



Annual Report and Accounts
2005/2006



Fixed Wing
Rotary Wing
Engines
Electronics
Components





Annual Report and Accounts
2005/2006



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Annual Report and Accounts 2005/2006

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Statement by the Chief Executive

The decision on the future direction of DARA was the issue dominating the minds of management, employees and stakeholders throughout the reporting period. The consequences of the End-to-End study and the DARA Strategic Review were the determining factors that shaped the final conclusions on DARA's future.



ARCHIE HUGHES
Chief Executive

Following the outcome of the End-to-End study in November 2004 and the decision by the Armed Forces Minister to transfer work on the Tornado GR4 and Harrier aircraft to Main Operating Bases (MOBs) as well as increasing work volumes in DARA's Rotary business, work began immediately with a Strategic Review to assess the future prospects for DARA's five Business Units. As an integral part of this process, the MOD engaged the services of Morgan Stanley to test market interest in DARA, either in whole or in its constituent parts.

Early indications showed sufficient market interest by the private sector in DARA to take the process forward to the next stage. Although, given the prognosis for the Fast Jets business, it was necessary to continue working on the drawdown of this work. This gave the earliest indication to employees of the future prospects for St Athan, whilst presenting to the market a number of viable businesses that should deliver a sustainable long-term future for the workforce and offer best value for defence.

As work progressed it was clear that DARA's Fast Jets business was in terminal decline, with a reducing workload that would make this business unviable beyond 2007. However, in contrast to the declining Fast Jets business work, DARA's future prospects, working in partnership with BAE Systems, on the VC10 Tanker fleet at St Athan benefited from the award of additional work under the banner of the Javelin – Joint Approach to VC10 Maintenance and Logistics – contract. Javelin progresses in a series of phases; with each phase increasing the scope of work. The contract's initial 'red' phase began in 2003 and progressed to 'amber' in June 2005. We are now preparing to enter the 'green' phase, which will help secure work on this important platform well into the next decade.

The positive outcome of the End-to-End study for DARA's helicopter business at Fleetlands brought with it its own set of unique challenges. Delivering increased efficiencies and significant cost reductions with minimal investment helped focus the minds of many. It also allowed DARA the opportunity to completely review long-established, and sometimes deeply entrenched, processes that would be insufficient to deliver expected outputs. Invaluable support from stakeholders and experts in developing 'lean' principles and 'pulse line' activities have all helped DARA to achieve and deliver against targets that would have been unimaginable 18 months ago.

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Whilst work continued to determine the viable options for DARA's future we were advised in July 2005 that the Engines business at Fleetlands was unsuccessful in securing a contract for the servicing and repair of engine modules on the Tornado RB199 engine. DARA lost out in open competition to Rolls Royce and the immediate effect of this disappointing news was the announcement of 50 redundancies from within the Engines business. Working closely with all the relevant Trades Unions we were able to achieve the reductions through natural wastage and early release under voluntary terms. The loss of such a significant contract for the Engines business set in train a series of consequences where it quickly became very difficult for this business to compete effectively for new engine repair contracts. The result being the decision to exit from this market and close the Engines business.

The culmination of all the work undertaken to determine DARA's future produced a number of preferred options, which the Armed Forces Minister duly announced to Parliament on 8 November 2005. Following a period of consultation with the Trades Unions, he ratified his earlier announcement in a statement to Parliament on 2 February 2006. In summary his decision was to:

- Close DARA's Fast Jets business at St Athan by April 2007
- Close DARA's Engines business at Fleetlands by April 2007
- Prepare for the possible sale of DARA's VC10, Rotary and Components businesses at St Athan, Fleetlands and Almondbank
- Retain in MOD ownership DARA's Electronics business at Sealand

The cumulative effect on manpower levels means that a further 725 jobs will be lost across DARA, up to 50 of which will come from reductions to DARA's corporate headcount.

Since becoming a Trading Fund, DARA has consistently achieved all the measurable key performance targets set for the business each financial year. This year DARA was once again on track to deliver a series of positive operating results. However, under UK accounting rules, the business is required to recognise any costs arising from the impending closure of the Fast Jets and Engines businesses. This has adversely affected the operating profit and DARA has, for the first time, posted an operating loss of £3.3m in its accounts.

There have, however, been a number of significant accomplishments during the year due, in no small part, to DARA's employees who continue to deliver a service of exceptionally high standard. The transformation of the VC10 working environment has earned praise from customers and industry alike. All the more impressive was that this was achieved in less than ideal circumstances. Great credit is due to those at St Athan who made possible the seamless transition when moving the platform from its home in the Twin Peaks facility into the new superhangar. Likewise at Fleetlands, where the transformation of the helicopter business is a real testament to everyone pulling together to bring about such major changes in a matter of a few months.

Fostering good relationships with customers and industry partners is a culture embedded in DARA that continues to reap benefits. During the year, we were encouraged by the very positive results of our Customer Review Programme (CRP) and worked hard at further consolidating relationships with our industry partners, all of which will hopefully deliver additional business opportunities for DARA in the future.

Working closely with the Welsh Assembly Government and Welsh Development Agency, we helped secure new commercial work for St Athan in the shape of ATC Lasham. It is hoped that up to 300 jobs can be created by the company, which is now working from DARA's Twin Peaks facility.

It is important to place on record the contribution made by so many people - past and present - who have given, and continue to give, such professional support and commitment to our business.

Statement by the Chief Executive

Evidence of the breadth of talent and expertise nurtured in DARA over the years has been seen over the past year with many of our most gifted people leaving for top-class new jobs, not only within MOD, but also for exciting new opportunities in the commercial sector. It is important to place on record the contribution made by so many people - past and present - who have given, and continue to give, such professional support and commitment to our business. We all now have greater clarity about the future and many employees can now begin to make informed decisions about their longer-term job prospects.

DARA is facing another very challenging year ahead. We are closing two businesses, retaining one in MOD ownership and potentially selling the three remaining businesses.

My final words therefore are reserved for DARA's employees who have all shown great dignity and resilience in the face of uncertainty over their future. They take, quite rightly, great pride in the support they provide to our Armed Forces; a service delivered over many years. Ministers, politicians, military customers and industry partners have all acknowledged the significant contribution made to the UK's defences by DARA's people, which is wholly justified and entirely appropriate recognition of a job well done.



Archie Hughes
Chief Executive
15 June 2006

The Executive Board of Directors

IAN DOUGLAS
Finance Director

ARCHIE HUGHES
Chief Executive

JOHN REILLY
Chief Operating Officer

ALAN LEWIS
Commercial Director

DEREK OWEN
Human Resources
Director



Our Business, Mission, Vision and Strategy



Business

The Defence Aviation Repair Agency (DARA) is a Government owned facility for the repair, overhaul and maintenance of military aircraft, systems and components including engines and avionics, benefiting from more than 60 years of experience in direct support to the UK Armed Forces. DARA was launched as an Agency on 1 April 1999 and established as a Trading Fund on 1 April 2001.

Mission

To deliver outstanding repair support to all our customers.

Vision

To be responsive, flexible, customer focused and highly competitive in the provision of deep aviation repair and supply in logistics to the UK Armed Forces and other customers.

Strategy

In 2005/06 the strategy was to continue to be a preferred expert subcontractor in the aerospace maintenance, repair and overhaul (MRO) sector. Major features of the revised strategy were also to focus on implementing End-to-End (E2E) decisions; operating as fully accountable business units and driving further improvements in productivity, efficiency and customer confidence.

The key strategic goals for 2005/06 were:

- ➔ Achieve all Key Targets and deliver the Business Plans.
- ➔ Deliver Rotary Roll-Back programme and its declared cost reductions.
- ➔ Improve customer satisfaction by following through results of Customer Review Programme.
- ➔ To secure long-term contractual commitments to a future order book.
- ➔ To shape the resources in the business in line with E2E outcome and order book.

The year has seen DARA's Rotary business transform its operations and embrace 'lean principles' within a 'pulse line' environment. The results have been impressive.

Performance against Key Targets

DARA's Key Targets (KTs) for 2005/06 were agreed with the Minister of State for the Armed Forces, and are designed to provide clear indicators of performance in the areas critical to DARA's success. These KT's, along with other performance measures based on our Critical Success Factors, form the basis of a DARA wide performance management system linking corporate strategy with business and individual performance plans.

Performance against Key Targets 2005/06 were:

→ Key Target 1

Quality



Achieve less than 15 attributable major Customer Concerns annually, on average financial year 2004/05 to financial year 2006/07.

Achieved



There were 2 attributable major Customer Concerns in 2005/06.

→ Key Target 2

Business Performance and Efficiency



Achieve an annual Return on Capital Employed (ROCE) of at least 3.5%.

Not Achieved (See Note 1)



The actual ROCE was -2.43% (minus)

Note 1

The actual ROCE of -2.43% (minus) reflects the costs resulting from the decisions to close the Fast Jets and Engines businesses. The target would have been achieved if considered net of these costs.

→ Key Target 3

Business Sustainability



Achieve a Closing Order Book of at least £180m, abated to £160.37m (see note 2), at the end of financial year 2005/06, which includes at least £80m to be deliverable in the following year.

Achieved (See Note 2)



The Closing Order Book was £167.74m, of which £81.63m is to be delivered in 2006/07.

Note 2

The rationale for Key Target 3 included the following qualification: "Applicability of this target is based on the critical assumption that there are no major changes to the workloads planned in DARA's 2005/06 Strategic Plan, and no reductions in existing elements of the order book. The target would therefore be adjusted on a pro-rata basis for any reductions to contracted MOD workload which were in the final order book of 2004/05, the value of which is ratified by DIA as part of the 2004/05 KT audit." This adjustment has been made due to the loss from the FY2004/05 audited closing Order Book of £19.63m leaving a revised target of £160.37m.

→ Key Target 4

Efficiency



Improve overall efficiency by at least 8%.

Achieved



Overall improvement of 15.78%

Future Key Targets

The Key Targets agreed for 2006/07 are:

→ Key Target 1

Quality

Achieve less than 15 attributable major Customer Concerns annually, on average financial year 2004/05 to financial year 2006/07.

→ Key Target 2

Financial Performance

Achieve an annual Return on Capital Employed of at least 3.5% (excluding the Fast Jets and Engines businesses).

→ Key Target 3

Business Transformation

Carry out the actions, by April 2007, that are required to effectively drawdown DARA's Fast Jets and Engines businesses.

→ Key Target 4

Efficiency

Improve overall efficiency by at least 6% (excluding the Fast Jets and Engines businesses).

DARA improved overall efficiency by

15.78%

Financial Review

2005/06 was a difficult year for DARA in its fifth year as a Trading Fund. The decision to close the Fast Jets and Engines businesses by 1 April 2007 had significant effects on DARA's overall financial performance. The need to impair the assets of those businesses that will close and provide for decommissioning costs contributed towards the overall operating loss of £3.3m in 2005/06.

Despite the impact of the uncertainty over DARA's future during the year and the final closure decisions, the various businesses produced a commendable performance under very difficult trading conditions.

Trading results

The most significant factor during the year, which produced a negative impact on DARA's trading performance, was the immediate decline in workload on the Fast Jet platforms. The increasing work volumes on the VC10, emerging because of the success in the partnering arrangements with BAE Systems on the 'Javelin' programme, only marginally offset this loss in DARA's core business activity.

Conversely, the decision to roll back Chinook, Sea King and Lynx work to Fleetlands resulted in a significant increase in workload for the Rotary business with an additional 123,000 hours - or increase of 23% - over last year's total.

The decision to delay impending contracts for DARA's Electronics and Components businesses until 2006/07 resulted in reductions in work volumes during the reporting period.

