



Ministry
of Defence

de&s

Defence Equipment & Support Annual Report and Accounts

2015-16



Equipping and supporting UK Armed Forces

*Front cover: HMS Queen Elizabeth, the
first of the UK's new aircraft carriers*

Defence Equipment & Support

Annual Report and Accounts 2015-16

For the year ended 31 March 2016

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

Ordered by the House of Commons to be printed 8 November 2016



© Crown copyright 2016

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3 or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at www.gov.uk/government/publications

Any enquiries regarding this publication should be sent to us at:

Defence Equipment and Support Secretariat
Maple 0A
MOD Abbey Wood
Bristol
BS34 8JH
DESSec-ParliamentaryBusiness@mod.uk

Print ISBN 9781474137539
Web ISBN 9781474137546
ID 22091607 11/16

Printed on paper containing 75% recycled fibre content minimum

Printed in the UK by the Williams Lea Group on behalf of the Controller of Her Majesty's Stationery Office

Designed by:
DE&S Corporate Communications - Creative Team
ABW-16-155

Contents

Page

Chairman's introduction	1
-------------------------	---

SECTION 1: PERFORMANCE REPORT

Overview	4
Chief Executive's statement	5
Chief Financial Officer's report	6
Our purpose	8
Performance analysis	12
Safety, sustainability and security	24
Looking forward	26

SECTION 2: ACCOUNTABILITY REPORT

Corporate Governance Report	30
Directors' Report	31
Statement of Accounting Officer responsibilities	31
Governance Statement	32
Remuneration and Staff Report	46
Parliamentary Accountability and Audit Report	58
Parliamentary Accountability Report	59
Certificate of the Comptroller and Auditor General	62
Report of the Comptroller and Auditor General	64

SECTION 3: THE FINANCIAL STATEMENTS

Accounting information	69
Notes to the accounts	74

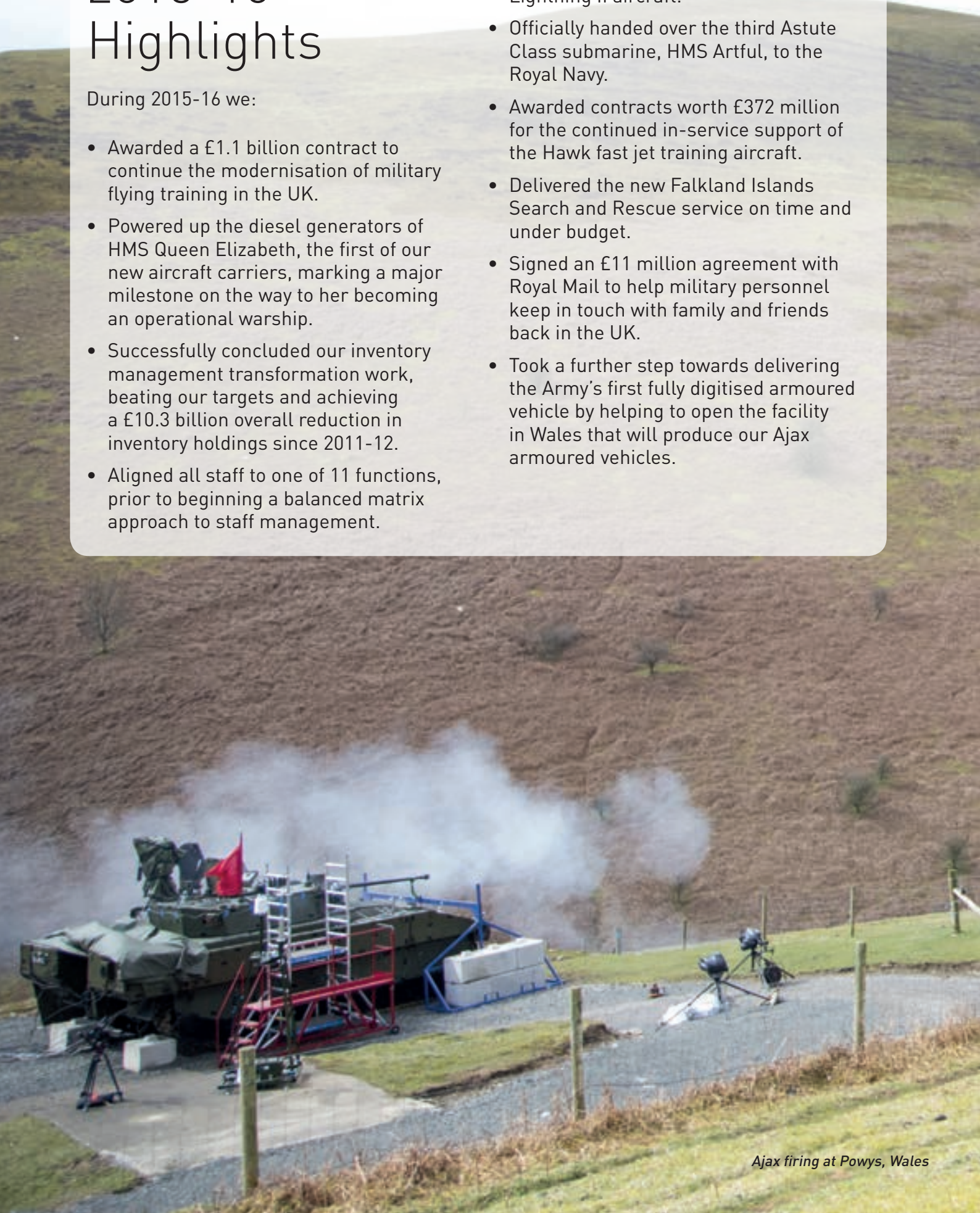
GLOSSARY

Glossary	86
----------	----

2015-16 Highlights

During 2015-16 we:

- Awarded a £1.1 billion contract to continue the modernisation of military flying training in the UK.
- Powered up the diesel generators of HMS Queen Elizabeth, the first of our new aircraft carriers, marking a major milestone on the way to her becoming an operational warship.
- Successfully concluded our inventory management transformation work, beating our targets and achieving a £10.3 billion overall reduction in inventory holdings since 2011-12.
- Aligned all staff to one of 11 functions, prior to beginning a balanced matrix approach to staff management.
- Took delivery of the fourth F-35B Lightning II aircraft.
- Officially handed over the third Astute Class submarine, HMS Artful, to the Royal Navy.
- Awarded contracts worth £372 million for the continued in-service support of the Hawk fast jet training aircraft.
- Delivered the new Falkland Islands Search and Rescue service on time and under budget.
- Signed an £11 million agreement with Royal Mail to help military personnel keep in touch with family and friends back in the UK.
- Took a further step towards delivering the Army's first fully digitised armoured vehicle by helping to open the facility in Wales that will produce our Ajax armoured vehicles.



Ajax firing at Powys, Wales



Chairman's Introduction

by Paul Skinner, DE&S Chairman

This Annual Report and Accounts reflects another significant year of transition for DE&S. Our staff continue to deliver some of the largest and most complex procurement projects in progress in the UK, while, at the same time, supporting ongoing operations and demonstrating huge energy and ambition in driving forward a comprehensive change programme.

This report reflects that backdrop and shows that, despite many challenges over the last year, DE&S has made positive progress against its Key Performance Indicators, particularly in delivering procurement projects, where the majority of our targets were exceeded. This is the first year that the DE&S Bespoke Trading Entity (BTE) has formally measured its performance against agreed Command Acquisition and Support Plans, which replaced our former arrangements. While there remain some reporting complexities to be addressed, our experience this year has established a solid basis for setting 2016-17 performance measures. In overall terms, delivery of our projects and programmes shows continuing performance improvement but there remain areas, particularly in equipment support, where we need to do better.

Alongside DE&S' continued focus on the timely and reliable delivery of equipment and support, the organisation's transformation programme is well into the implementation phase. Everyone in DE&S is now involved in driving change as the programme moves forward. This momentum will see the organisation achieve its transformation objectives, pushing for better value for money across all areas of acquisition and support. Our ambition remains to become a world-class defence procurement organisation.

Underpinning the transformation programme, the management freedoms and flexibilities that DE&S

secured when it became a BTE are enabling the organisation to implement a new approach to people management, which will help deliver improved organisational effectiveness and, ultimately, a better service to our customers. Over the past year, significant progress was made in this area, including the introduction of a revised performance management approach and the launch of DE&S' own competency framework.

We want to make the very best of our existing talent base and, where we have skill deficits, to fill these by the recruitment of high-quality individuals. On 1 December 2015, Tony Douglas became the Chief Executive Officer, bringing with him significant and valuable project management experience. He has made a very strong start. As Chairman of DE&S, I have worked with my fellow Board members to support this leadership transition and to continue to provide strategic oversight and governance of the organisation. This has included overseeing the organisational changes and endorsing the Transformation Implementation Plan and People Strategy.

Looking forward there remains much to do, not least in managing an increased equipment programme following the Strategic Defence and Security Review 2015. I know that DE&S staff at all levels will continue to seek improvements in supporting the Armed Forces and that they are committed to making transformation of the organisation a success. This is evident from their achievements over the past year for which I thank them. I am confident that DE&S is now well-placed to build on this – ensuring continued success into the next year and beyond.

A handwritten signature in blue ink, which appears to read 'Paul Skinner'.



Section One

Performance Report

OVERVIEW



*On behalf of the Royal Navy, DE&S delivers
the nuclear submarine programme*



Chief Executive Statement

by Tony Douglas, Chief Executive DE&S

I am pleased to report on a successful year of DE&S operations as we continue our transformation journey. The establishment of DE&S as a BTE in April 2014 marked the beginning of our three-year programme of transformation into a world-class acquisition and support organisation. Building on the baselining activity conducted over the first transition year, our focus during 2015-16 has been on implementing the new systems and organisational and behavioural changes required to deliver business improvements.

Alongside our transformation work, we have continued to deliver a genuinely impressive programme of work in support of our customers on the front line. Since joining, I have been incredibly impressed with DE&S staff, who work with great commitment and diligence to support our Armed Forces. This year we have, among other achievements, awarded a £1.1 billion contract to continue the modernisation of military flying training in the UK, continued to support Successor design work – the next generation of nuclear submarines – and powered up the diesel generators of the first of our new aircraft carriers. This good work has also now been underpinned by our new Command Acquisition Support Plans, which have helped to formalise and crystallise our requirements and outputs with our customers.

And all this in the context of the Strategic Defence and Security Review 2015, which increases the size of the equipment programme and requires us to deliver more with less; a challenge DE&S staff have risen to and we will continue to tackle. We have already made demonstrable improvements in delivery right across the programme of work – as the 2015 Major Projects Report underlines. This recognised the progress we have made in reducing the level of time and cost overruns, and improved delivery performance of our largest projects.

Transformation will lock in these gains – and everyone in DE&S is involved in the changes as momentum gathers over this next important year. All staff are now aligned to one of 11 new functions – moving closer to the balanced matrix approach which will both support career management and ensure that the right person is in the right job at the right time. Important new ways of working are being rolled out through the Spirals programme – ensuring that project teams have a common set of processes for project management; project controls and engineering. This is a key enabler to minimising duplication and maximising efficiency. We are also using our unique management freedoms to establish a new Human Resources capability. This work is already helping us get better at being better and takes us further towards becoming a leading defence acquisition organisation, of which DE&S staff and its customers can be proud.

A handwritten signature in black ink, appearing to read 'A. Douglas', with a stylized flourish at the end.



Chief Financial Officer's Report

by Michael Bradley, Director General Resources

Our second year of operation as a BTE has seen us make significant progress in developing and implementing the changes in structure, business processes, tools and skills envisaged by DE&S Transformation. 2015-16 was an extremely busy year, which included the 2015 Strategic Defence and Security Review (SDSR), some significant leadership changes and a great deal of transformational activity. This combination of challenges has tested the whole organisation, but the excellent results we have achieved under this pressure are testament to the skills, dedication and hard work of our staff.

Transformation is already having tangible and positive impacts on the whole organisation and the way we carry out our business. In my own area, we have focused our efforts on standing up the brand new Project Controls function, developing our thinking about the future organisational design of the finance and accounting function, and designing new processes and tools that will improve efficiency and allow our staff to improve the support they give to the wider business.

DE&S programme of work

Despite the challenging environment, the organisation has continued to improve the effectiveness of our project management and delivery against performance, time and cost envelopes across the equipment portfolio as reflected in the National Audit Office (NAO) Major Projects Report (MPR) 2015¹. This was published in October 2015 and, while I referred to a number of the key findings in my previous report, the following bear repetition:

- **Performance** – MPR 2015 reported a continuing forecast of 99% success in meeting customer requirements.
- **Time** – MPR 2015 reported the smallest increase (0.3%) in forecast project delivery timescales since 2001².
- **Cost** – MPR 2015 reported one of the largest reductions in forecast costs (totalling £247 million) in recent years.

A more detailed analysis of delivery performance to our customers over the last year is contained in the Performance Analysis on page 12, but there are a couple of positive themes that I believe highlight the improved control that DE&S is bringing to the management of the equipment programme:

- The overall cost of the 10-year Equipment Plan has been very stable over the last few years, and moved by just 0.1% in 2015-16, a real testament to the effective working between DE&S, the Commands and MOD Centre.
- Our ability to predict the rate of expenditure is also improving. The equipment programme 2015-16 outturn expenditure of £13,115 million closed within 1.3% of budget, with the minor favourable variance largely attributable to changes in the treatment of VAT receipts and foreign exchange fluctuations, both of which are outside of DE&S' control.

These very positive results demonstrate the improved financial control and predictability that our customers rightly expect, and I am grateful to our staff for the hard work they have put in to deliver such excellent results.

The other significant achievement that I would like to highlight is in relation to inventory management. Three years ago we launched an Inventory Management Transformation programme which targeted a £10 billion (25%) reduction in defence's £40.3 billion inventory. This programme came to an end in March 2016 and I was absolutely delighted to hear that the team managed to outperform its target. We have started the 2016-17 financial year with £10.3 billion less value on the MOD balance sheet, which represents a significant improvement in the economy and efficiency with which we meet the demands of our customers for stocks. We will continue to use the processes and disciplines we have now established to ensure that progress continues to be made.

¹ The Major Projects Report has been replaced by a project performance delivery summary published in the Department's annual Equipment Plan statement from 2016 onwards and which will be made available for Parliamentary and NAO scrutiny. The 2016 statement will be published towards the end of the calendar year.

² Excluding the exceptional issue associated with maintaining nuclear core production capability for VANGUARD class submarines.

Operating costs

During the year we have continued to drive greater efficiency and control of our operating costs as we seek to meet the stretching budgetary challenges set by the Department. Notable headlines are as follows:

- **Operating cost forecast accuracy** – DE&S operating costs (excluding communicated costs³) outturned at £1,111 million against a budget of £1,130 million. The delivery of a budget to outturn variance of less than 1% is clear evidence of the robust and effective financial management exercised by DE&S. In the process, DE&S delivered in-year savings of £63 million against its original budget, as a contribution to the Department's management of its overall financial challenge.

The organisation has continued to exercise firm control of all operating costs including those associated with external assistance (reflected as private sector support in the Statement of Comprehensive Net Expenditure). As a result, the costs of private sector support (excluding those related to transformation activities) reduced by £42 million (11%) in 2015-16 compared to the previous year⁴.

- **BTE accounting** – We continue to face some of the system and process challenges that were evident in our first year of operation. The management of the accounting boundary between the BTE and the Equipment Plan accounts requires more manual intervention than is desirable, however, progress is being made. The significant work undertaken over the last year has importantly led to the removal of the audit qualification on liabilities in this year's accounts and provides a robust baseline for the remaining qualifications on private sector support and other programme cost expenditure to be removed in 2016-17.
- **Time Recording** – We have completed the roll-out of a time recording tool to all our project and corporate teams and 98% of staff are now routinely recording their hours. As a result, we have been able to generate and use activity/time-based information to inform decisions on the optimisation of manpower/skills. The time recording tool is also informing the ongoing work to develop and implement processes for "hard charging" of DE&S operating costs to customers.

Outsourcing of Logistics, Commodities and Services

The 2015-16 budget and outturn figures reflect the outsourcing of a range of Logistics Commodities and Services to industry – the contract with Team Leidos becoming effective from 1 August 2015. The placement of this contract necessitated a change in reporting of costs from BTE internal operating activities to contract-based equipment programme expenditure. The latter now being reported in the Departmental, not BTE accounts. It was a major undertaking and a significant achievement that the complex system and process updates needed to implement this change were delivered in an effective and timely manner.

Outlook

DE&S has undoubtedly made tangible progress in improving management of our programme of work. With a programme portfolio as broad and as complex as ours, we must continue to drive this agenda forward. Some of our key priorities for 2016-17 are:

- Working closely with our Armed Forces customers to fully implement the outcome of the 2015 SDSR, which involves a significant expansion of the equipment programme portfolio.
- Robust control of our operating costs, ensuring that DE&S outturns within its current control totals of £1,157 million for 2016-17 and £1,039 million for 2017-18. To put this budgetary challenge into context, when transformation costs are excluded, these control totals represent a cumulative reduction of 24% in DE&S operating costs from the 2013-14 baseline, with a further 5% reduction expected in 2018-19. When the costs of implementing additional programme activity introduced since 2013-14 are also excluded, the underlying reduction in our operating costs will reach 31% by 2017-18, and 32% in 2018-19.
- Providing high quality financial information that informs investment and long term financial planning decisions.
- Continuing to deliver the transformation programme by fully embedding organisational design, business process and system improvements as well as optimising the deployment of our skilled manpower resource.
- Delivering a clean NAO audit opinion on the DE&S BTE accounts in 2016-17.

I am delighted by the progress we have made but recognise we must continuously strive to deliver best value for money in the Equipment Plan and our operating activities – our Armed Forces customers and other stakeholders rightly demand no less from us.

³ Communicated Costs have been excluded from the commentary as these are estimates of costs incurred by other MOD organisations in supporting DE&S operations for which the organisations and not DE&S have budgetary control.

⁴ The private sector costs are subject to qualification

Our purpose and activities

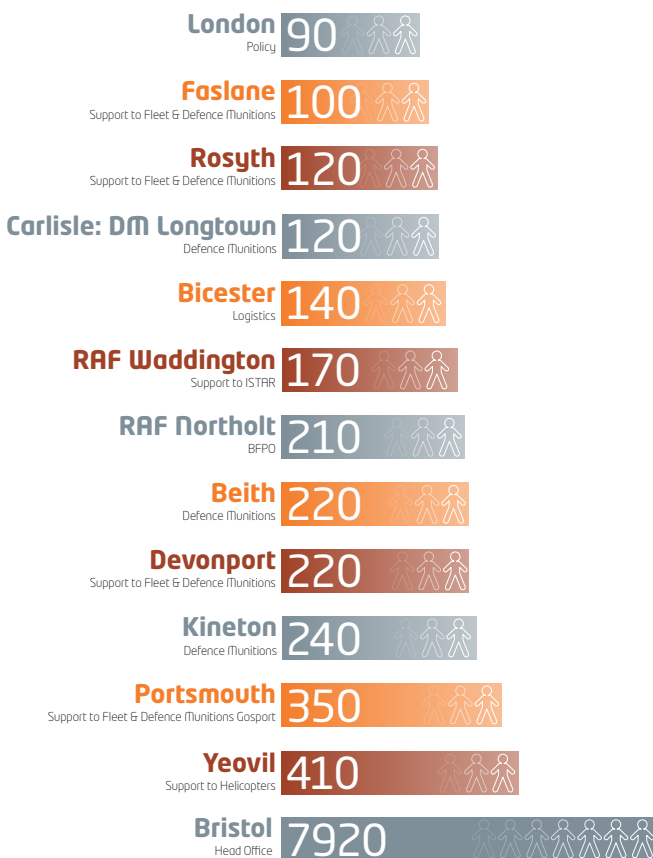
DE&S' purpose is 'to equip and support the UK's Armed Forces for operations now and in the future'. We do this through safely managing a vast range of complex projects to deliver equipment and support to the Armed Forces; from submarines, warships, aircraft and missiles, through to armoured vehicles, utility trucks, body armour, field kitchens and postal services to the front line. On behalf of our Ministry of Defence (MOD) customers, we aim to deliver a programme of work that provides best possible support to the Armed Forces and best value for money for the taxpayer.

DE&S has a combined workforce of more than 11,500 civilian, military and private contractor staff, who are deployed at over 150 locations in the UK and overseas.

DE&S History

April 2007	DE&S begins operating following the merger of the Defence Procurement Agency and the Defence Logistics Organisation.
May 2011	The MOD launches the Materiel Strategy programme to examine how DE&S could operate differently to become more efficient and effective.
December 2013	Proposals for a Government Owned Contractor Operated (GOCO) structure halted.
April 2014	DE&S established as a bespoke trading entity, an arm's length body of the MOD.

