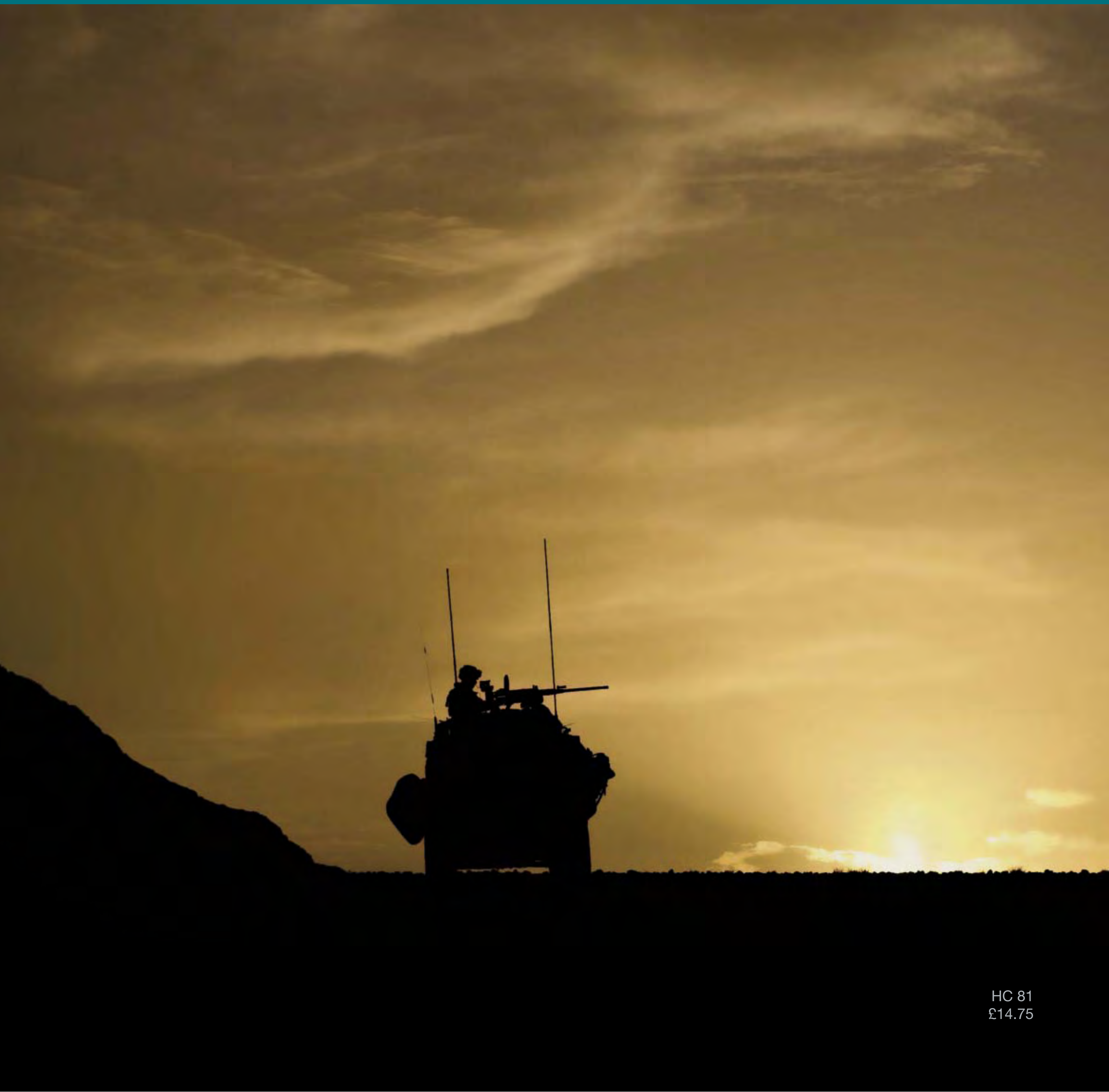
DEFENCE SUPPORT GROUP

Annual Report and Accounts

2009/2010



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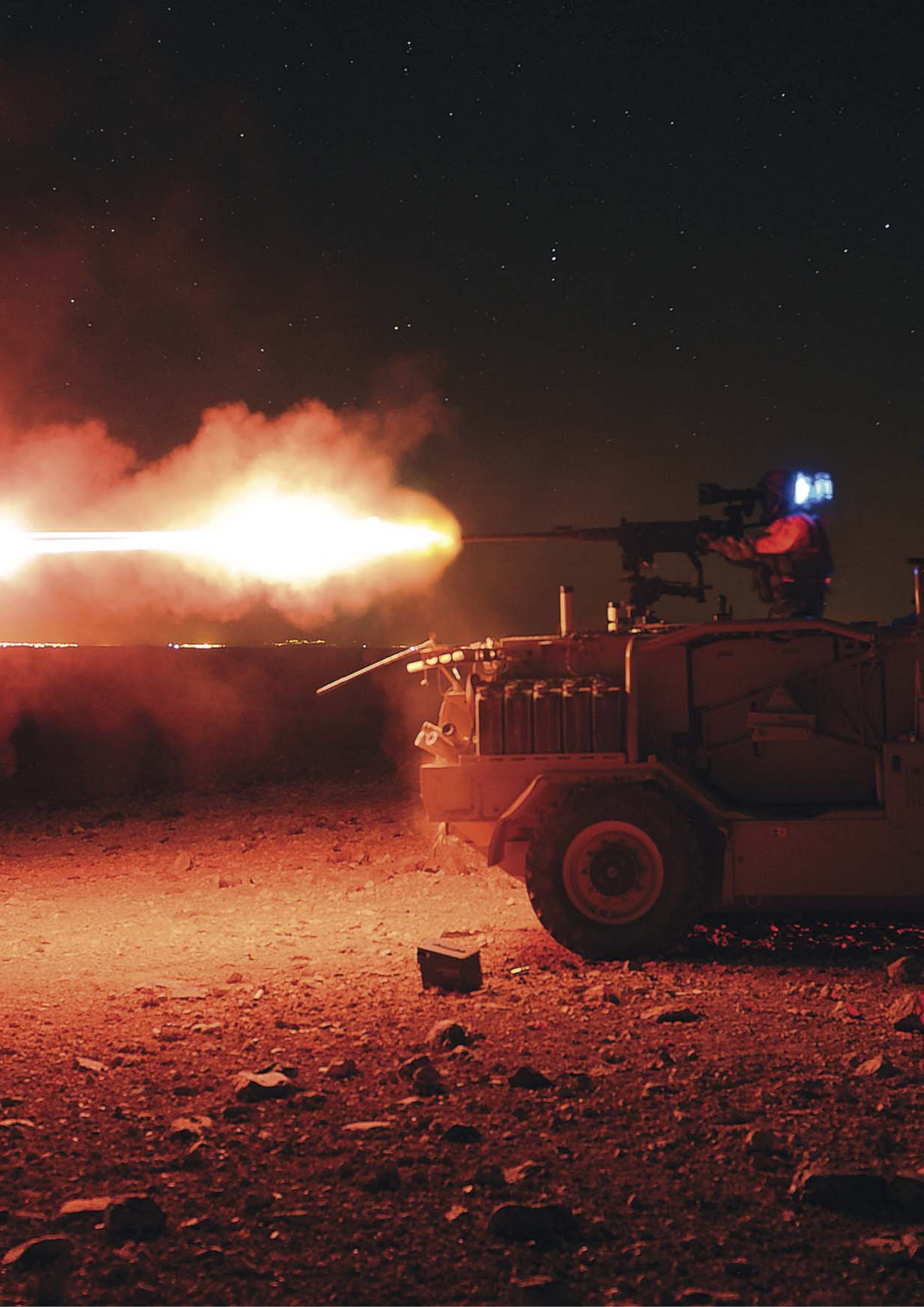

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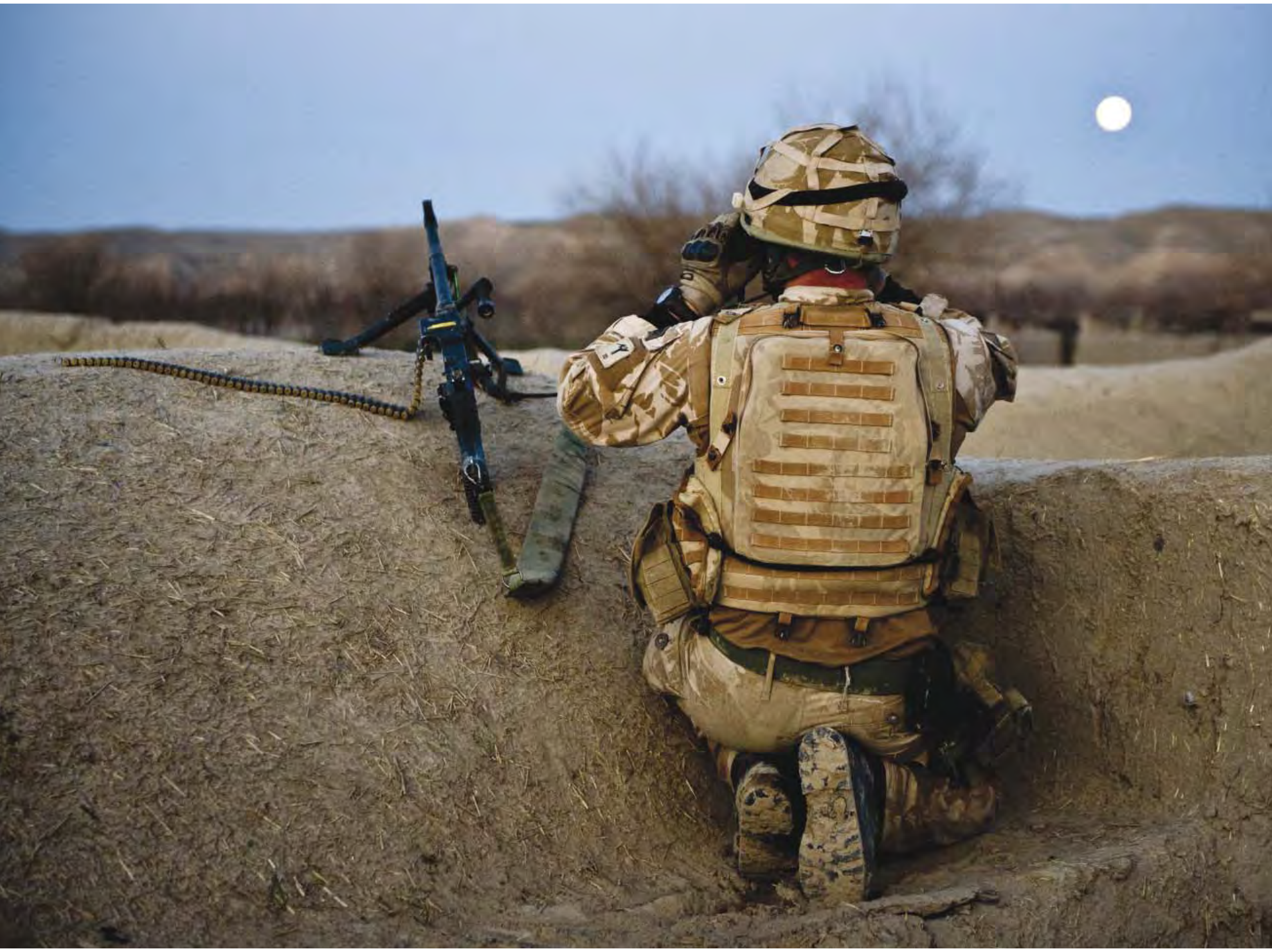

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MINISTRY OF DEFENCE

DEFENCE SUPPORT GROUP

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REPORT CONTENTS

INTRODUCTION FROM THE CHAIRMAN

“I am extremely proud of the progress DSG is making in transforming its operations.

By introducing new ways of working and empowering individuals to take decisions at a local level, DSG is driving through improvements and delivering tangible benefits to the end customer.”

JAMIE PIKE
Chairman

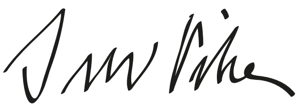
JAMIE PIKE
DSG Chairman

As Chairman of the Defence Support Group (DSG) Trading Fund Board it falls to me to help provide this business with the external advice, guidance and direction along with the invaluable support and expertise of my fellow Non-Executive Directors. At the end of 2009, we said goodbye to Michael Jones who was a key asset to our team of Non-Executive Directors and DSG benefited greatly from his expertise and counsel. In his place, we welcomed Janet Baker who brings with her a long and distinguished career working with public sector organisations and I know she will be of great benefit to the Board and to DSG as a whole.

On DSG's creation, we made a conscious decision, where possible, to hold our Trading Fund Board meetings away from the DSG Head Office. This allows those of us not involved in the day-to-day running of the business an opportunity of seeing how the various business units function and develop a deeper understanding and greater appreciation of the key issues DSG and its employees face. Besides the Andover Head Office, our Board meetings have now taken place at Bovington, Colchester, Donnington and St Athan.

As a member of the DSG Owner's Advisory Council, which is chaired by the Minister of Defence Equipment and Support, I am extremely proud of the progress DSG is making in transforming its operations. By introducing new ways of working and empowering individuals to take decisions at a local level, DSG is driving through improvements and delivering tangible benefits to the end customer.

I am fully aware of the high regard in which those who depend on the vital equipment and support needed by our Armed Forces hold DSG's employees. This is a view shared by many within the wider MOD and defence communities and is something in which everyone in DSG should take great pride. This year has signalled and consolidated DSG's arrival as a key provider of support to the various equipments and systems of the UK's Armed Forces. It is vital we maintain the momentum and continue delivering the very best value for Defence.



Jamie Pike
Chairman
28 June 2010

STATEMENT BY THE CHIEF EXECUTIVE

"The sustained and thorough commitment of DSG staff to supporting our Armed Forces in operational theatre is there for everyone to see. We commend DSG staff for this full-hearted commitment and for maintaining a high level of performance in support of operations."

EXTRACT FROM THE REPORT BY THE HOUSE OF COMMONS DEFENCE SELECT COMMITTEE
Published in June 2009.

ARCHIE HUGHES
Chief Executive

In this second year of trading, DSG produced an excellent business performance during a period of sustained transformation and change. Delivering output while focussed on reducing costs and removing non-value added overheads was critical to DSG achieving all the Key Targets against which Parliament measures DSG's performance. This achievement is due primarily to the efforts of its main asset, which are its people. All DSG's employees share a common vision and goal; they strive to deliver best value for Defence and the UK Armed Forces.

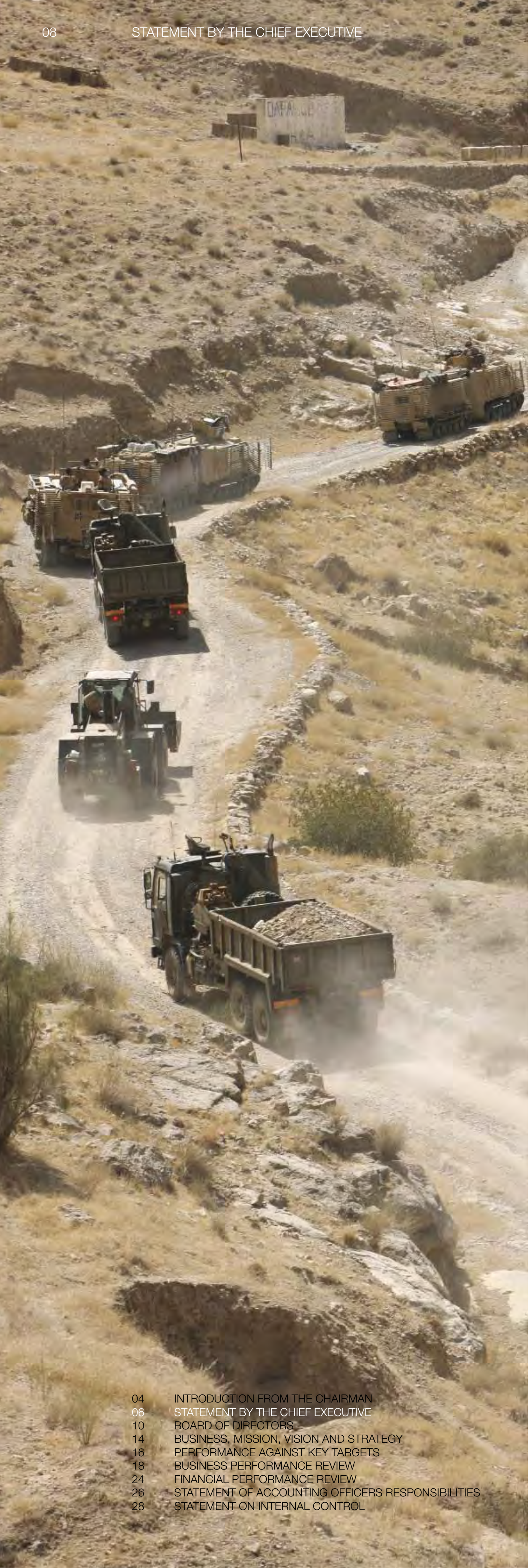
Their pride and commitment in supporting the country's service men and women is not limited to keeping vital battle equipment working efficiently and effectively from our workshops in the UK but extends to DSG employees deploying to operational Front Lines. This is where their skills and expertise are truly tested in an unfamiliar and, at times, dangerous environment. As an integral part of the Equipment Sustainability System (ESS) team at Camp Bastion in Helmand Province, Afghanistan, our people are proving true ambassadors for DSG and their positive attitude and adaptability is not going unnoticed by their military customers at every level. If successful, it is our intention to increase our presence in Camp Bastion threefold to ensure we continue delivering services of the very highest standards and turn round the vital equipment for those engaged in operational conflicts as efficiently and effectively as possible.

