



House of Commons
Defence Committee

Costs of operations in Iraq and Afghanistan: Winter Supplementary Estimate 2006–07

Third Report of Session 2006–07

*Report, together with formal minutes and
written evidence*

*Ordered by The House of Commons
to be printed 5 December 2006*

The Defence Committee

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Contents

Report	<i>Page</i>
Summary	3
Report	5
Introduction	5
Approval of expenditure for operations	5
Approval of the costs of Balkans Operations	6
Estimated costs of operations in 2006–07	7
Outturn costs of operations in 2005–06	9
Votes A	13
Conclusion	14
Conclusions and recommendations	15
Annex: List of Abbreviations used in the Report and Evidence	16
Formal minutes	18
List of written evidence	19
Defence Committee Reports in this Parliament	20

Summary

The Winter Supplementary Estimate 2006–07 presented by the Ministry of Defence (MoD) seeks additional funding of £1,599.982 million, of which £1,400 million is to meet the estimated additional costs of operations in Iraq and Afghanistan in the financial year 2006–07.

We commend the MoD for bringing forward the presentation of estimates on the cost of operations in Iraq and Afghanistan to the Spring Supplementary Estimates, but reiterate our recommendation that there should be provision for the cost of commenced operations in the Main Estimates.

The report presents the information provided by the MoD in support of the Winter Supplementary Estimate, including a breakdown of the anticipated costs of operations in Iraq and Afghanistan. We point out that the actual cost is likely to exceed the amount requested in the Winter Supplementary Estimate.

The report also considers the outturn information on the actual costs of operations in 2005–06, as presented in the MoD's Annual Report and Accounts. We highlight the variation between the actual costs and the estimates and call for the Annual Report and Accounts to explain any significant variation in future. We acknowledge that publishing estimates of the costs of operations at the beginning of the financial year would increase the scope for error, and that the MoD might need to seek additional funds by Supplementary Estimate.

We draw attention to retention problems in the Royal Marines which have required a supplementary estimate for the Votes A, increasing the permitted maximum of Reservists.

We recommend that the House of Commons approves the Winter Supplementary Estimate.

Report

Introduction

1. The Winter Supplementary Estimates for the Financial Year 2006–07 were laid before the House on 21 November 2006.¹ The Ministry of Defence (MoD) is seeking a net increase in resources of £1,599.982 million—in cash terms a net increase of £1,699.982 million.²

2. The Supplementary Estimate includes funds taken up from some of the MoD's under-spends in previous years under the End Year Flexibility arrangements—£120 million resource and £72 million capital. It also splits out Defence Estates net expenditure into its gross expenditure and appropriations-in-aid components, correcting an error in the Main Estimates. And it reallocates funds between Top Level Budgets mainly to reflect changes in the way in which the MoD accounts for its fixed assets.³

3. Most of the additional funds requested in the MoD's Winter Supplementary Estimate are to meet the additional costs of operations in Iraq and Afghanistan, which the MoD estimates to be £1,040 million in resources and £360 million in capital in the current financial year.⁴

4. The House of Commons will be asked to approve the Winter Supplementary Estimates on Thursday 7 December.

Approval of expenditure for operations

5. The MoD does not make provision for the cost of operations in the Main Estimates, on the ground that the unpredictable nature of operations makes it difficult to forecast their cost with accuracy at the beginning of the financial year. Until this year, it has waited until the Spring Supplementary Estimates in February to present estimated costs of operations.

6. In our report on the Spring Supplementary Estimate 2005–06, we said that we considered the arrangement by which the MoD waited for the Spring Supplementary Estimates before seeking Parliament's approval of expenditure on operations to be unsatisfactory; and we recommended that in future provision for already commenced operations be made in the Main Estimates in the usual way, if necessary with a large element for contingency.⁵ The Government's response did not accept this recommendation, arguing that costs were difficult to forecast in fast moving operational circumstances and Supplementary Estimates were the first occasion when the Department

1 *Central Government Supply Estimates 2006–07 Winter Supplementary Estimates and New Estimates*, HC 2, November 2006

2 HC Deb, 21 November 2006, col 29WS; and HC 2, p 8, Table 1.3, and pp 171–184. The £1,599.982 million additional funding comprises £1,592.272 million additional DEL cited in the Written Statement on the Supplementary Estimates (for Request for Resources 1 and 2) and £7.710 million additional AME (for Request for Resources 3).

3 See Ev 1–3 and Ev 6–8

4 HC 2, p 171–172

5 Defence Committee, Fourth Report of Session 2005–06, *Costs of Operations in Iraq and Afghanistan: Spring Supplementary Estimate 2005–06*, HC 980, para 15

could reach a reasonably firm conclusion. However, in the light of our recommendation, the Government undertook to seek provision for conflict prevention for commenced operations in the 2006–07 Winter Supplementary Estimate, rather than waiting for the Spring Supplementary Estimates as in the past.⁶

7. In our report on the Main Estimates 2006–07, we recommended that the MoD reconsider whether provision for commenced operations might be included in the Main Estimates in future.⁷ The Government’s response merely reiterated that “Requests for resources for Conflict Prevention have normally been made in the Supplementary Estimates, because costs are difficult to forecast in fast moving operational circumstances”.⁸ We find this explanation insufficient. **Military operations are by their nature unpredictable and it would be understandable if estimates made at the beginning of the financial year required revision. But the MoD will undoubtedly have made internal planning assumptions about the costs of the operations in Iraq and Afghanistan and we believe these should be shared with Parliament.**

8. While we commend the MoD for bringing forward the presentation of estimates on the cost of operations in Iraq and Afghanistan to the Winter Supplementary Estimates, we still consider that there ought to be provision for the cost of commenced operations in the Main Estimates. We repeat our earlier recommendation that the MoD consider this. We expect this change to be made unless a more compelling argument can be offered for not doing so.

Approval of the costs of Balkans Operations

9. Our argument that the cost of commenced operations could, and should, be presented in the Main Estimates is strengthened by the fact that the Government manages to make provision for the cost of operations in the Balkans in the Main Estimates—albeit in those presented by the Foreign and Commonwealth Office (FCO) rather than by the MoD. The current practice is for the FCO to seek funding for peacekeeping in the Balkans in the Main Estimates, and for some of this to be transferred to the MoD in the Spring Supplementary Estimates.