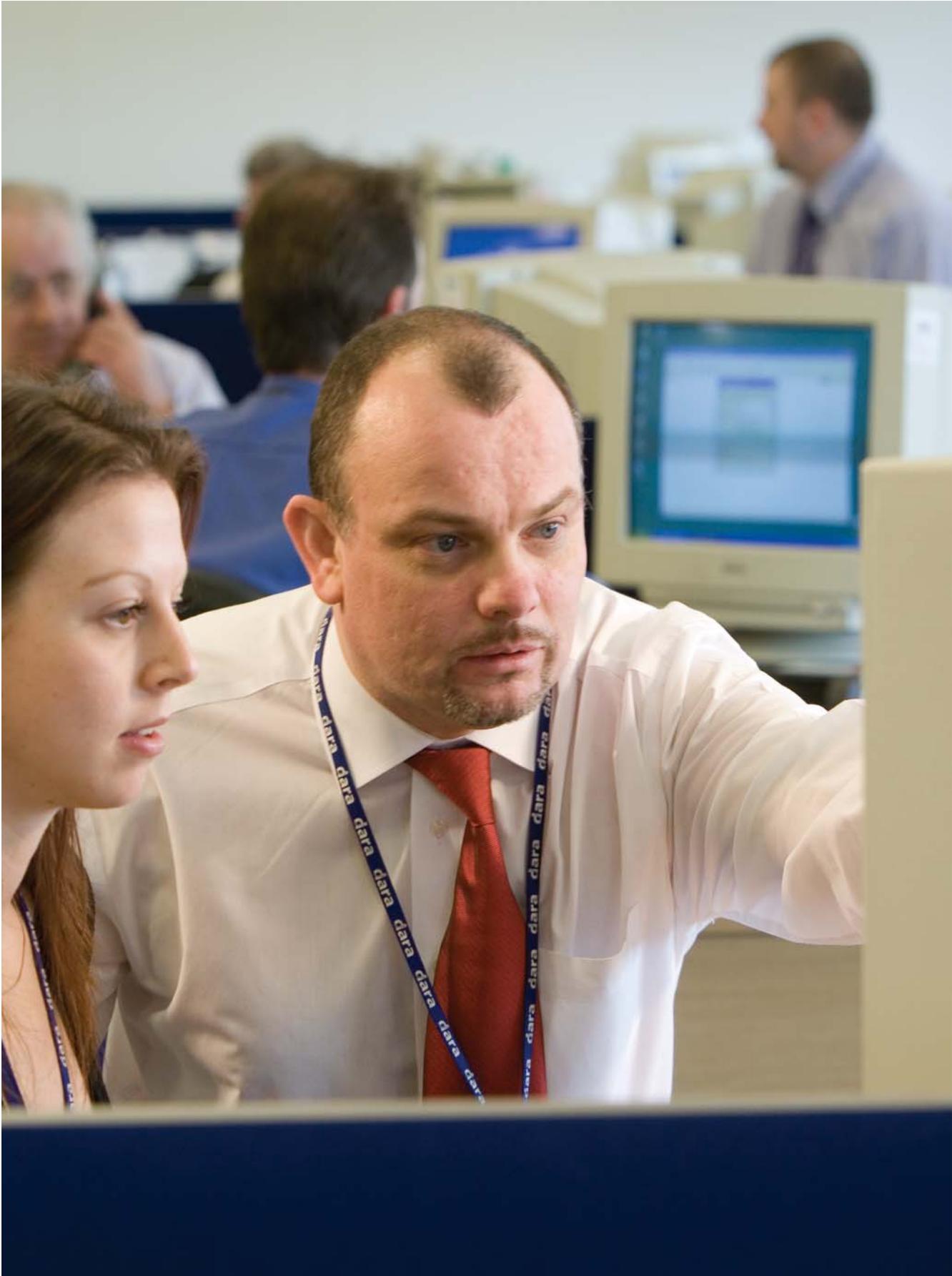
The cost base continued to reduce across all areas of the business. This was most notable in the Corporate area where tight and diligent cost control, particularly in our IS support costs, and an accelerated reduction in manpower levels meant that costs were 20% below Plan, a near 36% improvement based on last year's costs.

The closure announcements led us to re-appraise the value of our fixed assets, resulting in an impairment charge of £11.56m being taken in DARA's 2005/06 Accounts.

Additionally, DARA carried out the planned quinquennial review of assets, which is required under the Government rules for Modified Historical Cost Accounting (MHCA). The revaluation was conducted for DARA by the firm of Fuller Peiser and whilst overall asset values increased as expected, there were some small reductions as part of the review. These resulted in a further impairment charge being taken during 2005/06 of £1.45m.

The MOD has, to date, met DARA's redundancy costs and has confirmed that it will continue to do so for the immediate future. The Department has also confirmed that it will meet all operating and termination costs of the Red Dragon facility due to the closure of the Fast Jets business at St Athan and DARA's resulting withdrawal from the facility in 2007. Accordingly, no provision has been made for these future liabilities in these Accounts.

The cost base continued to reduce across all areas of the business. This was most notable in the Corporate area.



Cash Flow and Funding

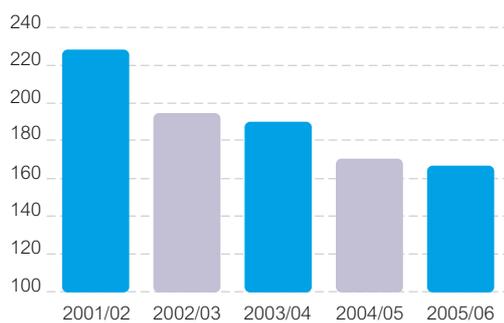
Current liquidity remains strong with a net cash position of £64.2m (2004/05: £71.1m), showing a decrease of £6.9m in year (2004/05: decrease £6.1m). Once again, operational cash flows were very strong and ahead of forecast. Loan repayments and interest of £4.8m and £2.3m respectively were made on time and in line with the loan agreements. No early repayment of loans was made during the year.

Cash is principally held in Sterling (£62.9m), but is also held in US Dollars (\$1.5m) and Euros (€0.6m). All cash investment activity is conducted using a combination of Lloyds TSB money market calls and the HM Treasury Debt Management Account Deposit Facility. Currency risks are managed through a combination of natural hedges and forward contracts. There is one outstanding contract for the sale of US\$3.6m through to 2008.

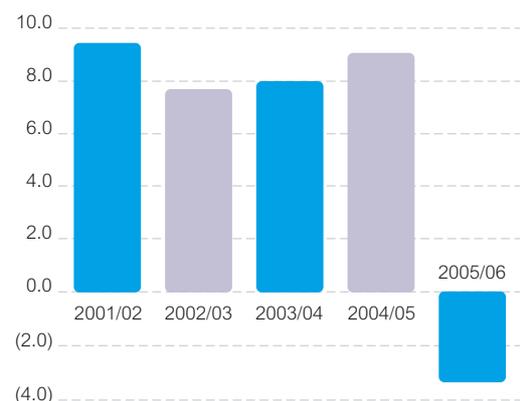
The capital structure consists of Public Dividend Capital (PDC), which remained unchanged at £42.3m, and loan capital of £45.4m (2004/05: £50.2m). The debt is structured through three loans held with the MOD: £31.8m at 4.875% maturing over 15 years, £1.6m at 5% maturing over 5 years and £12.0m at 5.625% maturing over 5 years. All borrowings are at fixed rates of interest.

The Balance Sheet continues to be characterised by the high levels of cash, which is, in part, financed by the short-term creditors. Nevertheless, cash resources are clearly sufficient for the business's needs and accordingly an interim dividend of £10.0m was declared and paid in December 2005. No final dividend is proposed for 2005/06.

Turnover £m



Profit before interest £m



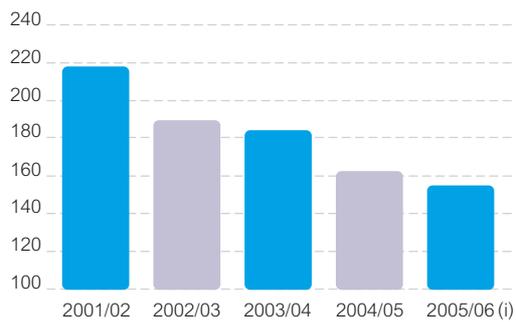
Trading History

2005/06 saw the continuing overall contraction of DARA's business, particularly in the Fast Jets and Engines areas, with further small reductions in Components and Electronics. Although the increase in Rotary work to Fleetlands was welcomed it did not compensate for the loss of work elsewhere in the business.

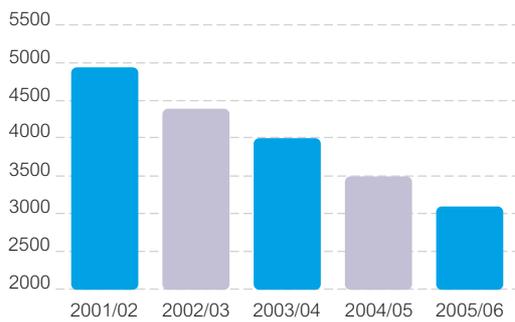
Future

On the basis that, during 2006/07, two businesses will be closed, three businesses may be offered for sale and one business will remain within MOD control, the provision of mainstream financial services during 2006/07 will continue to be provided by the centralised financial shared service centre based at Fleetlands in Hampshire. The future provision of financial services will be dependent upon the outcome of any possible sale and the consequential preferences of any potential purchaser or new departmental owner.

Cost base £m



Headcount



Note

(i) Cost Base in 2005/06 depicts the reductions in underlying costs net of the costs resulting from the decisions to close the Fast Jets and Engines businesses.

Business Review

Ministry of Defence – Modernising Logistics Provision

“My judgment, therefore, is that, regrettably, the Fast Jets business at St. Athan does not have a long-term future, so I am announcing, subject to consultation, that it should close by April 2007.”

(Extract from the Armed Forces Minister's statement to Parliament on 8 November 2005)

“DARA, with BAE Systems, has really gone for lean methods and established a ‘no surprises’ culture, improving visibility of progress and requirements. They are contributing significantly to the excellent aircraft availability that we now enjoy on VC10.”

(Group Captain Peter Ewen, the Air Refuelling and Communications Fleet Integrated Project Team Leader)

Impact on DARA Fixed Wing at St Athan

The consequences of the End-to-End study and DARA Strategic Review were to have the most significant impact for DARA's Fixed Wing business at St Athan. The decreasing workloads on all Fast Jet platforms signalled that there was unlikely to be a sustainable and viable future for this part of DARA's Fixed Wing business.

The Fast Jets workload has reduced for a variety of reasons. MOD announced the - earlier than anticipated - withdrawal of the Jaguar fleet, a reduction in size of the Tornado F3 fleet and the migrated maintenance of the Harrier and Tornado GR4 fleets to RAF Main Operating Bases at RAF Cottesmore and Marham respectively; the latter being a direct output of the MOD's End-to-End study into future air depth support.

The spiralling decline in Fast Jets work, within a definitive timeframe, resulted in the announcement that confirmed closure of these workstreams by April 2007. The effect of closure results in a further 450 job losses at St Athan. This follows on from announcements made in previous years of reductions in manpower levels totalling up to 1,050. Up to a further 50 posts will be lost across DARA's corporate Head Office function.

The End-to-End study, which so adversely affected DARA's Fast Jets business, has, conversely, resulted in additional VC10 work migrating to DARA's large aircraft business at St Athan and will help secure up to 350 jobs working on this major air platform.



