MINISTRY OF DEFENCE: DEPARTMENTAL RESOURCE ACCOUNTS 2002-2003

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

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Section 1: Summary

1 The Ministry of Defence (the Department) is required by Directions issued by the Treasury to prepare annual Resource Accounts. The Resource Accounts, drawn up on an accruals basis, should be prepared in accordance with the Treasury's *Resource Accounting Manual* and should give a true and fair view of the state of affairs of the Department and of its net operating costs, recognised gains and losses and cashflows for the year.

2 In producing its Resource Accounts the Department faces a number of challenges. It undertakes a wide range of complex functions and holds a vast range of assets. Some of these assets are held by contractors for manufacture and repair purposes. It has many old information systems which although adequate for the purposes they were designed for, are not suited in all respects to the production of accurate and timely accruals based information, particularly during the escalation of military operations. The Department has therefore had to invest considerable efforts in implementing resource accounting and budgeting, both in IT and staffing.

3 The Department has made significant efforts to improve the standard of its financial accounting information over the last four years. I qualified my audit opinion on the 2001-2002 resource accounts because I was unable to confirm some figures in the operating cost statement in respect of consumption charges for certain stock and fixed assets. The Department has continued over this last year to make strenuous efforts to secure further improvements. In Section 2 of my Report I consider whether the Department is still taking appropriate steps to implement resource accounting effectively.

4 In Section 3 of my Report I explain why I do not yet consider the Department's resource accounts are robust enough to support a true and fair opinion. I conclude that although major improvements have been achieved in the accuracy and reliability of its stock management information, further progress is required. Because of continuing problems in this information I am still unable to confirm whether some stock and fixed asset accounting transactions generated by the Defence Logistics Organisation's Air environment are correctly recorded and accordingly I have qualified my audit opinion.

5 The Treasury's *Resource Accounting Manual* requires that losses and special payments be reported in departments' Resource Accounts. The Ministry of Defence has faced significant changes in its expenditure programmes over recent years because of a variety of factors, including changes in threat and advances in weapons technology and the scale of change in organisational structures. These factors have led to many of the losses and special payments recorded in Note 29 to the 2002-2003 Resource Accounts. In Section 4 of my Report I consider some of the more significant losses.

6 In Section 5 of my Report I confirm that according to Departmental records the maximum numbers of military personnel maintained during 2002-2003 for the Naval, Army and Air Force Services in all active and reserve categories were within the numbers voted by Parliament.

7 The Department continues to demonstrate a strong and effective grip on the accounts production process. For 2002-2003, it has again submitted Resource Accounts for audit in line with the timetable agreed with my staff and the Treasury. And it has accelerated their finalisation and publication. When compared with the quality of the Department's first Resource Accounts for 1999-2000, on which I placed a disclaimer covering a range of accounting deficiencies, the Department has consistently made good progress during the last three years in improving the quality of its accounts. During 2002-2003 the Department has successfully cleared one of the two substantive issues which together with an excess vote were the basis for the qualification of my audit opinion last year and it assures me it is fully aware of what remains to be done and is committed to securing the necessary improvements. My staff will continue to work closely with the Department in this task.

Section 2: Is the Department still making good progress to implement Resource Accounting effectively?

8 In my Report on the 2001-2002 Accounts[1] I explained my reasons for qualifying my audit opinion. I was unable to confirm whether charges to the operating cost statement for the use of departmental stock and capital spares by contractors were complete and whether stock and fixed asset accounting transactions generated by the Defence Logistics Organisation's Air environment were complete or correctly recorded. The Department has made good progress on the first of these issues so that it no longer contributes to a qualification of the audit opinion.

Charges to the operating cost statement for the use of departmental stock and capital spares by contractors are more robust

9 Assets belonging to the Department may be held by contractors for a number of reasons. For example spare parts may be supplied to contractors to carry out repairs on major components (capital spares) or stock items may be supplied for incorporation into new builds or modifications. The contractor has responsibility for maintaining information on the items held. The degree of detail to be recorded by the contractor varies according to the contract type. The Defence Logistics Organisation maintains a central database of these items where they are not already accounted for on departmental inventory systems. The gross value of these stock and capital spares items in the Department's Resource Accounts amount to some £819 million. After provisions for obsolescence and depreciation are taken into account the net book value is some £324 million.

