DSG
DEFENCE SUPPORT GROUP

Annual Report and Accounts

2008/2009

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MINISTRY OF DEFENCE

DEFENCE SUPPORT GROUP

DSG Annual Report and Accounts 2008/2009

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INTRODUCTION FROM THE CHAIRMAN

"As chairman of the Defence Support Group (DSG) Trading Fund Board it has been my pleasure to witness the emergence of an organisation with a clear vision of the future and with genuine strength of purpose."

JAMIE PIKE
Chairman

JAMIE PIKE
DSG Chairman

Since its formation on 1 April 2008, DSG has quickly integrated and channelled the expertise of its many committed and driven employees who share a common vision and goal to make the business the success it deserves to be.

Together with the invaluable support of my fellow Board colleagues, it has been my responsibility to give DSG the direction and external expertise that is available through the non-executive directors. It has also been useful to call upon the broad knowledge of our Trade Union officers who bring with them their own business perspective. DSG is now embarking on an ambitious but achievable Transformation programme, which I expect will deliver even greater benefits to the business and its customers.

As the calls made upon the Defence budget increase, so the many challenges DSG will face are unlikely to diminish or recede. There is no room for complacency or inaction, if DSG is to remain a viable, operationally excellent support provider it must continue to be innovative and reactive to change.

Everyone in DSG should take great pride in this first year of operation for DSG, as the business performance has been a strong one. To assimilate both the ABRO and DARA organisations into a high performing single entity in the short time that has passed since the decision to merge was taken, is clear testament to the professionalism and talent that is evident throughout DSG.

Jamie Pike
Chairman
29 June 2009

ARCHIE HUGHES
Chief Executive

STATEMENT BY THE CHIEF EXECUTIVE

"In this first year of operation, DSG has produced an outstanding operating performance, which is due in no small part to the shared vision of our employees."

In its first operating year DSG has concentrated its efforts on stabilising and transforming the various businesses with the aim of delivering the performance targets set by our Owner. In achieving such an outstanding performance, DSG's employees have shown great resilience and adaptability in circumstances where the needs of our Armed Forces are at the forefront of everyone's minds.

As with all Government Trading Funds, DSG's performance is measured against a number of Key Targets (KTs) and the five that DSG had to achieve during the reporting period brought their own set of challenges. The individual targets for Return On Capital Employed (ROCE), Quality, Efficiency and Delivery were all comfortably achieved, which is significant given the pace of change that DSG employees are embracing in this our first year of operation.

The value placed on the work of DSG employees is in evidence throughout the Ministry of Defence (MOD) and across industry, and I am constantly reminded of the high regard in which those who are at the very top in the UK Armed Forces hold our employees. This includes the various Chiefs of Defence who are united in their praise of the work done by DSG employees both at home and on overseas deployments. In January 2009, MOD's Defence Equipment and Support (DE&S) Chief of Defence Materiel, General Sir Kevin O'Donoghue travelled to our Bovington site to present seven of our employees with campaign medals for their work supporting operations in Iraq.

Those receiving their medals volunteered to travel to Front Line operations where they worked on the critical equipment needed by their Service colleagues, who were engaged in combat situations in Iraq. For many of these medal recipients this was not their first visit to Basra where they were involved in upgrading and modifying armoured vehicles.

"You have all shown a level of commitment and loyalty to your colleagues in the Armed Forces of which you should all be immensely proud. Facing the challenging conditions with such professionalism while you are thousands of miles from home is a true testament of your dedication in supporting our Armed Forces.

The medals you are receiving today are a token of gratitude, not only from those operating at the front line, but from everyone in MOD who recognise the invaluable work you are doing and the contribution you are making in helping better equip those who are engaged in combat."

GENERAL SIR KEVIN O'DONOGHUE
Chief of Defence Materiel praised the work of DSG employees after presenting their Iraq campaign medals.

"The commitment and dedication of the workforce is truly impressive and is appreciated by many including me and by those currently deployed on operations. It is, perhaps, appropriate that on my last day in post as Armoured Fighting Vehicle Group Leader I should be here with the Defence Support Group paying tribute to their workforce and to this platform which is one of the key vehicles saving the lives of our soldiers in both Iraq and Afghanistan today."

MAJOR GENERAL ALAN MACKLIN
Speaking at a media event in Donnington, celebrating the 1000th Warrior to leave the DSG workshops.

This level of praise for the DSG employees is shared across our customer community and is neither restricted nor limited to just those in the Armed Forces for whom the equipments we support are vital to their day to day work and, more importantly, their safety.

Upgrading and uparmouring battle-ready vehicles to fulfil their critical combat roles are paramount and every DSG employee is conscious of the importance in making equipment platforms, whether these are for Air or Land environments, available when they are needed. One example of note is employees at Donnington who worked over the Christmas break to meet a tight schedule in turning around CVR(T) vehicles required under an Urgent Operational Requirement (UOR) Environmental Mitigation contract with BAE Systems.

This level of commitment and customer focus is replicated across all of DSG where employees are willing to travel the extra mile to ensure deadlines are met and vital equipment is delivered on time and to the highest quality standards.

During the past year DSG has started out on an ambitious transformation journey under the banner of DART – DSG Achieving Rapid Transformation. This programme will inevitably impact on all areas of DSG, but it will deliver the efficiencies and benefits that merger was designed to provide to our Owner and customers.

Production of a realistic and meaningful Transformation Plan was another Key Target (KT) that we have been able to achieve within the timeframe set by our Owner. Pivotal to this transformation programme is giving greater transparency, accountability and autonomy to our business units by providing them with the opportunities and freedoms they need when making important day to day decisions. There is now no hiding place for underperforming or underutilised businesses. Our focus remains clearly on helping each business achieve the highest levels of performance, and when combined with the other business interests of DSG will produce the positive results against which we are measured annually.

THE EXECUTIVE BOARD OF DIRECTORS

STEVE HALL Finance Director	**KEITH NORRIS** Strategy Director	**ARCHIE HUGHES** Chief Executive	**ALAN LEWIS** Commercial Director	**JOHN REILLY** Chief Operating Officer	**DEREK OWEN** Human Resources Director

With more accurate financial reporting processes and procedures in place that give us the necessary assurance and confidence in the business performance figures, DSG is now firmly on the transformation track that should deliver even greater benefits to our Armed Forces and the MOD. Our most significant achievement during the year was in the KT related to our financial performance where we have turned around parts of the DSG business into viable and profitable concerns. This has enabled DSG to offer substantial rebates to our customers in terms of price reductions and lower than anticipated materials usage.

Although only a few months into its first year of operation, DSG was under the spotlight of the House of Commons Defence Committee, which decided that its first Inquiry of 2009 should be to look at how DSG was performing since its creation.

In coping with the many trials and uncertainties thrown up following merger, DSG has produced an excellent business performance through the professionalism and outstanding determination of its employees. It is clear that this past year is just the first small step on DSG's path towards transformation and the challenges that lie ahead will neither recede nor diminish as pressures increase to deliver even greater efficiencies and savings.

The foundations on which DSG is now established will provide the stability that is essential if we are to consolidate and build upon all the positive actions that we put in place during the past year. As an MOD asset we must also continue to deliver best value for defence if we are to retain our position as an in-house provider of skilled maintenance, repair, overhaul and upgrade services to the UK's Armed Forces.

The DSG Trading Fund Board comprises the DSG Chief Executive and executive directors, John Reilly, Chief Operating Officer, Alan Lewis, Commercial Director, Steve Hall, Finance Director, Derek Owen, Human Resources Director and Keith Norris, Strategy Director. As the Land Operations Director, David Mather served on the Board until leaving DSG on 31 December 2008. A non-executive Chairman, Jamie Pike, together with three non-executive directors, Michael Jones as Chairman of DSG's Audit Committee, Terence Jagger as Chairman of DSG's Remuneration Committee and David Barrass all provide invaluable external expertise and advice. Andy Akerman and Richard Holroyd served as non-executive directors until leaving on 30 June 2008 and 31 December 2008 respectively.

A. Hughes

Archie Hughes
Chief Executive
29 June 2009

BUSINESS, MISSION, VISION AND STRATEGY

MISSION

To provide expert in-house maintenance, repair, overhaul, upgrade and support services for the UK Armed Forces' air and land systems.

VISION

Excel in Supporting Defence.

STRATEGY

The strategic aims of DSG are as follows:

- It will go forward as a Trading Fund;
- It will concentrate on a core mission to support the UK Armed Forces and deliver wider Defence objectives;
- It will focus on the provision of expert in-house maintenance, repair, overhaul, upgrade and spares procurement services for the through life support of UK Armed Forces air and land systems. It will provide additional services in support of wider Defence objectives where individual MOD strategies dictate, and it will have the ability to grow if required;
- It will provide MOD with an in-house strategic support capability, primarily for Land and Air Equipment;
- It will be agile, flexible and provide its services directly to MOD or indirectly through industrial primes/OEMs as appropriate in agreement with MOD, positioning itself to be a preferred partner or subcontractor where appropriate;
- It will provide both a competitive spur to industry and provide the MOD with commercial leverage to help deliver the Defence Industrial Strategy;
- As a retained defence capability, its utility should be maximised and where necessary sustained to provide a core capability to the MOD customer. To this effect, it should be integrated, wherever cost effective and appropriate, into future MOD procurement and support solutions;
- It will work closely with MOD customers to ensure that it is appropriately funded to enable it to retain the required capacity and capability to support planned future procurement and support strategies;
- It will continue to provide a flexible response to meet evolving operational requirements, particularly in terms of surge and Urgent Operational Requirements (UORs);
- It will build upon and grow its capability and knowledge base in support of Air and Land assets, including its ability to utilise free user rights of 3rd party IPR under the rights secured by the MOD;
- It will focus on developing the necessary capabilities to enable it to be deployed in a flexible manner as part of planned future procurement and support strategies;
- It will increasingly seek to develop its capabilities to provide support to customers at their preferred locations;
- It will be a modern, lean organisation, structured as a series of separate businesses supported by a slim line Head Office;
- It will pursue a strategic goal of achieving 'best value for Defence' through focusing on and delivering, where appropriate, cost reduction, efficiency and productivity improvements, and improved delivery to the customer across all areas of the business; and
- It will focus in the short-term on the further integration and optimisation of its assets and capabilities to deliver its outputs at least cost.