The presence of DSG employees in deployed operations is not restricted to those critical areas of conflict. This year our staff deployed to areas from as far apart as the Falkland Islands to the frozen plains of the Canadian Prairies. The positive attitude and adaptability of the DSG workforce is valued and wholly recognised by the military personnel at every level as an integral part of the defence support chain.

During the year, we attracted the interest of Ministers and politicians for all the right reasons. Firstly, we saw the then Armed Forces Minister Bob Ainsworth, visit DSG Stafford to see at first hand the extensive and, on occasion, unique capabilities of the DSG employees who offer a range of innovative solutions to their many customers in the air, land and maritime defence sectors. Then in June 2009, we saw the long-awaited publication of the House of Commons Defence Select Committee's (HCDC) Inquiry into DSG, which produced some very positive comments about the work of the organisation and its people. In particular, the HCDC Chairman, Sir James Arbuthnot and the committee members stated in their report that;

"The workforces of both ABRO and DARA, now within DSG, are to be commended for their conscientious and flexible approach to the merger. The executive team implementing the merger should also be praised for ensuring that there was no hiatus in DSG's support for the Armed Forces nor any diminution to the quality of that support."

The report went on to commend DSG staff and say;



"We express our gratitude to all those DSG employees who have volunteered, sometimes on more than once occasion, to deploy in theatre in support of operations. Such commitment is of great value to DSG and to our Armed Forces and clearly indicates the high level of dedication amongst the staff within DSG."

The then Minister with responsibility for DSG, Quentin Davies paid a visit to DSG Donnington following his attendance at a Remembrance Day event taking place at the National Memorial Arboretum near Lichfield. His visit allowed him to see the scope and breadth of work undertaken at this site and gain greater appreciation of the damage and necessary recuperation of a range of vehicles that DSG employees maintain, repair and upgrade to the very highest standards.

A visit by MOD's top civil servant, the Permanent Under Secretary, Sir Bill Jeffrey, to DSG Donnington was an important occasion for DSG as his busy diary precludes many visits outside Whitehall. We made use of the visit to have him present campaign medals to those DSG employees returning from deployment in Afghanistan and brief him fully on the developing role DSG is taking in the field of equipment support.

He had this to say to the employees receiving their medals;

"The medals you are receiving today are a token of gratitude, not only from those for whom this equipment is vital on battlefield operations, but also from me, the Chief of the Defence Staff and everyone in MOD who recognise the invaluable work you are doing. This is yet another superb example of the crucial role civilians play in supporting current operations."

Throughout the trading year, however, the focus for all DSG's employees remained the business-wide Transformation Programme, which is driving through change and benefits across a range of processes and procedures with the aim of delivering a service of the highest standards to our customers and maximum value for money to the taxpayer. We are witnessing great progress but recognise there is still some significant way to go. We recognise the continued constraints on the military budget, which is not unique within Government as all departments are striving to do more with less. We have our part to play and are continuously looking for ways to improve our service and reduce our costs to our military customers, and this will remain a major priority as we move forward.

In December 2009, I was present to witness DSG Donnington apprentice, Aiden Johnson, receive the gold medal and title of MOD Apprentice of the Year at the annual awards ceremony in London. Aiden received his award from HRH The Princess Royal at an event attended by fellow apprentices from throughout MOD, their families, friends and colleagues. It is clear Aiden has far to go as his enthusiasm and clear commitment to his work makes him a true ambassador for DSG and the apprenticeship scheme.

DSG is progressively forging closer links with industry in partnerships that fully exploit our combined capabilities and expertise. The Secretary of State's announcement that General Dynamics UK would become the preferred bidder for the Future Rapid Effect System (FRES) programme is welcome news for DSG, as our Donnington site shall play a key role in the Assembly, Integration and Test as well as the future maintenance, repair and upgrade of these specialist vehicles.

In conclusion, I pay tribute to the efforts and tenacity of the DSG employees who are rising to the many challenges facing them on an almost daily basis. Their determination to provide outstanding levels of service to their colleagues in the Armed Forces is only matched by their willingness to embrace change and develop new skills in an evolving environment.

Archie Hughes
Chief Executive
28 June 2010

BOARD OF DIRECTORS

RICHARD ATKINSON Commercial Director

DEREK OWEN Human Resources Director

KIETH NORRIS Strategy Director

ARCHIE HUGHES Chief Executive

JOHN REILLY Chief Operating Officer

STEVE HALL Finance 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 DARA's Chief Executive from January 2004 until he assumed responsibility for the merger of ABRO and DARA in July 2007 to form the Defence Support Group 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 (VDS), encompassing Specialist Engines and Vickers OMC as well as the Main Battle Tank and Military Bridging businesses.

JOHN REILLY, OBE
Chief Operating Officer

John Reilly, Chief Operating Officer is responsible for the Air, Electronics, Armoured Vehicles and Land & B Vehicle business streams and determining the Operational Excellence strategy of the Defence Support Group. He is also responsible for a number of other business support functions including Quality, Environment, Safety, Health, Information Services and Facilities.

John was Chief Operating Officer at DARA from 2001 until he assumed the role of Chief Operating Officer following the formation of the Defence Support Group. He joined MOD in 1975 after a successful four-year engineering apprenticeship in industry. He has an MBA from Abertay University and has worked on a number of major programmes within MOD. He was awarded the OBE in the Queen's Birthday Honours list in 2006 for his contribution to the Defence industry.

RICHARD ATKINSON
Commercial Director

Richard Atkinson was appointed Acting Commercial Director in October 2009, taking responsibility for all customer and procurement activities in support of the DSG Business Units.

Richard is DSG's Commercial Head for the Land business, a role he held in ABRO. Richard started his career with Royal Ordnance and has extensive commercial experience in the Defence sector having held a number of senior commercial roles in Marconi, AWE and BAE Systems. Before joining ABRO he was Head of Commercial for the Joint Strike Fighter Project.

STEVE HALL
Finance Director

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

Steve was previously Finance Director at DARA until he assumed the role of Finance Director in the Defence Support Group. 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 Finance Director for Military Survey.

DEREK OWEN
HR Director

Derek Owen, HR Director is responsible for the full HR function as well as internal communications, parliamentary business and security policy.

Derek was previously HR Director at DARA until he assumed the role of HR Director in the Defence Support Group. He worked in Germany for nearly three years as HR Manager for The Health Alliance, an innovative partnership with Guy's & St Thomas' Hospital Trust and the Soldiers', Sailors' and Airmen's Families Association responsible for delivering health care to British Forces in Germany. He has extensive HR, employee relations and change management experience in a variety of roles throughout the MOD and with all three Services, although notably with the Army. He is a Chartered Fellow of the Chartered Institute of Personnel and Development and a Chartered Fellow of the Chartered Management Institute.

KEITH NORRIS
Strategy Director

Keith Norris was appointed as the Defence Support Group's Strategy Director in January 2008. He previously led the DARA Rotary and Components sales team within 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.

JAMIE PIKE
DSG Chairman, an independent Non-Executive Director

DAVID BARRASS
Independent Non-Executive Director

TERENCE JAGGER
Non-Executive Director

JANET BAKER
Independent Non-Executive Director

JAMIE PIKE

DSG Chairman, an independent Non-Executive Director

As DSG's Chairman, Jamie Pike is responsible for leading the Board to ensure it operates efficiently and effectively and to oversee and scrutinise the organisation's plans and performance. He has a personal role, in advising the Owner about the high-level business issues affecting DSG, both directly and as a member of the Owner's Advisory Council.

Jamie began his career as a management consultant before joining Burmah Castrol in 1991. He rose to Chief Executive of Burmah Castrol Chemicals before leading the buy-out of Foseco, in 2001 and its subsequent flotation in 2005. He was Chief Executive of Foseco plc until it was acquired in April 2008. He has previously been a Non-Executive Director of RMC Group plc, Kelda Group plc and the Army Training and Recruitment Division. He is currently Chairman of the RPC Group plc, a quoted plastic packaging business and Chairman of MBA Polymers Inc., a plastics recycling business, which is a private company incorporated in the USA.

DAVID BARRASS

Independent Non-Executive Director

David Barrass's experience covers a broad range of industries both in the UK and internationally and he is currently Chairman of both CastleCare Group Ltd and Material Advantage Group Ltd. A professional Interim Manager, his most notable recent assignment was as CEO and Deputy Master of the Royal Mint where he delivered a major turnaround of the business.

TERENCE JAGGER

Non-Executive Director

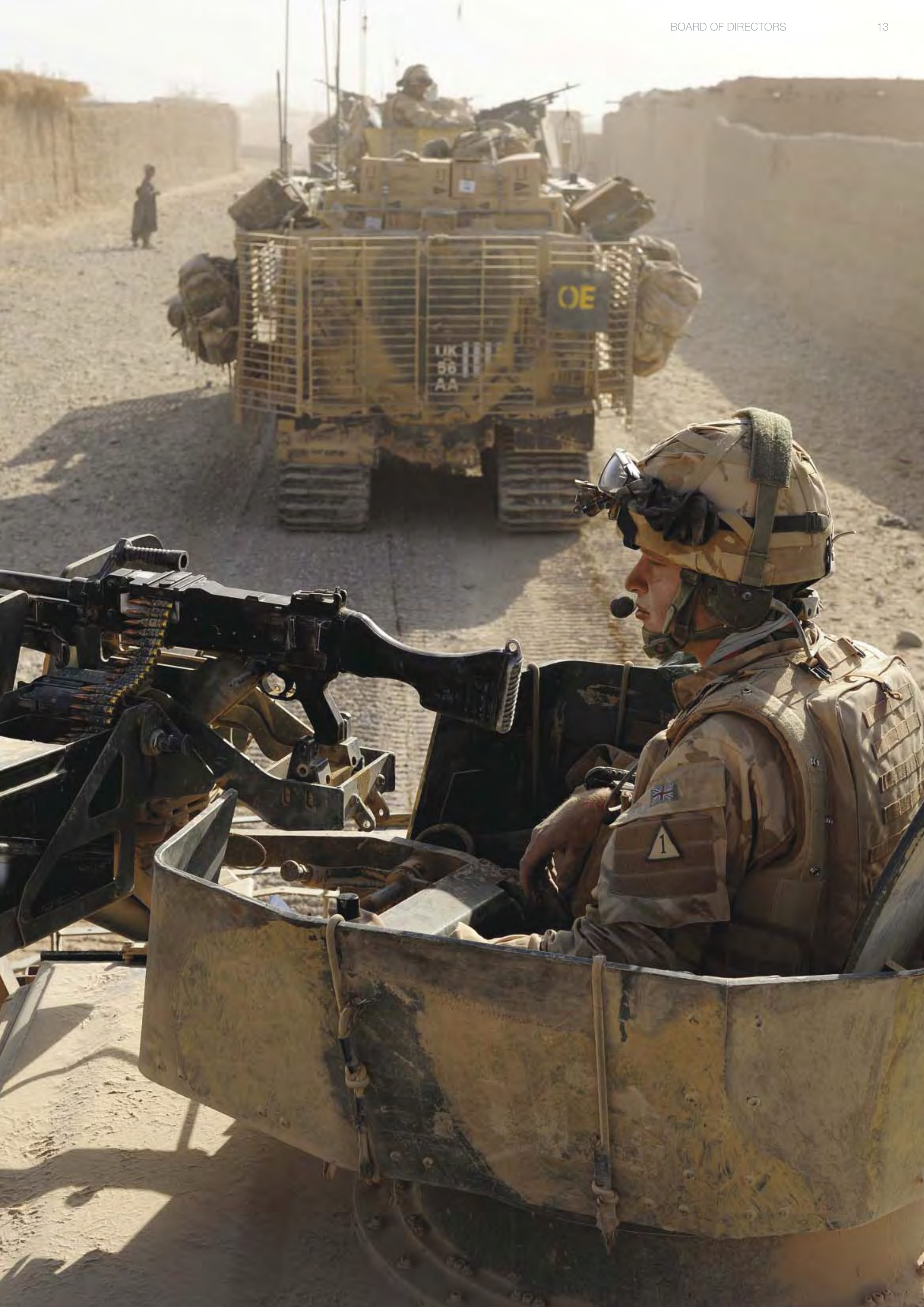
Terence Jagger's first career was in financial public relations and strategic planning in the private sector in both the UK and abroad. After a Masters degree in Finance at London Business School, he then joined MOD, where he was head of PFI, then led the privatisation of QinetiQ. After a year at the Royal College of Defence Studies, and postings in the UK and Afghanistan, he took up his post of Director Financial Management in 2007, responsible for managing MOD's financial systems and the production of its annual report and accounts.

JANET BAKER

Independent Non-Executive Director

Janet Baker's career started in the public sector before she left to pursue career in management consultancy firstly with Coopers and Lybrand and Ernst and Young then PA Consulting Group where she was a Senior Partner, leading the firm's Defence account, its International Sourcing advisory services, as well as its public sector work in Hong Kong and the USA. After leaving full-time consultancy work in 2006, she became a Non-Executive Director on the Board of the HealthCare Purchasing Consortium, and is Chair of HPC's Audit committee and a member of the Remuneration committee. She is also a Non-Executive Director on HM Treasury Group's Risk and Audit Committee, having been appointed in 2008.

All independent Non-Executive Directors are recruited in accordance with the HM Treasury Corporate Governance Code of Good Practice.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BUSINESS, MISSION, VISION AND STRATEGY

MISSION

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

VISION

Excel in Supporting Defence.