10 In my Report on the 2001-2002 Accounts I noted the progress made by the Defence Logistics Organisation to account more accurately for these assets. However, the accounting treatment adopted to create closing balances for these items meant that I was unable to confirm whether the charges to the operating cost statement for the use of departmental stock and capital spares by contractors was complete and I qualified my opinion in this regard. At the time the Defence Logistics Organisation was aiming to improve data capture and estimating techniques to remedy this for the 2002-03 Accounts.

11 Over the last year the Defence Logistics Organisation has made further improvements to the accuracy of the balance sheet data. The existence of some 98 per cent of the assets has been confirmed by reference to updated returns from contractors. This has been supplemented with compliance visits to selected contractors to confirm their stock management systems record accurately their holding of Departmental assts. Some 77 per cent of values have been derived from existing validated pricing records held by the Department; while the remaining items have been valued using estimating techniques based on the type of asset and an average price. And the classification between stock and capital spares has been refined. In addition, the Defence Logistics Organisation undertook a review of how stock and capital spares issued to contractors are recorded in the stock accounting systems and posted to the general ledger. The review established revised accounting treatments for items issued to contractors, the disposal of items held by contractors and the calculation of obsolescent provisions and depreciation.

12 As a result, the Defence Logistics Organisation has been able to estimate a net charge of some £244 million in respect of charges for the use of departmental assets by contractors. These charges have been recognised in the operating cost statement. I have examined the basis of the calculation of this charge and concluded that it is robust and accurately recorded in the operating cost statement. As a result I have been able to remove my qualification in this regard.

The Department has remained within its resource budgets for 2002-2003

13 I also had to qualify my opinion on the 2001-2002 accounts because the Department had breached its resource budget approved by Parliament for Request for Resource 1 "provision of defence capability". I noted in my Report[2] last year that the Department had implemented a more robust system for monitoring resource expenditure during the year so that appropriate levels of additional resources could be requested from Parliament if required. Schedule 1 of the Departmental Resource Accounts summarises the Department's expenditure and net cash requirement against these revised budgets authorised by Parliament. The Department has remained within all of its budgets for 2002-2003 subject to Parliamentary control.

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[1] MOD: Departmental Resource Accounts 2001-2002 HC 47 Session 2002-2003: 21 November 2002

[2] MOD: Departmental Resource Accounts 2001-2002 HC 47 Session 2002-2003: 21 November 2002

14 Through its in year monitoring procedures the Department identified during the course of 2002-2003 that it required additional provision and presented Supplementary Estimates to Parliament as summarised below.

£000	Main Estimate	Winter Supplementary	Spring Supplementary	Total	Outturn	Variance
Gross Resource provision RfR 1	32,683,620	178,668	10,980,190	43,842,478	41,180,611	2,661,867
* A in A RfR 1	1,395,807	0	300,142	1,695,949	1,449,767	246,182
* Net Resource provision RfR 1	31,287,813	178,668	10,680,048	42,146,529	39,730,844	2,415,685
* Net Resource provision RfR 2	341,141	213,849	600,844	1,155,834	1,117,429	38,405
* Net Resource provision RfR 3	1,186,720	0	0	1,186,720	1,165,411	21,309
Capital	5,843,772	110,620	835,796	6,790,188	6,512,466	277,722
* Non operating A in A	217,169	0	277,501	494,670	373,756	120,914
* Net Cash Requirement	26,091,927	729,844	1,481,201	28,302,972	26,991,365	1,311,607

* Subject to Parliamentary control

15 The Department has significantly underspent against its budget in respect of two elements of Parliamentary control and has provided explanations for these variances in the notes to Schedule 1. Request for Resource 1 "provision of defence capability" is underspent by some £2,416 million or 5.7 per cent. The reasons for this include:

- over estimate of some £733 million of the effect of the quinquennial revaluation of fixed assets;
- over estimate of some £200 million for the impact of amended fixed asset lives affecting the resource consumption of the Commander-in-Chief Fleet;
- a decision taken not to write down the value of Swordfish torpedoes saving some £170 million resource consumption;

- fixed asset reclassifications by the Defence Logistics Organisation of some £550 million; and

- a range of other smaller provision movements.

