



**DEFENCE ESTATES**

*Delivering Estate Solutions to Defence Needs*

# **Agency Annual Report**

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## **Accounts**

### **2005/2006**







# **Annual Report and Accounts 2005/2006**

Presented to Parliament pursuant to Section 7 of the  
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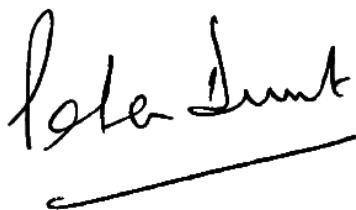
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## SECTION 1

### CHIEF EXECUTIVE'S STATEMENT

- 1.1 This Annual Report and Accounts sets out *Defence Estates'* performance during the past year. It covers the first year that *Defence Estates* operated as a Top Level Budget (TLB) as well as an Agency within the Ministry of Defence (MOD) and the achievements in this Report reflect the hard work and dedication of the staff across the whole Agency.
- 1.2 The Agency exists in direct support of military capability. The Vision of *Defence Estates* remains 'To provide an estate of the right size and quality, which is managed and developed effectively in line with acknowledged best practice and is sensitive to social and environmental considerations'. Equally important, is the need to ensure that we deliver our outputs effectively and efficiently and that our staff are properly equipped to do their jobs. These principles are at the heart of how the Agency operates.
- 1.3 A key achievement of 2005/2006 has been the publication of the refreshed Defence Estate Strategy "In Trust and On Trust". The Strategy has been the subject of extensive consultation with all of our stakeholders including both customers and suppliers and was launched by Secretary of State for Defence on 21 March 2006. The Strategy is forward looking and takes into account the excellent progress made on modernising our estate management services.
- 1.4 Further achievements during the past year include the award of the Central and East Regional Prime Contracts (RPC) and, in addition, the award of the Housing Prime Contract (HPC) which brings the principles of Prime Contracting to the maintenance of Service Families Accommodation (SFA). These major contracts will underpin the maintenance and improvement in the estate for the next 7 years.
- 1.5 The delivery of the programme to upgrade both Single Living Accommodation (SLA), through Project SLAM (Single Living Accommodation Modernisation) and the programme to upgrade Service Families Accommodation remain key objectives for the Department. Project SLAM has exceeded its in year target by over 40%, having delivered 3,570 new en-suite bedrooms against a target of 2,500. The target of 600 upgraded houses has been exceeded by an additional 1,105, surpassing the target by 184%.
- 1.6 Improving the condition of the estate is crucial to achieving our vision and it is important that we can measure our progress in this area. We have continued to develop the Estate Performance Measurement System (EPMS) in order to measure the improvements achieved on Prime Contracting against Departmental targets.
- 1.7 The Agency continued to support Estate Rationalisation through the purchase of office accommodation in the Bristol area to enable some elements of the Defence Logistics Organisation to collocate with the Defence Procurement Agency. Assistance was also given in the collocation projects for single Service Top Level Budget Holders and other major studies.
- 1.8 Sustainability and our impact on the natural environment are areas of significant and increasing importance and *Defence Estates* continues to implement what is set out in the Framework for Sustainable Development on the Government Estate. In support of English Natures' 2010 target for Sites of Special Scientific Interest (SSSI) we have exceeded our target to have 75% of SSSI in a satisfactory condition. I am pleased to report that *Defence Estates* was recognised by several national and regional awards in the field of conservation and sustainability. Sustainability will remain high on the agenda and will be at the forefront of all estate related activities.

- 1.9 We recognise that a number of our stakeholders are not directly connected with defence, including the general public, and in line with this we have continued to enhance arrangements for public access to the defence estate. As a leading Government Department we have negotiated a new 'Managed Access' symbol with Ordnance Survey (OS) for use on the 1/25,000 scale OS maps. A key achievement in 2005 was completion of a 90km bridleway, the Epynt Way, at Sennybridge Ranges in Mid Wales. It is also Government policy to get more visitors into the countryside – for health purposes and to boost the tourist economy – and MOD is helping to deliver this agenda by providing better information on public access on a new website ([www.access.mod.uk](http://www.access.mod.uk)). With 1,300km of public rights of way, 200km of “permissive” routes and a number of new “open access areas” the public can now enjoy many and varied walks on MOD land in a countryside rich in heritage, archaeological interests, captivating views and a diversity of flora and fauna.
- 1.10 During the past year we have continued to consolidate and build on our achievements and have taken on new responsibilities such as maintenance of the estate in Northern Ireland and Germany and, as I mentioned earlier, we continue to support the Department's Estate Rationalisation programme by enabling our customers' plans for downsizing and collocation.
- 1.11 I recognise that the coming year will bring new challenges as we further embed Prime Contracting and continue with our programme to improve the condition of the estate whilst striving to deliver our outputs efficiently. We will also take on additional responsibility for the overseas estate and for the supply side of the Training Estate. All of these will bring their own demands, but if we all continue to work together we will be able to deliver a defence estate which matches the Estate Strategy and the Agency's Vision. I continue to be delighted with our achievements and record my thanks to all staff for their support and commitment.



Vice Admiral P A Dunt CB  
Chief Executive

21 June 2006

## SECTION 2

### MANAGEMENT REPORT

2.1 The Chief Executive of *Defence Estates* presents the annual report, together with the audited financial statements for the year ended 31 March 2006.

### Financial Performance

2.2 The net operating cost for the year of £965.181m (2004/05: £626.889m) has been charged to the General Fund.

### Principal Activities

2.3 *Defence Estates* has responsibility for ensuring that the MOD estate is managed efficiently and effectively as a corporate asset to support the delivery of defence capability. From April 1999, all property scheduled for disposal in the United Kingdom and North West Europe has become the responsibility of *Defence Estates*, up to the point of sale, as soon as it ceases to be used by the former occupier and all formal requirements of the site closure procedure have been met. From April 2005, this has been extended to cover all property throughout the world. All proceeds from such sales are reflected in the Agency Accounts.

### History

2.4 *Defence Estates* was re-launched on 1 April 2003. The primary role of the Agency is to provide specialist support to the Ministry of Defence (MOD) on estate policy and the Sustainable Development in Government agenda and to maintain the estate and its infrastructure, including families' housing.

### Statutory Background

2.5 *Defence Estates* is an Agency of the MOD. Its owner, from 1 April 2005, is the Permanent Under Secretary and it operates in accordance with a Service Level Agreement with the Department. The owner receives advice from the Defence Estate Committee on the standards of service supplied by the Agency. The composition of the Committee as at 31 March 2006 was as follows:

Mr I C F Andrews (Chairman)	2nd Permanent Under Secretary
General Sir Timothy Granville-Chapman	Vice-Chief of the Defence Staff
General Sir Richard Dannatt	Commander-in-Chief Land
General Sir Kevin O'Donoghue	Chief of Defence Logistics
Air Chief Marshal Sir Joe French	Commander-in-Chief Strike Command
Vice Admiral Adrian Johns	2nd Sea Lord and Commander-in-Chief Naval Home Command
Lieutenant General Nick Houghton	Chief of Joint Operations
Mr T A Woolley	MOD Finance Director
Mr S Barter	External Member
Mr R Spray	External Member

### Equal Opportunities Policy and Employment and Training Disabled Persons

2.6 The Agency is committed to the MOD programme on equal opportunities and the employment of disabled persons and has produced its own equal opportunities statement. The Agency has 124 employees who have indicated that they are registered as disabled.

### Accounts Direction

2.7 HM Treasury has directed *Defence Estates* to prepare a statement of accounts in the form and on the basis set out in an Accounts Direction dated 13 January 2006.



## Management of the Agency

2.8 The day-to-day management of the Agency is carried out by the Agency's Management Board, which at 31 March 2006 consisted of:

Vice Admiral P A Dunt	Chief Executive
Mr D I Olney	Director General Operations
Brigadier R A Cary	Director Programming (appointed to the Board 24 February 2006)
Air Commodore K J Pellatt	Director Housing
Mr W C Clark	Agency Secretary
Mr R Jones	Director Projects
Mr M E Martindale	Finance Director
Mr R J McKinney	Director Estate Strategy and Policy (appointed to the Board 13 June 2005)
Mrs C J Nicholson	Non-Executive Director
Mr M W Pengelly	Director Commercial

Other persons who held office during the year were:

Air Commodore N J Kurth	Director Programming (resigned from the Board 20 February 2006)
Mr A R Baillie	Director Estate Strategy and Policy (resigned from the Board 13 June 2005)

## Policy on the Payment of Creditors

2.9 The majority of bills are paid on behalf of *Defence Estates* by the Defence Bills Agency (DBA), who is committed to ensuring compliance with the Government-wide standard on bill paying. Following implementation of the Late Payment of Commercial Debt (Interest) Act 1998, DBA aim to ensure that 99.9% of correctly presented bills are paid within 11 calendar days. In 2005/06, actual performance achieved was 99.9% paid within 11 calendar days. No liabilities were incurred under the Late Payment of Commercial Debt (Interest) Act 1998 and no interest payments arose.

## Pension Arrangements

2.10 These are covered in notes 1 and 2 to the accounts and in the Remuneration Report.

## Staff Involvement

2.11 The Agency maintains systems for the provision of information to, and consultation with, employees, and for the dissemination of necessary information regarding health, safety and welfare at work.

## Auditors

2.12 The accounts of the Agency are audited by the Comptroller and Auditor General under section 7(3)(b) of the Government Resources and Accounts Act 2000. The notional cost of the statutory audit is £125,000 (2004/05 £125,000).

2.13 So far as I, as Accounting Officer of the Agency, am aware:

- a. there is no relevant audit information of which the Agency's auditors are unaware; and
- b. I have taken all steps that I ought to have taken to make myself aware of any relevant audit information and to establish that the Agency's auditors are aware of that information.

**A. KEY TARGETS – 2005/2006**

2.14 The performance targets laid out in the table below are consistent with the targets set out in the *Defence Estates Corporate Plan 2005-2010*.

