Defence Procurement Agency

Annual Report and Accounts 2006/2007

DPA

Equipping the Armed Forces

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Contents

Annual Report

Accounts

Foreword

By the *Accounting Officer*

I am very pleased to report that in its final year of operation as an Agency, prior to its integration into Defence Equipment and Support (DE&S), the Defence Procurement Agency (DPA) succeeded in meeting all of the Key Targets set for it by Ministers for the second year in succession.

The DPA also, for the second year in succession, met the more challenging targets associated with the Departmental Public Service Agreement (PSA) for procurement, which is negotiated with HM Treasury and reflects the outcomes of Spending Review 2004.

This is a tremendous achievement, not just for the Agency, but for the MoD and sets the standard for the work of Defence Equipment and Support.

These successes could not have been accomplished without the work, commitment and determination of a great many people in MoD and Industry.

The targets for 2006/2007 were more challenging than in previous years – taking into account the need for continuous improvement. The first three Key Targets covered Performance, Time and Cost for all Category A, B and C projects that had passed their Main Gate approval but were yet to achieve their In-Service Date. There were 42 projects meeting the criteria. Key Target 4 (Asset Deliveries) and Key Target 5 (Efficiency) were based on the Agency as a whole. All targets were met.

Throughout the year the DPA Board closely monitored performance data on a monthly basis and, whilst the targets for Time and Asset Deliveries were seen to be potential risks at various points in the year, appropriate management action ensured that targets were subsequently met.

It was the cost growth identified early in the year that was seen to be most problematic, with Key Target 3 consistently classified at red throughout most of the year. A combination of DPA management action and development of alternative courses of action ensured that this cost growth was mitigated, all of which involved considerable effort by both DPA Integrated Project Team (IPT) and Support Group (SG) staff, to accurately identify the scale of the growth and then to assist with developing the strategies for its subsequent removal in conjunction with the former Defence Logistics Organisation (DLO), the Sponsor (Equipment Capability) and the User (Front Line Commands).

Performance Management continues into the future within the Defence Equipment and Support organisation under the Directorate of Corporate Performance and Risk, taking the best of the DPA and DLO practice with the development of a sound and robust performance structure against which to manage the performance of the new organisation.

All of the Agency's former staff should be proud of this performance – as should their colleagues in MoD and Industry who have an equal share in our success – a success that I am confident gives Defence Equipment and Support an excellent start as it faces the challenges the future will bring.

David Gould | **Accounting Officer**
22 June 2007

Our Mission:

To equip the Armed Forces

The Defence Vision:

Defending the United Kingdom and its interests

Strengthening international peace and stability

Defence Values for Acquisition:

By working together across all the Lines of Development, we will deliver the right equipment and services fit for the purpose required by the customer, at the right time and the right cost. In delivering this vision in acquisition, we all must:

- recognise that **people are the key to our success;** equip them with the right skills, experience and professional qualifications;
- recognise the **best can be the enemy of the very good;** distinguish between must have, desirable, and nice to have if affordable;
- identify **trade-offs between performance, time and cost;** cases for additional resources must offer realistic alternative solutions;
- **never assume additional resources** will be available; cost growth on one project can only mean less for others and for the front line;
- understand that **time matters;** slippage costs – through running on legacy equipment, extended project timescales, and damage to our reputation;
- think **incrementally;** seek out agile solutions with open architecture which permit 'plug and play'; allow space for **innovation** and the application of best practice;
- **quantify risk** and reduce it by placing it where it can be managed most effectively; stopping a project before Main Gate can be a sign of maturity;
- **recognise and respect the contribution made by Industry;** seek to share objectives, risks and rewards while recognising that different drivers apply;
- valuing **openness and transparency;** share future plans and priorities wherever possible to encourage focused investment and avoid wasted effort;
- embed a **through life culture** in all planning and decision making;
- value **objectivity** based on clear evidence rather than advocacy; ensure that we capture past experience and allow it to shape our future behaviour;
- realise that **success and failure matter;** we will hold people to account for their performance.

Executive Summary

The accounts which follow cover the period 1 April 2006 to 31 March 2007 and have been prepared in accordance with a Treasury direction, dated 13 January 2006, in accordance with Section 7[(2)] of the Government Resources and Accounts Act 2000.

History and Background

The Agency was established on 1 April 1999 as an Executive Agency of the Ministry of Defence.

Performance Targets

Key Targets are set out in the Agency's Corporate Business Plan and are agreed by Ministers. Details of the Agency's performance against these targets are set out on *pages 12, 13 and 14*.

Principal Activities

The principal activities of the Agency are:

- providing a full project management function: undertaking studies and assessments of cost, time and risk to inform investment decisions, preparing specifications, placing and managing acquisition contracts, monitoring industry's deliverables and managing integrated, multi-disciplinary project management teams;
- in conjunction with other Departmental areas with an acquisition role, developing and maintaining acquisition strategies and expertise and advising Ministers on these and related procurement matters;
- maintaining specialist expertise associated with its core functions, for example in the fields of commercial and technical standards, and disseminating guidance on those activities for which the Agency has, by agreement, taken the lead within the Department;
- within the capacity determined by its core tasks, supporting defence exports by assisting the Defence Export Services Organisation and industry on appropriate financial terms;
- improving communication and liaison between MoD, industry and other organisations by means of steadily improving business processes and the establishment of a shared information environment;
- working with suppliers to achieve best overall value for money and, subject to this, helping sustain a strong defence industrial base which can continue to meet the needs of UK defence policy;
- promoting international collaboration in defence procurement and associated activities, wherever such a course is compatible with broad Government policies and value for money aims.

Fixed Assets

The changes in fixed assets during the year are summarised in *notes 9, 10 and 11*.

Research and Development

Research and Development expenditure is incurred on the development of new fighting equipment and the improvement of existing fighting equipment. The amount spent on Research is generally not capitalised and is shown in Other Operating Costs. *Refer note 5*. However, where the conditions of the relevant accounting standard (FRS 15) are satisfied, and with the agreement of the DPA Finance Director about certainty, pre-Main Gate expenditure may be capitalised. Development expenditure incurred during the year is included in Intangible Fixed Assets and shown in *note 9*.

Management

Members of the Executive Board during the year were:

Sir Peter Spencer	*Chief Executive*
David Gould	*Deputy Chief Executive*
Dr Iain Watson (from 1 April 2006 to 31 December 2006)	*Director Information Superiority*
Mr George Gardiner (from 1 January 2007)	*Director Information Superiority*
Major General Andrew Figgures (from 1 April 2006 to 16 June 2006)	*Technical Director*
Rear Admiral Simon Henley (from 17 June 2006)	*Technical Director*
Jonathan Lyle	*Director Air & Weapons Systems*
Rear Admiral Ric Cheadle (from 1 April 2006 to 12 April 2006)	*Director Land & Maritime*
Dr Andrew Tyler (from 1 May 2006)	*Director Land & Maritime*
Gordon Croy (from 1 June 2006)	*Commercial & Supplier Relations Director*
David Noble	*Finance Director*
Rear Admiral Andrew Mathews (from 1 April 2006)	*Director General Nuclear*
Steve McCarthy (from 1 April 2006)	*Strategy Director*
Professor Tom McGuffog (from 1 April 2006 to 6 June 2006)	*Non-Executive Director*
Dr George Watkins	*Non-Executive Director*
Wendy Barnes	*Non-Executive Director*
Lord Denis Tunnicliffe (from 1 August 2006 to 31 March 2007)	*Non-Executive Director*

The Chief Executive was appointed through open competition for a term of three years, (May 2003 – April 2006). The fixed term was extended by two years to April 2008 but the post ceased to exist after 31 March 2007 following the creation of DE&S. The Chief Executive's appointment and termination is in line with other senior MoD appointments.

Details of remuneration and any other significant interests of the members of the Management Board are given on *pages 18 to 22*.

Employee Policy

The DPA operates a policy of equal opportunity for all staff and potential recruits, regardless of gender, marital status, ethnic origin, religion, sexual orientation, disability or anything else unconnected with an individual's ability to do their job.

The MoD is part of the Principal Civil Service Pension Scheme (PCSPS) and the Armed Forces Pension Scheme (AFPS). Further details are contained in *Note 1.16*.

We are also a Family Friendly employer. We have a Family Friendly website on our intranet designed to bring together all relevant information, clarifying the various flexible working patterns, providing information for people with parental or other caring responsibilities, and encouraging networking amongst staff.

The Abbey Wood site has a large workplace nursery with 100 full time equivalent places, providing day care facilities for children aged between 3 months and 5 years, at very attractive rates.

Employee Involvement

The DPA is committed to excellent and regular working relations with the Trades Unions, through both the formal consultation and the Whitley processes, and more informal day to day liaison. In addition, the DPA continues to seek to maximise communication channels to employees in order to involve them in the decision-making processes of the Agency. Various methods, including regular in-house news letters and bulletins, Chief of Defence Procurement's (CDP's) Business Improvement Seminars, cascade management briefings, Trades Union consultation and widespread training programmes are used to achieve this aim. The DPA systematically listens to its staff and conducts an annual staff survey, which contributes to its programme of continuous improvement.

Diversity

We continue to strive towards an environment in which all people are treated fairly and with respect through equality of opportunity, fairness and freedom from harassment, bullying, discrimination and stress, by valuing their differences and by facilitating good work/life balance.

Development and Training

The training and development of staff remains a priority with investment being directed at individuals gaining business related competences to meet the requirements of the Agency.

More and more emphasis is being placed on increasing the professionalism of our staff, particularly in the Commercial and Project Management areas.

DaLearning, the DPA funded centre for acquisition training, has built on the success of previous years and provided 22,250 student days training in financial year 2006/2007. This figure comprises 21,368 days of classroom training and 882 days of e-learning. Offsite delivery has continued to increase in the year with more training being taken to customers particularly at Wyton and Andover to meet particular requirements.

A total of 1,237 delegate days of acquisition training were delivered under the wider markets initiative, with a reduced but continuing commitment to deliver the Commercial Foundation Programme to BAE Systems.

Whilst the delivery of training has remained relatively constant, 2006/2007 was a significant year for training development with the launch of the Commercial Awareness Practitioner Programme Blended Learning (a combination of e-learning and activity based workshops) in September 2006. This has reduced the overall number of classroom delegate days, with workshops being reduced from 10 days to 4. Early evaluations of the e-learning indicate that delegates prefer having the ability to learn at their own pace.

Development Partners

A key element of our 'DPA Forward' programme was the establishment of a 'Development Partner' network, comprising senior experts in each of our primary functions, including project management, various technical specialisations, secretariat, commercial and finance. Development Partners have an important role to play in defining the size and shape of their functional areas, both now and in the future, and in helping to ensure that the supply of functional skills matches demand. They also serve to provide guidance on career paths and anchors to those in their functional areas; to act as sponsors of Continuous Professional Development (CPD) and to inspire individuals to pursue development opportunities. CDP jointly with the Chief of Defence Logistics (CDL) re-launched the 'Development Partner' initiative across the DPA and the Defence Logistics Organisation (DLO) in October 2005. This initiative feeds into MoD HQ led work on implementing the wider professionalising Government agenda.

Health and Safety

The Agency is committed to full compliance with all legislation in respect of our staff and buildings and equipment delivered to the Armed Forces.

Investors In People (IIP)

The Agency achieved IIP re-accreditation in July 2004. Our commitment to continue to meet or exceed the IIP standard is a key component of our drive for continuous improvement and will continue to be so within the merged DE&S organisation.

Payments to Suppliers

The Agency aims to ensure that all invoices not in dispute are paid within 30 days or in accordance with contractual terms if otherwise agreed. For the financial year ended 31 March 2007 99.95% of correctly presented bills were paid within 11 calendar days.

Environmental Policy

The Agency is committed to compliance with both the letter and spirit of the Environmental Protection Act and the Environment Act (which apply to all personnel, service and civilian) and with all other existing environmental legislation. Crown or Defence exemptions from legislation are only invoked when these are essential to operational effectiveness.

Political and Charitable Donations

The DPA does not make political or charitable donations.

Auditors

The Financial Statements for the Agency are audited by the Comptroller and Auditor General under Section 7[(2)] of the Government Resources and Accounts Act 2000. The Key Target results on page 13 are also validated by the National Audit Office. A notional audit fee of £230,000 has been disclosed in respect of the statutory Audit Services. The auditors did not undertake any non-audit services. The Auditor's Certificate and Report on the Financial Statements is set out on *pages* 28 & 29.

Statement on Disclosure to Auditors

As far as the Accounting Officer is aware there is no relevant audit information of which the entity's auditors are unaware and he has taken all appropriate steps to make himself aware of any relevant audit information and to establish that the entity's auditors are aware of that information.

