This will confirm the direction of the Highways Agency's integrated asset management information system – a new single database of the strategic road network's assets.

This year a new £3.7 million collaborative programme of research has been awarded, with the Highways Agency leading on road worker safety and the use of vehicle restraint systems; this collaboration promises to deliver valuable research that would otherwise have been funded solely by the Highways Agency.

We are members of the CEDR climate change group, reporting on adaptation to climate change. Risks relating to climate change have been shared, along with proposed adaptation planning and examples of good practice from across Europe.

The Highways Agency is taking forward a number of successful research collaborations initiated by European Research Area Networks (ERA-NET). The Energy – Sustainability and Energy Efficient Management of Roads programme is a cross-border funded, trans-national joint research programme that was initiated by ERA-NET ROAD II.

Carriageway surfacing research

The Highways Agency is committed to collaborating with the road construction industry by co-sponsoring research with the Mineral Products Association and the Refined Bitumen Association to meet the practical challenges in providing and maintaining road infrastructure.

The year 2012 saw the culmination of a three-year research programme designed to ensure that the aggregates used in asphalt surfacing on the strategic road network are optimised for safety, sustainability and cost. Asphalt materials conforming to an enhanced specification were laid on the strategic road network and subjected to a rigorous test programme to establish their safety and durability.

These tests demonstrated that changes could be made to the specification without compromising safety. This gives greater flexibility in sourcing, and improves surfacing durability without the loss of performance, thereby enhancing sustainability. Close collaboration with the roads industry has allowed enhanced materials to be available since summer 2012.

3. Our Team

At the end of March 2013, there were 3,220 permanent, full time equivalent staff working directly for the Highways Agency, with 1,596 of these working as part of our Traffic Officer Service. We aim to recruit and retain people who reflect the diverse nature of our customers. We want them all to feel engaged in the workplace and to receive recognition for doing their jobs well.

Building capability

The Highways Agency's resourcing and capability group co-ordinates a range of programmes and activities that support learning and development in line with the Highways Agency's business needs. They work with all directorates and heads of profession to agree delivery priorities. These priorities aim to drive forward capability within the organisation, and are based around four key areas of activity; contract performance, project and programme performance, people performance and operational delivery performance.

The new approach to delivering learning and development across the Civil Service has been introduced into the Highways Agency with over 85 per cent of staff currently registered on Civil Service Learning (CSL). CSL provides access for Highways Agency staff to a wide range of development initiatives across the four key priority areas.

During the year, staff have undertaken in excess of 4,000 e-learning modules and nearly 2,000 staff attended some form of training event.

Staff engagement

We conduct an annual People Survey to build an accurate picture of the views of our staff, which forms part of a wider Civil Service survey. In 2012 our People Survey had a participation rate of 80 per cent, which means that the results give us a meaningful picture of the views and opinions of our staff. The results were less positive than 2011; our overall engagement score – which measures the degree of attachment and commitment to our organisation and work – decreased by one percentage point, and the majority of responses were down on the 2011 survey. We are using local findings to identify commitments to change, helping us to have a positive impact on how our staff feel about being at work.

Another measure which is often associated with engagement is staff sickness absence. We have a very clear management and reporting process to monitor the levels of attendance of our people. This is measured as the average number of days off work due to sickness absence for each full time equivalent employee. In 2012-13 this was 9.5 days, compared to 9.6 days in 2011-12, which remains a cause for concern. We have introduced a new policy and procedures for managing absence and have started a programme of 'wellbeing' activity which we expect will help reduce sickness absence.

Our change initiative

We understand that organisational change will be a constant feature as we adapt to meet different challenges. In September 2012, we looked at the external drivers that impact on our organisation and concluded that the nation requires:

- a more dynamic and effective public sector that can drive better value for money
- the Highways Agency to be a thriving organisation at the forefront of the economy and a foundation for economic growth
- a flexible and responsive organisation that can support the Government quickly and effectively to meet the changing needs of the tax payer.

We spoke with the DfT, our suppliers and our staff in autumn 2012. They told us that they want to work with and in an organisation that is pacy, engaging, effective, appreciative and fun, and they confirmed that change was needed for a variety of reasons.

Our change initiative

Highways Agency staff said that we need to change to:

- support the drive for economic growth
- reduce costs and provide better value for money
- be able to deliver at pace
- ensure our survival.

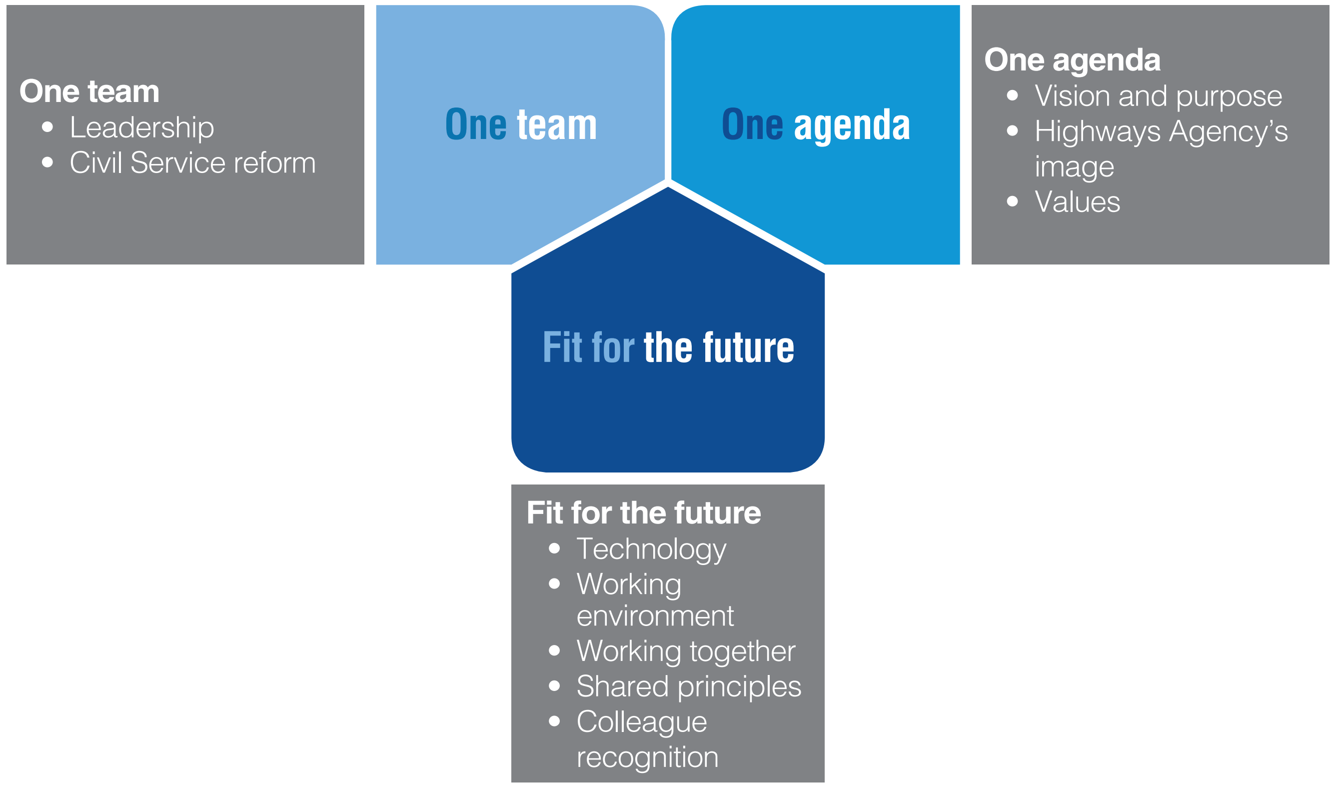
In order to achieve this, we need to:

- break the mould of the short-term investment model
- be clearer about the focus of the Highways Agency's role and image
- be more efficient, and less frustrated and held up by unnecessary processes and bureaucracy
- we need to be more collaborative, flexible and effective as an organisation and with our partners.

As a result of change, we will feel that we:

- have a lively, proactive working environment
- take more individual responsibility and receive and show more respect and recognition
- have quicker, more responsive and up to date IT systems
- can do business easier - a 'can do' culture
- pacy, positive and proud
- engaged, empowered and enjoyable
- confident, skilled, trusted and appreciated.

We have set up three work streams to make changes.



Staff recognition

We want our staff to receive recognition for the good work that they do. In addition to performance pay, we also recognise achievement through our Staff Appreciation and Recognition Scheme (STARS) and annual You Make It Happen awards.

STARS recognises and commends staff who have demonstrated a special achievement by going beyond their normal duties. Anyone can nominate a colleague or member of their team for an award, and nominations are considered in each directorate of the Highways Agency. In 2012-13, 374 staff received a financial STARS recognition.

The Highways Agency's annual You Make It Happen awards recognise outstanding examples of behaviours which bring our values to life, 'Delivering a professional and affordable service through innovation and partnership working'. The scheme is about being valued and recognised. We want to identify the staff who demonstrate our values in exceptional ways and who make the Highways Agency a great place to work. Like the STARS awards, anyone in the organisation can nominate an individual or team.

Supplier recognition

In December 2012 the Highways Agency concluded the second year of its supplier recognition scheme. The scheme again recognised outstanding examples of the important contribution and industry leading performance from our supply chain in:

- health and safety
- managing down cost
- supply chain management
- building and sustaining capability
- delivering sustainable value and solutions.

This year's scheme also provided a special recognition for contribution during the London 2012 Games.

Safety

We are acutely aware that there were around 250 road user fatalities on our network in 2011, the most recent year for which we have validated data; each and every death on our network is one too many. We will continue to work closely with our partners to improve safety on our roads through engineering, enforcement and education, building on the 30 per cent reduction in fatalities compared with 2009's data.

We take health and safety performance very seriously. 'Aiming for Zero' is our strategy for improving the health, safety and wellbeing of our workforce. It sets an unambiguous goal for health and safety performance, confirms the Highways Agency's leadership role in the industry, and brings together health and safety work across the whole organisation. Aiming for Zero covers road workers, construction and maintenance workers, traffic officers and office-based staff.

But working on live carriageways continues to be a hazardous environment for our workforce. This was brought home in the autumn of 2012 by two tragic incidents.

In September 2012, our Traffic Officer Service suffered its first fatality, when traffic officer John Walmsley, who was based at Dartford outstation, died while dealing with an incident on the M25 near Sevenoaks in Kent. John was assisting at the scene of an earlier collision when he was struck and fatally injured by another vehicle. His death reverberated throughout the Highways Agency, attracting tributes from colleagues, partners, people in organisations from as far afield as Australia, and members of the public.

Then in October 2012, just days after John Walmsley's death, a road worker employed by joint venture Balfour Beatty Mott MacDonald was killed in a construction accident while carrying out barrier repairs during roadworks on the A2 in Kent. This was the first road worker fatality since November 2010 and again highlights the risks involved when working on the road network.

We are co-operating with the Health and Safety Executive to establish and take on board the lessons learned from these incidents – developing the risk management arrangements for our Traffic Officer Service, and setting the standards that we expect from our partners in order to maximise safety at construction and maintenance sites.

Case study

Our contractor A-one+ has set the pace in simplifying the way we deploy temporary traffic management signs at roadworks, helping to improve road worker safety. Using this new method, they have removed half the number of traditional warning signs on the approach to roadworks.

Since December 2011, A-one+ has deployed the 'simplified signs layout' more than 6,000 times, saving around 200,000 carriageway crossings and removing more than 2,275 hours that would otherwise have seen road workers exposed to the risk of working in live traffic.

The new layout has been widely welcomed by road workers. Across our supply chain it has led to a 40 per cent reduction in the number of carriageway crossings.

We continue to measure and report the 'accident frequency rate' of our supply chain and work with our suppliers to significantly improve road worker safety. We've implemented temporary traffic management techniques to reduce the risks to road workers who are working on, or close to, the live carriageway. We have also worked in partnership with our supply chain to conduct a number of 'on road' trials, which have provided evidence on the safety of these new traffic management techniques. We have also published guidance that enables signs in the central reserve – used to warn road users that they are approaching roadworks – to be removed during off-peak periods. This will lead to a further reduction in the need for road workers to cross live carriageways on foot. In addition, we have introduced guidance that reduces the time spent setting out the approach taper at off-peak roadworks, further reducing road workers' exposure to risk.

In 2012 we launched our 'raising the bar' initiative, which is a collaborative approach to improving health and safety performance. Working with our delivery partners, we are identifying current best practice and expect this to represent a minimum standard for construction and maintenance activities.

A number of 'raising the bar' guides have been published and we've established a programme to produce further guides in the future.

We have identified and completed risk assessments for the hazards that our traffic officers are exposed to. We have also implemented an assurance and compliance process for on-road traffic officers to ensure that our people are operating safely and adhering to operational policy and procedures.

Equality and diversity

In April 2012 the Highways Agency published *Making a Difference – our equality objectives for 2012–16*. These emerged following analysis of relevant information, research and consultation with customers, staff and our supply chain to establish activities that would deliver long-term positive outcomes for our diverse range of customers and staff.

Our objectives are to:

- encourage our supply chain to take the next step in improving equality outcomes
- improve our understanding of, and responsiveness to, the needs of protected groups within local communities that are affected by our work on the strategic road network
- promote an inclusive culture where the needs of a diverse workforce are valued and promoted
- successfully encourage talented people from a broad range of backgrounds to join and progress through the Highways Agency.

In January 2013, as part of our public sector equality duty, we published *Gathering Momentum* summarising our progress to date. Our focus has been on embedded activities across our different business areas ranging from those working in partnership with our supply chain to those who provide frontline customer support on our network.

Delivering administrative efficiency

The challenge to become more efficient and make the very best use of taxpayers' money continues to drive many actions across the Highways Agency's administration.

During the year we:

- closed our central London headquarters in March 2013 following a year-long relocation project. This will result in an annual saving of over £1 million and forms part of a drive to reduce costs and rationalise the Civil Service estate nationally. Posts have been relocated to other Highways Agency offices in Bedford, Birmingham and Dorking
- started to retender our contract for ICT service, following the model developed by Cabinet Office, which should see savings in excess of 25 per cent across all desktop ICT and telephony services
- sub-let space in Highways Agency offices
- started planning for the migration of finance and human resource services to the newly divested the Department for Transport Shared Services centre, which will generate long-term savings through lower transaction costs and ICT licence costs.

4. Sustainability Report

Introduction

Sustainability is founded on bringing full and lasting economic, social and environmental benefits. The challenge for the Highways Agency is twofold; to ensure our network and the surrounding environment are fit for present and future generations, and to make sure our activities and practices have as little adverse impact as possible on people and the wider environment.

Delivering sustainable development requires leadership, cooperation and involvement from all areas of our business and our supply chain and so all of our Executive Directors have objectives to contribute to minimising our impact on the environment and on society. We need to work with partner organisations with an interest in the strategic road network, both from the point of view of its operation and of its impacts. Importantly we need to ensure that the views of communities neighbouring our network form a part of our decision making processes.

The Highways Agency faces long-term challenges in improving reliability and tackling capacity constraints against a backdrop of increasing construction costs, environmental concerns and growing traffic volumes. Finding the right balance between measures to make better use of the existing network, and prioritising network improvements which support economic growth, will be a key challenge over the coming years.

Road transport has a vital role in supporting economic recovery. The strategic road network carries a third of all vehicle traffic and two thirds of all freight journeys in England. Our network is a part of our national way of life, facilitating links between communities and to leisure and cultural centres. We understand this does not come without a cost to the environment or communities adjacent to our network, but we will seek to minimise that impact.

Summary of performance

In 2012-13 we have continued to make strong progress in delivering our commitment to minimising the impact of the strategic road network on the environment. An overview of our sustainability performance is set out in the table below. Details of our sustainability performance metrics are set out in the tables on pages 45 and 46.

Sustainability performance overview	Performance 2012-13	Performance 2011-12
Greenhouse gas emissions (tonnes of CO2 equivalent)	106,985	115,004
Electricity and gas £m	24.015.	22.121
Business travel (tonnes of CO2 equivalent)	1,291	1,202
Business travel £m	3.494	3.136
Whole estate waste (tonnes)	266	252
Office water consumption (cubic metres)	17,670	18,468

Greenhouse gas emissions

Over the year we have continued to implement measures to reduce our greenhouse gas emissions from our office estate, business travel and from the strategic road network. We have achieved a further 6 per cent reduction in greenhouse gas emissions in 2012-13. A significant proportion of this reduction is due to a change to the Defra emission factor for electricity; however a substantial reduction in energy consumption has been achieved through a range of energy saving interventions including:

- switching off lighting on the network at a further two sites
- continuing to replace lighting and roadside equipment with more energy efficient equipment at the end of the existing equipment's useful life
- further reducing energy consumption in our offices. The Highways Agency reduced greenhouse gas emissions by 1.3 per cent on its estate compared with 2011-12. Savings have been achieved by measures such as relocating to more energy efficient premises and by reducing the area of floor space we heat and light at less busy times, although cooler autumn and winter months have meant we have used more energy to heat our offices, so progress on reducing emissions from our offices has been slower than planned

- reduced emissions from our Traffic Office Service vehicles have been achieved through improved deployment strategies, which maintain operational performance while reducing mileage. We are also continuing a phased programme of replacing vehicles with more fuel-efficient vehicles of the same type.

We continue to broaden the scope and improve the quality of the data we collect to help us understand and reduce our carbon footprint.

Supply chain emissions

Although we are a significant source of greenhouse gases emissions, our supply chain emits much more on our behalf. Collaboration with our major suppliers has the potential to deliver significant reductions in greenhouse gas emissions. For example reductions in the use of steel and the use of recycled steel in construction on our M25 junctions 27 to 30 scheme (see case study) has enabled our contractors to avoid greenhouse gas emissions that are the equivalent to over half of the Highways Agency's total annual emissions.

In the last three years greenhouse gas emissions from our supply chain has apparently reduced by more than half. However much reduced construction activity since 2010 naturally leads to less materials, and therefore reduced greenhouse gas emissions.

In 2012-13 we have continued to work with our major maintenance and construction suppliers to improve the way we work together to manage their greenhouse gas emissions. The estimated emissions from construction and maintenance sites are now reported to operation and project managers in the Highways Agency, rather than to central sustainability managers. Operation and project managers are much better placed to instigate action, or innovation to achieve further greenhouse gas reductions. In the future we will produce a per £1 million normalisation of greenhouse gas emissions – this will give a much clearer picture of the efforts of our supply partners to reduce our impact on the environment.

Office waste

The amount we throw away has increased by 14 tonnes compared to 2011-12. Flood damage at Quinton and Woodlands has contributed to the increased volume of waste, and the flood-damaged waste was not suitable for recycling. The closure of our London office and the preparation of office space in our Bedford and Dorking offices also generated increased volumes of waste.

Construction waste

As the quality of data on supply chain carbon emissions improves, so does the data on the volume of waste generated at our maintenance and construction sites. All major projects have a site waste management plan, which is the basis for construction waste reporting.

From all major project construction sites where complete and disaggregated data is available, the total volume of waste sent to landfill in 2012-13 was 347 tonnes compared to 3,185 tonnes in 2011-12, of a total waste volume of more than 297,000 tonnes. See the table on page 46 for more details. In the period from 2009 to 2012 more than 38 per cent of aggregate was purchased from recycled sources.

As with greenhouse gas emissions from construction sites, the volume of waste correlates closely with the level of construction activity. In the future we will attempt to find a meaningful normalisation for construction waste, so our reporting can more clearly demonstrate the achievement of our supply chain partners in minimising construction waste.

Water

We have introduced more accurate reporting for our supply chain's water use on major projects. This is supplemented by advice on how to save water on construction sites, produced jointly with the Strategic Forum for Construction.

We completed a research project to understand how water is used by our service providers and to assess whether this could affect water stress in catchments where we are working, or whether measures to mitigate water stress could impact on our operations. The study found that the volumes of water typically consumed in our operations are unlikely to impact on local water supplies in the UK.

Water management at Stanford depot

A Balfour Beatty Mott MacDonald joint venture is responsible for the management of the Highways Agency's network in Kent. One of the depots is at Stanford near Folkestone.

Water use at this site is sourced from mains water, rainwater harvesting and a 'grey' water recycling system. Surface water runoff is collected from the buildings, workshops and facilities and is stored for recycling. Foul water discharge from the offices and other recycled water is pumped (after cleansing) to on-site wetlands, ecological systems used to treat waste water.

The main water reduction activities are:

- using run-off water for washing down vehicles
- using a brine tank in the on-site salt barn, which is one of the largest in the UK, to produce water saturated with salt. The majority of this water is sourced from an attenuation tank
- installing push-release taps have been installed in site office wash basins. Urinal cisterns are water efficient and funding is being made available for waterless urinals.