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BUSINESS PERFORMANCE AGAINST KEY TARGETS

The Defence Equipment & Support Minister agreed DSG's Key Targets for 2008/09. These targets aim to provide clear indicators of DSG's success in key performance areas. The targets are also used with other measures to form a Performance Management System that links corporate strategy with the performance plans of the business and our employees.

PERFORMANCE AGAINST KEY TARGETS 2008/09:

Key Target 1: **Quality** To deliver an improved quality performance by achieving fewer than 4 attributable major customer concerns within DSG's Air Business and reducing upheld customer complaints within the Land Business by 5% against the 2007/08 outturn.	**Achieved** There were no attributable major customer concerns within DSG Air Business and upheld customer complaints for the Land Business reduced in excess of 5%
Key Target 2: **Financial Performance** To achieve at least a 3.5% Return on Capital Employed.	**Achieved** The actual ROCE achieved was 9.22%
Key Target 3: **Business Transformation** To establish a transformation plan, approved by the DSG Trading Fund Board, by December 2008 that fully exploits the synergies and benefits of merger, including numerical targets for improvements in cost and performance for subsequent years.	**Achieved** The Transformation Plan received Trading Fund Board approval and was endorsed by the Owners Advisory Council
Key Target 4: **Efficiency** To improve overall efficiency by at least 4% against 2007/08 outturn.	**Achieved** Overall efficiency improved by 9.59%
Key Target 5: **Delivery** To meet delivery targets as agreed with the Customer as follows:	
· Air Business – To achieve 95% of Customer Programmes; and	All targets achieved
· Land Business – To meet Customer agreed targets for delivery schedules on: Critical Programme lines (94% Sep 08, 94% Dec 08 and 97% Mar 09) and, Land Load tasks (92% Jun 08, 92% Sep 08, 92% Dec 08, and 92% Mar 09).	All targets achieved

FUTURE KEY TARGETS

The Key Targets agreed for 2009/10 link corporate strategy with business and individual employee performance and supports the implementation of the DSG Transformation Plan building on baselines established on formation on 1 April 2008.

Key Target 1: **Quality**

Deliver an improved quality performance by achieving fewer than 4 attributable major customer concerns within DSG's Air Business and reducing upheld Customer Complaints within the Land Business by 5% per annum against the 2007/08 outturn.

Key Target 2: **Financial Performance**

To achieve at least a 3.5% Return on Capital Employed.

Key Target 3: **Business Transformation**

Realise the benefits approved by the DSG Trading Fund Board in the DSG Transformation Plan.

Key Target 4: **Efficiency**

Improve overall efficiency by at least 12% against the baseline established for DSG on formation.

Key Target 5: **Delivery**

Meet delivery targets as agreed with the Customer as follows:

(a) Air Business – To achieve 95% of Customer Programmes; and

(b) Land Business – To meet Customer agreed targets for delivery schedules on:
Critical Programme lines (94% Sep 09, 94% Dec 09 and 97% Mar 10) and,
Land Load tasks (92% Jun 09, 92% Sep 09, 92% Dec 09, and 92% Mar 10).

BUSINESS PERFORMANCE REVIEW

"Everyone in DSG has a part to play in helping to create and sustain a world class business, too often in the past we only measured the people on the shop floor. I believe the wonderful thing about our operational excellence approach is that it measures everyone in the business from those on the DSG Board to the staff on the shop floor."

JOHN REILLY
DSG Chief Operating Officer

The most significant development during the past year has been the introduction of autonomous business units across the DSG portfolio. By initiating a coherent regime, which allows the daily management and decision-making to be made at a local site level ensures greater accountability and transparency. It also engenders an environment of responsibility that ensures decisions are taken and options considered, which reflect the local needs of that particular business unit.

The diversity existing in DSG's Air and Land businesses is allowing us to further develop and nurture shared best practice. Transformation is crucial if the various elements that make up DSG are to succeed in the longer term. Critical to this transformation is delivering Operational Excellence across the various business interests. DSG is already starting to benefit from the work that is taking place to integrate the DSG processes with its people and the tools they need to do their jobs effectively and efficiently.

The journey towards Operational Excellence is long and cannot be reached overnight but recognising the weaknesses and putting in place the remedial actions to consolidate best practice and deliver benefits is an important step in the right direction.

"Operational excellence will result in higher customer satisfaction, improved employee satisfaction, and best overall value for defence. The DSG Board could have chosen the easy route by maintaining the status quo… but it didn't. It chose consistency and excellence over inconsistency and mediocrity."

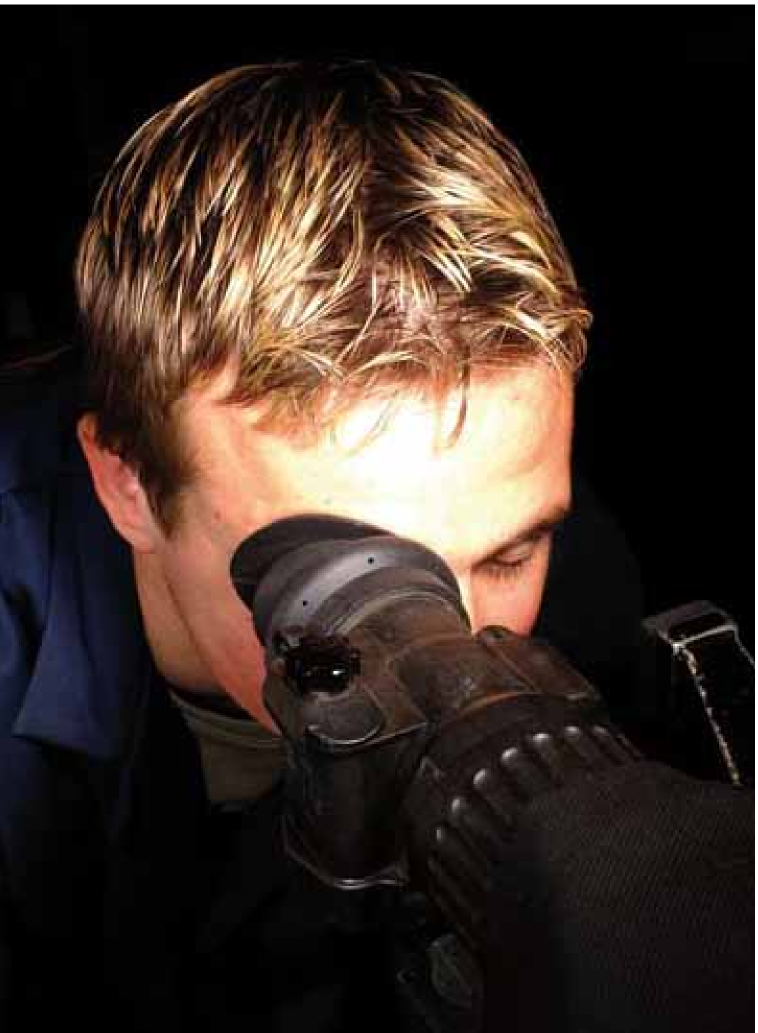
RAY PADILLA
Operational Excellence Expert

LAND AND AIR – BUSINESS PERFORMANCE

DSG's Land businesses are performing strongly and delivering a commendable output against increasing pressures to support UORs. The service DSG employees are delivering in the operational theatres of Afghanistan and Iraq, as well as in Kuwait, greatly enhances DSG's reputation and value to the UK Armed Forces. It is this level of commitment and professionalism that also marks DSG out as an established provider of equipment support to MOD.

Embedding the new business processes is giving each site the business clarity and focus it needs in order to make the right decisions. Each business unit now has clear performance goals and objectives that are shared by every employee and against which their individual performances are measured. Taking this approach allows each site a level of responsibility and accountability that is essential if they are to remain viable and sustainable businesses.

DSG Donnington
The DSG Donnington business has delivered an excellent business performance on all its major platforms during periods of increased demand on various Land activities, particularly in the small arms business workstream. Work on the Warrior platform was intense during the year and this was especially evident on UOR related activities where Donnington employees deployed to support the operations at Camp Bastion in Afghanistan.



Base overhaul and upgrade programmes for the CVR(T) fleet have achieved solid results on a range of activities with particular emphasis on the delivery of the first vehicles to undergo the environmental upgrade programme. Upgrades for Snatch Landrovers to Vixens, under contract with the Specialist Utility Vehicle (SUV) IPT, was successfully completed and aims to provide greater crew protection and better running performance. Other highlights during the year was the Land Equipment IPT Leader forum hosted at Donnington, which presented the business with an excellent opportunity to showcase the breadth of expertise and talent available to our key customers.

"It was extremely encouraging to see a busy and purposeful site, churning out battle equipment, which is essential to our success on operations. It was rewarding to meet several members of the workforce who have been out on direct support to operations and to see ideas being generated by experienced staff on the shop floor."