Overview of the Year

Equipment Deliveries

The Defence Procurement Agency delivered new equipment valued at more than £4.9Bn in the financial year 2006/2007. Eleven projects were accepted into service. Key milestones included:

- delivery of three 16,000 tonne auxiliary landing ships (*RFA Mounts Bay, RFA Largs Bay and RFA Cardigan Bay*);
- delivery of the Guided Multiple Launch Rocket System on schedule, with its associated Future Fire Control System, now due for operational deployment;
- delivery of Bulldog armoured vehicles to troops on operations. Deliveries are continuing;
- delivery of Titan and Trojan armoured vehicles to the Royal Engineers under the £250m Engineer Tank Systems project. Deliveries of these vehicles are continuing;
- delivery of 10,700 Bowman tactical communications systems with a value of £380m and other infantry weapons and equipment;
- continued delivery of Javelin anti-armour missiles and equipment;
- delivery of a number of Urgent Operational Requirements, including Automatic Lightweight Grenade Launchers to soldiers on operations;
- delivery of Rapier air defence missiles;
- delivery of 16 Typhoon combat aircraft and associated equipment to a value of £1.6Bn;
- continued delivery of the very advanced Storm Shadow Conventionally Armed Stand Off Missile;
- delivery of an initial batch of Advanced Medium Range Air to Air Missiles to enhance the capability of both the Typhoon and Tornado F3 fleets;
- delivery of the last of a fleet of 357 wheeled fuel and water tankers for all three Services.

Projects obtaining Main Gate Approval:

- twelve sophisticated Nimrod MRA4 patrol aircraft were ordered under a £1.1Bn contract;
- MoD entered a Strategic Partnering Arrangement and Business Transformation Incentivisation Agreement with AgustaWestland, placing a £1Bn contract for 70 Future Lynx helicopters;
- a £450m contract for 28 Hawk 128 Advanced Jet Trainers was placed;
- MoD contributed £325m to an £830m programme with Typhoon partner nations to transform the aircraft by providing it with advanced multi-role capabilities, and placed a £73m contract to equip Typhoon for autonomous all weather precision ground attack strike;
- MoD placed a £300m contract for the provision of a 20 year service covering aerial targets for the armed forces;
- MoD increased the supply of battlefield helicopters under contracts valued at up to £235m for six new Merlin aircraft and the conversion of eight Chinook Mk3s to the battlefield support role;
- MoD ordered a fifth C-17 transport aircraft and agreed that MoD will buy out leases on the RAF's four existing C-17s in 2008;
- MoD placed a £65m contract for new design more effective robot bomb disposal vehicles;
- a £56m contract for advanced new targeting pods for Typhoon aircraft was awarded.

Other highlights included:

- launch of the second Type 45 destroyer, *HMS Dauntless*, one of six either on order or under construction for the Royal Navy;
- launch of the first new generation Skynet 5 strategic communications satellite under a ground-breaking Private Finance Initiative deal;
- delivery of the first Airborne Stand Off Radar aircraft plus associated ground equipment to support the aircraft with an initial value of £428m;
- a £140m contract to refine and develop the design of the Future Aircraft Carrier was placed;
- MoD placed a £127m contract for a technology demonstration programme named Taranis, to investigate key technologies for next generation unmanned air vehicles;
- MoD signed a Memorandum of Understanding for the Production, Sustainment and Follow-on Development for the next phase of the Joint Combat Aircraft project;
- MoD placed a £250m contract for more than 2,000 new design versatile trucks to support the Armed Services.

Statement of Achievement against Key Targets

We measure our achievement against Key Targets, which are the drivers for the achievement of the targets set by the Treasury through the Public Services Agreement. Our Key Targets set a significant challenge for the Agency, focusing upon the performance of all projects with procurement costs valued over £20m.

Key Targets 1, 2 and 3 cover our achievement on the three principal project measures of performance, time and cost. Key Target 1 measures our ability to deliver equipment to the customer at the required technical performance. It compares the number of approved Key Requirements against the number which are forecast to be, or have been, met. Key Targets 2 and 3 measure in-year average programme slippage and cost growth. The projects monitored for these Targets were all projects valued at greater than £20m, which had passed their main investment decision point (Main Gate), but not yet achieved their In-Service Date (ISD) as at 1 April 2006. These are agreed with the National Audit Office (NAO) and the Key Target results are validated by the NAO. Performance against the Key Targets is shown in the table on *page* 13.

Results

Key Target 1: Equipment Performance

Achieved – The target for achievement of projects' core requirements was 97%. We achieved 99%.

Key Target 2: Programme Slippage

Achieved –To achieve this target, average new slippage had not to exceed 0.9 months during the course of the financial year. Actual average new slippage recorded was 0.5 months, this equates to a total cumulative slippage of 19 months across the project population.

Key Target 3: Cost Growth

Achieved – To achieve the target, average new cost growth had not to exceed 0.5% during the course of the financial year. Actual cost grew by an average of 0.0%.

Key Target 4: Asset Deliveries

Achieved – This Key Target covers the achievement of forecast asset deliveries in-year. The target required the Agency to deliver greater than 93%, by value, of its forecast Asset Deliveries for the year. This year the Agency delivered 102% of its forecast Asset Deliveries.

Key Target 5: Efficiency

Achieved – In 2004/2005 the Agency introduced three measures covering its efficiency. The Key Target requires the Agency to stay within the boundary set by each of the three ratios set out below.

Measure i) Asset Turnover in months. The target level for this measure was set at less than 52 months, actual achievement in year was 49 months.

Measure ii) Assets Delivered per £ of Operating Cost. The target level for this measure was set at greater than £15.44, actual achievement in year was £18.11.

Measure iii) Assets Produced per £ of Operating Cost. The target level for this measure was set at greater than £18.01, actual achievement in year was £20.26.

Other Measures

The achievement of a more detailed range of objectives is vital to our customers and other stakeholders. We therefore have targets and measures of performance in our Business Plan, which complement the Key Targets and ensure coverage of key supporting activities.

Key Targets

Key Target (KT)	02/03	03/04	04/05	05/06	06/07
			Outturns & Achievements		
KT1[1]					
Predicted achievement of Key User Requirements	97%	98%	97%	97%	97%
Outturn	99%	99%	99%	97%	99%
PSA Target				97%	97%
Outturn				97%	99%
KT2[1]					
Average in-year variation of forecast In-Service Date not to exceed (months)	0.4	0.5	0.9	1.0	0.9
Outturn	7.2	2.4	0.9	0.7	0.5
PSA Target (DPA Stretch Target)				0.7	0.5
Outturn				0.7	0.5
KT3[1]					
Average in-year variation of forecast cost not to exceed	0.0%	0.0%	0.5%	0.6%	0.5%
Outturn	5.4%	2.7%	-2.2%	0.2%	0.0%
PSA Target (DPA Stretch Target)				0.4%	0.3%
Outturn				0.2%	0.0%
KT4[2]					
Achievement of planned in-year asset deliveries			85%	>90%	>93%
Outturn			100%	107%	102%
KT5[2]					
Achievement of planned efficiency measures					
Measure i): Asset turnover (Months)[3]			<70	<83	<52
Outturn			59	72	49
Measure ii): Assets delivered per £ of Operating Cost[3]			>£10.72	>£13.20	>15.44
Outturn			£14.36	£15.23	£18.11
Measure iii): Assets delivered per £ of Operating Cost[3]			>£16.23	>£23.16	>18.01
Outturn			£19.13	£23.83	£20.26

Notes:

1. Prior to April 2004 the Agency calculated results of Key Targets 1 to 3 against the 20 largest projects for which the major investment decision had been made ("Main Gate"). Key Target 2 and 3 variation compared 50% confidence forecasts against the 90% confidence forecast at Main Gate. From 1 April 2004 the Agency expanded the population of projects covered by Key Targets 1 to 3 to include all projects valued at over £20m ("Category A-C") for which the major investment decision had been made ("Main Gate") and which were not yet in service at the start of the financial year. Furthermore the calculation of Key Target 2 and 3 now compares the 50% confidence forecast against the 50% confidence forecast at the 1 April of the financial year.

2. Key Targets 4 and 5 were introduced in 2004/05.

3. Targets for Key Target 5 Measures i), ii) and iii) are set at the outset of the corresponding financial year.

"Operating cost" includes staff costs and certain other staff related costs as agreed when the targets were set.

Report by the Comptroller and Auditor General on the Defence Procurement Agency's Statement of Performance against 2006/2007 Key Performance Targets

The Deputy Chief Executive of the Defence Procurement Agency has asked me to validate performance against the 2006/2007 Key Targets.

Respective responsibility of the Defence Procurement Agency, the Deputy Chief Executive and the Auditor

The Defence Procurement Agency and the Deputy Chief Executive are responsible for the measurement and reporting of the Agency's performance against the Key Targets.

I examine and conclude on whether the Agency has:

- Provided full details of performance against all the Defence Procurement Agency's Key Targets;
- Ensured that all performance information is reliable and fairly presented.

Basis of conclusion

The validation includes an examination, on a test basis, of evidence relevant to the amounts and disclosures of the outturns and achievements included within the Statement. It also includes an assessment of the significant judgements and methodologies made by the Defence Procurement Agency and Deputy Chief Executive in the Statement's preparation.

Conclusion

The Statement of Performance above includes all the Defence Procurement Agency's 2006/2007 Key Targets and it reliably and fairly presents the Agency's performance against the Key Targets 1 to 5. I have no observations to make on this Statement.

John Bourn

John Bourn | **Comptroller and Auditor General**
National Audit Office
157-197 Buckingham Palace Road
Victoria
London SW1W 9SP
26 June 2007

Financial Summary

The DPA has successfully completed its eighth and final year as an Agency. The Agency met all of its Key Targets set by Ministers for the second consecutive year since formation. We also delivered against the MoD's Public Service Agreements Targets for the second time – targets set independently by HM Treasury for acquisition.

We continued to reinforce our financial scrutiny and assurance processes supported by improvements in financial information and systems as a means of demonstrating that what we are doing represents best value for money and is consistent with good governance.

Integrated Project Team (IPT) Team Leaders, supported by the professional skills and strength of Financial Controllers in each team, continue to be at the heart of financial management, with supporting accounting services provided centrally. Our main focus is to maximise outputs to support operations and ensure all our acquisition decisions are based on comprehensive and reliable figures.

We are striving to find ways of reducing the burden of financial management and develop, or rather use to greater effect, the management accounting that will drive the new organisation forward. To do this we must have the right people in the right place with the skills – which will require flexibility in how we resource individual teams. Even greater professionalism, more recruitment – both internal and external – and more training are all high on the agenda for future years.

To complement the MoD accountancy training scheme, DPA has extended the programme of recruitment of graduate trainee accountants who are currently undertaking a concentrated and comprehensive managed training programme.

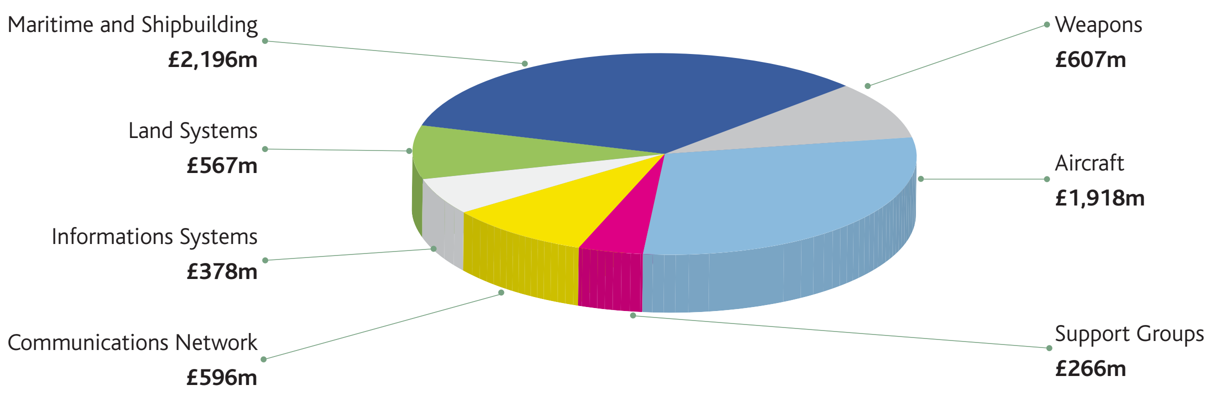
The creation of DE&S will enable us to make through life financial management more efficient and effective with a single financial planning and management system based on optimising the long term benefits to Defence.

