

National Audit Office

Report of the Comptroller and Auditor General

Appropriation Accounts 1998-99
Volume 1: Class I
Ministry of Defence

Confidential

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Ministry of Defence: Votes A

1 The statement on page 4 shows that the maximum numbers maintained during 1998-99 for the Naval, Army, and Air Force Services in all active and reserve categories were within the respective numbers voted by Parliament. Strength returns supporting this statement have been furnished to my officers.

Overspend on Class I, Votes 1 and 2

2 Each of Votes 1, 2 and 3 within Class I is treated as a separate cash limit for expenditure control purposes. Together, the three cash limits make up the Block Defence Cash Limit, which is managed as a block budget by the Ministry of Defence (the Department). The 1998-99 cash limit for Class I, Vote 1 of £10,885.8 million was overspent by £36.4 million (0.33 per cent), and the cash limit for Class I, Vote 2 of £5,027.2 million was overspent by £0.7 million (0.01 per cent). The cash limit of £6,637.1 million for Vote 3 was underspent by £111 million. In total, therefore, the Block Defence Cash Limit of £22,550.1 million was underspent by £73.9 million.

3 The appropriation accounts show that during 1998-99 the Department kept their expenditure within the gross amounts voted. However, there were shortfalls in the level of receipts authorised to be utilised as Appropriations in Aid. These shortfalls amounted to £74.6 million for Vote 1 and £4.8 million for Vote 2. Taking into account savings on expenditure subheads of £38.3 million on Vote 1 and £4.1 million on Vote 2, the Department incurred excess expenditure of £36.4 million and £0.7 million respectively on these two Votes. It is proposed to ask Parliament to provide for the excess expenditure by voting further supply grants of £36,395,756.21 for Vote 1 and £709,663.24 for Vote 2. Table 1 below summarises the overall outturn position across the three votes.

Table 1 : Class I, Votes 1, 2 and 3 - Summary of Outturn

Vote	Gross			Appropriations in Aid			Net		
	(1) Estimate £m	(2) Expenditure £m	(3) Saving £m	(4) Estimate £m	(5) Realised £m	(6) Shortfall £m	(1) - (4) Estimate £m	(2) - (5) Expenditure £m	(6) - (3) Excess/ (Saving) £m
1	12,080.8	12,042.5	38.3	1,195.0	1,120.4	74.6	10,885.8	10,922.2	36.4
2	5,519.1	5,515.0	4.1	491.9	487.1	4.8	5,027.2	5,027.9	0.7
3	7,266.5	6,935.6	330.9	409.7	409.5	0.2	6,856.8	6,526.1	(330.7)
Total	24,866.4	24,493.1	373.3	2,096.6	2,017.0	79.6	22,769.8	22,476.2	(293.6)

Source: Class I Appropriation Accounts

Note: The cash limits for Class I, Votes 1 and 2 equated to the net Estimate. On Class I, Vote 3, however, the cash limit was revised during the year to £6,637.1 million, a reduction of £219.7 million. Thus, while the underspend on the net Estimate was £330.7 million, as shown in the table, the underspend against the revised cash limit was £111.0 million.

4 On Vote 1, the main reasons for the £74.6 million shortfall in Appropriations in Aid were:

- the Department made an administrative error when formulating their Spring Supplementary Estimates which resulted in £7.4 million being added both to the estimated gross expenditure for the vote, and to the estimated Appropriations in Aid. Although the error had no effect on the Net Estimate or Cash Limit, it meant that the figure for estimated Appropriations in Aid was not fully supported by the level of forecast receipts;
- receipts from land disposals of £23 million which had been provided for in the Department's 1998-99 Estimates could not be brought to account until the beginning of the 1999-2000 financial year;
- negotiations with foreign governments over the cost of certain loan service personnel and on the cost of training certain foreign and Commonwealth personnel delayed the receipt of a further £10.9 million;