KEY TARGETS	EVIDENCE OF PERFORMANCE	OUTCOME
KT1 – To Improve the defence estate in a sustainable manner to improve its fitness for purpose and condition.		
1a. Improve Single Living Accommodation (SLA) to Grade 1 (Project SLAM and SLA Parallel Projects (PP), including overseas).	Project SLAM – 3,570 SLAM bedspaces were delivered in year against a target of 2,500.  SLA Parallel Projects – 3,055 bed spaces were delivered against a target 5,300.	<b>Target exceeded</b> – The <i>Defence Estates</i> SLAM Programme delivered an additional 1,070 bedspaces, exceeding the target by over 40%.  <b>Target not achieved</b> – The number of bedspaces delivered by the TLBs has failed to meet the target.
1b. Improve Service Families Accommodation (SFA) by completing the upgrade of properties to Standard 1 for Condition (S1FC) as part of the programme to upgrade all core stock required for the longer term.	Delivery of minimum number of upgraded properties (600).	<b>Target exceeded</b> – 1,705 upgraded properties complete at end of Qtr 4 (exceeding target by 184%).
1c. To improve and maintain the defence estate.	The target condition for the built estate has been established with customers. This now forms a baseline against which the performance of Regional Prime Contracting (RPC) will be measured in future.	<b>Target achieved</b> – in line with prime contracting roll out programme.
1d. Sites of Special Scientific Interest (SSSI) in Satisfactory Condition (95% by 2010).	79% of SSSIs have met the criteria for satisfactory condition.	<b>Target exceeded</b> – Target of 75% of MOD sites in England.
KT2 – To provide an estate of the right size through the consolidation of assets.		
2a. Provide an estate of the right size through implementing agreed Estate Rationalisation (ER) milestones.	Evidence of performance is reflected in the contribution to the achievement of a number of estate related projects, for example the progress of TLB Co-locations.	<b>Target achieved</b> – Progress towards estate of the right size resulting in a rationalised estate with financial receipts obtained through site disposal.
2b. Achieve Accrued Estates Disposal Receipts (Gross).	Achieve accrued Estates Disposal Receipts (gross) of £250m.	<b>Target exceeded</b> – Receipts of £257.5m (excluding assets transferred to the Private Sector).
KT3 – To improve customer satisfaction and service delivery.		
3a. Decrease customer dissatisfaction with the quality of property provided as SFA.	Housing Directorate has now completed the development of the new survey which will be rolled out in 2006/07.	<b>Target achieved.</b>
3b. Decrease customer dissatisfaction with service delivery to SFA occupants.	Housing Directorate has now completed the development of the new survey which will be rolled out in 2006/07.	<b>Target achieved.</b>
3c. Increase customer satisfaction with <i>Defence Estates</i> service delivery to Customer Estate Organisations (CEstOs).	The measure for 2005/2006 was overall achievement of Customer Service Agreement (CSAs) to be ≥ 90%. The CSAs measure delivery against performance targets but contain an element of customer satisfaction. For 2006/07 a separate measure of customer satisfaction will be developed.	<b>Target achieved.</b>

KEY TARGETS	EVIDENCE OF PERFORMANCE	OUTCOME
<b>KT4 – Achieve key milestones for implementation of key MOD Estates Change Initiatives.</b>		
4a. Regional Prime Contracts.	RPC (Central) Contract Awarded November 2005 against a target of September 2005.  RPC (East) Contract Award November 2005 against a target of October 2005.	<b>Target not achieved</b> – Due to protracted contract negotiations, but in Service Date of April 2006 achieved with Contract Award within Project tolerance of August to December 2005.  <b>Target not achieved</b> – Date of Contract award not met but no impact on planned go live date of June 2006.
4b. Defence Housing.	Housing Prime Contract (HPC) awarded 14 November 2005. Progress made against streamlined Housing Directorate structure.	<b>Target not achieved</b> – Due to extended contractual negotiations target was August 2005.
4c. Project Alexander.	Deferred Scope Implementation introduced across Northern Ireland (NI), Germany and UK training estate.	<b>Target achieved</b> – Implementation achieved by April 2006.
4d. Defence Training Estate Rationalisation Study (DTERS).	Completion of Phase 1 has been achieved.	<b>Target achieved</b> – All assets now transferred with two new organisations up and running, Customer and Supplier Organisations with Commercial and associated finance to manage the assets in place accordingly.
<b>KT5 – Deliver value for money efficiencies.</b>		
5a. Deliver 30% through-life value for money output efficiencies through the introduction of Prime Contracting.	Following the successful conclusion of pilots for the Estate Performance Measurement System (EPMS) at nine MOD locations, it was agreed to roll-out a single asset grading methodology, introduce Integrated Estate Management Plans (IEMPs), and demonstrate Value for Money using the developed model and associated performance indicators, across the defence estate.	<b>Target achieved</b> – Demonstrated 3% through-life Value For Money (VFM) efficiency target for 2005/06 in Prime Contracts against baseline.
5b. To deliver output efficiencies from Project SLAM.	£5.04m. This figure is taken directly from the Departmental Efficiency Programme.	<b>Target achieved</b> – Delivered profiled efficiency.
5c. To deliver output efficiencies from Project Aquatrine.	£11.04m. This figure is taken directly from the Departmental Efficiency Programme.	<b>Target achieved</b> – There is already improvement with significant investment in infrastructure taking place.
5d. To deliver the savings from the introduction of the Housing Prime Contract (HPC).	Initial restructuring of “soft” housing service is underway but further economies are being examined. Restructuring will be complete by April 2007.	<b>Target not achieved</b> – Due to delay in awarding HPC. The transfer of responsibility for all repairs and maintenance to Service Families Accommodation (SFA) to Housing Prime Contractor completed March 2006. Some Housing Directorate staff remain to be re-deployed.
5e. To deliver the savings from restructuring and the merger of DE and Defence Housing Executive.	New Housing Directorate Head Office structure in place and nine regional structures have been streamlined into two – North and South. Housing Directorate services managed within reduced budget allocation.	<b>Partially achieved</b> – £2.1m merger savings achieved. £500k unable to be realised due to late completion of final structure.
5f. To reduce the management margin of vacant housing to 10% by November 2005 (i.e. the proportion of working stock that is vacant, excluding housing earmarked for disposal in the next 12 months).	By November 2005 the management margin was 13%. If, however, the proportion of SFA held vacant awaiting deployments and/or rationalisation decisions by the Services is excluded, the margin reduces to 6.8%. The corresponding figures at 31 March 2006 were 13.9% and 7.9% respectively. The number of empty properties will reduce from 1 April 2006 as Gurkha families take up SFA following changes to their terms and conditions of service.	<b>Target not achieved</b> – Given the continued uncertainty in respect of many Service deployments and rationalisation studies there is a need to retain a large number of vacant properties (c3,000) to meet potential future requirements. The target of 10% will not be achieved until firm decisions have been taken and implemented.

## **B. DELIVERING TO OUR CUSTOMERS**

### **Regional Prime Contracting (RPC)**

- 2.15 Through improvements by *Defence Estates* in supply chain management, the provision of incentive based contracts and working closely with industry, the RPCs exist to meet the requirements of customer TLBs whilst providing value for money and improving the delivery of estate services. As part of this programme the last two out of five RPCs were awarded in 2005/2006, as set out below.
- 2.16 RPC (Central). Carillion Enterprise, a consortium comprising Carillion Services Ltd and Enterprise plc, was awarded the contract for RPC (Central) on 2 November 2005. The provision for Interim Services started on 6 January 2006 with the full 'In Service' by 22 April 2006.
- 2.17 RPC (East). Babcock DynCorp, a consortium comprising Babcock Infrastructure Services and DynCorp International, was awarded the contract for RPC (East) on 16 November 2005. The Contract went live in April 2006 with 'In Service' due by 30 June 2006.

### **Project Aquatrine**

- 2.18 Aquatrine is a MOD wide 25-year Private Finance Initiative (PFI) split into three geographical packages, to deliver water and waste water services to the MOD estate. Aquatrine provides increased value for money whilst achieving appropriate associated risk transfer to the respective PFI Service Providers.
- 2.19 There are already indications of improvements in delivery of water and waste water services from all 3 Packages. Packages B and C have become more effective at an earlier stage due to taking forward lessons learnt from Package A.

### **Housing Prime Contract (HPC)**

- 2.20 The HPC for England and Wales was awarded on 14 November 2005 to MODern Housing Solutions (MHS), a joint venture between Carillion, Enterprise and Atkins. The Contract represents a significant milestone in the programme to modernise service delivery for the repair and maintenance of Service Families Accommodation (SFA). It covers the whole of the SFA estate across England & Wales, with the exception of PFI-managed properties where existing arrangements will continue. SFA in Scotland falls under RPC Scotland.

### **Single Living Accommodation (SLA)**

- 2.21 The provision of good quality SLA plays a vital part in enhancing recruitment and sustaining retention and morale in the Armed Forces and as such *Defence Estates* is working in parallel with other Top Level Budget (TLB) holders to deliver high quality SLA. Through Project SLAM (Single Living Accommodation Modernisation) an additional 1,070 upgraded bedspaces have been delivered above the target of 2,500. Feedback from customers and occupants has been highly complimentary. There has also been anecdotal evidence of single service personnel in private lodgings requesting a return to base to take up SLAM accommodation and that the improved standard of accommodation will feature in decisions on whether to stay in the Services. The popularity with users is a clear endorsement of the improved living environment provided by the Project.

### **Service Families Accommodation**

- 2.22 The provision of good quality SFA plays a key role in maintaining the morale and retention of Service personnel. Additional funding was made available from the *Defence Estates* budget in 2005/2006 to increase substantially the number of properties upgraded to Standard 1 for Condition. During the year the target for upgrading properties was exceeded by 1,105 SFA properties with 1,705 SFA properties upgraded against a target of 600.
- 2.23 One of *Defence Estates* key principles is to focus everything it does to helping the customer, and *Defence Estates* has, therefore, continued to work to improve customer satisfaction with both the

quality of SFA and its maintenance, and the service that *Defence Estates* provides to Service families. As part of this continued commitment *Defence Estates* has completed the development of a new customer satisfaction survey to be rolled out during 2006/2007. Previous surveys were subject to variables outside the control of *Defence Estates* that impact on the well-being of the SFA community, such as long term detached duty and operational commitments. The new survey has been amended in agreement with the MOD's Service Personnel Policy staff to produce a more focussed result.

### Sustainable Development

2.24 Integrating Sustainable Development into estate management activities and business processes is a priority. *Defence Estates* continues to make excellent progress towards achieving 95% of the Sites of Special Scientific Interest in a satisfactory condition by 2010, and has exceeded the target for 2005/2006. Over 75% of sites are now at the required standard. Sustainability Appraisals for projects are being completed, and strategies published on sustainable procurement, estate management and social impacts.

### International Directorate

2.25 The principles of Project Alexander were implemented in Germany from April 2005 and are a major success story. *Defence Estates* Europe moved from a predominantly advisory organisation with a staff of 80 to a delivery organisation with a staff of 950 including those staff transferred in locally who will deliver projects, facilities management and lease negotiation.

2.26 In February 2006 the South Atlantic Islands Integrated Service Providers (ISP) arrangements were reviewed after the first year of operation. The review gave full confidence that the processes and procedures introduced by the ISP were being applied, that they were working and that value for money was being achieved. In addition to the annual £6m savings over the previous arrangements, the ISP is providing more for less.

2.27 The Overseas Division has continued to support its three principal areas of responsibility: the Operational Theatres [Afghanistan, Iraq and the Balkans], the Permanent Joint Operating Bases (PJOBS) [South Atlantic Islands, Gibraltar and Cyprus] and the Remote Overseas Stations (ROS) [Belize, Brunei, Canada, Kenya and Nepal]. In the Operational Theatres, contract replacement has been taking place and ISPs are about to be let in Iraq and Afghanistan. On the PJOBS, the target for the delivery of FM has been exceeded at the same time as major contract reform is on going in Cyprus and Gibraltar with the introduction of ISPs.

2.28 In August 2005 the first of five phases of the £127m "Liberty Village" project to build 606 SFA for United States Air Force personnel at RAF Lakenheath commenced construction. The first phase will deliver 89 houses together with new service infrastructure, roads and pathways. Full Local Authority Planning approval for the remaining four phases of Liberty Village has also been obtained which enabled Phase 2, a further 154 houses, to commence in May 2006.

2.29 *Defence Estates* continues to support the US visiting forces and NATO at 11 locations in the UK by delivering over £120m of construction and maintenance during the last financial year, handing over 82 completed projects.

### Security Services Group (SSG)

2.30 SSG continues to be successful in providing solutions to the security requirements for government, other public sector and some key private sector customers. During 2005/2006 the organisation continued to experience steady growth resulting in the delivery of £19m of sales.