The Agency's Programme

The Agency's programme has two parts:

- Equipment Procurement – purchase of new equipment systems and associated weapons, including some major upgrade programmes and system procurement expenses such as studies. Total expenditure for 2006/2007 was £6,528m (2005/2006: £5,931m).
- Agency Operating costs and Nuclear Programmes – Expenditure in 2006/2007 was contained within the planned levels reported to Parliament through the Supply Estimates and within allocations set by the Department.

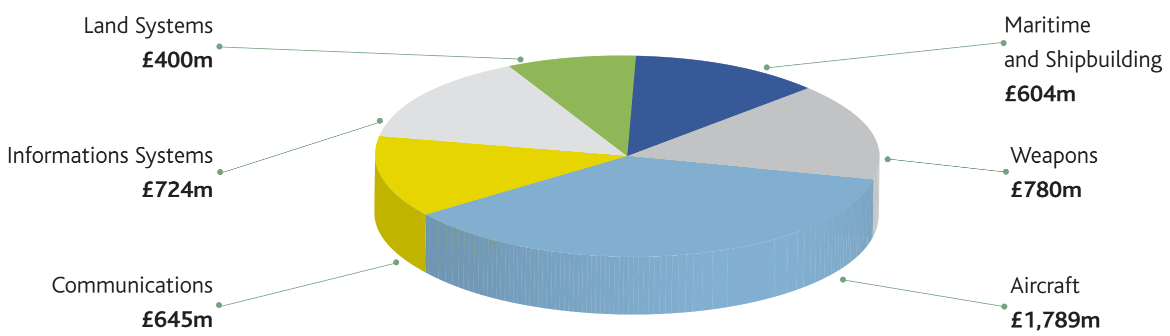
Expenditure in Resource Terms by Cluster Group £6,528m



Asset Deliveries 2006/2007

Equipment delivered to Armed Forces customers amounted to £4,942m for the 2006/2007 financial year as shown below.

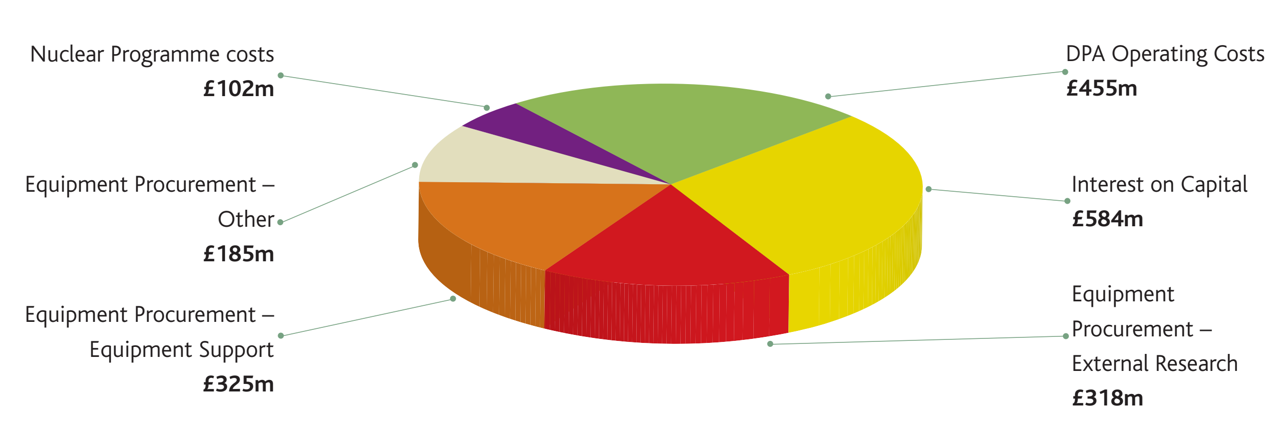
Asset Deliveries £4,942m



Operating Costs and Nuclear Programme

Operating costs of £1,969m in 2006/2007 consisted of £455m to run the Agency including staff costs of £258m (including provisions), £102m spent on the Nuclear Programme (significantly less than 2005/06 owing to a reduction of £532m in the nuclear decommissioning provision) and £1,412m for Equipment Procurement and interest on capital.

Analysis of Net Operating Costs after Interest **£1,969m**

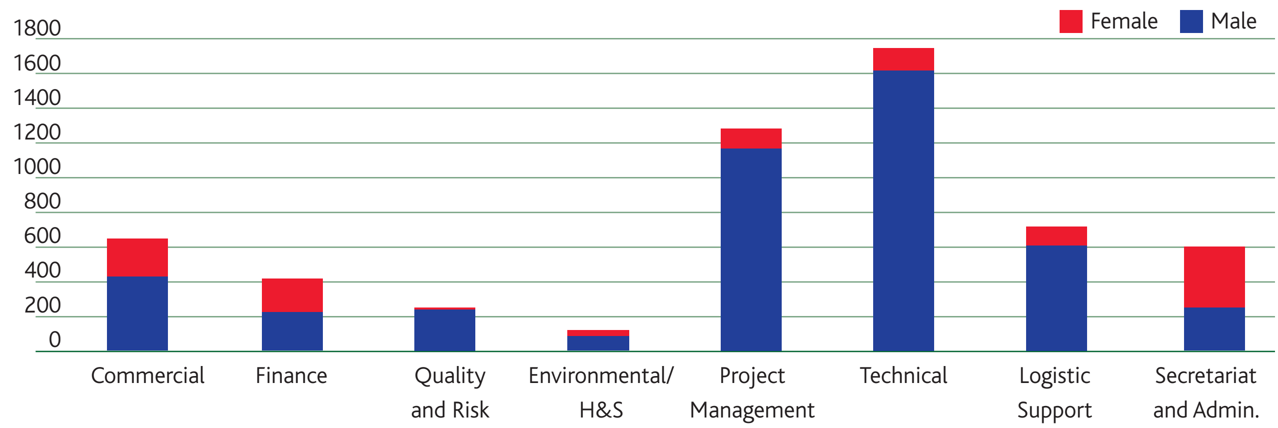


People

As at 31 March 2007 the Agency employed 5,594 people made up of 1,116 Service Personnel, 4,460 Civilians and 18 Agency staff.

Total number of male:	4,476
Total number of female:	1,118
Total	5,594

DPA Staff at 31 March 2007 by Role and Gender



Remuneration Report

Introduction

The DPA Agency Accounts seek to comply with the disclosure practices applicable to companies in the private sector and as set out in the Greenbury code on corporate governance. The level of disclosure sought has recognised the differences between private sector directors and the directors that comprise the DPA Executive Board.

The DPA Executive Board is composed of Senior Civil Servants, senior officers of HM Forces and three Non-Executive Directors. Contracts of service including early termination for Senior Civil Servants and senior officers of HM Forces are in line with other senior MoD positions. There has been no significant award in respect of early termination made to past senior managers.

Unlike private sector directors, civil servants and officers do not determine their remuneration package. There is no Remuneration Committee; however, Senior Civil Service pay is determined by the Senior Salaries Review Board. In particular civil servants do not qualify for the large elements of variable pay which were of particular concern to the Greenbury Committee. Annual bonuses and awards are not linked to the achievement of key targets or any other corporate performance conditions. They are awarded under normal Civil Service conditions.

The Executive Board

Where appointments to the Board were made after the beginning of the financial year (1 April 2006), details are disclosed relating to their period of office only. Similarly, where Board members left before the financial year-end (31 March 2007), only details up to departure are disclosed.

Remuneration of DPA Executive Board during the Year

(this section of Report is subject to audit)

The salary and pension entitlements of the most senior members of the DPA were as follows:	Age at 31 March 2007	Salary for period of DPA appointment[1] 2006-07 £000	2005-06 £000
Sir Peter Spencer	59	140-145	135-140
Chief of Defence Procurement and Chief Executive			
David Gould	57	140-145	135-140
Deputy Chief Executive			
Dr Iain Watson	59	85-90	90-95
Director Information Superiority (from 1 April 2006 to 31 December 2006)			
Full year equivalent salary		105-110	
George Gardiner	51	15-20	–
Director Information Superiority (from 1 January 2007)			
Full year equivalent salary		75-80	–
Major General Andrew Figgures	56	20-25	95-100
Technical Director (from 1 April 2006 to 16 June 2006)			
Full year equivalent salary		105-110	
Rear Admiral Simon Henley	50	70-75	–
Technical Director (from 17 June 2006)			
Full year equivalent salary		90-95	
Jonathan Lyle	48	90-95	80-85
Director Air & Weapons Systems			
Rear Admiral Ric Cheadle	57	0-5	90-95
Director Land & Maritime (from 1 April 2006 to 12 April 2006)			
Full year equivalent salary		95-100	
Dr Andrew Tyler	39	125-130	–
Director Land & Maritime (from 1 May 2006)			
Full year equivalent salary		135-140	
Gordon Croy	52	See note[2]	–
Commercial & Supplier Relations Director (from 1 June 2006)			
David Noble	51	110-115	105-110
Finance Director			
Rear Admiral Andrew Mathews	48	90-95	–
Director General Nuclear (from 1 April 2006)			
Steve McCarthy	48	70-75	–
Strategy Director (from 1 April 2006)			
Prof Tom McGuffog*	66	0-5	30-35
Non-Executive Director (from 1 April 2006 to 6 June 2006)			
Dr George Watkins*	63	15-20**	15-20
Non-Executive Director			
Wendy Barnes*	50	20-25**	20-25
Non-Executive Director			
Lord Denis Tunnicliffe*	64	5-10	–
Non-Executive Director (from 1 August 2006 to 31 March 2007)			

** Prof Tom McGuffog, Dr George Watkins, Wendy Barnes and Lord Denis Tunnicliffe are employed on a fixed term contract renewable by agreement. They are not employed as civil servants and are not members of the Principal Civil Service Pension Scheme (PCSPS).*
*** This included payments to both non-executive directors of £2.4k relating to fees for 2005/2006.*
Sir Peter Spencer received an early retirement package under the terms of the Civil Service Compensation Scheme.

[1] Salary, in bands of £5,000, includes gross salary, performance pay (paid in year but based on performance in an assessment period ended prior to start of the financial year) and allowances paid.
[2] Gordon Croy is not a Civil Servant but employed through a manpower substitution contract at a cost to the DPA of £287,709 for 2006/07.

Board Members' Salary

'Salary' includes gross salary, performance pay or bonuses, overtime, reserved rights to London weighting or London allowances, recruitment and retention allowances and any other allowance to the extent that it is subject to UK taxation.

Benefits in kind for 2006/2007

Benefits in kind were paid to the following Executive Board members:

	2006-07 Benefits in Kind (to nearest £100)	2005-06 Benefits in Kind (to nearest £100)
Sir Peter Spencer *Chief Executive*	56,300	29,400
David Gould *Deputy Chief Executive*	41,000	17,600

Benefits in kind figures for civilian Board members represent the value obtained from the private use of official cars, and for Service members the value obtained from the use of Official Service Residence. Official cars for Service Board members do not constitute a Benefit in Kind as residence to place of duty travel is not deemed to be private use. The MoD has an arrangement with the HM Revenue and Customs where MoD pays the tax liability that would ordinarily be paid by the individual. The tax liability is therefore included in the figures disclosed to arrive at the full 'value' of the benefit to the individual.

Significant Interests

David Noble is a deferred pensioner of Rolls-Royce plc as a result of his 16 years service with the company prior to joining the MoD. All other Executive Board members have confirmed in writing that they individually have no company directorships or other significant interests held which may conflict with their management responsibilities.

Board Members' Pensions

	Real increase in pension at pension age (in bands of £2,500) £000	Total accrued pension as at 31 March 2007 (in bands of £5,000) £000	CETV at 31 Mar 07 or date left DPA Executive Board £000	CETV at 31 Mar 06 or date of appointment £000	Real increase in CETV after adjustment for inflation and changes in market investment factors £000
Sir Peter Spencer	0-2.5	5-10	145	104**	32
David Gould	0-2.5 plus 5-7.5 lump sum	55-60 plus 165-170 lump sum	1,258	1,169**	46
Dr Iain Watson	0-2.5 plus 2.5-5 lump sum	35-40 plus 110-115 lump sum	934	883**	22
George Gardiner	0-2.5 plus 5-7.5 lump sum	25-30 plus 75-80 lump sum	495	456	34
Major General Andrew Figgures	0-2.5 plus 0-2.5 lump sum	45-50 plus 145-150 lump sum	1,025	998	21
Rear Admiral Simon Henley	2.5-5 plus 7.5-10 lump sum	40-45 plus 125-130 lump sum	406	358	29
Jonathan Lyle	0-2.5	35-40	544	495**	16
Rear Admiral Ric Cheadle	0-2.5 plus 0-2.5 lump sum	45-50 plus 140-145 lump sum	943	931	11
Dr Andrew Tyler	0-2.5	0-5	21	–	18
Gordon Croy*	–	–	–	–	–
David Noble	0-2.5	5-10	110	82**	23
Rear Admiral Andrew Mathews	0-2.5 plus 2.5-5 lump sum	40-45 plus 120-125 lump sum	963	905	37
Steve McCarthy	0-2.5 plus 0-2.5 lump sum	25-30 plus 75-80 lump sum	429	407	12
Prof Tom McGuffog*	–	–	–	–	–
Dr George Watkins*	–	–	–	–	–
Wendy Barnes*	–	–	–	–	–
Lord Denis Tunnicliffe*	–	–	–	–	–

* Not a civil servant therefore not in receipt of a Civil Service Pension.

