



Ministry
of Defence

de&s

Defence Equipment & Support Annual Report and Accounts

2017-18



Defence Equipment & Support

Annual Report and Accounts

2017-18

For the year ended 31 March 2018

Presented to the House of Commons pursuant to section 7 of the
Government Resources and Accounts Act 2000

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2017-18 Highlights

We have continued our progress with the wholesale transformation of DE&S, embedding our new processes and maturing our new ways of working. We also continued to focus on financial benefits and by 1 April 2018, had realised over £3.6 billion of savings for Defence.

HMS Queen Elizabeth, the first of two Queen Elizabeth class aircraft carriers left Rosyth to begin sea trials, and entered her new home port of Portsmouth for the first time.

The build of a £70 million Atlas transport aircraft maintenance, repair and overhaul facility to support RAF transport operations all over the world.

Signature of a £400 million deal for battle-winning Brimstone air-to-ground missiles for RAF Typhoons.

The firing of the 50,000th simulated round from an AS90 Self Propelled Artillery Weapon Turret Trainer - designed to allow gun crews to practice drills, procedures and duties without the expense or risk of live firing.

Delivery of the Defence Fulfillment Centre - a state-of-the-art logistics centre in Donnington, which will streamline distribution and storage and become a central hub for £30 billion of defence inventory including spare parts, food, clothing, and medical supplies - transforming the way we support the armed forces.

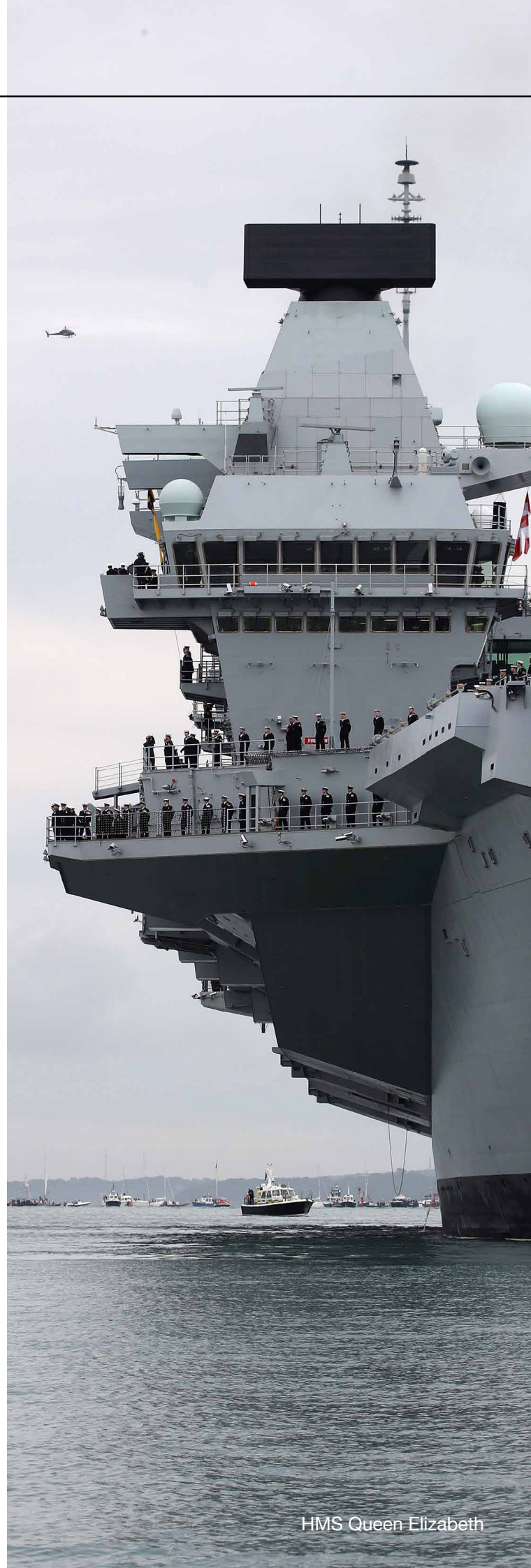
Signature of a contract worth around £3.7 billion to start building the first three of the Royal Navy's Type 26 Frigates and cutting steel on the first of these - HMS Glasgow.

Signature of a £260 million agreement with the United States Government to support the RAF's fleet of C-17A Globemaster III heavy lift transport aircraft into the next decade.

Negotiation of a six-year £48 million Apache helicopter training contract with Aviation Training International Ltd to provide world-class Apache training for around 700 Army personnel each year including 50 pilots and 400 ground crew.

Introduction of a £1 billion Common Support Model to bring together separate support agreements for individual ship types under a single, more efficient and more manageable model.

Investment of more than £90 million in a world-leading helicopter simulation centre at the Medium Support Helicopter Aircrew Training Facility based at RAF Benson in South Oxfordshire, to help train the Royal Air Force and Royal Navy helicopter pilots of the future.



HMS Queen Elizabeth



Chairman's introduction

by Paul Skinner, DE&S Chairman

I am pleased to introduce this report which covers the fourth year of DE&S' operation since the creation of its current operating model, within the overall Defence structure, in 2014.

During the year we continued to deliver major equipment and support programmes for our armed forces customers - totalling £13.5 billion¹ - many of which are described in detail in this report. Of these, the commissioning of HMS Queen Elizabeth, the first of the new aircraft carriers, and the initial deliveries of F35-B fighter aircraft which will fly from her, were important highlights but there were many more. Alongside these projects our transformation programme continues and, since it began in 2014, we have seen significant improvements in our project controls environment, our organisational design and efficiency, a revised market-reflecting pay and reward system, and new innovative risk-based procurement contracts with our suppliers.

Transformation of a large complex organisation takes time but we are now very well advanced in the process. We have declared meeting our original 'match fit' status and will continue to build on that foundation. By April 2018 we had realised £3.6 billion of savings for Defence² since 2015 - offsetting our change costs on a multiple basis. We aim to continue delivering significantly more in future. We have also been fully engaged in the MOD's Modernising Defence Programme and, from that, we shall be seeking further opportunities to enhance our contribution to Defence.

We have seen a number of changes in key personnel. After a very successful period as CEO, Tony Douglas left us for a major international assignment. He was succeeded on an interim basis by Michael Bradley and, after a smooth transition, by Sir Simon Bollom on a permanent basis. Simon has extensive experience of DE&S activities and we are very pleased to have him as CEO. Our thanks go to Tony and Michael for the contributions they have made.

The Board also saw changes. Paul Smith stood down after five years as a non-executive director and Chair of our important Audit Committee and has been succeeded by Iain Lanaghan. Andrew Wolstenholme also stood down having taken up a senior executive appointment which would be conflicted with his DE&S role. We are grateful for the contributions that Paul and Andrew made. We have also been joined recently by Gerard Connell who brings further industrial and finance experience to the Board.

In conclusion, I also express the Board's sincere appreciation of the part played by all DE&S people in delivering our results. I have personally seen them in action across many parts of our business and am very aware of how much we have asked of them in delivering what our armed forces customers need and, on top of that, in responding to the need for continuing change to improve our delivery.

¹ Including the SDA.

² The Transformation business case, and the total efficiencies achieved by the end of the financial year 2017-18, include the SDA. The SDA stood up as an Executive Agency of the MOD on 1 April 2018 and will run its own set of accounts for the 2018-19 financial year.



Section One

Performance Report





OVERVIEW



Chief Executive statement

by Sir Simon Bollom, CEO and Accounting Officer

On 21 May 2018, I assumed the role of DE&S Chief Executive Officer, taking over from Michael Bradley who was interim CEO between January and May 2018, following the departure of Tony Douglas.

I am delighted to have been appointed as CEO for DE&S. Our organisation plays a vital role in equipping and supporting the UK's armed forces and we must discharge our responsibilities as efficiently and effectively as possible. We have already delivered a great deal through our transformation programme, but it is clear to me that we still have much to do and I am determined to ensure that we fully embed our new tools and processes to become the world-class organisation to which we aspire to be.

The breadth of DE&S business is vast and spans the UK's Land, Sea and Air environments. We have had success in each arena following the dedicated and determined efforts of our people, who remain absolutely focused on providing the UK's armed forces with the equipment and support they need.

Our notable achievements include the Queen officially opening the new Lightning Operations Centre at RAF Marham, the future home of the UK's F-35B Lightning squadrons, we cut steel on the first of our Type 26 frigates – HMS GLASGOW; and just months after providing vital relief in the Caribbean, we agreed a £100 million deal to provide future support to the Royal Air Force's fleet of Puma HC Mk2 helicopters. That investment will ensure Puma helicopters continue to transport British troops and kit to the front line and to civil and emergency services responding to disasters and emergencies. We also opened the new Defence Fulfilment Centre, where streamlined operations are transforming the way we support the armed forces.

Alongside our delivery of equipment and support, we have continued to transform DE&S and this year focused on embedding our new ways of working and ensuring that we secure financial benefits for Defence.

In line with our Innovation Strategy, we also continue to explore opportunities for innovation in recognition of the need to be able to adapt in response to the ever-changing threats we face. We held the inaugural DE&S Inspiring Innovation event in May 2017, and we have

continued to work closely with the Defence Innovation Unit and our MOD partners, under the Defence Innovation Initiative, to support innovative ideas and developments across our business.

The 2015 Strategic Defence and Security Review (SDSR15) set out the intention to strengthen the procurement and in-service support of nuclear submarines by establishing a new delivery body with the authority and freedom to recruit and retain the best people to manage the submarine enterprise. To achieve this, the Submarine Delivery Agency (SDA) has been established as an Executive Agency, alongside DE&S, and operating with similar freedoms.

The SDA stood up as an organisationally and financially distinct body within DE&S in April 2017 ahead of achieving full Executive Agency status in April 2018. During the transition period, the SDA established its own governance through an independent Chair, Rob Holden, and the appointment of the SDA Board. Ian Booth was appointed as the SDA Chief Executive in September 2017, and following his induction period, he took responsibility for SDA output and delivery. DE&S remained accountable for SDA output and delivery during the 2017-18 financial year, and the SDA workforce and associated Operating Expenditure remained part of DE&S until 1 April 2018. This position was underpinned by a Letter of Delegation from me to SDA CEO. Accordingly, this Report and Accounts includes the SDA, unless otherwise stated. Going forward, the SDA and DE&S retain extensive and ongoing links, especially in the maritime area, working together to deliver the required capabilities to the armed forces.

I have reviewed the 2017-18 report and accounts and our comprehensive internal controls and am satisfied that this document reflects accurately, the financial status and corporate position of DE&S during the 2017-18 reporting period. I am delighted with our achievement of an unqualified audit opinion.

Chief Financial Officer's report

by Michael Bradley, Director General Resources

Our fourth year of operation as an arm's length body within the Ministry of Defence has been just as busy as the first three years, with yet more positive steps in the right direction.

In April we started to implement our new organisational design, with all of our people mapped to their new professional functional homes, creating a more flexible and resilient workforce to ensure we can better meet the needs of our front line customers. We also continued to establish a comprehensive set of formally documented and standardised processes and ways of working, which will enable us to be more agile in the way we deploy our people across our hugely varied portfolio of projects and services.

We made significant progress in improving our project performance capability by rolling out our new industry-standard project, programme and portfolio management (P3M) toolset, across the business. This toolset has already started to deliver returns and, once fully embedded, it will provide us with greater control and visibility of our project data, ensuring we make the best possible decisions for our customers and stakeholders. Our people have fully embraced this change and their continued support, professionalism and hard work have enabled us to achieve excellent results in the last year.

Following the appointment of a new Chief Information Officer (CIO) in July 2017, we have made substantial progress on information management and IT, creating a new IM&IT strategy and road map which builds on our existing electronic performance management dashboards, bringing modern flexible tools to manage the business.

To ensure our people have the skills they need, and in response to staff feedback in the 2017 annual Staff Survey, we have also increased our training budget, within our overall operating cost budget.

The Submarine Delivery Agency (SDA) was established in direct response to an action from the 2015 Strategic Defence and Security Review. The end of 2017-18 financial year marks the end of the phased set-up of the SDA, which has now become a separate delivery organisation outside the DE&S boundary. We have worked closely with SDA colleagues over the last year to ensure that this separation has been as seamless as possible for our customers and employees alike and I would like to place on record my thanks to all the staff involved in both organisations.

We are determined to continue to work closely with our SDA colleagues, who take with them the principles of our ongoing transformation programme to ensure that all our respective customers get an improving and consistent level of support going forward.

DE&S Programme of Work

As a direct result of our investment in the fabric of the business there have been notable improvements in our performance in delivering long-term complex programmes across the whole portfolio.

- The projected 10-year costs of the Equipment Plan we manage fell by £1,785 million or 1.7% from £107,593 million to £105,808 million during the year as our drive for efficiencies produced tangible results for customers.
- "In year" our ability to accurately predict expenditure on the programme of work was demonstrated by the fact that 2017-18 Equipment Plan expenditure outturned at £9,527 million - just £156 million, or 1.6%, under the budget of £9,683 million.

Inventory management

We are consistently meeting our customer demands for inventory – which includes items such as missiles, engines and ammunition through to washers, fuel and hand tools – effectively and economically, due to the disciplines established under our Inventory Management Transformation initiative. As a result, we exceeded our targets for reducing inventory holdings, achieving a further net reduction of £416 million in 2017-18, and keeping in-year inventory purchases down to £843 million; £131 million below the ceiling of £974 million that was set at the start of the year.

Operating costs

We have continued to robustly manage our operating expenditure within a reducing funding envelope delivering more output with less overhead.

- Operating cost forecast accuracy – DE&S operating costs (excluding communicated costs) outturned at £1,105 million, 0.27% under budget, a testament to the effective management control and accountability exercised across the business.



We remain committed to reducing private sector support (PSS) costs by building internal capability to provide a more cost-effective means of delivering our programme. PSS costs are external support to supplement DE&S capacity and capability to manage the agreed programme of work; examples of PSS include technical support, safety related work, project management and engineering activities. While we recognise that we have more to do in terms of the recruitment and retention of additional Crown Servants to reduce our spend on PSS costs, PSS costs (excluding Transformation but including Defence Science and Technology Laboratory)³ have reduced by 16% in the last financial year and by 34% from the baseline year of 2013-14, when PSS costs were £415 million.⁴

A more detailed analysis of DE&S delivery performance to our customers over the last year is provided in the Performance Analysis section at page 19.

Outlook

Looking ahead to financial year 2018-19, the Modernising Defence Programme, announced in January 2018, will support the delivery of better military capability and value for money, both of which are of equal importance and focus for DE&S. We recognise that this will bring new challenges to our customers and we stand by to work with them to build on the progress we have made. We will drive out further efficiencies, by increasing our productivity through investing in our

people and processes. This will ensure we continue to deliver the best possible equipment and support to our armed forces with the highest standard of professionalism and increased value for money.

Our key priorities include:

- Working closely with our armed forces customers and other stakeholders to identify opportunities for delivering efficiencies.
- Maintaining robust control of our operating costs, ensuring DE&S outturns within budget.
- Raising the bar by maintaining and improving our existing controls which have improved the quality of the DE&S financial accounts, with a view to moving towards controls-based audits in the future.
- Exploiting new technology to drive efficiency in internal processes.
- Supporting our staff, balancing recruitment and retention to deliver a sustainable, high performing workforce.

2017-18 has been a successful but challenging year, with DE&S achieving major milestones in our transformation programme. We enter 2018-19 with a matured organisational design, improved processes and systems, and the capabilities to face the challenges ahead.

³ Prior to financial year 2017-18, Defence Science and Technology Laboratory (DSTL) was a Trading Company and its costs were reported as PSS expenditure. On 1 April 2017 DSTL was brought back into the MOD boundary and these costs are now treated as Other Programme Costs (OPC).

⁴ PSS costs in 2013-14 included Defence Science and Technology Laboratory costs.

About DE&S

Our purpose

Our purpose is to equip and support the UK's armed forces for operations now and in the future.

Who we are

We are a professional defence acquisition organisation which manages a range of complex programmes that provide vital equipment and enduring support to the UK's armed forces.

We are part of the Ministry of Defence (MOD) but operate as an arm's length body. We have a unique Bespoke Trading Entity status, which allows us to operate in a more commercial way to improve the quality of delivery to our military customers. Our workforce consists of a mixture of civilian and military personnel and we are headquartered in Bristol. We also have people at numerous other locations across the UK and overseas, including in support of operations.

What we do

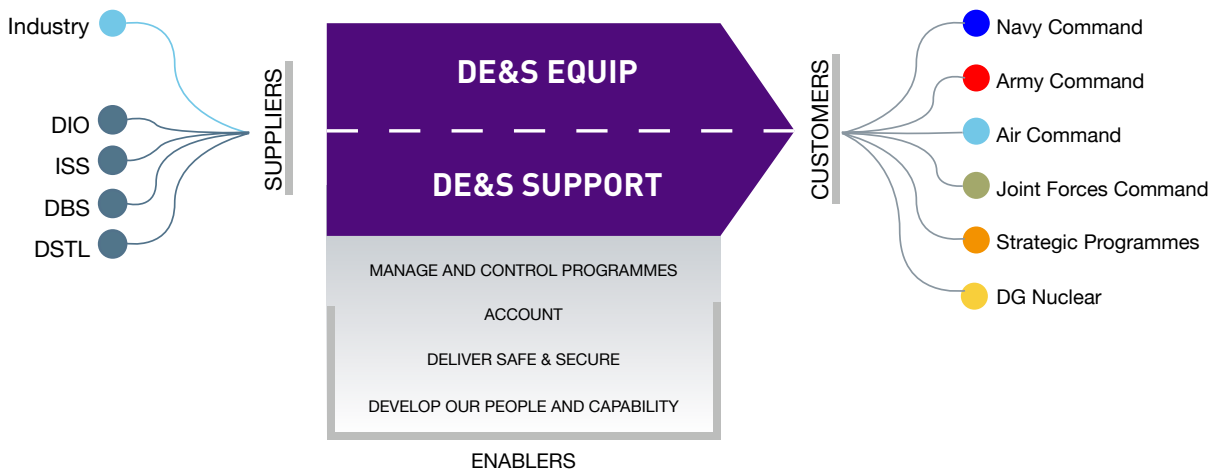
We are responsible for the safe procurement and support of a vast range of equipment – from warships, aircraft and missiles, to armoured vehicles, body armour and field kitchens. We undertake decommissioning and disposal when equipment reaches the end of its service life and we operate the British Forces Post Office, which delivers mail to service personnel in the UK and around the world.

Procurement and support go hand in hand and are of equal importance to DE&S and our customers. Taking this through-life approach is key to the delivery of the entirety of the DE&S programme of work, thereby ensuring that the armed forces have what they need, when they need it.

In discharging our responsibilities, we work very closely with our customers in the military commands as well as MOD Head Office.

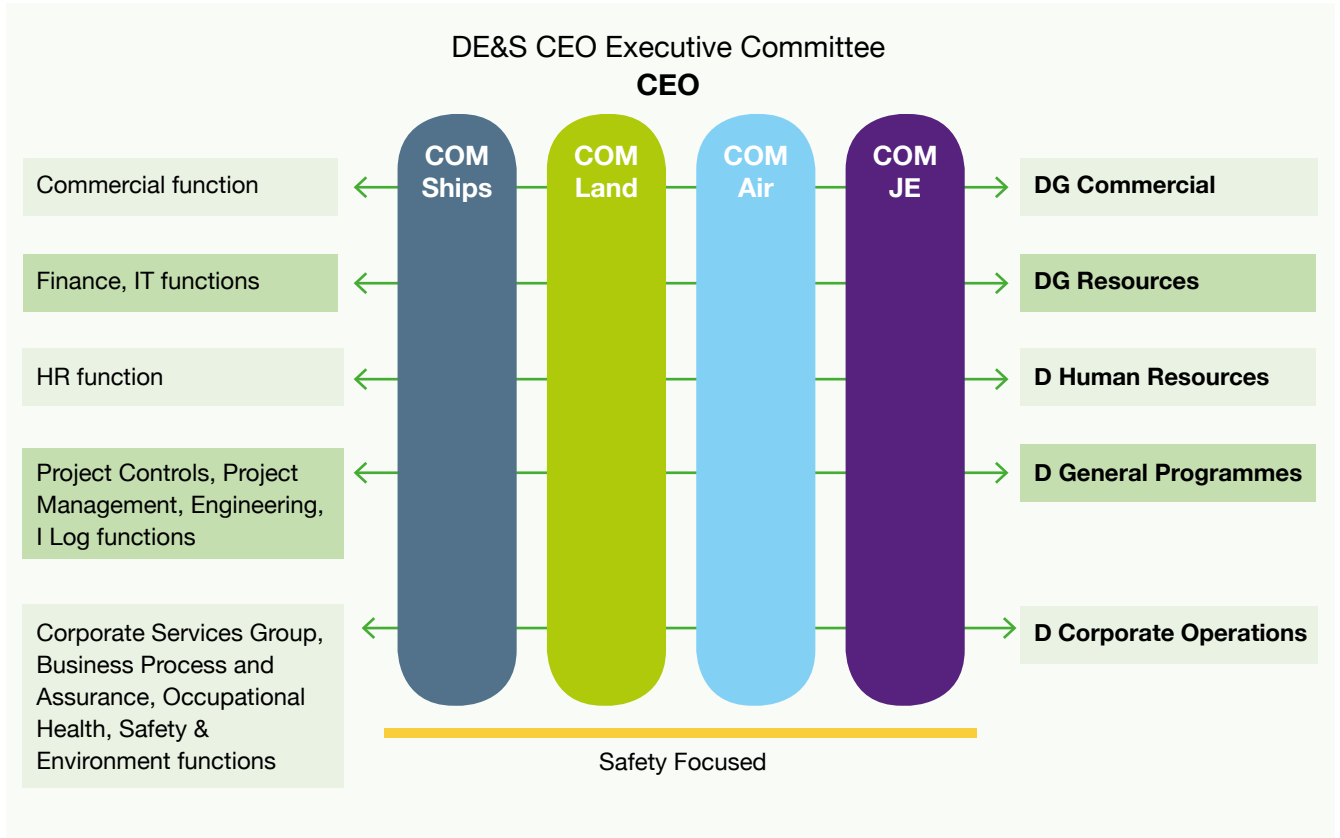
As illustrated below/overleaf, the DE&S operating model is a vital part of the wider Defence Operating Model, linking supplier capability to our military customers, ensuring they are equipped and supported to deliver what is required of them.

DE&S Operating Model

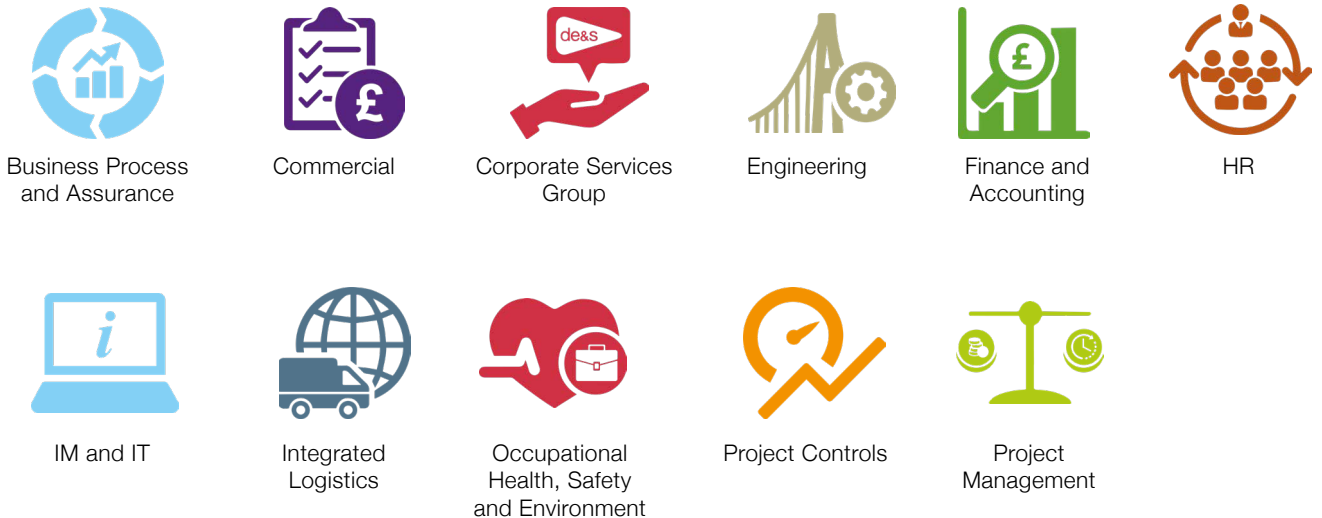


How we are organised

Our organisational structure reflects how we interact with our customers with a 3*/Director General Chief of Materiel leading each of our industry facing Ships, Land, Air and Joint Enablers delivery domains. Delivery of our business is supported by five cross cutting enabling teams: Commercial, Finance, Human Resources, General Programmes and Corporate Operations.