16 The overall net cash requirement is underspent by £1,312 million or 4.6 per cent. The Department attributes this to an underspend on relevant cash operating costs and an overestimate of working capital movements.

Other developments in Resource Accounting and the disclosure of financial information

The Department has undertaken a major revaluation of its fixed asset base

17 Note 8 to the 2002-2003 Resource Accounts summarises the Department's holdings of tangible fixed assets. The Treasury's *Resource Accounting Manual* requires that tangible fixed assets are professionally revalued at least once every 5 years. In December 2001 the Department started such a quinquennial review to determine up to date professional valuations of its assets at 1 April 2002. Because of the vast range of assets it holds, this has been a complex task for the Department to complete as a single exercise. Revised valuations were obtained, validated and posted to the accounts in 2002-2003 for the Land and Building and Fighting Equipment asset categories. However some valuation work was still being undertaken after the year end for Plant, Machinery and Vehicles and IT and Communications Equipment asset categories. The Department has therefore made adjustments to the year end balances to bring these revised valuations into the 2002-2003 resource accounts.

18 The overall net impact of the revaluation exercise has been a decrease in the carrying value of fixed assets of some £310 million. This reflects upwards revaluations of some £6,074 million and downwards revaluations of some £6,384 million of which £3,904 million in respect of permanent downward revaluations, adjustments for depreciation and capital charges has been charged to the operating cost statement. The Department had forecast a potential impact of some £4,637 million in additional resource costs and submitted a request for this amount in the Spring Supplementary Estimates. The results of the Department's quinquennial revaluation exercise are summarised in the table below.

£000	NBV of assets at 31	NBV of assets subject to	Percentage valued	Increased valuations	Reduced valuations	Net increase/	Impact on operating	Impact on reserves

	March 2002 (1)	revaluation (2)				(decrease)	cost statement	
Land and Buildings	14,348,075	13,425,454	96.19%	3,359,720	2,904,647	455,073	1,623,143	2,078,216
Fighting Equipment	27,280,885	25,941,088	98.98%	2,232,589	3,151,621	-919,032	2,110,255	1,191,223
Plant Machinery and Vehicles	4,142,223	3,926,405	77.36%	419,578	283,293	136,285	134,215	270,500
IT and Communications equipment	827,876	659,555	46.84%	62,406	44,851	17,555	36,795	54,350
Total	46,599,059	43,952,502	95.42%	6,074,293	6,384,412	-310,119	3,904,408	3,594,289

Notes: (1) the remaining fixed asset categories were excluded from this exercise: capital spares (£7,557,664k) are managed as part of the Department's stock inventory and are subject to separate arrangements for quinquennial revaluation; Assets in the Course of Construction (£13,984,112k) are not subject to quinquennial revaluation.

(2) Some assets had already been revalued in 2001-2002 and were excluded from the current exercise.

19 Some 95.4 per cent of the eligible asset base was revalued. The Department has identified a variety of reasons for the non valuation of the remaining 4.6 percent. In many cases the assets had been purchased within the last few years and were deemed to have up to date values and a number of assets due for disposal were excluded from the exercise. However some assets were omitted from the review in error. The Department has estimated that some £400 million or 1 per cent fall into this category.

20 Note 18 to the 2002-2003 Resource Accounts summarises the effects of the quinquennial revaluation on the reserves. Due to system constraints within certain departmental fixed asset registers the Department cannot roll forward the revaluation reserve that existed for individual land and building assets prior to the quinquennial revaluation. The Department is reviewing the future accounting treatment for this element of the revaluation reserve.

21 The Department has undertaken a detailed review of the quinquennial revaluation process to identify what worked well and improvements that might be made to the process in future. The Department made extensive use of workshops to communicate and discuss key decisions and issues and to monitor progress. And the Department kept my staff fully informed of plans, methodologies and progress. However the Department considered that the next quinquennial revaluation process should be subject to more formal project management disciplines which will improve strategic direction, support and approval from senior managers and clarify the policy roles of the teams involved. It has also determined that quinquennial revaluation should become embedded into the routine financial management process and a key change to underpin this is the proposal to move to a rolling programme of professional revaluations. The Department considers this to be more manageable and practical while still ensuring the requirements of the *Resource Accounting Manual* are met. The Department is currently consulting with my staff on future arrangements.