### Support to Ministers, MOD and the Public

2.31 In 2005/2006 the Agency Secretariat handled over 1,100 items of Ministerial and Parliamentary Business including both written and oral Parliamentary Questions (an increase of 4.37% on the previous year). The Secretariat also provided officials to brief Under Secretary of State for Defence and Minister for the Veterans and other Ministers before meetings with Members of Parliament and others.

- 2.32 Since 1 April 2005 *Defence Estates* has received in excess of 200 Requests for Information under either the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. The Requests have covered a wide range of topics, but notably information relating to sites that have either been or are in the process of disposal. As the Department continues to rationalise its estate, the trend for similar requests is likely to increase.

## C. BEING EFFICIENT IN THE DELIVERY OF OUR OUTPUTS

### Estate Rationalisation

- 2.33 A key aim of the Estate Strategy is to provide an estate of the right size to support Defence outputs. Funding was allocated in the last planning round to enable a number of projects to proceed. These projects included the collocation of the Headquarters of the Defence Logistics Organisation with the Defence Procurement Agency in North Bristol; the collocation of the two TLB Headquarters within each Service; to rationalise the Chief of Defence Intelligence Staff's estate; and to rationalise the estate used by the Defence Medical Education and Training Agency, the Royal College of Defence Medicine and the Army Training and Recruitment Agency. *Defence Estates* has supported the development of business cases for all of these projects, and the further study of other rationalisation opportunities. The programme to dispose of surplus estate has continued during 2005/2006. During the year disposal receipts, excluding transfers of assets to the Private Sector, totalled £257.5m, exceeding the target by £7.5m.
- 2.34 Project MoDEL (MOD Estate in London) aims to deliver major investment and restructuring of the MOD Estate in London. MoDEL is pursuing a new procurement strategy, Prime Contracting Plus, which will enable the contract to be entirely self-funding over its lifetime, utilising the value of the sites that are released as a result of the consolidation to fund the construction and relocation costs. A consortium of VINCI plc and St Modwen Properties plc was selected as the Preferred Bidder in March 2006.

### Supplier Management

- 2.35 In conjunction with major suppliers the Report *Building Collaboration – A Toolkit Based on Experience* – was published in February 2006. This Report provided an analysis of the data collected from feedback with Supplier Associations from the 5 RPCs, follow-up interviews with all RPC bidders and Integrated Project Team Leaders (IPTLs), and workshops held last summer. The Report is a unique study into what was a novel approach within the MOD, if not Government, identifying that collaborative working is a key ingredient to building a strong team approach to successful project delivery. The Report has been passed to other Government Departments as an exemplar of best practice.

### Supplier Associations

- 2.36 *Defence Estates* remains committed to developing its relationship with industry. During 2005 *Defence Estates* demonstrated this commitment by establishing two Supplier Associations – one with all Prime Contractors, the other with the 3 Aquatrine PFI Service Providers. The overarching purpose of these Associations is to create an environment where shared business improvement work, resourced by all parties, provides tangible benefits to *Defence Estates*, to *industry* and to our customers.
- 2.37 The Associations have the full commitment of both *Defence Estates* and their principal suppliers and, in the absence of a competitive atmosphere over the next few years, *Defence Estates* is confident they will greatly assist in improving project delivery and deliver efficiencies.

### Fraud Prevention

- 2.38 The *Defence Estates* Fraud Prevention Unit (FPU) has made great strides regarding the identification and mitigation of fraud risks and the raising of fraud awareness. This approach sends out a clear signal of the commitment of *Defence Estates* to fraud detection and deterrence.
- 2.39 *Defence Estates* has continued its training programme and has provided fraud awareness training to approximately 1,200 *Defence Estates* staff in both the UK and overseas.

## Lands Management System

2.40 Wherever possible *Defence Estates* seeks to generate income from the appropriate use of irreducible spare capacity, whilst ensuring that the estate is used to optimum capacity and facilitating increased public access. Work has also been ongoing throughout the year to support MOD's position in the new planning system with significant input into the Regional Spatial Strategies and Local Development Framework documents across the UK. This work will provide the planning backdrop to enable the optimum use of property against which future operational requirements can be met through the implementation of the Estate Strategy.

## D. EQUIPPING OUR PEOPLE TO DELIVER

2.41 Wide-ranging changes to the way the MOD manages its people have inevitably begun to impact on *Defence Estates*. For the Human Resources (HR) teams, managing those changes, whilst maintaining a focus on equipping people to deliver to their customers, has been a significant challenge.

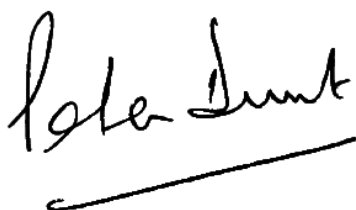
2.42 Development activity to improve functional, professional and core skills remains a high priority. Particular emphasis on project and programme management has been evident and *Defence Estates* is working closely with other areas of the MOD's Acquisition Community to ensure a cohesive approach and to learn with equipment-focused colleagues. This is consistent with the recently published Defence Industrial Strategy.

2.43 *Defence Estates* HR teams have merged into a single organisation in the Secretariat, with a primary role in supporting restructuring across the Agency. The unified HR team has also contributed to MOD-wide manpower reductions by managing a voluntary early release programme to help *Defence Estates* achieve its targets whilst ensuring it retains people with skills that are critical to delivering to customers.

2.44 The Chief Executive has been appointed as the MOD Skills Champion for the MOD Estates Job Family, covering skills development for a large number of our own specialist and customer facing roles as well as some posts in customer organisations. Within the Agency, the Agency Secretary champions people issues on behalf of the *Defence Estates* Management Board.

2.45 This year the key achievements include the launch of the Chief Executive's Commendation Scheme to encourage and recognise significant achievement across the Estates business, including customer organisations. The HR Team has supported business change (Regional and Housing Prime Contracts) through awareness and role-specific training and developed a medium term Estate Management training strategy and piloted new training products.

2.46 *Defence Estates* has continued its management of transfers-in to *Defence Estates* both overseas and through rationalisation of the defence training estate function. These achievements have been enabled by the development of new consultation structures with the Trade Unions to enable a more positive and collaborative employee relations process.



Vice Admiral P A Dunt CB  
Chief Executive

21 June 2006

## SECTION 3

### REMUNERATION REPORT

(All details contained in this report have been subject to audit)

- 3.1 Members of the *Defence Estates* Management Board, with the exception of Mrs C Nicholson, hold substantive civil service contracts or are in the armed forces. Appointments may be terminated in accordance with the Civil Service Management Code or Single Service Military Appointment procedures. Mrs C Nicholson receives a fee for attending meetings based on an agreed daily rate.
- 3.2 Salaries of the Board are determined through the Senior Civil Service Salaries Review Body, the Armed Forces Pay Review Body (AFPRB), the Senior Salaries Review Body or as part of the Departmental pay award, as appropriate. The only exception to standard salary levels being Mrs C Nicholson who was subject to separate negotiation and received a fee based on the number of days spent on the affairs of the agency.
- 3.3 The salary and pension entitlements of the Management Board are shown below. The disclosure note has been drawn up in accordance with DAO(GEN)12/00 dated 21 December 2000 whereby written consent has been obtained from all the members of the Management Board prior to the publication of their salary details.

	Year	Salary including Performance Pay £'000	Real increase in pension £'000	Accrued pension at 31 March 2006 £'000	Lump sum at 31 March 2006 £'000	Real increase in lump sum £'000	CETV* at 31 March 2006 £'000	Real increase in CETV £'000
<b>Current Board members</b>								
Vice Admiral								
P A Dunt	2005/06	110 – 115	0 – 2.5	55 – 57.5	170.0 – 172.5	5.0 – 7.5	1,079	40
Chief Executive	2004/05	105 – 110	(0 – 2.5)	52.5 – 55	160.0 – 162.5	(0 – 2.5)	1,040	(7)
Mr D I Olney	2005/06	75 – 80	0 – 2.5	25 – 27.5	75.0 – 77.5	2.5 – 5.0	397	23
Director General Operations	2004/05	80 – 85	2.5 – 5.0	22.5 – 25	67.5 – 70.0	12.5 – 15.0	356	70
Brigadier	2005/06	5.0 – 7.5	0 – 2.5	32.5 – 35	97.5 – 100.0	0.0 – 2.5	785	1
R A Cary	2004/05	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Director Programming (appointed 24/2/06)								
Air Commodore	2005/06	80 – 85	0 – 2.5	40 – 45	120.0 – 122.5	2.5 – 5.0	852	20
K J Pellatt	2004/05	80 – 85	2.5 – 5.0	35 – 40	112.5 – 115.0	12.5 – 15.0	829	95
Director Housing								
Mr R J McKinney	2005/06	45 – 50	0 – 2.5	10 – 12.5	35.0 – 37.5	5.0 – 7.5	142	24
Director Estate Strategy & Policy (appointed 13/6/05)	2004/05	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Mr W C Clark	2005/06	70 – 75	0 – 2.5	27.5 – 30	85.0 – 87.5	2.5 – 5.0	510	24
Agency Secretary	2004/05	65 – 70	0 – 2.5	27.5 – 30	80.0 – 82.5	2.5 – 5.0	471	14
Mr M E Martindale	2005/06	105 – 110	0 – 2.5	2.5 – 5.0	12.5 – 15.0	2.5 – 5.0	74	23
Finance Director	2004/05	100 – 105	2.5 – 5.0	2.5 – 5.0	7.5 – 10.0	7.5 – 10.0	50	20
Mr R Jones	2005/06	80 – 85	0 – 2.5	7.5 – 10.0	–	–	122	24
Director Projects	2004/05	60 – 65	0 – 2.5	5.0 – 7.5	–	–	99	14
Mr M W Pengelly	2005/06	65 – 70	0 – 2.5	22.5 – 25	70.0 – 72.5	2.5 – 5.0	406	21
Commercial Director	2004/05	65 – 70	0 – 2.5	22.5 – 25	65.0 – 67.5	2.5 – 5.0	367	13



Year	Salary including Performance Pay £'000	Real increase in pension £'000	Accrued pension at 31 March 2006 £'000	Lump sum at 31 March 2006 £'000	Real increase in lump sum £'000	CETV* at 31 March 2006 £'000	Real increase in CETV £'000
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**Former Board members  
(resigned during 2005/06)**

Air Commodore	<b>2005/06</b>	<b>75 – 80</b>	<b>0 – 2.5</b>	<b>35 – 40</b>	<b>107.5 – 110.0</b>	<b>5.0 – 7.5</b>	<b>843</b>	<b>43</b>
N J Kurth Director Programming (resigned 20/2/06)	2004/05	75 – 80	2.5 – 5.0	30 – 35	100.0 – 102.5	7.5 – 10.0	795	63
Mr A R Baillie Director Estate Strategy & Policy (resigned 13/6/05)	<b>2005/06</b>	<b>10 – 15</b>	<b>0 – 2.5</b>	<b>25 – 27.5</b>	<b>75.0 – 77.5</b>	<b>0 – 2.5</b>	<b>426</b>	<b>5</b>
	2004/05	60 – 65	0 – 2.5	25.0 – 30	75.0 – 77.5	2.5 – 5.0	420	14

\* CETV – Cash Equivalent Transfer Value.

