Annual Report and Accounts
2006/2007

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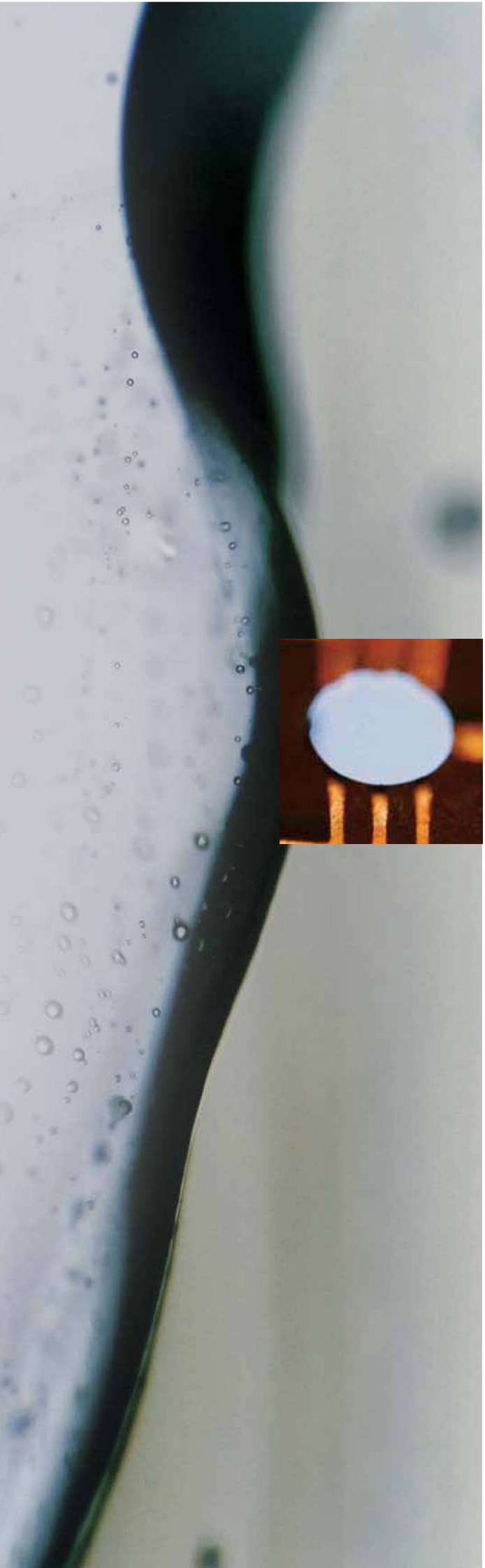

Defence Science and Technology Laboratory

Annual Report and Accounts 2006/2007

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Our Vision, Purpose, Mission and Values

Vision
Our Vision describes the kind of organisation we aspire to be. It is an expression of how Dstl will build a successful future. It addresses what we are passionate about doing, and what motivates us.

Our Vision is to be the indispensable source of Science and Technology at the heart of defence.

Purpose
Our Purpose defines what the organisation is here to do and is a statement of what the Ministry of Defence (MOD), as our Owner, requires from us.

Our Purpose is to deliver value to the UK taxpayer by providing outputs of research, timely advice and solutions to customers' defence and security-related problems.

Mission
Our Mission describes the organisation in terms of the impact we want to make in the world. It reflects how we intend to fulfil our Purpose and achieve our Vision.

Our Mission is to create the winning edge for UK Forces and Government through the best use of Science and Technology.

Values
The type of organisation Dstl becomes corporately, and what will distinguish us from others, will be defined by the way we behave as individuals. Our Values describe the way we behave, day by day:

- supporting each other regardless of position in the organisation
- cherishing knowledge
- commitment to the public interest
- responsiveness
- excellence
- creativity.

Note: on 1 July 2001, in accordance with the Statutory Instrument 2001 No. 1246, the Defence Science and Technology Laboratory (Dstl) was created as a result of the separation of the Defence Evaluation and Research Agency (DERA); Dstl continuing as the Trading Fund.

The work we do

Dstl provides science and engineering-based products, services and expertise to Government on defence and security issues. This work falls into six main product areas:

- decision support
- defence enterprise management support
- support to operations
- innovative capability and systems concepts
- innovative technology exploitation
- science and technology services.

Our work creates the evidence base for major decisions – covering the full range of policy, operational, military capability, scientific and acquisition issues. We support customers in their planning, procurement and risk management activities, and deliver assurance of the science and technology that they exploit.

We work extensively with industry and academia to help understand, develop and evaluate a range of options to meet customers' future capability requirements. We also exploit advances in science and technology to deliver practical solutions to defence and security-related problems in areas of national and international sensitivity.

Our wide-ranging expertise is underpinned by an authoritative understanding of defence policy, complete systems and subsystems and world-class research capabilities. Dstl's unique position within MOD gives us an overview of our customers' problems, across domains and over time, which helps to bring an integrated and coherent approach to our programmes.

The breadth of our work means that our highly skilled and professional workforce is operating at the leading edge of defence science and technology. We are therefore a key source of specialist staff for MOD and Other Government Departments (OGDs) and our people also work on secondment, or interchange, in these organisations.

Chairman's statement

This Annual Report and Accounts is a celebration of the many Dstl successes over the past year, all achieved during a period of great change in the environments in which we operate. We have seen change resulting from MOD's Defence Industrial Strategy and Defence Technology Strategy (DTS), from the merger of the Defence Procurement Agency and the Defence Logistics Organisation to form the Defence Equipment and Support organisation, and internally from our own i lab change programme.

In terms of i lab, it is exciting to see good progress on the new building at Porton Down, which is on course to provide excellent facilities for the Departments relocating there. Despite these changes, the professionalism and technological excellence of our dedicated staff have ensured that we continue to meet the needs of our customers in MOD and OGDs by addressing their key issues – whether short, medium or long term.

Much of our ability to provide this support is derived from research carried out over many years or even decades. One of the key messages outlined in the DTS is that Dstl must maintain the correct balance between the application of research and the research itself. It is not essential, or even desirable, for Dstl to carry out much of the necessary research, but we do have to establish and maintain close links with those who are at the forefront in a wide variety of disciplines. The Board is therefore closely reviewing Dstl's links with industry, academia and other research establishments, both in the UK and overseas, to be confident that the necessary foundations are in place for our future success.

Dstl's Board is rightly charged with ensuring the Trading Fund's financial wellbeing. It is therefore pleasing to report another year in which our financial targets were either met or exceeded. None of this would have been possible without a great deal of hard work by our staff. As we visit different parts of the organisation, my fellow Non-Executive Directors and I continue to be delighted by the enthusiasm of our employees for their work, and their keen interest in placing this work in the wider context of solving customers' most important problems. We thank them for their contribution.

Finally, I would like particularly to thank Frances Saunders for her contribution this year as Chief Executive, giving the strategic direction that will ensure Dstl provides the UK Armed Forces and Government with the world-class scientific expertise and advice they require now and in the future.

Richard Maudslay CBE FREng
Chairman
5 July 2007

Chief Executive's statement

'Dstl is now recognised as a key element in the UK's ability to harness science and technology to pursue its defence and security objectives.'

Dstl is currently undergoing a critical phase in its development. During the six years since Dstl was set up as a separate organisation and Trading Fund, we needed to establish ourselves firmly as MOD's in-house provider of scientific and technology support as well as using our capabilities to take forward the Government's wider security agenda. Our staff rose to these challenges and, as can be seen from the ways in which Dstl is included throughout the DTS, we are now recognised as a key element in the UK's ability to harness science and technology to pursue these objectives.

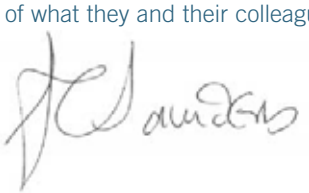
This Annual Report and Accounts highlights just some of the many ways that our work has contributed to defence and security during the year. The many letters of thanks that I receive from military colleagues are also testament to the efforts of Dstl staff in going that extra mile to deliver when it really matters.

However, if we are to remain truly indispensable to our customers we must not only deliver the support that they require today, and make an impact on their current priorities, but we must also develop our knowledge and skills so that we are ready to support them in the future. This is a challenge at any time but with the pressure of continuous military operations, the need for rapid responses to Urgent Operational Requirements (UORs) and the degree of change within the UK defence and security environment, it is particularly so.

We have worked throughout the year to develop further and join up our strategies. This is helping us to build a more complete understanding of our customers' future business requirements and articulate the implications for the skills, knowledge and relationships that must be developed in the longer term. We have also refreshed and refocused our corporate strategy to identify more clearly the critical areas in which we must deliver excellent business results to build our value to MOD.

In parallel, we have also continued to implement our i lab change programme, with major milestones in the development of the physical and information infrastructures being delivered during the year. The i lab programme is even more pertinent today than when it was initiated to help Dstl achieve the levels of responsiveness, excellence in capability and cost effectiveness that our future environment demands. i lab is much more than just another rationalisation programme as it impacts on all aspects of how people work on a day-to-day basis as part of an integrated organisation. It will ensure that we bring together the right team from across the laboratory, reach out into the wider science and technology base and create imaginative solutions for our customers.

Responding to the pressure of these external and internal changes while still delivering our required business results is a significant achievement. All our staff, whether in the operating Departments or Functional areas, have played their part in this success and should be justly proud of what they and their colleagues have achieved this year. I thank them all for their hard work.



Frances Saunders
Chief Executive
5 July 2007

Technical highlights

Future fighting capability

Dstl has made a significant contribution to the Future Rapid Effect System (FRES) programme over the past year.

FRES is the British Army's largest ever land equipment programme and aims to deliver a network-enabled fleet of medium-weight armoured vehicles. The programme is key to Army plans to develop rapid reaction capabilities and replace the ageing manoeuvre support capability currently provided by several armoured vehicle types. Dstl has supported the successful execution of the FRES initial assessment phase, which has included defining the optimum FRES capability and boundary, in terms of performance, time and cost, and identifying and mitigating the associated risks. The FRES team includes Dstl, the MOD customer, the Integrated Project Team (IPT) and a Systems House (Atkins). Dstl has brought to this team key technologies and expertise developed through extensive involvement in related science and technology programmes.

Dstl's contribution has relied on the close working of technologists, systems engineers, analysts and military staff in integrated teams drawn from across the laboratory and under the management of a single point of contact. This approach proved fundamental to the delivery of a co-ordinated programme of support and the efficient exchange of information between Government and industry.

World-leading technology

In a world first, Dstl has developed a new drug that is effective against all seven types of botulinum toxin. Previously, there were no effective medical countermeasures against the effects of Types F and G toxin, while the supplies of antitoxin against Types A to E were limited and liable to cause serious side effects. The antitoxin provides MOD with a unique, operational capability and will save lives if botulinum toxin is ever used as a Biological Weapon (BW) against UK Forces. The product is also finding application in the civilian sector and has been granted a 'specials' licence by the UK's Medicines and Healthcare products Regulatory Agency so that it can be given to patients under clinical supervision. The drug has been supplied to the UK Government's Department of Health and has been used to treat patients suffering from wound botulism. No adverse events have been reported, and these trials should ultimately pave the way for full product licensing.

Sinking the unsinkable

Dstl has helped to develop a remotely operated gun system that will deliver improved safety for ships. The novel gun is based on the DS30B system, currently deployed in Type 23 Frigates and Hunt Class Minehunters, which acts as the primary defence against small boat threats.

Current technology has been limited by the need to relay commands from the Operations Room to crew stationed on deck, offering reduced visibility for the gun controller. The high degree of manual control employed in operating this weapon system also significantly reduces performance.

In trials, the prototype gun system, with an optical sensor fitted on-board HMS Somerset, was controlled from the Operations Room. These trials were so successful that the prototype sank the 'unsinkable' target barge. The system, which will now be fitted to Type 23 Frigates, will provide improved protection for key vessels against asymmetric threats. Dstl has proven the technology in conjunction with a number of manufacturers.

Combating chemical attack

During an attack from Chemical Warfare (CW) agents, surface contamination may occur and this presents a real problem. Any CW agent must then be located and decontaminated before protective measures can be relaxed.

Dstl has devised a novel system based on cost-effective and non-toxic chemicals that can be sprayed onto surfaces. The clear spray produces a coloured solution on contact with CW agents. The colour response to individual CW agents can be tuned to distinguish the harmful substance from a background material, such as camouflage paint. The new system offers many safety benefits over the previous technology, which was abandoned because its key component (benzidine) was shown to cause bladder cancer in humans – the military therefore lost key capability in this area.

The proof-of-principle of the new technology has been established and a wider evaluation is under way. The system could help to maintain the speed of operations in a chemical and biological-contaminated environment by avoiding unnecessary decontamination.

Countering the threat

With terrorist threats against military and security forces becoming ever more sophisticated, science and technology advice is playing an integral part in the planning and prosecution of operations.
One of Dstl's key roles is to support MOD's Counter Terrorism Science and Technology Centre and the wider Counter-Improvised Explosive Devices (C-IED) community. The past year has seen opportunities for all Dstl Departments to contribute to C-IED research and related UORs. This work has included a major capability audit to deliver improved co-ordination and coherence across MOD's C-IED programme.

The audit will help to identify any gaps or overlaps in current activities and will have a key influence on the future direction of the programme. It will also have a significant impact internationally with the formation of the Integrated C-IED Action Group, which aims to establish a common understanding of the threat and to shape future plans.

Over the past 12 months, Dstl has also supported the Counter Terrorism Science and Technology Centre in establishing a series of research projects funded by the C-IED Innovation Fund. These projects are set to continue in the long term, with Dstl in a prominent, supporting role.

Battlefield solutions

In intense desert combat conditions, helicopter engine life can be reduced to as little as 10 hours as sand erodes compressor blades.

Dstl has joined forces with Rolls-Royce, the Helicopter Engine IPT and Joint Helicopter Command to evaluate a potential solution to this problem – a multi-layered titanium nitride coating. Specialists from Dstl provided expertise for laboratory testing and subsequent desert trials on engines in Iraq. Dstl has also acted as MOD's materials expert, ensuring that the IPT had ongoing access to impartial advice.

In these tests, the innovative, ceramic coating increased erosion resistance by more than 400 per cent. Apart from the obvious benefits, the test programme has helped to increase Dstl's capability in compressor erosion and its ability to address future MOD requirements.

Technical highlights

Secrets of the deep

An antibody discovered in sharks could soon find novel applications in the detection of BW agents. Dstl experts have recently teamed up with the United States Army Medical Research Institute for Infectious Diseases and the University of Maryland to exploit this new discovery.

Using recombinant technology, antibody libraries from nurse sharks have been used to produce antibodies against the ebola virus. These antibodies are not only highly specific and sensitive to the virus, but also demonstrate significantly improved heat stability compared with conventional antibodies. Antibodies are the most widely used means of providing timely identification of BW agents and are an essential component of the UK's detection capability. However, current antibodies require cold storage to maintain their performance. This newly discovered class of antibody could reduce or eliminate the need for 'cold chain' supply and storage of reagents – significantly lowering the logistics burden and through-life costs of BW detection equipment. The new technology could also be used to generate antibodies against other BW agents.