Delivering our business requires a range of specialist skills and our people are organised into 11 professional Functions:





RFA Tidespring

Our budget

The MOD delegates the bulk of the equipment budget to the military commands, giving them responsibility for prioritising what is most critical. As such, DE&S does not hold the budget for the equipment procurement and equipment support plans, but we do deliver against these.

Our agreed programme of work is set out in the Command Acquisition and Support Plans (CASPs) – individual formal agreements with our customers that capture the outputs against which our teams will deliver. The agreements set out the equipment, support and services DE&S will acquire on our customers' behalf, for what budget and to what timescale. MOD Head Office holds us accountable for delivery, and measures performance through the use of Key Performance Indicators (KPIs), which underpin our strategic objectives, as set out in the DE&S Corporate Plan 2017-20.

DE&S is directly responsible for its own operating expenses, and we carry out our business activities within an operating expenditure budget, which flows from MOD Head Office. Our operating budget includes manpower, operating support, private sector support costs and capital additions. In addition to these three main sources of costs we also reflect within the accounts notional communicated costs, which cover the services that are incurred through activities with other MOD organisations. For 2017-18 our operating budget to support our activities was £1.1 billion.

The financial statements at Section 3 have been prepared in accordance with the accounting boundary agreed with the MOD, which delineates between DE&S operating activities reported in our financial statements (manpower, private sector support and other programme costs) and equipment procurement/support activities which are reported in the MOD financial statements. More information regarding the accounting boundary can be found in the Statement of Accounting Policies in the Notes to the Accounts. We comply with Managing Public Money and supplementary instructions issued by HM Treasury and we observe the standard financial processes and rules set out by the MOD Director General (DG) Finance as the Defence Authority.

Operating as a Bespoke Trading Entity

DE&S was launched as a Bespoke Trading Entity (BTE)⁵ in April 2014, with delegated management freedoms allowing the organisation to manage its own business and workforce. As a BTE, DE&S is an arm's length body, with a separate governance structure and management freedoms delegated by HM Treasury and the Cabinet Office. These freedoms allow us to manage our outputs and workforce within an operating cost budget set to drive significant efficiencies. Our status has allowed us to strengthen the customer-supplier relationship with our military customers and facilitate a more business-like approach. We have used our management freedoms to implement changes outside of wider Government norms, particularly around the management of our people, to support us to attract, develop, retain and deploy talent as required to meet our customers' requirements.

⁵ DE&S is classified as an Executive Agency of the MOD, which operates as a BTE in line with Chapter 7 of Managing Public Money.

Our strategic objectives

Our strategic objectives set out the scale of ambition for DE&S and describe what we seek to achieve as a high performing organisation. They are focused on five key themes and designed to articulate clearly - in narrative form - our priorities and aspirations going forward. Underpinning our strategic objectives are a suite of performance management systems, business plans and corporate strategies. Our performance analysis starts on page 19.



Objectives Goals Strategies and Measures 2017-18

Our Objectives Goals Strategies and Measures (OGSM) framework underpins our strategic objectives and sets out our in-year delivery focus. The CEO's top level OGSM, depicted below, is cascaded through the organisation and is designed to provide a bridge between our strategic objectives and everyone's individual contributions. It provides a clear, concise and simple focus at each level of the business, helping to ensure that our people are aligned and engaged.

1

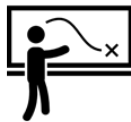
Objective
Hitting our numbers



Delivering our elements of the Equipment Procurement Plan (EPP) and the Equipment Support Plan (ESP) operating within our Operating Expenditure budget

2

Objective
Perform to plan



Delivering our equipment and support safely, on time and on budget

3

Objective
More "S" in DE&S



Improving support performance for our customers

4

Objective
Satisfy our Customers



Delivering to our customers as required in the Defence Plan and wider Government agenda; achieving customer satisfaction across all Domains and optimising processes and our organisation to enhance customer satisfaction

5

Objective
Transformation delivers benefit



Deliver the plan and communicate change effectively, to secure benefits

6

Objective
Develop our people & improve our processes



By driving a high performance culture deploying the balanced matrix and improving employee engagement



Our transformation

DE&S has been embarked on a comprehensive process of transformation since 2014, delivering one of the largest change programmes in government. Our wide-ranging programme of transformation was launched under the Materiel Strategy programme, which was designed to address long-standing problems in defence acquisition. The Materiel Strategy looked at how DE&S could operate differently to become more effective and efficient, and, since the establishment of DE&S as a BTE in 2014, we have been effecting organisational change through our transformation programme.

Following an assessment of our delivery against transformation milestones, our business maturity development and the substantial progress against the delivery of financial benefits, the DE&S Executive Committee confirmed that our initial transformation programme objectives had been achieved in April 2017. Our focus through this reporting period has been on ensuring momentum and embedding change.

We have introduced a new, bespoke approach to performance and reward based on four principles – simple, sustainable, fair and competitive. This system allows us to reward our people for their performance

and compete with industry, which is essential for us to attract and retain the people we need, and reduce our reliance on Private Sector Support (PSS).

We have continued to mature and embed our functional management system with our people deployed flexibly to task by the professional Function to which they belong, in line with our customers' requirements. Our new Business Management system now contains the essential functional processes to support delivery of the programme. Our work on processes and controls has included continuing training to ensure our people understand and employ our new ways of working; and the implementation of a sophisticated, interactive corporate performance dashboard. We have embedded new ways of working and adopted the project, programme and portfolio management (P3M) toolset, spearheaded through our exemplar projects – the first teams to be introduced to the new methodology and performance reporting.

We also have over 1,000 volunteers in our Change Advocate Network (CAN) – including people from every level, every Function and in every location. The CAN network is helping us to embed the new ways of working, tools and behaviours of transformation, and creating positivity about working in DE&S.



Improving our delivery: our new ways of working

2017-18 was a landmark progression in DE&S' project performance management capability, driven by the incremental deployment of the P3M toolset. Three tranches of P3M functionality were released over the year, with 17 exemplar projects leading the way in using the new capability to build a far greater understanding of the detailed interaction between cost and schedule performance and the means to control both to ensure successful project delivery. The progress made by our 17 exemplar projects will now expand to a much broader set of DE&S' other major projects in 2018-19. There is, however much left to do to fully exploit the system and to embed it as the core system driving delivery. In the coming periods, DE&S will need to continue to drive the whole organisation to adopt all releases of the system and exploit its full capabilities; including retiring legacy systems and utilising the outputs of the system in the way the organisation reviews performance.

We have also formalised our order book, with over 600 projects now established and managed as discrete order book items. A key focus for 2017-18 was establishing operating cost baselines for these projects. In addition, in 2017-18 over 100 projects established Equipment Plan (EP) baselines, in order to better measure and manage performance with industry.

We have made considerable progress in defining an integrated set of processes across our professional Functions, providing a clear structure for controlled, standardised project delivery and building the framework for DE&S to pursue organisational ISO 9001 certification. In parallel, our people's capability to harness the improvements offered by these tools has increased greatly over the course of 2017-18, through focused training in planning and scheduling, cost control and risk management, combined with the continuation of broader P3M toolset training, begun in 2016-17. Looking forward, priorities for further improvement include a focus on retiring now redundant processes existing within the organisation and refining the new set of processes with an enhanced focus on how they operate together cross-function to deliver DE&S business. We are also focused on maintaining coverage of our training in the new ways of working and developing experience and capability in the disciplines introduced.

Given the scale of investment, capability improvements, and the deployment of new tools and processes, 2017-18 has been a learning year for DE&S and, with those measures now in place, 2018-19 will see a firm shift to these measures being embedded as business

as usual. Challenges to overcome include refining how the business signals its demand for resourcing and how the professional Functions meet this demand with efficient deployment of our people to delivery priorities. We also recognise the need to build on the professional disciplines of the DE&S Functions with particular focus on the new specialised disciplines such as scheduling.

Working with industry: our commercial improvements

Throughout 2017-18 there has been a significant focus on commercially led business improvement, through the DE&S Commercial Improvement Programme. The range of initiatives involved in the Programme has included:

- **Indirect Cost Optimisation Programme:** This programme was established to identify a new approach that will deliver savings on single source indirect costs. Indirect costs are overheads allowable under the Single Source Regulations. With the new regulations in place the MOD has a greater ability to understand and challenge these costs. A new supplier-centric operating model has been established to deliver sustained improvements to how indirect costs are managed in the future; a pilot study with three suppliers is currently underway to test this approach.
- **Routes to Market:** The Routes to Market initiative is aimed at optimising elements of the acquisition process, to enable more effective buying decisions. This involves simplifying procurement choices, earlier decision making and validation of requirements, better use of category management and spend information in contract packaging and greater consistency of approach. The initiative has gained wide support across MOD and industry and implementation will take place throughout 2018-19.
- **Good to Manage:** This initiative is focused on delivering savings through improved contract management supported by a corporate centre of excellence. A successful pilot has been conducted and the lessons learned are in the process of being rolled out throughout the business.

In April 2017 we appointed a Commercial Delivery Partner, Paragon, a joint venture between Turner and Townsend and Mace, supported by Ernst and Young, Gardner and Theobald and Efficio. This procurement represents a step change in how we contract specialist resource to meet demand from within the business. More importantly, we are utilising our industry partners' expertise to drive further improvement and efficiencies into our processes and procedures. We are now rolling out this approach to Private Sector Support across the

other Functions, with procurement currently underway for an Engineering Delivery Partner and a Programme Delivery Partner.

We have continued to drive improvements in how we contract with our industry partners, better incentivising them to deliver enhanced performance and best value for money. In 2017 we signed the initial 'first in class' contract for procurement of a warship (Type 26) on a Target Cost gain share/pain share contract rather than the traditional Cost Plus arrangement. We have also focused on agile contracting in fast moving capability areas through contracting models which support late changes in the requirement and incentivise the delivery of more functionality through efficiencies realised over time.

Our people

In October 2017, we conducted our annual staff engagement survey - the People Survey - which enabled our civilian and military staff to highlight what they think DE&S is doing well and where we need to improve. The survey is part of the Civil Service-wide staff engagement exercise. 85% of staff completed the survey this year (compared to 73% in 2016).

While improvements were noted across the drivers of engagement relating to pay and benefits (up 2% to 30%) and leadership and managing change (up 1% to 37%), the other seven engagement drivers saw slight reductions of between 1% and 2%, with the exception of learning and development, which decreased significantly by 7% to 52%. Our overall engagement score was 51%, which represents a decrease of 2% from the previous year's survey.

There were positive increases in the areas we had targeted for action from the previous year's survey including: leadership visibility (up 9% to 56%), senior leaders taking action (up 2% to 41%), managers taking action (up 5% to 32%) as well as understanding of how transformation would affect staff (up 16% to 58%).

The survey highlighted four main issues that staff would like the leadership team to address: improving leadership and managing change, our working environment (including IT); bullying and harassment and learning and development. We have taken steps to address each of these issues:

Our Executive Committee hold roadshows and town hall events to update staff on our progress on the actions we have taken in response to their feedback and additionally, we provide regular updates in our monthly communications "Face to Face" cascade brief.

The next DE&S People Survey will take place during autumn 2018.

Leadership and managing change:

we have produced an embedding change plan for 2018-19 and a new DE&S vision - DE&S@21 - detailing what DE&S will look and feel like in 2021 when we have embedded fully, our new ways of working.

Learning and development: we have changed the way we manage learning and development in our functional structure and have introduced a new blended approach to learning which puts the emphasis on 70% (on the job); 20% (learning from others); and 10% (external training) opportunities. We have also produced a new guide - the DE&S Way to Learning - which explains how learning priorities will be managed.

Working environment (including IT): the programme of work we started last year to improve the working environment at our Abbey Wood HQ and our satellite sites continues. We have extended wifi capability across our sites which helps our people work more flexibly and reduces the pressures on accommodation. We now have 9,000 laptops and 3,000 mobile phones in use across our workforce to better enable flexible and 'smart' working. We have also developed a new IT strategy to improve IT performance and embed our new IT tools and systems.

Bullying and harassment: some members of staff continue to experience bullying and harassment, which is of particular concern to the Executive Committee and is not in keeping with DE&S behaviours or the inclusive culture we want to create. Our new policy makes it easier for our people to raise a concern and we have introduced a peer network to provide resolution guidance. We are also training our leaders and managers in inclusive leadership to reinforce the positive behaviours we expect from them and their teams.

Delivering for our customers: our performance, risks and issues

Corporate performance for the 2017-18 financial year is set out in the Performance Analysis chapter. Corporate performance, and performance against our Key Performance Indicators (KPIs), financial performance, management of risk and safety performance, are assessed each month by the Executive Committee and DE&S Board. Performance is also reviewed in detail in the monthly Performance Committees, which are individual performance management conversations between the CEO and each Chief of Materiel, where delivery against the CASPs and Corporate Plan based KPIs are standing agenda items. In addition we provide quarterly reports to our Owner's Council, which has formal oversight of DE&S and its performance and is chaired by the Minister for Defence Procurement, and we hold regular CASP performance reviews with each of our customers.

Our Corporate Plan, refreshed annually, presents our rolling three-year strategic outlook. Our 2017-20 Corporate Plan provided the 2017-20 in-year delivery focus for the organisation and can be found at:

<https://www.gov.uk/government/publications/defence-equipment-and-support-corporate-plan-financial-years-2017-to-2020>

More information on our governance structures and activity for 2017-18, as well as information on our key risks and issues, is set out in the Governance Statement which forms part of the Accountability Report.



Merlin Mk3

PERFORMANCE ANALYSIS



Delivery to our customers, safely, remains our purpose and our priority. Overall, we continue to perform well on delivering our projects.

Performance of our Delivery and Customer strategic objectives is formally measured through the CASPs agreed with each of our customers. The CASPs set out metrics and targets which are used to measure our delivery performance and feed into the corporate Key Performance Indicators (KPIs) outlined in our Corporate Plan. Our aggregate performance against the CASP metrics has a significant bearing on how well DE&S performs against its corporate KPIs.

For 2017-18, DE&S achieved or exceeded the majority of the CASP targets which were measured and monitored throughout the year. For the second successive year we satisfied all Key User Requirements (342 in total). We delivered cost reductions of £372 million across the Assessment, Demonstration and Manufacture phase projects reported, including large reductions on the Apache Capability Sustainment Programme, Poseidon Maritime Patrol Aircraft and Type 26 Global Combat Ship System programme.

Our performance on Equipment Support Plan targets for Availability, Reliability, Sustainability and Safety across all Commands significantly improved since 2016-17, and all targets, apart from Navy Sustainability, were achieved.

We achieved our Operating Expenditure Efficiency KPI, with expenditure out turning at £1,105 million, 0.27% under the budget of £1,108 million. We exceeded our targets for reducing inventory holdings, achieving a further net reduction of £416 million, and for controlling inventory purchases where we achieved a reduction of £131 million against the target.

During the year, on behalf of our customers we spent £9,527 million on delivering the Equipment Plan, against a budget of £9,683 million, a variance of -£156 million or -1.6%. We exceeded our overall targets for the stability of the 10 year costs of the Equipment Plan, with the forecast costs reducing by some £1.8 billion to £106 billion.

This year our Customer Satisfaction survey maintained the previous year's score of 6.4; falling short of our aim to achieve a year-on-year increase in the overall customer satisfaction for each Command. Further work is in hand to improve our customers' satisfaction to get back on an increasing trajectory.

As noted earlier in the report, the Submarine Delivery Agency (SDA) was formally established as an Executive Agency of the MOD in April 2018. As the SDA was initially (in April 2017) established within DE&S, CEO DE&S retained overall accountability for the submarine programme, with CEO SDA taking responsibility for output and delivery following completion of his induction in November 2017. At this point, and as part of the overall governance of the SDA, the new organisation monitored its own corporate KPIs and ensured delivery of the agreed outputs to its customers, Navy Command and the Defence Nuclear Organisation. As a result, all SDA KPI deliverables are excluded from the KPIs within this DE&S report. Further information on the development of the SDA, including its Performance Indicators, are published in the SDA Corporate Plan, which is available at: <https://www.gov.uk/government/publications/submarine-delivery-agency-sda-corporate-plan-financial-year-2018-to-2019>

DE&S KPIs with supporting information are provided on the following pages.⁶



HMS Queen Elizabeth

⁶ CAAS validation of Apache Capability Sustainment Programme project costs for the Equipment Plan 2018 identified a -£3 million variation from 2016-17 that was omitted. To ensure accuracy of accounts and transparency, the decision was taken to include these costs in the 2017-18 financial year when reporting against KPI 1.3.2.

KPI 1 – CASP DELIVERY PERFORMANCE

1.1 Achievement of CASP milestones	Metric	Navy	Army	Air	Joint Forces Command	Strategic Programmes	DE&S
	Green ≥90% Amber ≥80% <90% Red <80%	88% (22 of 25)	100% (10 of 10)	89% (16 of 18)	100% (17 of 17)	73% (8 of 11)	90% (73 of 81)

Each CASP included a number of strategic milestones that were due to be delivered in-year and were agreed as significant with our customers. These milestones are key to the measure of a project's success. In total, DE&S delivered 76 of 81 milestones during the year, of which 73 were achieved on time or early. The five remaining milestones across Navy, Air and Strategic Programmes were moved for completion in 2018-19, mainly due to technical or procurement issues.

Procurement projects

DE&S monitors delivery performance of all procurement projects, and our KPIs measure performance on projects with an expected value of more than £20 million. Defence Procurement projects are managed on a life cycle model known as the CADMID (Concept, Assessment, Demonstration, Manufacture, In-service, Disposal) cycle which incorporates four procurement planning and delivery phases, an In-Service phase and, finally, disposal. Procurement projects are approved with quality, cost and time constraints and are categorised by their phase in the procurement cycle.

As well as tracking whether projects are on track to meet the users' requirements (KPI 1.2), we monitor them in terms of both cost (KPI 1.3) and time (KPI 1.4), both for Demonstration and Manufacture Phase projects (those projects that have passed the main investment decision) and Assessment Phase projects (those which are yet to reach that point) as an average per project in the population. Variances in forecast cost or time can arise from technical challenges or opportunities encountered by the supplier, commercial and procurement processes, international collaboration, accounting adjustments and dependencies in associated projects.

1.2 Key User Requirements	Metric	Navy	Army	Air	Joint Forces Command	Strategic Programmes	DE&S
	Green ≥97% Amber ≥96% <97% Red <96%	100% (82 of 82)	100% (57 of 57)	100% (102 of 102)	100% (44 of 44)	100% (57 of 57)	100% (342 of 342)

The quality of new equipment is measured by how well it will fulfil its Key User Requirements (KURs). KURs are agreed with our customers when a project is approved and specify the essential core characteristics the equipment must fulfil when in operational use. KURs will be achieved when an equipment enters into service. Under all five CASPs we are forecasting to achieve 100% of KURs.

1.3 Cost	Metric	Navy	Army	Air	Joint Forces Command	Strategic Programmes	DE&S
1.3.1 Demonstration and manufacture phase projects – aggregate cost variance	Green ≤ 0% Red >0%	+0.1% (+£15.1M)	-2.3% (-£201.9M)	-1.3% (-£177.3M)	0.0% (£0.0M)	-0.2% (-£8.0M)	-0.9% (-£372.1M)
1.3.2 Assessment phase projects – aggregate cost variance	Green ≤ 0% Red > 0%	-4.0% (-£3.0M)	-0.6% (-£0.8M)	-0.0% (-£0.1M)	-1.2% (-£0.4M)	0.0% (£0.0M)	-0.7% (-£4.3M)

The cost variances under KPI 1.3.1 show how much the forecast cost to complete this phase of work changed over the year. In 2017-18, DE&S managed 46 large Demonstration & Manufacture phase projects, with a total combined forecast in excess of £42 billion, of which DE&S achieved an overall aggregate cost reduction across all CASPs of £372 million. In three of the five CASPs the aggregate forecast costs reduced and there was no reported variation in the Joint Forces Command CASP, which reflects DE&S' success in managing these programmes of work. Navy Command had the only CASP to report an overall cost increase. This was mainly caused by Queen Elizabeth Class, although cost increases were partially offset by a cost reduction on Type 26 which was the result of successful contract negotiations.

In KPI 1.3.2 there are 21 Assessment Phase projects in our programme of work with a total forecast cost of just under £600 million. The aggregate forecast costs metric was achieved by all CASPs.

1.4 Time	Metric	Navy	Army	Air	Joint Forces Command	Strategic Programmes	DE&S
1.4.1 Demonstration and manufacture phase projects – aggregate time variance	Green ≤0.6 months Amber >0.6 months ≤0.8 months Red >0.8 months	0 months (0 months total)	+1.4 months (10 months total)	+0.2 months (3 months total)	-0.3 months (-1 months total)	+0.2 months (2 months total)	+0.3 months (14 month total)
1.4.2 Demonstration and manufacture phase projects – time variance per project	Green ≤15% Amber >15% <25% Red ≥25%	0% (0 project)	+14.3% (1 project)	+7.7% (1 project)	0% (0 projects)	+10% (1 project)	+7.0% (3 projects)
1.4.3 Assessment phase projects – aggregate time variance	Green ≤2 months Amber >2 months ≤3 months Red >3 months	0 months (0 months total)	+2.9 months (26 months total)	-0.8 months (-3 months total)	0 months (0 months total)	0 months (0 months total)	+1.2 months (23 months total)

In 2017-18 there were 43 Demonstration and Manufacture Phase projects with an approved In-Service Date, three fewer than the associated cost KPI 1.3.1.

In KPI 1.4.1 we achieved our target in four out of five CASPs, with only Army Command reporting a growth beyond the threshold metric. The acquisition of new defence equipment and technology can be challenging and this is evident with the Army Command CASP as a few projects slipped due to poor contractor performance and change in customer requirements. Under KPI 1.4.2 there are three projects reporting significant delays to achieving their In-Service Date.

For our Assessment Phase KPI 1.4.3 project population, we published no variances under three of the CASPs and a time improvement against the forecast in the Air Command CASP, which is offset by a variance under the Army Command CASP.

Overall, DE&S achieved the target for all three time performance measures which is an improvement from 2016-17.

Support projects

This KPI measures how well we support In-Service equipment against the performance measures set individually in each CASP. It takes into account Availability, Reliability and Sustainability, and also measures how well we administer safety processes (i.e. the percentage of In-Service equipment where the Safety Case Report or Assessment has been signed off and remains current).

We work with each of our customers to determine how they define Availability, Reliability, Sustainability and Safety Process Administration and agree their own performance thresholds. Together, these four metrics provide an overview of our performance in supporting In-Service equipment. As the customers deal with very different operating environments, and as each CASP is negotiated on a bilateral basis, direct comparison of performance between different CASPs is not appropriate.

	Metric	Navy	Army	Air	Joint Forces Command
1.5.1 Availability	Green ≥80% Amber ≥70% <80% Red <70%	98%	92%	91%	98%
1.5.2 Reliability	Green ≥80% Amber ≥70% <80% Red <70%	95%	96%	94%	100%
1.5.3 Sustainability	Green ≥80% Amber ≥70% <80% Red <70%	71%	85%	90%	100%
1.5.4 Safety Process Admin	Green ≥ 90% Amber ≥80%<90% Red <80%	90%	96%	92%	93%

For this KPI, no overall DE&S target is set by the DE&S Owner's Council as the performance thresholds for individual equipments are negotiated separately with each customer.