DE&S main locations and approximate staff numbers*



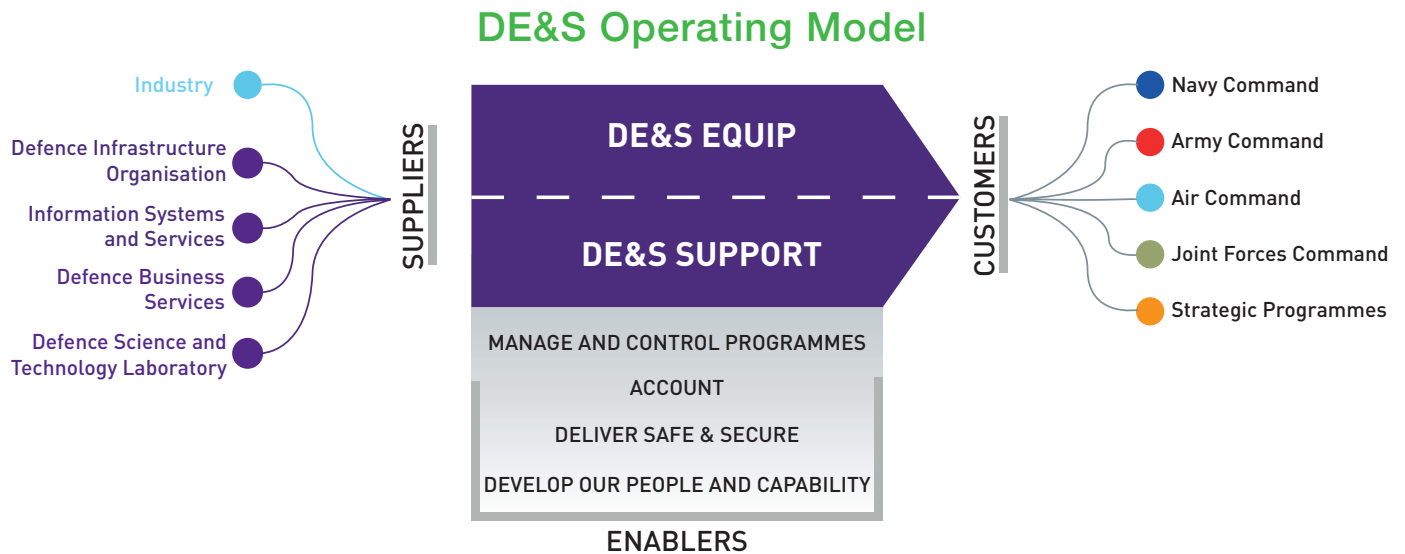
*As at February 2016

How we are organised

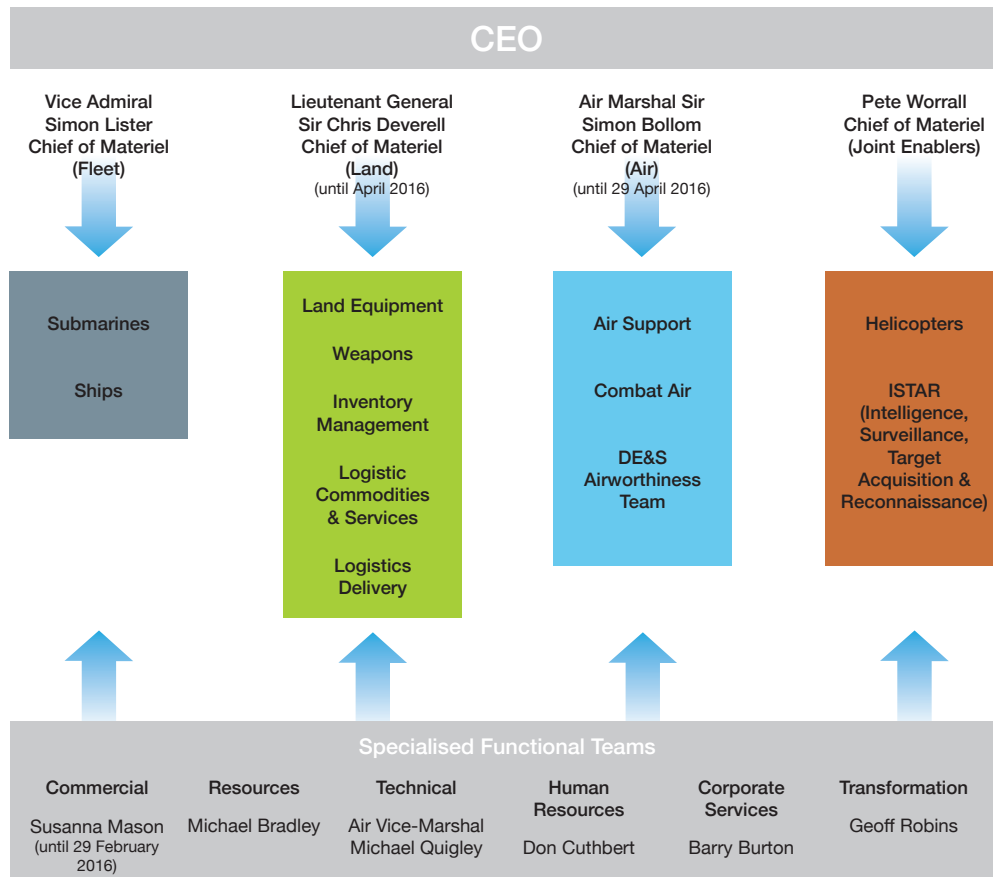
DE&S is a crucial part of the overall defence operating model, linking supplier capability to our military customers, ensuring that they are equipped and supported to deliver what is required of them. The DE&S operating model (overleaf) shows how DE&S is set up as a business, reflecting how we do what we do.

We are organised into four domains; Fleet, Land, Air and Joint Enablers. Each is headed by a Chief of Materiel, who is responsible for our relationship with a Command, and accountable to the Chief Executive for delivering outputs as effectively, efficiently and economically as possible. These domains are supported by corporate delivery teams made up of professionals from across our organisation, including commercial, finance and accounting, corporate affairs, HR and technical services.

How we are organised



DE&S Top Level Executive organisation as at 31 March 2016



Our budget

The MOD delegates the bulk of the equipment budget to the Commands, giving them responsibility for prioritising what is most critical and, consequently, the risks and rewards of the equipment programme. In DE&S, therefore, we do not hold the budget for the equipment programme but, on behalf of our MOD customers, we manage the acquisition and through-life support of equipment in service, and undertake decommissioning and disposal when equipment reaches the end of its service life¹.

Budgets flow from our customers using individual Command Acquisition Support Plans (CASPs), which are agreements that formally capture the outputs against which our teams will deliver. The agreements set out the equipment, support and services DE&S will acquire on our customers' behalf, for what budget and to what timescale. MOD Head Office holds DE&S accountable for delivery, and measures performance through the use of Key Performance Indicators (KPIs), which underpin our objectives. More detail on how we performed against our KPIs in 2015-16 is on page 14.

DE&S is directly responsible for its own operating expenses, and carries out its business activities within an operating expenditure budget, which flows from MOD Head Office. For 2015-16 the operating expenditure budget was £1,130 million. This covers DE&S manpower, operating support, and private sector support costs, all of which enable us to carry out our activities. The financial statements at Section 3 have been prepared in accordance with the accounting boundary agreed with the Department, which delineates between DE&S operating activities reported in the DE&S financial statements (manpower, private sector support and other programme costs) and equipment procurement/support activities which are reported in the MOD financial statements. More information on the accounting boundary can be found in the Statement of Accounting Policies on page 74.

This Annual Report and Accounts sits alongside our Corporate Plan, which sets out the strategic direction for DE&S and summarises our structure, purpose, objectives and corporate focus going forward. Our Framework Document is the agreement between MOD and DE&S which sets out the governance, policy and finance framework within which we operate.

DE&S complies with Managing Public Money and supplementary instructions issued by HM Treasury and

we observe the standard financial processes and rules set out by the MOD Director General (DG) Finance as the Defence Authority.

Operating as a Bespoke Trading Entity (BTE)

DE&S was launched as a BTE in April 2014. We are an arm's length body within the MOD – but remain very much part of our parent organisation². Our status gives us a strengthened customer-supplier relationship between the military and DE&S, and facilitates a more business-like approach. As a BTE, we also have a set of management freedoms that are unique across Government and which recognise the specialist nature of our organisation and what we deliver. Set within an operating cost envelope designed to drive efficiencies, these freedoms allow us to implement changes outside of wider Government norms, particularly around the management of our people.

Our freedoms

- Freedom to manage all aspects of our workforce as necessary to meet our business needs.
- A pay strategy that is treated as separate from the rest of the MOD.
- Freedom to pay 25 members of staff more than the senior salary cap set by HM Treasury without further agreement
- Exemption from Cabinet Office Controls (v4.0) relating to:
 - Strategic Supplier Management
 - Advertising, Marketing and Communications
 - External Recruitment
 - Redundancy and Compensation
 - Civil Service Learning
 - Commercial models
 - Consultancy

Our freedoms and flexibilities around how we recruit, reward and manage our staff reflect our work in carrying out some of the most complex procurement activity in the world. They will help us strengthen our capability as we become a world-class programme management organisation, allow us to adopt industry

¹ Any generated capital asset value is reported in the MOD Annual Report and Accounts

² DE&S is classified as an Executive Agency of the MOD, which operates as a BTE in line with Chapter 7 of 'Managing Public Money'.

best practice, and help us to manage our resources as efficiently and effectively as possible. We have made good progress in designing and implementing initiatives that make best use of our freedoms, particularly in the areas of:

- **Recruitment:** targeted rolling recruitment programme, use of social media.
- **Pay:** a DE&S pay strategy, new recruitment and retention allowances, and tailored higher starting pay.
- **The DE&S Professional:** a new competency framework unique to DE&S.
- **Performance management:** a new policy improving our ability to address poor performance.
- **The DE&S People Model:** being delivered progressively with a fully operational balanced matrix effective from April 2017.
- **A bespoke HR Function:** equipped to help DE&S attract, develop and retain talent.

Working with industry

We work hard to sustain productive, robust relationships with all of our suppliers. Our framework for working with industry remains the White Paper, 'National Security Through Technology', which was published in February 2012. This sets out the Government's approach to procuring Armed Forces capabilities. Open competition remains our default approach, and we examine the domestic and global defence and security market for products that are proven, reliable and that meet our current needs. Our primary driver is to ensure we get the right capability for our customers at the best value for money for the taxpayer.

In line with all Government departments and arm's length bodies, we aim to pay 80 per cent of our undisputed invoices from suppliers within five working days. This helps to ensure that the benefits of prompt payment to main contractors are felt throughout the supply chain and benefit smaller businesses. All MOD invoices relating to DE&S BTE activities are paid through the Defence Business Services (DBS) organisation and are reported in the MOD Annual Report and Accounts. The communicated costs shown in our Statement of Comprehensive Net Expenditure on page 70, include costs incurred by DBS in supporting DE&S activities, including those relating to the processing of invoices.

Performance overview, risks and issues

Three high-level objectives underpin what we do, driving how we behave, deliver and prioritise as an organisation: 'Delivery', 'Transformation' and 'Leadership and Engagement'. For our 'Delivery'

objective, our performance is formally measured through Command Acquisition and Support Plans, with specific KPIs, as outlined in our Corporate Plan. Performance against our 'Transformation' and 'Leadership and Engagement' objectives is measured by internal business metrics and practices.

The KPIs outlined in our CASPs focus on two aspects; how we deliver to our customers, and how we manage our budget and inventory. Our customer-related KPIs (1, 4 and 5) measure our delivery on equipment projects, support to in-service equipment and the accuracy of our financial forecasts. Against these, we continued our recent trend of performing well on how we deliver new equipment. On in-service support, we recognise that the final position was mixed and we are working closely with our customers to address the challenges we face. It is worth noting, however, that under-performing areas were principally where we had joint metrics with our customer; they do not reflect an isolated measure of DE&S performance. With regards to forecasting accuracy, in-year the overall DE&S position was balanced, with some Command-facing outturns marginally under or over budget. Our 10-year forecasts also reflect good performance. KPI 5, which relates to customer satisfaction, was run as a shadow KPI during 2015-16, in order to establish a baseline against which we can measure performance in 2016-17 and beyond.

KPIs 2 and 3 are our inward-looking KPIs, focused on managing our operating expenditure and inventory. We are pleased to have met our targets for both of these and the performance is reviewed in more detail in the next section.

Delivery performance against our high-level objectives, including our KPIs, is monitored each month by the Executive Committee and DE&S Board. Our governance arrangements have been further strengthened with the introduction of 'Performance Committees' which are individual monthly performance conversations between the CEO and each Chief of Materiel. In addition, we provide quarterly reports to our Owner's Council and we hold regular reviews with each of our customers. Defence Internal Audit conducted a review of our KPI reporting process between March and May 2016, returning an assessment of 'substantial assurance'.

Our objectives are reviewed annually and are explained in more detail in our Corporate Plan, which can be found on gov.uk at the following link: <https://www.gov.uk/government/publications/defence-equipment-and-support-corporate-plan-financial-years-2016-to-2019>.

Information on the key risks and issues that have faced DE&S over the past year are in the Accountability Report on page 41.

PERFORMANCE ANALYSIS



Helicopters play a major role in UK operations and DE&S supports more than 300, including the Wildcat

HIGH LEVEL OBJECTIVE 1: DELIVERY

Deliver safely the agreed DE&S programme of work and associated support and services to our customers.

This objective means that DE&S will:

- Improve delivery within the agreed performance, cost and time envelope and other metrics included in the CASPs.
- Maintain and, where possible, improve, delivery performance during transformation.
- Ensure DE&S operating expenditure is within the allocated provision.
- On behalf of the MOD, reduce the amount of inventory held.
- Ensure DE&S operating expenditure is within the allocated provision.
- Provide ongoing availability of equipment that is safe to operate.

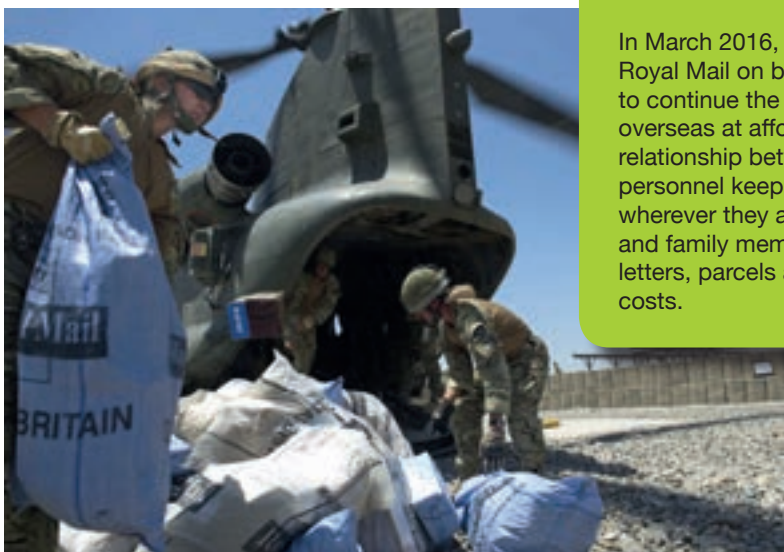
Delivery to our customers remains our purpose and our priority and this has been reflected over the past year in a clear focus on delivering CASP requirements. CASPs have now replaced our previous agreements with our customers, embedding a more disciplined customer-DE&S interface. Within each CASP are detailed metrics and targets used to measure our delivery performance and it is our aggregate performance against these metrics that determines how well DE&S performs against its corporate KPIs. These are explained further on the following pages.

Overall, we continue to perform well on delivering procurement projects, although some of the nuclear projects within the Strategic Programmes CASP contain their own challenges as we collectively

continue to pursue a challenging programme of work. It is harder to assess DE&S performance in support of Army and Navy equipment as there remains a significant number of joint metrics in these agreements and DE&S performance cannot be isolated.

It is particularly worth noting that Navy Command faced significant financial pressures within its programme during 2015-16, which brought associated challenges to DE&S. As a result of this, Navy Command released DE&S from its obligation to meet CASP targets in order to re-focus on addressing its financial programming challenge. Nonetheless, we continued to track and report our performance and maintained a consistent level of delivery, focused on the core outputs of the front line.

Key achievement



Keeping people connected

In March 2016, DE&S signed an £11 million agreement with Royal Mail on behalf of the British Forces Post Office (BFPO) to continue the carriage of mail to service personnel based overseas at affordable rates. The agreement, which reaffirms the relationship between Royal Mail and the BFPO, will help military personnel keep in touch with family and friends back in the UK, wherever they are in the world. The deal will ensure that friends and family members can continue to support our troops with letters, parcels and packages, without incurring extra postage costs.

KPI 1 – CASP DELIVERY PERFORMANCE

1.1 Achievement of CASP milestones. <i>This KPI measures the percentage of strategic milestones in each CASP that DE&S met in-year. Examples of strategic milestones are delivering an initial gate business case, placing a new equipment procurement contract, or a significant milestone ahead of reaching in-service.</i>						
	METRIC	NAVY	ARMY	AIR	JOINT FORCES COMMAND	STRATEGIC PROGRAMMES
	Green ≥90% Amber ≥80% <90% Red <80%	55%	100%	83%	100%	83%
Each CASP included up to 12 strategic milestones that were due to be delivered in-year and which were agreed as significant with the Command. We are pleased to have met 100% of the Army and Joint Forces Command milestones on time or early and, if we exclude the Navy CASP (as we were released from our performance measures), 21 out of 23 strategic milestones were achieved on time or early.						

1.2 Procurement Projects – Performance (key user requirements) <i>This KPI measures quality; how well the equipment we provide to our customers meets their requirements. It measures the percentage of key user requirements forecast to be achieved.</i>						
	METRIC	NAVY	ARMY	AIR	JOINT FORCES COMMAND	STRATEGIC PROGRAMMES
	Green ≥97% Amber ≥96% <97% Red <96%	100%	100%	94%	100%	100%
While we report the delivery performance of all procurement projects, our KPIs measure performance on projects with a procurement value of more than £20 million. Variances to forecasts can arise from technical challenges or opportunities encountered by the supplier, commercial and procurement processes, international collaboration, accounting adjustments, changes to inflation or exchange rates, and dependencies in associated projects managed by other parts of DE&S. We measure the quality of new equipment through how well it will fulfil its key user requirements. These are agreed with our customers and specify the essential core characteristics the equipment must fulfil when in operational use. Under four of our CASPs we forecast that we will achieve 100% of key user requirements when the equipment enters into service. The exception is under the Air CASP where Air Command has elected not to proceed with a project. We expect this project to be formally closed during 2016-17, when it will be removed from our programme of work.						

1.3 Procurement projects – cost <i>These KPIs measure the accuracy of our forecast costs for our demonstration and manufacture phase projects (i.e. those projects that have passed their main investment decision), and our assessment phase projects (i.e. those projects where we are assessing options ahead of reaching the main investment decision).</i>						
	METRIC	NAVY	ARMY	AIR	JOINT FORCES COMMAND	STRATEGIC PROGRAMMES
1.3.1 Demonstration and manufacture phase projects – aggregate cost variance	Green ≤ 0.4% Red >0.4%	0%	-0.4%	-1.1%	0%	+4.5%
1.3.2. Demonstration and manufacture phase projects – percentage of projects exceeding the cost growth threshold	Green ≤15% Amber >15% <20% Red ≥20%	0%	0%	8.3%	0%	23.1%
1.3.3 Assessment phase projects – aggregate cost variance	Green ≤3% Amber >3% ≤5% Red >5%	0%	-12.0%	-3.7%	-9.8%	+8.4%

In 2015-16, DE&S managed 42 large demonstration and manufacture phase projects, with a total combined forecast of nearly £37 billion. The aggregate forecast costs were either unchanged or lower under four CASPs. Only the projects under Strategic Programmes reported an aggregate forecast cost growth and this was principally due to changes in accounting policies, changes to build schedules and revised costs from suppliers.

We record the number of projects that forecast cost growth in-year in excess of 1.75% of their approved value. This occurred on four of the 42 projects, three of which were under the Strategic Programmes CASP, and one under the Air CASP.

In 2015-16, we managed 23 assessment phase projects with a combined forecast value of almost £4 billion. The aggregate forecast costs were either unchanged or lower under four CASPs. The Strategic Programmes CASP was the exception where forecast costs increased due to the maturing of the scope and assumptions of a number of capital programmes.

1.4 Procurement projects – time
These KPIs measure time variances and any changes to the forecast in-service dates for demonstration and manufacture phase projects and assessment phase projects.

	METRIC	NAVY	ARMY	AIR	JOINT FORCES COMMAND	STRATEGIC PROGRAMMES
1.4.1 Demonstration and manufacture phase projects – aggregate time variance	Green ≤0.6 months Amber >0.6 months ≤0.8 months Red >0.8 months	0 months	0.9 months	0.3 months	0 months	1 month
1.4.2 Demonstration and manufacture phase projects – percentage of projects exceeding time slippage threshold	Green ≤15% Amber >15% <25% Red ≥25%	0%	14.3%	8.3%	0%	15.4%
1.4.3 Assessment phase projects – aggregate time variance	Green ≤2 months Amber >2 months ≤3 months Red >3 months	0 months	-1.3 months	0.4 months	-0.2 months	0 months

This KPI reports the in-year variance to forecast in-service dates expressed as an average slippage per project. The factors that lead to these variances can arise from the same potential causes as cost variances. In 2015-16, only projects under the Army CASP and Strategic Programmes CASP reported aggregate time variances that exceeded targets. This was as a result of poor contractor performance.

Out of 42 demonstration and manufacture phase projects, only four projects reported aggregate time slippage that exceeded targets, which was the result of poor contractor performance. One project was under the Army CASP, one under the Air CASP and two projects under the Strategic Programmes CASP.

For our assessment phase projects, there was only a marginal increase in duration under the Air Command CASP. Under the other four CASPs our time forecasts were either unchanged or reduced.