- the Department's 1998-99 Estimates incorrectly included the projected receipt of £8.7 million in recoverable VAT for the January to March 1999 period. In the event, these were received when due, in early 1999-2000. In addition, VAT receipts of £1.2 million due to be recovered during 1998-99 were not received until 1999-2000;
- loan repayments of £5 million from the Meteorological Office, which the Department expected to receive during 1998-99, were not repaid until 1999-2000. A further shortfall of £1.4 million was due to forecasting errors. And £2.5 million in receipts expected from a Defence Evaluation and Research Agency contractor also slipped to the 1999-2000 financial year;
- expected receipts of £3.8 million in respect of works undertaken in Germany were included in the Spring Supplementary Estimate on Vote 1. However, the amount to be received had already been estimated for within the Vote 3 estimate. In the event, the amount, when received, was brought to account on Vote 3; and
- during the year the member states of NATO agreed to reduce the amount of cash to be made available against the NATO Security and Investment Programme. This reduced the receipts for UK projects by £1.5 million.

The remaining shortfall, of £9.2 million, comprised a number of small shortfalls over other areas.

5 The shortfall in Appropriations in Aid of £4.8 million on Vote 2 was mainly caused by a shortfall of £5.6 million in receipts collected by Naval Support Command from sales of departmental stores to the dockyard companies. The amount of stores they required was affected by changes to the refit programme for naval vessels, and by commercial decisions on purchasing taken by the companies. A shortfall in receipts of £0.5 million in the Quartermaster General's area was more than offset by additional receipts of £1.4 million collected by RAF Logistics Command.

6 The position on Vote 2 was complicated, however, by the fact that in the latter part of the financial year the Department made payments of some £2.8 million on Kosovo-related operations. These operations could not be funded by means of a Spring Supplementary Estimate, since deployment decisions had not been made at the time the Supplementary Estimate was presented to

Parliament. In the absence of the requirement to incur this expenditure, the Department's net expenditure on Vote 2 would have been held within the net Estimate.

7 The Department have incurred excess expenditure in seven of the past ten years. During this period the number of Excess Votes reported to Parliament has steadily fallen: in 1997-98 there were just two departments with Excess Votes, one of them being the Ministry of Defence. The excesses of expenditure incurred by the Department in 1998-99 follow excesses on Class I, Votes 1, 2 and 3 in 1996-97 and on Class I, Votes 2 and 4 in 1997-98. During 1997-98 the Department reviewed their procedures for monitoring expenditure, and were confident that the revised processes they put in place should identify potential overspends and allow for action to be taken to avoid excesses in future. Whilst these measures have led to improved monitoring and control of the Department's gross expenditure, the shortfall in receipts collected in 1998-99 indicates that further improvements in financial monitoring and management are needed.

Class I, Votes 1, 2 and 3: Losses on Information Technology Projects

8 My report on the 1997-98 Defence appropriation accounts (HC 1-1 of 1998-99) referred to a loss of £34.6 million incurred on an information technology project - Project Trawlerman. Following further review, the Department identified additional expenditure of £6.1 million which should have been recorded in the 1997-98 account. The Class I, Vote 1 1998-99 appropriation account includes a note relating to these additional costs. I have reviewed the Department's papers supporting the note, and am satisfied that it discloses the full and final amounts relating to the project.

9 The appropriation accounts for 1998-99 include notes on losses incurred on a number of other information technology projects. Information on the two projects which led to the largest losses is set out at paragraphs 10 to 14 below.

Common User Data System

10 The Class I, Votes 2 and 3 appropriation accounts note losses totalling £21 million arising from a decision not to bring into operational use a bespoke signal message handling system to meet the needs of the Royal Air Force. The system, known as the Common User Data System, was intended to replace teleprinters used for sending and receiving signal messages to about 500 terminals, at 13 sites. The main elements of the contract for the project were

on a fixed price basis: when initially let in 1989, the value of the contract was for £10.2 million, with a planned completion date of April 1994. Table 2 below summarises the significant events in the life of the project from 1989 to 1997, when it was abandoned.

