DSG
DEFENCE SUPPORT GROUP

ANNUAL REPORT AND ACCOUNTS
2012/2013

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MINISTRY OF DEFENCE

DSG
DEFENCE SUPPORT GROUP

DEFENCE SUPPORT GROUP
Annual Report and Accounts

2012/2013

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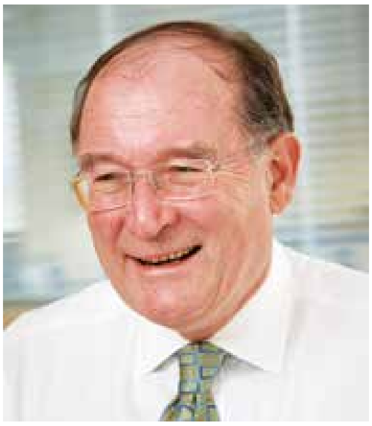
INTRODUCTION FROM THE CHAIRMAN

As Chairman of the Defence Support Group's (DSG) Trading Fund Board (TFB) it is my responsibility, along with my fellow Non-Executive Directors (NEDs), to provide advice, guidance and challenge to the DSG Management Board using the varied skills and expertise we have developed in our various careers at senior management level in both public and private sector. The role of Chairman also extends to me supporting DSG's Chief Executive on the Ministerial Owner's Advisory Council (OAC) chaired by MOD's Minister for Defence Equipment, Support and Technology, (Min(DEST)), Philip Dunne who holds this responsibility on behalf of the Secretary of State for Defence.



ALEX JABLONOWSKI
DSG Chairman

This latest Annual Report and Accounts, which covers the 2012/13 financial year, provides a clear indication of DSG's excellent trading performance during the year. Despite continued pressures on the public purse and budgetary constraints, DSG's employees continued to rise to the challenges of delivering an outstanding service to the UK's Armed Forces both at home and overseas, particularly in the on-going operational environment in Afghanistan.

Witnessing the work ethic and commitment of the DSG employees gives me great confidence for the future success of the business whether that is in public or private ownership. Any private sector organisation would benefit greatly from the skills and expertise that is so abundant across all areas of the DSG business and it is this knowledge and experience that gives DSG its value and worth within the defence industry. There is little doubt in my mind of the high regard in which DSG and its employees are held both within Government and externally in the wider world of business.

DSG has an important and essential role in the future support of the UK's Armed Forces, which the business is demonstrating fully by taking a key role in the emerging strategies supporting the Army 2020 vision. DSG's reputation continues to grow across its customer base as it cements its presence in Camp Bastion and continues providing innovative and effective solutions for the equipment support requirements of the Armed Forces of the future.

My introduction would not be complete without my offering thanks to my fellow Directors for their valued advice, expertise and support, which they share willingly and to great effect. These thanks extend to DSG's Chief Executive, Archie Hughes and his team of Executive Directors and senior management who are well equipped to continue driving DSG forward during these times of austerity and challenge.

In conclusion, I have every confidence in DSG, its employees and its role as a support provider with a secure future.

Alex Jablonowski
Chairman
Defence Support Group
27th June 2013

STATEMENT BY THE CHIEF EXECUTIVE

The 2012/13 Annual Report and Accounts of DSG demonstrate the solid performance of the business during the year whilst in a challenging environment of changing priorities and evolving strategies.

ARCHIE HUGHES
Chief Executive

DSG's performance is measured across four distinct areas of business. The first assesses Quality in both the Air and Land environments where DSG must achieve no more than one and fewer than seven major customer concerns respectively over the reporting period. The second area measured is Delivery in Air and Land where DSG must achieve 96% delivery of all Air programmes, 97% delivery of Land's Critical Programme Lines and 92% of all Land Load tasks. The third measure is Efficiency where DSG must develop the DSG Capability Growth Programme (CGP) in support of the Land Change Programme and grow shareholder and sale value. The final measure used to assess DSG's performance is Financial Performance which requires a minimum 5% Return on Capital Employed (ROCE). This year, once again, DSG achieved all the targets set by Ministers.

It is in Camp Bastion in Afghanistan, where DSG's contribution to the efforts of the UK's Armed Forces efforts is most visible to the customer and end-users. Although an integral part of MOD, it is as the prime contractor that DSG is enhancing operational capability whilst providing MOD with cost avoidance savings to date of over £90m since DSG began working in the Equipment Sustainability System (ESS) regeneration facility. With over 100 DSG employees volunteering at a time for deployment tours lasting from 6 to 12 months and sometimes longer, it is little wonder the work of the DSG employees earns justifiable praise from Ministers, politicians, Service chiefs and senior civil servants. However, it is the recognition of the value of their work at the serving soldier level that means most to the volunteers working so far from home and their families, in the most hostile of environments.

During the year, DSG played a key role in the Operation HERRICK redeployment planning. DSG will play a fundamental part in ensuring the end-to-end equipment redeployment process is achieved in good order, through the establishment of the DSG Equipment Redeployment Hub Forward (ERHF) in Bastion and the HERRICK Exchange Point (HXP) in Warminster. DSG will receive equipment from the battlefield, managing it through recuperation and delivering it to the Army in the home base ready for future operations and training.

DSG's various business units produced another sound operating performance this year with many of the smaller DSG businesses, which previously relied on the profit generated by the larger businesses to carry them through the year, now making their own positive contributions to the success of the overall DSG bottom line performance. This was achieved by keeping a firm control on costs and managing their businesses effectively and efficiently. It is important to emphasis the contribution made by the corporate areas in DSG to the overall business performance this year with corporate overheads and costs now at £9.7m, which is a large reduction from the original combined figure of £25.5m back in 2008 at the launch of DSG. However, there is still more to do to reduce our reliance on the numbers of indirect employees and bring in further reductions in overheads and costs.

Shaping DSG for the future was a high priority during the year with significant work undertaken in collaboration with our customers to develop a long-term strategy for the business. The collective vision is for DSG to embrace all aspects of the support chain to the UK Army's various fleets from receipt through inspection, storage and eventual disposal. This aspiration, of course, includes DSG's

traditional role of maintenance, repair, overhaul (MRO) and upgrade as well as assembly, integration and test (AIT) besides our growing capabilities in support of deployed operations.

We now have close involvement in a number of high profile projects driven by Army HQ, which include deepening DSG's role in Fleet Management (FM), the Army's future footprint – Project BARNDALE – and projects looking at Light Weapons support and maintenance and repair optimisation. All these activities come under the umbrella of DSG's CGP, which aims to give DSG a clear vision for the future success of the business.

I make no apology for repeating my annual mantra that it is DSG's employees that are, without a doubt, this business's greatest asset. During the year, promising improvements in the Civil Service People Survey repaid the sterling work undertaken during the year to act on the findings of the surveys from previous years. There is no room for complacency and although we still have some way to go these positive moves are in the right direction and I have every confidence we will build on these successes.

However, wage freezes, changes to pension and redundancy terms and conditions and the uncertainty in the minds of employees over the Government's intention to sell DSG to industry all combine to cause great concern for our employees, which is entirely understandable in the current economic climate. I take great pride in leading such a customer focussed team who have demonstrated, during the year, great resilience and commitment to their customers and colleagues across the business, MOD and the wider defence industry.

In DSG, we recognise the importance of developing our employees in order that they may achieve their maximum potential and emerge as future leaders of the business. During the year, we have broadened the roles of identified individuals in order to grow their skills and experience. We are now witnessing a rich seam of talent, which we can best utilise for the DSG of the future.

In conclusion, DSG has proved to be an adaptive, cooperative and responsive partner in support of the UK's Armed Forces. It produced an excellent financial and operational performance during the year due to the continued professionalism and expertise of a world-class workforce and I have every confidence in the future success of this business whether this is in public or private sector ownership.

Archie Hughes
Chief Executive
27th June 2013

BOARD OF DIRECTORS

ARCHIE HUGHES
Chief Executive

GERAINT SPEARING
Chief Operating Officer

DAVID MORGAN
Commercial Director

ARCHIE HUGHES
Chief Executive

Archie Hughes is responsible to the Owner and Parliament for delivering the strategic aims and objectives of the business and providing corporate governance leadership.

Archie was Defence Aviation Repair Agency's (DARA) Chief Executive from January 2004 until he assumed responsibility for the merger of the ABRO and DARA in July 2007 to form DSG when he took on the role of Chief Executive. He has extensive experience in changing business culture; delivering improved business performance; and acquiring, integrating and managing high technology engineering and manufacturing businesses in the Defence and Aerospace industries. An honours graduate from Strathclyde University, he was previously Chief Executive of Vickers Defence Systems, encompassing Specialist Engines and Vickers OMC as well as the Main Battle Tank and Military Bridging businesses.

GERAINT SPEARING
Chief Operating Officer

DSG appointed Geraint Spearing as DSG's new Chief Operating Officer (COO) in February 2012 following the retiral of John Reilly.

Geraint began his career as a technician apprentice at St Athan in 1989 on a dual four-year apprenticeship with MOD. His career path followed management roles in DARA where he became Business Director at DARA Almondbank, Scotland, following a period in management roles on the shop floor supporting the Hawk Training Fleet among others. He then held responsibility for DSG Sealand business unit before taking on the post as Head of DSG's Support Functions where he led the project to merge into DSG the vehicle support activities undertaken in the Defence Storage and Distribution Agency.

DAVID MORGAN
Commercial Director

David Morgan is responsible for all DSG's customer and supply chain activities across the various business interests.

Prior to joining DSG, David was Commercial Director (CD) for the Technology Solutions Sector at QinetiQ with responsibility for building a team supporting the commercial negotiating and management of contracts at both a national and international level.

Starting his career at British Aerospace, he moved into senior commercial roles at both KBR and Logica.

STEVE HALL
Finance Director

JANE WILLIAMS
Human Resources Director

KEITH NORRIS
Strategy Director

STEVE HALL
Finance Director

Steve Hall, Finance Director (FD) is responsible for financial strategy, propriety and governance and the delivery of high quality management information to the business.

Steve was previously FD at DARA until he assumed the role of FD in DSG. He has extensive experience in finance, change management and project management gained from 20 years in a variety of senior roles in MOD and its Agencies. Prior to joining DARA, Steve was FD for Military Survey.

DEREK OWEN
Human Resources Director
(To October 2012)

Derek Owen, HR Director until October 2012, left DSG on voluntary early release, was responsible for the HR function as well as internal communications, parliamentary business and security policy.

JANE WILLIAMS
Human Resources Director
(From November 2012)

Jane Williams, HR Director is responsible for the HR function as well as internal communications, parliamentary business and security policy.

Jane has a wealth of senior management experience in the HR environment covering a number of government departments including; MOD's Defence Equipment and Support (DE&S); Department for Communities and Local Government; and the Department for Transport.

Apart from a short secondment to PricewaterhouseCoopers prior to joining MOD, Jane is a career civil servant. Her past roles include Acting Head of Unit for the Stabilisation Unit, which is HM Government's civilian response to conflict affected countries and in her first Senior Civil Service post, she was Head of HR Services with specific responsibility for the merger of the Strategic Rail Authority and Department for Transport (Rail).

She is a Chartered Fellow of the Chartered Institute of Personnel and Development.

KEITH NORRIS
Strategy Director

Keith Norris was appointed as DSG's Strategy Director (SD) in January 2008. He previously led the DARA Rotary and Components sales team in MOD Centre having previously conducted a number of strategic reviews of ABRO and DARA. He has worked extensively overseas, including Hong Kong as Assistant Civil Secretary - British Forces; Germany as secretary to the Tornado Board; Saudi Arabia on the Al Yamamah Project and more recently as Project Director of the UK/ South African Strategic Defence Equipment Programme.

ALEX JABLONOWSKI
Chairman

JANET BAKER
NED

DAVID BARRASS BSC. (MECH ENG), FCMA, FRSA NED

PETER SHORTT
NED

ALEX JABLONOWSKI
Chairman

As Chairman of DSG, Alex Jablonowski is responsible for leading the Board to ensure it operates efficiently and effectively and to oversee and scrutinise the organisation's plans and performance.

Alex had a 30-year career with Barclays retiring as CEO Barclays International. He has considerable experience of managing technology based operational service businesses and of strategic planning, having served as Barclays Group Strategy Director. For the past 8 years, Alex has had a portfolio of interests across the public and private sector. He currently serves on a number of boards including the boards of the Supreme Court and the House of Commons and chairs its audit committees, the first non-MP to do so.

JANET BAKER
NED

Janet Baker worked as a management consultant at Coopers and Lybrand, Ernst and Young and then as a Senior Partner at PA Consulting Group. She is expert in all forms of organisational and commercial structuring and restructuring, including outsourcing and sale processes. Working on the development and delivery of Better Business Models across government, Janet was appointed Crown Commercial Lead in the Cabinet Office in February 2012. She is a member of the Audit Commission Board and a member of its Audit Committee. Janet is also a NED on the Audit Committee of HM Treasury and a NED member of the Board of the Rural Payments Agency as well as a member of its audit committee.

As a NED to the DSG TFB, Janet's role is to provide expert advice, guidance and challenge to the DSG Management Board. She is a member of the Audit Committee and Chairs the Remuneration Committee.

DAVID BARRASS BSC. (MECH ENG), FCMA, FRSA
NED

David Barrass's experience covers a broad range of industries both in the UK and internationally. He is currently Chairman of CastleCare Group Ltd, Gabbro Precision Ltd and SGX Sensortech Ltd. He also sits on Defra's Strategic Advisory Board for FERA.

As a NED to the DSG TFB, David's role is to provide expert advice, guidance and challenge to the DSG Management Board.