This effort to reduce waste was shortlisted for Chartered Institution of Highways and Transportation's 2013 award for sustainability.

Nevertheless, we continue to raise awareness of water use in the civil engineering construction industry and beyond. We contribute to the Green Construction Board's Greening the Industry water sub-group, and will be seeking water use savings on our projects when compared with the benchmark identified by the group.

Biodiversity

The Highways Agency owns around 22,000 hectares of land, referred to as our 'soft estate', which includes the area between highway fences that is not occupied by the carriageway. This soft estate is made up of a range of habitat types, including sites of national importance, designated for their wildlife and natural features. The Highways Agency's activities, including road construction projects and maintenance schemes, have the potential to impact on protected sites, habitats and species.

Following the publication of the *Natural Environment White Paper* (The Natural Choice: Securing the Value of Nature: June 2011) and England's biodiversity strategy (Biodiversity 2020: A strategy for England's wildlife and ecosystem services: 2011), the Highways Agency is giving further consideration to its approach to biodiversity and nature conservation. We aim to contribute to the creation of coherent and resilient ecological networks by maximising opportunities for protecting, promoting, conserving and enhancing our diverse natural environment.

The Highways Agency works in partnership with other stakeholders to deliver biodiversity action at a national and local level. In line with this approach we have established a 'memorandum of understanding' with Natural England to support effective working between the two organisations.

The Highways Agency has also published its own guidance on nature conservation and biodiversity issues, which is included in the *Design Manual for Roads and Bridges*. This guidance is maintained and supplemented through continued research on aspects of environmental best practice relevant to our activities.

Recycling hard hats into wheelie bins

We have begun a trial to recycle our old hard hats and so reduce the amount of waste we send to landfill. Hard hats normally have a life expectancy of about three years, as exposure to sunlight and environmental conditions can cause the plastic to degrade. This means the Highways Agency can dispose of nearly 100kg of hard hats every year, all of which have been sent to landfill.

A company in Bedford now recycles our hard hats, turning them into high-density polythene regrind – this is used to create new products, such as wheelie bins.

M1 junctions 10 to 13 managed motorway scheme

Work to improve the M1 between junctions 10 and 13 by converting it to a managed motorway has relieved congestion by using technology to vary speed limits.

Notable highlights include delivered by the Costain/Carillion joint venture include:

- **managing water** – run-off from the site compound and a dedicated site allotment was collected
- **biodiversity** – invasive alien crayfish species, that were discovered in large numbers in a brook, were humanely destroyed
- **greenhouse gas reduction** – lighting was removed and permanently switched off, with the exception of junctions, their approaches and a short section of the M1 either side of junction 11 which will remain lit. A safety assessment of this section of the M1 using current standards no longer justified the need for lighting.

The scheme's environment work won the Highways Agency's supplier award for sustainable development.

Sustainable procurement

The Highways Agency's procurement strategy is structured around three tenets: value for money, delivery and sustainability.

The Highways Agency's *Sustainable development plan 2012-15* includes specific challenges for procurement, including developing an action plan to achieve level five of the flexible framework by 2015. Work is under way on this by preparing for a full Chartered Institute of Purchasing and Supply accreditation assessment, including a sustainable procurement module.

We work with suppliers to provide over 90 per cent of what we need, our requirements ranging from operating and developing our road network to keeping our offices and staff properly supported.

To maximise the opportunities which the procurement process offers and in line with the priorities set out in the Highways Agency's procurement strategy, we:

- o Continue to apply sustainability measures at the pre-qualification stage of the procurement cycle via the Strategic Alignment Review Tool
- o Place contracts, which include requirements to deliver sustainable working operations that use resources effectively (reducing waste and maximising recycling/reuse), and reduce energy, water consumption and carbon emissions, as well as implement diversity, equal opportunities and skills/apprenticeship policies. This approach is being reinforced through the incorporation of Government buying standards
- o Monitor sustainable development performance post-contract award by means of sustainability action plans agreed between suppliers and the Highways Agency.

In addition, the Highways Agency raised the profile of sustainability by including a category for 'delivering sustainable value and solutions in its supplier recognition scheme (see case study). The annual awards, first presented in November 2011, are equally open to those in direct contract with the Highways Agency and to those that support delivery through the extended supply chain.

A sustainability e-learning package is currently being developed for the Highways Agency and its suppliers.

A project to build our capability in sustainability has recently been approved. This has resulted in closer liaison with the Dutch road administration, innovations and best practice being spread through the supply chain, and developments to Highways Agency standards.

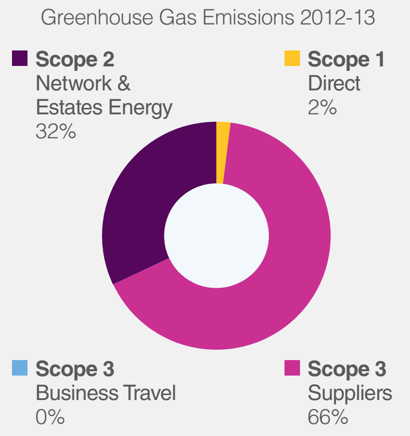
Noise

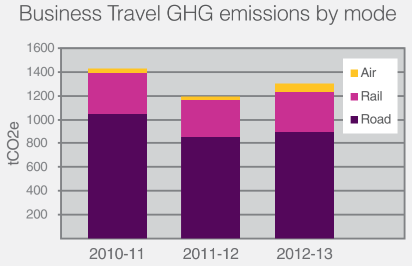
We recognise the impact that excessive noise levels have on those living close to roads. In the past year, we have built on the progress made to minimise this impact through continuing to install low-noise surfacing materials whenever major maintenance is due.

2012-13 Highways Agency Sustainability Report

	Greenhouse Gas (GHG) Emissions	2010-11	2011-12	2012-13
Gross Emissions (tonne CO_2e)	Scope 1: Direct traffic officer fuel and estates gas usage	7,110	5,971	5,531
	Scope 2: Indirect emissions from network and estates electricity consumption	119,000	107,891	100,165
	Scope 3 item: Business Travel	1,200	1,202	1,292
	Scope 3 items: Suppliers' emissions	507,000	411,124	207,668
	Total	**634,310**	**526,188**	**314,656**
Related Consumption Data	Estates (HA offices) Electricity (kWh)	3,543,898	3,459,849	3,333,092
	kWh per full time employee	1,774	1,714	1,779
	Estates (HA offices) Gas (kWh)	1,512,680	1,572,247	2,652,695
	kWh per full time employee	1,421	1,202	1,240
	Private car mileage (million road miles)	1.250	1.226	1,253
	Hire car mileage (million road miles)	1.250	1.402	1.620
Financial Indicators	Total energy expenditure (roadside lighting and equipment, offices, RCCs and outstations)	£20.300m	£22.121m	£24.015m
	CRC related expenditure (admin fee and provision for allowances)	£2,240	£1,024,290	£967,290
	Expenditure on business travel	£2,520,000	£3,125,729	£3,493,866

Graphical Analysis





Performance Commentary Including Measures

Performance commentary – In 2012-13 the Highways Agency achieved a 6% reduction in greenhouse gas emissions compared to 2011-12, although a significant proportion of this reduction is due to a change to the Defra emission factor for electricity.

Commentary on emission factors – Scope 1 direct emissions from the consumption of fuel in traffic officer vehicles reduced by 7.5%, we have reduced consumption of diesel by 265,000 litres through implementing a more efficient vehicle deployment strategy.

Scope 1 direct emissions from the consumption of gas in our offices has increased by 60%. Much higher than expected emissions were caused in part by the need to heat our offices for longer in the cooler autumn and winter months. However, less than 1% of Highways emissions derive from the consumption of gas, so this increase has very little impact on our overall level of greenhouse gas emissions. Plans remain in place to achieve our planned reduction by March 2015.

Scope 2 indirect emissions from the consumption of electricity in our offices and regional control centres has fallen slightly, again the need to heat our offices during the cold weather has meant that we have reduced energy consumption less than planned.

Scope 2 indirect emissions from the consumption of electricity in lighting, communication, signs and signals on the strategic road network and in our outstations and depots has reduced by 6% as energy reduction measures continue to be implemented. However, a significant proportion of the decrease is due to the change to the Defra emission factor for electricity.

Scope 3 indirect emissions from business travel have increased by 7%. Some data for business travel in March 2013 is not yet available, an estimate has been made using data from the previous March.

Controllable Impacts Commentary

Performance commentary – Total Scope 3 emissions from our supply chain, made when maintaining and enhancing the strategic road network have (almost) halved in 2012-13 when compared to 2011-12.

The majority of our suppliers' greenhouse gas emissions are embodied in the construction materials used, so there is a strong correlation between the level of emissions and the level of construction activity on the network. The reduction in supplier greenhouse gas emissions is due to reduced construction activity on our network. However there have been significant efforts right across our supply chain to reduce our impact on the environment, some of which are highlighted in the case studies above.

The Highways Agency and our suppliers will continue to collaborate to improve our management of greenhouse gas emissions associated with highways maintenance and construction. A more informative metric is the amount of greenhouse gas emissions per £1 million of capital spend. For future years, we will report normalised carbon emissions of our supply chain.

Overview of Influenced Impacts

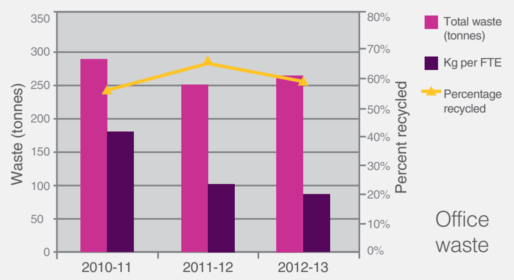
Performance commentary – Clearly, the greatest source of greenhouse gas emissions associated with the strategic road network is the emissions from vehicles travelling on our network. Although road user travel emissions are outside the Highways Agency greenhouse gas footprint accounting boundary, the Highways Agency has an important role to play to help to make road user journeys as carbon efficient as possible. For example, good information can help road users to avoid fruitless journeys and needless detours, effective use of variable speed limits can help to reduce road user emissions by minimising the time spent in queues.

We seek to engage employees in reducing our (and their) environmental impact, like celebrating Climate Week, by launching a competition, inviting everyone across the Highways Agency to take part, with a prize for the best ideas on how to make our buildings more sustainable.

The Highways Agency also seeks to influence the greenhouse gas emissions of its employees commuting to and from our workplaces. Flexible working, car parking policy, car share schemes, etc all contribute to minimising commuter.

Waste		2010-11	2011-12	2012-13
Non-Financial Indicators	**Total admin waste (tonnes)**	287	252	266
	Recycled waste (tonnes)	155	168	162
	Kg per FTE	184	100	90
	Percentage recycled	54%	67%	60%
Non-Financial Indicators	**Construction waste (tonnes)**		355,716	297,888
	Percentage waste to landfill		0.9%	0.1%
	Non-hazardous waste (tonnes)		354,725	296,700
	Percentage recovered		99%	99%

Graphical Analysis



Performance Commentary including Measures

Estates waste – Figures in the above table are for the whole office and control centre estate, but outstations and depots are excluded. Figures for 2010-11 exclude waste from our offices in Manchester and Bristol.

The Highways Agency has increased the total volume of waste generated at its offices by 14 tonnes. Of the total volume of waste, 60% was recycled compared with 67% in 2011-12. The increase in the volume of waste is due, in part, to the need to dispose of flood damaged equipment (most of which was not suitable for recycling or re-use), the closure of our London office has also generated additional waste.

We are working with all of our Facilities Management partners to better understand how our waste is treated, with the aim of minimising the volume of waste we sent to landfill.

Controllable Impacts Commentary

Construction waste – We are continuing to improve the scope and the quality of data that we collect on waste generated at our major projects construction sites, we have also worked with our contractors to develop materials management strategies to maximise the use of recycled materials and to minimise waste from our major projects.

Figures in the table are based on Site Waste Management Plans from our major projects in their construction phase in 2012-13 where complete and disaggregated data is available. Almost 87% of all construction waste was reused and 12% recycled. Our landfill diversion rates remain very low by any industry.

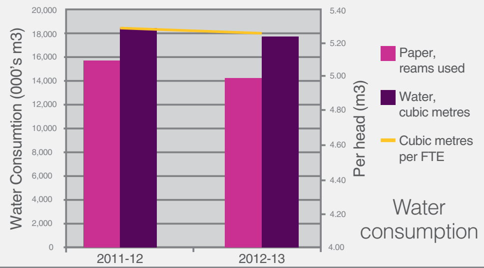
Overview of Influenced Impacts

See section on “Litter removed from the network” on page 30

Finite Resource Consumption

Paper Use		2010-11	2011-12	2012-13
Non-Financial Indicators	**Reams used**	no data	15,601	14,047
Water Consumption		**2010-11**	**2011-12**	**2012-13**
Non-Financial Indicators	Estates water m³	13,900	18,468	17,670
	Estates water tonnes (tonne CO_2e)	4.2	6.1	6.0
	m^3 per FTE	4.6	5.3	5.28
	Water use at construction sites	no data	212,725	

Graphical Analysis



Performance Commentary including Measures

Office water – The figures for 2012-13 in the table include estimates for water consumption at our Birmingham and London offices. The estimates are based on the average per head consumption across the rest of our office estate.

We have reduced out consumption of water at our offices and regional control centres by 4%. Most of the reduction has been achieved by the installation of waterless urinals in our regional control centres and in some of our offices.

Paper – We have reduced our paper consumption by 10% compared to 2011-12. This has been achieved by further reducing the number of printers and setting double sided printing as the default. We minimise the number of paper copies of corporate publications, like this Annual Report.

Controllable Impacts Commentary

We have introduced more accurate reporting of water use by our supply chain on major projects. This was supplemented by the provision of advice produced jointly with the Strategic Forum for Construction to save water on construction sites.

Water consumption at construction sites was lower than in 2011-12, but just as greenhouse gas emissions correlate directly with the level of construction activity, so does water consumption.

Overview of Influenced Impacts

Sustainable procurement – We seek to maximise the opportunities which the procurement process offers in relation to sustainability, and in line with the priorities of our Procurement Strategy, see text above for details.

Notes to the tables:

Note 1: The above report has been prepared in accordance with guidelines laid down by HM Treasury in ‘Public Sector Sustainability Reporting’ published at www.financial-reporting.gov.uk.

Note 2: The Defra conversion factors appropriate for each year have been used to account for greenhouse gas emissions. Scope 3 Supplier emissions calculations have also used the following sources; Environment Agency - Carbon Calculator for Construction Activities, Ofwat (2007) Security of Supply Report, Bath Inventory, Capita Symonds - Carbon Footprint of Motorway Electrical Equipment, Environment & Heritage Service - Municipal Waste Data Monitoring and Reporting, Department of Environment (1997). Energy Efficiency in Hotels, Defra / DECC National Energy Statistics and CIBSE (2004) - Guide G: Public Health Engineering.

Note 3: Electricity consumption road lighting and roadside equipment is normally through unmetered supplies. Electricity consumption is determined by the suppliers, for example for street lighting the calculation is based on the number of active streetlights and the hours of darkness. The calculation of greenhouse gas emissions from unmetered electricity consumption is based on annual statements of consumption from our electricity suppliers. The Highways Agency does not attempt its own estimates of unmetered electricity consumption.

Note 4: We have made a small change to our reporting on emissions from our office estate. In previous years, for locations where our office space was shared with other government bodies, we reduced the emissions reported by the proportion of our floorspace occupied by others. This year all emissions for such shared locations are reported here. This brings this report in line with the requirements for other reports, eg for the CRC Energy Efficiency Scheme.

Note 5: At present estimation methodologies in relation to utilities is considered separately by each different responsible unit. Each estimation method used has been documented in the commentary above. Best practice for the Highways Agency has been developed and will be applied to each business unit as facilities management contracts allow.

We have continued to make good progress in implementing the processes set out in Defra’s noise action plans, as required by the Environmental Noise (England) Regulations. We consulted with local authorities on the results of our investigations at 1,347 locations which Defra identified as those most severely affected by road traffic noise – ‘Important Areas with First Priority Locations’. We also used innovative geographic information system techniques to complete investigations at the remaining 1,061 ‘important areas’ identified by Defra and will be consulting with local authorities on the results of these investigations during 2013, with a view to installing any noise mitigation identified in 2014 and beyond.

Governance

We monitor our sustainability performance as an integral part of our performance management processes. Risks on our preparedness for climate change and our ability to manage our greenhouse gas emissions are escalated to and monitored through the Highways Agency’s corporate risk register. The Directors of the Network Services and Finance and Business Services directorates are responsible for ensuring that appropriate mitigating action is planned and delivered.

The Highways Agency’s Board receives regular reports on sustainability performance, both in terms of business plan measures, such as reducing carbon emissions, and performance against external requirements such as the Greening Government Commitments laid down by Cabinet Office for all central government organisations. Also diversity statistics and action to encourage the achievement of our equality and diversity objectives are reported regularly to the Highways Agency’s Executive Committee.

An internal audit regularly reviews internal sustainability reporting, focussing on validating the data that supports external reports as part of the Carbon Reduction Committee Energy Efficiency Scheme, and verifying claimed performance against our business plan measures.

Financial Statements

The financial statements cover the period 1 April 2012 to 31 March 2013 and have been prepared in accordance with a direction issued by Her Majesty’s Treasury under Section 7 of the Government Resources and Accounts Act 2000. A copy of the direction may be accessed online on the Treasury website at www.hm-treasury.gov.uk. The financial statements of the Highways Agency are audited by the Comptroller and Auditor General (C&AG), head of the National Audit Office. The financial statements have been prepared in accordance with the 2012-13 Financial Reporting Manual (FReM) issued by HM Treasury.

Past and present employees are covered by the provisions of the Principle Civil Service Pension Scheme. Details of the costs associated with this can be found at Note 1.11 and Note 3(a) of the financial statements in Section 9.

Auditors

In so far as the Accounting Officer (AO) is aware, there is no relevant audit information of which the entity’s auditors are unaware, and the AO has taken all the steps that he ought to have taken to make himself aware of any relevant audit information and to establish that the entity’s auditors are aware of that information. The statutory audit of the Agency’s financial statements is undertaken by the National Audit Office (NAO) and costs £275,000 (2011-12 £275,000). In addition £16,500 plus VAT (2011-12 £14,000) was paid to the NAO in respect of the audit of the 2011-12 Dartford-Thurrock Road User Charging Scheme account, and a charge of £14,000 (2011-12 £14,000) was made for the audit of the 2011-12 Severn Bridges account. No amounts were paid to the NAO for non-audit work.

Graham Dalton
Accounting Officer
25 June 2013

5. Governance Statement

Introduction

HM Treasury's 'Managing Public Money' and 'Financial Reporting Manual' require that I, as Accounting Officer, provide a statement on how I have discharged my responsibility to manage and control the resources for which I am responsible during the year.

HM Treasury introduced a new Corporate Governance Code for central government departments in July 2011. The new code builds on the principles of the original code published in July 2005, focusing on the role of boards, since these provide leadership. I have provided details below, of how the Highways Agency's system of corporate governance has operated during 2012-13, including any areas where the system has not operated in line with the Code.

Role of Accounting Officer

The Permanent Secretary of the Department for Transport has appointed me as Chief Executive and as Accounting Officer for the Highways Agency. As Accounting Officer, I have responsibility for maintaining a sound system of governance that supports the achievement of the Highways Agency's policies, aims and objectives, while safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in HM Treasury's Managing Public Money.

Highways Agency Governance

Corporate Governance is deemed to be the system by which an organisation is directed and controlled. I have ensured that the Highways Agency's corporate governance arrangements are designed to comply with the Code of Good Practice on Corporate Governance in central government departments.

The key elements of the Highways Agency's system are:

- the Highways Agency Board, Executive Committee and its sub-committees
- the Highways Agency Audit Committee and its Counter Fraud Sub-Committee
- a good governance culture
- a sound system of internal control including an independent audit and assurance activity.

Each of these areas is explained more fully in this statement, and illustrated in the diagram of the governance framework on page 61.

Highways Agency Board, Executive Committee and its sub-committees

The Highways Agency is managed by a formal Board and an Executive Committee, supported by a Senior Appointments Committee, and two sub-groups of the Executive Committee.

Highways Agency Board

The Highways Agency Board (HAB) meets frequently to consider the plans, performance, strategic direction of the Highways Agency, the most important risks to successful delivery of those plans, and the Highways Agency's stewardship of public assets. The composition and attendance during 2012-13 was as follows:

Attendance at Board meetings

Member	Board	Audit Committee
Alan Cook (Non-Executive Chairman)	10(10)	
Graham Dalton (Chief Executive)	10(10)	3(4)[1]
Peter Adams (Major Projects)	10(10)	
Ginny Clarke (Network Services)	10(10)	
Stephen Dauncey (Finance and Business Services)	10(10)	4(4)[1]
Simon Sheldon-Wilson (Traffic Management)	8(10)	
Derek Turner (Network Development and Delivery)[2]	10(10)	
Tracey Barlow (Non-Executive Board Member) – Until Jul 2012	4(4)	2(2)
David Hughes (Non-Executive Board Member)	10(10)	4 (4)
Simon Murray (Non-Executive Board Member) – From Nov 2012	4(4)	1(1)
Tim Walton (Non-Executive Board Member)	10(10)	4(4)

Note: Figures in table denote meetings attended (meetings available for individual to attend); eg 10 (12).