- 3.4 The comparatives for military personnel have been restated based on information provided by AFPAA. No lump sum is shown in respect of **Premium** members.
- 3.5 The note above reflects the relevant remuneration appropriate to the period of tenure as members of the Management Board. Mrs C Nicholson received fees of £14,800 in the year to 31 March 2006 (2005/06 £12,000). In addition to the salaries shown above, two members of the Board, Brigadier R A Cary and Air Commodore N J Kurth, were eligible to a taxable allowance in respect of school fees for their children at boarding school in secondary education (one and two, respectively). The maximum amount payable by the MOD was £4,557 per term per child. The tax on the allowance is also settled by the MOD.
- 3.6 All non-military members of the board are eligible to receive performance related bonuses subject to a maximum payment of £10,000. Recommendations are made by the Chief Executive to the Permanent Under Secretary who determines whether an award is made.

**Pension Arrangements**

3.7 Pension benefits are provided through the Civil Service pension arrangements. From 1 October 2002, civil servants may be in one of three statutory based “final salary” defined benefit schemes (**classic, premium, and classic plus**). New entrants after 1 October 2002 may choose between membership of premium or joining a good quality “money purchase” stakeholder based arrangement with a significant employer contribution (**partnership pension account**).

**(a) Classic Scheme**

3.8 Benefits 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. Members pay contributions of 1.5 per cent of pensionable earnings. On death, pensions are payable to the surviving spouse at a rate of half the member’s pension. On death in service, the scheme pays a lump sum benefit of twice pensionable pay and also provides a service enhancement on computing the spouse’s pension. The enhancement depends on length of service and cannot exceed 10 years. Medical retirement is possible in the event of serious ill health. In this case, pensions are brought into payment immediately without actuarial reduction and with service enhanced as for widow(er) pensions.

**(b) Premium Scheme**

3.9 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 commute some of their pension to provide a lump sum up to a maximum of 3/80th’s of final pensionable earnings for each year of service or 2.25 times pension if greater (the commutation rate is £12 of lump sum for each £1 of pension given up). For the purposes of pension disclosure the tables assume maximum commutation. Members pay contributions of 3.5 per cent of pensionable earnings. On death, pensions are payable to the surviving spouse or eligible partner at a rate of 3/8ths the member’s

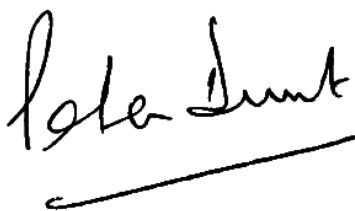
pension (before any commutation). On death in service, the scheme pays a lump-sum benefit of three times pensionable earnings and also provides a service enhancement on computing the spouse's pension. The enhancement depends on length of service and cannot exceed 10 years. Medical retirement is possible in the event of serious ill health. In this case, pensions are brought into payment immediately without actuarial reduction. Where the member's ill health is such that it permanently prevents them undertaking any gainful employment, service is enhanced to what they would have accrued at age 60.

**(c) Classic Plus Scheme**

- 3.10 This is essentially a variation of **premium**, but with benefits in respect of service before 1 October 2002 calculated broadly as per **classic**.
- 3.11 Pensions payable under **classic**, **premium**, and **classic plus** are increased in line with the Retail Prices Index.

**(d) Partnership Pension Account**

- 3.12 This is a stakeholder-type arrangement where the employer pays a basic contribution of between 3% and 12.5% (depending on the age of the member) into a stakeholder pension product. The employee does not have to contribute but where they do make contributions, these will be matched by the employer up to a limit of 3% (in addition to the employer's basic contribution). Employers also contribute a further 0.8% of pensionable salary to cover the cost of risk benefit cover (death in service and ill health retirement). The member may retire at any time between the ages of 50 and 75 and use the accumulated fund to purchase a pension. The member may choose to take up to 25% of the fund as a lump sum.
- 3.13 For 2005/06 employers' contributions of £13,642,398 were payable to the PCSPS (2004/05 £8,651,486) at one of four rates in the range 16.2 to 24.6 per cent of pensionable pay, based on salary bands. The scheme's Actuary reviews employer contributions every four years following a full scheme valuation. Rates increased in 2005/06.
- 3.14 Civilian employees joining after 1 October 2002 could opt to open a partnership pension account, a stakeholder pension with an employer contribution.
- 3.15 Employers' contributions of £113,579 (2004/05 £257,406) were paid to one or more of a panel of four appointed stakeholder pension providers. Employer contributions are age-related and range from 3 to 12.5 per cent of pensionable pay.
- 3.16 Employer contributions of £1,015,754 were payable to the AFPS (2004/05 £949,432) at rates of 34.3 per cent of pensionable pay for Officers and 21.3 per cent of pensionable pay for other ranks. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme. The last actuarial valuation was carried out as at 31 March 2005.
- 3.17 Salary costs also include taxable payments attributable to a special bonus scheme whereby civilian staff are paid a bonus in recognition of a well performed one-off task. Currently, there is no limit on the number of awards which can be made within a financial year, although the total value of these bonus payments should not exceed 0.4% of the overall civilian payroll.
- 3.18 No compensation payments were made to former members of the Board and no amounts were payable to third parties for the services of past or present Board members.



Vice Admiral P A Dunt CB  
Chief Executive

21 June 2006

## SECTION 4

### STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

Under Section 7(2) of the Government Resources and Accounts Act 2000, HM Treasury has directed *Defence Estates* to prepare for each financial year a statement of accounts in the form and on the basis set out in an Accounts Direction dated 13 January 2006. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of *Defence Estates* and of its income and expenditure, recognised gains and losses and cash flows for the financial year.

In preparing the accounts the Accounting Officer is required to comply with the requirements of the Government Financial Reporting Manual and in particular to:

- observe the Accounts Direction issued by HM 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 applicable accounting standards as set out in the Government Financial Reporting Manual have been followed, and disclose and explain any material departures in the financial statements;
- prepare the financial statements on a going concern basis.

The Departmental Accounting Officer for the Ministry of Defence has designated the Chief Executive of *Defence Estates* as the Accounting Officer for the Agency. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding *Defence Estates'* assets, are set out in the Accounting Officers' Memorandum, issued by HM Treasury and published in 'Government Accounting'.

## SECTION 5

### STATEMENT ON INTERNAL CONTROL

#### 1. Scope of responsibility

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of the *Defence Estates* policies, aims and objectives. The Permanent Under Secretary (PUS), as the Department's Principal Accounting Officer, is responsible for the overall organisation, management and staffing of the Department and for ensuring that there is a high standard of management in the Department as a whole. I am accountable directly to the PUS for safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting. In exercising this responsibility, I report through the 2nd Permanent Under Secretary who has delegated responsibility from Under Secretary of State for the *Defence Estates*.

*Defence Estates* provides complete estate and housing management services to the Ministry of Defence (MOD) to support the delivery of defence capability. During FY 2005/06 *Defence Estates* has additionally taken responsibility for the delivery of estate services in a number of overseas locations.

#### 2. The purpose of the system of internal control

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control adopted is based on an ongoing process designed to identify and prioritise the risks to the achievement of *Defence Estates* policies, aims and objectives. Through the risk regime *Defence Estates* is able to evaluate the likelihood of risks being realised, the impact should they be realised, and to manage them efficiently, effectively and economically. There are some elements within the system of internal control that have not been fully embedded during FY 2005/06 but generally *Defence Estates* has been working towards full compliance with Treasury Guidance since FY 2001/02 and up to the date of approval of this Annual Report and Accounts.

#### 3. Capacity to handle risk

Overall responsibility for Corporate Governance, including risk management, within *Defence Estates* lies with me through the Management Board with advice from the Audit Committee. The Agency Secretariat and *Defence Estates* Internal Control Audit Team provide assurance to the Management Board on the integrity of corporate governance processes within the Agency.

#### 4. The risk and control framework

An underpinning Risk Strategy supplemented by a Risk Mitigation Planning Strategy, Risk Implementation Plan and simplified Business Risk Management guidance document detail the processes by which *Defence Estates* identifies, evaluates and controls risk. This policy is in line with Government best practice. *Defence Estates'* staffs have been equipped to manage risk through a programme of project management training and risk workshops, and to ensure risk remains focused Risk Co-ordinators have been established at all levels within the Agency. The Finance Director is the nominated Risk Champion at Management Board level. Assistant Director Internal Control is the nominated senior level Risk Implementation Manager to champion risk, disseminate guidance, facilitate workshops and provide an independent review of risk management.

*Defence Estates'* process for gaining assurance on any given risk is to identify a risk owner for each risk, then determine the various ways the risk may be realised and subsequently managed with an action plan being used to address any gaps in controls. The Risk Co-ordinators, Internal Control Audit Team and Fraud Prevention Unit are utilised to provide assurance that the controls in place are adequate for the purpose.

Involvement of stakeholders is an integral part of the *Defence Estates* project management principles. All our major projects conduct regular review meetings to discuss risk and issues affecting both parties.

## 5. Review of effectiveness

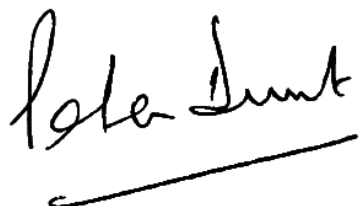
As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. In line with Departmental Guidance I have established the following governance procedures:

- A Management Board that normally sits monthly to review the performance of the business and the risks to it, take corrective action as necessary and to consider plans and strategic direction. The Management Board currently comprises of myself as Chair, eight Directors and a Non-Executive Director (NED).
- An Executive Committee of the Management Board, established October 2005 and chaired by Director General Operations, normally sits monthly and provides assistance to me in exercising my in-year financial management responsibilities as Agency Accounting Officer.
- An Audit Committee chaired by my Management Board NED and supported by other independent members, exists to provide advice on the adequacy of audit arrangements (both internal and external) and on the implications of assurances provided in respect of corporate governance, risk management and internal control systems.
- Internal audits conducted on behalf of *Defence Estates* by Defence Internal Audit (DIA) use a risk-based approach. The Internal Control Audit Team has adopted a cross section of compliance and risk based auditing techniques to provide a full range of assurances. All risk audits are linked to the Corporate Risk Register and Strategic Objectives contained within the Balanced Scorecard. Audit activity reports are presented to the Management Board and Audit Committee at least three times a year. 'Control Self Assessment' was implemented in June 2004 and has been further embedded into the Agency throughout FY 2005/06.
- Office of Government Commerce led Gateway reviews in order to provide valuable assurance on high profile projects.
- Risk has been intrinsically linked, managed and reported through the performance management system that fully complies with Departmental requirements.
- The refreshed Business Continuity Management Strategy, endorsed by the Management Board in December 2005, has been issued to all Business Continuity planners within *Defence Estates*. Business Continuity Site Recovery plans will now be refreshed and tested to take account of the Strategy. Plans have been proactively identified and addressed to ensure that critical business functions can continue to operate in the event of a disruptive event.
- There has been significant improvement in the understanding of Safety, Health, Environment and Fire (SHEF) risks across *Defence Estates* senior management. Audit activity has been programmed, audit team resources significantly increased, and a Chief Health & Safety Advisor appointed. There is evidence now that the right documentation is in place across the business: an updated and common SHEF management system, revised Policy, Organisational & Arrangements Statements, as well as the introduction of a range of Balance Scorecard SHEF Key Performance Indicators. MOD Safety Rules & Procedures have been reviewed and updated. Action continues to embed SHEF processes and cascade roles and responsibilities throughout the organisation, working closely with all stakeholders through the newly formed Estate SHEF Forum.

## 6. No significant internal control problems

I have identified no significant internal control weaknesses and controls in the areas taken over from the former Defence Housing Executive are now operational and embedded. *Defence Estates* has continued to expand its responsibilities for delivery of the new overseas roles and is proactively addressing any risk or control issues as they arise.

