

# Defence Equipment & Support Annual Report and Accounts 2014-15



Equipping and Supporting UK Armed Forces



Defence Equipment & Support

# Annual Report and Accounts 2014-15

For the year ended 31 March 2015

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 17 December 2015



© Crown copyright 2015

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](http://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](mailto: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](http://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](mailto:DESSec-ParliamentaryBusiness@mod.uk)

Print ISBN 9781474117395  
Web ISBN 9781474117401  
ID 08041502 12/15

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 - MultiMedia  
ABW-15-229



## Contents

## Page

Chairman's statement	1
Introduction	3
Chief Executive Officer statement	5
Chief Financial Officer's review	6

### SECTION 1: STRATEGIC REPORT

1.1 Our purpose	10
1.2 Our business	11
1.3 Our transformation	13
1.4 Our performance and delivery	15
1.5 Our people	18
1.6 Our communications	22
1.7 Our approach to safety, sustainability and security	24

### SECTION 2: DIRECTORS' REPORT

2.1 Statement of Accounting Officer responsibilities	30
2.2 Governance statement	31
2.3 Annual assessment of governance	46

### SECTION 3: REMUNERATION REPORT

3.1 Remuneration Report	50
-------------------------	----

### SECTION 4: OUR FINANCIAL PERFORMANCE

Certificate and report of the Comptroller and Auditor General	60
Accounting information	64

### SECTION 5: OUR FINANCIAL PERFORMANCE

Notes to the accounts	70
Glossary	80



## 2014-15 Highlights

During 2014-15 we:

Officially named and floated out the first of our new Aircraft Carriers, HMS QUEEN ELIZABETH

Finalised the redeployment of more than 3,400 vehicles and major equipment from Afghanistan

Signed a £859 million contract for the Demonstration Phase of the Type 26 Global Combat Ship programme

Ran the competition and awarded contracts to our Managed Service Providers to help us deliver our transformation

Handled more than 190,000 bags of mail and more than 48,000 couriered items through the British Forces Post Office

Achieved Initial Operating Capability milestones for the Chinook Mk6, Puma Mk2, Merlin Mk2, and the Army and Royal Navy variants of the Wildcat helicopter

Signed a £3.5 billion contract to purchase 589 Ajax vehicles (formerly known as Scout); the biggest single order for a UK armoured vehicle in 30 years

Took delivery of the first two A400M Atlas aircraft and signed an initial two-year A400M in-service support contract

Awarded a £1.5 billion contract to deliver air traffic management services to the Armed Forces at more than 60 MOD airfields and ranges in the UK and overseas





# Chairman's Statement

by Paul Skinner, DE&S Chairman

**This is the first Annual Report and Accounts for DE&S since its establishment as a Bespoke Trading Entity (BTE). It reflects a challenging and successful year - one in which DE&S staff continued their excellent work in the safe and effective delivery of equipment and support to the UK Armed Forces, against a backdrop of significant transformational change within the organisation itself.**

From the official naming of the first of the new aircraft carriers to the successful return of thousands of tons of equipment from Afghanistan, 2014-15 saw DE&S staff at all levels do everything possible to ensure that the Armed Forces have the equipment and support they need, when and where it is required. I am full of admiration for the people in DE&S and what they continue to achieve. Personally, I am committed to ensuring that DE&S successfully transforms into the world-class acquisition and support organisation we want it to become. The progress made on this to date, and the positive performance metrics for 2014-15 given in this report, provide clear evidence that the transformation journey is well underway.

The establishment of DE&S on 1 April 2014 as a BTE was an important milestone. This change in status has given DE&S a number of significant management freedoms and flexibilities which enable the organisation to operate in a more business-like fashion. DE&S is establishing a more disciplined interface between DE&S

and its customers, and has a greater ability to recruit and retain the highly skilled people it needs to deliver its challenging objectives. DE&S is now governed by a Non-Executive Board, which includes a number of highly-experienced business leaders from the private sector with skills relevant to the DE&S key tasks. It is led by a Chief Executive who is also accountable to Parliament for the performance of the organisation.

At the end of 2015, Sir Bernard Gray, who has led DE&S since 2011, was succeeded by Tony Douglas, who has a successful track record of major project delivery both in the UK and internationally. We thank Bernard for all he has done in transforming DE&S into the successful organisation it is today and welcome Tony into the vitally important role of Chief Executive Officer.

During this transitional year, my role as DE&S Chair was to work with my fellow Board members to provide strategic oversight and governance of the organisation. I am very encouraged by the progress that has been made on the transition plan, implementation of the new governance arrangements, and the policies that underpin our freedoms. I am confident that we have approached 2015-16 with a solid foundation and with the potential to perform at an even higher level in our primary task of providing equipment and support to our Armed Forces.

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









# Introduction

by Sir Bernard Gray, Chief of Defence Materiel (4 Jan 2011 – 30 Nov 2015)

**I am pleased to introduce the first Annual Report and Accounts for DE&S, which reflects an unparalleled year in the organisation's history.**

As a BTE, DE&S now has the freedom to make the changes needed to transform into a world-class acquisition and support organisation. While 2014-15 was a year of transition, we made a good deal of real progress. We appointed three Managed Service Providers (MSPs) to help us deliver business change and we agreed Command Acquisition and Support Plans – bespoke formal agreements with each of our military customers – setting out clearly what is required of us.. People and skills remain central to our success and we introduced a rolling recruitment programme for key roles and functions, offering higher starting pay where appropriate. We also introduced a tailored retention allowance in certain disciplines to ensure we keep hold of our specialist staff.

Alongside these organisational changes, our purpose of delivering the equipment and support required by our Armed Forces remains paramount, and I am proud that the Major Projects Report 2015 recorded a fall in the forecast cost of the projects for the second consecutive year and had a small increase in time performance of just eight months. When the 52 months for the re-fuelling of HMS Vanguard is excluded, this was our lowest increase for 15 years. This clearly builds on the success of the Major Projects Report 2014 which was one of the best in recent times.

An account of how we performed against our high-level objectives is contained later in this report, which

also includes case studies reflecting some of our key delivery highlights over 2014-15. We achieved much across a wide spectrum of activity, including ensuring that the Army will have its first fully digitised armoured fighting vehicle with the award of a £3.5 billion contract for the Ajax (formerly Scout) vehicle, awarding contracts worth £3.2 billion to maintain and repair Royal Navy ships and to support management of our Naval Bases, signing a contract for the first production batch of four Lightning II stealth combat aircraft, officially naming the first of the new Queen Elizabeth Class Aircraft Carriers, and delivering some of the most technologically advanced and well-supported helicopter fleets in the world.

None of this success would have been possible without the hard work and dedication of DE&S staff throughout the organisation. I recognise that 2014-15 was a demanding year and that the future will bring its own challenges, but I am positive that DE&S will continue to deliver successfully its objectives with commitment and skill during the next year and beyond, building upon the firm foundations that are now in place.

On 1 December 2015, I handed over my Accounting Officer responsibilities to Mr Tony Douglas, the new DE&S Chief Executive Officer. These accounts are therefore signed by us both, representing my position as Chief of Defence Materiel during 2014-15, and Tony Douglas' responsibilities as the new Accounting Officer for DE&S.

A handwritten signature in blue ink, appearing to read 'B. P. Gray'.





# Chief Executive Officer Statement

By Tony Douglas, Accounting Officer

**On 1 December 2015 I took over from Sir Bernard Gray as DE&S Chief Executive Officer. Reflecting this handover of responsibilities, I am signing these accounts in conjunction with Sir Bernard in my capacity as Accounting Officer.**

I assume responsibility for DE&S at an exciting point and I am pleased to have the opportunity to build upon the excellent work that Sir Bernard has undertaken during his tenure in post. As well as continuing to deliver the equipment and support that our Armed Forces need, and taking forward the investment

in defence capabilities outlined in the Strategic Defence and Security Review 2015, I look forward to continuing to improve our performance through the ongoing transformation of DE&S into a world-class procurement organisation.

As the new Accounting Officer for DE&S, I have reviewed the 2014-15 accounts and the effectiveness of our system of internal control. Having sought assurance from Sir Bernard, I am satisfied that this annual report and accounts reflects the financial status and state of affairs of DE&S during the year.







# Chief Financial Officer's Report

by Michael Bradley, Director General Resources

**Our first year of operating as a Bespoke Trading Entity (BTE) was an exciting, challenging, and most importantly, a successful year with clear evidence of improvement in the performance of the organisation. I would like to pay tribute to staff at all levels of the organisation for their professionalism, enthusiasm, and hard work over the year.**

Throughout the year of transition, our number one priority has remained that of providing support to the Armed Forces across the globe. We have achieved this by bringing new equipment projects into service, supporting equipment already in service and, importantly, driving greater levels of efficiency across all areas of our business. Key highlights from 2014-15 are as follows:

## Major Projects Report (MPR) 2014

The National Audit Office's (NAO) annual MPR, which is produced for Parliament, reports on the Ministry of Defence's (MOD's) performance in delivering the largest equipment procurement projects. For the last two years the performance statistics have consisted exclusively of projects delivered by DE&S. It sets out any changes to forecast costs, timescales and quality (fulfilment of key user requirements).

MPR 2015 was published in October 2015 and its key findings were:

Cost	Time	Quality
<b>-£297 million</b>	<b>8 months</b> (when excluding 52 months for refuelling of HMS Vanguard)	<b>99%</b>
<b>-0.4%</b> decrease in forecast costs of a total combined approved value of <b>£60.3 billion</b>	<b>0.3%</b> increase in forecast time from a total combined approved duration of <b>2,473 months</b>	<b>207</b> of <b>208</b> key user requirements are forecast to be met, equal to the performance in MPR 2014

Comparison with previous MPRs dating back to 2001 shows that:

- This year has seen one of the largest reductions in forecast costs of the projects, in recent years bettered only by the reductions seen in MPR 2014 and MPR 2005.

- Excluding the 52 months due to the decision to defer the Core Production Capability project to accommodate the production of an additional reactor core for HMS Vanguard and, if required, to maintain the capability to supply a further core for HMS Victorious, this is the smallest increase in forecast timescales of any MPR from 2001 onwards
- We are continuing to forecast a high level of meeting our customers' requirements at 99 per cent, which represents as strong a quality delivery forecast as any MPR during this period, equalling the figures reported in MPR 2014 and MPR 2012.

Taken together, the MPR 2014 findings demonstrate that DE&S is continuing to make real and tangible progress in improving the effectiveness of its project management.

## Equipment Support cost reduction

During the year, DE&S project teams were engaged in a number of cost reduction activities with industry partners and customers to drive greater efficiency in the cost of the Equipment Support Plan in order to meet budget reductions agreed with HM Treasury in the 2013 Spending Review. With the help of external support, customers and industry partners, savings of over £2 billion were achieved and removed from budgets for the next decade, with further savings expected in 2015-16 as we close out contract negotiations.

## Inventory Management Transformation (IMT)

In 2014-15, on behalf of the MOD, DE&S was working towards two inventory management targets in support of the successful inventory management strategy we launched in mid 2012.\* These were:

- Reducing the level of **total inventory holdings** from £34.4 billion to £33.1 billion, as part of the overall IMT target of achieving a £9.5 billion cumulative reduction in inventory holdings by 31 March 2016 versus the April 2012 opening balance
- Limiting **purchases of raw materials and consumables (RMC)**(excluding fuel) to no more than £1,118 million

\*The inventory is owned by the MOD, therefore inventory holdings are included in the MOD accounts, not those of DE&S.

Both targets were exceeded during the year:

- **Holdings** were reduced to £31,626 million beating the target reduction by £1,496 million
- **Purchases** were limited to £936 million, £182 million within target.

## Operating costs

DE&S operating costs (excluding communicated costs), outturned at £1,143 million against a budget of £1,274 million, an underspend of £131 million. This was mainly as a result of improved control of private sector support costs and a later than planned start to the MSP contracts. The operating cost budget is set to fall by some 18 per cent 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. Communicated costs have been excluded from this analysis as they are notional and not budgetary related items.

## Managed Service Providers (MSPs)

In November 2014, DE&S contracted with three private sector MSPs to support our transformation programme over the next three years:

- Bechtel
- CH2M HILL
- PwC

Bechtel and CH2M HILL are providing advice on developing DE&S programme and project management skills, systems and processes. PwC is providing advice on DE&S organisational design and HR systems and processes, including how best to use the HR freedoms granted to DE&S when it became a BTE.

The three MSPs are working closely together and with the business to provide unified advice to DE&S, and this integrated approach has been enshrined in a Collaboration Charter agreed by all four parties.

## Accounting

The move to BTE status has created a new set of challenges for the organisation, not least that of creating a completely new set of independent financial statements with a clear and auditable separation between the operating costs of our organisation and the far greater costs of the equipment and equipment support projects that we deliver for our customers. Our finance and commercial teams have demonstrated real diligence in establishing new working practices to enable transparent reporting of costs across the boundary in this first year, but the speed of the transition to our new status did require to us create this separation with a high number of manual entries (journals) and ultimately this led to a couple of scope

qualifications. We will be working to develop different approaches to these challenges in future years.

## Time recording

During the last quarter of 2014-15, we implemented a time recording system based on the Oracle Time & Labour tool for the 7,970 staff in project delivery teams. This was extended to the 1,760 staff in corporate roles in early 2015-16. Time recording will provide vastly improved management information on our activities and processes, and will also facilitate any future moves towards a regime based on directly charging our customers in the Commands and Strategic Programmes for the services we provide.

## Outlook

DE&S has a great opportunity to build on the success of its first year as a BTE. Harnessing the skills of the MSPs and the considerable investment the Department is making in the long term capability of the business represents a great opportunity for us all to provide an even better service to our customers. Financial priorities for 2015-16 will include:

- Helping our customers to improve efficiency in their respective Equipment Plan budgets
- Assisting our customers in longer-term financial planning, through regular reviews of the costs of the forward Equipment Programme
- Continuing to maintain tight controls over inventory purchases and management, such that overall MOD holdings reduce to no more than £30.8 billion by March 2016
- Developing and rolling out plans to develop skills, processes and systems across the finance function in DE&S, leveraging the abilities of the MSPs wherever possible.
- Robust control of our operating costs, ensuring that DE&S outturns within its budget of £1,125 million and is on course to reduce total operating costs within the budgets for 2016-17 (£1,099 million) and 2017-18 (£981 million)
- Working to improve the auditability of the separation of Equipment Plan costs from operating costs

**I personally am excited to be part of this transition and look forward to working with all our staff, customers, suppliers and support partners as we look to take the organisation to a level that sets the standard in defence procurement to which other nations aspire.**





## Section One

---

# Strategic Report

### 1.1 OUR PURPOSE

#### **‘To equip and support the UK’s Armed Forces for operations now and in the future’**

1.1.1 DE&S fulfils its purpose 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 and field kitchens. On behalf of our MOD customers, we will deliver an Equipment Programme that provides best possible support to the Armed Forces and best value for money for the taxpayer.

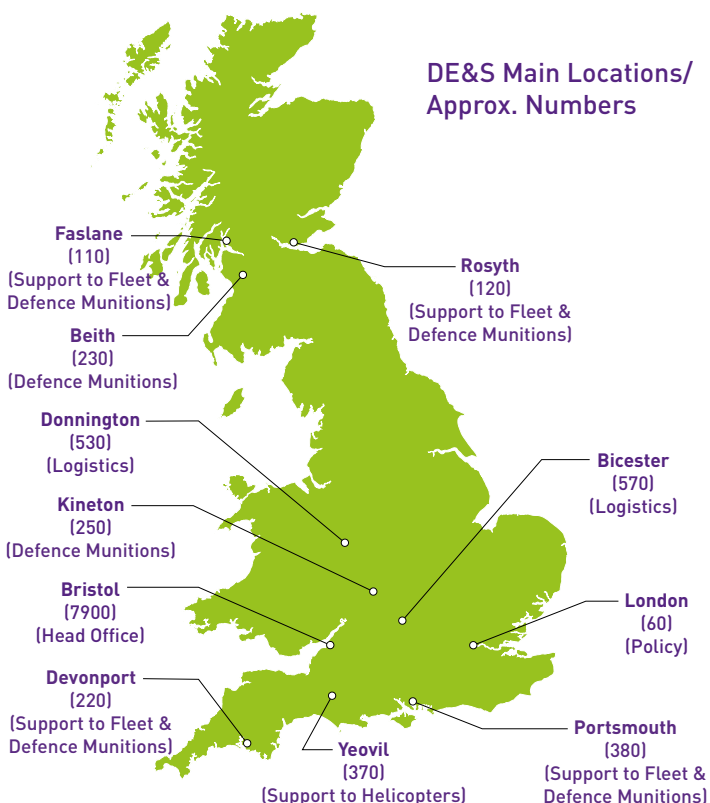
1.1.2 DE&S began operating in April 2007 following the merger of the Defence Procurement Agency and the Defence Logistics Organisation. In 2011, the MOD launched the Materiel Strategy programme to examine how DE&S could operate differently to become more efficient and effective. It sought to address long-standing problems in defence acquisition, and ensure that DE&S would become a high-performing organisation, improving delivery to its customers and providing best value for money to the taxpayer. While a Government Owned Contractor Operated (GOCO) structure was initially pursued, this was halted in December 2013. To facilitate root and branch transformation, DE&S was instead established as a BTE, an Arm’s Length Body of the MOD, in April 2014.

1.1.3 Our status as a BTE gives us a strengthened customer-supplier relationship between the military and DE&S, and facilitates a more business-like approach. As a BTE, we have been given a number of freedoms and flexibilities around how we recruit, reward and manage our staff, to reflect their work in carrying out some of the most complex procurement activity in the world. Our headquarters is in Bristol, and we have staff based at numerous locations around the UK and overseas.

1.1.4 Going forward, we will build on our current capability to become a world-class programme management organisation which exceeds the expectations of our customers. We will meet our customers’ needs as a high performing delivery organisation, which delivers vital equipment and support to the front line, on time and at the agreed price. We will also play our part in generating a more strongly defined relationship between us and the Commands we support, to ensure the right incentives

are in place. We are held to account for delivery to the front line through Smart Contracts and, from 2015, Command Acquisition Support Plans (CASPs). We will also have the agility and flexibility to respond to operational pressures and front line needs as they arise.

1.1.5 This Annual Report and Accounts sits alongside our Corporate Plan, which sets out the strategic direction for DE&S, outlining how we intend to deliver our high level objectives. It 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.



‘Source: DE&S staff numbers as at 28 February 2015, rounded to the nearest 10’

## 1.2 OUR BUSINESS

1.2.1 DE&S is part of the acquisition system within the Defence Operating Model (below). UK defence strategy and objectives are set through the National Security Strategy and Strategic Defence and Security Review (SDSR) and the MOD also publishes its Equipment Plan each year, setting out how it will buy and support the military equipment it requires over the next ten years to meet these objectives. Procurement and support of military equipment is coordinated between MOD Head Office (which provides strategic oversight), the Commands (who specify requirements) and DE&S (which buys and maintains the equipment on behalf of the MOD).