DE&S delivery performance to In-Service platforms was consistently good throughout the year and all KPIs were met under the Army, Air and Joint Forces Command CASPs. Navy Command's CASP Sustainability target was the only one not achieved. The underperformance in this area was mainly the inability to clear Operational Defects caused by the late delivery of spares and the progress of fault rectification during Fleet Time Support Periods (FTSP). Work is being undertaken to address these issues.

KPI 2 – OPERATING EXPENDITURE EFFICIENCY

	Performance
Reduce the total DE&S operating expenditure in line with agreed resource profile in the DE&S Corporate Plan	<p>Our target was to spend no more than our operating cost budget, which we achieved. Our final costs were £1,105 million against a revised budget of £1,108 million. During the year measures were taken to deliver £20 million of savings against the original budget, which was also adjusted to reflect a number of budgetary transfers as part of normal business. These figures exclude communicated costs which are notional, non-budgetary items of expenditure.</p> <p>The delivery of a budget to out turn variance of less than £3 million (0.27%) is clear evidence of the robust and effective financial management exercised by DE&S.</p>

KPI 3 – INVENTORY MANAGEMENT

	Metric	Performance
3.1 Inventory holdings to be no greater than £24.9Bn	Green \leq £24.9Bn Amber $>$ £24.9Bn \leq £25.5Bn Red $>$ £25.5Bn	£24.829Bn
3.2 RMC Purchases to be no greater than £0.97Bn	Green \leq £0.97Bn Amber $>$ £0.97Bn \leq £0.99Bn Red $>$ £0.99Bn	£0.843Bn
<p>Both targets were achieved in 2017-18:</p> <ul style="list-style-type: none"> → Closing Inventory: During 2017-18, we achieved a further net reduction of £416 million of inventory holdings, which is in addition to the £13.1 billion reduced between 2011-12 and 2016-17. In achieving this, £1.6 billion of inventory was disposed of at the end of its useful life during 2017-18. → Raw materials and consumables purchasing: In 2017-18, there was a further purchasing saving of £131 million against the £974 million target. <p>Following the reorganisation of DE&S in 2017-18, KPI 3 now excludes Information Systems & Services, Fuels and the Submarine Delivery Agency.</p>		



A400M

KPI 4 – FORECAST ACCURACY AND STABILITY

	Metric	Navy	Army	Air	Joint forces command	Strategic programmes	Other EP	Total
4.1 Forecast accuracy (in year) – out turn below baseline	Baseline	£2,820M	£1,592M	£3,543M	£628M	£944M	£157M	£9,683M
	Overspend: Red Underspend: Green <0% ≥-1.5% Amber <-1.5% ≥-2% Red <-2%	-3.7% (-£104M)	-1.4% (-£22M)	-0.4% (-£15M)	-1.5% (-£9M)	-0.2% (-£2M)	-2.2% (-£3M)	-1.6% (-£156M)

The equipment programme out turn was £9,527 million against a budget of £9,683 million, which includes adjustments for foreign exchange movement and scope change. Significant cost reduction was attributed to delays on MARS tanker and River Class.

	Metric	Navy	Army	Air	Joint forces command	Strategic programmes	Other EP	Total
4.2 Forecast stability – 10 year equipment procurement plan – variance to costing	Baseline	£9,030M	£14,486M	£9,378M	£3,539M	£8,469M	£0M	£44,902M
	≤ 0%	-0.7% (-£64M)	-1.2% (-£180M)	-0.8% (-£77M)	-10.0% (-£353M)	0.7% (+£57M)	0.0% (£0M)	-1.4% -£617M

The 2017-18 forecast of DE&S' 10 year equipment procurement plan was £44,902 million against an adjusted baseline of £45,519 million, a total reduction of £617 million. Forecast reductions have been achieved in four of the Commands and only a minor increase reported in Strategic Programmes.

	Metric	Navy	Army	Air	Joint forces command	Strategic programmes	Other EP	Total
4.3 Forecast stability – 10 year equipment support plan – variance to costing	Costing	£15,959M	£10,903M	£24,933M	£5,303M	£2,789M	£1,019M	£60,906M
	≤ 0%	-3.5% (-£560M)	-3.0% (-£322M)	-0.6% (-£143M)	-1.5% (+£79M)	-2.3% (-£65M)	0.1% (+£1M)	-1.9% (-£1,168M)

The 2017-18 forecast of DE&S' 10 year equipment support plan was £60,906 million against an adjusted baseline of £62,074 million, a total reduction of £1,168 million was achieved. Forecast reductions were reported in all Commands.

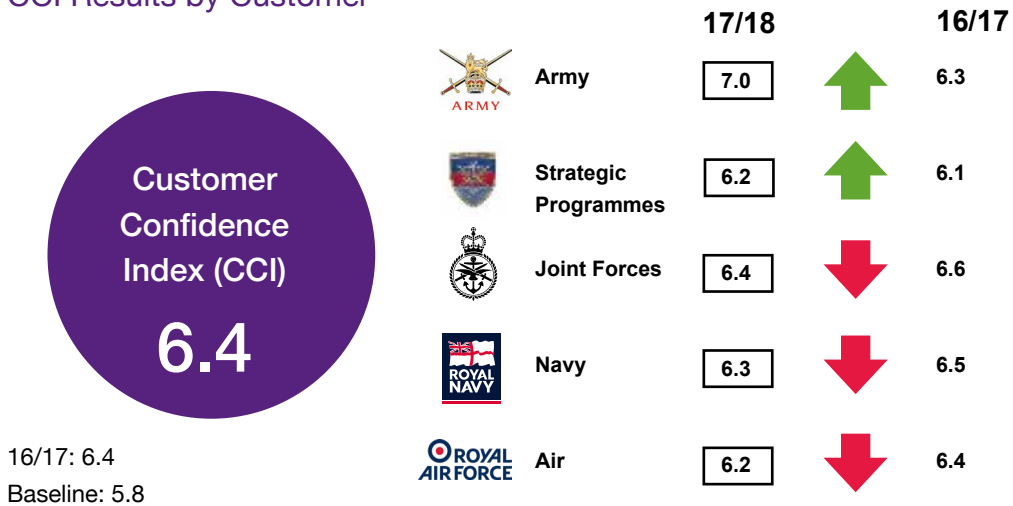
KPI 5 – CUSTOMER SATISFACTION 2017-18

Following feedback, the Customer Confidence Index (CCI) process was reviewed and changed this year from the average of two scores to a single score that remains supplemented by senior customer interviews.

The 2017-18 response rate has significantly improved to 81% from 50% obtained in 2016-17. The 2016-17 CCI score of 6.4 has been maintained overall and was due to an increase in the Army Command and Strategic Programmes results which were offset by decreased scores from Joint Forces, Navy and Air Command.

Our aim is to achieve a year-on-year increase in the overall customer satisfaction for each Command. This was not achieved in 2017-18 for every Command. Following the survey, a series of working groups were held with Commands. Lack of Suitably Qualified & Experienced Personnel (SQEP) resource within DE&S and complexity surrounding the CASP process were highlighted as common themes for improvement. Action plans have been developed to address these areas of concern. Discussions will occur within the DE&S Performance Committees to ensure subsequent engagement with customers is continuously sustained and improved.

CCI Results by Customer

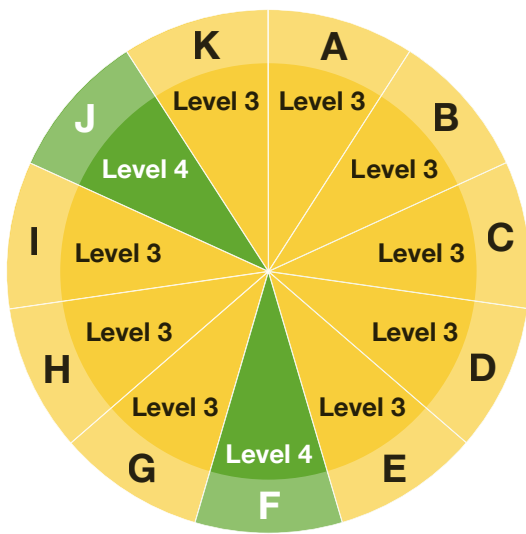


Customer Confidence Index is a score derived from numerical responses to the theme and relationship questions (against a 1 to 10 scale where 1 is the 'most negative' and 10 the 'most positive').

KPI 6: HEALTH, SAFETY & ENVIRONMENTAL PROTECTION

DE&S' overall KPI metric is Amber highlighting that more work is required across a number of areas. DE&S' compliance is measured across eleven different elements, each of which is assessed against the Defence Maturity Model. All eleven elements must be considered compliant (level 4) or above for DE&S' KPI to be Green.

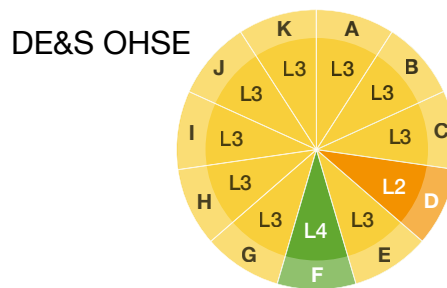
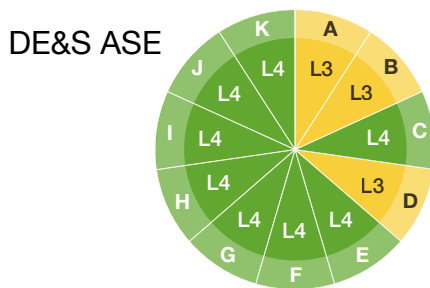
DE&S is compliant (level 4) against elements F (Equipment/Material & Infra Design & Manufacture) and J (Emergency Arrangements). All other categories are level 3 indicating minor weaknesses have been identified. Performance has decreased from 2016-17 where there had previously been another two compliant elements (Self Assurance and Supervision & Control).



- **A** - Legislation, Regulations, Policy & Guidance
- **B** - Information Management
- **C** - Leadership, Culture, Capability & Change
- **D** - Personnel Competence & Training
- **E** - Risk Assessment & Safety Cases
- **F** - Equipment/Materiel & Infra Design & Manufacture
- **G** - Equipment/Materiel & Infra Maintenance
- **H** - Supervision & Control of Activities
- **I** - Incident Management & Learning From Experience
- **J** - Emergency Arrangements
- **K** - Self Assurance

Key: Defence Maturity Model	Level 1	Level 2	Level 3	Level 4	Level 5	Level 6
	Serious weakness(es)	Significant weakness(es)	Minor weakness(es)	Compliant	Developed	Excelling

Each element is based on an average of both the Occupational Health, Safety and Environment (OHSE) and Acquisition Safety and Environment (ASE) scores. This separation was introduced to increase visibility of both the ASE and OSHE results. The metric is now more effective in helping us identify areas where further improvement is required. The diagrams below show that DE&S is compliant (level 4) in eight ASE elements in comparison to being compliant in just one OHSE element.



Appropriate action is being taken to reach level 4 compliance across all elements for both OHSE and ASE by the end of financial year 2018-19. This improvement activity involves embedding safety goals at the very top of the organisation, and cascading them throughout DE&S as part of the Chief Executive Officer's Objectives, Goals, Strategies and Measures (OGSM) strategy in an effort to raise the overall assessment level and drive continuous improvement.

BUSINESS ETHICS

The DE&S Fraud Board, which reports to the Audit Committee, leads on the identification and analysis of extant fraud risks in DE&S including scrutinising mitigation activities. Management of DE&S fraud risks in 2017-18 included anti-bribery and corruption measures and travel and subsistence controls. The Board also engaged with the MOD's Fraud Defence team on departmental and government level anti-corruption initiatives and reporting this year, including the UK Anti-Corruption Strategy introduced in December 2017.

The DE&S Code of Business Ethics was published in March 2018, setting out the appropriate standards and behaviours that all DE&S employees should embody, whether civilian, military or contractor. The Code summarises the main principles of our policies on conduct and behaviour and has been designed to help all DE&S employees to make the right decisions. It covers our approach to:

- Trust in the workplace
- Trust in business practices
- Acting as a good corporate citizen
- How to report potential violations of the code

The Code provides an important reference in support of day-to-day decision making and provides guidance on how DE&S staff can create and develop the solid foundation of trust that is reflected in our relationships with customers, suppliers, and each other. It makes clear that all of our people have a personal responsibility to uphold and ensure the letter and spirit of our Code every day, through individual roles. It also outlines how people should deal with situations that might be damaging to each other or to our organisation.

We also introduced an electronic travel and subsistence auditing process in March 2018, which has improved both compliance and the transparency of audits and allows us to assess the total value of claims checked across the business.

DE&S is committed to ensuring the highest standards of conduct in all that it does. For civil servants, these standards are reinforced by the Civil Service Code and Policy Rules and Guidance: Standards of Conduct and Behaviour. However, wrongdoing can occur. It

is important that employees know what to do if, in the course of their work, they come across something that they think is fundamentally wrong, illegal or endangers others within DE&S or the public. DE&S has a Whistleblowing and Raising a Concern process which outlines what staff should do when reporting perceived wrongdoing or malpractice within the organisation, including something they believe goes against the core values in the Civil Service Code. The Whistleblowing and Raising a Concern process has been written in accordance with the process set out in the Civil Service Code and the Civil Service Management Code and follows that of the MOD Whistleblowing and Raising a Concern process.





SAFETY, SUSTAINABILITY AND SECURITY



Safety and environmental protection

We are committed to ensuring that we provide safe equipment to the armed forces and protect the environment in which our equipment operates. In parallel, we also ensure the potential harm presented to people and the environment by our business activities and infrastructure is minimised so far as is reasonably practicable. Embedding an effective safety culture throughout the organisation continues to be a priority, as does the provision of accurate and meaningful management information to the DE&S Safety, Health and Environment Committee, Executive and Performance Committees, and the DE&S Board. We recognise that our performance can always be improved and we strive to take appropriate action to realise these improvements and ensure we deliver equipment that is safe to operate to the duty holders in the front line.

DE&S transformation continued to dominate the safety agenda in 2017-18. We carried out several Organisational Safety Assessments, both for the transformation of the organisation as a whole, and as individual business units redesign their organisations. These showed that the transformation changes have not negatively impacted safety or environmental protection, but also highlighted opportunities where we could make further progress.

In 2017-18 we separated out the OHSE Function and the Acquisition Safety & Environmental Protection (ASEP) discipline as part of the wider Engineering Function, providing an impetus for more focused upskilling for people in these areas. We have a roadmap for training our safety and environmental community, which will see ASEP professionals achieve 'practitioner' status and membership of a recognised professional body within defined timescales. Our suites of System Safety and Environmental Protection training courses have been updated to help deliver this. We continued to hold regular safety-related 'learning from experience' events through the year, identifying lessons learned and ensuring that best practice is shared across all areas of the business. We have also run a series of masterclasses to build competence in key safety and environmental topics.

A major achievement was development, in consultation with industry and academia, of a new Defence Standard (Def Stan 00-051 - Environmental Management Requirements for Defence Systems). This will make environmental management easier for our people and our suppliers by standardising the information we ask for and the way we expect our suppliers to assess and manage environmental impacts. We have also brought our introductory guidance booklets on system

safety and environmental management up to date. These developments, and ongoing improvements to the tools that define and capture the data to support our safety and environmental management systems, will help further standardise approaches within project areas, with the aim of supporting a unified DE&S way of delivering safety and environmental protection across the organisation.

We held our third annual Safety Day in June 2017, building on the success of previous events. This involved events across the whole of the DE&S estate to reinforce the message about our safety vision and commitment. All our people were actively encouraged to take part and we received strong support from our suppliers. We also used the day to launch our annual Safety Culture Survey. This has helped us target work for the coming year that will emphasise the role of the senior leadership group in driving a positive safety culture, and the important contribution from people outside the ASEP and OHSE specialist disciplines, both in keeping our own people safe and in delivering safe-to-use equipment to our customers. An Acquisition Safety Project will take this work further over 2018-19.

Across the DE&S estate, all sites now have environmental management systems in place which are regularly assessed and audited. Improving overall maturity is the goal. To assist this work, as part of our Transformation, the OHSE Function is developing an organisational Safety and Environmental Management System that will be integrated into the new and overarching Business Management System and include a new policy statement for Environmental Protection. A key challenge remains trying to ensure that our fuels infrastructure is, and remains, compliant, and we are working with both the Defence Infrastructure Organisation (DIO) and the Fuels and Gases Safety Regulator to ensure this is achieved.

Sustainable development

The DE&S Executive Committee supports the advancement of sustainable development within the organisation and three new steering groups were established in 2017 to strengthen governance and drive improvements to DE&S' estates, operations and acquisition activities.

The Greening Government Commitments Steering Group is a committee responsible for ensuring DE&S meets requirements under the government sustainability targets. The group is 2*/Director level led with representatives from across DE&S Functions and delivery operating centres and is focused on the Greening Government Commitments including estates

operations (such as energy, water and waste). During 2017-18 we have introduced a delivery plan to address DE&S requirements on both infrastructure and office related targets including domestic flights and paper usage. DE&S, as a consumer of energy, contributes to the delivery of MOD sustainability targets, however, in most cases, DE&S is a lodger unit within MOD sites, where responsibility for energy use on site sits with the DIO.

DE&S continues to engage with the DIO to improve management information as well as the development of behavioural management measures including an employee awareness campaign on the Triad energy saving initiative that ran last winter. DE&S has also strengthened its governance of estate environmental management, introducing a new 1* led Occupational Environmental Protection Steering Group. The Group is tasked with monitoring environmental protection performance arising from DE&S's activities against legal requirements and MOD policy and performance targets, and provides assurance to the CEO via the Safety Health and Environment Committee. We will be developing our management information to better assess our environmental impact over the 2018-19 financial year.

The Acquisition Environment Steering Group is a separate 2* led committee, focused on addressing DE&S' key environmental and sustainability risks affecting the acquisition of equipment and support services.

As part of the refresh of the Acquisition Safety and Environmental Management System, Sustainable Procurement (SP) is now also being incorporated in the Project Orientated Environmental Management System. We have developed new guidance and a five-step tool kit for use by DE&S project teams, which is being rolled out in 2018-19, and updated the SP information available on the Acquisition Systems Guidance website to provide stakeholders with policy guidance on how different sustainability risks tie into Defence priorities.

DE&S project teams in different operating centres have continued to consider climate resilience through various initiatives during 2017-18, as well as undertaking energy efficiency related work to reduce fuel costs and greenhouse gas emissions. For example, design changes introduced thanks to the Hydrodynamic Improvement Programme, have resulted in fuel efficiency savings of up to 20% on Type 23 Frigates.

DE&S is represented at external working groups to ensure we continue to work collaboratively with stakeholders, including other nations and UK suppliers

through forums including the joint MOD and industry Sustainable Procurement Working Group to develop effective SP practices in the supply chain.

Building understanding continues to be an important part of the programme and in September 2017, our Director of Safety & Environment, Quality and Technology hosted an SP upskilling event to raise awareness and provide guidance. This was part of our wider upskilling programme to strengthen competences on key safety and environmental themes.

In summary, we have made significant progress on sustainable development in 2017-18 and laid the ground-work for further improvement in the future. Details of DE&S' performance in all key areas is included in the Sustainable MOD Annual Report, which will be available on the gov.uk website later this year.

Security

The security of our personnel and estate remains hugely important and we have taken further steps to remind people of the business and personal safety benefits of adopting a robust security culture both in and out of work. Our Security Committee meets on a quarterly basis, driving the provision of proportionate and effective security for DE&S; it provides oversight and governance for all elements of security including physical, personnel, cyber, and business resilience. The Security Committee has provided regular updates to the Executive Committee and the DE&S Board throughout the financial year.

The Security and Resilience Specialism is fully engaged with the Security and the Business Continuity Institutes, working together to deliver several events offering continuous professional development to our staff. The career pathways, support networks and associated training and development are provided to ensure that security and resilience improvements are delivered by professionals at all levels throughout the acquisition and support of defence equipment.

Nuclear security, of course, remained a priority in 2017-18, and in 2018-19 the DE&S Principal Security Advisor will continue to deliver services to the Submarine Delivery Agency and the Defence Nuclear Organisation, ensuring both continuity and a holistic second line nuclear assurance capability for Defence. The DE&S Principal Security Advisor also sits on the Independent Police Committee working closely with the MOD Police and MOD Guard Service to ensure effective policing and guarding arrangements are in place to meet site requirements. This committee ensures that any staffing



HMS Queen Elizabeth and support ships

or capability issues are managed effectively and any impact on nuclear infrastructure is mitigated.

Aged infrastructure remains a challenge across the MOD estate. Work is underway to provide professional support to ensure that security and resilience threats, mitigations and residual risks are framed in a way that ensures senior decision makers can properly manage them. Our security and infrastructure teams continue to identify and prioritise infrastructure investment to ensure future physical infrastructure meets security requirements, and to ensure that appropriate mitigations are in place in the meantime. We have increased the assurance activity around our Defence Critical National Infrastructure in 2017-18, and have more people being trained to deliver this next year.

Physical security capability across DE&S was audited by Defence Internal Audit in 2017, and all actions within DE&S control have been completed. The report recognised the limitations on delivery by DIO of infrastructure improvements and effective guarding through the MOD Guard Service. It also noted the more limited MOD Police capability which is expected to further reduce in 2018-19. It was these three areas that prevented DE&S from having more than Limited Assurance of its physical security capability, and the report noted that these outputs were beyond the direct control of DE&S.

On behalf of the MOD, DE&S continues to ensure that all classified defence information and physical assets held at industry sites are protected appropriately, through life, under the List X clearance process. This is delivered through a rolling visit programme, provision of training for security professionals in industry, Board level briefings and general awareness material. This relationship is underpinned by a secure, modern, communication capability, alongside close collaboration with their relevant industry bodies.

The DE&S security culture campaign continues to achieve a positive impact, and the new General Security Threat Brief, introduced in 2017-18 has been very well received and reached more staff than in any other year, resulting in a CEO Commendation. Awareness campaigns have been delivered throughout the year, to correspond with national campaigns, such as Counter Terrorism Week and Business Continuity Week to raise the bar in terms of our security behaviours. Accordingly, we have revamped security training to deliver a clear articulation of the threat faced by Defence staff and to provide practical steps to ensure the integrity of the Defence supply chain. The cumulative effect of the campaign has been a reduction in reported security breaches across all domains, and a closer relationship between projects and security specialists.

LOOKING FORWARD



In May 2018, we published our Corporate Plan for 2018-21. The Plan, which is refreshed annually, sets out our strategic outlook and highlights some of our key programmes and projects. It also contains our indicative budget for 2018-19.

The 2018-21 Corporate Plan is available online via <https://www.gov.uk/government/organisations/defence-equipment-and-support>

During 2018-19 we will deliver the programme of work to our military customers as agreed in the CASPs. Our programme of work remains intensive and is set against the need to continue to realise significant efficiencies, over and above our transformation based ones. It is within this context that we are embedding our transformation changes and developing our workforce to drive our performance and deliver further efficiency savings. During 2018-19 we will be embedding our transformation changes by deepening our understanding and utilisation of the P3M toolsets, and refining our people model and matrix management. Our commitment in 2018-19 to 'even more 'S' in DE&S' includes the introduction of the Common Support Framework. This draws together customer requirements, commercial considerations and technical foundations to give us a single framework for through-life equipment support that fully leverages our buying power in the marketplace. With the introduction of a standardised set of processes and tools to define, measure and control our performance, along with a strengthened governance structure, we will ensure that support stays at the heart of our delivery as we strive to deliver more effective and efficient capability services to the front line.

We will continue to roll out new ways of working which our exemplar projects have adopted most fully in the first instance. Alongside this growth in project management improvement, we are also continuing work on strategic savings initiatives in selected projects. This is helping us to identify savings through a series of structured interventions to remove cost from an increasing number of Equipment Plan projects. These savings will build on the transformation benefits of over £3.6 billion which we achieved by the end of March 2018.