10. In our report on the Spring Supplementary Estimate 2005–06, we stated that we failed to see why funding was not sought by the MoD in the first place and recommended that in future provision be set out in the MoD’s Main Estimate.⁹ The Government did not accept this recommendation, on the grounds that the FCO had always been the lead department for administering the Global Conflict Prevention Pool, that managing the UK’s peacekeeping activities as a whole was beneficial and that the current arrangements allowed flexibility to respond to a volatile international scene.¹⁰

6 Defence Committee, Fifth Special Report of Session 2005–06, *Costs of Operations in Iraq and Afghanistan: Spring Supplementary Estimate 2005–06: Government’s Response to the Committee’s Fourth Report of Session 2005–06*, HC 1136, Appendix, para 4

7 Defence Committee, Ninth Report of Session 2005–06, *Ministry of Defence Main Estimates 2006–07*, HC 1366, para 9

8 Defence Committee, Tenth Special Report of Session 2005–06, *Ministry of Defence Main Estimates 2006–07: Government Response to the Committee’s Ninth Report of Session 2005–06*, HC 1601, para 2

9 HC (2005–06) 980, para 17

10 HC (2005–06) 1136, paras 11–14

11. In our report on the Main Estimates 2006–07, we stated that, while we appreciated the value in managing peacekeeping activities centrally, we could not see why this should preclude separation of the anticipated costs by department. We recommended that the Government reconsider this.¹¹ In its response, the Government said it would reconsider this in the preparation of the Main Estimates 2007–08.¹² **We repeat our earlier recommendation that provision for operations in the Balkans should in future be set out in the MoD’s Main Estimate, and hope that this will be done in the Main Estimates 2007–08.**

12. In the meantime, it was not clear to us why the transfer to the MoD had to wait for the Spring Supplementary Estimates, rather than appearing in this Winter Supplementary Estimate, alongside the costs of operations in Iraq and Afghanistan. The MoD’s supplementary memorandum states:

Unlike operations in Iraq and Afghanistan, funding for operations in the Balkans comes from the Peacekeeping element of the Conflict Prevention Pools. This funding is sought from the FCO in the Spring Supplementary Estimates, when they will have received full funding for Global Conflict Prevention Pool activities.¹³

We do not find this a sufficient explanation.

Estimated costs of operations in 2006–07

13. The Winter Supplementary Estimate estimates the additional costs of operations in Iraq and Afghanistan in 2006–07 as £1,040 million in resources and £360 million in capital.¹⁴ The MoD’s Estimates Memorandum breaks this down as follows:¹⁵

11 HC (2005–06) 1366, para 12

12 HC (2005–06) 1601, para 3

13 Ev 7, response 7

14 HC 2, p 171–172

15 Ev 3–4, para 5.1

Table 1: The cost of operations in Iraq and Afghanistan

Cost Type	Iraq Actual £ m 2005/06	Iraq Forecast £ m 2006/07	Afghanistan Actual £ m 2005/06	Afghanistan Forecast £ m 2006/07
Resource – Direct				
Personnel	94	77	9	32
Stock / other consumption	219	191	57	103
Infrastructure costs	82	106	11	73
Equipment support costs	220	189	24	81
Other costs and services	111	112	38	67
Income foregone	10	5	8	4
Total	736	680	147	360
Capital				
Capital Additions	160	180	51	180
Total	160	180	51	180
Grand Total	896	860	198	540

Source: Ministry of Defence

14. The costs of operations are identified on the basis of net additional costs. Expenditure such as wages and salaries for permanently employed personnel are not included, as these costs would have been incurred anyway. Costs of activities such as training and exercises which have been cancelled owing to operational commitments are deducted.¹⁶

15. The MoD's supplementary memorandum states that, of the estimated personnel costs, £29 million is attributable to civilian personnel (£22 million for Iraq and £7 million for Afghanistan).¹⁷ While the Department's estimate is that additional personnel costs in Iraq will be £17 million less this year than last, civilian manpower costs will increase from £14 million to £22 million.¹⁸ Civilian manpower costs will account for over 28% of the MoD's additional manpower costs in Iraq this year, in contrast to only 15% in 2005–06, suggesting that the role of MoD's civilian personnel in Iraq is becoming increasingly significant.

16. The MoD's supplementary memorandum explains that the infrastructure costs cover estates and facilities management services, building rental or maintenance and provision of IT and communications. Examples of current major projects are, in Iraq, the development of the single Contingency Operating Base at Basrah Air Station, and a water generation

16 Ministry of Defence Annual Report and Accounts 2005–06, HC (2005–06) 1394, p 201, para 2.3

17 Ev 7, response (6) (i)

18 See Table 1 and Table 3; and Ev 3–4, para 5.1

plant; and, in Afghanistan, the upgrade of living accommodation at Kandahar Airfield and Camp Bastion, upgraded hospital facilities at Camp Bastion, and the relocation of the UK Task Force HQ to Lashkar Gah.¹⁹

17. Other costs and services include utility costs, personnel and freight movements, hire of transport, staff training, medical treatment, welfare services, food and administration costs.²⁰

18. The MoD's Estimates Memorandum states that the MoD has not included a contingency in the Winter Supplementary Estimate, which will be updated at the Spring Supplementary Estimates if required.²¹ We note that last year the MoD included a large element for contingency —£146 million—which in the event was not needed (see Table 3 and paragraph 26 below).

19. The Estimates Memorandum also points out that the MoD has not included in the Winter Supplementary Estimate an estimate for indirect resource costs (stock write-off, provisions, depreciation, cost of capital charges etc). These will be funded by an internal transfer from the main 'defence capability' Request for Resource estimate, which will be requested at the Spring Supplementary Estimates.²² This could be significant. In 2005–06, indirect resource costs of Iraq and Afghanistan operations were £63 million.²³

20. Nor has the MoD included in the Winter Supplementary Estimate the costs of the tax-free bonus to personnel on designated operational deployments, announced by the Secretary of State for Defence on 10 October 2006.²⁴ This is expected to cost around £60 million a year. Provision for the costs of the operational allowance in the current year will be requested in the Spring Supplementary Estimates.²⁵

21. It seems likely, therefore, that the actual additional costs of operations in Iraq and Afghanistan in 2006–07 will exceed the amounts requested in the Winter Supplementary Estimate.