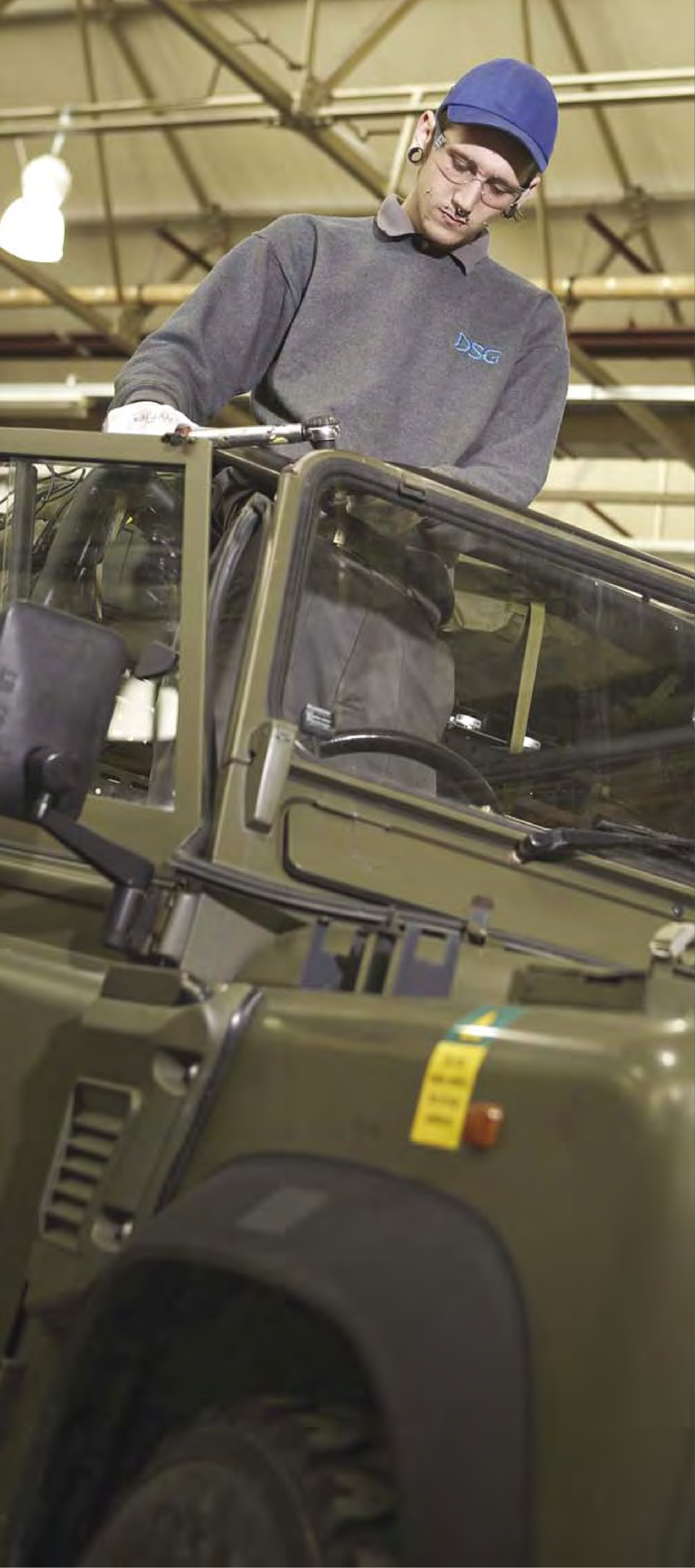
STRATEGY

The Defence Support Group enables MOD to secure access to assured onshore capacity and capability for the through life maintenance, repair, overhaul, upgrade and procurement services for strategically important Defence equipment. DSG's core mission is to support the UK Armed Forces and deliver wider Defence objectives, including current and future MOD equipment acquisition and support strategies.

It will pursue a strategic goal of achieving 'best value for Defence' through focusing on and delivering, where appropriate, cost reduction, efficiency and productivity improvements, and improved delivery to the customer across all areas of the business.

In support of this, the strategic aims of DSG are as follows:

- It will go forward as a Trading Fund;
- It will provide physical assembly, integration and test capabilities as required by the Customer/Industry;
- It will be agile, flexible and provide its services directly to MOD or indirectly through industrial primes / Original Equipment Manufacturers (OEMs) where it will position itself to be the partner of choice on major Land Equipment acquisition programmes;
- As a retained Defence capability, its utility will be maximised and where necessary sustained to provide a core capability to MOD customers. 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;
- It will continue to provide a flexible response to meet evolving operational requirements, particularly in terms of surge and Urgent Operational Requirements (UORs) and will provide support to deployed operations and training for operations. Developing its capabilities to provide support to customers at their preferred locations;
- It will build upon and grow its capability and knowledge base in support of Defence assets, including its ability to utilise MOD free user rights of 3rd party IPR;
- It will focus on developing the necessary capabilities to enable it to be deployed in a flexible manner as part of planned future procurement and support strategies;
- It will be a modern, lean organisation, structured as a series of Business Streams, as well as the Large Aircraft Business Unit, supported by a slim line Head Office; and,
- It will take forward any DSG specific recommendations of the Operational Efficiency Programme (OEP), the Defence Support Review (DSR) and the future Strategic Defence Review (SDR).



"Winning the MOD Apprentice of the Year award in 2009 was one of my greatest achievements. However, I get the same great sense of achievement when the vehicle I am working on is fitted with the last bolt. Knowing that the vital equipment we maintain in DSG is crucial in helping our service men and women is very rewarding"

Aiden Johnson
Senior Craft on Remus Project, Donnington

PERFORMANCE AGAINST KEY TARGETS

The Minister for Defence Equipment & Support endorsed DSG's Key Targets for 2009/10. DSG has been retained in MOD ownership to support delivery of the Defence Industrial Strategy by securing access to in-house capacity and capability for the maintenance, repair, overhaul and upgrade of strategically important Land and Air in-service equipment (deploying personnel to operational theatres if required), and to build a similar capability to support future MOD equipment acquisition and support strategies.

For its second year of trading DSG adopted Key Targets that will help to sustain FY2008/09 levels of performance and build upon the benefits of merger achieved to date.

PERFORMANCE AGAINST KEY TARGETS 2009/10:

Key Target 1: **Quality** Deliver an improved quality performance by achieving fewer than 4 attributable major customer concerns within DSG's Air Business and reducing upheld Customer Complaints within the Land Business by 5% per annum against the 2007/08 outturn.	**Achieved** There were no attributable major customer concerns within DSG Air Business and upheld complaints for the Land Business reduced in excess of 5%
Key Target 2: **Financial Performance** To achieve at least a 3.5% Return on Capital Employed.	**Achieved** The actual ROCE achieved was 8.25%
Key Target 3: **Business Transformation** Realise the benefits approved by the DSG Trading Fund Board in the DSG Transformation Plan.	**Achieved** The benefits approved by the DSG Trading Fund Board in the DSG Transformation Plan were realised.
Key Target 4: **Efficiency** Improve overall efficiency by at least 12% against the baseline established for DSG on formation.	**Achieved** Overall efficiency improved by 12.98%
Key Target 5: **Delivery** Meet delivery targets as agreed with the Customer as follows:	
• Air Business – To achieve 95% of Customer Programmes; and	**All targets achieved**
• Land Business – To meet Customer agreed targets for delivery schedules on Critical Programme lines (94% Sep 09, 94% Dec 09 and 97% Mar 10) and LAND Load tasks (92% Jun 09, 92% Sep 09, 92% Dec 09, and 92% Mar 10)	**All targets achieved**

FUTURE KEY TARGETS

For its third year of trading DSG has developed Customer-focused Key Targets that will help to build upon FY2009/10 levels of performance and improve longer-term efficiency through close structural alignment with Customer planning assumptions.

Key Target 1: **Quality**

Deliver an improved quality performance by:

- Air – achieving fewer than 3 attributable Major Customer Concerns; and,
- Land – implementing a new system to record 'Major' Customer Concerns for the Land Business and set a baseline against which future years' targets can be set.

Key Target 2: **Financial Performance**

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

Key Target 3: **Efficiency**

To develop a phased DSG Capacity and Capability Optimisation Plan.

Key Target 4: **Delivery**

Meet delivery targets as agreed with the Customer as follows:

- Air Business – To achieve 95% of Customer Programmes; and,
- Land Business – To meet Customer agreed targets for delivery schedules on: Critical Programme Lines (94% Sep 10, 94% Dec 10 and 97% Mar 11) and LAND Load Tasks (92% of Urgent Specified Tasks, 85% of Routine Tasks).

BUSINESS PERFORMANCE REVIEW

The primary focus for all the operational and functional areas of DSG during the reporting period was on transformation while continuing to deliver a cost effective and value for money service.

The overall performance of DSG during the year was sound with improved reporting information providing management with the data required to make the key decisions that will shape DSG for the future.
The integration into DSG of staff at Sapphire House in Telford working on the Land-based procurement and provisioning activities is now complete and forms an integral part of DSG's overall offering to its Armed Forces customers.

Moreover, in December 2009 HM Treasury laid before Parliament an Operational Efficiency Programme (OEP) report, the objective of which is to realise a range of efficiency measures across the public sector by reducing revenue spending and generating capital receipts. DSG undertook work alongside teams from DSDA, the Joint Support Chain and external advisors, to identify what synergies exist between vehicle activities that may offer best value by transferring these activities from DSDA into DSG. This work is still progressing but it is likely that potential opportunities exist for DSG to develop and further enhance its support provision role within the Land environment.

Throughout all this additional activity, the work of transforming the business to deliver its services more efficiently and effectively was the highest priority for every DSG employee. No area of the business is immune to the process of driving through change and this was most evident within DSG's operational capabilities where the pursuit of Operational Excellence is currently underway at every level from the shopfloor to the Boardroom. Enterprise Resource Planning (ERP) together with Sales and Operations Planning initiatives are the cornerstones, which aim to provide DSG with a more sophisticated and transparent base from which new processes and procedures will emerge to deliver greater value for money for the UK Armed Forces and taxpayer.

A structural reorganisation of the operational functions, approved by the DSG Board, aims to drive through further savings while enhancing DSG operational capabilities. Embedding DSG's Land activities within two distinct business workstreams will improve accountability and operational effectiveness. The first business stream has responsibility for the business activities undertaken at DSG's Donnington, Stafford and Sealand sites.

The second business stream is accountable for the business activities at the Bovington, Warminster, Stirling, Colchester and Catterick sites. In addition a Support Service Stream has responsibility for the ERP and Operational Excellence programmes, IS, Business Support Services, Facilities, Compliance and the DSDA project.

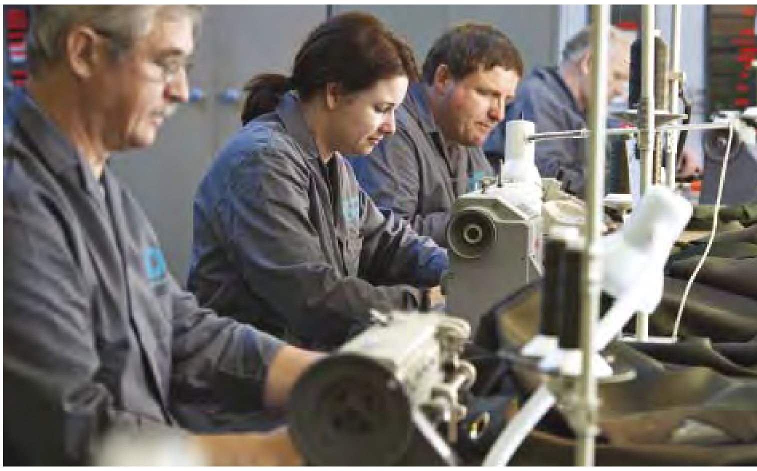
Following the announcement in Parliament by the Defence Secretary on 29 March 2010 about the proposed drawdown of staff and subsequent closure of DSG's Large Aircraft business at St Athan in South Wales, the existing reporting regime will remain extant until its closure by 2013. In his statement Mr Ainsworth told Parliament,

"Our priority is to ensure that the redundancy and retraining schemes available to the workforce fully reflect our appreciation of the loyal, reliable and very skilled work that employees of St Athan have delivered for the benefit of the RAF and the country."

He concluded by saying,

"I pay tribute to the outstanding service of DSG St Athan personnel, both past and present, in supporting the UK Armed Forces with the vital equipment needed on critical operations both at home and overseas."

These are sentiments echoed by the DSG management team and by top-level military commands across Defence.



The increased pressures on Defence spending and prioritisation of new and existing programmes required that DSG look closely at demand forecasts across its various workload platforms in the Land and Air sectors. Of particular importance to DSG and its MOD customer is the role of DSG personnel at Camp Bastion in Afghanistan where they are closely involved supporting the UK military's initial Equipment Sustainability System. DSG is working to enhance its support when the final capability solution comes on line during the latter part of 2010. DSG continues supporting the Army's Training Unit at Suffield on the Canadian Prairies but expects that budgetary pressures on the Land customer will see DSG manpower levels decrease in the future on this particular deployed operation.

"Naturally, it is the work our troops are undertaking on operations that make the headlines but it is important we also recognise how critical the support of the DSG employees is to the efforts and success of our Armed Forces. This visit has been of great interest to me and has certainly given me a valuable appreciation and understanding of the key role DSG and all its employees play in supporting our servicemen and women with the vital equipment they need both at home and overseas."

SIR BILL JEFFREY
MOD's Permanent Under Secretary, speaking during his visit to DSG Donnington in November 2009.

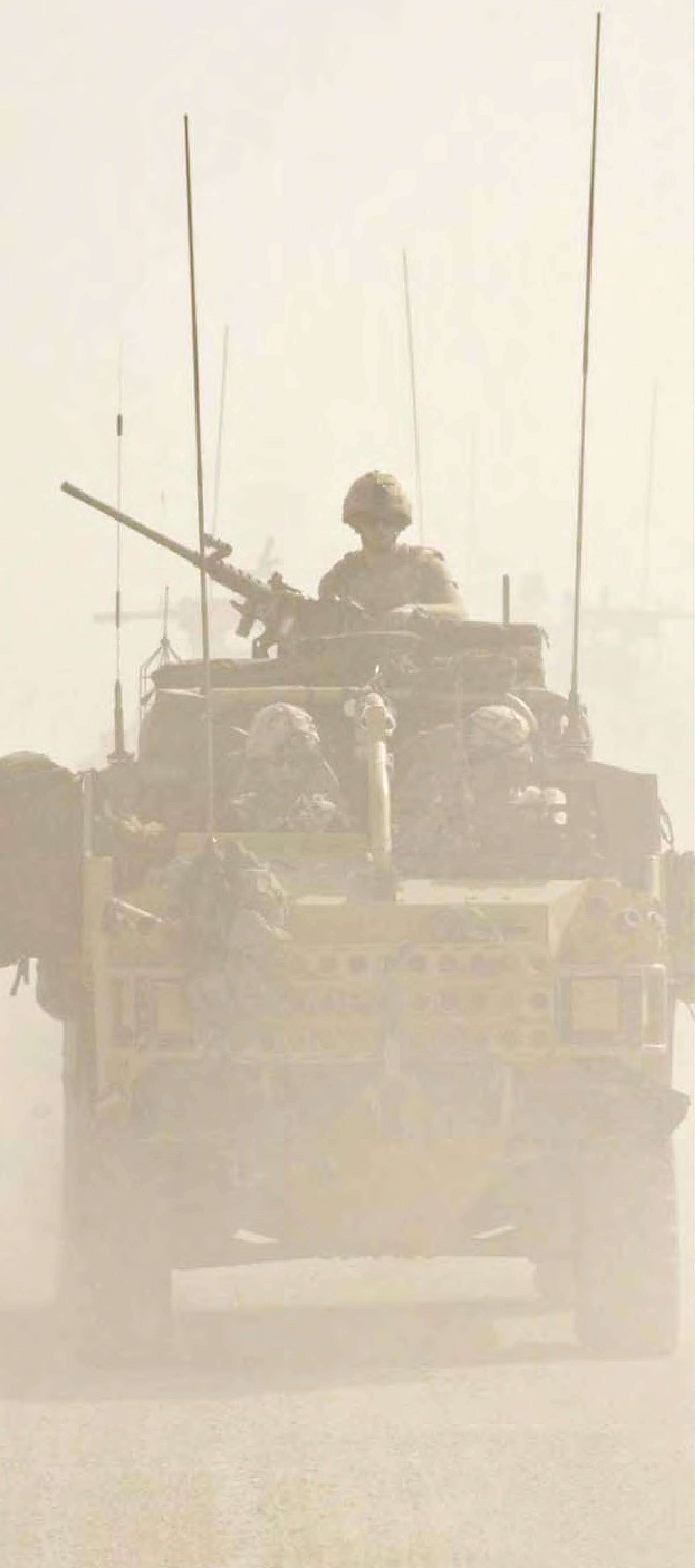
DSG is enhancing its role across its In Barracks Equipment Support (IBES) programme of activities. Embedding our skilled employees where they are needed most is helping sustain and enhance our reputation amongst our customer community. Coupled with a positive attitude, DSG staff working on IBES programmes are the vanguards of the business, dealing daily with customers and helping foster better relations in locations throughout the UK.

Collaborating with industry is not a new phenomenon for DSG and during the year, the business signed, or renewed existing partnering agreements with major defence contractors such as BAE Systems, General Dynamics and Lockheed Martin to help secure work on future equipment programmes. Confirmation by the Defence Equipment and Support (DE&S) organisation's Chief of Defence Materiel and its Chief Operating Officer that DSG must play a significant role in the integration and support activities of the Protected Patrol Vehicle (PPV) strategy is an important vote of confidence in the future role DSG will play in the future. The rewritten and reissued DE&S Standing Instruction 20 to the MOD-wide customer community reinforces the need to maximise DSG's capabilities and capacity for the broader benefit of the UK Armed Forces.