PETER SHORTT
NED
(From May 2012)

Peter is Head of Business Strategy and Governance at the MOD looking after a portfolio of defence related businesses and leads the Department's Asset Management Programme. Prior to joining MOD, Peter spent five years with the Shareholder Executive where, among other things, he helped create Capital for Enterprise, the Government's fund of fund investor and was on the Board of the Met Office.

Peter is an experienced venture capital fund manager having led and managed investments in a wide range of businesses and sectors ranging from IT to clean tech. He has taken businesses from initial seed investment to Initial Public Offering and sale.

He is also on the Board of the UK Hydrographic Office and the Oil and Pipeline Agency.

As a NED to the DSG TFB, Peter's role is to provide expert advice, guidance and challenge to the DSG Management Board.

EMMA DAVIES
NED
(To April 2012)

Emma's role was to represent MOD on the DSG TFB; and provide expert advice, guidance and challenge to the DSG Management Board. Peter Shortt replaced Emma.

BUSINESS, MISSION, VISION AND STRATEGY

MISSION

To be a trusted partner in the delivery of assembly, MRO, upgrade and support services for the UK Armed Forces.

VISION

Excel in Supporting Defence.

STRATEGY

DSG provides MOD secure access to assured onshore capacity and capability for through life MRO, upgrade and procurement services for Defence equipment in line with the Defence White Paper 'National Security through Technology: Technology Equipment and Support for UK Defence and Security Feb 12'. DSG's core mission is to be a trusted partner supporting the UK Armed Forces; support and deliver wider Defence objectives, including current and future, MOD equipment acquisition and support strategies.

DSG pursues a strategic goal of achieving 'best value for Defence' through focusing on and delivering, where appropriate, cost reduction, efficiency and productivity improvements as well as improved delivery to the customer across all areas of the business. In support of this, the strategic aims of DSG are to:

- Go forward as a trading fund until the point of sale, which is currently planned to be by the end of FY14/15 at the latest;
- Continue to contribute to the Land Support Change Portfolio including the development of customer initiatives such as the Land Equipment Support Strategy (LESS), Director General Land Support and Equipment Change Portfolio and the Total Support Force (TSF);
- Work closely with the Air customer to explore new development opportunities (seedcorn) and sustain extant capabilities as necessary to support legacy fleets;
- Continue to work closely with our Land Customer to ensure that the future strategic direction and capability growth which DSG pursues is in line with what they require;
- Be agile, flexible and provide its services directly to MOD or indirectly through industrial primes/ original equipment manufacturers where it will position itself to be the partner of choice on major Land equipment acquisition and support programmes;
- Maximise and where necessary sustain utility to provide a core capability to support the UK Armed Forces. It will work closely with MOD customers to ensure that it is appropriately funded to enable it to retain the required capacity and capability to support planned future acquisition and support strategies;
- Continue to provide a flexible response to meet evolving operational requirements particularly in terms of surge and urgent operational requirements (UOR), support to deployed operations, training for operations and develop its capabilities to provide support to customers at their preferred locations;
- Provide physical AIT capabilities as required by the customer/industry;
- Actively explore opportunities for supporting MOD, either on its own or in partnership with industry, in the management of current and future Land equipment fleets;

- Build upon and grow its capability and knowledge base in support of Defence assets, including its ability to utilise MOD free user rights of third party Intellectual Property Rights;

- Focus on developing the necessary capabilities to enable it to be deployed in a flexible manner as part of planned future procurement and support strategies;

- Be a modern, lean organisation, structured as a series of businesses supported by a slim line Head Office;

- Continue to operate from Ashchurch during the period of this plan but will work with Defence Infrastructure Organisation (DIO) and Army HQ to ensure continuity of output as the future of Ashchurch becomes clearer;

- Continue to operate from Stafford and support the Air customers ongoing review of its long-term requirements;

- Work with Army HQ and DIO to ensure continuity of support in line with the recommendations of the Regular Army Basing Plan; and

- Take forward any DSG specific recommendations of the Strategic Defence and Security Review (SDSR) and Defence Transformation as well as embracing appropriate elements of the Civil Service Reform agenda.

CAPABILITY GROWTH PROGRAMME

DSG has been very successful in growing horizontally across the Land environment. It has expanded the service and range of products delivered by Land Supply Business Unit (LSBU); absorbed the vehicle receipt, inspection, maintenance and storage activities previously carried out by Logistic Commodity & Services (LCS) at Ashchurch, Longmoor and Catterick; and has broadened its support to the Land Fleets such as the Operational Training Equipment Pack (OTEP) and the Reinforcing Fleet. Vertical growth has seen DSG expand into the AIT arena supporting new vehicles acquisitions.

In late 2011, DSG embarked on its CGP and formally stated its intent to move the business from MRO to FM. Recognising the gaps in DSG's capability the business has sought to grow its capabilities incrementally, leveraging its role in support of the Training Fleets, its Light Weapons (LW) support role, the success of LSBU; aligning its footprint to current and future Army requirements and the Army 2020 outcomes.

The key components of the CGP are:

- Light Weapons Strategic Support Suppliers - To deliver an evaluation and statement of requirement for a LW 'Contracting for Availability' service, covering provisioning and procurement activity; through receipt, store, maintain and issue to the distribution/collection; and eventual disposal of in-scope equipment by DSG and LCS.

- FM – Working with Army HQ to plan, manage and optimise the Land Forces equipment fleets in order to deliver the required outputs at agreed standards and in the most efficient and cost effective manner. This includes the incremental growth of the OTEP and Reinforcing Fleet concepts across the Land Fleets beginning with the Training Fleets.

- Project BARNDALE - to align the DSG infrastructure to deliver future operational capability in support of SDSR and Army 2020 outcomes.

- TSF/Joint Endeavour for Maintenance Repair Optimisation - To deliver an agile, optimised DSG/REME maintenance and repair regime that strategically aligns a Total Equipment Support Solution with the Army's TSF concept.

PERFORMANCE AGAINST INTERNAL BUSINESS MEASURES

FY12/13 Internal Business Measures (IBM), reflect continuous improvement in those areas identified as being critical to DSG performance for inclusion in the DSG FY12/13 Corporate Strategic Plan (CSP). DSG developed these business measures in consultation with the MOD Owner and Customer focal point to ensure they continue to be relevant. Additionally, they needed to align with MOD's strategic priorities arising from SDSR.

PERFORMANCE AGAINST BUSINESS MEASURES

Business Measure 1: **Quality** Deliver an improved quality performance by: • Air - achieving no more than 1 attributable Major Customer Concern; and • Land – achieving no more than 7 attributable Major Customer Concerns.	**Achieved**
Business Measure 2: **Delivery** Meet delivery standards as agreed with the Customer as follows: • Air Business – achieve 96% delivery of Customer Programmes; and • Land Business – achieve: 94% (Sep 12 and Dec 12) and 97% (Mar 13) delivery on Critical Programme Lines; and 92% of all LAND Load Tasks.	**Achieved**
Business Measure 3: **Efficiency** To develop the DSG CGP in support of the Land Change Programme and grow DSG shareholder and sale value.	**Achieved**
Business Measure 4: **Financial Performance** Achieve at least a 5% ROCE.	**Achieved**

DSG will continue to work with the Customer focal point in FY13/14 to subsume IBM 2 within the body of new commercial arrangements and reflect any changes to these measures in FY14/15 IBMs where appropriate. FY 13/14 business measures are:

Business Measure 1: **Quality**

Deliver an improved quality performance by:
• Air - achieving no more than 1 attributable Major Customer Concern; and
• Land – achieving no more than 6 attributable Major Customer Concerns.

Business Measure 2: **Delivery**

Meet delivery standards as agreed with the Customer as follows:
• Air Business – achieve 96% delivery of Customer Programmes; and
• Land Business – achieve: 94% (Sep 13 and Dec 13) and 97% (Mar 14) delivery on Critical Programme Lines; and 92% of all LAND Load Tasks.

Business Measure 3: **Efficiency and Transformation**

To support MOD's Business Strategy and Governance, and their appointed advisors, in preparing DSG for sale in accordance with the DSG sale strategy and timetable.

Business Measure 4: **Financial Performance**

Achieve at least a 5% ROCE.

BUSINESS PERFORMANCE REVIEW

OPERATIONAL PERFORMANCE

The combined operational performance of DSG's various business units produced another successful year for the organisation; achieved by driving through and embedding continuous improvements in efficiencies and cost controls whilst maintaining a focus on meeting customers output requirements.

Employing almost 700 staff, DSG Donnington is the largest of DSG's businesses. Based in Shropshire, the unit works on various military platforms ranging from Warrior fighting vehicles to other combat vehicles/equipment and LW. Consolidating DSG's relationship with Lockheed Martin began in earnest this year with work starting on the Warrior Capability Sustainment Programme (WCSP) which involved the conversion of the vehicles' turrets. This is an important Programme of work for DSG, which will showcase the capabilities of the Donnington employees when working in partnership with the private sector. Along with their colleagues in DSG Ashchurch, the Donnington employees rose to the challenge of completing the re-hulling of 60 Combat Vehicles Reconnaissance (Tracked) in time to meet the tight deadlines required to clear the approval timescales and get the vehicles out to Theatre (Afghanistan).

During the year, the DSG Board approved investment of over £340,000 in DSG Donnington in order to install capital equipment designed to improve and strengthen support to the shop floor.

At DSG Ashchurch, the unit has almost 200 employees where the focus this year was predominantly on rationalisation of the DSG footprint allowing us to vacate and return three vehicle storage sheds to the MOD thus reducing costs. The team at Ashchurch improved the Bowman equipment accounting, testing and processing while meeting the customer delivery targets. An important aspect of Ashchurch's output during the year was the continued support to British Army Training Unit Suffield training fleets in Canada, channelled through Marchwood Military Port; and ongoing support to Front Line operations by delivering urgently required platforms such as Foxhound.

DSG Bovington in Dorset is DSG's second largest business employing nearly 400 staff and providing corporate services for other DSG operating units such as support for the deployment of DSG employees in Camp Bastion. The unit successfully delivered its final output for the range of Multi-

Foam Vehicles and the Remus Programme of Land Rovers. The team delivered 203 Foxhound Pods as part of DSG's role on this new platform and they are on track to deliver the full requirement of Challenger Armoured Repair and Recovery Vehicles within the agreed timescale with the Customer.

Although one of DSG's smaller businesses, DSG Warminster customers recognise it as the Centre of Excellence supporting the Army's training fleet of vehicles. The unit employs around 180 staff and supports our satellite teams at Abingdon, Brawdy, Chivenor, Tidworth, St Athan and Sennybridge as well as housing a large element of the Corporate IS team, which supports all of the DSG sites throughout the UK and provides limited support to DSG staff in Camp Bastion.

At DSG Colchester, employees regularly volunteer for deployment to Camp Bastion and at any one time, around 10% of Colchester's workforce may be in Theatre at our facility in Afghanistan. It employs nearly 150 staff, but the site also supports the DSG teams based at Aldershot, Longmoor, Wattisham and Woolwich. Community successes for the unit during the year include the Colchester Business and Essex County Council award for its active and sustainable travel policies for the second successive year.

DSG Catterick employs nearly 120 staff and, besides supporting DSG operations on deployments during the year, the team refurbished 45 Pinzgauer vehicles on behalf of Navy Command HQ. Mobile Support Teams from Catterick also provided support to the Defence School of Training at Leconfield over a three-month period. Aligned to Catterick is Kinnegar, DSG's only footprint in Northern Ireland, which employs 8 staff on hand to support the Army's vehicles as well as offering support on deployed operations.

One of DSG's smaller, main sites is DSG Stirling with 80 employees. However, this unit punches well above its weight when it comes to supporting Land equipment platforms and offering volunteers for deployment to Camp Bastion. After three years, the Remus Programme ended with a ceremony at Stirling, which was the DSG site that piloted the original Programme. The customer praised the Stirling workforce for their efforts and excellent working relationship that developed during the pioneering pilot of the Remus design back in 2009.

DSG's Electronics and Components Business Unit (ECBU) at Sealand in North Wales employs almost 380 staff. In addition to its work within the Air sector on Tornado, Hercules Air Commodities and Calibration, Sealand has also secured new work in the Land sector, including the Defence Science and Technology Laboratory and the International Guns, Munitions and Rockets Project Team. The unit has secured work on the Typhoon aircraft predominantly working on fibre optic cabling and test equipment. Sealand also provides support and governance to DSG Stafford where there are 78 staff working on a variety of tasks for the Air and Land customers. Sealand retains a small satellite operation at DSG Donnington as well as supporting a number of units such as Medical and Dental; Calibration and Crypto, which are all spread across the country from Leuchars in Scotland to Portsmouth on the south coast; and overseas in order to be close to the end-user.

ECBU maintains a deployed Level 4 support capability in the DSG ESS facility in Camp Bastion. This has delivered cost savings of over £2m and returned critical equipment to service in a matter of days compared to the months required to return the equipment to the UK for maintenance. This service is highly regarded by the customer and in-theatre capabilities include calibration, electro-optical inspection and repair, plus engineering support to the regeneration of Electronic Counter Measures and vehicle support tasks.

The Donnington site is also home to DSG's LSBU, which employs 250 staff working on the procurement and inventory management of a wide range of equipment totalling around 250,000 items, predominantly consumable parts for the UK's Land Forces. It spends annually in excess of £200m on behalf of its customers. In December 2012 Director Equipment Support, Director Land Equipment (DES LE-Dir) presented LSBU with a commendation in recognition of the support provided by the unit to front line operations in Afghanistan. It also recognised the innovative approach taken by the unit in providing 'unparalleled levels of support' to the DE&S project teams, which will deliver a robust and agile forecasting and planning business application. This has delivered benefits of around £60m during the reporting period. LSBU is playing a key role in the Chief of Defence Materiel's (CDM) Inventory Management Initiative, which is initially showing that DSG's approach to inventory management may be the exemplar for MOD to follow in the future.