Table 2: Common User Data System - Chronology of events

Date	Event
1989	Contract awarded with completion date of April 1994.
December 1994	Transfer of system to the Department. System accepted without any caveat regarding functionality.
March 1995	System tests reveal that the original specification did not fully address the procedure for handling diverted incoming messages. Additional contract let to the contractor to supply this functionality at a cost of £250,000.
November 1995 to January 1996	System trials reveal significant problems with the software.
May 1996	Technical working group set up to address the problems.
June 1996	Network trial started to observe the results of live traffic passing between RAF stations. Testing problems persisted.
July 1996 to January 1997	Performance of the system showed up operationally unacceptable problems. These include a tendency for the system to stop, and failure of site processors.
January 1997	RAF begin to consider possible alternative commercial systems.
March 1997	RAF decide not to renew the support contract (valued at £6.5 million) for the system.
June 1997	Trials reveal continuing problems with the system.
July 1997	Department conclude that continual problems prevent the system from becoming operational. The Department further consider that they neither have the manpower nor technical resources to establish whether the problems are the responsibility of the contractor.
August 1997	Project terminated.

11 Despite efforts both by the contractor and the Department in the three years between the transfer of the system and to its termination, there was still no clear indication of how the project could be made operationally sound, how long this would take, or the associated costs of remedying the problems. During most of its development, the project's anticipated technological superiority was being eroded as commercial developments advanced. By the time the project was undergoing its trials however, it became clear that the project's technology had been overtaken. In February 1998, the Department began to implement a, mainly, off the shelf solution at a cost of £1.3 million, with projected running costs of £1.7 million a year.

Pay Replacement System 2

12 The Class I, Vote 1 appropriation account for 1998-99 notes a loss of £8.7 million arising from the decision not to proceed with an information technology project, Pay Replacement System 2. The project was sponsored by the Second Sea Lord, and intended to deliver the Royal Navy's pay and pension system,

unit based applications and associated infrastructure. The project was initiated in 1993, and in 1994 the Department obtained Treasury approval to proceed at a total cost of £18.9 million (including VAT). Within three months of the Treasury approval being given however, it was clear that the project was proving to be far more complex than originally envisaged. The estimated date for delivery was then assessed as having slipped by 12 months, and costs were expected to increase by £4 million. Testing and system rollout was then expected in 1996. However, because of further delays in software development, a major review of the project was commissioned.

13 The review team reported in March 1995 that costs to completion would rise to £41.1 million with implementation delayed by a further three years. Following the report, and in the light of the change in policy to a tri-service approach to pay and the ministerial decision to form the Armed Forces Personnel Administration Agency, in March 1996 the Department decided to suspend, run down and close the project. A post project evaluation, carried out by a firm of IT consultants, highlighted the project's expenditure of £10.2 million - of which £7 million represented manpower - and concluded that nugatory expenditure could have been limited if the project had been suspended earlier. The evaluation also made a number of recommendations for future IT projects. These included:

- projects should be staffed with experienced personnel from the outset, who should regularly review plans for realism and accuracy;
- requirements should be specified in a testable way and, if possible, the developmental risks should be transferred outside the Department; and
- that the systems to be used to track the progress of any project should be designed to suit the project's needs.

14 The Department regard the recommendations made as lessons learned from the project. A substantial product was produced by the Department which, together with the detailed design documentation for the system has been lodged with the Armed Forces Personnel Administration Agency for use with their new tri-service pay system. Of the £10.2 million spent, £1.5 million related to hardware and software which has subsequently been utilised elsewhere in the Department. The total amount written off is therefore £8.7 million.

Class I, Vote 4: Misappropriation of funds

15 The Class I, Vote 4 appropriation account includes a note describing an alleged fraud in the Pensions Division of the Army Personnel Centre. Between February 1998 and February 1999, a civil servant employed at the Army Personnel Centre, Glasgow, allegedly paid into his personal bank accounts one-off payments using the accounting records of Army personnel currently on the pensions database. In February 1999, when his alleged actions came to light, the individual concerned was suspended from duty, and in November 1999 was on bail, pending his case coming to trial.