In the arena of wider Defence markets, the Jordanian Armed Forces contracted DSG to purchase a number of Land Rover Defender vehicles and spares. DSG continues to develop potential opportunities for work on behalf of the Kuwait and Oman governments on Desert Warrior and Challenger tanks.

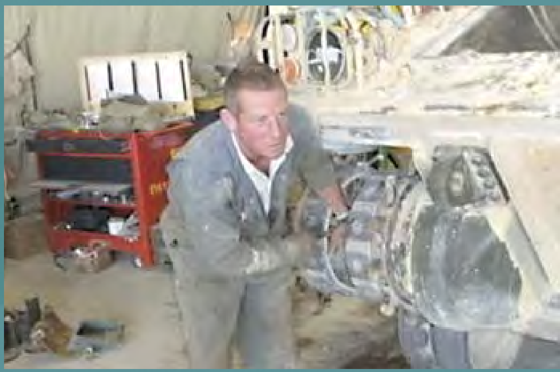
The positive improvements and rising performance levels across the various business units all contributed to a successful trading year for DSG. However, the most significant challenges for DSG and its employees are still ahead as the public sector faces further constraints on funding and a new Strategic Defence Review will surely impact in some way on how DSG delivers equipment support in the future.

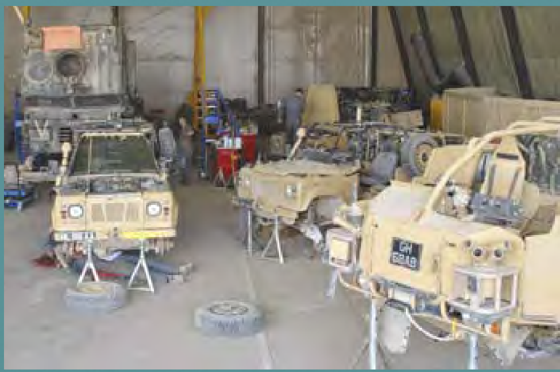
Delivering a value for money, cost effective, high quality service relies solely on the expertise, professionalism and skills of DSG's employees. This is evident across all disciplines and work areas from the technicians, mechanics and engineers on the shopfloor to those in desk-bound jobs fulfilling the support functions that are, as with any organisation, an essential element of any organisation's structure. Everyone has a role to play, all contribute by degrees to the success of the business, and all add value in their own unique way.

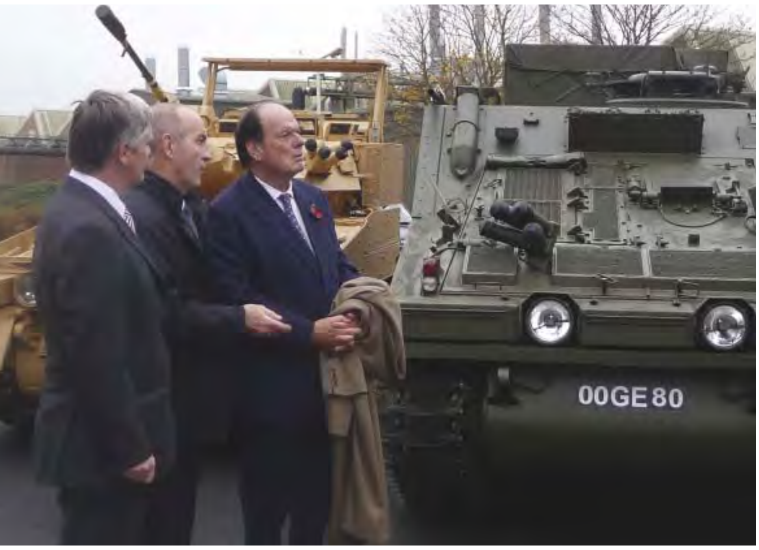


"Working and living in Camp Bastion is challenging but despite the hostile environment I am inspired to deliver 100%. This is because I know that the regeneration facility we are running helps reduce equipment down time and ensures that front line troops are equipped and ready for combat."

Russell Drew
Senior Craft,
Camp Bastion







"From everything I have witnessed today when touring the shopfloor it is certainly evident to me that the DSG Donnington employees share a common vision and are a highly skilled and motivated workforce. They all show great pride in their work – and rightly so – since the quality service they consistently provide to our troops is of critical importance."

QUENTIN DAVIES
Minister for Defence Equipment and Support on a visit to DSG Donnington.

DSG lays great store in fostering open, honest relations with the various representative Trades Unions, witness to this tenet of cooperation and respect for the views of the employees' representatives, is that DSG's Trading Fund Board contains officials from both the Industrial and Non-Industrial unions. The Board values their contributions and lays great store in the benefits that accrue from forging relationships based on common goals and a shared vision to deliver a valued service by a valued workforce in a successful business.

DSG's employees coupled with their expertise and skills remain the business's single most valuable asset. The UK Armed Forces recognise the work of the DSG employees and their value to Defence. This is most evident when DSG deploys its workforce to operational Theatres of conflict. The most significant advance during the year in relation to DSG's employees is the introduction of a fully harmonised single status workforce, which combines the traditional industrial and non-industrial employees into a single, unified workforce spread across four distinct pay bands. Work is underway in drawing together the disparate inherent policies and procedures from the Air and Land businesses into a single set best suited to DSG's needs. The total number of working days lost due to sickness was 32,894 which equates to 9.8 days per employee.

DSG's Transformation programme, DART – DSG Achieving Rapid Transformation – is moving up a gear with all operational and functional directorates driving through improvements and efficiencies. DSG is now following a much clearer strategic direction and engages at every level with its customers to ensure plans are adapted or revised to suit the changing environment in which DSG works. Matching DSG's capability to its capacity remains a major challenge due to the continuous inability to remove costs quite as quickly as workload reductions and decreasing income streams.

The results of DSG's Customer Review Programme – Talkback – shows positive increases in all areas measured for this annual survey, which is welcome news in a challenging trading year. In addition to improving customer relations, DSG gained full Investors in People status and formal accreditation at the end of 2009, which many consider a remarkable achievement in such a relatively short period of time.

Devolving responsibility and day-to-day decision making to the Business Streams and Unit Heads will continue as DSG works toward reducing the burden of costly overheads that many perceive as non-value added and a significant drain on precious resources. Naturally, there are roles within the corporate structure that must remain separate and distanced from the operational business environment but it remains the aim of the DSG Board to minimise this function's manpower levels commensurate with the existing and future needs of the business.

"My team and I carry out work on the Multiple Launch Rocket System which allows the troops at the front line to operate further away from hostile areas.

Personal satisfaction comes from knowing that my team, with a combination of expertise, knowledge, skills and capabilities complete tasks, no matter how diverse."

Donna Matthews,
Team Leader,
Donnington

FINANCIAL PERFORMANCE REVIEW

DSG successfully completed its second year as a Trading Fund with a very satisfactory outcome, resulting in good profits and a strong Balance Sheet.

Overall, DSG's financial performance exceeded its plan with a Profit before Interest and Dividend of £8.7m.

TRADING RESULTS

DSG achieved turnover and profit better than plan.

The financial performance was after providing in the Accounts for a £5.8m price rebate to the MOD customer. This has arisen as a result of efficiencies and cost reduction in excess of those assumed in the Plan.

The Return on Capital Employed achieved was 8.25%.

CASH FLOW AND FUNDING

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

At 31st March 2010 DSG had Public Dividend Capital (PDC) of £23.3m and Government Loans of £30.0m.

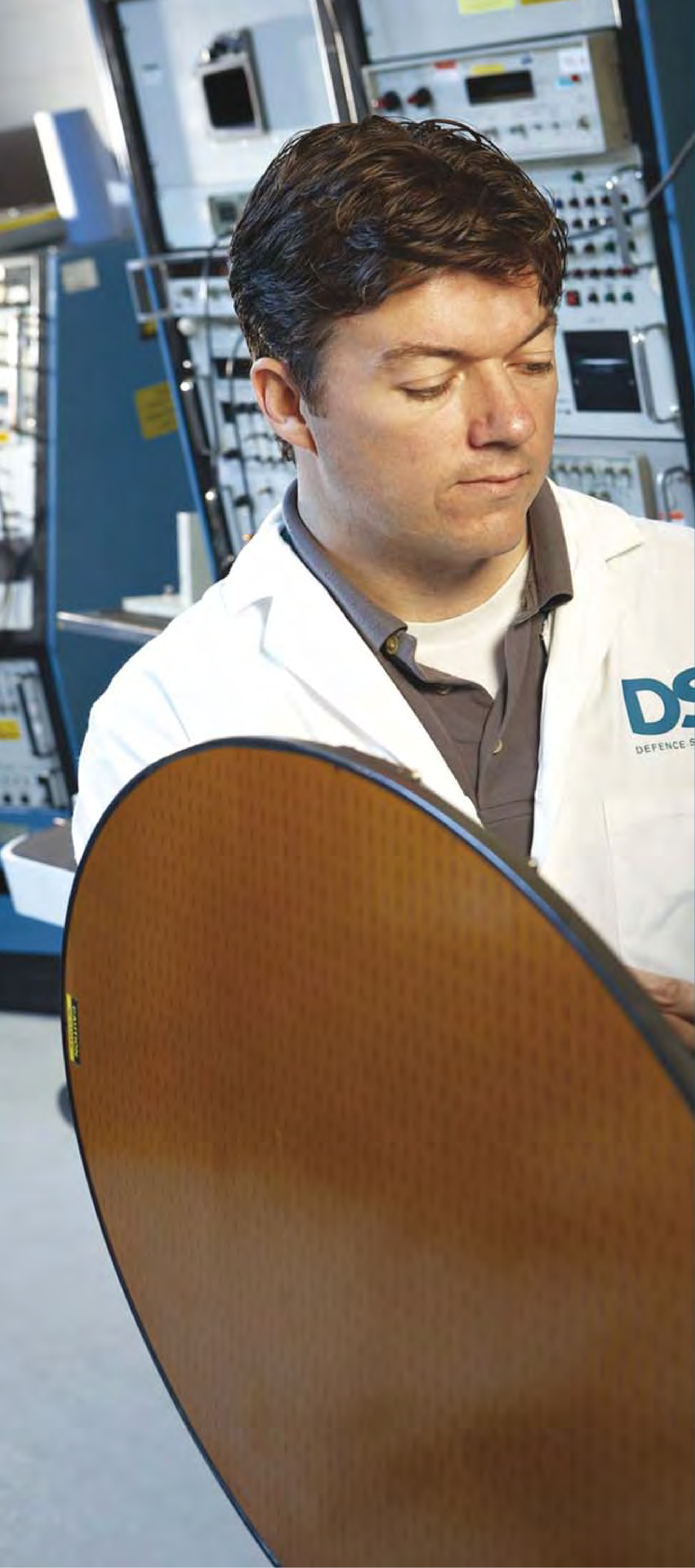
Liquidity was strong throughout the year with a closing net cash position at 31st March 2010 of £34.6m.

CAPITAL INVESTMENT

Expenditure on capital projects amounted to £1.6m during the year.

DIVIDEND

DSG has provided in the Accounts for a dividend of £4.5m to be paid to the MOD in respect of the year 2009/10.



"I am the team leader for the Tornado Nose Radar repair, which is under contract from the original equipment manufacturer. This work demonstrates our ability to maintain and support legacy equipment and partner with industry to deliver savings to Defence.

With the current climate of high level operational commitments, my team and I are constantly facing challenges to meet crucial delivery targets. We understand the need to satisfy the demands for radars and approach it with a flexible and productive attitude. We are always aware that the pilots and navigators at the sharp end depend on this equipment to do their job efficiently and effectively."

Andy Peterson
Tornado Partnered
Support Team

STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

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

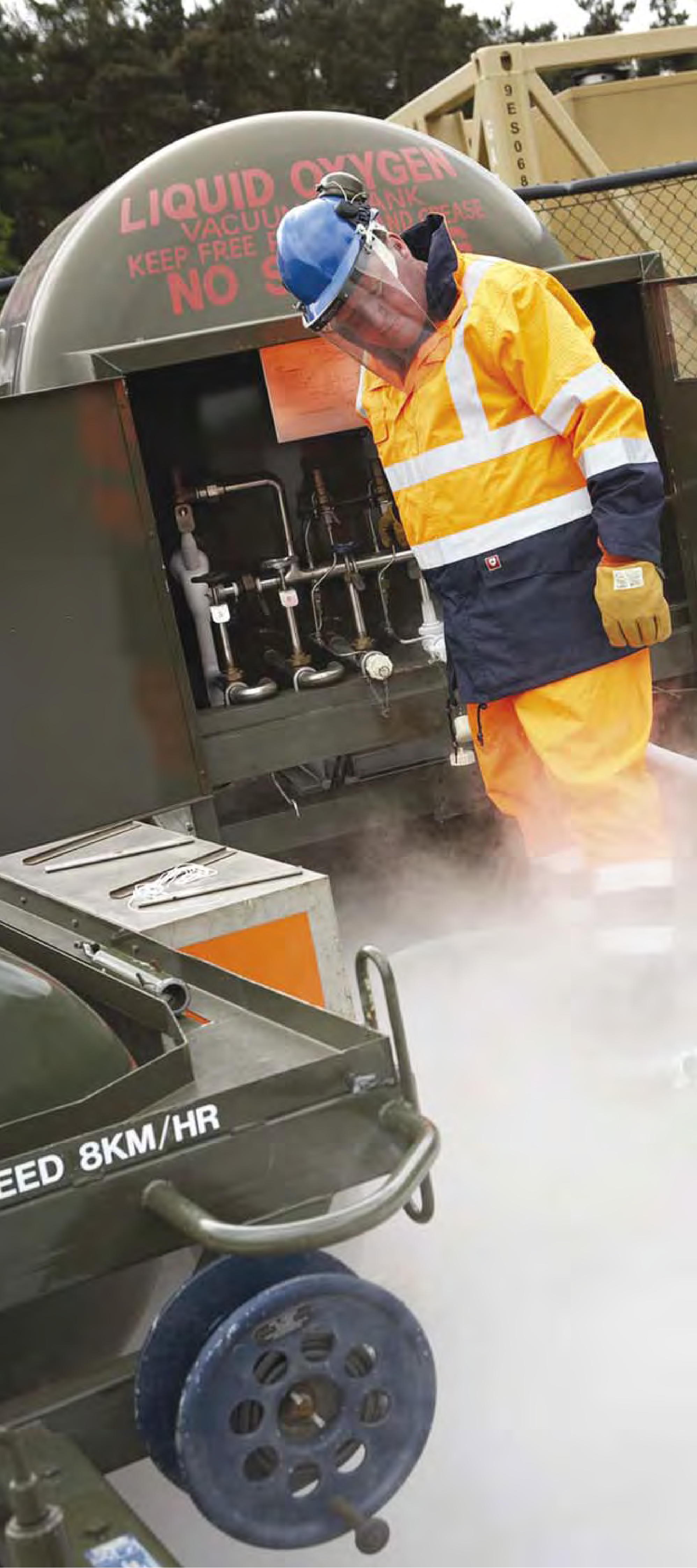
In preparing the accounts, the Accounting Officer is required to comply with the requirements of the Government Financial Reporting Manual and in particular to:

- observe the Accounts Direction issued by HM Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards as set out in the Government Financial Reporting Manual have been followed, and disclose and explain any material departures in the financial statements; and,
- prepare the financial statements on a going concern basis.

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

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

Archie Hughes
Chief Executive and Accounting Officer
28 June 2010



"I am fortunate to be leader of a great team, providing a specialist service to the Royal Air Force. Knowing that the items of Cryogenic Ground Support Equipment that leave my work area for use on aircraft are safe and in a first class serviceable condition gives me great personal satisfaction."

Steve Cropper,
Team Leader Cryogenics Bay, Stafford

STATEMENT ON INTERNAL CONTROL

SCOPE OF RESPONSIBILITY

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

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 Corporate Strategic Plan. The DSG Owners Advisory Council, chaired by the Minister for Defence Equipment and Support as representative of our owners, meets quarterly to review DSG's performance against its key targets and Business Plan objectives.