1.5 Equipment support projects <i>This KPI measures how well we support equipment in service against performance measures set individually in each CASP. It takes into account availability, reliability and sustainability, and also measures how well we administrate safety processes (for example, completing safety cases for all equipment and ensuring we have effective reporting processes in place).</i>						
	METRIC	NAVY	ARMY	AIR	JOINT FORCES COMMAND	STRATEGIC PROGRAMMES
1.5.1 Availability ¹	Green ≥80% Amber ≥70% <80% Red <70%	40%	86%	86%	100%	100%
1.5.2 Reliability ¹	Green ≥80% Amber ≥70% <80% Red <70%	59%	59%	95%	99%	100%
1.5.3 Sustainability ¹	Green ≥80% Amber ≥70% <80% Red <70%	66%	55%	87%	97%	100%
1.5.4 Safety Process Admin ²	Green = 100% Amber ≥95% <100% Red <95%	27%	81%	66%	97%	Not measured
<p>In conjunction with DE&S, each of our customers determines how it defines availability, reliability, sustainability and safety process administration, and negotiates its own performance thresholds. In the Army and Navy CASPs, performance of both the customer and DE&S was measured jointly and, therefore, the table reflects our collective performance – not just that of DE&S.</p> <p>Due to the individual nature of the KPIs against each customer, it is important to note that a direct comparison of performance between the CASPs is not possible. It is also worth noting that the safety process administration 'green' threshold was particularly stretching at 100%. While we acknowledge that there is work still to do in this area, particularly in standardising reporting methodologies, we are clear that safety remains effectively managed in service.</p> <p>Navy: It has been a challenging year in support of this element of the Navy CASP, following a high operational tempo, and changes to the programme of work and budget. In recognition of this and, as performance metrics were not subsequently adjusted, Navy Command released us from our CASP obligations. Nonetheless, we have, of course, continued to sustain our support to Navy in-service platforms. The measurements above reflect performance against the KPIs which were set at the beginning of the year. For 2015-16, availability, reliability and sustainability KPIs were measured against activities of joint responsibility; a sole measure of the DE&S contribution will be used for 2016-17 onwards.</p> <p>We highlight the low safety process administration score in the Navy CASP, which was largely due to the process for measuring the Ships Operating Centre element changing during the reporting year to include a more-rigorous self-assessment. This indicated 'limited assurance' of our safety processes and thereby significantly lowering the overall score for the year. A safety improvement programme has been implemented and is expected to make our processes more efficient and effective. We continue to work closely with Navy Command to address the challenges that we are both facing.</p> <p>Army: The Army CASP equipment support programme measures were, in the main, joint measures of performance across all four categories. The level of performance against our Army CASP support targets was relatively consistent, but, reflecting the joint nature of the targets, the low availability of Army maintainers and spares issues in the helicopter environment contributed to lower performance levels under reliability and sustainability. With regards to safety process administration, a significant effort across the year to complete outstanding safety cases resulted in this metric reporting 97% in the final month of 2015-16 and lifting the annual average to 81%.</p> <p>Air: Performance against the Air CASP equipment support metrics was consistently high throughout the year. Where shortfalls were identified, we worked closely with Air Command to address these, identifying cause and resolution as efficiently as possible. Improving safety management (for example the timely completion of safety cases) remains one of our key priorities for 2016-17, and the situation is steadily improving, particularly as newly recruited suitably qualified and experienced personnel arrive in post.</p> <p>Joint Forces Command: We are pleased that our performance was consistently high throughout the year. The performance metrics selected were reflective of our performance, they were not 'joint', and the targets agreed with the Command were achievable based upon historic performance.</p> <p>Strategic Programmes: The Strategic Programmes organisation is unlike the three front line commands and JFC, as it does not have front line military units under its control. There were only three support outputs and we consistently met them throughout the year.</p>						

¹ Percentage of CASP Equipment Support Programme outputs reported 'green' and 'yellow'.

² Percentage of CASP Equipment Support Programme outputs reported 'green'.

KPI 2 – OPERATING EXPENDITURE EFFICIENCY

<i>This KPI measures how well we manage our operating cost budget.</i>	
Reduce the total DE&S operating expenditure in line with agreed resource profile in the DE&S Corporate Plan	<p>Our target was to spend less than our operating cost budget, which we achieved. Our final costs were £1,111 million against a revised budget of £1,130 million (the budget at the start of the year was £1,222 million, which was adjusted for various activities transferred out (for example, Logistics Commodities and Services), offset by some increases. These figures exclude communicated costs which are notional, non-budgetary items of expenditure.</p> <p>The delivery of a budget to outturn variance of less than 1% is clear evidence of the robust and effective financial management exercised by DE&S. The variance reflected lower civilian recruitment, gapped military posts and other operating costs. The operating cost budget is set to fall by some 18% between 2013-14 and 2017-18, so a continuing drive to reduce expenditure on private sector support will be important, along with rigorous control of other forms of operating expenditure.</p> <p>We have taken action to address the accounts qualifications reported by the NAO in 2014-15 relating to weaknesses in the robustness of the accounting boundary between equipment programme and DE&S operating activities. The qualifications specifically related to private sector support and other programme cost expenditure, and the associated liabilities. As a result of the action taken by DE&S, the audit qualification on closing liabilities was removed by NAO in 2015-16 which provides a solid baseline from which the remaining qualifications can be removed in 2016-17.</p>

KPI 3 – INVENTORY MANAGEMENT

<i>This KPI relates to DE&S performance in executing the MOD Inventory Management Transformation project. The project intends to reduce the amount of inventory the MOD holds, cut the amount spent on inventory and effect lasting change in the way it is managed.</i>		
	METRIC	Performance
3.1 Closing inventory (including fuel)	Green ≤£30.8 billion Amber >£30.8 billion ≤£31.0 billion Red >£31.0 billion	£30,086 million
3.2 Raw materials and consumables purchasing (excluding fuel)	Green ≤£1.0 billion Amber >£1.0 billion ≤£1.025 billion Red >£1.025 billion	£787 million
<p>Inventory Management Transformation is a MOD project, executed by DE&S, which is intended to reduce the amount of inventory the MOD holds, cut the amount spent on inventory, and effect lasting change in the way inventory is managed. The Inventory Management Transformation project has now concluded and we successfully accomplished the targets set out in the inventory management strategy:</p> <ul style="list-style-type: none"> • Closing inventory: As at 31 March 2016, the MOD had achieved a £10.3 billion overall reduction from the 2011-12 baseline position of £40.3 billion, to a closing position of £30 billion. In achieving this, £12.6 billion of inventory was disposed of at the end of its useful life. • Raw materials and consumables purchasing: As at 31 March 2016, the cumulative purchasing saving since 2011-12 was £2,593 million against the £561 million target. <p>The two DE&S in-year inventory KPIs have helped drive this achievement and we have again achieved our targets.</p>		

KPI 4 – FORECAST ACCURACY AND STABILITY

4.1 Forecast accuracy (in year) – outturn below baseline <i>This KPI measures how well we forecast our expenditure in-year on the DE&S programme of work.</i>								
	METRIC	NAVY	ARMY	AIR	JOINT FORCES COMMAND	STRATEGIC PROGRAMMES	DE&S	TOTAL ¹
	Baseline	£3,261M	£1,621M	£3,683M	£701M	£3,818M	£159M	£13,242M
4.1 Forecast accuracy (in year) – outturn below baseline	Green <-1% Amber >-1% ≤ -1.5% Red >-1.5%	+0.5% (+£16M)	-7.8% (-£126M)	-0.9% (-£33M)	-15.8% (-£111M)	+3.1% (+£117M)	+6% (+£9M)	-1% (-£127M)
The Command-facing equipment programme outturn was £13,115 million against a budget of £13,242 million, which includes adjustments for foreign exchange movement and accounting changes to VAT receipts. The overall underspend of £127 million is not attributable to any overarching strategic change or adjustments. The DE&S outturn by customer is provided above.								

4.2 Forecast stability – 10 year equipment procurement plan – variance to baseline <i>This KPI measures how well we forecast our 10-year expenditure on the DE&S programme of work in relation to the equipment procurement plan.</i>								
	METRIC	NAVY	ARMY	AIR	JOINT FORCES COMMAND	STRATEGIC PROGRAMMES	DE&S	TOTAL ¹
	Baseline	£10,188M	£11,693M	£9,040M	£1,539M	£31,132M	-	£63,592M
4.2 Forecast stability – 10 year equipment procurement plan – variance to baseline	Green <2% Amber >2% ≤ 3% Red >3%	-0.0% (-£4M)	+0.6% (+£73M)	+0.6% (+£56M)	-0.5% (-£7M)	+5.1% (+£1,584M)	-	+2.7% (+£1,702M)
The 2015-16 forecast of the 10-year equipment procurement plan facing front line commands was £65,294 million against a baseline of £63,592 million, an increase of £1,702 million. The forecast cost increase is mainly within Strategic Programmes element of the programme, driven by schedule changes, facilities cost growth and maturing industry data. All remaining Commands reported within 2% of their respective baseline.								

4.3 Forecast stability – 10 year equipment support plan – variance to baseline <i>This KPI measures how well we forecast our 10-year expenditure on the DE&S programme of work in relation to the equipment support plan.</i>								
	METRIC	NAVY	ARMY	AIR	JOINT FORCES COMMAND	STRATEGIC PROGRAMMES	DE&S	TOTAL ¹
	Baseline	£22,167M	£11,794M	£19,778M	£4,403M	£20,360M	-	£78,502M
4.3 Forecast stability – 10 year equipment support plan – variance to baseline	Green <1.5% Amber >1.5% ≤ 2.5% Red >2.5%	+2.1% (+£473M)	-5.7% (-£674M)	-1.8% (-£363M)	-0.2% (-£9M)	-4.6% (-£943M)	-	-1.9% (-£1,515M)
The 2015-16 forecast of the 10 year equipment support plan facing front line commands was £76,987 million against a baseline of £78,502 million, a reduction of £1,515 million. Forecast cost reductions were reported across all Commands with the exception of Navy Command.								

¹ Rounding has been used so total may not equal the sum of its rounded parts

KPI 5 – CUSTOMER SATISFACTION

From 2016-17 onwards, this KPI will measure how satisfied our customers are with DE&S performance across a number of key areas.

5.1 From 2015-16 onwards, a year on year increase in the mean customer satisfaction score by each Command

During 2015-16, customer satisfaction was run as a shadow KPI in order to establish the baseline scores for DE&S. Surveys were conducted in April and October, and a baseline formed as the weighted average of the two scores. This has given us a baseline 'customer confidence index' of 5.8, which is an aggregated score (out of ten) derived from numerical responses across eight themes (collaboration, expertise, flexibility, programme management, consultation, communication, challenge and management information) and three perceptions (satisfaction, loyalty and 'customer first' culture).

The survey will be conducted twice again in 2016-17 to enable performance to be reported and compared with the baseline. It will be supplemented with structured interviews to elicit further qualitative feedback from our customers. Our aim is to achieve a year-on-year increase in the customer confidence index.

Successor submarine design

2015-16 saw DE&S make significant progress on the development of the Royal Navy's next generation of nuclear submarines. Work continued apace on the design phase throughout 2015-16, drawing on cutting edge capabilities in innovation, design and engineering from across the MOD and industry. The new submarine will be one of the stealthiest submarines in the world, and will be the safest and most technically advanced submarine ever built in the UK.

The design phase of the programme has now concluded and main production work on Successor began in October 2016.

Key achievement



HIGH-LEVEL OBJECTIVE 2: TRANSFORMATION TO A MATCH FIT ORGANISATION

Implement the DE&S Transformation Implementation Plan to create a 'match fit' DE&S.

This objective means that DE&S will be:

- A customer-focused, innovative, value adding, best-in-class acquisition and support organisation recognised for its ability to deliver results and the professionalism of its people.
- A self-confident organisation that is trusted and empowered to get on with its job.

We have continued to make progress against our three-year timeline of transformation, designed to reach 'match fit' by 2017. Building on the baselining activity conducted over the first transition year, our focus during 2015-16 has been on beginning to implement the business systems and organisational and behavioural changes we need to ensure a best-in-class acquisition and support organisation.

We are delivering against a comprehensive Transformation Implementation Plan, developed with the Managed Service Providers (MSPs) - Bechtel, CH2M and PwC. Alongside DE&S personnel, the MSPs act as our transformation partners, providing tailored private sector expertise in the areas of project delivery and human resources. Together, we are driving through the Transformation Implementation Plan, which is centred around the following key themes:



A wide range of individual projects are being taken forward against each theme and, taken together, they will ensure the delivery of benefits to our customers, to our people and to taxpayers.

People Model

As part of our transformation, we are developing a bespoke DE&S HR capability. A new People Strategy was launched in March 2016, which sets out our approach to attracting, developing, deploying and retaining the skilled personnel we need. In 2015-16, we also developed and launched the 'DE&S Professional', a new competency framework unique to DE&S. The framework comprises five cross-cutting competencies that describe the skills, knowledge and behaviours required in a transformed and thriving DE&S.

We have made good progress in harnessing our management freedoms in relation to our people, particularly with regards to reward, recognition and development. Over the past year we have:

- Continued to develop appropriate recruitment and retention allowances to staff in key, scarce and critical disciplines.
- Sought to recruit the highest quality leaders to deliver our business objectives by using our freedom to employ up to 25 staff at salaries higher than the senior salary cap.
- Developed our future HR structure and recruited into the senior roles that will take this forward.
- Implemented our own pay award arrangements.
- Launched a revised DE&S performance management process.
- Introduced the 'DE&S Professional' – our new competency framework.

In January 2016, the Chief Executive established the People Committee to consider and approve changes which are specific to DE&S, ensuring that appropriate governance and oversight of our freedoms is in place.

We have also rolled out a time recording system across DE&S, and 98% of staff are now recording their hours. Time recording will improve management information relating to our key activities and will support any future move towards charging our customers for the services we provide.

Balanced Matrix

In line with many specialist organisations, we recognise the depth and breadth of skills required across our business. As such, we are moving towards a balanced matrix management approach to improve operational efficiency and resource management. Over the past year, we have made significant progress towards adopting this model, which will ensure that our people are deployed functionally and flexibly to task, according to their skillset and availability. Staff have been aligned to one of 11 functions, for example engineering, project management, commercial, finance and corporate services. We have recruited new function managers who are standing up these functions and establishing the common processes that will define how our outputs are delivered in the future. Competence frameworks for each specialism are being developed and these will support our ability to ensure that the right person is deployed to the right job, at the right time.

Process and controls framework

During 2015-16, we started to introduce new processes and tools to our delivery teams as part of our Spirals programme. The Spirals mechanism establishes our new ways of working incrementally, gradually increasing the number of delivery teams, tools and processes involved. Along with improved information management, these standardised ways of working are a key aspect of ensuring that our staff are able to maximise their time, reducing duplication and maximising efficiency.

Spiral one began in January 2016, with 500 staff, drawn from 25 project teams across four domains, being trained. The training was focused on ensuring project teams have a common set of processes for project management, project controls and engineering. This process set will be expanded in subsequent Spirals; Spiral two began in May 2016 and Spiral three in October 2016.

We have made good headway on this crucial element of changing the way that DE&S delivers and we will continue to progress towards consistent processes and more disciplined delivery across the organisation.

Objectives, Goals, Strategies and Measures (OGSM)

Our adoption of a new OGSM framework will help us to focus attention on what really matters for our business. This framework provides a robust mechanism to set out what we intend to do and how we measure our progress against it. It will help to link our strategic objectives to our individual contribution to DE&S, with a focus on:

1. Hitting our numbers (delivering our elements of the Equipment Plan and operating within our operating expenditure budget)
2. Performing to plan (delivering our equipment and support on time and on budget)
3. Putting more 'S' in DE&S (improving our support performance)
4. Satisfying our customers (delivering to our customers and achieving satisfaction)
5. Achieving our transformation milestones (transformation takes effect)
6. Developing our people and improving our processes (improving functional capability)

The achievement of our transformation objectives will drive better value for money right across acquisition and support. The specific benefits across the equipment procurement plan and equipment support plan will extend to better contracting, better management of projects and an improved process and control framework. Recruitment, retention, support and recognition of our people will be at the centre of our business, driving up skill levels, motivation and performance. Our comprehensive implementation plan is designed to achieve these goals, and support our position as a leader in defence acquisition and support.

HIGH LEVEL OBJECTIVE 3: LEADERSHIP AND ENGAGEMENT

Build a culture of professionalism, continuous improvement, effective engagement and high performance through creating an exciting and challenging set of business targets where delivery will be rewarded

This objective means that DE&S will:

- Foster strong leadership behaviours that will enhance our reputation and support our delivery of the programme of work.
- Improve results in the annual DE&S employee engagement survey.
- Ensure leaders at all levels use effective processes and tools in an agreed, defined, coherent and consistent manner.

As an organisation, we want to motivate and inspire staff, to value every individual's contribution and provide opportunities for people to share their thoughts and experiences of working in DE&S. We recognise that strong, inspiring leadership is crucial to the success of DE&S and, as such, the past year has seen us develop and start to implement strategies to improve leadership visibility and interaction with DE&S staff.

In October 2015, we conducted our annual staff engagement survey - the People Survey - which enabled all staff, civilian and military, to tell us what we are doing well and where we need to improve. This survey remains part of the Civil Service-wide staff engagement exercise, although, for 2015, we introduced a number of changes based on feedback from previous years. This included improving the relevance for military personnel and providing definitions where questions offered scope for uncertainty. 67% of DE&S staff completed the survey this year (compared to 79% in 2014) and our overall engagement score was 49%, which mirrored the 2014 survey.

While staff reported improvements in leadership visibility, greater clarity in DE&S' long-term strategy and better learning and development opportunities, the survey highlighted that there are three big issues that staff would like the leadership team to focus on: improving our working environment; changing our performance management approach; and continuing to improve our communications. As such, we have taken the following steps to address these:

Working environment

- We have put together a package of short and long-term initiatives that will improve site safety, security and our Head Office working environment, including deep cleaning and maintenance, and increasing desk space.
- We have been working with the Defence Infrastructure Organisation (DIO) and site owners to see how we can improve working environments at our remote sites.

Performance management

- We launched a new DE&S performance management process in March 2016, which aims to be fairer for staff and will better enable us to develop and reward good performance.
- We have also launched the 'DE&S Professional'; the new DE&S Competency Framework. This will provide us with a clearer understanding of what constitutes good performance in DE&S, helping everyone to achieve this.

Communications

- The Chief Executive holds regular roadshows and town hall events in order to update staff on issues which matter most to them.
- We have launched the 'The DE&S Way', a document which sets out who we are, how we are organised and how we deliver our comprehensive programme of work. This is for everyone in the organisation and contains the ways of working and behaviours that everyone in DE&S will be expected to embody as the transformation programme progresses.

- We have introduced monthly face-to-face leadership briefings to ensure that leaders have the information they need to keep staff updated on what's changing in DE&S.
- We have developed a Leadership Engagement Strategy to increase the visibility and engagement of our senior leaders.
- We have produced a communications strategy for the domains/functions and will be appointing internal communications business partners to help improve engagement through delivering best practice communications and engagement activity.
- We have launched a digital media strategy to introduce more interactive ways for leaders to engage with staff and stakeholders.

The next DE&S People Survey will take place during autumn 2016.

Leadership development

The past year has seen us make particular use of our freedoms to help us build our leadership capability. Through judicious use of our ability to employ up to 25 staff at salaries higher than the senior salary cap, we have sought to attract the highest quality leaders with the necessary skills to improve delivery of business objectives and transform DE&S. To the end of 2015-16, we have employed seven people above the senior salary cap. We have also exercised our freedom to work outside the Civil Service Learning framework to deliver enhanced business-focused learning for DE&S senior managers. And, for our Band B staff who have strong potential to reach 1* level, we have developed the DE&S Catalyst talent programme. These actions will help us to foster strong, inspiring leaders at all levels of the organisation, helping us to enhance DE&S' reputation, support our delivery of the programme of work and keep our staff engaged.

Future military flying training

In February 2016, DE&S placed a £1.1 billion contract to continue the modernisation of military flying training in the UK. Ascent Flight Training will design, deliver and manage the fixed wing training service until 2033, providing modern training aircraft as well as up-to-date ground-based training such as simulators and classroom learning for military aircrew.

The single prime contract will cover provision of elementary flying training, basic flying training and multi-engine pilot training, ensuring coherent delivery of the training system.

Multi-engine pilot training will be in place from mid-2018 and the basic flying training element will be up and running by early 2019.

Key achievement



Safety, Sustainability and Security

Safety

We are committed to ensuring that we provide safe equipment to the Armed Forces, a safe environment for our people to work in and that we protect the environment in which we and our equipment work. While we strive to embed an effective safety culture throughout the organisation, we also monitor performance at the DE&S Safety Committee and at our monthly Executive Committee meetings.

During 2015-16, we promoted our positive safety culture and key safety messages to DE&S staff across all of our main sites through our inaugural 'Safety Day', which took place in October 2015. This reinforced our commitment to the safety of our staff and customers, and all staff were actively encouraged to take part. Four safety-related 'learning from experience' events were also held during the year, identifying lessons learned and ensuring that best practice was shared across all areas of the business.

We have also continued to develop our defence standards for improved contracting of safety within the procurement process, and further developed our suite of tools that define and capture the data that supports the safety and environmental management systems across all areas. This work will form the basis for standardised approaches within project areas and support a unified DE&S way of delivering safety across the organisation.

Work has continued over the year to increase the level of suitably qualified and experienced personnel across DE&S through the delivery of an extensive training and upskilling programme. Moving forward, as part of DE&S transformation, the 'Occupational Health, Safety and Environmental Protection' and Engineering functions will ensure an increased focus in these areas and provide defined career and development paths for our people in the future.

Sustainability

We recognise how important sustainable development principles are to delivering defence capabilities safely and effectively. Across the DE&S estate, all DE&S sites have environmental management systems in place which are regularly assessed and audited. The most recent review indicates that sound systems of control are in place but, over the next year, we will seek to strengthen the interfaces between the different

organisations supporting DE&S sites. Our main challenge is ensuring that our fuel infrastructure is, and remains, compliant. We are working with the Fuels and Gases Safety Regulator and the DIO to ensure this is achieved.

We have continued to work closely with our suppliers through a joint MOD-industry Sustainable Procurement Working Group. This forum allows DE&S and its suppliers to consider jointly how best to embed sustainable procurement into business practices. We also organised a successful defence industry sustainable procurement symposium in October 2015, which highlighted key topics including the benefits of improving energy efficient technologies and behaviours, and the importance of materiel security and climate resilience.

DE&S, as a consumer of energy, contributes to delivery of MOD sustainability targets, however, in the majority of cases, DE&S is a lodger unit within MOD sites, where responsibility for energy use on site sits with the DIO. Details of DE&S performance in all key areas is included in the Sustainable MOD Annual Report, which was published in July 2016 on gov.uk at: <https://www.gov.uk/government/collections/mod-annual-reports#sustainability-annual-reports>.

Security

The security of our personnel and estate remains of paramount importance and we have taken further steps to remind people of the business and personal safety benefits of adopting a robust security culture both in and out of work. Our Security Committee meets on a quarterly basis to drive the provision of proportionate and effective security for DE&S; it provides oversight and governance for all elements of security including physical, personnel, cyber, and business resilience.

DE&S transformation is also helping us to establish a 'security specialism', offering career paths and appropriate training and development to ensure that security and resilience improvements are driven by professionals at all levels throughout the acquisition and support of defence equipment. The Corporate Security team, under the Principal Security Advisor, has been redesigned and provided with more resource in order to increase its reach into the business.

Nuclear security, of course, remains a priority and, as such, a Submarine Operating Centre security governance meeting, chaired by the Chief of Strategic Systems Executive, oversees the security risks related

to the nuclear enterprise within DE&S. The DE&S Principal Security Advisor also sits on the Independent Police Committee working closely with the MOD Police and MOD Guard Service to ensure effective policing and guarding arrangements are in place to meet site requirements. This committee ensures that any staffing or capability issues are managed effectively and any impact on nuclear infrastructure is mitigated. The level and depth of nuclear assurance has been increased further, improving the understanding and visibility of nuclear security risks and mitigations.