Outturn costs of operations in 2005–06

22. In our report on the Spring Supplementary Estimate 2005–06, we pointed out that the MoD's Annual Report and Accounts 2004–05 presented little more than an overall outturn figure for the costs of operations in the Balkans, Afghanistan and Iraq, and recommended that in future the Annual Report and Accounts should contain significantly more detailed information on the cost of operations.²⁶ The Government accepted this recommendation.²⁷

19 Ev 7, response (6) (ii)

20 Ev 7, response (6) (iii)

21 Ev 3, para 5.1

22 Ev 3–4, para 5.1

23 See Table 3 below and HC (2005–06) 1394, p 201

24 HC Deb, 10 October 2006, col 175

25 Ev 4, para 8.1, and Ev 8, response (8)

26 HC (2005–06) 980, para 10

27 HC (2005–06) 1136, Appendix, para 2

23. The overall net additional cost of these and other operations in 2005–06 was £1,266 million, of which £957 million was for operations in Iraq, £199 million for operations in Afghanistan, and £63 million for operations in the Balkans (Bosnia and Kosovo). The Annual Report and Accounts first breaks this down as follows:²⁸

Table 2: Costs of operations 2005–06

Net Additional Costs of Operations 2005–06 (£ million)			
	Final Voted Provision	Outturn	Variation
Resource			
Iraq (Operation TELIC)	838	797	(41)
Afghanistan (Operation HERRICK)	150	148	(2)
Balkans (Operation OCULUS)	64	63	(1)
Programme Expenditure (African and Global Pool)	49	47	(2)
Total Resource	1,101	1,055	(46)
Capital			
Iraq (Operation TELIC)	260	160	(100)
Afghanistan (Operation HERRICK)	70	51	(19)
Balkans (Operation OCULUS)	-	0	0
Total Capital	330	211	(119)
Total Net Additional Cost of Operations	1,431	1,266	(165)

Source: Ministry of Defence

24. The Annual Report and Accounts 2005–06 also provides a much more detailed breakdown, as follows:²⁹

28 HC (2005–06) 1394, p 128, para 260 and Table 11

29 HC (2005–06) 1394, p 201

Table 3: Costs of operations in Iraq, Afghanistan and the Balkans 2005–06

Total Outturn 2005–06 (£000)									
Resource Cost (by area)	Iraq			Afghanistan			Balkans		
	Total Outturn	Total Departmental Allocation 2005–06	Outturn 2004–05	Total Outturn	Total Departmental Allocation 2005–06	Outturn 2004–05	Total Outturn	Total Departmental Allocation 2005–06	Outturn 2004–05
Direct costs									
Service manpower	80,237	80,278	115,590	7,575	7,172	14,898	11,509	11,640	15,960
Civilian manpower	14,213	11,688	13,889	1,627	1,116	996	4,949	7,336	7,614
Infrastructure costs	81,407	84,082	87,550	10,522	25,663	7,197	12,633	13,954	15,912
Equipment support	220,232	243,097	198,273	24,399	14,832	6,488	7,840	7,339	4,399
Other costs and services	111,186	103,984	110,169	37,595	46,070	19,863	11,824	16,935	32,480
Income	10,054	3,812	2,110	7,792	5,917	(2,054)	2,369	(9,209)	(8,681)
Stock consumption	218,920	202,936	156,280	57,171	33,918	10,178	9,332	8,566	7,642
Contingency	-	55,000	-	-	14,000	-	-	-	-
Indirect Costs									
Stock write-off	51	44	1,559	(2)	(2)	9	-	-	-
Provisions	1,560	3,000	6,192	-	-	-	(437)	87	299

Total Outturn 2005–06 (£000)									
	Iraq			Afghanistan			Balkans		
	Total Outturn	Total Departmental Allocation 2005–06	Outturn 2004–05	Total Outturn	Total Departmental Allocation 2005–06	Outturn 2004–05	Total Outturn	Total Departmental Allocation 2005–06	Outturn 2004–05
Depreciation and amortisation (inc UORs)	33,611	15,577	41,270	1,255	1,596	177	2,376	6,944	8,608
Fixed asset write-off	21,848	30,000	8,000	-	-	-	-	-	-
Cost of capital	4,441	4,594	6,186	183	162	185	284	408	444
Total	797,760	838,092	747,068	148,117	150,444	57,937	62,679	64,000	84,677
Capital cost (by area)									
Capital addition (inc UORs and Recuperation)	159,838	199,944	162,862	51,231	53,053	9,097	174	-	2,430
Net Book Value of fixed asset disposals	-	-	-	-	-	-	-	-	(547)
Contingency	-	60,000	-	-	17,000	-	-	-	-
Total	159,838	259,944	162,862	51,231	70,053	9,097	174	-	1,883
Total by Operation	957,598	1,098,036	909,930	199,348	220,497	67,034	62,853	64,000	86,560

Source: Ministry of Defence

25. We commend the MoD for including considerably more detail on the cost of operations in the Annual Report and Accounts 2005–06, and recommend that it continue this practice in future.

26. We note that **the outturn for 2005–06 was significantly less than the final voted provision: the MoD over-estimated the cost of operations by £165 million (12%)**. This included an over-estimate of capital costs by more than 36%. We appreciate that the cost of operations is hard to estimate, but the variation between anticipated and actual capital spend is surprising, particularly since the estimates were not made last year till more than half way through the year (and presented to the House in the Spring Supplementary Estimates in February). **Where there is significant variation in the cost of operations between voted provision and outturn in future, we shall expect the Annual Report and Accounts to contain some explanation of it, just as there is for significant variations against budgets in other parts of the Defence Estimate. However, we fully accept that, if the MoD agrees to publish estimates of the additional costs of commenced operations at the beginning of the financial year, as we recommend, the scope for error in those estimates might be increased. We accept that in following this approach the MoD might subsequently need to seek additional funds to correct its initial estimates, by seeking a Supplementary Estimate later in the year.**

Votes A

27. In addition to the Winter Supplementary Estimate, the MoD has also laid a Supplementary Estimate to the Votes A for the financial year 2006–07.³⁰