[1] Graham Dalton and Stephen Dauncey are not members but are invited to attend the Audit Committee. They have no voting rights.

[2] David Brewer has been appointed to the new role of Director, Asset Delivery and to the Board of the Agency, succeeding Derek Turner on his retirement.

The Board is chaired by the Non-Executive Chairman who gives assurance to the Secretary of State for transport on the quality of the running of the Highways Agency and its effectiveness in meeting its objectives. The purpose of the Board is to advise the Accounting Officer in the course of his duties and to ensure that the Highways Agency is organised, resourced and motivated to deliver its objectives efficiently and effectively, giving collective leadership to the Highways Agency by:

- providing strategic direction to the Highways Agency and ensuring that the wider, cross-cutting and longer term issues are properly considered
- ensuring that the Highways Agency has sufficient resources and staff with the skills, knowledge, motivation and support to deliver its objectives
- ensuring appropriate standards of corporate governance are in place and are observed
- listening to, and tackling, the concerns of staff and promoting good management
- communicating with staff and representing the Highways Agency's collective interests to the outside world.

Key items discussed by the Board this year were:

- monthly corporate performance reports
- quarterly health and safety updates
- corporate risk reviews
- quarterly reviews of the Spending Review 2010 implementation plans
- London 2012 Games updates
- 2013-14 business planning
- the future strategy for the Highways Agency.

The Board commissioned an internal board effectiveness evaluation in April 2012, reflecting on performance during 2011-12. Following discussion of the findings of the evaluation the Board has undertaken action to improve in areas including leadership and development, succession planning, Board skills and experience and training for Board Members.

During the 2012-13 period, Tracey Barlow completed her tenure as Non-Executive Board Member and was replaced by Simon Murray, who was appointed to the Board on 5 November 2012 for a two year period.

Highways Agency Audit Committee

The Highways Agency Audit Committee (HAAC) is responsible for providing assurance, to me as Accounting Officer that the Highways Agency's system of internal control is operating effectively. It meets approximately every quarter and reviews the Board's assessment of corporate risk, considering wider Departmental risk as appropriate. In addition, it considers reports from the Counter Fraud Sub-Committee and monitors progress with the internal audit programme, health and safety audits, Network Delivery and Development (NDD) contract assurance and other assurance processes operating across the Highways Agency, ensuring recommendations arising are implemented. It also monitors the performance of internal and external audit functions.

In line with HM Treasury's Audit Committee best practice guidance, the HAAC is made up of the Highways Agency's three Non-Executive Board Members, one of whom has been appointed as chair. The chair of the Highways Agency's Audit Committee also sits on the DfT Audit Committee and meets with his fellow Audit Committee Chairmen regularly throughout the year. The composition and attendance of the Committee during 2012-13 is shown above:

The HAAC Chairman advises, as appropriate, on key risk and control issues arising from the work of the Committee.

During 2012-13 the Audit Committee specifically reviewed or considered various topics including the:

- annual report and accounts
- internal audit annual report and opinion
- year-end 2011-12 and mid-year 2012-13 stewardship (management assurance) reports
- Highways Agency's corporate risk register
- reporting of instances of identified fraud, together with assurance over the relevant central enforcement, as appropriate
- internal audit and NAO audit strategies and progress for providing assurance to the Chief Executive, as accounting officer
- NAO value for money work
- Dartford river crossing and Severn bridge accounts 2011-12
- planning and accounting policy changes for 2012-13, including network valuation and depreciation
- health and safety audit programme and sources of assurance analysis
- strategy and planning for the contract assurance regime over NDD supply chain contracts
- HAAC's terms of reference and related matters.

The HAAC reviews its effectiveness on an annual basis and takes forward actions to improve its performance. The last exercise was undertaken in April 2013 and actions were agreed by the Committee at their June meeting. Progress on implementation is monitored throughout the year and results incorporated into its next exercise.

Highways Agency Executive Committee

The Executive Committee meets frequently to consider the day-to-day administration of the Highways Agency. The Executive Committee is chaired by the Chief Executive and is responsible for ensuring that the appropriate plans are in place to allow the Highways Agency to meet business plan objectives and live within its budget. Key items discussed this year were:

- Executive performance reports
- communications forward looks
- 2010 spending review implementation plans
- Highways Agency resource plans.

The Board and Executive Committee are supported by a Senior Appointments Committee, a Delivery of the Investment Programme Sub-Committee, the Highways Agency Audit Committee and a Network Performance Group.

Senior Appointments Committee

The purpose of the Senior Appointments Committee (SAC) is to ensure that succession planning and progression/developmental strategies are in place for senior roles across the Highways Agency. The SAC is a sub-committee of the Board and meets on a quarterly basis or more regularly if required.

This year the SAC focused on:

- ensuring that succession planning is in place for all senior appointments including those to the Executive for both the longer term and for emergency needs
- providing moderation and agreement to high level objectives for all senior staff
- ensuring that progression for senior staff is also mapped to include both personal and developmental objectives
- agreeing performance and pay recommendations on an annual basis.

Delivery of Investment Programme Sub-Committee

The Delivery of Investment Programme (DIP) Sub-Committee is responsible for monitoring the capital investment programme, tracking the delivery of efficiencies and ensuring a strategic approach to supply chain and commercial activities. It provides reports to the Executive Committee of any material risks to the delivery of the principal capital investment programmes set out by the Department for Transport for the Highways Agency to deliver. Copies of the minutes of meetings are provided to the HAB for information.

This year the DIP focused on:

- monitoring progress in the delivery of the Highways Agency's capital investment programme with specific review of potential under or over spends in the year, including considering the mitigation of these variances, either within the Highways Agency or, in conjunction with finance functions, across the Department
- tracking the outcomes from Project Control Framework stage gate and OGC gateway reviews, with common themes identified and learning and best practice shared with the business
- challenging the financial outcomes of Spending Review 2010 delivery plans (existing cost plans) to ensure clarity and the existence of a strong evidence base for claimed efficiency savings
- tracking the efficiencies delivered by the supply chain using unit cost information captured within the Major Projects and Network Development and Delivery directorates
- assessing the spend profiles and performance of the supply chain across all directorates against a range of measures and using intelligence to inform the strategic supply chain direction
- supporting consistency across all directorates in how the Highways Agency engages contractors and consultants and ensures best practice in cost and commercial management is maintained across all directorates
- reviewing sector activity delivery risks and mitigating actions and, where appropriate, ensuring strategic risks are captured and assigned and key lessons are being applied to future investment planning
- reviewing the pipeline of procurement opportunities in line with the Highways Agency's future procurement strategy ensuring that strategic procurement opportunities are considered, that the procurement strategy delivers reduced bureaucracy, incentivise's consistent high performance and collaborative working at fair market prices with appropriate risk transfer.

Network Performance Group

The Network Performance Group (NPG) is responsible for driving improvements in the performance of the strategic road network. The operation and performance of the network is at the core of the service that the Highways Agency offers to its customers, and NPG is key in driving a mindset and culture that ensures that the customer experience is consistent with our aspiration to be the world's leading road operator. NPG focuses in particular on:

- safety
- traffic performance
- network availability (including winter and severe weather service)
- customer service (information and feedback)
- network development.

NPG takes the lead in facilitating cross-directorate communication, collaboration and issue resolution relating to all of the above issues. Key elements discussed in 2012-13 were the London 2012 Games, network performance and network strategy.

Highways Agency Counter Fraud Sub-Committee

The Counter Fraud Sub-Committee is chaired by the Director of Finance and Business Services and its membership comprises: the Highways Agency's Fraud Management Advisor, the Head of Audit and Assurance, the Procurement Director, a representative from the Department's legal function and a Non-Executive Board Member, with additional representation from the business, as required. The sub-committee meets approximately every quarter, in line with the HAAC and reports of the business handled by the sub-committee are provided to the HAAC for information.

During 2012-13 the sub committee undertook the following:

- A review of the current case load that has been identified through the counter fraud and whistle blowing facility.
- Directing the appropriate body (internal audit; human resources or business managers) to conduct further work or investigation to establish if an allegation is correct to enable remedial action to be taken.
- A review of the 2012-13 fraud horizon scan (which was undertaken by the Fraud Management Advisor through a series of workshops) to determine the current risk environment where the potential for fraud is more significant. Results and ongoing actions will be monitored through the sub-committee and reported to HAAC, as appropriate.
- Oversight of the exercise to provide clarity on the Highways Agency's business operations in relation to the Bribery Act and the potential risk of non compliance.

The sub-committee reviews its own effectiveness on an annual basis and takes forward actions to improve its performance. The last exercise was undertaken in April 2013. Progress on implementation of actions arising is monitored throughout the year and results incorporated into the next annual exercise.

The Governance Culture

The Highways Agency recognises that the culture of the organisation can impact substantially on its success in terms of good governance and compliance with required risk and internal control policies and processes. As Civil Servants, all staff of the Highways Agency are bound by the Civil Service Code. The Highways Agency values statement; 'providing a professional and affordable service through innovation and partnership working' supplies the foundation of its culture.

A key element of culture is the engagement of staff. In 2012 the Civil Service Staff Engagement Survey results showed that the Highways Agency's engagement index decreased by 1 per cent to 52 per cent compared with the previous year. The results against the majority of engagement questions are less positive than last year, and less positive than the Civil Service overall. We are focusing on several areas to ensure we deliver real improvements and make the Highways Agency a better place to work.

The vast majority of our work is delivered through a tiered relationship with our supply chain. Our procurement strategy positions us to deliver a first class and consistent approach to procurement, based on the three key themes of value-for-money, delivery and sustainability. We are determined that the procurement function should develop beyond delivering a process, into a position where the Highways Agency is actively encouraging and demanding best practice and innovation to fulfil these aims.

The Highways Agency does not make grants to locally governed organisations.

System of Internal Control

There are a number of internal control processes, which provide a framework for managers and staff to successfully and efficiently deliver the Highways Agency's objectives. These processes are designed to manage risk to an optimum level rather than to eliminate all risk of failure; as such, compliance can only provide reasonable and not absolute assurance of effectiveness.

All Highways Agency processes have an assigned owner and are documented on the Highways Agency's intranet through the 'Way we Work' system. This is supported by a clear Process Management policy, which requires Process Owners to regularly review their processes and seek assurance on both compliance and their suitability.

The key processes of internal control, which provide the basis of delivering all of the Highways Agency's objectives, include the following, with further details on each below:

- Risk management
- The identification and mitigation of conflicts of interest
- Business planning
- Performance management
- Financial management
- Project and contract management
- Compliance with standards and requirements

Risk Management

The Highways Agency's Executive Directors and other senior managers are responsible for risk management within their commands. The Highways Agency has a published risk management policy which is available to all staff via the intranet. The guidance outlines key aspects of the risk management process, including the main reporting procedures and the system for identifying and escalating risks. Senior managers have received training in risk management tailored to their responsibilities and concerns.

Staff and managers are required to identify new or increased risks and opportunities as part of the routine performance reporting process. Risk is a standard agenda item in team meetings in many areas of the Highways Agency. Risks are reviewed, the effectiveness of mitigating actions and their impact on residual risk is monitored, and changes identified and evaluated throughout the year, as part of routine management activity. Risk owners include reports on their handling of operational risk as part of their wider stewardship reports. The Board allocates the management of strategic risks to a nominated Director, as a single responsible owner, who then reports back as appropriate through the year.

My staff work closely with their counterparts in the Department to ensure that risk management systems are compatible, there is clear accountability for managing risks, joint action is taken where appropriate to manage risks, and the Department is kept informed of risks as appropriate. The Highways Agency's risk appetite is set to ensure that:

- all risks with a high impact on the Highways Agency's performance, stewardship of public funds, stewardship of the environment or the reputation of the Highways Agency or wider Government receive focused, cost justified management attention
- where appropriate, action is escalated via a formal process through the line management chain, to the Highways Agency's Board, to the Department and to Ministers.

The Highways Agency Board has a Corporate Risk Register, which is the main tool used to monitor the management of the most significant risks in the Highways Agency. This is included in the monthly performance report reviewed by the Board at its Governance meeting. In addition the Board has an in-depth risk review every four months, considering changes to the operating environment as part of this review.

In 2012-13 the most significant risks represented on the corporate risk register included:

- a terrorist incident on the network results in serious congestion
- the Highways Agency being unable to maintain the network in a serviceable condition
- loss, irregular disclosure or corruption of important data
- failure to manage the additional pressures of the London 2012 Games.

I hold regular meetings with Ministers where operational risks are discussed. Ministers receive reports either directly or through the Department reporting process about risks to key initiatives as well as to delivery of the Highways Agency's objectives.

I am keenly aware that risks to the public arise from many aspects of the development and operation of the strategic road network. While developing new works, the Highways Agency involves the public in risk management through the normal consultation process. My senior staff and I regularly meet with stakeholder groups and cover their views on risks to their interests in these meetings. Road safety risks are managed through a developing set of safety action plans based on the views from the public and stakeholders with the objective of meeting the targets set by the Department Road Safety Strategy.

This is supplemented by the introduction of our Aiming for Zero strategy, which has a goal of zero accidents and ill-health in relation to the health and safety risks to our workforce. Legal compliance is seen as the minimum standard of health and safety. The strategy covers both our own staff in the Traffic Officer Service and our people who work in and from our offices. It also applies to our supply chain of operatives working on our network.

Identification and mitigation of conflicts of interest

The Highways Agency delivers the significant part of its responsibilities through the procurement of goods and services. As such, I recognise that it is extremely important that the Highways Agency has sound processes for identifying and mitigating potential or real conflicts of interest.

The Highways Agency has clear, documented requirements for staff in relation to:

- completing declarations of interests forms – The Highways Agency is required to disclose related third party transactions in its Annual Accounts. An audit of this disclosure is undertaken by the Highways Agency's internal audit function to provide me with assurance that the process is operating correctly
- completing hospitality and gifts registers – Register entries for Board Members are published on our website.

The declarations of interests are regularly used by our procurement function to ensure that there are no conflicts of interest in relation to procurement decisions.

During 2012-13 there was one conflict of interest case that required management intervention when a conflict was self reported. Appropriate action was taken to remove the individual from internal decisions, and subsequently, the individual removed himself from the arrangements giving rise to the conflict.

Business Planning

It is vital that the Highways Agency has a clear strategic direction, objectives, responsibilities and key targets in support of government policies through business and strategic planning. I work closely with the Department to achieve this. Before the start of each financial year the Highways Agency publishes a business plan to cover the deliverables for the coming year along with confirmation of the budget within which we have to deliver.

In addition to business plan commitments, the Executive Committee also set internal supporting objectives for the Highways Agency which are communicated at the start of the year by means of a scorecard.

Performance Management

The Highways Agency has clear performance management processes, which include requirement for reporting progress to the Board. Each directorate has its own performance management function and produces performance reports covering its own internal operations and progress on corporate targets/ measures. Formal reporting takes place monthly to ensure that any areas of concern are identified for management action as soon as possible.

Performance management processes are designed to link non-financial and financial reporting with risk management procedures.

Financial Management

We ensure efficiency, best value, integrity, propriety and regularity in the use and stewardship of public funds and assets and that clear accountability for expenditure and stewardship of assets is in place through a variety of control systems including:

- a mandatory Investment Control Framework, which encompasses HM Treasury Green Book and Department investment appraisal standards for all expenditure. This includes a process of testing whether a proposed project or expenditure offers value for money and considers affordability, prioritisation, risk and strategy. These arrangements dovetail with those of our parent Department for larger investments that require approval from DfT or Ministers
- the Investment Control Framework also addresses financial propriety and other requirements from HM Treasury's Managing Public Money and other requirements
- an Oracle financial accounting system with embedded controls
- asset management procedures to record and account for all assets
- a Counter Fraud Sub-Committee meets regularly to oversee the handling of any significant issues or allegations, all of which are taken seriously by the Highways Agency and fully investigated
- an Investors in People accreditation which is a proven business improvement framework that significantly improves financial performance, productivity and employee involvement and focus.

Project and Contract Management

We manage our projects and contracts to ensure delivery on time, within budget and to the appropriate quality. Control systems include:

- a Project Control Framework, which specifies the detailed governance processes and procedures that major projects must follow to ensure they deliver the required outputs of each project phase on time and to budget. The framework also defines the project lifecycle, roles and responsibilities and project deliverables
- use of the Gateway Review method of providing project assurance. Competent programme and project management ensures that issues are not overlooked, time and money is not wasted, and resources are effectively deployed
- centralised procurement function for contracts more than £15,000, which are handled by a central division and any single tender action requires the personal approval of the Procurement Director
- the use of earned value management on all key investments to inform and enable meaningful challenge
- compliance by service providers to their contracts is checked through the Service Quality Review process undertaken within regional teams. Assurance over the management of contract risk is provided through the Highways Agency's contract assurance regime work carried out by the internal audit function.

Compliance with Standards and Requirements

Our people, partners and procedures comply with relevant legal, government, departmental and technical standards and requirements. The Highways Agency's arrangements include:

- a dedicated team that deals with compliance with the statutory processes for the acquisition, management and disposal of land and property in connection with the Highways Agency's activities. Other teams deal with the statutory requirements concerning road building, and the management and maintenance of the strategic road network
- technical governance procedures to ensure that the Highways Agency conducts its business in accordance with the appropriate technical standards, and include measures to govern any necessary departure from engineering standards
- compliance with European Union legislation and standards where appropriate regarding several areas including procurement and health and safety.

Audit and Assurance

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the Executive Managers within the Highways Agency who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I am advised on the implications of the effectiveness of the system of internal control by the Board and the Audit Committee.

Internal Audit

My head of Audit and Assurance provides regular reports on key risk and control issues, to standards defined in the Government Internal Audit Standards, and an annual independent opinion on the adequacy and effectiveness of the Highways Agency's system of internal control together with recommendations for improvement. The implementation of recommendations is monitored closely by the Highways Agency Board and is included on the performance scorecard. The head of Internal Audit's opinion for the year 2012-13 is that on the basis of the evidence obtained during the year a Reasonable assurance rating can be provided on the adequacy and effectiveness of the Highways Agency's arrangements for corporate governance, risk management and internal control, ie that they are generally established and effective, with some minor weaknesses or gaps identified. In her opinion there are no significant weaknesses that fall within the scope of issues that should be reported in the Governance Statement.

Our Performance Audit Framework (PAF), an assurance and process improvement function concerning our supply chain community, was replaced in 2012-13 with a Contract Assurance Regime, which moved away from assessing our service provider's compliance with their contracts and assessed their ability to manage core risks within the contract. The function continues to combine technical specialists with experienced auditors and forensic accountants, delivering to an agreed methodology, offering a consistent and informed challenge to the way business is conducted within the supply chain community. Results from this year's work has established that risks are being managed at a reasonable level by the supply chain and although issues were identified at a regional level, there are no significant weaknesses that fall within the scope of issues that should be reported in the Governance Statement.

Counter Fraud Arrangements

Building on an earlier assessment of risk of liability under the 2010 Bribery Act, the focus during the year was to incorporate bribery awareness into the fraud awareness programme.

During the course of 2012-13 the Highways Agency recorded 84 whistle blowing allegations from both internal and external sources. The majority of these proved to be either related to another body (such as a local authority), or were low level issues resolved by the relevant operational area. However, eight cases were deemed worthy of investigation by the Highways Agency's internal audit function, none of which resulted in any fraudulent or improper activity being identified.

The supplier related fraud identified and reported in my 2011-12 Governance Statement, which saw the Highways Agency being charged for a number of fictitious schemes (or over-scoped schemes), and the consequent review of controls by internal audit, resulted in a number of recommendations for improvements in the control environment of suppliers. These have been taken forward and implemented. Results of a recent contract assurance review showed a significant improvement in the supply chain's management of this risk. All amounts identified as part of the original fraud were identified and have been recovered from both the current service provider and the preceding Managing Agent. The Highways Agency worked with the Police during their criminal investigation and is awaiting the outcome of the court hearings due in early summer 2013.

Stewardship Reporting

Twice a year, Highways Agency Board Directors provide stewardship reports that take account of management assurance from Divisional Directors and others who report on the full range of delegations, policies and procedures laid down by the Highways Agency. Directors report on:

- compliance within their division
- the adequacy of the arrangements within their division
- what remedial action is being taken where assurance cannot be provided.