2016 has seen the launch of the new List Xtranet, a modern shared working environment to enable us to share security policy, guidance, threats and other relevant information with our suppliers who protect defence assets at Secret or above. This represents a step change in capability and significantly extends our reach, particularly within the small and medium-sized enterprise community.

Aging infrastructure remains a challenge across the MOD estate. Our security and infrastructure teams continue to identify and prioritise infrastructure investment to ensure future physical infrastructure meets security requirements, and to ensure that appropriate mitigations are in place in the meantime. Linked to this, on behalf of the MOD, DE&S continues to ensure that all classified defence information and physical assets held at industry sites are protected appropriately under the List X clearance process, through a rolling visit programme.

Key achievement



Black Hornet and Desert Hawk

In the last year, DE&S brought two unmanned air systems that were used to protect troops in Afghanistan into the core MOD equipment programme. The Black Hornet and Desert Hawk 3 systems were used on operations to provide surveillance and intelligence for troops on the ground and such systems are increasingly important in today's operational environment.

The Black Hornet, which is palm-sized, provides real-time video and snapshot images while Desert Hawk 3, which is battery-powered and weighs only 8lbs, gathers intelligence, and provides reconnaissance and surveillance.

Looking Forward

Over the next few years, our corporate priorities, which are set out in our Corporate Plan and reflect our high level objectives, outline the areas that we will focus on to ensure that we succeed. In short, we will:

- Continue to improve the delivery of the DE&S programme of work to performance, cost and time. We recognise that this will be especially challenging following the MOD's increased investment in equipment and support, as announced in SDSR 2015.
- Take forward our work on transforming the organisation, using the private sector expertise of our Managed Service Providers and building the capability we need to sustain that change.
- Focus on our people – ensuring that they are properly skilled, developed, engaged and incentivised.

In terms of our performance, our experience of operating under the CASPs for 2015-16 has informed conversations with the Commands that have set our performance measures for 2016-17. The Army CASP, in particular, will see a marked change in introducing DE&S-only support metrics. We recognise that we have to undertake a longer-term endeavour on the Navy CASP, which is currently a consequence of legacy systems and operating procedures. We are also evaluating options to isolate DE&S performance for the procurement project delivery KPIs, as the current measures still relate to the overall defence acquisition system and do not highlight DE&S' specific role and deliverables.

Looking at the KPIs more broadly, a tighter tolerance on forecast cost growth will be introduced in 2016-17, with zero tolerance applied to positive aggregate cost forecasts. We will also begin reporting the results of our customer satisfaction surveys. A sixth KPI will be introduced on health, safety and environmental protection, and this will report on DE&S as an organisation. Overall, we expect the KPIs to gradually evolve to provide a realistic report of DE&S performance.

With regards to transformation and our people, 2016-17 is a pivotal year as we drive through the business systems, organisational and behavioural changes required to transform DE&S into an organisation that is better able to support the Armed Forces and provide better value for money. Over the coming year, we will implement new HR policies, including the new pay and grading structure for the organisation. We will also start using the balanced matrix to assign staff to projects, and continue to roll out the Spirals to progressively establish new ways of working.

The next three years will undoubtedly bring major changes in all of these areas and more detail on our priorities can be found in our Corporate Plan, which is published on gov.uk at the following link: <https://www.gov.uk/government/publications/defence-equipment-and-support-corporate-plan-financial-years-2016-to-2019>.

Tony Douglas
Accounting Officer
27 October 2016



Fast jet pilot training

Fast jet pilots will continue to benefit from the world-class Hawk training aircraft thanks to contracts awarded by DE&S teams in March 2016. Under the five-year agreements, worth a total of £372 million, BAE Systems and Rolls-Royce will continue to provide crucial in-service support of Hawk and the 'Adour' engines which power the Hawk aircraft.

The fleet of Hawk TMk1 and TMk2 aircraft are used by the UK Armed Forces for military flying training prior to conversion onto frontline fast jet aircraft, such as Typhoon or the future F35 Lightning II, and for a variety of other Royal Navy and Royal Air Force training requirements. They are also the aircraft of choice by the RAF Aerobatic Team, the Red Arrows - one of the world's premier aerobatic display teams.

Key achievement





HMS Protector, the Royal Navy's ice patrol ship, which DE&S supports through a Contractor Logistic Support arrangement

Section Two

Accountability Report

CORPORATE GOVERNANCE REPORT



Directors' report

Management

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

Directorships and significant interests

DE&S senior executives must declare any personal interests that they have with current or potential customers or suppliers. There have been no reported conflicts of interest or related party transactions between the senior executives and their activities.

Personal data related incidents

No personal data related incidents were reported to the Information Commissioner's Office in 2015-16. Any incidents suspected of relating to personal data were investigated thoroughly but none were found to be in breach of the Data Protection Act. They were, nonetheless, used to formulate awareness in order to reduce the risk of reoccurrences. Small, localised incidents are not recorded centrally and are not cited in this report.

Statement of Accounting Officer's responsibilities

Under the Government Resources and Accounts Act 2000, HM Treasury has directed DE&S to prepare, for each financial year, resource accounts detailing the resources acquired, used, held or disposed of during the year, and a statement of accounts in the form and on the basis set out in the Accounts Direction issued by HM Treasury on 28 January 2016. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of DE&S and of its net resource outturn, application of resources, changes in taxpayers' equity and cash flows for the financial year.

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

- Observe the Accounts Direction issued by HM Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis.
- Make judgements and estimates on a reasonable basis.
- State whether applicable accounting standards, as set out in the Government FReM, have been followed, and disclose and explain any material departures in the accounts.
- Prepare the accounts on a going concern basis.

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

So far as I, the Accounting Officer, am aware, there is no relevant audit information of which the Department or its auditors are unaware. I have taken all the steps that I ought to have taken to make myself aware of any relevant audit information and to establish that the Department and its auditors are aware of that information.

I take personal responsibility for this annual report and accounts and the judgments required for determining that as a whole it is fair, balanced and understandable; which I can confirm.

Governance statement

I, Tony Douglas, Chief Executive of DE&S, assumed responsibility as Accounting Officer for DE&S from 1 December 2015, while Sir Bernard Gray was the Accounting Officer up to 30 November 2015. Over the 2015-16 reporting year, we have therefore both held responsibility for maintaining a sound system of corporate governance and internal control to support DE&S’ purpose and high level objectives, while safeguarding the public funds and MOD assets for which we were personally responsible. I have sought assurances from Sir Bernard and from my teams that enable me to conclude that the system of internal control in DE&S we have in place complies with the HM Treasury Code of Good Practice on Corporate Governance in Central Government Departments.

This Governance Statement represents my assurance that, as Accounting Officer, I am satisfied that DE&S finances are adequately controlled and that significant progress is being made in addressing the audit qualifications reported by the NAO in 2014-15.

Our governance structure

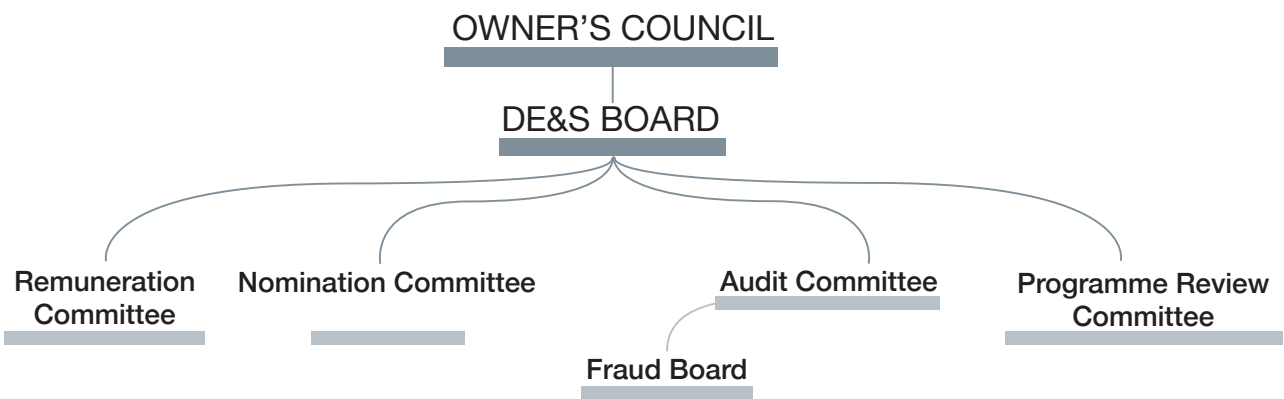
Our governance structure is designed to provide effective control, transparency and efficient decision making to drive progress and delivery, and I am confident that we have a Board and Audit Committee structure in place that allows us to fulfil DE&S’ governance arrangements. Our Board and Committee members have the right blend of knowledge, skills and experience to govern effectively, and meetings occur with sufficient regularity to provide appropriate coverage of governance, risk, control and assurance matters.

During 2015-16 I introduced improvements to the DE&S internal board and committee structures to provide clearer accountability and escalation routes for organisational risks, controls and system issues. The aim of this was to simplify our decision-making hierarchy so that it would inspire and empower leaders,

increase confidence and improve accountability. More specifically, the establishment of discrete sub-committees to consider, inter alia, the Transformation and People agendas have ensured a sharper and more dedicated focus is given by the Executive to these fundamental aspects of our business improvement.

Owner’s Council

The Minister for Defence Procurement (Min[DP]) chairs the Owner’s Council, which has formal oversight of the performance of DE&S. The Owner’s Council met three times during 2015-16, in June, September and February. Standing agenda items cover the governance of DE&S, including the Board and use of our freedoms. Corporate KPIs are also reviewed. The Council also considers and endorses the Corporate Plan each year, and the Framework Document every three years. Other papers and topics are discussed as necessary.



DE&S Board

The DE&S Board provides the strategic leadership of DE&S, helping to ensure that we are delivering our strategic objectives. It is chaired by a Non-Executive Director (NED), Mr Paul Skinner, and is supported by a sub-committee structure that provides oversight of the delivery of DE&S business. Four independent NEDs worked alongside Mr Skinner during 2015-16; Mr

James Dorrian, Ms Kathleen Harmeston (until January 2016), Mr Paul Smith and Mr Andrew Wolstenholme. They brought specialist skills in HR, commercial, audit and project management respectively. Other Board members include the MOD Permanent Secretary and the Deputy Chief of the Defence Staff (Military Capability) representing our customers. I attend, as Chief Executive, as does the DE&S Director General Resources as Chief Financial Officer.

DE&S Board as at 31 March 2016



Paul Skinner CBE - Chairman
Former Group Managing Director of Royal Dutch/Shell, Chairman of Rio Tinto and Chairman of Infrastructure UK in HM Treasury



Jon Thompson
MOD Permanent Secretary (PUS)
(until April 2016)



Tony Douglas
DE&S Chief Executive Officer



Lt Gen Mark Poffley OBE
Deputy Chief of the Defence Staff (Military Capability)



Michael Bradley DE&S
Director General Resources



James Dorrian
Non-Executive Director
Former Executive Vice President HR Royal Dutch Shell, HR Director Shell UK and Marketing Director Shell France



Paul Smith
Non-Executive Director
Former Ford UK Finance Director and presently a Non-Executive Director for a number of private and public sector organisations



Andrew Wolstenholme OBE
Non-Executive Director
Previously a Construction Director for BAA plc and a Director of Innovation and Strategic Capability for the Balfour Beatty Group. Currently the CEO of Crossrail

DE&S Board activity

The Board met ten times during 2015-16, including at two extraordinary meetings that were convened to discuss the DE&S People Strategy and the Transformation Implementation Plan.

Number of meetings attended 2015-16	
Mr Paul Skinner (Chair)	10 (10)
Mr Paul Smith	10 (10)
Mr Andrew Wolstenholme	8 (10)
Mr James Dorrian	10 (10) ¹
Ms Kathleen Harmeston	7 (8) ¹
Mr Jon Thompson	4 (10)
Sir Bernard Gray	7 (7) ²
Mr Tony Douglas	5 (5) ³
Air Marshal Sir Stephen Hillier/ Lt Gen Mark Poffley	9 (10)
Mr Michael Bradley	10 (10)
Mr Jonathan Slater/ Mr Mark Preston/ Ms Louise Tulett (representing Mr Jon Thompson)	5 (10)

¹ Ms Kathleen Harmeston recused herself from DE&S Board responsibilities in January 2016

² Mr Tony Douglas succeeded Sir Bernard Gray in December 2016

³ Mr Douglas attended the September and November meetings as an observer.

DE&S Board processes

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

Board performance

by Paul Skinner, DE&S Chairman

As Chairman I have overseen the continued evolution of the Board during its second year of operation, building on the experience gained throughout 2015-16 and implementing those improvements to Board effectiveness that were identified by the review conducted last year. These included developing a stronger focus on strategic risk and supplier issues, ensuring the Board had a strong line of sight on the progress on Transformation, and continuing to deepen the understanding by the Non-Executive Directors of the DE&S business. The Board also played an important role in providing leadership continuity during the CEO transition phase. Continuity of Board composition during 2015-16 has also enhanced its effectiveness, and I am confident that the combined knowledge and experience of its members has been harnessed effectively during Board discussions. Consistent with the approach taken in 2014-15, I conducted the second effectiveness review in July 2016. This has identified further enhancements to the Board's operation as we mature to support the transformed DE&S business; we will work hard to implement these. My intention is to conduct a formal, external, review of Board effectiveness after the third year of our operation.

Key business discussed at the DE&S Board during 2015-16

Subject	Discussion	Outcomes
Governance	The Board sought to review its effectiveness over its first year of operation by way of a questionnaire issued to Board members.	A number of recommendations were implemented over the course of the year.
Performance	The Board received briefings on equipment procurement and support performance. It discussed progress on a number of projects, including Type 26, Astute, Successor, Queen Elizabeth Class carriers, the Leidos contract, Typhoon, A400M and progress made towards driving reductions in inventory.	Progress and concerns were reviewed by the Board, which also considered more detailed reports from the Programme Review Committee.
Safety	The Board discussed safety management over the year, and received updates from the DE&S Safety Committee. It also discussed particular safety issues within the programme of work and defined organisational direction and reporting requirements.	The Board emphasised safety as a core business issue, to reiterate this, the NEDs and senior leadership attended the inaugural DE&S Safety Day.
Risk	DE&S strategic risks were reviewed and discussed throughout the year to ensure they were captured appropriately.	A strategic risk workshop, involving the DE&S Executive Team and Board NEDs, was held in November 2015. The Board ensured that the appropriate strategic risks were escalated to the Defence Board.
Transformation	At all meetings, the Board monitors progress on DE&S transformation, including tracking progress on use of the DE&S freedoms. Two extraordinary meetings were held to scrutinise the Transformation Plan and the People Strategy.	The People Strategy was endorsed by the Board in December 2015. The Board reviewed and endorsed the Transformation Plan in September.
Managed Service Providers	The Board regularly reviewed the MSP progress and milestones, and discussed contractual arrangements and performance. It also scrutinised the progress towards development of the Transformation Plan and the benefits case.	The Board engaged with the MSPs to evaluate Transformation Plan milestones.
Corporate documents	The Board tracked the progress and publication of the first DE&S Annual Report and Accounts and worked through updated versions of the DE&S Corporate Plan 2016-19, which was published in May 2016.	The first DE&S Annual Report and Accounts was published in December 2015. The Board considered the NAO qualification for 2014-15, recognising the issues leading to it, and reviewing the actions necessary to remove it.
DE&S committees	The DE&S Board received reports on the progress, themes and membership of its sub-committees and considered the work being taken forward. It was noted that DE&S is the first MOD organisation to establish a Fraud Board.	The terms of reference for the Fraud Board were agreed and guidance on the agenda provided for the first meeting.
Staffing	The Board discussed recruitment concerns within DE&S and noted the impact that such vacancies had on the business. Senior staffing changes were discussed, including the Chief Executive leadership transition. The Board discussed the annual staff engagement survey and considered the results.	The Board challenged the Executive Committee to improve the engagement score next year. It also provided feedback on the communications strategy for engaging staff.

DE&S Board sub-committees

The DE&S independent NEDs attend the following committees:

Name	Committee (meetings attended) ¹
Mr Paul Skinner ²	Nomination Committee Chair (1/1) Programme Review Committee member (2/2)
Mr Paul Smith	Audit Committee Chair (5/5) DE&S Fraud Board (3/3)
Mr James Dorrian	Remuneration Committee Chair (4/4) Audit Committee (1/5)
Mr Andrew Wolstenholme	Programme Review Committee member (2/2)
Ms Kathleen Harmeston	Remuneration Committee member (2/4) Audit Committee member (3/5)

¹ The number in brackets represents the number of meetings attended / the number of meetings available to attend

² As Chairman, Mr Skinner has an open invitation to all Committees. He has attended meetings of the Remuneration Committee and Audit Committee in 2015-16.

Audit Committee

The role of the Audit Committee is to support the DE&S Board and myself, as Accounting Officer, in monitoring the organisation's corporate governance and internal control systems. The Committee also has a responsibility to the wider MOD where any DE&S issues impact on the Department. It is chaired by an independent NED, Mr Paul Smith. Members are responsible for reviewing the comprehensiveness, reliability and integrity of internal controls and reviewing the financial statements.

The Audit Committee advises on:

- The strategic processes for risk, control and governance, and the Governance Statement.
- The accounting policies, the accounts, and the Annual Report.
- The planned activity and results of both internal and external audit.
- Adequacy of management response to issues identified by audit activity.

- Assurances relating to the corporate governance requirements for DE&S.
- Proposals for external audit services or for purchase of non-audit services from contractors who provide audit services.
- Anti-fraud policies, whistle-blowing processes, and arrangements for special investigations.

The Audit Committee met five times during 2015-16. Key themes for discussion over the year included the DE&S contribution to the MOD Annual Report and Accounts, the establishment of the DE&S Fraud Board, the development of a DE&S fraud risk register to identify where internal audit activities could be best targeted, the DE&S Annual Assurance Report, the Defence Internal Audit Annual Report for DE&S, endorsement of the first DE&S Annual Report and Accounts, and the further development of management assurance and controls.

Remuneration Committee

The Remuneration Committee is closely involved in developing the DE&S People Strategy. It advises Min(DP), myself, and the Board on matters relating to the proper development and application of the DE&S total compensation strategy, including its pay structures, as set out in the published Framework Document. It also advises the Board on the remuneration of the Chief Executive, the top civilian executive team and other senior staff as appropriate, where these are not set by Senior Civil Service (SCS) or Departmental guidelines.

The Committee is chaired by Mr James Dorrian, NED, and comprises a minimum of three NEDs, one of whom should be the MOD NED. The DE&S Chairman has a standing invitation to attend. I, the DE&S HR Director and other executives may be invited to attend as appropriate. The quorum necessary for the transaction of business is two NEDs including its Chair.

The Remuneration Committee has met four times during the last year. Discussion included the agreement of a strategic people strategy, individual recruitment proposals, workforce reward and performance policy and its application, the use of recruitment and retention allowances, and senior executive performance assessment and outcomes.

Nomination Committee

A Nomination Committee meets as necessary to advise on appointments to the DE&S Board (except for the Chairman, whose appointment is the responsibility of the Owner).

The Nomination Committee comprises a minimum of three NEDs and is chaired by Mr Paul Skinner, DE&S Chairman. The quorum necessary for the transaction of business is two NEDs, including its Chair or nominated vice chair.

The Nomination Committee met once during the last year to discuss senior succession planning and the future strategic workforce challenges facing the organisation.

Programme Review Committee

The role of the Programme Review Committee is to advise the Owner, the DE&S Board and myself as Chief Executive on matters relating to the effective delivery of the equipment and equipment support programmes. Members are responsible for strategic governance of the programme delivery, and to provide advice and support to me and the Executive Committee on delivering the agreed programme of work. It comprises at least three members for the conduct of its business, including the DE&S Chairman, another independent DE&S Board NED, the MOD Permanent Secretary, and Deputy Chief of Defence Staff (Military Capability). The MOD DG Finance is a co-opted member of the Committee. I attend with the support of executives as required. The Committee can also request the attendance of executives as necessary.

The Programme Review Committee met twice during 2015-16. Key themes for discussion included progress on the appointment of senior responsible owners, review of CASPs and KPIs, the substantial progress made on inventory management, updates on key programmes, and the first performance report for the equipment procurement and equipment support programmes.

Astute Class submarines

The Astute Class submarine programme reached another key milestone in November 2015, when DE&S placed a £1.3 billion contract with BAE Systems to build Anson, the fifth submarine. The Astute Class provides the Royal Navy with the most technologically advanced submarines, offering much greater firepower, better communications and more advanced stealth technology than their predecessors.

Working closely with its customers, DE&S saved both time and money on the building of Anson. Savings of £50 million for the taxpayer were achieved during negotiations with BAE Systems and the agreed build time is, to date, the shortest ever for the Astute Class. Alongside the fourth submarine, Audacious, Anson is now currently being built in Barrow.

The first two of class, HMS Astute and HMS Ambush, are already in service and making a vital contribution to the defence of UK's interest, both at home and overseas. Third of class, HMS Artful was commissioned into the Royal Navy in March 2016.

Key achievement



DE&S Executive Committee

DE&S is led on a day-to-day basis by its Executive Committee. Alongside me are DG Resources (the Chief Financial Officer), DG Commercial and the four Chiefs of Materiel who lead the delivery of the programme in their respective areas.

The DE&S Executive Committee provides collective leadership for the organisation. It is responsible for delivering the DE&S programme of work, as set out in the CASPs, within set performance, cost and time targets. It oversees management of DE&S resources – human, finance and infrastructure – in an effective, efficient and safe way to deliver DE&S outputs, and manages and delivers the work required to successfully transform DE&S.

During 2015-16 the Executive Committee considered the following key issues

DE&S performance: The Committee discussed the equipment support and equipment procurement programme at each meeting, reviewing delivery against the CASPs and the developing financial forecast. Savings measures, including the impact of the Strategic Defence and Security Review, were discussed. Progress against other KPIs was also reviewed and updates agreed for the Corporate Plan. Updates on the DE&S strategic risks were also considered.