THE PURPOSE OF THE SYSTEM OF INTERNAL CONTROL

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of DSG's policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place in DSG for the year ended 31st March 2010 and up to the date of approval of the annual report and accounts, and accords with Treasury guidance.

CAPACITY TO HANDLE RISK

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

Our procedures for corporate and business unit risk registers, together with our implementation of risk management for major projects, continues to ensure that risk management is embedded in all our business activities. We are continually assessing the approach to risk management, to ensure that all business units and projects continue to operate within Treasury guidelines. All business units and support directorates are using the risk management software Active Risk Manager (ARM) and bid management areas are now also being included. Additional training for all business units has been organised along with supplementary training on the reporting mechanisms.

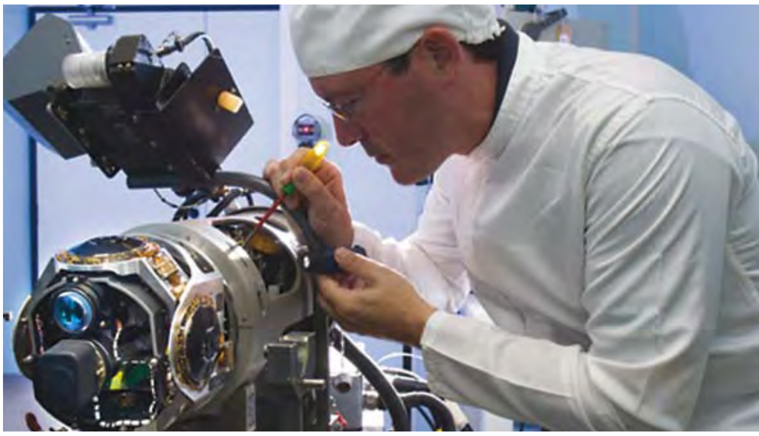
THE RISK AND CONTROL FRAMEWORK

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

- **A Risk Management Policy with associated procedures**, which outlines the approach used within DSG for implementing risk management and includes a risk management reporting structure.
- **Appointed Risk Management Committee**, which reviews and evaluates internal standards and procedures relative to the management of risk and disseminates risk information and guidance on best practice.
- **Appointed Risk Co-ordinators** within each business unit and directorate who are responsible for the maintenance of local risk registers.
- **A DSG Corporate Risk Register**, which represents the broad spectrum of corporate risks and is owned and regularly reviewed by the DSG Boards.
- **Business Continuity Plans**, which are managed by the Business Continuity planners to facilitate the unity of risk management and business continuity. All DSG sites have reviewed their Business Continuity Plans in 2009/10, and are subject to regular review in accordance with the DSG Business Continuity Manual action plan.
- **Insurance Policies** are in place to meet DSG's legal responsibilities and to mitigate certain risks. No insurance is taken against any potential liabilities to the MOD.
- **Information Risk Management**, is being consolidated and strengthened with the appointment of Information Asset Owners and an Information Asset Management process under the control of the SIRO and this includes the protection of electronic data. There have been a number recent audits and reviews in this area. Policies and procedures controlling the storage of information and access to the IT systems are being revised to accommodate the DSG policies and uploaded into the new DSG Business System, where all policies and procedures are held. There has been no loss of data or unauthorised release or loss of personal data.
- **Internal Audit Services** provide an annual risk and compliance based programme of internal audits. During 2009/10, in addition to the audit of the Key Targets, there were five major risk based audits completed, two of which gained substantial assurance, two limited assurance and one no assurance. In addition there were five workshop audits, four of which achieved substantial assurance and one full assurance. The Executive Governance Review Group scrutinises all accepted recommendations with a target to ensure that they are implemented within three months.

REVIEW OF EFFECTIVENESS

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within DSG who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I have received satisfactory letters of assurance from executive managers and the DSG Governance Review Group. I have also received annual reports from DIA and HIA which give an overall view of the level of assurance which is substantial in both cases. The Board and the Audit Committee have advised me on the implications of the result of my review of the effectiveness of the system of internal control. Plans to address control weaknesses and ensure continued improvement of our processes are in place.



DSG has established the following processes to maintain and review the effectiveness of the system of internal control:

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

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

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

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

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

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

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

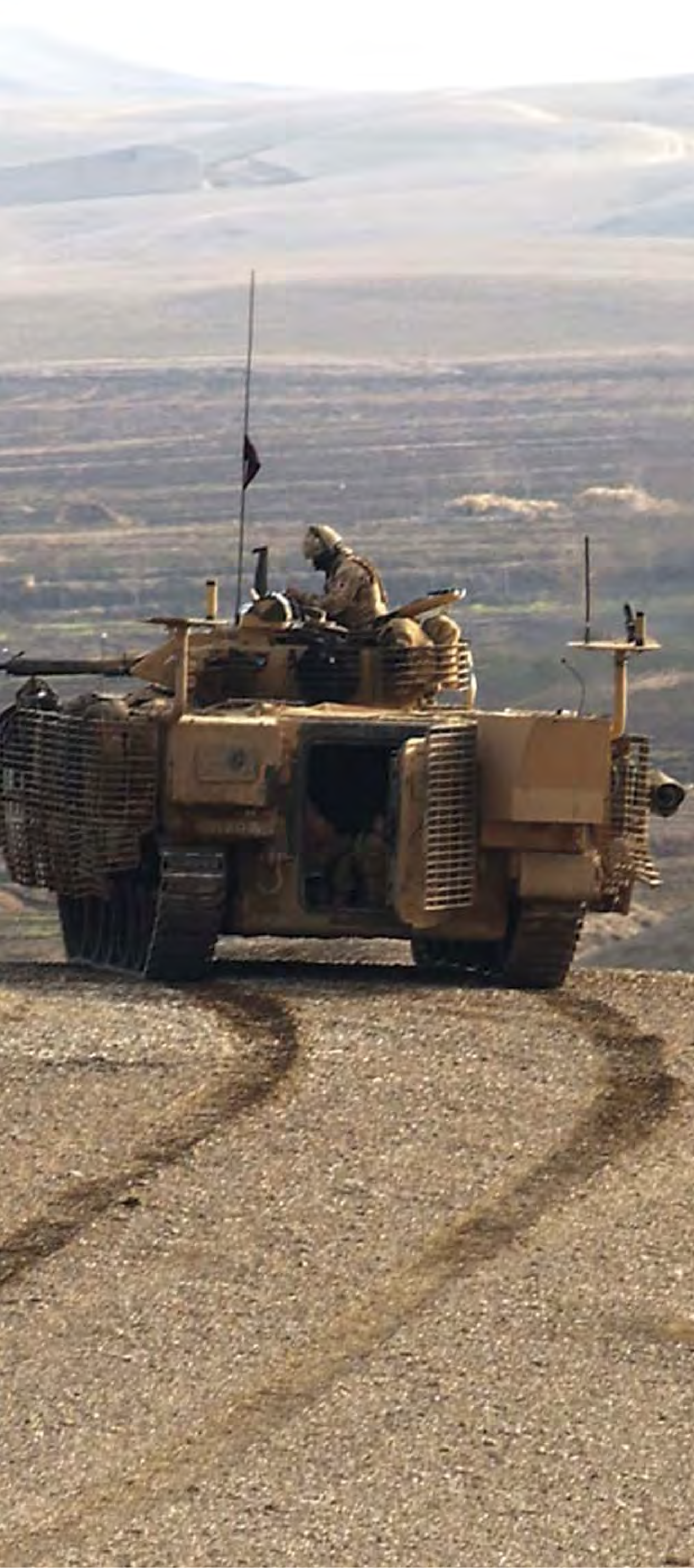
- DSG risk management structure has been designed to ensure that information is communicated upstream and downstream within the organisation. Risk management is included as a regular agenda item at site and directorate meetings with links into the Business Continuity Plans. The risk management software,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

INTERNAL CONTROL WEAKNESSES

For the financial year 2009/10, the internal audit process did not identify any areas of significant control weakness. However, whilst the overall level of assurance achieved is substantial, some of the lower level reports indicate that there was some slippage in management control especially in the areas of travel & subsistence and vehicle hire. The Executive Directors have been tasked with taking action to tighten these controls. There still remain issues relating to Work In Progress (WIP) reconciliations and goods received not invoiced accounting, which were not fully resolved by the year end, however the transition to a new ERP system will eliminate most of these issues during 2010/11. During the transformation process there will be a period of uncertainty and it is recognised that there will be new risks arising that will need careful management and control, but I am confident that our systems of internal control are more than adequate for the task.

A. Hughes

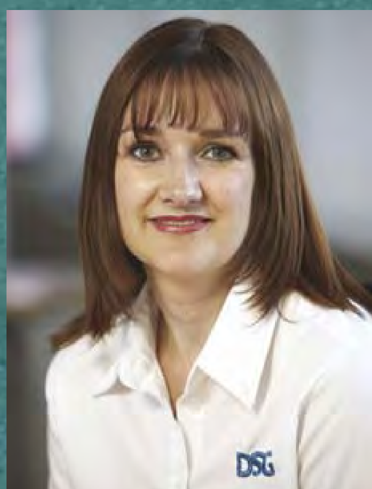
Archie Hughes
Chief Executive
28 June 2010



"Although I am not fixing tanks or aircraft and my job of optimising inventory is desk-bound, I am still aware that I must buy the right equipment and materials in a timely manner. This ensures front line commands are equipped to meet their critical operational commitments.

I am also very conscious of the need for us to continue offering best value for Defence and the tax payer. Therefore, we are always looking at ways to optimise our purchasing activities"

Lis Wall,
Business Planner for 'B' Cluster, Telford



REMUNERATION REPORT

REMUNERATION COMMITTEE

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

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

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

The committee continues to make a positive input to the strategic direction of DSG pay settlements prior to ratification by the DSG Board.

REMUNERATION POLICY

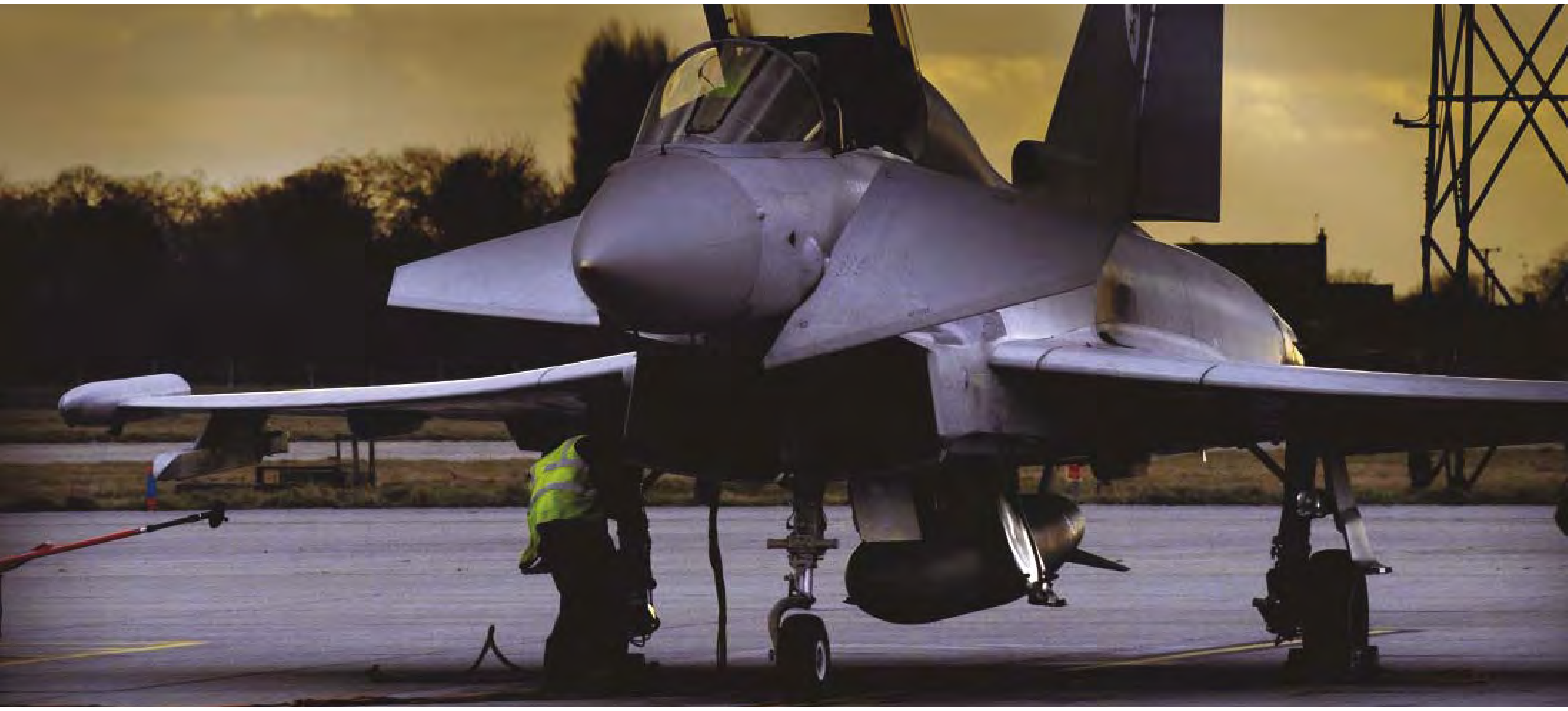
The Chief Operating Officer, Finance Director, Commercial Director (to 30 September) 2009 and Human Resources Director are Senior Civil Servants. As such, their pay is set through recommendations made by the Review Body on Senior Salaries. The Review Body on Senior Salaries provides independent advice to the Prime Minister and the Secretary of State for Defence on the remuneration of SCS taking account of evidence it receives about wider economic considerations and the affordability of its recommendations. Further work about the work of the Review Body can be found at www.ome.uk.com.

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

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

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

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



SERVICE CONTRACTS OF DIRECTORS

Directors who are members of the SCS hold appointments that are open-ended and made in accordance with the Civil Service Commissioner's Recruitment Code. This requires appointment to be on merit and based on fair and open competition, but also includes the circumstances when appointments may otherwise be made. Further information about the work of the Civil Service Commissioners can be found at www.civilservicecommissioners.gov.uk. Members of the SCS recruited or promoted to the grade before 2 April 1990 have a 3 month notice period, members recruited or promoted to the grade after this time have a 1 month notice period. Early termination of an executive director's appointment, other than for misconduct, would result in the individual receiving compensation as set out in the Civil Service Compensation Scheme. Details of the Civil Service Compensation Scheme can be found at www.civilservice-pensions.gov.uk

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

Richard Atkinson was appointed on a temporary basis as acting Commercial Director on 01 October 2009 until such time as a permanent replacement is appointed and is otherwise on a fixed term contract due to expire on 31 October 2010.