The process lays down stringent evidence requirements for managers to rate their assessments by. These are reviewed by the relevant internal process owners along with the action plans proposed to address deficiencies in compliance. Over the year, overall assurance ratings have shown a gradual improvement, with the majority of processes now achieving the targeted level of assurance.

Senior Information Risk Officer's (SIRO) Assessment

During this year the Highways Agency continued to comply with the Cabinet Office guidance on information risk management. My Senior Information Risk Owner (SIRO) assessment of information risk performance is that the Highways Agency's information assets held on the Highways Agency's business and operational IT infrastructure are being managed effectively and that appropriate and proportionate risk controls are in place.

All staff including Executive and Non-Executive Board Members are required to sign up to an Acceptable Use Policy before gaining access to our business ICT systems and have been trained in data handling. A revised data-handling training policy has been implemented to reinforce the requirement for all new starters and key roles to undertake data handling training and refresher training.

We continue to pursue a policy of continuous improvement in our controls and have recently had our HMG Security Policy Framework compliance assessment independently audited to support that improvement process. The results of this have identified that there are weaknesses in some of our compliance processes, including the evidence supplied to support the statements. The Highways Agency will work this year to improve the situation. The Highways Agency has no personal data related incidents to report. Following a successful trial, we have rolled out end port control software to ensure unauthorised devices cannot work on our business ICT systems.

Throughout the year our Records Management Team has been working with a number of key business areas to support them in moving from paper to electronic filing processes. This has seen a significant reduction in our paper records file creation and storage costs. Further training workshops regarding improving records management processes and usage of the Agency Electronic Document and Records Management System (EDRMS) has also been delivered. The Highways Agency is in the process of upgrading its current EDRMS platform, and a work stream is planned for delivery across the next financial year to further improve both the utilisation of the system and improved information management to introduce efficiencies to our core processes and our information management.

The Highways Agency has welcomed the Cabinet Office review of the current HMG Protective Marking Scheme. A new HMG Security Classification Scheme will be implemented in April 2014. A number of briefings have already been given to Senior Managers and Board Members regarding the changes and the potential benefits of a simplified policy. Training will be rolled out across the organisation and to our third party suppliers nearer the go-live date.

Project Management Assurance

We have maintained an open and close working relationship with the Major Projects Authority (MPA). Its confidence in our approach to Gateway Reviews and Government Major Projects Portfolio (GMPP) scrutiny appears to be strong and has resulted in the delegation of increased levels of responsibility to our Centre of Excellence. We have the authority to manage high risk Gateway Reviews, in addition to the medium and low risk that we were already delegated. During 2012-13 we negotiated the removal of the Managed Motorway programme from the GMPP in recognition that the Highways Agency has developed a mature management approach that has increased delivery confidence and moved the programme to a position of business as usual.

Quality Assurance Framework for Business-Critical Models

The Highways Agency maintains an appropriate quality assurance framework for its business critical models. An up-to-date list of business critical models is publicly available.

Other explicit assurance reviews:

Managing the risk of financial loss – In October 2010, following a cross-Government Financial Systems Risk Review, HM Treasury introduced new guidance and tools to support a review of processes, which had an associated risk of financial loss. A financial loss in this context was defined as a loss of monetary assets in relation to deliberate or accidental errors during the processing of financial transactions. The Highways Agency completed a review of all relevant processes and associated controls during 2011-12 and the majority of processes were found to have the necessary levels of control in place. Where weaknesses were found, action plans were developed and remedial action taken during 2012-13 to improve areas where control was not deemed to be at the appropriate level – although no areas were considered to be at a critical risk. An internal audit review of action plan implementation reported that the majority of actions had been implemented.

For the remainder it was suggested that actions be incorporated into the periodic reviews undertaken by process owners as part of their quality management responsibilities.

Controls around the Highways Agency's Shared Services arrangement – The Highways Agency is party to the DfT group Shared Service Centre (SSC) for the provision of payroll and human resource services, governed by a service level agreement and managed through the Single Client function within the DfT. The Highways Agency monitors the performance of the SSC through the Single Client Function and the Single Client Board of which the Highways Agency Chief Executive is a member. The Highways Agency's SSC Relationship Manager is a member of the Department's Single Client Team, reviewing system and service performance and participating in governance and change management decisions. A service level agreement is in place and monthly Key Performance Indicator reports provide evidence of SSC performance against the contracted service requirements.

The Highways Agency receives a quarterly management assurance report that is based primarily on Shared Services management's risk and control monitoring activities and reporting processes. This assurance also draws upon internal audit reports provided by the Department's own internal audit function, and other relevant risk/control reports and sources of assurance. Through this, the SSC has reported to the Highways Agency that its system of internal control met the criteria for effective internal control, although a small number of exceptions remain in relation to controls that did not directly impact the financial statements. The most critical of these related to succession planning, the completion of its disaster recovery policy, and a system for archiving/disposing of records. For these areas, the SSC determined that the level of residual risk did not warrant any further action prior to divestment. Shared Services also maintains a tracker of outstanding internal audit recommendations and the Highways Agency receives independent assurance from the Department's Chief Internal Audit Executive regarding any significant control weaknesses.

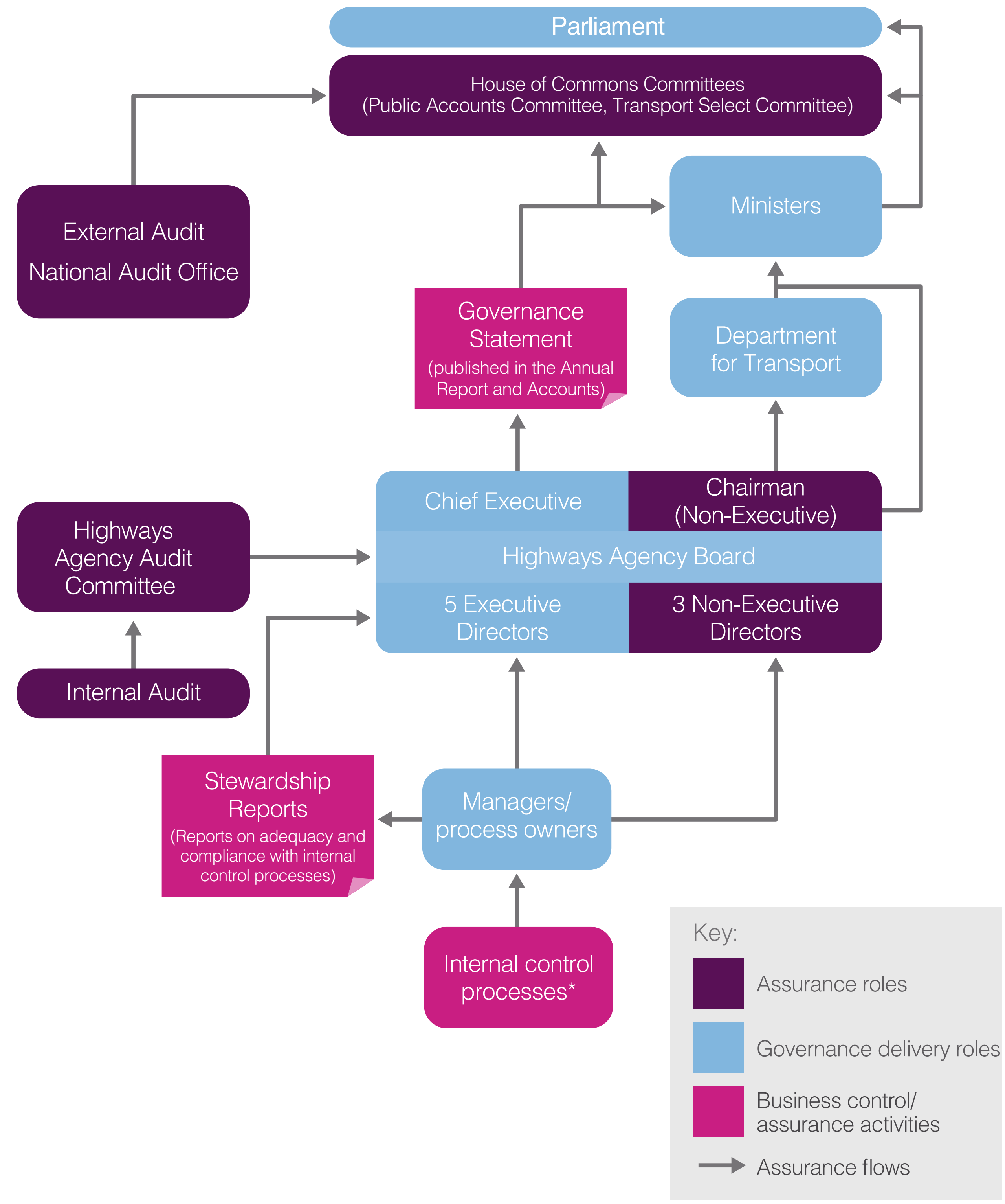
Throughout the year, the Highways Agency has continued to take responsibility for ensuring that controls and processes are operating effectively. These factors, combined with the quarterly reports from Shared Services, ensure that the combination of controls is appropriate and adequate in terms of our overall internal and assurance requirements.

In February 2013, the Department successfully divested the SSC to the private sector. The contract was awarded to arvato, part of the Bertelsmann group, who took over ownership of, and responsibility for, provision of service from 3 June 2013. The Highways Agency is currently working with the Cabinet Office, the Departmental Shared Service Futures team and arvato to support the design of the post divestment services and to ensure that appropriate governance, control and assurance processes are established for the migration of the Highways Agency's finance and HR systems to the new SSC platform in October 2014. In April 2013, the Highways Agency's project team received an amber rating in relation to the confidence of delivery from its first Gateway review and the team are currently working on developing and implementing an action plan to deliver the recommendations arising from this.

I have taken all necessary steps to make myself aware of any relevant audit information and to establish that the Highways Agency's auditors are aware of that information. In so far as I am aware, there is no relevant audit information of which the Highways Agency's auditors are unaware.

Graham Dalton
Accounting Officer
25 June 2013

Highways Agency Governance Framework



* The Highways Agency operates a quality control regime which includes clear process management guidelines covering internal control activities such as:

- Performance management (financial and non-financial)
- Risk management
- Investment control
- Planning
- Programme and project management

6. Remuneration Report

Senior civil servants' pay and performance management is not delegated to departments. Departments operate within a framework set by the Cabinet Office. Some elements of the framework are mandatory; in other areas Departments have flexibility to meet departmental business needs.

The remuneration of the Highways Agency's senior civil servants for current and future years is determined by the Department for Transport's Pay and Performance Committee in accordance with the Government's response to the recommendations of the independent Review Body on Senior Salaries.

Pay and Performance Committee

The Pay and Performance Committee comprises the Department for Transport's Permanent Secretary (as Chairman), all DfT Directors General and a Non-Executive Board Member.

Remuneration Policy for Senior Civil Servants (SCS) within the Highways Agency

The reward package for the SCS in the Highways Agency comprises four elements:

- Pay – base salary which is consolidated, pensionable pay (for some members of the SCS not all base salary is pensionable), and variable pay which is a non-consolidated (non-pensionable and conditional) one-off award to recognise in-year performance.
- Conditions – pension which is defined benefit and index-linked, and other contractual benefits such as annual leave.
- Benefits including any taxable benefits and allowances.
- Intangibles, for example, a commitment to work/life balance; interesting and socially valuable work; commitment to development; and, a supportive work environment made up of a diverse workforce.

Pay System and Performance Management

The Senior Civil Service pay system is based on simple broad bands, underpinned by a tailored job evaluation scheme (JESP - Job Evaluation for Senior Posts). JESP provides a consistent basis for comparing the relative value of jobs within and across Departments. It broadly ensures that people with particular levels of responsibility have access to salaries within the same range, and supports equal pay. The Highways Agency has 3 SCS pay bands:

- Pay band 1 (Deputy Director) JESP range of 7-12 points
- Pay band 2 (Director) JESP range of 13 - 18 points
- Pay band 3 (Chief Executive) JESP range of 19 - 22 points

Each pay band has a minimum and a maximum base salary:

- Pay band 1 (Deputy Director) £58,200 - £117,800
- Pay band 2 (Director) £82,900 - £162,500
- Pay band 3 (Chief Executive) £101,500 - £208,100

SCS in the Highways Agency have objectives in the following categories:

- Leadership objectives – the DfT common leadership objective plus leadership behaviours and providing direction for the organisation; delivering results; and building capability in the organisation to address current and future challenges.
- Business delivery objectives – defining business outcomes for the specific post, and assigning accountability and responsibility for each business plan or structural reform plan commitment.
- Finance/efficiency – capturing what the jobholder will do to ensure that costs are minimised and budgets are managed to ensure maximum value to the taxpayer.

- People/capability objectives – ensuring that individuals, the Department and civil service have the right capability to deliver business outcomes now and in the future.
- Personal development objectives – Emphasis on the importance of continuous personal development and an individual's growth in competence.

Objectives incorporate diversity by embedding it in business, people/capability or finance/ efficiency objectives, or through a separate diversity objective.

Performance against objectives, and relative to SCS peers, determines allocation to a performance group, to which non-consolidated variable pay is linked. There are three performance groups:

- Top – top 25% of performers
- Achieving – next 65% of performers
- Low – bottom 10% of performers

To be allocated to the top performance group an individual must deliver to the highest standards in all objective categories.

The annual value of non-consolidated performance pay and base pay is set by the Government's response to the recommendations of the Review Body on senior salaries.

A performance group is the starting point for non-consolidated performance pay determination. For 2012/13, only the top 25% of performers, those in the top performance group, will receive an award.

In 2012/13, no base pay increases are available for members of the SCS.

Remuneration policy for Non-Executive Board Members

The Highways Agency undertook a review of the fees payable to Non-Executive Directors during 2008, comparing them with other DfT agencies. As a result rates were increased with effect from 1 September 2008. No changes have been made to the rates since then; however following a HM Treasury led review, in line with the requirements set out by the DfT Permanent Secretary in July 2012, all payments for new or renewed contracts will be processed through the payroll system rather than payables. Existing Non-Executives have confirmed that income taxation and national insurance obligations have been met.

Service contracts

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

Senior managers are either permanent appointments or on fixed term contracts. Their contracts are standard with terms and conditions set by the Cabinet Office.

Non-Executive Board Members are generally appointed for a fixed term of two years. Contracts are renewable for further fixed terms if both parties agree. In the event of early termination, for whatever reason, there is no provision for compensation.

Details of the service contract for each senior manager and letters of appointment for the Non-Executive Board Members who served during the year are:

	Date of initial appointment	Unexpired terms (months remaining at 31/03/13)
Executive Directors serving at 31/03/13		
Graham Dalton	30/06/2008	Open - ended
Peter Adams	09/01/2012	Open - ended
Ginny Clarke	02/07/2001	Open - ended
Stephen Dauncey	02/02/2009	Open - ended
Simon Sheldon - Wilson	01/02/2010	Open - ended
Derek Turner	07/03/2005	2
Executive Directors leaving before 31/03/13 [1]	-	-
Non-Executive Board Members serving at 31/03/13		
Alan Cook [2]	01/01/2011	15
David Hughes [3]	15/07/2009	3
Tim Walton [4]	10/01/2011	3
Simon Murray [5]	05/11/2012	19

1 David Brewer has been appointed to the new role of Director, Asset Delivery and to the Board of the Highways Agency, succeeding Derek Turner on his retirement.
2 Alan Cook, a Non-Executive Board member of the DfT, joined the Highways Agency on 1 January 2011 on a 12 month contract which has been extended until 30 June 2014.
3 David Hughes' contract expires on 14 July 2013 and the Highways Agency will be seeking an extension.
4 Tim Walton's contact was extended for a further six months and is now due to expire on 9 July 2013.
5 Simon Murray was appointed as a Non-Executive Board member on the 5 November 2012 for a two year period.

Salary and pension entitlements (audited)

The following sections provide details of the remuneration and pension interests of the Highways Agency's Executive Directors.

	2012-13			2011-12		
	Salary £000	Bonus payments £000	Benefits in kind (to nearest £100)	Salary £000	Bonus payments £000	Benefits in kind (to nearest £100)
Officials						
Graham Dalton	145-150	-	-	145-150	-	-
Ginny Clarke	105-110	5-10	-	105-110	-	-
Stephen Dauncey	115-120	-	-	115-120	5-10	-
Simon Sheldon-Wilson	90-95	5-10	-	90-95	5-10	-
Derek Turner	140-145	-	-	140-145	10-15	-
Peter Adams	115-120 -	- -	- -	25-30 FYE [1] 115-120	- -	- -
Nirmal Kotecha	- -	- -	- -	80-85 FYE 150-155	35-40 -	- -
Steve Williams	- -	- -	- -	10-15 FYE 105-110	- -	- -

1 Full-year equivalent (FYE) salaries are included for those Directors joining or leaving the Highways Agency part way through the year. Peter Adams joined the Board on 9 January 2012.

Salary

Salary includes gross salary, overtime, London weighting or London allowances, recruitment and retention allowances, private office allowances and any other allowance to the extent that it is subject to UK taxation. The payment of legitimate expenses is not part of salary.

Bonus payments

Bonus payments relate to performance in the preceding year and are in line with contractual conditions.

Benefits in kind

The monetary value of benefits in kind covers any benefits provided by the employer and treated by the Inland Revenue as a taxable emolument. During the year there were no benefits in kind, no compensation was payable to former senior managers, and no payments were payable to third parties for the services of a senior manager.

Median remuneration of staff (audited)

	2012-13	2011-12
Midpoint of salary range and bonus of highest paid Director (£)	147,500	155,000
No of staff	3,400	3,512
Median point	1,700	1,756
Median remuneration (£)	25,687	25,420
Ratio	**5.74**	**6.10**

- Midpoint of salary range and bonus of highest paid Director is calculated by summing the midpoint of the relevant £5k salary range with the mid point of the relevant £5k bonus range.
- Median salary is the full time equivalent salary, and includes TRA and shift allowance where appropriate. ERNIC, superannuation contributions and bonus payments are not included.
- Temporary staff have been included but not consultants/contractors. In the absence of relevant data these have been assumed to be paid at the average salary for the grade of the post (or if not known, PB7).

The median remuneration of the Highways Agency's staff in 2012-13, based on full time equivalents, is £25,687, which slightly increased from the previous year due to natural pay progression. The ratio between the median remuneration and the mid point of the banded remuneration of the highest paid Director is 5.74, which has fallen due to changes in Directors and corresponding salaries.

Pension benefits (audited)

Pension benefits are provided through the Civil Service pension arrangements for which details are given in Note 3 to the Financial Statements.

	Accrued pension at pension age as at 31/3/13 and related lump sum £000	Real increase in pension and related lump sum at pension age £000	CETV at 31/3/13 £000	CETV at 31/3/12 £000
Graham Dalton	25-30 no lump sum	0-2.5 no lump sum	425	387
Ginny Clarke	45-50 plus 145-150 lump sum	0-2.5 plus 0-2.5 lump sum	1,042	984
Stephen Dauncey	10-15 no lump sum	-	261	219
Simon Sheldon-Wilson	-	-	-	-
Derek Turner	15-20 no lump sum	0-2.5 no lump sum	354	308
Peter Adams	5-10 no lump sum	2.5-5.0 no lump sum	85	56

	Real increase in CETV as funded by employer £'000	Employer contribution to partnership pension account Nearest £100
Graham Dalton	13	-
Ginny Clarke	2	-
Stephen Dauncey	25	-
Simon Sheldon-Wilson	-	11,400
Derek Turner	25	-
Peter Adams	17	-

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. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme.

The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies. The CETV figures include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the Civil Service pension arrangements and for which the Civil Superannuation Vote has received a transfer payment commensurate with the additional pension liabilities being assumed. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost. CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries 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 the value of the CETV

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

Remuneration of Non-Executive Board Members (audited)

The Non-Executive Board Members received the following remuneration for their services during the year ended 31 March 2013:

	2012-13 £000s	2011-12 £000s
Alan Cook [1]	35-40	35-40
David Hughes [2]	25-30	25-30
Tim Walton	10-15	10-15
Simon Murray [3]	5-10	-
Tracey Barlow	0-5	10-15

[1] Alan Cook is also a Non-Executive Director at the DfT, but his remuneration for that role is disclosed separately in the DfT accounts.
[2] David Hughes is a member of the DfT Audit Committee and his remuneration for that role is included in this total.
[3] Simon Murray joined the Board on 5 November 2012.
[4] Tracey Barlow left the Board on 31 July 2012

The amounts reported above were paid to the individual or the individual's company and are exclusive of travel & subsistence and VAT. We do not regard these payments as being of a third party nature. We have received confirmation that where the Non-Executive Board Member is engaged off-payroll that income taxation and national insurance obligations have been met in relation to their role.