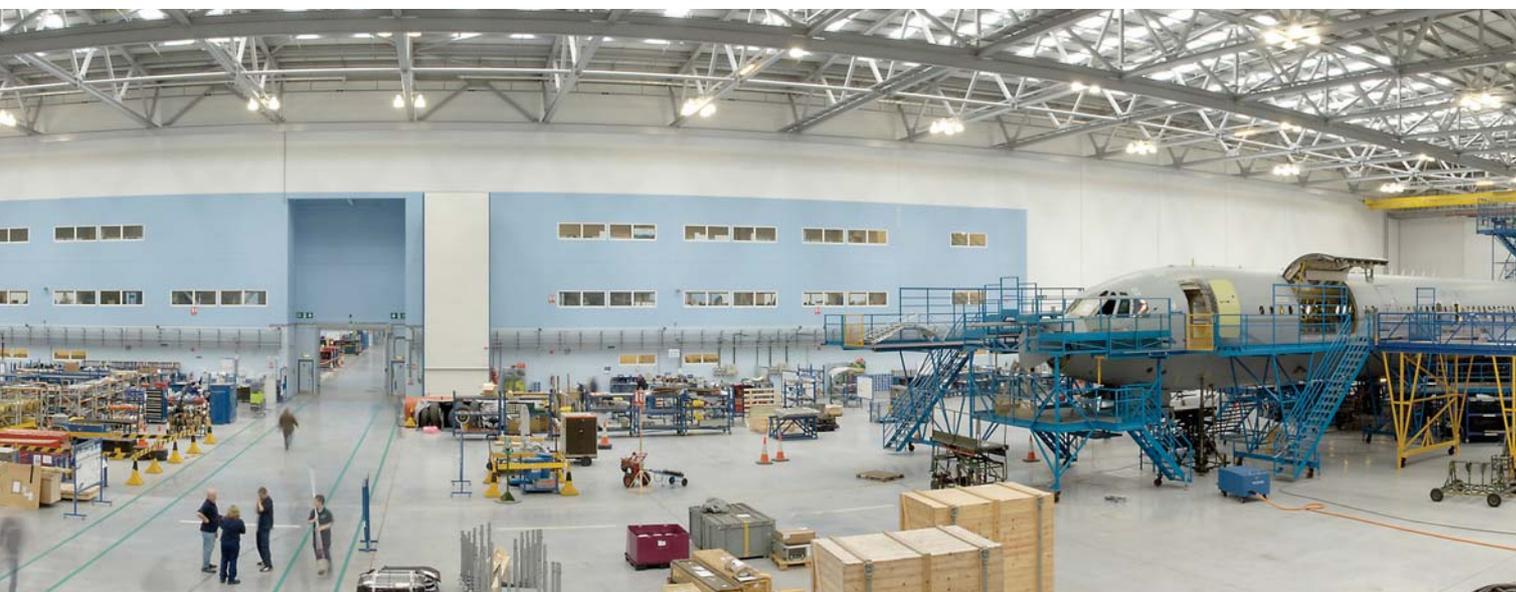
With no strategic imperative to retain this work within MOD ownership, the Minister has agreed that the VC10 business should now be taken to the market to test whether sale might deliver improved effectiveness and value for money for defence and a better long-term future for employees.

The decision to close DARA's Fast Jets business at St Athan has also had consequences for a number of 'off aircraft' activities traditionally undertaken within the Fixed Wing business environment. The Minister sought – and was given – assurances by the MOD's Defence Logistics Organisation (DLO) that, with the exception of a small amount of work that can transfer to other DARA sites, suitable alternative arrangements for carrying out the complementary work in areas such as components, structures, manufacturing, paint and plastic media stripping (PMS) and fuel would be in place before DARA ceased operations at St Athan in 2007.

These are just some examples of a range of 'off aircraft' activities undertaken by DARA that were not subject to review under the End-to-End study. However, without the work on Fast Jets, this relatively small revenue stream would be unable to sustain the running costs and overheads of a commercial DARA operation at St Athan.

As part of DARA and MOD's commitment to working closely with the Welsh Assembly Government and Welsh Development Agency and to help mitigate the consequences of DARA ceasing operations at St Athan, DARA was able to co-operate and help secure an important new commercial opportunity at St Athan. In November 2005, ATC Lasham collocated wing-tip modification work on Boeing 737s, owned by various worldwide airlines, to DARA's Twin Peaks facility. Twin Peaks has been the home for all DARA's VC10 work for a number of years and the transfer of the large tanker fleet into the new superhangar was achieved with minimum disruption to output and minimal cost. Great credit is due to everyone who helped facilitate the successful move within a very short timescale.

In addition to meeting challenging deadlines and moving into new facilities, the VC10 team also managed to develop and deliver new 'lean' working principles in an attempt to further improve productivity and deliver greater benefits to our customers. An independent audit of the transformation achieved in the VC10 workplace by the Bourton Group has shown quite dramatic improvements in just the first four months of implementation. Lead times for major services have been cut by almost 20%, there has been a 95% reduction in wasted materials and a 70% reduction in unplanned work. This all adds up to an excellent achievement under difficult circumstances; and the journey is just beginning for our VC10 team as work progresses in shaping this business for possible sale.



Impact on DARA Rotary and Engines at Fleetlands

“I am very impressed with the commitment of the workforce at all levels and the rate of progress achieved in such a short space of time. There is no doubt that DARA has stepped up to the challenge.”

(The Chief of Defence Logistics, Sir Kevin O'Donoghue commenting after his visit to DARA's Rotary business at Fleetlands)

At the end of 2004, the Armed Forces Minister announced to the House that DARA Rotary at Fleetlands in Hampshire would provide all of the depth maintenance and repair needs of the Chinook, Lynx and Sea King platforms. The challenge for DARA was to double its output using existing facilities and to significantly reduce unit costs – the response is the DARA Roll-Back Programme.

The year has seen DARA's Rotary business transform its operations and embrace 'lean principles' within a 'pulse line' environment. The results have been impressive. The first helicopter platform to enter the pulse line during April 2005 was the Lynx and the Chief of Defence Logistics, Sir Kevin O'Donoghue was present to witness this landmark event.

DARA selected Simpler, a strategic lean transformation consultancy to provide external assistance in the implementation of the Roll-Back Programme. Simpler was chosen as they were already a proven supplier to the DLO on Harrier and Sea King platforms and had considerable expertise in the aviation industry, applying the techniques originally developed inside the Toyota car manufacturing business. Simpler supports and implements a 'one piece flow' – pulse line – approach where work is only undertaken to meet the customer's requirement. Thus work is 'pulled' by the customer's need and work in progress, along with inventory, is driven down, leading to a higher level of operational efficiency.

Understanding that any process contains a significant proportion of waste was the beginning of the 'lean' journey for DARA. Implementing a number of process improvement initiatives that incorporate the intensive application of 'lean' principles are central to the successful achievement of the challenging targets. DARA embarked on its 'Lean Transformation' journey with one aim – to deliver the best possible quality and value for its customers, now and into the future, by achieving dramatic increases in efficiency and reductions in cost.

“Change management has been well beyond our expectations. The rotary transformation programme at Fleetlands has been most impressive, particularly the speed of implementation.”

(Commodore Ian Tibbitt (RN), DLO Rotary Wing Cluster Leader)



Chinook

As a result of embracing lean principles, Chinook maintenance has moved from the traditional 'Bay' environment to a 'Pulse line' system with aircraft progressing through a number of time limited 'Phases'. This has increased the number of aircraft from 5 to 20 per year whilst reducing the number of aircraft out of service and undergoing depth maintenance at any time from 11 to 8. In addition, the average Turn Round Time (TRT) for Major maintenance has reduced from 220 days to 175 days and for Minor maintenance from 89 days to 64 days.

Lynx

The pulse lines in DARA's Lynx Depth Repair Hub illustrate the progress of our Lean Transformation. Aircraft now move between streamlined phases that have been designed to deliver the maximum added value at each step. This will reduce the turnaround time and cost to our customer. Prior to implementing lean principles, 42 Lynx Helicopters were out of service and in depth maintenance at any given time. In steady state this figure will be just 27.

Sea King

Sea King maintenance has also moved from the traditional 'Bay' environment to a 'Pulse line' system and has increased the throughput of aircraft each year from 8 to 33, whilst reducing the number of aircraft out of service and undergoing depth maintenance at any time from 15 to 11 in steady state. The average TRT for Depth 1 aircraft will reduce from an average 100 days to 78 whilst the TRT for Depth 2 reduces from an average of 140+ days to 110 days.

Future

Lean transformation is providing a total rotary solution that makes best use of the DARA Rotary infrastructure, together with the skills, enthusiasm and commitment of the workforce. For DARA this is an exciting period and a major challenge where the necessary people and resources have been installed to achieve the formulated targets.

As with DARA's VC10 business, there is no strategic imperative for the work undertaken at Fleetlands on helicopters to remain within MOD ownership. Therefore, in his announcement on 8 November, the Armed Forces Minister asked that this business be taken to the market to determine if sale offers better value for defence and a more sustainable long-term future for the workforce.