28. The Votes A provide the mechanism by which Parliament exercises control over the maximum number of personnel in the Armed Forces. The Votes A for the financial year 2006–07, agreed by the House on 20 March 2006, provided for a maximum of 42,050 personnel serving in the Royal Navy and Royal Marines, and 16,550 in the Reserve Naval and Marine Forces.³¹ The Supplementary Estimate increases the maximum number of personnel in the Royal Fleet Reserve Marine Other Ranks category from 1,200 to 1,350, raising the maximum for the Reserve Naval and Marine Forces to 16,700 overall. The MoD's Estimates Memorandum states that this increase is caused by "higher than anticipated numbers of Regulars leaving the Royal Marines and automatically entering the Reserve this year".³²

29. An increase in 150 reservists is not a significant number, increasing the Tri-Service Votes A maxima by only 0.04%.³³ But it is worrying that more Regulars have been leaving the Royal Marines than anticipated. Evidence provided by the MoD to our inquiry into the MoD's Annual Report and Accounts 2005–06 showed that the voluntary outflow rates for Royal Navy and Royal Marine Ratings has significantly exceeded target for the past three years, and identified Royal Marine Junior Ranks as a pinchpoint trade.³⁴ The recent report

30 *Ministry of Defence Votes A 2006–07 Supplementary Votes*, HC 18

31 *Ministry of Defence Votes A 2006–07*, HC (2005–06) 869

32 Ev 5, para 14.1

33 *Ibid.*

34 Defence Committee, Second Report of Session 2006–07, *Ministry of Defence Annual Report and Accounts 2005–06*, HC 57, Ev 27; and HC (2005–06) 1394, p 140, para 282 and Table 20

from the National Audit Office on Recruitment and Retention in the Armed Forces states that, as at 1 April 2006, there was a shortfall of 9.6% of Royal Marines Other Ranks.³⁵

30. The Estimates Memorandum states that the MoD has proposed to the Armed Forces Pay Review Body measures that aim to improve the retention within the Royal Marines. **We welcome the MoD’s proposal of financial incentives to aid retention in the Royal Marines. We shall be monitoring the retention figures closely.**

Conclusion

31. **While we continue to have some concerns about the manner in which the MoD seeks parliamentary approval for the costs of operations, we recommend that the House of Commons approve the request for resources set out in the MoD’s Winter Supplementary Estimate.**

³⁵ National Audit Office, *Recruitment and Retention in the Armed Forces*, HC (2005–06) 1633-I, 3 November 2006, p 14, Table 3

Conclusions and recommendations

1. Military operations are by their nature unpredictable and it would be understandable if estimates made at the beginning of the financial year required revision. But the MoD will undoubtedly have made internal planning assumptions about the costs of the operations in Iraq and Afghanistan and we believe these should be shared with Parliament. (Paragraph 7)
2. While we commend the MoD for bringing forward the presentation of estimates on the cost of operations in Iraq and Afghanistan to the Winter Supplementary Estimates, we still consider that there ought to be provision for the cost of commenced operations in the Main Estimates. We repeat our earlier recommendation that the MoD consider this. We expect this change to be made unless a more compelling argument can be offered for not doing so. (Paragraph 8)
3. We repeat our earlier recommendation that provision for operations in the Balkans should in future be set out in the MoD's Main Estimate, and hope that this will be done in the Main Estimates 2007–08. (Paragraph 11)
4. It seems likely that the actual additional costs of operations in Iraq and Afghanistan in 2006–07 will exceed the amounts requested in the Winter Supplementary Estimate. (Paragraph 21)
5. We commend the MoD for including considerably more detail on the cost of operations in the Annual Report and Accounts 2005–06, and recommend that it continue this practice in future. (Paragraph 25)
6. The outturn for 2005–06 was significantly less than the final voted provision: the MoD over-estimated the cost of operations by £165 million (12%)... Where there is significant variation in the cost of operations between voted provision and outturn in future, we shall expect the Annual Report and Accounts to contain some explanation of it, just as there is for significant variations against budgets in other parts of the Defence Estimate. However, we fully accept that, if the MoD agrees to publish estimates of the additional costs of commenced operations at the beginning of the financial year, as we recommend, the scope for error in those estimates might be increased. We accept that in following this approach the MoD might subsequently need to seek additional funds to correct its initial estimates, by seeking a Supplementary Estimate later in the year. (Paragraph 26)
7. We welcome the MoD's proposal of financial incentives to aid retention in the Royal Marines. We shall be monitoring the retention figures closely. (Paragraph 30)
8. While we continue to have some concerns about the manner in which the MoD seeks parliamentary approval for the costs of operations, we recommend that the House of Commons approve the request for resources set out in the MoD's Winter Supplementary Estimate. (Paragraph 31)

Annex: List of Abbreviations used in the Report and Evidence

AG	Adjutant General
AME	Annually Managed Expenditure
CDEL	Capital Departmental Expenditure Limit
CDL	Chief of Defence Logistics
CJO	Chief of Joint Operations
CTLB	Central Top Level Budget
DCSA	Defence Communications Services Agency
DE	Defence Estates
DEL	Departmental Expenditure Limit
DLO	Defence Logistics Organisation
DPA	Defence Procurement Agency
EYF	End Year Flexibility
FCO	Foreign and Commonwealth Office
GOCNI	General Officer Commanding Northern-Ireland
HQ	Headquarters
IT	Information Technology
ME	Main Estimates
MoD	Ministry of Defence
NAO	National Audit Office
OPC	Office of the Parliamentary Counsel
PEOWPS	Public Expenditure Provisional Outturn White Paper
PNISS	Principal Non-Industrial Superannuation Scheme
PSA	Public Service Agreement
PTC	Personnel and Training Command
RAF	Royal Air Force
RDEL	Resource Departmental Expenditure Limit

RfR	Request for Resources
SBSO	Single Balance Sheet Owner
SSE	Spring Supplementary Estimates
STC	Strike Command
TLB	Top Level Budget
UK	United Kingdom
WSE	Winter Supplementary Estimates

Formal minutes

Tuesday 5 December 2006

Members present:

Mr James Arbuthnot, in the Chair

Mr David Crausby

Linda Gilroy

Mr David Hamilton

Mr Dai Havard

Mr Bernard Jenkin

Mr Brian Jenkins

Willie Rennie

John Smith

Costs of operations in Iraq and Afghanistan: Winter Supplementary Estimate 2006–07

The Committee considered this matter.