Graham Dalton
Accounting Officer
25 June 2013

7. Statement of Accounting Officer's Responsibilities

Under the Government Resources and Accounts Act 2000, HM Treasury has directed the Highways Agency 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 Highways Agency 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 Highways Agency at the year-end and of its income and expenditure, changes in taxpayers' equity, 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 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
- prepare the accounts on a going-concern basis.

The Permanent Secretary for the Department for Transport has appointed the Highways Agency Chief Executive as an additional 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 Agency's assets are set out in the Accounting Officers' Memorandum, issued by HM Treasury and published in Managing Public Money. Details may be accessed online at www.hm-treasury.gov.uk

8. Certificate and Report of Comptroller and Auditor General to the House of Commons

I certify that I have audited the financial statements of the Highways Agency for the year ended 31 March 2013 under the Government Resources and Accounts Act 2000. The financial statements comprise: the Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity; 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 Chief Executive and auditors

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Chief Executive as Accounting Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Government Resources and Accounts Act 2000. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Highways Agency's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Highways Agency; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on regularity

In my opinion, in all material respects the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on the financial statements

In my opinion:

the financial statements give a true and fair view of the state of the Highways Agency's affairs as at 31 March 2013 and of the net operating cost for the year then ended; and

the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions issued thereunder.

Opinion on other matters

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with HM Treasury directions made under the Government Resources and Accounts Act 2000
- the information given in Sections 1 to 5 of the Annual Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I report by exception

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- o adequate accounting records have not been kept or returns adequate for my audit have not been received from branches not visited by my staff
- o the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records and returns
- o I have not received all of the information and explanations I require for my audit
- o the Governance Statement does not reflect compliance with HM Treasury's guidance.

Report

I have no observations to make on these financial statements.

Amyas C E Morse
Comptroller and Auditor General

National Audit Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP
26 June 2013

9. Financial Statements

Statement of Comprehensive Net Expenditure for the year ended 31 March 2013

		2012-13			
	Note	Staff costs £000	Other costs £000	Income £000	2011-12 £000
Administration costs					
Staff costs	*3*	21,821	-	-	21,575
Other administration costs	*4*	-	42,588	-	41,646
Operating income	*6*	-	-	(2,166)	(1,746)
Programme costs					
Staff costs	*3*	95,556	-	-	98,508
Programme costs	*5*	-	2,071,001	-	2,278,966
Income	*6*	-	-	(66,343)	(61,345)
EU income		-	-	(23,971)	(1,978)
Totals		**117,377**	**2,113,589**	**(92,480)**	**2,375,626**
Net operating cost				**2,138,486**	**2,375,626**

Other Comprehensive Expenditure

	Note	2012-13 Total £000	2011-12 Total £000
Net (gain)/loss on revaluation of property, plant and equipment	*7, 9*	(2,101,414)	(2,752,080)
Total comprehensive (income)/expenditure for year ended 31 March 2013		**37,072**	**(376,454)**

All income and expenditure is derived from continuing activities.

The Notes on pages 77 to 113 form part of these accounts.

Statement of Financial Position as at 31 March 2013

	Note	31 Mar 2013 £000	31 Mar 2012 £000
Non-current assets			
Property, plant and equipment	*7*	109,600,436	108,483,417
Intangible assets	*8*	902	5,306
Trade and other receivables	*12*	365,753	340,988
Total non-current assets		**109,967,091**	**108,829,711**
Current assets			
Assets classified as held for sale	*9*	12,314	17,620
Inventories	*11*	45,202	56,249
Trade and other receivables	*12*	206,653	124,271
Cash and cash equivalents	*13*	31,467	17,377
Total current assets		**295,636**	**215,517**
Total assets		**110,262,727**	**109,045,228**
Current liabilities			
Trade and other payables	*14*	689,347	638,285
Provisions	*15*	52,761	119,840
Total current liabilities		**742,108**	**758,125**
Non-current assets less net current liabilities		**109,520,619**	**108,287,103**
Non-current liabilities			
Provisions	*15*	139,821	137,066
Other payables	*14*	2,056,854	2,054,170
Total non-current liabilities		**2,196,675**	**2,191,236**
Assets less liabilities		**107,323,944**	**106,095,867**
Taxpayers' equity			
General fund		42,775,161	43,321,466
Revaluation reserve		64,548,783	62,774,401
Total taxpayers' equity		**107,323,944**	**106,095,867**

The Notes on pages 77 to 113 form part of these accounts.

Graham Dalton
Accounting Officer
25 June 2013

Statement of Cash Flows for the year ended 31 March 2013

	Note	2012-13 £000	2011-12 £000
Cash Flows from operating activities			
Net operating cost		(2,138,486)	(2,375,626)
Adjustment for non-cash transactions	*4, 5*	1,170,618	1,279,356
(Decrease) in inventories		11,047	32,505
(Increase) in trade and other receivables		(107,147)	(17,812)
less movement in receivables relating to items not passing through the SCNE		(3,325)	(2,154)
Increase in trade and other payables		53,745	357,158
less movement in payables relating to items not passing through the SCNE		(97,050)	(22,570)
Use of provisions		(94,005)	(97,569)
Non-cash movement in classification of provision	*15*	(953)	-
Release from grant deferred reserve		-	(1,978)
Capital grant income		-	4,449
Adjustment for capital and interest element of PFI payments		58,215	52,443
Net cash outflow from operating activities		**(1,147,341)**	**(791,798)**
Cash flows from investing activities			
Purchase of property, plant and equipment	*7(a)*	(855,085)	(1,290,143)
Proceeds of disposal of assets held for sale		11,878	8,624
Capital element of movement in provisions	*15*	29,477	59,920
Net cash outflow from investing activities		**(813,730)**	**(1,221,599)**
Cash flows from financing activities			
From consolidated fund (supply): Current year		1,968,094	2,072,880
From consolidated fund (supply): Prior year		65,282	29,120
Capital element of payments in respect of on balance sheet PFI contracts		(58,215)	(52,443)
Net financing		**1,975,161**	**2,049,557**
Net increase/(decrease) in cash and cash equivalents in the period before adjustment for receipts and payments to the consolidated fund		14,090	36,160
Payments of amounts due to consolidated fund		-	(128)
Net increase/(decrease) in cash and cash equivalents in the period		**14,090**	**36,032**
Cash and cash equivalents at the beginning of the period	*13*	**17,377**	**(18,655)**
Cash and cash equivalents at the end of the period	*13*	**31,467**	**17,377**

The Notes on pages 77 to 113 form part of these accounts.

Statement of Changes in Taxpayers' Equity for the year ended 31 March 2013

	Note	General fund £000	Revaluation reserve £000	Restated grant reserve £000	Total reserves £000
Balance at 31 March 2011		**39,899,014**	**58,131,655**	**4,409**	**98,035,078**
Change in accounting treatment of infrastructure asset		34,040	-	-	34,040
Change in accounting treatment of EU grants		-	-	(4,409)	(4,409)
Restated Balance at 31 March 2011		**39,933,054**	**58,131,655**	**-**	**98,064,709**
Changes in taxpayers' equity for 2011-12					
Net gain on revaluation of property, plant and equipment		-	2,752,080	-	2,752,080
Adjustments to non-current assets		3,552,214	2,030,256	-	5,582,470
Reversionary interest on M6 toll road		6,120	-	-	6,120
Non-cash charges - auditors' remuneration	4	275	-	-	275
Transfers between reserves		139,590	(139,590)	-	-
Net comprehensive expenditure for the year		(2,375,626)	-	-	(2,375,626)
Total recognised income and expenses for 2011-12		**1,322,573**	**4,642,746**	**-**	**5,965,319**
Funding from the Department for Transport		2,102,000	-	-	2,102,000
CFERs payable to the consolidated fund		(36,162)	-	-	(36,162)
Balance at 31 March 2012		**43,321,466**	**62,774,401**	**-**	**106,095,867**
Changes in taxpayers' equity for 2012-13					
Net gain on revaluation of property, plant and equipment		-	2,101,414	-	2,101,414
Adjustments to non-current assets		(483,972)	(201,432)	-	(685,404)
Reversionary interest on M6 toll road		13,952	-	-	13,952
Non-cash charges - auditors' remuneration	4	275	-	-	275
Transfers between reserves		125,600	(125,600)	-	-
Net comprehensive expenditure for the year		(2,138,486)	-	-	(2,138,486)
Total recognised income and expenses for 2012-13		**(2,482,631)**	**1,774,382**	**-**	**(708,249)**
Funding from the Department for Transport		2,033,376	-	-	2,033,376
Supply payable		(13,853)	-	-	(13,853)
CFERs payable to the consolidated fund		(83,197)	-	-	(83,197)
Balance at 31 March 2013		**42,775,161**	**64,548,783**	**-**	**107,323,944**

The Notes on pages 77 to 113 form part of these accounts

Notes to the Highways Agency's Accounts

1. Statement of accounting policies

The financial statements have been prepared in accordance with the 2012-13 Government Financial Reporting Manual (FReM) issued by HM Treasury. The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context. Where the FReM permits the choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of the Highways Agency for the purpose of giving a true and fair view has been selected.

1.1 Accounting convention

These accounts have been prepared under the historical cost convention modified to account for the revaluation of property, plant and equipment.

1.2 Other recent accounting developments

Standards

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 March 2013, and have not been applied in preparing these financial statements. The following are those standards, amendments and interpretations that may need to be adopted in subsequent periods:

- Phases 1 and 2 of IFRS 9 Financial Instruments, which will replace parts of International Accounting Standard (IAS) 39, deals with the classification and measurement of financial assets and financial liabilities. IFRS 9 is intended to improve and simplify the reporting of financial instruments. The completed phases require financial assets and liabilities to be measured according to their classification, and simplify the classification structure. According to the IASB, application of this standard is required for reporting periods beginning on or after 1 January 2015, though earlier application is permitted. This will have no material effect on the Highways Agency's financial statements.
- IAS 1 – an amendment will come into effect from 1 April 2013, relating to the presentation of items in the Statement of Other Comprehensive Expenditure. It requires that items that may be reclassified to profit or loss should be presented separately from those items that may not. It also requires that, where items are presented before tax, the tax effects of the reclassifiable items should be presented separately from the tax effects of non-reclassifiable items. This is likely to reflect the presentation of items in the Highways Agency's Statement of Other Comprehensive Expenditure, though not the amounts. Other changes due to come into effect after 2012-13 are considered to have no impact on the Highways Agency.

FReM

There were no accounting changes affecting the 2012-13 Highways Agency financial statements.

1.3 Prior period adjustments

Material adjustments applicable to prior periods arising from either changes in accounting policy, correction of material errors, or the value of trunked/detrunked roads are accounted for as prior year adjustments. Opening balances are adjusted for the cumulative effect of the prior year adjustment and comparative figures for the preceding period are restated in accordance with International Accounting Standard IAS 8.

1.4 Non-current assets: Property, plant and equipment

Property, plant and equipment is sub-categorised into:

i) Network infrastructure assets – these relate to the motorways and all-purpose trunk roads (APTRs) in England, which form a single integrated network. The network infrastructure consists of carriageways, including earthworks, tunnelling and road pavements, roadside communications, bridges and other structures, and land and buildings within the highway's perimeter.

ii) Non-network assets – these include land and buildings outside the highway's perimeter, non operational buildings, plant and equipment and information technology. All residential properties owned by the Highways Agency and not part of an existing scheme under construction are reported as dwellings.

Capitalisation policy

Expenditure on property, plant and equipment for acquisition or enhancement of an asset is capitalised above the thresholds as summarised below:

Non network assets (excluding Land)	£2,000
Land	No minimum value
Network Infrastructure – new build [1]	No minimum value
Road and structures renewals [1]	No minimum value

[1] Major projects and road and structure renewals thresholds have been changed to a no minimum value to ensure administrative efficiency.

Expenditure falling below these values is charged as an expense in the Statement of Comprehensive Net Expenditure (SoCNE). Other than assets included within the network infrastructure and ring-fenced relocation projects, there are no grouped assets.

Expenditure on construction schemes in the course of design or construction is capitalised when it is reasonably certain the scheme will go ahead. Where a scheme is subsequently withdrawn from the capital programme, cumulative design expenditure is written off to the SoCNE. Any retained land and property is transferred to surplus land and buildings or dwellings, as appropriate. Surplus land, buildings or dwellings to be sold within one year are valued and reported as assets held for resale, in accordance with IFRS 5.

Internal staff costs that can be attributed directly to the construction of an asset, including capital renewal schemes, are capitalised.

The road network is inspected regularly to enable maintenance to be planned on a priority basis and ensure the safety of the road user. All planned non-routine road renewals maintenance expenditure is capitalised as it is recognised the maintenance spend enhances or replaces the service potential of the road network. Routine maintenance expenditure, eg repairing potholes is regarded as day to day servicing and is charged to the SoCNE.

Expenditure on renewal of structures is capitalised when the planned maintenance spend enhances or replaces the service potential of the structure. All routine maintenance expenditure such as clearing drainage is charged to the SoCNE.

Technology equipment is capitalised from inventory when a project is under construction.

Purchased operating software or any in-house developed software that can only operate on a given hardware platform is capitalised with the hardware as a property, plant and equipment asset.

Valuation

Network infrastructure assets

The network infrastructure asset consists of carriageways, structures, land and communication equipment which form a single integrated network. The network infrastructure is intended to be maintained at a specific level of service potential by continual replacement and refurbishment.

The network infrastructure assets are specialised (ie a market value is not available) and therefore must be valued using Gross Replacement Cost (GRC) in accordance with the FReM, before applying depreciation.

The purpose of the valuation is to provide an asset value of the network, including all classes of roads, structures, and land, for which the Highways Agency is responsible. This is to ensure the inclusion of all asset classes in the annual accounts.

The infrastructure asset valuation is based on a standard cost model, using accounting estimates, to determine the valuation of the network. The gross replacement cost is calculated as if providing a replacement asset, on a 'green-field' site, constructed to modern build standards and then depreciated to take account of the condition of the network. This approach is undertaken in accordance with the general principles of the Appraisal and Valuation Manual (Red Book) of the Royal Institution of Chartered Surveyors (RICS).

External professional surveyors undertake a full valuation of the network at intervals not exceeding five years. The valuation is not based on historic actual cost of construction for individual assets. Rather, the Highways Agency determines standard costs for the network based on accounting estimates that use the actual cost of recent schemes together with physical assets records and the best information available to provide unit rates for all elements and components of the network.

Standard costs unit rates are determined for the following elements of the network infrastructure: road, structures, technology equipment and land. When calculating the unit rates for the various elements of the network, a number of accounting assumptions are implicit in determining the network valuation. These assumptions are reviewed every five years when the Highways Agency seeks to provide a new valuation of the network. A full valuation of the network infrastructure was carried out by EC Harris LLP, professional surveyors during the year ended 31 March 2010.

Unit Cost	Unit cost determination
Road	The standard costing for roads has a series of road types created to identify all roads and determine the unit costs. Each road types will have a width for the carriageway, hard-strip or hard-shoulder, central reservations, etc.
Structures	*Non-special structures* – Unit rates for bridges, tunnels, gantries and retaining walls are based on a number of standard road types and standard structure types, which are extrapolated where necessary. *Special structures* – These are structures that, due to a combination of their size, construction and character cannot be quantified and valued in the same manner as other structures, eg the Dartford River Crossing. The valuation for special structures is based on unit rates and actual cost data.
Land	Land is an integral part of the road network and forms an important part of the valuation. Although some of the land occupied by the network may not actually be owned by the Highways Agency, it is considered that, as the Highways Agency had an entitlement to use the land in perpetuity, it is included within the valuation at freehold values. The unit costs rates for land is determined by a series of rates calculations based on external sources including the Royal Institute of Chartered Surveyors (RICS) market surveys.
Technology	Technology equipment unit costs are developed using rates from technology frameworks currently in place between the Highways Agency and its contractors and bulk purchase prices for materials procured direct by the Highways Agency. The unit costs also include a percentage of the subcontractors' preliminaries and other on-costs where applied to construction works.

Information on infrastructure assets is held on a number of operational asset management systems. Where appropriate, dimensional data is used from these systems to inform the valuation of individual roads and structures. The application of professional judgement by engineers will impact the variability of dimensional data which in turn will impact the valuation of the infrastructure asset.

Indexation

Various indices are applied to the valuation of the network to ensure the final valuation is at current replacement cost. Indexation of the network valuation is applied as follows:

Indexation		
Roads and structures	Five year revaluation	Unit costs are calculated from projects opened to traffic over the last 5 – 10 years to value carriageways, structures and technology. Unit rates from projects with different opening dates are brought to a common baseline using RoadCon, a construction industry index. This index is calculated from tenders for highway works and reflects contractor's output costs.
Roads and structures	Year end revaluation	Road Construction Resource Cost Indices (ROCOS) is the index applied to roads and structures for yearly revaluation and reflects the movement in prices in the construction industry. ROCOS is published on a quarterly basis by the Department for Business, Innovation and Skills (BIS).
Technology		ROCOS is the index applied to all technology assets.
Land		Land indexation is determined by the Highways Agency in consultation with external consultants and independent external sources, including the Royal Institute of Chartered Surveyors (RICS) market surveys and other reputable market analysis published nationally in England.

Indexation based on these indices is applied to all elements of the network. However there may be occasions where the use of indices for particular network assets may give an unrealistic outcome. This may happen for example where there has been substantial technological change when changes in the cost of specific assets are known to have been significantly different from the changes in the index; or where the historical purchase cost of assets was affected by special circumstances unlikely to be repeated and for which no allowance can be made. In such circumstances the gross current replacement cost is based on expert opinion or other evidence of the current cost of assets or groups of assets having a similar service potential.

The valuation of the network is based upon a non recoverable VAT rate of 20% which reflects a consistent long-term approach to valuing the network. Certain special structures are valued at historic prices appropriately indexed, or insurance valuations have been used as the best approximation of replacement cost.

Assets under construction

All new projects in the course of design or construction are accounted as AUC at their actual build cost. On completion of a project, the project is transferred out of AUC and into Infrastructure Assets at the current standard replacement cost (which will be different from the actual cost).

The difference between a project's actual cost of construction and the current replacement cost is treated as a write down which is charged to the SoCNE.

Write-downs

Write-downs arise due to the difference between the cost of construction and the current replacement standard costs. There are a number of reasons for this difference in cost including:

i) One of the assumptions in the standard cost is that all construction is new build on a 'green-field' site. This is not always the case; therefore cost of new constructions can be much higher due to building in non-rural areas or replacing existing roads etc

ii) Generally it is cheaper to build a three lane motorway in the first instance rather than two lanes initially and then to widen at some point thereafter. In a road widening scheme, a significant amount of cost will be in traffic management and therefore will be written-down.

The Highways Agency uses standard write-down percentages for different types of projects. These percentages are based on projects constructed over the previous five years. The write down percentages are applied to construction projects lasting more than one year, this ensures the Highways Agency writes-down the asset on an on-going basis rather than when the project is opened for traffic. When a project is open for traffic, a formal calculation of the write-down required is completed and compared with the cumulative write-down; adjustments are made as necessary.

Land and buildings, including dwellings

Freehold land and buildings have been valued on the basis of open market value for existing use. External professional surveyors, in accordance with the RICS Appraisal and Valuation Manual, undertake a full valuation of these assets at intervals not exceeding five years. Between valuations values are adjusted using regional land and building indices published twice yearly by the VOA.

Land and buildings are freehold and leasehold. Some Regional Control Centres are leasehold properties under 50 years and defined as short leasehold properties.

The land and buildings assets were last fully valued as follows:

Asset	Valuation date	Undertaken by
Federated House	17 March 2010	Donaldson's LLP, professional surveyors
Motorway Maintenance Compounds	1 October 2011	Valuation Office Agency (VOA)
Motorway Service Areas	31 March 2010	VOA
Surplus properties (including dwellings)	31 December 2010	VOA
Regional Control Centres	31 March 2011	VOA
National Traffic Operations Centre	31 March 2011	VOA

Plant and equipment

Structural steelwork is stated at fair value using the current market value of steel. Other plant and machinery is stated at fair value using monthly plant and equipment indices supplied by BIS.

Information technology

Information Technology consists of IT Hardware and Database Development. The development of Highways Agency databases is stated at cost. Other information technology assets are stated at fair value using monthly plant and equipment indices supplied by BIS.

1.5 Depreciation

Network infrastructure assets

Depreciation is a measure of the book value of an asset that has been consumed during the accounting period. It attempts to allocate the cost of the asset over the accounting periods that will benefit from its use, it is charged each year to the SoCNE.

The network infrastructure asset as reported in the annual accounts is based on depreciated replacement cost (DRC), as required by the FReM.

All parts of the network infrastructure, apart from land which has an unlimited useful life, are depreciated. However, the land element of the network infrastructure is not depreciated as land has an unlimited useful life.