COLONEL PAUL CARTWRIGHT
Assistant Director, Combat Equipment on his visit to Donnington

DSG Bovington and Warminster

The focus for the team at Bovington during the year was fixed on developing a successful merger with the DSG Warminster site to create a single business unit. The output of the Armoured Vehicle platforms was strong, which in turn produced a healthy and solid business performance. However, with the Challenger 2 Base Inspection and Repair contract ending it is imperative that new work is identified to compensate for this decline in workload. Otherwise, Bovington will experience a strain on manpower and efficiency targets and compromise future Key Targets.

Major UOR work was completed to plan on the Bushmaster and Viking vehicles and Bovington was able to celebrate delivery of the 500th Bulldog to the customer at a high profile media event attended by broadcast and trade journalists. During the year the SUV IPT contracted with DSG Bovington to create an up-armoured Cougar training fleet for pre-deployment training operations, with all vehicles on plan to be successfully delivered during the first half of 2009. DSG Warminster continues to provide excellent engineering support to Land Training Fleet's armoured and wheeled vehicles used for training exercises on Salisbury Plain. The workshops at Warminster are ably supported by In-Barrack Equipment Support teams at Sennybridge, Brawdy, Tidworth, Abingdon and Chivenor.

As with other DSG sites, employees at Bovington and Warminster are stepping up to the mark by supporting our customer at the Front Line in both Afghanistan and Iraq and in some cases employees are making return journeys to combat zones where the threat of enemy fire is a reality. DSG's employees are consistently praised for their adaptability and loyalty to their service colleagues and this is also evident when supporting the UK Army's Training Unit at Suffield in Canada, BATUS where numbers of DSG employees working there have increased from 22 through to 40 and now currently stands at 57. The employees volunteering for deployment to BATUS are drawn from across all DSG's sites, although the programme is managed through the Bovington business unit.

"This is a hugely impressive achievement. It demonstrates both the technical ability of the DSG staff and their dedication to ensuring our forces on operations have the equipment they need. I'd like to thank everyone involved for the work they have done upgrading the vehicles so quickly."

BARONESS TAYLOR
then Minister for Defence Equipment and Support speaking about the 500th Bulldog

Other DSG Land Sites

DSG's other key Land sites produced an improved performance during the reporting period and in allowing them to focus on their site-based businesses they are delivering measurable benefits. DSG Stirling has turned out an admirable performance by delivering the Land Rover Tithonus programme back to the customer ahead of schedule by some eight weeks. DSG Catterick's contribution to the Tithonus programme is also worthy of mention and this business is now firmly focussed on delivering the Leyland DAF DROPS programme and become DSG's Centre of Excellence for this major platform.

DSG Colchester experienced increased demand from its customers across a range of vehicle platforms and DSG is firmly embedded as the In Barracks Equipment Support (IBES) provider at Colchester, Aldershot, Bordon and Wattisham as well as at Kinnegar in Northern Ireland. Of particular note during the year, the employees at Colchester must take pride in producing an outstanding performance in delivering the Weapon Mounted Installation Kit (WMIK) project, which saw 142 operational vehicles returned to a very satisfied customer.

DSG Stafford's performance during the year was dominated by work generated by UORs and Conflict Prevention Fund activities, supplying equipment, including Hercules airdrop platforms, and containerised systems for all three Services. In addition, the Air ComMoDities IPT is moving considerable quantities of Ground Support Equipment to MOD Stafford, which they will use as a hub to rotate equipment for DSG to service and repair, prior to deployment. The year also saw employees at DSG Stafford carry out essential repair and restoration work on a key component on the aircraft used by the Red Arrows display team.

DSG St Athan Large Aircraft Business Unit

DSG's Large Aircraft Business Unit (LABU) at St Athan has, once again, turned in another outstanding operational performance despite significant changes to workload, which emerged as a result of additional inspections across the VC10 fleet. By increasing turnover and further reducing operating costs, this DSG business makes a major contribution to DSG's overall improved in-year business performance. All the employees within LABU should be justifiably proud of their achievements over many years supporting the VC10 fleet.

With the anticipated Out of Service Date for the VC10 drawing ever closer and the cessation of the Javelin Green contract with BAE Systems, for whom DSG St Athan carries out all maintenance and repair activity on this fleet, expected in December 2010, work is underway to explore what opportunities and options exist for this valuable DSG business and its employees.

"I know how important it is for our troops to have vital equipment that is maintained to the very highest of standards. The work done by everyone here at DSG Catterick is crucial in the support of our Armed Forces and I know this is greatly appreciated by the troops at the Front Line."

THE RT HON WILLIAM HAGUE MP
Local Richmond MP, on a visit to DSG Catterick

DSG Sealand and Donnington – Electronics and Components Business Unit

DSG's Electronics and Components Business Unit (ECBU) extends across both the Sealand and Donnington sites where a significant drop in the order book was experienced during the year. From our Sealand site, the ECBU continues providing strategic support to platforms, which include Tornado, Chinook and Lynx currently on operations and equally significant through the forward deployment of our specialist technical employees to both Afghanistan and Iraq from the DSG Donnington site.

The ECBU continues to work as a full partner in the Total Support Solutions alliance with industrial primes with the aim of delivering an optimised avionic support solution. Major activity is also underway looking at embedding DSG as the strategic supplier for the Commodity Availability Procurement Strategy solution, which accounts for around 35% of DSG Sealand's current volume. DSG is also working at the highest levels exploring opportunities for a future DSG role in the Typhoon and Joint Combat Aircraft support strategies.

Early in the financial year ECBU signed a two-year contract with the Theatre and Formation Communications Systems (TFCS) IPT for the calibration of Rubidium clocks, which are fitted to Cormorant. This is a secure, digital, state of the art wide area communications system used by the Army.

The first visit to a DSG site by the Minister for Defence Equipment and Support, Quentin Davies took place at Sealand in February 2009. The Minister showed great interest in the work that is undertaken at Sealand and praised the employees for their innovation and ability to challenge conventional solutions.

“In the highly technical field of avionics it is heartening to witness such enthusiastic employees who all share a common goal, while taking great pride in what they are doing in support of our Armed Forces.”

QUENTIN DAVIES MP
Defence Equipment and Support Minister, on his visit to DSG Sealand

SUPPORT FUNCTIONS OVERVIEW

All DSG's functional support areas have maintained a high tempo of activity aimed at delivering a harmonised and unified business with a single shared vision. The unifying factor that impacts every element of DSG is the Transformation Programme, DART.

Every DSG Board Director is responsible for delivering measurable outputs from DART and this covers all areas in DSG from Finance and HR through to Commercial, Strategy and Operations. Under DART, the DSG Trading Fund Board approved the goal of securing a 20% efficiency improvement over the first five years of DSG's operation and identified the initial areas for business focus – efficiency, corporate overhead and materials and spares purchase price variation improvements.

In its first year of operation everyone in DSG can take great pride in what has been achieved so far. Delivering in excess of £10m savings, reducing costs, increasing efficiencies and implementing more robust and credible financial and business performance reporting processes are laudable achievements within the first twelve months of operation. Add to these achievements, implementation of a DSG-wide Customer Review Programme, a streamlined corporate structure, agreement on three separate pay deals and dates for alignment of employee terms and conditions, as well as a business-wide Continuous Improvement Programme and it is clear the pace of activity has been both rapid and effective.

No transformation programme could hope to succeed without a workforce that is willing to embrace change and adapt to meet the major challenges that any business faces when it embarks on such a significant journey. DSG has now established a single DSG Agency Whitley constitution, which was agreed with the various representative Trades Unions (TU) and the inaugural meeting took place on 30 October 2008. Work is now continuing with the TU officials over how a partnership arrangement might operate in DSG as it is vital that the business works with the employees' representatives in the most constructive and beneficial way for the future of both the DSG business and its employees. The total number of working days lost due to sickness was 28,790 which equates to 9.1 days per employee, which compares favourably to MOD's industrial figures.

FINANCIAL PERFORMANCE REVIEW

2008/09 was the first year of trading for DSG following its formation on 1 April 2008.

Overall, DSG's financial performance exceeded its plan with an Operating Profit of £9.6m, a considerable improvement on the plan of £6.1m.

TRADING RESULTS

DSG achieved turnover close to plan. Costs, principally in the corporate areas, were below plan and delivered the better than plan profit.

The financial performance was after providing in the Accounts for a £4.6m retrospective rebate to the MOD customer which has arisen by way of an adjustment to provisional prices charged throughout the year as costs have been contained at a lower level than planned.

The Return on Capital Employed achieved was 9.22%.

CASH FLOW AND FUNDING

The capital structure of DSG on formation was defined in the DSG Establishment as a Trading Fund Entry Terms document. This provided for DSG to retain the balance of ABRO and DARA Public Dividend Capital (PDC) and Government Loans, with the previous loans being replaced by a single 20 year loan.

At 31st March 2009 DSG had PDC of £23.3m and Government Loans of £31.6m.

Liquidity was strong throughout the year with a closing net cash position at 31st March 2009 of £44m, which was higher than planned due to good control of working capital.

CAPITAL INVESTMENT

Expenditure on capital projects amounted to £2.1m during the year.

DIVIDEND

DSG paid a dividend of £5.2m to the MOD during the year.

STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

Under section 4(6) of the Government Trading Funds Act 1973, HM Treasury has directed the Defence Support Group (DSG) to prepare for each financial year a statement of accounts in the form and on the basis set out in the Accounts Direction. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of DSG and of its profit and loss, recognised gains and losses and cash flows for the financial year.