DSG's operations in Camp Bastion continue to receive praise and plaudits not only from senior figures, but also from those most valued by the DSG employees, the Servicemen and women for whom this equipment is saving many lives and contributing to the efforts of the British Armed Forces in Afghanistan. The facility is now working to maximum capacity with work on Electro-Optics undertaken within the Battalion HQ. DSG Bastion is also making its own major contribution to DSG's overall operational performance. During the year, the Bastion facility regenerated around 70 platforms every month and employees extended their capabilities by regenerating additional platforms such as Warrior, Husky and Warthog.

DSG Bastion has contributed cost avoidance savings in excess of £90m to MOD since DSG began operating the Permanent Joint Headquarters (PJHQ) ESS in 2009. The Customer extended the original three-year full operating capability (FOC) contract awarded to DSG in 2010 by a further year through to 2014. With just over 100 employees working in the facility under the existing contract, the DSG numbers swelled to over 130 with the addition of a DSG team of 20 employees working on the PJHQ ERHF, which will see DSG staffing and helping manage the Programme to redeploy around 2000 vehicles to the UK.

In tandem with the team operating out of Afghanistan, DSG also provides a fully managed service for the HXP back in the UK enabling the recuperation of vehicles back into the Army's fleet at home. Both the ERHF and HXP teams will work closely together to ensure the whole vehicle inspection, storage and scheduled maintenance and repair records are accurate and aligned to the vehicle's passport. MOD's new Permanent Under Secretary (PUS), Jon Thompson, visited the DSG team in Camp Bastion earlier in the year on a familiarisation visit during which he presented the team with a Commander Equipment Capability Certificate of Commendation.

COMMERCIAL OVERVIEW

The focus for DSG's commercial team during the year was negotiating the New Commercial Agreement (NCA) with the Land Equipment customer, which runs from 1 April 2013 for a five-year period taking it out beyond the timeframe for sale. This involved the amalgamation of a number of existing contracts into the NCA, which now covers virtually all the work DSG undertakes for MOD. This was a major exercise involving all members of the Commercial team to various degrees during the year. Underpinning the NCA will be new ways of working for DE&S and DSG, which aims to support a wider transformation of both organisations.

The Commercial team supported the Business Strategy and Governance (BSG) team in MOD, which is leading on all aspects of the sale process, by providing input in response to BSG's requests for data. DSG has also supported the study activities carried out by the various consultancy and legal teams employed as advisors to BSG on sale matters.

STRATEGIC OVERVIEW

Before vesting as a trading fund on 1 April 2008, capacity and capability was a focus of interest. The prevailing strategic environment meant that declining customer workloads required DSG to focus on capacity and rightsizing the business. The strategic environment also required DSG to evolve and in some cases take on new capabilities, which included embracing the procurement and provisioning work previously undertaken by DE&S and now embedded in LSBU.

As a legacy equipment support provider it was an essential part of DSG's strategy to grow its portfolio of capabilities horizontally across a wider range of activities and equipments and vertically into new capabilities in order to remain viable.

DSG was very successful in growing horizontally across the Land environment. It expanded the service and range of products delivered by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LSBU; absorbed the vehicle receipt, inspection, maintenance and storage activities previously carried out by LCS at Ashchurch, Longmoor, Warminster and Catterick broadening its support to the Land Fleets such as the OTEP and the Reinforcing Fleet.

Vertical growth has seen DSG expand into the AIT arena, providing support to the FOXHOUND Light Protected Patrol Vehicle with Force Protection (Europe); WCSP with Lockheed Martin (UK); and subject to the requirements of the programme, Future SCOUT with General Dynamics (UK).

DSG has successfully demonstrated its ability to support equipment in the operational environment, vertically deepening its capability in support to deployed operations in Camp Bastion.

Although DSG has already developed a breadth and depth of capabilities, which provide the foundations for a true end-to-end support solution for the Land environment, it also recognises that it cannot stand still. The capability improvement and growth journey needs to continue irrespective of the potential sale of the business in order to shape DSG as a holistic support provider.

There are two major areas of capability growth that require addressing, which will complement the strategies of DE&S and Army HQ, providing the ability to deliver and support the development of Strategic Support Suppliers (SSS) and FM respectively.

The first is in support of our customer's desire to create SSS, we must offer a more complete service. This includes the ability to develop maintenance and repair solutions, which can influence fleet availability and more efficient MRO schedules and processes. The second is to grow our managerial capability and offer a full FM service to our customers.

To date, the evolution of DSG's capabilities was incremental and for the most part organic. As an in-house MOD business, this strategy has proved successful in providing quick wins for the customer and delivering improved performance and efficiencies across the Land environment. However, DSG has exhausted its ability to grow from within and the prospect of sale for the last two years has limited DSG's ability to acquire or partner as required. Indeed, sale may now offer the best opportunity for DSG to reach its destination and deliver the integrated support provider journey that began with the DSG Capacity and Capability Review in 2008.

Notwithstanding the confines of the current environment, DSG will work closely with both its MOD owner and Army customer to make sure that where it is both prudent and practical we will continue developing our capabilities through the DSG CGP.

BUSINESS SUPPORT OVERVIEW

DSG's business support functions provide the technical services covering areas such as Compliance, Estates and Facilities Management and Information Systems and Technology. These business critical activities are the responsibility of DSG's COO and the various teams responsible for delivering these services work closely with all areas of the business.

Health and safety in the workplace is a high priority for the DSG Board and this year the number of incidents that fall under the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR) were fewer than in previous years. Although the regulations changed in April 2012, increasing the sickness absence-reporting period from over three days to over seven days, DSG still saw fewer reportable incidents when using the previous reporting calculator. CO_2 emissions fell this year through concerted efforts in energy management and reductions in domestic travel by increased use of video-conferencing. DSG's Technical Support departments continue to develop the Baan engineering database, introducing more effective change controls.

DSG's Estates and Facilities Management Team responded swiftly to the urgent requirements necessary in support of the HXP Programme, which implemented upgrades to buildings at DSG Warminster to meet the initial operating capability (IOC) timeframe. The team is also working closely with DIO and Army HQ to facilitate, plan and potentially manage the provision of follow-on infrastructure requirements to meet the FOC. In relation to asset management, the team led a pan-DSG project to review the tools and various equipment held. In parallel to this project, the team reviewed and amended, where necessary, the systems and procedures used to record and maintain these assets. This ensures we are only holding, accounting for and maintaining the assets necessary for DSG's future success.

During the year, DSG's IS Department worked with the HR Department to bring the technical support for DSG's HR data system, Rebus, in-house. This resulted in reduced support costs thus providing DSG a greater ability to transfer personnel data more efficiently and effectively. The IS Team upgraded areas of the business suffering from poor wide area network connectivity. Upgrades to a larger bandwidth in all main areas of the business, stabilised performance and on those sites where DSG has its In-Barracks Equipment Support, teams are now benefiting from a sharing agreement with other MOD users located on the sites. The IS team played its role in supporting the HXP Programme at DSG Warminster and continues to work closely to deliver continuous improvements to IS service support.

ENVIRONMENTAL SUSTAINABILITY

Greenhouse Gas Emissions Data

The sustainability element of this year's report concentrates on the performance of DSG against MOD measures and IBMs for Sustainability. Greenhouse Gas (GHG) emissions and generated waste are both set against 2009/2010 baselines. The Disposals Services Authority waste is not included as DE&S accounted for it separately. The Business Travel Performance Target was against a 2011/2012 target, as it was the first year the data was robust, providing a suitable baseline from which to measure future reductions.

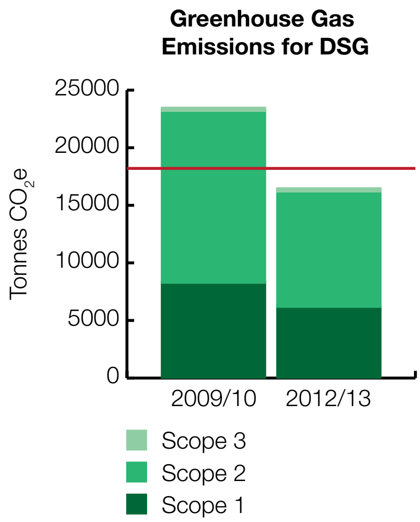
The 3 scopes of GHG emissions are:

- Scope 1 – Direct Greenhouse Gas Emissions (includes gas usage, fuel oil, LPG and fuel from vehicles owned and operated by DSG)
- Scope 2 – Energy Indirect Emissions (usage of electricity supplied to DSG)
- Scope 3 – Other Indirect Emissions (includes business travel by air, rail and hire/private car use)

The Table below shows the breakdown of the various emissions by scope for this financial year with the graph depicting the performance of DSG against the 2009/10 baseline. The target for the Emissions Reduction Measure is to reduce GHG emissions by 25% by 2014, against the 2009/10 baseline (red line on graph). At the end of this financial year, DSG exceeded the target and reduced its emissions by 30%, one year ahead of schedule; the slight increase on last year is due to the harsh winter resulting in heating being used for longer periods. DSG is working on capturing further Scope 1 direct emissions from air conditioning systems for reporting in the next annual report.

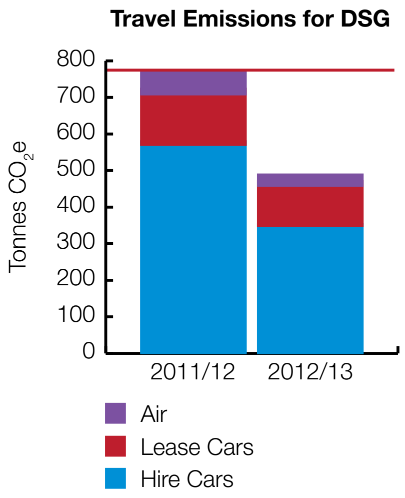
GHG	FY2012/13		FY2011/12		FY2010/11	
	CO_2e Tonnes '000	£'000	CO_2e Tonnes '000	£'000	CO_2e Tonnes '000	£'000
Scope 1 Direct GHG Emissions						
Natural Gas	5,062	628	4,213	1,299	NR	621
Fuel Oil/LPG	1,118	263	618	232	NR	188
DSG Fleet Vehicles	119	333	178	429	NR	308
Scope 2 Energy Indirect Emissions						
Electricity	9,842	808	10,626	1,837	NR	1,883
Scope 3 Official Business Travel Emissions						
Domestic Air Travel	26	112	45	177	NR	103
Rail Travel	1	39	1	42	NR	24
Hire/Private Car	344	350	530	286	NR	NR

NR = Not recorded



DSG Travel Profile

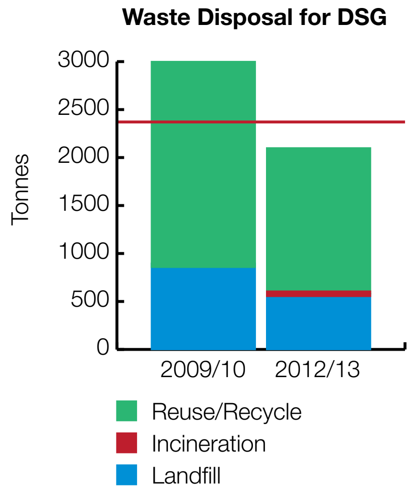
DSG reduced its travel profile over the past twelve months. Increased use of video conferencing facilities and more effective planning of meetings combined with car sharing (business) led to a 34% decrease in travel related GHG emissions compared to the 2011/12 baseline (red line on the graph below), thus achieving the target of 20% reduction by 2014, one year earlier than planned. The total mileage for 2011/12 was 2,556,520 for all forms of transport whilst in 2012/13 it reduced to 1,689,080 miles.



DSG Waste Profile

The DSG business performance target was a 25% reduction in waste generated through its operations by 2014 compared with the 2009/10 baseline year. In FY2012/13, DSG reduced its generated waste by 32%, exceeding the target one year early. The reported data does not include material supplied through DE&S, which the Disposals Services Authority collects and reports separately. The following table and associated graph depicts the breakdown of the waste data and performance against the target (red line on graph). Future areas for attention are reduction in waste to landfill and increase in reuse/recycling which currently sits at 72.09% for DSG. Financial data for waste disposal is not recorded.

Waste Category	FY2012/13 Tonnes	FY2011/12 Tonnes	FY2010/11 Tonnes
Hazardous			
Landfill	134.68	97.90	158.20
Incinerated	30.33	31.90	9.80
Reuse/ Recycle	444.13	436.90	364.60
Non-Hazardous			
Landfill	405.17	467.00	437.50
Incinerated	0	0	0
Reuse/ Recycle	1,028.47	1,200.00	930.00
Composted	0	0	0
Total Waste	**2,042.78**	**2,233.70**	**1,900.10**



PEOPLE

The outcome of the 2012 Civil Service People Survey shows encouraging results, which reflects the enormous amount of work done during the year to act on the issues raised in the 2011 survey. From a low baseline response rate in 2009 of 28%, this year's response rate witnessed a promising rise to 60%.

Across almost all of the areas covered in the survey, the responses given by DSG employees

showed positive movements. Unsurprisingly, the only two areas showing a negative move covered pay and benefits. In the current environment of pay freezes and changes to terms and conditions and pension arrangements, this is one area outside DSG's control.

People development is high on the senior management's agenda and during the year DSG made significant progress in putting in place action plans to identify skills gaps across the business, thus aligning DSG with training providers with the aim of developing bespoke training for our future leaders and middle management. During the year, DSG introduced a new nine-box grid designed to give the business an overview of the senior management potential.

The HR function in DSG continues supporting the deployments of staff to Afghanistan as well as providing information to MOD Centre and the Sale Project Team, which will inform the decision-making process. The sale of DSG is, of course, a concern to the DSG employees but during the year, we have kept them all updated on developments within MOD on all matters relevant to the sale process. This includes updating the workforce through our magazine Digest as well as during the Chief Executive's corporate briefings across the various sites.