Road depreciation

The road surface asset comprises:

i. Surface layer of flexible pavements

ii. Sub pavement layer of determinate life pavements

iii. Fencing, drainage, lighting, signage, kerbs and footways

iv. Road markings and studs

v. Rigid concrete pavements.

For the purpose of depreciation, the road surface is recognised as a single asset and depreciation is calculated in two parts:

1. Capital renewal maintenance expenditure on network road surface is capitalised, to the extent that it restores the service potential of the asset that has previously been consumed, and is therefore reflected as a depreciation charge in the SoCNE. The value of materials replaced by subsequent expenditure is derecognised from gross book and accumulated depreciation values.
2. The condition of the road surface is measured by rutting, obtained from the Traffic Speed Road Assessment Condition Survey (TRACS). Rutting is a good overall indicator for the condition of the road surface and is a measurement of the deterioration of the wearable element of the road surface. The condition of the road surface, as assessed by condition surveys, is undertaken and any movement in the condition is taken to the SoCNE as a depreciation charge or conversely an improvement credit.

Structures

Depreciation for structures is determined in two parts as follows:

1. Renewal maintenance expenditure on structures is capitalised, to the extent that it restores the service potential of the asset that has previously been consumed, and is therefore reflected in as a depreciation charge in the SoCNE. The value of materials replaced by subsequent expenditure is derecognised from gross book and accumulated depreciation values.
2. Structures have a number of definable components with different design life and are depreciated on a straight-line basis at rates to write off the assets over their economic life as follows:

Structure	Life in years
Road bridges, tunnels and underpasses	20 to 120
Road culverts	20 to 120
Retaining walls	20 to 120
Gantries	20 to 120

The following infrastructure components are considered to have an indefinite life and are not depreciated:

- Freehold land
- Sub pavement layer of long life pavements
- Earthworks

Technology

The depreciation charge for technology assets is based on the linear 'straight line' depreciation method based on an assigned design life. This overall anticipated life span of technology equipment varies according to the type of equipment between 15 to 50 years.

Impairment

The road surface and other infrastructure components are subject to an annual impairment review. Impairment is recognised as required by the International Accounting Standard IAS 36, Impairment of Assets.

Non-network assets

Freehold land is not depreciated. Other assets are depreciated at rates calculated to write off the assets over their expected useful lives on a straight-line basis as follows:

Asset	Life in years
Property	
Freehold buildings	up to 60 years
Leasehold buildings	length of the lease
Historic leasehold building	length of the lease
Surplus properties awaiting sale	no depreciation
Plant and machinery:	
Winter maintenance equipment	10 to 25 years
Office equipment	5 to 10 years
Asset	
Technology equipment	15 to 25 years
Vehicles	5 to 10 years
Test equipment	5 to 10 years
IT equipment	5 years
Database development costs	5 years
Structural steelwork	10 years
Assets in storage	no depreciation
Assets awaiting sale	no depreciation

Assets in storage (for example overhead gantries), become a network asset once issued from stores. These items are kept in controlled conditions and do not deteriorate. Whilst not depreciated, they are subject to an annual impairment review.

1.6 Non-current assets: Assets held for sale

Assets in this category comprise surplus land, buildings and dwellings (being land and property released from road schemes), plant and equipment and other assets no longer used. Assets held for sale are available for sale within one year, in their present condition, and are being actively marketed. These assets are valued at the lower of carrying amount and fair value (market value) less selling costs where material.

Non-current assets: Intangible assets

Purchased computer software licences are capitalised as intangible fixed assets where expenditure of £2,000 or more is incurred. These are valued at cost.

Internally developed intangible assets, such as software or databases, are recognised as intangible assets if:

i) the software can be run on different hardware platforms

ii) there is an identifiable asset that will produce future benefits

iii) the cost can be determined reliably.

Intangible assets are amortised over their useful lives, typically on a straight-line basis, which is considered to be three to five years. The estimated useful life and amortisation method are reviewed at the end of each annual reporting period.

1.7 Inventories

Inventories are valued at the lower of cost and net realisable value. The cost of inventories comprise all costs incurred in bringing the inventories to their present location and condition. Where excess or obsolete inventory holdings have been identified, a provision has been made to reduce the carrying value to estimated net realisable value.

1.8 Research and development

Expenditure on research is not capitalised. Expenditure on development is capitalised and written off over the useful life of the asset if it meets the criteria specified in the FReM. Expenditure that does not meet the criteria for capitalisation is treated as an expense and shown in the SoCNE in the year in which it is incurred.

Non-current assets acquired for use in research and development are depreciated over the life of the associated project

1.9 Operating income

Operating income is income that relates directly to the operating activities of the Highways Agency.

It principally comprises fees and charges for services provided on a full-cost basis to external customers in both the public and private sectors. It includes not only income appropriated in aid of the Estimate but also income due to the Consolidated Fund, which in accordance with the FReM is treated as operating income. Operating income is stated net of VAT, and is measured at the fair value of the consideration received or receivable.

1.10 Administration and programme expenditure

The SoCNE is analysed between administration and programme income and expenditure. The classification of expenditure and income as administration or as programme follows the definition of administration costs set by HM Treasury. In line with other Arms Length Bodies, the classification applied by the Highways Agency was reviewed and clarified as part of the SR10 exercise. This resulted in some expenditure being reclassified between the two categories to ensure the Highways Agency's approach was consistent with that now being applied across central government.

Administration costs reflect the costs of running the Highways Agency and include expenditure on administrative staff (such as wages and salaries, training and development and travel expenditure) and associated costs including accommodation, IT and office supplies.

Programme costs reflect the costs of operating, managing, maintaining and improving the motorway and trunk road network. They include staff costs where they directly relate to service delivery.

1.11 Pensions and other employee benefits

Past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS), which are described in Note 3. The defined schemes are unfunded and are mostly non-contributory except in respect of dependants' benefits. The Highways Agency recognises the expected cost of these elements on a systematic and rational basis over the period during which it benefits from employees' services by payment to the PCSPS of amounts calculated on an accruing basis. Liability for payment of future benefits is a charge on the PCSPS. In respect of the defined contribution schemes, the Highways Agency recognises the contributions payable for the year.

The Highways Agency recognises liabilities for short-term employee benefits (which fall due within twelve months of the period in which they are earned). In practice, all material short-term employee benefits are settled during the period in which they are earned.

The Highways Agency is required to pay, as termination benefits, the additional cost of benefits, beyond the normal PCSPS benefits, in respect of employees who retire early, unless the retirements are on approved medical grounds. The Highways Agency recognises the full cost of benefits (including pension's payable up to the normal retirement age and lump sums) as an expense and liability when it becomes demonstrably committed to providing those benefits.

1.12 Leases

At their inception, leases are classified as operating or finance leases, based on the extent to which the risks and rewards of ownership lie with the Highways Agency. In making the classification, the Highways Agency does not separate the land and buildings elements of arrangements which cover both elements. Where we are the lessor (when all risk and reward has been transferred to the lessee) we will adopt the accounting principles set out in IAS17.

Arrangements, including some PFI contracts that are not service concessions, whose fulfilment is dependent on the use of a specific asset or which convey a right to use an asset, are assessed at their inception to determine if they contain a lease. If an arrangement is found to contain a lease, that lease is then classified as an operating or finance lease. Transactions involving the legal form of a lease, such as sale and leaseback arrangements, are accounted for according to their economic substance.

Rentals under operating leases are charged to the SoCNE on a straight-line basis over the term of the lease. Where the arrangement includes incentives, such as rent-free periods, the value is recognised on a straight-line basis over the lease term. Where the Highways Agency bears substantially the risks and benefits of owning a leased item it is accounted for as a finance lease. The asset is recorded as property, plant and equipment and a liability to the lessor is recorded of the minimum lease payments discounted by the interest rate implicit in the lease. The interest element of the finance lease payment is charged to the SoCNE over the period of the lease at a constant rate in relation to the balance outstanding.

1.13 Service concessions

Under a service concession, a government entity contracts with a private sector entity to develop, finance, operate and maintain infrastructure, to deliver services directly or indirectly to the public, but controls or regulates those services and controls any significant residual interest in the infrastructure. Services indirectly provided to the public include those related to assets held for administrative purposes in the delivery of services to the public.

The Highways Agency recognises the infrastructure associated with service concessions as an asset and recognises the related liability. The asset is accounted for in a manner consistent with other assets of that type. Interest on the liability and expenditure on services provided under the service concession are recognised in the SoCNE as they accrue. Unitary Charges are apportioned between three elements: an element to pay for services; an element to pay interest on the liability and an element to repay the initial liability.

Where at the end of the concession all or part of the property reverts to the Highways Agency for a specified value, the difference between the expected fair value of the residual asset on reversion at the start of the contract and any agreed payment on reversion is built up over the life of the contract to ensure proper allocation of payments between the cost of services under the contract and acquisition of the residual interest. Capitalisation of residual interest is disclosed within non-current Assets under Assets under Construction.

The Highways Agency currently has twelve PFI properties in service that are recognised as being assets of the Highways Agency. The capital value of the pre 2005-06 PFI schemes was estimated using the public sector comparator. From 2005-06, the capital value has been based upon the PFI contractor's best estimate of capital cost at the time the contract is awarded.

In respect of the M6 toll, the reversionary interest is based on the current net book value (NBV) of the M6 toll road. The NBV is projected forward then discounted back, with the balance being built up and indexed over the life of the assets until they revert back to the Highways Agency in 2054.

1.14 Provisions and financial liabilities

In accordance with IAS 37 the Highways Agency provides for legal and constructive obligations that are of uncertain timing or amount at the statement of financial position date on the basis of management's best estimate of the expenditure required to settle the obligation and, where appropriate, this is supported by independent professional advice. Provisions are charged to the SoCNE unless they have been capitalised as part of additions to fixed assets.

1.15 Contingent liabilities

In accordance with IAS 37, the Highways Agency discloses as contingent liabilities potential future obligations arising from past obligating events, where the existence of such obligations remains uncertain pending the outcome of future events outside of the Highways Agency's control, unless their likelihood is considered to be remote. Guarantees, indemnities and undertakings which are not financial guarantee contracts under IAS 39 are treated as contingent liabilities.

In addition to contingent liabilities disclosed in accordance with IAS 37, the Highways Agency also discloses for Parliamentary reporting and accountability purposes certain contingent liabilities where the likelihood of a transfer of economic benefit is remote.

Where the time value of money is material, contingent liabilities, which are required to be disclosed under IAS 37, are stated at discounted amounts and the amount reported to Parliament is noted separately. Contingent liabilities that are not required to be disclosed by IAS 37 are stated at the amounts reported to Parliament.

1.16 Financial instruments

Financial instruments are contractual arrangements that give rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial assets are typically cash or rights to receive cash or equity instruments in another entity. Financial liabilities are typically obligations to transfer cash. A contractual right to exchange financial assets or financial liabilities with other entities will also be a financial asset or liability, depending on whether the conditions are potentially favourable or adverse to the reporting entity.

1.16.1 Financial assets and liabilities

The Highways Agency classifies its financial assets and liabilities in the following categories: Financial assets are loans, receivables and assets available for sale. Financial liabilities are any contractual obligations to deliver cash or other financial assets to a third party. Management determines the classification of financial assets and liabilities at initial recognition.

1.16.2 Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not classified as available for sale. Loans and receivables are initially recognised at fair value and subsequently held at amortised cost using the effective interest method. Fair value is usually the original invoiced amount.

1.16.3 Available for sale financial asset

Available for sale financial assets are non-derivative financial assets that are designated as available for sale. They are initially recognised at fair value and subsequently re-measured to fair value at each Statement of Financial Position (SoFP) date. Any increase due to changes in fair value is recognised in reserves.

1.16.4 Financial liabilities

The Highways Agency determines its financial liabilities as contractual obligations to deliver cash or other financial assets to another entity. Financial liabilities are recognised initially at fair value and are subsequently held at amortised cost using the effective interest method. Financial liabilities are derecognised when the right to receive cash flows has expired.

1.16.5 Embedded derivatives

Some hybrid contracts contain both a derivative and a non-derivative component. In such cases, the derivative component is termed an embedded derivative. Where the economic characteristics and risks of the embedded derivatives are not closely related to those of the host contract, and the host contract itself is not carried at fair value through profit or loss, the embedded derivative is separated and reported at fair value with gains and losses being recognised in the SoCNE. The Highways Agency has carried out a review of its contracts and has determined that, as at 31 March 2013, it had no arrangements meeting the criteria to require separation.

1.16.6 Determining fair value

Fair value is determined by reference to a quoted market price for that instrument or by using a valuation model that makes use of market inputs wherever possible. However, investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are shown at cost.

1.16.7 Impairment of financial assets

The Highways Agency assesses at each SoFP date whether there is objective evidence that financial assets are impaired as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the statement of financial position date, and that loss event or events has had an impact on the estimated future cash flows of the financial asset or the portfolio that can be reliably estimated.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar risk characteristics, taking into account asset type, industry, geographical location, collateral type, overdue status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the counterparty's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

The amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. Future cash flows in a group of loans and receivables that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

1.17 VAT

Most of the activities of the Highways Agency are outside the scope of VAT and, in general, output tax does not apply and input tax on purchases is not recoverable. Input VAT on certain contracted-out services is recovered through the Department for Transport's VAT registration, under annual Treasury Direction. Irrecoverable VAT is charged to the relevant expenditure category or included in the capitalised purchase cost of non-current assets. Where output tax is charged or input VAT is recoverable, the amounts are stated net of VAT.

1.18 Estimation techniques

Estimation techniques are the methods adopted to arrive at estimated monetary amounts for income and expenditure during the reporting period and the valuation of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. There may be several alternative estimation techniques, which could produce a range of results. The significant estimation techniques for the Highways Agency include the valuation of the trunk road network where the application of indices and standard costs generate a valuation.

1.19 EU grants

EU grants are not recognised in the accounts until it is certain they will be received. Grants that relate to specific capital expenditure are credited to deferred income on the SoFP and then credited to the SoCNE over the asset's construction period. Grants for revenue expenditure are credited to the SoCNE.

1.20 Segmental reporting

IFRS 8 requires the Highways Agency to disclose information to enable users of the financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. The Highways Agency's reportable segments are based on the way management has chosen to organise the business activities, manage the organisation and allocate resources for assessment of segment performance.

1.21 Trunkings/detrunkings

The detrunking of roads as part of the Government's policy announced in the 1998 White Paper to transfer responsibility for non-core network routes to local authorities is treated as a transfer of function. This process is now completed. However, the Highways Agency will continue the more routine detrunking that will occur after construction of a bypass or new road.

Merger accounting principles are applied with opening balances adjusted for the cumulative effect of the detrunking/trunking and comparative figures for the preceding period restated.

2. Segmental reporting

	2012-13					
	Resource expenditure £000	Resource income £000	Resource total £000	Capital expenditure £000	Capital income £000	Capital total £000
Total by segment						
Major Improvements	458,908	(34,419)	424,489	369,889	(5,170)	364,719
Maintaining the Network	298,164	(11,773)	286,391	421,504	-	421,504
Technology Improvements	57,778	(19,391)	38,387	3,801	-	3,801
Traffic Management	48,447	(3,473)	44,974	5,257	-	5,257
Smaller schemes and R&D	36,318	(557)	35,761	35,508	-	35,508
Running costs - Programme	98,537	-	98,537	-	-	-
Running costs - Admin	62,314	(2,163)	60,151	19,321	-	19,321
Other	129	(20,704)	(20,575)	2,315	-	2,315
	1,060,595	**(92,480)**	**968,115**	**857,595**	**(5,170)**	**852,425**
Unallocated costs						
Depreciation & write downs	1,165,225	-	1,165,225	-	-	-
Other	5,146		5,146	(2,510)	-	(2,510)
Highways Agency total	**2,230,966**	**(92,480)**	**2,138,486**	**855,085**	**(5,170)**	**849,915**

	2011-12					
	Resource expenditure £000	Resource income £000	Resource total £000	Capital expenditure £000	Capital income £000	Capital total £000
Total by segment						
Major Improvements	390,667	(28,322)	362,345	830,529	(8,624)	821,905
Maintaining the Network	444,728	(9,345)	435,383	373,367	-	373,367
Technology Improvements	70,388	(1,855)	68,533	11,270	-	11,270
Traffic Management	57,442	(3,046)	54,396	15,174	-	15,174
Smaller schemes and R&D	30,636	(1,078)	29,558	34,854	-	34,854
Running costs - Programme	100,964	-	100,964	-	-	-
Running costs - Admin	60,651	(1,742)	58,909	16,763	-	16,763
Other	152	(19,681)	(19,529)	1,505	-	1,505
	1,155,628	**(65,069)**	**1,090,559**	**1,283,462**	**(8,624)**	**1,274,838**
Unallocated costs:						
Depreciation & write downs	1,294,796	-	1,294,796	-	-	-
Other	(9,729)	-	(9,729)	6,681	-	6,681
Highways Agency total	**2,440,695**	**(65,069)**	**2,375,626**	**1,290,143**	**(8,624)**	**1,281,519**

- The operating segments above are business activities that are regularly reviewed by the Highways Agency's Board and senior management.
- Consolidated expenditure in the financial statements is split between capital and resource expenditure.
- Unallocated costs cannot be reasonably apportioned across segments.

Segmental income

- Major Improvements income includes contributions from private developers who make contributions to highways works by entering into an agreement with the Secretary of State under section 278 (s278) of the Highways Act 1980 and also contributions from local authorities.
- Maintaining the network income is mostly attributable to where the Highways Agency claims compensation from users of the network who damage the network.
- Traffic Management income is generated from the national vehicle recovery programme.
- Running costs – Admin income is mostly attributable to rent recoveries where the Highways Agency sub lease parts of their office space.
- Other income is primarily interest received from Severn River Crossing Ltd and Midland Expressway Ltd (MEL).

3. Staff numbers and related costs

3. (a) Staff costs

Staff costs comprise:	2012-13			2011-12
	Permanent staff £000	Other £000	Total £000	**Total £000**
Wages and salaries	104,289	4,948	109,237	109,271
Social security costs	8,266	-	8,266	8,235
Other pension costs	18,967	-	18,967	19,214
Sub total	**131,522**	**4,948**	**136,470**	**136,720**
Capitalised staff costs	(18,980)	-	(18,980)	(16,567)
Less recoveries in respect of outward	(113)	-	(113)	(70)
Highways Agency total	**112,429**	**4,948**	**117,377**	**120,083**

Permanent staff are those staff with a permanent employment contract with the Highways Agency. Wages and salaries includes gross salaries, performance pay or bonuses, overtime, London weighting or London allowances, recruitment and retention allowances, private office allowances, ex-gratia payments and any other taxable allowances or payments as well as costs relating to agency, temporary and contract staff engaged by the Highways Agency on a contract to undertake a project or task. The payment of legitimate expenses is not part of salary.

Pension costs

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded multi-employer defined benefit scheme but the Highways Agency is unable to identify its share of the underlying assets and liabilities. The scheme actuary valued the scheme as at 31 March 2007. You can find details in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice.gov.uk/pensions).

For 2012-13, employers' contributions of £18,857,344 were payable to the PCSPS (2011-12 £19,105,015) at one of four rates in the range 16.7% to 24.3% of pensionable pay, based on salary bands. The Scheme Actuary reviews employer contributions usually every four years following a full scheme valuation. The contribution rates are set to meet the cost of the benefits accruing during 2012-13 to be paid when the member retires and not the benefits paid during this period to existing pensioners.

Employees can opt to open a partnership pension account, a stakeholder pension with an employer contribution. Employers' contributions of £102,726 (2011-12 £105,204) were paid to one or more of the panel of three appointed stakeholder pension providers.

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 £6,820 (2011-12 £7001), 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 or ill health retirement of these employees.

Contributions due to the partnership pension providers at the balance sheet date were £14,457. Contributions prepaid at that date were £nil.

No individuals retired early on ill-health grounds: the total additional accrued pension liabilities in the year amounted to £nil.

3. (b) Average number of persons employed

	2012-13			2011-12
	Permanent staff	Other	Total	Total
Staff funded from administration budgets	482	2	484	518
Staff funded from programme budgets				
Traffic officer staff	1,531	5	1,536	1,652
Direct support to front line projects and service delivery	895	12	907	958
Staff engaged on capital projects	398	5	403	347
Average FTE persons employed	**3,306**	**24**	**3,330**	**3,475**

Over the course of the financial year, the actual full time equivalents (FTE) reduced from 3,385 to 3,250.

See Note 1.10 for details of administration and programme classifications.

3. (c) Civil Service and other compensation schemes – exit packages

During the year, no payments were made which were not covered by the Civil Service Compensation Scheme. (2011-12: one payment was made between £25k and £50k).