16 Most one-off payments consist of the gratuity element of pension awards to retiring members of the armed forces. However, the Armed Forces Pension Scheme allows payments to be made during the course of a person's career, rather than only when they leave the services. Such payments may be recorded against any valid name held on the database, and payments may be directed to any bank account.

17 The Department have identified a number of transactions, totalling in excess of £470,000, where the member of staff allegedly set up and authorised payments. Of this total, approximately £48,000 has been recovered to date. These payments were recorded on the pensions database as being in addition to any entitlement due to existing pensioners, and therefore no pensioner was underpaid as a result of the alleged fraud.

18 A subsequent internal investigation by the Department identified a number of weaknesses in the operating procedures within the Pensions Division that exposed the organisation to potential fraud. These included inadequate documented regulations, failure to monitor information reports detailing payments made, staff inexperience and inadequate staff rotation procedures. In addition, it was impossible automatically to reconcile pension payments made to individuals' entitlements, and there were weaknesses in the control of ad-hoc payments and in the control and issue of life certificates to confirm the existence of pensioners. Most of these weaknesses mainly resulted from the automation of much of the Army pension system following the formation of the Army Personnel Centre in 1996-97. This involved the closure of a number of dispersed offices, and the consolidation of the assessment and payment authorisation processes within the new Army Personnel Centre Pensions Division. Following the investigation, the Department are reviewing procedures at the Pensions Division with a view to improving controls.

19 Although the Department are satisfied that they have identified all payments made by the individual to his personal bank accounts, they are not in a position to confirm the validity of all other pension payments. However, in October 1999 they were undertaking an exercise to reconcile all categories of pension transactions where internal investigations had indicated processing weaknesses that could give rise to fraud. They had also introduced arrangements to review individuals' entitlements with payments made for 10 per cent of all Army pensions in payment. This is in line with procedures operated for both Royal Navy and Royal Air Force pensions.

Control over Suspense Accounts

20 My reports on the 1996-97 and 1997-98 Defence appropriation accounts referred to the Department's management and control of suspense accounts. My report on the 1996-97 accounts noted that the Department had launched a major review of the management of suspense accounts. My report on the 1997-98 accounts noted that progress had been made by the Department but more needed to be done, particularly with the introduction of Resource Accounting from 1 April 1998. The Department anticipated that further investigation would result in additional write-off action, and that the position would appear to get worse before it got better.

21 As part of my examination of the 1998-99 appropriation accounts, as in previous years my staff examined all suspense accounts with balances at the year-end in excess of £1 million, a total of 160 accounts. Of the 160 accounts, 20 could not be fully reconciled. My report on the 1997-98 appropriation accounts noted that the Department were developing more effective reporting processes to enable rigorous management review of suspense accounts by Senior Finance Officers and centrally. These new processes have evidently met with some success, in that all 20 unreconciled accounts were already known to the Department, and the examination undertaken by my staff revealed no other problem cases. Eight of the 20 accounts which were unreconciled at the end of the 1998-99 financial year could also not be reconciled at the end of the previous year.

22 Notes to the 1998-99 appropriation accounts record that £9.1 million of unreconciled suspense account balances were written off during the year. The total comprises amounts relating to the Army Pay Disbursement Suspense Account (£7.8 million), the Foreign and Commonwealth Office (£1 million), Payments to Army Bandsmen (£0.2 million) and Miscellaneous Payments (£0.1 million).

23 The Army Pay Disbursement Suspense Account referred to in the note to the 1998-99 account is the successor to the account on which £19.6 million was written off in 1997-98. The Department examined the transactions undertaken on this account in detail to try to identify the reasons for the unreconciled balance. They identified £7.1 million of the total amount as incorrect bookings made to the suspense account in 1996-97 relating to boarding school allowances (£5.7 million) and fuel and light charges for married quarters (£1.4 million) and these have now been brought to account on Vote 1 in 1998-99. The balance of some £650,000 could not be traced, although the amount does include about £30,000 in respect of fraud allegedly carried out by an Army Senior Non-Commissioned Officer. In November 1999, the case against this individual was being considered, with a view to bringing court martial proceedings.