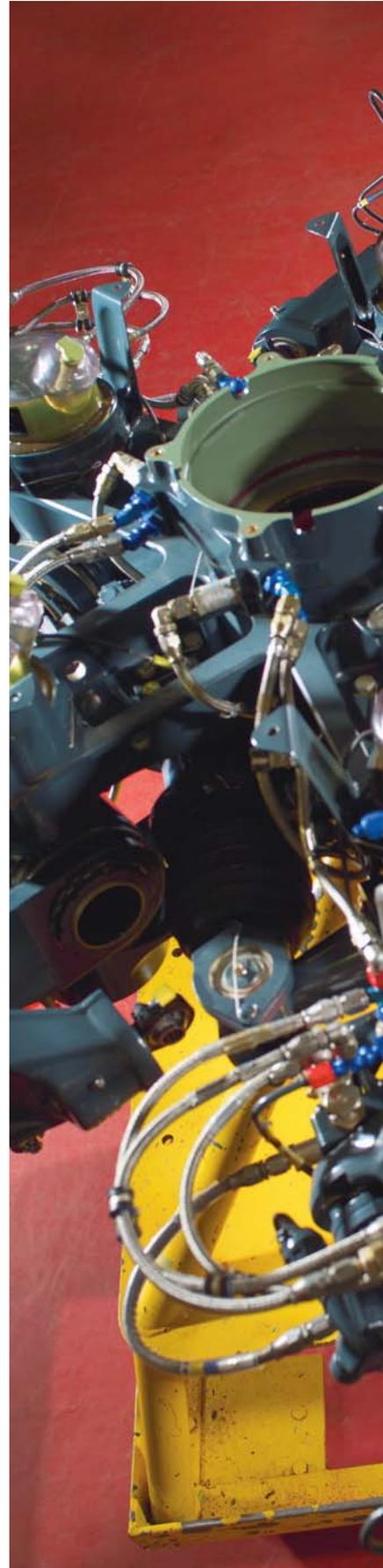
Engines

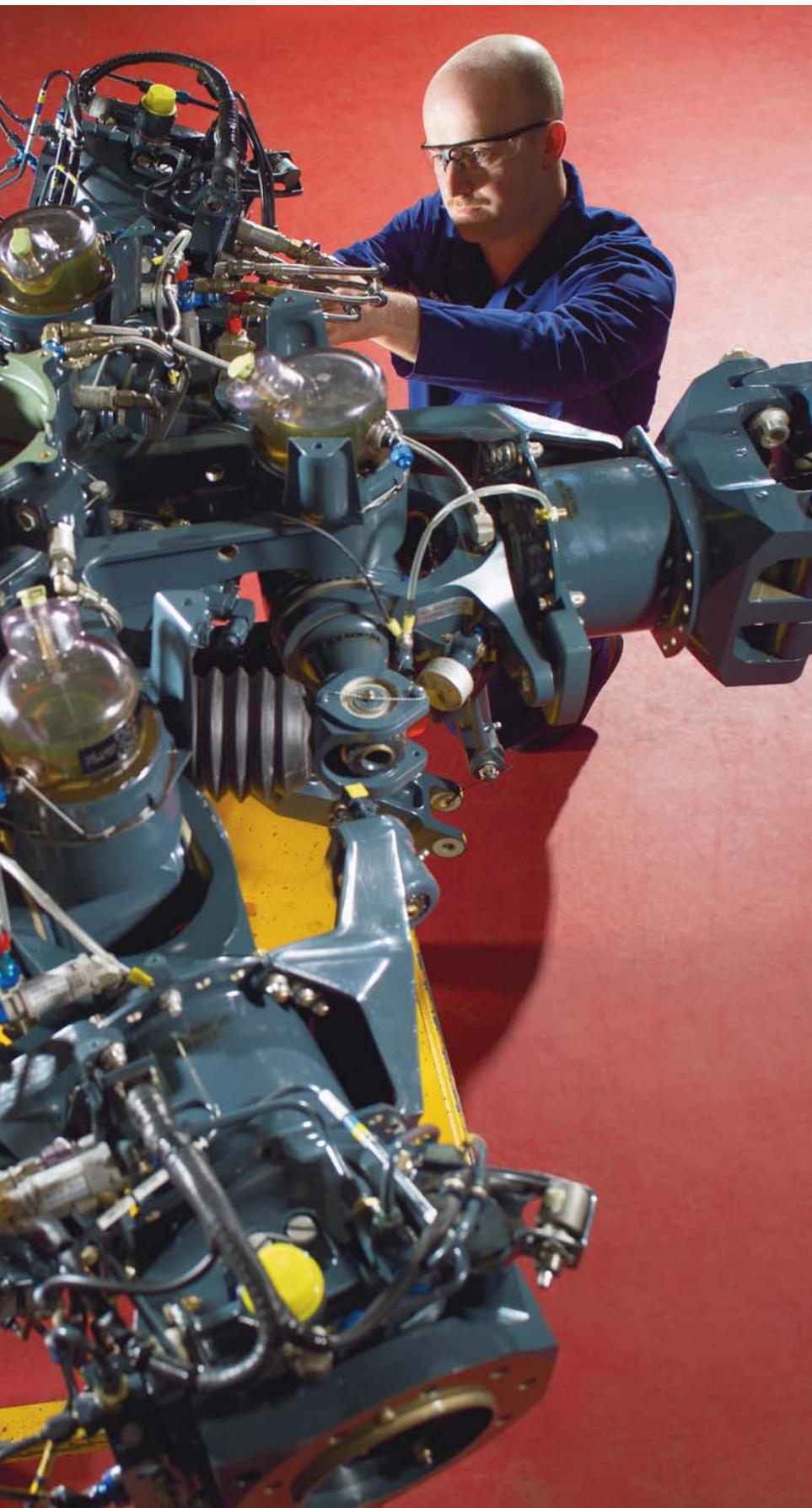
The outcome for DARA's Engines business at Fleetlands told a very different story to that of DARA's thriving helicopter business. The Engines business was always reliant on a small number of important key contracts, therefore it was very disappointing for everyone to learn that, under open competition, DARA had failed to secure future work on the Tornado RB199 engine modules. Losing out to Rolls Royce, this contract represented 25% of the Engines workload and resulted in the loss of 50 jobs. Working closely with all the relevant Trades Unions, it was possible to minimise the impact and achieve the manpower reductions through voluntary means and natural wastage.

However, the erosive impact on DARA's ability to successfully bid on other key engines contracts was a clear indication that this part of DARA's business would now be in terminal decline. The subsequent loss of the Gem, and then the Gnome engine contracts, sealed this business's future and the Armed Forces Minister announced, on 8 November, his intention to close the Engine facility at Fleetlands by April 2007, with the loss of a further 225 jobs.

Work on the remaining engines contracts will run down to coincide with the closure timescale. DLO has given the Minister assurances that any residual work beyond April 2007 will be appropriately sourced through alternative arrangements.

Management and Trades Unions are working closely to mitigate the impact of redundancy by offering conversion training courses to those employees working on engines who now wish to take up a position in the helicopter business. There is now a need for skilled workers to take on the increased volumes of work coming back to Fleetlands on the three major helicopter platforms.





Impact on Components at Almondbank

“Our contacts at DARA are open-minded, helpful and demonstrate innovative approaches to cost-reduction solutions.”

(Jay Brown, Procurement and Supply Manager, Boeing Integrated Defence Systems)

Closely aligned to DARA's Rotary business at Fleetlands, is the Agency's Components business at Almondbank where almost 300 employees work on a range of hydraulic and transmission components on both fixed and rotary wing aircraft. DARA's workforce at Almondbank also delivers an important manufacturing and electroplating capability that is regarded by many in industry as unique.

Again, this part of DARA's business portfolio was not considered by MOD to be a strategic asset that required to be retained within Government ownership. The Components business will, therefore, be taken to market along with DARA's VC10 and Rotary businesses to determine if sale offers better value for defence and a more sustainable long-term future for the workforce.

Working closely with industry partners and customers is a strength of the team at Almondbank that continues to pay dividends. During the year, there was increased consolidation of contract arrangements with important customers such as Boeing, AgustaWestland, Rolls Royce and Claverham. Working on the components of Chinook fleets from countries around the world is establishing Almondbank as a global centre for expertise in this particular field.

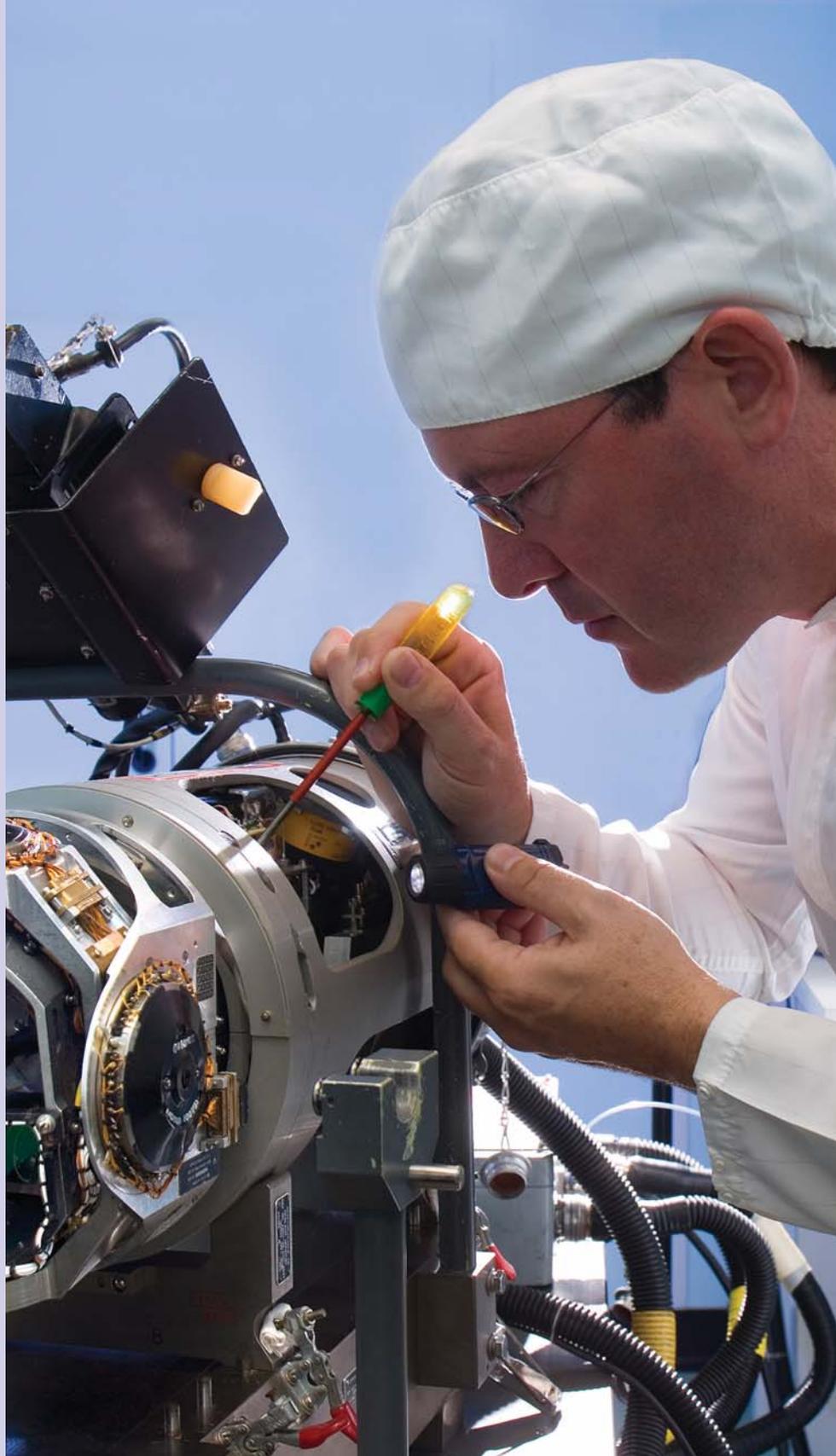
Impact on Electronics at Sealand

“The final business unit in DARA is the Electronics business, based in Sealand, North Wales, which employs some 600 people. This will be retained within MOD ownership. That business provides critical support to our current aircraft and has scope for further growth as we optimise the Department’s future avionics support arrangements.”

(Extract from the Armed Forces Minister’s statement to Parliament on 8 November 2005)

Early in the review process to determine the future of all DARA’s businesses, the DLO recommended that DARA’s Electronics business should not be taken to the market at this time. It regarded this part of the business as being of strategic importance, having a unique facility, currently operating under unique circumstances, and may be a key contributor to the successful development of Partnered Support for future avionics support arrangements.

Work is now underway to determine the shape, size and future management regime of the Sealand business.



Operating Performance



The performance of all DARA's businesses during a highly emotive and turbulent year has been impressive.

The output of the teams working on the Fast Jets at St Athan belies the fact that these workstreams are now in terminal decline and will cease operating in 2007.

Great credit is due and given to everyone associated with DARA's Fast Jets business for putting in such a powerful performance and continuing to deliver a level of service of exceptional standard. Particularly considering this was achieved at a time when the real spectre of closure was dominating the horizon.

Working closely with our main customers, we have been able to plan the draw down on fast jet work at St Athan. This has enabled us to accurately forecast manpower requirements to match the declining volumes of work coming through our business. The result is that we are now able to better match the future plans and aspirations of those individuals affected by the closure of this business. Through diligent planning and taking a sympathetic approach to the various needs of the individual, compulsory redundancies at St Athan have been kept to a minimum.

In 2005, DARA's VC10 operation at St Athan was delighted to receive a silver award for innovation from BAE Systems. This award follows the Defence Procurement Minister's award for Smart Acquisition received in 2004 following the innovative partnering arrangement between MOD, BAE Systems and DARA on the first phase of the VC10 Javelin contract. This is the evidence that shows what a professional and committed workforce there is still at DARA – even when times are tough and the future looks uncertain.

“I am greatly impressed by the skill, expertise and enthusiasm of the Sealand workforce. I am determined that we work together in developing a Business Plan that will ensure the long-term viability of the Electronics business.”

(General Sir Kevin O'Donoghue, the Chief of Defence Logistics, on his first visit to DARA Electronics at Sealand)



The teams working on the Jaguar, Tornado and Hawk aircraft have mirrored the performance of their VC10 colleagues and can hold their heads high, having delivered what they promised under very testing conditions. Maintaining the highest standards of quality was certain to be a major challenge - more so at a time when morale and professional esteem are at a low ebb. It should be no surprise to learn, however, that major customer concerns are at a level that is well below those set in DARA's Key Targets, which is further testament of the worth and value of DARA's employees.

DARA's Components and Electronics businesses have both turned in another solid performance this year with each business making significant contributions to DARA's operating performance. The Components business is consolidating its position as an ideal partner with industry by winning new work on Chinook fleets from as far afield as Malaysia and Australia. Whilst working closely with Boeing, AgustaWestland and Rolls Royce Deutschland is helping keep the Almondbank site at the forefront of new business opportunities.