Draft Report (Costs of operations in Iraq and Afghanistan: Winter Supplementary Estimate 2006–07), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 31 agreed to.

Annexes (Summary and List of Abbreviations) agreed to.

Several papers were ordered to be appended to the Report.

Resolved, That the Report be the Third Report of the Committee to the House.

[Adjourned till today at 4.30 pm]

List of written evidence

1	Memorandum from the Ministry of Defence	Ev 1
2	Supplementary memorandum from the Ministry of Defence	Ev 6

Defence Committee Reports in this Parliament

Session 2005–06

First Report	Armed Forces Bill	HC 747 (<i>HC 1021</i>)
Second Report	Future Carrier and Joint Combat Aircraft Programmes	HC 554 (<i>HC 926</i>)
Third Report	Delivering Front Line Capability to the RAF	HC 557 (<i>HC 1000</i>)
Fourth Report	Costs of peace-keeping in Iraq and Afghanistan: Spring Supplementary Estimate 2005–06	HC 980 (<i>HC 1136</i>)
Fifth Report	The UK deployment to Afghanistan	HC 558 (<i>HC 1211</i>)
Sixth Report	Ministry of Defence Annual Report and Accounts 2004–05	HC 822 (<i>HC 1293</i>)
Seventh Report	The Defence Industrial Strategy	HC 824 (<i>HC 1488</i>)
Eighth Report	The Future of the UK's Strategic Nuclear Deterrent: the Strategic Context	HC 986 (<i>HC 1558</i>)
Ninth Report	Ministry of Defence Main Estimates 2006–07	HC 1366 (<i>HC 1601</i>)
Tenth Report	The work of the Met Office	HC 823 (<i>HC 1602</i>)
Eleventh Report	Educating Service Children	HC 1054 (<i>HC 58</i>)
Twelfth Report	Strategic Export Controls: Annual Report for 2004, Quarterly Reports for 2005, Licensing Policy and Parliamentary Scrutiny	HC 873 (<i>Cm 6954</i>)
Thirteenth Report	UK Operations in Iraq	HC 1241 (<i>HC 1603</i>)
Fourteenth Report	Armed Forces Bill: proposal for a Service Complaints Commissioner	HC 1711

Session 2006–07

First Report	Defence Procurement 2006	HC 56
Second Report	Ministry of Defence Annual Report and Accounts 2005–06	HC 57

Written evidence

Memorandum from the Ministry of Defence

WINTER SUPPLEMENTARY ESTIMATES 2006–07

1. INTRODUCTION

1.1 This Memorandum covers the Winter Supplementary Estimate for the Ministry of Defence (MoD). The Department's spending plans for 2006–07 are based upon the outcome of the Government's Spending Review 2004, which was published in the Government's Expenditure Plans 2006–07 to 2007–08 (Cm 6822).

1.2 There is no requirement for a Winter Supplementary Estimate for the Armed Forces Retired Pay, Pensions vote.

2. SUMMARY OF RESOURCES SOUGHT IN THE ESTIMATE

2.1 The Ministry of Defence's Winter Supplementary Estimates seek additional funds of:

<i>Resource/Annually Managed Expenditure</i>	<i>£ million</i>
Provision of Defence Capability (RfR1)	120.272
Conflict Prevention (RfR2)	1,040.000
War Pensions and Allowances (RfR3)	7.710

<i>Capital Expenditure</i>	<i>£ million</i>
Provision of Defence Capability (RfR1)	72.000
Conflict Prevention (RfR2)	360.000

<i>Cash</i>	<i>£ million</i>
Near Cash in Resource DEL	1,260.272
Near Cash in Capital DEL	432.000
War Pensions and Allowances AME	7.710
Net Cash Requirement	1,699.982

2.2 The most significant changes to the Defence Expenditure Limits (DEL) for both RfR1 and 2 are:

- the take up of end year flexibility of £120 million Resource DEL Direct (near cash) and £72 million Capital DEL, which includes our entitlement in 2006–07 to the proceeds of the sale of QinetiQ last year;
- transfers in of £0.272 million from other Government departments under RfR1; and
- to increase the RfR2 by £1,040 million Resource DEL and £360 million Capital DEL to reflect the forecast costs of peace-keeping in Iraq and Afghanistan.

In addition, there is a transfer from Resource DEL Indirect (non-cash) to Resource DEL Direct (near cash) of £100 million, mainly for fuel costs.

2.3 There is also a £7.2 million increase to the RfR3 War Pensions Benefits Programme costs and £0.5 million for Far Eastern Prisoner of War Pensions Benefits Programme Costs.

3. DETAILED EXPLANATION OF CHANGES

3.1 The transfers and other changes outlined in the Introduction to the Estimate are analysed in this section of the Memorandum.

3.2 The table below shows how the Winter Supplementary Estimate is compiled, taking the figures for 2006–07 Main Estimates, and identifying subsequent changes.

<i>£ million</i> [1]	<i>Direct</i> <i>R DEL</i> 1	<i>Indirect</i> <i>R DEL</i> 2	<i>Total</i> <i>R DEL</i> 3	<i>AME</i> 4	<i>Non</i> <i>budget</i> <i>Near cash</i> 5	<i>Total</i> <i>Net</i> <i>Resources</i> 6	<i>Capital</i> <i>DEL</i> 7	<i>Capital</i> <i>AME</i> 8	<i>Total</i> <i>Net</i> <i>Capital</i> 9
RfR1 Total as at Main Estimates	21,140.2	10,655.0	31,795.2	178.1	12.4	31,985.7	6,926.0	–7.0	6,919.0
Transfers in	0.3		0.3			0.3			
Transfers out	0.0		0.0						
EYF	120.0		120.0			120.0	72.0		72.0
Flexibility	100.0	–100.0	0.0						
RfR1 Total as at WSE	21,360.5	10,555.0	31,915.5	178.1	12.4	32,106.0	6,998.0	–7.0	6,991.0
RFR2 Provision	47.3		47.3			47.3			
	1,040.0		1,040.0			1,040.0	360.0		360.0
RFR2 Provision as at WSE	1,087.3	0.0	1,087.3			1,087.3	360.0		360.0
RFR3 Provision			0.0	1,030.0		1,030.0			
				7.7		7.7			
RFR3 Provision as at WSE				1,037.7		1,037.7			
WSE Estimate Total[2]	22,447.8	10,555.0	33,002.8	1,215.8	12.4	34,231.0	7,358.0	–7.0	7,351.0

[1] Definitions of the column headings are shown at Annex C.1

[2] Minimal differences may occur due to roundings.