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

– observe the Accounts Direction issued by HM Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;

– make judgements and estimates on a reasonable basis;

– state whether applicable accounting standards as set out in the Government Financial Reporting Manual have been followed, and disclose and explain any material departures in the financial statements; and

– prepare the financial statements on a going concern basis.

The Accounting Officer of the Ministry of Defence has designated the Chief Executive of DSG as Accounting Officer for the Trading Fund. The responsibilities of an Accounting Officer include responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding DSG's assets, are set out in Managing Public Money published by the HM Treasury.

As far as I am aware, there is no relevant audit information of which DSG's auditors are unaware and as Accounting Officer, I have taken all the steps that ought to have been taken to make myself aware of any relevant audit information and to establish that DSG's auditors are aware of that information.

Archie Hughes
Chief Executive and Accounting Officer
29 June 2009

STATEMENT ON INTERNAL CONTROL

SCOPE OF RESPONSIBILITY

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of DSG's policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting.

As Chief Executive of DSG, I am personally accountable to the Secretary of State for Defence for the performance of DSG in accordance with the Framework Document and DSG's Corporate Strategic Plan. The DSG Owners Advisory Council, chaired by the Minister for Defence Equipment and Support as representative of our owners, meets quarterly to review DSG's performance against its key targets and Business Plan objectives.

THE PURPOSE OF THE SYSTEM OF INTERNAL CONTROL

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of DSG's policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place in DSG for the year ended 31 March 2009 and up to the date of approval of the annual report and accounts, and accords with Treasury guidance.

CAPACITY TO HANDLE RISK

The DSG Board has provided leadership to the risk management process through the regular consideration of risk, at The Trading Fund Board, The Executive Management Board and in the Executive Governance Review Group and Audit Committee meetings, and by the risk management strategy and policy.

Our procedures for corporate and business unit risk registers, together with our implementation of risk management for major projects, continues to ensure that risk management is embedded in all our business activities. We are continually assessing the approach to risk management, to ensure that all business units and projects continue to operate within Treasury guidelines. The risk management software previously introduced into DARA has been upgraded and is now being rolled out throughout all the business units and support directorates. Additional training for all business units has been organised along with supplementary training on the reporting mechanisms.

THE RISK AND CONTROL FRAMEWORK

DSG complies with HM Treasury instructions and guidelines for Corporate Governance. In order to meet the requirements of an embedded system of internal control, DSG has established a risk management system, which consists of:

- A Risk Management Strategy, which incorporates the aims, objectives and rationale within DSG for managing risk.
- A Risk Management Policy, which outlines the approach used within DSG for implementing risk management and includes a risk management reporting structure.
- Appointed Risk Management Committee, which reviews and evaluates internal standards and procedures relative to the management of risk and disseminates risk information and guidance on best practice.
- Appointed Risk Co-ordinators within each business unit and directorate who are responsible for the maintenance of local risk registers.
- A DSG Corporate Risk Register, which represents the broad spectrum of corporate risks and is owned and regularly reviewed by the DSG Boards.
- Business Continuity Plans, which are managed by the Business Continuity planners to facilitate the unity of risk management and business continuity. All DSG sites have reviewed their Business Continuity Plans in 2008/09, and are being redrafted in accordance with the DSG Business Continuity Manual action plan.
- Insurance policies are in place to meet DSG's legal responsibilities and to mitigate certain risks. No insurance is taken against any potential liabilities to the MOD.
- Information Risk, DSG as part of the merger process is consolidating its information management systems, including the protection of electronic data and there have been a number of recent audits and reviews in this area. There has been no loss of data or unauthorised release or loss of personal data. Policies and procedures controlling the storage of information and access to the IT systems are being revised to accommodate the DSG policies and uploaded into the new DSG Business System, where all policies and procedures are held.
- Internal Audit Services provide an annual risk and compliance based programme of internal audits. During 2008/09, in addition to the audit of the Key Targets, there were six major risk based audits completed, four of which gained substantial assurances and two limited assurance. In addition there were four workshop audits completed, all of which achieved substantial assurances. The Executive Governance Review Group ensure that all accepted recommendations from these audits are implemented within three months.

REVIEW OF EFFECTIVENESS

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within DSG who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I have received satisfactory letters of assurance from executive managers and the DSG Governance Review Group. The Board and the Audit Committee have advised me on the implications of the result of my review of the effectiveness of the system of internal control.

Plans to address control weaknesses and ensure continued improvement of our processes are in place.

DSG has established the following processes to identify evaluate and control risk:

- A Trading Fund Board, which meets 5 times a year to consider the plans and strategic direction of the organisation, comprising the Executive Directors of DSG and four external non executive directors, one of whom is Chairman of DSG, one is the Chairman of the Audit Committee, and another is Chairman of DSG's Remuneration Committee.

- An Executive Management Board which meets every month and controls the strategic direction of the organisation, generates and reviews the corporate plans and reviews the Corporate Risk Register.

- A Governance Review Group, which comprises all Executive Board members together with the Head of Internal Audit and other key personnel as required. The primary purpose of the Governance Review Group is to monitor and review all assurance activities being undertaken within DSG. The group also aims to further develop Corporate Governance practices in general.

- Periodic reports from the Chairman of the Audit Committee, to the Board, concerning internal control.

- Regular reports from each Directorate as part of the performance management regime. An assessment of the key risks and their management/mitigation is included in these reports.

- DSG employees and the Board fully understand the Department's approach to Corporate Governance and the management of risk. This approach has produced a robust risk methodology using subjective assessments of Very High/High/Medium/Low/Very Low risks against the impact of a particular risk to DSG objectives as well as a likelihood of the risk maturing. These assessments are updated regularly and form the basis of the decision making process at the Board.

- Risk Registers are owned, maintained and managed by the business units and support directorates with a Strategic Risk Register owned and managed by the Board. The Risk Manager reporting through the Head of Internal Audit to the Finance Director has responsibility for coordinating and managing the Risk Management process.

- DSG risk management structure has been designed to ensure that information is communicated upstream and downstream within the organisation. Risk management is included as a regular agenda item at site and directorate meetings with links into the Business Continuity Plans. The risk management software, Active Risk Manager (ARM), is fully functional and reports are generated and issued to management to facilitate the control and mitigation of the risks.

INTERNAL CONTROL WEAKNESSES

For the financial year 2008/09, the internal audit process did not identify any areas of significant control weakness. The Interim Management Letter from the National Audit Office identified issues relating to Work In Progress (WIP) reconciliations and goods received not invoiced accounting which were not fully resolved by the year end and will require further attention during 2009/10. During the transformation process there will be a period of uncertainty and it is recognised that there will be new risks arising that will need careful management and control, but I am confident that our systems of internal control are more than adequate for the task.

Archie Hughes
Chief Executive
29 June 2009

REMUNERATION REPORT

REMUNERATION COMMITTEE

The purpose of the Remuneration Committee is to agree the strategic policy in relation to the remuneration of DSG employees, consistent with the Personnel Delegations held by the Chief Executive of DSG.

The remuneration of all DSG employees except Senior Civil Servants (SCS) is set by the Remuneration Committee in agreement with HM Treasury.

The Remuneration Committee consists of the independent non-executives of DSG's Board with the Human Resources Director in attendance in an advisory capacity. One of the non-executive directors is appointed to act as Chairman and other executive directors are invited to attend meetings to assist the committee in their deliberations as appropriate. The committee met as required during the financial year and all recommendations arising from the committee have been implemented.

The committee continues to make a positive input to the strategic direction of DSG pay settlements prior to ratification by the DSG Board which this year included endorsement of the framework for the employee corporate bonus scheme.

REMUNERATION POLICY

The Chief Operating Officer, Commercial Director, Finance Director and Human Resources Director are SCS. As such their pay is set through recommendations made by the Review Body on Senior Salaries. The Review Body on Senior Salaries provides independent advice to the Prime Minister and the Secretary of State for Defence on the remuneration of SCS taking account of evidence it receives about wider economic considerations and the affordability of its recommendations. Further work about the work of the Review Body can be found at www.ome.uk.com.

All other employees have their remuneration determined by a process consistent with MOD and Treasury regulations. The Chief Executive has delegated powers for the setting of terms and conditions of employment, including pay, for all DSG employees. This delegation requires him to consult with the MOD and HM Treasury before agreeing to any changes to pay and grading systems and arrangements. This is achieved through the pay remit process whereby the DSG Pay Strategy is submitted for MOD and HM Treasury approval before negotiation with staff representatives. The outcome of negotiations is reported back to HM Treasury through the annual outturn statement.

The DSG Pay Strategy is approved by the DSG Board and Remuneration Committee and is designed to achieve the Corporate Business Strategy having due regard to the financial success of DSG, current Government and MOD policies and targets, and public sector pay guidance.

Performance Pay is dependent firstly on DSG meeting agreed Key Targets at a corporate level and then on individuals meeting agreed targets cascaded from the Corporate Plan. Achievement is determined by individual assessment within the line management chain. Pay and changes to conditions of services are approved by the DSG Board and Remuneration Committee prior to the annual pay negotiating process with the Trades Unions and reviewed after implementation.

All pay awards are subject to the satisfactory performance of the duties assigned.

SERVICE CONTRACTS OF DIRECTORS

Directors who are members of the SCS hold appointments that are open-ended and made in accordance with the Civil Service Commissioner's Recruitment Code. This requires appointment to be on merit and based on fair and open competition, but also includes the circumstances when appointments may otherwise be made. Further information about the work of the Civil Service Commissioners can be found at www.civilservicecommissioners.gov.uk. Members of the SCS recruited or promoted to the grade before 2 April 1990 have a 3 month notice period, members recruited or promoted to the grade after this time have a 1 month notice period.