At Sealand, DARA's Electronics business is building on its reputation of delivering unique and innovative support solutions to a range of avionics equipment. Important new business wins include an equipment support contract with Rolls Royce for the Tornado RB199 Whole Engine Support project. The focus in the Electronics business this year has been on working with the Avionics and Air Electronic Warfare IPT to determine the future avionics support requirements for the Typhoon aircraft.

The good news in the Rotary business is that the volume of work has increased on some workstreams by up to 50%. The challenge has been to minimise the costs and limit the overheads to ensure we achieve the real cost benefits and improved efficiencies identified in the End-to-End study. This year, for example, the output of Chinook aircraft increased from 5 to 20, using 20% less manpower and in 25% less time. The maintenance bays reduced their footprint on the site by 50%, which has all contributed to this year's positive performance across DARA's helicopter business.

It has been a similar story on both the Lynx and Sea King platforms where output has also significantly increased, with improved Turn Round Times up by 43% in the case of Lynx.

DARA places great emphasis on improving customer relationships and remains fully committed to delivering a worldclass service even through turbulent times. The results from 'Talkback', DARA's Customer Review Programme, are showing significant improvements with increased confidence in DARA's customer focus. Customers are also more assured and willing to do business with us, which is further testament that continuous improvements across all areas of the business can deliver a service that is valued and appreciated.

The results from this latest period are more positive than ever before with an overall customer confidence rating of 62 – a further 19% increase from the previous results – giving a clear indication that customers recognise that DARA is achieving and delivering much more of what is promised. For the first time no customer rated their confidence in DARA as low and with this increase in customer confidence DARA will be working hard to maintain and further improve performance in key areas. DARA will, once again, run action-planning workshops across all areas of the business to address all the issues raised by customers.

DARA has been nominated for Bsquared Consulting's Customer Driven Excellence Award in recognition of how we have applied CRP to drive change in customer perception and confidence in DARA. The results of the competition will be known later in 2006.

The End-to-End study, which so adversely affected DARA's Fast Jets business, has, conversely, resulted in additional VC10 work migrating to DARA's large aircraft business at St Athan and will help secure up to 350 jobs working on this major air platform.

“Sound communication processes and all staff should be commended for their efforts in very difficult circumstances.”

(Extract from the final report of the All Wales Investors in People Quality Centre recognition panel.)

People – a valued asset

This has been another challenging and difficult time for DARA employees. Following the outcome of the End-to-End Review in November 2004, we made considerable progress during the year in realigning the organisational structure at Fleetlands in order to meet the increased volumes of work.



This has been another challenging and difficult time for DARA employees. Following the outcome of the End-to-End Review in November 2004, we made considerable progress during the year in realigning the organisational structure at Fleetlands in order to meet the increased volumes of work. Whilst the overall levels of manpower resources were kept under constant review, it became apparent that the element of Agency manpower required to meet the ebb and flow of demand was becoming increasingly difficult to obtain. This was partly due to intense competition for skilled technicians from across the aerospace sector. As a result, and for the first time for a number of years, we mounted a technician recruitment campaign in early 2006.

Consultation with the Trade Unions started in June 2005 on the implementation of the 500 job losses at St Athan resulting from the earlier Ministerial announcements relating to the declining Tornado and Jaguar workstreams at St Athan. DARA's Future Manpower Project team once again successfully implemented a redundancy programme that led to no compulsory redundancies and fewer than 50 compulsory early retirements being delayed until December 2006. This excellent outcome was achieved through a combination of close co-operation between management and the Trade Unions, together with the continuation of a voluntary early release scheme.

Pro-active management of alternative job opportunities with other MOD establishments, close co-operation with the Welsh Assembly and other Government agencies, Department of Work and Pensions outplacement services and advisory support and training providers continue to offer DARA's St Athan employees new employment opportunities as well as career and financial management guidance. Following the announcement of closure for DARA's Fast Jets and Engines businesses, Trade Union consultation began at both St Athan and Fleetlands on implementation, the overriding aim being to minimise the impact for employees and their families.

The 2005 annual pay negotiations were held against a background of continued uncertainty about the future of DARA and consequently became quite protracted. Despite this, an innovative agreement was reached, which was a considerable achievement and reinforces the excellent relationship that continues to exist because of the DARA Trade Union Partnership Agreement.

The announcement that DARA's VC10, Rotary and Components businesses would be prepared for possible sale led to inevitable concern by some employees about what it would mean for them and their conditions of service. TUPE presentations at each of the affected sites were organised in conjunction with the Trade Unions and external legal training providers. These were very successful and enabled many employees to have their questions answered and concerns allayed. An on-line list of FAQs giving much of the background to TUPE was set up on DARA's intranet site, which is providing employees with some useful information and is helping them to better understand the process and their rights.

DARA students once again performed well at the annual MOD Apprentice of the Year awards with Dan Nicholas from St Athan winning the Silver medal in the overall Apprentice of the Year category. It was also a notable double for Almondbank's Stuart Hardy who picked up the top prize in the Tom Nevard Skills competition for the second year in a row.

In December DARA was assessed against the new business-focused Investors in People (IIP) standard. The assessor team was unanimously impressed with the way in which DARA has managed and developed its people in the last few years and was satisfied that DARA continues to satisfy the requirements of the National Standard. The Recognition Review verification panel endorsed this and added how impressed it was with the way DARA has driven forward business efficiencies and improved quality during a very difficult period. Gaining the IIP award at this very challenging time once again shows the continued loyalty and commitment of all DARA's employees.

Communication and employee involvement remain a high priority for DARA. Management at every level encourages open two-way communication with employees and the Chief Executive, supported by key Board members, takes every opportunity to brief staff on emerging issues of importance. DARA News is now produced bi-monthly for the benefit of employees, customers and stakeholders. Mandatory monthly team briefings across all areas of the business ensure employees are kept fully and accurately informed. DARA's intranet site is accessible from all sites and supplements other more traditional forms of communication.

Throughout the year, DARA has cemented positive relationships with politicians representing the DARA constituencies. A sound media relations policy delivers effective results and DARA has emerged with continued good relationships with journalists and broadcasters across the media spectrum following a year in which the business has been subject to intense media and political scrutiny.

DARA is fully committed to a policy of equality and diversity. The only test applied for recruitment, retention or advancement is the ability to do the job. DARA's Equality and Diversity Officer and an effective committee are responsible for monitoring DARA's equality and diversity policy. Whilst also ensuring that new policies are introduced in line with changes in legislation and MOD policy, and to meet DARA's emerging and changing business needs.

Statement of Accounting Officer's Responsibilities

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

In preparing the accounts, the Accounting Officer is required to comply with the Government Financial Reporting Manual prepared by HM Treasury and in particular to:

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

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



Archie Hughes

Chief Executive and Accounting Officer
15 June 2006



Statement on Internal Control

Scope of responsibility

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

As Chief Executive of DARA, I am personally accountable to the Secretary of State for Defence for the performance of DARA in accordance with the Framework Document and DARA's Corporate Strategic Plan. The DARA Ministerial Advisory Board, chaired by the Minister for Armed Forces as representative of our owners, meets quarterly to review DARA's performance against its key targets and Business Plan objectives.

The purpose of the system of internal control

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of DARA's policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place in DARA for the year ended 31 March 2006 and up to the date of approval of the Annual Report and Accounts, and accords with Treasury guidance.

Capacity to handle risk

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

Our procedures for Corporate and Business Unit risk registers, together with our implementation of risk management for major projects, continues to ensure that risk management is embedded in all our business activities. We are continually assessing the approach to risk management, to ensure that all business units and projects continue to operate within Treasury guidelines. To this end, we have introduced during the year, computerised Risk Management software, which provides a fully integrated system, giving a consistent and more comprehensive analysis of our risk exposure.

A programme of risk awareness training ensures that staff are equipped with the skills required to manage risk effectively and meet business needs.

The risk and control framework

DARA is required to comply with HM Treasury instructions and guidelines for Corporate Governance. In order to meet the requirements of an embedded system of internal control, DARA has established a Risk Management system, which consists of:

A **Risk Management Strategy**, which incorporates the aims, objectives and rationale within DARA for managing risk.

A **Risk Management Policy**, which outlines the approach used within DARA for implementing risk management and includes a risk management – reporting structure.

An **appointed Risk Management Committee**, which reviews and evaluates internal standards and procedures relative to the management of risk and disseminates risk information and guidance on best practice.

Appointed Risk Co-ordinators within each Business Unit and Directorate who are responsible for the maintenance of local Risk Registers.

A **DARA Corporate Risk Register**, which represents the broad spectrum of corporate risks and is owned by the DARA Board.

Business Continuity Plans, which are managed by the site risk co-ordinators to facilitate the unity of Risk Management and Business Continuity. All four DARA sites invoked their Business Continuity Plans in 2005/06, either by test or live incident.

Insurance Policies are in place to meet DARA's legal responsibilities and to mitigate certain risks. No insurance is taken against any potential liabilities to the MOD.

Internal Audit Services, which were outsourced from July 2005 and five major audits were completed during the year.

Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. DARA has established the following processes to identify, evaluate and control risk:

- A Board, which meets each month to consider the plans and strategic direction of the organisation, comprising the Executive Directors of DARA and two external independent Non-Executive Directors, one of whom is Chairman of the DARA Audit Committee, and the other chairman of DARA's Remuneration Committee.

- Mr David Galloway, the Chairman of the Audit Committee announced his intention to retire late in 2005. Given the pending closure and potential sale issues, I consulted with MOD Centre, DGMO and the Shareholder Executive with regard to the process for identifying a suitably qualified individual who had the appropriate background and experience, was available and could immediately add value as interim Chairman of the DARA Audit Committee until DARA's future was finalised. On the advice of the key stakeholders, I appointed Mr A Akerman, the former DARA Finance Director, as Chairman of the Audit Committee. As a recent member of DARA's Executive Management team, Mr Akerman may not have been viewed as an independent member of the Committee. However, it was concluded that Mr Akerman was able to act as an independent Non-Executive Director and Chairman of the Audit Committee and he was appointed with effect from the end of February 2006. In reaching this conclusion the following points were considered important to the final decision-making process:

- Mr Akerman was not party to the detailed work carried out to inform the Ministerial decision - making process regarding either the closures or potential sale of DARA business units as he had left DARA some months earlier. Hence he was not regarded as conflicted in this area.

- This is an interim situation, put in place until the end of 2006 when the future of DARA should become clear, at which point the situation will be revisited.

- Mr Akerman's detailed knowledge of DARA is viewed as a strength, which will allow continuity on the Audit Committee during a sensitive time.

- He has no other work commitments which conflict with this one.

- In addition to Mr Akerman the Audit Committee has sufficient independent representation to ensure that the Committee as a whole expresses independent and impartial views.

- A Governance Review Group, which comprises all Executive Board members together with the Head of Internal Audit and other key personnel as required. The primary purpose of the Governance Review Group is to monitor and review all assurance activities being undertaken within DARA. The group also aims to further develop Corporate Governance practices in general.
- Periodic reports from the Chairman of the Audit Committee, to the Board, concerning internal control.
- Regular reports from each Directorate as part of the performance management regime. An assessment of the key risks and their management/mitigation is included in these reports.
- DARA staff and the Board fully understand the Department's approach to Corporate Governance and the management of risk. This approach has produced a robust risk methodology using subjective assessments of Very High/High/Medium/Low/Very Low risks against the impact of a particular risk to DARA objectives as well as a likelihood of the risk maturing. These assessments are updated regularly and form the basis of the decision-making process at the Board.
- As experience increases, key performance and risk indicators will be established within our planning and performance management systems, allowing management to identify emerging risk more swiftly and systematically than before.
- Risk Registers are owned, maintained and managed by the Business Units and Support Directorates with a Strategic Risk Register owned and managed by the Board. The Risk Manager reporting directly to the Finance Director has responsibility for co-ordinating and managing the Risk Management process.
- DARA Risk Management structure has been designed to ensure that information is communicated upstream and downstream within the organisation. Risk Management is included as a regular agenda item at Site and Directorate meetings with links into the Business Continuity Plans.

