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REVIEW OF MOD CASH MANAGEMENT ARRANGEMENTS

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Contents

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REVIEW OF MOD CASH MANAGEMENT ARRANGEMENTS

1. Introduction

This draft report has been commissioned by Sir Andrew Likierman, Head of the Government Accountancy Service, to provide an assessment of the effectiveness of cash management and cash controls within the MOD and to review the financial management arrangements with MOD and TLBs.

The document reports a number of key findings against the terms of reference and offers some additional relevant findings. The report does not draw conclusions or make recommendations. The final section of the report suggests areas where additional work is required in order to move this study forward.

2. Terms Of Reference

The following terms of reference have been referenced:

"This review will be set up by the Head of the Government Accountancy Service and will be led independently of the government, but with the full involvement of Treasury and MOD officials.

It will examine:

- the quality and effectiveness of MOD's cash planning, monitoring and control within the Government's Resource Accounting and Budgeting framework; and
- the division of responsibilities, flow of information and effective financial management between the top level budget holders and MOD centre.

It will report initial findings to the Chief Secretary and the Defence Secretary within two weeks, and will be completed by the end of November 2003."

3. Review Conduct

This review was undertaken between 28th October and 5th November by a from Cap Gemini Ernst & Young. Comments have been received on the first and second draft reports and have been considered in completing this final version.

We are grateful to the MOD, which has provided documents for review, and has arranged a number of interviews at short notice to allow us to respond to our terms of reference. The following interviews have been conducted:

<u>MOD Centre</u>
Trevor Woolley – FD
Bruce Mann – DGFM
Tom McKane – DGRP

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REVIEW OF MOD CASH MANAGEMENT ARRANGEMENTS

John Thornton – CFC

MOD TLB
Carl Mantell – DGCB Central TLB
Peter Ryan – Deputy Command Secretary – Land Command
Chris Mace – Senior Finance Officer – DLO
David Noble – Senior Finance Officer - DPA

We have also had input and assistance from John Dodds from HMT.

We have also reviewed draft findings with Trevor Woolley, Ian Woodman, Andrew Likierman, John Dodds and

4. Definitions

In the interests of clarity it has proved necessary to define and use some specific terms:

- **Net Cash Requirement** – the actual cash requirement flowing through the bank account, derived from the accruals based accounts and the management of working capital. This represents the required draw down on the Consolidated Fund and is voted as part of the Estimates process.
- **Near Cash** – approximates to RDEL plus CDEL less old AME.
- **Net Cash Control** – the process of defining, cascading and controlling against net cash totals voted by Parliament.
- **Net Cash Management** – the process of ensuring that annual net cash requirements are identified and covered through the supply Estimate, ensuring that supplementaries are raised as required.
- **Net Cash Estimating** – the process of determining the Net Cash Requirement flowing from the planning round before the start of the financial year. This feeds into the Supply Estimate process;
- **Net Cash Forecasting** – the process of ensuring that immediate (<2 month) and longer term (within a year) cash flow requirements are identified. The short term forecasting impacts the draw down from the Consolidated Fund and the longer term forecasts support the Estimates process.
- **Near Cash Control** – the process of defining, cascading and controlling selected lines within the Operating Cost Statement, plus Capital expenditure against limits set by the Treasury.
- **CAPITAL systems** – these are the commercially available packaged software that MOD uses to produce its financial information. The CAPITAL systems include Accounting Operations systems (which are being systematically upgraded and standardised on Oracle 11i software) and the Short Term Planning system (based on Oracle Financial Analyser software).

5. Key Findings

This section of the report is structured in three parts. The first two parts respond to the specific terms of reference and the third part offers some additional pertinent findings.

TOR: Examine the quality and effectiveness of MOD's cash planning, monitoring and control within the Government's Resource Accounting and Budgeting framework.

It is important to note that the RAB budgetary framework (Stage 2) requires control of RDEL and CDEL but does not require Departments to control the Net Cash Requirement. This is a Parliamentary rather than Treasury control. Together, the parliamentary and RAB frameworks provide the control mechanism for public expenditure.

Net Cash Planning

- Consistent with the requirements of the RAB budgetary framework this is calculated by MOD at the end of the planning process, as a consequence of other resource based decisions;

Near Cash Planning

- Consistent with the requirements of the RAB budgetary framework, the planning process in 03/04 did not look at near cash after the completion of its initial phase;

Short Term (1-2 months) Net Cash Forecasting

- Short term monitoring and forecasting is effective.

Longer Term (2 month to End of Year) Net Cash Forecasting

- The approaches to longer term monitoring are not well developed and would need further work if Net Cash Control were included as part of the RAB budgetary framework;

Net Cash Management - In Year

- Processes are in place to forecast net cash needs and to flag these for Supplementary Estimates. These rely on a variety of cash monitoring and forecasting processes which deliver a range of outcomes but which are not designed to enforce Net Cash Control.