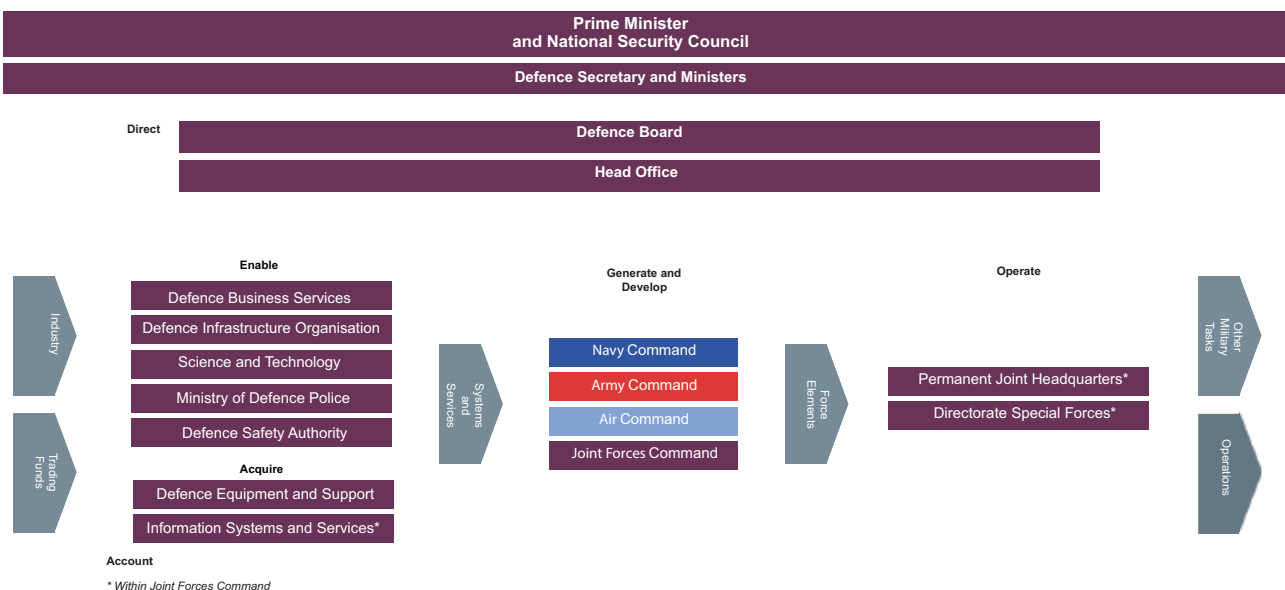
### Financial framework

1.2.2 In DE&S, 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 life.

1.2.3 DE&S carries out its business activities within an operating cost envelope negotiated as part of its transition to a BTE. This is set to reduce year on year, by reducing our dependence on private sector support and strengthening our internal capabilities where appropriate. The operating cost envelope covers DE&S manpower costs, operating support costs, and private sector support costs to enable DE&S to carry out its activities. The financial statements at Section 4 that reflect our business are therefore prepared with some basic boundaries around what costs and charges remain within the MOD Equipment Programme, and what costs and charges support DE&S project management services for the procurement and support of military capability on behalf of our customers, the Commands and Strategic Programmes. More information regarding the accounting boundary can be found in the Statement of Accounting Policies on page 70.

1.2.4 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.

## Defence Operating Model





Our customers

1.2.5 Each of the Commands and Strategic Programmes – our key customers – manages its own equipment and support budget and DE&S is accountable to them for the delivery of an agreed programme of work. Budgets flow through the Commands and Strategic Programmes using Smart Contracts, which were replaced in 2015 by individual CASPs. Both the Smart Contracts and the CASPs are agreements between each of our customers and DE&S, detailing the programme of work we are being asked to deliver and the resources the Commands and Strategic Programmes will provide for us to do so. Through these arrangements, DE&S aims to drive better value for money in acquisition, supporting our customers through making economically rational and evidence-based decisions and by providing consistent and reliable financial, commercial, industrial and technical advice and information.

1.2.6 DE&S is organised into four domains; Fleet, Land, Air and Joint Enablers as shown below. 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, and for safeguarding regularity and propriety. The Chiefs of Materiel oversee a number of Operating Centres within which sit the project and support teams. A number of cross-cutting functional teams are also in place to

provide advice and support to the Board and DE&S teams.

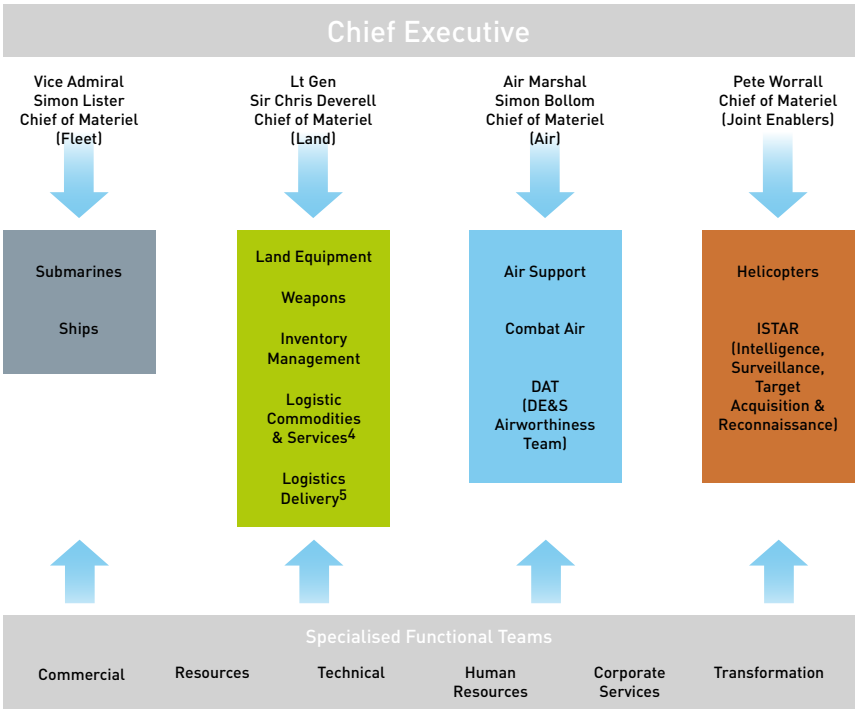
Working with industry

1.2.7 Successfully delivering the equipment, support and technology our Armed Forces require means sustaining sound and productive relationships with defence industry in the UK and around the world. The White Paper, ‘National Security Through Technology’, published in February 2012, sets out the Government’s approach to procuring Armed Forces capabilities and remains our framework for working with industry. Wherever possible, we use competition to fulfil our customers’ requirements and we examine the domestic and global defence and security market for products that are proven, reliable and that meet our current needs. With all our contractors, we aim to strike a balance between having open, fruitful discussions – through, for example, industry days – yet maintaining the professional distance necessary to be able to negotiate robustly on behalf of our customers. This applies both in the establishment of contracts and the renegotiation thereafter, where the primary driver for all DE&S staff involved is to make sure we get the right capability for our customers at the best value for money for the taxpayer.

1.2.8 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, including those 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 64, include costs incurred by DBS in supporting DE&S activities, including those relating to the processing of invoices.

DE&S Top Level Executive organisation



4 The LCS OC transferred to the LCS(T) Delivery Partner on Service Commencement on 1 July 15.  
5 The Logistics Delivery OC stood up on 1 April 15.

## 1.3 OUR TRANSFORMATION

### Transition year

1.3.1 During 2014-15 we continued our unprecedented programme of transformation which is being taken forward under the Materiel Strategy. Our work in this area, which is aligned to the Report on Defence Acquisition 2009 and the work on wider Defence Reform led by Lord Levene, seeks to address long-standing problems in defence acquisition. The Materiel Strategy is DE&S' main transformation programme and is examining how we can operate differently to become more effective and more efficient.

1.3.2 The establishment of DE&S as a BTE in April 2014, and the associated management freedoms we have been granted, marked the beginning of a three-year timeline of transition and transformation. We made good progress over the first year of the programme, designed as a transition year, laying the foundations upon which we will deliver the transformation required.

1.3.3 We have embedded a robust new governance regime, with the externally-recruited Non-Executive Chairman and four Non-Executive Directors (NEDs) who, together, provide independent scrutiny, challenge and support through the DE&S Board to the Chief Executive and the DE&S Executive Board. This structure ensures a strong level of accountability and oversight, without eroding the status DE&S now has as an Arm's Length Body to the rest of the MOD.

1.3.4 In business terms, the focus over the transition year has been the design and development of the skills, tools and processes DE&S needs if it is to ensure real change. We have designed, piloted and begun to implement a system of time recording to support our ability to hard charge customers in the future. We also agreed a tasking and change control mechanism with the Commands in the form of Smart Contracts for 2014-15, and the new CASPs from 2015. These formalise the relationship DE&S has with its customers, ensuring a more business-like interface. Underlining our drive to be more customer focused, we have developed a customer satisfaction metric, which will provide an assessment of how effective DE&S is at meeting the expectations of its customers as a trusted delivery agent.

1.3.5 Work has progressed on the design of a suite of Human Resources (HR) policies that will better support DE&S people and our business requirements. In 2014-15 we introduced a range of early measures

in key areas, including performance management, recruitment, recognition of exceptional contribution to DE&S business, changes in senior remuneration and support for personnel casework.

1.3.6 In specific terms, we have taken action to address the shortage of staff with business critical skill sets by offering higher starting pay to those applicants with suitable experience, allowing us to begin to compete with industry on salary where necessary for the business. Alongside this, we have introduced a tailored retention allowance in certain disciplines to ensure that the specialist staff already employed by DE&S continue to work for the organisation.

### Managed Service Providers

1.3.7 The Materiel Strategy recognises that root and branch reform of DE&S cannot be achieved solely through existing staff, skills and experience. As such, a key strand of the transformation programme is the introduction of tailored private sector expertise, termed the Managed Service Providers (MSPs), to provide support in the key areas of Project Delivery and HR.

1.3.8 Over the course of the past year, a commercial competition was designed and undertaken to secure the Project Delivery and HR MSPs, resulting in contract awards in November 2014. The Project Delivery contracts were split into four lots covering each of the DE&S domains; an approach designed to increase market appetite and enable us to evaluate how a mix of providers would offer different strengths for the challenges associated with each of the domains. CH2M HILL was awarded the Land and Joint Enabler Domain contracts, with Bechtel awarded the Maritime and Air Domain contracts. PwC was awarded the single contract for HR.

1.3.9 The MSPs are providing skilled personnel who have the expertise of operating in complex engineering and procurement environments along with past experience in supporting transformational change in organisations as large and complex as DE&S. They are working alongside DE&S staff, providing support and assistance in specific, clearly defined areas. DE&S staff retain the responsibility for decision making and running the entirety of the business.

1.3.10 The initial focus of the MSPs has been on baselining DE&S performance and identifying our strengths and weaknesses. The Project Delivery MSPs are helping DE&S to develop a coherent, DE&S-wide project delivery methodology that will allow better control and cooperation across the organisation. The

HR MSP is helping to build a bespoke HR function for DE&S that will properly reflect the new structure of the organisation, as well as aiding the business transformation, particularly around behavioural change.

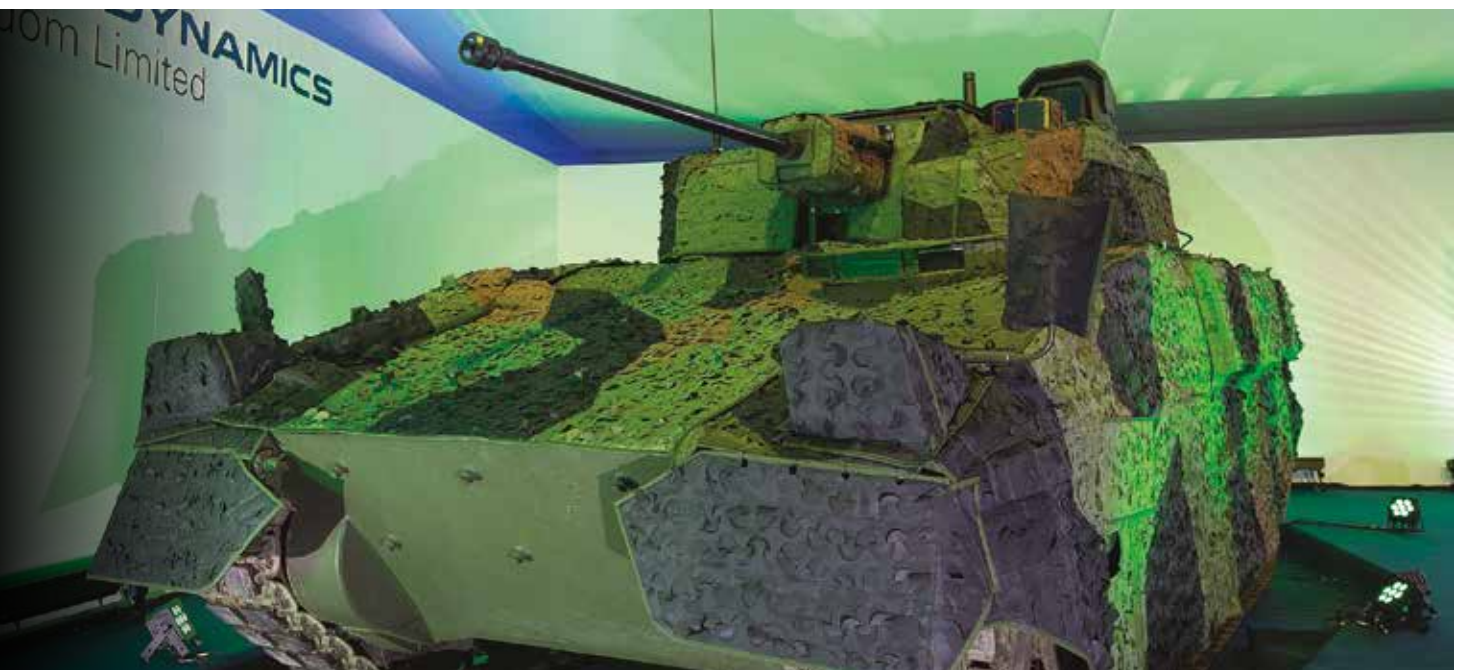
1.3.11. We had intended to procure a third MSP this year, focused on the area of management information and information technology. Following a re-examination of the context and requirement, we have decided not to proceed with the competition at this point and will, instead, address our requirements by making further use of our in-house capabilities and by drawing on the lessons learnt from the MSPs working in DE&S now. We will continue to monitor progress and will examine at a later date, whether there is a need for a new commercial competition to address any residual management information and information technology requirements.

### Transformation outlook

1.3.12 Having completed the year of transition, over the next two years, the Materiel Strategy will be

focused on implementing and embedding the changes designed to improve DE&S, including our ability to forecast programme spend, accurately estimate performance, time and cost, and understand our customers, dealing with them in a robust, business-like way.

1.3.13 The progress we have made over the transition year, and the plans in place going forward, will enable us to implement and embed the business systems, organisational and behavioural changes required to transform the organisation. We will introduce some major shifts in how we manage people, incentivising more business-like behaviours and making DE&S a place where professionals thrive. And we will continue to work closely with our suppliers of all sizes throughout the defence industry, ensuring we have productive relationships that enable us to meet defence requirements effectively and efficiently. It is this approach that will ensure better value for money, and sustainable, long term and enduring improvements in the delivery of equipment and support to the Armed Forces.



### Ajax (formerly Scout Specialist Vehicles)

In September 2014, DE&S placed a contract with General Dynamics UK for 589 Ajax; the biggest single order for a UK armoured vehicle in 30 years. Not only will the Ajax programme secure at least 1,400 jobs in the UK, it also illustrates how we are now working smarter in how we design and procure equipment. Centred on a common base vehicle that can be adapted for specific roles, Ajax ensures higher reliability, lower cost and a smaller logistics footprint

thanks to the commonality of components across the fleet, and avoids a proliferation of bespoke platforms. The vehicle will give the Army enhanced intelligence, surveillance, protection, target acquisition and reconnaissance capabilities and a highly efficient 40mm cannon. It will be effective in even the most difficult terrains around the world, and removes the 40-year-old Combat Vehicle Reconnaissance (Tracked) from service. The first brigade is expected to be ready to deploy from the end of 2020.



## 1.4 OUR PERFORMANCE AND DELIVERY

1.4.1 In our first year of operation as a BTE, we have worked hard to make significant changes to our organisation while not allowing our performance to suffer. It has been a successful year, with performance meeting or exceeding our targets in most instances. We measure our performance against detailed Key Performance Indicators (KPIs), as described in our Corporate Plan and which were agreed at the start of last year with our Owner's Council. Our performance against a summary of our KPIs is below.

### KPI 1: Delivering equipment procurement projects and equipment support

#### Procurement projects

1.4.2 Defence equipment projects are managed in an extended lifecycle model that encompasses four procurement planning and delivery phases, an in-service phase and, finally, disposal, known as the CADMID (Concept, Assessment, Demonstration, Manufacture, In-service, Disposal) cycle. Our performance targets assess our ability to deliver the equipment and outputs that MOD Head Office and our customers have approved as a result of a formal investment decision, either for the assessment phase or the demonstration and manufacture phase of the project. Over the year, we monitor and report on our progress in delivering these approved phases of our largest projects (those which we term "category A, B or C", having an expected value of at least £20 million each).

1.4.3 We have performed well against our project delivery objectives this year, with performance, cost and time on our largest procurement projects all remaining well within the targets set out in last year's Corporate Plan.

1.4.4 In measuring our performance, we have accounted for all variances that it is reasonable for DE&S to be held to account for, including those due to technical challenges or opportunities, 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. However, while we also report the impact of changes that are outside DE&S control, such as alterations that the

customer makes to the requirement, changes in our customers' budgetary priorities, and those which arise from problems or difficulties encountered in a dependent project that is not under DE&S control, these variances are not attributable to the DE&S performance position.

#### Performance on assessment phase projects

1.4.5 The assessment phase is the period between the initial and main investment decisions. In 2014-15, DE&S managed 20 category A, B or C assessment phase projects, where the total combined forecast value of the approved assessment phase activity was £4,096 million. Over the year, our overall performance on these projects is shown in the following table.

Key Performance Indicator	Target	Achieved Performance
<b>Cost variation:</b> the maximum level of forecast cost growth against approved assessment phase costs.	+£205 million <sup>1</sup>	+£40 million
<b>Time:</b> the maximum level of forecast aggregate delay for approved assessment phase durations.	+60 months <sup>2</sup>	-17 months

1 Five per cent of the total combined approved value

2 A total of three months per project

#### Performance on demonstration and manufacture phase projects

1.4.6 The demonstration and manufacture phase covers the period between a project's main investment decision and reaching the in-service date. In 2014-15, DE&S managed 38 category A, B or C demonstration and manufacture phase projects, where the total combined forecast value of the approved activity was £47,772 million. No projects exceeded the cost growth threshold of 2.5 per cent and only one project exceeded the time slippage threshold of three months. Performance against our targets is shown in the following table.