My review of the effectiveness of the system of internal control is informed by the work of Defence Internal Audit, the *Defence Estates* Internal Control Audit Team, Fraud Prevention Unit, my Directors and other senior managers within *Defence Estates* who have responsibility for the development and maintenance of the internal control framework. In addition, my review is also informed by comments made by the 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 Management Board and Audit Committee and will address any weaknesses should they occur and ensure continuous improvement of the systems in place.

A handwritten signature in black ink, appearing to read 'Peter Dunt', with a long horizontal line underneath it.

Vice Admiral P A Dunt CB  
Chief Executive

21 June 2006

## SECTION 6

### 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 *Defence Estates* for the year ended 31 March 2006 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.

#### Respective responsibilities of the Agency, the Chief Executive and auditor

The Agency and Chief Executive are responsible for preparing the Annual Report and the financial statements in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions made thereunder 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 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 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 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. I also report to you if, in my opinion, the Annual Report is not consistent with the financial statements, 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 relevant authorities regarding remuneration and other transactions is not disclosed.

I review whether the statement on pages 15 to 17 reflects the Agency's compliance with HM Treasury's guidance on the Statement on Internal Control, and I report if it does not. I am not required to consider whether the Accounting Officer's statements on internal control cover 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 opinions

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 judgments made by the Agency and Chief Executive 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 the part of the Remuneration Report to be audited.

### Opinions

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 thereunder by HM Treasury, of the state of the Agency's affairs as at 31 March 2006 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
- 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.

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

Date: 29 June 2006



## SECTION 7

### DEFENCE ESTATES ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

#### OPERATING COST STATEMENT FOR THE YEAR ENDED 31 MARCH 2006

	Note	<u>2005/06</u> £'000	<u>2004/05</u> £'000
<b>OPERATING COSTS</b>			
Staff costs	2	147,621	102,195
Accommodation costs	3a	970,797	644,956
Other operating costs	3c	<u>134,080</u>	<u>115,014</u>
<b>GROSS OPERATING COSTS</b>		<b><u>1,252,498</u></b>	<b><u>862,165</u></b>
<b>OPERATING INCOME</b>			
Proceeds from the sale of property	5	(257,537)	(211,629)
Transfer of assets to the Private Sector	6	(15,357)	(97,001)
Open Market Value of property disposals		172,840	255,798
Share of Proceeds to third parties		<u>260</u>	<u>3,001</u>
Surplus on sale of property		(99,794)	(49,831)
Income from United States Forces (USF)	5	(125,169)	(144,436)
Cost of services provided to USF		<u>123,730</u>	<u>139,979</u>
Surplus from providing services to USF		(1,439)	(4,457)
Income from NATO	5	(5,394)	(20,017)
Cost of services provided to NATO		<u>4,642</u>	<u>19,207</u>
Surplus from providing services to NATO		(752)	(810)
Rental Income	5	(137,986)	(138,889)
Other operating income	5	<u>(47,346)</u>	<u>(41,289)</u>
<b>TOTAL NET OPERATING INCOME</b>		<b><u>(287,317)</u></b>	<b><u>(235,276)</u></b>
<b>NET OPERATING COST</b>		<b><u>965,181</u></b>	<b><u>626,889</u></b>

All activities undertaken during the year are continuing.

The notes on pages 24 to 39 form part of these accounts.

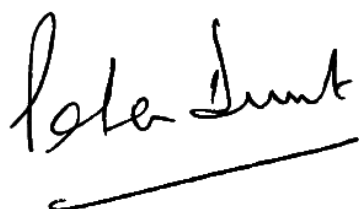
**STATEMENT OF RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDED 31 MARCH 2006**

	<b>Note</b>	<u><b>2005/06</b></u> <b>£'000</b>	<u>Restated</u> <u>2004/05</u> <b>£'000</b>
Revaluation of assets credited to Revaluation Reserve	<b>17</b>	<u><b>108,284</b></u>	<u>233,891</u>
<b>RECOGNISED GAINS DURING THE YEAR</b>		<u><b>108,284</b></u>	<u>233,891</u>

The notes on pages 24 to 39 form part of these accounts.

**BALANCE SHEET AS AT 31 MARCH 2006**

		<u>31 March</u> <u>2006</u>	<u>31 March</u> <u>2005</u>
	Note	£'000	£'000
<b>TANGIBLE FIXED ASSETS</b>			
Land and Buildings	8	1,526,196	1,063,939
Other Fixed Assets	8	<u>3,035</u>	<u>3,308</u>
		<u>1,529,231</u>	<u>1,067,247</u>
<b>DEBTORS receivable in more than one year</b>	<b>11</b>	<u>227,120</u>	<u>232,870</u>
<b>CURRENT ASSETS</b>			
Assets held for resale	9	165,588	262,677
Stock and Work in Progress	10	8,145	6,278
Debtors	11	159,435	182,041
Cash at Bank and in hand	12	<u>4,051</u>	<u>3,761</u>
		<u>337,219</u>	<u>454,757</u>
<b>CURRENT LIABILITIES: DUE WITHIN ONE YEAR</b>			
Creditors	13	<u>(368,430)</u>	<u>(282,410)</u>
<b>NET CURRENT (LIABILITIES)/ASSETS</b>		<u>(31,211)</u>	<u>172,347</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<b>1,725,140</b>	<b>1,472,464</b>
Creditors: amounts due after one year	13	<b>(69,726)</b>	<b>(72,172)</b>
Provisions for liabilities and charges	15	<b>(103,656)</b>	<b>(68,919)</b>
<b>NET ASSETS</b>		<u><b>1,551,758</b></u>	<u><b>1,331,373</b></u>
<b>TAXPAYERS' EQUITY</b>			
General Fund	16	994,681	760,683
Revaluation Reserve	17	<u>557,077</u>	<u>570,690</u>
		<u><b>1,551,758</b></u>	<u><b>1,331,373</b></u>



Vice Admiral P A Dunt CB  
Chief Executive

21 June 2006

The notes on pages 24 to 39 form part of these accounts.

**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2006**

	Note	<u>2005/06</u> £'000	<u>2004/05</u> £'000
<b>NET CASH OUTFLOW FROM OPERATING ACTIVITIES</b>	<b>20</b>	<b>(640,770)</b>	<b>(418,018)</b>
Cash Payments to acquire tangible fixed assets	<b>8</b>	<b>(446,590)</b>	<b>(247,213)</b>
Proceeds from disposal of fixed assets		<b>24</b>	–
Repayments of principal under finance leases		<b>(571)</b>	<b>(502)</b>
Repayments of principal under loans		<b>(1,695)</b>	<b>(1,599)</b>
<b>NET CASH OUTFLOW BEFORE FINANCING</b>		<b><u>(1,089,602)</u></b>	<b><u>(667,332)</u></b>
<b>FINANCING</b>			
Payments and Receipts on Defence Resource Account	<b>16</b>	<b><u>1,089,892</u></b>	<b><u>666,585</u></b>
<b>NET FINANCING FROM THE DEFENCE RESOURCE ACCOUNT</b>		<b><u>1,089,892</u></b>	<b><u>666,585</u></b>
<b>INCREASE/(DECREASE) IN CASH</b>		<b><u>290</u></b>	<b><u>(747)</u></b>

The notes on pages 24 to 39 form part of these accounts.

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2006

### **NOTE 1**     **Statement of Principal Accounting Policies**

#### **A. Basis of Accounts**

The accounts have been prepared in accordance with the Financial Reporting Manual issued by HM Treasury. The particular accounting policies adopted by the Agency are described below. They have been applied consistently in dealing with items considered material to the accounts.

These accounts have been prepared under the historical cost convention modified to account for the revaluation of fixed assets, and stocks where material, at their value to the business by reference to their current cost.

#### **B. Taxation and Social Security**

As the Ministry of Defence charges the Agency during the year with the gross payments, inclusive of PAYE and National Insurance contributions, due to Agency employees, the Department is liable for the payment of any liabilities that may be due to HM Revenue & Customs or the Department of Works and Pensions at the balance sheet date, and these are not disclosed in the Agency's balance sheet.

#### **C. Value Added Tax**

Whilst the Agency is not separately registered for Value Added Tax (VAT), Security Services Group has a VAT registration and accounts for its own VAT. VAT collected on other activities is accounted for centrally by the Ministry of Defence. The Agency's accounts include irrecoverable VAT attributable to its activities.

Input VAT on certain contracted out services is recoverable by the Agency through the MOD registration under specific HM Treasury direction. Since 1 April 2003, Contracted-Out Services VAT has been accounted for centrally by the MOD and therefore no VAT debtor is included in the Agency accounts as at 31 March 2006.

#### **D. Income**

Income represents the invoiced value of transactions with the Private Sector, the Public Sector and Government Departments. In particular, income derives from:

- a. The sale of MOD properties held by *Defence Estates* for disposal;
- b. The provision of estate services to United States forces based in the United Kingdom. These services are charged out on the basis of cost plus an agreed management fee;
- c. The provision of estate services to NATO forces based in the United Kingdom. These services are charged out on the basis of cost plus an agreed management fee;
- d. The collection of rental for Services Family Accommodation. Services Family Accommodation charges are determined annually for each of the Services as part of Armed Forces Pay Review. Rents are collected from Service tenants by direct deduction from salary by the relevant Service payroll authorities. The remaining income relates to damages for trespass and is collected directly by the Agency. All income is VAT exempt;
- e. Profit sharing receipts from Annington Homes Limited. Profit sharing payments made by Annington Homes Limited are accounted for as and when received. Profit share receipts accrue to the Treasury and not *Defence Estates* or the Ministry of Defence;
- f. Sales made by the Security Services Group;
- g. Rent for land and buildings, and other miscellaneous income.

Income is accounted for and recognised in the Operating Cost Statement net of VAT.

## **E. Notional Charges**

Notional amounts are included in the operating costs for charges in respect of services provided from other areas of the Ministry of Defence. The amounts charged are calculated to reflect the full cost of providing these services to the Agency.

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

A notional charge for interest on capital is included in the operating costs. This is calculated as 3.5% of the average value of the net assets employed during each accounting period of the financial year. Interest on capital charges on the revaluation of assets for resale are accounted for within the financial period that the information is made available.

Notional charges for *Defence Estates* are analysed within Note 7 of these accounts.

## **F. Pension Arrangements**

On 1 October 2002 new Civil Service pensions arrangements came into effect. From that date all new non-military entrants to the Department have the option to join either the new defined benefits (DB) scheme, known as 'Premium' or to join the new defined contributions (DC) scheme known as the 'Partnership Pension Account'.

Under the new arrangements, new entrants are not able to join the current Principal Civil Service Pension Scheme (PCSPS), which has now been renamed the 'Classic' and has become a closed scheme. Existing members of the PCSPS have been given the option of remaining within the Classic, electing to transfer to the Premium, or choosing 'Classic Plus' whereby they transfer to Premium but only in respect of service after 1 October 2002.

Military personnel serving in *Defence Estates* are part of the Armed Forces Pension Scheme (AFPS). This is non-contributory and unfunded.

The Department makes regular payments of Superannuation Contributions Adjusted for Past Experience (SCAPE) into the relevant pension schemes at rates determined by the Government Actuary. Liability for payment of future pension benefits to members is a charge on the schemes and not a liability of the Department.