Work continues in shaping DSG for the future, which includes retaining essential skills going forward but rationalising the manpower levels to best match future workloads. The existing Voluntary Early Release scheme continues with the aim of reducing the number of indirect employees across the business. Achieving the optimum number of employees without the need for reductions through compulsory means remains a priority for DSG.

The total number of working days lost due to sickness was 22,240, which equates to 8.23 days per employee.

FINANCIAL PERFORMANCE REVIEW

DSG successfully completed its 5th year as a Trading Fund with a very satisfactory outcome of good profits for the year and a strong Balance Sheet at the year-end.

Overall, DSG's financial performance exceeded its plan with a Profit before Interest and Dividend of £17.4m.

TRADING RESULTS

DSG achieved a better than plan profit with below plan operating costs, which enabled the MOD customer to be given an unplanned price rebate of £5m.

ROCE achieved was 10.58%.

CASH FLOW AND FUNDING

The capital structure of DSG on formation is defined in the DSG Establishment as a Trading Fund Entry Terms document.

At 31st March 2013, DSG had Public Dividend Capital (PDC) of £23.3m and Government Loans of £25.0m.

Liquidity was strong throughout the year with a closing net cash position at 31st March 2013 of £63.7m.

CAPITAL INVESTMENT

Expenditure on capital projects amounted to £0.7m during the year.

DIVIDEND

DSG has provided to pay a dividend of £7m to MOD in respect of the year 2012/13.

STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

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

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

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

– make judgements and estimates on a reasonable basis;

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

– prepare the financial statements on a going concern basis.

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

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

A. Hughes

Archie Hughes
Chief Executive and Accounting Officer
27th June 2013


ICE

GOVERNANCE STATEMENT

SCOPE OF RESPONSIBILITY

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

As Chief Executive of DSG, I am personally accountable to the Secretary of State for Defence for the performance of DSG in accordance with the Framework Document and DSG's CSP.

In the preparation of this statement, I have sought the views and support of the Executive Board, NEDs, Audit Committee and the senior management of DSG.

GOVERNANCE FRAMEWORK

From the reviews I have undertaken I believe the Governance Structure and systems of Internal Control within DSG, to the extent that it is deemed relevant and practical, have followed the requirements of the Corporate Governance Code of Good Practice. The Governance policy and process are subject to regular review and Internal Audit on a frequent basis. The governance structure is defined as follows: -

- **DSG OAC,** chaired by Min(DEST) as representative of our owners, is scheduled to meet up to 3 times a year to review DSG's performance against its key performance measures and Business Plan objectives.

- **TFB**, which is chaired by an independent NED and whose members comprise the four NEDs, one of whom is the representative of the shareholder; AO; FD; and SD; and should meet 6 times a year. The main responsibilities are to review and manage the performance of DSG, review the risk management policy and process, primarily the Corporate Risk Register, and to review the Information Asset Management process.

- **Executive Management Board (XMB)**, which meets every month and comprises the Executive Directors of DSG and whose main responsibilities are to manage the performance of DSG against its targets and review the Corporate Risk Register.

- **Audit Committee**, which is chaired by an independent NED with two other NEDs as members and Defence Internal Audit (DIA); NAO, FD and Head of Internal Audit (HIA) DSG are attendees and meets at least four times a year. The DSG Audit Committee is a sub-committee of the DSG XMB. The role of the committee is to support the Board and to advise the AO on the adequacy and effectiveness of governance, risk and control arrangements within DSG.

- **Executive Governance Group** is chaired by the AO and includes all XMB members and HIA. The main responsibilities are to review the Governance policy and processes of DSG and manage the Internal Audit and Risk Management policies and processes.

Schedule of meetings and attendance

Meeting	Members	No. of Members	Scheduled frequency	Meetings held	Attend-ance
Owners Advisory Council	Min (DEST), CDM, DGF, DES LE-Dir, BSG, DSG Exec Directors	8	Up to 3 times annually	2	Full
Trading Fund Board	Independent NEDs, MOD NED, DSG AO, FD and SD	7	6	4	92.75%
Executive Management Board	Exec Directors	6	Monthly	12	95.8%
Remuneration Committee	Independent NEDs, DSG Executives	4	2	2	Full
Audit Committee	Independent NEDs, MOD NED, (NAO, DIA, DSG FD & DSG HIA in attendance)	3	4	4	Full
Executive Governance Group	DSG Executive Directors & DSG HIA	7	4	4	92.85%

There are subsidiary committees that report to the XMB in respect of Compliance, Health & Safety, Environmental Control, Information Asset Management, Remuneration, Internal Audit and Risk Management (the latter two being covered in detail in the following paragraphs).

All of the above meetings are minuted and have a requirement to report to the AO any significant issues/risks should they arise; demonstrate how they are being managed; assign owners; and enter on the appropriate risk register.

DSG's NEDs continue to make a valuable contribution to the Board meetings and governance of DSG.

There is a register of member's interests maintained by the TFB Secretariat for the NEDs and this includes the Executive Board members.

BOARD PERFORMANCE

The OAC, TFB, XMB and Audit Committee have met 2, 4, 12 and 4 times respectively during the last year. The XMB and Audit Committee have received regular reports from Compliance, Internal Audit, Security, Business Continuity, Risk Management and Finance. Specifically Compliance, Internal Audit and Risk Management provide reviews of Corporate Governance issues that may have arisen. All meetings were quorate and there is a Board Secretariat that records minutes and actions.

The TFB reviews and assesses its own performance each year during May/June and last year determined that it had performed satisfactorily. The TFB reviewed the Corporate Governance Code of Good Practice and believe there were no departures from this Code. During this assessment, TFB also reviewed the effectiveness of the Audit Committee and Remuneration Committee and found that they had also performed satisfactorily.

HIGHLIGHTS OF BOARD COMMITTEE REPORTS

The Audit Committee, Remuneration Committee, Risk Management and Compliance Meeting Minutes are circulated to the Executive Board along with any relevant reports. Significant items from these meetings are: -

Audit Committee

- The Audit Committee has been proactive in reviewing the Internal Audit activities; attending to process improvements for both Internal Audit and Risk Management; approving the annual internal audit plan; and monitoring its progress during the year.

- The principal audits carried out in year were:
  - IBMs – to confirm DSG met its targets
  - Commercial Invoicing processes
    - Substantial Assurance
  - Cash Management – payments and processes – Substantial Assurance

– Government Procurement Card governance – Substantial Assurance
– Procurement – Low Value Purchases – Substantial Assurance
– IT Procurement – policy and procedures – Substantial Assurance
– Follow up of Procurement policies and processes – Satisfactory
– Fraud – Management and awareness of Fraud policies and process – Limited Assurance, this will require a follow up in 2013/14
– In addition, DSG internal auditors have carried out compliance audits across all sites during the year with no significant findings or non-conformances.

- In addition the Audit Committee received explanations in person from sponsors of audits receiving less than Substantial Assurance (Procurement 2011/12 and Fraud 2012/13) and reviewed the analysis of outstanding recommendations from previous audits.

- The Annual Report and Accounts were approved with no significant issues raised.

- The Audit Committee reviewed and amended its terms of reference (TOR) and prepared a report on its own effectiveness to the AO. The report highlighted the principal activities of the Committee which included:
  – Approval of the Annual Report & Accounts
  – Approval of the revised processes and procedures for Risk Management and Governance
  – In-depth review of the recommendations from Internal Audit reports with special emphasis on the improvements to the Procurement process and impact of the Fraud audit

Remuneration Committee

- The Committee has met as required during the year and its core activity has been to approve the policy in relation to the remuneration of DSG employees. In addition, the Committee approved targets and payments for XMB members.

Risk Management

- Both the TFB and XMB have carried out in-depth reviews of the Corporate Risk Register and identified new risks relating to the proposed sale of DSG.

Compliance Meeting

- This has met 4 times and issues a report to the XMB detailing Quality, Health & Safety and Compliance issues. There were 2 major Quality non-conformances and for Health & Safety issues (RIDDORS - which involved fractures), there was a 27% reduction in work-related

incidents and currently average less than 10 per 1000 employees. These were reviewed in-depth at the compliance meetings where the cause, impact and resulting actions were reviewed.

CORPORATE GOVERNANCE

The structure of Corporate Governance within DSG has worked well in practice and is regularly reviewed both internally and, periodically, externally. In the Board's opinion, DSG to the extent that it is deemed relevant and practical, has followed the Code's requirements. All meetings have been held as scheduled with no significant issues arising.

INFORMATION REPORTING

Integrated Business Reporting (IBR) is controlled through the IBR Department, which aims to handle all data requirements supplied to the Board to assist in decision-making. This has been enhanced by the consolidation of DSG onto one enterprise resource planning system. Reports are generated and reviewed by the TFB, XMB and senior management on a regular basis. Both the TFB and XMB have expressed their satisfaction with the levels of data being generated to assist management decision-making. There is frequent review by the Board of the quality and suitability of the data and reports generated in order to optimise the effectiveness and suitability for use for management action.

RISK MANAGEMENT

The focus of Risk Management within DSG during the last year has been to consolidate the good work done in previous years and concentrate on embedding risk management culture throughout the organisation. In addition, there has been increased focus on Project Risk Management in support of bids and proposals. There have been maturity reviews and peer reviews, using matrixes from the Institute of Risk Management, to examine the progress, which in terms of the Institute of Risk Management's, Risk Maturity Matrix Model, is at the, Risk Defined, stage approaching, Risk Managed. This demonstrates that DSG has passed the median point and is achieving an improved level of maturity. A report was prepared by the HIA and submitted to the XMB.

The DSG XMB accepts that some degree of business risk is inevitable, being a normal part of the operation of an organisation. Within the in-depth reviews of the Corporate Risk Register, the XMB has demonstrated its tolerance with the different categories of risk and through its Directors has given guidance to the functional heads for the functional and site risk registers. Similar decisions will be made in respect of new business, key projects and business plans. Decisions on risk levels will be communicated to those responsible for managing those risks or risk areas.

Risk Management within DSG is structured as follows:

- Corporate Risk Register – owned and reviewed by the TFB and reviewed regularly by the XMB. Risks included are those identified as affecting DSG as a whole and requiring Board members to manage them. The key risks identified within this register are:

– Business restructuring - as a result of changing customer requirements
– Sale of DSG – as DSG is now operating within the context of a sale the risks of adverse effects on core functions and the delivery of the business plan are now included
– Compliance failure – failure to adhere to compliance measures could result in loss of accreditation
– Loss of personal or key data
– Loss of control of the business – failure to recognise targets are not being met or over achieved
– Inaccurate data – data not available or inaccurate
– Failure to deliver the Business Continuity Plan
– Major security breach
– Adverse customer perception/opinion of DSG
– Future business strategy – failure to secure strategic development opportunities for DSG.
– Unable to maintain profitability- failure to achieve cost reduction programme
– Key staff – loss of key individuals

• Functional Risk Registers – owned by Board members or Heads of Site and cover all the functions within DSG. Risks are identified as those not affecting DSG as a whole and include risks that have been downgraded due to mitigation actions.

• Site Risk Registers – these are owned and managed by Heads of Sites and are reviewed regularly at Senior Management Team meetings.

• Project Risk Registers – are required for all major projects and proposals.

• Information Asset Management Risk – is managed by HR and reviewed regularly.

The Risk Management Process is structured as follows:

• TFB – owns the Corporate Risk Register and is responsible for ensuring mitigation is in place and reviewing the actions of the XMB.

• XMB – carry out more frequent in-depth reviews of the corporate risks and recommend downgrading or approving and accepting upgrades of risks.

• Audit Committee – has approved the Risk Policy and Process and through HIA receives regular updates to incorporate central government advice and recommendations and implement recommendations from Internal Audit activity.

• Risk Management Committee – meets at least 4 times a year and manages the policy and process for the Audit Committee and has recently reviewed its TOR, which have been approved by the Audit Committee. The chair is the FD or his delegated deputy and members are Board Directors or their deputies and functional heads. Proposals for upgrading or downgrading of risks will normally be handled through this committee who will make the recommendations.

- Risk Coordinators Committee – meets at least 4 times a year and handles the management of the site registers and manages the software package, Active Risk Manager (ARM). It is here that risks are identified for possible elevation through the Risk Management Committee if considered serious or becoming significant across most sites.

- ARM – is the software tool used to manage all risks throughout DSG and provides regular reports on risk activity for management. All new proposals/bids must include a risk assessment with a report from ARM.

FRAUD AND INFORMATION ASSURANCE

DSG has ensured that all its Information Asset Owners have undertaken the annual assessments to the required levels. DSG is pleased to report that it has now achieved Level 3 from the Information Assurance Maturity Model (IAMM) as introduced by the Information Handling and Assurance Team set up by the Defence Board. The Risk Register is maintained within the HR function, is subject to continual review and there is an audit conducted from the MOD Information Assets Management Centre on a regular basis. There have been no breaches of the Information Management Asset process and no loss of corporate data.

There has been an internal audit of the management of fraud within DSG, which has identified that whilst there are processes in place, they have not been kept up to date and management have not ensured that fraud awareness is cascaded out across the organisation. As a result, there have been substantial reviews of the policy and processes with improvements introduced, which will be ongoing during the next six months, after which there will be further activity to embed the revised processes across DSG.

There have been no reported incidents of Fraud during the year.

HEALTH & SAFETY

There has been a 27% reduction in work-related incidents reported (RIDDORS) and currently averages less than 10 per 1000 employees, although 3 reports were major involving fractures. The most common injuries being muscle strain/sprain.

SUMMARY

The HIA has issued his annual statement, which includes the assessment of the overall level of Assurance and, with respect to the internal audits performed during the year, this is assessed as Substantial.