Future force structure

Dstl continues to play a key role in supporting MOD on strategic defence planning. The laboratory is currently undertaking the Future Force Structures Study for MOD's Development, Concepts and Doctrine Centre. The aim is to identify and evaluate alternative force structures that could meet the UK's defence needs over the next 20 years in an ever-changing security environment.

Dstl's analysts are examining different scenarios illustrative of military tasks that may be required to support the UK's foreign and security policy. These scenarios are used to assess the potential for different future force structures to meet operational aims in single or concurrent operations. The study is also looking at the impact of factors such as readiness, harmony, force rotation and permanently committed forces.

In the past year, Dstl's work has supported the development of policy guidelines indicating how defence capability should evolve over the next two decades. In the coming year, the output of this work will help shape the strategic guidance that underpins the whole of MOD's planning process.

Support to operations

Supporting front-line activities and troops overseas remains at the heart of Dstl's work. Dstl's deployed Scientific Advisers (SciAds) play a vital role in solving urgent operational problems and providing commanders with access to key decision-support tools.

In December 2006, Dstl was asked to provide urgent modelling expertise to assist with Operation THYME. This operation involved the demolition of the Jameat building in Basra, which housed a rogue Iraqi Police Service unit. Three options were under consideration but UK Forces were concerned about possible

collateral damage to surrounding buildings. Dstl's SciAd in Iraq contacted colleagues in the UK who simulated the options using a collateral damage model. Within hours, the results had been passed to military personnel through the Dstl SciAd. The operation went ahead, taking the model findings into consideration and with only minimal damage to surrounding buildings. The senior officer commanding troops in this region commended Dstl's contribution to the operation.

Attacking the threat

Helicopters play a crucial role in the operational theatre and survivability against hostile attack is therefore a high priority. Many factors influence helicopter survivability in the event of an attack by threat weapons, including mission planning, tactics and the signature of the aircraft. Attack from threat weapons can be averted through the use of sophisticated countermeasures deployed from the helicopter or, if not, the threat can be mitigated through the expert use of lightweight armour, for example.

Dstl has developed a method that helps to optimise these factors and improve survivability. This approach is already delivering significant benefits to UK Armed Forces in Iraq and Afghanistan and is also playing an invaluable role in the acquisition of future helicopters.

Working closely with operational staff, Dstl has developed a tactic to defeat the threat from gunfire. Helicopter crews in theatre have commented that this technology has literally saved lives.

A 'flare' for technology

Dstl has world-class expertise in the field of infrared countermeasures for aircraft platforms. The laboratory's research has led directly to the development of Infrared (IR) flares to defeat threat missiles, and these countermeasures are in use on all UK aircraft.

The IR flares currently being flown on UK helicopters are the result of very rapid pull-through from Dstl research to development and production in industry in around four months. The requirement has been driven by changes in the assessment of the threat and a major fire at one of the suppliers. Dstl worked very closely with UK suppliers to accelerate development and production of the flares. The laboratory's knowledge and advice on design optimisation has played a key role in the process.

Dstl staff have also been deployed, at short notice, to assess the performance of IR countermeasure systems fitted to aircraft in Iraq and Afghanistan, which has helped to deliver improvements and optimise flight operations. Dstl's contribution was commended by front-line commanders, Joint Helicopter Command and by MOD's Chief Scientific Adviser.

Customers and programmes

Our effectiveness as an organisation relies on our ability to ensure that the work we do makes a real difference to our customers' most important issues.'

Peter Starkey, Future Business Director

This year has seen a number of changes in the strategic environment in which we operate. Dstl is playing an important role in responding to these changes and driving through associated initiatives.

Aligning our capabilities

The DTS, which was published in October 2006 and sets out MOD's research and development priorities over the next 20 years, outlines how science and technology (S&T) can be better delivered and exploited to support military capability. Key themes include closer working with industry to enable joint planning and well-targeted S&T investment, an emphasis on Through Life Capability Management (TLCM) and technology insertion, and closer collaboration with universities. The DTS also highlights the need to understand better the optimum balance between undertaking research that develops the science and engineering skills-base and activities that address MOD's immediate need for advice.

Dstl is responding to, and has indeed anticipated, these challenges. We have implemented a continuous Programme Assessment process that covers all Dstl's programmes. This process ensures that activities are aligned with MOD's priorities and with our role, which is to provide independent, high-quality scientific and technological services to MOD, the UK Armed Forces and Government. We are also engaged with the TLCM process, both in terms of embedding our staff within MOD's TLCM implementation team and in supporting the overall approach.

We are undertaking a range of initiatives to increase our engagement with industry and academia. One such example is the Defence Systems Partnerships model. Dstl acts as an interface and facilitator to provide a supportive environment in which MOD, industry and academia can work together to address the most complex systems challenges.

Customer focus

As part of the i lab programme, we have also made good progress in establishing structures and processes that create an effective customer interface and a coherent programme of work that delivers the greatest possible impact. We have developed an account management strategy, currently being implemented, and account management roles and responsibilities have now been identified. Directors and Senior Programme Leaders (SPLs) have been assigned to all key accounts, and the role of the SPL as the primary point of contact for our customer community has been established. The assignment of SPLs to specific strategic relationships has also enabled us to implement a number of targeted engagement strategies, notably with the acquisition community. These changes are already having a positive impact on our customer relations and communications.

Again under the i lab programme, we have reviewed our project management processes, with a view to sharpening our delivery, and these will be updated shortly. We have also introduced three new project management training courses to ensure a consistent approach. A sales order book was launched in March 2007 to provide a more unified way of capturing project-related data. This new tool provides instant visibility of our entire programme of work, and thus enables the rapid identification of individual customer projects.

Our SPLs have developed strategies for their individual domains that capture overall trends and they have also set domain-specific objectives and identified action plans for implementation. These strategies are now being taken forward with Departments and our customer community to align programme formulation and capability development with MOD's priorities and wider domain trends. These efforts will help to ensure that we continue to provide a customer-focused service.

A key challenge is how to safeguard the long-term interests of our customers by meeting emerging needs while continuing to meet current demands.'

Michael Steeden, Technical Director

Technical capabilities and collaboration

Technical capability development

This year, as part of the i lab programme, we have developed a new process for capability development planning, which has been implemented at Group and Department level across Dstl. This is the first time that all of Dstl's Departments have produced capability development plans using a common methodology. We have also completed initial analysis of the priorities for each Department and Group, and the cross-linkages between them.

Building on this analysis, we are now in the process of developing our strategic view of capability needs across Dstl. This takes into account the requirements described in our forthcoming Future Business Strategy and our Senior Programme Leaders' (SPL) domain strategies, and outlines how we anticipate our customers' needs will evolve in the future. We are thereby ensuring alignment between Dstl's capability planning and our programme development and future business activities.

Our Technical Capability Strategy, due for publication in July 2007, will set out how we plan to develop our in-house capabilities and external links to meet these new requirements. As highlighted in MOD's Defence Technology Strategy Balance Study, we are also developing our thinking about the areas where we must conduct research to sustain and enhance the knowledge and expertise that underpin our ability to provide sound advice.

A key challenge is how to safeguard the long-term interests of our customers by meeting emerging needs while continuing to meet current demands, including support to operations and our response to UORs. We must therefore strike a balance between short- and long-term planning and the allocation of intellectual resources. We are currently considering how to meet these competing needs in a way that maximises the benefit to our customers and stakeholders.

The technical benchmarking exercise confirmed Dstl's continuing improvement in a wide range of technical areas, exceeding our three-year target of 72 per cent by achieving 73.1 per cent. However, the exercise also highlighted a number of important strategic issues. These stem from a need to balance long-term planning and implementation against short-term pressures and responsiveness, and they are a central focus of the Technical Capability Strategy. We will continue to monitor the strength of our capabilities in this way through an improved process for technical benchmarking. We have been developing this process in the latter part of the year, with strong guidance from an external review team led by Non-Executive Director Lord May.

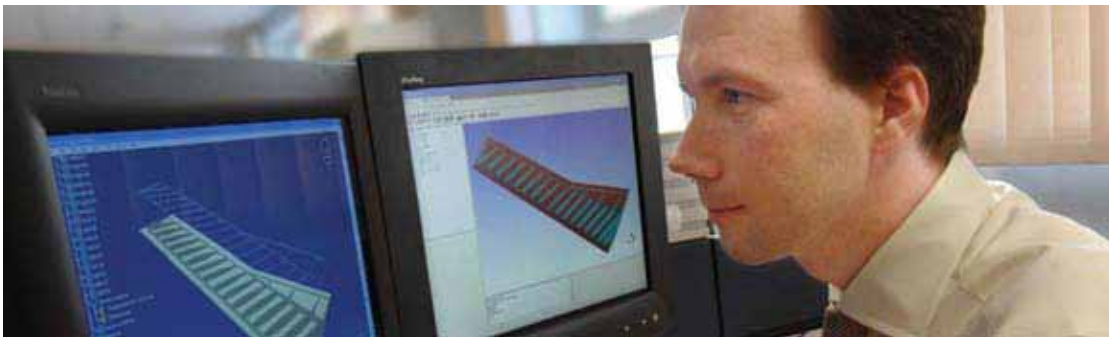
Research collaboration

International links

The Defence Technology Strategy (DTS) emphasises the importance of international research collaboration. Dstl continues to develop and use international research collaborative links through established forums to underpin its capability to deliver MOD programmes. This includes close collaboration with the main European nations, the US, Australia and Canada.

Outstanding collaborative activity under The Technical Cooperation Programme (TTCP) has been recognised by the UK Minister for Defence Equipment and Support – Min(DES). TTCP is a five-nation defence forum that includes representatives from Australia, Canada, New Zealand, the UK and the US. During the year, seven TTCP awards were made to Dstl staff in the areas of Command, Control, Communications and Intelligence (C3I), electronic warfare, human resources and performance, joint systems and analysis, maritime systems, materials technologies and processes, and weapon systems. The awards were made in recognition of significant, scientific work and contributions to defence technology and capability.

Dstl continues to develop the International Technology Alliance (ITA) with US counterparts. This year has seen the launch of the Network and Information Science ITA – a joint MOD/US Army Research



Laboratory-funded fundamental research programme to develop and exploit technologies that are central to NEC and effective coalition operations. This programme will address some of MOD's priority technologies identified in the DTS. Dstl has also agreed a project arrangement with the US (under the US-UK High Cycle Fatigue programme) that provides the UK with access to unique facilities for aircraft engine tests.

Collaborative activity with Swedish counterparts in the chemical and biological domain has focused on developing a new vaccine against tularaemia. In other work, next generation propellants are being developed and tested under a UK, German, French and US programme, which has also involved UK industry. We have also strengthened collaborative activity between the French DGA (the government's Armament Procurement Agency) and Dstl in a number of areas, notably precision engagement and chemical, biological and radiological defence. We are in the process of establishing staff interchange processes between Dstl and the DGA, and sharing information about capability development processes and competencies.

National links

Over the past two years, Dstl has continued to develop strategic links with industry and academia, including interactions at the organisational and working levels between Dstl and UK companies and academia. Dstl has established a number of new co-operation agreements with industry as a framework for developing closer, trusting relationships and confidential information exchange. Future activities will also focus on building external engagement. For example, we are already working with the Research Acquisition Organisation to set up the new Defence University Research Centre on signal processing.

Dstl has continued to support strategic links with the Systems Engineering Innovation Centre (SEIC) – a national centre of excellence based at Loughborough University. A fifth member of staff has been seconded to SEIC and we also held our internal technical symposium there in late 2006. We recognise that one of the most effective ways of improving inter-organisation awareness is through joint working and staff exchange and, over the past year, a number of staff have taken up placements in industry. These include a one-year attachment to BAE Systems' Future Systems Group, which follows the highly successful inward secondment of a systems engineer into Dstl. We have also seconded a member of staff to SBAC (the Society of British Aerospace Companies), and are in negotiations with several other companies on additional staff exchanges.

Many of our links with academia are built on close personal relationships with university research groups, and an increasing number of Dstl's top scientists have been recognised through visiting professorships in the past 12 months.

Professional development

During the year, we have revised the Dstl Fellowship Scheme to create a direct link with career level. Additionally, we have clarified the access routes for all science and technical staff, including those engaged in systems work.

Three new Fellowships have been awarded this year and successful quinquennial reviews for two Senior Fellows and six Fellows took place. We have launched a new Associate Fellowship Scheme, with five initial appointees who have each commenced a two-year tenure. A further five Associate Fellows will be appointed each year.

Finally, the Scheme for Technical Events and Professional Support (STEPS), which is run by new starters for new starters, continues to thrive with many events and networking initiatives. During the past year, the STEPS committee has organised a number of highly successful technical activities, including a two-day event on war fighting experimentation and war gaming, and a conference jointly organised with new starters in QinetiQ.

Technology transfer

'In its first two years, Ploughshare has transformed the technology transfer landscape in Dstl.'

David Harris, Head of Technology Transfer

The knowledge created through the public investment in R&D in universities and Public Sector Research Establishments (PSREs) such as Dstl is a major component of the UK's capital stock. It is UK Government policy that this knowledge should, wherever possible, be transferred to the economy for the fullest possible exploitation of its commercial and social potential.

Since 2005, Dstl's technology management company, Ploughshare Innovations Ltd, has been responsible for ensuring that Dstl's innovative ideas and technologies are exploited by others for this wider purpose, where appropriate. In some situations, this can also bring industry investment in the development of technologies that MOD may have a subsequent interest in purchasing. In its first two years, Ploughshare has transformed the technology transfer landscape in Dstl. The company's business strategy is a balance of investment exercise to maximise its income over the medium term.

Ploughshare Innovations Ltd – exploitation strategy

1 Balancing investment in its resources between:

Licensing Converting as much as possible of the bow wave of opportunities into new licence agreements. The aim is to ramp up regular income as quickly as possible.

Spin-outs/Joint ventures Identifying and spinning out technologies that would best be exploited through a dedicated company or joint venture.

Equity disposal Supporting the value development of existing spin-outs and joint ventures so that prospects for early sales are enhanced.

2 Vital and complementary activities to achieve success

Intellectual Property (IP) pipeline development Stimulating innovation performance in Dstl and improving the pipeline of good ideas using 'rewards to inventors' and proof-of-concept funds.

Controlling IP costs Improving the value for money spent on protecting IP by culling or restricting patents with little or no commercial potential.

In 2006/07, Ploughshare's progress against its principle financial targets was encouraging. Income from licensing rose from £180,000 (in 2005/06) to £283,000, exceeding its budget by £70,000, and expectations are for continued growth in up-front payments, annual fees and royalties. Ploughshare was awarded a grant for capacity building from the Department of Trade and Industry's Public Sector Exploitation Fund (Third Round), which contributed £112,500 of income in 2006/07.

Most significantly of all, however, the first disposal of equity in a Dstl spin-out company took place with the sale of Acolyte Biomedica to 3M Healthcare. Ploughshare's share of the up-front payment to Acolyte shareholders was around £900,000. There may be a further payment made in 2009/10 based on the sale of Acolyte products by 3M Healthcare in that year.