The Modernising Defence Programme (MDP) was launched by the Defence Secretary in January 2018. It builds on the foundations of the National Security Capability Review and the 2015 Strategic Defence and Security Review (SDSR15). The MDP workstreams seek to optimise the organisation and operation of the MOD; identify efficiencies and opportunities for business modernisation, and improve performance on commercial and industrial issues. A fourth workstream

is examining the capabilities Defence requires to contribute to our three National Security Objectives now, and into the future, in the context of a rapidly evolving threat environment. DE&S has supported the MDP by sharing our transformation principles and learning, while continuing to pursue continuous improvement, efficiency and delivering greater value to Defence. On 19 July 2018, the Secretary of State laid a written statement in Parliament, providing an update on the headline conclusions of the MDP and the areas of focus going forward. The MDP has since moved into a period of more detailed analysis and cross-Government discussion ahead of providing more detailed conclusions.

The UK will leave the European Union on 29 March 2019. During 2017, negotiations with the Commission led to the agreement at the December European Council that 'sufficient progress' had been made to move to the next phase of negotiations. Since then, a key focus, for the wider Defence and security community, has been to consider how transitional arrangements during an Implementation Period would apply. DE&S has supported this and the ongoing effort to reach an agreed policy position on the desired end state; recognising the potential requirement to put in place measures to mitigate or minimise business and supply chain risks.

Within this changing landscape and in recognition of our ongoing transformation and development, in July 2018 we published our DE&S@21 vision, setting out where we want to be by 2021 - a confident, commercial organisation that is:

- Customer and performance focused
- Tech-enabled supporting us to be agile in delivery
- Forward-looking and results orientated
- Offering an employee value proposition that attracts, builds and develops a skills base to underpin better performance

This strategic vision acknowledges the changing landscape whilst ensuring we remain focused on our primary objective; the efficient and effective delivery of the agreed equipment and support to our military customers.



Sir Simon Bollom
Accounting Officer
31 October 2018

Member of staff working at the Defence
Fuels Group site - West Moors



Section Two

Accountability Report



CORPORATE GOVERNANCE REPORT



Directors' report

Management

Details of the DE&S Chairman and CEO, and more information on the composition of the DE&S Board and Executive Committee are set out in the Governance Statement, and the Remuneration and Staff Report.

Directorships and significant interests

DE&S senior executives must declare any personal interests that they have with current or potential customers or suppliers. There have been no reported conflicts of interest or related party transactions between the senior executives and their activities that have impacted on the conduct and consideration of Board business by its members.

Personal data related incidents

No personal data related incidents were reported to the Information Commissioner's Office in 2017-18. In preparation for changes to the law protecting personal data, tighter processes have been implemented to ensure that all incidents suspected of relating to personal data are investigated as normal but that the data protection cell are made aware of such incidents to ensure that the investigation is in accordance with the new Data Protection Act and General Data Protection Regulations, and that any lessons may be learnt from the incident. An awareness campaign has been undertaken during 2017-18 to highlight the areas where there is high potential for personal data incidents and promote the appropriate course of action to be taken to minimise the impact and report any suspected incidents appropriately.

Statement of Accounting Officer responsibilities

Under the Government Resources and Accounts Act 2000, HM Treasury has directed DE&S to prepare, for each financial year, resource accounts detailing the resources acquired, used, held or disposed of during the year, and a statement of accounts in the form and on the basis set out in the Accounts Direction issued by HM Treasury on 19 December 2017. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of DE&S and of its net resource outturn, application of resources, changes in taxpayers' equity 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 (FReM) 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 FReM, have been followed, and disclose and explain any material departures in the accounts.
- Prepare the accounts on a going concern basis.

The Permanent Secretary of the MOD, as Accounting Officer, has designated the CEO of DE&S as Accounting Officer for DE&S. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, keeping proper records and safeguarding DE&S assets, are set out in *Managing Public Money*, published by HM Treasury.

The Accounting Officer is required to confirm that, as far as he is aware, there is no relevant audit information of which the Department or its auditors are unaware, and the Accounting Officer has taken all the steps that he ought to have taken to make himself aware of any relevant audit information and to establish that the Department and its auditors are aware of that information.

The Accounting Officer is required to take personal responsibility for this annual report and accounts and the judgments required for determining that as a whole it is fair, balanced and understandable.



Governance Statement

I, Sir Simon Bollom, Chief Executive and Accounting Officer of DE&S, am responsible for maintaining a sound system of corporate governance and internal control to support DE&S' purpose and high level objectives, while safeguarding the public funds and MOD assets for which I am personally responsible. I have obtained assurances from Michael Bradley, who was Interim Accounting Officer for the period from 1 January 2018 until 31 March 2018, and my teams that enable me to conclude that the system of internal control in DE&S complies with the HM Treasury Code of Good Practice on Corporate Governance in Central Government Departments.

This Governance Statement represents my assurance that, as Accounting Officer, I am satisfied that DE&S finances are adequately controlled through sound financial management systems, processes and controls.

Our governance structure

The DE&S governance hierarchy is headed by the Owner's Council and the DE&S Board and its associated sub-committees, each of which is established with the objective of providing suitable assurance that DE&S is fulfilling its responsibilities to its stakeholders, and its management is operating within the framework, procedures and plans that have been set.

DE&S Board

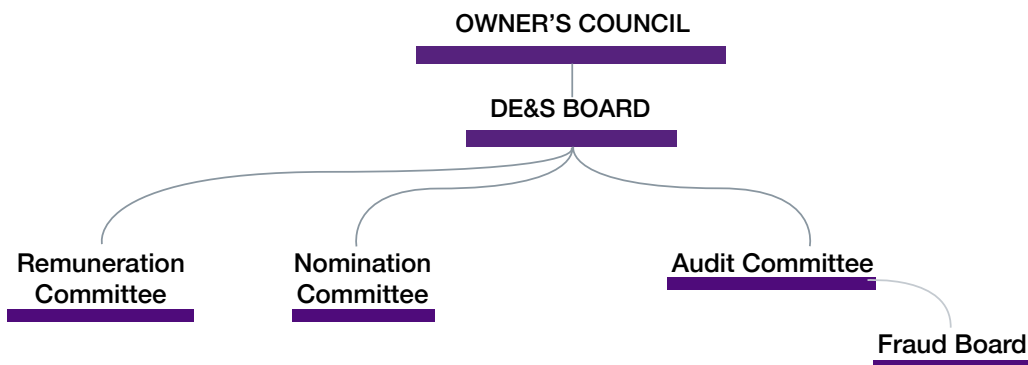
The DE&S Board provides the strategic leadership for

DE&S in delivering its objectives. As such it enables non-executive approval of the Corporate Plan for submission to the Owner's Council and oversight of the delivery of DE&S business. The DE&S Board provides a forum for independent, non-executive, support and constructive challenge to the DE&S CEO and Executive Committee.

To strike the right balance of skills, experience and objectivity, the Chair agrees the size and composition of the Board with the CEO, taking into account guidance and best practice on boards in the public and private sectors, subject to approval from the Ministerial Owner.

Membership

- Mr Paul Skinner, DE&S Chair
- MOD Permanent Secretary (with MOD Director General Head Office and Commissioning Services attending as his representative)
- DE&S CEO
- DCDS Military Capability
- DE&S Director General (Resources)
- Mr Andrew Wolstenholme, Non-Executive Director (NED)⁷
- Mr Paul Smith, NED⁸
- Mr James Dorrian, NED
- Dr Ros Rivaz, NED
- Mr Iain Lanaghan, NED
- Mr Gerard Connell, NED⁹



⁷ Mr Wolstenholme resigned from the DE&S Board on 16 February 2018.
⁸ Mr Smith resigned from the DE&S Board on 31 March 2018.
⁹ Mr Connell joined the DE&S Board in the 2018-19 financial year, on 1 June 2018.

Owner's Council

Departmental interest and governance at Ministerial level is reflected through the DE&S' Owner's Council. The Owner's Council supports and advises the Owner on the review and setting of DE&S' strategic objectives, the approval of the Corporate Plan and novel or contentious decisions, and on performance.

The Owner's Council is an internal MOD committee chaired by the Minister for Defence Procurement and meets as necessary, and at least quarterly. Membership includes MOD Permanent Secretary, MOD Director General Finance, MOD Director General Head Office and Commissioning Services and Deputy Chief of the Defence Staff (Military Capability) as the customer representative. The DE&S Chair and DE&S CEO attend. The Cabinet Office Chief Procurement Officer has a standing invitation to attend.

DE&S Board as at March 2018



DE&S Board activity

The Board met nine times during 2017-18, this included the Strategy Day which was held in February 2018.

Number of meetings attended 2017-18¹⁰	
Mr Paul Skinner	9(9)
Mr Stephen Lovegrove or Julie Taylor as his representative	9(9)
Mr Tony Douglas	6(6) ¹¹
Lt Gen Mark Poffley	5(9)
Mr Michael Bradley	9(9)
Mr Andrew Wolstenholme	4(8) ¹²
Mr Paul Smith	8(9)
Mr James Dorrian	9(9)
Dr Ros Rivaz	7(9)
Mr Iain Lanaghan	8(9)

DE&S Board processes

All key processes and procedures affecting the Board are maintained and operated by the Board Secretary. Formal minutes of all Board meetings are distributed promptly and, between meetings, other information is circulated as necessary to keep Board members informed on relevant issues. At its meetings, the Board takes regular written reports from the CEO, the Chief Financial Officer and the Chairs of the Board sub-committees, as well as on other business as required. Papers taken at the Board are prepared by those with sufficient seniority and experience to enable them to report with authority on each subject and, where the Board is presented with options for approval, our papers adopt the principles of evidence-based decision making. This helps us to ensure that the information to which the Board has access is current, balanced and accurate.

Board performance

By Paul Skinner, DE&S Chairman

As Chairman I have overseen the continued evolution of the Board during its fourth year of operation. We have sought to implement those improvements to Board effectiveness that were identified by the review conducted last year, in particular: a consideration of how to utilise better the knowledge and experience brought by the Board; and to increase consideration of People, Transformation and Risk Management issues, involving our customers where possible. The change in Board composition during the year, with the resignation of both Mr Tony Douglas and Mr Andrew Wolstenholme, did present challenges, but with the appointment of Sir Simon Bollom as our new Chief Executive, and the additional non-executive position that has been filled, I am confident that we have now secured a stable and resilient senior governance framework. As I indicated in last year's report, my intention had been to conduct a formal, external, review of Board effectiveness at the end of our fourth year of operation. However, after consideration of the value to be gained, given the context of the Modernising Defence Programme, I decided that a further, internal, review for 2017-18 would be conducted, the findings of which we will again use to enhance our effectiveness over the coming year.

¹⁰ The figures displayed are the number of meetings attended by each individual, with the total number of meetings available to attend in brackets.

¹¹ Mr Tony Douglas resigned as DE&S CEO on the 31st December 2017.

¹² Mr Andrew Wolstenholme resigned as a DE&S Non-Executive Director on the 16th February 2018.

Key business discussed at the DE&S Board during 2017-18

Subject	Discussion	Outcomes
Strategy	The Board held a strategy day in February 2018 to explore the contextual issues affecting DE&S. The Board discussed the future strategic direction of the organisation (“DE&S@21”) and its role in the Modernising Defence Programme.	The Board reviewed the strategic context and financial outlook within DE&S from both the Equipment Programme and operating expenditure perspectives; and agreed the focus for DE&S’ strategic objectives.
Risk	DE&S strategic risks were scrutinised and discussed throughout the year. Risk management practices have continued to evolve.	A strategic risk workshop, involving Executive Committee members and Board Non-Executive Directors, was held on 16 October 2017. This reviewed the scope and nature of the risks managed by the business at Executive Committee and Board level.
Transformation	At all meetings, the Board received updates on progress toward implementation, and achievement of, Transformation benefits. The planned departure of the Managed Service Providers during 2018-19, with additional resource being provided to the Strategic Savings Initiative, was noted.	The Board evaluated Transformation delivery against the milestone plan. The approach to 2017-18 Pay and Reward was endorsed.
Corporate documents	The Board tracked the progress and publication of the DE&S Annual Report and Accounts and contributed to the development of the DE&S Corporate Plan 2018-21.	The DE&S Annual Report and Accounts for 2016-17 was published in November 2017. The Board noted that the accounts had been approved, with the comparatives qualified by the NAO.
DE&S Committees	The Board received reports on the progress, themes and membership of its sub-committees and considered the work being taken forward.	The Board recognised the value of the NEDs on the DE&S Committees and approved plans to recruit additional NEDs to support, in particular, the Audit Committee.
DE&S Business Updates	The Board received regular business updates from the Domain Chiefs of Materiel and from function leads in Security, Commercial, HR and Information Technology.	The Board engaged with the business and evaluated the IT Strategy, HR People Strategy and HR Organisation Plan enabling appropriate challenge to the Executives.
Submarine Delivery Agency (SDA)	The Board received regular updates on progress made to establish the SDA, including the provision of milestone delivery data.	Mr Ian Booth was appointed as the SDA CEO on 4 September 2017. A letter of delegation for Equipment Programme responsibilities was provided by DE&S CEO to the SDA CEO in November 2017.

DE&S Board sub-committees

The DE&S independent Non-Executive Directors (NEDs) attend the following sub-committees:

Name	Committee (meetings attended) ¹³
Mr Paul Skinner ¹⁴	Nomination Committee Chair (2/2)
Mr Paul Smith	Audit Committee Chair (4/4) Fraud Board (3/3)
Mr Andrew Wolstenholme	N/A
Mr James Dorrian	Remuneration Committee (5/5) Nomination Committee (2/2)
Mr Iain Lanaghan	Audit Committee (3/4) Fraud Board (1/4)
Dr Ros Rivaz	Audit Committee (1/1) Remuneration Committee (4/5)

Audit Committee

The Audit Committee's remit is to review and challenge the adequacy of internal controls and risk management assurance processes within DE&S. Where assurance is ineffective, the Committee will make recommendations to the DE&S Board for appropriate action to be taken. The Audit Committee met four times during 2017-18. Three meetings were chaired by Mr Paul Smith, who

was also a Non-Executive member of the Defence Audit Committee during this period, and one meeting was chaired by Mr Iain Lanaghan, who took over the role during the year. As well as the Chair, formal membership consisted of a MOD NED, Director General Head Office and Commissioning Services.

The meetings were attended by the Director General Resources, the Director Corporate Operations; Director Financial Plans and Analysis; Director Commercial Capability and the Head of Financial Accounting. The National Audit Office and Defence Internal Audit were also in attendance.

The Audit Committee's programme of business over the course of the year primarily focused on DE&S' Annual Report and Accounts and monitored the progress of implementing the recommendations raised in the National Audit Office management letters. It also reviewed the Defence Internal Audit outputs and findings, whilst monitoring the progress of agreed management actions. In addition, the Audit Committee reviewed strategic risk, contingent liabilities, losses and special payments, the change in legislation on General Data Protection Regulations and Assets Under Construction.



Merlin Mk2 Flight Deck Operations

¹³ The number in brackets represents the number of meetings attended/the number of meetings available to attend.

¹⁴ As Chairman, Mr Paul Skinner has an open invitation to all Committees.

Fraud Board

The Fraud Board is a sub-committee of the Audit Committee with a remit to oversee a risk-based approach using the available management information to protect DE&S' business reputation, assets and finances from fraud, corruption, theft and misappropriation.

The Fraud Board met four times during 2017-18. One meeting was chaired by Mr Paul Smith and three by Mr David Johnson, the DE&S Director of Financial Plans and Analysis, who was formally appointed as the Chairman at the meeting in December 2017. Also in attendance were the Risk Owners responsible for managing the principle DE&S fraud risks, together with representatives from the DE&S corporate financial team, the MOD Director Performance and Analysis, the Director Audit, Risk and Assurance, Defence Internal Audit and Fraud Defence.

The Fraud Board's programme during 2017-18 primarily focused on assessing fraud risks and the appropriate mitigation activities (policies, systems and controls). This included approval of the proposal to centrally manage fraud investigations to ensure more prompt resolution of cases. In February 2018, a Fraud Risk Workshop was held at which the eight Fraud risks were discussed in detail and amended accordingly. The Fraud Board also received updates on fraud, corruption and theft investigations.

A summary report of Fraud Board activity was provided to the Audit Committee after each meeting.

Remuneration Committee

The Remuneration Committee advises the Owner, the DE&S Board and the CEO on matters relating to the proper development and application of the DE&S total compensation strategy, including its pay structures, as set out in the DE&S Framework Document. It also advises the Board on the remuneration of the CEO, the top civilian executive team and other senior staff as appropriate, where these are not set by Senior Civil Service or Departmental guidelines.

During the 2017-18 period the Remuneration Committee met five times. Discussion included a broad range of People Strategy issues, including succession planning, senior executive performance assessment and outcomes and the further development and implementation of the new pay and reward strategy for the business.

Nominations Committee

The Nominations Committee meets as necessary to advise the DE&S Board and the CEO on appointments to the DE&S Board (except for the Chair, whose appointment is the responsibility of the Owner) and on senior leadership roles in the Executive.

Issues covered by the Nominations Committee during the 2017-18 period include senior workforce requirements, the division of the SDA from DE&S, and the appointment of senior positions including the CEO, Director Human Resources and appointments to the Chief Operating Officer role.

DE&S Executive Committee

The DE&S Executive Committee supports the CEO in the discharge of delegations and responsibilities set out in the CEO Letter of Delegation as Accounting Officer and Letter of Authority from the MOD Permanent Secretary – to ensure that DE&S delivers its purpose to equip and support the UK's Armed Forces for operations now and in the future. In delivering this remit, the Executive Committee's considerations will include:

- The development of strategy (in preparation for DE&S Board consideration)
- The establishment of business plans and their context
- The review of plans presented from its sub-committees
- Monitoring performance against all approved plans
- The primary coordination of the operating model and the satisfaction of end user requirements
- The review of the plan delivery set out by the Performance Committee
- Review of commercial plans
- The management of the issues in the strategic risk register
- Monitoring and review of safety issues including occupational health and safety and equipment safety.

Membership

The CEO chairs the Executive Committee, which adopted a '5 by 5' structure as depicted on page 9, in April 2017, to reflect the move to the balanced matrix and the establishment of the Submarine Delivery Agency (SDA).

DE&S Executive Committee as at 31 March 2018



In September 2017 the Chief of Materiel Submarines role amalgamated into the new SDA CEO role. On 1 April 2018 the SDA stood up as a separate Executive Agency of the MOD. Consequently, for 2018-19 the Executive Committee membership comprises the Ships, Land, Air and Joint Enabler domain leads and the five cross-domain functional leads of DG Commercial, DG Resources, Director Human Resources, Director General Programmes and Director Corporate Operations.

Sir Simon Bollom was appointed as the new DE&S CEO on 21 May 2018.

During 2017-18 the Executive Committee considered the following key issues:

Transformation: The Committee discussed and encouraged the embedding of change across the organisation. Proposals to improve the time recording tool have been implemented. The Committee discussed the Support issues and approved the DE&S Way for

Support document. The Committee has utilised the Change Advocate Network to embed the changes required and it also discussed the future interface with the Submarine Delivery Agency.

Safety and Security: The Committee continuously reviewed the DE&S's OHSE and Acquisition Safety Dashboards. The Committee reviewed the safety culture survey results, an independent report into Acquisition Safety and the new Safety Governance Structure. Following previous success, the Committee agreed to hold a further DE&S Safety Day. The Committee has discussed physical and information security, Business Continuity and security culture throughout the year. The Committee also received a briefing on the cyber threat.

Commercial: The Committee reviewed the Commercial Fraud Strategy Plan, Commodity Procurement Strategy, the routes to market proposals and work to address issues of the rates applied on single source contracts.

Communications: Committee members agreed the Corporate Communication Strategy and throughout the

year reviewed focused and comprehensive campaign material. The Committee also reviewed the key priorities and campaigns to take place over the next 12 months. Action plans to address the results of the employment engagement survey were agreed.

DE&S People: Staff pay and performance were discussed throughout the year. Proposals to improve facilities and infrastructure across DE&S were reviewed and discussed. The use of the balance matrix to address skills shortages and retention issues were discussed throughout the year. The Committee reviewed proposals for resource workforce planning and agreed

the DE&S Code of Business Ethics and agreed the action plan in response to the 2017 Staff Survey feedback.

DE&S Performance: The Committee regularly discussed progress against financial forecasts and strategic milestones based on the KPIs in the Corporate Plan. The committee discussed options to address the 2018-19 operating expenditure challenge. The Committee endorsed Performance Dashboard and its use at the Performance Committee. Management activities to mitigate DE&S strategic risks were considered at every meeting.

Executive Committee sub-committees



A number of subordinate committees are in place to support the Executive Committee.

The **Performance Committee** chaired by the CEO, reviews the programme in each Domain, providing the forum to review the performance of each Domain in terms of its delivery of equipment and support to agreed plans. This includes reviewing the relevant KPI and CASP metrics and any risks and contingency plans.

Safety throughout the organisation is governed by our **Safety Health & Environment Committee**, chaired by the Chief of Materiel (Air), which has oversight of organisational key safety risks and directs work to develop and deliver improvement programmes for the business. A NED is invited to attend the Safety Committee as a permanent member.

The Chief of Materiel (Land) chairs the quarterly **Security Committee**, which owns and manages strategic-level risk and provides oversight of security across DE&S and industrial partners.

The **Transformation Committee**, chaired by the CEO, continues to report to the Executive Committee on driving and embedding the transformation of DE&S forward, focusing now on the 2018-19 plan and ensuring that the programme delivers the agreed

outcomes and benefits.

The **People Committee**, chaired by the CEO, is charged with driving forward and implementing the important changes to the management of our staff which underpins our Transformation and the Balanced Matrix structure. In particular, the Committee continues to evolve our approach to performance management and reward, with its recommendations being considered by both the Executive Committee and Board Remuneration Committee.

Other Executive Committee sub-committees include the **Business Case Review Committee**, chaired by DG Resources, and the **Innovation and Prosperity Committee** chaired by the CEO. These meet regularly, and update the Executive Committee as necessary on matters within their jurisdiction.

Outside of this formal governance structure, the CEO holds one-to-one meetings with the members of the Executive Committee. The CEO also meets regularly with the DE&S Senior Leadership Group (the highest grade in our new structure incorporating our Senior Civil Servant and military rank equivalent population) to keep DE&S' leaders apprised of developments as our transformation continues, and providing a forum for discussion and feedback.

DE&S risk and control framework

Risk management

Managing risk is all about reducing the uncertainty in our delivery to a level that allows successful management through the life of our projects and programmes. In DE&S, successful risk management is achieved through proactive identification, assessment, reduction, mitigation, monitoring and control, and takes place at all levels in the organisation. The DE&S Board and Executive Committee determine the governance and controls we have in place to manage risk, with a focus on strategic risk. Risk management arrangements below the strategic level are now organised by the new Project Controls Function and its dedicated Risk Discipline, both of which stood up as planned in April 2017 as part of our Transformation.

Achievements in 2017-18 included the introduction of domain-level risk registers, development of a new risk management procedure and risk management desk instruction to make our arrangements simpler and clearer. Further upgrades to our customised risk management tool – Active Risk Manager™ – to support

DE&S new ways of working, and a Risk Management Road Map to close identified gaps in the areas of risk management systems, process, capacity and capability, and wider communication within DE&S.

The DE&S Board examines DE&S risk and the controls that are in place to manage risks and address opportunities. It pays particular attention to strategic risks facing DE&S, that is, those risks which might have a negative impact on the achievement of our strategic objectives, or have serious legal, financial, reputational or health, safety and environmental implications.

Management of strategic risks is delegated to the Executive Committee. The Committee regularly reviews, supports and challenges risk owners to manage and reduce the risks as far as is reasonably practical. We continue to apply the MOD's risk management policy to our strategic risks, including reporting significant risks to the Defence Risk Committee and ultimately the Defence Board.

In 2017-18 we held our third annual strategic risk stocktake, facilitated once again by Defence Audit, Risk and Assurance. For the first time we also invited Defence Internal Audit to observe the event.