The control weakness identified within the procurement area last year has been rigorously reviewed with all identified actions implemented and further external reviews carried out. Further monitoring will be performed to ensure these actions are embedded, which was the final outstanding action and was recognised that it would take some months for full effect.

The Transformation Project was extended into the Optimisation Project, which ran throughout 2012/13. This optimisation was successful and included implementation of a Sales & Operational Planning process, which is now being fully embedded across all of DSG.

Further action will be required during 2013/14 to monitor the effectiveness of the improvements to the Fraud policy and processes that have been introduced.

A. Hughes

Archie Hughes
Chief Executive
27th June 2013

REMUNERATION REPORT

REMUNERATION COMMITTEE

The Remuneration Committee is a sub-Committee of the DSG TFB and exists to advise its owner, MOD, DSG's Chairman, Chief Executive and the TFB on matters relating to employee remuneration, and to ensure consistency with the Personnel Delegations held by the Chief Executive.

The remuneration of all DSG employees except, senior civil servants (SCS), is set within the Civil Service Pay Guidance issued by HM Treasury annually.

The Remuneration Committee consists of the independent NEDs of DSG's Board, an MOD representative and a representative from Human Resources to act as secretary. One of the NEDs acts as Chairman and other Executive Directors attend meetings to assist the Committee in their deliberations as appropriate. The Committee met as required during the financial year and all recommendations arising from the meetings have been implemented.

The Committee continues to make a positive input to the strategic direction of DSG pay settlements prior to sharing these with the Trades Unions. The terms of the DSG Corporate Bonus Scheme are agreed by the Remuneration Committee and endorsed by the TFB who then, having taken due consideration of the performance of the business, approve any bonus to be paid, the amount of which is presented to and endorsed by the DSG OAC.

REMUNERATION POLICY

FD, COO and HR Director are SCS. As such, their pay is set through recommendations of the Review Body on Senior Salaries. The Review Body on Senior Salaries provides independent advice to the Prime Minister and the Secretary of State for Defence on the remuneration of SCS taking account of evidence it receives about wider economic considerations and the affordability of its recommendations. Further work regarding the Review Body is at www.ome.uk.com.

All other employees have their remuneration determined by a process consistent with MOD and HM Treasury guidance.

The Chief Executive has delegated powers for the setting of terms and conditions of employment, including pay, for all DSG employees below SCS. This delegation requires him to consult with MOD and HM Treasury before agreeing to any changes to pay and grading systems and arrangements. This is achieved through the business case and pay remit process whereby the DSG pay proposals is submitted for MOD and HM Treasury approval before negotiation with staff representatives. DSG reports the outcome of negotiations back to HM Treasury through the annual outturn statement.

For the 2012/13 pay settlement year, most employees were subject to a pay freeze for the second of two years in accordance with government public sector pay policy. However, those earning a full-time salary of £21k or below received a £250 consolidated payment. DSG also took the opportunity, with MOD's agreement, to align former LCS employees, who originally transferred to DSG from MOD in 2011, to DSG pay and terms and conditions.

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

Performance Pay for staff is dependent firstly on DSG meeting agreed IBMs at a corporate-level and then on individuals meeting agreed targets cascaded from the Corporate Plan. Achievement is determined by individual assessment within the line management chain. The DSG Board and Remuneration Committee approve pay and changes to conditions of service prior to commencing the pay negotiating process with the Trades Unions.

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

SERVICE CONTRACTS OF DIRECTORS

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

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

Archie Hughes was re-appointed on 1 August 2011 as Chief Executive on a fixed-term contract, which is due to expire in September 2015. Compensation for early termination, other than for misconduct, would be in accordance with the Civil Service Compensation Scheme.

David Morgan was appointed as CD on a fixed-term contract, which is due to expire in May 2014. Compensation for early termination, other than for misconduct, would be in accordance with the Civil Service Compensation Scheme.

Independent NEDs are appointed for a fixed-term and are not appointed as civil servants. Contracts may be terminated at one-month's notice by either party or on dissolution of the Board unless found guilty of gross misconduct when termination will be immediate. Their contracts may be extended by mutual agreement.

Remuneration for NEDs is set at a fixed annual rate determined by the Department's PUS. Fees are set on the basis that the role should require around 40 days work per year. This excludes the NED representing the interests of the MOD's FD whose services are not charged to DSG. NEDs are not involved in any discussion about their own remuneration and all payments made are non-pensionable. There are no compensation entitlements for early termination.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THE FOLLOWING INFORMATION IS SUBJECT TO AUDIT

REMUNERATION DETAILS OF DIRECTORS

Salary

Executive Directors	2012/13 Salary and allowances[1] £'000	Performance Bonus £'000	2011/12 Salary and allowances[1] £'000	Performance Bonus £'000
Archie Hughes Chief Executive[2]	155-160	60-65	155-160	60-65
Steve Hall Finance Director	65-70	–	65-70	0-5
Geraint Spearing Chief Operating[3] Officer (from 1st March 2012)	80-85	–	5-10	–
Jane Williams Human Resources Director[4] (from 1 November 2012)	25-30	–	–	–
Keith Norris Strategy Director[5]	65-70	5-10	65-70	5-10
David Morgan Commercial Director[5]	95-100	5-10	95-100	5-10
Derek Owen Human Resources Director[6] (to 31st October 2012)	95-100	–	80-85	0-5
John Reilly Chief Operating Officer[7] (to 31st March 2012)	–	–	240-245	0-5

1 Gross salary includes salary; reserved rights to London Weighting or London allowances; recruitments and retention allowances; travel and subsistence allowances, compensation packages and any other allowance to the extent that it is subject to UK taxation.
2 Performance Bonuses are considered as part of the overall performance appraisal process, the outcome of which is not usually known until after the publication of the Annual Accounts. The value reported for this Executive Director reflects the estimated bonus in year for the individuals' performance for that same year which has been accrued at the maximum value payable whilst awaiting formal approval.
3 The full year equivalent salary for this appointment is £75k-£80k in 2011/12.
4 The full year equivalent salary for this appointment is £60k-£65k in 2012/13.
5 The performance bonus value reported for these Executive Directors reflects the actual bonus payable for the individuals performance for that same year.
6 Derek Owen left under voluntary early release terms on 31 October 2012. The capitalised cost of the package he received was £30k-£35k. For 2012/13, the full year equivalent salary for this appointment is £65k - £70k and the value reported above also includes compensation in lieu of notice.
7 John Reilly left under voluntary release terms on 31 March 2012. The capitalised cost of the package he received was £130k-£135k.

Pension Benefits

	Accrued Pension at pension age as at 31/03/13 and related lump sum £'000	Real increase/ (decrease) in pension and related lump sum at pension age £'000	CETV at 31/03/13 £'000	CETV at 31/03/12[1] £'000	Real increase/ (decrease) in CETV £'000	Employee contribution to partnership pension account £'000
Archie Hughes	20-25	2.5-5	331	271	38	–
Steve Hall	20-25 Plus lump sum of 65-70	(2.5)-0 Plus lump sum of (2.5)-0	358	343	(5)	–
Geraint Spearing	20-25 Plus lump sum of 65-70	0-2.5 Plus lump sum of 2.5-5	311	283	11	–
Jane Williams (from 1 November 2012)	25-30 Plus lump sum of 85-90	0-2.5 Plus lump sum of 0-2.5	558	552	–	–
Keith Norris	25-30 Plus lump sum of 85-90	0-2.5 Plus lump sum of 0-2.5	645	608	2	–
David Morgan	5-10	2.5-5	103	67	25	–
Derek Owen (to 31 October 2012)	35-40 Plus lump sum of 105-110	0-2.5 Plus lump sum of 0-2.5	857	846	(1)	–

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

MEDIAN EARNINGS

Reporting bodies are required to disclose the relationship between the remuneration of the highest paid Director in their organisation and the median remuneration of the organisation's workforce.

The banded remuneration of the highest-paid Director in DSG in the financial year 2012/13 was £215,000 - £220,000 (2011/12; £240,000 - £245,000). This was 9.75 times (2011/12; 10.99 times) the median remuneration of the workforce, which was £22,300 (2011/12; £22,300).

No employees in either 2012/13 or 2011/12 received remuneration in excess of the highest-paid Director. Remuneration fell in ranges from £10,000 - £15,000 to £215,000 - £220,000 (2011/12; £10,000 - £15,000 to £240,000 - £245,000).

Total remuneration includes salary, non-consolidated performance-related pay, benefits-in-kind and up to 31 March 2012 only it included severance payments. It does not include employer pension contributions and the CETV of pensions.

The higher median remuneration multiple in the previous year was as a result of a compensation package temporarily increasing the highest paid Director band to that payable to a former Director.

CIVIL SERVICE PENSIONS

A CETV is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the members' accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies.

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

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

Further details relating to the civil service pension arrangements are in Note 5 to these accounts and at the website www.civilservice.gov.uk/pensions

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

No Director has received a payment for compensation for loss of office under the terms of an approved compensation scheme and no award or compensation has been paid to former Directors.

None of the Directors have remuneration packages containing non-cash elements or other benefits-in-kind. No payments have been made to third parties for the services of a Director.

Non-Executive Directors	Fees 2012/13 £'000	Fees 2011/12 £'000
Alex Jablonowski (from 01 January 2012)	20-25	5-10
David Barrass	15-20	15-20
Janet Baker	15-20	15-20
Peter Shortt[1] (from 16 April 2012)	–	–
Emma Davies[1] (from 01 June 2011 to 5 April 2012)	–	–
Jamie Pike (to 31 December 2011)	–	25-30

1 This position has been appointed in conjunction with its responsibilities at MOD. It is not entitled to receive separate remuneration in undertaking its DSG duties.

APPROVAL

The Directors' Remuneration Report is approved.

A. Hughes

Archie Hughes
Chief Executive
27th June 2013

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

I certify that I have audited the financial statements of the Defence Support Group for the year ended 31 March 2013 under the Government Trading Funds Act 1973. The financial statements comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Taxpayers' Equity, the Statement of Cash Flows; 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 SUPPORT GROUP, ACCOUNTING OFFICER AND AUDITOR

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Defence Support Group and Accounting Officer are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Government Trading Funds Act 1973. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Defence Support Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Defence Support Group; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies, I consider the implications for my certificate.

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

OPINION ON REGULARITY

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

OPINION ON FINANCIAL STATEMENTS

In my opinion:

- the financial statements give a true and fair view of the state of the Defence Support Group's affairs as at 31 March 2013 and of its profit for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Trading Funds Act 1973 and HM Treasury directions issued thereunder.

OPINION ON OTHER MATTERS

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with HM Treasury directions made under the Government Trading Funds Act 1973; and
- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

MATTERS ON WHICH I REPORT BY EXCEPTION

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

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

REPORT

I have no observations to make on these financial statements.

Amyas C E Morse
Comptroller and Auditor General
National Audit Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP

2nd July 2013

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2013

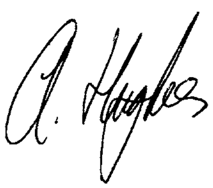
		2012/13	2011/12		
		Continuing	Continuing	Discontinued	Total
				Restated	
	Note	*£'000*	*£'000*	*£'000*	*£'000*
Turnover	2	182,492	169,594	14,307	183,901
Cost of sales	3	(154,670)	(152,952)	(8,802)	(161,754)
Gross profit		**(27,822)**	**16,642**	**5,505**	**22,147**
Operating expenses	3	(10,546)	(9,993)	(674)	(10,667)
Operating profit		**17,276**	**6,649**	**4,831**	**11,480**
Large Aircraft business closure provision	13	137	2,141	409	2,550
Profit on ordinary activities before interest		**17,413**	**8,790**	**5,240**	**14,030**
Interest receivable		359	253	0	253
Interest payable	4	(1,205)	(1,282)	0	(1,282)
Profit on ordinary activities before Dividend		**16,567**	**7,761**	**5,240**	**13,001**
Dividend Payable		(7,000)	(4,500)	0	(4,500)
Net Income after interest and dividend		**9,567**	**3,261**	**5,240**	**8,501**
Other comprehensive Income/(Expenditure)					
Net gain/(loss) on revaluation of Property Plant & Equipment		770	258	0	258
Net gain/(loss) on revaluation of Inventories		0	149	0	149
Total comprehensive Income/(Expenditure) for the year		**10,337**	**3,668**	**5,240**	**8,908**
ROCE		**10.58%**			**8.84%**

The notes on pages 48 to 67 form part of these accounts.

STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2013

	Note	31 March 2013	31 March 2012
		£'000	£'000
Non-current assets			
Property, Plant and Equipment	7	84,601	87,706
Total non-current assets		**84,601**	**87,706**
Current assets			
Inventories and work in progress	8	21,184	21,544
Trade and other receivables	9	35,352	32,960
Cash and cash equivalents	10	63,718	64,756
Total current assets		**120,254**	**119,260**
Total Assets		**204,855**	**206,966**
Current liabilities			
Trade and other payables	11	(37,494)	(49,049)
Loans	12	(1,663)	(1,663)
Provisions	13	(1,263)	(493)
Total current liabilities		**(40,420)**	**(51,205)**
Non-current liabilities			
Loans	12	(23,299)	(24,962)
Total non current liabilities		**(23,299)**	**(24,962)**
Net Assets		**141,136**	**130,799**
Financed by:			
Capital and reserves			
Public dividend capital		23,324	23,324
Revaluation reserve		66,088	66,504
Retained earnings		51,724	40,971
Taxpayers' equity		**141,136**	**130,799**

The notes on pages 48 to 67 form part of these accounts.