### Early Retirement Costs:

The Agency is required to meet the additional cost of benefits beyond the normal pension benefits in respect of civilian employees who retire early. The Agency provides in full for this cost when the early retirement programme has been announced and is binding on the Agency. The Agency may, in certain circumstances, settle some or all of its liabilities in advance by making a payment to Paymaster's account at the Bank of England for the credit of the Civil Superannuation Vote. The amount provided is shown net of any such payments.

## **G. Tangible Fixed Assets**

All purchases of fixed assets over £2,500, or £10,000 in respect of land and buildings other than housing, are capitalised in the accounts. The costs of refurbishment/upgrade of housing in excess of £75,000 as part of a single project on an individual property are capitalised. The values of fixed assets are revised annually, between formal revaluation, using indices provided by the Department.

Increases arising on revaluation of fixed assets, including adjustments to previous depreciation provisions are taken to a revaluation reserve except to the extent that they represent a reversal of a previous impairment. That element is credited to the Operating Cost Statement. Permanent diminutions in value are charged to the operating cost statement except where they represent a reversal of a previous increased revaluation. That element is offset against the revaluation reserve.

Freehold land and buildings are revalued by qualified valuers every five years or at shorter intervals if it is considered that values have changed materially.

Plant, Machinery, Vehicles and Computers are valued at their depreciated replacement cost.

## H. Depreciation

Fixed Assets, other than land, are depreciated to a nil value on a straight-line basis over their estimated useful lives. The following estimated lives are used in accordance with MOD resource accounting policy.

	Life in years
a. Buildings – permanent	5-50
b. Buildings – temporary	5-20
c. Housing	5-50
d. Plant & Machinery	5-15
e. Office Equipment	5-15
f. Motor Cars	3-5
g. Computers	3-7

## I. Assets held for resale

Assets held for resale comprise MOD land and buildings identified for future disposal, which are transferred to *Defence Estates* at their net book value, having satisfied the requirements of the site closure guide. Upon receipt by *Defence Estates* these properties are subsequently valued at their open market value, by professionally qualified *Defence Estates* staff, in accordance with the Royal Institution of Chartered Surveyors (RICS) 'Appraisal and Valuation' manual. The open market value of sites transferred to *Defence Estates* and not disposed of during a financial year are re-valued on an annual basis at the year-end. The last such valuation was conducted on 31 March 2006. Revaluation losses are written off to the Operating Cost Statement, revaluation gains are held against the revaluation reserve in the Balance Sheet and released to the General Fund upon disposal.

## J. Leases

### Operating Leases

Annington Homes Limited lease agreement determined at the time of sale that the properties leased from the company should not be on-Balance Sheet. The agreement is treated as an operating lease and the lease payments are charged to the Operating Cost Statement. Rentals payable under other operating leases are charged to the Operating Cost Statement over the term of the lease.

### Finance Leases

Assets Constructed under PFI/PPP arrangements are reviewed on a case-by-case basis to determine the appropriate balance sheet treatment. Only the PFI properties at RAF Lossiemouth have been included on-Balance Sheet. The lease payment consists of three elements – Principal, Interest and service charges. Interest and service charges are charged to the Operating Cost Statement. The principal payment reduces the Long Term Creditor on the Balance Sheet.

## K. Stocks and Work in Progress

Stocks comprise equipment and components on hand for resale in connection with the work carried out by Security Services Group. Stock is valued at the lower of cost and net realisable value. Work in Progress represents the value of contracts, stated at cost, which had not been completed at the year end. Some incomplete contracts had been invoiced in part by the year end and these amounts are shown as Deferred Income at the balance sheet date.

## L. Cash at Bank and in hand

Cash at bank represents the sums held by Security Services Group with their own account held by Paymaster. A reconciliation of operating costs to cash flows is given in the Cash Flow Statement on page 23.

## M. Provisions for Liabilities and Charges

Provisions for liabilities and charges have been established under the criteria of FRS12 (Provisions, Contingent Liabilities and Contingent Assets) and are based on realistic and prudent estimates of the expenditure required to settle future legal or constructive obligations that exist at the Balance Sheet date.

**NOTE 2 Staff Costs and Numbers**

A. The average number of employees during the year was:

	<u>2005/06</u>	<u>Restated</u>
	No.	2004/05
		No.
Service Personnel	83	69
Non-Industrial civilian	3,201	2,748
Industrial civilian	540	162
Agency staff	356	151
	<u>4,180</u>	<u>3,130</u>

B. Staff costs incurred during the year were:

	<u>2005/06</u>			<u>2004/05</u>		
	Service	Civilian	Total	Service	Civilian	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Salaries & Wages	4,216	119,164	123,380	3,814	81,701	85,515
Social Security Costs	346	6,299	6,645	324	5,553	5,877
Other Pension Costs	1,016	13,756	14,772	949	8,952	9,901
Early Retirement Costs	-	2,722	2,722	-	817	817
Unwinding of Discount on Early Retirement Provision	-	102	102	-	85	85
	<u>5,578</u>	<u>142,043</u>	<u>147,621</u>	<u>5,087</u>	<u>97,108</u>	<u>102,195</u>

Civilian salaries and wages include payments of £9.402m (2004/05 £4.050m) for temporary agency staff.

**Salary**

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

**Pensions**

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded multi-employer defined benefit scheme but the Agency is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out as at 31 March 2003. Details can be found in the resource accounts of the Cabinet Office: Civil Superannuation (<http://www.civilservice-pensions.gov.uk/>).

Military personnel serving in *Defence Estates* are part of the Armed Forces Pension Scheme (AFPS). The scheme is non-contributory and unfunded. The last actuarial valuation was carried out as at 31 March 2005.



**NOTE 3****a) Accommodation Costs**

Accommodation Costs comprise the following cash and non-cash costs:

	<u>2005/06</u>	<u>Restated</u>
	£'000	2004/05
		£'000
Depreciation on buildings	31,008	23,337
Impairment arising from a fall in market value of fixed assets	1,748	2,825
Reversal of prior year permanent diminution	(499)	(25,189)
Diminution in value of assets held for resale (See 3b i)	17,393	27,853
Diminution in value of assets transferred & sold in year (See 3b ii)	26,707	84,742
Rent and Rates	96,375	63,059
Rent – Annington Homes Limited	136,735	130,882
Dilapidation costs	2,357	3,007
Payments in respect of housing PFI contracts	19,093	19,333
Accommodation stores	10,424	6,163
Fuel & utilities	6,601	7,005
Accommodation costs on other MoD sites	3,500	2,216
Aquatrine Public Private Partnership	84,483	33,141
Works services – housing	109,247	83,757
Regional Prime Contracting Core Services	245,501	119,921
Other Estate Expenditure – UK and overseas	156,694	59,405
Disposal and remediation costs in respect of Estate disposals	3,957	4,578
Provision for environmental liabilities	19,473	152
Provision for other Estate liabilities	–	(1,231)
	<u>970,797</u>	<u>644,956</u>

**b) Permanent Diminution**

	<u>2005/06</u>	<u>2004/05</u>
	£'000	£'000
<b>(i) Diminution in value of assets held for resale</b>		
Net Book Value	56,372	51,303
Open Market Value	(38,979)	(23,450)
	<u>17,393</u>	<u>27,853</u>
<b>(ii) Diminution in value of assets transferred and sold in year</b>		
Net Book Value	40,930	97,859
Open Market Value	(14,223)	(13,117)
	<u>26,707</u>	<u>84,742</u>

**c) Other Operating Costs**

Other Operating Costs comprise the following cash and non-cash costs:

	<u>2005/06</u>	<u>2004/05</u>
	£'000	£'000
Depreciation	889	1,617
Impairment of other fixed assets	615	752
Travel and Subsistence	6,980	6,129
Post and telecommunications	4,568	2,812
(Profit)/Loss on disposal of fixed assets	(4)	1,896
Contracted-out professional and technical services	15,887	36,936
IT Services – Payments in respect of PFI Contract	6,894	7,253
Other Computer and IT costs	2,507	1,500
Entertainment & Hospitality	244	195
Miscellaneous administration expenses	3,961	1,954
Consumable materials & stores	2,038	1,445
Office machinery	580	288
Training & Recruitment	2,045	1,367
Provision for Bad debts	41	769
Bad debts written off	–	349
Other Provisions	6,825	(11,562)
Interest Paid – Loans	3,349	3,417
Interest Paid – On-Balance Sheet PFI Contract	2,903	2,972
Whitefleet – Payment in respect of PFI Contract	425	416
Bought in Materials and Services by Security Services Group	10,607	10,922
Headquarter charges	6,196	4,601
Audit fee	125	125
Unwinding of Discount on Provision for Environmental/Other Liabilities	3,143	2,595
Interest on capital	53,262	36,266
	<u>134,080</u>	<u>115,014</u>

**NOTE 4 Interest on Capital**

A charge, reflecting the cost of capital utilised by *Defence Estates*, is included in Other Operating Costs (Note 3c). The charge is calculated at the Government standard rate of 3.5% in real terms on average net assets held during the year.

**NOTE 5 Operating Income**

Income is derived from sales of properties held for disposal, recovery of costs and management fees for services provided to United States Forces and NATO, charges made in respect of Services Family Accommodation, profit share sales made by Security Services Group and rental and other miscellaneous charges.

An analysis of the proceeds from the sale of property is set out below. Clawback is a term that applies to a contractual clause within a property disposal sale agreement that entitles the Agency to a share of any future increases in land value derived from changes in local authority planning consents.

	<u>2005/06</u>	<u>2004/05</u>
	£'000	£'000
Disposal Receipts	232,024	193,672
Clawback & Other Income	25,271	17,681
Interest on Deposits	242	276
<b>Proceeds from Sale of Property</b>	<u>257,537</u>	<u>211,629</u>

Costs relating to property disposals are included within Accommodation Costs and Other Operating Costs at Note 3.

An analysis of rental and other income is set out below:

	<u>2005/06</u>	<u>2004/05</u>
	£'000	£'000
<b>Rental Income</b>		
Accommodation charges – Housing	124,440	123,496
Damages for Trespass – Housing	5,922	5,881
Other rental income from land and buildings	7,624	9,512
	<u>137,986</u>	<u>138,889</u>
<b>Other Income</b>		
Profit sharing	18,366	15,220
Sales made by Security Services Group	18,989	18,313
Other Income	9,991	7,756
	<u>47,346</u>	<u>41,289</u>

**NOTE 6 Transfers of Assets to the Private Sector**

Project Aquatrine is the department-wide Public Private Partnership (PPP) to transfer responsibility for the operation and maintenance of all MOD water and wastewater systems in England, Wales and Scotland. Package A (the first of three packages covering the Midlands, Wales and the South West) commenced operation in 2003/04 with Packages B (covering Scotland) and C (covering the remainder of England) commencing in 2004/05. The fair value of the total assets transferred to the contractors for all three packages (taken to be the net book values at the time of transfer) was £197.2m of which £7.2m was transferred during 2005/06. This formed the basis for the prepayments against the unitary charges of the contracts and these amounts will be amortised over the terms of the contracts of 25 years. Details of the unamortised elements of the prepayments in respect of all three packages are included in Note 11.

Land valued at £8.2m was transferred to the Private Sector in respect of an Off Balance Sheet Private Finance Initiative for the provision of Family Quarters at Portsmouth. This is treated as a prepayment against the unitary charge of the contract to be amortised over 25 years and is included within Note 11.