Progress against non-financial indicators portrays a rapidly developing and diversifying business, which is already having an impact in non-defence markets. In 2006/07, Ploughshare signed nine new licence agreements, paving the way for potential royalty income downstream and covering a range of technologies from ceramic armour to microbial assays. Dstl technologies are now commercially available in scanning products for illegal substance detection; cryogenic cooling products for the aerospace industry; sportswear and medical research equipment; telemetry systems; rapid diagnostics for healthcare (eg MRSA); industrial microbiology and drug discovery. Animal health products are in development with industrial partners as well as drug delivery platforms and rapid genetic testing systems.

During the year, Ploughshare set up three new spin-out/joint venture companies (see table on page 15) and this pattern is expected to continue in future years. In the past two years, Dstl and Ploughshare have made 126 payments to Dstl staff for patenting and successful commercialisation of IP through the Rewards To Inventors scheme. Ploughshare also invested a further £100,000 in proof-of-concept work for Dstl ideas, bringing the total invested so far to £388,000.

Spin-out success

Some technologies with great potential are too immature to be licensed for immediate commercialisation and require further development. In some cases, this can be achieved by creating a dedicated spin-out or joint venture company. Dstl invests IP and third-party investors fund R&D and commercialisation activities in exchange for a shareholding in the company.

When the technology is ready for market, Dstl and its shareholding partners will seek to realise a financial return for their investment by selling the company to a trade buyer or through a flotation. Generally, only a minority of spin-outs succeed, but these can generate substantial value for shareholders.

The Acolyte story

In February 2007, Ploughshare Innovations Ltd, Dstl's technology management company, completed the sale of its stake in Acolyte Biomedica Ltd to 3M Healthcare. This represents the first sale of a Dstl spin-out company – a very successful outcome that fulfils the original promise of the IP and proves the effective management of Dstl's interests in Acolyte by the Ploughshare team.

Acolyte was originally formed in 2000 to develop Dstl's bacterial detection technology in medical diagnostics for commercial applications. Initial research focused on proof-of-concept studies for a rapid microbiology system for detecting antibiotic resistance. However, with growing national and global concerns over hospital 'superbugs', the focus of research soon shifted to the development of a specialist product for the MRSA (Methicillin-Resistant Staphylococcus Aureus) detection market.

By early 2004, the company had raised £6.3 million and launched BacLite MRSA the following year. The product can detect MRSA in only five hours whereas conventional methods take 48 hours. The first customer was Salisbury District Hospital in Wiltshire. With an upgraded product introduced in 2006, the company was set for sales and distribution across the UK and Ireland.

Acolyte's next challenge was to refine the product to detect MRSA strains found in other countries and expand sales into new markets. By January 2007, the company had developed a world-leading product for fast, cost-effective MRSA screening with global applications.

Discussions with potential acquisition companies had been under way for some time and the sale of Acolyte to 3M Healthcare was completed in February 2007. Acolyte staff are now in the process of moving the business to 3M Healthcare at its Loughborough site, and will support the company's international business in infection-prevention products. Acolyte is now looking to extend BacLite MRSA to detect other hospital-acquired infections such as VRE (Vancomycin Resistant Enterococci) and sepsis (blood poisoning).

Ploughshare spin-out/joint venture companies (at March 2007)

Company	Technology	Market application
Spin-out/joint venture companies in which Dstl equity was sold in 2006/07		
Acolyte Biomedica Ltd	Adenylate Kinase (AK)	Diagnostic systems for clinical microbiology (eg MRSA)
Existing spin-out/joint venture companies		
Alaska Food Diagnostics Ltd	AK/Phage and AK alone	Food pathogen testing across the supply chain
Enigma Diagnostics Ltd	Rapid polymerase chain reaction	Rapid detection of animal diseases, genetically modified entities, clinical pathogens and diseases
Porton Plasma Innovations Ltd (P2i)	Pulse plasma coatings	Repellent coatings for medical devices, automobile components and consumer-wear markets
Remo Technologies Ltd	Telemetry devices	Implantable and surface-mounted telemetry devices
New spin-out companies set up by Ploughshare in 2006/07		
ProKyma Technologies Ltd	Use of ultrasound to handle micro-particulates (eg bacteria and blood cells)	Sample preparation and cell manipulation (eg in tests for blood grouping)
Barrier Materials Ltd (with Queen's University, Belfast)	Pepgel (water vapour permeable, chemical-resistant materials)	Protective clothing for security and blue light services
Sherwood Therapeutics Ltd (with Nottingham University)	Wound-healing enzymes identified in maggots	Accelerated wound healing and immuno-modulation in healthcare

The integrated laboratory – i lab

The i lab programme is Dstl's major transformational change activity and is designed to unify all aspects of the laboratory. i lab will ensure that we deliver the complete solution to our customers' really important problems – through the excellence of our people, our management and our integrated expertise.

This year, the programme moved firmly into the delivery phase and is now having an impact across the organisation through a range of projects that encompass delivery to customers, technical capability and people management, and the future working environment. We have made real progress in identifying measures against which benefits can be quantified and we have further intensified our communications activities to ensure that staff are kept fully updated, and are actively engaged, in the change process.

The governance of the i lab programme has been reviewed internally by independent auditors PKF and has been subjected to a thorough healthcheck by the Office of Government Commerce. In both cases, the programme received commendation for its management and control.

i lab is much more than a rationalisation project and we can see the influence of the programme across all of our activities. The programme has increasingly become a focus for how we manage the business – that is, in an integrated way with a strong focus on what we need to do well to deliver to our customers. Therefore, this year's Annual Report and Accounts does not include a separate review of i lab activities. Instead, progress on i lab projects is integrated into each section of the report.

'Overall this has been a year of significant progress for the i lab programme and we are well positioned to deliver the consolidated outputs of the projects and the benefits to Dstl as a whole.'

Roy Bexon,
Head of Laboratory Integration

Our people

The achievement of our goals is dependent on a skilled and knowledgeable workforce, comprising people who are highly motivated, strive to maximise their own potential and deliver their very best work, both individually and as part of multi-disciplinary teams.'

Ruth Davies, Human Resources and Communications Director

People continued to be the single most important contributing factor in achieving success for Dstl in 2006/07. Developing outstanding leadership, improving our HR processes and communications channels, building individual capability and preparing for change have been key elements of our people strategy.

Last year, we laid the foundations for improved leadership by clarifying our expectations of managers and reviewing people in the operating Departments against the new role profiles. Following this, under the i lab programme, we recruited and trained new Group and Team Leaders in these Departments. The Functions are now undergoing a similar review to ensure that they too have the right people with the right skills. We are currently benchmarking our senior managers and identifying their development needs. A new suite of management and leadership learning and development modules has been designed to support staff in delivering these requirements.

Workforce planning is now being developed under the i lab programme to look at the future profile of our workforce in order to support capability development. In the past 12 months, we have published a career map, defining both scientific and management paths for progression. We have also refreshed the Career Development Framework and process, helping staff to understand better how to make the transition between career levels. In 2006/07, more than 300 employees successfully achieved an increase in their career level.

Many of Dstl's processes depend on our ability to identify people's skills and knowledge, such as matching people to project requirements. A common set of descriptors has been piloted with the aim of identifying people with specific expertise and ensuring that we can develop capabilities in priority areas.

As part of the i lab programme, we have updated the personal competency framework, which supports the revised Performance and Development Agreement (PDA). The latter encourages managers and their staff to set objectives and regularly discuss achievements and development needs. This year, we have also worked with line managers to develop guidelines to improve the consistency of performance assessment.

In recent months, we have started work on a new Training and Development Strategy. This will continue in 2007/08 and will build on the output of the technical capability planning process to ensure that technical learning and development activity matches current and future needs.

Interchange opportunities provide another excellent way to develop our people. More than 100 employees are currently on secondment to MOD or OGDs. We have worked with MOD to assess the efficiency of our interchange arrangements and review the benefits. We continue to support Departments seeking to enhance their capabilities through outreach, Year in Industry and chartership initiatives.

As we prepare to relocate onto three core sites, communication with staff becomes even more important. We are hosting regular one-to-one meetings and drop-in days for Dstl's Movers as well as providing news updates on our website and information guides. These activities are designed to raise greater awareness about what support is available together with location information for staff and their families.

We have introduced a new cascade briefing process, Team Talk, which has been developed in line with feedback from staff and managers. The intranet has also been refreshed to improve the overall format and accessibility of information.

In the past year, we have recruited more than 150 graduates and continue to improve the range and use of selection tools to identify the best candidates. Staff retention remains healthy and our new central recruitment team will research specific skills' markets and provide strategic solutions to recruitment issues.

Keeping people healthy and safe at work is a high priority. One of our focus areas is to reduce levels of stress in the workplace. The 2006 Health and Safety Executive Stress Management Standards survey indicated that Dstl is 'good/very good' at reducing the causes of stress in the workplace, which compares favourably with other organisations. Dstl aims to continue to deliver improvements in this area in the future. In the past 12 months, we have also restructured the Safety, Health, Environment and Fire (SHEF) team to ensure that all Departments have access to support locally. We are also in the process of improving the SHEF management system and supporting processes.

Finally, our good people-practices were formally acknowledged with re-accreditation to the Investors In People award.

Statement by Dstl Trades Unions

The past 12 months have seen increased activities for the Trades Unions (TUs) as plans under the i lab programme are realised. This has led to some successes that must be balanced against continued uncertainty in other areas.

i lab

Dstl's plans to consolidate its activities onto three core sites are progressing under the i lab programme. The relocation of staff, which is a key part of the programme, continues to have the greatest impact on large numbers of TU members. TU officers are lending their support to groups and individuals to help facilitate a smooth transition and we are also encouraging staff to work with Dstl's 'On The Move' team, which is co-ordinating relocation efforts. The TUs are expecting to become more closely involved in this process once the Posting Letters start to be issued. The unions are continuing to help to manage the changes and seek to match individuals' aspirations with Dstl's business needs.

Management transformation

The TUs support management efforts to transform the careers process. Progress along the line management axis has been promising and the unions look forward to seeing more logical paths for progression on the science and technology axis.

There are growing opportunities for staff to rise to senior levels of Dstl on the basis of technical and scientific merit alone. This should help Team and Group Leaders to strike a better balance between technical and managerial work, and reduce some of the traditional tensions between management and staff. The TUs will help to embed these principles through ongoing work on careers, performance management and pay.

Pay

The four-year agreement negotiated in 2005 has delivered a period of relative stability at a time when public sector and civil service pay has been in a state of flux. The TUs have engaged in early discussions about future plans for the period beyond the four-year deal, and it is hoped that further improvements can be made to Dstl's pay system in a timely manner.

Age discrimination and retirement age

The TUs welcomed legislation that outlaws discrimination on the grounds of age and the right of people to work to the age of 65. However, these changes to the law pose challenges as Dstl adjusts terms and conditions to fulfil its legal obligations. Last year, the TUs stressed their willingness to work with management to help meet these changes, provided that there is no detrimental effect on the workforce. Unfortunately, a change to transfer terms for staff approaching retirement was the subject of our only formal disagreement with Dstl management in 2006/07. This remains in dispute and has been referred to MOD's Whitley Council.

Health and safety

The TUs have continued to work closely with Dstl's management to help maintain a safe working environment. The number of cases of stress in the workplace remains a concern. Following concerns from the TU side, we are working with Dstl on enhancing the way that safety incident investigations are done. We support the move towards a more integrated pan-Dstl SHEF management system. It is hoped that reform of the Site Consultative Committees does not reduce local consultation on SHEF matters.

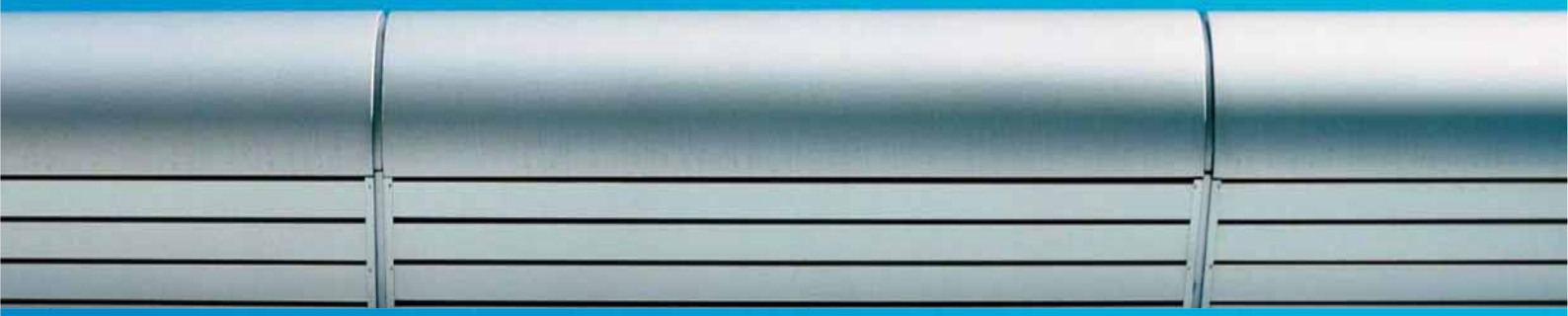
Staff morale

TU officers, by the very nature of their role, deal with problems that arise in the workplace and so it could be argued that their perspective on morale is inevitably rather gloomy. Overall, however, Dstl is a good employer and management tries to work with staff in the vast majority of cases. However, in areas affected by relocation plans, morale is more brittle and will require careful handling in the coming period.

Overall picture

Although staff are now better informed about the i lab programme, and what it means to them as individuals, many are being moved out of their personal 'comfort zones'. This has contributed to a busy year for the TUs, and relocation activities will continue to present us with many challenges in the short and long term.

The future workplace



The environment in which we work, and the equipment and services we use, are the enablers for the cultural change we are looking for under the i lab programme. In August 2006, the Facilities Management (FM) contracts for the three core sites were migrated to Serco. Our FM provider introduced an electronic tool called i-serve to enable staff to access services more efficiently. This was a significant step forward and has generally been well received and further improved in the light of feedback from staff. Some services are also now available to staff on non-core sites.

Construction work on Project INSPIRE, which is the focus for rationalisation activities in the i lab programme, is now well under way at Porton Down and Portsdown West. Good progress has been made and the work is on schedule to deliver as expected. Following discussions with local authorities, we have appointed a Travel Plan Co-ordinator to address issues associated with the remote location of our three core sites and our reliance on motor vehicles.

As part of 'On The Move', INSPIRE's sister project, we have issued 529 Letters of Intent (LOIs) to Movers who are due to relocate to Porton Down and Fort Halstead. More than 75 per cent have responded to a request for feedback on their possible intentions. Further LOIs and Posting Letters will be sent out in late 2007. As well as the drop-in days for Movers, we are organising reconnaissance visits. A second information booklet has been published and we have produced an internet-based Area Information Package for Movers and their families. The redeployment project is designed to assist people who are not subject to the Dstl Transfer Clause and who decide not to relocate. We have held meetings with more than 75 per cent of these staff and have already placed several people in alternative employment.

One of the significant elements of the i lab programme is looking at how we work in open plan offices, what support is available and how we can make more effective use of our assets. This will be a key enabler to introducing new ways of working within the organisation. As part of the Future Working Environment project, we have developed some guidance to help us work together in the new open plan areas.

We are also launching pilots at Porton Down and Portsdown West to determine how administrative support can be most effectively provided in the future. Significant progress has been made in reducing our paper holdings and updating our asset database in anticipation of Dstl's Electronic Document and Records Management (EDRM) system and the move to three core sites.