Black Hornet 2 Remotely Piloted Aircraft System (RPAS)

Principal strategic DE&S risks and their mitigations during 2017-18

Risk	Potential impact	Progress in 2017-18
<p>Government Furnished Equipment (GFE) The risk that ineffective management of MOD equipment and assets provided to contractors and failings in DE&S systems and processes may result in a material over/under statement of DE&S asset holdings and distorted operating costs.</p>	<p>In addition to damage to DE&S reputation for the efficient management of assets it could lead to financial losses and the qualification of the financial accounts by the NAO.</p>	<p>We have trialled the use of Base Inventory Warehouse Management Service (BIWMS) in the Air domain. This trial proved that with some adaptive changes this system can be used to effectively manage and provide improved visibility of GFE assets. Other improvements to GFE processes include enhancements to the verification of quarterly reports on assets held by contractors and publication of a detailed guidance document on the new Business Management System.</p>
<p>Cyber Potential deficiencies in technical awareness, processes, standards, tools, security behaviour of staff, contractors and suppliers, and management of insider threat causing a successful cyber attack against Defence equipment and/or infrastructure.</p>	<p>Reduced safety, impaired military capability, and loss of intellectual property or information asset, loss of business services, financial impact and reputational damage to Defence.</p>	<p>DE&S is committed to further enhancing its cyber capability by building on the existing resilience programmes such as the Defence Cyber Protection Partnership and Information Security Management System through active engagement with prime contractors, strategic suppliers, National Cyber Security Centre and other stakeholders. Based on the work completed during 2017-18, DE&S is now aligning itself with best practice standards, including ISO 27001, with a programme driven and sponsored by the Security Committee. Additionally, we are using the findings of recent audits by Defence Internal Audit to focus and prioritise our work in 2018-19.</p>
<p>Technology Development and Innovation The risk of deficiencies in DE&S organisation and processes undermining our ability to exploit new and emerging technology.</p>	<p>Front line commands unable to access, develop and maintain agile, leading edge capability.</p>	<p>We have initiated cross-cutting activities to improve our readiness for delivery of new and emergent technologies while supporting stakeholders across Defence in the use of open system architecture. We have improved policy, tools and training for the management and use of technical standards. We have delivered the first year of the DE&S Innovation Initiative, under clear direction of our CEO. We also continue to be a proactive participant in the work of the Defence Innovation Unit.</p>
<p>Equipment Safety The risk of shortfalls in governance, assurance or resourcing causing a failing in the DE&S safety management system.</p>	<p>A serious accident or incident involving products, systems or services we supply.</p>	<p>We have carried out Organisational Safety Assessments throughout our Transformation, which have demonstrated that there has been no negative safety impact from the changes introduced. This is reflected in DE&S achieving similar scores again in our annual Safety Culture survey for 2017-18. We have updated and improved the policy in our Acquisition Safety and Environmental Management System, delivered acquisition safety training to over 800 delegates and held six executive-level safety workshops for the senior leadership group. We commissioned an Acquisition Safety Study that was delivered in March 2018 and Defence Internal Audit also reported on Safety Governance through Transformation. These latter areas indicate where we can make still further progress in the coming year, including based on staff feedback from our Safety Survey.</p>
<p>Operating Cost Budget Departmental financial pressures causing the DE&S operating budget to be insufficient to deliver the programme of work.</p>	<p>An inability to deliver the programme of work and the Equipment Plan efficiency challenge.</p>	<p>Indicative control totals were issued to Chiefs of Materiel to enable forward planning and manage pressures on the operating budget. This also enabled informed conversations to be held with Head Office and front line command customers about costs and priorities, and resulted in a 2018-19 budget settlement which enables DE&S to continue delivering the programme of work.</p>

Update on principal risks identified in 2016-17

The risks outlined in the table above are those that were identified as a principal strategic risk during 2017-18. In the 2016-17 Annual Report and Accounts, we reported three further principal risks:

DE&S Transformation

The transformation plan for 2017-18 focused on embedding the changes made throughout DE&S and delivering expected benefits. This plan was delivered as evidenced by DE&S exceeding its transformation financial benefits target. It is further reflected in the audit undertaken by the Infrastructure and Projects Authority which resulted in a recommendation that the transformation programme exits the Defence Major Projects Portfolio and Government Major Projects Portfolio. Consequently, our annual risk stocktake closed the original risk on transformation and commissioned another focused on fully embedding change. This new strategic risk on Embedding Change was approved by the DE&S Board in October 2017. The programme continues to be managed through a monthly Transformation Committee chaired by the CEO, which tracks progress and reviews all risk areas and associated mitigation plans.

Equipment Support

The 'More S in DE&S' initiative has gained ever more traction over the 2017-18 financial year. A second successful Support Day was held in December 2017, jointly hosted by Director General Programmes and Director Support Enablers. Over one hundred of our people from a range of professional Functions attended an interactive day, generating ideas to help and refine the initiative around the six key themes – common support framework, inventory, support performance, information systems and tools, processes and organisational alignment. Governance to drive forward progress has also been established. Principal to this is a Support Steering Committee that recently approved a 'More S' campaign plan that will ensure coherence across all working group activity. Equipment support remains a strategic item for DE&S and, while no longer a principal risk following the annual risk stocktake, remains a focus through OGSM objective number 3.

Infrastructure Compliance

We have continued to improve our Intelligent Customer capability, developing both the size and expertise of the DE&S Infrastructure team. We have also participated

in Defence-wide activities to improve infrastructure performance, for example contributing to the overarching Infrastructure System Operating Model and the Future Defence Infrastructure Organisation initiative. This allows us to meet our growing responsibilities and requirements including acceptance of infrastructure funding delegations and to better direct and prioritise infrastructure spend against DE&S requirements. We are also improving commercial arrangements through membership of Future Procurement Programme boards. Finally, we have delivered a 10-year prioritised infrastructure requirements submission introducing a robust risk-based approach to prioritisation. Infrastructure compliance remains a strategic item for DE&S, but is no longer a principal risk following the annual risk stocktake.

Principal internal controls

Everyone in DE&S shares accountability for managing their time, protecting public money and delivering their objectives. To enable this, we ensure that we delegate effectively; that people should have the authority to commit resources, with accountability for outcomes, and that leaders and managers monitor progress. Delegation results in objectives that are agreed between individuals, their delivery managers and their Function managers – and that progress and achievements are reported through the DE&S annual performance management process. Underpinning this, we exercise a strong system of internal control for specific elements of our business. Where elements are determined to require strengthening, they are reviewed and the appropriate changes are implemented.

Financial

The DE&S Board formally endorses and monitors performance against our annual budget. We practise financial control through a system of financial delegation to senior staff, who then sub-delegate to appropriate senior managers and finance managers to ensure value for money judgements are made at all levels of the business.

DE&S has been granted significant freedom of action for manpower pay, remuneration, recruitment and approvals of consultancy and we regularly review the appropriateness of letters of delegation as part of routine business. Board level letters of delegation were updated, to provide greater coherence in the delegation of responsibilities, and reissued to take account of the appointment of Mr Michael Bradley as interim Chief Executive Office in January 2018.

We implemented our finance internal controls and assurance framework, bringing greater structure to and increased confidence in our financial management processes. This included the introduction of a new Contracting, Purchase and Finance (CP&F) system in financial year 2016-2017, which has improved the integrity of the management information we use.

We have placed an emphasis on developing a robust stance on Business Ethics with the publication of our Code. As outlined in last year's Annual Report, we launched our new policy on gifts and hospitality at the start of the 2017-18 financial year. We also launched an innovative, digitised process to allow our Delivery Managers to check the travel and subsistence claims of those members of staff who directly work for them; coupled with this is the greater use of analytics that we have developed to provide an enhanced insight into possible fraud risks.

We worked closely with KPMG during 2016-17 ahead of the formal NAO audit, which resulted in an unqualified audit opinion for the DE&S BTE accounts. We have this year worked with KPMG once again to ensure we achieve an unqualified audit opinion for 2017-18. We continue to improve on the controls implemented since 2016-17 and introduced several additional controls during 2017-18 which aim to address the points highlighted in NAO's management letter following the end of the 2016-17 audit. This will further improve the quality of our financial information and record keeping.

Our accounting is subject to detailed audit by both Defence Internal Audit and the NAO to test our compliance with Departmental and HM Treasury policies. No major departures from government accounting principles were identified during the year.

The freedoms granted to DE&S as a BTE mean that the organisation is exempt from all Cabinet Office controls except for information communication technology and property. The Cabinet Office has clarified that these exemptions include both equipment programme and BTE operating activities. Information about Cabinet Office controls can be found at: <https://www.gov.uk/government/publications/cabinet-office-controls/cabinet-office-controls-guidance-version-40>

Assured delivery and support

DE&S is committed to providing the most effective equipment and services to our armed forces safely and to the agreed standards of performance, cost and time. The adoption of sound quality management principles is a key enabler to achieving this and we have committed

to put in place a 'best in class' Business Management System (BMS) and Quality Management capability to ensure we perform our processes in a consistent and acceptable manner.

Our new BMS database was introduced in 2017 to provide a common platform for a consistent set of operating processes across the DE&S enterprise. Clear functional ownership of the operating processes has been established and each of our Functions has developed their essential processes required for delivery operation. Our overall end to end process for 'agreeing and delivering programmes of work' has been fully re-mapped to encompass the agreement, execution and closeout of a programme and to ensure all Functions' process activities are fully integrated within it.

This approach to integrated processes housed within a modern BMS solution is a key driver in our goal to achieve certification to ISO9001 – the international quality management system standard. In 2018 we will see the determination of the actual path to certification including the placement of a contract to engage a third-party certification body.

Commercial

In 2017-18 we placed over £9 billion of new work with our supply chain either through new contracts or through amendments to existing contracts. Over the course of the year we managed around 3,700 contracts with a value of approximately £166 billion¹⁵. A focus on contract consolidation has seen this reduce from over 5,000 contracts some three years ago and we intend to further consolidate going forward. Major new platforms contracted for over the year include the first batch of three Type 26 Global Combat Ships and Astute Boat 7. Responsibility for future submarine procurement has now transferred to the Submarine Delivery Agency. We have been subject to no legal challenges to our procurement over the course of the 2017-18 financial year. We have continued to be fully compliant with the Single Source Regulations with new contracts falling within the regime being placed as Qualifying Defence Contracts (QDCs). We have also focused on converting high value contracts to QDCs on amendment.

Our focus on continuous improvement continued with the formal establishment of a Commercial Improvement Programme. This programme is driving a variety of initiatives under three categories: of Routes to Market, Indirect Cost Optimisation Programme and Good to Manage. Further details of these initiatives are included above in the 'About DE&S' section of this report. Furthermore, we have been working closely

¹⁵ All numbers quoted include those contracts which, from 1 April 2018, will be managed by the Submarine Delivery Agency.



with MOD centre preparing for the introduction of a new contract management system. This long-awaited addition will enable us to further improve supplier and contract management through greater visibility of management information and better control of spend and procurement routes.

In respect of our people, we have built on the previous year's success of bringing significant new levels of resource into the business by focusing on capability development in 2017-18. We have continued to invest in upskilling our staff and this was reflected in the 2017 DE&S Learning and Development score for function engagement where the Function scored 63%; 10% higher than the overall Civil Service score. Following the introduction of a new pan-MOD Commercial Licensing process, 67% of our commercial staff passed first time both the sourcing and contract management elements of the licence requirements. The overall DE&S pass rates for sourcing at 71% and contract management at 89% were also high. We continue to send our senior commercial staff to the Government Commercial Office Assessment Centre where they rate highly against their cross-Government peers. The upskilling of our own staff has been supported by the appointment of a Commercial Delivery Partner, Paragon – a joint venture between Turner and Townsend and Mace and supported by Ernst and Young and Officio amongst others. This is proving to be an extremely successful partnership bringing both general capability reinforcement and the provision of specialist skills and services.

Safety, security and resilience

Keeping our people, facilities, assets and equipment safe and secure is of critical importance and, as such, across all areas of responsibility, we aim to continually develop and improve safety and security management. We have a corporate safety KPI which supplements our safety and environmental protection business performance indicators. We have corporate level risks to ensure that security and resilience, including cyber, receives thorough and regular oversight throughout the business. We continue to build on strong safety education, with an annual safety day event, and have enhanced the “security – yours to deliver” awareness campaign this financial year, taking the opportunities offered by get-safe-online, cyber-security, counter-terrorism and business continuity awareness weeks to develop an effective and robust culture.

Business continuity management and resilience risks and issues are managed at the quarterly Security Committee. Our central business resilience team, with the support of the Security and Resilience specialism,

provides strategic direction on business continuity and resilience along with training and career pathways for practitioners. The DE&S Strategic Business Continuity Impact Analysis was reviewed and agreed again this year, to ensure that we have captured our priorities and resource dependencies including key suppliers and information systems. Business Continuity plans have been reviewed and exercised, and put into practice, very effectively, during the severe weather this winter, with lessons learned being fed back into the revised plans.

Our people

As part of transformation we have fundamentally reshaped the way our people are managed. We have moved away from viewing our staff as generalists with add-on specialisms to a world where everyone is a defined professional. Individual performance has come to the fore, including enabling staff to take responsibility and then be accountable. Corporate control of the demand for resources since April 2017 has been supported by our people model – a key pillar of our transformation.

We have introduced a new set of employment policies and processes, including a new performance management system directly linked to bench-marked, job-evaluated pay and performance awards; replaced the vast array of DE&S jobs with around 250 roles aligned to the market within which people are flexibly deployed to meet the needs of the Balanced Matrix; grouped everyone into 11 Functions (professions) who plan and manage them as a group including responsibility for their upskilling, development and talent management; and replaced the ‘line manager’ with a matrix of a delivery manager or managers addressing the outputs of particular assignments and a more enduring function development manager responsible for the individual's overall performance, development and career.

The new DE&S HR capability has supported these changes and introduced an in-house casework service, a growing recruitment capability, centres of expertise for HR policy, organisation development and learning, and embedded HR business partners. Our functional management and HR capability will continue to mature through a range of embedding transformation programmes, and the DE&S People Committee has continued to meet every other month to manage the tranche of new HR policies and to agree the pay, performance and reward approach for the year. We are responding to staff feedback on our new performance reporting process and are taking steps to streamline.

Transformation

The DE&S Transformation Committee is responsible for the strategic management of DE&S' transformation, reporting to the DE&S Executive Committee. The Transformation Committee meets monthly to review progress against plans, provide operational control and initiate actions to resolve barriers to progress of the delivery of project milestones. Since April 2017 DE&S Transformation has focused on embedding the new ways of working and realising efficiency savings. The Transformation Committee approves any changes to the milestone plan and provides assurance to the Executive Committee and the DE&S Board that any such change is manageable and risk has been properly assessed. The Committee also oversees the performance of the Managed Service Providers (MSPs).

Information management

As part of the DE&S transformation programme, the Information Management process (including records) has been developed and documented within the BMS. This has enabled a clearer understanding of how the business utilises information consistently and documenting of the essential information management controls, such as creation, storage, control of access, disclosure and destruction. A major programme of work will continue to improve and develop Data Incidents and Information Management by aligning the business to an industry standard for information security.

Quality assurance of analytical models

Recommendation four of the Macpherson review¹⁶ requires Accounting Officers' governance statements to confirm that an appropriate quality assurance framework is in place for analytical models. The MOD continues to implement the Macpherson report recommendations and DE&S has been part of the Department's Action Plan to strengthen the approach to quality assurance. The 2018 published list of business critical analytical models, including those in use in DE&S, is available online at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/701222/2018_BCML_FINAL.pdf

The MOD's independent Cost Assurance and Analysis Service (CAAS) Modelling Centre of Excellence (MCoE) conducted a review of the quality assurance of the Business Critical Models (BCM) listed for 2017-18. Of the 59 BCM declared, minor deficiencies in the quality assurance process were found in only three models (concerning quality assurance coverage and change and configuration control). The review concluded that

there is substantial assurance that the quality assurance of DE&S models has been conducted in a way that satisfies the requirements of HM Treasury and the recommendations from the Macpherson Review. This maintains the level of assurance given by CAAS for the 2016-17 and 2015-16 reviews. The CAAS MCoE continues to work closely with the wider MOD on quality assurance, sharing best practice. In line with DE&S transformation, new roles and responsibilities have been established within the reporting process, to best serve the delivery of quality assurance in DE&S.

Annual assessment of governance

As in previous years, the governance, risk management, internal control and assurance arrangements in DE&S have been comprehensively reviewed in conjunction with the DE&S Audit Committee. Risks deemed to be significant are reported as strategic risks to the DE&S Board. The organisation is also subject to a number of internal and external reviews throughout the year that test the effectiveness of these controls. This culminated in an Annual Assurance Report, highlighting key internal control issues, which provided an overall opinion of 'substantial assurance' for 2017-18.

We have engaged with Defence Internal Audit (DIA) further to their 2017-18 Annual Internal Audit Report and Government Furnished Equipment (GFE) Industry Annual Report findings, where the DIA's overall audit opinion was limited. More specifically, the DIA stated that: those financial controls that were assessed were largely adequate; some weaknesses remained in the administration of contract management; specific weaknesses had been identified in the oversight of military travel and subsistence and general conflicts of interest; and that the management of GFE would be subject to significant improvement. Actions to address the audit findings will be taken forward during 2018-19 via agreed management actions. In this context it is worth noting the DIA comment that DE&S maintains a robust system to ensure the implementation of such actions arising from their audits, with progress toward their achievement being monitored closely by the DE&S Audit Committee. The DIA audit activity is directly linked to around 10% of our Annual Assurance Report assurance criteria.

¹⁶ The final report by Sir Nicholas Macpherson, Permanent Secretary to the Treasury, into the quality assurance of analytical models that inform government policy, published in March 2013.



Mexifloat unloading on a beach

Chairman's assessment

by Paul Skinner, DE&S Chairman

As I note in my Introduction to this report DE&S continues to make strong progress in delivering the outputs required by its armed forces customers and increased economic benefits to Defence.

For 2017-18, whilst I remain satisfied that we have an overall system of internal control that has improved over the reporting period, there remain areas in which further improvements can be made. In this regard, I note the engagement we have had with the DIA on the findings from its 2017-18 Annual Internal Audit Report GFE Industry Annual Report and the link that this has to our own DE&S Annual Assurance Report. The DIA were purposely directed to investigate operational areas over the course of the year where we believed there were areas of relative weakness that we wished to address. As such, it is not surprising that the overall audit opinion is one of Limited Assurance, although I note the proportional impact this has on our Annual Assurance

Report, which reported a position of Substantial Assurance. The DIA work is vital to good governance and we will look to strengthen the relationship between its work and our Annual Assurance Report over the course of the 2018-19 financial year.

Our governance structure remains robust, although the DE&S Executive Committee has seen some changes over 2017-18 and will see further personnel changes over 2018-19. We have been strengthening the DE&S Board with new Non-Executive Directors who will continue to support and scrutinise the Executive as the organisation continues its transformation journey.

Overall, I remain confident that DE&S can deliver its objectives while complying with agreed standards, within delegated budgetary responsibility and accountability.

REMUNERATION AND STAFF REPORT



Remuneration policy

The following remuneration policy refers to the employment of the DE&S Directors on the DE&S Board and Executive Committee. Remuneration details for the Minister for Defence Procurement and MOD representatives on the Owner's Council and other DE&S Committees are not included as they are not paid by DE&S. Information on their remuneration can be found within the MOD Annual Report and Accounts. During 2017-18, six members of the DE&S Executive Committee were members of the Senior Civil Service (SCS), one was on secondment from Network Rail, three were senior officers of the armed forces¹⁷ and one was engaged on an interim basis.

As set out in the DE&S Framework Document, DE&S has been granted the freedom to manage its workforce as necessary to meet its business needs, within the operating cost envelope agreed with the MOD. This includes setting the terms and conditions of service for all DE&S staff under the CEO's letter of authority from the MOD Permanent Secretary, and in line with the freedoms set out in Annex A to the Framework Document. This delegated authority is carried out under the provisions of the Civil Service (Management Functions) Act 1992. In exercising this authority, DE&S must be cognisant of best practice across the wider Civil Service and Government and MOD policies on Civil Service terms and conditions.

Remuneration of civilian senior executives takes into account the advice of the DE&S Remuneration Committee, whereas military senior executives are bound by the remuneration policy for senior officers of the armed forces. Appointments at SCS Pay Band level 3 are made in conjunction with the Permanent Secretary. The Remuneration Committee is a subcommittee of the DE&S Board. It is chaired by a Non-Executive Director (NED) and comprises a minimum of three NEDs, including a MOD NED. The Chairman has a standing invitation to attend, and the CEO, DE&S HR Director, and other executives or non-executives are invited to attend as appropriate.

The Committee advises the Minister for Defence Procurement, the DE&S Board and the CEO on matters relating to the proper development and application of the DE&S total compensation strategy, including its pay structures, and as set out in the published Framework Document. It also advises the Board on the remuneration of the CEO, the top civilian executive team and other senior staff as appropriate, where these are not set by SCS or Departmental guidelines. More details of the responsibilities of the Remuneration Committee are on page 43.

Performance and reward

The 2017-18 Statement of Comprehensive Net Expenditure reflects payments made or due to directors during the financial year. Salary and reward for the CEO was considered by the DE&S Remuneration Committee.

In 2017 DE&S launched a new market informed, performance driven reward framework and a new grading structure. The new framework enabled DE&S to implement a single, consistent approach to performance and reward across all levels of the organisation. From 1 April 2017, all members of the SCS in DE&S were aligned to the newly formed Senior Leadership Group (SLG) within the new structure, with the Chief Executive Committee (CEC) being a constituent part. All members of the SCS retained their shadow SCS pay band, and were moderated against their peers in the pay band.

All staff within SCS pay bands 1, 2 and 3 were evaluated against their OGSM (the "What") and The DE&S Way Behaviours (the "How"), with both aspects having equal weighting to determine end of year performance outcomes. Salary increases were determined based on individual performance outcome and gap to market benchmark for their role. Non-consolidated performance awards were also awarded to "Good" or better performers. Performance awards in 2017-18 were 9% of the total SCS salary costs. Awards reported in the remuneration tables for 2017-18 relate to performance in 2017-18, and comparative bonuses reported for 2016-17 relate to performance in 2016-17.

DE&S also employs some members of the SCS on fixed term appointments. These individuals are externally recruited to fill specific roles where DE&S does not already have the necessary skills in-house. They are employed on individual contracts which allow them a base salary and the opportunity to earn performance related awards, specifically linked to business and corporate objectives. They are expected to deliver substantial benefits to DE&S both in terms of outputs, delivering change programmes and skills transfer. As with the rest of the SCS, any awards paid to those on fixed term appointments are non-consolidated and non-pensionable and are subject to rigorous scrutiny.

All senior (2* and above) military officers are paid under the Performance Management and Pay System (PMPS). Depending on their performance, time in rank, and position on the pay scale, individuals can be awarded a single increment or no increment, and progress accordingly up the incremental pay scale for their rank. The average value of one incremental rise under the PMPS was 2.6% in 2017-18 (it was also 2.6% in 2016-17).

¹⁷ Reducing to two members of the armed forces on the departure of Vice Admiral Sir Simon Lister, following the appointment of the SDA CEO in September 2017.

While non-executive remuneration is not directly linked to performance, in part to avoid any suggestion that an employee/employer relationship exists, NED performance is kept under review. The aim of the reviews, which are informal, is to consider the impact of individuals on the performance of the Board and sub-committees, recognise the contribution of the NED, identify ways this could be improved, and provide feedback.

Senior manager contracts

The Constitutional Reform and Governance Act 2010 requires appointments to the Civil Service to be made on the basis of fair and open competition. The recruitment principles published by the Civil Service Commission specify the circumstances when appointments may otherwise be made.

Unless otherwise stated, the civilian officials covered by this report hold appointments which are open ended. Early termination, other than for misconduct, would result in the individual receiving compensation as set out in the Civil Service Compensation Scheme. Further information about the work of the Civil Service Commission can be found at www.civilservicecommission.org.uk.

The terms and conditions of the DE&S Chairman and independent NEDs on the DE&S Board are determined by the MOD and set out in their individual appointment letters. Independent NEDs are appointed for a fixed term through a transparent recruitment and selection process, with appointment on merit, thus following the Office of the Commissioner of Public Appointment principles. While they are paid by DE&S, they are not DE&S employees or appointed as civil servants. NEDs appointed to the DE&S Board receive a letter of appointment setting out, among other things, details of their remuneration. Appointments may be terminated at one month's notice by either party or on dissolution of the Board, unless found guilty of gross misconduct when termination will be immediate. Their appointments may be extended by mutual agreement. NEDs are not involved in any discussion about their own remuneration and all payments made are non-pensionable. There are no compensation entitlements for early termination.