In March 2016, the Committee established the Objectives, Goals, Strategies and Measures (OGSM) methodology for the business, creating a framework for aligning business objectives and how they will be achieved throughout DE&S.

DE&S people: Staff pay and performance principles were discussed throughout the year and improvements made to the performance management process. Resourcing levels for DE&S were reviewed regularly. Proposals to improve the facilities at Abbey Wood were also considered.

Transformation: The Committee evaluated the Transformation Implementation Plan, including scrutinising the financial assessment of the benefits. The Committee also deliberated on the development of the People Model. The Committee reviewed the progress made on the new pay and reward policies, making use of DE&S' freedoms.

Safety: The Committee regularly reviewed safety matters at DE&S sites. The CEO emphasised safety as a key leadership issue and directed further analysis to be undertaken across the business. It was agreed that, following the success of the 2015 event, a Safety Day would be an annual DE&S-wide event.

Communications and staff engagement: A new approach to face-to-face staff engagement was endorsed and key messages to be transmitted were agreed. Work to refresh the DE&S brand was also approved.

DE&S Executive Committee as at 31 March 2016



Tony Douglas
Chief Executive
Officer



Vice Admiral
Simon Lister
CB OBE
CoM(Fleet)



Lt Gen
Sir Chris Deverell
CoM(Land)
(until April 2016)



Air Marshal
Sir Simon Bollom
CoM(Air)
(until April 2016)



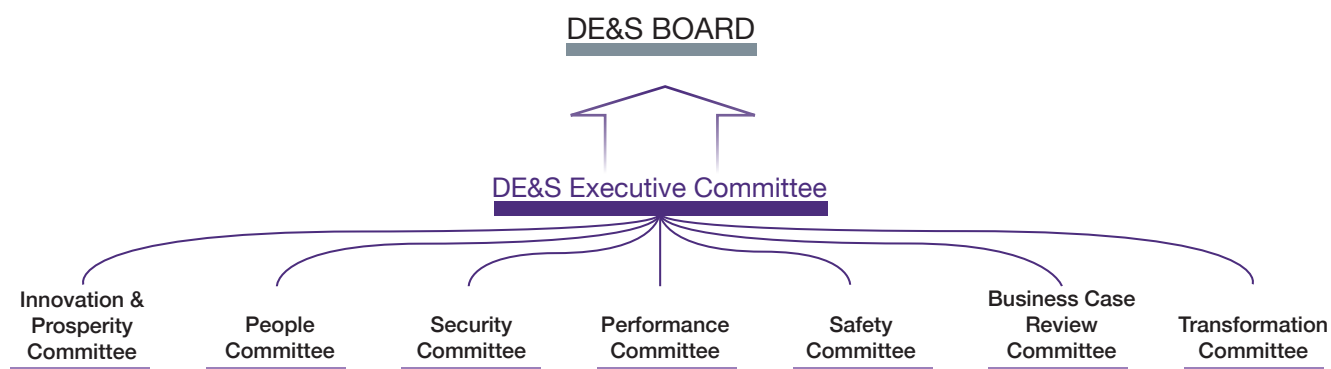
Pete Worrall
CB OBE CoM
(Joint Enablers)



Michael Bradley
DG Resources



Susanna Mason
(until 29
February 2016)
Nick Elliott
(from May 2016)
DG Commercial



Executive Committee sub-committees

A number of subordinate committees provide specialised support to the Executive Committee.

Safety throughout the organisation is governed by our **Safety Committee**, which has oversight of organisational key safety risks and directs work to develop and deliver improvement programmes for the business. A NED is invited to attend the Safety Committee as required.

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

Other Executive Committee sub-committees include the **Performance Committee**, which focuses on internal controls and risk management, the **Business**

Case Review Committee, the **Innovation and Prosperity Committee**, the **Transformation Committee** and the **People Committee**. These meet regularly, updating the **Executive Committee** as necessary on matters within their jurisdiction.

All Chiefs of Materiel chair monthly domain meetings, which provide a regular strategic review of cross-cutting issues. They also hold routine monthly one-to-one meetings with their Operating Centre Directors for more detailed discussions on performance, as well as their domain transformation plan.

Finally, I hold regular one-to-one meetings with all of my Executive Committee. I also meet regularly with my Senior Leadership Team (Executive Committee members and others as appropriate), where discussion can take place on any wider concerns which members may have.

DE&S risk and control framework

Risk management

Within DE&S, we use risk management techniques to make better informed decisions and to reduce the uncertainty in our delivery. Our approach to risk management is based on years of experience and good practice derived from the Association for Project Management, ISO 31000, and the Office of Government Commerce. In 2015-16, we started to design and establish a new risk discipline as part of our transformation programme. In time this will ensure we have a robust, tested and best-in-class approach to managing project and business risks. Across the business, we use Active Risk Manager™ (ARM), which is industry standard software for the management of risks and opportunities. ARM allows us to standardise our approach to risk management, meaning that, across the organisation, risk measurement is understood and applied consistently.

The DE&S Board examines DE&S risk appetite and the controls that are in place to manage risks and threats and address opportunities. It pays particular attention to strategic risks, defined as those that either have the potential to directly impact the achievement of our strategic objectives, have serious legal, financial viability or reputational implications, or have a serious impact across the business and require senior management oversight for effective control.

Management of strategic risks is delegated to the appropriate member of the Senior Management Team. The Executive Committee regularly and systematically reviews, supports and challenges risk owners to manage and reduce the risks as far as is reasonably practical. In 2015-16, we implemented a number of changes to how we manage risk, including alignment with the MOD's new risk management policy and process, the establishment of an annual strategic risk stocktake, and we have also begun to report our significant risks to the Defence Board.

Key achievement



Merlin upgraded

DE&S delivered the seventh modified and upgraded Merlin Mk3 helicopter to the Royal Navy in March 2016, six months ahead of schedule. Under the Merlin Life Sustainment Programme, DE&S is delivering 25 Merlin HC Mk3 helicopters, converted to a HC Mk4 standard, optimising their utility for naval service at sea and exploiting many of the benefits included in the Royal Navy's Merlin HM Mk 2 fleet. The delivery of the seventh helicopter saw DE&S meet the programme's initial operating capability six months ahead of the original schedule, allowing the Commando Helicopter Force to maintain essential capability following the Sea King Mk4 out of service date on 31 March 2016. The programme introduces several changes to enhance the aircraft for maritime operations, including a powered folding main rotor head, fast roping capability, undercarriage modifications and additional communications.

Strategic DE&S risks and their mitigations during 2015-16

Risk	Potential impact on business	Progress in 2015-16
Equipment safety The risk of serious accident or incident attributable to a failing in the DE&S safety management system.	Apart from causing harm to people or property, a serious accident or incident may damage DE&S' reputation, and incur legal and other costs.	The DE&S Safety Committee has regularly reviewed a wide range of activities to sustain and improve equipment safety, in the areas of personnel competence and training, self-assurance, safety culture and safety management. Through the transformation programme, we have begun to look at balanced matrix management – placing the right people in the right place.
Occupational health, safety and environment The risk that poor health and safety practices lead to a preventable health and safety occurrence.	Serious injury or loss of life (outside of theatre) and significant reputational damage.	During 2015-16 we made a comprehensive assessment of workplace transport arrangements across the whole DE&S estate. We regularly communicate and consult with stakeholders, including through site and Operating Centre safety forums.
Poor equipment support The risk that a tendency to focus on equipment procurement over equipment support activities, and the relative difficulty of measuring those activities, delivers poor equipment support for our customers.	Damage to DE&S' reputation for both delivery and efficient use of resources.	Inventory Management Transformation secured a substantial assurance audit rating. We have worked with McKinsey to review our major programmes. We now review independent assessments of support solutions at Business Case Review Committees.
Transformation The risk that insufficient clarity and unity of purpose, and weak programme leadership by the DE&S Executive team, cause the failure of DE&S transformation.	Inadequate DE&S performance, loss of customer confidence, reputational damage to the MOD, and erosion of DE&S freedoms.	We have implemented our engagement plan covering customers, suppliers and senior stakeholders. We have refined the contract with our MSPs to incentivise delivery. We manage and track progress through the Transformation Committee.
Security breach The risk that exploitation of vulnerabilities in protective security, poor security behaviour of staff in key positions, and insider threat could result in a major security breach (both cyber and physical and by insider or third party).	Adverse impact on operations, loss of intellectual property and assets, and reputational damage.	We have a team dedicated to continual monitoring of and response to the security threat. We have delivered a prioritised assurance plan to enable security of DE&S outputs. We have developed the security culture within DE&S and industry partners.

Update on principal risks identified in 2014-15

The risks outlined in the table overleaf are those that were identified as a strategic risk during 2015-16. In the 2014-15 Annual Report and Accounts, we reported three further principal risks, as follows:

- **Manpower resources.** Issues with recruitment and retention of specialist staff. During 2015-16 we have taken forward a number of mitigating actions including better recruitment and marketing processes, increased volume of recruitment campaigns, and greater use of fixed term appointments. Following the annual strategic risk stocktake, the DE&S Board continues to hold a lower-impact version of this risk. However, this is no longer considered a principal risk to DE&S.
- **Accounting.** The reputational and other damage caused by accounts qualifications. The DE&S 2014-15 financial statements were qualified by the NAO due to weaknesses in the robustness of reported private sector support and other programme cost expenditure, and the associated liabilities. DE&S engaged an accounts and audit external support partner and has undertaken a detailed lessons learnt review and accounts improvement programme. The result of which is that the liabilities qualification was removed by NAO in their 2015-16 audit, creating the solid baseline position from which the remaining qualifications can be removed in 2016-17. Following our annual strategic risk stocktake, this is no longer considered a principal risk to DE&S.
- **Industry and market.** The risk that industry suppliers fail to deliver required equipment and support. Mitigations against this risk are now firmly embedded within the culture of the organisation, such that this was not considered a principal risk for 2015-16. Staff continue to conduct routine contract evaluations to manage individual contract delivery, and we have continued our quarterly reviews of the defence industrial sector to evaluate industry strategic performance. Furthermore, following the annual strategic risk stocktake, we have identified a number of MOD-wide actions that we are now taking forward with the Defence Commercial Director.

Principal internal controls

In DE&S, we all share accountability for managing our time, protecting public money and delivering our objectives. To enable this, we ensure that we delegate effectively; people should have the authority to commit resources, with accountability for outcomes, and leaders and managers monitor progress. Delegation results in objectives that are agreed between a leader and their direct reports through the annual performance management process. Underpinning this, we exercise a strong system of internal control for specific elements of our business.

Financial

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

DE&S has been granted significant freedom of action for manpower pay, remuneration, recruitment and approvals of consultancy and we regularly review the appropriateness of letters of delegation as part of routine business. Following my appointment as CEO, Board level letters of delegation were updated and reissued to take account of changes in both personnel and delegated responsibilities.

During 2015-16, as part of a cross-Government NAO review on the acceptance of gifts and hospitality, DE&S records and processes were reviewed. The review identified no serious weaknesses but we will be taking steps to refresh and reissue our policy in this area, to ensure it is as robust as possible.

The DE&S BTE accounts were audited for the first time during 2014-15 and this concluded with a qualified opinion. During 2015-16, significant work has been undertaken with KPMG to address this risk. We have issued revised instructions, set up a steering group to provide advice and guidance, and improved reporting and classification of expenditure.

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

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

Programme and project management

On behalf of the MOD, DE&S manages a vast range of equipment procurement and equipment support projects. Assurance relating to these is based on a system of investment appraisals and project evaluations, production of which is the responsibility of the project manager with support from finance and commercial staff, and the DE&S Cost Assurance and Analysis Service Approval Team.

The assurance and endorsement of Investment Appraisals for Category A, B and centrally-approved Category C¹ projects rests with Defence Economics. For Category C and D projects delivered by DE&S and approved by the Commands, responsibility rests with the Cost Assurance and Analysis Service Approval Team. The Defence Economics team regularly reports on the quality of a sample of DE&S-endorsed cases. In November 2015, 83% of DE&S-approved Investment Appraisals were judged good or adequate.

Moving forward, we will increasingly use earned value to measure performance. Relevant earned value management tools and techniques will be used across our programme of work and will improve our ability to deliver. Earned value management will help us to assure that progress against the baselined scope, schedule and cost are measured together. We will use these tools in accordance with the Association for Project Management methodology and industry best practice.

Commercial

Across DE&S, our teams proactively monitor and manage contracts with our suppliers, holding them to account for their committed obligations. If a supplier falls short of its commitments, or if it outperforms in a way that delivers additional benefit to the MOD, we act promptly and use the relevant remedy or reward provisions in the contract. We also continue to aim to pay all of our suppliers within five days to comply with the Government's prompt payment initiative.

Refinement of our contract management information processes remains a key area for development in DE&S. In support of this, we are actively cleansing our management information but, with more than 3,500 live contracts in DE&S' current portfolio, this is a resource-intensive task. As such, a central team has been established to take it forward. Contract management and administration is being regularly reported at the DE&S Board and Executive Committee. Delivery of this 'Good to Pay' programme is now complete in all Operating Centres (including a review of the Leidos processes) with an average of 96% of controls in place and we are putting in place an enduring capability in both system and process to ensure we retain full control.

We also continue to focus on the development and retention of commercial skills. During 2015-16 we began work to review roles, responsibilities, accountabilities and authorities as part of the functional work being taking forward under DE&S transformation. We also re-launched the Commercial Professionalism Programme in DE&S, which seeks to upskill existing commercial staff and recruit suitably qualified commercial people into the organisation. At the end of 2015-16, 90 commercial staff had progressed through Chartered Institute of Purchasing and Supply Level 4, and more than half of the people in the commercial function had undergone some form of training through the Commercial Professionalism Programme.

Safety and security resilience

Keeping our people, facilities, assets and equipment safe and secure is of critical importance and, as such, across all areas of responsibility, we aim to continually develop and improve safety and security management. During 2015-16, to ensure rigorous review of our performance in this area, we introduced a corporate safety KPI to supplement our existing safety and environmental protection business performance indicators. Performance against this KPI will be measured in 2016-17. More generally, we have sought to improve safety and security education at all levels of the organisation, reminding staff of the importance of an effective and robust culture.

Related to this, our Fraud Board, which reports to the Audit Committee, has met three times to mitigate against the risk of fraud in DE&S. The Fraud Board identified the top eight fraud risks for DE&S and allocated senior management owners to ensure these are reviewed and progressed. Fraud roadshows have also taken place throughout the year, to remind staff of their responsibilities, the relevant policies and where they can seek guidance and advice.

¹ Project category thresholds are: Category A – above £400 million, Category B – £100 million to £400 million, Category C – £20 million to £100 million, Category D – under £20 million.

Business continuity management and resilience issues are reported to the quarterly Security Committee. Our central Business Resilience team provides strategic direction on business continuity and resilience. The DE&S Strategic Business Impact Analysis captures our priorities and resource dependencies, including our key suppliers, and we have in place contingency plans to deal with risks to business continuity. Business Continuity Plans have also been developed across DE&S to ensure we can maintain and support an effective level of service. We recognise that we need to continue to improve the business continuity process and a programme of activity, including a business continuity exercise, is in place to improve and assure business continuity management across the business.

Manpower and resources

As explained on page 20, we are developing a new People Model to deliver a new and bespoke approach to people management across DE&S. 2015-16 saw a significant amount of work undertaken on this, culminating in the launch of our new People Strategy in March 2016. This sets out our approach to attracting, developing, deploying and retaining the skilled personnel we need. In support of this, a new HR team has been formed and we have undertaken a full HR policy review, rationalising our policies wherever possible. Significant progress has also been made in moving towards matrix management, which will ensure our people are deployed functionally and flexibly to task, according to their skillset and availability.

Progress against delivery of our People Strategy is being measured as part of the main transformation programme, with milestones being monitored by the transformation project management office. The People Committee, which I established in January 2016, also meets on a monthly basis to consider and approve changes which are specific to DE&S people.

Assurance

In 2015-16, as well as our regulatory audit programmes, 14 full scope and six follow-up audits and 2 pieces of consultancy work were carried out by Defence Internal Audit (DIA). Overall, the DIA provided DE&S with a limited assurance in relation to risk management, internal control and governance. This was the same overall assessment as for 2014-15. In his annual assurance report, the Group Head of DIA highlighted the following against these three main areas of assessment:

- The implementation of the revised governance arrangements had been achieved. It was noted that the Audit Committee had met on a regular

basis and was effective at challenging the executive and supporting the audit process. It was suggested that the development of an assurance matrix would help this body better understand the nature and extent of assurance across DE&S.

- The complete review and endorsement of Strategic Risks by senior staff was acknowledged, as was the first contribution by DE&S to the Director Audit Risk and Assurance quarterly risk reporting cycle. The issue of a Risk Management Framework was also noted, this being an interim measure until a new risk policy, procedures and risk discipline are established.
- On systems of internal control, limited assurance was noted against BTE time recording; accruals; contract accounting; MSP governance; overtime compliance; assets in industry. Substantial assurance was given for Apache spares management and the implementation of the inventory management strategy.

On the six follow-up audits; DIA assessed that five of these warranted a satisfactory opinion, namely: Import Duty Waiver; civilian self-authorised claims and three audits relating to Project Teams' management of assets in industry. The unsatisfactory opinion was in relation to the management of reported losses of government furnished equipment; the DIA intends to undertake a further full audit on this area as part of the 2016-17 programme. The DIA also acknowledged the role of the Audit Committee in monitoring the implementation of agreed management actions that arose from audit activity.

Transformation

Governance and control of our three-year programme of transformation is through the DE&S Transformation Committee, which meets ten times annually and reports to the Executive Committee. Through the Transformation Committee, we drive the transformation programme forward, ensuring that the programme delivers the agreed outcomes and benefits. The Committee approves the overall transformation strategy and Implementation Plan and project manages delivery against milestones and performance targets. It also approves any changes, providing assurance to the Executive Committee and the DE&S Board that any such change is manageable and risk has been properly assessed. The Transformation Committee also oversees the performance of the MSPs. The Transformation Plan was endorsed by the Board in September 2015. Our management freedoms, which are explained on page 10, are integral to our day to day business. These are managed through the relevant sub-Committees reporting to the Executive

Committee. The freedoms are regularly reviewed by the Owners' Council.

Information management

As part of the DE&S Transformation Programme, in the past year there has been an extensive review of information requirements, including reviewing how we attribute people's time, improved project information, and changes to workforce planning, skills and experience information. We are now working with the MSPs to identify practical measures that can be implemented to continue improving information management. Alongside this, an active program of work to improve information assurance maturity is underway.

Quality Assurance of Analytical Models

Recommendation four of the MacPherson review¹ requires Accounting Officer's governance statements to confirm that an appropriate quality assurance framework is in place for analytical models. The MOD is implementing the MacPherson report recommendations and has published a list of business critical analytical models² which include those in use within DE&S. DE&S will play a full role in the Department's Action Plan to strengthen processes and documentation, together with the culture and environment in which quality assurance takes place.

Annual assessment of governance

Each year, alongside my Audit Committee, I comprehensively review the governance, risk management, internal control and assurance arrangements in DE&S. DE&S is also subject to a number of internal and external reviews throughout the year that test the effectiveness of these controls, and any weaknesses are addressed through the

Audit Committee. Risks deemed to be significant are reported as strategic risks to the DE&S Board. For 2015-16, while I am satisfied that we have in place an overall system of internal control in DE&S, we recognise that there are individual elements that require development. In this respect, I would note the Defence Internal Audit 2015-16 annual report on DE&S, which reported issues in our management of some MOD assets held by contractors, which we are addressing. Also, my annual assurance report to the MOD Permanent Under Secretary, which acknowledged the ongoing work being undertaken to improve our contract management. Moving forward, we will particularly be looking to improve assurance on our accounting boundary, DE&S transformation and refinement of our contract management processes. As such, for 2015-16, given the differing levels of assurance, I have concluded that I can only provide overall limited assurance that our management systems and internal controls are operating as effectively as they could be. This overall assessment has not changed from the 2014-15 position but, given this is only our second year of operation as a BTE, tangible progress has been made, notably in the following key areas:

- The governance arrangements that we established as a BTE were reviewed by Defence Internal Audit, who concluded that they were operating effectively.
- We have re-baselined our strategic risks and improved reporting and accountability for the mitigations associated with each (more details are on page 40).

Work will continue through 2016-17 and onwards to continue strengthening our internal governance and control, with the aim of raising the level of assurance that we can provide.

Chairman assessment by Paul Skinner

I am satisfied that DE&S continues to operate within an essentially successful governance and control framework. Over the past year we have sought to embed changes to the governance framework to ensure clear accountability and I am pleased that the internal auditors recognise that our arrangements are suitably robust and effective. As this report shows, we acknowledge that some management controls require further development, which is reasonable given that DE&S is only in its second year of operation as a BTE. I have seen, however, that work is ongoing through the DE&S Board and relevant committees to address these. Significant work continues, for example, to address the weaknesses identified by the NAO in the 2014-15 financial statements, and we have revised our approach to risk management to ensure our resources are directed in the most effective and efficient manner. Overall, I remain confident that, fundamentally, DE&S can deliver its objectives while complying with agreed standards within delegated budgetary responsibility and accountability.

¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/206946/review_of_qa_of_govt_analytical_models_final_report_040313.pdf

² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/513663/20160404_business_critical_models_in_the_ministry_of_defence_in_2016_final.pdf

REMUNERATION AND STAFF REPORT



Remuneration Policy

The following remuneration policy refers to the employment of the DE&S Directors on the DE&S Board and Executive Committee. Remuneration details for Min(DP) and MOD representatives on the Owner's Council and other DE&S Committees are not included as they are not paid by DE&S. Information on their remuneration can be found within the MOD Annual Report and Accounts. Four members of the Executive Committee are members of the SCS, and three are senior officers of the Armed Forces.

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

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

The Committee advises Min(DP), the DE&S Board and the Chief Executive on matters relating to the proper development and application of the DE&S total compensation strategy, including its pay structures, and as set out in the published Framework Document. It also advises the Board on the remuneration of the Chief Executive, the top civilian executive team and other senior staff as appropriate, where these are not set by SCS or departmental guidelines. More details of the responsibilities of the Remuneration Committee are on page 36.