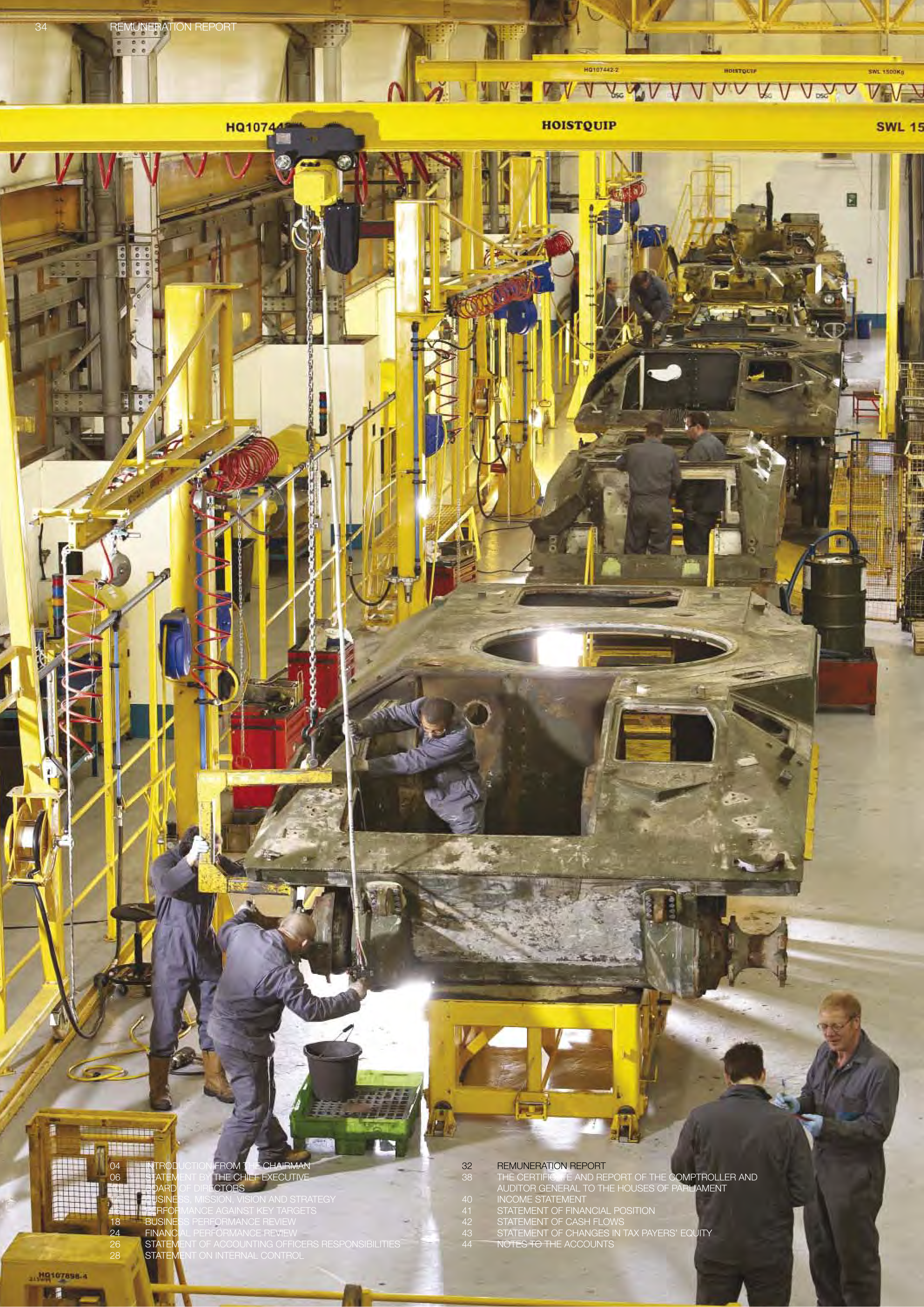
Independent non-executive directors are appointed for a fixed term and are not appointed as civil servants. Contracts may be terminated at one month's notice by either party or on dissolution of the Board unless found guilty of gross misconduct when termination will be immediate. Their contracts may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

Remuneration for non-executive directors is set at a fixed annual rate determined by the Department's Permanent Under Secretary. Fees are set on the basis that the role should require around 40 days work per year. This excludes the non-executive director representing the interests of the MOD's Finance Director whose services are not charged to DSG. Non-executive directors are not involved in any discussion about their own remuneration and all payments made are non-pensionable. There are no compensation entitlements for early termination.

REMUNERATION DETAILS OF DIRECTORS (AUDITED)

Non-Executive Directors	Fees 2009/10 £'000	Fees 2008/09 £'000
Jamie Pike	40-45	40-45
Michael Jones (to 30 December 2009)	15-20	20-25
David Barrass	20-25	20-25
Terence Jagger[1]	N/A	N/A
Janet Baker (from 01 January 2010)	5-10	N/A

[1] Terrence Jagger has been appointed in conjunction with his responsibilities at MOD. He is not entitled to receive separate remuneration in undertaking his DSG duties.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REMUNERATION DETAILS OF DIRECTORS (AUDITED)

	2009/10		2008/09	
	Gross Salary Bonuses and allowances[1]	Performance Bonus as a percentage of Total Remuneration	Gross Salary Bonuses and allowances[1]	Performance Bonus as a percentage of Total Remuneration
Executive Directors	£'000	%	£'000	%
Archie Hughes Chief Executive	195-200	20	235-240	35
John Reilly Chief Operating Officer	110-115	9	110-115	10
Steve Hall Finance Director	75-80	13	70-75	12
Derek Owen Human Resources Director	90-95	6	90-95	10
Alan Lewis Commercial Director (to 30 September 2009)	40-45		90-95	10
Keith Norris Strategy Director	70-75	9	75-80	11
Richard Akinson Commercial Director (from 01 October 2009)	35-40	0	N/A	N/A

SALARY

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

PENSION BENEFITS

	Accrued Pension at pension age as at 31/03/10 and related lump sum	Real increase in pension and related lump sum at pension age	CETV at 31/03/10	CETV at 31/03/09[1]	Real increase in CETV	Employee contribution to partnership pension account
	£'000	*£'000*	*£'000*	*£'000*	*£'000*	*£'000*
Archie Hughes	10-15	2.5-5.0	192	144	34	–
John Reilly	30-35 Plus lump sum of 100-105	0-2.5 Plus lump sum of 2.5-5.0	755	677	35	–
Steve Hall	20-25 Plus lump sum of 60-65	0-2.5 Plus lump sum of 5.0-7.5	300	254	29	–
Derek Owen	35-40 Plus lump sum of 100-105	0-2.5 Plus lump sum of 2.5-5.0	803	689	77	–
Alan Lewis (to 30 September 2009)	20-25 Plus lump sum of 60-65	0-2.5 Plus lump sum of 2.5-5.0	429	381	27	–
Keith Norris	25-30 Plus lump sum of 75-80	0-2.5 Plus lump sum of 2.5-5.0	546	501	17	–
Richard Atkinson (from 01 October 2009)	0-5	0-2.5	49	29	16	–

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

CIVIL SERVICE PENSIONS

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

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

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

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

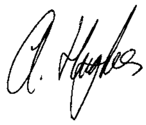
None of the Directors have opted for a Partnership Account therefore there are no employer contributions to such accounts in respect of these Directors.

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

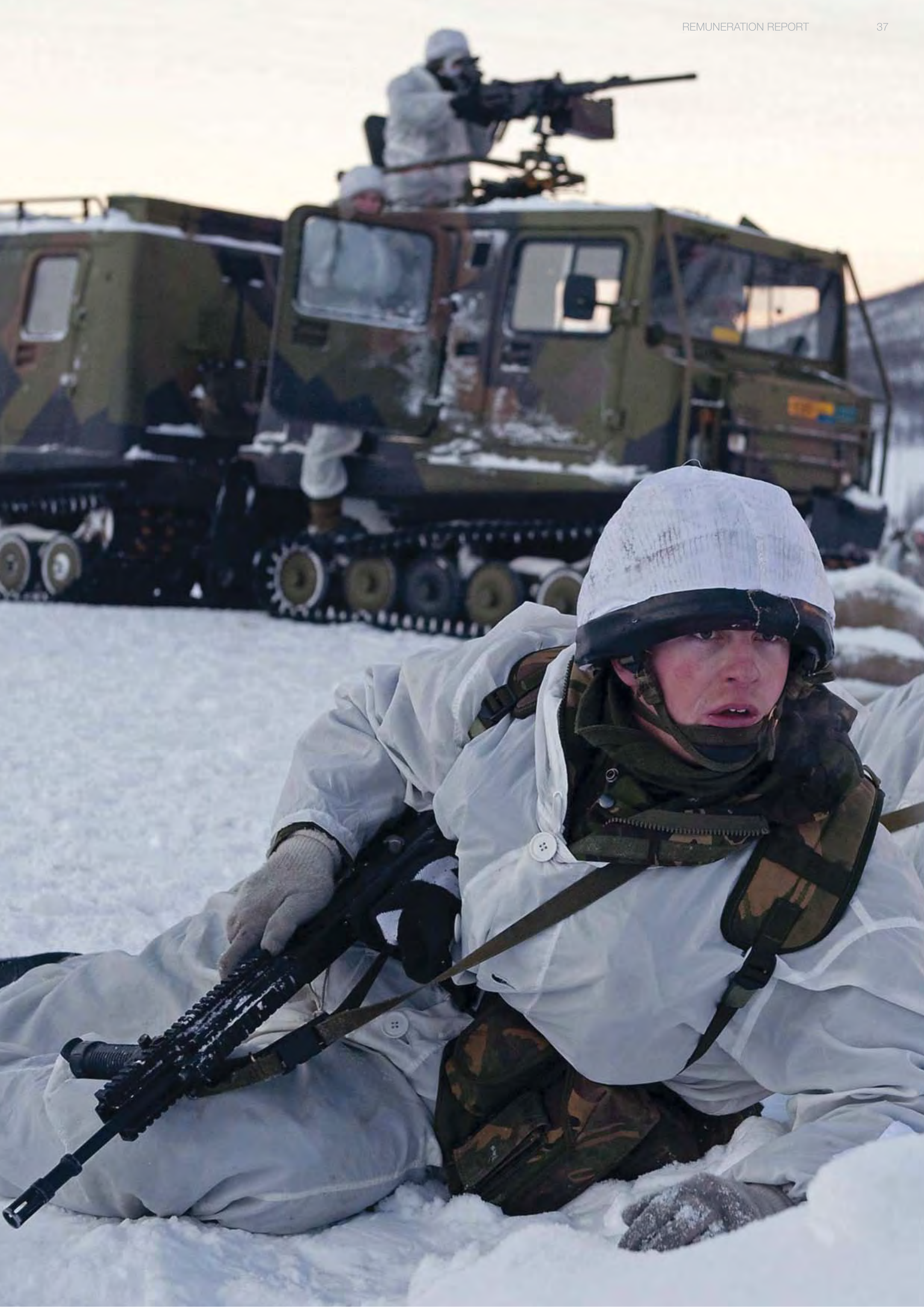
None of the Directors have remuneration packages containing non-cash elements. No payments have been made to third parties for the services of a Director.

Approval

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



Archie Hughes
Chief Executive
28 June 2010



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 31st March 2010 under the Government Trading Funds Act 1973. These comprise the Income Statement and Statement of Changes in Taxpayers' Equity, the Statement of Financial Position, 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 CHIEF EXECUTIVE/ACCOUNTING OFFICER AND AUDITOR

As explained more fully in the Statement of Chief Executive's/Accounting Officer's Responsibilities, the Accounting Officer is 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 the financial statements in accordance with applicable law and 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 am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income reported in the financial statements have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

OPINION ON REGULARITY

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

OPINION ON FINANCIAL STATEMENTS

In my opinion:

- the financial statements give a true and fair view of the state of Defence Support Group's affairs as at 31st March 2010 and of its profit, changes in taxpayers' equity and cash flows 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 Statement by the Chief Executive, Business, Mission, Vision and Strategy, Performance against Key Targets, the Business and Financial Performance Review and the unaudited part of the Remuneration Report, included within the Annual Report 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 returns adequate for my audit have not been received from branches not visited by my staff; or,
- the financial statements are not in agreement with the accounting records or returns; or,
- I have not received all of the information and explanations I require for my audit; or,
- the Statement on Internal Control 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
30 June 2010

INCOME STATEMENT FOR THE PERIOD ENDED 31 MARCH 2010

	Note	2009/2010 £'000	2008/2009 £'000
Turnover	2	232,554	226,672
Cost of sales	3	197,804	192,225
Gross profit		**34,750**	**34,447**
Administrative expenses	3	22,101	24,926
Operating profit		**12,649**	**9,521**
Large Aircraft business closure provision	13	3,973	-
ABRO/DARA Merger costs		-	224
Profit on ordinary activities before interest		**8,676**	**9,297**
Interest receivable		96	734
Interest payable	4	1,435	1,512
Profit on ordinary activities before dividend		**7,337**	**8,519**
Dividend payable		4,500	5,200
Retained Profit/(Loss)		**2,837**	**3,319**
Return on capital employed (ROCE)		**8.25%**	**9.22%**

All operations reported above are continuing.
The notes on pages 44 to 61 form part of these accounts.

STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2010

	Note	31 March 2010 £'000	31 March 2009 £'000	1 April 2008 £'000
Non-current assets				
Property, Plant and Equipment	7	47,380	52,696	54,486
Total non-current assets		**47,380**	**52,696**	**54,486**
Current assets				
Inventories	8	27,396	25,362	21,712
Trade and other receivables	9	48,390	47,465	71,409
Cash and cash equivalents	10	34,567	44,006	65,491
Total current assets		**110,353**	**116,833**	**158,612**
Total assets		**157,733**	**169,529**	**213,098**
Current liabilities				
Trade and other payables	11	(54,691)	(68,088)	(115,033)
Loans	12	(1,664)	(1,664)	(55,059)
Provisions	13	(4,485)	(555)	(67)
Total current liabilities		**(60,840)**	**(70,307)**	**(170,159)**
Non-current liabilities				
Loans	12	(28,290)	(29,955)	-
Total non-current liabilities		**(28,290)**	**(29,955)**	**-**
Net assets		**68,603**	**69,267**	**42,939**
Financed by:				
Capital and reserves				
Public Dividend Capital		23,324	23,324	-
Revaluation reserve	14	20,180	27,294	28,149
Donated asset reserve	17	253	-	-
Retained earnings	15	24,846	18,649	14,790
Taxpayers' equity		**68,603**	**69,267**	**42,939**

The notes on pages 44 to 61 form part of these accounts.

Archie Hughes
Chief Executive
28 June 2010

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

STATEMENT OF CASH FLOWS FOR THE PERIOD ENDED 31 MARCH 2010

	Note	2009/2010	2008/2009
		£'000	£'000
Cash flows from operating activities			
Operating profit		12,649	9,521
Adjustments for:			
Losses on disposals of non-current assets		59	163
Permanent diminution of non-current assets		464	380
Depreciation and impairment charges		2,536	2,842
Large Aircraft closure costs		(3,973)	-
Merger costs		-	(224)
Increase in inventories		(2,031)	(3,458)
(Increase)/decrease in receivables		(925)	23,944
Decrease in payables		(17,897)	(46,945)
Increase in provisions for liabilities and charges		3,930	488
Net cash (outflow) from operating activities		**(5,188)**	**(13,289)**
Cash flows from investing activities			
Payments to acquire Property, Plant and Equipment	16a	(1,337)	(2,102)
Receipts for sale of Fixed assets		90	-
Interest received	16a	96	734
Net cash (outflow) from investing activities		**(1,151)**	**(1,368)**
Cash flows from financing activities			
Decrease in borrowings	16a	(1,665)	(23,440)
Increase in Public Dividend Capital		-	23,324
Dividends paid		-	(5,200)
Interest paid	16a	(1,435)	(1,512)
Net cash (outflow) from financing activities		**(3,100)**	**(6,828)**
Decrease in cash and cash equivalents	16c	**(9,439)**	**(21,485)**
Cash and cash equivalents at start of year		44,006	65,491
Cash and cash equivalents at end of year		34,567	44,006

The notes on pages 44 to 61 form part of these accounts.

STATEMENT OF CHANGES IN TAXPAYERS' EQUITY FOR THE YEAR ENDED 31 MARCH 2010

	Public Dividend Capital	Revaluation Reserve	Donated Asset Reserve	Retained Earnings	Total Equity
	£'000	*£'000*		*£'000*	*£'000*
Taxpayers' equity at 1 April 2008	**-**	**28,149**	**-**	**16,603**	**44,752**
Changes in accounting policy – short term employee benefits	-	-	-	(1,813)	(1,813)
Restated balance at 1 April 2008	**-**	**28,149**	**-**	**14,790**	**42,939**
Revaluation deficit	-	(315)	-	-	(315)
Profit for the year	-	-	-	8,519	8,519
Realised element of revaluation reserve	-	(540)	-	540	-
Total recognised income and expense for 2008/2009	**-**	**(855)**	**-**	**9,059**	**8,204**
Increase in Long Term Loan	-	-	-	-	0
Increase in Public Dividend Capital	23,324	-	-	-	23,324
Dividend paid	-	-	-	(5,200)	(5,200)
Taxpayers' equity at 31st March 2009	**23,324**	**27,294**	**-**	**18,649**	**69,267**
Profit for the year	-	-	-	2,837	2,837
Increase in donated asset reserve	-	-	253	-	253
Realised element of revaluation reserve	-	(3,360)	-	3,360	0
Revaluation defecit	-	(3,754)	-	-	(3,754)
Total recognised income and expense for 2009/2010	**-**	**(7,114)**	**253**	**(6,197)**	**(664)**
Taxpayers' equity at 31st March 2010	23,324	20,180	253	24,846	68,603

The notes on pages 44 to 61 form part of these accounts.