Key Performance Indicator	Target	Achieved Performance
<b>Performance:</b> the percentage of approved Key User Requirements that are forecast to be achieved when the project is completed.	97%	98%
<b>Cost variation:</b> the maximum level of forecast cost growth against approved costs.	+£191 million <sup>1</sup>	-£134 million
<b>Time:</b> the maximum level of forecast aggregate slippage to in-service dates.	+29 months <sup>2</sup>	+6 months

<sup>1</sup> 0.4 per cent of the total combined approved value.

<sup>2</sup> A total of 0.8 months per project.

### Equipment support

1.4.7 Our performance in providing support to in-service equipment is measured against metrics in four categories: availability, reliability, sustainability and safety. Since many of these metrics do not measure DE&S performance on its own and are dependent on our collective performance alongside other parts of defence, the DE&S Owner's Council did not set a target for DE&S to achieve. Looking at the year as a whole, 52 per cent of equipment support metrics reported meeting or exceeding the required level of output. While there was no specific performance target to achieve, we do recognise the need to improve and we will be actively pushing further with the development of our performance metrics in this area.

### KPI 2: Operating Expenditure Efficiency

1.4.8 In 2014-15 we spent significantly less than the operating cost envelope, largely due to improved control of private sector support and the timing of the appointment of the MSPs, which was later than initially planned. Our final costs were £1,143 million against a budget of £1,274 million. These figures exclude communicated costs which are notional, non-budgetary items of expenditure.

### KPI 3: Inventory Management

1.4.9 Inventory Management Transformation is a MOD

project, executed by DE&S, which is intended to reduce the amount of inventory the Department holds, cut the amount spent on inventory, and effect lasting change in the way inventory is managed. The MOD has committed to reduce inventory holdings from a gross book value of more than £40 billion to less than £31 billion by 31 March 2016 and, in the same timescale, to reduce annual inventory purchasing by £561 million against the 2011-12 baseline of £2.37 billion. In addition, the MOD has committed to undertake the necessary structural changes to ensure that inventory levels continue to be well managed beyond 2015-16.

1.4.10 DE&S KPIs on inventory management reflect these targets. Over the last year we have achieved both targets, reducing inventory holdings by eight per cent and beating the expenditure target by 16.2 per cent:

Key Performance Indicator	Target (£M)	Achieved Performance (£M)
Raw materials and consumables purchasing (excluding fuel)	<1,118	936
Closing inventory (inc fuel)	33,122	31,626

1.4.11 We have also made significant progress in closing the gap between purchasing and consumption of raw materials and consumables. While this is not a reported KPI, the variance between purchasing and net consumption is monitored to provide confidence that purchases are related to demand. In 2011-12 purchases of raw materials and consumables (excluding fuel) exceeded consumption by £511 million. In 2014-15, the equivalent difference was £88 million. It is worth noting that there will always be a timing difference between the purchase of inventory for new platforms and its consumption. Some purchases also relate to strategic stockpiles with shelf-life and, by nature, are not expected to be consumed in support of standard outputs.

### KPI 4: Forecast accuracy

1.4.12 Operating costs expenditure for 2014-15 was -£131 million below budget. This mainly reflects improved control of private sector support costs, and a later than planned start to the MSP contracts. The operating cost budget is set to fall by some 18 per cent 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. In addition further work is being undertaken to improve the ongoing robustness of the accounting boundary between DE&S operating and programme activities in order to address NAO audit qualifications.

1.4.13 The total DE&S outturn was £14,076 million, including equipment programme, against a budget of £14,330 million. The underspend of -£254 million is mainly attributable to historic accounting adjustments to correct over-estimates of expenditure in previous years. Excluding these adjustments, the underspend would have been -£8 million which is within the target of +0 and -1.5 per cent at -0.06 per cent. The total DE&S outturn by customer for the equipment programme was as below:

	Performance (£M)*	Target (£M)
Strategic Programmes	3,843	3,686
Air Command	3,375	3,682
Navy Command	3,372	3,506
Army Command	1,608	1,692
Joint Forces Command	700	831

The above table covers customer outturn only. It excludes DE&S operating costs and DE&S-facing Equipment Programme expenditure

#### KPI 5: Customer Satisfaction

1.4.14 A customer satisfaction survey has been launched after being developed and tested with the MOD and the Commands. The survey incorporates 32 questions, grouped in 11 themes, such as communication, expertise, programme management and satisfaction. Each will be scored and the total from

all themes will form the overall customer confidence index. First results are expected by the end of the year and will form the baseline for next year's corporate KPIs. From 2015-16 onwards, DE&S will strive to achieve a year on year increase in the customer confidence index.

#### KPI 6: Transformation Plan

1.4.15 Completion of the DE&S Transformation Plan, which outlines how DE&S will become a world-class procurement organisation, was delayed from December 2014 until March 2015 in order to ensure that we had in place robust commercial arrangements with the MSPs, providing us with a solid foundation to take our transformation forward. We had planned to bring in the MSPs by September 2014, but we continued work on our commercial negotiations to ensure the best deal was achieved. Contracts were placed in November 2014.

#### Outlook

1.4.16 Going forward, the KPIs for 2015-16 have been developed and strengthened to reflect the CASPs, and cover performance against the breadth of DE&S responsibilities. They are designed around the five broad objectives of delivery, operating expenditure efficiency, inventory management, forecast accuracy and stability, and customer satisfaction.

1.4.17 Where appropriate, the revised KPIs have been disaggregated to measure performance against each of the Commands rather than aggregating into a single metric. This is expected to provide a much more granular assessment of corporate performance and reflects the work being undertaken to strengthen the interface between DE&S and the Commands.



### 1.5 OUR PEOPLE

1.5.1 People are at the heart of DE&S and with their diverse range of skills, from nuclear engineers to financial specialists, a central reason for becoming a BTE was to enable us to create a more efficient and effective environment for managing such a specialist workforce. We have been given substantial freedom to make our own decisions about how best to do this. We want to preserve the values and pride that are intrinsic in public service, but we also want to use our freedoms to support some major shifts in how we manage people – to make DE&S a place where professionals thrive. In real terms this will include the ability for us to implement our own pay and grading structures, to develop, manage, attract and retain the skills we need and to incentivise more business-like behaviours. PwC, the MSP for HR, was engaged in late 2014 to help us with those aims.

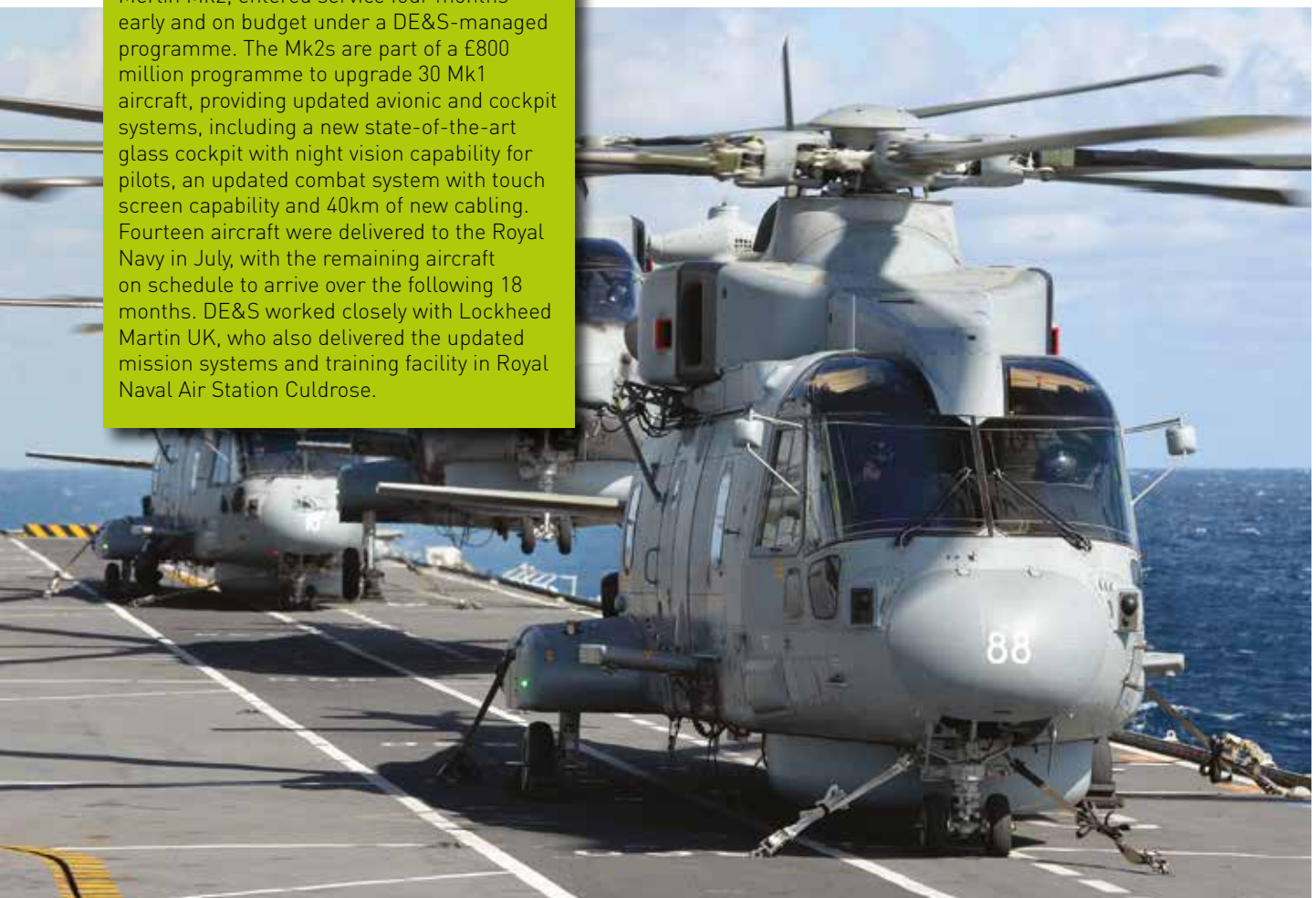
#### Merlin

In July 2014, one of the world's most technologically advanced helicopters, the Merlin Mk2, entered service four months early and on budget under a DE&S-managed programme. The Mk2s are part of a £800 million programme to upgrade 30 Mk1 aircraft, providing updated avionic and cockpit systems, including a new state-of-the-art glass cockpit with night vision capability for pilots, an updated combat system with touch screen capability and 40km of new cabling. Fourteen aircraft were delivered to the Royal Navy in July, with the remaining aircraft on schedule to arrive over the following 18 months. DE&S worked closely with Lockheed Martin UK, who also delivered the updated mission systems and training facility in Royal Naval Air Station Culdrose.

1.5.2 In 2014-15, our initial focus was on:

- Developing terms and conditions, including reward structures, appropriate to a specialist workforce
- Placing a central focus on performance
- Creating functional management structures, strengthening career management and workforce planning
- Balancing the use of employed, interim and contracted labour
- Building self-reliance in HR

1.5.3 These changes will not happen overnight, but we have taken some important initial steps. We have begun initiatives to make clear that individual performance matters within DE&S and we are introducing changes to our performance management system. We are also looking at how we recognise functional specialisms and we have enhanced our special bonus system to reward exceptional contributions. Finally, we have introduced pay changes at Senior Civil Service (SCS) 1 level and for some specialist groups to address particular risks and retention issues.





## Diversity and inclusion

1.5.4 During 2014-15 we employed, on average, 12,845 people\* and the tables below reflect relevant changes to the composition of the organisation over the year by protected characteristics. We continue to actively promote inclusion of colleagues with protected characteristics, as set out in the Equality Act (Public Sector Equality Duty), and we remain committed to improving DE&S as an inclusive and fair employer of choice. As such, as part of our transformation programme, we have formed a Diversity and Inclusion team to work across DE&S to identify priorities, quick wins and set the agenda for long-term sustainability. This has included establishing local diversity networks and senior champions across the business, including one focused on procurement and supplier diversity. We also continue to operate the 'Two Ticks' scheme, interviewing all disabled applicants who meet essential job criteria. Moving forward, the Diversity and Inclusion team will implement a rolling and enduring programme of initiatives which will help to increase support and raise awareness of diversity within DE&S.

\* This was the average over the course of the year. More information on our staff numbers can be found in Note 2 to these accounts.

### Gender breakdown at DE&S Board and Executive Board level

	1 April 2015 <sup>1</sup>
Total DE&S Board and Executive Board	14
Female	2
Male	12
Percentage Female	14%
Percentage Male	86%

1. Comparative figures for April 2014 not provided as Boards were not fully established.

### Gender breakdown at Senior Civil Service level

	1 April 2014	1 April 2015
Total DE&S SCS	89	80
Female	18	17
Male	71	63
Percentage Female	20%	21%
Percentage Male	80%	79%

## Changes to civilian personnel strength over the year by protected characteristic (headcount):

	1 April 2014	1 April 2015
<b>Civilian Total<sup>1</sup></b>	<b>13386<sup>2</sup></b>	<b>10861</b>
<b>Gender</b>		
Female	4254	3322
Percentage Female	32%	31%
<b>Ethnicity<sup>3</sup></b>		
Black & Minority Ethnic	398	370
Percentage Black and Minority Ethnic	3%	3%
<b>Disability</b>		
Declared a Disability	725	595
Percentage Disabled	5.4%	5.5%
<b>Sexual Orientation<sup>3</sup></b>		
Lesbian, Gay, Bisexual	159	90
Percentage Lesbian, Gay, Bisexual	1%	1%
<b>Religion or Belief<sup>3</sup></b>		
Non Christian Religion	400	311
Percentage Non Christian Religion	3%	3%
Secular	2876	2411
Percentage Secular	21%	22%
Christian	5881	4475
Percentage Christian	44%	41%

Source: Defence Statistics (Civilian)

1. Totals include all industrial and non-industrial personnel but exclude all Royal Fleet Auxiliary and Locally Engaged Civilians for whom declaration data are not available.

2. The headcount includes some 2,600 civilians who were transferred out of DE&S to other parts of the MOD in April 2014, but which were still included in this count.

3. 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.

### Our skills and capabilities

1.5.5 The year saw a concerted drive to increase the professionalism and skills of the DE&S workforce and we are clear that our future People Model will place a strong focus on recognising our people as professionals within functions under a balanced matrix model. We are working to enhance professionalism across all functions, but we have taken a number of steps in the last year in the following areas.

#### Engineering, project and programme management (PPM)

1.5.6 For our engineers and project and programme managers, we are setting out a governance structure, where people with agreed knowledge and expertise levels will act as champions for their profession. Supplementing this, and to help us benchmark our skills, we have developed a close relationship with the Association for Project Management (APM) and the Institution of Engineering and Technology, and we continue to work closely with the UK defence industry and across the defence community to capitalise on good practice. During 2014-15 we offered more than 1,000 places on APM courses and doubled the number of DE&S places on the part time Cranfield PPM Masters of Science degree course. Overall, we are continuing to build the professionalism of DE&S engineering with a 23 per cent increase in recorded Chartered Engineers, a 45 per cent increase in Incorporated Engineers, and a 47 per cent increase in Engineering Technicians since April 2014.

#### Commercial

1.5.7 The nature of our business means that improving commercial skills will always be a priority for us and, as such, our commercial training programme is now led by a Professional Development Director. The training, which is being developed with the Defence Academy, will be a formal, rigorous qualification programme for contracting officers, based on practical, academic and professional training, testing, board scrutiny and ongoing peer reviews.

1.5.8 For those commercial officers new to the organisation, in 2014-15 we launched an aggressive training and qualification programme, including an intensive four-week induction course for all new entrants. Professionals with two-three years of MOD experience, but without significant training since arrival are undertaking a three-week commercial profession foundation course. At the end of March 2015, around 2,600 days of training had been delivered.

### Inventory management

1.5.9 We have established an Inventory Management Professional Development Team with the aim of evolving those within the inventory management function into a highly-skilled and responsive cadre recognised across defence for their knowledge, experience and professional service. We have undertaken a comprehensive study of the function, identifying opportunities for change and highlighting the need for effective, targeted recruitment and retention, and career and talent management. We are now working on developing and improving training and revised, accredited, qualifications.

#### Leadership

1.5.10 We recognise that good leadership is crucial for inspiring performance and managing outcomes efficiently and effectively. As such, we are developing our SCS community to enable them to drive organisational transformation. At a corporate level we have introduced a strengthened leadership communications programme and formal talent reviews, supported by coaching, development plans and mentoring. And on an individual basis, reflecting the professionalism of DE&S, our Executive Board members are highly qualified in a number of disciplines and are recognised at the highest level by professional bodies, holding Fellowships with the Royal Academy of Engineering, Chartered Institute of Procurement and Supply (CIPS) and Chartered Institute of Management Accountants (CIMA). Nearly half of our staff at SCS 1 and 2 level have recently undertaken, or are planning to undertake, the Major Projects Leadership Academy programme, or a comparable Masters of Science qualification, while another quarter have recent MBAs or equivalent. We are also sourcing a bespoke business school programme, which will offer high-quality business, academic and global perspectives to take senior staff through a baseline executive level development process.

#### Recruitment and retention

1.5.11 To help with recruitment and retention of key skilled personnel, we have adopted an increasingly successful higher starting pay approach to recruiting individuals into key posts. While recruitment of commercial officers remains a challenge, we are taking action to improve this. We have had greater success in recruiting programme and project managers, with more than 120 recruited during 2014-15.

1.5.12 For those staff already in situ, we are taking steps to reward people who have achieved qualifications

and registrations most valuable to DE&S, including APM levels of PPM professionalisation and those who have achieved engineering chartered status. We have also re-launched the DE&S Specialist Fellowship scheme, which rewards specialist individuals, working in critical parts of the business, with up to £10,000 per year to retain and grow their knowledge and expertise.

### Private sector support (PSS)

1.5.13 PSS is broadly described as external support to help us manage our agreed programme of work, including support to deliver business improvement within DE&S. As part of the agreement reached with the MOD to create DE&S as a BTE, PSS that was funded from the Equipment Programme was moved into the BTE. Identifying and separating these costs from the Equipment Programme means we can exercise our freedoms to consider in-sourcing these requirements and introduce more effective purchasing methods for PSS, ensuring we take a strategic view of the support requirement across DE&S, rather than just for individual projects.

1.5.14 Our PSS costs exclude similar project management costs that are intrinsic within contracts and which cannot be separated out. Examples of such embedded costs include international defence collaborative agreements, memoranda of understanding, and strategic support initiatives such as Carrier Alliance, Weapons Portfolio contracts, and Contractor Logistics Support/Contracting for Availability arrangements.