Business systems and processes

Improving our business systems is another integral part of the i lab programme and we have made significant progress with related projects during the year. The integrated Corporate Application System (iCAS), which will replace the current financial reporting system, went through a thorough rescoping and is now on track for implementation in October 2007. We have introduced guidance on electronic ways of working to help staff use our IT systems, updated the front end of the Dstl Management System (DMS) and provided an improved search engine. Over the next few months, we will undertake a thorough review of the DMS, which will include an overhaul of processes and policies.

Corporate social responsibility

Throughout the year, we have continued to raise the profile of Corporate Social Responsibility (CSR), and built on the successes of our many social and environmental initiatives. We are now integrating these activities more fully into Dstl's decision-making processes so that they become an essential part of our culture and values.

Community and workplace

Our Education Outreach programme continues to flourish with many events in the communities close to our core sites. We have supported around 30 different schools, encouraging and inspiring more than 3,500 students in a range of science and engineering activities. For example, our Science and Engineering Ambassadors (SEAs) helped to staff the Institute of Physics' 'Lab in a Lorry' during National Science Week and hosted science fairs in local schools. We have more than 150 SEAs across Dstl and these numbers are growing as staff discover that, by getting involved, they can make a real difference in the community.

At Dstl, our charity days have raised a total of £2,630 for Marie Curie Cancer Care, £1,800 for Jeans for Genes Day and £2,700 for Red Nose Day. In addition to site events, staff have also been actively involved in raising funds for their chosen charities.

Environment

Work has commenced on the roll-out of an environmental management system across our core sites. We have also published a new integrated SHEF policy, and improved processes and procedures are being introduced over the next year. Portsdown West will be the first of our core sites preparing for certification to the international standard ISO14001:2004 in 2008.

Working closely with our FM provider, we have significantly improved our waste recovery rates. At our Fort Halstead site, for example, more than 80 per cent of solid dry waste is now being recycled – already exceeding the Government's departmental recycling target of 40 per cent by 2010 and 75 per cent by 2020.

Dstl is very aware of its potential contribution to climate change, particularly through the use of energy. Ongoing monitoring is helping us to identify significant energy 'hot spots' for efficiency improvement. We continue to reduce our energy consumption but the challenge will be to maintain this trend in the coming years.

We have also achieved considerable success on the conservation front. In the past two years, Dstl has introduced a number of field management schemes, which have included sowing a variety of wild flower species. As a result, we have seen a 15-fold increase in the numbers of butterflies found at the field margins.

Ethics

More than 20 per cent of all stationery purchased by Dstl is environmentally friendly, and our aim is to increase this significantly over the next year through greater promotion.

Working with our new travel partner, we are also looking at the number of business miles our staff accumulate each year to establish a carbon 'travel' footprint for the organisation. We will then formulate ideas for change which, combined with the increasing use of video conferencing, will help to reduce Dstl's carbon emissions.

Future plans

Dstl is already doing much to deliver a comprehensive CSR policy and programme.

Over the next few months, we will define Dstl's key responsibilities, measure recent performance and set quantifiable targets for future improvements.

'Dstl remains in a robust financial position after another successful year, with an agreed and affordable programme of future investment to deliver improved capability and value for money.'

Mark Hone, Finance Director

Financial highlights and outlook

Financial highlights

The past 12 months have seen an extremely encouraging financial outturn. This is despite the cut in Dstl's margin on ascertained cost contracts and the hold on staff charge rates, which represents a reduction in real terms to our customers. The Trading Fund's turnover rose from £353.3 million (in 2005/06) to £366.8 million. Group turnover amounted to £367.1 million. This strong performance reflects the continuing confidence placed in Dstl by its customers. Work for MOD increased marginally during the year along with a healthy increase of 19 per cent from OGDs and non-Exchequer customers. This continues the growth in non-MOD work seen in recent years. Growth in turnover reflects the fact that Ploughshare Innovations Ltd, now in its second year of operations, is contributing to Group results.

Cost control and the ongoing monitoring of financial performance throughout the year contributed to a Group Profit on Ordinary Activities before Interest of £19.0 million. This represents an increase of 1.6 per cent despite the reduction in margins on ascertained cost contracts.

The Group had a positive cash inflow during the year amounting to £12.2 million (excluding the dividend payment). This inflow is partly due to the continued monitoring of the Balance Sheet to ensure that cash does not get tied up and increased interest earned on cash invested in addition to cash being received upon the sale of investments. Additionally, the anticipated outflow on i lab did not materialise due to some project delays and costs have therefore slipped to future years. Cash and cash equivalents on the Balance Sheet improved by £9.2 million and cash balances remained positive throughout the period.

Cash expenditure on fixed assets was £16.1 million (2006: £5.6 million), which included the £10.4 million capitalisation of costs associated with Project INSPIRE and £1.4 million on a new boiler house at Portsdown West. The balance was allocated to the acquisition of equipment to maintain Dstl's position at the leading edge of technology.

During the year, the Group earned interest amounting to £4.1 million from surplus funds being placed on the money markets with HM Treasury-approved institutions. This year's increase reflects Dstl's improved cash position prior to planned expenditure on i lab programmes and also reflects the rise in interest rates. During the year, contributions to community projects and charities amounted to £950.

The level of Government funds, represented by the Group Balance Sheet value, increased by £24.6 million to £242.6 million, primarily due to the £20.1 million retained profit for the year. A dividend of £3.0 million (2006: £3.0 million) will be paid. The Group's Return on Capital Employed (ROCE) was 8.1 per cent (2006: 8.8 per cent). The Trading Fund's ROCE was 7.9 per cent (2006: 9.1 per cent).

Credit payment policy and practice

Dstl's policy is to make payments to suppliers within Government guidelines that comply with the requirements of the Late Payment of Commercial Debts (Interest) Act 1998. Dstl paid 98.23 per cent of invoices within the agreed credit period on receipt of an undisputed invoice or date of confirmation of receipt of an acceptable service. Trade creditors were equivalent to 18.4 days' purchases during the year.

Transition to International Financial Reporting Standards (IFRS)

HM Treasury has announced that public sector accounts will be produced using IFRS from 2008/09. Dstl's accounts for 2007/08 will therefore be the last to be based on United Kingdom General Accepted Accounting Practice (UK GAAP). We are currently assessing the effects of this change. The full impact on the accounts has not yet been quantified.

Provisions

The accounts include a provision for certain infrastructure maintenance and upgrades where Dstl is legally responsible for the infrastructure concerned and there is a clear obligation to act, resulting in the transfer of economic benefits. This is the only significant provision held and amounts to £4.0 million. Details of all provisions are included in Note 16 to the accounts.

Financial risk and Treasury management

The Treasury function is a centralised service and its role is to monitor the cash flow and future cash requirements of the business on a daily basis. Surplus cash is invested in accordance with HM Treasury guidelines.

The main financial risks to Dstl are the availability of funds to meet future business requirements, particularly in the medium term as the organisation restructures, and the risk of default by counterparties to financial transactions (credit risk). To a lesser extent, there is an exchange rate risk associated with certain transactions designated in foreign currencies.

Funding and liquidity Dstl finances its operations from retained profits linked to the ability to borrow funds from MOD. The objective is to ensure continuity of funding. The policy is to minimise any potential borrowings by careful planning, ensuring that adequate funding is in place before commitments are taken on board. Regular contact is maintained with MOD to plan and agree any borrowing requirements.

Credit risk The objective is to reduce the risk of loss arising from default by parties engaged in financial transactions. The risk is mitigated to a large degree by the fact that more than 84 per cent of Dstl's turnover is with MOD. All non-Exchequer parties are credit checked prior to contract agreement and are regularly monitored.

Foreign currency risk Certain contracts are quoted in foreign currencies and Dstl's policy is to minimise the exchange rate exposure as far as possible. To achieve this, most Dstl contracts include a clause that allows for the price to be revised if the relevant exchange rate fluctuates by more than 2.5 per cent during the life of the contract.

Financial outlook

Looking ahead, the focus is to deliver the site rationalisation and i lab programme within the known funding constraints, and ensure that the benefits are realisable. Over the next three years, Dstl will invest more than £140 million to provide new and refurbished accommodation, relocate nearly a third of the workforce and associated laboratory assets, and renew IT applications and network infrastructure to improve internal capability and external connectivity. The ROCE remains on track to exceed the current target average of 3.5 per cent over the five-year period from 2004/05 to 2008/09. The future outlook shows that the planned expenditure under i lab remains affordable without recourse to borrowed funds from MOD. However, seasonal variations in working capital require careful management to maintain positive balances at all times in future years. The headline numbers for profit and cash will show a marked reduction over the next two years, but this is expected in the context of the site rationalisation programme. Planned expenditure for the next year includes the first tranche of staff relocation costs, completion of the new accommodation at Porton Down, and associated expenditure to install the required IT infrastructure in advance of these moves. The completion of Portsdown West refurbishment and the main wave of migration activity will take place in 2008/09.

Financial challenges

Dstl has been set challenging financial targets by MOD that are reflected in Dstl's Business Plan for 2007/08, whereby we seek to minimise the risk to future planned investments on the grounds of affordability.

Discretionary expenditure is focused on strengthening leadership and technical capabilities, and the introduction of new initiatives will be dependent on the achievement of underlying financial performance. There is a need for a continuing reduction in the cost base through reduced expenditure on non-core activities and more effective use of facilities, such as shared laboratories.

During 2007/08, a proof-of-concept pilot of shared support resources for operational areas will be completed at two key sites to identify further opportunities for efficiencies. This will be complemented by a Dstl-wide benchmarking of corporate support activities to focus on areas with the greatest potential for improvement. With this continuing drive to reduce overheads, coupled with the cost reductions from site rationalisation, there will be scope either to bring forward expenditure to realise further benefits, invest more in future capability development or provide better value for customers. Various options on how we can effectively share the benefits between Dstl's stakeholders are currently being evaluated.

Support to facilities

The transition to a new FM service provider at Dstl's three core sites took place in August 2006. This is expected to yield further benefits in 2007/08 as services are delivered more cost effectively, and improved management information is used to inform changes to working practices and behaviours.

The principle of Capacity Charge funding to underpin the costs of maintaining specified critical capabilities has been established and will continue in 2007/08. This will ensure that strategic facilities are sustained in a state of full operational readiness despite low levels of current activity.

External factors

The underlying financial performance of Dstl is affected by the volume of work and the profit margins that are applied. These are, to a certain extent, influenced by factors outside Dstl's control and can be affected by the allocation of budget funds to customers and policy changes, which are linked to the expected performance of trading funds relative to their risks.

For the medium term, Dstl remains alert to the changes that may arise from short-term budget constraints, Government spending reviews and HM Treasury policy. Cash flow is also significantly influenced by the agreed trading terms with Government customers and suppliers, and Dstl is actively looking to reduce the degree of seasonal variation in its working capital through revision of these terms.

Future outlook

The timing of major cash outflows is now better understood following the agreement of the construction timetable for Project INSPIRE and associated relocation costs. While some constraints will be in place until at least 2010, Dstl remains in a robust financial position after another successful year, with an agreed and affordable programme of future investment to deliver improved capability and value for money.

Performance against MOD key targets 2006/07

Delivery

1. Achieve a level of overall customer satisfaction in our delivery of at least 76.4 per cent for 2006/07 against a three-year target of 76.9 per cent (2007/08).

In the penultimate year of this three-year rising target, the 2006/07 customer satisfaction score for service provision (measured with the agreed composite metric) was 74.4 per cent compared with the target of 76.4 per cent. Nevertheless, of the customers surveyed, 29 per cent reported that Dstl's level of service had increased and seven per cent stated that it had decreased. Clearly, customer expectations continue to rise, and the consultancy firm that conducted the survey has advised that, at this high level of satisfaction, the metric used is relatively insensitive to positive shifts in the underlying data. Priority areas for improvement have been identified and are reflected both in action plans and in an additional key target for the coming year.

2. Deliver high-quality outputs that have impact on MOD customers' 'top 10' priority issues.

Achieved. Significant impact has been reported by our senior customer community against all the benchmark programme areas.

People

3. Achieve an overall score of at least 72 per cent for scientific and engineering capability in the technical benchmarking exercise. Develop, and agree with the Chief Scientific Adviser (CSA), a robust process for assessing the quality of Dstl's evolving technical capabilities for the period 2007 to 2011.

Achieved. Dstl achieved a score of 73.1 per cent in the 2005/06 technical benchmarking exercise – an improvement of 6.7 per cent over the 2002/03 baseline score of 67 per cent. Dstl therefore exceeded its three-year target of 72 per cent. A total of 13 external audits were carried out by 34 independent external auditors agreed with CSA. The auditors operated, typically, in teams of three, consisting of a senior MOD official (not a direct customer), a senior academic and an industry representative.
A joint internal and external review panel chaired by Non-Executive Director Lord May has been set up, with Terms of Reference agreed with CSA, to make recommendations for the revised technical benchmarking process for the period 2007 to 2011. The panel has now met and implementation of its recommendations will be discussed with CSA prior to a re-baselining exercise being initiated by the end of the first quarter of 2007/08.

Environment

4. As part of the strategic aim to bring Dstl onto three sites by 2009, agree the overarching construction and Facilities Management (FM) contract and achieve key milestones on programme to time and cost, including delivering predicted efficiency gains.

Achieved. The overarching contract with Serco was signed to allow the start of the FM element of the contract on 1 August 2006, as planned. The necessary document incorporating the cost of construction was signed on 22 September 2006. This completed contract negotiations. The terms of the contract allowed Dstl to achieve its objective of rationalising onto three core sites without the need for a loan and met the savings objectives required. Planning approval for the required construction was received for both Porton Down and Portsdown West and construction on the two Porton Down buildings began on schedule.

5. To enable greater knowledge-sharing, improved management and operational efficiencies, by meeting agreed in-year targets to ensure that Dstl has in place an integrated corporate business environment by the end of 2008/09.

Achieved. The Dstl Executive and Board approved the integrated Corporate Application System (iCAS) programme in July 2006. Additionally, the risk of failure of the current Dstl core business system for administering finance, commercial services, HR, project management and reporting (FISP) has been successfully managed so that no unrecoverable failure of the system has occurred. This target continues into 2007/08 with new in-year milestones, including iCAS implementation prior to the end of October 2007.

6. Achieve an average Return on Capital Employed (ROCE) of at least 3.5 per cent over the period 2004/05 to 2008/09.

Achieved. The ROCE for the year was 7.9 per cent. For the Group, it was 8.1 per cent (2006: 8.8 per cent) and Dstl remains on track to achieve the average target over the five-year period.
This year's target was achieved alongside the reduction in the fee rate on ascertained cost contracts and was better than predicted, primarily because some internal project expenditure has been deferred to 2007/08.

Dstl key targets 2007/08

In our new Corporate Plan, we have identified our strategic themes, and achievement in these areas will underpin Dstl's continued success:

- Customers – delivering high-quality, customer-focused products and services.
- Capability – enhancing our authority and credibility through the development of our knowledge, our people and our capabilities.
- Reputation – positioning ourselves as an effective, trusted partner while maintaining our independence from suppliers' interests.
- Results – building our organisational excellence and proactively managing delivery of our business performance.