** The factors used to calculate the CETV for members of the PCSPS were revised for 2006/2007, following advice from the Cabinet Office. The figures for 31 March 2006 have been recalculated using the new factors and this has led to changes to the figures published last year.

'Accrued Pension' benefits are provided through either the Principal Civil Service Pension Scheme for civilian Board members or Armed Forces Pension Scheme for Service Board members. The accrued pension quoted is the pension the member is entitled to receive when they reach 60, or immediately on ceasing to be an active member of the scheme if they are already 60. *Refer note 1.16*

'Real Increase in Pension' and 'related lump sum at pension age' represents the increase in value of the Total Accrued Pension over the course of the year 2006/07. It is expressed in real terms after adjustment for inflation as illustrated. Accrued Pension at 31/3/07 less Accrued Pension at 31/3/06 adjusted for inflation gives real increase in pension.

Cash Equivalent Transfer Values

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies. The CETV figures include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the CSP arrangements and for which the Cabinet Office's Civil Superannuation Vote has received a transfer payment commensurate to the additional pension liabilities being assumed. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost. CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries.

Real increase in CETV

This reflects the increase in CETV effectively funded by the employer. It does not include the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

David Gould | **Accounting Officer**
22 June 2007

Statement of Accounts

Statement of Agency's and Deputy Chief Executive's Responsibilities

Under Section 7 of the Government Resources and Accounts Act 2000, the Treasury has directed the DPA to prepare a statement of accounts for the financial year in the form and on the basis set out in the Accounts Direction. The accounts are prepared on an accruals basis and must give a true and fair view of the Agency's state of affairs at the year end and of its net operating cost, recognised gains and losses and cash flows for the financial year.

In preparing the accounts the Agency is required to:

- observe the Accounts Direction issued by the Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether the Financial Reporting Manual and applicable accounting standards have been followed;
- disclose and explain any material departures in the financial statements;
- prepare the financial statements on the 'going concern basis', unless it is inappropriate to presume that the Agency will continue in operation.

The Permanent Under Secretary of State (PUS), as the MoD's Principal Accounting Officer, has formally tasked the Deputy Chief Executive with responsibilities analogous to those of an Accounting Officer for the Agency. The Deputy Chief Executive's relevant responsibilities in this role, including his responsibility for the propriety and regularity of the public finances for which he is answerable and for the keeping of proper records, are set out in the Accounting Officer's Memorandum issued by the Treasury and published in *Government Accounting*.

Statement on Internal Control

1. Scope of responsibility

As Accounting Officer and Deputy Chief Executive of the DPA, I had responsibility for maintaining a sound system of internal control that supported the achievement of the Agency's policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which the Chief Executive and I were personally responsible, in accordance with the responsibilities assigned to us in '*Government Accounting*'.

The Chief Executive and I were accountable to the Minister for Defence Procurement for the management and performance of the Agency. We reported quarterly to the Defence Management Board on the performance of projects and against targets set for the DPA through the annual Service Delivery Agreement (SDA) that the Chief Executive agreed with PUS and Chief of Defence Staff. The Agency's Key Targets were consistent with the targets set in the SDA.

2. The purpose of the system of internal control

The system of internal control was designed to identify and to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives. It could therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control was based on an on-going process designed to identify and prioritise the risks to the achievement of the Agency's policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control had been in place in the Agency for the year ended 31 March 2007 and accorded with Treasury guidance.

3. Capacity to manage and mitigate risk

During 2006/2007 the DPA Executive Board continued to work towards embodying Risk Management and an associated system of internal controls into DPA's business and management systems. The programme of Risk Master Classes for IPT Leaders and other senior staff introduced in 2006/2007 continued throughout the year, with useful feedback obtained from each session. Risk training at awareness and practitioner levels was available to all staff. Training at expert level was available for specialists, such as IPT Risk Managers. Risk Management guidance, provided in documented and controlled procedures, was regularly reviewed and updated where appropriate.

4. The risk and control framework

The DPA aimed to capture risks from across the depth and breadth of the Agency and its stakeholder community. The Agency's approach to Risk Management addressed both **corporate risks** which were defined as having a probability and severity of impact that could adversely influence the achievement of one (or more) of the Agency's Key and Functional Targets and **project risks** that were specific to each project.

a) The **DPA Corporate Risk Management** process provided a controlled and documented framework for Agency staff to identify, categorise, and prioritise risks to Key and Functional Targets in terms of probability and impact. The Executive Board assumed ownership of the risks and appointed risk controllers to manage all mitigation activities.

b) All DPA IPTs and SGs were required to implement a recommended best practice **Project Risk Management** process, which was fully supported by detailed guidance, targeted training and appropriate tools including a new Corporate Risk Reporting Solutions software package. Project risks that threatened DPA Key and Functional targets were escalated to higher levels of management as part of the Corporate Risk Management process or through the periodic individual Project Review events.

c) The DPA had a strategy and policy for **Business Continuity** which was reviewed annually or if significant changes to business conditions occurred such as reorganisation. An extraordinary review of Business Continuity took place prior to the launch of the DE&S organisation, which was completed in April 2007. Detailed plans were held at IPT/SG Business Unit level, which identified key staff and other resources necessary for the continuation of business. Risk assessments were undertaken on a continual basis and were monitored via periodic trials and exercises. The DPA Management Board and Audit Committee continued to review Business Continuity as part of the Corporate Risk Management Process and the Security and Business Continuity Stakeholder Group reviewed the effectiveness of our plans.

5. Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. The following processes were in place in order to maintain and review the effectiveness of the system of control:

a) An **Executive Board** chaired by the Chief Executive, which met monthly to manage the performance, plans and strategic direction of the Agency, comprising the Executive Directors of the Agency and three external, independent Non-Executive Directors. A subsidiary Management Board, chaired by myself as the Deputy Chief Executive, concentrated on performance management, allowing the Executive Board to focus on building for the future and shaping the context for DPA operations.

b) A DPA **Audit Committee** chaired by a Non-Executive Director. The Audit Committee met quarterly to review the adequacy of the Agency's internal controls, Risk Management, and assurance processes, providing regular reports to the Executive Board. At each of its four meetings the Audit Committee continued to review specific corporate risks highlighting issues and concerns for the Board's consideration. These received a positive response from the Board and included their support for a programme of work to provide the required level of assurance to underpin the Statement on Internal Control.

c) A process of **Project Review & Assurance**. Operations Directors and Deputy Directors formally reviewed the risks to performance, whole life costs and time on a regular basis and at each key project stage.

d) A key component of the Agency's **Financial Assurance Process** remained the professionalism and independence of the Financial Controller in each IPT and SG who had a direct reporting link to the Finance Director.

e) Additionally the Agency utilised a wide range of **Project Assurance Processes** and Support Group teams to provide assurance in the key areas of Project Delivery; Technical Maturity and Safety, Commercial Arrangements and long term Support Solutions.

f) An annual risk based programme of internal audit was provided by Defence Internal Audit and the Agency's Compliance Audit Team to standards defined in the Government Internal Audit Standards which provided an independent opinion on the system of internal control and recommendations for improvement.

My review of the effectiveness of the system of internal control has been informed by the work of the internal auditors and the executive managers within the Agency, who had responsibility for the development and maintenance of the internal control framework, and comments made by external auditors in their management letter and other reports. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Board and Audit Committee and a plan to address weaknesses and ensure continuous improvement of the system is in place.

6. Significant internal control weaknesses

It was a matter of the highest priority for me and the Executive Board to continue to improve how our complex projects are managed. Progress had been made in respect of the weaknesses highlighted in last year's Statement on Internal Control, as described below:

(a) Earned Value Management – Since January 2006 EVM has been mandatory for all Category A-C projects entering Demonstration Phase. Training and guidance packages were developed for project and commercial staff and preparatory work was undertaken to launch an EVM Master Class for IPT Team Leaders (IPTLs) in April 2007 with an EVM maturity model to measure effectiveness. The adoption of EVM techniques by IPTs has provided early indications of potential delays to programmes and enabled project teams to develop risk mitigation plans.

(b) Project Cost Estimating – A new team was established in April 2006 to produce historic trend analysis to validate cost estimates. A tool was developed by the Pricing & Forecasting Group (PFG) to maintain key costing assumptions and provide key cost information to support project estimates. PFG were subsequently able to provide early warnings of unrealistic project cost estimates and assist IPTs to rectify these shortfalls and improve confidence in business case cost estimates.

(c) Risk Management – During 2006/2007 both the Agency's Corporate Risk Manager and its Audit Committee carried out critical reviews of the existing arrangements for Risk Management and related controls. The reviews showed that whilst current processes dealt well with project risk, they did not always adequately address areas of potential corporate risk. Consequently in October 2006 the DPA Management Board re-considered the risks facing the achievement of the Agency's key targets and business objectives for 2006/2007. Risk owners were appointed at Board level for those risks to be prioritised in 2006/2007 and mitigation strategies were developed. Progress reports were provided to the Executive Board on a monthly basis.

The Board subsequently concentrated its attention and efforts on controlling the following risks:

- Merger and Change Programme
- People Issues
- IT Infrastructure and migration to Defence Information Infrastructure (DII)
- Funding constraints
- Equipment Safety

To further enhance controls during 2006/2007 the Executive Board introduced additional monthly review meetings between Operational Directors, Deputy Directors and IPTLs to review key projects to manage the achievement of Key Targets. This enabled the Board to identify risks and develop a series of options to mitigate adverse performance, time and cost variances and help deliver the Agency's Key Targets and business objectives.

The Executive Board also initiated a Risk Management process to ensure that the formation of DE&S did not impact on the DPA's performance and achievement of its key objectives; and conversely that the Agency's day-to-day activities did not affect work carried out in support of the DPA/DLO merger.

These actions helped mitigate the distracting and disruptive effects of the preparations for the merger with the DLO and ensured that the Agency achieved its Key Targets.

We have identified internal control weaknesses in the following areas: approval process compliance and the quality of Category D business cases, succession planning for key posts, greater focus on Through Life Management Plans (TLMPs) and an improved linkage between project and corporate risk registers. We have initiatives in place to manage these risks as part of the DE&S Corporate Governance strategy.

David Gould | **Accounting Officer**
22 June 2007

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

I certify that I have audited the Financial Statements of the Defence Procurement Agency for the year ended 31 March 2007 under the Government Resources and Accounts Act 2000. These comprise the Operating Cost Statement and Statement of Recognised Gains and Losses, the Balance Sheet, the Cashflow Statement and the related notes. These Financial Statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

Respective responsibilities of the Agency, the Accounting Officer and Auditor

The Agency and Accounting Officer are responsible for preparing the Annual Report, which includes the Remuneration Report, and the Financial Statements in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions made there-under and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's Responsibilities.

My responsibility is to audit the Financial Statements and the part of the Remuneration Report to be audited in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the Financial Statements give a true and fair view and whether the Financial Statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000. I report to you whether, in my opinion, certain information given in the Annual Report, which comprises a Foreword, a section on the Mission Statement and Defence Values, an Executive Summary, an Overview of the Year, a Statement of Achievement against Key Targets, a Financial Summary and a Remuneration Report, is consistent with the financial statements. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

In addition, I report to you if the Agency has not kept proper accounting records, if I have not received all the information and explanations I require for my audit or if information specified by HM Treasury regarding remuneration and other transactions is not disclosed.

I review whether the Statement on Internal Control reflects the Agency's compliance with HM Treasury's guidance, and I report if it does not. I am not required to consider whether this statement covers all risks and controls, or to form an opinion on the effectiveness of the Agency's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report and consider whether it is consistent with the audited Financial Statements. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Agency and Accounting Officer in the preparation of the Financial Statements, and of whether the accounting policies are most appropriate to the Agency's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error, and that, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements and that part of the Remuneration Report to be audited.