My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within DARA who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I have received satisfactory letters of assurance from executive managers and the DARA Governance Review Group. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Board and the Audit Committee. Plans to address control weaknesses and ensure continued improvement of our processes are in place.

Significant Internal Control Weaknesses

During the year the internal audit process did not identify any areas of significant control weakness. However, since the announcements regarding the future of DARA it is recognised that there will be new and significant risks arising that will need careful management and control, but I am confident that our systems of internal control are more than adequate for the task.



Archie Hughes
Chief Executive
15 June 2006



Remuneration Report

Remuneration Committee

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

The remuneration of all DARA staff except Senior Civil Servants is set by the Remuneration Committee in agreement with HM Treasury. A Non Executive Director (Richard Fenny) is chairman of the Committee and there are three other Members, the Chief Executive of DARA, Finance Director and Human Resources Director.

The Committee met as required during the financial year and all recommendations arising from the Committee have been implemented.

The Committee continues to make a positive input into the strategic direction of DARA Pay Settlements prior to ratification by the DARA Board. There is a second remuneration committee which is a subsidiary of the Ministerial Advisory Board (MAB) and which is chaired by the MAB Non-Executive Director. This committee advises the MAB on the DARA Chief Executive's annual bonus.

Remuneration Policy

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

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

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

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

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

Service contracts of Directors

Civil Service appointments are made in accordance with the Civil Service Commissioners' Recruitment Code, which requires appointment to be on merit on the basis of fair and open competition but also includes the circumstances when appointments may otherwise be made.

Unless otherwise stated below, the Executive Directors hold appointments, which are open-ended until they reach the normal retiring age of 60. 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 Commissioners can be found at www.civilservicecommissioners.gov.uk.

Archie Hughes was appointed as Chief Executive on 01 January 2004 on a 3 year fixed-term contract. Compensation for early termination, other than for misconduct, would be in accordance with the Civil Service Compensation Scheme.

Ian Douglas was appointed as Finance Director on 27 June 2005 on a 2 year fixed term contract. Compensation for early termination, other than for misconduct, would be in accordance with the Civil Service Compensation Scheme.

Andy Akerman was appointed on a 3 year fixed term contract as Finance Director which was extended by 3 months to 30 June 2005 when he left this role.

Non-Executive Directors are not appointed as Civil Servants. Contracts may be terminated at one month's notice by either party or on dissolution of the Board unless found guilty of gross misconduct when termination will be immediate. They may be exceptionally extended by mutual agreement at the end of the period for one further period only. There are no compensation entitlements for early termination. Current contractual arrangements applying to the non-executive directors as at 31 March 2006 were as follows:

Remuneration Report

Richard Fenny was appointed as a Non-Executive Director on a 3 year contract commencing 21 January 2001. This was extended by a further 3 years to January 2007.

Andy Akerman was appointed as a Non-Executive Director on a 9 month contract commencing on 22 February 2006.

Remuneration Details of Directors

	Age	Gross Salary, bonuses and allowances	Real increase in pension and related lump sum at age 60	Total accrued pension at age 60, at 31/03/06 and related lump sum	Cash Equivalent Transfer Value (CETV) at 31/03/05	Cash Equivalent Transfer Value (CETV) at 31/03/06	Real increase in Cash Equivalent Transfer Value (CETV) after adjustment for inflation and changes in market investment factors
		£'000	£'000	£'000	£'000	£'000	£'000
Executive Directors							
Archie Hughes Chief Executive Officer	45	170 - 175	0 - 2.5	2.5 - 5	22	42	20
John Reilly Chief Operating Officer	52	90 - 95	2.5 - 5	120 - 125	414	453	20
Andy Akerman Finance Director (to 30th June 2005)	54	35 - 40	0 - 2.5	10 - 15	51	55	5
Ian Douglas Finance Director (Commenced 27 June 2005)	54	75 - 80	0 - 2.5	5 - 10	119	133	11
Derek Owen Human Resources Director	54	85 - 90	2.5 - 5	115 - 120	454	492	23
Alan Lewis Commercial Director	49	Consent for disclosure not obtained					

A Cash Equivalent Transfer Value (CETV) is the actuarially capitalised value of the pension scheme benefits accrued by a member at a particular point in time.

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

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

None of the directors have remuneration packages which contain non-cash elements.

No payments have been made to third parties for the services of a director.

	Age	Fees
	£'000	(last year in brackets)
Non-Executive Directors		
Richard Fenny Non-Executive Director	56	0 - 5 (0 - 5)
David Galloway Non-Executive Director (to 25 January 2006)	60	0 - 5 (5 - 10)
Andy Akerman Non-Executive Director (Commenced 22nd February 2006)	54	0 - 5 (-)



Archie Hughes
Chief Executive
15 June 2006

The Certificate and Report of the Comptroller and Auditor General to the Houses of Parliament

I certify that I have audited the financial statements of DARA for the year ended 31st March 2006 under the Government Trading Funds Act 1973. These comprise the Income and Expenditure Account, the Balance Sheet, the Cashflow Statement and Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of DARA, the Chief Executive and Auditor

DARA and the Chief Executive are responsible for preparing the Annual Report, the Remuneration Report and the financial statements in accordance with the Government Trading Funds Act 1973 and HM Treasury directions made thereunder and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's Responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Government Trading Funds Act 1973 and HM Treasury directions made thereunder. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I also report to you if, in my opinion, the Annual Report is not consistent with the financial statements, if DARA has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by relevant authorities regarding remuneration and other transactions is not disclosed.

I review whether the statement on pages 30 to 32 reflects DARA's compliance with HM Treasury's guidance on the Statement on Internal Control, and I report if it does not. I am not required to consider whether the Accounting Officer's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of DARA's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Statement by the Chief Executive, Our Business, Mission, Vision and Strategy, Performance against Key Targets, the Statement of Accounting Officer's Responsibilities, the Statement on Internal Control, the un-audited part of the Remuneration Report and the Financial and Business Reviews. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by DARA and the Chief Executive in the preparation of the financial statements, and of whether the accounting policies are appropriate to DARA's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

Opinions

In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Trading Fund Act 1973 and directions made thereunder by HM Treasury, of the state of DARA's affairs as at 31st March 2006 and of its deficit for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Government Trading Fund Act 1973 and HM Treasury directions made thereunder; and
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

My report on these financial statements is at pages 38 to 39.



John Bourn

Comptroller and Auditor General
National Audit Office
157-197 Buckingham Palace Road
Victoria, London SW1W 9SP
22 June 2006

The maintenance and integrity of the DARA website is the responsibility of the Accounting Officer; the work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the Financial Statements since they were initially presented on the website.

Report of the Comptroller and Auditor General Defence Aviation Repair Agency 2005/2006

Introduction

The Defence Aviation Repair Agency (DARA), was established as a Trading Fund¹ in accordance with the Government Trading Funds Act 1973 in April 2001. The Agency was established to provide aviation and other repair support services to the Ministry of Defence and other Crown bodies.

On 2 February 2006, the Armed Forces Minister announced to the House of Commons the closure, by April 2007, of DARA's Fast Jets business based at St Athan and its Engines business based at Fleetlands in Hampshire. The closure of the Fast Jets business also has implications for the ongoing use of the Red Dragon facility on the St Athan site. The Minister also announced plans to test the market for a possible sale of DARA's Components business, based at Almondbank, Rotary Wing business based at Fleetlands and Large Aircraft business also based at St Athan, with view to gaining increased effectiveness and value for money. The results of this market testing will form the basis for a Ministerial decision in November 2006.

The restructuring of DARA has a number of implications for my audit of the financial statements, with the closure or potential sale of five of DARA's six business units. These issues are of ongoing interest to Parliament and, therefore, I have decided to report these issues accordingly.

Compliance with International Standard on Auditing (ISA) 570

As part of my audit I am required, under ISA 570, to consider whether or not there are events or conditions which would make the use of the going concern assumption to prepare the financial statements inappropriate². In doing so, I consider the assessment made by management about whether or not the entity will remain a going concern for a twelve month period³ after the accounts are signed by the Accounting Officer. DARA's management have provided me with representations that DARA remains a going concern as at the balance sheet date. Their assessment is based on the fact that the organisation has liquid cash reserves of some £64.2 million to meet operating costs, and because once the Fast Jets and Engines businesses are closed, the remaining four business units generate sufficient revenues to meet their normal cost of operations. Three of these business units are currently being reviewed as part of a process to 'test the market' to decide whether or not they should be sold.

The Ministerial announcement already made and the decisions to follow on the possible sale of the Rotary, Components and Large Aircraft businesses will materially affect DARA. Although the organisation has cash to meet its operating costs, and a commitment from the Ministry of Defence to meet restructuring costs, within twelve months of the date of the financial statements being signed by the Accounting Officer, two of the six business units operated by DARA will have closed, and a further three may be subject to a possible sale thus ceasing to form part of DARA's operations. Together these account for 80 per cent of 2005-06 turnover of £165.7 million.

I have accepted management's assurances about their assessment of the going concern status of DARA as a whole at the balance sheet date. Pending the determination of the future status of DARA, and the completion of the restructuring process designed to strengthen the remaining business units with view to either retaining them in MOD ownership or putting them to the market for testing, I have decided to report this to Parliament.

¹ A Trading Fund is defined by Government Accounting as the means of financing the trading operations of a department. They use their receipts to meet their outgoings. Financial control is exercised through the setting of financial targets, usually a level of return on capital employed.

² ISA 570 paragraph 8 refers

³ ISA 570 paragraphs 18 and 22 refer

Impairment of Assets

Fixed assets are valued in accordance with Financial Reporting Standard 11 which requires assets to be recorded at no more than their recoverable amount. The recoverable amount is the higher of net realisable value and value in use. Assets should also be subjected to a regular impairment review if events suggest that changes to the entity's circumstances indicate that the carrying value of an asset may no longer be recoverable.

In preparing the 2005-06 financial statements for audit, DARA have carefully considered the possibility of impairments to the Agency's assets base, to reflect any circumstances where management consider that likely revenues flowing from those business units to be closed down are limited, or where the remaining useful lives of assets held by those business units has been reduced as a result of the decision to close.

DARA have been proactive in recent years, recording impairment provisions of £24 million in the period 1 April 2003 to 31 March 2006, including £11.5 million in 2005-06 in respect of the business units to be closed which have been fully written down. I am, therefore, content that DARA's assets are valued in accordance with Financial Reporting Standard 11.

Provisions and Restructuring Costs

Financial Reporting Standard 12 requires organisations to provide in their accounts for costs to be incurred where there is an obligation (legal or constructive) as a result of a past event, which will result in a transfer of economic benefit which can be reliably estimated.

Included within DARA's financial statements are provisions to cover the costs of decommissioning buildings occupied by DARA's Engines business. No provisions are included, however, in respect of any redundancy costs for staff, or for the ongoing and termination costs for the Red Dragon facility at St Athan. These costs will be met by the Ministry of Defence.

The Ministry of Defence have provided the Chief Executive and Accounting Officer with a letter of comfort agreeing to meet these costs, which are estimated by DARA to total £125.6 million, comprising £40.7 million for redundancy costs from 1 April 2006 onwards and £84.9 million for costs relating to the Red Dragon facility. In accepting these liabilities, both DARA and the Ministry have deemed the decommissioning of buildings used by the Engines business to be in the normal course of DARA's business, however, the other costs are not considered to be in the normal course of business as they are being driven by Department-wide restructuring.

I have considered whether DARA's treatment of redundancy and restructuring costs is in accordance with FRS 12. DARA have not provided for the full restructuring costs, based on the assurances to fund such costs provided by the Ministry of Defence, and because the costs represent those incurred in restructuring the services and capability provided to the Ministry rather than in carrying out the day-to-day business of the trading fund. The Ministry have also not included within their accounts provisions for these costs because of the significant degree of uncertainty that exists over the likely quantum which will be clarified once Ministers have taken final decisions on the sale of business units, and alternative uses for the DARA estate.