1.5.15 At the beginning of 2013-14, we employed in the region of 400 non-industrial, and 200 industrial staff as manpower substitutes (otherwise known as contingent labour) to fill short-term vacancies in a range of areas, including specialist information systems staff, programme and project managers, accountants and engineers. During the last six months of 2014-15, we reduced our use of non-industrial contingent labour by 50 per cent and we will continue to focus on this area. We have developed a more stringent approval mechanism to ensure that only the most pressing cases for employment of short-term staff are approved. We are also making greater use of fixed-term appointments to meet medium-term requirements, and investing heavily in graduate and apprentice schemes in technical, commercial and finance roles to develop a better supply of trained and experienced personnel to take on roles that have previously been undertaken by contingent labour.

1.5.16 Details of senior 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. All 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 2014-15. There have been no off-payroll engagements of Board members and/or senior officials with significant financial responsibility between 1 April 2014 and 31 March 2015.

### All off-payroll appointments

	2014-15
All off-payroll arrangements, at 31 March 2015 for more than £220 per day and that last longer than six months	86
<b>of which</b>	
Those that have existed for less than one year	77
Those that have existed for between one and two years	9
Those that have existed for between two and three years	0

### New off-payroll appointments

	2014-15
Number of new engagements, or those that reached six months in duration, between 01 April and 31 March	127
Number which include contractual clauses giving DE&S the right to request assurance in relation to income tax and National Insurance obligations	127
Number for whom assurance has been requested	127
<b>of which</b>	
Number for whom assurance has been received	85
Number for whom assurance has not been received	42 <sup>1</sup>
Number that have been terminated as a result of assurance not being received	1 termination 1 resignation

<sup>1</sup> For those from whom assurance has not been received, all have been reported to HM Revenue and Customs.

### 1.6 OUR COMMUNICATIONS

1.6.1 As expected, staff engagement and communication have become increasingly important as we have embarked upon our ambitious programme of transformation. In September 2014 we published a new Communications and Engagement Strategy, which pulls together a wide range of initiatives to better engage and communicate with staff. We have also appointed a Head of Communications who is strengthening and restructuring the DE&S communications team to aid delivery of a refreshed communications and engagement strategy going forward.

#### Staff engagement survey

1.6.2 We want to be an organisation that motivates and inspires staff, one that values their contribution and provides opportunities for involvement in future organisational changes. The 2014 Staff Engagement Survey enabled all our staff, civilian and military, to tell us what we are doing well and where we need to improve. Although we are now separate from the main MOD survey, the DE&S survey remains part of the Civil Service-wide exercise, allowing us to compare our results with the MOD, with previous years' responses, and across government. In 2014, 79 per cent of DE&S staff completed the staff engagement survey; the largest response rate we have ever achieved.

1.6.3 Our overall engagement score was 49 per cent, down four per cent on the previous year. This understandably reflects a transitional year and, as a result, there are a number of areas where we recognise we need to improve. In 2015-16 we want to build on these results, particularly focusing on those areas which staff told us needed most work, including providing further clarity on what DE&S is expected to look like on reaching 'match-fit' status in 2017. We will also be focusing on improving leadership visibility across DE&S and supporting our senior leaders in communicating a clear vision and direction to employees through a proactive leadership communications programme. And we will continue to build on the positives:

- 89 per cent of people continue to be enthusiastic and challenged by their work
- Staff report that they continue to receive positive support from team members and line managers
- Access to learning and development opportunities has improved thanks to actions taken as a result of the last survey, though there is still work to do
- 80 per cent of staff report that they are treated

fairly and 84 per cent say they are treated with respect

- We are improving in the areas of leadership and managing change

#### Communications

1.6.4 We use a multitude of channels to communicate internally and externally, including through *desider*, our in-house magazine, the intranet/internet and via the media where appropriate. Internally we have enhanced the range of visual communication material on display and continued to run face-to-face briefing sessions with staff at all levels, through, for example, 'Talk to the Board Live' sessions and open forums on the Materiel Strategy. We have also launched a monthly series of master-class events which will run throughout 2015. These will help us to share our successes more widely with staff and to emphasise the improvements we are making to the way we work in DE&S. Alongside our internal communications, we have run media events on a wide range of subjects, including covering key milestones on F-35, Voyager, Type 26, Ajax Specialist Vehicle, Maritime Support Delivery Framework and A400M. These have involved senior DE&S personnel, Ministers and, on occasion, the Prime Minister.

1.6.5 For any proposed changes to terms and conditions of service, we ensure that staff are fully consulted and we engage openly and constructively with recognised Trades Unions in discussing proposals for changes affecting staff. In February 2015, DE&S signed its own Employee Relations Framework Agreement which sets out principles and behaviours and the processes under which both parties will operate to ensure good employee relations, reflecting the organisation's new status.

1.6.6 Parliament retains a keen interest in the progress of the organisation and we continue to respond to a wide range of Parliamentary Questions on the organisation and the delivery of our projects. In 2014-15 we answered more than 400 Parliamentary Questions and responded to 365 pieces of Ministerial and Treat Official correspondence. We also provided briefing in support of a range of Parliamentary business, including monthly Defence Oral questions, the Defence Reform Bill, the Public Accounts Committee, Parliamentary debates and House of Commons Defence Committee inquiries.

1.6.7 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 2014-15 we answered more than



600 requests for information covering all aspects of our business, with key areas of interest for DE&S including submarines and nuclear, contracts and disposals.

1.6.8 In line with Cabinet Office guidelines on Transparency, DE&S proactively publishes a range of

information online, including a biannual organogram, 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.



## Carrier Naming Ceremony

On 4 July 2014, the first of the UK's new aircraft carriers, HMS QUEEN ELIZABETH, was named by The Queen at a high-profile ceremony organised by DE&S in Rosyth. Attending the launch were workers who helped build the ship, MOD and DE&S representatives, the Secretary of State for Defence, and the Prime Minister. The ceremony concluded with a bottle of whisky being smashed over the bow of the ship in lieu of the traditional bottle of champagne and in recognition of the carrier's Scottish roots. HMS QUEEN ELIZABETH is the largest ship ever built for the Royal Navy and will be used in a full range of military tasks, from war-fighting to providing humanitarian aid and disaster relief. It will operate with Lightning II Joint Strike Fighter jets on board.

The naming ceremony marked a major milestone in regenerating the UK's aircraft carrier fleet and in the DE&S-managed carrier programme. Work continues on the carriers in four UK shipyards (work at Portsmouth and Tyne has now concluded). The programme has created or sustained between 7-8,000 jobs at the tier 1 shipyards in Glasgow, Rosyth, Portsmouth and Devon. More than 150 equipment subcontracts have also been placed by the Aircraft Carrier Alliance, worth around £1.65 billion. Throughout the supply chain we estimate companies to employ 2-3,000 people on the carrier programme, thereby boosting local economies across the UK.

## 1.7 OUR APPROACH TO SAFETY, SUSTAINABILITY AND SECURITY

1.7.1 We are committed to effective safety, security and environmental management; to delivering quality and safe equipment to the Armed Forces. While we readily fulfil our legal obligations in these areas, we also continue to be a learning organisation, one which seeks to develop continually and to improve safety, security and environmental management across all areas of responsibility.

### Safety

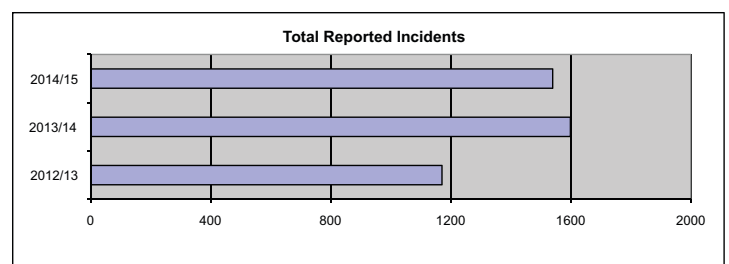
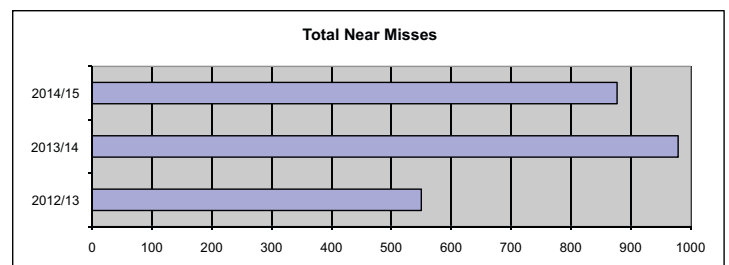
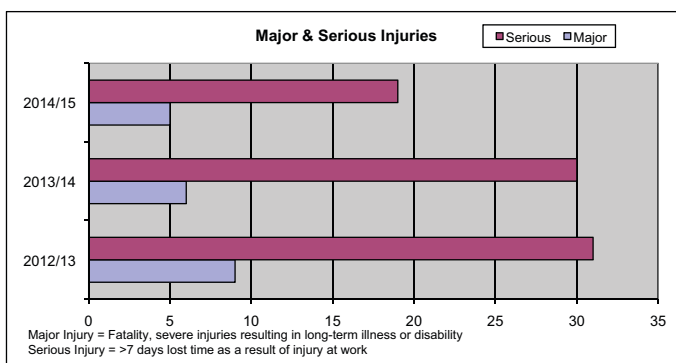
1.7.2 DE&S aims to be 'delivery focused; safety driven'. We have designed our policies to ensure that we provide safe equipment to the Armed Forces, a safe environment for our people to work in and that we protect the environment in which we and our equipment work. DE&S remains within the wider MOD governance structure for safety and our Board is committed to DE&S being 'the best in class' in the worldwide defence sector at preventing unintended harm to people and the environment. This commitment is underpinned by our Safety Board, which reports to the DE&S Executive Board and which oversees and directs work to embed eight key safety messages in every level and role of DE&S. These messages express in simple, clear terms everything that needs to be done to deliver good safety and environmental management in the organisation. This ranges from having effective safety leadership, through learning and sharing safety lessons, to using the appropriate suitably qualified and experienced people for the business it is in, and ensuring that everyone in DE&S acts in a safe, professional way at work.

1.7.3 Our policy is that all accidents, incidents and near misses are reported to the DE&S Incident Notification Cell (DINC). The charts below reflect the major and serious injuries, near misses, and total incidents reported in DE&S during 2014-15, and for the two years preceding DE&S' formation as a BTE. These show that the number of major and serious injuries has decreased, as has the total number of reported incidents. Near misses have also shown a fall on the previous year, although efforts continue to maintain and increase the number of near misses reported as this helps to prevent a reoccurrence, identify weaknesses in operational procedures and reveal patterns from which lessons can be learned. Through a continued focus on workplace safety and the actions undertaken to embed the key safety messages and improve safety culture, we are aiming to deliver continuous improvements in this critical area in the years ahead.

1.7.4 To strengthen governance in this area, the Chief Executive, as the senior duty holder for safety, has established a three-tier duty holder governance structure, appointing individuals who are responsible and accountable for managing those instances where our activities give rise to a risk to life. We also now sponsor and deliver a full suite of system safety and system environmental courses, which meet the competence requirements of our safety and environmental practitioners, together with meeting the expectations of the Commands. The courses have now been approved and recognised by the International Institute of Risk and Safety Management and the Institute of Environmental Management and Assessment, who provide professional affiliation on successful completion of the newly embedded benchmark examination.

### DE&S incident statistics

(excluding Naval Bases, which transferred from DE&S on 1 April 2014)



1.7.5 In relation to safety in procurement, we have updated and re-issued Defence Standards 00-56 and 00-55 which allow effective and proportionate contracting for safety management and software safety throughout all national and international contracting arrangements. These allow us to consider, for the first time, the option to tailor requirements which meet the risk profile of the project being undertaken and which take into account existing civilian standards which could be used as an acceptable means of compliance.

1.7.6 Fundamentally, we strive to embed an effective safety culture throughout the organisation and we expect all of our delivery teams to think hard about safety and environmental matters when procuring equipment for the Armed Forces. This is backed up by comprehensive safety governance flowing throughout the organisation, safety experts at all levels, and a clear focus on 'safe by design' and 'safe for use' considerations.

### **Sustainability**

1.7.7 We recognise that managing environmental and socio-economic effects at an organisational level supports a modern military and helps deliver defence capability, which is why we have affirmed our commitment to sustainability in the DE&S Framework Document. This states that we will incorporate sustainable development principles in all our strategies, policies, decision-making processes and associated programmes, projects and activities as stipulated in MOD policy. Our performance against this commitment is monitored through the DE&S Safety Board.

1.7.8 During 2014-15, we continued to work hard in support of this commitment to sustainability. All DE&S sites have environmental management systems in place (although the level of maturity across the organisation is variable), and we seek to develop these continually. As such, we have undertaken reviews into biosecurity arrangements, waste management and the storage of fuels and lubricants. Our main challenge is to ensure that our fuels infrastructure is, and remains, compliant, and we are working with both the Defence Infrastructure Organisation (DIO) and the Fuels and Gases Safety Regulator to ensure this is achieved.

1.7.9 In terms of reporting against targets, DE&S, as a consumer of energy, contributes to delivery of MOD sustainability targets through its behaviours and means of delivering its services. 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. As the infrastructure lead for defence, DIO is responsible for providing sustainable, safe and legally compliant infrastructure and infrastructure services. Details of DE&S performance in all key areas is included in the Sustainable MOD Annual Report, which was published in July on gov.uk at: <https://www.gov.uk/government/collections/mod-annual-reports#sustainability-annual-reports>.

### **Sustainable Procurement**

1.7.10 DE&S is the MOD lead for sustainable procurement. Our commercial policy mandates that all sustainability objectives within contracts must comply with Government Buying Standards and that these requirements are appropriately addressed in the specification. We are working jointly with suppliers to develop and embed sustainable procurement principles, processes and activities into acquisition and through-life capability management practices. The Sustainable Procurement Working Group, run by DE&S, provides a forum for MOD and its suppliers to consider jointly how best to embed sustainable procurement into business practices.

1.7.11 We also continue to build on the measures that have been introduced to raise awareness of the mandatory requirements of Government Buying Standards. This includes featuring the requirements in the sustainable procurement section of the Acquisition System Guidance (formerly the Acquisition Operating Framework) and in our Commercial Managers' toolkit, together with the development of online training.

### **Reinforcing safety and sustainability behaviours**

1.7.12 The 2013-17 Safety Delivery Plan sets out a rolling programme of projects, monitored by the Safety Board, which will build on safety and environmental behaviours at all leadership and management levels, and all roles, from the Chief Executive to desk officers. Overall performance is measured against the agreed MOD-wide safety and environment maturity model.

1.7.13 In 2014-15, in accordance with the Delivery Plan, we:

- Hosted an international two-day conference; the Environment, Safety and Assurance Symposium
- Created a bespoke full suite of system safety and system environmental courses with tough examination standards leading to professional accreditation
- Held safety workshops aimed at the senior personnel and duty holders in DE&S

- Ran a senior safety leadership event and five Operating Centre Director-led 'learning from experience' sessions
- Started groundbreaking work on the measurement of safety culture in collaboration with Dstl and Greenstreet Berman
- Continued establishing and leading 'community of interest' groups for safety and sustainable procurement specialists across the defence sector
- Held a combined MOD/industry sustainable procurement seminar at Abbey Wood in September 2014
- Continued our active representation on safety and environmental management at European Defence Agency and NATO forums, and working collaboratively with the French Direction générale de l'armement (DGA) to develop common approaches and understanding

### Security

1.7.14 The security of our personnel and estate is 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. Our Security Board meets on a quarterly basis to drive the provision of proportionate and effective security for DE&S. This encompasses all aspects of security, including the behaviour of personnel and assessment of any apparent vulnerability. DE&S is also represented on a number of MOD bodies that review all types of security risks.

1.7.15 Nuclear security, of course, remains imperative and, as such, a Nuclear Security Programme Board is held separately, chaired by the DE&S Chief of Materiel Fleet. 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. The 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, improving the understanding and visibility of nuclear security risks and mitigations.

1.7.16 In April 2014, the introduction of the revised Government Security Classification scheme provided us with the opportunity to improve understanding of information security across the organisation. Together with industry partners we launched a revitalised communications programme, explaining the new security classifications and providing a refresh on general security awareness. This programme was in

addition to the rolling security awareness programme which saw around 2,300 members of staff attend security general threat briefings in the first four months of 2014-15.

1.7.17 Aging infrastructure remains a challenge across the MOD and our security and infrastructure teams have taken measures to identify and prioritise infrastructure investment to ensure physical infrastructure meets security requirements. 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. In April 2014, a secure, web-based information portal was also introduced, making it easier for industry to access our security policy and guidance.



**Tony Douglas**  
**Accounting Officer**  
**4 December 2015**



**Sir Bernard Gray**  
**Chief of Defence Materiel**  
**(04/01/11 – 30/11/15)**



### Energy saving at Bicester

DE&S Logistics Services was named as a runner-up for the Energy Project Award at the MOD Sanctuary Awards in 2014 for its work on saving energy. Bicester is a principle logistics centre and has been classified as a high energy user, spending some £6 million per year on utilities. A study run by the Defence Infrastructure Organisation, and carried out by Logistics Services and its industry partner, PriDE, looked at high usage warehouses with the aim of saving money, reducing the carbon footprint and improving the working environment.

Following the study, the DE&S team took a number of steps to save more than £850,000 in a year, including switching the primary fuel from furnace fuel oil to natural gas, installing LED lighting, draft exclusions and boiler and pipe work modifications. Quick drop fabric doors fitted to the outside of most of the warehouses also ensured that more heat is retained.

Such was the success of the project that the energy initiatives and latest technology delivered at Bicester are now informing the MOD wider energy efficiency programme.







## Section Two

---

# Directors' Report

### 2.1 STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

2.1.1 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 under reference DAO[Gen]04-14 (18 December 2014). 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.

2.1.2 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

2.1.3 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.

2.1.4 The Accounting Officer is required to confirm that, as far as he is aware, there is no relevant audit information of which the entity's auditors are unaware, and the Accounting Officer has taken all the steps that he ought to have taken to make himself aware of any relevant audit information and to establish that the entity's auditors are aware of that information.

2.1.5 The Accounting Officer for DE&S is required to confirm that the annual report and accounts as a whole is fair, balanced and understandable and that he takes personal responsibility for the annual report and accounts and the judgments required for determining that it is fair, balanced and understandable.



## 2.2 GOVERNANCE STATEMENT

**I, Tony Douglas, Chief Executive of DE&S, assumed responsibility as Accounting Officer from 1 December 2015, while Sir Bernard Gray was the Accounting Officer for the period of these accounts and up to 30 November 2015. During this time, Sir Bernard had 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 he was personally responsible. I have therefore sought assurances from him that enables me to conclude that DE&S governance and control arrangements are satisfactory, and that they are designed to comply with the HM Treasury Code of Good Practice on Corporate Governance in Central Government Departments. These arrangements are explained in more detail below.**

**This Governance Statement represents my assurance that, as Accounting Officer, I am satisfied that DE&S finances are adequately controlled.**

2.2.1 DE&S' first year of operation as a BTE was one of transition and, as such, its governance arrangements continued to be refined. They are set out in detail in the DE&S Framework Document and draw on best practice in the public and private sectors. Our governance centres on a number of key roles, which are represented on our Boards and described below.