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2010

1 ACCOUNTING POLICIES

Basis of accounting

The accounts have been prepared in accordance with the Government Financial Reporting Manual (FReM) for 2009/10 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 acounting 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.

Transfer of Functions

On 1 April 2008 the finance functions of ABRO and DARA were brought together with merged accounting. The closure of ABRO and DARA required full repayment of all public dividend capital and loans at 31 March 2008 to be replaced by DSG financing structure from 1 April 2008.

Accounting convention

These accounts have been prepared in accordance with the accruals concept and the historical cost convention, modified to account for the revaluation of land and buildings and other 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).

Turnover is recognised in the Land environment generally as the invoiced value of sales at job completion whereas in the Air environment it is in line with the underlying sales contract which may result in turnover and costs declared prior to job completion.

Property, Plant and Equipment

Basis of Valuation

Property, Plant and Equipment are carried at fair value which has been established as described below. A professional valuation, in accordance with the Royal Institute of Chartered Surveyors Appraisal and Valuation Standards, was carried out by Fuller Peiser during 2005/06 in the case of assets formerly in the Air environment and by GVA Grimley in the case of assets formerly in the Land environment. The basis of valuation is generally Existing Use exept for two sites where Depreciated Replacement Cost was adopted and for those sites where a significant curtailment or reduction in activities was expected and where an open market valuation was adopted. A quinquennial asset review by professional valuers is due to be undertaken in 2010/11.

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 (DASA), and is carried at valuation as at the end of the accounting period.

Land and buildings

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

Other property, plant and equipment

Plant, equipment, computers and transport equipment are capitalised where the useful life exceeds one year and the cost of acquisition exceeds £5,000 excluding VAT in the former Land environment or £10,000 excluding VAT in the former Air environment. These thresholds are due to be aligned from 1 April 2010 and the different thresholds did not give rise to material under or over capitalisation across the business as a whole. The value of capitalised plant, equipment and transport equiment is reviewed annually and adjustments made for technological obsolescence, using the CFC MHCA Index in the relevant periods.

Depreciation

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

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

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

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

Pension costs

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

Inventories

Inventory is valued at current cost, being the amount of cash or cash equivalents that would have to be paid if the same or equivalent inventory was acquired at the date of the Statement of Financial Position. Provisions are made to cover obsolescent items. Items are reviewed for obsolescence on a regular basis and at the end of the financial year.

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

Surplus inventories are estimated on the basis of projected consumption using historical trends. Inventory is analysed into four categories based on frequency of usage with any inventory balance remaining in the two lowest usage categories is the subject of a 100% provision.

Work in progress

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

Long-term contracts

Long-term contract (LTC) balances are stated at costs incurred (net of amounts transferred to cost of sales), after deducting related payments on account. Profit on individual long-term contracts is taken only when their outcome can be foreseen with reasonable certainty, based on the lower of the percentage margin earned to date and that prudently forecast at completion, taking account of agreed claims. Turnover on long-term contracts is ascertained in a manner appropriate to the stage of completion of the contract. All long-term contracts, accounted for under this policy during the year ended 31 March 2010.

Provisions

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

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 profit and loss account as incurred.

Return on capital employed

The basis for calculating return on capital employed is the profit before interest for the year, as a percentage of the average capital employed during the year. Capital employed comprises total net assets (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 forwards 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. This is a change in accounting policy this year 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 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 the closure of the Large Aircraft business and any associated employment issues and obselete stock. 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. Detail of provisions are set out in note 13.

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 the MOD. Any difference between accounting accruals and the actual liability when presented will be accounted for in the period when such determination is made.

CFC Indexation rates

Indices are provided by the Corporate Financial Controller (CFC) for revaluing non-current assets under the Modified Historic Cost Accounting (MHCA) regime. Whilst these indices predict a valuation as at the end of the accounting period they include corrections for previous periods. DSG has applied the historical corrective element only of the 2010/11 indices, as advised by DASA, to Land and Building non-current asset values as at 31 March 2010.

Inventory revaluation reserve realisation

DSG uses standard costing to value its inventory but, where the standards are subject to annual or periodic revaluation, does not track on an item by item basis the realisation of this revaluation. The realisation is accounted for by applying an aged inventory analysis to the inventory revaluation reserve. Detail of revaluations and transfers are set out in notes 14 and 15.

Disclosure impact of future accounting standards

IFRS 8 "Operating Segments" has an effective date of 1 January 2010 but DSG adopted this standard early as at 1 April 2009 in line with the requirements of the 2009/10 FReM.

IAS 24 "Related Party Disclosures" has an effective date of 1 January 2011 but DSG adopted this standard early as at 1 April 2009 in line with the requirements of the 2009/10 FReM.

IAS 36 "Impairment of Assets" is adapted in the 2010/11 FReM and consititutes a major change whereby any impairment caused by the clear consumption of economic benefit should be charged in full to the Income Statement and not first against the revaluation reserve for the specific asset until the asset reaches it's historical cost level. This change will be applied from the effective date of 1 April 2010 but will only impact the 2010/11 accounts should any qualifying impairments arise.

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

1a FIRST TIME ADOPTION OF IFRS

	Public Dividend Capital	Revaluation Reserve	Retained Earnings	Total Equity
	£'000	£'000	£'000	£'000
Reconciliation of opening taxpayers' equity under IFRS with the previously published UK GAAP compliant accounts				
Taxpayers' equity at 31 March 2009 under UK GAAP	23,324	27,294	20,403	71,021
Change in accounting policy re employee benefits	-	-	(1,754)	(1,754)
Taxpayers' equity at 1 April 2009 under IFRS	**23,324**	**27,294**	**18,649**	**69,267**

2 TURNOVER AND SEGMENTAL ANALYSIS

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

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

Although substantially all turnover relates to the same class of business: the repair, overhaul and maintenance 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.

The following amounts relating to prior year income have been recognised in year, the previous treatment was based on the best information at the time and therefore these are not errors, just correction of estimates. Relating to large aircraft work an amount of £1,714k is included as a result of the signing of a new contract and relating to land vehicle work, and previously disclosed in contingent assets, an amount of £1,818k is included following the agreement of cost certificates.

Analysis of turnover and operating profit by these segments for the year ended 31 March 2010:

	Land	Air and Electronics	Land Supply	Total
2009/2010	£'000	£'000	£'000	£'000
Turnover	164,152	56,638	11,764	232,554
Cost of sales	143,620	44,742	9,442	197,804
Operating expenses	14,257	6,544	1,300	22,101
Operating profit	**6,275**	**5,352**	**1,022**	**12,649**
2008/2009				
Turnover	157,971	62,349	6,352	226,672
Cost of sales	139,983	47,591	4,488	192,062
Operating expenses	14,458	9,669	799	24,926
Operating profit	**3,530**	**5,089**	**1,065**	**9,684**

3 COST OF SALES AND OPERATING EXPENSES

	Note	2009/10 £'000	2008/09 £'000
Cost of sales:			
Staff costs (i)	5b	107,416	101,810
Supplies and services consumed (i)		76,854	71,834
Accommodation costs		10,452	12,452
Depreciation and impairment		2,766	2,456
Cost reimbursement (ii)		(4,787)	(2,795)
Other administration costs (i)	6	5,103	6,468
Total cost of sales		**197,804**	**192,225**
Operating expenses:			
Staff costs (i)	5b	11,189	11,872
Supplies and services consumed (i)		4,792	3,979
Accommodation costs		827	511
Depreciation and impairment		279	386
Other administration costs (i)	6	5,014	8,178
Total operating expenses		**22,101**	**24,926**
Cost of sales & operating expenses:			
Staff costs (i)	5b	118,605	113,682
Supplies and services consumed (i)		81,646	75,813
Accommodation costs		11,279	12,963
Depreciation and impairment		3,045	2,842
Cost reimbursement (ii)		(4,787)	(2,795)
Other administration costs (i)	6	10,117	14,646
Total cost of sales & operating expenses		**219,905**	**217,151**

(i) The following amounts relating to prior year expenditure have been recognised in year, the previous treatment was based on the best information at the time and therefore these are not errors, just correction of estimates. Relating to a reduction in cost of sales, £1,100k of purchase order receipting accruals in goods received not invoiced have been cleansed, £246k of corporate bonus over accrued for 2008/09 has been released and £213k of aged accounts payable creditors have been cleansed.

(ii) Cost reimbursement primarily relate to MOD and Welsh Assembly Government contibutions to St Athan airfield running costs (£2,357k), the MOD funding of the Large Aircraft hanger relocation (£1,444k) and various facility management costs recharged to units lodging on DSG sites (£986k). These are shown separately to assist visibility.

4 INTEREST PAYABLE AND SIMILAR CHARGES

	2009/10 £'000	2008/09 £'000
On loans wholly repayable within five years	-	-
On loans not wholly repayable within five years	1,435	1,512
	1,435	**1,512**

5 STAFF NUMBERS AND COSTS

	2009/2010	2008/2009
(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	20	18
Civilian personnel	3,334	3,359
Agency staff	236	202
	3,596	3,585

(b) Payroll Costs	*£'000*	*£'000*
in Cost of sales:		
Salaries, wages and allowances	82,056	76,780
Social security	5,505	5,385
Pension costs	12,598	13,424
Agency staff	7,257	6,221
	107,416	101,810

	£'000	*£'000*
in Operating expenses:		
Salaries, wages and allowances	8,321	9,149
Social security	758	585
Pension costs	1,039	1,330
Agency staff	1,071	808
	11,189	11,872

	£'000	*£'000*
Total:		
Salaries, wages and allowances	90,377	85,929
Social security	6,263	5,970
Pension costs	13,637	14,754
Agency staff	8,328	7,029
Total payroll costs	**118,605**	**113,682**

5 STAFF NUMBERS AND COSTS (CONTINUED)

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

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

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

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded defined benefit scheme and it is not possible to separately identify DSG's share of the underlying assets and liabilities. A full actuarial valuation was carried out as at 31 March 2007. Details can be found in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice-pensions.gov.uk). For 2009/10 employers' contributions of £13,649,823 were payable to the PCSPS (2008/09 £14,621,434) at one of four rates in the range 16.7% to 24.3% of pensionable pay, based on salary bands.

The Scheme's Actuary reviews employer contributions usually every four years, following a full scheme valuation. The contribution rates are set to meet the cost of the benefits accruing during 2009-10 to be paid when the member retires and not the benefits paid during this period to existing pensioners. From 2010/11, the rates will be in the range 16.7% to 24.3%. Similarly, employers' contributions to the Armed Forces Pension Scheme (AFPS) are determined by the Government Actuary at a rate of 36.3% for Officers and 21.8% for other ranks. A valuation of the schemes liabilities of the AFPS was carried out in 2009/10.

For 2009/2010 employers' contributions of £53,625 were paid to one or more of a panel of four appointed stakeholder pension providers (2008/2009: £49,216). In addition employer contributions of £3,735 were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service and ill health retirement of these employees. Contributions due to the partnership pension providers at the balance sheet date were £6,154 (2008/2009: £6,150).

6 employees retired early on ill-health grounds; the total additional accrued annual pension liabilities in the year amounted to £19,619 (2008/2009 3 persons – additional pension liabilities amounted to £6,159).

6 OTHER ADMINISTRATION COSTS

	2009/2010	2008/2009
in Cost of sales:	*£'000*	*£'000*
Travel and subsistence, including vehicle hire	3,328	2,904
IT and telecommunications	8	136
Training, recruitment and consultancy	1,043	834
Insurance	8	14
Permanent diminution of non-current assets	-	178
Other expenses	756	2,402
Movement in provisions	(40)	-
	5,103	**6,468**

in Operating expenses:	*£'000*	*£'000*
Auditors' remuneration (i)	109	137
Travel and subsistence, including vehicle hire	882	808
IT and telecommunications	142	2,948
Training, recruitment and consultancy	1,983	1,593
Insurance	1,116	1,177
Permanent diminution of non-current assets	-	27
Other expenses	647	1,006
Gains on Foreign Exchange	(36)	(6)
Movement in provisions	171	488
	5,014	**8,178**

Total:	*£'000*	*£'000*
Auditors' remuneration (i)	109	137
Travel and subsistence, including vehicle hire	4,210	3,712
IT and telecommunications	150	3,084
Training, recruitment and consultancy	3,026	2,427
Insurance	1,124	1,191
Permanent diminution of non-current assets	-	205
Other expenses	1,403	3,408
Gains on Foreign Exchange	(36)	(6)
Movement in provisions	131	488
Total of Other administration costs	**10,117**	**14,646**

(i) Including fees of £9k for 2009/10 (£8k 2008/09) relating to IFRS transition.

7 PROPERTY, PLANT AND EQUIPMENT

The movements in each class of assets were:

	Land	Buildings	Plant and Machinery	Transport Equipment	IT	Assets in course of construction	Total Tangible
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Cost or valuation:							
At 31 March 2009	16,967	77,373	19,787	590	1,528	411	116,656
Additions	-	222	259	31	54	1,024	1,590
Donations	-	-	-	-	-	-	-
Disposals	-	-	(420)	-	-	-	(420)
Permanent dimunitions in value	(207)	(209)	(38)	-	(14)	-	(468)
Reclassification	-	286	9	-	32	(330)	(3)
Revaluation	(2,812)	(7,288)	458	31	(78)	-	(9,689)
At 31 March 2010	**13,948**	**70,384**	**20,055**	**652**	**1,522**	**1,105**	**107,666**
Depreciation:							
At 31 March 2009	-	47,020	15,492	267	1,181	-	63,960
Depreciation charged during the year	-	1,372	793	82	287	-	2,534
Disposals	-	-	(271)	-	-	-	(271)
Permanent dimunitions in value	-	-	-	-	-	-	-
Reclassification	-	-	-	-	-	-	-
Revaluation	-	(6,142)	351	14	(160)	-	(5,937)
At 31 March 2010	**-**	**42,250**	**16,365**	**363**	**1,308**	**-**	**60,286**
Net book value:							
At 31 March 2010	**13,948**	**28,134**	**3,690**	**289**	**214**	**1,105**	**47,380**
At 31 March 2009	16,967	30,353	4,295	323	347	411	52,696
Asset financing:							
Owned	13,948	28,134	3,690	289	214	1,105	47,380
NBV as at 31 March 2010	**13,948**	**28,134**	**3,690**	**289**	**214**	**1,105**	**47,380**

7a PROPERTY, PLANT AND EQUIPMENT

The movements in each class of assets were:

	Land	Buildings	Plant and Machinery	Transport Equipment	IT	Assets in course of construction	Total Tangible
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Cost or valuation:							
At 1 April 2008	18,724	72,722	18,906	586	1,621	465	113,024
Additions	770	716	330	-	11	275	2,102
Donations	-	-	-	-	-	-	-
Disposals	-	-	(261)	(2)	-	-	(263)
Permanent dimunitions in value	-	-	(174)	-	(27)	(4)	(205)
Reclassification	-	100	220	-	5	(325)	-
Revaluation	(2,527)	3,835	766	6	(82)	-	1,998
At 31 March 2009	**16,967**	**77,373**	**19,787**	**590**	**1,528**	**411**	**116,656**
Depreciation:							
At 1 April 2008	-	43,336	14,209	185	808	-	58,538
Depreciation charged during the year	-	1,498	834	83	427	-	2,842
Disposals	-	-	(98)	(2)	-	-	(100)
Permanent dimunitions in value	-	-	-	-	-	-	-
Reclassification	-	-	-	-	-	-	-
Revaluation	-	2,186	547	1	(54)	-	2,680
At 31 March 2009	**-**	**47,020**	**15,492**	**267**	**1,181**	**-**	**63,960**
Net book value:							
At 31 March 2009	**16,967**	**30,353**	**4,295**	**323**	**347**	**411**	**52,696**
At 31 March 2008	18,724	29,386	4,697	401	813	465	54,486
Asset financing:							
Owned	16,967	30,353	4,295	323	347	411	52,696
NBV as at 31 March 2009	**16,967**	**30,353**	**4,295**	**323**	**347**	**411**	**52,696**

8 INVENTORIES

	31 March 2010		31 March 2009		1 April 2008	
	£'000	£'000	£'000	£'000	£'000	£'000
Gross Inventories	15,882		12,833		14,822	
Less inventory provision	(1,400)		(30)		(1,697)	
		14,482		12,803		13,125
Work in progress – net costs incurred		12,914		12,559		8,587
Total inventories		**27,396**		**25,362**		**21,712**

9 RECEIVABLES AND PREPAYMENTS

	31 March 2010	31 March 2009	1 April 2008
	£'000	£'000	£'000
Trade and sundry invoiced receivables	41,248	43,351	38,310
Other receivables	1,171	1,346	1,509
Receipt due from sale of Rotary and Components	-	-	29,059
Bad debt provision	(113)	(150)	(7)
Prepayments and accrued income	6,084	2,918	2,538
	48,390	**47,465**	**71,409**

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

	31 March 2010	31 March 2009	1 April 2008
	£'000	£'000	
Other central government bodies	37,783	37,288	31,241
Local authorities	359	708	429
NHS bodies	-	-	12
Bodies external to government	10,248	9,469	39,727
	48,390	**47,465**	**71,409**

All the above balances 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 2010	30,752	7,712	1,902	203	679	41,248
At 31 March 2009	32,112	7,851	1,296	564	1,528	43,351

10 CASH AT BANK AND IN HAND

	31 March 2010	31 March 2009	1 April 2008
	£'000	£'000	£'000
Cash on short term deposit (i) (ii)	34,200	43,700	-
Cash at bank (ii)	360	301	65,489
Cash in hand	7	5	2
	34,567	**44,006**	**65,491**

(i) Wherever possible cash is held in interest earning accounts, which are redeemable on demand within one working day.
(ii) Other than cash in hand all deposits and balances were held within a commercial bank.
An analysis of change in net funds can be found at note (16b).