Opinions

Audit Opinion

In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and directions made there under by HM Treasury, of the state of the Agency's affairs as at 31 March 2007 and of the net operating cost, recognised gains and losses and cashflows for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000; and
- the information given within the Annual Report, which comprises a Foreword, a section on the Mission Statement and Defence Values, an Executive Summary, an Overview of the Year, a Statement of Achievement against Key Targets, a Financial Summary and a Remuneration Report, is consistent with the financial statements.

Audit Opinion on Regularity

In my opinion, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Report

I have no observations to make on these Financial Statements.

John Bourn | **Comptroller and Auditor General**
National Audit Office
157-197 Buckingham Palace Road
Victoria
London SW1W 9SP
26 June 2007

Operating Cost Statement

For the year ended 31 March 2007

	Note	2006/2007 £000	2005/2006 £000
Operating Costs			
Staff costs	2.2	257,698	176,804
Operating leases	5	84,749	82,238
Other operating costs	5	1,057,890	2,106,885
Finance lease charges		–	–
Gross operating costs		1,400,337	2,365,927
Operating income	6	(17,480)	(18,772)
Net operating cost before interest		**1,382,857**	**2,347,155**
Net interest payable /(receivable)	7	2,442	1,615
Cost of capital charge	8	584,058	553,229
Net operating cost after interest		**1,969,357**	**2,901,999**

The notes on pages 34 to 59 form part of these Financial Statements.

Statement of Recognised Gains and Losses

For the year ended 31 March 2007

	Note	2006/2007 £000	2005/2006 £000
Net (gain)/loss on revaluation of fixed assets and stocks	20	(132,576)	(348,805)
Net gain on revaluation of donated assets	20	–	(1)
Transfer of donated assets	20	–	72
Recognised (gains)/losses relating to the year		**(132,576)**	**(348,734)**
Prior year adjustment		–	(4,348,035)
Recognised (gains)/losses since last Annual Report		**(132,576)**	**(4,696,769)**

The results shown above are in respect of continuing activities.

The notes on pages 34 to 59 form part of these Financial Statements.

Balance Sheet

As at 31 March 2007

	Note	2006/2007 £000	2005/2006 £000
Fixed Assets			
Intangible assets	9	7,593,498	6,578,833
Tangible fixed assets:			
Assets under Construction	10	11,151,904	11,177,407
Other tangible assets	11	1,824,668	1,853,740
Investments	12	–	–
		20,570,070	19,609,980
Current Assets			
Stocks and work-in-progress	13	2,034,090	2,635,220
Debtors	14	198,194	216,166
Cash at bank and in hand	16	100,035	133,147
		2,332,319	2,984,533
Current Liabilities			
Creditors: amounts falling due within one year	17	(2,713,063)	(2,704,641)
Net current assets		(380,744)	279,892
Total assets less current liabilities		20,189,326	19,889,872
Creditors: amounts falling due after more than one year	17	(271,941)	(173,218)
Provisions for liabilities and charges	19	(2,817,662)	(3,256,008)
Net Assets		**17,099,723**	**16,460,646**
Taxpayers equity			
General fund	21	15,249,821	14,224,711
Revaluation reserve	20	1,849,902	2,235,935
Donated assets reserve	20	–	–
		17,099,723	**16,460,646**

The notes on pages 34 to 59 form part of these Financial Statements.

David Gould | **Accounting Officer**
22 June 2007

Cash Flow Statement

For the year ended 31 March 2007

	Note	2006/2007 £000	2005/2006 £000
Net cash outflow from operating activities before interest	29	6,367,272	4,958,515
Net capital expenditure	30	630,776	1,928,163
Net cash outflow before financing		6,998,048	6,886,678
Financing:			
– Payments from the Defence Resource Account		(7,012,815)	(6,934,735)
– Receipts from the Defence Resource Account		45,437	33,457
– Financing from other sources		–	(26,300)
– Returns on investment and servicing of finance (net interest paid)		2,442	1,615
		(6,964,936)	(6,925,963)
Net financing from the Defence Resource Account	31	(6,964,936)	(6,925,963)
(Increase)/decrease in cash in hand and at bank in the period		**33,112**	**(39,285)**

Cash at bank includes overdrafts which are included in creditors.

The notes on pages 34 to 59 form part of these Financial Statements.

Notes to the Agency Accounts

For the year ended 31 March 2007

1. Statement of Accounting Policies

1.1 Introduction

These Financial Statements have been prepared in accordance with the Financial Reporting Manual issued by HM Treasury, the Resource Accounting Policy Manual issued by the Ministry of Defence, and the Treasury Accounts Direction.

The principal accounting policies adopted by the Agency are summarised below. The policies set out the framework within which the Agency conducts financial management and have been applied consistently in dealing with items considered material to the Financial Statements.

1.2 Accounting Convention – Modified Historic Cost Accounting (MHCA)

The Financial Statements are prepared under the historical cost convention, modified to include the revaluation of intangible and tangible fixed assets, Assets under Construction (AuC) and stocks. MHCA is applied to AuC when the value is over £25m and on Intangible Fixed Assets when the value is over £20m. The indices are produced by Defence Analytical Services Agency (DASA) and are common across the MoD.

1.3 Net Operating Costs

Costs are charged to the Operating Cost Statement in the period in which they are incurred and matched to any related recoveries.

1.4 Value Added Tax (VAT)

The Agency is not separately registered for Value Added Tax (VAT), which is accounted for centrally by the Ministry of Defence. Amounts included in the Operating Cost Statement and Balance Sheet are exclusive of VAT where it is recoverable from HM Revenue and Customs in respect of certain contracted out services as directed by the Treasury.

1.5 Intangible Fixed Assets

Intangible fixed assets are stated at actual contract cost, as adjusted for indexation. The total indexation value to date is £537m. Capitalised development costs are transferred to other parts of MoD at the same time as delivery of the first item of equipment. Development costs are capitalised where they contribute towards defining the specification of an asset type, e.g. class of ship or aircraft in accordance with the principles of SSAP 13. Amortisation commences when the asset type first enters service within the Department. If it is decided to withdraw a whole asset type early then any un-amortised development costs are written off to the Operating Cost Statement, at the time of the decision, along with the underlying asset. Pure and applied research costs are charged to the Operating Cost Statement in the period in which they are incurred.

1.6 Tangible Fixed Assets

On 1 April the Ministry of Defence transferred responsibility for accounting for fixed assets from the DPA to other parts of the Department. Where the Agency retains the risks and rewards of ownership of the tangible fixed assets they will continue to be accounted for on the Agency's Balance Sheet in accordance with FRS 5 and SSAP 21. In all other cases the costs of the use of these assets will be communicated to the DPA by the asset owners and charged to the Operating Cost Statement.

Tangible fixed assets are stated at their value to the Agency, with asset values and estimated economic lives being reviewed annually. The capitalisation threshold is £10,000. Tangible fixed assets are subject to professional valuations every 5 years and modified in the intervening years by the application of prospective indices which are produced by the Defence Analytical Services Agency (DASA).

The Abbey Wood site and non-estate nuclear assets were subject to a professional revaluation by the Valuation Office Agency (VOA) in March 2007.

The principal asset categories and their estimated useful economic lives are as follows:

	Category	Years
Land and Buildings	Land	Indefinite, not depreciated
	Buildings, dwellings (perm)	Useful economic life
	Buildings non-dwellings (perm)	Useful economic life
	Buildings temporary	5-20
	Leasehold	Shorter of expected life and lease period
Single-use military equipment		
(Including Guided Weapons, Missiles and Bombs		Effective operational life
		(on a pooled basis for GWMB)
Fighting Equipment transport		Effective operational life
Plant & Machinery	Specialised Vehicles	5-15
	(includes non-fighting vessels and aircraft)	Effective operational life
	Specialist plant and machinery	Effective operational life
Other transport	Standard vehicles	3-5
IT & Communications Equipment	Computers	3-7
	Satellites	10
	Communications equipment	Effective operational life
Non-Operational Heritage Assets		Indefinite, not normally depreciated
Assets under Construction		Not depreciated
Capital Spares	Capital spares are items of repairable materiel retained for the purpose of replacing parts of an asset undergoing repair, refurbishment, maintenance, servicing, modification, enhancement or conversion.	Effective operational life (on a pooled basis, consistent with the effective operational life of the prime equipment supported)

Upon completion Assets under Construction are transferred to other parts of the MoD for inclusion in their Balance Sheets.

1.7 Depreciation

Depreciation is calculated so as to write off the cost, or valuation, of tangible fixed assets, less their estimated residual values, on a straight line basis over their estimated useful economic lives.

1.8 Donated Assets

Donated tangible fixed assets are capitalised, within the principal asset category to which they relate, at their valuation on receipt; this value is credited to the Donated Asset Reserve. Subsequent revaluation and associated depreciation are also taken to this reserve. Where donated assets are classed as Non-Operational Heritage Assets they are deemed as having an infinite life. In such cases no depreciation is charged.

1.9 Disposal of Tangible Fixed Assets

Assets declared for disposal and intended to be sold in bulk and where necessary subject to refurbishment prior to sale, are transferred to stock at the net recoverable amount. The remaining assets are eliminated from tangible fixed assets only on disposal to a third party and any surplus or deficit is shown in Other Operating Costs.

1.10 Operating Leases

Expenditure under operating leases is charged to the Operating Cost Statement in the period in which it is incurred. Operating Leases are detailed in *Note* 23.

1.11 Private Finance Initiative Transactions

Where the substance of the transaction is such that the risks and rewards of ownership remain with the Agency, the assets and liabilities remain on the Agency's Balance Sheet. Where the risks and rewards are transferred to the Private Sector the transaction is accounted for in the Operating Cost Statement through service charges in accordance with FRS5 and HM Treasury Guidance.

1.12 Investments

Investments represent holdings that the DPA intends to retain for the foreseeable future. Fixed asset investments are stated at market value where available, otherwise they are stated at cost.

1.13 Stocks

Stocks are stated at either current replacement cost or net realisable value. Current replacement cost applies to stocks expected to be used or sold in the ordinary course of business, and represents the cumulative revaluation of stock using latest cost of acquisition or indexation. Net realisable value applies to stocks that are not expected to be used or sold in the ordinary course of business, and have been identified for disposal. Where appropriate, provision is made for obsolete, surplus and defective stock. Provisions are also made to reduce the value of certain stock items over their estimated useful economic life. Current cost comprises purchase price and/or cost of conversion, and includes expenses incidental to acquisition, including irrecoverable VAT. Net realisable value is the estimated disposal sale value less the incidental costs chargeable to the sale.

1.14 Provisions for Liabilities and Charges

Provisions for liabilities and charges have been established to recognise a realistic and prudent estimate of the expenditure required to settle future legal or constructive obligations that exist at the Balance Sheet date where the amount and/or timing is uncertain. Provisions are charged to the Operating Cost Statement unless they have been capitalised as part of the underlying facility where the expenditure provides access to current and future economic benefits. In such cases the capitalised provision will be depreciated as a charge to the Operating Cost Statement over the remaining estimated useful economic life of the underlying asset. Where appropriate, provisions have been discounted to a current price base using HM Treasury's discount rate of 2.2% (2005/2006: 2.2%). The discount for each material class of provision will be unwound over the remaining life of the asset class as an interest charge to the Operating Cost Statement. Provisions for restructuring and redundancy have been made only where the Agency has a detailed formal plan from which it cannot realistically withdraw. Provision made for early departure costs arising from retirement programmes and redundancies is charged to the Operating Cost Statement in the year in which the programmes are announced.

1.15 Reserves

The Revaluation Reserve reflects the unrealised element of the cumulative balance of indexation and revaluation adjustments on fixed assets and stocks (excluding donated assets and those financed by Government grants). The Donated Asset Reserve reflects the net book value of assets that have been donated to the Agency. The balance of taxpayers' equity is represented by the General Fund.

1.16 Pensions

Civil Service Pensions

From 1 October 2002, civil servants may be in one of three statutory based 'final salary' defined benefit schemes (classic, premium, and classic plus). The Schemes are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under classic, premium, and classic plus are increased annually in line with changes in the Retail Prices Index. New entrants after 1 October 2002 may choose between membership of premium or joining a good quality 'money purchase' stakeholder arrangement with a significant employer contribution (partnership pension account).

Employee contributions are set at the rate of 1.5% of pensionable earnings for classic and 3.5% for premium and classic plus. Benefits in classic accrue at the rate of 1/80th of pensionable salary for each year of service. In addition, a lump sum equivalent to three years' pension is payable on retirement. For premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike classic, there is no automatic lump sum (but members may give up (commute) some of their pension to provide a lump sum). Classic plus is essentially a variation of premium, but with benefits in respect of service before 1 October 2002 calculated broadly as per classic.