4. Other administration costs

	Note	2012-13 £000	2011-12 £000
Communication		1,077	1,138
Consultancy		150	300
Information technology		18,211	18,896
Maintenance		766	552
Professional services		210	296
Recruitment and training		1,485	1,336
Rent, rates and building costs		5,487	4,699
Stationery, postage and printing		389	494
Travel and subsistence		947	920
Other administration costs		4,923	4,002
		33,645	**32,633**
Rentals under operating leases:			
Hire of plant and machinery		70	72
Other operating leases		6,511	6,096
		6,581	**6,168**
Non-cash items:			
Depreciation:			
Property, plant and equipment	*7*	1,571	2,086
Impairment of non-current assets	*10*	34	-
Amortisation:			
Intangible fixed assets	*8*	13	65
Loss on disposal of property, plant and equipment		-	-
Notional costs:			
Auditors' remuneration and expenses:			
Annual audit		275	275
Provision for doubtful debt		(6)	-
Provisions provided for in year	*15*	475	419
		2,362	**2,845**
Total: Other administration costs		**42,588**	**41,646**

5. Programme costs

	Note	2012-13 £000	2011-12 £000
Research and development expenditure		4,623	3,747
Maintenance and similar activities		382,601	536,740
Interest on PFI finance leases		139,375	119,707
PFI service charges		350,812	314,814
Information technology		4,902	4,860
Traffic Management vehicle costs		7,413	7,453
Carbon emissions licence		966	1,008
Other programme costs		12,052	14,127
		902,745	**1,002,456**
Non-cash items:			
Depreciation:			
Property, plant and equipment	*7*	719,007	680,650
Property, plant and equipment held under PFI finance leases	*7*	112,390	55,770
Impairment of non-current assets	*10*	17,888	33,136
Amortisation:			
Intangible fixed assets	*8*	4,391	5,066
Write down of network assets	*7*	309,930	506,593
Notional costs:			
Loss on disposal of property, plant and equipment		636	294
Provision for doubtful debt		1,078	(475)
Provision for slow moving stock		2,253	6,152
Provisions provided for in year	*15*	683	(10,676)
		1,168,256	**1,276,510**
Total: Programme costs		**2,071,001**	**2,278,966**

6. Operating income

Operating income principally arises from:

- fees and charges for work carried out on a full-cost basis to external customers in both the public and private sectors
- rental income from offices where the Highways Agency is the main occupier and surplus accommodation is let to other organisations
- rental income from properties acquired for road schemes which have yet to be disposed of
- recoveries from third parties in respect of claims for damage to the motorways and trunk roads
- statutory charges relating to the removal of vehicles from the completed road network
- interest receivable
- sale of strategic salt stock
- grants and contributions from the European Union
- other income including contributions on schemes.

Operating income analysed by classification and activity is as follows (all Appropriated in Aid):	2012-13 Total £000	2011-12 Total £000
Administration income		
Fees and charges to external customers	-	-
Cost recoveries/rental income	1,281	767
Other income	885	979
	2,166	**1,746**
Programme Income		
Fees and charges to external customers	17,849	10,546
Rental income from properties	4,166	4,031
Claims for damage to network	10,415	8,219
Interest receivable	20,601	19,467
Recovery of costs incurred on M6 toll scheme	5,083	9,270
National Vehicle Recovery	2,994	2,794
Sales of strategic salt stock	236	179
Other income	4,999	6,839
	66,343	**61,345**

Under the Department's Estimate, Subhead C certain income known as Appropriation in Aid (AinA) is available for offset against costs of the Highways Agency in determining its Net Operating Costs. Other income, not available for offset against the costs of the Highways Agency, is known as Not Appropriated in Aid. Recoveries in excess of AinA for the Highways Agency may be netted against AinA shortfalls elsewhere within the Department's consolidation boundary.

Disclosure under HM Treasury Managing Public Money

Fees and charges provided to external and public sector customers can be analysed as follows:

	2012-13			2011-12		
	Income	Full cost	Surplus/ (deficit)	Income	Full cost	Surplus/ (deficit)
	£000	£000	£000	£000	£000	£000
Fees and charges to external customers	17,849	17,849	-	10,546	10,546	-
Cost recoveries/rental income administration	189	189	-	227	227	-
Rental income from programme properties	4,166	4,194	(28)	4,031	4,549	(518)
Claims for damage to network	10,415	11,380	(965)	8,219	8,885	(666)
National vehicle recovery	2,994	6,375	(3,381)	2,794	5,403	(2,609)
Recovery of other costs from MEL	282	270	12	1,190	1,156	34
Recovery of costs incurred from schemes	1,300	1,300	-	2,883	2,883	-
Sales of strategic salt stock	236	236	-	179	179	-
Other income	4,447	4,447	-	4,233	4,233	-
	41,878	**46,240**	**(4,362)**	**34,302**	**38,061**	**(3,759)**

The financial objective for each of these services is full recovery of the service costs in accordance with HM Treasury Managing Public Money. The purpose of the above table is to comply with the disclosure requirements of HM Treasury Managing Public Money.

7. (a) Property, plant and equipment 2012-13

	Infrastructure assets	Assets under construction	Land	Buildings	Dwellings	Plant and machinery	Information technology	Total
	£000	£000	£000	£000	£000	£000	£000	£000
Cost or valuation								
At 1 April 2012	125,846,897	753,628	148,275	161,022	60,980	113,443	1,144	127,085,389
Detrunking	-	-	-	-	-	-	-	-
Restated sub-total	**125,846,897**	**753,628**	**148,275**	**161,022**	**60,980**	**113,443**	**1,144**	**127,085,389**
Adjustments to opening position	(1,396,936)	13,952	-	-	-	239	-	(1,382,745)
Capital additions	393,038	462,047	-	-	-	-	-	855,085
Write down	(393,038)	(309,930)	-	-	-	-	-	(702,968)
Disposals	-	-	(1,000)	(395)	(993)	(10,875)	(1,000)	(14,263)
Revaluation	2,201,425	-	(48)	74	(168)	8,090	20	2,209,393
Impairments	(21,889)	-	(54)	-	(840)	(60)	-	(22,843)
Transfers	560,505	(565,582)	778	-	3,842	457	-	-
Reclassifications to assets held for sale	-	-	(3,329)	(716)	(2,106)	-	-	(6,151)
At 31 March 2013	**127,190,002**	**354,115**	**144,622**	**159,985**	**60,715**	**111,294**	**164**	**128,020,897**
Depreciation								
At 1 April 2012	18,458,270	-	-	80,538	-	62,078	1,086	18,601,972
Detrunking	-	-	-	-	-	-	-	-
Restated Sub-total	**18,458,270**	**-**	**-**	**80,538**	**-**	**62,078**	**1,086**	**18,601,972**
Adjustments to opening position	(711,293)	-	-	-	-	-	-	(711,293)
Valuation adjustments	(393,038)	-	-	-	-	-	-	(393,038)
Impairment	(5,612)	-	-	-	-	(26)	-	(5,638)
Charged in year	821,692	-	-	3,948	-	7,302	26	832,968
Disposals	-	-	-	(140)	-	(10,865)	(1,000)	(12,005)
Revaluation	101,939	-	-	-	-	5,544	12	107,495
Reclassifications to assets held for sale	-	-	-	-	-	-	-	-
At 31 March 2013	**18,271,958**	**-**	**-**	**84,346**	**-**	**64,033**	**124**	**18,420,461**
Net book value at 31 March 2013	**108,918,044**	**354,115**	**144,622**	**75,639**	**60,715**	**47,261**	**40**	**109,600,436**
Net book value at 31 March 2012	**107,388,627**	**753,628**	**148,275**	**80,484**	**60,980**	**51,365**	**58**	**108,483,417**
Asset financing								
Owned	106,522,414	152,047	144,622	72,932	60,715	47,261	40	107,000,031
On-balance sheet PFI contracts	2,395,630	-	-	2,707	-	-	-	2,398,337
M6 reversionary interest	-	202,068	-	-	-	-	-	202,068
Net book value at 31 March 2013	**108,918,044**	**354,115**	**144,622**	**75,639**	**60,715**	**47,261**	**40**	**109,600,436**

7. (b) Property, plant and equipment 2011-12

	Infrastructure assets	Assets under construction	Land	Buildings	Dwellings	Plant and machinery	Information technology	Total
	£000	£000	£000	£000	£000	£000	£000	£000
Cost or valuation								
At 1 April 2011	114,458,369	1,120,578	129,306	89,468	57,060	123,610	52,242	116,030,633
Detrunking	-	-	-	-	-	-	-	-
Prior period adjustment	-	34,040	-	-	-	-	-	34,040
Restated sub-total	**114,458,369**	**1,154,618**	**129,306**	**89,468**	**57,060**	**123,610**	**52,242**	**116,064,673**
Adjustments to opening position	7,502,123	6,120	-	-	-	(2,759)	-	7,505,484
Capital additions	345,103	945,040	-	-	-	-	-	1,290,143
Valuation adjustments	(345,103)	(506,593)	-	-	-	-	-	(851,696)
Disposals	-	-	(997)	(998)	(788)	(1,761)	(51,098)	(55,642)
Revaluation	3,099,322	-	18,014	69,316	6,509	2,854	-	3,196,015
Impairments	(47,765)	-	(137)	(1,972)	(363)	0	-	(50,237)
Transfers	834,848	(845,557)	441	2,274	6,596	1,398	-	-
Reclassifications to assets held for sale	-	-	1,648	2,934	(8,034)	(9,899)	-	(13,351)
At 31 March 2012	**125,846,897**	**753,628**	**148,275**	**161,022**	**60,980**	**113,443**	**1,144**	**127,085,389**
Depreciation								
At 1 April 2011	15,784,192	-	-	23,231	-	59,927	51,661	15,919,011
Detrunking	-	-	-	-	-	-	-	-
Restated Sub-total	**15,784,192**	**-**	**-**	**23,231**	**-**	**59,927**	**51,661**	**15,919,011**
Adjustments to opening position	1,919,896	-	-	-	-	(2,197)	-	1,917,699
Valuation adjustments	(345,103)	-	-	-	-	-	-	(345,103)
Impairment	(17,129)	-	-	(296)	-	-	-	(17,425)
Charged in year	727,557	-	-	2,852	-	7,574	523	738,506
Disposals	-	-	-	(252)	-	(1,715)	(51,098)	(53,065)
Revaluation	388,857	-	-	51,474	-	2,018	-	442,349
Reclassifications to assets held for sale	-	-	-	3,529	-	(3,529)	-	-
At 31 March 2012	**18,458,270**	**-**	**-**	**80,538**	**-**	**62,078**	**1,086**	**18,601,972**
Carrying value at 31 March 2012	**107,388,627**	**753,628**	**148,275**	**80,484**	**60,980**	**51,365**	**58**	**108,483,417**
Carrying value at 31 March 2011	**98,674,177**	**1,154,618**	**129,306**	**66,237**	**57,060**	**63,683**	**581**	**100,145,662**
Asset financing								
Owned	105,022,323	565,512	148,275	77,731	60,980	51,365	58	105,926,244
On-balance sheet PFI contracts	2,366,304	-	-	2,753	-	-	-	2,369,057
M6 reversionary interest	-	188,116	-	-	-	-	-	188,116
Carrying value at 31 March 2012	**107,388,627**	**753,628**	**148,275**	**80,484**	**60,980**	**51,365**	**58**	**108,483,417**

Network assets

Adjustment to opening position

The infrastructure asset valuation as at 1 April 2012 was restated to include the following adjustments:

- During the year the Highways Agency managed a project to check and update dimensional information for all structures across the network. This work resulted in an decrease in structures valuation by £740,848,000.
- Dimensional changes to other areas of the network, including pavements, resulted in a increase in the valuation by £55,205,000; this represents improved formation on network infrastructure.
- During the year the Highways Agency continued a programme of data improvement for the network. There was no material effect of this work on the valuation during the year.

Valuation adjustments

This consists of the following:

- **Capital renewal** – the Highways Agency has a yearly programme of renewal of the network to ensure the infrastructure continues to deliver according to the service potential. This yearly renewal expenditure is classified as Capital and the Highways Agency spent £393,038,000 during the year. This expenditure will provide significant benefits for the network in future years.
- **Write-down** – the infrastructure valuation is based on standard cost and indexation, as required by Government financial reporting. Standard cost is based on a number of assumptions and is an accounting estimate of the cost of replacing the network. The write-down is calculated by comparing the actual cost of constructing a scheme with the standard cost valuation, this difference is the write-down. During the year the write-down was £309,930,000. The level of write-down is determined by the type of schemes under construction or opened to traffic during the year.

Revaluation

The total revaluation of the network infrastructure was £2,099,486,000 and consists of the following:

Financial reporting standards require that an indexation factor must be applied to the network valuation to reflect current prices etc. The Highways Agency uses ROCOS for this purpose and the result was an increase of £1,988,819,000 in the valuation of the network.

During the year, the Highways Agency reviewed and amended standard cost for structures to ensure this was robust and included relevant accounting estimates. The revised standard cost reflects the valuation of structures at current price. The impact of the change in standard cost for structures was £110,667,000.

Depreciation

The network is depreciated on a yearly basis to reflect the current condition of the network. The depreciation charge for the year was £821,692,000. This included a charge of £32,431,000 for the deterioration in the road condition.

Assets under Construction

The 1 April 2012 opening position was adjusted to include an additional £13,952,000 of reversionary interest for the M6 toll road.

Analysis of land and buildings, excluding dwellings is as follows:

	2012-13 £000	2011-12 £000
Freehold buildings (96.7%)	211,560	219,681
Long leasehold buildings (50+ years)	-	-
Short leasehold buildings (less than 50 years)	8,701	9,078
Total	**220,261**	**228,759**

8. Intangible assets

	Software licences £000	Developed costs £000	Total £000
Cost or valuation			
Balance at 1 April 2011	6,417	76,088	82,505
Additions	-	-	-
Disposals	-	-	-
Balance at 1 April 2012	**6,417**	**76,088**	**82,505**
Additions	-	-	-
Disposals	-	-	-
Balance at 31 March 2013	**6,417**	**76,088**	**82,505**
Amortisation			
Balance at 1 April 2011	6,340	65,728	72,068
Charged in year	65	5,066	5,131
Disposals	-	-	-
Balance at 1 April 2012	**6,405**	**70,794**	**77,199**
Charged in year	12	4,392	4,404
Disposals	-	-	-
Balance at 31 March 2013	**6,417**	**75,186**	**81,603**
Net book value at 31 March 2013	**-**	**902**	**902**
Net book value at 31 March 2012	**12**	**5,294**	**5,306**

9. Assets classified as held for sale

	Land and buildings £000	Dwellings £000	Plant and machinery £000	Total £000
Balance at 1 April 2011	7,865	4,654	-	12,519
Disposals	(2,809)	(3,531)	-	(6,340)
Revaluation	(964)	(622)	-	(1,586)
Impairment	(103)	(221)	-	(324)
Reclassifications from property plant and equipment	5,317	8,034	-	13,351
Balance at 1 April 2012	**9,306**	**8,314**	**-**	**17,620**
Disposals	(7,418)	(2,838)	-	(10,256)
Revaluation	(288)	(196)	-	(484)
Impairment	(372)	(345)	-	(717)
Reclassifications to/from property plant and equipment	4,045	2,106	-	6,151
Balance at 31 March 2013	**5,273**	**7,041**	**-**	**12,314**

10. Impairments

	2012-13 £000	2011-12 £000
Total Impairment charge through Statement of Comprehensive Net Expenditure	17,922	33,136

The impairment charge for 2012-13 mainly comprised of:

- £2,207,000 of communication and electrical equipment impairment (2011-12: £5,344,000), removed from the network as damaged or obsolete
- £14,071,000, the Highways Agency demolished and scrapped a number of bridges and gantries as part of the ongoing renewal of the network infrastructure (2011-12: £12,713,000).

11. Inventories

	31 Mar 2013 £000	31 Mar 2012 £000
Communication/electrical equipment for strategic road network	31,712	40,450
Highway damage repair items - barriers and parts for the repair of bridges, tunnels and special structures	987	1,279
Salt	12,092	14,096
Uniforms for traffic officers working on the strategic road network	411	424
Total	**45,202**	**56,249**

Inventory of communication/electrical equipment has fallen with the ongoing roll-out of Managed Motorway schemes across the network. Salt holdings have remained stable. The net realisable value of salt has been reduced to reflect market conditions; although the Highways Agency's objective remains full cost recovery on sales of salt.

12. Trade and other receivables

12. (a) Analysis by type

	31 Mar 2013 £000	31 Mar 2012 £000
Amounts falling due within one year		
Trade receivables	89,049	5,004
Deposits and advances	7,652	6,252
VAT	89,113	85,560
Midland Expressway Limited M6 concession	11,509	11,446
Prepayments and accrued income	8,739	15,623
Finance leases	68	-
Other receivables	523	386
	206,653	**124,271**

	31 Mar 2013 £000	31 Mar 2012 £000
Amounts falling due after more than one year		
Severn River Crossing Plc subordinated loan	108,322	105,011
Severn River Crossing Plc deferred interest	74,721	64,361
Midland Expressway Limited M6 concession	167,664	162,634
Deposits and advances	8,417	8,947
Finance leases	6,614	-
Staff relocation housing loans	15	35
	365,753	**340,988**
Total	**572,406**	**465,259**

Trade receivables include the Highways Agency's share of a gain sharing arrangement with the contractors on the M25 upgrade.

A £60 million subordinated loan was granted to Severn River Crossing Plc (SRC) on 26 April 1992 as part of the consideration for a concession agreement granted by the Secretary of State for the operation and maintenance of the existing Severn River crossing and the design, construction, operation and maintenance of a second crossing. The loan is indexed by reference to the Retail Price Index and carries an interest rate of 6% per annum. It is repayable at the end of the concession period, which is the earlier of 2022 and SRC achieving a pre-determined cumulative revenue target from tolls. It is currently predicted the concession period will end in May 2018. Under a re-financing agreement in 2002-03 interest on the subordinated loan is deferred and is repayable at the end of the concession period.

Midland Expressway Ltd (MEL) entered into a contract with the Highways Agency on 28 February 1992 to build and maintain the M6 toll road. The debtor balance represents costs incurred by the Highways Agency in their capacity as agents for land acquisition and compensation payments. The reimbursement of the above costs to the Highways Agency started in October 2010.