4. RfR 1 PROVISION OF DEFENCE CAPABILITY—EXPLANATION OF CHANGES

4.1 *Transfers in*

The Estimate includes two transfers from Other Government Departments.

Table showing Transfers in to MoD from Other Government Departments in RfR1

<i>Exporting Department</i>	<i>£ million</i>	<i>Purpose</i>
Cabinet Office	0.072	Contribution for the expansion of the Parliamentary Counsel Office.
Department for Trade and Industry	0.200	Contribution to the Principal Non-industrial Superannuation Scheme (PNISS) for individuals who transferred to the MoD from the UK Atomic Energy Authority.
Total	0.272	

4.2 *Indirect Resource DEL to Direct Resource DEL Transfer—£100 million*

4.2.1 HM Treasury have agreed the transfer of £100 million from non-cash to near-cash. Of this £80 million has been allocated to Strike TLB to cover increased fuel costs and £20 million to the DLO to cover increased logistical costs.

4.3 *End Year Flexibility: £120 million RDEL and £72 million CDEL*

4.3.1 The take up of our entire End Year Flexibility (EYF) available at Winter Supplementary Estimates of £120 million Resource DEL Direct (near cash) and £72 million Capital DEL, which includes our 2006–07 entitlement to the proceeds of the sale of QinetiQ last year.

4.3.2 The £120 million Resource EYF has been allocated to Defence Logistics Organisation (£60 million), Adjutant General (£10 million), Central (£30 million), Defence Estates (£10 million) and Fleet (£10 million). These alterations reflect changes in allocations between TLBs to match required defence outputs.

4.3.3 The £72 million Capital EYF has been allocated to Defence Procurement Agency (£60 million) and Defence Logistics Organisation (£12 million). Once more these alterations reflect changes in allocations between TLBs to match required defence outputs.

4.4 Top Level Budget (TLB) Sub Head Changes

4.4.1 The changes under these sub-headings reflect alterations to TLB allocations of Resource and Capital funding to bring the allocations into line with responsibility transfers between TLBs, and other adjustments to reflect the defence outputs required since Main Estimates. These comprise a number of individual changes, and reasons for some of the more significant allocations are set out in the table:

Table: Major TLB re-allocations

<i>TLB</i>	<i>RDEL Direct £ million</i>	<i>Capital £ million</i>	<i>Notes</i>
FLEET	5.079	0	1,4
PTC	-69.861	0	2,4
DPA	72.752	-2.866	3,4
DLO	-67.738	-7.134	3,4
LAND	-7.052	-10.637	4
AG	-4.887	0	4
GOCNI	0.077	-3.267	4
STC	1.460	0	4
CTLB	-4.453	-0.581	4
DE	127.775	24.485	2,4
CJO	-53.152	0	4
Total	0	0	

Notes:

1. Transfer of RAF St Athan's training responsibilities and costs to Fleet as part of the Defence Training Review.
2. Reallocation of RAF Single Living Accommodation and married quarters' income to Defence Estates (DE) who are incurring the costs.
3. Transfer of specialist advice costs for projects from DLO to DPA.
4. Transfer of fixed assets to Single Balance Sheet Owners (SBSOs).

4.5 Indirect Resource DEL

4.5.1 MoD has a fixed asset management project which is part of the Defence Resource Management Programme to "simplify and improve" financial processes across the Department. The second stage of this is the centralisation of fixed asset management under four single balance sheet owners (SBSOs) Defence Estates (DE), Defence Logistics Organisation (DLO), Defence Procurement Agency (DPA) and the Defence Communications Services Agency (DCSA), which is part of the DLO. When the Main Estimate was prepared, the budgetary implications had not been finalised, and the effect of these transfers is shown in the Winter Supplementary Estimates. There will be further adjustments in the Spring Supplementary Estimates.

4.6 Operating and non-operating Appropriations-in-Aid (A-in-A)

4.6.1 The Appropriations in Aid forecasts have been reviewed in August 2006 (Accounting Period 2005) and the changes to the Estimate reflect the latest estimate of outturn for each Top Level Budget Holder.

5. REQUEST FOR RESOURCES 2: CONFLICT PREVENTION

5.1 This estimate requests £860 million for the costs of operations in Iraq and £540 million for operations in Afghanistan. This reflects the latest estimate of outturn for each Top Level Budget Holder, and is detailed in the table below. The Department has not included a contingency in this Estimate, which will be updated at Spring Supplementary Estimates if required. The Department has not included an estimate for Indirect Resource DEL for Conflict Prevention. As in previous years, it is expected that this will be funded internally by a transfer from RfR1 to RfR2, which will be requested at Spring Supplementary Estimates.

<i>Cost Type</i>	<i>Iraq— Actual £ million 2005–06</i>	<i>Iraq— Forecast £ million 2006–07</i>	<i>Afghanistan— Actual £ million 2005–06</i>	<i>Afghanistan— Forecast £ million 2006–07</i>
Resource—Direct				
Personnel	94	77	9	32
Stock/Other Consumption	219	191	57	103
Infrastructure Costs	82	106	11	73
Equipment Support Costs	220	189	24	81
Other costs and services	111	112	38	67
Income Foregone	10	5	8	4
Total	736	680	147	360
Capital				
Capital Additions	160	180	51	180
Total	160	180	51	180
Grand Total	896	860	198	540

6. NON-VOTED ITEMS

6.1 No changes have been made to the Non-Voted element of the Estimate.

7. RfR3 WAR PENSION BENEFIT

7.1 RfR3 has increased by £7.2 million for annually managed expenditure for War Pensions Benefits Programme costs and £0.5 million for Far Eastern Prisoner of War Pensions Benefits Programme Costs. This reflects the latest forecasts received from the Veterans Agency.

8. ADDITIONAL RESOURCES THAT WILL BE REQUESTED IN SPRING SUPPLEMENTARY ESTIMATES

8.1 The Department plans to request the following major additional resources in the Spring Supplementary round:

- The Indirect Resource DEL claim for RfR2, which will be funded from a transfer from RfR1 Indirect Resource DEL;
- The tax-free bonus to Personnel on designated operational deployments; and
- The RfR2 Conflict prevention claim for operations in the Balkans.