### Ministers and Owner's Council

2.2.2 The Secretary of State for Defence delegates the day-to-day ownership responsibilities for DE&S to the Minister for Defence Procurement (Min (DP)) but remains accountable to Parliament for all aspects of DE&S performance and the effectiveness of its governance arrangements.

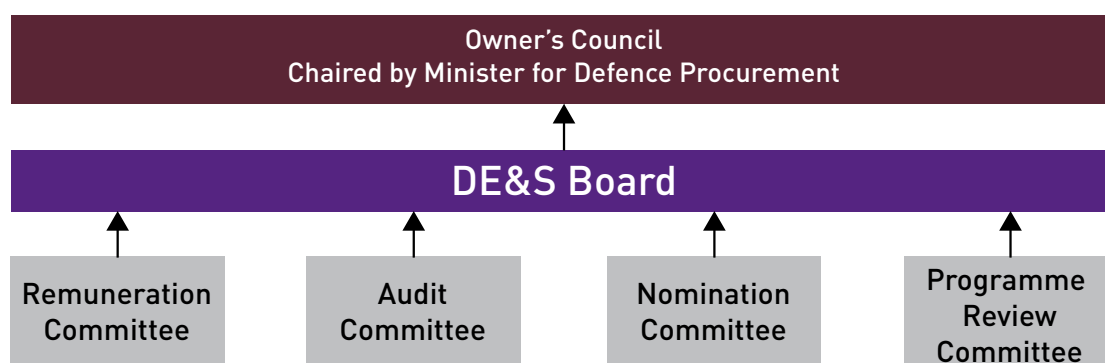
2.2.3 As Chief Executive, I am accountable to Min(DP), and ultimately responsible to Parliament for DE&S performance. I am also accountable to the DE&S Board for performance of the organisation. To discharge these duties, I receive delegated authority from the MOD Permanent Secretary to manage the financial, audit, fraud, commercial, pay and personnel matters of DE&S. I must also ensure that DE&S adheres to MOD policies on safety, health and environmental protection, sustainable development

and security.

2.2.4 As the responsible Minister for DE&S, Min (DP) chairs an Owner's Council which meets at least four times a year and exercises formal oversight of the performance of the organisation. This includes setting DE&S high-level objectives, approving the Corporate Plan and maintaining strategic oversight of performance. Membership includes the MOD Permanent Secretary, DG Finance, DG Head Office & Commissioning Services as the MOD formal NED on the DE&S Board, and Deputy Chief of the Defence Staff (Military Capability) as the customer representative. The DE&S Chairman and I, as Chief Executive, attend, and the Cabinet Office Chief Procurement Officer has a standing invitation to attend.

### Owner's Council activity

2.2.5 The Owner's Council met four times during 2014-15, in April, July, November and March. 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

2.2.6 The DE&S Board, under the chairmanship of the lead Non-Executive Director (NED), Mr Paul Skinner, plans to hold ten meetings a year and provides the strategic leadership for DE&S in delivering its objectives. As such it enables non-executive approval of the Corporate Plan for submission to the Owner's Council and oversight of the delivery of DE&S business. The Board provides a forum for independent, non-executive support and constructive challenge covering:

- DE&S purpose and role, the policy and commercial constraints under which it operates, and relevant good practice across the Government and private sectors
- Development of the Corporate Plan, business plans and budgets
- DE&S performance against the Corporate Plan, KPIs and CASPs
- The allocation of financial and human resources to achieve the Corporate Plan outcomes, including a review of the 'health' of DE&S (for example staff engagement and HR indicators)
- Approval of the DE&S pay strategy on advice from the Remuneration Committee, ensuring it is consistent with DE&S pay freedoms
- DE&S risk appetite and the controls that are in place to manage risks and threats and to address opportunities
- Regular review of DE&S relationships with customers and suppliers
- The DE&S Annual Report and Accounts

2.2.7 Alongside Mr Skinner are four NEDs: Mr James Dorrian, Ms Kathleen Harmeston, Mr Paul Smith and Mr Andrew Wolstenholme, who bring special skills and delivery in Human Resources, finance, 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 activity

2.2.8 The Board met nine times during 2014-15. At each DE&S Board meeting, members take reports from the Chairman, myself as Chief Executive, the Chief Financial Officer and each of the Board's sub-committees. Performance of DE&S is reviewed and specific business areas update the Board as required. We adopt the principles of evidence-based decision making when preparing all our papers, helping to ensure that the quality of data used by the Board is of an acceptable standard.

Number of meetings attended 2014-15	
Mr Paul Skinner (Chair)	7 (7) <sup>1</sup>
Mr Paul Smith	9 (9)
Mr Andrew Wolstenholme	3 (4) <sup>2</sup>
Mr James Dorrian	4 (4) <sup>2</sup>
Ms Kathleen Harmeston	1 (1) <sup>3</sup>
Mr Jon Thompson	4 (9)
Sir Bernard Gray	9 (9)
Air Marshal Sir Stephen Hillier	9 (9)
Mr Michael Bradley	8 (9)
Mr Jonathan Slater (representing Jon Thompson)	2 (9)
Sir Gerry Grimstone	3 (3) <sup>4</sup>

<sup>1</sup> Appointed in June 2014

<sup>2</sup> Appointed in October 2014

<sup>3</sup> Appointed in February 2015

<sup>4</sup> Interim chair before the appointment of Mr Paul Skinner

2.2.9 Formal minutes of all meetings are circulated promptly. Between meetings, other information is circulated as necessary to keep Board members informed on relevant issues. All key procedures and policies affecting the Board are maintained and operated by the Board Secretary.

### Board performance

by Paul Skinner, DE&S Chairman

I am confident that, in its first year of operation as a BTE, DE&S developed and implemented an appropriate corporate governance structure. As Chair of the DE&S Board, I consider that, collectively, members have the appropriate balance of skills, experience and qualities to discharge the Board's roles and responsibilities that will ensure effective oversight of the organisation. This year we have refined and developed our role as NEDs, agreeing a Board charter with Terms of Reference for the Board, the Executive Board, the Audit Committee and other supporting subordinate committees. I conducted a formal effectiveness review in July 2015, the outcome of which is a set of Board enhancements which we will implement over the course of 2015-16, adding value to the business and seeking to achieve a 'best practice' operation of the Board.

## The DE&S Board as at 31 March 2015



**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)



**Sir Bernard Gray**  
DE&S Chief of Defence  
Materiel



**Air Marshal  
Sir Stephen Hillier**  
KCB CBE DFC MA RAF  
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



**Kathleen Harmeston -  
Non-Executive Director**  
Former Managing Partner  
for ATos Consulting and  
Group Procurement Director  
for Royal Mail and the  
Cooperative Group



**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

### Key business discussed at the DE&S Board during 2014-15

Subject	Discussion	Outcomes
Governance	During its first year of operation, the Board sought to develop its function, to define its role and purpose, and to identify the most appropriate management information required for strategic governance purposes.	A Board Charter was drafted and agreed.
Transformation / BTE status	Management and governance of the new DE&S freedoms, including working with the wider MOD on implementation and co-ordination, was an important focus for the Board in 2014-15. For example, DE&S future strategy on rewarding performance was considered. The Board tested and challenged the rationale behind the proposals and confirmed that the appropriate governance arrangements were in place.	The Board agreed a formal, transparent governance process to ensure that DE&S freedoms are managed appropriately.
Safety	The importance of effective safety governance and the ongoing development of DE&S safety culture was a key area for discussion during the year, with Board members analysing trends and providing advice on how to continue improving in this area.	Because of its importance, the Board agreed that objectives in the next iteration of the Corporate Plan and Framework document be amended to include one relating to health and safety.
Performance	The Board reviewed progress on a number of major projects throughout the year, including Type 26, Aircraft Carriers, Lightning II, A400M, Ajax, Apache and Project Marshall. Board members received updates from the relevant business areas and decided on the necessary activities and management information that would help them maintain effective oversight.	Progress and concerns were noted by the Board. An overview of DE&S business operations was initiated for the NEDs. The establishment of a separate Programme Review Committee was agreed.
High-level risks	Risks and their mitigations were discussed throughout the year. The Board refined the relationships between itself, the Audit Committee and the Performance, Finance and Risk Board, to ensure that the correct linkages for strategic consideration of risk were in place.	The Board confirmed that, following the appointment of the full complement of Board NEDs, the Audit Committee had appropriate NED membership allowing effective oversight of DE&S risk.
Managed Service Providers	Progress on appointing the MSPs was reviewed throughout the year, with Board members ensuring that a clear audit trail was in place, and that a strong focus on driving benefits from the MSPs continued.	The first MSPs were appointed in November 2014. A Collaboration Charter was agreed. During 2015-16, the Board will engage with the MSPs to evaluate Transformation Plan outputs.
Review of corporate documents	The first DE&S Corporate Plan and Framework Document were published in May 2014. The Board worked throughout the year on updates to the refreshed DE&S Corporate Plan 2015-18, which was published in March 2015.  The Board also considered the DE&S Transformation Plan and reviewed the first DE&S Annual Report and Accounts.	The Board reviewed, challenged and provided advice on all corporate documents, ensuring that they developed into valuable, fair and accurate documents.
Other committees	The DE&S Board commented on terms of reference for its sub-committees and considered the most effective transmission of information between all parties.	Linkages between the DE&S Board and its subcommittees were refined throughout the year.



## DE&S Board sub-committees

2.2.10 The DE&S NEDs attend the following committees:

Name	Committee (meetings attended) <sup>1</sup>
Mr Paul Skinner	Nomination Committee Chair <sup>2</sup> Remuneration Committee member (2/2) Programme Review Committee member (1/1)
Mr Paul Smith	Audit Committee Chair (4/4)
Mr James Dorrian	Remuneration Committee Chair (2/2)
Mr Andrew Wolstenholme	Programme Review Committee member (0/1)
Ms Kathleen Harmeston	Audit Committee member (1/4) Remuneration Committee member <sup>3</sup>

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

2 No meetings of the Nomination Committee have yet been held.

3 Ms Harmeston was not yet in post for either of the Remuneration Committees held during 2014-15

### Audit Committee

2.2.11 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 insofar as 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.

2.2.12 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

2.2.13 The Audit Committee comprises a minimum of three NEDs (including the Chair of the Audit Committee and DG Head Office and Commissioning Services as the MOD NED). The DE&S Chief Financial Officer attends every meeting and I, as Accounting Officer, have a standing invitation to attend. Representatives from the NAO and Defence Internal Audit (DIA) may attend as observers. The quorum necessary for the transaction of business is two NEDs (including the Chair of the Audit Committee).

### Audit Committee business

2.2.14 The Audit Committee met four times during 2014-15, discussing a number of issues:

- **Year-end accounting:** Throughout the year, the Committee placed great emphasis on the need for careful planning around the year-end processes for DE&S as a BTE, to ensure that cost boundaries were as well-defined as possible and that the accounting issues that had affected the Departmental accounts around accruals and inventory continued to be well managed. The Committee regularly reviewed progress in the development, presentation and audit of the DE&S ARAC, recognising the significant challenges associated with first year presentation of the financial statements that ultimately led to the accounts qualifications reported by NAO.
- **NAO reports specifically relating to DE&S:** For example, the Committee considered the NAO Audit Completion and Major Projects Reports, deciding that the actions planned to address NAO audit points were both appropriate and reasonable.
- **DE&S audit plan:** The Committee monitored the progress of the internal audit programme and management responses to those audits. Where audits received a limited assurance rating, the Committee introduced a practice of inviting the audit sponsor to the meeting to discuss progress. The Committee also introduced a policy of zero tolerance of unsatisfactory progress on follow-up audits and, at year end, the trend on follow-up

audits was largely favourable. The Committee recognises that there has been a significant improvement in management focus on audit recommendations raised and would like to see DE&S reach a substantially assured position by the end of 2015-16.

- **Risk management:** During the year, the Committee received updates from the Performance, Finance and Risk Board on the management of strategic risks and their mitigations. Overall, the Committee was assured that the process was being managed effectively. Going forward, the Committee has suggested that the complexity of the strategic risks may benefit from being more clearly broken down to give greater clarity around timelines and priorities for action.
- **Contract management:** The Committee considered issues around overall contract management in DE&S, recognising that this was receiving senior management attention and that progress was being made. The Committee agreed that an ongoing review was needed to give confidence that controls are fully effective, and set an objective for the issues to be resolved by the end of 2015-16.
- **Fraud Board:** The Committee established a quarterly DE&S Fraud Board to oversee the implementation of a comprehensive strategy to protect DE&S assets, finances and business reputation from fraud, corruption, theft and misappropriation. The Fraud Board reports to the Audit Committee and terms of reference were agreed.

### Remuneration Committee

2.2.15 The Remuneration Committee is closely involved in the development of the DE&S People Strategy and advises Min(DP), myself, and the Board on matters relating to the proper application of DE&S compensation strategy. Details of Remuneration Committee responsibilities can be found in the Remuneration Report in Section 3.

2.2.16 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.

2.2.17 The Remuneration Committee has met twice during the last year; its inaugural meeting was in

February 2015, but an ad-hoc meeting took place in January 2015 to specifically discuss the recruitment of the DE&S Director Transformation. At its first meeting, the Committee decided on the following:

- **Effective conduct of business:** The Committee agreed that the nature of its business would develop over time, given the current level of maturity of the DE&S BTE and taking into account the issues that we would be seeking to take forward.
- **Pay and reward:** Discussions began on arrangements for the future DE&S compensation package. Proposals on how to manage the 2014-15 pay award were considered, with the conclusion that rewards should be targeted and differentiated by performance and business critical specialist skills.

### Nomination Committee

2.2.18 A Nomination Committee has been set up and will meet as necessary, but not less than twice a year, to advise on appointments to the DE&S Board (except for the Chairman, whose appointment is the responsibility of the Owner). Specific responsibilities for the Nomination Committee include:

- Supporting the Chairman to evaluate regularly (at least every three years) the balance of skills, knowledge and experience of the DE&S Board
- Succession planning for the senior executive Group and independent NEDs

2.2.19 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.

2.2.20 Our first year as a BTE saw us ensure that the correct structure and arrangements for the Nomination Committee are in place. No meetings have yet been held.

### Programme Review Committee

2.2.21 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 Programme and Equipment Support Programme. The Committee will review elements of programme delivery on a periodic basis at the direction of its Chair, and consider other issues that might arise on an ad hoc basis.

2.2.22 Members are responsible for the provision of strategic governance of programme delivery, and for advice and support to myself and the Executive Board on the delivery of the agreed programme of work. It comprises at least three members for the conduct of its business, including the DE&S Chairman, another external 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. At its first meeting the Committee decided on the following matters:

- **Effective conduct of business:** agreement to the Terms of Reference and a forward programme which will ensure the periodic review of salient programmes as identified by the Chief Executive and Deputy Chief of the Defence Staff (Military Capability)
- **SDSR:** identification of options to address specific equipment issues in the context of the forthcoming SDSR
- **Development of the CASPs:** development of the change configuration process for updating the formal agreements of deliverables between DE&S and its customers.

## DE&S Executive Board

2.2.23 DE&S is led on a day-to-day basis by its Executive Board. Alongside me are DG Resources (the Chief Financial Officer), DG Commercial and the Chiefs of Materiel for Fleet, Land, Air and Joint Enablers, who lead the delivery of the programme in their respective areas. The function of the Executive Board is to:

- Provide collective leadership for the organisation
- Ensure the business operates safely and securely, reviewing performance and managing risks
- Manage business delivery and financial performance
- Take actions necessary to ensure overall business performance is to the standards set by the Owner and within the remit prescribed in the Framework Document



Sir Bernard Gray  
Chief of  
Defence Materiel

## DE&S Executive Board as at 31 March 2015



Vice Admiral  
Simon Lister  
CB OBE  
Chief of Materiel  
(Fleet)



Lt Gen  
Sir Chris Deverell  
KCB MBE  
Chief of Materiel  
(Land)



Air Marshal  
Simon Bollom  
CB  
Chief of Materiel  
(Air)



Pete Worrall  
CB OBE  
Chief of Materiel  
(Joint Enablers)

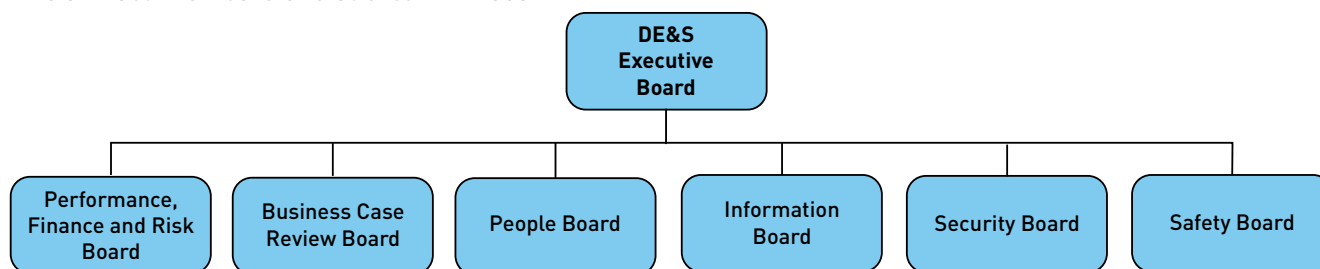


Susanna Mason  
Director General  
Commercial



Michael Bradley  
Director General  
Resources

### DE&S Executive Board and sub-committees



2.2.24 During 2014-15 the Executive Board considered the following key issues:

- **DE&S performance:** Progress against KPIs was reviewed at each meeting and updates were also considered for the latest iteration of the DE&S Corporate Plan, which was published in March 2015. Operational updates are provided at each meeting, with the DE&S contribution to the Afghanistan drawdown being of particular note this year. Strategic risks and their mitigations were also considered at all meetings.
- **Transformation:** Over the year, the milestones taking us towards becoming a match-fit organisation were reviewed and adjusted as necessary to inform development of the Transformation Plan. New governance arrangements were established and updates given on the appointment of the MSPs, and how we planned to manage our relationship with them.
- **Pay freedoms:** Executive Board members considered proposals on how to take forward our new pay freedoms, including approving changes at SCS 1 level and the introduction of a strengthened special bonus scheme. Future performance management, and recruitment and retention issues were also discussed throughout the year.
- **Safety updates:** The Executive Board recognises that safety is critical to the operation of the organisation and, as such, it is a standing agenda item. As an additional governance measure, it was agreed that the Safety Board would report to the DE&S Board through the Executive Board.
- **Communications and engagement:** This was a key focus for the Executive Board throughout the year with measures taken to strengthen this area in light of the DE&S Your Say results and other feedback. A new communications and engagement strategy was agreed by the Executive Board.