Early termination of an executive director's appointment, other than for misconduct, would result in the individual receiving compensation as set out in the Civil Service Compensation Scheme. Details of the Civil Service Compensation Scheme can be found at www.civilservice-pensions.gov.uk

Archie Hughes was appointed as Chief Executive of DSG on a fixed term contract which is due to expire in July 2011. Compensation for early termination, other than for misconduct, would be in accordance with the Civil Service Compensation Scheme.

Non-executive directors are appointed for a fixed term and are not appointed as civil servants. Contracts 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 contracts may be extended by mutual agreement.

Remuneration for non-executive directors is set at a fixed annual rate determined by the Department's Permanent Under Secretary. Fees are set on the basis that the role should require around 40 days work per year. This excludes the non-executive director representing the interests of the MOD's Finance Director whose services are not charged to DSG. Non-executive directors 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.

REMUNERATION DETAILS OF DIRECTORS (AUDITED)

	2008/09		2007/08	
	Gross Salary Bonuses and allowances[1]	Performance Bonus as a percentage of Total Remuneration	Gross Salary Bonuses and allowances	Performance Bonus as a percentage of Total Remuneration
Executive Directors	£'000	%	£'000	%
Archie Hughes Chief Executive	235-240	35	295-300	42
John Reilly Chief Operating Officer	110-115	10	105-110	7
Steve Hall Finance Director	70-75	12	70-75	11
Derek Owen Human Resources Director	90-95	10	90-95	9
Alan Lewis Commercial Director	90-95	10	90-95	9
Keith Norris Strategy Director	75-80	11	N/A[2]	N/A[2]
David Mather Director Land Operations (to 31 December 2008)	90-95	N/A	110-115	N/A

SALARY

[1] Gross salary includes: salary; performance pay or bonuses; reserved rights to London Weighting or London allowances; recruitments and retention allowances; travel and subsistence allowances and any other allowance to the extent that it is subject to UK taxation.

[2] This position was resourced and remunerated by the Ministry of Defence.

PENSION BENEFITS

	Accrued Pension at age 65 as at 31/03/09 and related lump sum	Real increase in pension and related lump sum at pension age	CETV at 31/03/09	CETV at 31/03/08[1]	Real increase in CETV	Employee contribution to partnership pension account[2]
	£'000	£'000	£'000	£'000	£'000	£'000
Archie Hughes	10-15	0-2.5	146	110	23	–
John Reilly	35-40 Plus lump sum of 105-110	0-2.5 Plus lump sum of 0-2.5	743	685	2	–
Steve Hall	15-20 Plus lump sum of 105-110	0-2.5 Plus lump sum of 0-2.5	259	233	4	–
Derek Owen	30-35 Plus lump sum of 50-55	0-2.5 Plus lump sum of 0-2.5	757	700	–	–
Alan Lewis	20-25 Plus lump sum of 60-65	0-2.5 Plus lump sum of 0-2.5	391	353	6	–
Keith Norris	25-30 Plus lump sum of 75-100	0-2.5 Plus lump sum of 0-2.5	530	468	20	–
David Mather (to 31 December 2008)	10-15 Plus lump sum of 0-2.5	0-2.5 Plus lump sum of 0-2.5	178	155	5	–

1 The figure may be different from the closing figure in last year's accounts. This is due to the CETV factors being updated to comply with The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008.

2 There were no contributions to partnership pension account.

Civil Service Pensions

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies. The figures include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the Civil Service pension arrangements. They also include any additional pension benefit accrued to the member as a result of their buying additional pension benefits at their own cost. CETVs are calculated in accordance with The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations and do not take account of any actual or potential reduction to benefits resulting from Lifetime Allowance Tax which may be due when pension benefits are taken.

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

Further details relating to the Civil Service pension arrangements can be found in Note 5 to these accounts and at the website www.civilservice-pensions.gov.uk

None of the directors have opted for a Partnership Account. Therefore there are no employer contributions to such accounts in respect of these directors.

None of the directors have received a payment of compensation for loss of office under the terms of an approved compensation scheme and no awards or compensation have been paid to former directors.

None of the directors have remuneration packages containing non-cash elements. No payments have been made to third parties for the services of a director.

Non Executive Directors	Fees 2008/09 £'000	Fees 2007/08 £'000
Jamie Pike	40-45	40-45
Michael Jones	20-25	20-25
Richard Holroyd **(to 31 December 2008)**	15-20	20-25
David Barrass	20-25	15-20
Terence Jagger[1]	0	0
Andy Akerman **(to 30 June 2008)**	–	5-10

[1] This position is resourced by the Ministry of Defence.

Approval

The Directors' Remuneration Report has been approved by the DSG Chief Executive.

Archie Hughes
Chief Executive
29 June 2009

THE CERTIFICATE AND REPORT OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSES OF PARLIAMENT

I certify that I have audited the financial statements of the Defence Support Group for the year ended 31 March 2009 under the Government Trading Funds Act 1973. These comprise the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement and Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

RESPECTIVE RESPONSIBILITIES OF THE DSG, CHIEF EXECUTIVE AND AUDITOR

DSG and the Chief Executive as Accounting Officer are responsible for preparing the Annual Report, which includes the Remuneration Report, and the financial statements in accordance with the Government Trading Funds Act 1973 and HM Treasury directions made thereunder and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's Responsibilities.

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

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Government Trading Funds Act 1973 and HM Treasury directions made thereunder. I report to you whether, in my opinion, the information, which comprises, the Statement by the Chief Executive, Business, Mission, Vision and Strategy, Performance against Key Targets, the Financial and Business Performance Review and the unaudited part of the Remuneration Report, included in the Annual Report, is consistent with the financial statements. I also report whether, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

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

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

I read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises the Statement by the Chief Executive, Business, Mission, Vision and Strategy, Performance against Key Targets, the Financial and Business Performance Review and the unaudited part of the Remuneration Report. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

BASIS OF AUDIT OPINIONS

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

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

OPINIONS

In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Trading Funds Act 1973 and directions made thereunder by HM Treasury, of the state of DSG's affairs as at 31 March 2009 and of its profit, recognised gains and losses and cashflows for the year then ended;

- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Government Trading Funds Act 1973 and HM Treasury directions made thereunder; and

- information, which comprises the Statement by the Chief Executive, Business, Mission, Vision and Strategy, Performance against Key Targets, the Financial and Business Performance review and the unaudited part of the Remuneration Report, included within the Annual Report, is consistent with the financial statements.

OPINION ON REGULARITY

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

REPORT

I have no observations to make on these financial statements.

Amyas C E Morse
Comptroller and Auditor General
National Audit Office
151 Buckingham Palace Road
Victoria
London
SW1W 9SS
30 June 2009

The maintenance and integrity of the DSG website is the responsibility of the Accounting Officer; the work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the Financial Statements since they were initially presented on the website.

PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 MARCH 2009

	Note	2008/2009 £'000	2007/2008 £'000
Turnover	2	226,672	201,856
Cost of sales	3	192,121	177,399
Gross profit		**34,551**	**24,457**
Operating expenses	3	24,926	23,050
Operating profit		**9,625**	**1,407**
Loss on disposal of fixed assets	3a	163	77
Exceptional release of provisions	3a	–	(1,126)
Exceptional costs	3a	224	506
Profit on ordinary activities before interest		**9,238**	**1,950**
Interest receivable		734	3,942
Interest payable	4	1,512	3,038
Profit on ordinary activities before dividend		**8,460**	**2,854**
Dividend paid		5,200	8,700
Retained Profit/(Loss)		**3,260**	**(5,846)**
Return on capital employed (ROCE)		**9.22%**	

All operations reported above are continuing.
The notes on pages 44 to 57 form part of these accounts.

BALANCE SHEET AT 31 MARCH 2009

	Note	31 MARCH 2009 £'000	31 MARCH 2008 £'000
Fixed assets			
Tangible	7	52,696	54,486
		52,696	**54,486**
Current assets			
Stocks & work in progress	8	25,362	21,712
Debtors and prepayments	9	47,465	71,409
Cash at bank and in hand	10	44,006	65,491
		116,833	158,612
Current liabilities			
Creditors: amounts falling due within one year	11	(67,998)	(168,279)
Net current assets/(liabilities)		**48,835**	**(9,667)**
Total assets less current liabilities		**101,531**	**44,819**
Provisions for liabilities and charges	12	(555)	(67)
Net assets		**100,976**	**44,752**
Financed by: Capital and reserves			
Public dividend capital		23,324	–
Long-term loans	13	29,955	–
Revaluation reserve	14	27,294	28,149
General reserve	15	20,403	16,603
Government funds		**100,976**	**44,752**

The notes on pages 44 to 57 form part of these accounts.

Archie Hughes
Chief Executive
29 June 2009

The above date is the due date authorised for issue, being the date of despatch by the Trading Fund's Board, to the Comptroller and Auditor General, for laying before the Houses of Parliament.