Net Cash Control - Year End

- The MOD has basic processes in place to control the net cash position during the run up to year end, building on the end year controls used under the pre-RAB control regime. These provide basic assurance that the MOD does not overspend the Spring Supplementary Net Cash Requirement agreed by parliament but have not had to be tested since the introduction of RAB.

Near Cash Control - In Year

- Consistent with the RAB budgetary framework, near cash control was not in place at the start of the year (in the period from April to September) although MOD managed to re-implement this quickly once instructed by Treasury. This instruction took effect in October 2003, although Treasury had previously indicated concerns over near cash control.

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REVIEW OF MOD CASH MANAGEMENT ARRANGEMENTS

Key Finding 1.1: The Stage 2 Resource Accounting and Budgeting Framework does not require control of net cash or near cash by Departments. Control of the net cash requirement is a parliamentary control, which together with RAB forms the broader public expenditure control framework.

Sources:
- The Treasury guidance on Stage 2 RAB is clear that departments only need to budget for and control RDEL and CDEL.
- Government Accounting, Section 11.8

Key Finding 1.2: Within the MOD there are different levels of cash (near cash and net cash) management and forecasting.

Sources:
- Interviews with MOD Centre and 4 TLBs (there are a total of 11 TLBs)
- Review of TLB reporting packs (pre AP3 and post AP3)
- Written response to our draft report.

Net Cash

Given the nature of the RAB control regime, across the piece there is limited focus on the management of working capital and some further work is required around the management of these items. TLBs and the Centre expressed concern about their ability to derive reliable working capital figures in year limiting the ability of MOD to monitor and control its cash flow. This is compounded by the timing of the underlying processes - i.e. the STP and Estimates processes complete prior to the end of the financial year (and certainly before the final balance sheet values are known). This means that there is always going to be a variation between the STP and net cash estimates in the Supply Estimates and the actual opening position at the start of the financial year.

Near Cash

Although the MOD had moved to control based on the RAB Stage 2 Control Framework, and the IYM instructions from DGRP/ DGFM made it clear that RDEL and CDEL were the control totals, among the TLBs we visited different internal controls have been implemented. Land Command decided to retain the previous near cash (old DEL) control regime – based on an assumption that the MOD internal ring fencing arrangements for some non cash items would leave no room for flexing between old DEL and old AME in their budget. Others (DLO and DPA) did not see any need to control and manage cash versus old AME, although they have maintained the split for TLB internal reporting purposes. Central TLB had moved away from the split entirely.

MOD Centre has said that all TLBs, and the MOD Centre, had full visibility of both the accrued cash and non-cash lines in the OCS and carried out full variance analysis against these lines . However, this was not reflected in the requirements in the in-year AP reporting pack until October 2003 (AP06). The reports prior to that date focus on total RDEL and CDEL. The revised reporting pack now requires separation of Direct and Indirect RDEL. Top level reports on near cash could have been derived from the MOD's CAPITAL systems had MOD recognised this requirement under the overall control regime.

Key Finding 1.3: For the past 2 years there has been no net cash control framework. However, the MOD has a simple mechanism that provides some control over the final year end net cash position.

Sources:

- Interviews with MOD centre
- Instructions on Control Regime for In Year Management 2003/04 issued 12 May 2003 by DGRP and DGFM
- Net Cash Requirement – End Year Monitoring and Control Instruction dated 17 January 2003.

The NetCash control (as applied prior to RAB) ceased with the change to resource accounting. That, combined with the introduction of new systems to deliver RAB, allowed the removal of the MOD's central cash ledger.

In line with the RAB control framework, MOD has not had a system of Net Cash Control for the last 2 years. Net cash has been a consequence of managing on an accruals basis (using the CAPITAL systems designed to manage on a full RAB basis), and changes in net cash requirements have been flagged through Supplementary Estimates. Near cash continued to be controlled until the end of 2002/3 under Stage 1 RAB.

Short term net cash forecasting and draw down from the BOE is effective and year end control processes exist to ensure that net cash control can be exercised after the Spring Supplementary. This ensures that there is no overspend against the net cash requirement but acts as a fairly crude tool that can only act as a control at the margins. As the MOD has under-spent its net cash requirement (including supplementaries) by £1bn in each of the last two years these processes have not had to be used.

Key Finding 1.4: Whilst there is no Net Cash control, some Net Cash forecasting and management is in place. This is of mixed quality and ongoing development continues.

Sources:

- Interviews
- TLB AP Returns
- Short Term Cash Management - League table of Departmental Performance
- Fleet AP 03 In Year Management Pack.

REVIEW OF MOD CASH MANAGEMENT ARRANGEMENTS

Short Term Net Cash Management
The MOD has processes in place to identify and draw down (net) cash required to meet monthly demands with a high degree of accuracy. This estimate is based on a number of sources of data including information from the Accounts Payable, Payroll and Foreign Imprest systems.