The Department has reported some £630 million net additional resource costs were incurred on operations in Iraq during 2002-03

22 Note 27 to the Resource Account summarises the financial impact of operation TELIC during 2002-2003. TELIC is the UK name for military operations in Iraq. This is the first major conflict where the Department has accounted for a military operation on a resource basis and this has generated a number of issues not encountered in previous operations managed under a cash accounting regime. In early 2003 the Department received some £600 million resources and £400 million capital from the Treasury for the net additional costs of preparing for operation TELIC. The funding excludes wages and salaries of armed forces and civilian personnel as these would have been incurred anyway and the costs of training and exercises which have been cancelled because of the operational commitment are excluded. After several months of preparation, hostilities commenced on 20 March 2003 some eleven days before the end of the financial year.

23 A particular accounting issue for the Department has been to determine the correct level of stock consumption to report in the 2002-2003 resource accounts. The stock accounting systems generate consumption transactions for stock and ammunition when the materiel is issued to frontline units even though it may be stored locally for some time before use. This is because accounting transactions cannot be generated automatically by systems, some of which are manual, after a certain point in the supply chain. This can result in an overstatement of stock consumption particularly

during a period of build up of stock levels at the front line. The Department recognised the need for greater visibility of stock movements in its report *Operations in Iraq - First Reflections*[3] and concluded it needs a common robust tracking system to enable equipment and stock to be tracked throughout the supply chain in fast-moving complex operations. Other accounting issues include:

- the loss or impairment of fighting and other equipments which have to be recognised in the correct accounting period on an accruals basis;
- assets acquired quickly to support operations need to be brought to account correctly;
- the Department's chart of accounts is not designed to record automatically the cost of individual operations.

24 The Department therefore undertook a specific review to examine the financial impact of these issues and determine the correct additional resource costs of operation TELIC attributable to the 2002-2003 account. This involved a detailed examination of available accounting and inventory information including records held locally in Iraq. My staff have reviewed the Department's estimates of the cost of operation TELIC up to 31 March 2003 in particular estimates for stock consumption and impairment of fixed assets and concluded that they are robust. Some of the remaining stock and fixed assets sent to Iraq are still in use there for peacekeeping purposes. Until all unused stock and fixed assets are returned to the United Kingdom the Department will be unable to make a comprehensive assessment of stock consumption and the level of asset impairment in order to determine the full cost of operation TELIC since 1 April 2003.

Section 3: Are the Department's Resource Accounts for 2002-2003 true and fair?

25 My certificate on pages 14 to 15 explains that I am required to report my opinion as to whether the financial statements give a true and fair view. I noted in Section 2 of my Report the Department has made significant progress in addressing one of the

[3] Ministry of Defence July 2003

issues that led me to qualify my opinion on the 2001-2002 Resource Accounts. But there is still more that the Department is required to do in order to be in a position to produce Accounts which could be considered to be free from material mis-statement. In the context of the 2002-2003 Resource Accounts I have qualified my audit opinion because I am unable to confirm whether certain charges to the operating cost statement in respect of stock and capital spares managed by the Department's Defence Logistics Organisation are correctly recorded.

Some stock and fixed asset accounting transactions generated by the Defence Logistics Organisation's Air environment may not be correctly recorded

26 In my Report on the 2001-2002 accounts I noted the problems the Department had with existing stock inventory systems which were not designed to provide stock accounting data for accruals based financial accounts. While progress has been and continues to be made, the supply system for the Defence Logistics Organisation's Air environment continues to generate data that cannot be wholly supported. Each month the stock accounting system compares opening and closing values with the movements generated by the stock inventory system. Where there is a difference a reconciling balance is automatically created. This ensures that the accounts reflect the stock inventory system, however there is no supporting audit trail as the procedure is embedded within the software programme.

27 In the 2002-2003 accounts this autobalance procedure generated a net credit to the operating cost statement of some £1,128 million. In the previous year it had generated a credit of £340 million. During 2002-2003 the gross monthly postings varied between a £114 million credit and £117 million charge for consumable stock and a £763 million credit and a £262 million charge for capital spares.