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 MARCH 2009

	Note	2008/2009 £'000	2007/2008 £'000
(a) Reconciliation of operating profit to net cash inflow /(outflow) from operating activities:			
Operating profit		9,625	1,407
Permanent diminution of fixed assets		380	362
Depreciation and impairment charges		2,842	2,757
Increase/(decrease) in Provisions for liabilities and charges		488	(256)
Exceptional costs		(224)	(506)
Increase in stock & WIP		(3,458)	(2,250)
Decrease/(increase) in debtors		23,944	(1,661)
(Decrease)/increase in creditors		(46,886)	12,751
Net cash (outflow)/inflow from operating activities		**(13,289)**	**12,604**
(b) Cash flow statement:			
Net cash (outflow)/inflow from operating activities		(13,289)	12,604
Dividend paid		(5,200)	(8,700)
Returns on investments and servicing of finance	16a	(778)	904
Capital expenditure	16a	(2,102)	(1,246)
Financing	16a	(116)	(6,994)
(Decrease) in cash		**(21,485)**	**(3,432)**
(c) Reconciliation of net cash flow to movement in net funds:			
Decrease in cash	16b	(21,485)	(3,432)
Decrease in borrowings		23,440	6,994
Movement in net funds	16b	1,995	3,562
Net funds at start of year		10,432	6,870
Net funds at end of year	**16b**	**12,387**	**10,432**

The notes on pages 44 to 57 form part of these accounts.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDED 31 MARCH 2009

	2008/2009 £'000	**2007/2008** £'000
Profit for the financial year	8,460	2,854
Revaluation deficit charged/surplus credited to the reserves	(315)	4,842
Transfer out of revaluation reserve	(540)	(225)
Transfer into general reserve	540	222
Total recognised gains and losses relating to the year	**8,145**	**7,693**

RECONCILIATION OF MOVEMENTS IN GOVERNMENT FUNDS

	2008/2009 £'000	**2007/2008** £'000
Government funds at 1 April	44,752	162,526
Dividend paid	(5,200)	(8,700)
Total recognised gains and losses relating to the year	8,145	7,693
Movements in long-terms loans	29,955	(55,059)
Movement in Public Dividend Capital	23,324	(61,708)
Net movement in Government funds	**56,224**	**(117,774)**
Balance at year end	**100,976**	**44,752**

The notes on pages 44 to 57 form part of these accounts.

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2009

1 ACCOUNTING POLICIES

Basis of accounting

The accounts have been prepared in accordance with the FReM issued by HM Treasury, which provides guidance on the application of generally accepted accounting practice in the United Kingdom to Trading Funds, and the Accounts Direction issued by the Treasury. The particular accounting policies adopted by DSG are described below. They have been applied consistently in dealing with items considered material in relation to the accounts.

Transfer of Functions

On 1 April 2008 the finance functions of ABRO and DARA were brought together with merged accounting. The comparative figures for 2007/08 have been restated to include the whole of ABRO and the continuing operations of DARA as if they had been operating as DSG throughout the current and prior accounting period. Net Assets of the merged entity total £44,752k comprising former ABRO net assets of £26,791k and former DARA net assets of £17,961k. The closure of ABRO and DARA required full repayment of all public dividend capital and loans at 31 March 2008 to be replaced by DSG financing structure from 1 April 2008.

Accounting convention

These accounts have been prepared in accordance with the accruals concept and the historical cost convention, modified to account for the revaluation of land and buildings and other fixed assets, at current costs or value to the business.

Turnover

Turnover comprises the invoiced and accrued value of services (excluding VAT and other sales taxes).

TANGIBLE FIXED ASSETS

Basis of Valuation

A professional valuation, in accordance with the Royal Institute of Chartered Surveyors Appraisal and Valuation Standards, was carried out by Fuller Peiser during 2005/06 in the case of assets formerly in the books of DARA and by GVA Grimley in the case of assets formerly in the books of ABRO. The basis of valuation is generally Existing Use except for two sites where Depreciated Replacement Cost was adopted and for those sites where a significant curtailment or reduction in activities was expected and where an open market valuation was adopted.

Fixed Assets are revalued in the years between professional valuations, using the Corporate Financial Controller (CFC) Modified Historic Cost Accounting (MHCA) index.

Land and buildings

Where DSG is the principal beneficial user of Departmental Estate, such estate is treated as an asset of the Trading Fund although legal ownership rests with the Secretary of State for Defence.

Other fixed assets

Plant, equipment, computers and motor transport are capitalised where the useful life exceeds one year and the cost of acquisition exceeds £5,000 excluding VAT. The value of capitalised plant, equipment and motor transport is reviewed annually and adjustments made for technological obsolescence, using the CFC MHCA Index in the relevant periods.

Depreciation

Freehold land is not depreciated. Depreciation on buildings, plant and equipment, motor vehicles and IT equipment is calculated to write off the cost, or valuation, of assets by equal instalments over their estimated useful lives. The lives are periodically reviewed for obsolescence of the assets.

The depreciation rates applied to the main categories of assets are based on the following estimates of useful life.

Buildings	Not exceeding fifty years
Plant & Equipment	Between three and twenty years
Motor Vehicles	Between three and twenty years
IT Equipment	Between three and ten years

Where an impairment loss has occurred with reference to the value in use of an asset, a discount rate of 3.5% has been applied to the cashflows.

Pension costs

Past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS) and Armed Forces Pension Schemes (AFPS) which is non-contributory and unfunded. Although the scheme is a defined benefit scheme, liability for payment of future benefits is a charge to the PCSPS or AFPS appropriately. The cost of pension cover provided is by payments of charges (Accrued Superannuation Liability Charges – ASLC) based on a percentage of salary. Salaries include gross salary, certain performance bonuses and recruitment and retention allowances. It does not include the estimated monetary value of benefits in kind. Payments are made at contribution rates determined by the Government Actuary.

Foreign exchange

All foreign denominated transactions are translated at the average exchange rate for the previous month, being a proxy rate for that ruling at the time of transaction. At 31 March, balances are translated into sterling at a year end spot range. Foreign exchange differences are taken directly to the profit and loss account.

Stock

Stock is valued at the lower of cost (including attributable overheads) or net current replacement cost, if materially different and net realisable value. Net realisable value is the estimated price at which stocks can be sold in the normal course of business after allowing for all costs to bring them from their existing state to a finished condition. Provisions are made to cover obsolescent items. Items are reviewed for obsolescence on a regular basis and at the end of the financial year.

Provision is made where necessary, for obsolete, surplus or defective stocks. The provision is based on 100% provision against the value of any stocks considered obsolete. Provision is also made against any surplus stocks.

Surplus stocks are estimated on the basis of projected consumption using historical trends. Stock is analysed into four categories based on frequency of usage. Any stock balance remaining in the two lowest usage categories after five years projected usage is the subject of a 100% provision less a nominal amount for disposal proceeds.

Work in progress

WIP is valued on the basis of direct labour and indirect production support, plus those business overheads that are directly related to normal levels of production activity. For spares inclusive contracts, the cost of the spares consumed is also included in the WIP valuation. The value is reviewed monthly to reflect the lower of cost or net realisable value and the rates used to value WIP are reviewed, at least annually.

Long term contracts

Long term contract (LTC) balances are stated at costs incurred (net of amounts transferred to cost of sales), after deducting related payments on account. Profit on individual long term contracts is taken only when their outcome can be foreseen with reasonable certainty, based on the lower of the percentage margin earned to date and that prudently forecast at completion, taking account of agreed claims. Turnover on long term contracts is ascertained in a manner appropriate to the stage of completion of the contract.

Provisions

When it is known that a contract is forecast to make a loss, a provision is made at the time the loss is identified. Other provisions represent liabilities of uncertain timing or amount. Provisions are not discounted where the effect of the discount would not be material.

Operating leases

Rentals under operating leases are charged to the profit and loss account as incurred.

Return on capital employed

The basis for calculating return on capital employed is the profit before interest for the year, as a percentage of the average capital employed during the year. Capital employed comprises total net assets (fixed assets at net book value, plus current assets, less current liabilities) and adding back the short term loans provided from government sources.

Provision for bad and doubtful debts

DSG makes provision for bad and doubtful debts based on an aged debtor and specific debt review analysis. Bad debts are written off immediately they are deemed to be irrecoverable.

Value Added Tax

DSG has a single registration for VAT with HM Revenue & Customs and accounts for VAT on an accruals basis.

2 TURNOVER

Turnover is not analysed by market segment because substantially all of the turnover relates to the same class of business: the repair, overhaul and maintenance of equipment.

Turnover is stated net of trade discounts, provisions, VAT and similar taxes. There were no acquisitions or discontinued operations with the majority of turnover arising from UK sources.

Where the substance of the transaction is such that DSG effectively operates as an agent, turnover represents the net revenue receivable.

3 COST OF SALES AND OPERATING EXPENSES

	Note	2008/2009 £'000	2007/2008 £'000
Cost of sales:			
Employee costs	5b	101,869	96,492
Supplies and services consumed		71,834	64,924
Accommodation costs		12,452	12,636
Depreciation and impairment		2,456	2,330
Other administration costs	6	3,510	1,017
Total cost of sales		**192,121**	**177,399**
Operating expenses:			
Employee costs	5b	11,872	10,782
Supplies and services consumed		3,979	2,145
Accommodation costs		511	779
Depreciation and impairment		386	427
Other administration costs	6	8,178	8,917
Total operating expenses		**24,926**	**23,050**
Cost of sales & operating expenses:			
Employee costs	5b	113,741	107,274
Supplies and services consumed		75,813	67,069
Accommodation costs		12,963	13,415
Depreciation and impairment		2,842	2,757
Other administration costs	6	11,688	9,934
Total cost of sales & operating expenses		**217,047**	**200,449**

3a Exceptional items

Exceptional release of Engine Business decommissioning provisions (i)	–	(1,126)
Exceptional costs specific to merger activity	224	506
Loss on disposal of fixed assets	163	77
	387	(543)

(i) The Engines decommissioning provision was released in 2007/08 as it was no longer required upon the sale of the Fleetlands site on 31 March 2008.