Longer Term Net Cash Management
At the centre there are a number of processes and systems working alongside each other (CLIME, Oracle, Net Cash Requirement Tool, Historic Extrapolation) to manage net cash:

- Oracle and CLIME – (CLIME consolidates data from Oracle and other financial systems used in TLBs) provide actual and forecast net cash figures.
- The NCR tool provides a further forecasting system using OCS and B/S data from Oracle or other TLB financial systems. It is a mandatory tool for use each month by TLBs.
- Historic extrapolation offers an alternative check on forecasts on the basis of past experience.

These tools used together help formulate requests for changes in net cash provision through the Supplementary Estimate process. Although there are differences between the results generated from these tools, due in part to uncertainties in working capital forecasts on a month by month basis, MOD Centre believe that together they provide a sufficiently clear picture for the purpose for which they are used – i.e. forecasting to support the Supply Estimates process. Some TLBs, however, expressed concern over the quality and accuracy of the information generated, others raised concerns over the quality of the inputs, given the TLB's ability to forecast working capital and consumption. These would need to be addressed were there to be a requirement to control net cash.

Some TLBs have developed complex and sophisticated approaches to tracking net cash requirements; others have not.

Whilst there is a net cash spend profile generated by IPTs for the DPA and this is updated throughout the year, it appears that this planned cash flow information is not used as part of the central net cash management process.

The MOD does not have a consolidated commitment accounting ledger (or visibility on purchase orders) and does not have visibility on invoices received (accounts payable) until these have been processed by DBA (this is often well after the accrual should have been recorded). This restricts its ability to assess accruals on a monthly basis and pro-actively to foresee potential cash flow needs and to manage its working capital. However, the AP report, post AP06, does include a section on Committed Expenditure.

REVIEW OF MOD CASH MANAGEMENT ARRANGEMENTS

Key Finding 1.5: The near cash consequences of MOD's plans for 2003/4 were £1.1bn higher than the near cash estimate quoted in the settlement letter from HMT. MOD is now taking action to live within the new near cash control set by the Treasury. However, there is no reliable system for determining with precision the resultant Net Cash requirement, due to the level of working capital within the MOD and the high pace of current operations driving stock consumption.

Sources:

- Interviews
- 2003/04 In Year Management: Issue of Revised Control Totals and Amendment to AP06 Model Submission from DPA to TLBs - 14 Ocober 2003
- SR2002 Guidance
- E-mail from HMT to dated 20th Feb

Summary Chronology:

- Although the Treasury's SR2002 guidance does not differentiate between near cash and non cash for control regime purposes, the MOD's Spending Review bid was prepared on a near cash and non cash basis and did, as required, distinguish between Stage 1 RDEL and AME;

- In early January 2003MOD input the relevant financial data from the initial phase of STP 03 to the PES database for the Main Estimates process. Figures generated automatically by the PES database showed a decrease innon cash resource of £806m. From February 2003, HMT sought to clarify this amount in correspondence with MOD. The Settlement Letter contained an 'estimate of the cash spending associated with SR02 plans for presentational purposes and to allow a reconciliation back to previous plans'.

- 2nd April John Dodds wrote to MOD increasing its near cash and net cash provision by £200m 'without prejudice';

- After discussions between HMT and MOD,a residual non-cash to near cash sum of £490m remained at issue (versus the initial £806m). As part of this MOD said that they had reduced non cash items through good management and that they wanted to re-deploy this to cash. Eventually it was discovered that £170m of the £806m was due to technical adjustments. The remainder of the reduction from £806m to £490m related to planned write-offs which had not actually been implemented.;

- In September 2003 MOD advised the Treasury that the residual £490m had increased to £870m, as a result of further non-cash to near cash transfers. These were identified in the later stages of the STP process, which had been finally completed some months before, but after the Main Estimates had been submitted.

- 2 weeks later MOD advised that the final sum at issue was £1.15bn. The MOD Centre said that this further change was a result of additional analysis and re-calculation and clarification of the assumed SR02 near cash baseline. Treasury said that at this time the

MOD Centre explained that they did not have a full understanding of all the changes made by TLBs, which had resulted in this further reduction in the non cash cost base.

In October 2003, following instruction from HMT, the MOD re-instated Near Cash control. The MOD has made cuts to its near cash plans to bring them into line with the new near cash control totals, but with an agreed flex from non cash to near cash of £400m.

- The Winter Estimate now requests a change against the original RDEL and CDEL Estimate. The additional request is largely for Iraq. This brings with it an increase in net cash close to £1.55bn.

Commentary:

Based on a near cash view of the world the final MODshortfall against the supplementary budget information attached to the settlement amounted to £1.15bn). **The £1.15bn figure was a** consequence of the Resource and Capital DEL plans from the planning round, **not the result of** an in-year forecast or changes.

Action has already been taken to deal with the shortfall including a range of internal adjustments to budgets and Treasury agreement to the 'flex' of £400M from 'non-cash' to 'near-cash' within the overall Resource DEL control. MOD are satisfied that this action will enable them to meet the 2003/04 near cash control total imposed by HMT in September 2003, albeit with significant slippage into 2004/05. .