Performance and Reward

The 2015-16 Statement of Comprehensive Net Expenditure reflects payments made or due to directors during the financial year. Salary and reward for the Chief Executive was considered by the Permanent Secretaries' Remuneration Committee and, in common with that for other members of the SCS, was subject to the rules and regulations imposed by the Senior Salary Review Body and the Cabinet Office.

For staff at SCS Pay Band Level 1, we implemented separately negotiated performance-based base pay increases and non-consolidated performance award arrangements, that allowed for awards up to 4% of the SCS Pay Band 1 salary costs and discretion to award top 1% of performers a higher level of performance award, within the overall 4% budget.

For SCS Pay Band Levels 2 and 3, we implemented separately negotiated performance-based base pay increases and non-consolidated performance awards of up to 30% of salary were available, based on how well an individual had performed against their peers. Awards were made to individuals judged to have made the highest in-year contribution to business objectives. There is no restriction on the nature of the contribution; the only requirement is that it benefits DE&S, the department or defence more widely. Recommendations for awards, which are considered by moderation committees, must therefore be supported by demonstrable evidence of delivery. Awards reported in the Remuneration Report tables for 2015-16 relate to performance in 2015-16, and comparative bonuses reported for 2014-15 relate to performance in 2014-15.

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

All senior (2-Star and above) military officers are paid under the Performance Management and Pay System (PMPS). Depending on their performance, time in rank, and position on the pay scale, individuals can

be awarded a single increment or no increment, and progress accordingly up the incremental pay scale for their rank. The average value of one incremental rise under the PMPS was 2.6% in 2015-16 (it was also 2.6% in 2014-15).

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

Senior Manager Contracts

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

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

The terms and conditions of the DE&S Chairman and independent NEDs on the DE&S Board are determined by the MOD and set out in their individual appointment letters. Independent NEDs are appointed for a fixed term through a transparent recruitment and selection process, with appointment on merit, thus following the Office of the Commissioner of Public Appointment principles. While they are paid by DE&S, they are not DE&S employees or appointed as civil servants. NEDs appointed to the DE&S Board receive a letter of appointment setting out, among other things, details of their remuneration. Appointments may be terminated at one-months' notice by either party or on dissolution of the Board, unless found guilty of gross misconduct when termination will be immediate. Their

appointments may be extended by mutual agreement. NEDs are not involved in any discussion about their own remuneration and all payments made are non-pensionable. There are no compensation entitlements for early termination.

Sir Bernard Gray, Chief of Defence Materiel until 30 November 2015, was appointed through open competition under the terms of the Civil Service Management Code on 4 January 2011. He was originally appointed with a four-year contract, which was extended in January 2015 for a further year. Under the terms of his contract, Sir Bernard was entitled to a compensation payment on exit, which was paid to him on his formal departure from DE&S in January 2016.

Mr Tony Douglas, Chief Executive Officer from 1 December 2015¹, was appointed through open competition under the terms of the Civil Service Management Code. He was appointed with a three-year contract. Conditions covering termination of employment are set out in his contract of employment, which requires him to provide notice of not less than six months. The contract also provides for the opportunity to earn a non-consolidated performance award.

Mr Michael Bradley, the Chief Financial Officer, was also appointed through open competition under the terms of the Civil Service Management Code. His appointment was on a fixed term contract which was extended in January 2016 by four years to January 2020.

Ms Susanna Mason was appointed through open competition under the terms of the Civil Service Management Code on 1 July 2014. She left her role as Director General Commercial on 29 February 2016 and the post was held vacant for the remainder of the financial year.

Management

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

¹ Mr Douglas's employment began on 1 September 2015 and he formally replaced Sir Bernard Gray as Chief Executive Officer from 1 December 2015. Mr Douglas was paid a salary between £70,000 and £75,000 between September 2015 and his formal appointment as Chief Executive Officer.

DE&S Board and senior executive salaries, taxable benefits-in-kind and pension benefits (subject to audit)

DE&S Executive Directors	2015-16					2014-15				
	Salary (£000) ¹	Annual performance award (£000) ⁵	Benefits-in-kind (nearest £100) ⁶	Pension benefits (nearest £1,000) ⁷	Total (£000)	Salary (£000)	Annual performance award (£000) ⁵	Benefits-in-kind (nearest £100) ⁶	Pension benefits (nearest £1,000) ⁷	Total (£000)
Mr Tony Douglas ² (from 1 December 2015)	95-100 [285-290]	-	-	37,000 ⁸	130-135	-	-	-	-	-
Sir Bernard Gray (from 1 April 2014 to 30 November 2015) ³	145-150 [220-225]	45-50	16,700	56,000	270-275	220-225	45-50	23,800	83,000	375-380
Mr Michael Bradley (from 1 April 2014)	165-170	50-55	-	69,000	290-295	160-165	45-50	-	65,000	270-275
Vice Admiral Simon Lister (from 1 April 2014)	135-140	N/A	-	69,000	205-210	125-130	N/A	-	69,000	195-200
Lieutenant General Sir Chris Deverell (from 1 April 2014)	145-150	N/A	-	72,000	215-220	140-145	N/A	-	70,000	210-215
Air Marshal Sir Simon Bollom (from 1 April 2014)	140-145	N/A	-	78,000	215-220	130-135	N/A	-	67,000	200-205
Mr Pete Worrall (from 1 April 2014)	140-145	40-45	-	197,000 ⁹	380-385	125-130	35-40	10,500	25,000	195-200
Ms Susanna Mason ⁴ (from 1 July 2014 to 29 February 2016)	160-165 [175-180]	30-35	-	-	190-195	130-135 [175-180]	45-50	-	-	180-185

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

² The salary banding for Mr Douglas reflects the actual salary received from his appointment as Chief Executive Officer on 1 December 2015. The value in brackets reflects his annual equivalent salary. Mr Douglas was paid a salary between £70,000 and £75,000 between September 2015 and his formal appointment as CEO on 1 December 2015 encompassing a handover period.

³ The salary banding for Sir Bernard Gray reflects actual salary received until 30 November 2015 when he left his role as Chief Executive Officer. The value in brackets reflects his annual equivalent salary. Sir Bernard Gray's employment ceased on 31 December 2015 and he was paid a salary of between £15,000 and £20,000 from the period that he stood down as CEO and the end of his employment. He also received a compensation payment for loss of office in the range £60,000 to £65,000.

⁴ The salary banding for Ms Mason reflects actual salary received from 1 April 2015 until her final day in post on 29 February 2016. The value in brackets reflects the annual equivalent salary.

⁵ Military terms and conditions do not include provision for a performance award. Bonuses are based on performance levels attained and are made as part of the appraisals process. The bonuses reported in 2015-16 relate to performance in 2015-16 and the comparative bonuses reported for 2014-15 relate to the performance in that year. Mr Douglas did not receive a bonus award during 2015-16.

⁶ Benefits-in-kind liability is incurred by civilians for home-to-duty travel in an official pool car, irrespective of the number of journeys. Military personnel are subject to different tax rules and therefore no liability was incurred for 2015-16. For the disclosed benefits-in-kind, DE&S has arrangements under which we pay the tax liability that would normally be paid by the individual; this liability is included in the figures quoted.

⁷ The value of pension benefits accrued during the year is calculated as the increase in pension multiplied by 20, plus the real increase in any lump sum less the contributions made by the individual. The real increase excludes increases due to inflation or any increase or decrease due to a transfer of pension rights.

⁸ Mr Douglas's employment began on 1 September and he accrued £27,000 in pension benefits from this date until his appointment as CEO. This amount is not included in the above table.

⁹ The significant in-year value of pension benefits for Mr Worrall reflects the impact on pension benefits (pensionable pay and lump sum) of a 15% salary increase implemented in July 2015.

DE&S Board – Non-Executive salaries¹ (subject to audit)

DE&S Non-Executive Directors	2015-16 Salary (£000) ²	2014-15 Salary (£000) ²
Mr Paul Skinner ³ (from June 2014)	-	-
Mr Paul Smith ⁸ (from April 2014)	25-30	25-30 ⁸
Mr Andrew Wolstenholme ³ (from October 2014)	-	-
Mr James Dorrian (from October 2014)	25-30	10-15 (25-30 annually)
Ms Kathleen Harmeston ⁴ (from February 2015 to January 2016)	10-15 (25-30 annually)	-
Mr Jon Thompson ⁵ (from 1 April 2014)	-	-
Lt General Mark Poffley ⁶ (from January 2016)	-	-
Air Marshal Sir Stephen Hillier ⁶ (from April 2014 to January 2016)	-	-
Mr Gerry Grimstone ⁷ (from April 2014 to June 2014)	-	-

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

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

³ Mr Skinner and Mr Wolstenholme waived their fees for their DE&S Board membership.

⁴ Ms Harmeston recused herself from DE&S Board Membership in January 2016.

⁵ Mr Thompson received no remuneration for DE&S Board membership as he was an MOD employee. His salary details are reflected in the MOD Annual Report and Accounts. Mr Thompson left his role as MOD Permanent Secretary in April 2016 and has been replaced by Mr Stephen Lovegrove.

⁶ Sir Stephen Hillier was succeeded in his role by Lt Gen Poffley in January 2016. Neither received remuneration for DE&S Board membership as they are MOD employees.

⁷ Mr Grimstone, lead Non-Executive Director of the Defence Board, was the interim chair of the DE&S Board until the appointment of Mr Skinner. He received no payment for this interim role.

⁸ Mr Smith's comparative figures have been restated to reflect amounts paid in 2014-15

DE&S Board and Senior Executive Pension Benefits (subject to audit)

Pension benefits for individuals who served on the DE&S Board or Executive Committee are set out below (Non-Executives are not employees and are therefore not enrolled in an employee-related pension scheme).

	Total accrued pension at pension age [and related lump sum] as at 31 March 2016 (£000)	Real increase in pension [and related lump sum] in 2015-16	CETV ¹ as at 31 Mar 2015 (£000)	CETV ¹ as at 31 Mar 2016 or on cessation of employment if earlier (£000)	Real increase in CETV ² (000)
Mr Tony Douglas	0-5 [Nil]	2.5 – 5 [Nil]	-	46	32
Sir Bernard Gray	25-30 [Nil]	2.5 – 5 [Nil]	294	354	25
Mr Michael Bradley	15-20 [Nil]	2.5 – 5 [Nil]	170	238	28
Vice Admiral Simon Lister ³	65-70 [200-205]	0 – 2.5 [5 – 7.5]	1,546	1,655	91
Lieutenant General Sir Chris Deverell	70-75 [220-225]	0 – 2.5 [5 – 7.5]	1,598	1,710	93
Air Marshal Sir Simon Bollom	70-75 [210-215]	0 – 2.5 [5 – 7.5]	1,569	1,685	97
Mr Pete Worrall ⁴	60-65 [190-195]	7.5 – 10 [25 – 27.5]	1,035	1,296	173
Ms Susanna Mason ⁵	-	-	-	-	-

¹ The CETV figures include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the AFPS or Civil Service pension arrangements. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost. CETVs are calculated in accordance with the Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008, and do not take account of any actual or potential reduction benefits resulting from Lifetime Allowance Tax.

² This reflects the increase in CETV that is funded by the employer. It does not include the increase in accrued pension due to inflation or contributions paid by the employee and uses common market valuation factors for the start and end of the period.

³ The calculation of the CETV as at 31 March 2015 for Admiral Lister has been restated in the table above.

⁴ The significant in-year increase in CETV for Mr Worrall reflects the impact on pension benefits (pensionable pay and lump sum) of a 15% salary increase implemented in July 2015.

⁵ Ms Susanna Mason was not a member of an exchequer funded scheme but DE&S did make a contribution in the band of £20,000 to £25,000 to her private pension scheme in the period prior to her departure date of 29 February 2016.

Pension liabilities

The transactions and balances of the Armed Forces Pension Scheme (AFPS) (including the Gurkha Pension Scheme, the Non-Regular Permanent Staff Pension Scheme, the Reserve Forces Pension Scheme and other minor pension schemes covering locally employed personnel) and the Armed Forces Compensation Scheme are not consolidated in the financial statements. The funding for these schemes is voted separately by Parliament although the cost of administering the schemes falls to the MOD and is included in their accounts. Separate accounts are prepared for the schemes and can be found at: <https://www.gov.uk/government/publications/armed-forces-pension-scheme-annual-accounts-2012-13>.

DE&S' share of the transactions and balances of other pension schemes to which employees belong (e.g. under Civil Service Pension arrangements, the NHS Superannuation Scheme and the Teachers' Pension Scheme) is also not consolidated in the accounts. Separate accounts are prepared for the schemes, and details can be found on the following websites:

<http://www.civilservice.gov.uk/pensions> 93

<http://www.education.gov.uk/schools/careers/payandpensions>

<http://www.nhsbsa.nhs.uk/pensions>

Employer's contributions payable to the Armed Forces and Civil Service pension schemes have been charged to the Statement of Comprehensive Net Expenditure.

No member of the Executive Committee has opted for a Partnership Account; therefore there are no employer contributions to such accounts in respect of members of the executive team.

Compensation for loss of office (subject to audit)

Sir Bernard Gray left DE&S at the end of his fixed term contract on 31 December 2015. He received a compensation payment of £62,322.

Pay multiples (subject to audit)

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

The civilian multiple uses a median based on civil service pay i.e. it excludes agency staff covering permanent posts due to a lack of availability of data. Annual equivalent remuneration includes salary, benefits-in-kind allowances and non-consolidated performance-related pay. It does not include severance payments, employer pension contributions, compensation payments and the Cash Equivalent Transfer Value (CETV) of pensions.

	2015-16	2014-15
Mid-point of the £5,000 band for the annual equivalent remuneration of the highest earning military Board member in the tables above	147,500	142,500
Median total remuneration of Armed Forces personnel	51,609	47,689
Military pay ratio	2.86	2.99
Mid-point of the £5,000 band for the annual equivalent remuneration of the highest earning civilian Board member in the tables above	297,500 ¹	297,500
Median total remuneration of civilian staff	32,644	31,573
Civilian pay ratio	9.11	9.42

¹ Reflects the annual equivalent salary, performance related pay and benefits in kind allowances for Sir Bernard Gray.

The military pay ratio has decreased due to the increase in the median pay of the rest of the Armed Forces.

In 2015-16 the remuneration of civilian employees (annual equivalent salary) ranged from £15,681 to £287,000. No civilian employees received remuneration in excess of the highest paid director (nil in 2014-15 as well).

In 2015-16 the remuneration of military employees (annual equivalent salary) ranged from £21,249 to £148,857.

Staff report

Staff numbers

The number of full time SCS staff employed by pay band as at the end of the financial year:

SCS Pay Band	2015-16	2014-15
Band 1	77	57
Band 2	12	12
Band 3 and above	3	3
Total	92	72

The increase in the number of senior civil servants reflects the organisational design requirements for delivery and forward management of the DE&S transformation programme.

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

	2015-16	2014-15
Permanent staff	11,406	12,347
Contingent labour	292	498
Total	11,698	12,845

The reduction in the reported numbers of permanent staff resulted from placement of the Logistics Commodities and Services contract with Team Leidos on 1 August 2015. This involved the transfer of 1,544 posts from DE&S to Team Leidos under Transfer of Undertakings Protection of Employment (TUPE) terms, of which 1,128 were filled at the time of transfer.

Staff costs (subject to audit)(see also Note 2 to the financial statements)

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

	2015-16			2014-15		
Staff costs comprise:	Permanently employed £000	Contingent labour £000	Total £000	Permanently employed £000	Contingent labour £000	Total £000
Salaries and wages	454,562	27,119	481,681	461,109	48,114	509,223
Social security costs	35,457	-	35,457	37,316	-	37,316
Other pension costs	109,099	-	109,099	97,823	-	97,823
Total	599,118	27,119	626,237	596,248	48,114	644,362

The movement of manpower resource between DE&S and other MOD organisations is dependent on agreement being reached on funding transfers between the two parties. Expenditure continues to be borne by the exporting organisation until this agreement is reached and this principle is reflected in the staff numbers and costs reported above.

Principal Civil Service Pension Scheme

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded multi-employer defined benefit scheme. DE&S is unable to identify its share of the underlying assets and liabilities. An actuarial valuation of the PCSPS has been completed and can be found at www.civilservicepensionscheme.org.uk/about-us/scheme-valuations/. Employee rates are set by the Scheme actuary to meet the cost of the benefits accruing, to be paid when the member retires, not the benefits paid to existing pensioners.

Employees can opt to open a partnership pension account, a stakeholder pension with an employer contribution. Employer contributions are age related and ranged from 3% to 12.5% up to 30 September 2015 and from 8% to 14.75% from 1 October 2015 (2014-15 from 3% to 12.5%) of pensionable pay. Employers also match contribution up to 3% of pensionable pay.

Armed Forces Pension Scheme

The Armed Forces Pension scheme is an unfunded, non-contributory, defined benefit, salary related, contracted out, occupational scheme. Scheme members are entitled to a taxable pension for life and a tax-free pension lump sum if they leave the regular Armed Forces at or beyond normal retirement age. Those who have at least two years' service and who leave before age 55 will have their pensions preserved until age 60 or 65 depending on the scheme.

Staff sickness

We are committed to the health and wellbeing of our staff and have a comprehensive sickness absence policy. During 2015-16 the average number of days for sickness absence was 6.5 days per employee, compared to 7.3 days in 2014-15. This is a significant drop from last year and compares favourably with the MOD average of 7.8 days. The launch of a revised Departmental sickness policy in February 2015 has ensured that we now have a robust, clearly understood procedure for managing sickness absence, and our HR Business Partners continue to work closely with staff to ensure that sickness absence is dealt with appropriately and in accordance with our policy.

Staff policies

We want DE&S to be recognised as an inclusive, fair employer of choice and, as such, we continue to actively promote inclusion of colleagues with protected characteristics. We are committed to ensuring that equality is considered throughout all aspects of our business, without unnecessary processes and bureaucracy, and in accordance with our legal obligations under the Public Sector Equality Duty (PSED) 2010.

DE&S transformation has allowed us to substantially increase the prominence of our diversity and inclusion employee networks and associated champions and we have established a steering group for governance and oversight of this area. Over the past year, we have designed an equality assessment approach for DE&S, under which we seek to ensure that the decisions we take which affect individuals maximise opportunity and minimise risk to those falling within the PSED 2010 characteristics. We also continue to operate the 'Two Ticks' scheme, interviewing all disabled applicants who meet essential job criteria.

We recognise the need to become more representative of the people we serve and are engaging with the community to attract a wider range of talent. The tables following reflect changes to the civilian composition of the organisation by protected characteristics over the year.

Staff breakdown

	1 April 2015	1 April 2016
Civilian total^{1, 2, 3}	10,861	9,845
Gender		
Female	3,322	3,056
Percentage female	31%	31%
Ethnicity⁴		
Black and minority ethnic	370	360
% Black and ethnic	3%	4%
Disability⁴		
Declared a disability	595	648
	5.5%	6.6%
Sexual orientation⁴		
Lesbian, gay, bisexual	90	106
	1%	1%
Religion or belief⁴		
Non Christian	311	279
% Non Christian religion	3%	3%
Secular	2,411	2,293
	22%	23%
Christian	4,475	3,721
	41%	38%

¹ There has been a downturn in the civilian population in 2016 due to outsourcing of 1,128 staff in August 2015.

² Totals include all industrial and non-industrial personnel but exclude all Royal Fleet Auxiliary and locally engaged civilians for whom declaration data is not available.

³ A breakdown of the military composition of DE&S by protected characteristic is currently unavailable.

⁴ Percentages are calculated from known declarations of ethnicity, sexual orientation and religion/belief and exclude personnel whose declarations are unknown or who have chosen not to declare.

Gender breakdown at DE&S Board and Executive Committee level

	1 April 2016	1 April 2015
Total DE&S Board and Executive Committee	12	14
Female	0	2
Male	12	12
% Female	0%	14%
% Male	100%	86%

¹ The April 2016 figures do not include Ms Kathleen Harmeston, who recused herself from Board duties in January 2016.

Gender breakdown over the year at senior civil service level

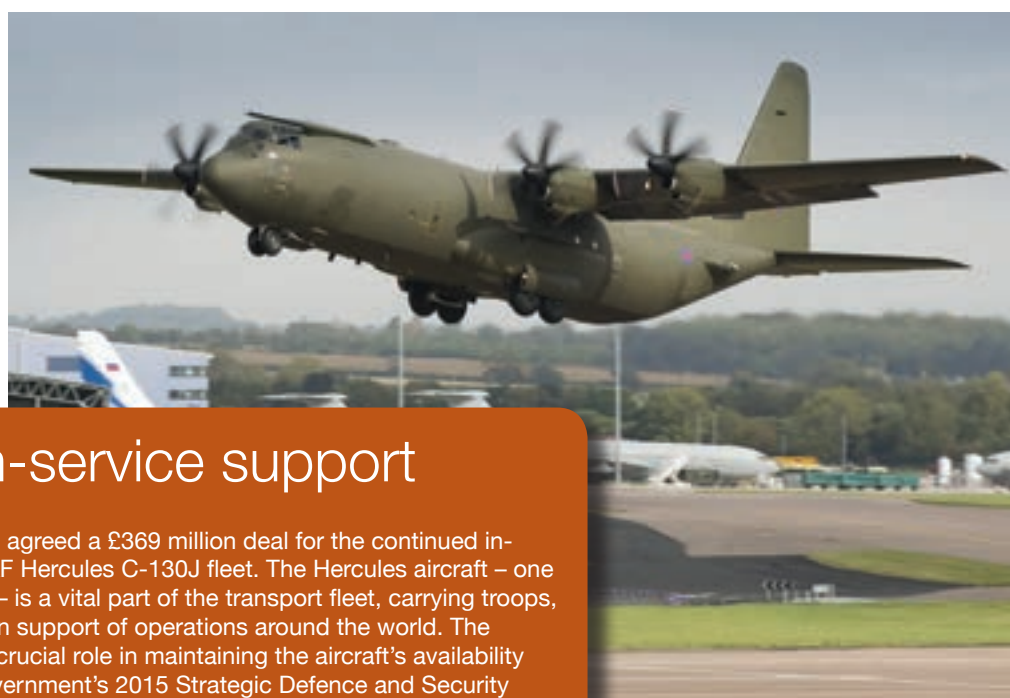
	1 April 2016	1 April 2015
Total DE&S SCS	92	72
Female	20	15
Male	72	57
% Female	22%	21%
% Male	78%	79%

Civil Service and other compensation schemes exit packages

The figures in the following table include redundancy and other departure costs paid in accordance with the Civil Service Compensation Scheme (CSCS). Where DE&S has agreed early retirements, the costs are met by DE&S and not by the Civil Service Pension Scheme. The table includes 15 individuals who retired early on ill health grounds during 2015-16; their compensation payments were £0.468 million.