These themes help to define our short-term business priorities and also to shape the longer-term, transformational activities. Success in these areas will position Dstl as a single, integrated laboratory acting as the indispensable source of science and technology at the heart of defence. Our key targets for 2007/08 will drive Dstl towards achievement of the critical success factors associated with these themes.

Customers

1 Achieve a level of overall customer satisfaction in our delivery of at least 76.9 per cent by the end of 2007/08.

2 Deliver at least 90 per cent of all projects to time and to budget.

3 Deliver high-quality outputs that have impact on MOD customers' benchmark programmes.

Capability

4 Ensure that at least 80 per cent of technical capability groups assessed as being in the lowest quartile in 2006/07 achieve assessments in 2007/08 that increase their average scores by at least one quartile.

5 Increase the value of strategic co-operations with companies by negotiating two new co-operation agreements and identify and initiate interaction with four new university capabilities in priority technologies according to the Defence Technology Strategy.

Results

6 Achieve the necessary key i lab programme milestones so that, by October 2007, Dstl will:

- issue posting notices to staff moving to Porton Down in 2008
- complete implementation of iCAS.

7 Deliver an improvement (per full-time equivalent member of staff) of 0.47 per cent in direct hours and £29.05k of overhead costs.

8 Achieve an average ROCE of at least 3.5 per cent over the period 2004/05 to 2008/09.

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 Dstl's policies, aims and objectives, while safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting.

Dstl was established as an Executive Agency of MOD in July 2001. It operates as a Trading Fund, for which the Secretary of State for Defence has ultimate responsibility. The Secretary of State has appointed the Minister for Defence Equipment and Support (MIN(DES)) to assist him in the discharge of his responsibilities with regard to Dstl. This includes determining the policy and resources framework within which Dstl operates, setting its objectives and targets, and monitoring its overall performance.

The Corporate Plan, agreed with Ministers, sets out our strategic objectives and the way in which we will deliver impartial and trusted support and advice based on our excellent knowledge and understanding of defence-relevant science and technology. The plan also identifies corporate-level risks that could impact on delivery of successful performance and strategies for risk management. We also have an agreed set of in-year key targets that track the performance of the organisation as it delivers the Corporate Plan. I am responsible for informing Ministers and the Permanent Under Secretary of State as the Principal Accounting Officer of any material issue that may inhibit the effective and efficient performance of Dstl.

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 departmental 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 Dstl for the year ended 31 March 2007 and up to the date of approval of the Annual Report and Accounts, and accords with Treasury guidance.

Capacity to handle risk and control framework

As an integral element of its system of internal control, Dstl has a well-established corporate approach to risk management which we continue to improve in line with the evolution of the business. During the period covered by this report, Dstl has established a new corporate governance structure to enhance our ability to manage risk in a way that most suits the business.

Dstl's risk management process is based around the strategic risk cycle, principles and terminology outlined in 'Management of Risk' (issued by the Treasury in 2004, updated in 2007). The procedure sets out a framework to ensure consistency in the way in which Dstl identifies and assesses risks, reports probability and impact, and develops mitigation and contingency plans. Dstl policy on corporate governance and the management of risk is set out in its Policy Manual, which is available to all staff. This is currently being updated to reflect Dstl's new structure and will be integrated into Dstl's Management System (DMS). Dstl's risk management and corporate governance policies, including audit and business continuity, are also implemented in line with Dstl procedures in the DMS.

The Dstl Executive reviews the Corporate Risk Register at regular meetings, and progress with identified actions aimed at mitigating the corporate risks is also reviewed and the risk register updated. Operations Managers (for both Departments and Functions) meet on a monthly basis and risk management is a fixed agenda item at these meetings. Corporate risks are communicated to Departments and Functions through these meetings, and delegated where appropriate. Risks are also elevated from the operational to the corporate level, where appropriate.

Training on risk awareness and use of the risk register is an essential part of Dstl's internal training for Project Managers. Dstl has a designated Corporate Risk Manager and a Risk Co-ordinator who ensure that risk is effectively communicated and co-ordinated across the organisation.

Dstl's strategy for business continuity is set out in the DMS. Drawing on business continuity management guidelines (as set out in JSP503), the strategy sets out business continuity processes and requirements at corporate and line management level. Dstl's current Business Continuity Plan includes an evaluation of key business priorities, which is subject to ongoing review to incorporate new business-critical issues. Dstl has a Business Continuity Co-ordinator to ensure that sufficient focus is given to this issue.

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 the department 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 been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Board and the Audit Committee, and a plan to address weaknesses and ensure continuous improvement of the system is in place.

Audit Committee arrangements

Dstl's audit arrangements comply with Government Internal Audit Standards and details are set out in the DMS. The Dstl Audit Committee, which met three times during 2006/07, reports to the Board on the implications of assurances provided in respect of risk and control in Dstl and the adequacy of audit arrangements. The Audit Committee reviews both the internal and external auditing requirements, the adequacy of the financial systems, risk management, control and governance.

The Dstl Board reviews the system of internal control through reports from its committees and Executive Directors, who have responsibility for Dstl's strategic improvement programmes and key risks. These reports are made on an exception basis. Where there are control deficiencies, mitigation measures are put in place. The Executive is responsible for updating the Dstl Board on emerging significant corporate and departmental risks and ensuring that Departments are informed about corporate risks that affect their areas. Dstl's Chief Executive, who has ultimate responsibility for the risk management process, attends the Audit Committee and has presented the revised risk management process and its implementation at two meetings and discussed the evolution of the risk register with the Board throughout the year.

PKF was appointed as Dstl's internal auditor for financial years 2003/04 to 2006/07. Regular reports to senior management and the Dstl Audit Committee provide independent assessment of the system of internal control and include recommendations for improvement.

Maturity of risk management arrangements

As part of the internal audit process, Dstl's risk management arrangements were reviewed by PKF who found that: 'at corporate level, risk management now appears to be working well and at departmental level is much improved, and both have a strong link to planning and performance management'. Their overall conclusion was that satisfactory levels of internal control were in place in all major respects for corporate governance and the management of risk activities.

External reviews

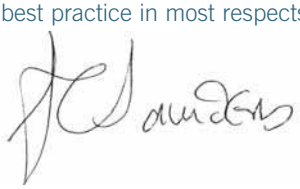
Dstl's management system was subject to two LRQA visits in 2006/07. In both cases, it was concluded that the management system continued to meet the requirements of ISO9001:2000, and no major non-conformities were raised.

The following comments were made:

- Communication of Mission, Vision, Values and key objectives and cascade of these into Departments (including projects) and Functions has significantly improved since 2005.
- Monthly departmental reports provided more focused and consistent reporting of progress against Dstl's objectives.
- i lab continues to be well managed with management controls improved by the new project structure and monthly reporting methods.
- The Electronic Filing System utilised within Departments was found to be effective and good retrieval of project data was demonstrated.
- A quality review form, introduced on projects for tracking action status, is a good mechanism for monitoring progress on a month-to-month basis.

Significant internal control problems

There are currently no significant internal control problems. Based on the audit work carried out in 2006/07, PKF concluded that its audits support the annual Statement on Internal Control required by the Treasury. PKF's audits were carried out in accordance with Government Internal Audit Standards and other external requirements. The Dstl governance structure was judged by PKF to meet best practice in most respects.



Frances Saunders
Chief Executive
5 July 2007

Statement of Dstl's and Chief Executive's responsibilities

Under Section 4(6) of the Government Trading Funds Act 1973, the Treasury has directed Dstl to prepare accounts for each financial year in the form and on the basis set out in the Accounts Direction. The accounts are prepared on an accruals basis, modified for the effect of changing prices on the valuation of fixed assets, and give a true and fair view of Dstl's state of affairs at the year end and of its profit, total recognised gains and losses, and cash flows for the financial year.

In preparing accounts Dstl is required to:

- observe the Accounts Direction issued by the Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis
- make judgements and estimates on a reasonable basis
- state whether applicable accounting standards have been followed, and to disclose and explain any material departures in the financial statements
- prepare the accounts on a going concern basis, unless it is inappropriate to presume that Dstl will continue in operation
- disclose that the Directors who held office at the date of approval of this report confirm that, so far as they are each aware, there is no relevant audit information of which Dstl's auditors are unaware; and each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that Dstl's auditors are aware of that information.

The Treasury has appointed the Chief Executive as the Accounting Officer of Dstl. Her relevant responsibilities as Accounting Officer, including her responsibility for the propriety and regularity of the public finances for which she is answerable and for the keeping of proper records, are set out in the Accounting Officers' Memorandum issued by the Treasury and published in 'Government Accounting' (The Stationery Office).

So far as the Accounting Officer is aware, there is no relevant information of which Dstl auditors are unaware and the Accounting Officer has taken all steps that she ought to have taken to make herself aware of any relevant audit information and to establish that Dstl's auditors are aware of that information.

Frances Saunders
Chief Executive
5 July 2007

Dstl Board and Executive

Dstl has an established governance structure and this is defined in the laboratory's Framework Document, which was revised in November 2006. Governance is achieved through a Non-Executive led Board and an Executive Committee.
The Board, which meets bimonthly, constructively challenges the Executive and applies scrutiny both in the development of business strategies, plans, business cases and targets and in assessing the business performance of Dstl in delivering its Corporate Plan.

The Board

Richard Maudslay	Non-Executive Chairman	
Martin Earwicker	Chief Executive	Resigned 02 May 2006
Frances Saunders	Operations Director Chief Executive	Resigned 02 May 2006 Appointed 03 May 2006
Mark Hone	Finance Director	
Peter Starkey	Future Business Director Deputy Chief Executive	Appointed 04 May 2006 Appointed 02 May 2006
Michael Steeden	Technical Director	Appointed 23 Oct 2006
Jill Cook	Operations Director	Appointed 29 Mar 2007
Roger Platt	Independent Non-Executive Director	
Admiral Sir Nigel Essenhigh	Independent Non-Executive Director	
Professor Patrick Dowling	Independent Non-Executive Director	
Christopher Swinson	Independent Non-Executive Director	
Lord Robert May	Independent Non-Executive Director	
Major General Andrew Figgures	Non-Executive Director	Resigned 05 May 2006
Mark Preston	Non-Executive Director	Resigned 26 Jul 2006
Alison Stevenson	Non-Executive Director	Appointed 26 Jul 2006 Resigned 23 Nov 2006
Huw Walters	Non-Executive Director	Appointed 23 Nov 2006

The Executive

Martin Earwicker	Chief Executive	Resigned 02 May 2006
Frances Saunders	Operations Director Chief Executive	Resigned 02 May 2006 Appointed 03 May 2006
Mark Hone	Finance Director	
Peter Starkey	Future Business Director Deputy Chief Executive	Appointed 04 May 2006 Appointed 02 May 2006
David Harris	Technical Director	Resigned 22 Oct 2006
Michael Steeden	Technical Director	Appointed 23 Oct 2006
Jill Cook	Operations Director	Appointed 03 May 2006
Ruth Davies	Human Resources and Communications Director	
Nicholas Helbren	Rationalisation Director	
Richard Scott	Programme Director (Science and Technology)	
Christopher Gibson	Programme Director (Systems)	Appointed 01 Apr 2006

Directors' remuneration report

Remuneration Committee

The Remuneration Committee includes Richard Maudslay (Chair), Christopher Swinson, Admiral Sir Nigel Essenhigh and Roger Platt. The Dstl Chief Executive, HR and Communications Director and MOD Non-Executive Director also attend committee meetings. The committee met once in the year.

Remuneration policy

The committee applies the following remuneration policy to the employment of its Directors. All Directors are Senior Civil Servants (SCS) and subject to SCS terms and conditions, including the remuneration policy, with the exception of two individuals. The remaining two Directors are Dstl employees and subject to the same performance-related remuneration policy as all other Dstl staff. However, their bonus arrangements fall under SCS rules rather than the Dstl performance-award system.

Performance conditions

Directors who are subject to SCS terms and conditions are also subject to the SCS performance conditions. The remaining Executive Directors are subject to the Dstl performance management rules.

Service contracts

Dstl appointments are made in accordance with the Civil Service Commissioners' Recruitment Code and, wherever possible, on the basis of merit and fair and open competition.
Unless otherwise stated, the officials named in this report hold appointments that are open-ended until they reach the standard retirement age of 60. Early termination would result in the individual receiving compensation (except in cases of misconduct) as outlined in the Civil Service Compensation Scheme.
There were no significant awards made to past senior managers.
Frances Saunders is currently in post as Acting Chief Executive.

Board Directors' remuneration (excluding pension arrangements):

This information is subject to audit.

Name	Note	Age	Salary Band 2006/07 £'000	Salary Band 2005/06 £'000	Bonus 2006/07 £'000	Bonus 2005/06 £'000	Fee 2006/07 £'000	Fee 2005/06 £'000
Richard Maudslay		60					45–50	30–35
Martin Earwicker	1	58	10–15	100–105		5–10		
Frances Saunders		52	80–85	70–75	5–10	0–5		
Mark Hone		45	65–70	60–65		0–5		
Peter Starkey	2	53	70–75	70–75	0–5	0–5		
Michael Steeden	2	55	30–35					
Jill Cook	2	50	60–65		0–5			
Roger Platt		62					15–20	10–15
Admiral Sir Nigel Essenhigh		62					15–20	5–10
Professor Patrick Dowling		68					15–20	5–10
Christopher Swinson		59					15–20	5–10
Lord Robert May		71					20–25	
Major General Andrew Figgures	1	56						
Mark Preston	1	45						
Alison Stevenson	3	43						
Huw Walters	2	44						

Note 1 Resigned from the Board during the year
Note 2 Appointed to the Board during the year
Note 3 Appointed and resigned during the year

Bonuses have been awarded as indicated for 2006/07. Fees have been paid as indicated for 2006/07.
No additional remuneration or other allowances were paid to members of the Dstl Board.
No Board members, key managerial staff or other related parties have undertaken any material transactions with Dstl during the year.
The salary bands set out above relate only to emoluments paid during the period of each Director's membership of the Dstl Board.
Mark Preston, Alison Stevenson and Huw Walters have received no fee; all have represented MOD as Non-Executive Directors.
Major General Andrew Figgures also received no fee.

Dstl Board pension provision

This information is subject to audit.

The information below details the real increase in pension and related lump sum.

Name	Real increase in pension [and related lump sum at age 60] £'000	Total accrued pension at age 60 at 31/3/07 [and related lump sum] £'000	Cash equivalent value at 31/3/06 £'000	Cash equivalent value at 31/3/07 £'000	Real increase in cash equivalent transfer value as funded by employer £'000
Martin Earwicker	0–2.5 [0–2.5]	5–10 [20–25]	151.0	146.0	1.0
Frances Saunders*	2.5–5	35–40	515.0	599.0	64.0
Mark Hone	0–2.5 [0–2.5]	10–15 [30–35]	147.0	160.0	10.0
Peter Starkey	0–2.5 [0–2.5]	25–30 [80–85]	510.0	536.0	9.0
Michael Steeden*	0–2.5	5–10	114.0	133.0	13.0
Jill Cook	2.5–5 [7.5–10]	20–25 [60–65]	311.0	372.0	53.0

*Premium Pension Scheme, only refund of contributions due.

Executive remuneration (excluding pension arrangements)

This information is subject to audit.