DARA have, however, included within the report, disclosures based on the range of options that will be considered.

I consider that DARA have correctly treated and disclosed restructuring costs within their financial statements for the reasons detailed above. However, I have included the possible financial implications of these options in my report, as set out in the previous paragraphs, to bring them to the attention to Parliament.



John Bourn
Comptroller and Auditor General
22 June 2006

Profit and Loss Account for the year ended 31 March 2006

	Note	2005/2006 £'000	2004/2005 £'000
Turnover	2	165,723	171,335
Cost of sales	3	157,070	142,833
Gross profit		8,653	28,502
Operating expenses	3	11,887	19,232
Operating (loss)/profit		(3,234)	9,270
Loss on disposal of fixed assets	3	29	153
(Loss)/profit on ordinary activities before interest		(3,263)	9,117
Interest receivable		3,155	3,414
Interest payable	4	2,311	2,990
(Loss)/profit on ordinary activities before dividend		(2,419)	9,541
Dividend payable		10,000	2,000
Retained (loss)/profit		(12,419)	7,541
Return on capital employed (ROCE)		(2.43%)	6.71%

The notes on pages 44 to 59 form part of these accounts.

Balance Sheet as at 31 March 2006

	Note	31 March 2006 £'000	31 March 2005 £'000
Fixed assets			
Tangible	7	60,616	60,132
		60,616	60,132
Current assets			
Stock & work in progress	8	10,323	12,748
Debtors and prepayments	9	23,677	25,030
Cash at bank and in hand	10	64,182	71,139
		98,182	108,917
Current liabilities			
Creditors: amounts falling due within one year	11	(32,004)	(44,410)
Net current assets		66,178	64,507
Total assets less current liabilities		126,794	124,639
Provisions for liabilities and charges	12	(3,380)	(2,412)
Net Assets		123,414	122,227
Financed by:			
Capital and reserves			
Public dividend capital		42,303	42,303
Long-term loans	13	40,510	45,350
Revaluation reserve	14	22,798	4,527
General reserve	15	17,803	30,047
Government funds		123,414	122,227

The notes on pages 44 to 59 form part of these accounts.



Archie Hughes
Chief Executive
15 June 2006

Cash flow statement for the year ended 31 March 2006

	Note	2005/2006 £'000	2004/2005 £'000
(a) Reconciliation of operating (loss)/profit to net cash inflow from operating activities:			
Operating (loss)/profit		(3,234)	9,270
Impairment of fixed assets		13,023	5,407
Depreciation charges		6,807	4,608
Increase/(decrease) in provisions for liabilities and charges		968	(2,507)
Decrease/(increase) in stock & WIP		2,425	(648)
Decrease in debtors		1,353	6,061
(Decrease)/increase in creditors		(9,750)	3,991
Net cash inflow from operating activities		11,592	26,182
(b) Cash flow statement:			
Net cash inflow from operating activities		11,592	26,182
Dividends paid		(12,000)	-
Returns on investments and servicing of finance	16a	865	420
Capital expenditure	16a	(2,574)	(11,090)
Financing	16a	(4,840)	(21,640)
Decrease in cash		(6,957)	(6,128)
(c) Reconciliation of net cash flow to movement in net funds:			
Decrease in cash	16b	(6,957)	(6,128)
Decrease in borrowings		4,840	21,640
Movement in net debt	16b	(2,117)	15,512
Net debt at start of year		20,949	5,437
Net funds at end of year	16b	18,832	20,949

The notes on pages 44 to 59 form part of these accounts.

Statement of total recognised gains and losses for the year ended 31 March 2006

	2005/2006 £'000	2004/2005 £'000
(Loss)/profit for the financial year	(2,419)	9,541
Surplus on revaluation of fixed assets credited to the reserves	19,652	2,222
Less: revaluations on assets disposed	(36)	(31)
Transfer out of revaluation reserve	(1,345)	(389)
Transfer into general reserve	175	329
Total recognised gains and losses relating to the year	16,027	11,672

Reconciliation of movements in Government funds

	2005/2006 £'000	2004/2005 £'000
Government Funds at 1 April	122,227	131,795
Dividends	(10,000)	(2,000)
Total recognised gains and losses relating to the year	16,027	11,672
Movements in long-terms loans	(4,840)	(19,240)
Net movement in Government funds	1,187	(9,568)
Balance at 31 March	123,414	122,227

The notes on pages 44 to 59 form part of these accounts.

Notes to the Accounts for the year ended 31 March 2006

1 Accounting policies

Basis of accounting

The accounts have been prepared in accordance with the Financial Reporting Manual (FRM) issued by HM Treasury, which provides guidance on the application of generally accepted accounting practice in the United Kingdom to Trading Funds, and the Accounts Direction issued by the Treasury. The particular accounting policies adopted by DARA are described below. They have been applied consistently in dealing with items considered material in relation to the accounts.

Accounting convention

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

Turnover

Turnover comprises the invoiced and accrued value of services (excluding VAT and other sales taxes).

Tangible fixed assets

Land and buildings

Where DARA is the principal beneficial user of Departmental Estate, such estate is treated as an asset of the Agency although legal ownership rests with the Secretary of State for Defence. A professional valuation, in accordance with the Royal Institute of Chartered Surveyors Appraisal and Valuation Standards, was carried out by Fuller Peiser during the year. Land and Buildings are revalued in the years between professional valuations, using the Corporate Financial Controller (CFC) Modified Historic Cost Accounting (MHCA) index.

Other fixed assets

Plant, equipment, computers and motor transport are capitalised where the useful life exceeds one year and the cost of acquisition exceeds £10,000 excluding VAT. The value of capitalised plant, equipment and motor transport is reviewed annually and adjustments made for technological obsolescence, using the CFC MHCA indices in the relevant periods.

Depreciation

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

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

Buildings

Not exceeding fifty years

Plant & Equipment

Between three and twenty years

Motor Transport

Between three and ten years

IT Equipment

Between three and ten years

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

Pension costs

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

Foreign exchange

All foreign denominated transactions are translated at the appropriate rate of exchange, being the previous month's average rate. At 31 March, balances are translated into sterling at the year end spot rate.

Use of financial instruments is explained in note 19.

Stock

Stock is valued at the lower of cost (including attributable overheads) and net realisable value. The majority of DARA's work for the MOD is on a spares exclusive basis. Material held for this purpose continues to be owned by MOD and is not included in DARA's stock valuation. DARA's stock comprises material purchased to support spares inclusive contracts and spares manufactured and owned by DARA itself. Provisions are made to cover obsolescent items. Items are reviewed for obsolescence on a regular basis and at the end of the financial year.

Work in progress

Most of DARA's sales contracts exclude the cost of spares, which are provided free of charge by the customer. Therefore, work in progress (WIP) is valued on the basis of direct labour and indirect production support, plus those business overheads that are directly related to production activity. For spares inclusive contracts, the cost of the spares consumed is also included in the WIP valuation. The rates used to value WIP are reviewed annually.

Long term contracts

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

Provision for losses on contracts

When it is known that a contract is forecast to make a loss, a provision is made at the time the loss is identified.

Operating leases

Rentals under operating leases are charged to the profit and loss account as incurred.

Return on capital employed

The basis for calculating return on capital employed is the profit before interest for the year, as a percentage of the average capital employed during the year. Capital employed comprises public dividend capital, retained earnings, realised revaluation surpluses, unrealised revaluation surpluses and all loans both short term and long term provided from government sources.

Provision for bad and doubtful debts

DARA makes provision for bad and doubtful debts based on an aged debtor and debtor category analysis. Bad debts are written off immediately they are deemed to be irrecoverable.

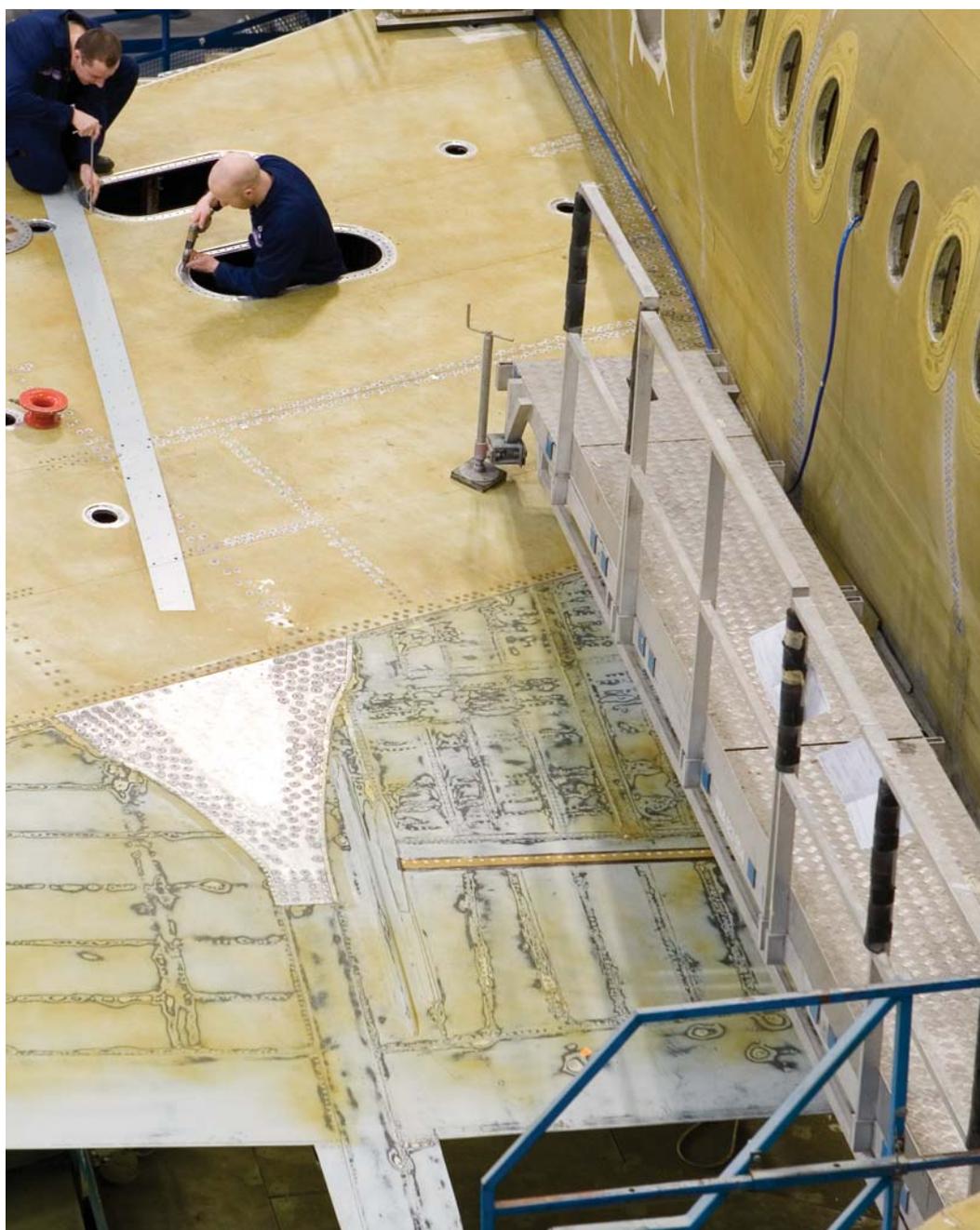
Value Added Tax

DARA has a single registration for VAT with HM Revenue & Customs and accounts for VAT on an accruals basis.

2 Turnover

Turnover is not analysed by market segment because substantially all of the turnover relates to the same class of business: the repair, overhaul and maintenance of military aircraft, systems and components, including engines and avionics.