12. (b) Intra-Government receivables

	Amounts falling due within one year		Amounts falling after more than one year	
	31 Mar 2013 £000	31 Mar 2012 £000	31 Mar 2013 £000	31 Mar 2012 £000
Balances with:				
Other central government bodies	89,854	86,419	-	-
Local authorities	2,178	4,004	6,614	-
Public corporations and trading funds	2	211	-	-
Total intra-government balances	**92,034**	**90,634**	**6,614**	
Balances with bodies external to government	114,619	33,637	359,139	340,988
Total	**206,653**	**124,271**	**365,753**	**340,988**

13. Cash and cash equivalents

	31 Mar 2013 £000	31 Mar 2012 £000
Balance at 1 April 2012	17,377	(18,655)
Net change in cash and cash equivalent balances	14,090	36,032
Balance at 31 March 2013	**31,467**	**17,377**
The following balances at 31 March were held at:		
Commercial banks	1,122	45
Government Banking Service	30,345	17,332
Balance at 31 March 2013	**31,467**	**17,377**

14. Trade and other payables
14. (a) Analysis by type

	31 Mar 2013 £000	31 Mar 2012 £000
Amounts falling due within one year:		
Other taxation and social security	4,594	4,475
Trade payables	28,562	3,078
Accruals and deferred income	423,043	500,197
Current part of imputed finance lease element of on balance sheet PFI contracts	61,891	57,574
Consolidated fund extra receipts due to be paid to the Consolidated Fund:		
Received	-	-
Receivable	83,204	6
Amounts due to DfT in respect of Dartford River Crossing road user charges	8,109	7,040
Amounts due to the Consolidated Fund in respect of supply	79,135	65,282
Other payables	809	633
	689,347	**638,285**

	31 Mar 2013 £000	31 Mar 2012 £000
Amounts falling after more than one year:		
Imputed finance lease element of on balance sheet PFI contracts	1,806,820	1,795,146
Consolidated fund extra receipts due to be paid to the Consolidated Fund in respect of:		
Severn River Crossing Plc subordinated loan	108,322	105,011
Severn River Crossing Plc subordinated loan interest	54,815	54,815
Midland Expressway Ltd concession	61,497	61,497
Other payables, accruals and deferred income:		
Payable as agents in respect of the Midland Expressway Ltd concession	11,235	10,132
Other	14,165	27,568
	2,056,854	**2,054,170**
Total	**2,746,201**	**2,692,455**

Accruals and deferred income comprise:

	31 Mar 2013 £000	31 Mar 2012 £000
Amounts payable relating to road schemes	342,252	342,279
PFI related accruals	48,133	128,663
Third party funded projects (s278)	13,685	18,365
Administration accruals	10,596	9,566
Other	8,377	1,324
Total	**423,043**	**500,197**

14. (b) Intra-Government receivables

	Amounts falling due within one year		Amounts falling after more than one year	
	31 Mar 2013 £000	31 Mar 2012 £000	31 Mar 2013 £000	31 Mar 2012 £000
Balances with:				
Other central government bodies	170,724	71,320	224,635	231,456
Local authorities	4,888	193	-	-
Public corporations and trading funds	47	28	-	-
Total Intra-Government balances	**175,659**	**71,541**	**224,635**	**231,456**
Balances with bodies external to government	513,688	566,744	1,832,219	1,822,714
Total	**689,347**	**638,285**	**2,056,854**	**2,054,170**

15. Provisions

	Land and property acquisition	Engineering and construction services	Bridge strengthening	Tunnels	Early retirement	Pension and other liabilities	Total
	£000	£000	£000	£000	£000	£000	£000
Balance at 1 April 2011	149,095	64,595	52,777	26,495	3,768	8,082	304,812
Provided in the year	26,673	57,482	8,496	1,448	-	3,668	97,768
Provisions not required written back	(38,631)	(6,543)	(1,571)	-	-	(1,360)	(48,105)
Provisions utilised in the year	(24,024)	(31,697)	(32,726)	(4,928)	(907)	(3,287)	(97,569)
Balance at 1 April 2012	**113,113**	**83,837**	**26,976**	**23,015**	**2,861**	**7,103**	**256,906**
Provided in the year	37,766	30,039	2,450	-	-	1,603	71,858
Provisions not required written back	(23,281)	(12,890)	(4,510)	-	-	(542)	(41,224)
Provisions utilised in the year	(28,041)	(51,090)	(5,354)	(7,330)	(819)	(1,371)	(94,005)
Reclassification incl. accruals	-	-	-	-	-	(953)	(953)
Balance at 31 March 2013	**99,557**	**49,896**	**19,562**	**15,685**	**2,042**	**5,840**	**192,582**

Analysis of expected timing of discounted flows:

	Land and property acquisition	Engineering and construction services	Bridge strengthening	Tunnels	Early retirement	Pension and other liabilities	Total
	£000	£000	£000	£000	£000	£000	£000
In 2013 - 2014	12,587	27,247	450	7,667	618	4,192	52,761
Between 2015 and 2019	74,282	22,649	19,112	8,018	1,352	1,648	127,061
Between 2019 and 2024	12,688	-	-	-	72	-	12,760
Thereafter	-	-	-	-	-	-	-
Balance at 1 April 2012	**99,557**	**49,896**	**19,562**	**15,685**	**2,042**	**5,840**	**192,582**

Land and property acquisition

Land and property acquisition provisions relate principally to the estimated cost of planning blight, discretionary and compulsory acquisition of property and compensation for property owners arising from physical construction of a road scheme. It may take several years from the announcement of a scheme to completion of the road and final settlement of all liabilities.

Engineering and construction services

The provision for engineering and construction services is required to meet the estimated cost of work to meet generally accepted highways standards, after a road has been opened for traffic, and disputed contractual claims.

Bridge strengthening

The provision is required to strengthen bridges and other structures to comply with legal minimum requirements, as established by European Community legislation and authoritative statements by Ministers in Parliament.

Tunnels

The Secretary of State is required to bring long tunnels on the Trans-European Roads Network up to new safety standards. The tunnels related works are scheduled to be completed before the deadline of 2014 set in the Directive.

Migration, pensions and other liabilities

Other liabilities include those to third parties who have suffered damage or injury as a result of the road network being damaged and are entitled to submit a claim to the Highways Agency for compensation. A provision has been made which estimates the number and value of the claims received as at 31 March 2013 that will require settlement by the Highways Agency.

The pension liability relates to former staff who left the Highways Agency's employment before the formal retirement age of 60. The Highways Agency is responsible for making payments to the pension plan until their retirement age.

In-year increases and decreases in provisions

These can impact on both the Capital Expenditure and Statement of Comprehensive Net Expenditure. Capital Expenditure provisions increased by £29,476,000 (2011-12 increased by £59,920.000) during the year. The following provisions were charged to the Statement of Comprehensive Net Expenditure:

	2012-13 £000	2011-12 £000
Programme:		
Land and property acquisition	97	(11,506)
Engineering and construction services	-	(1,060)
Bridge strengthening	-	-
Tunnels	-	-
Early retirement	-	-
Pensions and other liabilities	586	1,890
	683	**(10,676)**
Administration:		
Early retirement	-	-
Other	475	419
	1,158	**(10,257)**

16. Capital commitments

	31 Mar 2013 £000	31 Mar 2012 £000
Contracted capital commitments at 31 March 2013 not otherwise included in these accounts:		
Property, plant and equipment	455,482	229,913

17. Commitments under leases

The Highways Agency has the following future lease commitments under non-cancellable operating leases:

	31 Mar 2013		31 Mar 2012	
	Land and buildings £000	Other £000	Land and buildings £000	Other £000
Obligations under operating leases comprise:				
Not later than one year	7,672	2	8,644	19
Later than one year and no later than five years	29,287	-	34,183	14
Later than five years	40,493	-	59,219	-
Total	**77,452**	**2**	**102,046**	**33**

18. Commitments under Private Finance Initiatives

The Highways Agency has entered into the following on balance sheet PFI contracts for the design, build, finance and operation of sections of the network:

- M1-A1 Yorkshire link
- A1 (M) Alconbury to Peterborough
- A419/A417 Swindon to Gloucester
- A50/A564 Stoke - Derby link
- M40 Junctions 1-15
- A19 Dishforth to Tyne Tunnel
- A30/A35 Exeter to Bere Regis
- A69 Carlisle to Newcastle
- A1(M) Darrington to Dishforth
- A249 Iwade to Queenborough
- \- National Roads Telecommunications Services
- M25 London Orbital Motorway contract

The substance of the PFI contract is that the Highways Agency has a finance lease, with the asset being recognised as a non-current asset of the Highways Agency. Payments under PFI contracts comprise two elements – imputed finance lease charges and capital payments.

Imputed finance leases obligations under on balance sheet PFI contracts comprise:

	31 Mar 2013 £000	31 Mar 2012 £000
Not later than one year	197,590	172,150
Later than one year and not later than five years	780,456	762,245
Later than five years	2,989,235	2,995,921
	3,967,281	**3,930,316**
Less interest element	(2,098,570)	(2,077,596)
	1,868,711	**1,852,720**

The future total service element payments which the Highways Agency is committed to for each of the following periods are given in the table below, analysed according to the period in which the commitment expires. The amount expected to be paid has fallen due to payment made and changes to inflation and traffic forecasts.

	31 Mar 2013 £000	31 Mar 2012 £000
Not later than one year	537,607	553,453
Later than one year and not later than five years	2,076,424	2,092,012
Later than five years	12,416,123	12,938,142
	15,030,154	**15,583,607**

The total amount charged in the Statement of Comprehensive Net Expenditure in respect of the service element of on balance sheet PFI transactions for the year was £288,293,000 (2011-12 £314,815,000).

19. Financial instruments

IFRS 7 requires minimum disclosures about the nature and extent of credit risk, liquidity risk and market risk that the Highways Agency faces in undertaking its activities. Due to the largely non-trading nature of its activities and the way in which government agencies are financed, the Highways Agency is not exposed to the degree of financial risk faced by many business entities. Moreover, financial instruments play a much more limited role in creating or changing risk than would be typical of the listed companies to which IFRS 7 mainly applies. The Highways Agency has very limited powers to borrow or invest surplus funds. Financial assets and liabilities are generated by day-to-day operational activities and are not held to change the risks facing the Highways Agency in undertaking its activities.

Liquidity risk
This is the risk that the Highways Agency is unable to meet its obligations when they fall due and to replace funds when they are withdrawn. The Highways Agency's net revenue resource requirements are mainly financed by resources voted annually by Parliament to the Department for Transport. The Highways Agency is therefore not exposed to significant liquidity risks.

Credit risk
Credit risk is the risk of suffering financial loss, should any of the Highways Agency's customers or counterparty's fail to fulfil their contractual obligations to the Highways Agency. Some of the Highways Agency's customers and counterparty's are other public sector organisations. There is no credit risk from these organisations.

For those customers and counterparty's that are not public sector organisations, the Highways Agency has policies and procedures in place to ensure credit risk is kept to a minimum.

Interest rate risk
This is the risk that the Highways Agency will suffer financial loss due to interest rate fluctuation. The Highways Agency's financial assets and its financial liabilities carry nil or fixed rates of interest, therefore the Highways Agency is not exposed to significant interest rate risk.

Exchange rate risk
This is the risk that the Highways Agency will suffer financial loss due to changes in exchange rates. The Highways Agency undertook a small number of foreign currency transactions and is not exposed to significant exchange risk.

Fair values
For PFI obligations not carried at fair value, there is no active market for them, and it is not possible to make a reliable estimate of fair value. The Highways Agency has no intention of disposing of these obligations. Accordingly, it has not disclosed a fair value for these obligations. For other financial assets and liabilities, the carrying value is a reasonable approximation of fair value.

20. Contingent liabilities and assets

20. (a) Contingent liabilities

	31 Mar 2013 £000	31 Mar 2012 £000
Land and property acquisition	168,049	173,550
Engineering and construction services	7,500	7,500
Other	9,684	8,770
	185,233	**189,820**

Land and property acquisition
Contingent liabilities from land and property acquisition arise from the following sources:

Acquisition and blight
The construction of any major road construction scheme invariably requires the acquisition of property. The Acquisition and Land Act 1973 gives the Secretary of State the power to make compulsory purchases. Possible purchases for schemes in the Secretary of State's major projects programme are included as contingent liabilities until the point when Compulsory Purchase Orders are made and a reliable estimate is available.

In addition, road schemes, when announced, can adversely impact surrounding property values and The Town and Country Planning Act 1990 provides for individuals to claim compensation for the blight of their properties. Possible blight costs for schemes in the major projects programme are included as contingent liabilities until the point when Blight Notices are issued and a reliable estimate is available.

Compensation for loss after construction
Home owners can apply for compensation for lost value ('injurious affection') under Part 1 of The Acquisition and Land Act 1973, where property, which was not acquired for a road scheme, has lost value because of physical factors, including noise, light, dirt, smell and vibration, associated with the new or improved roads.

Claims become inevitable once the construction phase is started and the Highways Agency accounts for the constructive obligation as a provision. A legal obligation crystallises one year after the road has opened for traffic when homeowners are entitled to lodge claims that are normally settled in less than a year. Such obligations are treated as contingent liabilities until the start of construction work.

Claims in dispute
As at the statement of financial position date, the Highways Agency is involved in a number of property cases that have been referred to the Lands Tribunal for resolution or are otherwise in dispute. The Highways Agency has provided for, in its accounts, management's best estimate of the outcome of these cases although this may be exceeded by the actual outcome.

Engineering and construction services
The Highways Agency is involved in a number of arbitration cases in respect of contractual claims for engineering and construction services and has provided for the best estimates of the outcome of these cases, although this may be exceeded by the actual outcome.

Other
Other contingent liabilities relate to management estimates of partial claims from third parties who have suffered damage or injury as a result of the road network being damaged but for which no claim has been received at the year-end and are based on prior years' experience.

20. (b) Contingent assets

The Highways Agency seeks to dispose of property surplus to requirement promptly at the best price reasonably obtainable in the market. Sometimes there is uncertainty over potential use of the property and planning permissions, and in these cases the Highways Agency may decide to sell the property at the underlying land value.

In these circumstances, the Highways Agency will incorporate a “clawback” clause into the terms of the sale, under which it is able to reclaim a percentage of any increase in value arising from a grant of planning permission, for a given term after the sale has been agreed.

As it is not known for some years after the initial disposal whether any further income will arise the Highways Agency has a contingent asset relating to future values. To date in 2012-13 £7,000 (2011-12 £318,000) has been received under these arrangements.

The Highways Agency has a contingent asset with Midland Expressway Ltd in relation to refinancing and developments of the M6 toll road.

21. Losses and special payments

Managing Public Money requires a statement showing losses and special payments by value and by type to be shown where they exceed £250,000 in total and those that, individually, exceed £250,000. Losses may relate to cash and store losses, bookkeeping losses, losses arising from a failure to make adequate charge for the use of public property or services, fruitless payments and claims abandoned as well as frauds. Special payments may relate to extra-contractual, extra-statutory and ex-gratia payments and compensation.

	2012-13 £000	2011-12 £000
Losses:		
Bookkeeping/cash losses: 19 cases (2011-12: 44 cases)	85	772
Fruitless payments: No cases (2011-12: 1 case)	-	37
Claims abandoned/store losses: 2,123 (2011-12: 3,699)	11,690	5,530
Special payments:		
Ex-gratia compensation: 5 cases (2011-12: 4 cases)	13	25

The claims abandoned/store losses disclosed above include 1978 cases valued at £5,725,000 (2011-12: 3078 cases valued at £5,066,000) for damage to the road network where the culprit could not be identified or otherwise pursued for costs.

In addition the 2012-13 losses include several instances of theft of metal (mainly cable) and associated equipment from the Strategic Road Network totalling £5,845,000. There are other cases of metal theft which are yet to be formally recognised totalling £933,000.

During 2011-12 there were two cases of £267,000 and £429,000 where debts from third parties have been written-off due to book-keeping errors in prior years.

22. Related party transactions

The Highways Agency is an executive agency of the Department for Transport. The Department is regarded as a controlling related party. During the year the Highways Agency had a significant number of transactions with the Department. In addition the Highways Agency had transactions with other Government departments and agencies, principally Treasury Solicitors, Valuation Office Agency, Planning Inspectorate and a number of Local Authorities. In addition the Highways Agency had transactions with QinetiQ, a public limited company in which the Ministry of Defence holds shares.

The Highways Agency has a contract with Lex Autolease Ltd whose ultimate parent company is Lloyds Banking Group in which the Government holds an interest. As per Note 23, the Highways Agency draws monies from Escrow accounts held at Lloyds TSB.

No Board member, key manager or other related parties have undertaken any material transaction with the Highways Agency during the year. There are no potential conflicts of interest to report.

23. Third party assets

The Highways Agency, under section 278 of the Highways Act 1980, receives payment in advance of works. These are paid into interest bearing Escrow Accounts at Lloyds TSB Bank. Monies are drawn down from the Escrow accounts by the Highways Agency as work progresses.

The Highways Agency was appointed as the co-ordinator for a Coordination Action under the EU Sixth Framework Programme. It holds a Lloyds TSB Euro bank account where funding from the EU is deposited and subsequently distributed to the eleven partners across Europe. The final action of this project is to reimburse partners, including the Highways Agency, for the remaining costs incurred in this collaboration action.

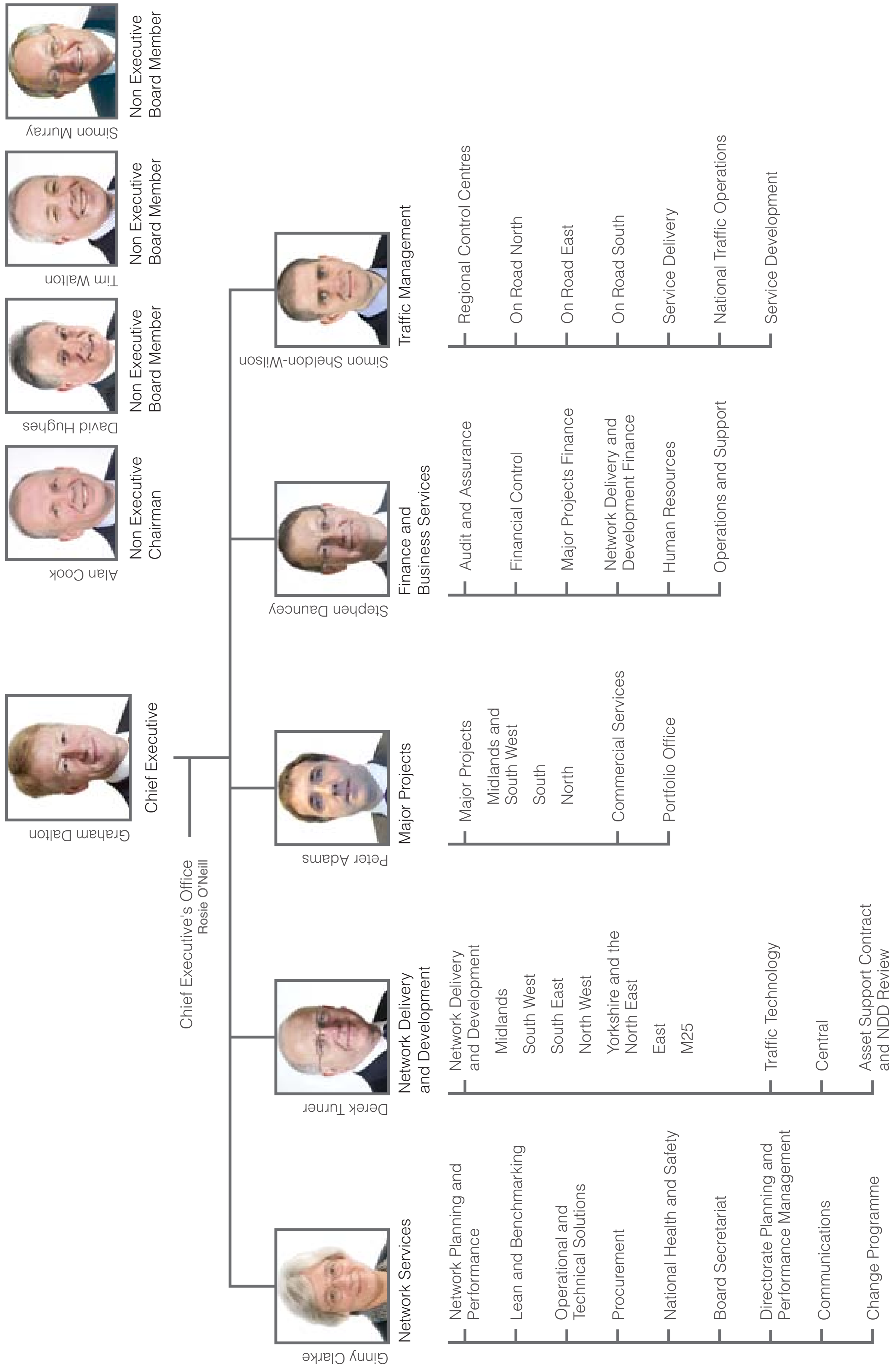
These are not Highways Agency assets and therefore are not included in the accounts.

	31 Mar 2013 £000	31 Mar 2012 £000
Lloyds TSB Escrow Bank Accounts	3,675	2,035
Lloyds TSB Euro Bank Account	135	115
	3,810	**2,150**

24. Events after the reporting period

There have been no significant events between the financial reporting date and the date of these Financial Statements. These Financial Statements are laid before the Houses of Parliament by the Secretary of State of the Department for Transport. IAS 10 requires the Highways Agency to disclose the date on which the accounts are authorised for issue. This is the date the certified accounts are despatched by the Highways Agency's management to the Secretary of State of the Department for Transport. The Accounting Officer has authorised these accounts to be issued on the date they were certified by the Comptroller and Auditor General.

Annex A – The Highways Agency Board and organisational structure



Board as at end of March 2013

Annex B – The Highways Agency Business Plan Measures

Highways Agency Business Plan Measure	2012-13	2011-12
Cost of operating the Highways Agency motorway and A road network per vehicle mile	0.3 pence	0.3 pence
Cost of maintaining the Highways Agency motorway and A road network per lane mile	£40,000	£43,000
Percentage of Highways Agency's appraised project spending that is assessed as good or very good value for money	100%	100%
Reliability of journeys on the Highways Agency motorway and A road network	77.6% 'on time'	83.90% 'on time'
Annual road fatalities on the Highway Agency motorway and trunk road network	Available July 2013	251
The mean and median average incident duration times on motorways	Mean 29 minutes Median 16 minutes (these are figures for the month of March 2013)	Mean 28 minutes Median 15 minutes (these are figures for the month of March 2012)
Contribute to national and international goals for a reduction in carbon dioxide emissions by lowering the Highway Agency's emissions	7,984 tonnes CO2e reduction	9,321 tonnes CO2e reduction
The proportion of the network that is in a condition that does not require further investigation for possible maintenance	96.4%	95.6%
For the programme of schemes in the construction phase, maintain a programme level of at least 1.0 against the cost performance index (CPI) and the schedule performance index (SPI)	CPI 1.11 SPI 1.02	CPI 1.12 SPI 1.05
The accident frequency rate of the Highways Agency supply chain	0.12	0.20
The severity weighted accident frequency rate of the Highways Agency's supply chain	2.47	N/A
Customer satisfaction on the Highways Agency's motorway and A road network	90.73%	91.48%

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