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

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

Key achievement**Hercules in-service support**

In December 2015, DE&S agreed a £369 million deal for the continued in-service support of the RAF Hercules C-130J fleet. The Hercules aircraft – one of the RAF's workhorses – is a vital part of the transport fleet, carrying troops, supplies and equipment in support of operations around the world. The support contract plays a crucial role in maintaining the aircraft's availability and is in line with the Government's 2015 Strategic Defence and Security Review announcement to extend the life of the aircraft until 2030.

Civil Service and Other Compensation Schemes Exit packages (subject to audit)

Exit package cost band ¹	Number of compulsory redundancies	Number of other departures agreed	Total number of exit packages by cost band
<£10,000		5	5
£10,000 - £25,000		9	9
£25,000 - £50,000		12	12
£50,000 - £100,000	1	16	17
£100,000 - £150,000		4	4
£150,000 - £200,000		2	2
£200,000 - £250,000			
Total number of exit packages	1	48	49
Total resource cost (£000)	62	2,602	2,664

¹ 16 individuals with agreed exit packages in 2014-15 (total value of £741,000) have also been included within the table above.

In addition to the exit packages detailed above, DE&S may occasionally make use of early release schemes to reduce the number of civilian staff who are not members of the CSCS. No such usage was made during 2015-16.

Expenditure on consultancy and temporary staff

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

Contingent labour relates to circumstances where external manpower is brought in to temporarily discharge the duties of specific DE&S posts. The costs of contingent labour are shown as a separate entry in the staff costs at Note 2.

Private sector support is defined as external support to supplement DE&S capacity and capability to manage our programme of work including those elements of external support that are being employed to deliver business improvement and transformation within the organisation. As such, private sector support

encompasses contracts for the employment of consultancy assistance, support provided through the MOD Framework Agreement for Technical Support (FATS) and other external support to supplement DE&S core manpower capability. Private sector support also addresses resource and skills gaps in our project and logistics management capability. A breakdown and prior year comparator is shown at Note 3 to the accounts.

High paid off-payroll appointments

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

Government policy is that individual departments must themselves exercise governance over such appointments where the appointees are not engaged directly on departmental payrolls. DE&S senior off-payroll appointees have been requested to provide assurance that they paid the right amount of tax and National Insurance contributions in 2015-16.

There were no off payroll engagements of Board members or senior executives with significant financial responsibility between 1 April 2015 and 31 March 2016.

The following table provides an analysis of all extant off-payroll engagements as of 31 March 2016, for more than £220 per day and that last for longer than six months:

	Defence Equipment & Support Bespoke Trading Entity
Number of existing arrangements as of 31 March 2016 ¹	220
<i>of which</i>	
No. that have existed for less than one year at time of reporting.	144
No. that have existed for between one and two years at time of reporting.	46
No. that have existed for between two and three years at time of reporting.	23
No. that have existed for between three and four years at time of reporting.	3
No. that have existed for four or more years at time of reporting.	4

¹ We have reviewed the scope of governance in consultation with HM Treasury in the light of the tightening of government policy on off-payroll appointments. From 2015-16 we consider within scope of off-payroll governance, all those high-paid appointees who we deem in substance to be employees for tax purposes.

The following table provides an analysis of all new off-payroll engagements, or those that reached six months in duration, between 1 April 2015 and 31 March 2016, for more than £220 per day and that last for longer than six months.

	Defence Equipment & Support Bespoke Trading Entity ¹
No. of new engagements, or those that reached six months in duration, between 1 April 2015 and 31 March 2016 ²	299
No. of the above which include contractual clauses giving the department the right to request assurance in relation to income tax and National Insurance obligations ³	299 ⁴
No. for whom assurance has been requested	235 ⁵
Of which...	
No. for whom assurance has been received	215
No. for whom assurance has not been received	20 ⁶
No. that have been terminated as a result of assurance not being received.	0

¹ The difference in publication timescales between MOD and DE&S accounts leads to some differences in numbers reported, DE&S reflecting the most up to date position in respect to taxation assurance.

² We have reviewed the scope of governance in consultation with HM Treasury in the light of the tightening of government policy on off-payroll appointments. From 2015-16, we consider within scope of off-payroll governance all those high-paid appointees who we deem in substance to be employees for tax purposes.

³ Assurance has been sought from all contactable off-payroll appointees and for those from whom assurance has not been received and those that have not been contactable, all have been reported to HMRC.

⁴ This figure reflects that numbers of off-payroll appointments have been made under legacy contracts that are no longer extant and that new categories of staff have been brought into scope in 2015-16 for the first time. We are ensuring that the appropriate contract provision allowing DE&S to seek assurance is made in new contracts for off-payroll appointees, but it is our policy is to seek assurance from off-payroll appointees whether or not there is specific enabling contract provision to do so.

⁵ DE&S sought assurance from all its high-paid off-payroll appointees that they paid the right amount of income tax and National Insurance Contributions on work undertaken for DE&S during the 2015-16 financial year, except where they were also in scope of governance in 2014-15 and either (a) provided satisfactory assurance and left post early in the 2015-16 financial year (by 31 July 2015) or (b) were referred to HM Revenue & Customs for failing to provide satisfactory assurance and have left DE&S. In the interests of good governance, we have also sought assurance from appointees engaged under legacy contracts which have not been amended to include specific provision to seek evidence of compliance with the tax legislation, all new appointees are being asked to sign a declaration on taking up a DE&S engagement that they are compliant with the tax legislation and that they agree to provide the appropriate evidence of compliance when asked.

⁶ The detailed assurance process starts after the end of the financial year to which it relates and assurance for 2015-16 is therefore still under way. Where satisfactory assurance is not forthcoming, DE&S will terminate contracts and refer the appointees involved to HM Revenue & Customs.

PARLIAMENTARY ACCOUNTABILITY AND AUDIT REPORT



Parliamentary Accountability Report

In 2015-16 we responded to 357 Parliamentary Questions and 270 pieces of Ministerial and Treat Official correspondence from Members of Parliament, Peers and the public, meeting our departmental targets for on-time delivery. We also provided briefing in support of a range of Parliamentary business, including defence oral questions, the Defence Reform Bill, Parliamentary debates, Public Accounts Committee and House of Commons Defence Committee inquiries. Key subject areas included shipbuilding, MOD ranges, nuclear convoys, steel procurement and legal claims arising from operations in Iraq.

We continue to fulfil our statutory responsibilities under the Freedom of Information Act 2000 in responding to requests for information from members of the public. During 2015-16 we answered 720 requests for information, again meeting our departmental target for on-time delivery. Interest in DE&S activities has remained high, with requests covering all aspects of our business and particular interest in submarines and nuclear issues, contracts and disposals.

In line with Cabinet Office guidelines on Transparency, DE&S proactively publishes a range of information online, including a biannual organogram detailing staff numbers and costs, information on expenditure over £25,000, and contracts with a value of more than £10,000. DE&S data is not published separately, but is included on gov.uk as part of overall MOD information.

Remote contingent liabilities

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

Regularity of expenditure (audited)

All expenditure and income incurred by DE&S during 2015-16 was in accordance with the requirements of Treasury and other Government guidance.

Losses and special payments (audited)

Losses and special payments are emergent items that Parliament would not have envisaged when funds were allocated. In principle they are items that should not have arisen and result from some unexpected or failure of process. As a result they are subject to more rigorous approval requirements than would be the case for normal transactions.

Losses during 2015-16 total £647,000 of which £536,000 reflects the resolution of a longstanding VAT issue with HM Revenue and Customs (HMRC). Interest and penalty charges were payable to HMRC due to the length of time required to resolve the complex issue. The figure reported relates to one case. Following resolution of this issue, we have clarified Departmental guidance, improved training and awareness on VAT policy, and we seek to resolve issues with HMRC as quickly as possible to minimise interest payments. The charge incurred was in excess of the £300,000 reportable limit, and therefore requires a separate disclosure in the annual accounts.

The remaining £111,000 relates to other losses including £108,000 of fruitless payments related to late hotel cancellations and unused travel tickets.

Losses statement

	2015-16	2014-15
	£000	£000
Fruitless payments (volume of cases)	518	448
Fruitless payments (value £000)	643	80
Cash losses (volume of cases)	3	2
Cash losses (value £000)	0	1
Stores losses (volume of cases)	1	-
Stores losses (value £000)	1	-
Claims Waived or Abandoned (volume of cases)	2	-
Claims Waived or Abandoned (value £000)	4	-
Total number of losses	524	450
Total value of losses (£000)	647	81

Details of Closed Cases £300,000:	2015-16
Fruitless payment	
Penalty fine from HM Revenue and Customs on Value Added Tax.	536

Special payments

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

	2015-16	2014-15
Total number of special payments	7	5
Total value of special payments (£000)	281	120

Long term expenditure trend by category

	Estimate 2017-18	Estimate 2016-17	Outturn 2015-16	Outturn 2014-15
Total Departmental Expenditure Limit DE&S BTE (£M)	1,039	1,157	1,111	1,143



Tony Douglas
Accounting Officer
27 October 2016

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

I certify that I have audited the financial statements of Defence Equipment & Support for the year ended 31 March 2016 under the Government Resources and Accounts Act 2000. The financial statements comprise: the Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity; 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 and Staff Report and Parliamentary Accountability disclosures that are described in those reports as having been audited.

Respective responsibilities of the Accounting Officer and auditor

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Chief Executive as Accounting Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Government Resources and Accounts Act 2000. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

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

Opinion on regularity

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

Basis for qualified opinion on financial statements

I have qualified my opinion on the financial statements because the audit evidence available to me was limited. The limitation of the scope of my audit has arisen because the Agency was unable to provide me with sufficient and appropriate audit evidence to support the private sector support costs and other programme costs recorded in the Statement of Comprehensive Net Expenditure for the period. This is the second year that I have qualified my opinion in respect of this. In response to my qualification of last year's opinion, the Agency has introduced an improvement programme. This programme recognised that further work will be required next year to support in year private sector support and other programme costs, and as a consequence was designed this year to remove that element of my previous opinion that qualified the related trade and other payables balances. Consequently, in my view the Agency's financial management systems, processes and controls for these in year transactions are still not yet sufficiently well developed, and as a consequence, management did not provide me with all the information, explanations and evidence I needed for my audit.

In 2014-15 I also qualified my opinion in relation to the trade and other payables balances recorded in the Statement of Financial Position that were related to private sector support and other programme costs. The Agency's improvement programme did not focus on these balances so it did not provide me with sufficient and appropriate evidence to support these balances as at 31 March 2015, and as a consequence I have also qualified my opinion on the 2014-15 trade and other payables comparative balances recorded in the Statement of Financial Position that were related to private sector support and other programme costs.

As a result of its improvement programme however, the Agency has been able to provide me with sufficient and appropriate evidence to support the trade and other payables balances as at 31 March 2016, and I have therefore been able to provide an unqualified opinion in relation to these balances recorded in the Statement of Financial Position.

Qualified opinion on financial statements

In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraph:

- the financial statements give a true and fair view of the state of the Defence Equipment & Support's affairs as at 31 March 2016 and of the total net expenditure for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions issued thereunder.

My report, which follows, provides further detail of my qualified audit opinion on the financial statements.

Opinion on other matters

In my opinion:

- the parts of the Remuneration and Staff Report and the Parliamentary Accountability disclosures to be audited have been properly prepared in accordance with HM Treasury directions made under the Government Resources and Accounts Act 2000; and
- the information given in the Performance Report and Accountability Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I report by exception

In respect solely of the limitation of scope on my work relating to private sector support costs and other programme costs and the related comparative trade and other payables balances, as described in the basis of qualified opinion paragraph above:

- I have not received all of the information and explanations I require for my audit; and
- adequate accounting records have not been kept.

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

- the financial statements and the parts of the Remuneration and Staff Report and the Parliamentary Accountability disclosures to be audited are not in agreement with the accounting records and returns; or
- the Governance Statement does not reflect compliance with HM Treasury's guidance.

Sir Amyas C E Morse
Comptroller and Auditor General

Date 3 November 2016

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

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

Introduction

Defence Equipment & Support (DE&S) is a key part of the Ministry of Defence (MOD) Operating Model, responsible for managing the acquisition and through-life support of the MOD Equipment Programme. It was established in April 2014, classified as an Executive Agency of the MOD, and operates as a Bespoke Trading Entity (BTE), a status designed to strengthen the customer-supplier relationship with the military, provide it with freedoms over recruitment and reward, and to support the identification of efficiencies in costs.

These financial statements report the costs incurred by DE&S in delivering its programme of project and logistics management in line with its operating cost as defined by the Framework Document and the Letter of Delegation issued by the MOD Permanent Secretary to the DE&S Chief Executive.

Purpose of Report

The financial statements on the following pages represent the results of DE&S for the period from 1 April 2015 to 31 March 2016, its second year of operation.

I qualified my opinion on the financial statements during the Agency's first year of operation due to a limitation on the scope of my audit. This arose because DE&S were unable to provide me with sufficient and appropriate audit evidence to enable me to confirm whether or not the private sector support costs, other programme costs, and the related trade and other payables balances recorded in the financial statements were free from material misstatement.

I have again qualified my opinion on the financial statements for the Agency's second year of operation due to a limitation on the scope of my audit. This arose because DE&S again did not provide me with sufficient and appropriate audit evidence to enable me to confirm whether or not the private sector costs and other programme costs recorded in the Statement of Comprehensive Net Expenditure are free from material misstatement. DE&S were however, able to provide me with sufficient and appropriate evidence to enable me to conclude that the related trade and other payables balances recorded in the financial statement for the year ending 31 March 2016 are free from material misstatement, although the opening trade and other payables balances remain unsupported.

This report explains the reasons for the qualification.

Limitation of scope in respect of private sector support costs and other programme costs

The Statement of Comprehensive Net Expenditure to the financial statements reports £434 million of private sector support costs and £65 million of other programme costs. The private sector support costs represent external support procured by DE&S to supplement the management of its work programme and encompasses contracts for the employment of manpower support, consultancy assistance and technical support in the areas of project management and logistics capability. The other programme costs include travel and subsistence, training, safety and other office running costs. As a result of the DE&S financial systems and processes still not being sufficiently developed to fully support this expenditure, I have limited the scope of my audit opinion in respect of these transactions.

Explanation for limitation of scope

DE&S maintains financial systems which record both DE&S and MOD related costs. As a result, in preparing its financial statements DE&S has to perform a manual analysis of its accounting records to identify and include only those costs that relate to DE&S. This particularly impacts the calculation of private sector support and other programme costs.

This situation was complicated by the fact that in its first year of operation, the relatively short period of time between its establishment and the requirement to prepare its initial financial statements, DE&S had limited time to establish its new processes and systems and to train its staff. Notably, there were insufficiently detailed instructions on what costs related to DE&S activities, and insufficient central review of the submissions made by Operating Centres and Project Teams.

DE&S have been investing time and resource in strengthening the systems, processes and controls that support the derivation of its private sector support and other programme costs. However, as the 2014-15 accounts were only certified in December 2015, the improvements in the control environment were not substantively implemented until the final quarter of 2015-16. As a result, the weaknesses that affected last year's figures continued into this year.

This is illustrated by the significant number of manual journals that are still relied on to create the accounts as individual lines of expenditure are analysed between DE&S and MOD activities. While an improvement on last year where journals were in excess of 100,000, the level of journals for the year ending 31 March 2016 is still significant, remaining at over 80,000 journal lines.

Given the scale of the exercise, the cleansing of data by DE&S focussed on the final quarter of the financial year, and was deliberately designed to support the trade and other payables data as derived from private sector support and other programme expenditure. The Agency has expended considerable time and effort in supporting these balances and has been able to provide me with sufficient evidence to enable me to provide an unqualified opinion on the trade and other payables balances within the Statement of Financial Position.

However, the Agency chose not to undertake a similar cleansing exercise on the expenditure data for the year, nor did it revisit the opening payables information which was subject to a qualified opinion in 2014-15, choosing rather to release the balances to the in year Statement of Comprehensive Net Expenditure. Consequently, the Agency was unable to provide me with adequate evidence to enable me to confirm whether or not the private sector support costs and other programme costs shown in the financial statements are free from material misstatement. I have therefore qualified my audit opinion on the financial statements due to a limitation on the scope of my audit in respect of the £434 million of private sector support costs and £65million of other programme costs. My testing did not identify any irregularity with this expenditure.

Actions being taken by DE&S

DE&S continues to face a significant challenge to identify and record those private sector support costs and other programme costs relevant to its defined operating cost envelope to a level of accuracy to support an unmodified audit opinion.

During the last quarter of 2015-16 and into 2016-17, DE&S has instigated a number of initiatives in order to improve processes, with the aim of working towards a solid baseline from which the Agency can support the removal of the remaining qualifications in 2016-17. Initiatives have included: the publication of a DE&S accounting manual; increased use of exception reporting and reconciliations in order to monitor the volume of journal adjustments and coding of primary data; further updates to the instructions to Operating Centres and Project Teams; and the operation of a PSS Steering Group which discusses contracts where the boundary allocation may be unclear. DE&S feels that these steps will help support the accuracy of information going forward and build a case for the removal of the remaining qualification in relation to Private Sector Support and Other Programme Costs during 2016-17.

Sir Amyas C E Morse
Comptroller and Auditor General

Date 3 November 2016

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



A Merlin helicopter: DE&S is currently delivering the Merlin Life Sustainment Programme, which will enhance the capability of the Commando Helicopter Force

Section Three

The Financial Statements

STATEMENT OF COMPREHENSIVE NET EXPENDITURE
FOR THE YEAR ENDED 31 MARCH 2016

	Note	2015-16 £000	2014-15 £000
Expenditure - Direct Programme Costs			
Direct staff costs	2	626,237	644,362
Private sector support costs	3	434,229	439,638
Other programme costs	4	65,258	73,769
Total Direct Programme Costs		1,125,724	1,157,769
Income - Direct Programme	5	(14,823)	(14,557)
Net Direct Programme Expenditure		1,110,901	1,143,212
Expenditure - Non-Cash Items			
Communicated costs from other MOD organisations	6	111,568	125,508
Auditors' remuneration	7	219	334
		111,787	125,842
Total Net Expenditure		1,222,688	1,269,054

The notes on pages 74 to 85 form part of these accounts.

STATEMENT OF FINANCIAL POSITION
AS AT 31 MARCH 2016

	Note	2015-16 £000	2014-15 £000
Non-current assets			
Intangible Fixed Assets	8	5,941	
Total Non-current assets		5,941	-
Current assets			
Trade and other receivables	9	5,813	3,336
Inventories		-	
Cash and cash equivalents		-	
Total Current Assets		5,813	3,336
Total assets		11,754	3,336
Current liabilities			
Trade and other payables	10	(146,017)	(158,912)
Non-current assets less current liabilities		(134,263)	(155,576)
Reserves			
General fund		(134,263)	(155,576)

The notes on pages 74 to 85 form part of these accounts.

The financial statements were signed on 27 October 2016.



Tony Douglas
Accounting Officer
27 October 2016

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 MARCH 2016

	Note	2015-16 £000	2014-15 £000
Cash flows from operating activities			
Net operating cost		(1,222,688)	(1,269,054)
Adjustments for non-cash transactions	6,7	111,787	125,842
Amortisation	8	239	
(Increase) in trade and other receivables		(2,477)	(3,336)
Increase/(Decrease) in trade and other payables		(12,895)	158,912
Less movements in payables not passing through the Statement of Comprehensive Net Expenditure		(5,373)	
Net cash outflow from operating activities		(1,131,407)	(987,636)
Cash flows from investing activities			
Purchase of intangibles		(807)	
Net cash outflow from investing activities		(807)	-
Cash flows from financing activities			
Net Parliamentary Funding - Drawn Down		1,132,214	987,636
Net increase/(decrease) in cash and cash equivalents in the period		-	-

The notes on pages 74 to 85 form part of these accounts.

STATEMENT OF CHANGES IN TAXPAYERS' EQUITY
FOR THE YEAR ENDED 31 MARCH 2016

	Note	General Fund 15-16 £000	General Fund 14-15 £000
Balance at 1 April		(155,576)	-
Changes in taxpayers equity for 2015-16			
Total Net Comprehensive expenditure for the year		(1,222,688)	(1,269,054)
Non-Cash Adjustments	6,7	111,787	125,842
Net Parliamentary Funding - drawn down		1,132,214	987,636
Balance at 31 March 2016		(134,263)	(155,576)

The notes on pages 74 to 85 form part of these accounts.

NOTES TO THE ACCOUNTS

1. STATEMENT OF ACCOUNTING POLICIES

The financial statements contained within the Annual Report and Accounts relate to the financial year 1 April 2015 to 31 March 2016 (2015-16) with comparative analysis for the prior year 2014-15. They have been prepared in accordance with the Accounts Direction given by HM Treasury under Section 7 of the Government Resources and Accounts Act 2000 and in accordance with HM Treasury guidance as set out in the Financial Reporting Manual (FReM). The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of DE&S for the purpose of giving a true and fair view has been selected.

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

DE&S is classified as an Executive Agency which operates as a Bespoke Trading Entity in line with Chapter 7 of 'Managing Public Money'. The 2015-16 financial statements reflect the second accounting period for DE&S as a BTE and therefore include prior year comparative information.

1.1 Accounting convention

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

1.2 Basis of preparation of annual accounts - accounting boundary

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

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

The operating cost envelope specifically encompasses staff (including travel and training), other operating and private sector support (PSS) expenditure and any associated revenue. The financial statements also include costs incurred by other MOD organisations in support of DE&S operations as non-cash communicated costs (see item 1.8 below and Note 6 to the financial statements).