4 INTEREST PAYABLE AND SIMILAR CHARGES

	2008/2009 £'000	2007/2008 £'000
On loans wholly repayable within five years	–	3,038
On loans not wholly repayable within five years	1,512	–
	1,512	**3,038**

5 EMPLOYEE NUMBERS AND COST

(a) Employee numbers
The average number of persons employed during the year was:

	2008/2009 Number of employees	2007/2008 Number of employees
Senior management	6	11
Service personnel	18	27
Civilian personnel	3,359	3,298
Agency staff	202	221
	3,585	**3,557**

(b) Payroll costs
In Cost of sales:

	2008/2009 £'000	2007/2008 £'000
Salaries, wages and allowances	76,839	73,298
Social security	5,385	5,227
Pension costs	13,424	12,612
Agency staff	6,221	5,355
	101,869	**96,492**
in Operating expenses:		
Salaries, wages and allowances	9,149	7,940
Social security	585	681
Pension costs	1,330	1,554
Agency staff	808	607
	11,872	**10,782**
Total:		
Salaries, wages and allowances	85,988	81,238
Social security	5,970	5,908
Pension costs	14,754	14,166
Agency staff	7,029	5,962
Total payroll costs	**113,741**	**107,274**

5 EMPLOYEE NUMBERS AND COSTS (CONTINUED)

(c) Pension benefits for civilian employees are provided through the Civil Service Pension arrangements. From 1 October 2002, civil servants may be in one of three statutory based 'final salary' defined benefit schemes (Classic, Premium and Classic Plus). The schemes are unfunded, with the cost of benefits met by monies voted by Parliament each year. Pensions payable under Classic, Premium and Classic Plus are increased annually in line with changes in the Retail Prices Index. New entrants between 1 October 2002 and 30 July 2007 could choose between membership of Premium or joining a good quality 'money purchase' stakeholder arrangement with a significant employer contribution (partnership pension account). New entrants from 30 July 2007 may choose only between a partnership pension and the "Nuvos" occupational pension scheme.

Employee contributions are set at the rate of 1.5% of pensionable earnings for Classic and 3.5% for Premium, Classic Plus and Nuvos. Benefits in Classic accrue at the rate of 1/80th of pensionable salary for each year of service. In addition, a lump sum equivalent to three years' pension is payable on retirement. For Premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike Classic, there is no automatic lump sum (but members may give up (commute) some of their pension to provide a lump sum). Classic Plus is essentially a variation of Premium, but with benefits in respect of service before 1 October 2002 calculated broadly as per Classic. Benefits in Nuvos accrue at the rate of 2.3% of pensionable earnings towards members pensions annually, to a maximum of 75% of final salary.

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

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded defined benefit scheme and it is not possible to separately identify DSG's share of the underlying assets and liabilities. A full actuarial valuation was carried out as at 31 March 2007. Details can be found in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice-pensions.gov.uk).

For 2008-09 employers' contributions of £14,621k were payable to the PCSPS (2007-08 £13,986k) at one of four rates in the range 17.1% to 25.5% of pensionable pay, based on salary bands.

The Scheme's Actuary reviews employer contributions usually every four years, following a full scheme valuation. The contribution rates are set to meet the cost of the benefits accruing during 2008-09 to be paid when the member retires and not the benefits paid during this period to existing pensioners. From 2009-10, the rates will be in the range of 16.7% to 24.3%. Similarly, employers' contributions to the Armed Forces Pension Scheme (AFPS) are determined by the Government Actuary at a rate of 36.3% for Officers and 21.8% for other ranks.

For 2008/2009 employers' contributions of £49k were paid to one or more of a panel of four appointed stakeholder pension providers (2007/2008: £3k). In addition employer contributions of £3k were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service and ill health retirement of these employees. Contributions due to the partnership pension providers at the balance sheet date were £6k (2007/2008: £7k).

3 employees retired early on ill-health grounds; the total accrued pension liabilities in the year amounted to £6k (2007/2008 9 persons – liabilities amounted to £7k).

6 OTHER ADMINISTRATION COSTS

	2008/2009 £'000	2007/2008 £'000
in Cost of sales:		
Travel and subsistence, including vehicle hire	2,904	1,913
IT and telecommunications	136	117
Training, recruitment and consultancy	834	952
Insurance	14	–
Permanent diminution of fixed assets	178	361
Other expenses	2,239	1,339
Cost reimbursement (i)	(2,795)	(3,482)
Movement in provisions	–	(183)
	3,510	**1,017**
in Operating expenses:		
Auditors' remuneration (ii)	137	144
Travel and subsistence, including vehicle hire	808	952
IT and telecommunications	2,948	4,286
Training, recruitment and consultancy	1,593	878
Insurance	1,177	1,770
Permanent diminution of fixed assets	27	1
Other expenses	1,006	978
Gains on foreign exchange	(6)	(27)
Movement in provisions	488	(65)
	8,178	**8,917**
Total:		
Auditors' remuneration (ii)	137	144
Travel and subsistence, including vehicle hire	3,712	2,865
IT and telecommunications	3,084	4,403
Training, recruitment and consultancy	2,427	1,830
Insurance	1,191	1,770
Permanent diminution of fixed assets	205	362
Other expenses	3,245	2,317
Gains on foreign exchange	(6)	(27)
Cost reimbursement (i)	(2,795)	(3,482)
Movement in provisions	488	(248)
Total of Other administration costs	**11,688**	**9,934**

(i) Cost reimbursement shown separately for greater visibility.
(ii) Including non audit fees of £8k for 2008/09 (£5k 2007/08)

7 FIXED ASSETS

The movements in each class of assets were:

	LAND AND BUILDINGS	PLANT MACHINERY AND MOTOR VEHICLES	INFORMATION TECHNOLOGY	ASSETS IN COURSE OF CONSTRUCTION	TOTAL TANGIBLE
	£'000	£'000	£'000	£'000	£'000
Cost or valuation:					
At 1 April 2008	91,446	19,492	1,621	465	113,024
Additions	1,486	330	11	275	2,102
Disposals	–	(263)	–	–	(263)
Permanent diminutions in value	–	(174)	(27)	(4)	(205)
Revaluation (i)	1,308	772	(82)	–	1,998
Reclassification	100	220	5	(325)	–
At 31 March 2009	**94,340**	**20,377**	**1,528**	**411**	**116,656**
Depreciation:					
At 1 April 2008	43,336	14,394	808	–	58,538
Depreciation charged during the year	1,498	917	427	–	2,842
Disposals	–	(100)	–	–	(100)
Revaluation (i)	2,186	548	(54)	–	2,680
At 31 March 2009	**47,020**	**15,759**	**1,181**	**–**	**63,960**
Net book value					
At 31 March 2009	**47,320**	**4,618**	**347**	**411**	**52,696**
At 1 April 2008	48,110	5,098	813	465	54,486

(i) Downward revaluation of £507k is charged against the revaluation reserve with the balance of £175k, being in excess of the reserve held for specific assets, charged to the profit and loss account.

8 STOCKS AND WORK IN PROGRESS

	31 MARCH 2009		31 MARCH 2008	
	£'000	£'000	£'000	£'000
Gross Stocks	12,833		14,822	
Less stock provision	(30)		(1,697)	
		12,803		13,125
Work in progress – net costs incurred		12,559		8,587
Total stocks and work in progress		**25,362**		**21,712**

9 DEBTORS AND PREPAYMENTS

	31 MARCH 2009	31 MARCH 2008
	£'000	£'000
Trade debtors (i)	43,351	38,310
Other debtors (i)	1,346	1,509
Receipt due from sale of Rotary and Components	–	29,058
Bad debt provision	(150)	(7)
Prepayments and accrued income	2,918	2,539
	47,465	**71,409**

(i) Within debtors is a balance of £37,288k for other central government bodies, £708k for Local Authorities, nil for NHS Trusts and £9,468k for bodies external to government, (2007/08 other government bodies £31,241k, Local Authorities £429k, NHS Trusts £12k and bodies external to government £9,851k).

Aged Trade Debt

	NOT YET DUE	30 TO 60 DAYS	60 TO 90 DAYS	90 TO 120 DAYS	120 + DAYS	TOTAL
	£'000	£'000	£'000	£'000	£'000	£'000
At 31 March 09	32,112	7,851	1,296	564	1,528	43,351
At 31 March 08	31,092	5,435	838	421	524	38,310

10 CASH AT BANK AND IN HAND

	31 MARCH 2009	31 MARCH 2008
	£'000	£'000
Cash on short term deposit (i) (ii)	43,700	–
Cash at bank (ii)	301	65,489
Cash in hand	5	2
	44,006	**65,491**

(i) Wherever possible cash is held in interest earning accounts, which are redeemable on demand within one working day.
(ii) Other than cash in hand all deposits at 31 March 2009 were held within a commercial bank.

11 CREDITORS

	31 MARCH 2009 £'000	31 MARCH 2008 £'000
Amounts falling due within one year:		
Trade creditors (i) (ii)	5,891	8,943
Taxation and social security (ii)	8,230	8,579
Accruals (ii)	38,737	19,839
Deferred income (ii)	10,242	13,155
Sundry creditors (ii)	3,234	996
Public Dividend Capital (ii)	–	61,708
Loans payable within 12 months (ii)	1,664	55,059
	67,998	**168,279**

(i) DSG's policy is to pay its suppliers within contracted payment terms or general conditions governing the terms for the type of business undertaken or, in the absence of specially agreed terms, within 30 days of receipt of a valid invoice although it is working towards a 10 day target as directed by HM Treasury.