Name	Note	Age	Salary band 2006/07 £'000	Salary band 2005/06 £'000	Bonus 2006/07 £'000	Bonus 2005/06 £'000
Martin Earwicker	1	58	10–15	100–105		5–10
Frances Saunders		52	80–85	70–75	5–10	0–5
Mark Hone		45	65–70	60–65		0–5
Peter Starkey		53	70–75	70–75	0–5	
David Harris	1	57	35–40		0–5	
Michael Steeden	2	55	30–35			
Jill Cook	2	50	60–65		0–5	
Ruth Davies		48	70–75	65–70	5–10	0–5
Nicholas Helbren		61	50–55	65–70	0–5	5–10
Richard Scott		58	75–80	75–80	5–10	0–5
Christopher Gibson	2	48	70–75			

Note 1 Resigned from the Dstl Executive during the year.

Note 2 Appointed to the Dstl Executive during the year.

Executive pension provision

This information is subject to audit.

Name	Real increase in pension [and related lump sum at age 60] (£'000)	Total accrued pension at age 60 at 31/3/07 [and related lump sum] (£'000)	Cash equivalent value at 31/3/06 (£'000)	Cash equivalent value at 31/3/07 (£'000)	Real increase in cash equivalent transfer value as funded by employer (£'000)
Martin Earwicker	0–2.5 [0–2.5]	5–10 [20–25]	151.0	146.0	1.0
Frances Saunders*	2.5–5	35–40	515.0	599.0	64.0
Mark Hone	0–2.5 [0–2.5]	10–15 [30–35]	147.0	160.0	10.0
Peter Starkey	0–2.5 [0–2.5]	25–30 [80–85]	510.0	536.0	9.0
David Harris	0–2.5 [2.5–5]	25–30 [75–80]	543.0	587.0	25.0
Michael Steeden*	0–2.5	5–10	114.0	133.0	13.0
Jill Cook	2.5–5 [7.5–10]	20–25 [60–65]	311.0	372.0	53.0
Ruth Davies*	0–2.5	0–5	27.0	44.0	14.0
Nicholas Helbren	N/A N/A	N/A N/A	N/A	N/A	N/A
Richard Scott	0–2.5 [0–2.5]	30–35 [100–105]	736.0	780.0	10.0
Christopher Gibson	0–2.5 [0–2.5]	15–20 [55–60]	308.0	327.0	11.0

*Premium Pension Scheme, only refund of contributions due.

With the exception of Frances Saunders, Ruth Davies and Michael Steeden, who belong to the Premium Civil Service Pension Scheme, all Directors belong to the Classic Civil Service Pension Scheme. Both schemes are part of the Principal Civil Service Pension Scheme. See Note 6 to the accounts.

Disclosure of pension provision for Nicholas Helbren is not required as he has attained pensionable age.

There was no non-cash element of the remuneration package.

No compensation was payable to former senior managers during the year.

There were no amounts payable to third parties for services of a senior manager.

Frances Saunders
Chief Executive
5 July 2007

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 Science and Technology Laboratory for the year ended 31 March 2007 under the Government Trading Funds Act 1973. These comprise the Profit and Loss Account, the Balance Sheet, the Cashflow 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 Defence Science and Technology Laboratory, Chief Executive and Auditor

The Defence Science and Technology Laboratory and Chief Executive 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 the Defence Science and Technology Laboratory's and Chief Executive'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, certain information given in the Annual Report and Accounts, which comprises pages 17 and 19-25, is consistent with the financial statements. I also report whether, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

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

I review whether the Statement on Internal Control reflects the Defence Science and Technology Laboratory'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 the Defence Science and Technology Laboratory's corporate governance procedures or its risk and control procedures.

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

Basis of audit opinion

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

Audit opinion

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 the Defence Science and Technology Laboratory's affairs as at 31 March 2007 and of its profit 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
- information given within the Annual Report and Accounts, which comprises pages 17 and 19-25, is consistent with the financial statements.

Audit opinion on regularity

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

I have no observations to make on these financial statements.

John Bourn
Comptroller and Auditor General
National Audit Office
157–197 Buckingham Palace Road
Victoria London SWIW 9SP
12 July 2007

Dstl profit and loss account

For the year ended 31 March 2007

	Note	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Turnover	**2**	**367.1**	**353.4**	**366.8**	**353.3**
Cost of sales		(97.1)	(91.5)	(96.8)	(91.4)
Net income		**270.0**	**261.9**	**270.0**	**261.9**
Net operating expenses		(249.9)	(243.2)	(249.1)	(242.4)
Operating profit before impairments		**20.1**	18.7	20.9	19.5
Net operating expenses – impairments	**3, 10**	**(1.1)**	**-**	**(1.1)**	**-**
Operating profit	**3**	**19.0**	**18.7**	**19.8**	**19.5**
Share of operating profit in associate		-	-	-	-
Loss on disposal of fixed assets		-	-	(1.2)	-
Profit on ordinary activities before interest		**19.0**	**18.7**	**18.6**	**19.5**
Interest receivable	7	4.1	3.1	4.2	3.1
Profit for the financial year		**23.1**	**21.8**	**22.8**	**22.6**
Dividends	8	(3.0)	(3.0)	(3.0)	(3.0)
Retained profit for the year	**19**	**20.1**	**18.8**	**19.8**	**19.6**
Return on Capital Employed (ROCE)	4	8.1%	8.8%	7.9%	9.1%

All operations are continuing.

Statement of total recognised gains and losses

For the year ended 31 March 2007

	Note	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Profit for the financial year		**23.1**	**21.8**	**22.8**	**22.6**
Unrealised surplus on revaluation of tangible fixed assets	10,11,20	4.5	0.3	2.6	0.3
Total gains and losses recognised since the previous Annual Report		**27.6**	**22.1**	**25.4**	**22.9**

The notes on pages 37 to 51 form an integral part of these accounts.

Balance sheet

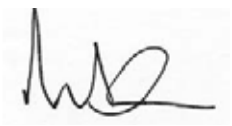
As at 31 March 2007

	Note	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Fixed assets					
Tangible assets	10	132.1	123.8	132.1	123.8
Investments	11	2.2	0.8	-	0.8
Investments in associates		-	-	-	-
		134.3	124.6	132.1	124.6
Current assets					
Stocks and work in progress	12	7.0	6.4	7.2	6.5
Debtors	13	93.6	95.2	94.6	95.7
Cash and cash equivalents	21	87.9	78.7	87.2	78.7
		188.5	180.3	189.0	180.9
Creditors: amounts falling due within one year	14	(74.2)	(80.3)	(74.0)	(80.1)
Net current assets		**114.3**	**100.0**	**115.0**	**100.8**
Total assets less current liabilities		**248.6**	**224.6**	**247.1**	**225.4**
Financed by:					
Creditors: amounts falling due after more than one year	15	1.1	2.1	1.0	2.1
Provisions for liabilities and charges	16	4.9	4.5	4.9	4.5
		6.0	6.6	5.9	6.6
Capital and reserves					
Public dividend capital	18	50.4	50.4	50.4	50.4
Revaluation reserve	19	40.8	36.9	38.9	36.9
Profit and loss account	**19**	**151.4**	**130.7**	**151.9**	**131.5**
Government funds		**242.6**	**218.0**	**241.2**	**218.8**
Total		**248.6**	**224.6**	**247.1**	**225.4**

The accounts were signed on 5 July 2007

The financial statements were authorised for issue on 13 July 2007*

Frances Saunders, Chief Executive



Mark Hone, Finance Director

*This represents the date of despatch by the Trading Fund's Board, to the Secretary of State for Defence, for laying before the Houses of Parliament.

Cash flow statement

For the year ended 31 March 2007

	Note	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Cash flow from operating activities					
Net cash inflow from operating activities	28	23.3	22.4	23.5	22.4
Dividends from associate		-	-	-	-
Returns on investments and servicing of finance					
Interest received		4.1	3.0	4.1	3.0
Interest paid		-	-	-	-
Net cash inflow from returns on investments and servicing of finance		**4.1**	**3.0**	**4.1**	**3.0**
Net cash inflow before capital expenditure		**27.4**	**25.4**	**27.6**	**25.4**
Capital expenditure and financial investment					
Payments to acquire tangible fixed assets		(16.1)	(5.6)	(16.1)	(5.6)
Amounts received upon sale of investments		0.9	-	-	-
Net cash outflow from capital expenditure and financial investment		(15.2)	(5.6)	(16.1)	(5.6)
Dividends paid		(3.0)	(3.0)	(3.0)	(3.0)
Net cash inflow before financing		9.2	16.8	8.5	16.8
Increase in cash	**21**	**9.2**	**16.8**	**8.5**	**16.8**

Notes to the accounts

1 ACCOUNTING POLICIES

(a) Accounting convention

The accounts are prepared in accordance with applicable accounting standards and under the historical cost convention modified to include the revaluation of tangible fixed assets.

Dstl has prepared accounts for the year ended 31 March 2007 in compliance with the accounting principles and disclosure requirements of the Financial Reporting Manual issued by HM Treasury, which is in force for 2006/07.

The accounts have been prepared so as:

(i) to give a true and fair view of the income and expenditure, total recognised gains and losses, and cash flows of the Trading Fund and Group, and of the state of affairs as at period ended 31 March 2007

(ii) to provide disclosure of any material income or expenditure that has not been applied to the purposes intended by Parliament, or material transactions that have not conformed to the authorities that govern them.

(b) Basis of consolidation

The consolidated accounts incorporate those of the Trading Fund together with its associate, Tetricus Limited, its joint venture, Enigma Diagnostics Limited, and those of its wholly owned subsidiary undertaking, Ploughshare Innovations Limited, together with all of its joint ventures. Enigma Diagnostics Limited has no material trading income or expenditure.

The subsidiary undertaking has been consolidated using the acquisition method. The associate has been consolidated using the equity method, and all joint ventures have been consolidated using the gross equity method. The accounts are drawn up to 31 March 2007.

(c) Subsidiary and its joint ventures

Ploughshare Innovations Limited was incorporated as a wholly owned subsidiary of Dstl on 6 April 2005. It has been created as a vehicle to manage Dstl's joint venture initiatives. Various joint ventures exist to allow Dstl's technology to be developed for commercial purposes. During the year, Dstl's holdings in Acolyte Biomedica Limited and Remo Technologies Limited were transferred to Ploughshare Innovations Limited in exchange for 20,000 £1 ordinary shares in the subsidiary undertaking. Subsequently, the holdings in Acolyte Biomedica Limited have been disposed of. Also during the year, an agreement was put in place transferring from Dstl to Ploughshare Innovations Limited all beneficial interests in Porton Plasma Innovations Limited (P2i) and Leading Light Scientific Limited.

Ploughshare Innovations Limited has performed its own valuation of the joint ventures using an independent valuer, Alivero Limited. These valuations have been adopted by the Board, and have been incorporated into the Group accounts on consolidation of the subsidiary undertaking, with just one group adjustment in respect of the P2i valuation. Details are provided in Note 11.

(d) Associate

Tetricus Limited was incorporated on 22 November 1999. It has been consolidated using the equity method. Management accounts are used to consolidate for the 12 months to 31 March 2007. Details are provided in Note 11.

(e) Joint venture

Enigma Diagnostics Limited remains as the only joint venture where the Trading Fund has direct ownership of all beneficial interests. The investment has been valued by an independent valuer, Alivero Limited. The Board has adopted a nil valuation, due to a Group adjustment. Details are provided in Note 11.

(f) Tangible fixed assets

Tangible fixed assets are stated at valuation less accumulated depreciation. The valuation bases for different classes of asset are as follows:

Land and buildings:

Porton Down	– depreciated replacement cost
Portsdown West	– existing use valuation for land and buildings that have been declared surplus
	– open market value
Legacy and acquired facilities	– net recoverable amount
Plant, machinery, computers and office equipment	– net current replacement cost.

A facility is a collection of fixed assets operated together to provide discrete services. Fixed assets included as legacy and acquired facilities incorporate, as appropriate, land, buildings, plant and machinery, computers and office equipment. The net recoverable amount is calculated as the greater of:

(i) the estimated net present value of the cash flows deriving from the continued use of the asset less an allowance for profit to be earned in accordance with the Government Profit Formula

(ii) the estimated net sale proceeds of the asset.

In order to meet the Treasury's requirement for modified historic cost accounting, tangible fixed

assets are revalued in the years between professional valuations using the following indices:

Land	– Gross Domestic Product Deflator Index
Buildings	– Buildings Cost Information Service (BCIS), All-In Tender Price Index
Other assets	– relevant indices published by the Office for National Statistics.

Depreciation is provided evenly over the useful economic lives of the assets, which are generally considered to be the following:

Freehold land	Not depreciated
Freehold buildings	1–30 years
Legacy and acquired facilities	1–12 years
Plant and machinery	1–25 years
Computers and office equipment	1–10 years

Plant and machinery, computers and office equipment are capitalised where their historical cost of acquisition is greater than £10,000.
The revaluation reserve is released to the profit and loss account reserve in accordance with FRS15.

(g) Leased assets
Assets held under finance leases are capitalised as tangible fixed assets and depreciated over the term of the lease.
Rentals are apportioned between reductions in the capital obligations included in creditors and finance charges, which are charged to the profit and loss account.
Expenditure under operating leases is charged to the profit and loss account as incurred.

(h) Work in progress
Work in progress represents costs incurred on specific contracts, not classified as long-term contracts, and is stated at the lower of cost (or net replacement cost if materially different), and net realisable value. Cost represents direct materials and labour and other directly attributable overheads.

(i) Long-term contracts
Amounts recoverable on long-term contracts are stated at cost (or net current replacement cost if materially different), plus attributable profits less provision for any known or anticipated losses and payments on account, and are included in debtors as amounts recoverable under contracts.

(j) Insurance
In common with other Government-owned organisations, Dstl carries commercial insurance only where it is considered cost effective. Dstl carries its own risks in respect of fire, explosion, common law, third party etc and its operating costs include claims against self-insurance. In the event of a loss occurring that exceeds the ability of the organisation to bear the cost, Dstl will consult with MOD about the action to be taken.

(k) Pensions
Past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS), which is an unfunded multi-employer scheme providing benefits based on final salary. Dstl is unable to identify its share of the underlying assets and liabilities. Therefore, as required by FRS17 'Retirement Benefits', Dstl accounts for the scheme as if it was a defined contribution scheme. As a result, the amount charged to the profit and loss account represents the contributions payable to the scheme in respect of the accounting period.
Employees joining after 1 October 2002 could opt to open a partnership pension, with an employer contribution. Details of rates and amounts of contributions during the year are given in Note 6.

(l) Foreign currencies
Transactions denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the Balance Sheet date are translated at the rates ruling at that date. The resulting exchange differences are dealt with in the determination of profit for the financial year.

(m) Corporation tax
Dstl is exempt from corporation tax under Section 829(2) of the Income and Corporation Taxes Act 1988 and consequently the requirements to account for current tax and deferred tax under FRS16 and FRS19 are not relevant for these financial statements.
Ploughshare Innovations Limited is liable to pay corporation tax in the UK on its taxable profits and is incorporated in the Group financial statements. See Note 9 to the accounts.

(n) Going concern
The accounts have been prepared on the basis that Dstl is a going concern.