Archie Hughes
Chief Executive
27th June 2013

These accounts have been authorised for issue by the AO on the same date as the Comptroller and Auditor General's audit certificate.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 MARCH 2013

	Note	2012/13	2011/12
		£'000	*£'000*
Cash flows from operating activities			
Operating profit	Statement of Comprehensive Income	17,276	11,480
Adjustments for:			
Losses on disposals of non-current assets	7	22	10
Permanent Diminution and Reclassification of non current assets	7	(389)	(54)
Depreciation charges	7	4,901	5,900
Decrease in Large Aircraft closure costs	13	137	2,550
Decrease/(increase) in inventories	8	360	(6,454)
(Increase)/decrease in receivables	9	(2,392)	23,727
(Decrease)/increase in payables	11	(14,055)	836
(Decrease) in provisions for liabilities and charges	13	770	(3,553)
Net cash inflow from operating activities		**6,630**	**34,442**
Cash flows from investing activities			
Payments to aquire property plant and equipment	14a	(659)	(784)
Interest received	14a	359	253
Net cash (outflow) from investing activities		**(300)**	**(531)**
Cash flows from financing activities			
Decrease in borrowings	14a	(1,663)	(1,663)
Dividends paid	Statement of Comprehensive Income	(4,500)	(2,300)
Interest paid	14a	(1,205)	(1,282)
Net cash (outflow) from financing activities		**(7,368)**	**(5,245)**
(Decrease)/increase in cash and cash equivalents	14c	**(1,038)**	**28,666**
Cash and cash equivalents at start of year	14b	64,756	36,090
Cash and cash equivalents at end of year	14b	63,718	64,756

The notes on pages 48 to 67 form part of these accounts.

Cash Flows from the 2011/12 Discontinued Operations are shown in note 14d.

STATEMENT OF CHANGES IN TAXPAYERS' EQUITY FOR THE YEAR ENDED 31 MARCH 2013

	Public Dividend Capital	Revaluation Reserve	Retained Earnings	Total Equity
	£'000	*£'000*	*£'000*	*£'000*
Taxpayers' equity at 31st March 2011 (Restated)	**23,324**	**66,332**	**32,235**	**121,891**
Comprehensive income for the year	0	407	8,501	8,908
Realised element of revaluation reserve	0	(235)	235	0
Taxpayers' equity at 31st March 2012	**23,324**	**66,504**	**40,971**	**130,799**
Comprehensive income for the year	0	770	9,567	10,337
Realised element of revaluation reserve	0	(1,186)	1,186	0
Taxpayers' equity at 31st March 2013	**23,324**	**66,088**	**51,724**	**141,136**

The notes on pages 48 to 67 form part of these accounts.

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2013

1 ACCOUNTING POLICIES

Basis of accounting
The accounts have been prepared in accordance with the Government Financial Reporting Manual (FReM) for 2012/13 and the Accounts Direction, both issued by HM Treasury. The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of DSG for the purpose of giving a true and fair view has been selected. The particular policies adopted by DSG are described below. They have been applied consistently in dealing with items considered material in relation to the accounts.

Going Concern
In autumn 2010 the MOD's SDSR announced that DSG would be one of the MOD owned assets which would be offered for sale as a going concern. Work is progressing in MOD Centre to bring about the sale of DSG during 2014 and it is still unclear if any of the existing DSG business is to remain in MOD ownership. The Chief Executive as AO has considered the impact of the announcement on DSG's ability to continue as a going concern. In his view, whilst there remains uncertainty about the future ownership of the organisation, this will not have any affect on the going concern of the organisation for at least the next 12 months. It is appropriate therefore, that the financial statements have been prepared on a going concern basis.

Discontinued Operations
On 29th March 2010 the then Secretary of State for Defence, Bob Ainsworth, laid before Parliament a Written Ministerial Statement about Defence Equipment, which concluded with a statement confirming the intention to close the Larege Aircraft Business Unit facility at St Athan by June 2013 at the latest. Whilst the major production line ceased in December 2010, DSG continued to operate these facilities until the minor production stream ended during 2011/12. In alignment with IFRS 5, the Large Aircraft business was presented as discontinued in the 2011/12 accounts. Further details are at note 13.

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

Turnover
Turnover comprises the invoiced and accrued value of services (excluding VAT and other sales taxes) and is recognised in line with the underlying sales contract which may result in turnover and costs recognised prior to job completion.

Property, Plant and Equipment

Basis of Valuation
Property Plant and Equipment are carried at fair value. A professional quinquennial valuation, in accordance with the Royal Institute of Chartered Surveyors Appraisal and Valuation Standards Red Book, was carried out by GVA Grimley Ltd as at 31st March 2011 and covered all classes of non current assets. Due to the nature of the business assets a market valuation is difficult to determine therefore, the basis of valuation applied is generally Depreciated Replacement Cost (DRC) or Existing Use where DRC is not appropriate.

Property, Plant and Equipment is revalued in the years between professional valuations, using the Corporate Financial Controller (CFC) Modified Historic Cost Accounting (MHCA) indices produced by the Defence Analytical Services Agency and is carried at valuation as at the end of the accounting period.

Basis of Recognition
Expenditure on plant, equipment, computers and transport equipment is periodically reviewed and capitalised where the useful life exceeds one year

and the cost of acquisition exceeds the threshold of £10,000 excluding VAT. The value of capitalised plant, equipment and transport equipment is reviewed annually and adjustments made using the CFC MHCA Index in the relevant periods.

Individual items valued at less than the threshold are ordinarily capitalised only if they constitute integral parts of a composite or grouped asset that is in total valued greater than a threshold of £25,000. A composite or grouped asset is intended only to encompass items that are purchased to operate together rather than bulk purchases of items that can, or would ordinarily, operate in an individual capacity.

Non current assets are recognised initially as Assets in the Course of Construction which are not depreciated. At the point that an asset becomes fully available for use, it is recategorised appropriately and depreciation commences.

Land and buildings
Where DSG bears the risks and rewards of using Departmental Estate, such estate is treated as an asset of the Trading Fund although legal ownership rests with the Secretary of State for Defence.

Depreciation
Freehold land is not depreciated. Depreciation on buildings, plant and equipment, transport equipment and IT equipment is calculated to reflect the consumption of economic benefit of assets by equal instalments over their estimated useful lives. The lives of the assets are periodically reviewed with reference to obsolescence and continued asset useage.

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

Buildings	Not exceeding sixty years
Plant & Equipment	Between three and twenty years
Transport Equipment	Between three and twenty years
IT Equipment	Between three and ten years

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

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

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

Inventories
Inventory is valued on a first in first out basis and at the lower of cost or net realisable value. Following periodic reviews, inventory is written down to address obsolescence, surpluses and defective items using two main criteria based on redundancy and technical validity.

Redundant inventory will be written down to its net recoverable value and disposed of. Items that are technically valid, but for which DSG has no current forecast requirement, will also be written down to their net recoverable amount and disposed of unless a justification is made for retention due to a definable imminent contractual requirement.

Where provision is made it is based on 100% provision against the value of the appropriate items. This calculation can include any significant surplus inventories based on projected consumption using historical trends.

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

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

Provisions
At the point any contract is foreseen to become loss making, a provision will be made for the future losses identified. Other provisions represent liabilities of uncertain timing or amount. Provisions are discounted where the effect of the discount would be material.

Provision for bad and doubtful debts
DSG makes provision for bad and doubtful debts as soon as they are deemed to be irrecoverable based on analysis and reviews of aged receivables.

Operating leases
Rentals under operating leases are charged to the Statement of Comprehensive Income as incurred.

ROCE
ROCE is expressed as the profit before interest for the year as a percentage of the average capital employed during the year. Capital employed comprises the total net assets (non-current assets at net book value, plus current assets, less current liabilities, less non current liabilities) and adding back the short and long-term loans provided from government sources.

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

Employee benefits
DSG accrues for untaken employee leave entitlement at the end of the financial year. For permanent employees the leave year runs to 30th April and employees are able to carry forward an element of entitlement at the end of the financial year. These amounts fall due within one year and the value of the liability is calculated using records of actual untaken leave and average pay rates to comply with IAS 19.

SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

DSG management makes judgements and assumptions concerning the future that impact the application of policies and reported amounts. The resulting accounting estimates calculated using these judgements and assumptions will, by definition, seldom equal the related actual results but are based on historical experience and expectations of future events. The risk generated by these judgements and estimates is therefore materially only cost related and is mitigated as far as is practical. The judgements and key sources of estimation uncertainty that have a significant effect on the amounts recognised in the financial statements are discussed below.

Provisions
Provisions have been made for obsolete stock, expected future legal/employment tribunal costs and other relevant events. These provisions are estimates and the actual costs and timing of future cash flows are dependent on future events. Any difference between expectations and the actual future liability will be accounted for in the period when such determination is made.

Accounting Accruals
Accruals for the costs of goods and services received are recognised based on the best information available at the reporting date. Accruals include significant balances related to reimbursement for utilities payable to MOD. Any difference between accounting accruals and the actual liability when presented will be accounted for in the period when such determination is made.

During 2012/13, the historical position for the majority of the expected MOD liabilities for utilities and similar costs over a number of prior years were agreed and settled. This activity resulted in the release of £1.965m of accruals where MOD did not require the aged liabilities to be reimbursed. The £0.861m residual balance of these aged liabilities has been transferred to provisions from accruals at the year end to recognise the reducing probability that MOD will seek future payment.

CFC Indexation rates for the Quinquennial Non-Current Asset Review
Indices are provided by the CFC for revaluing non current assets under the MHCA regime. Whilst these indices predict a valuation as at the end of the accounting period they also include corrections for previous periods. In these accounts, DSG has applied the professional external revaluations of its non current assets from GVA Grimley at as 31 March 2011.

Impairment of Assets
Management judgements with regard to the impairment of buildings and equipment in the Electronics and Components Business Unit are made on the basis of the approved business case for rationalisation of that site. A review of the previous impairment of the Bicester site proved that the intended cessation of the workflow for that site was no longer extant and the impairment was therefore reversed.

Inventory revaluation reserve realisation
DSG has historically used standard costing to value its inventory but, where the standards are subject to annual or periodic revaluation, does not track the realisation of this revaluation on an item by item basis. As a proxy, the realisation is accounted for by applying an aged inventory analysis to the inventory revaluation reserve.

IFRS's amendments and interpretations in issue but not yet effective or adopted

IAS 1 (amendment to IAS 1) Presentation of Items of Other Comprehensive Income
This amendment is effective for accounting periods beginning on or after 1st July 2012. This amendment will have no material effect on DSG's accounts.

IAS 19 Employee benefits
The amendment makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits and to the disclosures for all employee benefits. The revised standard has been adopted by the EU and is effective for annual periods beginning on or after 1 January 2013. Under the current interpretation of IAS 19 in the FReM, the new changes in the amended standard are effectively already followed; therefore there will be no material affect on DSG's Accounts. The amended disclosures relating to accounts incorporating consolidate pension schemes will have no effect on DSG's accounts.

IFRS 7 Financial Instruments - Disclosures
This standard has been amended with respect to netting arrangements and is in force for accounting periods commencing after 1 January 2013. This change is not expected to have an effect on DSG's accounts.

IFRS 9 Financial Instruments
This will replace IAS39 to improve and simplify the reporting of financial instruments for reporting periods beginning on or after 1 January 2015. Earleir adoption is permitted but DSG has not applied this for 2012/13. Whilst the impact on DSG's accounts is not yet clear as the standard is still being developed, it is not expected result in material changes.

IFRS 13 Fair Value Measurement
This sets out an IFRS framework for measuring fair value such as on property, plant and equipment and is expected to be applicable for accounting periods commencing on or after 1 January 2013 requiring affected entities to increase the disclosure for non financial items held at fair value. This standard has not been applied for 2012/13 and it's impact on DSG's accounts, whilst is not yet clear, is not expected to be material.

Further Considerations
Other changes to, and new issues of, IFRS, but which are not yet in effect or applied, do not have a material impact on the accounting or disclosure of these annual accounts.

2 TURNOVER AND SEGMENTAL ANALYSIS

Turnover is stated net of trade discounts, provisions, VAT and similar taxes. There were no acquisitions and the majority of turnover arose from UK sources. The discontinued operation in 2011/12 relating to the Large Aircraft Business Unit is detailed on the face of the Statement of Comprehensive Income and included in Air and Electronics for 2011/12 below.

Where the substance of the transaction is such that DSG effectively operates as an agent, turnover represents the net revenue receivable and due to DSG in accordance with contractual terms.

Although substantially all turnover relates to the same class of business: the MRO of equipment, DSG is able to analyse its operating profit by activity depending on the type of equipment platform being worked on. The major segments are Land platforms; Air and Electronic platforms; and specialist procurement and supply operation carried out by the Land Supply business.

Analysis of turnover and operating profit by segment:

2012/13	**Land**	**Air and Electronics**	**Land Supply**	**Total**
	£'000	*£'000*	*£'000*	*£'000*
Turnover	139,473	28,872	14,147	182,492
Cost of sales (i)	121,646	23,881	9,143	154,670
Administrative expenses	7,544	2,034	968	10,546
Operating profit	**10,283**	**2,957**	**4,036**	**17,276**

(i) £177.079m relates to MOD customers.

2011/12	**Land**	**Air and Electronics**	**Land Supply**	**Total**
	£'000	*£'000*	*£'000*	*£'000*
Turnover (ii)	127,348	43,523	13,030	183,901
Cost of sales	119,218	33,771	8,765	161,754
Administrative expenses	6,929	2,931	807	10,667
Operating profit	**1,201**	**6,821**	**3,458**	**11,480**

(ii) £151.638m relates to MOD customers.