9. THE DEPARTMENTAL EXPENDITURE LIMIT (DEL)

9.1 The following table shows the DEL from 2003–04 to 2006–07 for all RfRs

	<i>2003–04SSE £ million</i>	<i>2004–05SSE £ million</i>	<i>2005–06SSE £ million</i>	<i>2006–07ME £ million</i>	<i>2006–07WSE £ million</i>
Resource DEL	32,315	32,831	33,727	32,643	33,803
Capital DEL	6,421	6,662	6,798	6,926	7,359
Depreciation ¹	–7,437	–8,049	–8,168	–7,551	–7,551
Total DEL	31,299	31,444	32,357	32,018	33,611

1. *Depreciation, which forms part of resource DEL is excluded from total DEL, since capital DEL includes capital spending and to include depreciation of those assets would lead to double counting.*
2. *The figures are for voted and Non voted DEL the Non voted figure for 2006–07 is £331.294 million net of depreciation.*

10. ADMINISTRATION COSTS LIMIT

10.1 The Department is not subject to an Administration Costs Limit.

11. PROVISIONS AND CONTINGENT LIABILITIES

11.1 There are no additional provisions for liabilities and charges requested at Winter Supplementary Estimates. We acknowledge that the contingent provision for QinetiQ, contained in the 2006–07 Main Estimates, is no longer extant following the sale of QinetiQ, and this will be removed in the 2007–08 Main Estimates.

12. MACHINERY OF GOVERNMENT CHANGES

12.1 There are no Machinery of Government changes in this Estimate.

13. NET ADDITIONAL CASH REQUIREMENT

13.1 The Net Cash impact for the Winter Supplementary Estimate is an increased requirement of £1,700 million, of which £1,692 million relates to DEL (£1,260 million Resource DEL and £432 million Capital DEL) and £7.71 million relates to War Pensions and Allowances AME.

14. VOTES A

14.1 We will be laying a Supplementary Estimate for Votes A alongside the Winter Supplementary Estimate; this will be published as HC18. The reason for this amendment is to increase the maximum numbers of personnel in the Royal Fleet Reserve Marine Other Ranks category from 1,200 to 1,350. This potential increase in numbers of Reservists is caused by higher than anticipated numbers of Regulars leaving the Royal Marines and automatically entering the Reserve this year. This increases the Tri-service Votes A maxima by 0.04%. The MoD has proposed to the Armed Forces Pay Review Body measures that aim to improve retention within the Royal Marines.

Definition of terms

1. DIRECT RESOURCE DEL

This is a control aggregate within the resource budget it excludes the non-cash items such as depreciation, cost of capital and movement in provisions, however, it does in the expenditure that, in generally accepted accounting practice (GAAP) terms, is financed by the release of provisions. Direct Resource DEL is also known as “near cash in the resource budget”.

2. INDIRECT RESOURCE DEL

This covers items such as depreciation, cost of capital charges and movement in provisions, and the notional auditors’ fees for the NAO. This is also known as non-cash.

3. TOTAL RESOURCE DEL

This is the sum of Direct and Indirect Resource DEL.

4. ANNUALLY MANAGED EXPENDITURE (AME)

Annually Managed Expenditure (AME) are Programmes that are demand-led, such as war pensions, or exceptionally volatile in a way that could not be controlled by the department and where the programmes are so large that the department could not be expected to absorb the effects of volatility in their programme, such as cash release of nuclear provisions.

5. NON-BUDGET

Items of expenditure which are included in the Estimate, but are outside of DEL and AME. This is a Parliamentary control but not a Treasury control.

6. TOTAL NET RESOURCES

This is the net of items 1 to 5.

7. CAPITAL DEL

This is for new investment, including Capital additions, disposals, and the capital repayment of loans.

8. CAPITAL AME

Includes the capital element of the loan repayments for self-financing public corporations, such as QinetiQ.

9. TOTAL NET CAPITAL

This is the sum of the above capital items.

10. TOTAL NEAR CASH

This is the total accrued expenditure spend and is the sum of Direct RDEL and Capital DEL.

20 November 2006

Supplementary memorandum from the Ministry of Defence

Set out below are the Department's responses to the Select Committee questions arising from the Winter Supplementary Estimate and the Department's Estimates Memorandum.

1. *What is the rationale for the figure of £120 million Resource DEL End Year Flexibility drawdown, and for the £72 million figure for Capital DEL EYF drawdown? The Memorandum identifies the TLBs which will be given the extra funds, but for what purpose do these TLBs need the additional funds?*

RESPONSE

The EYF drawdown was agreed between the Department and the Treasury, reflecting the Department's emerging 2005–06 outturn in near cash Resource DEL and Capital DEL under RfR1.

The TLBs have been given the additional funding to cover fuel cost pressures (Fleet), carry forward of Defence Modernisation Fund projects (DLO), IT and Communication projects (in both DLO and the Central TLB), some slippage in Defence Estates expenditure (DE), some additional expenditure over initial budget on the Army's manning and training margin (AG), and additional spend on equipment projects (DPA).

2. *Did the Department wish to draw down more of its available stock of EYF, identified in the Public Expenditure Provisional Outturn White Paper [Cm 6883, Table 5]? To what extent did the Treasury restrict the amounts that could be drawn down in this Winter Supplementary Estimate?*

RESPONSE

The figures published in the Public Expenditure Provisional Outturn White Paper (PEOWPS) were based on provisional outturn. The EYF for 2006–07 was agreed with the Treasury subsequently. The Treasury did not restrict the Department's entitlement to EYF which could be drawn down in the Winter Supplementary Estimate.

3. *In the Memorandum, the DEL EYF to be drawn down is broken down between TLBs [Memo para 4.3], "to match required defence outputs". But there are also more significant reallocations of existing provision between TLBs. To what extent are the allocations (and reallocations) between TLBs tied to the need to maintain performance against specific PSA targets (or to prevent targets being missed), and to what extent do the allocations reflect a need to cover particular TLBs' outturns exceeding originally envisaged spending levels?*

RESPONSE

The allocations (and reallocations) between TLBs are not tied to the need to achieve performance against specific PSA targets but rather to enable TLBs to deliver across the range of their outputs in accordance with our plans.