**NOTE 7 Notional Charges (Communicated and Non-Cash Costs)**

The MOD does not charge for services provided by other parts of the Department. The cost of services provided are communicated and included in the Accounts as non-cash costs. These costs, and other notional charges and income, are included in Note 3 Other Operating Costs or Note 5 Operating Income shown above:

	<u>2005/06</u>	<u>2004/05</u>
	£'000	£'000
Income received by other parts of the MOD on behalf of the Agency	(124,440)	(123,496)
Income received by HM Treasury on behalf of the Agency	(18,366)	(15,220)
Headquarters Charges	6,196	4,601
Audit Fee	125	125
Interest on Capital	53,262	36,266
Fuel & utilities	2,199	757
Post and telecommunications	3,690	981
Administration charges	2,677	741
Accommodation costs	3,500	2,216
Hospitality	71	16
Early Retirement costs in Year	2,722	817
Unwinding of Discount on Early Retirement Provision	102	85
	<u>(68,262)</u>	<u>(92,111)</u>

**NOTE 8 Fixed Assets**

An analysis of the balances and movements of the cost and depreciation on the main categories of fixed assets is shown below. Fixed Assets are valued on the basis of existing use:

**a. Land and Buildings**

	Land & Buildings Non-Dwellings £'000	Land & Buildings Dwellings £'000	Assets under Construction (AUC) £'000	Total £'000
Cost or Valuation:				
At 1 April 2005	259,432	580,665	293,858	1,133,955
Additions	20,994	490	424,284	445,768
Transfers from AUC	78,867	176,076	(254,943)	–
Revaluations	9,950	63,849	12,170	85,969
Disposals	(20,143)	(4,557)	–	(24,700)
Impairment reversal	499	–	–	499
Permanent Diminution	(915)	(1,503)	–	(2,418)
<b>At 31 March 2006</b>	<b>348,684</b>	<b>815,020</b>	<b>475,369</b>	<b>1,639,073</b>
Depreciation:				
At 1 April 2005	34,841	35,175	–	70,016
Charged in Year	12,074	18,934	–	31,008
Impairment	(60)	(610)	–	(670)
Disposals	(1,421)	(558)	–	(1,979)
Revaluations	888	13,614	–	14,502
<b>At 31 March 2006</b>	<b>46,322</b>	<b>66,555</b>	<b>–</b>	<b>112,877</b>
Net Book Value:				
<b>At 31 March 2006</b>	<b>302,362</b>	<b>748,465</b>	<b>475,369</b>	<b>1,526,196</b>
At 1 April 2005	224,591	545,490	293,858	1,063,939

**b. Other Fixed Assets**

	Plant & Machinery £'000	Transport £'000	Computer Equipment £'000	Total £'000
Cost or Valuation:				
At 1 April 2005	1,188	711	4,462	6,361
Additions	23	526	273	822
Transfers from AUC	–	–	–	–
Revaluations	11	5	–	16
Transfers from other parts of MOD	35	–	–	35
Disposals	–	(68)	–	(68)
Permanent Diminution	(85)	(110)	(1,189)	(1,384)
Reclassifications	(371)	371	–	–
<b>At 31 March 2006</b>	<b>801</b>	<b>1,435</b>	<b>3,546</b>	<b>5,782</b>
Depreciation:				
At 1 April 2005	709	261	2,083	3,053
Charged in Year	70	291	528	889
Disposals	(196)	(48)	(203)	(447)
Impairment	(80)	(110)	(579)	(769)
Revaluations	3	3	–	6
Transfers from other parts of MOD	15	–	–	15
Reclassifications	(138)	138	–	–
<b>At 31 March 2006</b>	<b>383</b>	<b>535</b>	<b>1,829</b>	<b>2,747</b>
Net Book Value:				
<b>At 31 March 2006</b>	<b>418</b>	<b>900</b>	<b>1,717</b>	<b>3,035</b>
At 1 April 2005	479	450	2,379	3,308

All fixed assets are subject to a quinquennial review by external professional valuers in accordance with FRS15. The properties owned by the Agency were last valued by the Valuation Office Agency, as at 31 March 2005 in accordance with the revaluation timetable and in accordance with the RICS 'Appraisal and Valuation' manual and these values are reflected in the above figures. The values of fixed assets are revised annually, between formal revaluation, using indices provided by the Department.

The European Centre for Medium-Range Weather Forecasting was granted occupancy of Shinfield Park by the Government in 1979 until such time as the centre is closed or transfers from the UK. *Defence Estates* maintains the site under a maintenance undertaking expiring in 2019. Shinfield Park is included in Fixed Assets at a nominal amount as, although owned by the MOD, *Defence Estates* does not have beneficial use of the site.

Land and Buildings (Dwellings) include amounts in respect of RAF Lossiemouth Family Quarters which is treated as an on-Balance Sheet PFI transaction. The cost/valuation at 1 April 2005 was £28.204m with revaluations in year of £3.275m giving a revised cost at 31 March 2006 of £31.479m. Depreciation at 1 April 2005 was £4.382m with in year depreciation of £2.110m and revaluations of £1.946m giving revised depreciation at 31 March 2006 of £8.438m. The net book value of the assets at 31 March 2006 was £23.041m (2005: £23.822m).

**NOTE 9     Assets held for Resale**

The following analysis is intended to reflect the timing of future disposals and the current valuation of properties identified for disposal:

	<u>31 March 2006</u> £'000	<u>31 March 2005</u> £'000
Land and Buildings held for disposal:		
Within One Year	63,000	175,000
Between Two to Five Years	102,588	87,677
Over Five Years	—	—
	<u>165,588</u>	<u>262,677</u>

**NOTE 10     Stock and Work in Progress**

	<u>31 March 2006</u> £'000	<u>31 March 2005</u> £'000
Stock	1,346	844
Work in Progress	6,799	5,434
	<u>8,145</u>	<u>6,278</u>

**NOTE 11     Debtors, Prepayments and Accrued Income**

	<u>31 March 2006</u> £'000	<u>Restated</u> <u>31 March 2005</u> £'000
<u>Due in more than one year:</u>		
Trade debtors	28,000	49,073
Prepayments relating to Aquatrine Private Finance Initiative	184,890	177,194
Prepayments relating to other Private Finance Initiatives	14,230	6,603
	<u>227,120</u>	<u>232,870</u>
<u>Due within one year:</u>		
Trade debtors	64,281	91,544
Accrued Income	54,701	52,822
Sundry Debtors	762	637
VAT debtor	147	122
Prepayments	33,363	32,019
Prepayments relating to Aquatrine Private Finance Initiative	8,290	7,427
Prepayments relating to other Private Finance Initiatives	573	354
Provision for Bad Debts	(2,682)	(2,884)
	<u>159,435</u>	<u>182,041</u>

**NOTE 12 Cash at Bank and in Hand**

	<u>31 March 2006</u>	<u>31 March 2005</u>
	£'000	£'000
Cash held at Bank – Security Services Group	4,046	3,756
Cash in hand	5	5
	<u>4,051</u>	<u>3,761</u>

**NOTE 13 Creditors, Accruals and Deferred Income**

	<u>31 March 2006</u>	<u>31 March 2005</u>
	£'000	£'000
<b>Amounts falling due within one year:</b>		
Trade creditors	67,809	79,904
Loans	1,797	1,695
Current part of imputed finance lease element of PFI contract	650	571
Deferred Income	16,425	11,613
Accruals	280,844	187,948
Sundry creditors	905	679
	<u>368,430</u>	<u>282,410</u>
<b>Amounts falling due after one year:</b>		
<u>Loans</u>		
Amount payable in 1 – 2 years	1,904	1,797
Amount payable in 2 – 5 years	6,430	6,064
Amount payable after 5 years	40,001	42,271
	<u>48,335</u>	<u>50,132</u>
<u>Imputed finance lease element of on-Balance Sheet PFI contract</u>		
Amount payable in 1 – 2 years	749	649
Amount payable in 2 – 5 years	2,892	2,550
Amount payable after 5 years	17,750	18,841
	<u>21,391</u>	<u>22,040</u>
	<u>69,726</u>	<u>72,172</u>

Under the Armed Forces (Housing Loans) Acts 1949, 1958, & 1965, the Ministry borrowed £94m from the National Loans Funds for the construction of married quarters over the period 1950/1951 to 1967/1968. These loans are fully repayable between 2012 and 2028, with the last instalment due on 20th February 2028. Interest on the loans is payable at rates ranging from 4% to 7% per annum.

**NOTE 14 Intra-government and other balances**

	Debtors due within 1 year £'000	Debtors due after 1 year £'000	Creditors due within 1 year £'000	Creditors due after 1 year £'000
Balances with central government bodies	25,466	28,000	2,225	48,335
Balances with MOD Trading Funds/QinetiQ	1,656	–	644	–
Balances with overseas governments	13,182	–	–	–
Other balances	119,131	199,120	365,561	21,391
<b>At 31 March 2006</b>	<u>159,435</u>	<u>227,120</u>	<u>368,430</u>	<u>69,726</u>
Balances with central government bodies	23,747	42,000	1,695	50,132
Balances with MOD Trading Funds/QinetiQ	134	–	1,061	–
Balances with overseas governments	62,594	–	–	–
Other balances	95,566	190,870	279,654	22,040
<b>At 31 March 2005</b>	<u>182,041</u>	<u>232,870</u>	<u>282,410</u>	<u>72,172</u>

**NOTE 15 Provisions for Liabilities and Charges****Environmental liabilities**

During the year *Defence Estates* made specific provisions for future environmental and other remediation works. These provisions were on properties held for disposal and other approved remediation expenditure for which *Defence Estates* is responsible. The provision is based on the Agency's current assessment against contractual and legal obligations that satisfy the requirements of FRS12: Provisions, Contingent Liabilities and Contingent Assets.

**Other Liabilities**

Provisions for other liabilities have been established under the criteria of FRS12 and are based on realistic and prudent estimates of the expenditure required to settle future legal or constructive obligations that exist at the Balance Sheet date. It is not considered appropriate to disclose details of the purpose of provisions made on the grounds that such disclosure would be prejudicial to the Agency's legal position.

**Early Retirement Costs**

A provision has been set up to represent the future liability to pay early pensions and lump sum payments. The provision has been charged to the Operating Cost Statement for the year.

The full cost of early retirements provided during the year was £2,722,161 of which £965,771 has been paid, and the balance carried forward as a long-term provision. In addition a number of civilians left *Defence Estates* as part of the MOD early departure scheme. Total lump sum compensation payments of £360k were paid by the MOD but these amounts are not reflected in the Operating Cost Statement.

A summary of the provisions for liabilities and charges is as follows:

	Environmental Liabilities £'000	Other Liabilities £'000	Early Retirement £'000	Total £'000
Balance at 1 April 2005	47,689	19,460	1,770	68,919
Provided in year	25,612	19,946	2,722	48,280
Transfers	11,220	–	–	11,220
Release of provision	(6,139)	(10,763)	–	(16,902)
Unwound Discount	2,403	740	102	3,245
Paid in year	(6,151)	(3,432)	(1,523)	(11,106)
<b>Balance at 31 March 2006</b>	<b>74,634</b>	<b>25,951</b>	<b>3,071</b>	<b>103,656</b>

The table below analyses total costs still to be incurred at current prices, and discounted to the Balance Sheet date. Following a change to the Treasury Discount Rate on 1 April 2005, the discount rate applied is 2.2% (2004/05: 3.5%). The reduction in the rate increased the unwinding discount charge to the Operating Cost Statement by £2.35m.