11 PAYABLES

Amounts falling due within one year:	31 March 2010	31 March 2009	1 April 2008
	£'000	£'000	£'000
Trade payables (i)	2,957	5,891	8,943
Taxation and social security	2,088	2,138	2,941
Value Added Tax	3,035	6,092	5,638
Accruals (ii)	29,936	40,491	21,652
Dividend payable	4,500	-	-
Deferred income	6,225	10,242	13,155
Sundry payables	5,950	3,234	996
Public Dividend Capital	-	-	61,708
	54,691	**68,088**	**115,033**

Payables are further analysed by creditor category as below:

	£'000	£'000	£'000
Other central government bodies	22,821	29,835	77,626
Local authorities	-	-	1
Bodies external to government	31,870	38,253	37,406
	54,691	**68,088**	**115,033**

(i) DSG's policy is to pay its suppliers within contracted payment terms or general conditions governing the terms for the type of business undertaken or, in the absence of specially agreed terms, within 30 days of receipt of a valid invoice although it is working towards a 10 day target for 2009/10 and a 5 day target for 2010/11 as directed by HM Treasury.
(ii) Within accruals is a liability for short term employee benefits of £2,084k (2008/09 £1,754k) created under a change of accounting policy upon the first time adoption of IFRS.

12 SHORT TERM AND LONG TERM LOANS

	31 March 2010	31 March 2009	1 April 2008
	£'000	£'000	£'000
Current portion of long-term borrowings	1,664	1,664	55,059
Loan repayments due within 2 and 5 years	6,657	6,657	0
Loan repayments due after 5 years	21,633	23,298	0
	29,954	**31,619**	**55,059**

13 PROVISIONS FOR LIABILITIES AND CHARGES

	Loss on contracts	Revenue Provision	Other	Large Aircraft Closure	Total
	£'000	£'000	£'000	£'000	£'000
Balance at 1 April 2008	-	23	44	-	67
Increase in provisions	226	-	266	-	492
Utilised in year	-	-	(4)	-	-
Balance at 1 April 2009	226	23	306	-	555
Increase in provisions	0	0	429	3,973	4,402
Utilised in year	(226)	0	(246)	-	(472)
Balance at 31 March 2010	**-**	**23**	**489**	**3,973**	**4,485**

Revenue Provision

This provision arises out of an obligation to pay damages to a customer in respect of equipment damage caused by DSG. The calculation is based on DSG's best estimate of the value of the equipment damaged and the liabilities and charges provided for are expected to fall due within one year.

Other Provisions

These provisions are to meet a variety of obligations including primarily the costs associated with changing DSG's facilities management arrangements and the liabilities and charges provided for are expected to fall due within one year.

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

13 PROVISIONS FOR LIABILITIES AND CHARGES (CONTINUED)

Large Aircraft Closure Provision

On 29th March the Secretary of State for Defence, Bob Ainsworth, laid before Parliament a Written Ministerial Statement about Defence Equipment, which concluded with a statement confirming the intension to close the LABU facility at St Athan by June 2013 at the latest. The costs of redundancy are funded directly by the MOD a provision has been created to cover the costs arising from this closure (see below and note 24).

DSG will operate these facilities until the major and minor production streams end – the major repair line ceases in December 2010 and the minor repair line ceases during 2012/13. At this final point DSG will abandon the facilities and the business will be treated as discontinued.

Expenditure will be charged against this provision as incurred from 1st April 2010 until the closure date and is primarily related to the costs of cleaning up the site and supporting the costs associated with a proportion of mobile grade employees remaining in the redeployment pool.

	2010/11	2011/12	2012/13	2013/14	2014/15
	£'000	*£'000*	*£'000*	*£'000*	*£'000*
Large Aircraft Closure Provision Utilisation	885	330	1,433	1,223	102

14 REVALUATION RESERVE

	2009/2010		2008/2009		2007/2008	
	£'000	*£'000*	*£'000*	*£'000*	*£'000*	*£'000*
Balance at 1 April	-	27,294	-	28,149	-	23,532
Transfer to profit and loss account	-	-	-	-	-	(3)
Realised element transferred to general reserve	-	(3,360)	-	(540)	-	(222)
Non Current Asset Revaluations in year	(3,757)	-	(507)		2,157	-
Inventory Revaluations in year	3	-	192		2,685	-
	-	(3,754)	-	(315)	-	4,842
Balance at 31 March	**-**	**20,180**	**-**	**27,294**	**-**	**28,149**

15 RETAINED EARNING

	2009/2010	2008/2009	2007/2008
	£'000	*£'000*	*£'000*
Balance at 1 April	18,649	14,790	22,227
Adjustment for employee benefit obligations	-	-	(1,813)
Retained profit/(loss)	2,837	3,319	(5,846)
Transfer from Revaluation Reserve	3,360	540	222
Balance at 31 March	**24,846**	**18,649**	**14,790**

16 CASH FLOW STATEMENT NOTE

(a) Detailed analysis of gross cash flows

	2009/2010	2008/2009
	£'000	*£'000*
Returns on investments and servicing of finance		
Interest received	96	734
Interest paid	(1,435)	(1,512)
	(1,339)	(778)
Capital expenditure		
Non-current assets in the course of construction	(1,024)	-
Less assets donated	253	-
Purchase of non-current assets	(566)	(2,102)
	(1,337)	(2,102)
Financing		
With the MOD:		
Decrease in borrowings	(1,665)	(23,440)
Increase in Public Dividend Capital	-	23,324
	(1,665)	(116)

(b) Analysis of changes in net funds/(debt)

	At 1 April 2008	Cashflow	At 31 March 2009	Cashflow	At 31 March 2010
	£'000	*£'000*	*£'000*	*£'000*	*£'000*
Cash at bank and in hand	65,491	(21,485)	44,006	(9,439)	34,567
Debt due within one year	(55,059)	53,395	(1,664)	-	(1,664)
Debt due after one year	-	(29,955)	(29,955)	1,665	(28,290)
Total	**10,432**	**1,955**	**12,387**	**(7,774)**	**4,613**

(c) Analysis of changes in cash and cash equivalents

	£'000
Balance at 1 April 2008	**65,491**
Net change in cash and cash equivalent balances	(21,485)
Balance at 31st March 2009	44,006
Net change in cash and cash equivalent balances	(9,439)
Balance at 31st March 2010	**34,567**

17 DONATED ASSET RESERVE

	2009/2010
	£'000
Balance at 1st April 2009	**-**
Funding of new Land Supply building at Donnington by customer	253
Balance at 31 March 2010	**253**

18 OPERATING LEASES

Operating lease payments recognised as expenses in the period were:

	2009/2010	2008/2009
	£'000	£'000
Lease of buildings at RAF St Athan (i)	281	415
Lease of vehicles & Other Equipment (ii)	697	190
Total operating leases paid	**978**	**605**

(i) Contained within note 3 – Accommodation costs.
(ii) Contained within note 6 – Vehicle hire, and Other expenses and within note 3 – Supplies and services consumed.
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 2010	31 March 2009	1 April 2008
	£'000	£'000	£'000
Not later than one year	688	236	605
Later than one year and not later than five years	642	127	281
Later than five years	-		
	1,330	**363**	**886**

DSG has only one lease of significance, this relates to the lease of a building on the St Athan site which commenced on 1st April 2010 and runs for 119 years with 10 year breaks. It has been agreed between DSG, the Ministry of Defence and the Welsh Assembly Government that when DSG vacates the site the Welsh Assembly Government will take over responsibility for the lease.

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:

	£'000
Receivable within one year	324
Receivable after one year	-
	324

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

There are no finance leases.

19 COMMITMENTS, CONTINGENT ASSETS AND LIABILITIES

Whilst not yet commited, £619k of capital expenditure has been authorised but not provided for in the accounts as at 31 March 2010 (2009 £808k). Capital commitments of £63k existed and were not provided for as at 31 March 2009 (2009 £91k).

There are no contingent assets at 31 March 2010 (£2m at 31 March 2009).

There are no contingent liabilities at 31 March 2010 (nil at 31 March 2009). Any liabilities concerning environmental pollution are considered to be pre-Trading Fund events and the liability therefore falls to the MOD.

20 FINANCIAL INSTRUMENTS

DSG's treasury operations are governed under the Government Trading Funds Act 1973 (a) as supplemented by DSG's Framework Document and are conducted within a framework of policies, mandates and delegations authorised by the Board and regularly reviewed. DSG's financial instruments comprise cash deposits, debtors, creditors and loans. DSG uses forward foreign currency sales and purchase contracts as derivative instruments when required for risk management purposes only, although none have been utilised during 2009/10. The main purpose of these financial instruments is to finance DSG's operations and DSG has limited powers to borrow or invest surplus funds. The main risks arising from the financial instruments are foreign currency, liquidity and interest rate risks. DSG's policies for managing these risks are set to achieve compliance with the regulatory framework including the rules contained within Managing Public Money.

Interest Rate Risk

DSG's funding is determined by fixed rate Government loans. There are no floating rate liabilities and DSG has only one loan with an interest rate of 4.6% fixed for the remaining 18 years of the loan term.

Currency Risk

DSG conducts business in Sterling, US Dollars, Canadian Dollars, Euros and Swedish Krone and is therefore subject to foreign exchange risk. At 31 March liabilities of $22k US Dollars and Kr65k Swedish Krona existed. An adverse movement in foreign currency exchange rates of 10% for these currencies would give rise to addition liabilities of £1k and £1k respectively.

DSG manages this risk by natural hedging and entering into forward foreign exchange contracts where amounts are material. DSG has one active foreign currency bank account which held $302k US Dollars at 31 March 2010. DSG policy states that transactions are translated at the prior month average rate. Year-end foreign denominated net assets have been translated at a year end spot rate.

Liquidity Risk

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

Counter-party/Credit Risk

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

Capital Management

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

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

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

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

Categories of Financial Instruments

Financial assets

	At 31 March 2010 £'000
Trade, sundry and other debtors	42,419
Cash on short term deposit	34,200
Cash at bank and in hand	367
	76,986

Financial liabilities

	At 31 March 2010 £'000
Trade and other payables	24,755
Ministry of Defence loans	29,954
	54,709

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

21 RELATED PARTIES

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

22 POST BALANCE SHEET EVENTS

There are no post balance sheet events.

23 LOSSES AND SPECIAL PAYMENTS

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

24 REDUNDANCY

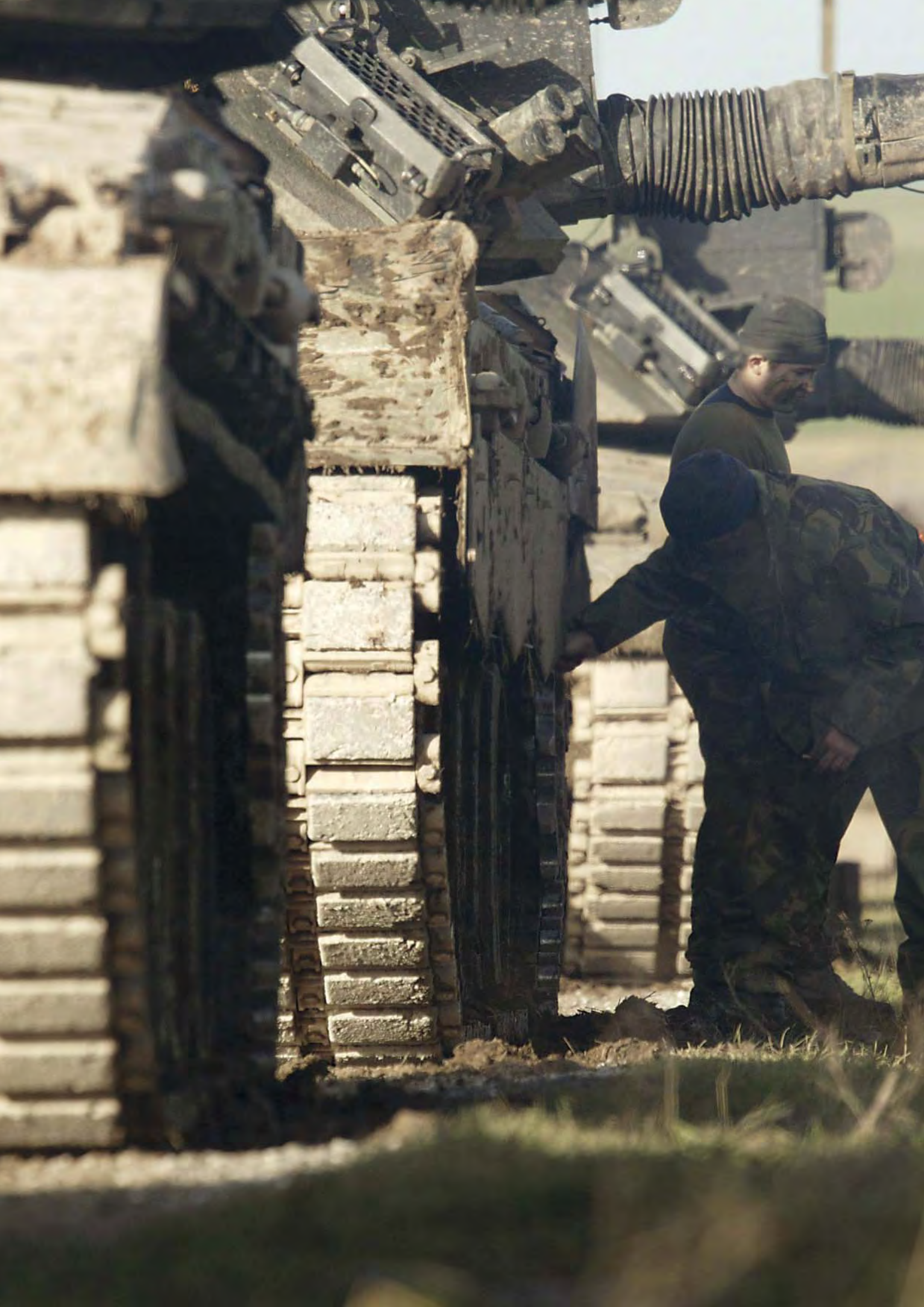
Redundancy costs of £8.6m in 2009/10 relating to former DSG employees are funded directly by the MOD.

25 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 National Audit Office (NAO). The cost of this audit is £99,800 (2008/09 £128,500) The Key Targets within the Annual Report and Accounts are audited by the MOD Defence Internal Audit Service.

26 THIRD PARTY ASSETS

In connection with contracts held with the Jordanian Armed Forces, DSG holds in its name a bank account, controlled by a member of the Jordan Armed Forces, with a balance of £632k as at 31 March 2010.



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