3 COST OF SALES AND OPERATING EXPENSES

	Note	2012/13	2011/12
			Restated
	Note	*£'000*	*£'000*
Cost of sales:			
Staff costs	5b	87,603	97,034
Supplies and services consumed		53,314	51,774
Accommodation costs		4,217	3,981
Depreciation and impairment		4,470	5,696
Cost reimbursement (i)		(470)	(5,052)
Other administration costs	6	5,536	8,321
Total cost of sales		**154,670**	**161,754**
Operating expenses:			
Staff costs	5b	8,173	8,537
Supplies and services consumed		99	156
Accommodation costs		(8)	109
Depreciation and impairment		102	135
Cost reimbursement (i)		(135)	(52)
Other administration costs	6	2,315	1,782
Total operating expenses		**10,546**	**10,667**
Cost of sales & operating expenses:			
Staff costs	5b	95,776	105,571
Supplies and services consumed		53,413	51,930
Accommodation costs		4,209	4,090
Depreciation and impairment		4,572	5,831
Cost reimbursement (i)		(605)	(5,104)
Other administration costs	6	7,851	10,103
Total cost of sales & operating expenses		**165,216**	**172,421**

(i) Cost reimbursement primarily relates to various facility management and other costs recharged to units lodging on DSG sites of £446k (2011/12 £895k) and also reimbursement of termination costs relating to former Large Aircraft staff of £159k (2011/12 £1,169k). In 2011/12 there were recoveries of costs from other government departments of £3,038k relating to use of the St Athan site. There were no such recoveries in 2012/13 following the closure of the Large Aircraft operation. These reimbursements are shown as a separate line to assist visibility.

4 INTEREST PAYABLE AND SIMILAR CHARGES

	2012/13	2011/12
	£'000	£'000
On loans wholly repayable within five years	0	0
On loans not wholly repayable within five years	1,205	1,282
	1,205	**1,282**

5 STAFF NUMBERS AND COSTS

	2012/13	2011/12
(a) Staff Numbers	Number of employees	Number of employees
The average number of persons employed during the year was:		
Senior Management	6	6
Service personnel	1	21
Civilian personnel	2,484	2,820
Agency staff	212	101
	2,703	**2,948**

(b) Payroll Costs	£'000	£'000
in Cost of sales:		
Salaries, wages and allowances	65,886	75,799
Social security	4,994	5,824
Pension costs	10,629	12,384
Agency staff	6,094	3,027
	87,603	**97,034**
in Operating expenses:		
Salaries, wages and allowances	6,011	6,425
Social security	534	432
Pension costs	875	882
Agency staff	753	798
	8,173	**8,537**
Total:		
Salaries, wages and allowances	71,897	82,224
Social security	5,528	6,256
Pension costs	11,504	13,266
Agency staff	6,847	3,825
Total payroll costs	**95,776**	**105,571**

5 STAFF NUMBERS AND COSTS (CONTINUED)

(c) Pension benefits for civilian employees are provided through the Civil Service Pension arrangements. From 30 July 2007, civil servants may be in one of four defined benefit schemes; either a final salary scheme (Classic, Premium and Classic Plus) or a whole career scheme (nuvos). These statutory schemes are unfunded, with the cost of benefits met by monies voted by Parliament each year. Pensions payable under Classic, Premium and Classic Plus and nuvos are increased annually in line with Pensions Increase Legislation. Members joining from 1 October 2002 may opt for either the appropriate defined benefit arrangement or a "money purchase" stake holder pension with an employer contribution (partnership pension account).

Employee contributions are salary related and range between 1.5% and 3.9% of pensionable earnings for Classic and 3.5% and 5.9% for Premium, Classic Plus and Nuvos. Increases to employee contributions will apply from 1 April 2013. Benefits in Classic accrue at the rate of 1/80th of final pensionable earnings for each year of service. In addition, a lump sum equivalent to three years' initial pension is payable on retirement. For Premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike Classic, there is no automatic lump sum. Classic Plus is essentially a hybrid with benefits for service before October 2002 calculated broadly as per Classic and benefits for service from October 2002 worked out as in Premium. In Nuvos a member builds up a pension based on their pensionable earnings during their period of scheme membership. At the end of the scheme year (31 March) the members' earned pension is credited with 2.3% of their pensionable earnings in that scheme year and the accrued pension is uprated in line with Pension Increase Legislation. In all cases members may opt to give up (commute) pension for a lump sum up to the limits set by the Finance Act 2004.

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

The accrued pension quoted is the pension the member is entitled to receive when they reach pension age, or immediately on ceasing to be an active member of the scheme if they are already at or over pension age. Pension age is 60 for members of classic, premium and classic plus and 65 for members of nuvos.

The PCSPS is an unfunded multi employer defined benefit scheme and it is not possible to separately identify DSG's share of the underlying assets and liabilities. A full actuarial valuation was carried out as at 31 March 2007. Details can be found in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice-pensions.gov.uk). For 2012/13 employers' contributions of £11,501,192 were payable to the PCSPS (2011/12 £13,068,209) at one of four rates in the range 16.7% to 24.3% of pensionable pay, based on salary bands. The Scheme Actuary reviews employer contributions usually every four years following a full scheme valuation. The contribution rates are set to meet the cost of the benefits accruing during 2012/13 to be paid when the member retires and not the benefits paid during this period to existing pensioners.

For 2012/13 employers' contributions of £41,160 were paid to one or more of a panel of four appointed stakeholder pension providers (2011/12 £42,554). In addition, employer contributions of £2,654 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 (2011/12 £2,935). Contributions due to the partnership pension providers at the statement of financial position date were £4,759 (2011/12: £4,694) .

3 employees retired early on ill-health grounds; the total additional accrued pension liabilities in the year amounted to £7,538 (2011/12 5 persons - additional pension liabilities amounted to £2,303).

5 STAFF NUMBERS AND COSTS (CONTINUED)

(d) Reporting of Civil Service and other compensation schemes - exit packages

Exit costs are accounted for in full in the year of departure except for the annual compensation costs of certain packages which fall into future years and are accounted for in the year of payment.

Comparative data shown in brackets for 2011/12.

Exit package cost band	Number of compulsory redundancies		Number of other departures agreed		Total number of exit packages by cost band	
<£10,000	0	(0)	4	(17)	4	(17)
£10,000 - £25,000	0	(63)	29	(245)	29	(308)
£25,000 - £50,000	0	(11)	26	(176)	26	(187)
£50,000 - £100,000	0	(0)	5	(34)	5	(34)
£100,000- £150,000	0	(0)	1	(4)	1	(4)
Total number of exit packages for in year departures	**0**	**(74)**	**65**	**(476)**	**65**	**(550)**
Total cost of in year departures £'000	**0**	**(1,264)**	**4,452**	**(13,063)**	**4,452**	**(14,327)**

Redundancy and other departure costs have been paid in accordance with the provisions of the Civil Service Compensation Scheme, a statutory scheme made under the Superannuation Act 1972. Exit costs are funded directly by MOD and are therefore not accounted for in DSG.

Where early retirements have been agreed, the additional costs are met by DSG and not by the CSPS. Ill-health retirement costs are met by the pension scheme and are not included in the table.

The total cost includes £1,299k for pre 1 April 2013 leavers, which will fall into financial year 2013/14 (£5,019k for pre 1 April 2012 leavers costs falling into 2012/13).

6 OTHER ADMINISTRATION COSTS

	2012/13	2011/12
		Restated
in Cost of sales:	*£'000*	*£'000*
Travel and subsistence, including vehicle hire	1,949	2,280
IT and telecommunications (i)	3,007	4,078
Training, recruitment and consultancy	588	406
Insurance	34	27
Other expenses	(105)	1,471
Movement in provisions	63	59
	5,536	**8,321**
in Operating expenses:	*£'000*	*£'000*
Auditors' remuneration	85	95
Travel and subsistence, including vehicle hire	463	600
IT and telecommunications (i)	372	572
Training, recruitment and consultancy	101	198
Insurance	872	1,008
Other expenses	423	231
(Gains)/Losses on Foreign Exchange	(1)	(3)
Movement in provisions	-	(919)
	2,315	**1,782**
Total:	*£'000*	*£'000*
Auditors' remuneration	85	95
Travel and subsistence, including vehicle hire	2,412	2,880
IT and telecommunications (i)	3,379	4,650
Training, recruitment and consultancy	689	604
Insurance	906	1,035
Other expenses	318	1,702
(Gains)/Losses on Foreign Exchange	(1)	(3)
Movement in provisions	63	(860)
Total of Other administration costs	**7,851**	**10,103**

(i) DSG internally apportions all central IT and telecommunications costs to the users of the equipment and services. In previous published accounts, DSG included the apportionment of the pay element of this recharge within this administration note, but for clarity, this was removed for 2012/13 with the prior year restated accordingly.

7 PROPERTY, PLANT AND EQUIPMENT

The movements in each class of assets during 2012/13 were:

	Land	Buildings	Plant & Machinery	Transport Equipment	IT	Assets in course of construction	Total Tangible
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Cost or valuation:							
At 31 March 2012	21,473	67,685	3,216	240	310	675	93,599
Additions	0	0	334	0	43	282	659
Donations	0	0	0	0	0	0	0
Disposals	0	(14)	(514)	(82)	(97)	0	(707)
Impairment / Reversal of Impairment (i)	0	207	122	0	0	0	329
Reclassification	0	208	100	0	268	(516)	60
Revaluation (i)	473	(72)	450	39	(3)	1	888
At 31 March 2013	**21,946**	**68,014**	**3,708**	**197**	**521**	**442**	**94,828**
Depreciation:							
At 31 March 2012	0	4,482	1,094	138	179	0	5,893
Depreciation charged during the year	0	4,401	375	25	100	0	4,901
Disposals	0	(14)	(492)	(82)	(97)	0	(685)
Impairment	0	0	0	0	0	0	0
Reclassification	0	0	0	0	0	0	0
Revaluation	0	97	21	1	(1)	0	118
At 31 March 2013	**0**	**8,966**	**998**	**82**	**181**	**0**	**10,227**
Net book value:							
At 31 March 2013	**21,946**	**59,048**	**2,710**	**115**	**340**	**442**	**84,601**
At 31 March 2012	21,473	63,203	2,122	102	131	675	87,706
Asset financing:							
Owned	21,946	56,710	2,710	115	340	442	82,263
Donated	0	2,338	0	0	0	0	2,338
NBV as at 31 March 2013	**21,946**	**59,048**	**2,710**	**115**	**340**	**442**	**84,601**

(i) These figures include the reversal of a previous decision to impair the Bicester site in 2010/11 following a reappraisal of expected future workloads totalling £1.981m, split between revaluation of £1.415m and a reversal of impairment of £0.566m. In addition, following a decision to reduce the number of buildings utilised by ECBU at the Sealand site, a total impairment of £2.625m was posted in 2012/13, split between revaluation of £2.400m and impairment of £0.225m.

The movements in each class of assets during 2011/12 were:

	Land	Buildings	Plant & Machinery	Transport Equipment	IT	Assets in course of construction	Total Tangible
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Cost or valuation:							
At 31 March 2011	26,259	60,102	16,989	294	264	2,506	106,414
Additions	0	39	83	0	0	662	784
Donations	0	0	0	0	0	0	0
Disposals	0	0	(13,818)	(1)	0	0	(13,819)
Impairment	0	56	13	0	0	0	69
Reclassification (i)	(5,625)	8,093	68	(58)	0	(2,493)	(15)
Revaluation	839	(605)	(119)	5	46	0	166
At 31 March 2012	**21,473**	**67,685**	**3,216**	**240**	**310**	**675**	**93,599**
Depreciation:							
At 31 March 2011	0	0	13,887	0	7	0	13,894
Depreciation charged during the year	0	4,459	1,164	135	142	0	5,900
Disposals	0	0	(13,809)	0	0	0	(13,809)
Impairment	0	0	0	0	0	0	0
Reclassification	0	0	0	0	0	0	0
Revaluation	0	23	(148)	3	30	0	(92)
At 31 March 2012	**0**	**4,482**	**1,094**	**138**	**179**	**0**	**5,893**
Net book value:							
At 31 March 2012	**21,473**	**63,203**	**2,122**	**102**	**131**	**675**	**87,706**
At 31 March 2011	26,259	60,102	3,102	294	257	2,506	92,520
Asset financing:							
Owned	21,473	60,865	2,122	102	131	675	85,368
Donated	0	2,338	0	0	0	0	2,338
NBV as at 31 March 2012	**21,473**	**63,203**	**2,122**	**102**	**131**	**675**	**87,706**

(i) Reclassification between land and buildings is primarily the separate identification of infrastructure assets, which had been previously disclosed as land. The affect of this adjustment on depreciation is not material and therefore, no adjustments for this has been made.

8 INVENTORIES AND WORK IN PROGRESS

	31 March 2013		31 March 2012	
	£'000	£'000	£'000	£'000
Gross Inventories	15,255		16,863	
Less inventory provision	(2,424)		(1,451)	
		12,831		15,412
Work in progress - net costs incurred		8,353		6,132
Total inventories		**21,184**		**21,544**

During 2012/13, inventory with a value of £26.922m was charged to cost of sales along with the creation of an additional £1.626m of inventory provision. Inventory with a value of £0.652m was written off against previously created provisions. During the same period, £5.531m of WIP was expensed to Cost of sales.

9 RECEIVABLES AND PREPAYMENTS

	31 March 2013	31 March 2012
	£'000	£'000
Trade and sundry invoiced receivables	26,811	27,810
Other receivables	289	719
Bad debt provision	(6)	(401)
Prepayments and accrued income	8,258	4,832
	35,352	**32,960**

Current assets are further analysed by debtor category as noted below:

	31 March 2013	31 March 2012
	£'000	£'000
Other central government bodies	31,686	27,544
Bodies external to government	3,666	5,416
	35,352	**32,960**

All the balances above fall due within 1 year.