4. *What is the rationale for the transfer from the Cabinet Office for the expansion of the Parliamentary Counsel Office?*

RESPONSE

During 2004, Government decided that the Office of the Parliamentary Counsel (OPC) should be expanded to cope with the growth in the volume of legislation, and that the increase in its cost should be shared amongst user departments. This transfer represents the share of the baseline funding for the Department for 2006–07. The Department will be invoiced for its share of the costs during the year.

5. *Supplementary Estimate includes a £100 million transfer within RfR-1 Resource DEL, from “non-cash” (or “indirect” costs) to “near cash” (“direct”). The Estimate Memorandum identifies this as comprising £80 million allocated to Strike Command to cover increased fuel costs and £20 million to the DLO for higher logistical costs [Memo para 4.2.1]*

- (i) *From which TLBs will the “non cash” funds come?*
- (ii) *What is the basis of these £80 million and £20 million figures—do they reflect the extent of increased fuel and logistical costs or the extent by which non-cash costs now appear to have been over-estimated?*

RESPONSE

(i) This has been resourced from the Central TLB which was holding an excess of Indirect Resource DEL above its requirement.

(ii) The £100 million near cash has been allocated to Strike (£80 million) and the DLO (£20 million) reflecting increased fuel and logistical costs. The amounts of transfers between Near Cash Resource DEL and Indirect Resource DEL require Treasury agreement.

6. *A further breakdown of the figures on the costs of operations in Iraq and Afghanistan [Memo, para 5.1] would be helpful. In particular,*

- (i) *How much of the personnel costs are attributable to civilian personnel?*
- (ii) *What infrastructure projects are the infrastructure costs attributable to?*
- (iii) *Please explain, by way of example, what falls under “other costs and services”, as opposed to “stock/other consumption”.*

RESPONSE

(i) A total of £29 million is attributable to civilian personnel of which £22 million relates to Iraq and £7 million to Afghanistan.

(ii) Infrastructure costs cover estates and facilities management services, building rental or maintenance and provision of IT and communications. Examples of the current major projects are:

Iraq

To develop the single Contingency Operating Base located at Basrah Air Station, which will allow planned re-basing of UK and coalition forces within Multi-National Division (SE) to a single enduring location; and the development of a water generation plant to help support our forces.

Afghanistan

The infrastructure priority is the continued expansion and consolidation of facilities in Helmand province and at Kandahar Airfield (KAF). In the main this involves the upgrade of living accommodation at KAF and Camp Bastion from Tier 1 to Tier 2 standard, upgraded hospital facilities at Camp Bastion and relocation of the UK Task Force HQ to Lashkar Gah.

- (iii) The major elements which fall under “Other Costs and Services” are:
 - utility costs, personnel and freight movements, hire of transport, staff training, medical treatment, welfare services, food and administration costs.

7. *Why are the costs of Balkan operations not presented in these Winter Supplementary Estimates?*

RESPONSE

Unlike operations in Iraq and Afghanistan, funding for operations in the Balkans comes from the Peacekeeping element of the Conflict Prevention Pools. This funding is sought from the FCO in the Spring Supplementary Estimates, when they will have received full funding for Global Conflict Prevention Pool activities.

8. *You expect to build the costs of the tax-free bonus for operationally deployed personnel in the Spring Supplementary Estimates [Memo para 8.1]. What is your approximate current estimate of the likely figure? Why have you been unable to present a figure at the time of these Winter Estimates?*

RESPONSE

The Winter Supplementary Estimates were based on figures reported by MOD Top Level Budgetary areas at the end of August prior to the announcement of the “Operational Allowance”. The “Operational Allowance” was not announced until 10 October 2006. We currently estimate that the annual costs are likely to be around £60 million.

9. *The Winter Supplementary Estimates include an increase in capital costs of £858 million. Part of this is accounted for as an £360 million increase for Iraq/Afghanistan operations. What are the main causes of the remainder of the increase?*

10. *What is the cause of the increase in the RfR-1 Capital DEL provision for Defence Estates, which has grown from £34 million at Main Estimate to £428 million in the WSE?*

RESPONSE

The Department manages its Capital DEL on a net basis, whereas the Estimate shows the Capital expenditure and Non Operating Appropriations in Aid under separate columns. Erroneously at Main Estimates, as previously reported, the Capital DEL figure for Defence Estates was entered as a net figure. The bulk of the increase in Capital DEL for Defence Estates is offset by a similar increase in Defence Estates non-operating Appropriations in Aid. The net capital budget for RFR1 remains as agreed at Main Estimates, with the addition of £72 million end of year flexibility.

11. *What are the main causes in the changes in the RfR-1 net Resource DEL provision for the individual TLBs listed below [in Part 2 of the Estimate]*

Fleet	Cut of £2.0 billion	= 47% cut
CinC Land	Cut of £1.4 billion	= 24% cut
Strike Command	Cut of £1.7 billion	= 45% cut
CDL	Increase of £5.8 billion	= 80% increase
Central	Cut of £1.1 billion	= 34% cut
Defence Estates	Increase of £1.5 billion	= 163% increase

RESPONSE

The Department has centralised fixed asset management under four Single Balance Sheet Owners (Paragraph 4.5.1 of the Estimates Memorandum refers) and this has resulted in an adjustment of Indirect Resource DEL (depreciation and cost of capital charge) across the Department. There have therefore been significant increases in the Indirect Resource DEL for the Defence Logistics Organisation (DLO) and Defence Estates (DE), offset by reductions in the other TLBs. It is expected that there will be further adjustments in the Spring Supplementary Estimates.

12. *The increase in RfR-1 Resource DEL funded from EYF (£120 million) includes a shortfall in income that can be Appropriated-in-aid of £28 million [Part II of the Estimate]. What are the main reasons for this shortfall on A-in-A income overall, and for the individual TLBs most affected?*

RESPONSE

The Main Estimate for 2006–07 was prepared on the basis of the second year’s data from the 2005 planning round. When the TLBs drew up their budgets for 2007–08 more up to date information about likely income was available, and in sum the Appropriations in Aid were lower than those notified in the planning round by some 2%. Additionally, there have been transfers of Appropriations in Aid to Defence Estates as part of the Direct Resource DEL consequence of the introduction of Single Balance Sheet Owners. This relates to receipts from single living accommodation and service families accommodation.

30 November 2006