Mr Tony Douglas, CEO from 1 December 2015, was appointed through open competition under the terms of the Civil Service Management Code on 15 September 2015. He was originally appointed with a three-year contract, with the possibility of an extension (subject to conditions) for a maximum of five years. Under the terms of his contract he was also eligible to earn a non-pensionable performance related payment of up to £250,000 per annum. Conditions pertaining to termination of employment were set out in his contract of employment, which required him to provide notice of not less than three months. He announced his departure from DE&S on the 28 September 2017 and left on 29 December 2017 after serving his notice period.

Mr Michael Bradley, Chief Financial Officer, was also appointed through open competition under the Civil Service Management Code on 3 January 2012. His initial contract of employment was for four years; it was extended on the 3 January 2016 until 2 January 2020 with an option to extend, by mutual agreement, and subject to satisfactory performance. He was appointed Interim CEO from 1 January 2018 until 21 May when Sir Simon Bollom was appointed as the new DE&S CEO. Although Mr Bradley's delegations were altered during his time as interim CEO to reflect his additional responsibilities he received no additional remuneration or changes to his existing contractual terms and conditions.

Mr Nick Elliott, Director General Commercial, took up post on 5 July 2016. He transferred into the Department on loan from Network Rail for a period of 2 years with an option to extend by a year at a time for an additional 2 years. DE&S do not pay Mr Elliot's salary, but do make a fixed sum contribution paid to Network Rail on a quarterly basis. This fixed sum goes towards covering his employment costs.

Management

The following pages contain details of the pay, pensions and benefits-in-kind of individuals who served on the DE&S Board and Executive Committee during the financial year. The disclosures cover only the periods individuals were members of the Board and Executive Committee.



DE&S Executive Committee Senior Executive salaries, taxable benefits-in-kind and pension benefits (subject to audit)

DE&S Executive Directors	2017-18				2016-17					
	Salary ¹ £000	Annual performance ³ award £000	Benefits in Kind to nearest £100	Pension benefits ² £000	Total £000	Salary £000	Annual performance ³ award £000	Benefits in Kind to nearest £100	Pension benefits £000	Total £000
Tony Douglas ⁴ (to 29 December 2017)	210-215 (285-290)	-	-	80	290-295	285-290	220-225	-	110	620-625
Michael Bradley ⁵	190-195	-	-	78	270-275	180-185	85-90	-	74	340-345
Vice Admiral Simon Lister (to 4 September 2017) ⁶	60-65 (150-155)	-	-	18	80-85	140-145	-	-	149	290-295
Lieutenant General Paul Jaques	135-140	-	-	74	210-215	130-135	-	-	141	270-275
Air Marshal Julian Young	135-140	-	-	130	265-270	120-125 [130-135]	-	-	128	245-250
Sir Simon Bollom ⁷ (from 3 April 2017)	200-205	-	-	-	200-205	30-35 [145-150]	-	-	23	55-60
Pete Worrall	160-165	45-50	-	104	310-315	150-155	55-60	-	67	270-275
Barry Burton ¹¹ (from 1 April 2017)	105-110	30-35	-	101	235-240	-	-	-	-	-
Tony Chisnall ^{8/11} (from 1 April 2017)	165-170	30-35	-	-	200-205	-	-	-	-	-
Don Cuthbert ^{8/11} (from 1 April – 4 November 2017)	115-120 [150-155]	-	-	-	115-120	-	-	-	-	-
David Ball ⁹ (from 5 November 2017)	30-35 [75-80]	10-15	-	-1	40-45	-	-	-	-	-
David Johnson (from 1 January)	30-35 [130-135]	40-45	-	14	85-90	-	-	-	-	-
Nick Elliott ¹⁰	225-230	65-70	-	-	295-300	165-170 [220-225]	80-85	-	-	250-255

¹. Salary includes gross salary, overtime, reserved rights to London allowances, recruitment and retention allowances, private office allowances and any other allowance to the extent that it is subject to UK taxation.

². The value of pension benefits accrued during the year is calculated as the increase in pension multiplied by 20, plus the real increase in any lump sum less the contributions made by the individual. The real increase excludes increases due to inflation or any increase or decrease due to a transfer of pension rights.

³. Military terms and conditions do not include provision for a performance award. Bonuses are based on performance levels attained and are made as part of the appraisals process. The bonuses reported in 2017-18 relate to performance in 2017 and the comparative bonuses reported for 2016-17 relate to the performance in that year.

⁴. The 2017-18 salary banding and pension costs for Tony Douglas reflect the actual remuneration received from his appointment as CEO on 1 December 2015 until the time of his departure on 29 December 2017; as he left DE&S mid-way through the reporting year he was not eligible to receive a performance award. The value in brackets reflects his annual equivalent salary; remuneration in 2016-17 reflects his full annual salary.

⁵. Michael Bradley took the position of Interim CEO from 1 January 2018 until the newly appointed CEO Sir Simon Bollom took position on 21 May 2018. Michael Bradley took no additional remuneration whilst he held the position of interim CEO. Although Mr Bradley was not replaced on the DE&S Board during this time, David Johnson represented DG Resources as a member of the Executive Committee. Michael Bradley's performance was assessed as exceptional in financial year 2017-18, which would have resulted in a performance award of £97.5K, but due to the application of DE&S policy on pay and reward, and the timing of his departure, the department has concluded that he is not eligible to receive this award.

⁶. The 2017-18 salary banding and pension costs for Vice Admiral Simon Lister reflect the actual remuneration received from his appointment as COM (Fleet) from 1 April 2014 until the time of his departure on 4 September 2017. The value in brackets reflects his annual equivalent salary; remuneration in 2016-17 reflects his full annual salary.

⁷. The remuneration for Sir Simon Bollom reflects the contribution DE&S makes towards his Network Rail remuneration package in addition to the value above DE&S also contribute an additional £47k towards Pension and National Insurance Contributions. Pension costs are not shown separately as they are included in the Network Rail pension scheme as part of the Department for Transport's Annual Report and Accounts. The 2016-17 salary figure has been adjusted to remove the element of pension and National Insurance contributions made by DE&S over and above Nick Elliott's salary.

⁸. Tony Chisnall and Don Cuthbert elected to participate in the Partnership Pension Account, details of the contributions made by DE&S in 2017-18 towards these schemes is detailed in the Staff Report section below.

⁹. David Ball took over as interim HR Director on 5 November 2017, the value in brackets reflects his annual equivalent salary.

¹⁰. Salary value for Nick Elliott reflects the contribution DE&S makes towards his Network Rail remuneration package in addition to the value above DE&S also contribute an additional £47k towards Pension and National Insurance Contributions. Pension costs are not shown separately as they are included in the Network Rail pension scheme as part of the Department for Transport's Annual Report and Accounts. The 2016-17 salary figure has been adjusted to remove the element of pension and National Insurance contributions made by DE&S over and above Nick Elliott's salary.

¹¹. There were three new members welcomed to the Executive Committee in 2017-18: the HR Director, General Programmes Director and Corporate Operations Director, this saw all major functions represented by an Executive Committee member.

DE&S Board Non-Executive salaries (subject to audit)

DE&S Non-Executive Directors ¹	2017-18 ² £000	2016-17 £000
Mr Paul Skinner ³	0-5 [5-10]	-
Mr Paul Smith	25-30	25-30
Mr Andrew Wolstenholme ⁴	-	-
Mr James Dorrian	25-30	25-30
Mr Stephen Lovegrove ⁵	-	-
Lt Gen Sir Mark Poffley ⁶	-	-
Dr Ros Rivaz	25-30	5-10 [25-30 annually]
Mr Iain Lanaghan	25-30	5-10 [25-30 annually]

¹ None of the Non-Executives received annual performance awards, benefits in kind, or pension benefits in relation to their role on the DE&S Board.

² Salary includes gross salary, overtime, reserved rights to London weighting or London allowances, recruitment and retention allowances, private office allowances and any other allowances to the extent that it is subject to UK taxation.

³ Until January 2018 Mr Skinner waived his fees so payments above reflect payments made between January and March 2018. Figures in brackets reflect the annual equivalent fee that would have been paid if he received payments all year.

⁴ Mr Wolstenholme waived his fee for DE&S Board membership.

⁵ Mr Lovegrove received no remuneration for DE&S Board membership as he is a MOD employee. His salary details are reflected in the MOD Annual Report and Accounts.

⁶ Lt Gen Sir Poffley received no remuneration for DE&S Board membership as he is a MOD employee. His salary details are reflected in the MOD Annual Report and Accounts.



Typhoon fighter jet

DE&S Executive Committee Senior Executive pension benefits (subject to audit)¹

	Total accrued pension at pension age [and related lump sum] as at 31 March 2018 [£000]	Real increase in pension [and related lump sum] in 2017-18 [£000]	CETV ^{2&3} as at 31 March 2017 or last date if later [£000]	CETV as at 31 March 2018 or on cessation of employment if earlier [£000]	Real increase in CETV ⁴ [000]
Mr Tony Douglas ^{5/6}	15-20	2.5-5	129	186	41
Mr Michael Bradley	25-30	2.5-5	301	372	39
Vice Admiral Simon Lister ⁷	80-85 [250-255]	0-2.5 [0-2.5]	2,025	2,048	5
Lieutenant General Paul Jaques	65-70 [205-210]	2.5-5 7.5-10	1,659	1,733	57
Air Marshal Julian Young	70-75 [220-225]	5-7.5 [15-17.5]	1,755	1,892	118
Mr Pete Worrall	75-80 [225-230]	5-7.5 [15-17.5]	1,416	1,606	96
Mr Barry Burton	50-55 [160-165]	2.5-5 [12.5-15]	1,058	1,230	101
David Johnson ⁸	50-55 [125-130]	0-2.5 [0-2.5]	885	900	7
David Ball ⁸	40-45 [125-130]	0-2.5 [0-2.5]	959	972	-1
Mr Nick Elliott ⁹	-	-	-	-	-

¹. Mr Tony Chisnall & Mr Don Cuthbert are not members of the Principle Civil Service Pension scheme so are excluded from the table above. Details of the contributions made to their Partnership Pension Accounts can be seen in the Staff Report section below.

². The CETV figures include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the AFPS or Civil Service pension arrangements. They also include any additional pension benefit accrued to the member as a result of purchasing additional years of pension service in the scheme at their own cost. CETVs are calculated in accordance with the Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008, and do not take account of any actual or potential reduction benefits resulting from Lifetime Allowance Tax.

³. This reflects the increase in CETV that is funded by the employer. It does not include the increase in accrued pension due to inflation or contributions paid by the employee and uses common market valuation factors for the start and end of the period.

⁴. This reflects the increase in CETV that is funded by the employer. It does not include the increase in accrued pension due to inflation or contributions paid by the employee and uses common market valuation factors for the start and end of the period.

⁵. Mr Tony Douglas' pension calculations reflect his time as DE&S CEO up until he left on 29 December 2017.

⁶. Mr Tony Douglas and Mr Michael Bradley are both members of the Alpha pension scheme; this scheme does not give an employee an automatic right to a lump sum payment; should the employee choose to take a lump sum they will be able to do so at a rate of £1 of annual pension in exchange for every £12 lump sum, subject to HMRC limits.

⁷. Pension costs for Vice Admiral Lister reflect pension rights accrued whilst he remained in post and up to 4 September 2017.

⁸. The pensions benefits of Mr David Johnson and Mr David Ball have been adjusted to reflect the time they served as members of the Executive Committee. For Mr David Ball this has resulted in a negative Real Increase in CETV.

⁹. Mr Nick Elliott is on loan from Network Rail; he continues to be paid by them and as such all pension costs are separately reported within the Department for Transport's Annual Report and Accounts.

Pay multiples (subject to audit)

The following table provides details of pay multiples – the ratio between the highest paid DE&S military and civilian executives and the median remuneration of the workforce.

Total remuneration includes salary, non-consolidated performance related pay and benefits in kind. It does not include severance payments, employer pension contributions and the cash equivalent transfer value of pensions.

The banded remuneration of the highest paid civilian director in 2017-18 was £202,500. This was 5.94 times the median remuneration of the workforce, which was £34,089.

The banded remuneration of the highest paid military director in 2017-18 was £137,500. This was 2.79 times the median remuneration of the workforce, which was £49,354.

No employee in 2017-18 received remuneration in excess of the highest paid director.

	2017-18	2016-17
Mid-point of the £5,000 band for the annual equivalent remuneration of the highest earning military board member in the tables above	137,500	142,500
Median total remuneration of armed forces personnel	49,354	48,359
Military pay ratio	2.79	2.95
Mid-point of the £5,000 band for the annual equivalent remuneration of the highest earning civilian board member in the tables above	202,500	512,500
Median total remuneration of civilian staff	34,089	33,452
Civilian Pay Ratio	5.94	15.32

In 2017-18 the remuneration of military employees (annual equivalent salary) ranged from £26,361 to £137,500. One member of the board had an annual equivalent salary in the range of £150k-£155k, but was only in post for the first six months of the financial year. As such, the highest paid senior military member who held position for the full year has been used in the median pay calculation. Due to the decrease in the median pay for the highest earning military board

member the military pay ratio has decreased, this is being offset by 2% increase in the median remuneration of the rest of the armed forces.

In 2017-18 the remuneration of civilian employees (annual equivalent salary) ranged from £16,274 to £202,500. The civilian pay ratio has decreased due to a decrease in the median pay for the highest earning civilian board member. This is being offset by a 1.9% increase in the median remuneration of the rest of the civilian workforce.

Staff report

Staff numbers (subject to audit)

The number (head count) of Senior Civil Servants within the DE&S Senior Leadership Group, as at the end of the financial year is as follows:

SCS Pay Band	2017-18	2016-17
Band 1	111	109
Band 2	18	16
Band 3 and above	4	3
Total	133¹⁸	128

The slight increase in the number of SCS continues to reflect the implementation of the organisational design requirements for delivery and forward management of the DE&S Transformation Programme. The increases have largely been in the Air and Ships domains to further underpin Transformation and as a result of the formation of the Submarine Delivery Agency.

The average numbers of full time equivalent persons employed are as follows:

	2017-18	2016-17
Permanent Staff	12,358	11,498
Contingent Labour	254	358
Total	12,612	11,856

The increase in the reported numbers of permanent staff is linked to the organisational design requirements and the fact that DE&S is continuing to build up workforce resilience across all Functions to reduce dependency on private sector support. Contingent labour has decreased from 2016-17 as Transformation programmes which required additional, short-term capability have now been concluded.

¹⁸ Figures for both years shown include SCS in the SDA – who remained DE&S employees until 1 April 2018.

Staff costs (subject to audit) (See also note 2 to the financial statements)

The aggregate staff costs, including allowances paid were as follows:

Staff costs comprise:	2017-18			2016-17		
	Permanently employed staff £000	Contingent labour £000	Total	Permanently employed staff £000	Contingent labour	Total
Salaries and wages	500,401	27,761	528,162	461,318	42,584	503,902
Social security costs	51,530	-	51,530	47,077	-	47,077
Other pension costs	120,499	-	120,499	112,261	-	112,261
Total	672,430	27,761	700,191	620,656	42,584	663,240

Staff costs including social security and pension costs have increased again in 2017-18 because of an increase in the overall number of individuals employed by DE&S. Contingent labour costs have decreased as DE&S builds its own internal capability and capacity and relies less on contingent labour to undertake core DE&S activities. This is consistent with the reduction in our overall operating expenditure which has fallen consistently since the formation of the BTE in anticipation that DE&S would build internal capability to reduce its reliance on the use of contingent labour.

For the year ended 31 March 2018, of the total pension contributions for DE&S in the table above, £79.8 million (2016-17: £71.8 million) were payable in respect of the various schemes in which civilian staff were members.

For the year ended 31 March 2018, of the total pension contributions for DE&S in the table above, £40 million (2016-17: £39.9 million) were payable in respect of the Armed Forces Pension Scheme in which military staff were members.

Where employees opened a Partnership pension account with an employer contribution, DE&S made contributions of £607K (2016-17: £492K) to the relevant pension providers.

Further details of pension schemes covering DE&S personnel are detailed below.

Principal Civil Service Pension Scheme

The Principal Civil Service Pension Scheme (PCSPS) and the Civil Servant and Other Pension Scheme (CSOPS), known as "Alpha", are unfunded multi-employer defined benefit schemes. DE&S is unable to identify its share of the underlying assets and liabilities. An actuarial valuation of the PCSPS has been completed and can be found at <https://www.civilservicepensionscheme.org.uk/about-us/scheme->

valuations/

Contributions to the PCSPS in 2017-18 were calculated at one of four rates in the range 20.0% to 24.5% of pensionable earnings, based on salary bands. The Scheme Actuary usually reviews employer contributions every four years following a full scheme valuation. The contribution rates are set to meet the cost of the benefits accruing during 2017-18 to be paid when the member retires and not the benefits paid during this period to existing pensioners.

Employees can opt to open a partnership pension account; employer contributions are age related and ranged from 8% to 14.75%. Employers also match employee contributions up to 3% of pensionable earnings. Further details about the Civil Service Pension arrangements can be found at the website <https://www.civilservicepensionscheme.org.uk/>. There were no contributions due to the partnership pension providers at the balance sheet date and no contributions have been prepaid.

Armed Forces Pension Scheme

The Armed Forces Pension Scheme (AFPS) is an unfunded, non-contributory, defined benefit, salary related, contracted out, occupational scheme. As such, this scheme is not consolidated in the accounts, separate accounts are prepared details of which can be found at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/679784/20170925_Armed-Forces-Pension-Board-Annual-Report-Final.pdf

Employer's contribution rates are determined by the Government Actuary. For 2017-18, the employer's contribution rates remained the same as 2016-17 at 53.4% of pensionable pay for officers and 52% of pensionable pay for other ranks. These include a contribution towards the Armed Forces Compensation

Scheme (AFCS) at 1% for officers and 2.4% for other ranks. No changes to the contribution rates are expected until 2019-20. Further information on the AFPS and AFCS can be found at <https://www.gov.uk/guidance/pensions-and-compensation-for-veterans>.

Scheme members are entitled to a taxable pension for life and a tax-free pension lump sum if they leave the regular armed forces at or beyond normal retirement age. Those who have at least two years' service and who leave before aged 55 will have their pension preserved until age 60 or 65 depending on the scheme. The scheme also includes an early departure payment (EDP) scheme for those who leave before aged 55 providing they have at least 18 years' service and are at least 40 years of age. The EDP scheme pays a tax-free lump sum and income of between 50% and 75% of preserved pension between the date of the individual's departure from the armed forces and age 55.

Staff sickness

We are committed to the health and wellbeing of our staff and have a comprehensive sickness absence policy. During 2017-18 the average number of days for sickness absence was 5.5 days per employee, compared with 6.2 days in 2016-17, which itself was a fall from the previous year. This compares favourably with the MOD average of 7.1 days. The launch of a revised DE&S health and attendance policy in April 2017 together with the launch of our own in-house Casework Service, that can better support managers when dealing with sickness absence, has ensured that we now have a more robust, clearly understood procedure for managing sickness absence. We have also instigated a range of well-being measures including on-site health fairs, the promotion of mental health awareness and signposting to support services, and promotion of a range of discounts and networks available to all staff.

Staff policies

Diversity and Inclusion (D&I)

A progressive approach to diversity and inclusion is about fairness, flexibility and contributing to the success of the business by removing any unnecessary barriers to either employees or stakeholders. Reinforcing this culture is key to our ongoing effective performance through diversity of skills, thought and management. At DE&S the style of delivery is as important as the output itself. Inclusive behaviours and progressive management practices are key to the future of our performance, and this is underpinned by effective D&I practice.

Our updated D&I strategy and action plan outline the activities that DE&S is committed to developing as an employer of choice organisation that better reflects the diversity of the UK population and delivers high levels of performance within an inclusive environment.

Our D&I objectives

At DE&S we have a fundamental belief that valuing our people for their individuality will create a culture in which talent, creativity and innovation can thrive. This in turn will help people to achieve their potential and enable us to deliver a high-quality service for the UK Defence community. We want our workforce to reflect the diversity of society and to develop and use the collective experience of that diverse workforce to deliver improvements in performance. We aim to achieve this through:

- Building a culture of inclusion where all individuals feel respected, are treated fairly, and able to develop and contribute confidently, regardless of their background or working style
- Building an organisation that reflects the diverse communities it serves by attracting, developing and retaining the best skills and thinking from all parts of society without barriers
- Building leadership capability and organisational capacity to deliver inclusion, diversity and outreach to maximise business benefits and meet legislative duties

This year our employee networks continued to provide support and guidance to their membership, improving inclusiveness for staff at DE&S and engaging new and diverse talent. These include the Multi-Cultural Community, Pride, Gender, Disability, Carers and Parents, Next Generation and Neuro-Inclusivity Networks. These networks are also key in acting as specialist consultees in the development of policy and supporting inclusive decision making.

We are part of the wider Defence Youth Engagement Programme delivering initiatives through outreach. For the second year we were at the Big Bang Fair in the NEC engaging with 91,000 students and sharing our equipment and technical experience to inspire our next generation. We have over 100 Science Technology Engineering and Maths Ambassadors supporting various initiatives in local schools. We hosted the launch of the South West Schools engineering competition. These initiatives form part of an outreach and engagement flight path which consolidates our outreach activities to ensure that we continue to raise the profile of DE&S as an employer of choice and can compete successfully for future talent.

Chinook flying over London



This outreach activity also focuses on engaging groups with limited social mobility, thus ensuring that we have as broad a reach as possible and not limit our focus to traditionally more easily engaged and affluent areas.

We have improved the way we make decisions by strengthening our impact assessment process. We continue to use our inclusive decision-making approach to ensure we give due consideration to the public sector equality duty and maximise the success of delivery by mitigating any risks of discrimination, and maximising opportunities to promote equality of opportunity. This has covered all our new policies and major people decisions to improve the lived experience of our staff.

We have successfully launched a mediator network and Fairness and Equality Advisors within the organisation in response to staff concerns and needs. The latter act as an initial signposting and advice service to ensure all staff have an easily accessible means to best understand available services and act on any concerns. Key this year has been the work to encourage an even more inclusive culture through workshops and training. Most significant amongst these programmes is 'Drive', a strategic D&I training package developed for the Senior Leadership Group. Our new induction programme, DE&S Way Behaviours and development of our culture and values set also reinforces this position.

The following tables reflect changes to the civilian composition of the organisation by protected characteristics over the year.

Staff breakdown

	31 March 2018	31 March 2017
Civilian total headcount <small>19, 20, 21</small>	11,474	10,799
Gender		
Female	3,738	3,468
% female	33%	32%
Ethnicity		
Black and minority ethnic	496	432
% Black and ethnic	4%	4%
Disability		
Declared a disability	815	692
% declared a disability	7%	6%
Sexual orientation		
Lesbian, gay, bisexual	186	158
% declared LGB	2%	1%
Religion or belief		
Non Christian religion	342	305
% Non Christian religion	3%	3%
Secular	2,822	2,582
% Secular	25%	24%
Christian	3,855	3,803
% Christian	34%	35%

Gender breakdown at DE&S Board and Executive Committee level

	31 March 2018	31 March 2017
Total DE&S Board and Executive Committee ²²	16	15
Female	2	2
Male	14	13
% Female	12.5%	13%
% Male	87.5%	87%

¹⁹ Totals include all industrial and non-industrial personnel of DE&S (including the SDA – who remained DE&S employees until 1 April 2018) but exclude all Royal Fleet Auxiliary and locally-engaged civilians for whom declaration data is currently unavailable.

²⁰ The table only includes civilian employees; a breakdown of the military composition of DE&S by protected characteristic is currently unavailable.

²¹ Percentages shown for ethnicity, disability, sexual orientation and religious belief are based on declarations made compared with total civilian workforce; as there is no requirement to make a declaration, they are likely to under-represent actual numbers of each characteristic.

²² The figures include DG HOCS, who attends in place of the Permanent Secretary.