### Executive Board sub-committees

2.2.25 A **Safety Board** is provided for in the DE&S Framework Document, reporting to the DE&S Board. In practice, the law requires that executives take responsibility and accountability for the delivery of safety throughout their areas of responsibility. Accordingly, the DE&S Board has agreed that the existing DE&S Safety Board (a subordinate of the DE&S Executive Board) will report to the DE&S Board through myself as the Chief Executive, as I am accountable personally for safety in DE&S. A NED may be invited to attend the Safety Board, as required.

2.2.26 The Chief of Materiel (Land) chairs the quarterly **Security Board**, which owns and manages strategic-level risk and provides oversight of security across DE&S and industrial partners. Information security risks are managed by the **Information Board**, which raises issues of interest to the Security Board; as does the Nuclear Security Programme Board, which is chaired by the Chief of Materiel (Fleet).

2.2.27 Other Executive Board sub-committees meet regularly, including the **Performance, Finance and Risk Board**, which focuses on internal controls and risk management, the **Business Case Review Board** and the **People Board**. These update the Executive Board as necessary on matters within their jurisdiction.

2.2.28 All Chiefs of Materiel chair monthly Domain Executive Board 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.

2.2.29 Finally, I hold regular one-to-one meetings with all of my Executive Board. I also meet with my Senior Management Team (Executive Board members and others as appropriate) at a regular forum at Shrivenham, where discussion can take place on any wider concerns which members may have.



## Internal control

### Principal DE&S risks and their mitigations during 2014-15

Risk	Impact on business	Progress in 2014-15
<b>Safety</b> The risk of serious accident or incident involving military systems, attributable to a failing in a DE&S Safety Equipment 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.	We have enhanced our acquisition safety training programme and are developing a recognised career structure for acquisition safety staff. Recruitment activity is prioritised to alleviate critical shortfalls and retention incentives have been implemented in some safety critical areas of the business. We are also focusing on effective learning from experience activity, and improving safety related communications across the business.
<b>Transformation and governance</b> The risk that the transformation programme being delivered by DE&S and the MSPs fails to deliver adequate value and benefit to the enterprise.	Ineffective transformation could affect business performance and morale, increase operating costs and hinder our ability to deliver equipment and support.	We have developed and established new governance structures and made it a priority to communicate the transformation programme to all staff. We are managing the delivery of the MSP contracted work package milestones, so they provide value and benefit.
<b>Manpower resources</b> The risk that DE&S is unable to retain and attract adequate numbers of specialist staff with the necessary skills.	Loss of staff and inability to attract new staff would impact DE&S performance, increase reliance on private sector support and drive up operating costs.	We have adopted an increasingly successful higher starting pay approach to recruiting individuals into key posts. We have also placed a greater focus on workforce planning and are adopting targeted recruitment actions supported by stronger emphasis on functional development, training and the development of skills. We are taking steps to reward people who have achieved qualifications most valuable to DE&S.
<b>Accounting</b> The risk that the DE&S accounts are qualified by the NAO as not being a true and fair reflection of its operating activities.	A qualification by the NAO would damage our reputation.	This risk has crystallised in the NAO audit qualifications against private sector support and other programme costs and the related liabilities balances. We are conducting a joint lessons learnt exercise with the NAO to identify key actions/mitigations to prevent the qualifications becoming enduring issues.
<b>Security, business continuity and resilience</b> The risk that vulnerabilities in protective security could be exploited and compromise DE&S people, assets, material and information.	A failure would adversely affect DE&S performance and reputation, weaken our negotiating position with contractors and increase operating costs.	We have a dedicated team devoted to continual monitoring of the security threat which includes the implementation of a risk-based security assurance programme. We have implemented continuous improvement strategies to increase the maturity of our business continuity and information assurance plans.
<b>Industry and market</b> The risk that our industry suppliers fail to deliver the required equipment and support that we have contracted for.	Without industrial capability and capacity, DE&S would be unable to deliver our customers' equipment and support requirements.	We have carried out a quarterly review of the defence industrial sector, to evaluate industry strategic performance and sustainability. We have put in place arrangements for DE&S project teams routinely to evaluate and manage individual contract delivery performance on a case-by-case basis.

### Risk management

2.2.30 Within DE&S, we use risk management techniques to take better informed decisions and to improve the probability of achieving our strategic and operational objectives. 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.

2.2.31 The DE&S Board examines DE&S risk appetite and the controls that are in place to manage risks and threats and to address opportunities. The Board pays particular attention to strategic risks, defined as those that either have the potential directly to 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.

2.2.32 Strategic risks are delegated to the appropriate member of the Senior Management Team, on the basis of his or her role, where the capability and resources to take ownership and to deal effectively with the risks exist. Below the DE&S Board, the Performance, Finance and Risk Board meets monthly to systematically review, support and challenge risk owners to manage and reduce the risks as far as is reasonably practical. During 2014-15, we have implemented a series of recommendations made by the DE&S Audit Committee Chair to assist the Performance, Finance and Risk Board in reviewing the strategic risks and to provide more focused discussions.

### Resource management

2.2.33 We have clearly defined processes and procedures for identifying and addressing resource requirements, including headcount, to achieve our performance objectives, which are monitored on a regular basis through our governance and board structures. In addition to this, the Executive Board can raise any specific areas of concern relating to resources with the Defence Internal Audit Team through formal meetings during the year, and through attendance at the monthly Performance and Finance Risk Board. To ensure we monitor and control the demands placed upon us by our principal customers (the Commands and Strategic Programmes), relevant Executive Board members attend quarterly Customer Reviews, chaired by DG Resources. These meetings review performance and cost, allowing us to address specific resource issues as they arise.

2.2.34 Business cases for the commitment of expenditure and manpower resources are subject to an approvals hierarchy which identifies those cases where external scrutiny and approval is needed (for example, if they are high-value). The DE&S Business Case Review Board meets twice a month to assess the quality of cases that require external approval – directing improvements in content and presentation where necessary. This ensures that all high-value business cases are supported by quality and consistent analysis (including endorsement by the DE&S Cost Assurance and Analysis Service (CAAS)).

2.2.35 The DE&S Board formally endorses and monitors performance against our annual budget. We exercise 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. Despite our change of status, delegations did not change significantly during 2014-15. However, a detailed DE&S Delegations Matrix is now in development and will be issued in 2015-16, encompassing authority from senior executive to working levels.

2.2.36 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. Our new status requires us to produce our own Annual Report and Accounts; separating Equipment Programme activities from those relating to BTE project management activities. As such, we have sought to clarify the new accounting boundary through issue of financial instructions on BTE business activities and briefings on boundary accounting to all staff, for example on definition and approvals of private sector support activities. The audit qualifications reported by NAO demonstrate that there is more work to do and we will continue to work to resolve outstanding accounting issues throughout 2015-16.

### Project management

2.2.37 On behalf of the MOD, DE&S manages a vast range of equipment procurement and equipment support projects. Ensuring that these are managed correctly and that they are done so within the relevant budget and timescale parameters, is the responsibility of the project manager. Corporately, the MOD uses Investment Appraisals, business cases and project evaluations as the formal mechanisms for the approval of expenditure on a project and, more broadly, for

ensuring that projects are progressing as expected. Production of these is the responsibility of project managers, supported by finance and commercial staff and the DE&S CAAS Approvals Team (CAT). The assurance and endorsement of Investment Appraisals for Category A, B and centrally-approved Category C projects rests with Defence Economics. For Category C and D projects delivered by DE&S and approved by the Commands, responsibility rests with the CAT.

2.2.38 Biannually, the Defence Economics team reviews and reports on the quality of a sample of DE&S-endorsed cases. In May 2014, 90 per cent of DE&S-approved Investment Appraisals were judged good or adequate, and 100 per cent in October 2014.

2.2.39 Over the last year we worked to raise the profile of project evaluations across DE&S. These identify the

key successes and failures of a project, enabling us to learn from experience. We are looking to promote project evaluation planning, embed the plans into the approvals process and establish firm commitment from managers and senior figures to enforce, encourage and support the process within DE&S. We have also put additional resources into the project evaluation support function in our CAT team.

### Commercial governance

2.2.40 A number of steps were taken in 2014-15 to strengthen governance across the Commercial function. The DE&S DG Commercial was appointed in July 2014. She has unlimited delegation, is the senior commercial advisor in DE&S and the MOD Head of Profession for Commercial. The DE&S



### Engineering skills development

Our commitment to strengthening engineering professionalism and skills was recognised in January 2015 when the DE&S Engineering Skills Development Team (ESDT) received one of the annual acquisition awards handed out by the Minister for Defence Procurement. The ESDT recruits, trains and manages engineering graduates and technician apprentices, deploying them across the business to develop their skills and knowledge. In 2014, the ESDT team increased the intake of DE&S technician apprentices by 42 per cent - from 69 in 2013 to 98. It also oversaw a 67 per cent increase in the number of students sponsored through Welbeck defence sixth form college, with more of the graduates achieving a 2:1 class degree rather than a 2:2. And, overall, a very healthy 93 per cent of apprentices completed their apprenticeships in 2014, compared to a national industry average of between 75 and 80 per cent.

Recognition for our apprentices is not limited to DE&S. We were also proud to see our engineering apprentices take the top three places in the 2014 MOD 'Apprentice of the Year' competition and gain national recognition as finalists in the Institution of Engineering & Technology and Engineering Employers Federation awards.

The ESDT is also continuing to focus on the successful re-launched DE&S Fellowship Scheme which looks to recognise and reward internationally-recognised niche technical specialists.



Director Commercial Operations continues to manage core DE&S commercial business. The new role of Professional Development Director was also established to focus on training and professional development of the commercial community in DE&S and across the MOD. Senior team meetings have also been realigned to drive change and improve DE&S commercial standards and reputation with other government departments, industry and other stakeholders.

2.2.41 During 2014-15, we instigated a number of actions to ensure that our contract management processes are improved. These are being driven by DG Commercial and include development of a new integrated information system supported by a training programme, data cleansing and self-assurance reviews. Over the next year, work will continue in this area to give confidence that the controls are fully effective.

2.2.42 As explained on page 20, we also continue to focus on development of commercial skills. As well as the training opportunities outlined earlier in this report, the commercial community will also be required to experience roles in contract placement and contract management workstreams, to broaden their vision and create a forward-looking, diverse workforce.

### **Quality control**

2.2.43 The Government Quality Assurance Framework was published in July 2014 and we ensure we consult with industry on our quality policies through the Defence Industries Quality Forum. We also continue to engage with NATO to ensure that we have contemporary quality processes and quality contract requirements for use in contracts with suppliers across NATO.

### **Safety and security compliance**

2.2.44 During 2014-15, DE&S met all of its responsibilities for safety compliance. As outlined on page 24 of this report, we place a great emphasis on safety and we aim continually to develop and improve safety management across all areas of responsibility. Related to this, we have also established a Fraud Board to mitigate against the risk of fraud in DE&S, and the consequent impact this could have on safety and security compliance. I act as the Senior Duty Holder for Safety and am supported in this role by a three-tier safety governance structure.







## Afghanistan drawdown

November 2014 saw the end of combat operations in Afghanistan. Arriving at that point, however, had only been possible thanks to DE&S efforts in the biggest logistic challenge in a military generation – moving people and equipment back to the UK from the largest operational UK military base since World War II. DE&S' Defence Support Chain Operations and Movements (DSCOM) team co-ordinated all DE&S redeployment activity and managed the air, land and sea lines of communication on behalf of Commander Joint Operations. From the start of the operation, and helped by the early deployment of DE&S-managed logistics information systems, DE&S staff reviewed all stocks in Afghanistan and made decisions on more than 45,000 stock lines – from helicopters to office chairs. Items no longer required were disposed of through sale, warlike scrap or gifting. Materiel stocks returning to the UK were managed by DE&S Logistics Commodities and Services personnel, who deployed to Camp Bastion to inspect and triage stock entering the reverse supply chain. They ensured that containers and pallets were correctly packed, consigned and marked up for return and their efforts meant that millions of pounds were saved in unnecessary disposal and transport costs. DSCOM was also responsible for moving items to and from Afghanistan, with Boeing 747s and C-17s flying almost five million air miles, and kit being transported thousands of miles by road, rail and by sea. In all, 3,465 vehicles and major equipment and 4,728 containers of materiel were recovered to the Strategic Base, and the equivalent of 6,293 containers were disposed of in theatre. The final elements of the returning stocks arrived back in the UK at the end of March 2015. The planning and the efforts of DE&S personnel, both in-theatre and in the UK, played a major part in the successful end of the military campaign.

2.2.45 The physical security of our staff and the assets we procure and utilise in discharging our business activities are of critical importance and, as such, a more detailed explanation of the structures and processes we follow to maintain effective security control was outlined earlier in this report on page 26.

### **Protected personal data-related incidents**

2.2.46 The Government has made a commitment to enhance transparency with Parliament and the public about action to safeguard information, and results of that action. As part of this process, departments and their agencies are required to publish details in their Annual Reports of incidents that have resulted in the unauthorised disclosure of personal data.

2.2.47 No personal data related incidents were reported to the Information Commissioner's Office in 2014-15. There was one loss of inadequately protected electronic equipment, devices or paper documents from a secured Government premises. This was deemed by the Data Controller not to fall within the criteria for reporting to the Information Commissioner's Office, but it was recorded centrally within DE&S. The circumstances surrounding the loss of the information were reviewed and action has been taken to reduce the risk of this happening again. Small, localised incidents are not recorded centrally and are not cited in this report.

### **Incident reporting**

2.2.48 DE&S has mature processes for the capture and reporting of incidents. The DINC maintains a Reporting of Injuries, Diseases and Dangerous Occurrences (RIDDOR) industry standard compliant system and process, which is being automated throughout DE&S, further improving the speed of reporting and our data analysis capability. More detail on incidents reported during 2014-15 is on page 24.

### **Business continuity**

2.2.49. Business continuity management and resilience issues are reported to the quarterly Security Board. 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, which cover our core functions, operational areas and sites. In the event of a major incident, they would help us to recover our systems

and processes and get our people back into critical roles as quickly as possible. 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 work to improve the business continuity process and the Business Resilience Team will take this work forward during 2015-16.

### **Information management**

2.2.50 We remain focused on ensuring effective protection and exploitation of information. Control mechanisms have continued to improve over the reporting year and now include regular reviews of risk exposure by the senior information risk owner. In August 2014, DE&S was assessed as having reached full operating capability against the Information Assurance Maturity Model (IAMM) Level 3; three months ahead of schedule. In March 2015, we conducted a further health check enabling us to put together a realistic implementation plan for the achievement of IAMM Level 4.

### **People and sickness absence**

2.2.51 The DE&S People Board, chaired by Director HR, meets monthly to provide a senior forum for reviewing people issues of corporate importance. This Board develops and oversees delivery of a skills and workforce plan, promotes good leadership, people management and business ownership of people issues and policy compliance. More details on our people-related policies and processes can be found in the 'Our People' section, starting on page 18. Pension information can be found in the Remuneration Report, on page 52 and in the Note on page 74.

2.2.52 Above all, we are committed to the health and wellbeing of our staff and have a comprehensive sickness absence policy. During 2014-15 the average number of days for sickness absence was 7.3 days per employee, compared to 7.2 days in 2013-14 (before DE&S became a BTE). This compares favourably with the MOD averages, which were 8.3 in 2014-15 and 8.2 in 2013-14. In February 2015, we adopted a new sickness absence policy, in line with the wider MOD, which aims to take a work-focused approach to attendance. Our HR Business Partners are continuing to work closely with staff to ensure that sickness absence is dealt with in accordance with this new policy and we will monitor its effectiveness over the year.

## Fraud and whistle-blowing

2.2.53 As described on page 36, we have established a quarterly Fraud Board, led by the Chair of the DE&S Audit Committee, to ensure we have robust procedures in place to mitigate the risk of fraud in DE&S. In the past year, we have also continued to publicise to all staff our fraud policies and procedures to help line managers identify and report fraud.

2.2.54 We are committed to ensuring that no one who makes a disclosure in exposing matters of public concern suffers detriment for doing so. In DE&S, our whistle-blowing policy is that all genuine concerns will be handled responsibly, professionally and in a positive manner; those raising a concern will be afforded protection as detailed in these procedures, and help and support will be available to employees where concerns are raised under the relevant whistle-blowing procedure.

## Assurance

2.2.55 In 2014-15, as well as our regulatory safety, health and environment audit programmes, eight full internal audits of DE&S and six follow-up audits from previous years (before DE&S became a BTE), were completed by the Defence Internal Audit (DIA) team. These audits encompassed single or multiple reviews of manpower substitution, project risk management, project milestones, and management of assets in industry, including losses and import duty waiver certificates.

2.2.56 Of the eight full scope audits DIA reported a 'no assurance' assessment for manpower substitution. Specific weaknesses were identified with the internal governance and assurance arrangements for approval and monitoring of manpower substitution. The DE&S HR Director is now implementing a number of process improvements to address these issues.

2.2.57 With regards to the six follow-up audits, which were undertaken after a previous year's audit reported less than substantial assurance, DIA have reported unsatisfactory progress on one 'assets in industry' review. A credible programme for resolution in 2015-16 is in place and the DE&S Audit Committee will continue to monitor progress. The rest were assessed as having made satisfactory progress.

2.2.58 The effectiveness and efficiency of our internal controls are reviewed regularly, and at least annually, as part of my input to the Department's Annual Assurance Report. Action is taken to improve controls

where weaknesses are identified and the DE&S Audit Committee regularly reviews and, where necessary, intervenes on progress being made to rectify weaknesses and failures identified through DIA and NAO activities.

2.2.59 With regards to overall assurance, DIA provided DE&S a 'limited assurance' in relation to governance, risk and control frameworks, given that this is the first year of operation and some processes have not been operating for a whole 12-month period. A specific DIA review on the effectiveness and operation of DE&S BTE governance arrangements took place in 2014-15, including a review of sub-committees. This gave substantial assurance, which reflects DE&S efforts to put in place a solid governance foundation on which to build in 2015-16.

## Significant events after the reporting period

2.2.60 On 23 November 2015, the Government published the 2015 Strategic Defence and Security Review (SDSR). This outlined the capabilities in which the MOD would invest and, as such, will inform much of DE&S' work over the coming years.

2.2.61 On 1 December 2015, I took over from Sir Bernard Gray as DE&S Chief Executive Officer, assuming Accounting Officer duties from that date.

## Auditor

2.2.62 DE&S financial statements are audited by the Comptroller and Auditor General under the Government Resources and Accounts Act 2000. The audit fees for this work are included in the Statement of Comprehensive Net Expenditure. DE&S did not contract with its external auditor for any non-audit services.