	31 March 2006 £'000	31 March 2005 £'000
<u>Environmental Liabilities</u>		
– Undiscounted	79,884	52,672
– Discounted	74,634	47,689
<u>Other Liabilities</u>		
– Undiscounted	26,923	20,904
– Discounted	25,950	19,460
<u>Early Retirement Costs</u>		
– Undiscounted	3,849	2,461
– Discounted	3,071	1,770

**NOTE 16 Statement of Movement on General Fund**

		<u>2006</u>	<u>2005</u>
		£'000	£'000
General Fund brought forward as at 1 April		760,683	510,721
Net Financing from Defence Resource Account	Page 23	1,089,892	666,585
Communicated and non-cash costs	Note 7	(71,086)	(93,013)
Transfers of assets from/to other parts of MOD and other Non-cash transactions		41,166	211,823
Released from Revaluation Reserves in Year	Note 17	139,207	91,456
Net operating cost	Page 20	<u>(965,181)</u>	<u>(626,889)</u>
General Fund Carried Forward as at 31 March		<u>994,681</u>	<u>760,683</u>

**NOTE 17 Movement on Revaluation Reserve**

	Assets for Resale	Fixed Assets	Total
	£000	£000	£000
Revaluation Reserve at 1 April 2005	172,155	398,535	570,690
In Year Movement			
Transferred In Revaluation	17,310	–	17,310
In Year Revaluation	13,079	85,985	99,064
End of Year Revaluation	23,728	–	23,728
	<u>226,272</u>	<u>484,520</u>	<u>710,792</u>
Released to General Fund Revaluations	(137,389)	(1,818)	(139,207)
	<u>–</u>	<u>(14,508)</u>	<u>(14,508)</u>
Revaluation Reserve at 31 March 2006	<u>88,883</u>	<u>468,194</u>	<u>557,077</u>

**NOTE 18 Movement on Donated Asset Reserve**

	<u>2006</u>	<u>2005</u>
	£'000	£'000
Donated Asset Reserve as at 1 April	–	–
Transfer from other part of MOD	1,248	12,978
Released to the Operating Cost Statement	<u>(1,248)</u>	<u>(12,978)</u>
Donated Asset Reserve as at 31 March	<u>–</u>	<u>–</u>

**NOTE 19 Related Party Transactions**

*Defence Estates* is an Agency of the Ministry of Defence. The MOD is regarded as a related party. During the year *Defence Estates* had various material transactions with the MOD and with other entities for which the MOD is regarded as the parent Department. These included QinetiQ (the former Defence Evaluation and Research Agency), the Meteorological Office, the Defence Aviation Repair Agency, the Defence Science and Technology Laboratory and the Hydrographic Office.

In addition, *Defence Estates* had a number of transactions with other Government Departments and Central Government bodies.

No member of the Management Board or the Defence Estate Committee nor key managerial staff or other related parties has undertaken any material transactions with the Agency during the year.



**NOTE 20 Reconciliation of Net Operating Cost to Operating Cost Cash Flows**

	Note	<u>2005/06</u> £'000	<u>2004/05</u> £'000
<b>NET OPERATING COST</b>		<b>965,181</b>	626,889
<b>Adjustments for non-cash items</b>			
Depreciation	8	(31,897)	(24,954)
Profit/(Loss) on disposal of fixed assets	3	4	(1,896)
Impairment arising from a fall in value of fixed assets	3	(2,363)	(3,577)
Reversal of prior year permanent diminution	3	499	25,189
Diminution in value of assets held for resale	3b	(17,393)	(27,853)
Diminution in value of assets transferred and sold	3b	(26,707)	(84,742)
Open market value of property sold		(172,840)	(255,798)
Notional charges (excluding early retirement)	7	71,086	93,013
<b>Movements in working capital</b>			
(Decrease)/Increase in debtors	11	(28,356)	130,159
(Increase) in creditors	13	(83,574)	(74,841)
Increase in stock and work in progress	10	1,867	1,835
<b>Movement in provisions for liabilities &amp; charges</b>			
(Increase)/Decrease in provisions	15	(34,737)	14,594
<b>NET CASH OUTFLOW FROM OPERATING ACTIVITIES</b>		<b><u>640,770</u></b>	<u>418,018</u>

**NOTE 21 Capital Commitments**

Capital Commitments for which no provision has been made in these financial statements, were as follows:

	<u>2006</u> £'000	<u>2005</u> £'000
Contracted at 31 March but not provided for	<b><u>322,500</u></b>	<u>303,900</u>

**NOTE 22 Contingent Liabilities**

Within the transfer of legal title on disposal sites, clauses exist that provide for potential future claims and liabilities against the Agency, in the event of additional remediation works being required above those determined at the point of sale.

*Defence Estates* hold a number of sites where it may be necessary to carry out remediation work in respect of contamination. It is not cost effective or practicable to identify all levels of contamination at individual sites nor to assess the likely cost of any remediation work necessary. As any liability cannot, therefore, be quantified it is not appropriate to include a provision in accordance with FRS 12.

*Defence Estates* has no other specific contingent liabilities as at 31 March 2006. There are, however, contingent liabilities to the Ministry of Defence estimated at £17.5m (2004/05 £17.8m) relating to potential claims in respect of the cost of providing utilities as a result of the sale of the Married Quarters Estate to Annington Homes Limited.

**NOTE 23** Commitments under PFI Contracts and Operating Leases

At 31 March 2006, *Defence Estates* was committed to making the following payments in 2006/07 under non-cancellable PFI contracts and operating leases. These were in respect of buildings and equipment for Annington Homes Limited rental, Project Aquatrine PFI, Housing PFIs and other office equipment and vehicles.

	<u>31 March 2006</u>	<u>31 March 2005</u>
	£'000	£'000
<b>PFI Commitments</b>		
<u>Land and Buildings</u>		
Expiry within 1 year	–	–
Expiry after 1 year but not more than 10 years	–	–
Expiry after 10 years but not more than 15 years	3,826	3,906
Expiry after 15 years but not more 20 years	2,058	–
Expiry after 20 years but not more than 25 years	93,765	90,029
<u>IT</u>		
Expiry within 1 year	–	–
Expiry after 1 year but not more than 5 years	7,004	–
Expiry after 5 years but not more than 10 years	–	6,840
<u>Plant and Machinery</u>		
Expiry within 1 year	–	–
Expiry after 1 year but not more than 20 years	–	–
Expiry after 20 years but not more than 25 years	280	315
<b>Obligations under operating leases comprise:</b>		
<u>Land &amp; Buildings</u>		
Expiry within 1 year	8,850	–
Expiry after 1 year but not more than 5 years	10,061	–
Expiry thereafter	147,894	134,613
<u>Other</u>		
Expiry within 1 year	63	313
Expiry after 1 year but not more than 5 years	295	306
Expiry thereafter	30	54
	<u>274,126</u>	<u>236,376</u>

The total amount charged in the Operating Cost Statement in respect of off-Balance Sheet PFI transactions and the service element of the on-Balance Sheet PFI transactions was £110,469,657 (2004/05 £59,726,913). The RAF Lossiemouth Family Quarters project is treated as on-Balance Sheet.

The following information is in respect of all PFI schemes (except White Fleet, which is a MOD-wide contract from which *Defence Estates* values are not separated).

<b>Description of Scheme</b>	<u>Estimated</u>	<u>Contract</u>	<u>Contract</u>
	<u>capital value</u>	<u>signature</u>	<u>end date</u>
	<u>£'000</u>	<u>date</u>	
<b><u>Land and Buildings</u></b>			
Project Aquatrine Package A	154,032	Apr 2003	Nov 2028
Project Aquatrine Package B	86,440	Sep 2004	Mar 2030
Project Aquatrine Package C	363,604	Oct 2004	Mar 2030
Family Quarters at RAF Lossiemouth	24,745	Jun 1998	Aug 2020
Family Quarters at Yeovilton	8,200	Jul 1998	Jul 2028
Family Quarters in Central Scotland	24,713	Aug 1999	Jan 2021
Family Quarters at RAF Cosford/RAF Shawbury	15,083	Mar 1999	Jun 2025
Family Quarters at Wattisham	34,200	May 2001	Mar 2028
Family Quarters at Bristol/Bath/Portsmouth	78,010	Nov 2001	Sep 2028
Family Quarters at Portsmouth	27,092	Oct 2005	Oct 2030
<b><u>IT Equipment</u></b>			
Provision of IT services in the Housing Directorate	11,600	Oct 2001	Sep 2010

**NOTE 24**    **Gifts and Write Offs**

In December 2004 the MOD gained Parliamentary approval to gift some surplus land in Aldershot to the English Churches Housing Group to provide short-term accommodation units for Service leavers considered at risk of social exclusion immediately after discharge. The value of the land is £350k and the gifting took place during the year.

During the year bad debts totalling £129k were written off as it had been concluded that no recovery could be made. Full provision had been made against these amounts in previous years.

Claims abandoned during the year totalled £343k. These related to historic water charges for former Services Family Accommodation in Rosyth of £228k, damage caused to Services Family Accommodation and water charges not recoverable from tenants of £54k and various claims of the Security Services Group of £61k. In addition payments of £8k were made for “fruitless” purposes following the late cancellation of hotel accommodation, travel arrangements and attendance on training courses.

**NOTE 25**    **Financial Instruments**

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 Agencies 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 Agency in undertaking its activities, or for trading. The fair values of all the Agency’s financial assets and liabilities approximate to their book values. In line with FRS 13, short term debtors and creditors (those which mature or become payable within 12 months from the balance sheet date) have been excluded from these disclosures (except for those relating to currency risk).

**Interest rate risk**

All the Agency’s financial assets carry nil rates of interest. All the Agency’s financial liabilities carry nil or fixed rates of interest and *Defence Estates* is not, therefore, exposed to significant interest rate risk.

**Currency risk**

The Agency does not hold assets or liabilities denominated in a foreign currency, and income and expenditure denominated in a foreign currency is negligible. The Agency is therefore not exposed to significant currency risk.

The Ministry of Defence, through whose Resource Account the Agency is financed, enters into forward purchase contracts annually with the Bank of England to cover the majority of its foreign exchange requirements for the following year. The details of the outstanding foreign currency contracts are given in its Departmental Resource Account.

**Liquidity risk**

The Agency is not exposed to significant liquidity risk, as liquidity requirements are met by financing from the Ministry of Defence Resource Account, and it has no borrowing facilities. The Department’s resource requirements are voted annually by Parliament.

**NOTE 26**    **Post Balance Sheet Events**

On 1 April 2006 the MOD transferred responsibility for accounting for certain fixed assets from *Defence Estates* to other parts of the MOD. Where the Agency retains the risks and rewards of ownership of these assets they will continue to be accounted for on the Agency's balance sheet in accordance with FRS 5 and SSAP 21. In other cases the costs of the use of these assets will be communicated to *Defence Estates* by the asset owners and charged to the operating cost statement. Consequently, these centrally accounted for assets will not be included on the Agency's balance sheet as they will be accounted for as operating leases under SSAP 21. There is no effect on the 2005-06 accounts as a result of this change, and no adjustments have been made to these financial statements.

*Defence Estates* became the asset owner for all MOD Land & Buildings from 1 April 2006. Assets with a net book value of £17bn plus related provisions and liabilities transferred to it from other parts of the MOD. At the same time all Plant & Machinery, Transport and Computer Equipment (apart from that held by the Security Services Group) was transferred to the Defence Logistics Organisation. The net book value of assets transferred to the Defence Logistics Organisation was £2.2m.

**NOTES**

**NOTES**

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