28 The Defence Logistics Organisation has reviewed the larger autobalance transactions to determine possible causes. For example, spurious transactions are generated when both the definition of quantity and the unit price are changed simultaneously in the stock management system. This software programme error is being rectified. A further area of concern is where the stock inventory system records items on repair as negative stockholdings. However when these balances are corrected the autobalance mechanism assumes the movement represents additions of new items. Items on repair tend to be capital spares and the value of these can be considerable. The Defence

Logistics Organisation has improved the transaction mapping from the inventory system through the accounting system in this regard.

29 Because of the lack of audit trail I have been unable to determine whether stock write-off and permanent diminution of capital spares charges to the operating cost statement generated by the autobalance mechanism are correct and I have qualified my opinion in this regard. The Defence Logistics Organisation recognises there are further improvements to be made and has mapped many of the transactions and re-programmed the software where required. However the effect of this cannot be measured until the following accounting period. The Defence Logistics Organisation has undertaken a detailed review of each source of the autobalance and its potential financial impact. It considers that the problem will become more manageable by October 2003. After the first five months of 2003-2004 the autobalance mechanism has generated a net charge to the operating cost statement of some £72 million. The gross monthly postings varied between a £8 million credit and £9 million charge for consumable stock and a £225 million credit and a £201 million charge for capital spares.

Section 4: The Department has reported significant losses and special payments

30 The Department's expenditure programmes are subject to many changes in requirements because of advances in weapons technology; changes in threat and the pace and scale of changes in organisational structures. These changes can result in the Department having to abandon procurement or development projects before the equipments are introduced into service or write off the value of assets no longer required. In my Report on the 2000-2001 Accounts[4] I noted the impact of these factors on specific equipment programmes.

31 The Treasury gives departments delegated authority to write off such expenditure as a loss or special payment after careful appraisal of all the facts, but requires departments to bring them to Parliament's attention at the earliest opportunity. Nevertheless, investigation of the circumstances can take some time. Where final details cannot be reported this may be noted as an advisory loss in departmental resource accounts.

[4] MOD: Departmental Resource Accounts 2000-2001 HC 434 Session 2000-2001: 18 December 2001

32 Note 29 of the Department's Resource Accounts for 2002-2003 discloses losses, special payments and gifts. In summary the Department has reported total losses of £131 million (12,765 cases) and total special payments of £129 million (1,327 cases) written off during the year. The Department has also identified some £1,015 million losses incurred in previous years and not previously reported as well as a number of potential losses which have not yet been quantified fully. I highlight below some of the more significant cases recorded in the Note.

The Department has incurred significant constructive losses

33 HM Treasury's *Government Accounting* defines a constructive loss as one where, for example, services are correctly ordered, delivered or provided, and are paid for as being in conformity with the order, but which owing to a change of policy or similar reason prove not to be needed or to be less useful than when the order was placed.

Joint Tactical Information Distribution System Sea Harrier

34 Joint Tactical Information Distribution System (JTIDS) is a secure electronic countermeasure resistant high capacity, tactical datalink system. It provides digital and voice communication and accurate relative navigation capabilities to air, land and maritime tactical operations using the Link 16 message standard. It is currently in service with the Royal Air Force and other NATO forces and was to be fitted to naval ships and aircraft, one of which is Sea Harrier.

35 The project comprised an upgrade to the Sea Harrier's radar, the supply of JTIDS terminals and the integration of the JTIDS equipment with the aircraft's existing avionics systems. I reported last year[5] on the Department's decision in February 2002 to withdraw the Sea Harrier from service by 31 March 2006, earlier than planned. In light of this decision the Department terminated the development and production contracts of JTIDS incurring a constructive loss of some £77.7 million.

The Department has reported other significant losses

JP233 anti personnel landmines

36 The United Kingdom announced a complete ban on the use of anti-personnel mines by UK troops in May 1997 and became one of the first nations to sign the Ottawa Convention in December the same year. The UK was then one of the first forty

[5] MOD: Departmental Resource Accounts 2001-2002 HC 47 Session 2002-2003: 21 November 2002

countries to ratify the Convention on 31 July 1998 committing to the withdrawal and destruction of all British Forces antipersonnel land mines by 2003. The £985 million loss represents the full cost of the JP233 land mines as well as the decommissioning costs.