2.2.63 So far as I, the DE&S 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.



## 2.3 ANNUAL ASSESSMENT OF GOVERNANCE

2.3.1 My overall assessment of DE&S governance takes account of the opinion of Defence Internal Audit and reflects the assurance assessments that DE&S teams have provided to the MOD as part of the Department's Annual Assurance Report. For 2014-15, an overall 'limited assurance' is given for DE&S BTE governance, risk and controls, which reflects the ongoing need to fully embed all of the new BTE assurance structures and processes. It is essential that DE&S has in place a strong governance and control framework to guide our day-to-day operations and help us maximise delivery of our high-level objectives and, while 2014-15 was a year of transition, I know that we have in place the foundations of a solid governance framework that will allow effective oversight of the organisation. This is echoed in the substantial assurance Defence Internal Audit was able to give specifically for BTE governance arrangements. The challenges and risks that DE&S faced during its first year of operation have tested its risk management, assurance and control frameworks, all of which are still being developed and refined. Nevertheless, where the effectiveness of these frameworks has been challenged, the organisation responded with proportionate action plans designed to begin reducing the risk to an acceptable level. I am confident that, once these are fully embedded, we will be able to provide a more positive governance opinion in the next report and make substantial progress in resolving the issues associated with the NAO's audit qualifications.

### Chairman assessment

by Paul Skinner

At the end of 2014-15, governance and control of the new DE&S BTE, including Board and Committee reporting had been established and operating for less than a year and, as such, it would be premature of us in this Annual Report to expect definitive assurance on our governance, risk and control frameworks. That said, based on assurance provided by the teams and the views of our internal auditors, I am confident that, fundamentally, DE&S can deliver its objectives while complying with agreed standards within delegated budgetary responsibility and accountability. Through my discussions at the Board and with teams across DE&S, I have seen that action plans are in place to address areas that require further development, for example in the control of private sector support and development of contract management processes. The next year will see DE&S embed these plans and further revise its governance framework, taking it further towards its aspired state as a world-class procurement delivery and customer support organisation.



**Tony Douglas**  
Accounting Officer  
4 December 2015



**Sir Bernard Gray**  
Chief of Defence Materiel  
(04/01/11 – 30/11/15)







## Section Three

---

# Remuneration Report

### 3.1 DIRECTORS' REMUNERATION REPORT

#### Remuneration Policy

3.1.1 The following remuneration policy refers to the employment of the DE&S Directors on the DE&S Board and Executive Board. Remuneration details for Min(DP) and MOD representatives on the Owner's Council and other DE&S Boards 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 Board are members of the Senior Civil Service (SCS), and three are senior officers of the Armed Forces

3.1.2 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 will take 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 3 level are made in conjunction with the Permanent Secretary.

#### Remuneration Committee

3.1.3 The Remuneration Committee is a sub-Committee of the DE&S Board. It comprises a minimum of three NEDs, including a MOD NED. The Chief Executive, the DE&S HR Director, the DE&S DG Resources and other Executives or Non-Executives may be invited to attend as appropriate.

3.1.4 The Committee advises Min(DP), the Board and the Chief Executive of DE&S 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.

#### Performance and Reward

3.1.5 The 2014-15 Statement of Comprehensive Net Expenditure reflects payments made for 2013-14 performance which were made in line with wider MOD non-consolidated award arrangements. 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, subject to the rules and regulations imposed by the Senior Salary Review Body and the Cabinet Office. For DE&S staff at SCS 1 level, we implemented separately negotiated performance-based base pay increases, but followed wider MOD non-consolidated award arrangements. For SCS 2 and 3, we decided to follow wider MOD reward and performance policies. MOD implemented its own pay and non-consolidated award arrangements within the Cabinet Office framework through an agreed pay strategy. With regards to SCS 2 and 3 performance in 2014-15, DE&S agreed separate arrangements with staff eligible for awards up to 30% of salary. Any non-consolidated awards were based on a judgement of how well an individual had performed against their peers, and awards 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 be linked to demonstrable evidence of delivery. The value of payments made in 2014-15 will be formally reported in the 2015-16 Statement of Comprehensive Net Expenditure.

3.1.6 DE&S also employs some members of the SCS on Fixed Term Appointments. These individuals are externally recruited to fill specific roles where the Department 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.

3.1.7 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 is 2.6 per cent of salary.

### Senior Manager contracts

3.1.8 The Constitutional Reform and Governance Act 2010 requires Civil Service appointments 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.

3.1.9 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](http://www.civilservicecommission.org.uk).

3.1.10 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 (OCPA) 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, amongst other things, details of their remuneration. Appointments may be terminated at one-month's notice by either party or on dissolution of the Board, unless found guilty of gross misconduct when termination will be immediate. Their 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.

3.1.11 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, recognising the contribution of the NED, identify ways this could be improved, and provide feedback.

3.1.12 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 and this was extended in January 2015 for a further year. 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.

3.1.13 DG Resources, the Chief Financial Officer, Mr Michael Bradley, was also appointed through open competition under the terms of the Civil Service Management Code on 3 January 2012. He was appointed with a four-year contract, which has the option to be extended to five years or made permanent by agreement.

3.1.14 DG Commercial, the Chief Commercial Officer, Ms Susanna Mason was also appointed through open competition under the terms of the Civil Service Management Code on 1 July 2014. She was appointed with a contract to 30 June 2018. Ms Mason is also the MOD Head of Profession for Commercial staff, responsible for providing a strategic overview of commercial skills in the MOD and for identifying commercial issues requiring MOD corporate action.



### Pay Multiples

3.1.15 The following table contains details of pay multiples – the ratio between the highest paid DE&S Executive Board member and the median remuneration of the workforce. No comparator year is provided as this is the first year DE&S has operated as a BTE.

3.1.16 Total remuneration includes salary, non-consolidated performance-related pay and benefits-in-kind.. It does not include employer pension contributions, compensation payments, severance payments and the Cash Equivalent Transfer Value (CETV) of pensions.

	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	£142,500
Median total remuneration of Armed Forces personnel	£47,689
Military pay ratio	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
Median total remuneration of civilian staff	£31,573
Civilian pay ratio	9.42

*The above table has been subject to audit*

### Conflicts of interest

3.1.17 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.

### Pensions

3.1.18 Pension benefits are provided through the Civil Service pension arrangements. The DE&S share of the transactions and balances of these is not consolidated in the accounts; separate accounts are prepared for the schemes and details can be found at [www.civilservice.gov.uk/pensions](http://www.civilservice.gov.uk/pensions).

3.1.19 The transactions and balances of the Armed Forces Pension Scheme (AFPS) and the Armed Forces Compensation Scheme are also not consolidated in the accounts. The report and accounts of the AFPS are prepared separately and are available at: <https://www.gov.uk/government/publications/armed-forces-pension-scheme-annual-accounts-2012-13>.

3.1.20 Employer's contributions payable to the Armed Forces and Civil Service pension schemes have been charged to the Statement of Comprehensive Net Expenditure. Further details relating to the Civil Service pension arrangements are at [www.civilservicepensionscheme.org.uk](http://www.civilservicepensionscheme.org.uk).

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

3.1.22 No member of the Executive Board has received a payment for compensation for loss of office under the terms of an approved compensation scheme, and no award or compensation has been paid to former members of the Executive Board. No payments have been made to third parties for the services of a member of the Executive Board.

**Non-Executive Remuneration**

	<b>2014-15</b>	
	Appointed	Salary (£000) <sup>2</sup>
Sir Gerry Grimstone <sup>1</sup>	April 2014 (until June 2014)	
Mr Paul Skinner <sup>3</sup>	June 2014	-
Mr Paul Smith	April 2014	10-15
Mr Andrew Wolstenholme <sup>3</sup>	October 2014	-
Mr James Dorrian	October 2014	10-15 (Full Time Equivalent (FTE) 25-30 annually)
Ms Kathleen Harmeston <sup>3</sup>	February 2015	-
Mr Jon Thompson <sup>4</sup>	April 2014	-
Air Marshal Sir Stephen Hillier <sup>4</sup>	April 2014	-

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

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. This report is based on accrued payments made by the Department and thus recorded in these accounts.

3 Mr Paul Skinner, Ms Kathleen Harmeston and Mr Andrew Wolstenholme waived their fees for their DE&S Board membership

4 Mr Jon Thompson and Air Marshal Sir Stephen Hillier receive no remuneration for DE&S Board membership as they are MOD employees. Their salary details are reflected in the MOD Annual Report and Accounts.

*The above table has been subject to audit*

## DE&S Executive Remuneration

	Appointed <sup>1</sup>	2014-15				
		Salary (£000) <sup>2</sup>	Annual performance award (£000) <sup>3</sup>	Benefits in kind (to the nearest £100) <sup>4</sup>	Pension benefits (to the nearest £1,000) <sup>5</sup>	Total (£000)
Sir Bernard Gray	1 April 2014	220-225	45-50	23,800	83,000	375-380
Mr Michael Bradley	1 April 2014	160-165	10-15	-	65,000	240-245
Vice Admiral Simon Lister	1 April 2014	125-130	N/A	-	69,000	195-200
Lieutenant General Sir Chris Devereil	1 April 2014	140-145	N/A	-	70,000	210-215
Air Marshal Simon Bollom	1 April 2014	130-135	N/A	-	67,000	200-205
Mr Pete Worrall	1 April 2014	125-130	-	10,500	25,000	160-165
Ms Susanna Mason <sup>6</sup>	1 July 2014	130-135 (FTE 175-180)	45-50	-	-	180-185

<sup>1</sup> Start dates are aligned to DE&S BTE vesting day for all Board members who were in place on this date. The only exception to this is Ms Susanna Mason who was appointed to her role on 1 July 2014.

<sup>2</sup> '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.

<sup>3</sup> Military terms and conditions do not include provision for a performance award. The values for civilians reflect awards for 2013-14 performance that were paid and reflected in the 2014-15 Statement of Comprehensive Net Expenditure. The values for 2014-15 performance awards for senior executives are in the £45,000 to £50,000 banding for Sir Bernard Gray, Mr Michael Bradley and Ms Susanna Mason, and £35,000 to £40,000 banding for Mr Pete Worrall. These awards will be formally reported in the 2015-16 Statement of Comprehensive Net Expenditure.

<sup>4</sup> 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 2014-15. 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.

<sup>5</sup> The value of pension benefits accrued during the year is calculated as the real increase in pension multiplied by 20, plus the real increase in any lump sum less the contributions made by the individual.

<sup>6</sup> The salary banding for Ms Susanna Mason reflects actual salary received from appointment on 1 July 2014 to 31 March 2015. The value in brackets reflects the annual equivalent salary.

*The above table has been subject to audit*

**DE&S Executive Pension Provision**

	Total accrued pension at pension age [and related lump sum] as at 31 March 2015 (£000)	Real increase in pension at pension age [and related lump sum] (£000)	CETV <sup>1</sup> as at 31 Mar 2014 (£000)	Real increase in CETV <sup>2</sup> (£000)	CETV <sup>1</sup> as at 31 Mar 2014 (£000)
Sir Bernard Gray	20 – 25 [Nil]	5 – 7.5 [Nil]	217	47	294
Mr Michael Bradley	10 – 15 [Nil]	2.5 – 5 [Nil]	114	30	170
Vice Admiral Simon Lister	65 – 70 [205 – 210]	2.5 – 5 [10 – 15]	1,455	135	1,607
Lieutenant General Sir Chris Deverell	70 – 75 [210 – 215]	2.5 – 5 [10 – 15]	1,439	141	1,598
Air Marshal Simon Bollom	65 – 70 [200 – 205]	2.5 – 5 [10 – 15]	1,417	135	1,569
Mr Pete Worrall	50 – 55 [160 – 165]	0 – 2.5 [0 – 5]	966	19	1,035
Ms Susanna Mason <sup>3</sup>	-	-	-	-	-

<sup>1</sup> 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 to benefits resulting from Lifetime Allowance Tax which may be due when pension payments are taken.

<sup>2</sup> The real increase is adjusted for inflation and therefore does not just reflect the difference between opening and closing CETV balances.

<sup>3</sup> Ms Susanna Mason was not a member of an exchequer funded scheme but DE&S did make a contribution in the band of £10,000 to £15,000 to her private pension scheme in the period from her appointment date to 31 March 2015.

*The above table has been subject to audit*



**Tony Douglas**  
Accounting Officer  
4 December 2015



**Sir Bernard Gray**  
Chief of Defence Materiel  
(04/01/11 – 30/11/15)



### Chinook

DE&S' Chinook Team successfully delivered the first of 14 new Chinook Mark 6 helicopters to the RAF in April 2014 on schedule. The Chinook Mark 6 is being delivered under a £1 billion programme with Boeing which will see the helicopters benefiting from the same digital cockpits currently being fitted to our existing Chinook fleet (under project JULIUS). The aircraft are also fitted with a new Digital Automatic Flight Control System (DAFCS) that provides improved handling qualities and aircraft stability within degraded visual environment conditions, such as sandy or snowy situations. The DAFCS significantly reduces workload for the aircrew and therefore enhances safety while operating in difficult conditions; early use of the aircraft by RAF pilots has confirmed all of these benefits. All 14 aircraft are due to be delivered before the end of 2015 with the full operational capability being achieved by early 2017.

The Chinook Team also placed a £150 million contract in October 2014 to retrofit DAFCS into our existing fleet, which will further enhance safety and improve coherence across the fleet. Furthermore, in December 2014 the team signed a £420 million contract amendment for the third pricing period of the through-life customer support (aircraft maintenance, spares and support) arrangement. This was achieved through close working with McKinsey consultants, Boeing and staff from Joint Helicopter Command. The contract delivers support at a lower cost, on a like-for-like basis, than the current pricing period, represents excellent value for money and considerable savings for the Army, MOD and UK taxpayer. The team has also realised savings through the placement of a new £115 million Chinook engine support arrangement, replacing five separate support contracts with one.







## Section Four

---

# Our Financial Performance

# 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 2015 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 Report that is described in that report 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 & 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. Defence Equipment & Support could not 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 and the related trade and other payables balance in the Statement of Financial Position. The period 1 April 2014 to 31 March 2015 was the first year of operation of Defence Equipment & Support as a separate agency of the MOD, and the first year it has had to prepare separate financial statements. In my view, the Agency's financial management systems, processes and controls for these transactions and balances are not yet sufficiently well developed; as a consequence, management were unable to provide me with all the information, explanations and evidence I needed for my audit.



### **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 2015 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 part of the Remuneration Report to be audited has been properly prepared in accordance with HM Treasury directions made under the Government Resources and Accounts Act 2000; and
- the information given in the Strategic Report and the Directors' 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 trade and other payables balance, as described in the basis for qualified opinion paragraph above:

- I have not received all the information and explanations that I considered necessary for the purposes of my audit; and
- Proper accounting records have not been maintained.

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 part of the Remuneration Report 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 15 December 2015**

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 and classified as an Executive Agency of the MOD and operates as a Bespoke Trading Entity (BTE) to strengthen the customer-supplier relationship with the military, provide freedoms around recruitment and reward, and drive through 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 defined operating cost envelope as determined 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 2014 to 31 March 2015, its first year of operation. I have qualified my opinion on the financial statements 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 balance recorded in the financial statements are free from material misstatement. This report explains the reasons for the qualification.

## Limitation of scope in respect of private sector support costs, other programme costs and related trade and other payables balance

The Statement of Comprehensive Net Expenditure to the financial statements reports £439.638 million of private sector support costs and £73.769 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 not being sufficiently developed to support the creation of a new accounting boundary, DE&S have been unable to provide adequate evidence to fully support this expenditure and the related trade and other payables figure of £122.214 million reported in the Statement of Financial Position; I have consequently limited the scope of my audit opinion in respect of these transactions and balances.

## Explanation for limitation of scope

In 2011, the MOD launched its Materiel Strategy programme to examine ways in which efficiencies and more effective performance could be identified in DE&S to improve delivery and value for money. A Government Owned Contractor Operated (GOCO) structure was initially pursued, but this process was halted in December 2013. To continue with the transformation programme, DE&S was instead established as a BTE in April 2014. The period 1 April 2014 to 31 March 2015 therefore represents the first year of operation of DE&S as a separate agency of the MOD, and the first year it has had to prepare separate financial statements.

The Agency is required to record in its financial statements the costs it incurs in line with its Framework Document and Letter of Delegation. As part of its provision of support to the MOD Equipment Programme, DE&S also manages and records expenditure relating to the non current assets and inventory of the MOD. Non-current assets and inventory are acquired by DE&S to support the delivery of capability to the Front Line Commands of Navy, Air, Land and Joint Forces. This expenditure is, however, outside the DE&S accounting boundary.

I have qualified my opinion on the financial statements due to a limitation on the scope of my audit because DE&S has been unable to provide me with adequate evidence to enable me to confirm whether or not the private sector support costs, other programme costs and the related trade and other payables balance shown in the financial statements are free from material misstatement. I believe this situation has arisen because the Agency's financial management systems, processes and controls for these transactions and balances are not yet sufficiently well developed to meet the Agency's needs. Specifically:

- **DE&S maintains a single set of financial systems which record both DE&S and MOD related costs, differentiated only by a management group coding structure.** As a result, in preparing these financial statements, DE&S has had to perform a manual analysis of its accounting records to identify and include in its financial statements only those costs that relate to its defined operating activities, as defined in its Framework Document; and
- **The period between the decision to terminate the GOCO model and to establish DE&S was short, leaving little time to develop new processes, acquire new tools and systems or adequately train staff to facilitate the creation of a new accounting boundary.** There were no dry-run procedures, sufficiently detailed thresholds for the reporting of information were not specified, and there was insufficient central review of the submissions made by Operating Centres. As a consequence, a significant number (over 100,000) of manual journal adjustments were used to create the accounts, as Operating Centres identified the need to move individual lines of expenditure across the boundary.

My audit of the Agency's private sector support costs, other programme costs and the related trade and other payables balance indicated a risk of material misstatement. I identified this risk because my examination of a sample of the data provided for audit found that: some reported transactions and allocations were not fully supported by the underlying source documentation; some reported transactions did not relate to the 2014-15 financial year; and some reported transactions did not accord with the defined accounting boundary. For the reasons outlined above, I was unable to obtain the level of assurance I need to enable me to reach a conclusion on whether or not the risk I had identified had crystallised. I have therefore limited the scope of my opinion on the financial statements in respect of the £439.638 million of private sector support costs, £73.769 million of other programme costs, and the related £122.214 million trade and other payables. My testing did not identify any irregularity with this expenditure.

#### **Actions to be taken by DE&S**

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

DE&S acknowledges that it has been unable to provide me with sufficient evidence to support private sector support costs, other programme costs, and the related trade and other payables balances, and given the fact that it will be operating the same financial systems going forward, recognises that it will need to put in place processes to support accurate recording of transactions that supports this expenditure in the future.

Instructions to Operating Centres and Project Teams have already been refined, and the level of central oversight has already improved, with new monthly reports on the coding of primary data being introduced which will improve management's assurance processes over journal adjustments. A programme of staff training is also being delivered and a revised Finance Instruction planned to be issued shortly. DE&S feels that these incremental steps will help support the accuracy of information going forward.