The partnership pension account is a stakeholder pension arrangement. The employer makes a basic contribution of between 3% and 12.5% (depending on the age of the member) into a stakeholder pension product chosen by the employee. The employee does not have to contribute but where they do make contributions, the employer will match these up to a limit of 3% of pensionable salary (in addition to the employer's basic contribution). Employers also contribute a further 0.8% of pensionable salary to cover the cost of centrally-provided risk benefit cover (death in service and ill health retirement).

The accrued pension quoted is the pension the member is entitled to receive when they reach 60, or immediately on ceasing to be an active member of the scheme if they are already 60.

Armed Forces Pension Scheme (AFPS)

This is a statutory scheme that provides benefits on a 'final salary' basis at a normal retirement age of 55. Benefits accrue from the age of 21 up to a maximum of 34 years reckonable service (aged 55) at which the pension benefit will equate to 50% of final salary. In addition a lump sum equivalent to 3 years pension is payable on retirement. Pensions are linked to the Retail Prices Index. On death, pensions are payable to an entitled surviving spouse at the rate of half the member's pension. On death in service, the scheme pays a lump sum benefit of between 97% and 150% pensionable pay depending on length of service. Where the death is attributable to service causes, dependants' benefits may be significantly enhanced at the discretion of the Defence Council.

1.17 Benefits in kind

The monetary value of benefits in kind covers any benefits provided by the employer and treated by HM Revenue and Customs as a taxable emolument.

1.18 Capital Charge

A charge, reflecting the cost of capital utilised by the Agency, is included in the Operating Cost Statement. The charge is calculated using the HM Treasury standard rate on all assets and liabilities (except for donated assets, and balances held with the Office of Paymaster General (OPG) which are exempt from the charge). The rate charged by HM Treasury is 3.5%.

1.19 Foreign Exchange

Transactions denominated in foreign currency are translated into sterling using the MoD's General Accounting Rate (GAR) ruling at the date of each transaction. Monetary assets and liabilities are translated at the spot rate applicable at the Balance Sheet date and the exchange rate differences are reported in the Operating Cost Statement.

1.20 Notional Costs

Notional amounts are included in the Operating Cost Statement for charges in respect of services provided from other areas of the MoD. The amounts charged are calculated to reflect the full cost of providing the services to the Agency.

The Agency is not charged an audit fee by the National Audit Office. The audit fee represents a notional charge to the Operating Cost Statement based on the cost of the services provided.

1.21 Cash Flow

The management of liquid resources, which includes balances at commercial banks, is mainly due to balances on international collaborative projects. The level of balances is contingent upon the level of funding and the stage of the project.

2. Staff Numbers and Costs

2.1 The average number of full-time equivalent persons employed during 2006/2007 was as follows:

		2006/2007 Persons Employed	2005/2006 Persons Employed
Service	Senior Management	40	30
	Other Service Personnel	1,020	710
		1,060	**740**
Civilian	Senior Management	580	530
	Other Civilian Personnel	3,876	3,292
	Agency	14	128
		4,470	**3,950**
		5,530	**4,690**

2.2 The aggregate payroll costs, including allowances, for these persons were as follows:

	2006/2007 £000	2005/2006 £000
Salaries and Wages		
– Service	55,542	38,833
– Civilian	141,390	117,490
– Agency and Temporary Staff	837	6,362
Social Security costs	16,232	13,047
Other pension costs	41,605	31,930
Other salary costs	–	–
Sub Total	**255,606**	**207,662**
Redundancy and severance payments	2,092	(30,858)
Total payroll costs including Redundancy Payments	**257,698**	**176,804**

3. Other Pension Costs

The PCSPS and the AFPS are non-funded multi-employer and non-funded single-employer defined benefit schemes respectively but the DPA is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out at 31 March 2003 for the PCSPS and at 31 March 2005 for the AFPS. Details can be found in the resource accounts of these schemes that are published and laid before the House of Commons. The PCSPS is also available on the web at www.civilservice-pensions.gov.uk.

For 2006/2007, employer's contributions of £26.461m were made (2005/2006: £21.322m) in respect of civilian staff at one of four rates in the range 17.1% to 25.5% of pensionable pay, based on salary bands. Rates will remain the same for the next year, subject to revalorisation of the salary bands. Employer contributions to the PCSPS are to be reviewed every four years following a full scheme valuation by the Government Actuary.

For Service personnel, employer's contributions of £15.144m (2005/2006: £10.607m) were made to the AFPS based on the rates of 36.3% of pensionable pay for Officers and 21.8% for other ranks, as determined by the Government Actuary. Employer contributions to the AFPS were reviewed during 2002/2003. The contribution rates reflect benefits as they are accrued, not when costs are actually incurred, and reflect past experience of the schemes.

Further details of the schemes are given in Notes 1.16

4. Early Departure Costs

The Agency provides in full for the cost of meeting pensions up to normal retirement age in respect of early retirement programmes and redundancies announced in the current or previous years. Pensions payable after normal retirement age are met by the PCSPS for civilian personnel and the AFPS for service personnel. However, the additional element payable beyond the normal retirement age which derives from the enhancement of reckonable service continues to be met by the Agency. The Agency may, in certain circumstances, settle some or all of its liability in advance by making a payment to the Office of the Paymaster General account for the credit of the Civil Service Superannuation Vote. The amount provided is shown net of any such payments. *See also note 19 for provisions for future expenditures.*

5. Other Operating Costs

	Note	2006/2007 £000	2005/2006 £000
Operating expenditure			
– Hospitality & entertainment		75	98
– Movements, including staff travel costs		19,887	17,881
– Fuel		16,864	14,444
Stock consumption and valuation provisions		94,956	62,461
Accommodation management			
– Utilities		2,546	2,644
– Property management		13,461	12,889
– Accommodation charges		1,242	9,762
IT & Comms		11,945	11,340
Research and development expenditure		418,678	431,925
Equipment support and post design services		580,386	600,853
Education & Training		3,045	7,906
Professional Fees		23,643	14,073
Cost of training services provided		45,177	50,420
(Gain)/Loss on Exchange		(15,211)	(925)
Stock and project adjustments		55,925	(39,579)
Asset Write (on)/off		21,937	17,737
Other expenditure		3,515	1,897
Increase/(decrease) in nuclear decommissioning provisions	19	(511,167)	(118,070)
Increase/(decrease) in non-nuclear provision		49,157	(4,192)
Change to Treasury discount Rate effect on unwinding of provisions		–	776,611
Unwinding of nuclear decommissioning provision discount	19	70,322	71,672
Unwinding of non-nuclear provision discount	19	640	1,329
Auditors' renumeration	8	230	220
Charges from other parts of MoD	8	45,098	31,820
Depreciation and amortisation			
– Intangible assets	9	–	–
– Tangible fixed assets	11	99,677	120,638
– Impairment in value of fixed assets		6,686	11,922
– (Surplus)/deficit on disposal of assets		(11)	–
Total Other Operating Costs before transfer		**1,058,703**	**2,107,776**
Communicated Costs to Lodger Units		(813)	(891)
Total Other Operating Costs after transfer		**1,057,890**	**2,106,885**
Operating Leases			
– Plant, Machinery & Vehicles (PMV)		2,516	24
– Other		82,233	82,214
Finance lease charges		–	–
Total Other Operating Costs (including Operating and Finance Leases)		**1,142,639**	**2,189,123**

6. Operating Income

	2006/2007 £000	2005/2006 £000
Operating income for 2006/2007 was received from external customers, Other Government Departments and Trading Funds – includes, £4.2m from NATO, Foreign Government funded work and Trading Funds; £3m commercial exploitation levies and £5m liquidated damages.	(17,480)	(18,772)
Total operating income	**(17,480)**	**(18,772)**

7. Net Interest Payable

	2006/2007 £000	2005/2006 £000
Interest receivable		
– Bank interest	(4,089)	(973)
Interest payable		
– Loan interest	6,531	2,588
Net interest payable	**2,442**	**1,615**

8. Charges from other parts of the MoD (Notional Costs)

Operating costs include non-cash items, and notional costs for services provided by other parts of the MoD:

	2006/2007 £000	2005/2006 £000
Charges from other parts of Mod		
– MoD Central Overheads	6,514	5,588
– MoD Guarding/Policing	22,865	22,307
– Defence Bills Agency	690	759
– Defence Internal Audit	230	121
– Defence Codification	–	1,142
– Pay and Personnel Agency	–	788
– Defence Communications Fleet Tasking Agency	54	26
– Defence Postal and Courier services	–	252
– Defence Transport & Movements Agency	851	837
– MoD Shared Service Centre*	4,980	–
– Estate CILOR charges*	8,914	–
Total Charges from other parts of MoD (Notional Costs)	**45,098**	**31,820**
NAO – Notional fee for Audit Work (See note below)	230	220
Cost of Capital	584,058	553,229
Total non-cash costs for services provided	**629,386**	**585,269**

The NAO did not undertake any non-audit work during the year.

** Communicated costs in respect of assets that are sitting elsewhere in the MoD but used by DPA (Refer note 1.6); previously paid directly by the DPA.*

9. Intangible Fixed Assets

	2006/2007 £000	2005/2006 £000
Cost or Valuation		
At 1 April	6,578,833	5,676,213
Additions	1,629,929	1,449,588
Impairment losses	–	–
Transfers to other parts of MoD	(981,353)	(533,127)
Revaluation	244,750	113,919
Net asset write-on / (write off)	(17,743)	6,669
Disposals	–	–
Reclassifications	139,082	(134,429)
At 31 March	**7,593,498**	**6,578,833**
Amortisation		
At 1 April	–	–
Disposed of in year	–	–
At 31 March	**–**	**–**
NBV at 31 March	**7,593,498**	**6,578,833**

Development costs are transferred to other parts of the MoD for inclusion in their Balance Sheets with the first production delivery of related equipment.

Reclassifications are between asset categories (Intangibles and AuC) in the following IPTs: Type 45 (£111m), Image (£18m), Tornado (£9.5m), Attack Submarines (£3.2m) and JBTSE (-£7m). Reclassifications are also sometimes made between Intangibles and the Operating Cost Statement.

10. Assets under Construction

	2006/2007 £000	2005/2006 £000
Cost or Valuation		
At 1 April	11,177,407	9,932,321
Additions	3,886,677	3,934,282
Impairment Losses	(241)	(4,155)
Transfers to other parts of the MoD	(3,963,641)	(2,926,689)
Revaluation	301,113	114,529
Net Asset write-on / (write off)	(34,362)	31,089
Disposals	–	–
Reclassification	(215,049)	96,030
At 31 March	**11,151,904**	**11,177,407**

Assets under Construction (AuC) are transferred to other parts of the MoD for inclusion in their Balance Sheets as the related equipment is delivered.

Reclassifications are between asset categories (Intangibles and AuC) the major ones being in the following IPTs: Type 45 (-£111m), Image (-£18m), Tornado (-£9.5m), Attack Submarines (-£3.2m) and JBTSE (£7m) and between AuC and other fixed asset categories within Nuclear Weapons IPT (-£74m). Reclassifications are also sometimes made between AuC and the Operating Cost Statement.

11. Other Tangible Fixed Assets

	Land and Buildings dwellings £000	Land and Buildings non-dwellings £000	Single-use military equipment £000	Plant & Machinery equipment £000	Fighting Equipment transport £000	Other Transport £000	IT and Comms Equipment £000	Capital Spares £000	TOTAL £000
Cost or Valuation									
At 31 March 2006	**412**	**740,365**	**3,870**	**2,129,582**	**571**	**4,201**	**24,514**	**51,008**	**2,954,523**
Additions	–	6,647	4	175	–	–	793	1,192	8,811
Impairment losses	–	3	–	(6,063)	–	–	(4,077)	–	(10,137)
Disposals	–	(46,346)	–	(3,885)	–	(118)	(4,478)	(24,209)	(79,036)
Revaluation	146	57,378	–	59,329	–	117	–	14	116,984
Transfers to other parts of the MoD	–	*(7,202)	*(3,892)	*(90,071)	*(571)	*(3)	*(1,102)	135	(102,706)
Reclassifications	–	45,271	18	11,744	–	368	21,948	(14)	79,335
At 31 March 2007	**558**	**796,116**	**–**	**2,100,811**	**–**	**4,565**	**37,598**	**28,126**	**2,967,774**
Depreciation									
At 31 March 2006	**(76)**	**(104,105)**	**(1,084)**	**(952,507)**	**(176)**	**(2,086)**	**(14,129)**	**(26,620)**	**(1,100,783)**
Charged in year	(19)	(22,961)	–	(77,958)	–	(671)	(8,762)	**10,694	(99,677)
Backlog depreciation	(6)	(3,237)	–	(32,128)	–	(133)	–	–	(35,504)
Impairment Losses	–	–	–	–	–	–	3,692	–	3,692
Disposals	–	47,383	–	471	–	12	3,758	–	51,624
Transfers to other parts of the MoD	–	80	1,084	35,485	176	–	717	–	37,542
Reclassifications	–	–	–	–	–	–	–	–	–
At 31 March 2007	**(101)**	**(82,840)**	–	**(1,026,637)**	–	**(2,878)**	**(14,724)**	**(15,926)**	**(1,143,106)**
Net Book Value at 31 March 2007	**457**	**713,276**	–	**1,074,174**	–	**1,687**	**22,874**	**12,200**	**1,824,668**
Net Book Value at 1 April 2006	**336**	**636,260**	**2,786**	**1,177,075**	**395**	**2,115**	**10,385**	**24,388**	**1,853,740**

*Assets transferred to the Defence Communications Services Agency, Defence Estates and the Defence Logistics Organisation.