It is important to note that there are a number of elements included within near cash, which may not impact directly on an immediate cash flow (Net Cash Requirement) eg:

- Stock consumption;
- Working Capital Movements;
- Accruals for assets in the course of construction.
- CDEL implications of on balance sheet PFIs.

History has shown that a near cash control does not necessarily translate to net cash control (the past 2 years have shown variant figures), nor can it be expected to. The overall control framework (RAB and parliament) relies on control of RDEL, CDEL and net cash. However, the experience of the last 2 years suggests that if HMT wish to control PSCE via 'near cash', these controls may not be sufficient.

The MOD does not have a single definitive system to provide a consistent and stable control over the MOD's net cash requirement. Whilst the systems provide forecasts that support the Estimates process, there remain issues with the overall accuracy of the numbers generated. As a result the MOD does not have a common view on how much, if any, of the near cash deficit would have materialised in net cash terms. Whilst the MOD has changed its spending plans there has been no corresponding adjustment to its NCR.But at this time, the MOD has not

asked for an increase in net cash beyond the £1.55bn Winter Supplementary, principally for Iraq and other operations.

The analysis of actual net cash spend to date against previous years' profiles, suggests that there would have been a major shortfall (but this calculation included the cost of Iraq) prior to the costs of operations being covered in the Winter Supplementary Estimates. There is no evidence at the moment that the net cash requirement will need to increase further subject to any necessary net cash cover being provided for £400m near cash flexibility now agreed by HMT and for the previously agreed non-cash to near cash movements included in the Main Estimate. This requirement will need to be considered in the Spring Supplementary Estimates subject to any forecast changes in the working capital movements over the remainder of the year.

It is not clear which (if any) system will prove accurate, although the DGFM suggests that if you look at the scatter of the outputs from the different forecasting tools and take the average then the MOD believe that it will be able to live within the currently agreed net cash requirement as provided through the Main and Winter Supplementary Estimates.

TOR: Examine the division of responsibilities, flow of information and effective financial management between the top level budget holders and MoD centre.

Division of Responsibility

- The structure of finance does not align with key processes but the division of responsibility between the DGFM and DGRP is clearly understood on the ground and the teams work effectively together.
- There is clear communication between the Centre and the TLBs with clear budgetary delegation and effective control and holding to account.

Flow of Information

- The planning data is held in systems owned by the DGFM but the data and process is owned by DGRP. At the end of the planning process the DGFM converts the STP data into an Estimate and enters the relevant data into the PES database. Planning data is loaded to Accounting Operations Systems and is not updated to reflect in year changes.
- Actual financial data is processed through the Accounting Operations systems, which are owned and maintained by DGFM. These are being standardised on Oracle 11i and this is providing greater visibility to the centre.
- Summary data for consolidation is input to CLIME and this provides the information available to the centres of each TLB and the Centre of the Department.
- The centre has access to financial consolidation data from the CLIME and/or Oracle financial systems, which allows the information to be reported and reviewed in a number of ways. Throughout the year the MOD could have reviewed aggregated data in the financial systems on a near cash basis, although there is no suggestion that this has happened and it was not required under RAB Stage 2.
- There is a regular monthly and quarterly flow of information from the TLBs to the DGRP. This includes commentary and analysis and there is a quarterly challenge and review

process to ensure financial control. This builds on the basic information taken from the Accounting Operations systems.

Financial Management

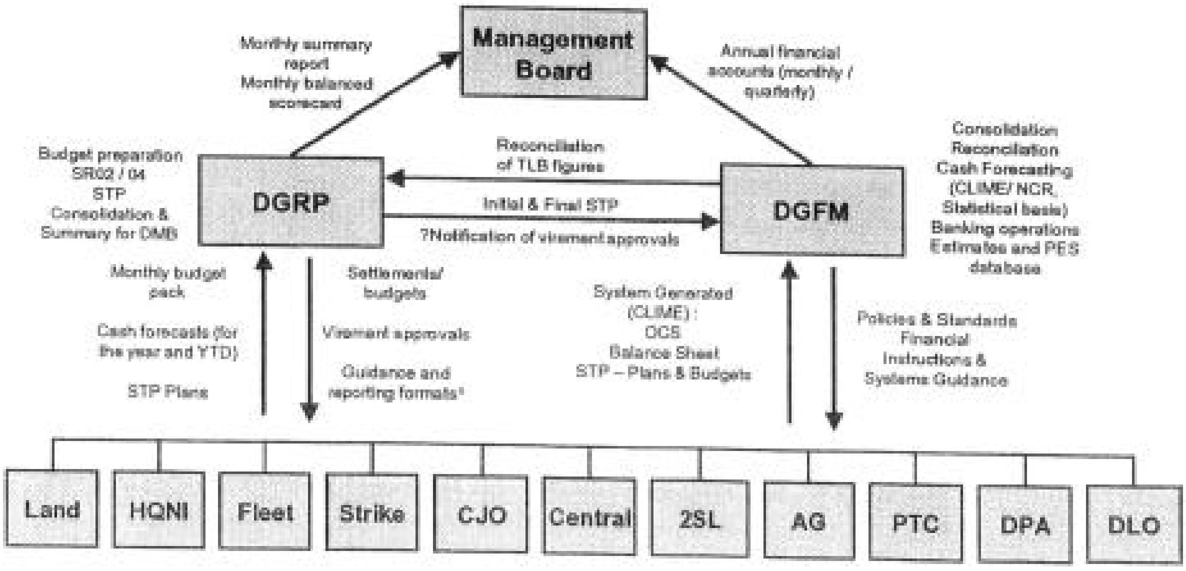
- There are processes and systems in place to ensure that RDEL and CDEL are controlled at the TLB and MOD levels.