(ii) Within Creditors is a balance of £29,835k for other central government bodies and £38,163k for bodies external to government, (2007/2008 central government bodies £132,685k, external to government £17,188k).

12 PROVISIONS FOR LIABILITIES AND CHARGES

	LOSS ON CONTRACTS £'000	REVENUE PROVISION £'000	EFFICIENCY AND OTHER £'000	TOTAL £'000
Balance at 1 April 2008	–	23	44	67
Increase in provisions	226	–	266	492
Utilised in year	–	–	(4)	(4)
Balance at 31 March 2009	**226**	**23**	**306**	**555**

The liabilities and charges provided for, all fall due within one year.

The MOD has confirmed that it will continue to meet any liabilities in respect of DSG's redundancy costs, and all operating and termination costs of the Large Aircraft Red Dragon facility at St Athan consequent upon DSG's withdrawal from the Red Dragon facility. Accordingly, no provision has been made for these future liabilities in these accounts.

13 LONG TERM LOANS

	31 MARCH 2009 £'000	31 MARCH 2008 £'000
Loan repayments due within 2 and 5 years	6,657	–
Loan repayments due after 5 years	23,298	–
	29,955	**–**

Amounts repayable within one year are included in creditors – see note 11.

14 REVALUATION RESERVE

	2008/2009		2007/2008	
	£'000	£'000	£'000	£'000
Balance at 1 April		28,149		23,532
Transfer to profit and loss account		–		(3)
Realised element transferred to general reserve		(540)		(222)
Fixed asset revaluations in year (i)	(507)		2,157	
Stock revaluations in year	192		2,685	
		(315)		4,842
Balance at 31 March		**27,294**		**28,149**

(i) Total downward revaluation of £682k has £507k charged against the revaluation reserve with the balance of £175k, being the excess above the level of reserve held for specific assets, being charged to the profit and loss account.

15 GENERAL RESERVE

	2008/2009 £'000	2007/2008 £'000
Balance at 1 April	16,603	22,227
Retained profit/(loss)	3,260	(5,846)
Transfer from revaluation reserve	540	222
Balance at 31 March	**20,403**	**16,603**

16 CASH FLOW STATEMENT NOTE

	2008/2009 £'000	2007/2008 £'000
(a) Detailed analysis of gross cash flows		
Returns on investments and servicing of finance		
Interest received	734	3,942
Interest paid	(1,512)	(3,038)
	(778)	**904**
Capital expenditure		
Assets in the course of construction	–	(22)
Purchase of fixed assets	(2,102)	(1,224)
	(2,102)	**(1,246)**
Financing		
With the MOD:		
Decrease in borrowings	(23,440)	(6,994)
Increase in public dividend capital	23,324	
	(116)	**(6,994)**

(b) Analysis of changes in net funds:	AT 1 APRIL 2008 £'000	CASHFLOW £'000	AT 31 MARCH 2009 £'000
Cash at bank and in hand	65,491	(21,485)	44,006
Debt due within one year	(55,059)	53,395	(1,664)
Debt due after one year	–	(29,955)	(29,955)
Total	**10,432**	**1,955**	**12,387**

17 OPERATING LEASES

Operating profit is shown after charging for operating lease rentals as follows:

	2008/2009 £'000	2007/2008 £'000
Lease of buildings at RAF St Athan (i)	415	350
Lease of vehicles & other equipment (ii)	190	442
Total operating leases paid	**605**	**792**

(i) Contained within note 3 – Accommodation costs.
(ii) Contained within note 6 – Vehicle hire, and Other expenses and within note 3 – Supplies and services consumed.

Commitments in the next financial year (2009/10) are as follows:

Leases expiring within:	LAND AND BUILDINGS £'000	OTHER £'000	TOTAL £000's
One year	107	101	208
Two to five years inclusive	–	107	107
Over five years	180	–	180
	287	**208**	**495**

Expected Rental Receipts in the next financial year (2009/10) are as follows:

Leases expiring within:	LAND AND BUILDINGS £'000
One year	65
Two to five years inclusive	–
Over five years	–
	65

There are no finance leases.

18 COMMITMENTS AND CONTINGENT LIABILITIES

Whilst not yet committed, £808k of capital expenditure has been authorised but not provided for in the accounts as at 31 March 2009. Capital commitments of £91k existed and were not provided for as at 31 March 2008.

A contingent asset may arise under a sales contract ending 31 March 2009 which may result in further receipts in future accounting periods. Whilst DSG has calculated a potential receipt of up to £2.0m this is dependant upon the final costs positions of the other interested parties to the arrangement which are not known and may materially reduce this value considerably.

There are no contingent liabilities at 31 March 2009 (nil at 31 March 2008). Any liabilities concerning environmental pollution are considered to be pre-Trading Fund events and the liability therefore falls to the MOD.

19 FINANCIAL INSTRUMENTS

DSG's treasury operations are governed under the Government Trading Funds Act 1973 (a) as supplemented by DSG's Framework Document and are conducted within a framework of policies, mandates and delegations authorised by the Board and regularly reviewed. DSG's financial instruments comprise cash deposits, debtors, creditors and loans. DSG uses forward foreign currency sales and purchase contracts as derivative instruments when required for risk management purposes only, although none have been utilised during 2008/09. The main purpose of these financial instruments is to finance DSG's operations and DSG has limited powers to borrow or invest surplus funds. The main risks arising from the financial instruments are foreign currency, liquidity and interest rate. DSG's policies for managing these risks are set to achieve compliance with the regulatory framework including the rules contained within Managing Public Money.

Interest Rate Risk

DSG's funding is determined by fixed rate Government loans. There are no floating rate liabilities, and DSG has only one loan with an interest rate of 4.6% fixed for the remaining 19 years of the loan term.

Currency Risk

DSG conducts business in Sterling, US Dollars, Canadian Dollars, Euros and Swedish Krone and is therefore subject to foreign exchange risk. At 31 March liabilities of $180k US Dollars, $183k Canadian Dollars and Kr248k Swedish Krona existed. An adverse movement in foreign currency exchange rates for these currencies would give rise to addition liabilities of £14k, £11k and £2k respectively.

DSG manages this risk by natural hedging and entering into forward foreign exchange contracts where amounts are material. DSG has one active foreign currency bank account which held $298k US Dollars at 31 March 2009. DSG policy states that transactions are translated at the prior month average rate. Year-end foreign denominated net assets have been translated at a year end spot rate.

Liquidity Risk

In excess of 70% of DSG's loans outstanding at the year end are repayable in more than 5 years. Current liquidity throughout the year was strong. Cash at bank is available on demand and short term investments are conducted through the Lloyds TSB Bank plc Money Market.

Counterparty/Credit Risk

DSG's approach is to minimise counter-party risk by only entering into contracts with institutions with long term credit ratings of AA or better.

Capital Management

The financial strategy of DSG supports its aim of sustaining its manufacturing capability and achieving the Return on Capital objectives set by its owner. The key elements of the strategy are:

Sufficient flexibility for the funding of necessary capital expenditure and working capital required for any expansion of the business.

Avoidance of risk and compliance with HM Treasury policies.

Funding of dividend payments as agreed with the owner.

Funding of loan repayment schedules.

The Capital structure of DSG is based on management's judgement of the balancing of all the elements of its financial strategy in order to meet its day-to-day and strategic needs. DSG together with its owner considers the amount of Public Dividend Capital in proportion to Loans and retained earnings and manages the capital structure and makes adjustments to it in the light of changes in economic conditions and risk characteristics of the underlying assets. DSG will take appropriate steps to maintain and if necessary adjust the capital structure.

DSG is not subject to covenants in any of its financing agreements.

Categories of Financial Instruments

Financial Assets

	At 31 March 2009 £'000
Trade, sundry and other debtors	44,697
Cash on short term deposit	43,700
Cash at bank and in hand	306
	88,703

Financial Liabilities

	At 31 March 2009 £'000
Trade and other payables	27,648
Ministry of Defence loans	31,619
	59,267

DSG does not hold any held to maturity investments or available for sale financial assets. For all assets and liabilities amortised cost is a proxy for fair value due to the short term nature of the instrument.

Embedded Derivatives

In accordance with FRS 26 - Financial Instruments: Recognition and Measurement, DSG has reviewed all material contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard. No instances were found that required embedded derivatives to be recognised at their fair value, separately from the non-derivative host contract. For the contracts reviewed, the economic characteristics and risks were closely related to those of the host contract.

20 RELATED PARTIES

The Ministry of Defence (MOD) is a related party. During the year, DSG has had material transactions with the Department and with other entities for which MOD is the parent department. None of the DSG Board members or key managerial staff have any related party interests which may conflict with their management responsibilities.

21 POST BALANCE SHEET EVENTS

There are no post balance sheet events.

22 LOSSES AND SPECIAL PAYMENTS

There were no material losses or any special payments made during the year.

23 REDUNDANCY

Redundancy costs of £7.1m in 2008/09 relating to former DSG employees are funded directly by the MOD.

24 AUDITORS

The Government Financial Reporting Manual (FReM) requires DSG's Annual Report and Accounts to be audited by the Comptroller and Auditor General. DSG's auditor is the National Audit Office (NAO). The cost of this audit is £128,500 (2007/2008 £139,000) and an additional payment is due to this auditor for the restatement of these accounts under International Financial Reporting Standards of £8,000. The Key Targets within the Annual Report and Accounts are audited by the MOD Defence Internal Audit Service.

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