The Department has given advance notification of significant losses

37 HM Treasury's *Government Accounting* requires that losses and special payments should be brought to the attention of Parliament at the earliest opportunity. Notification is separate from the accounting treatment, which will depend on the nature of the loss or special payment. A loss should be noted in the accounts even if it may be reduced by subsequent recoveries. The Department has provided advance notification for the following significant losses.

Defence Stores Management Solution

38 Following its formation the Defence Logistics Organisation initiated a comprehensive business change programme to underpin the Strategic Defence Review[6] goal of achieving lower support costs through asset reductions to fund enhancements to military capability. The Defence Stores Management Solution was one of a number of projects in the Defence Logistics Organisation's business change programme. The Defence Stores Management Solution was intended to provide a single common inventory across the Defence Logistics Organisation, which would enable more accurate tailoring of stock holdings to the real level of demand. The existing inventory systems were not capable of making intelligent predictions of future usage nor were they capable of tracking materiel in the industrial repair loop. They shared no common language, were complex and not linked adequately with either the purchasing or accounting functions.

39 The Department had found that traditional bespoke systems could be expensive to design and build and were difficult to maintain and upgrade over time. In October 1999 the Defence Logistics Organisation examined a range of potential commercial off the shelf packages for the Defence Stores Management Solution and selected the Indus PassPort software package. It was intended that as an off the shelf package, enhancements would be minimal and be incorporated into the standard package by the supplier which the Department would fund. Following testing to compare the software functionality to departmental logistic processes, the project team identified

[6] Strategic Defence Review Cm 3999 July 1998

essential changes to the software package to meet the Defence Stores Management Solution requirement.

40 In June 2000 the Department's Investment Approvals Board approved a budget of £133.6 million for the development and production of the Defence Stores Management Solution. The through-life 10 year cost estimate for the project was £605m and the target date for initial implementation was October 2002. Funding for the project was not taken into the core defence programme during the Department's annual planning round in autumn 2000. The then Chief of Defence Logistics therefore undertook in April 2001 to find the necessary resources from within the Defence Logistics Organisation's current funding on the assumption that future costs would be reduced through efficiencies. In October 2001 the target date for initial operating capability was revised to December 2003 because of budget constraints. And in December 2001, to reduce costs further, the scope of the project was reduced to be initially a replacement for the Air environment inventory system which as the oldest of the legacy inventory systems was considered to be increasingly difficult to support.

41 In November 2001, serious doubts were emerging in the Defence Logistics Organisation's Executive Board about the technical validity of the single all-encompassing application adopted for the Defence Stores Management Solution and about whether the levels of benefit which it would offer were sufficient to merit proceeding. Subsequently, in the Department's annual planning round, following the substantial savings actions that had been necessary that autumn to allow the Defence Logistics Organisation (and Department) to remain within budget, it was concluded that, unlike the previous year, the Business Change Programme (and within it the Defence Stores Management Solution) should be put on a formal funding basis. The Defence Management Board considered four alternatives for the funding of components of the Business Change Programme. In the event, it concluded that the Defence Stores Management Solution did not command sufficient priority pending the outcome of the 2002 Spending Review. As a result of these factors, the Defence Logistics Organisation's own senior management board suspended the Defence Stores Management Solution project. Contracts with suppliers were then terminated and settled. Total accrued expenditure on the Defence Stores Management Solution project was some £130.5 million.

42 The Department commissioned a post project evaluation review at the end of 2002 into the reasons for the suspension of the Defence Stores Management Solution

project and what remedial measures should be put in place to ensure that such failures did not recur in future. The review concluded more widely that there were a number of weaknesses in the management of the Business Change Programme at the time within the Defence Logistics Organisation and in its supervision by the Department.

43 In particular the post project evaluation review found that there were weaknesses in Department level change management. The change initiatives affecting the Defence Logistics Organisation were highly challenging and potentially clashing. But at Department level there was no framework within which the impact of major change initiatives could be tested for deliverability and managed once launched; nor for providing support and challenge services to change managers to ensure their programmes remained on track and deliverable.