Aged Trade and Sundry Invoiced Receivables Analysis	**Not Yet Due**	**30 to 60 Days**	**60 to 90 Days**	**90 to 120 Days**	**120 Days +**	**Total**
	£'000	£'000	£'000	£'000	£'000	£'000
At 31 March 2013	10,969	13,249	1,951	117	525	26,811
At 31 March 2012	14,016	9,904	2,296	480	1,114	27,810

10 CASH AT BANK AND IN HAND

	31 March 2013	31 March 2012
	£'000	*£'000*
Cash on short term deposit and at bank (i) (ii)	63,715	64,752
Cash in hand	3	4
	63,718	**64,756**

(i) Wherever possible cash is held in interest earning accounts, which are redeemable on demand within one working day.

(ii) Other than cash in hand all deposits and balances were held within a commercial bank.

An analysis of change in net funds can be found at note 14(b).

11 PAYABLES

Amounts falling due within one year:

	31 March 2013	31 March 2012
	£'000	*£'000*
Trade payables	2,017	943
Taxation and social security	1,739	2,393
Value Added Tax	4,991	5,533
Accruals	11,695	20,669
Dividend payable	7,000	4,500
Deferred income	6,772	11,538
Sundry payables	3,280	3,473
	37,494	**49,049**

Payables are further analysed by creditor category as below:

	31 March 2013	31 March 2012
	£'000	*£'000*
Other central government bodies	24,210	21,750
Bodies external to government	13,284	27,299
	37,494	**49,049**

12 SHORT TERM AND LONG TERM LOANS

	31 March 2013	31 March 2012
	£'000	£'000
Current portion of long term borrowings	1,663	1,663
Loan repayments due within 2 and 5 years	6,658	6,656
Loan repayments due after 5 years	16,641	18,306
	24,962	**26,625**

13 PROVISIONS FOR LIABILITIES AND CHARGES

	Large Aircraft Closure	Aged MOD Liabilities	Other	Total
	£'000	£'000	£'000	£'000
Balance at 1 April 2012	137	0	356	493
Increase/(decrease) in provisions	(120)	861	89	830
Utilised in year	(17)	0	(43)	(60)
Balance at 31 March 2013	**0**	**861**	**402**	**1,263**

Large Aircraft Closure Provision

This provision was fully discharged during the year.

Aged MOD Liabilities

During 2012/13 considerable work was completed to draw to a close a range of historical issues relating to utilities and other MOD liabilities that DSG had previously accrued over a number of years. The outcome of this work was not complete by 31 March 2013, but there is sufficent evidence to suggest that a provision for these liabilities is more appropriate than an accrual thus the current liability is now represented above.

Other Provisions

These provisions are to meet a variety of obligations including:

- £180k for the estimated replacement cost of a small number of Government Funished Assets which documentation indicates are in DSG's custody.
- £164k for the estimated costs for future legal/employment tribunal cases where evidence of potential claims exists.

The liabilities and charges provided for are expected to fall due within one year.

MOD has confirmed that it will continue to meet any liabilities in respect of DSG's redundancy costs and accordingly no further provision has been made for these future liabilities in DSG's accounts.

14 CASH FLOW STATEMENT NOTE

(a) Detailed analysis of gross cash flows	2012/13	2011/12
	£'000	*£'000*
Returns on investments and servicing of finance		
Interest received	359	253
Interest paid	(1,205)	(1,282)
	(846)	**(1,029)**
Capital expenditure		
Non-current assets in the course of construction	(282)	(662)
Purchase of non-current assets	(377)	(122)
	(659)	**(784)**
Financing		
With the MOD	(1,663)	(1,663)
Decrease in borrowings	**(1,663)**	**(1,663)**

(b) Analysis of changes in net funds/(debt)	At 31 March 2012	Cash flow	At 31 March 2013
	£'000	*£'000*	*£'000*
Cash at bank and in hand	64,756	(1,038)	63,718
Debt due within one year	(1,663)	-	(1,663)
Debt due after one year	(24,961)	1,663	(23,298)
Total	**38,132**	**625**	**38,757**

(c) Analysis of changes in cash and cash equivalents	
	£'000
Balance at 31st March 2012	**64,756**
Net change in cash and cash equivalent balances	(1,038)
Balance at 31st March 2013	**63,718**

14 CASH FLOW STATEMENT NOTE (CONTINUED)

(d) Net cash flows of Discontinued Operations	**2011/12**
	£'000
Cash flows from operating activities	
Operating profit from discontinued operations	4,831
Adjustments for:	
Depreciation charges	81
Decrease in Large Aircraft closure costs	409
Decrease in receivables	140
(Decrease) in payables	(1,610)
(Decrease) in provisions for liabilities and charges	(409)
Net cash inflow / (outflow) from operating activities	**3,442**
Cash flows from investing activities	
Payments to aquire Property, Plant and Equipment	0
Receipts for sale of non-current assets	0
Net cash (outflow) from investing activities	**0**
Cash flows from financing activities	
Decrease in borrowings	0
Net cash (outflow) from financing activities	**0**
Increase/(decrease) in cash and cash equivalents	**3,442**

The residual cash flows in 2012/13 following the discontinuation of Large Aircraft Business Unit operations were not sufficiently material in value to justify separate disclosure.

15 OPERATING LEASES

Operating Lease payments recognised as expenses in the period were:

	2012/13	2011/12
	£'000	*£'000*
Lease of buildings at RAF St Athan (i)	0	389
Lease of other Land and Buildings (i)	15	14
Lease of vehicles & other equipment (ii)	452	273
Total operating leases paid	**467**	**676**

(i) Contained in note 3 - Accommodation costs

(ii) Contained in note 6 - Vehicle hire and Other expenses; and within note 3 - Supplies and services consumed.

None of these payments were contingent rents or sublease payments.

Future minimum lease payments under non-cancellable operating leases are due as follows:

	31 March 2013	31 March 2012
	£'000	*£'000*
Not later than one year	305	267
Later than one year and not later than five years	16	87
Later than five years	0	0
	321	**354**

DSG had only one lease of significance, this was during 2011/12 only and relates to the lease of a building on the St Athan site, which commenced on 1st April 2010 and expired on 31st March 2012.

None of DSG's leasing arrangements have renewal or purchase options, rentals are payable on fixed installments over the duration of the lease.

There are no restrictions imposed by lease arrangements on dividends or further debt.

Future minimum lease payments under non-cancellable operating leases where DSG is acting as lessor are:

	As at 31 March 2013	As at 31 March 2012
	£'000	*£'000*
Receivable within one year	325	318
Receivable after one year	0	0
	325	**318**

This relates to a short term lease on facilities at the Sealand site.

There are no finance leases.

16 COMMITMENTS, CONTINGENT ASSETS AND LIABILITIES

Whilst not yet commited, £844k of capital expenditure has been authorised but not provided for in the accounts as at 31 March 2013 (2012 £345k). Capital commitments of £81k existed and were not provided for as at 31 March 2013 (2012 £269k).

There are no contingent assets at 31 March 2013 (nil at 31 March 2012).

There are no contingent liabilities at 31 March 2013 (nil at 31 March 2012). Any liabilities concerning environmental pollution are considered to be pre-Trading Fund events and the liability therefore falls to the MOD.

17 FINANCIAL INSTRUMENTS

DSG's treasury operations are governed under the Government Trading Funds Act 1973(a) as supplemented by DSG's Framework Document and are conducted within a framework of policies, mandates and delegations authorised at the top level by the Board and regularly reviewed. DSG's financial instruments comprise cash deposits, debtors, creditors and loans. DSG uses forward foreign currency sales and purchase contracts as derivative instruments when required for risk management purposes only, although none have been utilised during 2012/13 (nil during 2011/12). The main purpose of these financial instruments is to finance DSG's operations and DSG has limited powers to borrow or invest surplus funds. The main risks that would arise from the financial instruments are foreign currency, liquidity and interest rate risks. DSG's policies for managing these risks are set to achieve compliance with the regulatory framework including the rules contained in Managing Public Money.

Interest Rate Risk

DSG's funding is determined by fixed rate Government loans. There are no floating rate liabilities and DSG has only one loan with an interest rate of 4.6% fixed for the remaining 15 years of the loan term.

Currency Risk

DSG conducts business in Sterling, US Dollars, Euros and Swedish Krone and is therefore subject to foreign exchange risk. At 31 March liabilities of $8k US Dollars existed and SKr84k Swedish Krone. An adverse movement in foreign currency exchange rates of 10% for these currencies would give rise to additional liabilities of £1.6k.

DSG manages this risk by natural hedging and entering into forward foreign exchange contracts where amounts are material. DSG has one active foreign currency bank account, which held $23k US Dollars at 31 March 2013 ($59k at 31 March 2012). DSG policy requires that transactions are translated at the prior month average rate and year end foreign denominated net assets are translated at a year end spot rate.

Liquidity Risk

In excess of 66% of DSG's loans outstanding at the year end are repayable in more than 5 years. Current liquidity throughout the year was strong. Cash at bank is available on demand and short term investments are conducted through the Lloyds TSB Bank plc Money Market.

Counter-party/Credit Risk

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

Capital Management

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

- Sufficient flexibility for the funding of necessary capital expenditure and working capital required for any expansion of the business.
- Avoidance of risk and compliance with HM Treasury policies.
- Funding of dividend payments as agreed with the owner.
- Funding of loan repayment schedules.

The Capital structure of DSG is based on management's judgement of the balancing of all the elements of its financial strategy in order to meet its day-to-day and strategic needs. DSG, together with its owner, considers the amount of PDC in proportion to loans and retained earnings and manages the capital structure, making adjustments to it if necessary in the light of changes in economic conditions and risk characteristics of the underlying assets.

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

Categories of Financial Instruments

Financial assets

	At 31 March 2013	At 31 March 2012
	£'000	*£'000*
Trade, sundry and other debtors	27,100	28,529
Cash on short term deposit, at bank and in hand	63,718	64,756
	90,818	**93,285**

Financial liabilities

	At 31 March 2013	At 31 March 2012
	£'000	*£'000*
Trade and other payables	25,799	28,380
MOD loans	24,962	26,626
	50,761	**55,006**

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

Embedded Derivatives

In accordance with IAS 39 - Financial instruments: Recognition and measurement, DSG has reviewed all material contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard. No instances were found that required embedded derivatives to be recognised at their fair value separately from the non-derivative host contract. For the contracts reviewed, the economic characteristics and risks were closely related to those of the host contract.

18 RELATED PARTIES

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

19 EVENTS AFTER THE REPORTING PERIOD

There were no significant events after the reporting period. These accounts have been authorised for issue by the AO on the same date as the Comptroller and Auditor General's audit certificate.

20 LOSSES AND SPECIAL PAYMENTS

Other than the inventory write off disclosed in note 8, there were no material losses or special payments made during the year.

21 AUDITORS

The Trading Fund Act 1973 requires DSG's Annual Report and Accounts to be audited by the Comptroller and Auditor General. DSG's auditor is the NAO. The cost of this audit is £85,000 (2011/12 £95,000). The IBMS in the Annual Report and Accounts are audited by DIA.

22 THIRD PARTY ASSETS

In connection with contracts held with the Jordan Armed Forces, DSG holds in its name a bank account with a balance of £546k as at 31 March 2013 (£1,236k as at 31 March 2012), controlled by a member of the Jordan Armed Forces.

LIST OF ACRONYMS AND ABBREVIATIONS

AIT	Assembly, Integration and Test
AFPS	Armed Forces Pension Scheme
AO	Accounting Officer
ARM	Active Risk Manager
BSG	Business Strategy and Governance
CD	Commercial Director
CDM	Chief of Defence Materiel
CETV	Cash Equivalent Transfer Value
CFC	Corporate Finance Controller
CGP	Capability Growth Programme
COO	Chief Operating Officer
CSP	Corporate Strategic Plan
DARA	Defence Aviation Repair Agency
DE&S	Defence Equipment and Support
DES LE-Dir	Defence Equipment and Support, Director Land Equipment
DIA	Defence Internal Audit
DIO	Defence Infrastructure Organisation
DSG	Defence Support Group
ECBU	Electronics and Components Business Unit
ERHF	Equipment Regeneration Hub Forward
ESS	Equipment Sustainability System
FD	Finance Director
FM	Fleet Management
FOC	Full Operating Capability
FReM	Financial Reporting Manual
GHG	Greenhouse Gas
HIA	Head of Internal Audit
HR	Human Resources
HXP	HERRICK Exchange Point
IAMM	Information Assurance Maturity Model
IBM	Internal Business Measures
IBR	Integrated Business Reporting
IFRS	International Financial Reporting Standards
IOC	Initial Operating Capability
LCS	Logistic Commodity Services
LESS	Land Equipment Support Strategy
LSBU	Land Supply Business Unit
LW	Light Weapons
MHCA	Modified Historic Cost Accounting
Min(DEST)	Minister for Defence Equipment, Support and Technology
MRO	Maintenance, Repair and Overhaul
NAO	National Audit Office
NCA	New Commercial Agreement
NED	Non-Executive Director
OAC	Owner's Advisory Council
OTEP	Operational Training Equipment Packs
PCSPS	Prinicipal Civil Service Pension Scheme
PDC	Public Dividend Capital
PJHQ	Permanent Joint Headquarters
PUS	Permanent Under Secretary
RIDDOR	Reporting of Injuries, Diseases and Dangerous Occurrences Regulations
ROCE	Return on Capital Employed
SCS	Senior Civil Service
SD	Strategy Director
SDSR	Strategic Defence and Security Review
SSS	Strategic Support Suppliers
TFB	Trading Fund Board
TOR	Terms of Reference
TSF	Total Support Force
UOR	Urgent Operational Requirement
WCSP	Warrior Capability Sustainment Programme
WIP	Work in Progress
XMB	Executive Management Board

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