Key Finding 2.1: At the start of this year there was direction from the Centre of MOD to TLBs to control RDEL and CDEL and to report back on the impact on net cash. RDEL and CDEL control has been effective.

Sources:

- Interviews;
- AP In Year reporting packs;
- Management Board Pack;
- Finance Organisation Charts
- Terms of Reference for Finance Roles;
- Instructions to TLBs.

The following diagram shows the key information flows and MOD relationships:



[1] Owned by DGRP but issued jointly by DGRP and DGFM (October update issued by DGRP)

The MOD had moved away from stage 1 to stage 2 RAB in its entirety.

Control totals have been cascaded to TLBs on this basis – 12th May letter from D P&A and CFC makes it clear that TLBs are responsible for DEL control total (C and R) not net cash, but

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that on a quarterly basis net cash requirements need to be forecast for central management. The cascade is based on the detailed planning work undertaken as part of the STP. Final plan control totals for 2003/04 were issued to TLBs on March 12 and updated on May 21.

The MOD has effective systems and management processes to ensure that RDEL and CDEL are managed through a clear management cascade. Within TLBs there are clear processes for reviewing and controlling budget variances against RDEL and CDEL. These are supported by reports from the Accounting Operations systems and other sources.

Full variance reports are submitted to the centre of MOD (DPA) by each of the TLBs each quarter. These reports include a full OCS and B/S, variance analysis (including commentary) against the DEL control totals, and information showing the impact of change on the parliamentary controls. For Q1, Q2 and Q3, management meetings are held between the FD and each of the TLBs to challenge performance with the control emphasis directed on the DEL control totals. Thereafter meetings take place onan 'as required' basis.

There is a significant complexity around the MOD's supply chain, and processes are in place to manage centrally asset movements/changes and late equipment deliveries from the Defence Procurement Agency. Virements between TLBs are also managed and signed off centrally and controlled outside of the Accounting Operations systems. This process is well understood.

The MOD has been focused on reducing certain parts of its asset base (stock holding and capital assets) in order to reduce the capital charge and depreciation charged against RDEL. However, there are some areas where control could be improved - e.g. one of the systems that manages stock consumption and returns does not yet fully support the accounting for these items; the accounting framework introduced under RAB for stock is complex requiring revaluation of items to replacement cost; there is no consistent approach to commitment accounting. (Changes to the systems to properly reflect accounting movements should be achieved during 2003/04)

Significant learning is still required across much of the MOD and HMT as it gets to grips with full resource accounting (this is being addressed).

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REVIEW OF MOD CASH MANAGEMENT ARRANGEMENTS

Other Findings.

Key Finding 3.1: The Treasury at the macro level must control PSCE. Treasury has to calculate this using information from the PES database and GEMS. In MOD's case Treasury believes that near cash provides the best surrogate for this.

Sources:
- Documentation on PSCE from Liz Passman
- Interviews

The Treasury controls PSCE in order to help manage public spending and thereby monitor adherence to the fiscal rules. PSCE is a national accounts concept using internationally accepted definitions (as defined in EAS95).

The RDEL, CDEL and NCR framework has been instituted by Treasury as it believes that together they provide the right mix of management incentives and controls against the fiscal rules. This relies on the setting of robust baselines as part of the budgeting process. Significant cash underspends in previous years indicate that the degree of 'tautness' required by Government Accounting requirements may not have been present in MOD Estimates.

Treasury moved the MOD onto a near cash control regime in September responding to its concerns about MOD's controls. At this time there does not seem to be an agreed written definition of Near Cash (although the concept is however widely understood within the MOD and HMT).

History shows that near cash control has not provided a close control of net cash as in the past 2 years the MOD has significantly underspent in cash terms despite operating on this near cash basis. It is unclear how this will impact the final figures for PSCE. Treasury should not, therefore, assume that this will solve the PSCE problem, as there are significant timing differences e.g. around the capital programme and the treatment of stock consumption.

Key Finding 3.2: Treasury and MOD understand the specific requirements of the Resource Accounting and Budgeting Control framework. However, the interaction between RAB and other control regimes is unclear. Since Spring 2003, Treasury in correspondence to the MOD has sought to clarify that cash management remains important and has raised issues relating to both near cash and net cash management.