PSS is defined as external support to supplement DE&S capacity and capability to manage our programme of work including those elements of external support that are being employed to deliver business improvement and transformation within the organisation. It encompasses contracts for the employment of manpower support, consultancy assistance and technical support activities. As such, PSS addresses resource and skills gaps in our project and logistics management capability.

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

1.3 Critical accounting judgements and key sources of estimation uncertainty

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

- **Accounting boundary:** DE&S has established policy and governance supporting decisions on the types of revenue and expenditure that would fall within the operating envelope (particularly in respect to PSS) from those that are MOD equipment programme related. This has supported the judgements made in the preparation of the accounts by DE&S finance staff. Decision making is supported by a steering group, chaired by a senior finance manager, which provides structured consideration of accounting boundary decisions.
- A specific judgement has been made to exclude from our DE&S operating costs those **PSS** activities undertaken within overarching equipment procurement /support arrangements with our main industrial and international collaborative partners. This decision recognises that PSS activities within these arrangements are integral and indivisible from equipment programme activities.
- **Communicated costs:** The relationship between DE&S and other MOD organisations that incur costs in support of our operations is not currently supported by charging disciplines. As such, the communicated costs recognised reflect the best estimates available many of which are based on apportionment of costs based on staff number ratios. Note 6 provides further detail on communicated costs.
- **Accruals – payables and receivables:** In instances where revenue/expenditure has been earned/incurred but not invoiced, an estimate is made of the amount to be accrued as a payable or receivable item. As a guideline, a materiality threshold of £15,000 has been applied in the recognition of payables and receivables.

1.4 Changes during 2015-16 which have affected preparation of these annual accounts

The main change in accounting policy was the Simplifying and Streamlining Central Government Annual Report and Accounts which introduced three parts to the Annual Report and Accounts – the Performance Report, the Accountability Report and the Financial Statements.

The placement of the Logistics, Commodities and Services contract with industry (Team Leidos) on 1 August 2015 resulted in the transfer of 1,544 manpower posts from DE&S to Team Leidos, of which 1,128 were filled at the time of transfer. The Statement of Comprehensive Net Expenditure includes manpower costs for these individuals up to the time of transfer, after which Team Leidos contract costs have been treated as equipment programme, being reported in the Department, not DE&S BTE accounts. The rationale being that the Department has established that these functions are more effectively and efficiently delivered by industry rather than core DE&S manpower. Note 11 has been included to provide an estimate of the impact of the transfer on the DE&S SOCNE in 2015-16 and the comparative year 2014-15. DE&S continues to deliver some logistics services such as the British Forces Post Office and the Disposal Services Authority, the operating costs for which remain in the DE&S accounts.

1.5 Going concern

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

The MOD has demonstrated its commitment to continue funding DE&S while process/system developments are undertaken and rolled-out to support the future charging for DE&S operating activities. In this respect DE&S completed the roll out of the Time Recording and Charging (TRaC) system as a fundamental part of developing the mechanism for future charging of customers, implementation of which is planned to commence during 2017.

1.6 Revenue and expenditure recognition

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

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

The main sources of DE&S revenue are from contractual arrangements with industrial and international partners for services provided by our Defence Munitions teams.

1.7 Programme costs

DE&S expenditure and revenue is reported as Programme costs in line with MOD annual accounts reporting requirements. Where DE&S staff are temporarily reassigned to work in other areas of the MOD, for example in support of operations, their salary costs are not charged to those other areas given the low materiality involved. Similarly, where other areas of the MOD temporarily reassign their staff to support DE&S management activities, salary costs are not charged to DE&S on the basis that the values involved are immaterial to the DE&S operating envelope.

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

1.8 Communicated costs

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

1.9 Value Added Tax (VAT)

Most of the operating activities of DE&S are deemed to be outside the scope of VAT as they relate to direct manpower costs. Irrecoverable VAT is charged where appropriate to other expenditure categories.

Expenditure associated with recoverable VAT is treated as excluding VAT in the DE&S accounts with formal recovery administered by MOD. DE&S is not separately registered for VAT and VAT collected or any associated recoveries are processed centrally by MOD.

1.10 Non-current assets

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

1.11 Tangible non-current assets

Various areas of MOD provide DE&S with support services under central support contracts. These infrastructure support services include DE&S usage of MOD non-current assets, such as property and office furniture. The underlying risks and rewards of ownership of these assets are deemed to reside with MOD and therefore not reported in the DE&S Statement of Financial Position. The costs incurred by other MOD organisations in the routine maintenance of these assets are reported as communicated costs in the SOCNE. Where DE&S has incurred any direct costs for additional refurbishment/provision of such assets, DE&S expenses these costs in year. In accordance with this policy DE&S does not report any tangible Property, Plant and Equipment assets on the basis of these being immaterial.

1.12 Intangible non-current assets

DE&S does recognise as intangible non-current assets those investments in development and delivery of new information system software and licences that have been specifically made in order to deliver improved DE&S organisational performance. In this respect, a notional capitalisation threshold of £15,000 has been used.

DE&S has recognised such assets for the first time in 2015-16, reflecting the identification of new information system capability arising from business transformation. Externally purchased software and associated licences are capitalised as intangible assets in accordance with IAS38 where they directly and uniquely contribute to the delivery of DE&S business services and transformation.

After initial recognition, intangible non-current assets are periodically re-valued to current value in existing use, using a market value where an active market exists. Where no market exists, indices are used to revalue the intangible asset to Depreciated Replacement Cost (DRC)

Intangible non-current assets under construction are not subject to indexation where the contract payments capitalised during the period of construction are deemed to reflect fair value.

Intangible non-current assets are amortised, on a straight line basis, over the planned DE&S operational life of the software application.

Amortisation commences when the software application first enters operational service within DE&S and is calculated on a straight line basis, over the shorter of either the economic life or the licence period.

1.13 Impairment

No impairment events have arisen in 2015-16 that would impact on the valuation of the assets described above. Reviews are undertaken periodically to consider the potential for impairment events to have arisen in respect to the recognised Non-Current Assets.

1.14 Cash and cash equivalents

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

1.15 Inventories

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

1.16 Financial Instruments – receivables and liabilities

IAS 32 defines a financial instrument as “any contract that gives rise to a financial asset of one entity and financial liability or equity instrument of another entity”.

Trade and other receivables have been classified as current assets and measured at the invoiced amount as the impact of discounting, in the context of DE&S, is not deemed to be material. Given the short term nature of DE&S liabilities, this is considered equivalent to fair value. Goods or services received but not yet invoiced are accrued at estimated fair value.

Trade and other receivables are tested annually for impairment with any identified losses charged to the Statement of Comprehensive Net Expenditure.

The carrying value of trade and other receivables in the Statement of Financial Position is shown net of any impairment provisions. Provisions are only made for specific bad debts.

DE&S receivables and liabilities are de-recognised when the receivable or liability has been discharged, that is the payment required for settlement has been made or has been determined to no longer exist.

1.17 Employee benefits

A charge is made in these accounts for the value of employees’ annual leave entitlements earned, but not yet taken at 31 March each year. This has been valued by reference to DE&S average staff costs, by grade, based on a 365 day year, in line with MOD policy on recognition of untaken leave. The 2015-16 value of employee performance bonuses reflected within the Statement of Comprehensive Net Expenditure reflects those earned for performance in 2015-16.

DE&S has recognised costs of voluntary and compulsory redundancies and exits for the first time in FY2015-16 for departures arising from decisions taken since BTE vesting day. It was judged that departures in FY2014-15 resulted from decisions taken pre-vesting day and were therefore not relevant to the BTE accounts.

1.18 IFRS8 Segmental Reporting

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

1.19 Reserves

The General Fund reserve represents the balance of taxpayers’ equity. Specifically the General Fund reflects the net assets less liabilities entered into during financial year 2015-16.

1.20 IFRSs in issue but not yet effective

In order to comply with the requirements of IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors (IAS 8), we are required to disclose if we have not applied a new IFRS that has been issued but is not yet effective. We have carried out a review of the IFRSs in issue but not yet effective, to assess their impact on its accounting policies and treatment, and found that none of the updates has any material impact on the financial statements.

2. STAFF NUMBERS AND RELATED COSTS

2.1 Staff costs comprise:

	2015-16			2014-15		
	Permanently employed staff	Contingent Labour	2015-16 Total	Permanently employed staff	Contingent Labour	2014-15 Total
	£000	£000	£000	£000	£000	£000
Salaries and wages	454,562	27,119	481,681	461,109	48,114	509,223
Social security costs	35,457	0	35,457	37,316	0	37,316
Other pension costs	109,099	0	109,099	97,823	0	97,823
Total	599,118	27,119	626,237	596,248	48,114	644,362

2.2 Average number of persons employed:

The average number of whole-time equivalent persons employed during the year was as follows.

	2015-16			2014-15		
	Permanent staff	Contingent Labour	Total	Permanent staff	Contingent Labour	Total
Employed by DE&S	11,406	292	11,698	12,347	498	12,845

* Contingent Labour relates to individuals employed on a short term contractual basis to fill specific DE&S posts. The reduction in the value of reported DE&S contingent labour mainly reflects the transition of the Inventory Management Transformation programme from development/implementation (dependent on external support) to business as usual (managed by in-house manpower) and placement of Team Leidos contract which transferred staff costs to contract based equipment programme expenditure (being reported in the Department, not DE&S BTE accounts).

3. PRIVATE SECTOR SUPPORT (PSS)

	2015-16 £000	2014-15 £000
Manpower support	184,488	122,446
PSS for programmes in demonstration and manufacture phase	86,736	127,436
Consultancy support (project management, organisation design, finance, legal)	86,936	102,940
PSS for programmes in in-service support and disposal phases	50,358	47,134
PSS for programmes in concept and assessment phase	25,711	39,682
	434,229	439,638

4. OTHER PROGRAMME COSTS

	2015-16 £000	2014-15 £000
Staff travel and subsistence costs	24,055	30,161
IT and telecommunications	12,767	16,261
Other infrastructure expenditure	7,989	7,631
Staff training costs	8,050	7,306
Rentals	6,590	7,080
Regulatory safety costs	2,063	2,836
Other costs	3,744	2,494
	65,258	73,769

* Operating expenditure controls have contributed to a general decrease in these costs in the second year of operation as a BTE. The placement of the Team Leidos contract which transferred manpower driven activities to contract based equipment programme expenditure (being reported in the Departmental, not DE&S BTE accounts) also contributed to this reduction.

5. PROGRAMME INCOME

	2015-16 £000	2014-15 £000
Defence Munitions commercial revenue	12,502	12,221
Logistics Commodities Services revenue (including British Forces Postal Office)	1,471	1,889
DE&S BTE corporate receipts (including revenue from technical publications)	329	337
Other programme income	521	110
	14,823	14,557

6. COMMUNICATED COSTS

The following costs have been incurred by other MOD organisations in support of DE&S BTE activities. These costs have been included as a non-cash item in the DE&S BTE Statement of Comprehensive Net Expenditure to ensure a complete representation of BTE operating expenditure is reported. Other areas of MOD were requested to provide the communicated costs incurred on behalf of DE&S operations. There was no charging mechanism or commercial type relationships established for these activities and therefore the most appropriate apportionment methodologies were identified.

MOD organisation	Description of activities	Method of apportionment	2015-16 £000	2014-15 £000
Joint Forces Command	Information System and Communication Services	Number of DE&S users relative to total MOD users.	50,927	64,292
Defence Infrastructure Organisation	Infrastructure and Facilities Management costs	Cost per employee at DE&S headquarters extrapolated to total DE&S headcount.	20,230	24,394
Joint Forces Command	Training Services through the Defence Academy and Surgeon General Services	Number of DE&S training days relative to total MOD training days.	14,829	14,663
Defence Infrastructure Organisation	MOD Guard Service	Costs of main DE&S geographical locations extrapolated across total DE&S headcount.	13,463	13,237
Defence Business Services	Personnel and Payroll Services	Number of DE&S employees relative to total MOD employees.	10,928	6,781
Head Office and Corporate Services	Various	Based on actuals.	1,191	2,141
Total			111,568	125,508

The variations in cost reported by Joint Forces Command and Defence Business Services reflect movements in actual costs.

7. AUDITORS' REMUNERATION

DE&S is audited by the Comptroller and Auditor General. No cash charge is made for this service but a notional charge reflecting the cost of audit is included in the Statement of Comprehensive Net Expenditure. The notional charge of £219,000 covers the costs in respect of the audit of the DE&S 2015-16 Annual Report and Accounts.

8. INTANGIBLE ASSETS

	Software £000	Assets Under Construction (AUC) £100	Total £000
Cost or valuation			
At 1 April 2015	-	-	-
Additions	807	5,373	6,180
Disposals	-	-	-
Impairments	-	-	-
Revaluations	-	-	-
Reclassifications	-	-	-
At 31 March 2016	807	5,373	6,180
Amortisation			
At 1 April 2015	-	-	-
Charged In Year	(239)	-	(239)
Disposals	-	-	-
Impairments	-	-	-
Revaluations	-	-	-
Reclassifications	-	-	-
At 31 March 2016	(239)	-	(239)
Net Book Value			
At 31 March 2015	-	-	-
At 31 March 2016	568	5,373	5,941

Software reflects the value of the DE&S Time Recording and Charging (TRaC) system (based on the Oracle Time and Labour IS tool) which has been developed and deployed by DE&S to capture manpower activity based costing information.

AUC reflects investment made by DE&S in the P3M (Project, Programme and Portfolio Management) suite of Oracle tools (including Primavera) for rollout in support of DE&S transformation. The asset is being treated as AUC pending full rollout and implementation.

Additions reflect both prior (£727K - not previously reported) and in-year (£80K) capital expenditure on the DE&S Time Recording and Charging (TRaC) system and investment in P3M suite of applications.

9. TRADE RECEIVABLES, FINANCIAL AND OTHER ASSETS

	2015-16 £000	2014-15 £000
Amounts falling due within one year:		
Accrued Income	3,479	2,744
Other receivables	2,191	5
Trade receivables	-	372
Prepayments	142	166
Staff loans and advances	1	49
Total current receivables	5,813	3,336
Amounts falling due after more than one year:	-	-

The above balances are held with bodies outside of the whole of government accounting boundary.

10. TRADE PAYABLES AND OTHER CURRENT LIABILITIES

	2015-16 £000	2014-15 £000
Amounts falling due within one year		
Private sector support accruals	(80,336)	(104,785)
Direct Staff Accrual	(41,384)	(36,698)
Trade payables	(9,077)	(9,426)
Sundry payables	(15,220)	(8,003)
Total current liabilities	(146,017)	(158,912)
Amounts falling due after more than one year:	-	-

Direct Staff Accrual includes £20M for liabilities to the Principal Civil Service Pension Scheme, the Armed Forces Pension Scheme and HMRC.

11. ESTIMATE OF STATEMENT OF COMPREHENSIVE NET EXPENDITURE VALUE OF LCS FUNCTIONS TRANSFERRED TO INDUSTRY PRIOR TO CONTRACT PLACEMENT WITH TEAM LEIDOS ON 1 AUGUST 2015

The outsourcing of some Logistics Commodities and Services (LCS) functions to industry during 2015-16 involved the transfer of 1,128 individuals from DE&S to Team Leidos. The associated revenue and expenditure for these functions is reflected in the BTE Statement of Comprehensive Net Expenditure up to contract placement on 1 August 2015, and thereafter treated as equipment programme in the MOD and not DE&S accounts. The following estimate is provided on the impact of this transfer on the BTE Statement of Comprehensive Net Expenditure.

	2015-16 £000	2014-15 £000
Expenditure - Direct Programme Costs		
Direct staff costs	14,575	51,686
Private sector support costs	11	868
Other programme costs	965	3,366
Total Direct Programme Costs	15,551	55,920
Income - Direct Programme	(268)	(996)
Net Direct Programme Expenditure	15,283	54,924
Expenditure - Non-Cash Items		
Communicated costs from other MOD organisations	3,058	9,567
Total Net Expenditure	18,341	64,491

It should be noted that some Logistics Services functions continue to be delivered by DE&S core manpower (for example the British Forces Post Office, Disposal Services Authority and the West Moors facility) and that Defence Munitions Establishments were not in scope for transfer.

12. PROVISIONS, CONTINGENT LIABILITIES AND ASSETS

DE&S applies IAS37 in the consideration of provisions, contingent liabilities and contingent assets. In this respect, we do not consider that we have any provisions, contingent liabilities or contingent assets associated with our operating activities.

13. RELATED PARTY TRANSACTIONS

DE&S is a Bespoke Trading Entity under the control and management of the MOD and, for the purpose of these accounts, MOD is regarded as a related party. Funding is received from the MOD in the form of Net Parliamentary Funding with payments and receipts relating to DE&S operations also processed by MOD on our behalf.

The Department has also undertaken a number of transactions on behalf of DE&S most notably in respect to pension benefits with the Armed Forces Pension Scheme and the Principal Civil Service Pension Scheme, and taxation with HM Revenue and Customs. DE&S has also conducted a number of transactions with Dstl for which the Department is regarded as its parent organisation.

No board member or senior manager has undertaken any material business transactions with DE&S in the period to 31 March 2016.

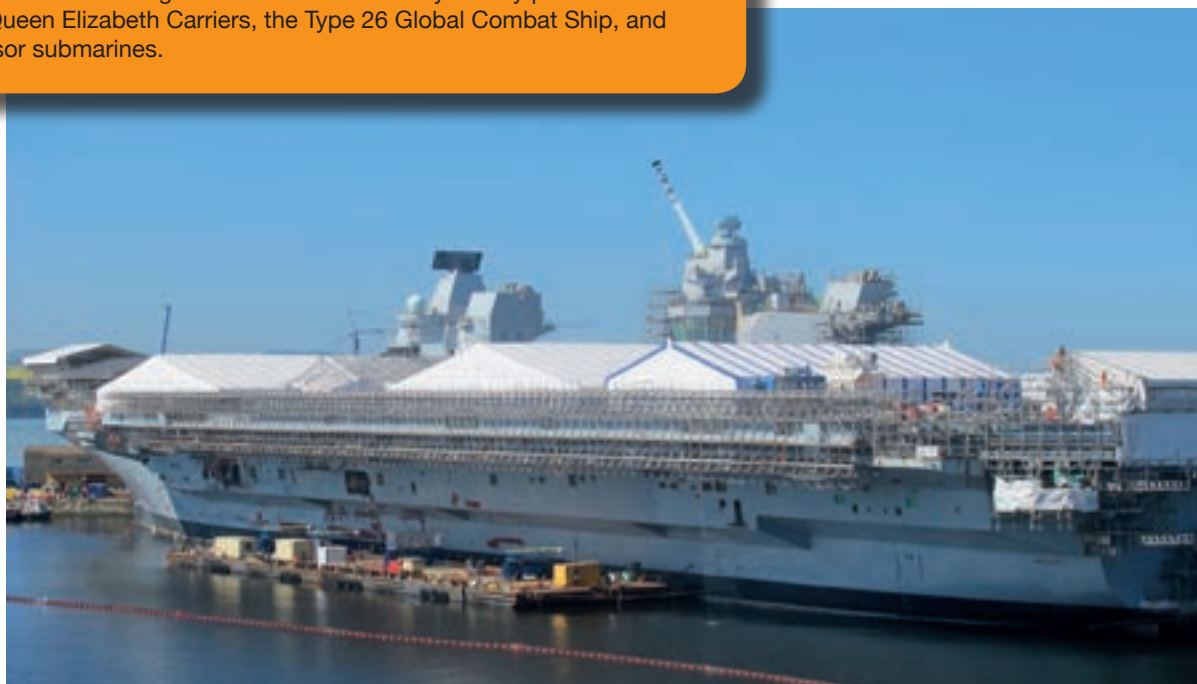
14. EVENTS AFTER THE REPORTING PERIOD

The accounts have been authorised for issue by the Accounting Officer on the same date as the C&AG's Audit Certificate. There have been no events since the reporting period that would give rise to any additional or updated disclosures.

New navigation radar system

Key achievement

New state-of-the-art navigation radars will be fitted to more than 60 Royal Navy ships, submarines and shore facilities thanks to work by DE&S. In January 2016, DE&S awarded a £44 million contract to Lockheed Martin Integrated Systems UK for provision of the radars, which will modernise critical ship and submarine navigation systems. Five shore facilities will also benefit from the new technology which provides a highly reliable and safe collision avoidance system. The contract also includes options for the introduction of the navigation radars to future Royal Navy platforms such as the Queen Elizabeth Carriers, the Type 26 Global Combat Ship, and Successor submarines.



Glossary

ARM	Active Risk Manager™
AUC	Assets Under Construction
BTE	Bespoke Trading Entity
C&AG	Comptroller and Auditor General
CASP	Command Acquisition and Support Plan
CEO	Chief Executive Officer
CETV	Cash Equivalent Transfer Value
CoM	Chief of Materiel
DBS	Defence Business Services
DE&S	Defence Equipment and Support
DIA	Defence Internal Audit
DIO	Defence Infrastructure Organisation
DG	Director General
DRC	Depreciated Replacement Cost
FReM	Government Financial Reporting Manual
FTE	Full Time Equivalent
GOCO	Government Owned Contractor Operated
HM	Her Majesty's
HMRC	Her Majesty's Revenue and Customs
HMS	Her Majesty's Ship
HR	Human Resources
IAS	International Accounting Standard
IFRS	International Financial Reporting Standards
ISO	International Standards Organisation
KPI	Key Performance Indicator
Min(DP)	Minister for Defence Procurement
MOD	Ministry of Defence
MPR	Major Projects Report
MSP	Managed Service Provider
NAO	National Audit Office
NED	Non-Executive Director
OCPA	Office of the Commissioner of Public Appointments
OGSM	Objectives, Goals, Strategies and Measures
P3M	Project, Programme and Portfolio Management
PCSPS	Principal Civil Service Pension Scheme
PMPS	Performance Management and Pay System
PSS	Private Sector Support
PUS	Permanent Under Secretary
RAF	Royal Air Force
RFA	Royal Fleet Auxiliary
SCS	Senior civil service
SDSR	Strategic Defence and Security Review
TRaC	Time Recording and Charging

Equipping and supporting UK Armed Forces



Ministry
of Defence

de&s

ISBN 978-1-4741-3753-9



9 781474 137539