44 The post project evaluation review also identified weaknesses in strategic change management inside the Defence Logistics Organisation. Its Business Change Programme was constructed in an environment of significant strategic change. But the Defence Logistics Organisation had ineffective arrangements for strategic change management. This was seen in significant changes in the governance of the Business Change Programme during its lifetime; and key weaknesses in the mechanisms put in place for strategic programme support and co-ordination.

45 There were weaknesses in the programme management of the Business Change Programme itself. The Department's post project evaluation review identified poor financial governance; weak benefits management; poor communications; risks materialising that need not have done so had they been identified at the outset and managed appropriately; and failure to establish an effective programme management organisation.

46 The Department's review also noted weaknesses in the scrutiny and approvals process. Although the Business Change Programme projects including the Defence Stores Management Solution did not meet the Department's Investment Approvals Board standing requirements in important areas acting as key tests of project viability - especially on affordability and benefits management - the projects were not rejected.

47 The Department has already put in place a number of initiatives to address the weaknesses identified from the post project evaluation review. At the beginning of 2002 the Department determined it should introduce a tighter top-level control process for the delivery of change across the Department. It created an integrated

'Defence Change Programme' for the whole Department covering all major initiatives to ensure that they are deliverable and are effectively managed and supported. The programme is overseen by the Change Delivery Board chaired by the second Permanent Under Secretary. Under these new arrangements the Defence Logistics Organisation's Business Change Programme has been revised to provide greater focus on accountability, deliverability and benefits management. Governance and peer reviews will be conducted at all stages of a project lifecycle. A peer review plan will be developed by the senior responsible officer and form a key part of any investment appraisal submission.

48 The Department has estimated that some £130.5 million was incurred in the development of the Defence Stores Management Solution. Following the suspension of the project, the Investment Approvals Board approved retention of those elements of the project identified as being of future value to the Department. These are in the main computer hardware and are valued at some £12.2 million. The remaining £118.3 million has been noted as a loss and comprises £77.9 m capital expenditure written off in 2002-2003 and £40.5 million revenue expenditure charged to the accounts in 2000-2001 and 2001-2002.

Nuclear submarine facilities at Devonport

49 In 1997 the Department contracted Devonport Management Limited (now known as Devonport Royal Dockyard Ltd) to design and build new and upgraded facilities (known collectively as D154) for the refitting and refuelling of the Royal Navy's submarines, including the Vanguard class submarines which provide the United Kingdom's nuclear deterrent through the Trident missile system. The main elements of the project are expected to be completed in 2004. In 1997 the Department obtained Treasury approval for funding of £650 million and estimated the project's most likely costs would be £576 million. Total project costs are now estimated to be £933 million of which the Department will pay £890 million to the contractor some £314 million more than the budgeted cost. I examined this construction project and the reasons for cost overruns in my Report[7] last year.

50 The facilities are not an asset of the Department although the Department has recorded its investment in the facility through the contractor as a prepayment in the Resource Accounts. In this way it recognises the construction cost of upgrading the

[7] The construction of nuclear submarine facilities at Devonport HC90 Session 2002-03: 6 December 2002

facilities as a deferred benefit of receiving reduced service charges for the refit activity work undertaken by the contractor.

51 The Department has recently re-assessed the use it will make of this facility. The refitting and refuelling cycle has been extended and the number of Fleet submarines reduced. In addition the repair time for the new Astute class is expected to be less than for the current Fleet submarines and there is a degree of uncertainty over the number of refits the Vanguard class submarines will require. On this basis the Department determined the level of facility it would now construct and estimated the costs of this to be some £287 million less than the current value. This has been written off in the 2002-2003 Resource Accounts and noted as a loss.

Section 5: Ministry of Defence - Votes A

52 The Ministry of Defence's Votes A is presented annually to Parliament to seek statutory authority for the maximum numbers of personnel to be maintained for service with the armed forces. Note 32 to the Accounts shows that the maximum numbers maintained during 2002-2003 for the Naval, Army and Air Force Services in all active and reserve categories were within the numbers voted by Parliament. My staff have been provided with strength returns to support this Note to the financial statements.

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