Sources:
- HM Treasury Secure Intranet Site
- Blue Book
- Government Accounting
- SR 02 Guidelines
- HMT Internet Site on RAB
- 2 April letter from John Dodds to Bruce Mann

REVIEW OF MOD CASH MANAGEMENT ARRANGEMENTS

The Treasury has defined the departmental control regime for 2003/4 based around RDEL and CDEL, with parliamentary control around DELs and net cash requirement.

There is clear guidance in the Treasury documentation, regarding the need for Departments to manage DELs, but these documents are supplementary to previous guidance and rules and do not replace them.

The HMT Government Secure Intranet Consolidated Budgeting Guidance, states in para 21 that in year control is provided through DEL limits set by Treasury. Other publications state that net cash control needs to continue, most notably in Government Accounting section 11 which states that Departments are responsible for planning and controlling the allocation of resources and net cash so that they do not exceed amounts voted by parliament.

For the past 2 years under Stage 1 RAB, the MOD has been controlled by Treasury on a near cash basis (old RDEL) which provided the required fiscal control. With the move to Stage 2 RAB and the removal of near cash (old RDEL) from the control regime, there needed to be a stronger direct focus on net cash to provide the necessary fiscal control.

The MOD's SR02 bid set out Stage 1 AME requirements to allow a new Stage 2 RDEL baseline to be agreed. The SR02 settlement was in terms of RDEL and CDEL though the Settlement Letter did show the estimated near cash consequences of the resource plans and a near cash requirement derived by Treasury, is included within the supplementary budget information to the Supply Estimates. These were to allow reconciliation back to previous plans and for use in presentations but were not themselves part of the RAB control regime. Therefore, at the start of 2003/4, MOD were of the belief that there was no requirement for them to implement a formal cash control (near cash or net cash) regime. While Phase 1 of STP03 was conducted on a Stage 2 RAB basis, old AME (i.e. non-cash) was still broken out separately at that stage.

Key Finding 3.3: There is no End Year Flexibility for net cash as EYF is a budgetary concept There is, therefore, an inconsistency in the treatment of resource and the cash required to fund it. For example, whilst accruals allow for the underlying resource to be consumed in year, the lack of EYF on cash potentially removes the ability to pay.

The absence of end-year flexibility for net cash suggests thatnet cash has not been regarded by the Treasury as part of the RAB Budgetary Control Framework.

Over the past 2 years the MOD has underspent by £1bn net cash (estimates plus supplementaries) each year. As net cash has been described in Treasury's RAB guidance as a consequence rather than a control and the MOD has previously obtained any additional net cash through Supplementaries, there have to date been no practical consequences of having no EYF on cash. Whilst the annual net cash requirement seems to be a consequence of other activities under RAB, the Parliamentary regime maintains annual net cash spend as part of its key controls. For the MOD however, there are legitimate causes of major short term timing differences that have a significant impact on net cash requirements (e.g. issuing stock to the front line before cash is expended on replacing it). An alternative explanation could also be a certain lack of 'tautness' in the original MOD Estimates.

As a result the MOD has concluded that it is able to call upon whatever cash is required to deliver its resource plans and aspirations. The behaviours driven through this approach are consistent with the philosophy of RAB, which seeks to move away from annuality.

Key Finding 3.4: There are a number of factors that have been offered to support the shift from non-cash to near cash.

The following are believed to have a material contribution, although at present only around 1/3 of the overall shift has been definitively identified:

- The QQR review revalued assets downwards at the end of 2002/3, thus reducing non-cash costs in 2003/04, which was reflected in STP03. In theory this released funds for this year as these changes were in the main reflected in STP03. Although these were internally ring fenced within TLBs, the MOD centre re-allocated the non cash savings to near cash headings within the overall RDEL total.

- There was a change to some of the asset lives spreading depreciation over a longer period. This had the effect of reducing depreciation and increasing the capital charge, however, the net effect was to release non cash to be spent on near cash items.

- The MOD has focused on reduction of assets to provide funding for near cash items. This is one of the behaviours that the RAB control framework allows and encourages. Indeed the strategic defence review made assumptions about the MODs underlying asset base shrinking, thereby releasing funds to be re-invested to deliver the strategy.

- The timing of the MOD planning process is not ideal for supporting the Estimates, which means that opening balance sheet values impacting net cash requirements are not known at the planning stage and this impacts the Estimate figures.

- Costs associated with slippage of the Equipment Plan are managed centrally through the ring-fencing provisions. Any slippage can reduce the depreciation charge significantly allowing non cash savings to be used for near cash expenditure.

Other factors considered but not regarded as material:

- The opening cash balance was different to plan. This is not an issue because the MOD does not carry large cash balances and therefore does not carry forward cash.

The MOD planning systems do not directly provide a net cash requirement figure;this is generated by the Estimates team as a consequence of resource plans.