(o) Turnover
Turnover represents amounts invoiced to customers (net of VAT) for all work performed in the year.
For cost-plus contracts, amounts receivable under contract are recognised as turnover, which includes a contract fee. For long-term contracts, an appropriate amount of profit is attributed where there is reasonable certainty of the final outcome.

2 Turnover

Turnover by major class of customer is analysed as follows:

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
MOD:	310.6	306.1	310.7	306.1
Research	161.3	159.6	161.3	159.6
Non-research	149.3	146.5	149.4	146.5
Non-MOD:	56.5	47.3	56.1	47.2
Government Departments	25.6	22.8	25.6	22.8
Non-Exchequer income	30.7	24.3	30.5	24.3
Non-Exchequer royalty income	0.2	0.2	-	0.1
Total	**367.1**	**353.4**	**366.8**	**353.3**

Turnover is categorised according to the main contracted customer. All turnover relates to the same class of business, which is the supply of scientific and technical services. This is conducted principally in the UK in sterling, and no other geographical market has contributed significantly to turnover.

3 Operating profit

This is stated after charging/(crediting):

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Depreciation charge for the year:	8.3	8.0	8.3	8.0
Depreciation of owned assets	7.6	8.0	7.6	8.0
Exceptional costs of impairment of tangible fixed assets	1.1	-	1.1	-
Adjustment/(downward) valuation of tangible fixed assets	(0.4)	-	(0.4)	-
Operating lease rentals – land and buildings	7.3	7.7	7.3	7.7
– plant and machinery	0.7	0.7	0.7	0.7
Travel, subsistence and hospitality	3.4	3.6	3.4	3.6
Foreign exchange losses	0.2	-	0.2	-
Other operating income	(10.0)	(9.6)	(10.5)	(9.9)

Operating expenses include a fee of £65,000 (2005/06: £60,000) for the external audit by the National Audit Office (NAO). No non-audit services were provided by the external auditors.

4 Key corporate financial target

Dstl has a ROCE, defined as follows:

a) Return – modified, historical cost profit on ordinary activities before interest and dividends
b) Capital employed – average net assets, being total assets less current and long-term creditors, but excluding provisions

The target for the year for ROCE was 3.5 per cent.

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Profit on ordinary activities before interest	19.0	18.7	18.6	19.5
Total assets less current liabilities	248.6	224.6	247.1	225.4
Less: long-term creditors excluding provisions	(1.1)	(2.1)	(1.0)	(2.1)
Capital employed at year end	247.5	222.5	246.1	223.3
Average capital employed during the year	235.0	213.4	234.7	213.7
ROCE	8.1%	8.8%	7.9%	9.1%

ROCE has reduced year on year due to a halving in the fee rate for all MOD cost plus work. This effect of this reduction has been partly offset by further internal efficiencies and rescheduling of the i lab programme.

5 Trading Fund Board members' emoluments

Details of members' emoluments are shown in the Remuneration Report.
They are summarised as follows:

	2007 £'000	2006 £'000
Salaries, bonuses and fees	**816.8**	**680.1**

6 Employee information

The average number of persons (including members of the Board) employed during the year was:

	2007 Group Number	2006 Group Number	2007 Trading Fund Number	2006 Trading Fund Number
Professional and technical staff	2,771	2,753	2,763	2,746
Administrative and industrial staff	648	620	645	618
Secondees	44	40	44	39
Total	**3,463**	**3,413**	**3,452**	**3,403**

In addition, there were 900 (2006: 718) agency and contract staff utilised during the year at a cost of £16.3 million (2006: £18.1 million).

Staff costs incurred during the year in respect of these employees were:

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Wages and salaries	110.8	106.0	110.3	105.7
Social security costs	9.5	9.0	9.4	8.9
Other pension costs	21.4	19.6	21.4	19.6
Total	**141.7**	**134.6**	**141.1**	**134.2**

The employees of Dstl are eligible to be members of the Principal Civil Service Pension Scheme (PCSPS), which is a final salary scheme. The PCSPS is an unfunded multi-employer defined benefit scheme but Dstl is unable to identify its share of the underlying assets and liabilities.
A full actuarial valuation was carried out at 31 March 2003. Details can be found in the resource accounts of the Cabinet Office; Civil Superannuation (www.civilservice-pensions.gov.uk). For 2006/07, normal employers' contributions of £21.4 million were payable to the PCSPS (2005/06: £19.6 million) at one of four rates in the range 17.1 per cent to 25.5 per cent of pensionable pay (2005/06: 16.2 per cent to 24.6 per cent). The scheme's Actuary reviews employer contributions every four years following a full scheme valuation. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred, and they reflect past experience of the scheme. Employees joining after 1 October 2002 could opt to open a 'partnership' pension account – a stakeholder pension with an employer contribution. Employers' contributions of £75,765 were paid to one or more of a panel of four appointed stakeholder pension providers. Employer contributions are age-related and range from 3 per cent to 12.5 per cent of pensionable pay. Employers also match employee contributions up to 3 per cent of pensionable pay. In addition, employer contributions of £5,550, representing 0.8 per cent of pensionable pay, 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 £8,564. There were no prepaid contributions at that date.
Three persons retired early on ill-health grounds; the total additional accrued pension liabilities in the year amounted to £3,509.

7 Interest receivable

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Interest receivable on deposits	**4.1**	**3.1**	**4.2**	**3.1**

8 Dividends payable

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Dividends	**3.0**	**3.0**	**3.0**	**3.0**

Dividends payable to MOD are set by agreement with the Secretary of State.

9 Taxation

Dstl is not subject to income or corporation tax in the UK under Section 829(2) of the Income and Corporation Taxes Act 1988, and consequently the requirements to account for current tax and deferred tax under FRS16 and FRS19 are not relevant to the Trading Fund. However, Ploughshare Innovations Limited is liable to pay corporation tax in the UK on its taxable profits. Ploughshare Innovations Limited made a capital gain of £0.9 million, realised from the sale of its joint venture investment in Acolyte Biomedica Limited. However, the capital gain is sheltered by the trading loss for the year. No provision has been made in these accounts for tax payable by Ploughshare Innovations Limited on the grounds that trading losses for the year completely shelter the capital gain.

10 Tangible fixed assets

Group and Trading Fund

The accounting policy for tangible fixed assets is covered in Note 1.
Tangible fixed asset movements during the year were as follows:

	Freehold land and buildings £ million	Legacy facilities £ million	Plant & machinery £ million	Computers & office equipment £ million	Assets under construction £ million	Total £ million
Historic cost, valuations and gross modified historic cost:						
Balance brought forward	105.0	0.3	63.0	2.5	9.7	180.5
Additions	0.2	-	0.4	-	13.9	14.5
Disposals	(0.6)	-	(2.0)	(0.1)	-	(2.7)
Transfers	0.8	-	0.8	0.2	(1.8)	-
Revaluations	(0.1)	-	-	-	-	(0.1)
Balance carried forward	**105.3**	**0.3**	**62.2**	**2.6**	**21.8**	**192.2**
Depreciation:						
Balance brought forward	(20.1)	(0.3)	(34.1)	(2.2)	-	(56.7)
Charge for year –						
historical	(3.4)	-	(4.0)	(0.2)	-	(7.6)
supplementary	-	-	(0.1)	-	-	(0.1)
downward revaluation	0.5	-	-	-	-	0.5
impairment	(0.4)	-	(0.7)	-	-	(1.1)
Disposals	0.1	-	2.0	0.1	-	2.2
Revaluations	2.7	-	-	-	-	2.7
Balance carried forward	**(20.6)**	**(0.3)**	**(36.9)**	**(2.3)**	**-**	**(60.1)**
Net modified historic cost:						
Balance carried forward	**84.7**	**-**	**25.3**	**0.3**	**21.8**	**132.1**
Balance brought forward	84.9	-	28.9	0.3	9.7	123.8

Land and buildings are subject to a quinquennial revaluation by an independent, professional valuer in accordance with FRS15. Land at Pyestock is valued annually. The latest valuation was carried out on 14 February 2007 on an Open Market basis by Knight Frank LLP, Chartered Surveyors. All other land and buildings at Porton Down and Portsdown West are valued on a rolling basis by GVA Grimley LLP, Chartered Surveyors. A third of all building assets at Porton Down were revalued as at 31 March 2007, and the remainder will be revalued during the next two years. Thereafter, the revaluation will be performed over a five-year rolling basis with the land at Porton Down being revalued in 2009.
The published figures for land and buildings include:
– a professional external valuation of 33 per cent of the building assets at Porton Down as at 31 March 2007
– a professional external valuation of the balance of the assets as at 31 March 2004.
The basis of the valuation was Market Value using the Depreciated Replacement Cost (DRC) method for Porton Down, and the Existing Use Valuation (EUV) method for Portsdown West. For DRC, fees and stamp duty are included; for EUV, acquisition costs are not included. In the event of Porton Down and Portsdown West being marketed for an alternative use to their current purpose, it is likely that the values would be materially lower than the reported figures for the following reasons:
– planning for alternative use has not been established
– site locations are not generally in areas of high land demand
– Dstl facilities are specialist and have a higher replacement cost than their value
– the specialist nature of some facilities would have no market elsewhere
– the liabilities included in the sites such as Sites of Special Scientific Interest (SSSIs) affect land value.
During the year, a business in use valuation carried out on the CAT4 facility identified an impairment. The business in use valuation extended over a period of 25 years, and cash flows were discounted at a required rate of return of 4.9 per cent. The impairment is disclosed as £0.4 million for buildings and £0.7 million for plant and machinery.

11 Investments

	Trading Fund subsidiary undertaking £ million	Trading Fund joint ventures and associate £ million	Trading Fund Total £ million	Group joint ventures and associate £ million	Group Total £ million
Cost					
At 1 April 2006	-	0.8	0.8	0.8	0.8
Additions	-	-	-	-	-
Disposals	-	(0.8)	(0.8)	(0.5)	(0.5)
Revaluations	-	-	-	1.9	1.9
At 31 March 2007	**-**	**-**	**-**	**2.2**	**2.2**
Amount provided	-	-	-	-	-
Net book value					
At 31 March 2007	**-**	**-**	**-**	**2.2**	**2.2**
At 1 April 2006	-	0.8	0.8	0.8	0.8

During the year, Dstl's holdings in Acolyte Biomedica Limited and Remo Technologies Limited were transferred to Ploughshare Innovations Limited, a wholly owned subsidiary of Dstl, in exchange for 20,000 £1 ordinary shares in the subsidiary undertaking. Subsequently, the holdings in Acolyte Biomedica Limited have been disposed of.
Also during the year, an agreement was put in place transferring all beneficial interests in Porton Plasma Innovations Limited (P2i) and Leading Light Scientific Limited from Dstl to Ploughshare Innovations Limited.
Ploughshare Innovations Limited has performed its own valuation of the joint ventures using an independent valuer, Alivero Limited. These valuations have been adopted by the Board, and have been incorporated into the Group accounts on consolidation of the subsidiary undertaking, with just one Group adjustment in respect of the P2i valuation. The valuation has been reduced by £0.5 million, which represents the joint venture's amortised valuation of a patent licence internally generated by the Trading Fund.
Enigma Diagnostics Limited remains as the only joint venture where the Trading Fund has direct ownership of all beneficial interests. The investment has been valued by an independent valuer, Alivero Limited. The Board has adopted a nil valuation due to an adjustment for the joint venture's amortised valuation of £2.8 million for a patent licence, which had been internally generated by the Trading Fund.

Further details of the joint venture and associate owned directly by the Trading Fund at 31 March 2007 are shown below:

Name of company	Principal area of operation and country of incorporation	Proportion of voting rights and shares held	Class of shares held	Last financial year ended	Aggregate capital & reserves £ million	Profit/(Loss) for year £ million	Nature of business
Joint Venture							
Enigma Diagnostics Ltd	Great Britain	19.0%	Ordinary of 10p	30 Apr 2006	2.5	(3.7)	R&D

Management accounts for 12 months to 31 March 2007 have been used for the disclosure because audited accounts were not available.

Associate							
Tetricus Ltd	Great Britain	33.3%	Ordinary C of £1	31 Mar 2007	0.2	-	Business support to biotechnology start-ups

Management accounts for 12 months to the year ended 31 March 2007 have been used for the disclosure because audited accounts were not available.

12 Stocks and work in progress

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Work in progress				
Central government bodies	5.4	4.8	5.4	4.8
Trading funds	-	-	0.2	0.1
NHS Trusts	0.1	-	0.1	-
Non-public sector organisations	1.5	1.6	1.5	1.6
Total	**7.0**	**6.4**	**7.2**	**6.5**

13 Debtors

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Trade debtors	21.0	21.6	21.0	21.5
Central government bodies	18.0	16.8	18.0	16.8
Local authorities	0.3	0.1	0.3	0.1
Non-public sector organisations	2.7	4.7	2.7	4.6
Amounts recoverable under contracts – central government bodies	67.5	69.1	67.5	69.1
Central government bodies	66.5	68.5	66.5	68.5
Non-public sector organisations	1.0	0.6	1.0	0.6
Other debtors	1.1	1.3	2.0	1.6
Central government bodies	0.9	1.0	0.9	1.0
Trading funds	-	-	0.9	0.3
Staff debtors	0.2	0.3	0.2	0.3
Loans due from Ploughshare Innovations Limited	-	-	0.2	0.3
Prepayments and accrued income	4.0	3.2	3.9	3.2
Central government bodies	-	0.1	-	0.1
Non-public sector organisations	4.0	3.1	3.9	3.1
Total	**93.6**	**95.2**	**94.6**	**95.7**

The loan due from Ploughshare Innovations Limited is an inter-company loan, set at an interest rate of the base rate plus two per cent. The loan arrangement is on demand, with a total limit set at £750,000.

The loan is repayable on the third anniversary of the loan agreement, which is 6 April 2008.

Within other debtors is a current account with Ploughshare Innovations Limited. The balance on this account represents amounts due for services provided and interest on the loan. There is no intention to demand payment during the next year, and Ploughshare Innovations Limited has indicated that it is unlikely to make payment during this period.