Gender breakdown over the year at SCS level

	31 March 2018	31 March 2017
Total DE&S SLG (SCS)	133	128
Female	34	31
Male	99	97
% Female	26%	24%
% Male	74%	76%

Trade Union relationships

The DE&S Framework Document gave DE&S the freedom to agree its own approach to Trade Union (TU) engagement and we subsequently created an Employee Relations Framework Agreement that governs successful engagement between DE&S and the TUs, including the principles and behaviours and the processes under which both parties will operate to ensure good employee relations. The agreement was signed by the Chief of Defence Materiel and the five recognised TUs on 2 February 2015. The HR team within DE&S leads on TU consultation for the organisation, with consultation with the TUs taking place in compliance with the law and to initiate engagement in the spirit of reaching agreement.

The Trade Union (Facility Time Publication Requirements) Regulations 2017 came into force on the 1 April 2017. These regulations place a legislative requirement on relevant public sector employees to collate and publish, on an annual basis, data on the amount and cost of facility time. The annual facility time data return, reflecting facility time within DE&S over the period 1 April 2017 to 31 March 2018 is shown here:

Relevant Union Officials

Number of employees who were relevant union officials during the relevant period	Full-time equivalent employee number
21	20.6

Percentage of time spent on facility time

Percentage of time	Number of employees
0%	3
1-50%	18
51-99%	0
100%	0

Percentage of pay bill spent on facility time

Total cost of facility time	£32,157,118
Total annual pay bill	£524,692,550
Percentage of total pay bill spent on facility time	0.01%

Paid trade union activities

Time spent on paid trade union activities as a percentage of total paid facility time	0.00% ²³
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TU activities means time taken off under section 170 (1) (b) of the 1992 TULR(C)A these might include: attendance at branch, regional or national TU meetings or conferences, meeting with full time officers regarding issues related to the workplace, voting in TU elections.

The above information is also published by the Cabinet Office online at: <https://www.gov.uk/government/news/trade-union-facility-time-publication-service-2017-2018-data-published>

²³ DE&S does not approve payment for TU officials to undertake TU activities.

Health and safety

The primary role of our Occupational Health, Safety and Environment (OHSE) Function is to encourage and enable all personnel to understand and take responsibility for safety and by doing so enhance organisational and personal values, behaviours, actions and workplace culture. The OHSE Function has this year promoted training and best practices, and intervenes decisively to prevent unsafe and undesirable actions. In addition, the Function has established policy and processes for DE&S to ensure standardised approaches and appropriate regulatory compliance for our people's health and safety at work.

Civil Service and other compensation schemes exit packages

The figures in the next table include redundancy and other departure costs paid in accordance with the Civil Service Compensation Scheme (CSCS). Where DE&S

has agreed early retirements, the costs are met by DE&S and not by the Civil Service Pension Scheme. There were 11 non-compulsory redundancies in 2017-18, none of these were individuals retiring early on ill health grounds.

For staff leaving under voluntary exit or voluntary redundancy terms the cost includes any top-up compensation provided by DE&S to buy-out the actuarial reduction on an individual's pension as well as the compensation payments.

All armed forces redundancies are compulsory; the law does not provide for voluntary redundancy. While personnel are invited to apply for consideration, the Services may retain applicants, and make non-applicants redundant in their stead in order to retain the right balance of skills and experience across the rank structures. Successful applicants are included in the table as 'other departures agreed'; non-applicants are listed as compulsory.



Civil Service and other compensation schemes exit packages (subject to audit)

Numbers in brackets are 2016-17 comparators

Exit package cost band	Number of compulsory redundancies	Number of other agreed departures	Total number of exit packages by cost band
<£10,000	- (-)	3 (1)	3 (1)
£10,000-£25,000	- (1)	4 (17)	4 (18)
£25,000-£50,000	- (2)	3 (11)	3 (13)
£50,000-£100,000	- (-)	1 (17)	1 (17)
£100,000-£150,000	- (-)	- (6)	0 (6)
£150,000-£200,000	- (-)	- (-)	- (-)
Total Number of Exit Packages	- (3)	11 (52)	11 (55)
Total resource cost (£000)	- (98)	289 (2,567)	289 (2,665)

One individual with an agreed package who was included in the 2016-17 accounts received £28k less than previously notified at the time of producing the accounts; the 2016-17 accounts have been re-stated to reflect this. During 2017-18 MyCSP have informed DE&S of four individuals who departed the organisation in 2016-17 and who should have been included in the accounts at this point. The total value of these compensation packages was £148k; 2016-17 has been restated accordingly.

In addition to the exit packages detailed above, DE&S may occasionally make use of early release schemes to reduce the number of civilian staff who are not members of the CSCS. No such usage was made during 2017-18.

Expenditure on consultancy and temporary staff

The DE&S operating cost envelope includes the engagement of contingent labour (also known as manpower substitution) and other external support defined as private sector support.

Contingent labour relates to individuals who are employed by DE&S on a demand basis to fill vacancies within the organisation. This includes independent contractors and consultants who are excluded from the DE&S payroll because they are not permanent

employees of the Department. The costs of contingent labour are shown as a separate entry in the staff costs at note 2 to the accounts.

Private sector support is defined by DE&S as external support to supplement DE&S capacity and capability to manage its programme of work. This includes packages of work aimed at delivering business improvements in line with DE&S transformation initiatives. Private sector support within DE&S includes consultancy assistance and other external support provided through the MOD Framework Agreement for Technical Support (FATS). Private sector support is also used within DE&S to address resource and skills gaps in project and logistics management capability. A breakdown and prior year comparator is shown at Note 3 to the accounts.



High paid off-payroll appointments

Details of DE&S’ most highly paid off-payroll appointments are shown in table 1. These represent temporary workers who are employed for limited periods of time, usually to fill short term vacancies, to deliver finite pieces of work, or to provide key skills needed to deliver the business which are not available in-house.

Government policy is that individual departments must exercise governance over such appointments where the appointees are not engaged directly on departmental payrolls. DE&S senior off-payroll appointees have been requested to provide assurance that they paid the right amount of tax and National Insurance contributions in 2017-18.

Table 1: all off-payroll engagements as at 31 March 2018, for more than £245 per day and that last longer than 6 months:

Defence Equipment & Support Bespoke Trading Entity	
Number of existing arrangements as of 31 March 2018	69
Of which:	
No. that have existed for less than one year at the time of reporting	69
No. that have existed for between one and two years at the time of reporting	0
No. that have existed for between two and three years at the time of reporting	0
No. that have existed for between three and four years at the time of reporting	0
No. that have existed for more than four years at the time of reporting	0

Table 2 provides an analysis of all new off-payroll engagements, or those that reached six months in duration, between 1 April 2017 and 31 March 2018, paid more than £245 per day and that last for longer than six months.

During the 2016-17 financial year, DE&S undertook an exercise to analyse its off-payroll appointee's workforce to ensure that they paid the right amount of income tax and National Insurance contributions on work undertaken for DE&S. All appointees were assessed with focus on those who were engaged for a period of over two years to analyse the roles that they were performing. Where an appointee was determined to be performing a permanent role, the individual in question was offered a contract of employment to ensure that the correct element of tax was paid.

This exercise has eliminated all appointees who had been engaged for a period of over two-years in 2017-18.

Defence Equipment & Support Bespoke Trading Entity	
No. of new engagements, or those that reached six months in duration, between 1 April 2017 and 31 March 2018	48
Of which:	
No. assessed to be in scope of IR35	48
No. assessed to be out of scope of IR35	0
Of which	
No. engaged directly (via PSC contracted to department) and are on the departmental payroll. .	0
No. of engagements reassessed for consistency/assurance purposes during the year.	0
No. of engagements that saw a change to IR35 status following the consistency review.	0

Table 3: off-payroll engagements of board members and/or senior officials with significant financial responsibility between 1 April 2017 and 31 March 2018:

Defence Equipment & Support Bespoke Trading Entity	
No. of new engagements, or those that reached six months in duration, between 1 Apr 17 and 31 Mar 18	0

There were no off-payroll engagements of Board members or senior executives with significant financial responsibility between 1 April 2017 and 31 March 2018.

PARLIAMENTARY ACCOUNTABILITY AND AUDIT REPORT



Parliamentary accountability report

In 2017-18 we responded to 351 Parliamentary Questions and 379 pieces of Ministerial and Treat Official correspondence from Members of Parliament, Peers and the public, meeting our departmental targets for on-time delivery. We also provided briefing in support of Parliamentary Committee business, including the House of Commons Defence Committee inquiry into F-35 Procurement and Public Accounts Committee inquiries into Delivering Carrier Strike, Acquisition and Support of Defence Equipment and the Defence Equipment Plan 2018-27. Key subject areas for Parliamentary and Ministerial business included shipbuilding, submarine dismantling programme, land equipment programmes, disposals including the former HMS Ocean, contingent liabilities and relationships with industry.

We continue to fulfil our statutory responsibilities under the Freedom of Information Act 2000 in responding to requests for information from members of the public. During 2017-18 we answered 911 requests for information, again meeting our departmental target for on-time delivery. Interest in DE&S activities remains high, with requests covering a wide range of DE&S business, with particular interest in defence nuclear activities, ex-military vehicles and contract information.

In line with Cabinet Office guidelines on transparency, DE&S proactively publishes a range of information online, including senior officials business expenses, hospitality and meetings, and information on expenditure over £25,000. DE&S data is not published separately, but is included on gov.uk as part of overall MOD information.

Fees and Charges (subject to audit)

Where we have spare capacity, we provide a range of services to external organisations. Costs are recovered in accordance with Managing Public Money. Where a chargeable activity produces a tangible benefit to Defence, we may reduce any charges levied below the full costs of the activity.

Remote contingent liabilities (subject to audit)

DE&S does not have any reportable remote contingent liabilities.

Regularity of expenditure (subject to audit)

All material expenditure and income incurred by DE&S

in 2017-18 was in accordance with the requirements of Treasury and other government guidance.

Losses and special payments (subject to audit)

Losses and special payments are unpredictable, as such parliament cannot envisage when funding is required to cover these costs. They are emergent in nature arising as a result of an unexpected incident or failure of process, as such they are subject to a higher level of scrutiny and approval than would be the case for normal business transactions.

Losses during the year totalled £663,000, the clear majority of which were for VAT payments following a series of contract reviews, there were also low value fruitless payments related to hotel cancellations and unused rail tickets. There were no significant or separately reported losses requiring separate disclosure in 2017-18.

Losses statement

Volume of Cases	2017-18	2016-17
Fruitless Payments (volume of cases)	871	556
Fruitless Payments (value £000)	660	199
Cash Losses (volume of cases)	1	1
Cash Losses (value £000)	-	-
Store Losses (volume of cases)	4	9
Store Losses (value £000)	3	1
Claims waived or Abandoned (volume of cases)	-	-
Claims waived or abandoned (value £000)	-	-
Total Number of Losses (volume of cases)	876	566
Total value of Losses (value £000)	663	200
Details of Closed Cases £300,000	2017-18	2016-17
Fruitless Payment	-	-

Special payments

No individual special payments exceeded the £300,000 value for individual reporting.

	2017-18	2016-17
Total number of special payments	2	5
Total Value of Special Payments (£000)	20	45

Long term expenditure trend by category

	Estimate 2019-20	Estimate 2018-19	Outturn 2017-18	Outturn 2016-17
Total Departmental Expenditure limit DE&S BTE (£M)	960	975	1,105	1,141



Sir Simon Bollom
Accounting Officer
31 October 2018

THE CERTIFICATE AND REPORT OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSE OF COMMONS

Opinion on financial statements

I certify that I have audited the financial statements of Defence Equipment & Support for the year ended 31 March 2018 under the Government Resources and Accounts Act 2000. The financial statements comprise: the Statement of Comprehensive Net Expenditure, Statement of Financial Position, Statement of Cash Flows, Statement of Changes in Taxpayers' Equity; and the related notes, including the significant accounting policies. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Accountability Report that is described in that report as having been audited.

In my opinion:

- the financial statements give a true and fair view of the state of Defence Equipment & Support's affairs as at 31 March 2018 and of the total net expenditure for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions issued thereunder.

Opinion on regularity

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

Basis of opinions

I conducted my audit in accordance with International Standards on Auditing (ISAs) (UK) and Practice Note 10 'Audit of Financial Statements of Public Sector Entities in the United Kingdom'. My responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of my certificate. Those standards require me and my staff to comply with the Financial Reporting Council's Revised Ethical Standard 2016. I am independent of Defence Equipment & Support in accordance with the ethical requirements that are relevant to my audit and the financial statements in the UK. My staff and I have fulfilled our other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Responsibilities of the Accounting Officer for the financial statements

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Chief Executive as Accounting Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Auditor's responsibilities for the audit of the financial statements

My responsibility is to audit, certify and report on the financial statements in accordance with the Government Resources and Accounts Act 2000.

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs (UK), I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Defence Equipment & Support's internal control.
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on Defence Equipment & Support's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the entity to cease to continue as a going concern.
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Other Information

The Chief Executive as Accounting Officer is responsible for the other information. The other information comprises information included in the annual report, other than the parts of the Accountability Report described in that report as having been audited, the financial statements and my auditor's report thereon. My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon. In connection with my audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

Opinion on other matters

In my opinion:

- the parts of the Accountability Report to be audited have been properly prepared in accordance with HM Treasury directions made under the Government Resources and Accounts Act 2000;
- in the light of the knowledge and understanding of the entity and its environment obtained in the course of the audit, I have not identified any material misstatements in the Performance Report and Accountability Report; and
- the information given in the Performance Report and Accountability Report for the financial year for which the financial statements are prepared is consistent with the financial statements and have been prepared in accordance with the applicable legal requirements.

Matters on which I report by exception

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- adequate accounting records have not been kept or returns adequate for my audit have not been received from branches not visited by my staff; or
- the financial statements and the parts of the Accountability Report to be audited are not in agreement with the accounting records and returns; or
- I have not received all of the information and explanations I require for my audit; or
- the Governance Statement does not reflect compliance with HM Treasury's guidance.

Report

I have no observations to make on these financial statements.

Sir Amyas C E Morse
Comptroller and Auditor General

Date 8 November 2018

National Audit Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP



Section Three

The Financial Statements



ACCOUNTING INFORMATION

STATEMENT OF COMPREHENSIVE NET EXPENDITURE FOR THE YEAR ENDED 31 MARCH 2018

	Note	2017-18 £000	2016-17 £000
Expenditure - Direct Programme Costs			
Direct Staff Costs	2	700,191	663,240
Private Sector Support Costs	3	329,328	406,389
Other Programme Costs	4	97,435	81,425
Total Direct Programme Costs		1,126,954	1,151,054
Income - Direct Programme	5	(32,154)	(20,380)
Net Direct Programme Expenditure		1,094,800	1,130,674
Expenditure - Non-Cash Items			
Communicated Costs from Other MOD Organisations	6	102,638	107,892
Auditors' Remuneration	7	200	215
Asset Adjustment Write Off	9	807	-
Depreciation	8&9	2,817	-
		106,462	108,107
Total Net Expenditure		1,201,262	1,238,781
Other Comprehensive Net Expenditure			
Revaluation of Tangible Assets	8	(38)	-
Revaluation of Intangible Assets	9	(518)	-
Total Comprehensive Net Expenditure		1,200,706	1,238,781

The notes on pages 82-96 form part of these accounts.

STATEMENT OF FINANCIAL POSITION
AS AT 31 MARCH 2018

	Note	2017-18 £000	2016-17 Re-stated £000
Non-current assets			
Tangible Fixed Assets	8	835	-
Intangible Fixed Assets	9	17,583	11,731
Total Non-current Assets		18,418	11,731
Current assets			
Trade and Other Receivables	10	9,180	8,091
Total Current Assets		9,180	8,091
Total assets		27,598	19,822
Current liabilities			
Trade and Other Payables	11	(136,385)	(181,190)
Provisions	12	(1,244)	-
Non-current Assets less Current Liabilities		(110,031)	(161,368)
Non-current Liabilities			
Payables due after more than 1 year	11	(746)	(176)
Total Non-current Liabilities		(746)	(176)
Assets Less Liabilities		(110,777)	(161,544)
Reserves			
Revaluation Reserve	8 & 9	556	-
General Fund		(111,333)	(161,544)
Total Reserves		(110,777)	(161,544)

The notes on pages 82-96 form part of these accounts.



Sir Simon Bollom
Accounting Officer
31 October 2018

STATEMENT OF CASH FLOWS
 FOR THE YEAR ENDED 31 MARCH 2018

	Note	2017-18 £000	2016-17 Re-stated £000
Cash flows from Operating Activities			
Net Operating Costs		(1,201,262)	(1,238,781)
Adjustments for non-cash transactions			
Communicated Costs	6	102,638	107,892
Auditors Remuneration	7	200	215
Amortisation/depreciation & impairment	8	3,624	371
Movement in Provision	12	1,909	-
Decrease in Trade and Other Receivables	10	(1,089)	(2,278)
Decrease in Trade and Other Payables	11	(44,235)	35,349
Less movements in payables not passing through the Statement of Comprehensive Net Expenditure		2,711	2,694
Use of Provisions	12	(665)	-
Net Cash Outflow from Operating Activities		(1,136,169)	(1,094,538)
Cash Flows from Investing Activities			
Purchase of Intangible Assets	9	(12,358)	(8,855)
Purchase of Tangible Assets	8	(108)	-
Net Cash Outflow from Investing Activities		(12,466)	(8,855)
Cash Flows from Financing Activities			
Net Parliamentary Funding - drawn down		1,148,635	1,103,393
Net increase/(decrease) in cash and cash equivalence in the period		-	-

The notes on pages 82-96 form part of these accounts.

STATEMENT OF CHANGES IN TAXPAYERS' EQUITY
FOR THE YEAR ENDED 31 MARCH 2018

	Note	General Fund £000	Revaluation Reserve £000	Total Reserves £000
Balance at 1 April 2016		(134,263)	-	(134,263)
Total Net comprehensive expenditure for the year	SoCNE	(1,238,781)	-	(1,238,781)
Net Parliamentary Funding - drawn down (Re-stated)	SoCF	1,103,393	-	1,103,393
Non-Cash Charges - Auditors Remuneration	7	215	-	215
Non-Cash Charges - Communicated Costs	6	107,892	-	107,892
Net (Loss)/Gain on revaluation of Tangible Assets	8	-	-	-
Net (Loss)/Gain on revaluation of Intangible Assets	9	-	-	-
Balance at 31 March 2017 (Re-stated)		(161,544)	-	(161,544)
Total Net Comprehensive Expenditure for the year	SoCNE	(1,201,262)	-	(1,201,262)
Net Parliamentary Funding - drawn down	SoCF	1,148,635	-	1,148,635
Non-Cash Charges - Auditors Remuneration	7	200	-	200
Non-Cash Charges - Communicated Costs	6	102,638	-	102,638
Net (Loss)/Gain on revaluation of Tangible Assets	8	-	38	38
Net (Loss)/Gain on revaluation of Intangible Assets	9	-	518	518
Balance at 31 March 2018		(111,333)	556	(110,777)

The notes on pages 82-96 form part of these accounts.



F35B arrival into the UK at RAF Marham

NOTES TO THE ACCOUNTS

1. STATEMENT OF ACCOUNTING POLICIES

The financial statements contained within the Annual Report and Accounts relate to the financial year 1 April 2017 to 31 March 2018 (2017-18) with comparative analysis for the prior year 2016-17. They have been prepared in accordance with the Accounts Direction given by HM Treasury under Section 7 of the Government Resources and Accounts Act 2000 and in accordance with HM Treasury guidance as set out in the Financial Reporting Manual (FRoM).

The accounting policies contained in the FRoM apply International Financial Reporting Standard (IFRS) as adapted or interpreted for the public sector context. Where the FRoM permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of DE&S for the purpose of giving a true and fair view has been selected.

The policies adopted by DE&S are described below. They have been applied consistently in dealing with items that are considered material to the accounts. The functional and presentational currency is in pounds sterling and figures expressed in pounds thousands unless expressly stated in a note.

DE&S is classified as an Executive Agency which operates as a Bespoke Trading Entity in line with Chapter 7 of 'Managing Public Money'. The 2017-18 financial statements are the fourth set of published accounts for DE&S.

1.1 Accounting Convention

The financial statements have been prepared under the historical cost convention, modified by the revaluation of assets and liabilities to fair value as determined by the relevant accounting standards, and subject to the interpretations and adaptations of those standards in the FRoM.

1.2 Basis of preparation of annual accounts – accounting boundary

The primary purpose of DE&S is to equip and support the UK's armed forces for operations now and in the future by procuring new military equipment, commodities and services, supporting in-service equipment through-life and managing some logistics operations.

DE&S delivers this programme of project and logistics management services within a defined operating cost envelope and in accordance with the Framework Document and the Letter of Delegation issued by the MOD Permanent Secretary to the DE&S Chief Executive Officer.

The operating cost envelope specifically encompasses staff (including travel and training), other operating and private sector support (PSS) expenditure and any associated revenue. The financial statements also include costs incurred by other MOD organisations in support of DE&S operations as non-cash communicated costs (see item 1.8 below and Note 6 to the financial statements). PSS is defined as external support to supplement DE&S capacity and capability to manage our programme of work including those elements of external support that are being employed to deliver business improvement and transformation within the organisation. It encompasses contracts for the employment of manpower support, consultancy assistance and technical support activities. As such, PSS addresses resource and skills gaps in our project and logistics management capability.

DE&S has developed and implemented accounting treatment policies defining those activities that are to be treated as PSS. PSS undertaken within overarching equipment procurement/support arrangements with our main industrial contractors and international collaborative partners are not treated as DE&S operating costs as they are considered integral and indivisible from equipment programme activities. Note 3 provides a breakdown of PSS expenditure and includes PSS in support of demonstration and manufacture phase programmes which are capitalised on the MOD accounts but correctly recorded here as operating costs. Activities that DE&S cannot undertake due to requirements for independent review and specialist one off/short term technically complex activities are treated as Equipment Programme expenditure and not PSS.

1.3 Critical accounting judgements and key sources of estimation uncertainty

When preparing the DE&S Annual Accounts judgement and estimation is applied in establishing the value of DE&S receivables and payables and likewise the amount of revenue and expenditure to be reported during the accounting period. The key areas in which judgement and estimates are necessary are as follows:

- Accounting boundary: DE&S have robust and well-established policies and governance arrangements supporting the delineation of costs between those recognised as operating costs and reported in the DE&S financial statements from those equipment procurement/support activities that are reported in the MODs financial statements. These policies and governance arrangements have been paramount in the preparation of these accounts by DE&S finance staff. Decision making continues to be supported by the Private Sector Support Group (PSSG), which is chaired by a senior finance manager, providing structured consideration of accounting boundary decisions.
- Activities undertaken with our main industrial partners continue to be excluded from our DE&S operating costs in recognition of the fact the PSS activities within these arrangements continues to remain integral and indivisible from equipment programme activities.
- Communicated costs: DE&S receive a number of benefits driven by the activities of other MOD organisations which support our operations. There is no mechanism in place for these costs to be directly charged to DE&S so these costs are recognised within the DE&Ss accounts as communicated costs. These costs reflect the best estimates available and the majority are allocated based on an apportionment of costs based on staff number ratios. Note 6 provides further detail on communicated costs.
- Accruals – payables and receivables: In instances where revenue/expenditure has been earned/incurred but not invoiced, an estimate is made of the amount to be accrued as a payable or receivable item. DE&S review annually the appropriateness of the materiality level set to ensure it continues to remain relevant. For 2017-18 a guideline materiality threshold of £15,000 has been applied in the recognition of payables and receivables.

1.4 Changes during 2017-18 which have affected preparation of these annual accounts

There have been no significant changes in 2017-18 which have required a change in the way the annual accounts have been prepared.

1.5 Going concern

DE&S continues to be funded on the same basis as other central government organisations (known as “onvote” or net parliamentary funding) and therefore receives funding allocations through the MOD. As DE&S does not operate a bank account, with liabilities being met by the MOD, the year-end net liabilities position in the Statement of Financial Position represents a timing difference that will be offset by future net parliamentary funding from the MOD.

The MOD has demonstrated its commitment to continue funding DE&S while process/system developments are undertaken and rolled-out to support the future charging for DE&S operating activities. In this respect DE&S completed the roll out of the Time Recording and Charging (TRaC) system several months ago as a fundamental part of developing the mechanism for future charging of customers. The system is not currently being used to hard charge customers; initial timescales for implementation would have seen this commencing in 2017, but this has been delayed whilst the process is further refined with no definitive timescales at present.