- The treatment of stock used for Iraq meant that consumption happened over the year-end (charged to 2002/3 accounts) with replacement and payment in 2003/4. This was compounded by both the re-credit of stocks not used and the revaluation of stocks to replacement cost based on a 'surge price', resulting in reduced resource consumption in 2003/4. This is separately funded from the Reserve and is therefore not relevant to this discussion.

6. Next Steps

The following issues / questions have been raised both in the presentation of this draft report and with the MOD. We have now received the following responses from MOD:

- Last year's STP planning sought additional non cash RDEL coverage. As MOD were looking at the plan in terms of near cash and non cash at that time, why did they not also identify and flag issues with funding on the cash side too?

Response:

During STP03, a net reduction in the requirement for provision for non-cash items emerged. STP03 was conducted on a Stage 2 RAB basis (i.e. RDEL and CDEL) but for scrutiny purposes, TLBs phase 1 submissions showed non-cash costs within total RDEL. In Dec 2002, MOD undertook a review of TLBs non-cash costs, but thereafter non-cash costs were not tracked separately. The remainder of the STP03 planning process was performed on a RDEL and CDEL basis only. STP / EP 03 were concluded in late Feb03. Main Estimates were submitted to the Treasury in early Jan 03 and a briefing given on the main elements, including cash consequences, in February 03

- During last year's QQR, the DGFM and Guy Lester identified some areas where there was an increase in the asset values, requiring additional funding of non-cash RDEL. Did these increases materialise and was additional RDEL funding provided for these despite the net overall asset value reduction?

Response:

The initial stages of the QQR in late 2002 indicated an increase in valuations, which would have impacted non-cash costs adversely. However, as the QQR progressed it became clear that re-valuations upwards were more than offset by revaluations downward. In 2003/03, £3.8bn of fixed asset impairments was charged to the OCS. In addition, extensions to asset lives further reduced non-cash requirements. These changes were reflected in the STP03 process

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REVIEW OF MOD CASH MANAGEMENT ARRANGEMENTS

- Confirm whether the £1.1bn gap is made up from RDEL and CDEL or whether it is confined to RDEL.

Response:

Of the planned non-cash RDEL reduction, £332m was to be re-invested in CDEL and £820m in RDEL.

- Ascertain from where the data in GEMS is sourced for the MOD submissions

The Treasury GEMS spreadsheet is completed on a monthly basis taking actual data from the CLIME system. Forecast data is based on the latest Supply Estimates figure, i.e. the original figure equates to the Main Estimate figure derived from the STP process. The forecast figures are subsequently adjusted to reflect the Winter Supplementary Estimate and ultimately the Spring Supplementary Estimate. Changes in the final STP figures arising after data is provided for the Main Estimate will therefore be reflected when the Winter Supplementary forecast is input to GEMS.

Other suggested actions flowing from this draft report, or suggested in discussion of this draft report but outside of the Terms of Reference, are:

- An analysis of the detailed causes breakdown of the £1.15bn against the contributory factors shown in this report;
- An analysis of the reasons for previous years' net cash "underspend" and the impact on 03/04 if any;
- A review of the expected and currently forecast net cash and near cash outturn for MOD and identification of the financial impact on PSCE;
- A review of the control regime to confirm: whether net cash or near cash should be used as a surrogate for PSCE; whether net cash, near cash or something else should be used to provide Treasury with comfort that PSCE can be controlled;
- A review of the control regime applied to MOD for the remainder of this year to allow Treasury and MOD priorities to be met.
- Rapid introduction of working capital and net cash control and management guidance processes for MOD – subject to clarification on the Treasury controls above.

CAP GEMINI ERNST & YOUNG

Appendix A

2003 – 2004 IYM REPORTING TIMETABLE INCLUDING CONFLICT PREVENTION RETURNS[1]

Period	Report	CLIME		Conflict Prevention	Detailed Variances	Date Due
		Actuals	Forecast			
AP01	-	With AP03	No	Actuals & FOO	No	-
AP02	-	With AP03	No	Actuals & FOO	No	-
AP03	Quarterly	Yes	Yes	Actuals & FOO	Yes	31-Jul-03
AP04	Monthly	Yes	Yes	Actuals & FOO	No	26-Aug-03
AP05	Monthly	Yes	Yes	Actuals & FOO	No	23-Sep-03
AP06	Quarterly	Yes	Yes	Actuals & FOO	Yes	23-Oct-03
AP07	Monthly	Yes	Yes	Actuals & FOO	Update	25-Nov-03
AP08	Monthly	Yes	Yes	Actuals & FOO	Update	05-Jan-04
AP09	Quarterly	Yes	Yes	Actuals & FOO	Yes	26-Jan-04
Ap10	Monthly	Yes	Yes	Actuals & FOO	No	24-Feb-04
Ap11	Monthly	Yes	Yes	Actuals & FOO	No	23-Mar-04
Ap12	Monthly	Yes	Yes	Actuals & FOO	No	27-Apr-04
Ap13	Monthly	Yes	Yes	Actuals & FOO	No	26-May-04