14 Creditors: amounts falling due within one year

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Payments received on account	8.3	12.9	8.3	12.9
Central government bodies	4.9	7.6	4.9	7.6
NHS Trusts	0.2	0.9	0.2	0.9
Local authorities	0.1	-	0.1	-
Non-public sector organisations	3.1	4.4	3.1	4.4
Trade creditors	10.4	11.4	10.3	11.4
Central government bodies	1.3	1.2	1.3	1.2
Non-public sector organisations	9.1	10.2	9.0	10.2
Taxation and social security	7.7	9.6	7.7	9.6
Other creditors	2.3	2.1	2.2	2.0
Central government bodies	2.0	-	2.0	-
Non-public sector organisations	0.2	0.1	0.1	-
Staff creditors	0.1	2.0	0.1	2.0
Accruals and deferred income	41.6	39.7	41.6	39.6
Central government bodies	3.8	4.1	3.8	4.1
Trading funds	0.1	0.1	0.1	0.1
Local authorities	0.7	0.3	0.7	0.3
Non-public sector organisations	36.9	35.2	36.9	35.1
Staff costs	0.1	-	0.1	-
Rationalisation, redundancy and early retirement costs – non-public sector organisations	0.9	1.6	0.9	1.6
Dividend	3.0	3.0	3.0	3.0
Total	**74.2**	**80.3**	**74.0**	**80.1**

15 Creditors: amounts falling due after more than one year

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Accruals and deferred income	0.1	0.4	-	0.4
Central government bodies	-	0.4	-	0.4
Non-public sector organisations	0.1	-	-	-
Rationalisation, redundancy and early retirement costs – non-public sector organisations	1.0	1.7	1.0	1.7
Total	**1.1**	**2.1**	**1.0**	**2.1**

16 Provisions for liabilities and charges

Group and Trading Fund

	Infrastructure maintenance and upgrades £ million	Decontamination £ million	Onerous contracts £ million	Total £ million
Balance brought forward	4.1	0.2	0.2	4.5
Utilised in year	(0.1)	(0.4)	-	(0.5)
Additions in year	0.1	0.2	0.9	1.2
Released in year	(0.1)	-	(0.2)	(0.3)
Balance carried forward	**4.0**	**-**	**0.9**	**4.9**

Infrastructure maintenance and upgrades A provision is recognised for certain infrastructure maintenance and upgrades where Dstl is legally responsible for the infrastructure concerned and there is a clear legal or constructive obligation resulting in an expected transfer of economic benefits. The timing for the transfer of economic benefits for the remaining amount is uncertain, but is expected to be completed before 2009.
Decontamination A provision has been recognised for certain contamination costs on Dstl sites where there is a clear legal or constructive obligation resulting in an expected transfer of economic benefits. This has now been completed.
Onerous contracts A leased property in Dunfermline had been vacated as part of a reorganisation programme. Under the terms of the contract, Dstl was liable for rent and some utilities until 11 August 2006.
All employment-related claims were settled during the year.
Dstl occupies a site at Farnborough under the terms of an operating lease. On exit from this lease during 2008, Dstl has an obligation (under dilapidation terms of the contract) to repair and refurbish the occupied areas of the site. It is unlikely that there will be liabilities on exit from other sites.

17 Operating leases

Group and Trading Fund
Commitments for rental payments under non-cancellable operating leases payable during the year to 31 March 2008 are as follows:

	2007 £ million	2006 £ million
Buildings		
Leases expiring:		
– within one year	3.2	3.3
– between two and five years	4.2	4.1
– over five years	-	-
Plant and machinery		
Leases expiring:		
– within one year	0.1	0.7
Total	**7.5**	**8.1**

18 Public dividend capital

Group and Trading Fund	2007 £ million	2006 £ million
Balance brought forward	50.4	50.4
Net movement in year	-	-
Balance carried forward	**50.4**	**50.4**

19 Revaluation and other reserves

	Note	Revaluation reserve Group £ million	Revaluation reserve Trading Fund £ million	Profit and loss account Group £ million	Profit and loss account Trading Fund £ million	Total Group £ million	Total Trading Fund £ million
At beginning of year as previously reported		36.9	36.9	130.7	131.5	167.6	168.4
Retained profit for the year		-	-	20.1	19.8	20.1	19.8
Release from revaluation reserve		(0.6)	(0.6)	0.6	0.6	-	-
Revaluation of tangible fixed assets	10, 11	4.5	2.6	-	-	4.5	2.6
Balance carried forward		**40.8**	**38.9**	**151.4**	**151.9**	**192.2**	**190.8**

20 Reconciliation of movements in Government funds

Government funds represent reserves

	Note	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Retained profit for the year		20.1	18.8	19.8	19.6
Movements on revaluation reserve	19	4.5	0.3	2.6	0.3
Net movement in Government funds		24.6	19.1	22.4	19.9
Balance brought forward		218.0	198.9	218.8	198.9
Balance carried forward		**242.6**	**218.0**	**241.2**	**218.8**

21 Analysis of the balances of cash as shown in the Balance Sheet

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Cash at bank and in hand	0.4	0.4	0.4	0.4
Short-term deposits	87.5	78.3	86.8	78.3
Balance carried forward	**87.9**	**78.7**	**87.2**	**78.7**

Analysis of changes in cash and cash equivalents during the year

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Balance brought forward	78.7	61.9	78.7	61.9
Increase in cash and liquid resources	9.2	16.8	8.5	16.8
Balance carried forward	**87.9**	**78.7**	**87.2**	**78.7**

Financial instruments

The Trading Fund and its subsidiary undertaking's principal financial instruments comprise cash and short-term deposits. The main purpose of these financial instruments is to finance the Group's operations. The Group has various other financial instruments, such as trade debtors and trade creditors, that arise directly from its operations.
It has been the Group's policy throughout the year that no trading in financial instruments shall be undertaken.
The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank current account facilities and investment of surplus funds in short-term, interest-bearing accounts.
The main risks arising from the Group's financial instruments are liquidity risk and foreign currency risk. The Board reviews and agrees policies for managing each of these risks. These policies have remained unchanged throughout the year. There is no interest rate risk. All investments are short term at a fixed rate. The Group has limited transactional currency exposures. Such exposures arise from sales or purchases by an operating unit in currencies other than sterling.
The Group does not use forward currency contracts to eliminate such exposure to currency losses.

22 Analysis of changes in financing during the year

Group and Trading Fund

	Note	2007 £ million	2006 £ million
Public dividend capital			
Balance brought forward		50.4	50.4
Net movement in year		-	-
Balance carried forward	**18**	**50.4**	**50.4**

23 Capital commitments

	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Capital expenditure that has been contracted for but has not been provided for in the accounts.	79.3	2.2	79.3	2.2
Capital expenditure that has been authorised but has not been provided for in the accounts.	3.9	87.4	3.9	87.4

24 Government accounting – losses and special payments

There were no losses or special payments exceeding £250,000 in the year.
There was a special payment during the year of £6,000.

25 Contingent liabilities

There are no contingent liabilities at the Balance Sheet date.

26 Related party transactions

Dstl is a trading fund owned by MOD.
MOD is regarded as a related party. During the year, Dstl had various material transactions with MOD with all transactions carried out under contract terms and subject to the normal course of internal and external audit:

	2007 £ million	2006 £ million
Sales	310.7	306.1
Purchases	11.1	6.8
Debtors	78.0	79.3
Creditors	8.0	7.9

Ploughshare Innovations Limited is a wholly owned subsidiary undertaking of Dstl. Details are provided in Note 1c. Inter-company trading has been eliminated on consolidation using the acquisition method. During the year, the following trading occurred with Ploughshare Innovations Limited, which was carried out under contract terms:

	2007 £'000	2006 £'000
Sales and other operating income	553.8	270.8
Purchases and expenses	314.5	112.6
Debtors	1,270.1	652.8
Creditors	-	20.7

Within the debtors balance is an inter-company loan, and the related interest receivable, set at an interest rate of the base rate plus two per cent. The loan arrangement is on demand, with a total limit set at £750,000. It is repayable on the third anniversary of the loan agreement, which is 6 April 2008. The repayable amount at year end is £200,000 (2006: £250,000), with interest receivable of £27,000 (2006: £8,448). During March 2007, Ploughshare Innovations Limited repaid £250,000 of the loan, when the balance owed stood at £450,000. During the year, Dstl transferred its joint venture holdings in Acolyte Biomedica Limited and Remo Technologies Limited to Ploughshare Innovations Limited. For each of these transfers, Dstl received 10,000 ordinary £1 shares in Ploughshare Innovations Limited. At the date of transfer, the Dstl historic cost carrying values of Acolyte Biomedica Limited and Remo Technologies Limited were £489,800 and nil, respectively. For Dstl, the transfers have resulted in a loss on disposal of £488,800 for Acolyte Biomedica Limited and a gain on disposal of £10,000 for Remo Technologies Limited. The transfer of Dstl's holdings in Acolyte Biomedica Limited to Ploughshare Innovations Limited was to enable the subsequent disposal of the joint venture to a third party to be realised while in the ownership of the subsidiary undertaking. During the year, an agreement was put in place to transfer all beneficial interests from Dstl to Ploughshare Innovations Limited of its joint venture holdings in Porton Plasma Innovations Limited (P2i) and Leading Light Scientific Limited. At the date of transfer, the Dstl historic cost carrying value of P2i was £297,400, resulting in a loss on disposal to Dstl of £297,400. The Dstl historic cost carrying value of Leading Light Scientific Limited was nil. Dstl's holdings in its joint venture with Alaska Food Diagnostics Limited transferred to Ploughshare Innovations Limited during the reporting year ended 31 March 2006. Ownership of the investment has remained with the subsidiary undertaking during the current year. Dstl's holdings in its joint venture with Enigma Diagnostics Limited remain with the parent Trading Fund. Details are provided in Note 11.

Joint ventures and associate

There has been no related party trading with the joint ventures Alaska Food Diagnostics Limited, Remo Technologies Limited, Porton Plasma Innovations Limited (P2i), Leading Light Scientific Limited and Enigma Diagnostics Limited. Tetricus Limited is an associate, and Acolyte Biomedica Limited was a joint venture of Dstl, which was disposed of during the year following transfer to P2i. These entities are considered to be related parties. Details of the joint ventures and associate are provided in Notes 1(c), (d), (e), and 11. During the year, the following trading occurred with these entities, which was carried out under contract terms:

	Sales		Purchases	
	2007	2006	2007	2006
	£	£	£	£
Acolyte Biomedica Ltd	2,340	5,760	-	-
Tetricus Ltd	129,308	140,686	16,998	70,103

	Debtors		Creditors	
	2007	2006	2007	2006
	£	£	£	£
Acolyte Biomedica Ltd	-	3,899	-	-
Tetricus Ltd	-	8,813	-	17,258

Other public sector bodies

Other public sector bodies are regarded as related parties by virtue of being under the same common control. During the year, Dstl had various material transactions with certain public sector bodies. All transactions are carried out on contract terms and are subject to the normal course of internal and external audit.

	Sales		Purchases	
	2007	2006	2007	2006
	£'000	£'000	£'000	£'000
British National Space Centre	634.9	1,342.0	-	-
Dept for Transport, Local Government and the Regions	1,241.0	614.7	-	-
Department of Health	689.3	951.1	-	-
Department of Trade and Industry	845.0	755.3	-	-
Engineering and Physical Sciences Research Council	-	-	-	-
Government Communications Headquarters	6,263.5	5,081.7	-	38.4
Home Office	14,215.6	11,401.3	0.1	-

	Debtors		Creditors	
	2007	2006	2007	2006
	£'000	£'000	£'000	£'000
British National Space Centre	291.1	956.8	-	-
Dept for Transport, Local Government and the Regions	999.0	-	-	46.4
Department of Health	-	-	-	890.5
Department of Trade and Industry	33.1	28.2	230.9	737.6
Engineering and Physical Sciences Research Council	-	-	-	800.0
Government Communications Headquarters	1,985.7	1,521.8	181.7	310.1
Home Office	3,611.2	4,805.3	875.9	2,649.8

27 Post-balance sheet events

No events have occurred subsequent to the financial year end that require disclosure in these financial statements.

28 Reconciliation of operating profit to operating cash flows

	Note	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Operating profit as per profit and loss account		19.0	18.7	19.8	19.5
Depreciation charge on owned tangible fixed assets	3, 10	7.2	8.0	7.2	8.0
Adjustment/downward valuation of tangible fixed assets	3, 10	1.1	-	1.1	-
(Increase)/decrease in stocks		(0.6)	1.4	(0.7)	1.3
Decrease in debtors		1.7	8.7	1.2	8.2
Decrease in creditors due within one year		(4.5)	(13.0)	(4.5)	(13.2)
Decrease in creditors due after more than one year		(1.0)	(0.7)	(1.0)	(0.7)
Increase/(decrease) in long-term provisions		0.4	(0.7)	0.4	(0.7)
Net cash inflow from operating activities		**23.3**	**22.4**	**23.5**	**22.4**

29 Reconciliation of net cash flow to movement in net funds

	Note	2007 Group £ million	2006 Group £ million	2007 Trading Fund £ million	2006 Trading Fund £ million
Increase in cash and liquid resources	21	9.2	16.8	8.5	16.8
Changes in net funds		9.2	16.8	8.5	16.8
Balance brought forward		78.7	61.9	78.7	61.9
Balance carried forward		**87.9**	**78.7**	**87.2**	**78.7**

30 Analysis of net funds

Group	Note	1 April 2006 £ million	Cash flows £ million	31 March 2007 £ million
Cash	21	0.4	-	0.4
Short-term deposits	21	78.3	9.2	87.5
Cash and cash equivalents		78.7	9.2	87.9
Debt due within one year		-	-	-
Debt due after one year		-	-	-
Debt		-	-	-
Total		**78.7**	**9.2**	**87.9**

Trading Fund				
Cash	21	0.4	-	0.4
Short-term deposits	21	78.3	8.5	86.8
Cash and cash equivalents		78.7	8.5	87.2
Debt due within one year		-	-	-
Debt due after one year		-	-	-
Debt		-	-	-
Total		**78.7**	**8.5**	**87.2**

Five-year summary

This information is not subject to audit.

	*Group 2007 £ million	*Group 2006 £ million	2005 £ million	2004 £ million	2003 £ million
Profit and Loss					
Turnover	367.1	353.4	353.3	358.1	343.5
Operating profit before impairments	20.1	18.7	23.2	19.8	13.3
Impairments/exceptional items	(1.1)	-	(4.7)	-	0.5
Loss on disposal of fixed assets	-	-	(0.3)	(0.1)	-
Interest receivable	4.1	3.1	2.0	1.0	1.5
Interest payable	-	-	-	(0.2)	(0.4)
Profit for the financial year	23.1	21.8	20.2	20.5	14.9
Dividends	(3.0)	(3.0)	(3.0)	(3.0)	(6.0)
Retained profit for the year	20.1	18.8	17.2	17.5	8.9
Balance Sheet					
Fixed assets	134.3	124.6	122.9	125.5	109.8
Working capital	26.4	21.3	22.1	34.4	15.8
Cash and cash equivalents	87.9	78.7	61.9	26.6	29.7
Creditors: amounts falling due after more than one year	(1.1)	(2.1)	(2.8)	(4.4)	(7.2)
Provisions for liabilities and charges	(4.9)	(4.5)	(5.2)	(5.6)	(7.6)
Net assets	242.6	218.0	198.9	176.5	140.5
Cash Flow					
Cash inflow/(outflow) from operating activities	23.3	22.4	43.5	11.3	24.7
Net cash inflow from returns on investments and servicing of finance	4.1	3.0	1.9	0.8	1.1
Capital expenditure and financial investment	(15.2)	(5.6)	(6.0)	(7.1)	(10.3)
Acquisitions and disposals	-	-	-	-	-
Dividends paid	(3.0)	(3.0)	(3.0)	(6.0)	(6.0)
Cash inflow/(outflow) before financing	9.2	16.8	36.4	(1.0)	9.5
Net cash outflow from financing	-	-	(1.1)	(2.1)	(2.1)
Increase/(decrease) in cash	9.2	16.8	35.3	(3.1)	7.4
Return on Capital Employed	8.1%	8.8%	9.4%	11.9%	9.6%

*The Group includes consolidation of wholly owned subsidiary undertaking, Ploughshare Innovations Limited.

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Dstl Executive at 31 March 2007

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Chief Executive

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Finance Director

Peter Starkey
Future Business Director
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