DE&S recognises however, given the limited time before the close of the next financial year, that there remains a credible risk that the improvements they are striving to achieve may not have reached a level of maturity necessary to secure an unqualified audit opinion on the 2015-16 financial statements, given the sheer volume of data currently generated through its present cost reallocation processes and the challenges of providing support and assurance to the recorded transactions.

**Sir Amyas C E Morse**  
**Comptroller and Auditor General**

**Date 15 December 2015**

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

# STATEMENT OF COMPREHENSIVE NET EXPENDITURE FOR THE YEAR ENDED 31 MARCH 2015

	Note	2014-15 £000
<b>Expenditure - Direct Programme Costs</b>		
Direct staff costs	2	644,362
Private sector support costs	3	439,638
Other programme costs	4	73,769
<b>Total Direct Programme Costs</b>		<b>1,157,769</b>
<b>Income - Direct Programme</b>	5	<b>(14,557)</b>
<b>Net Direct Programme Expenditure</b>		<b>1,143,212</b>
<b>Expenditure - Non-Cash Items</b>		
Communicated costs from other MOD organisations	6	125,508
Auditors' remuneration	7	334
		<b>125,842</b>
<b>Total Net Expenditure</b>		<b>1,269,054</b>

There are no prior year comparative values

The notes on pages 70 to 79 form part of these accounts.



## STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2015

	Note	2014-15 £000
<b>Current assets</b>		
Trade and other receivables	8	3,336
<b>Total assets</b>		<b>3,336</b>
<b>Current liabilities</b>		
Trade and other payables	9	(158,912)
<b>Current assets less current liabilities</b>		<b>(155,576)</b>
<b>Reserves</b>		
General fund		(155,576)

There are no prior year comparative values

The notes on pages 70 to 79 form part of these accounts.

The financial statements were signed on 4 December 2015.



**Tony Douglas**  
Accounting Officer  
4 December 2015



**Sir Bernard Gray**  
Chief of Defence Materiel  
(04/01/11 – 30/11/15)

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 MARCH 2015

	Note	2014-15 £000
<b>Cash flows from operating activities</b>		
Net operating cost		(1,269,054)
Adjustments for non-cash transactions		125,842
(Increase) in trade and other receivables		(3,336)
Increase in trade and other payables		158,912
<b>Net cash outflow from operating activities</b>		<b>(987,636)</b>
<b>Cash flows from investing activities</b>		
<b>Cash flows from financing activities</b>		
Net Parliamentary Funding - Drawn Down		987,636
<b>Net increase/(decrease) in cash and cash equivalents in the period</b>		<b>-</b>

There are no prior year comparative values

The notes on pages 70 to 79 form part of these accounts.

## STATEMENT OF CHANGES IN TAXPAYERS' EQUITY FOR THE YEAR ENDED 31 MARCH 2015

	Note	General Fund £000
Balance at 1 April 2014		-
<b>Changes in taxpayers' equity for 2014-15</b>		
Total Net Comprehensive expenditure for the year		(1,269,054)
Non-Cash Adjustments		125,842
Net Parliamentary Funding - drawn down		987,636
<b>Balance at 31 March 2015</b>		<b>(155,576)</b>

There are no prior year comparative values

The notes on pages 70 to 79 form part of these accounts.





## Section Five

---

# Notes to the Accounts



### 1. STATEMENT OF ACCOUNTING POLICIES

The financial statements contained within this first Annual Report and Accounts relate to the financial year 1 April 2014 to 31 March 2015. 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.

The 2014-15 financial statements reflect the first accounting period for DE&S and therefore do not include prior year comparative data (see also Note 1.3).

DE&S is classified as an Executive Agency which operates as a Bespoke Trading Entity in line with Chapter 7 of 'Managing Public Money'.

#### 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 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 global 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. The operating cost envelope specifically encompasses staff (including travel and training), other operating and private sector support (PSS) expenditure and 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. 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 activities 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.

Equipment assets and 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/MOD.

Various areas of MOD provide DE&S with infrastructure support services under central support contracts. Such infrastructure support services include DE&S usage of MOD non-current assets, such as IT systems and office furniture within the communicated costs figure (see Note 6). The ownership of these non-current assets remains with the Department and, where there are any costs incurred in support of maintenance or refurbishment of such assets, DE&S expenses these costs in year.

### 1.3 Transfer of functions and reserves

In establishing the first presentation of the DE&S financial statements, due consideration was given to those receivable and payable balances extant prior to the vesting day on 1 April 2014. MOD confirmed that the Department and not DE&S accepted responsibility for the settlement of receivable and payable items extant as at 31 March 2014. It was agreed with MOD that these balances should continue to be reported in the Departmental and not DE&S accounts and therefore there are no opening receivable/payable balances reported in the DE&S Statement of Financial Position nor any in-year transfers of functions or reserves.

### 1.4 Significant accounting judgements and key sources of estimation uncertainty

Preparation of the DE&S Annual Accounts requires significant judgements and estimates to establish 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 a policy and rule set (including PSS) defining the types of revenue and expenditure that would fall within the operating envelope and this has supported the judgements made in the preparation of the accounts by DE&S finance staff.
- A specific judgement was made to exclude from our DE&S operating costs those **Private Sector Support** activities undertaken within overarching equipment procurement /support arrangements with our main industrial partners and international collaborative partners. This decision recognised 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 such as 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 £3,800 was identified for payable/receivable recognition.

### 1.5 Going concern

DE&S is 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 these circumstances a going concern assumption is considered to be valid.

### **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 and any associated recoveries are processed centrally by MOD.

### **1.10 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.

### **1.11 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.

### **1.12 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 value of employee performance bonuses reflected within the Statement of Comprehensive Net Expenditure reflects those earned for performance in 2013-14 which were paid in 2014-15. As such, bonuses for 2014-15 performance will be reported in 2015-16 to align with payments.

### **1.13 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 segments.

### **1.14 Losses and special payments**

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 and special payments relating to DE&S in 2014-15 are disclosed at Note 10.

### **1.15 Reserves**

The General Fund reserve represents the balance of the Taxpayers' Equity. Specifically the General Fund reflects the net assets less liabilities entered into during financial year 2014-15.

### **1.16 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:

	Permanently employed staff	Others Contingent Labour	2014-15 Total
	£000	£000	£000
Salaries and wages	461,109	48,114	509,223
Social security costs	37,316	0	37,316
Other pension costs	97,823	0	97,823
	<b>596,248</b>	<b>48,114</b>	<b>644,362</b>

### Average number of persons employed:

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

	Permanent staff	Others Contingent Labour*	Total
Employed by DE&S	12,347	498	<b>12,845</b>

\*Contingent Labour relates to individuals employed on a short term contractual basis to fill specific DE&S posts.

### Manpower transfers

2.3 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 within the staff numbers and costs reported above.

### Principal Civil Service Pension Scheme

2.4 The Principal Civil Service Pension Scheme (PCSPS) is an unfunded multi-employer defined benefit scheme. The MOD is unable to identify its share of the underlying assets and liabilities. An actuarial valuation of the PCSPS has been completed with an effective date of 31 March 2012 and can be found at <http://www.civilservicepensionscheme.org.uk/about-us/scheme-valuations/>.

2.5 Contributions to the PCSPS in 2014-15 were calculated using four percentage rates (16.7%, 18.8%, 21.8% and 24.3%) of pensionable pay, based on four salary bands. The salary bands and percentage contribution rates will change for 2015-16. The scheme's Actuary reviews employer contributions, usually, every four years following a full scheme valuation. The contribution rates are set to meet the cost of the benefits accruing, to be paid when the member retires, not the benefits paid during the period to existing pensioners.

2.6 Employees can opt to open a partnership pension account, a stakeholder pension with an employer contribution. Employer contributions are age-related and range from 3% to 12.5% of



pensionable pay. Employers also match employee contributions up to 3% of pensionable pay.

### Armed Forces Pension Scheme

2.7 The Armed Forces Pension Scheme is an unfunded, non-contributory, defined benefit, salary-related, contracted out, occupational pension scheme. A formal valuation of the AFPS was carried out as at 31 March 2014 by the scheme's actuary, the Government Actuary's Department. 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 who leave before age 55 will have their pensions preserved until age 60 or 65 depending on the scheme. Pensions may be payable to the spouse, civil partner, partner or to eligible children. Death-in-service lump sums are payable subject to nomination.

2.8 AFPS offers ill-health benefits if a career is cut short by injury or illness, irrespective of cause. Additionally, if the injury or illness is mainly attributable to service, compensation for conditions caused on or after 6 April 2005 will be considered under the Armed Forces Compensation Scheme (AFCS). AFPS members who leave before the age of 55 may be entitled to an Early Departure Payment, providing they have at least 18 years service and are at least 40 years of age. The Early Departure Payment Scheme pays a tax-free lump sum and income of between 50% and 75% of preserved pension between the date of the individual's departure from the Armed Forces and age 55. The income rises to 75% of preserved pension at age 55 and is index linked. At age 65, the Early Departure Payment stops and the preserved pension and preserved pension lump sum are paid. A new Armed Forces Pension Scheme will be introduced in April 2015. It will be known as the Armed Forces Pension Scheme 2015 (AFPS15). All Service personnel who are members of one of the Armed Forces Pension Schemes (e.g. AFPS 75, AFPS 05, FTRS 97 and RFPS) who will be serving beyond April 2015 will be automatically transferred to the new scheme unless they qualify for Transitional Protection. The Government has offered Transitional Protection to those who are within 10 years of their respective scheme's Normal Pension Age on 1 April 2012. Further details of the new scheme are available at: <https://www.gov.uk/pensions-and-compensation-for-veterans#armed-forces-pension-scheme-2015>.

2.9 Employer's contribution rates are determined by the Government Actuary. For 2014-15, the employer's contribution rates were 42.6% of pensionable pay for officers and 30.6% of pensionable pay for other ranks. These rates will change to 53.4% for officers and 52% for other ranks from 1 April 2015. The contribution rates reflect benefits as they are accrued, not costs actually incurred in the period, and reflect past experience of the scheme. Further information on the AFPS and the AFCS can be found at: <https://www.gov.uk/pensions-and-compensation-for-veterans>.

## 3. PRIVATE SECTOR SUPPORT (PSS)

	2014-15 £000
Manpower support	122,446
PSS for programmes in demonstration and manufacture phase	127,436
Consultancy support (project management, organisation design, finance, legal)	102,940
PSS for programmes in in-service support and disposal phases	47,134
PSS for programmes in concept and assessment phase	39,682
	<b>439,638</b>

#### 4. OTHER PROGRAMME COSTS

	<b>2014-15 £000</b>
Staff travel and subsistence costs	30,161
IT and telecommunications	16,261
Other infrastructure expenditure	7,631
Staff training costs	7,306
Vehicle rentals	7,080
Regulatory safety costs	2,836
Other costs	2,494
	<b>73,769</b>

#### 5. PROGRAMME INCOME

	<b>2014-15 £000</b>
Defence Munitions commercial revenue	12,221
Logistics Commodities Services revenue (including British Forces Postal Office)	1,889
DE&S BTE corporate receipts (including revenue from technical publications)	337
Other programme income	110
	<b>14,557</b>

#### 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	2014-15 £000
Joint Forces Command	Information System and Communication Services.	Number of DE&S users relative to total MOD users.	64,292
Defence Infrastructure Organisation	Infrastructure and Facilities Management Services.	Cost per employee at DE&S Headquarters extrapolated to total DE&S headcount.	24,394
Joint Forces Command	Training Services through the Defence Academy and Surgeon General services	Number of DE&S training days relative to total training days.	14,663
Defence Infrastructure Organisation	MOD Guard Security Services	Costs for main DE&S geographical locations extrapolated across total DE&S headcount.	13,237
Defence Business Services	Personnel and Payroll Services	Number of DE&S employees relative to total MOD employees.	6,781
Head Office and Corporate Services	Provision of commercial graduates, hire car and MOD Police Services	Based on actuals	2,141
			<b>125,508</b>

## 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 £334,000 covers the costs in respect of the audit of the DE&S 2014-15 Annual Report and Accounts.

## 8. TRADE RECEIVABLES, FINANCIAL AND OTHER ASSETS

	2014-15 £000
<b>Amounts falling due within one year:</b>	
Accrued Income	2,744
Trade receivables	372
Prepayments	166
Staff loans and advances	49
Other receivables	5
<b>Total current receivables</b>	<b>3,336</b>
<b>Amounts falling due after more than one year:</b>	<b>-</b>

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

## 9. TRADE PAYABLES AND OTHER CURRENT LIABILITIES

	2014-15 £000
<b>Amounts falling due within one year</b>	
Private sector support accruals	104,785
Direct staff accrual	36,698
Trade payables	9,426
Sundry payables	8,003
<b>Total Current Liabilities</b>	<b>158,912</b>
<b>Amounts falling due after more than one year:</b>	<b>-</b>

It is noted that the direct staff accrual includes £7 million liability to the Principal Civil Service Pension Scheme, £2.5 million to the Armed Forces Pension Scheme and £10.5 million to HM Revenue and Customs.

## 10. LOSSES AND SPECIAL PAYMENTS

### 10.1 Losses statement

No individual losses exceeded the £300,000 value for individual reporting. The highest volume of losses relate to late hotel cancellations / "no shows" and unused travel tickets.

	2014-15
Fruitless payments(volume of cases)	448
Fruitless payments (value £000)	80
Cash losses (volume of cases)	2
Cash losses (value £000)	1
<b>Total number of losses</b>	<b>450</b>
<b>Total value of losses (£000)</b>	<b>81</b>

### 10.2 Special payments

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

	2014-15
<b>Total number of special payments</b>	<b>5</b>
<b>Total value of special payments (£000)</b>	<b>120</b>

## 11. PROVISIONS, CONTINGENT LIABILITIES AND ASSETS

DE&S has no provisions or reportable Contingent Liabilities or Assets associated with its operating activities.

## 12. RELATED PARTY TRANSACTIONS

12.1 DE&S is a BTE operating 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 processed by MOD on our behalf.

12.2 The Department has 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.

12.3 No board member or senior manager has undertaken any material business transactions with DE&S in the period to 31 March 2015.

## 13. EVENTS AFTER THE REPORTING PERIOD

13.1 The accounts have been authorised for issue by the Accounting Officer on the same date as the C&AG's Audit Certificate. There has been a change of Accounting Officer, with Mr Tony Douglas taking over the role of Chief Executive from Sir Bernard Gray from 1 December 2015.

13.2 The placement of the Logistics Commodities and Services contract with Team Leidos on 1 August 2015 has resulted in the movement of DE&S manpower under Transfer of Undertakings (Protection of Employment) (TUPE) terms. This involved the transfer of 1,560 posts from DE&S to Team Leidos of which 1,129 were filled at the time of transfer.

### Voyager

The Voyager programme achieved its in-service date in July 2014 on schedule. Nine aircraft were delivered to the RAF on time and on budget under the £10.5 billion programme, which is the MOD's biggest Private Finance Initiative contract. A total of 14 Voyager aircraft will be procured by AirTanker Ltd as part of the service contract, covering the 27 years of service from contract signature. From December 2013 until the end of UK operations in Afghanistan, Voyager played a key role in the operational airbridge that transported personnel and equipment between the UK and Afghanistan. On a typical deployment across the Atlantic, the aircraft is able to refuel four fast jets while carrying up to five tonnes of freight or passengers.





### GLOSSARY

<b>AFPS</b>	Armed Forces Pension Scheme
<b>APM</b>	Association of Project Management
<b>BTE</b>	Bespoke Trading Entity
<b>CAAS</b>	Cost Assurance and Analysis Service
<b>CADMID</b>	Concept, Assessment, Demonstration, Manufacture, In-Service, Disposal
<b>CASP</b>	Command Acquisition Support Plan
<b>CAT</b>	Cost Assurance and Analysis Service Approvals Team
<b>CDM</b>	Chief of Defence Materiel
<b>CEO</b>	Chief Executive Officer
<b>CETV</b>	Cash Equivalent Transfer Value
<b>CoM</b>	Chief of Materiel
<b>DAFCS</b>	Digital Automatic Flight Control System
<b>DBS</b>	Defence Business Services
<b>DE&amp;S</b>	Defence Equipment and Support
<b>DGA</b>	Direction générale de l'armement
<b>DIA</b>	Defence Internal Audit
<b>DINC</b>	DE&S Incident Notification Cell
<b>DIO</b>	Defence Infrastructure Organisation
<b>DG</b>	Director General
<b>DSCOM</b>	Defence Support Chain Operations and Movements
<b>DSEA</b>	Defence Safety and Environmental Authority
<b>ESDT</b>	Engineering Skills Development Team
<b>FRem</b>	Government Financial Reporting Manual
<b>FTE</b>	Full Time Equivalent
<b>HM</b>	Her Majesty's
<b>HMRC</b>	Her Majesty's Revenue and Customs
<b>HMS</b>	Her Majesty's Ship
<b>HR</b>	Human Resources
<b>IAMM</b>	Information Assurance Maturity Model
<b>IAS</b>	International Accounting Standard
<b>IFRS</b>	International Financial Reporting Standards
<b>IMT</b>	Inventory Management Transformation
<b>ISO</b>	International Standards Organisation
<b>KPI</b>	Key Performance Indicator
<b>MAA</b>	Military Aviation Authority
<b>MBA</b>	Master of Business Administration
<b>Min(DP)</b>	Minister for Defence Procurement
<b>Mk</b>	Mark
<b>MOD</b>	Ministry of Defence
<b>MPR</b>	Major Projects Report
<b>MSP</b>	Managed Service Provider
<b>NAO</b>	National Audit Office
<b>NATO</b>	North Atlantic Treaty Organisation
<b>NED</b>	Non-Executive Director
<b>OCPA</b>	Office of the Commissioner of Public Appointments
<b>OpEx</b>	Operational Expenditure
<b>PCSPS</b>	Principal Civil Service Pension Scheme

<b>PFI</b>	Private Finance Initiative
<b>PMPS</b>	Performance Management and Pay System
<b>PPM</b>	Project and Programme Management
<b>PriDE</b>	Joint venture comprising Interserve Defence Ltd and SSE Contracting Ltd
<b>PUS</b>	Permanent Under Secretary
<b>QEC</b>	Queen Elizabeth Class
<b>RAF</b>	Royal Air Force
<b>RFA</b>	Royal Fleet Auxiliary
<b>RIDDOR</b>	Reporting of Injuries, Diseases and Dangerous Occurrences
<b>RMC</b>	Raw Materials and Consumables
<b>SCAs</b>	Service Concession Arrangements
<b>SCS</b>	Senior Civil Service
<b>SDSR</b>	Strategic Defence and Security Review
<b>SUME</b>	Single use military equipment
<b>TLBs</b>	Top Level Budgets





# Equipping and Supporting UK Armed Forces