** In previous years, a provision has been raised against the gross stock balance on capital spares Assets in Industry and charged to the Operating Cost Statement as depreciation. Due to in year disposals of some Assets in Industry the level of provision required has decreased and has therefore been released to the Operating Cost Statement, resulting in a positive depreciation charge for the year.

Other Tangible Fixed Assets

11.1 Re-classifications include transfers from Assets under Construction (AuC) to Tangible Fixed Assets.

Quinquennial Review

11.2 All fixed assets, except Intangibles, Assets under Construction and Capital Spares, are subject to a quinquennial revaluation which is being conducted on a rolling programme. In 2006/2007 the Valuation Office Agency undertook a revaluation of the Abbey Wood site and the non-estate nuclear assets. The VOA is a Government Agency independent of the MoD. Assets were valued on the basis of Existing Use or Depreciated Replacement Cost, as appropriate to the nature of the asset.

11.3 As a result of the valuations undertaken in 2006/2007 the net increase to Land and Buildings was £25,007,113. For the non-nuclear estate there were net decreases to Plant and Machinery and IT & Comms of £10,927,633 and £3,708,000 respectively; impairments of £9,852,262 were taken to the Operating Cost Statement.

12. Investments

Investments, including Special Shares are held in the following companies at 31 March 2007:

Investments	£1 Preferential shares
Atomic Weapons Establishment plc	1 share
Atomic Weapons Establishment Pensions Trustees Limited	1 share
BAE SYSTEMS Marine (Holdings) Limited	1 share

All shares held are unlisted and are valued at historical cost.

Special Shares confer on the Secretary of State for Defence special rights regarding ownership, influence and control, including voting rights in certain circumstances, under individual Articles of Association of the relevant companies in which the shares are held. Further detailed information can be obtained from the companies' individual Annual Report and Accounts which can be obtained from:

Atomic Weapons Establishment plc, AWE Aldermaston, Reading RG7 4PR
Atomic Weapons Establishment Pensions Trustees Limited, AWE Aldermaston, Reading RG7 4PR.
BAE SYSTEMS Marine (Holdings) Limited, Warwick House, PO Box 87, Farnborough
Aerospace Centre, Farnborough, Hants, GU14 6YU

13. Stocks and Work in Progress

	2006/2007 £000	2005/2006 £000
Work in progress	4,525	13,960
Raw materials and consumables	2,029,565	2,621,260
Total stocks and work in progress	**2,034,090**	**2,635,220**

14. Debtors

	2006/2007 £000	2005/2006 £000
Amounts falling due within one year		
Trade debtors	56,581	19,548
Deposits and advances	2,758	9,184
Other debtors	102,174	139,126
Prepayments and accrued income	36,825	48,560
Less bad debts	(144)	(252)
Total debtors: amounts falling due within one year	198,194	216,166
Amounts falling due after one year		
Trade debtors	–	–
Prepayments and accrued income	–	–
Less bad debts	–	–
Total debtors: amounts falling due after one year	–	–
Total debtors	**198,194**	**216,166**

15. Intra-Government Debtor Balances

	2006/2007 £000		2005/2006 £000	
	Amounts falling due within one year	Amounts falling due after more than one year	Amounts falling due within one year	Amounts falling due after more than one year
Balances with other Central Government Bodies				
Civil Nuclear Constabulary	1	–	–	–
Home Office	1,040	–	–	–
Balances with Trading Funds				
Defence Science and Technology laboratory (DSTL)	128	–	85,439	–
Meteorological Office	2	–	1,432	–
Hydrographic Office	2	–	3,332	–
Sub-total: intra-governmental balances	1,173	–	90,203	–
Balances with bodies external to government	197,021	–	125,963	–
Total debtors at 31 March 2007	**198,194**	**–**	**216,166**	**–**

16. Cash at Bank and In Hand

	2006/2007 £000	2005/2006 £000
As at 1 April	133,147	94,237
Net Cash Inflow /(Outflow)	(33,112)	38,910
As at 31 March	100,035	133,147
Balances at:		
Office of HM Paymaster General (OPG)	321	1,793
Commercial Banks and Cash in Hand	99,714	131,354
As at 31 March	**100,035**	**133,147**

Of the total balance £22,585,654 is 'non-liquid cash'.

17. Creditors

	2006/2007 £000	2005/2006 £000
Amounts falling due within one year		
Trade creditors	351,941	207,753
Payments received on account	28	127
VAT	25,504	24,399
Other creditors	76,737	108,474
Accruals and deferred income	2,258,853	2,363,888
Total creditors due within one year	**2,713,063**	**2,704,641**
Amounts falling due after more than one year		
Other creditors	271,941	173,218
Capital element of finance leases	–	–
Total creditors due after more than one year	**271,941**	**173,218**

A re-assessment of the amounts owed under the Joint Combat Aircraft Memorandum of Understanding has resulted in £107m of accruals now being classified as Creditors due after more than one year.

18. Intra-Government Creditor Balances

	2006/2007 £000		2005/2006 £000	
	Amounts falling due within one year	Amounts falling due after more than one year	Amounts falling due within one year	Amounts falling due after more than one year
Balances with other Central Government Bodies				
Cabinet Office	–	–	118,365	–
Foreign and Commonwealth Office	19	–	375	–
GCHQ	233	–	–	–
Dept for Environment and Rural Affairs	35	–	–	–
Office of Government Commerce	5	–	–	–
Balances with Local Authorities				
Forest of Dean District council	–	–	9,634	–
Trafford Metropolitan Borough Council	25	–	24,681	–
Gateshead Borough Council	9	–	–	–
Preston City Council	20	–	–	–
Balances With Trading Funds				
Defence Science and Technology Laboratory (DSTL)	384	–	1,593,471	–
Defence Aviation Repair Agency (DARA)	112	–	101,325	–
Army Base Repair Organisation (ABRO)	305	–	7,323	–
Sub-total: Intra-government balances	1,147	–	1,855,174	–
Balances with bodies external to government	2,711,916	271,941	849,467	173,218
Total Creditors at 31 March 2007	**2,713,063**	**271,941**	**2,704,641**	**173,218**

19. Provisions for Liabilities and Charges

	Nuclear decommissioning £000	Early retirement pensions commitments £000	Other £000	Total £000
At 1 April 2006	3,196,437	12,942	46,629	3,256,008
Utilisation of provisions	(27,725)	(7,814)	(19,684)	(55,223)
Change in Treasury Discount Rate	–	–	–	–
Unwinding of discount	70,322	362	278	70,962
Amounts capitalised	6,647	–	–	6,647
Transfer	–	–	–	–
Capitalised provision movements	–	–	–	–
Increase/(Decrease) in provisions	(511,167)	333	50,102	(460,732)
At 31 March 2007	**2,734,514**	**5,823**	**77,325**	**2,817,662**

Major non-nuclear provisions relate to delay and dislocation claims and outstanding liabilities as a result of UK withdrawal from a collaborative project.

Nuclear Decommissioning

19.1 Nuclear decommissioning provisions relate principally to the cost of facility decommissioning and the treatment and storage of nuclear waste arising at MoD sites, operations of Royal Navy submarines and for the Departmental share of planning and constructing a national repository for the eventual disposal of that waste.

19.2 The liabilities include the costs associated with decommissioning and care and maintenance of redundant facilities including submarines (the conditioning, retrieval and storage of contaminated materials), research and development and the procurement of capital facilities to handle the various waste streams.

19.3 Calculation of the provision to cover the liabilities is based on schedules of information received by the MoD from major decommissioning contractors. These schedules are based on technical assessments of the processes and methods likely to be used in the future to carry out the work. Estimates are based on the latest technical knowledge and commercial information available, taking into account current legislation, regulations and Government policy. The amount and timing of each obligation are therefore sensitive to these factors. These sensitivities and their likely effect on the calculation and amount of the liabilities are reviewed on an annual basis.

19.4 The latest estimate of the undiscounted cost of dealing with the MoD's nuclear liabilities is £6,374,041,274 (2005/2006 £7,849,052,414).

19.5 The estimate of £2,734,513,796 (2005/2006 £3,196,437,258) at 31 March 2007 represents the liabilities discounted at 2.2% and expressed in 2006/2007 money values.

The estimated timescale over which the costs will need to be incurred is as follows:

	31 March 2007 £000	31 March 2006 £000
Up to 3 years	251,000	309,098
From 4 – 10 years	595,440	710,779
Beyond 10 years	1,888,074	2,176,560
Total	**2,734,514**	**3,196,437**

19.6 During 2006/2007, schedule and cost estimates have been reviewed and updated in preparation for the QQR that is to take place with the Nuclear Installations Inspectorate (NII) during 2007/2008. The resulting estimates incorporate risk and uncertainty appropriate to each type of expenditure and take into account progress made to date since the original estimates made in 2000. The provision has reduced as a result of this review.

20. Reserves

	Revaluation Reserve		Donated Assets Reserve	
	2006/2007 £000	2005/2006 £000	2006/2007 £000	2005/2006 £000
As at 1 April	2,235,935	1,961,139	–	71
Arising on revaluation during the year (net)	132,576	348,805	–	1
Transfers to other parts of MoD	(220,609)	(80,205)	–	–
Reclassifications	-	–	–	
Transferred (to) / from General Fund	(298,000)	6,196	–	(72)
Donated Asset:				
Profit / (Loss) on disposal	–	–	–	–
Depreciation charged to OCS	–	–	–	–
Impairment charged to OCS	–	–	–	–
At 31 March	**1,849,902**	**2,235,935**	**0**	**0**

21. Movements in the General Fund

	Note	2006/2007 £000	2005/2006 £000	2006/2007 £000	2005/2006 £000
General Fund at 1 April			14,224,711		13,005,506
Net Vote Expenditure			6,964,936		6,925,963
Net Operating Cost for the year			(1,969,357)		(2,901,999)
Realised revaluation on disposal of assets	20		298,000		(6,196)
Realised revaluation on donated asset	20		–		72
Non-Cash Transactions:					
Cost of Capital	8	584,058		553,229	
Cost Communication		(813)		(891)	
Auditors' Remuneration	8	230		220	
Notional Costs	8	45,098	628,573	31,820	584,378
Net transactions with other parts of MoD:					
Transfer of intangibles	9	(981,353)		(533,127)	
Transfer of AuC	10	(3,963,641)		(2,926, 689)	
Transfer of tangible fixed assets		(65,164)		(3,993)	
Transfer of revaluation reserve	20	220,609		80,205	
Transfer of investments	12	–		–	
Retained transfer		–		–	
Other transfers		(107,493)	(4,897,042)	591	(3,383,013)
General Fund at 31 March 2007			**15,249,821**		**14,224,711**

22. Capital Commitments

Capital Commitments at 31 March 2007, for which no provision has been made in these financial statements, were as follows.

	2006/2007 £000	2005/2006 £000
Contracted but not provided for	16,285,938	17,811,804

23. Financial Commitments

	31 March 2007 £000	31 March 2006 £000
Lease Obligations		
The DPA was committed to making the following payments during the next year in respect of non-land and buildings operating leases:		
Expiry within one year		–
Expiring between two and five years	79,057	79,057
Expiring after five years		–

DPA has leased four Boeing C17s from the Boeing Corporation in the United States. It has been agreed that the Ministry of Defence will buy out the leases on these four aircraft in 2008.

24. Financial Instruments

The DPA has no borrowings and relies primarily on Parliamentary Supply for its cash requirements, and is therefore not exposed to liquidity risks. It also has no material deposits, and all material assets and liabilities are denominated in sterling, so it is not exposed to interest rate risk or currency risk. All our disclosures exclude short-term debtors and creditors.