[1] Extract from 'Control Regime for IYM 2003/04' issued jointly by DGRP / DGFM on 12.05.03

Appendix B

REQUIRED CONTENT OF MONTHLY REPORT[a] – PRE AP06

Part 1 RDEL[1]	RDEL YTD vs Budget with commentary inc management actions taken RDEL Full Year Forecast vs Control Total with commentary inc management actions taken / tobe taken Risk / range assessment
Part 2 OCS	Actuals YTD vs Budget with commentary inc management actions taken Actuals Full Year Forecast vs Control Total with commentary inc management actions taken / tobe taken
Part 3 CDEL[1]	CDEL YTD vs Budget with commentary inc management actions taken CDEL Full Year Forecast vs Control Total with commentary inc management actions taken / tobe taken Risk / range assessment
Part 4 B/S	AP opening & closing balance inc. movement; AP closing balance vsEnd Year Forecast Intangible & Tangible FA;Current Assets; Creditors <1yr; Long term Liabilities (with breakdowns) YTD commentary inc management actions taken Full Year commentary inc management actions taken / to be taken
Part 5 Parl. Control Totals	Net Cash Requirement YTD vs Budget with commentary Net Cash Requirement Full Year vs Control Total with commentary Other (Net Resources, Resource & Non Op A-i-A) YTD vs Budget with commentary Other (Net Resources, Resource & Non Op A-i-A) Full Year vsBudget with commentary
Part 6 AME[1]	AME YTD vs Budget with commentary inc management action taken AME Full Year with commentary inc management action to be taken Risk / range assessment
Part 7 Ring fenced AME	Amt, cost category, event / narrative, stakeholders
Part 8 Transfers	RDEL / CDEL Transfers Exporting / importing TLB, detail, value in, value out
Part 9 Receipts	Major receipts (>£1mn) actual and forecast Item, anticipated / actual timing, amount

[a] Based on 'Control Regime for In-Year Management 2003/04' (issued 12.05.03)

[1] Where appropriate, sections require explanation of any variancesbetween data as reported and CLIME

Appendix C

NEW REQUIRED CONTENT OF MONTHLY REPORT[b] – POST AP06

Part 1a RDEL Direct[1]	RDEL Direct YTD vs Budget inc prior AP comparative and remarks Stock Consumption YTD against Budget inc prior AP comparative and remarks RDEL Direct Full Year vs Control Total inc prior AP comparative and remarks Stock Consumption Full Year vs Control Total inc prior AP comparative and remarks YTD commentary inc management actions taken Full Year commentary inc management actions taken / to be taken Risk / range assessment
Part 1b RDEL Direct[1]	RDEL Indirect YTD vs Budget inc prior AP comparative and remarks RDEL Indirect Full Year vs Control Total inc prior AP comparative and remarks YTD commentary inc management actions taken Full Year commentary inc management actions taken / to be taken Risk / range assessment Ring fenced items
Part 2 OCS	Actuals YTD vs Budget with commentary Actuals Full Year Forecast vs Control Total with commentary inc (OCS breakdown includes subtotals for RDEL Direct, Stock Consumption, RDEL Indirect, AME and Other)
Part 3 CDEL[1]	CDEL YTD vs Budget inc prior AP comparative and remarks CDEL Full Year vs Control Total inc prior AP comparative and remarks YTD commentary inc management actions taken Full Year commentary inc management actions taken / to be taken Risk / range assessment
Part 4 B/S	AP opening & closing balance inc. movement; AP closing balance vs End Year Forecast Intangible & Tangible FA; Current Assets; Creditors <1yr; Long term Liabilities (with breakdowns) YTD commentary inc management actions taken Full Year commentary inc management actions taken / to be taken
Part 5 Monthly Control Total Summary	Treasury Controls - RDEL, CDEL, AME Other Parliamentary - Net Resources, Net Cash Requirement, Resource & Non Op A-i-A YTD Actual vs Budget; Full Year vs Budget
Part 6 Parliamentary Control Totals	Net Cash Requirement - YTD commentary Net Cash Requirement - Full Year commentary Resource & Non Op A-i-A - Commentary

REVIEW OF MOD CASH MANAGEMENT ARRANGEMENTS

Appendix C (cont'd)

Part 7 AME	YTD vs Budget Full Year vs Budget
Part 8 Uncommitted Expenditure	Summary and split by RDEL / CDEL with breakdown
Section 2	Agreed Responsibility Transfers -Summary
Section 3	Major Receipts by Month - Actual and Forecast
Section 4	Quality Assurance & IYM Issues Log
Section 5	Agreed Responsibility Transfers- Detail

- Based on '2003/04 In-year management: Issue of revised control totals and amendment to AP06 model submission' (issued 14.10.03) and actuaDLO submission for AP06
- Where appropriate, sections require explanation of any variancesbetween data as reported and CLIME

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