1.6 Revenue and expenditure recognition

Funding received for revenue purposes from the MOD is treated as Net Parliamentary Funding from MOD rather than operating income and is therefore credited directly to the general fund.

Any revenue and expenditure generated directly from DE&S activities is recognised in the Statement of Comprehensive Net Expenditure on an accruals basis determined by when the related goods and services are provided and where an assessment of the stages of completion of revenue and expenditure generating activities can be reliably measured.

DE&S has two main sources of revenue.

(i) As agreed with HMT DE&S receive income in relation to Post Costing receipts where DE&S specifically have acted to recover funds (excess profits) outside the agreed profit rates from suppliers. In these circumstances DE&S conduct an audit and enter discussions with the supplier to determine the value of monies owed. Income is recognised at the point it is agreed by both parties.

(ii) The second source is from Defence Munitions whereby we sell spare capacity to QinetiQ on an ad-hoc basis. DE&S currently recognise the income as and when QinetiQ make a request for capacity and we have confirmed we are able to meet their requirement.

1.7 Programme costs

DE&S expenditure and revenue is reported as programme costs in line with MOD annual accounts reporting requirements. Where DE&S civilian staff are temporarily reassigned to work in other areas of the MOD their salary costs are charged to those other areas. Similarly, where other areas of the MOD temporarily reassign their staff to support DE&S management activities, salary costs are charged to DE&S.

The movement of manpower from or to other MOD organisations is subject to the agreement of funding transfers between DE&S and the other transacting party before implementation. The exporting organisation continues to record expenditure until this agreement has been reached.

1.8 Communicated Costs

Communicated costs are indirect costs in support of DE&S operations that are incurred through activities with other MOD organisations. These costs have been included as a non-cash item in the DE&S Statement of Comprehensive Net Expenditure to ensure that a full representation of operating expenditure is reported. Note 6 provides an analysis of these costs identifying the other MOD organisations involved and the key assumptions applied in determining the costs.

1.9 Value Added Tax (VAT)

Most of the operating activities of DE&S are deemed to be outside the scope of VAT as they relate to direct manpower costs. Irrecoverable VAT is charged where appropriate to other expenditure categories. Expenditure associated with recoverable VAT is treated as excluding VAT in the DE&S accounts with formal recovery administered by MOD. DE&S is not separately registered for VAT and VAT collected or any associated recoveries are processed centrally by MOD.

1.10 Non-current assets

Equipment assets delivered and supported by DE&S for use by the Commands (Navy, Air, Land and Joint Forces) are owned and reported in the MOD accounts as the risks and rewards of ownership are deemed to reside with the Commands and MOD.

Where assets are purchased for the sole benefit of DE&S and funded through our Operating Cost Expenditure budget these are considered for capitalisation where they meet the recognised threshold of £15k and are intended for use for a period of over 12 months. Given the relatively low volume and value of assets purchased specifically for DE&S use it is not our current policy to pool assets. We re-visit this policy annually to ensure that we are not omitting any material assets from our Fixed Asset Register.

1.11 Tangible non-current assets

Various areas of MOD provide DE&S with support services under central support contracts. These infrastructure support services include DE&S usage of MOD non-current assets, such as property and office furniture. The underlying risks and rewards of ownership of these assets are deemed to reside with MOD and therefore not

reported in the DE&S Statement of Financial Position.

The costs incurred by other MOD organisations in the routine maintenance of these assets are reported as communicated costs in the Statement of Comprehensive Net Expenditure. Where DE&S has incurred any direct costs for additional refurbishment/provision of such assets, and where they meet the criteria for capitalisation these are charged through the Statement of Financial Position and treated as non-current assets. Where such charges fall outside the recognised criteria DE&S expenses these costs in year.

1.12 Intangible non-current assets

DE&S continue to recognise as intangible non-current assets those investments in development and delivery of new information, system software and licenses that are aimed at improving DE&S's organisational performance.

DE&S recognised such assets for the first time in 2015-16 and further investments in 2016-17 and 2017-18 in software and licences have been made to enhance or increase system capability. All software and their associated licences continue to be capitalised as intangible assets in accordance with IAS38 where they continue to directly contribute to the delivery of DE&S business services and transformation activities.

Once initially recognised, intangible non-current assets are periodically re-valued to current value in existing use, using a market value where an active market exists. Where no market exists, indices are used to revalue the intangible asset to Depreciated Replacement Cost (DRC) Intangible non-current assets under construction are not subject to indexation where the contract payments capitalised during the period of construction are deemed to reflect fair value. Capitalised development costs are amortised, on a straight line basis and amortisation commences when the asset enters operational service.

1.13 Depreciation

All assets are depreciated on a straight line basis. The useful life of a tangible asset is based on the estimated out of service date and for Intangible assets the estimated period of use. The useful economic lives (UEL) of all assets are reviewed annually and revised where necessary to reflect changing circumstances.

The principal asset categories along with their useful lives are set out in the table below.

Main category	Sub category	UEL
Plant & Machinery	Equipment	5-25
	Plant & Machinery	5-25
IT & Comms	Office Machinery	3-10
	Communications Equipment	3-10
Intangible Assets	Software Licences	3-5

Assets under Construction are not depreciated. Depreciation commences from the point the assets are brought into operational use.

1.14 Impairment

During 2017-18 DE&S reviewed all existing assets and can confirm that no impairment events have arisen in 2017-18. Reviews continue to be undertaken periodically in order to establish whether there have been any impairment events that may result in a requirement for impairment action to be taken in respect of the recognised Non-Current Assets.

1.15 Cash and cash equivalents

Cash payments and receipts are processed on behalf of DE&S by MOD. DE&S does not, therefore, operate its own bank accounts nor does it have separate cash or cash equivalent balances within the Statement of Financial Position.

1.16 Inventories

Inventory delivered and supported by DE&S for use by the Commands (Navy, Air, Land and Joint Forces) are owned and reported in the MOD accounts as the risks and rewards of ownership are deemed to reside with the Commands and MOD and not with DE&S.

1.17 Financial instruments – receivables and liabilities

IAS 32 defines a financial instrument as “any contract that gives rise to a financial asset of one entity and financial liability or equity instrument of another entity”. Trade and other receivables have been classified as current assets and measured at the invoiced amount as the impact of discounting, in the context of DE&S, is not deemed to be material. Given the short-term nature of DE&S liabilities, this is considered equivalent to fair value. Goods or services received but not yet invoiced are accrued at estimated fair value.

Trade and other receivables are tested annually for impairment with any identified losses charged to the Statement of Comprehensive Net Expenditure. The carrying value of trade and other receivables in the Statement of Financial Position is shown net of any impairment provisions. Provisions are only made for specific bad debts. DE&S receivables and liabilities are de-recognised when the receivable or liability has been discharged, that is the payment required for settlement has been made or has been determined to no longer exist.

1.18 Employee benefits

A charge is made in these accounts for the value of employees’ annual leave entitlements earned, but not yet taken at 31 March each year. This has been valued by reference to DE&S average staff costs, by grade, based on a 365-day year, in line with MOD policy on recognition of untaken leave.

The 2017-18 value of employee performance bonuses reflected within the Statement of Comprehensive Net Expenditure reflects those earned for performance in 2017-18.

DE&S continue to recognise costs of voluntary and compulsory redundancies and exits for departures arising from decisions taken since BTE vesting day. The assumption that departures in 2014-15 pre-vesting are not relevant to the BTE accounts remain extant.

1.19 IFRS8 Segmental Reporting

The requirement for segmental reporting under IFRS8 is not considered appropriate for DE&S as the organisation operates and is managed as a single entity rather than as separate operational segments.

1.20 Reserves

The Revaluation Reserve reflects the unrealised element of the cumulative balance of revaluation and indexation adjustments on non-current assets. The General Fund reserve represents the balance of taxpayers’ equity in DE&S (BTE). Specifically, the General Fund reflects the net assets less liabilities entered during financial year 2017-18.

1.21 Provisions for Liabilities and Charges

Provisions for liabilities and charges have been established under the criteria of IAS 37 – Provisions, Contingent Liabilities and Contingent Assets and are based on realistic estimates of the expenditure required to settle legal or constructive obligations that exist at the Reporting Period Date. On initial recognition provisions are charged to the

SOCNE. Provisions have been made for the legal claims made by DE&S by employees seeking compensation as a result of loss or injury suffered as a result of motor incidents. In calculating the provisions, an estimate has been made of the cash flows required to settle the obligations. Estimates are based on historic volumes of claims and the anticipated settlement date.

1.22 IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

During financial year 2017-18 DE&S became aware of an error that impacts on the value recognised by DE&S for the main pensions schemes and other payroll related liabilities. In line with IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors we have re-stated the 2016-17 direct staff accrual and the Net Parliamentary Funding – see Note 11.

1.23 Adoption of new and revised standards

There are a number of IFRSs, amendments and interpretations that have been issued by the International Standards Board. Those with relevance to the Agency are outlined below, the agency has not adopted any standards early.

IFRS 15 – Recognition of revenue from contracts with customers effective from 1 January 2018.

This is effective from 1 January 2018 and will be introduced in the 2018-19 FReM. IFRS 15 introduces changes to the timing of revenue recognition for contracts, matching revenue to performance obligations, and changes to revenue disclosure requirements. DE&S have two main sources of income: Revenue obtained through post costing receipts; and from Defence Munitions whereby we sell spare capacity to QinetiQ on an ad-hoc basis. Management have assessed and concluded that the revenue recognition criteria will not change under IFRS 15.

IFRS 9 – Financial Instruments effective 1 January 2018

IFRS 9 introduces changes to the classification and measurement of financial instruments. Management have assessed the impact of the change and concluded that the treatment of financial assets and liabilities is not expected to change under IFRS 9.

IFRS 16 – Leases effective 1 January 2019

This standard will be incorporated into the financial year 2019-20 FREM and will replace the current IAS 17. This standard removes the distinction between operating and finance leases and should result in a more uniform accounting treatment for all leases. The Agency does not currently have any operating or finance leases.

2. STAFF NUMBERS AND RELATED COSTS (Subject to audit)
2.1 Staff costs comprise:

2.1 Staff Costs Comprise:	2017-18			2016-17		
	Permanently Employee Staff £000	Contingent labour £000	Total £000	Permanently employed Staff £000	Contingent labour £000	Total £000
Salaries and wages	500,401	27,761	528,162	461,318	42,584	503,902
Social security costs	51,530	-	51,530	47,077	-	47,077
Other pension costs	120,499	-	120,499	112,261	-	112,261
Total	672,430	27,761	700,191	620,656	42,584	663,240
Paid to:						
Armed Forces	136,921	-	136,921	134,757	-	134,757
Civilian	535,509	-	535,509	485,899	-	485,899
Contingent Labour	-	27,761	27,761	-	42,584	42,584

2.2 Average number of persons employed:

	2017-18			2016-17		
	Permanently employed Staff	Contingent labour	Total	Permanently employed Staff	Contingent labour	Total
Employed by DE&S	12,358	254	12,612	11,498	358	11,856
Of which:						
Civilian Personnel	10,968	-	10,968	10,101	-	10,101
Armed Forces	1,390	-	1,390	1,397	-	1,397
Contingent Labour	-	254	254	-	358	358

3. PRIVATE SECTOR SUPPORT (PSS)

	2017-18 £000	2016-17 £000
Manpower support	59,488	75,569
Manpower support - transformation	77,601	81,666
PSS for programmes in demonstration and manufacture phase	48,285	75,232
Constancy support (project management, organisation design, finance, legal)	90,996	107,371
PSS for programmes in in-service support and disposal phases	43,582	52,230
PSS for programmes in concept and assessment phases	9,376	14,321
Total	329,328	406,389

4. OTHER PROGRAMME COSTS

	2017-18 £000	2016-17 £000
Staff travel and subsistence costs	24,237	27,387
IT and telecommunications	23,190	19,227
Other infrastructure expenditure	7,012	8,498
Staff training costs	6,463	7,504
Rentals	9,223	6,460
Regulatory safety costs	1,916	1,922
OPC DSTL	20,240	-
Other costs	5,154	10,427
Total	97,435	81,425

In financial year 2016-17 Defence Science and Technology Laboratory (DSTL) was a Trading Company and its costs of £25 million were reported as PSS expenditure, spread over the various categories. On 1 April 2017 DSTL was brought back into the MOD boundary and these costs are now treated as Other Programme Costs (OPC).

5. PROGRAMME INCOME

	2017-18 £000	2016-17 £000
Defence Munitions commercial revenue	15,010	14,279
Logistics Commodities Services revenue (including British Forces Postal Office)	1,474	1,621
DE&S BTE Corporate receipts	14,187	3,655
Other programme Income	1,483	825
Total	32,154	20,380

The increase in income in 2017-18 relates to income generated as a result of post costing activities undertaken by DE&S in the financial year, this is in part offset by the settlement of a one-off income generation activity accrued in 2016-17. Other than that, income has remained consistent with 2016-17.

HMS Magpie



6. COMMUNICATED COSTS

The following costs have been incurred by other MOD organisations in support of DE&S BTE activities. These costs have been included as a non-cash item in the DE&S BTE statement of Comprehensive Net Expenditure to ensure a complete representation of BTE Operating Expenditure is reported. There is no formal charging mechanism or Commercial type relationships established for these activities and therefore the most appropriate apportionment methodologies have been applied.

MOD Organisation	Description of activities	Method of apportionment	2017-18 £000	2016-17 £000
Joint Forces Command	Information systems and communication services	Number of DE&S users relative to MOD users.	46,486	49,568
Defence Infrastructure Organisation	Infrastructure and facilities management costs	Cost per employee at DE&S headquarters extrapolated to total DE&S headcount.	18,793	19,516
Joint Forces Command	Training services through the Defence Academy and Surgeon Services	Number of DE&S training days relative to total MOD training days.	12,210	11,867
Defence Infrastructure Organisation	MOD Guard Service	Costs of main DE&S geographical locations extrapolated across total DE&S headcount.	13,845	13,689
Defence Business Services	Personnel and Payroll Services	Number of DE&S employees relative to total MOD employees.	10,023	11,884
Head Office and Corporate Services	Various	Based on actuals.	1,281	1,368
Total			102,638	107,892

Communicated Costs have reduced by approximately 5% during 2017-18. This has primarily been driven by a change in the methodology used to calculate costs associated with Joint Forces Command Information Systems and Services.

7. AUDITORS REMUNERATION

DE&S is audited by the comptroller and Auditor General. The charge of £200K is notional reflecting the costs incurred by the auditor in respect of the audit of the DE&S 2017-18 Annual Report and Accounts. This notional charge is reflected in the Statement of Comprehensive Net Expenditure to ensure completion of the accounts.

8. TANGIBLE FIXED ASSETS

	IT & Comms £000	Plant Machinery and Vehicles £000	Assets Under Construction (AUC) £000	Total £000
Cost or Valuation	-	-	-	-
At 1 April 2016	-	-	-	-
Additions	-	-	-	-
Disposals	-	-	-	-
Impairments	-	-	-	-
Revaluations	-	-	-	-
Reclassifications	-	-	-	-
Balance at 31 March 2017	-	-	-	-
Additions	-	-	289	289
Disposals	-	-	-	-
Impairments	-	-	-	-
Revaluations	38	-	-	38
Asset adjustment write off	-	-	-	-
Reclassifications	703	117	(108)	712
At 31 March 2018	741	117	181	1,039
Amortisation	-	-	-	-
Balance at 1 April 2016	-	-	-	-
Charged In Year	-	-	-	-
Disposals	-	-	-	-
Impairments	-	-	-	-
Revaluations	-	-	-	-
Reclassifications	-	-	-	-
Balance at 31 March 2017	-	-	-	-
Charged In Year	(185)	(19)	-	(204)
Disposals	-	-	-	-
Impairments	-	-	-	-
Revaluations	-	-	-	-
Reclassifications	-	-	-	-
At 31 March 2018	(185)	(19)	-	(204)
Net Book value	-	-	-	-
Balance at 1 April 2016	-	-	-	-
Balance at 31 March 2017	-	-	-	-
Balance at 31 March 2018	556	98	181	835

Tangible values include P3M server hardware rolled out in 2017-18 in support of the transformation programme and Defence Ordnance Safety Group test equipment to enable DE&S to fulfil safety obligations. AUC balance reflects continued investment in test equipment.

9. INTANGIBLE FIXED ASSETS

	Software £000	Assets under Construction (AUC) £000	Total £000
Cost or valuation			
At 1 April 2016	807	5,373	6,180
Additions	686	5,475	6,161
Disposals	-	-	-
Impairments	-	-	-
Revaluations	-	-	-
Reclassifications	-	-	-
Balance at 31 March 2017	1,493	10,848	12,341
Additions	162	9,304	9,466
Disposals	-	-	-
Impairments	-	-	-
Revaluations	518	-	518
Asset Adjustment write off	-	(807)	(807)
Reclassifications	10,001	(10,713)	(712)
At 31 March 2018	12,174	8,632	20,806
Amortisation	-	-	-
Balance at 1 April 2016	(239)	-	(239)
Charged In Year	(371)	-	(371)
Disposals	-	-	-
Impairments	-	-	-
Revaluations	-	-	-
Reclassifications	-	-	-
Balance at 31 March 2017	(610)	-	(610)
Charged In Year	(2,613)	-	(2,613)
Disposals	-	-	-
Impairments	-	-	-
Revaluations	-	-	-
Reclassifications	-	-	-
At 31 March 2018	(3,223)	-	(3,223)
Net Book value	-	-	-
Balance at 1 April 2016	568	5,373	5,941
Balance at 31 March 2017	883	10,848	11,731
Balance at 31 March 2018	8,951	8,632	17,583

Software values include DE&S time recording and charging (TRAC) system, Active Risk Manager (ARM), Business Management Systems (BMS) and P3M (Project, Programme and Portfolio) suite of Oracle tools as reported in financial year 2016-17.

AUC balances reflect existing and continued investment made by DE&S in P3M configuration and software licences to support the delivery of business activities.

Asset adjustments reflect a book-keeping correction in regard to the purchase of TRAC in financial year 2016-17.

The 2017-18 depreciation charge is classified as non-cash expenditure in the SOCNE. In prior years it was incorrectly classified as Other Programme Costs. As the prior year error is not material, in accordance with IAS 8 – Accounting Policies, Changes in Accounting estimates, no adjustment to the prior year comparative is required.

10. TRADE RECEIVABLES AND OTHER ASSETS

	2017-18 £000	2016-17 £000
Amounts falling due within one year:		
Accrued income	1,808	524
Other receivables	6,871	7,493
Trade receivables	-	-
Prepayments	500	73
Staff loans and advances	1	1
Total Current Receivables	9,180	8,091
Amounts falling due after more than one year:	-	-

11. TRADE PAYABLES AND OTHER LIABILITIES

	2017-18 £000	2016-17 Restated £000
Amounts falling due within one year:		
Private Sector Support accruals	(77,016)	(110,887)
Direct staff accrual	(48,112)	(42,150)
Trade payables	(9,510)	(25,931)
Sundry payables	(1,747)	(2,222)
Total Current Liabilities	(136,385)	(181,190)
Amounts falling due after more than one year:	(746)	(176)

Prior Period Adjustment:

The direct staff accrual includes liabilities to the Principal Civil Service pension scheme, the Armed Forces pension scheme, HMRC and other payroll related liabilities. For 2017-18 this figure is £15.2 million and for 2016-17 was £30 million. However, we have been made aware of an error in the underlying data used to calculate the DE&S proportion of this liability which has resulted in the 2016-17 figure being materially overstated by £17.5 million. In accordance with IAS 8 – Accounting Policies, Changes in Accounting Estimate, the direct staff accrual and the Net Parliamentary Funding have been restated as follows:

	£000	2016-17 £000
	Direct Staff Accrual	General Fund -Net Parliamentary Funding
Figure per 2016-17 Accounts	59,677	1,085,866
Prior-year error adjustment	(17,527)	17,527
Restated figure	42,150	1,103,393

12. PROVISIONS, CONTINGENT LIABILITIES AND ASSETS

DE&S applies IAS 37 in the consideration of provisions, contingent liabilities and contingent assets. During 2017-18 HOCS transferred the provision for legal claims brought about by employees relating to loss and injury. This provision should have been recognised in 2016-17. However, given that the amount involved is not material, we have not restated the comparative. We do not have any contingent liabilities or contingent assets associated with our operating activities.

	2017-18 £000	2016-17 £000
At 1 April	-	-
Increase in Provision	2,028	-
Provisions Written Back and Reclassifications	-	-
Provisions Used	(665)	-
Unwinding Discount	(119)	-
Provisions Capitalised	-	-
	-	-
Balance at 31st March	1,244	-

13. RELATED PARTY TRANSACTIONS

DE&S is a bespoke trading entity, an arm's length body of the Ministry of Defence, as such and for the purpose of these accounts MOD is regarded as a related party. Funding continues to come in the form of Net Parliamentary funding with all payments and receipts relating to DE&S operations being processed by MOD on our behalf.

DSTL came back into MOD on 1 April 2017, as such they are now considered a related party. DE&S incurred costs of £20.2 million during 2017-18 undertaking business activities with DSTL.

MOD continue to undertake a number of transactional activities on behalf of DE&S, the most significant of which relate to direct staff costs including the calculation and processing of taxation with HM Revenue and Customs and pension benefits for both the Armed Forces Pension Scheme and the Principal Civil Service Pension Scheme.

No senior employees of DE&S have undertaken any material business transactions in the period to 31 March 2018.

14. BUDGET RECONCILIATION NOTE

DE&S is responsible for its own operating expenses, and carries out its business activities within an agreed operating expenditure budget. The budget comprises both revenue and capital expenditure and DE&S has full control over how this funding is utilised. For 2017-18 this was £1.108 billion, however our outturn position for the year was £1.105 billion, a reduction against budget of £3 million.

The net revenue outturn position of £1.095 billion is captured within the statement of comprehensive net expenditure and is made up of Direct Staff Costs, Private sector Support Costs and Other programme costs of £1.127 billion offset by the income generated by DE&S in 2017-18 of £32.2 million.

The capital outturn position of £9.8 million represent continued investment in software assets and the purchase of new tangible assets relating to the Defence Ordnance Safety Group (DOSG), these are highlighted in the Intangible Fixed Asset Note.

15. EVENTS AFTER THE REPORTING DATE

Submarine Delivery Agency

On 1 April 2018 the Submarine Delivery Agency (SDA) was launched as an Executive Agency to sit alongside DE&S. Although this has not impacted on the 2017-18 accounts we have worked with the SDA to agree the opening position for the agency. Liability balances that will be transferred to SDA in 2017-18 but recognised in DE&S accounts in 2017-18 are £9.324 million, with an additional £1.485 million associated with 2017-18 performance awards and £1.1 million for Annual Leave and Overtime. There is an additional £1.574 million liability associated with Direct Staff Costs for liabilities to the principal Civil Service pension schemes, the Armed Forces pension scheme, HMRC and other payroll associated liabilities. Operating costs incurred by the Submarine Domain of £130 million have been expensed in DE&S accounts as this was prior to the establishment of the Submarine Delivery Agency. Going forward these costs will be incurred by the SDA who will present a separate annual report and accounts from 2018-19. DE&S will continue to manage on behalf of the SDA assets previously under the responsibility of DE&S to which SDA will be directly charged for this service.

DE&S Chief Executive Officer

Following Tony Douglas' departure in December 2017, Michael Bradley was appointed interim CEO until the conclusion of the formal recruitment process for a new CEO. This was completed in early 2018 with the announcement that Sir Simon Bollom had been appointed as the new DE&S CEO. Sir Simon took up office on 21 May 2018.

Resignation of the DE&S Chief Finance Officer

In July 2018, Michael Bradley announced that he was resigning from his role as Chief Finance Officer and would leave DE&S in October 2018. The recruitment process to determine his successor will be led by the DE&S Chairman, CEO and MOD Permanent Secretary.

Accounts authorised for issue date

The accounts have been authorised for issue by the Accounting Officer on the same date as the Comptroller and Auditor General's audit certificate. There have been no events since the reporting period that would give rise to any additional or updated disclosures.



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