FRS 13, Derivatives and Other Financial Instruments, requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities. Because of the largely non-trading nature of its activities and the way in which Government Departments are financed, the Agency is not exposed to the degree of financial risk faced by business entities. Moreover, financial instruments play a much more limited role in creating or changing risk than would be typical of the listed companies to which FRS 13 mainly applies. Financial assets and liabilities are generated by day-to-day operational activities and are not held to change the risks facing the Department in undertaking its activities.

Liquidity risk

The Department's revenue and capital resource requirements are voted annually by Parliament and are therefore not exposed to significant liquidity risks.

Interest rate risk

A significant proportion of the Agency's financial assets and liabilities carry nil or fixed rates of interest. The exposure to interest risk is therefore not significant.

Foreign currency risk

The MoD enters into forward purchase contracts annually with the Bank of England to cover the majority of its foreign exchange requirements for the following year. Details of the outstanding foreign currency contracts will be contained in the Departmental Accounts.

25. Private Finance Initiative (PFI) Commitments

The payments made during the year in respect of on and off Balance Sheet PFI transactions were £45,176,865 (2005/06: £118,969,770). The significant reduction compared to the prior year is attributable to the Skynet 5 PFI transferring to the Defence Communication Services Agency (DCSA) with effect from 1 April 2006. There were no leased assets included within Fixed Assets in 2006/2007 or 2005/2006. Therefore there were no capital elements of finance leases and On Balance Sheet PFI rentals.

There are no payment commitments during 2007/2008 as the liability transferred to another part of the MoD on 1 April 2007. Prior year figures are shown in the table below analysed below by time bands specifying the period in which the individual commitment expires:

	31 March 2007 £000	**31 March 2006 £000**
In the 1st Year	–	–
In the 2nd to the 5th Year	–	–
In the 6th to the 10th Year	–	–
In the 11th to the 15th Year	–	138,305*
In the 16th to the 20th Year	–	–
In the 21st to the 25th Year	–	45,275
In the 26th to the 30th Year	–	–

** Skynet 5 PFI transferred to another part of the MoD on 1 April 2006.*

The following information is provided for those schemes assessed as off Balance Sheet.

Project Description	**Estimated Capital Value £000**	**Contract Start Date**	**Contract End Date**
Attack Helicopter Training mission simulator: 3 field deployable simulators, ground crew, maintenance and armament training	165,000	July 1998	September 2027
Skynet 5 Provision of military satellite communications services	1,140,000	October 2003	February 2018

26. Related Party Transactions

The Defence Procurement Agency is an executive agency of the Ministry of Defence which is regarded as a related party. During the year the Agency had material transactions with the Department and other entities for which the Department is regarded as the parent.

In addition, the Agency had various material transactions with Other Government Departments (OGDs), other Central Government bodies, Public Corporations, NHS Trusts and local authorities as stated below.

MoD Trading Funds:	
Defence Science and Technology Laboratory	£65m
Army Base Repair Organisation	£11m
Defence Aviation Repair Agency	£3m
Other Government Departments:	
Foreign & Commonwealth Office	£5m
United Kingdom Atomic Energy Authority	£1m

Year-end balances with these entities are shown in *notes 15 and 18*.

During the year, no Board member or key manager has undertaken any material transactions with the Agency.

As development and equipment is completed it is delivered to the Armed Forces customer at which point the asset transfers from the DPA Balance Sheet to that of the owner of the equipment in service.

27. Contingent Liabilities

Contingent liabilities estimated at £433,590,000 have been identified. This relates to quantifiable indemnities granted to contractors and suppliers.

Details on restricted indemnities are not given because they are sensitive due to commercial confidentiality and/or national security.

28. Post Balance Sheet Events

28.1 Removal of Agency Status and merger with Defence Logistics Organisation (DLO)

On 1 April 2007 the DPA and the DLO merged to form Defence Equipment and Support (DE&S).

In December 2005 the Defence Industrial Strategy outlined a number of significant changes required within the UK defence acquisition community in order to improve performance in the delivery of capability to the Front Line and increase value for money for the tax-payer. The strategy provides a long-term strategic framework to give clarity to industry about future equipment needs and priorities.

The MoD commissioned the 'Enabling Acquisition Change' Review, by Tom McKane in June 2006, as part of the Defence Industrial Strategy implementation programme. The report evaluated existing MoD structures, organisational processes, culture and behaviours in acquisition. One of the recommendations from the report was to merge DPA and DLO taking best practice from both to form an integrated procurement and support organisation. It was subsequently decided that this new organisation would be known as Defence Equipment and Support.

A view was taken that Defence Equipment and Support would not have Agency status and also that no sub-divisions, except for the Defence Storage and Distribution Agency, should have separate Agency status. This was deemed the most effective way of ensuring that Defence Equipment and Support and its sub-divisions have fully aligned and coherent performance and financial objectives. The decision was announced in the House of Commons by the Minister of State, Ministry of Defence, Mr Adam Ingram on 28 March 2007.

With the retirement of the Chief of Defence Procurement and the removal of agency status from the DPA from 1 April 2007, the Permanent Under Secretary of State declared that by virtue of his previous appointment as Deputy Chief Executive, DPA, Mr David Gould should be responsible for certain accounting responsibilities that previously fell to CDP, in particular, the responsibility for signing the formal accounts of the Agency in accordance with the Accounts Direction issued by the Treasury.

28.2 Financial Statements: Date of authorisation for issue

The Accounting Officer has authorised the Financial Statements to be issued on 10th July 2007.

29. Reconciliation of Net Operating Cost before Interest to Net Cash Outflow from Operating Activities before Interest

For the year ended 31 March 2007

	Note	2006/2007 £000	2005/2006 £000
Net operating cost before interest		1,382,857	2,347,155
Non-cash transactions			
– Depreciation and amortisation charges	11	(99,677)	(120,638)
– Permanent diminution in value of fixed assets		(6,686)	(11,922)
– Stock provisions		2,538	(1,243)
– Stock write-off/on		(94,376)	(62,174)
– Auditors' remuneration	8	(230)	(220)
– Notional costs	8	(45,098)	(31,820)
– Communicated costs		813	891
– Surplus/(deficit) on disposal of fixed assets and investments	5	11	–
– Changes in provisions for liabilities and charges	19	460,732	153,989
– Unwinding of Provision Discounts	19	(70,962)	(849,612)
– Stock and project adjustments		(55,925)	39,579
– Write-off and write-on of assets		(21,937)	(17,737)
Adjustments for movements in working capital other than cash after adjustment for communicated costs			
– Increase/(decrease)in stocks/work in progress		(246,229)	(282,993)
– Increase/(decrease) in debtors		(17,971)	98,504
– (Increase)/decrease in creditors		(4,608)	(66,347)
Charged against provisions for liabilities and charges		57,533	93,241
Movement in inter management group balances		5,126,487	3,669,862
Net cash (inflow)/outflow from operating activities before interest		**6,367,272**	**4,958,515**

30. Analysis of Net Capital Expenditure and Financial Investment

For the year ended 31 March 2007

Acquisition of fixed assets	Note	2006/2007 £000	2005/2006 £000
Purchase of fixed assets			
– Intangibles		1,655,048	1,459,265
– AuC		3,763,124	3,852,298
– Other fixed assets		8,811	25,574
– Less capitalised provisions	19	(6,647)	(25,370)
Total purchase of fixed assets		**5,420,336**	**5,311,767**
Asset Transfers to other areas of the MoD			
– Intangibles	9	(981,353)	(533,127)
– AuC	10	(3,963,641)	(2,926,689)
– Other fixed assets		(65,164)	(3,993)
– Revaluation reserves	20	220,609	80,205
		(4,789,549)	**(3,383,604)**
Other Transactions			
– Proceeds from disposal of fixed assets		(11)	–
Total other transfers		**(4,789,560)**	**(3,383,604)**
Net cash outflow/(inflow) from capital expenditure and financial investment		**630,776**	**1,928,163**

31. Determination of net cash requirement

For the year ended 31 March 2007

	Note	2006/2007 £000	2005/2006 £000
Vote expenditure appropriated in year	21	(6,964,936)	(6,925,963)
(Increase)/decrease in cash	16	33,112	(38,910)
Net cash requirement		**(6,931,824)**	**(6,964,873)**
Movement in Inter-Management-Group Balances			
Balance at 1 April		(3,189)	(7,123)
Movement in year	29	5,126,487	3,669,862
Balance at 31 March		**5,123,298**	**3,662,739**

Note: the movement between opening balance of (3,189) and closing balance prior year of 3,662,739 is due to the clear-down of the inter-management accounts at year-end.

32. Losses and Special Payments

A Losses Statement, details of Special Payments, Gifts, Loans and other notes as described in 'Government Accounting' are required to be included in the financial statements. The purpose of the Losses Statement is to report all defined losses that have been brought to account during the year. In addition, any individual loss that exceeds £250,000 is noted separately.

The tables below give details of the payments made, and losses incurred, by the DPA as disclosed in the 2006/2007 Departmental Resource Accounts.

Losses Statement	**2006/2007 £000**
Total (425 cases)	**352,292**
Details (cases over £250,000)	
CLOSED CASES	
Constructive Losses	
This constructive loss arose from the UK Government decision not to proceed into the production for the long range TRIGAT anti-tank guided weapons system (LR TRIGAT). The amount was recorded previously as £205m until we were able to conclude all of the outstanding financial issues.	194,820
The extended range ordnance modular charge system (ERO/MCS) was cancelled due to technical difficulties with the MCS that could not be resolved. This produced an estimated constructive loss. We were able to recover £10.34m through a negotiated settlement package.	37,047
A loss arose as a result of the UK Government decision to reduce the number of Nimrod MRA4 being procured from 18 to 12. Previous estimated cost was £32.6m.	32,550
A constructive loss (inc VAT) arose as a result of settlement between the Agency and a manufacturer for the provision of Manportable Remote Control Vehicles (MRCVs).	1,354
Cancellation of Civil Pallet Conversion Kits in A400M's aircraft procurement programme.	484
Claims Abandoned	
A commercial compensation package agreed as a result of slippage to the delivery dates by the Contractor and the unavailability of components for the COBRA programme has resulted in a write-off. This was erroneously recorded last year as £2.7m.	540
Fruitless Payments	
An agreement breached with a Contractor that required contracts for nuclear cores to be placed within a certain timeframe rendering MoD liable to pay default costs.	562
Special Payments	
There was an extra contractual payment (inc VAT) resulting from the late supply of Government Furnished Assets to the TITAN and TROJAN project.	4,465
Payment in settlement of the Armoured Vehicle Training Services (AVTS) PFI strategy.	2,900

The contract for the Landing Ship Dock (Auxiliary) LSD(A) incurred additional expenditure of £32m for 2006/2007. The second ship built at Swan Hunter, RFA Lyme Bay, is nearing completion by BAE Systems.	32,000
Accounting and Bookkeeping Losses	
£37m relates to the write off of legacy project balances and £4m to the write off of residual balances post migration to the Single Balance Sheet Owners.	44,933
ADVANCE NOTIFICATION	
Notified in prior years	
The value of 8 Chinook Mk3 helicopters was written down by £205m under prudent accounting practices. The write down arose because, although the terms of the contract were met, the helicopters did not meet operational requirements and could not acquire a useful Military Aircraft release. The MoD intends to convert the Mk3 airframes to a modified Mk2 standard as a way forward, with a revaluation exercise of the 8 aircraft at the point of asset delivery.	205,000
Cancellation of the Alternative Launcher Drive System (ALDS) programme has resulted in a potential write-off.	4,000
A potential claim against a contractor on the ASTOR programme has been abandoned resulting in a loss, but other benefits of £16m have been secured in compensation.	28,000
Slippage in the construction programme for two Landing Ship Docks (Auxiliary) caused delay in supplying design information and equipment to a contractor. This resulted in a claim on the MoD relating to the associated delay and dislocation costs. Value of amount was reviewed and subsequently reduced.	53,836
Contractor is claiming extra costs resulting from the late delivery of unusable GFE items, purchased via Foreign Military Sales (FMS). An earlier disclosure of £1.763m was recorded in the 2004/2005 Accounts. However the MoD is attempting to re-claim via the US Courts.	4,000
Notified during the year	
A contract for an Integrated Biological Detection System (IBDS) was not progressed as a result of production delays and a strategic decision to reduce the number of systems required.	25,916
The Nuclear, Biological and Chemical Battlefield Information System Application (NBC BISA) Project was cancelled by mutual agreement with the Contractor, EDS Defence. Technical difficulties in pre-existing software introduced significant risks into the project which threatened its future success.	14,165
Estimated repair costs to the Type 45 Long Range Radar (LRR) Antenna damaged during installation.	700

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