24 The Department informed me that the successor Pay Disbursement Suspense Account is no longer being operated, and that they expected to close it during 1999-2000. It was itself replaced by a number of new suspense accounts, including the Cash Issue Suspense Account, in April 1998. The purpose of this account is to ensure that cash advances made to soldiers are recovered from their army pay accounts. My staff have noted that this new account was unreconciled at the end of the 1998-99 financial year and continued unreconciled into 1999-2000. There has been no central control by the suspense account holder (the Army Personnel Centre) over the postings made at unit level or at the central processing centre at Worthy Down. The Department have informed me that they are introducing measures to reconcile the account from 1 April 1999 and hope to achieve a retrospective reconciliation for the period April to May 1998. However, they have not been able to confirm that a reconciliation for the period June 1998 to March 1999 will be possible. A further write-off of the unreconciled balance for that period cannot therefore be ruled out. At the close of books for the 1998-99 financial year the unreconciled balance on this suspense account was £5.8 million, although the Department have told me that a significant proportion of this balance will be reconciled.

25 I am concerned that the Cash Issue Suspense Account, which was designed to regularise the recovery of cash advances to soldiers, should fall into the same difficulties as its two predecessors so soon after its creation. The Department have assured me that they have a recovery plan in place which aims to reconcile the new account. However, the difficulty of obtaining detailed information to support the underlying postings made to the account in the period June 1998 to March 1999 means they are not in a position to confirm to me that there will be no write-off of amounts booked during that period.

26 The write off of £1 million reported in the Vote 1 appropriation account is in respect of an erroneous balance on a general suspense account. It was set up in 1990 to handle payments made by the Foreign and Commonwealth Office on behalf of the Department in respect of expenditure incurred by Defence Attaches. Charges to the suspense account were made on receipt of vouchers from the Foreign and Commonwealth Office. Although the account was supposed to be restricted to approved transactions it was often used for other transactions. As a result, a large number of postings were made to it which more properly should have been booked to other suspense accounts. By 1993, the balance stood at £7.4 million. At that stage, the Department set up procedures to monitor the account. Remedial action led to the balance on the account being reduced to £2.5 million by 1995, and by June 1999 this had further reduced to £1 million.

27 This balance, which has been written off, constituted amounts that could not be traced to relevant departmental budget holders. The Department considered undertaking an exercise to attempt a full reconciliation, but concluded that the staff effort needed to undertake this work would be disproportionate to any gains which might be made, particularly since there could be no guarantee of success. The Department have closed this suspense account, and now book Foreign and Commonwealth Office transactions directly to the Vote.

28 My staff noted during the course of their examination that the Department are working on a number of the suspense accounts which were unreconciled at the end of 1998-99. These investigations would suggest that further amounts may have to be written off in the financial year 1999-2000.

Conclusion

29 As in my reports on the 1996-97 and 1997-98, my report this year has identified a number of serious internal financial management and control weaknesses within the Department, some of which span a number of financial years. The successful introduction of Resource Accounting in 1999-2000 is dependant upon the operation of reliable systems for recording and reporting financial information which managers can rely upon to monitor and manage the Department's affairs. The Department have made changes, and have put in place a number of action plans to address the weaknesses identified. However, it is of crucial importance that the lessons learned in one area are disseminated widely throughout the Department.

30 There is in my view scope for further improvement in financial management and control across the Department. I am therefore pleased to note that, in his first annual Statement on the System of Internal Financial Controls, the Accounting Officer has reported on his review of the adequacy of these financial controls, has recognised that weaknesses exist and noted the remedial action which is in hand.

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Comptroller and Auditor General

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