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



3 Cost of sales, operating expenses and exceptional items

✈ Cost of sales:		2005/2006	2004/2005
	Note	£'000	£'000
Staff costs	5b	93,589	97,391
Supplies and services consumed		19,005	18,574
Accommodation costs		20,592	14,288
Depreciation		6,680	4,391
Other administration costs	6	17,204	8,189
Total cost of sales		157,070	142,833
Operating expenses:			
Staff costs	5b	4,906	7,388
Supplies and services consumed		456	784
Accommodation costs		-	1,325
Depreciation		127	217
Other administration costs	6	6,398	9,518
Total operating expenses		11,887	19,232
Cost of sales & operating expenses:			
Staff costs	5b	98,495	104,779
Supplies and services consumed		19,461	19,358
Accommodation costs		20,592	15,613
Depreciation		6,807	4,608
Other administration costs	6	23,602	17,707
Total cost of sales & operating expenses		168,957	162,065
Exceptional items:			
Loss on disposal of fixed assets		29	153
		29	153

4 Interest payable and similar charges

	2005/2006 £'000	2004/2005 £'000
On short-term bank loans and overdrafts	-	-
On loans wholly repayable within five years	687	-
On loans not wholly repayable within five years	1,624	2,990
	2,311	2,990



5 Staff numbers and costs

✈ (a) Staff numbers	2005/2006 Number of employees	2004/2005 Number of employees
<hr/>		
The average number of persons employed during the year was:		
Senior management (i)	5	5
Service personnel	59	40
Civilian personnel	2,899	3,492
Agency staff	265	178
	3,228	3,715

Total number of persons employed as at 31 March 2006 (including Agency staff) was 3,076 employees (3,511 as at 31 March 2005), equivalent to 3,060 full time employees (3,497 as at 31 March 2005).

NOTE

(i) Senior Management are those who influence the decisions of the entity as a whole as defined in the Companies Act. 2004/05 previously included 12 key managerial staff now reclassified as Civilian personnel.

✈ (b) Payroll costs	2005/2006 £'000	2004/2005 £'000
in Cost of sales:		
Salaries, wages and allowances	69,582	77,449
Social security	5,221	5,796
Pension costs	11,854	9,704
Agency staff	6,932	6,152
Utilisation of provision for loss on termination of an operation	-	(1,710)
	93,589	97,391

✈ in Operating expenses:

Salaries, wages and allowances	3,644	5,681
Social security	301	491
Pension costs	693	786
Agency staff	268	430
	4,906	7,388

✈ Total:

Salaries, wages and allowances	73,226	83,130
Social security	5,522	6,287
Pension costs	12,547	10,490
Agency staff	7,200	6,582
Utilisation of provision for loss on termination of an operation	-	(1,710)
Total payroll costs	98,495	104,779

5 Staff numbers and costs continued

✈ (c) Pension benefits

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

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

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

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded defined benefit scheme and it is not possible to separately identify DARA's share of the underlying assets and liabilities. A full actuarial valuation was carried out as at 31 March 2003. Details can be found in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice-pensions.gov.uk).

Employer contribution rates are determined by the Government Actuary at one of four rates in the range 16.2% to 24.6% of pensionable pay, based on salary bands.

Employer contributions are reviewed every four years, following a full scheme valuation by the Government Actuary. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme.

Rates of charge will increase from 1 April 2006. Salary bands are revalorised each year.

Similarly, employers' contributions to the Armed Forces Pension Scheme (AFPS) are determined by the Government Actuary at a rate of 34.3% for Officers and 21.3% for other ranks.

For 2005/06 employers' contributions of £18,978 were paid to one or more of a panel of four appointed stakeholder pension providers (2004/05: £50,540). 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. Contributions due to the partnership pension providers at the balance sheet date were £1,488.

Four persons retired early on ill-health grounds; the total accrued pension liabilities in the year amounted to £3,376.

6 Other administration costs

	2005/2006 £'000	2004/2005 £'000
✈ in Cost of sales:		
Travel and subsistence, including vehicle hire	1,282	1,329
IT and telecommunications	32	201
Training, recruitment and consultancy	1,815	1,274
Impairment of fixed assets (i)	12,971	5,341
Other expenses	4,615	4,533
Cost reimbursement (ii)	(5,444)	(4,184)
Utilisation of provision for loss making contracts	(167)	(305)
Creation of provision for Engines decommissioning	2,100	-
	17,204	8,189
✈ in Operating expenses:		
Auditors' remuneration (iii)	92	80
Travel and subsistence, including vehicle hire	469	672
IT and telecommunications	4,696	7,221
Training, recruitment and consultancy	565	1,180
Insurance	1,059	1,154
Impairment of fixed assets (i)	52	66
Other expenses	162	1,159
Gains on foreign exchange (iv)	(398)	-
Cost reimbursement (ii)	(299)	(2,014)
	6,398	9,518
✈ Total:		
Auditors' remuneration (iii)	92	80
Travel and subsistence, including vehicle hire	1,751	2,001
IT and telecommunications	4,728	7,422
Training, recruitment and consultancy	2,380	2,454
Insurance	1,059	1,154
Impairment of fixed assets (i)	13,023	5,407
Other expenses	4,777	5,692
Gains on foreign exchange (iv)	(398)	-
Cost reimbursement (ii)	(5,743)	(6,198)
Utilisation of provision for loss making contracts	(167)	(305)
Creation of provision for Engines decommissioning	2,100	-
Total of other administration costs	23,602	17,707

(i) Impairment of fixed assets relates primarily to plant, equipment and buildings at the Fleetlands and St Athan sites to reflect the ministerial decision to close the Fast Jets and Engines businesses by April 2007, as required by Financial Reporting Standard 11.

(ii) The total cost reimbursement has been shown separately from other expenses for greater visibility.

(iii) Auditors' remuneration is for the statutory audit fee due to the National Audit Office (NAO).

(iv) Foreign exchange gains in 2004/05 were matched to turnover to reflect Engines business specific revenues.

This is no longer the case and 2005/06 the gains reflect US Dollar forward sales hedging transactions during the year.

7 Fixed assets

The movements in each class of assets were:

	Land & Buildings	Plant & Equipment, Motor Vehicles and IT	Assets in course of construction	Total tangible
	£'000	£'000	£'000	£'000
Cost or valuation:				
At 1 April 2005	54,189	31,638	2,297	88,124
Additions	-	-	1,950	1,950
Disposals	(145)	(1,544)	-	(1,689)
Revaluation (i)	78,754	1,971	42	80,767
Reclassification (ii)	1,748	2,514	(4,262)	-
At 31 March 2006	134,546	34,579	27	169,152
Depreciation:				
At 1 April 2005	12,248	15,744	-	27,992
Depreciation charged in year	1,886	4,921	-	6,807
Impairments (iii)	1,713	10,508	-	12,221
Disposals	(122)	(1,446)	-	(1,568)
Revaluation (i)	61,320	1,764	-	63,084
At 31 March 2006	77,045	31,491	-	108,536
Net book value				
At 1 April 2005	41,941	15,894	2,297	60,132
At 31 March 2006	57,501	3,088	27	60,616

(i) A professional valuation was carried out in year, in accordance with RICS Appraisal and Valuation Standards in the form of a quinquennial review as required by Financial Reporting Standard 15.

(ii) Reclassification comprises the capitalisation of assets in the course of construction.

(iii) Impairment of fixed assets, as required by Financial Reporting Standard 11, relates primarily to buildings, plant and equipment at the Fleetlands and St Athan sites to reflect the ministerial decision to close the Fast Jets and Engines businesses and by April 2007.

8 Stock and work in progress

	31 March 2006		31 March 2005	
	£'000	£'000	£'000	£'000
Stock		3,006		3,107
Work in progress - net costs incurred	7,317		9,967	
Less: applicable payments on account	-		326	
Subtotal		7,317		9,641
Total stock and work in progress		10,323		12,748

9 Debtors and prepayments

	31 March 2006 £'000	31 March 2005 £'000
Trade and other debtors (i)	11,769	21,015
Bad debt provision	(28)	(111)
Prepayments and accrued income	11,936	4,126
Total debtors and prepayments	23,677	25,030

(i) Within trade and other debtors is a balance of £7,872k for other central government bodies and £3,897k for bodies external to government.

10 Cash at bank

Cash on short term deposit (i)	62,028	70,000
Cash at bank	2,154	1,139
Total cash at bank	64,182	71,139

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

11 Creditors

Amounts falling due within one year		
Trade creditors (i) (ii)	2,360	2,140
Taxation and social security (ii)	2,321	3,219
Accruals	11,091	16,521
Deferred income	11,262	15,423
Sundry creditors (ii)	130	267
Long term loans payable within 12 months	4,840	4,840
Dividends Payable (iii)	-	2,000
Total creditors	32,004	44,410

(i) DARA's policy is to pay its suppliers within contracted payment terms or general conditions governing the terms for the type of business undertaken or, in the absence of specially agreed terms, within 30 days of receipt of a valid invoice. This complies with HM Treasury guidelines and the Governments 'Better Payment Practice Code'. In 2005/06 96% (2004/05 95%) of invoices, by value, were paid within this target.

(ii) Within trade, taxation and social security and sundry creditors is a balance of £2,622k for other central government bodies and £2,189k for bodies external to government.

(iii) An interim dividend of £10m was declared and paid during the year. No final dividend was declared for the year.

12 Provisions for liabilities and charges

	Loss on contracts note (i) £'000	Revenue Provision note (ii) £'000	Other note (iii) £'000	Total £'000
Balance at 1 April 2005	167	1,855	390	2,412
(Decrease)/increase in provisions	-	(1,089)	2,286	1,197
Utilised in year	(167)	-	(62)	(229)
Balance at 31 March 2006	-	766	2,614	3,380

(i) The provision for loss on contracts will be set against expected future losses on previously negotiated contracts.

(ii) Revenue provision is in respect of the probable repayment of amounts invoiced to MOD customers, where refunds or partial refunds are likely.

(iii) Other provisions consist of Engines Business Unit decommissioning (£2.1m), redundancy administration and slow moving stock.

The liabilities and charges provided for, fall due in the following periods:

	As at 31 March 2006		
	Revenue Provision £'000	Other £'000	Total £'000
Amounts payable within:			
Under one year	766	2,614	3,380
One to five years	-	-	-
Over five years	-	-	-
Total	766	2,614	3,380

The MOD has confirmed that it will continue to meet any liabilities in respect of DARA's redundancy costs, and all operating and termination costs of the Red Dragon facility consequent upon DARA's closure of its Fast Jets business at St Athan and withdrawal from the Red Dragon facility. Accordingly, no provision has been made for these future liabilities in these accounts.

13 Long term loans

	31 March 2006 £'000	31 March 2005 £'000
DLO Long Term Loan repayable by 31 March 2021	29,610	31,725
DG Logistics (Strike) loan repayable by 31 March 2011	9,600	12,000
DLO loan repayable by 31 March 2011	1,300	1,625
Total long term loans	40,510	45,350

Amounts repayable within one year are included in creditors - see note 11.

14 Revaluation reserve

	2005/2006 £'000	2004/2005 £'000
Balance at 1 April	4,527	2,725
Transfer to Profit and Loss account	(1,170)	(60)
Transfer to General reserve	(175)	(329)
Revaluations in year	19,652	2,222
Less: revaluations on assets disposed	(36)	(31)
Balance at 31 March	22,798	4,527

In October 2005 DARA implemented the revaluation of fixed assets resulting from its quinquennial review. This is a full revaluation carried out by professional valuers as required by Financial Reporting Standard (FRS) 15 and the Government rules for Modified Historical Cost Accounting (MHCA). In all other years the MOD Corporate Financial Controller (CFC) issues indices which are applied to relevant asset categories to facilitate revaluation.

15 General reserve

	2005/2006 £'000	2004/2005 £'000
Balance at 1 April	30,047	22,177
Retained (loss)/profit	(12,419)	7,541
Transfer from Revaluation reserve	175	329
Balance at 31 March	17,803	30,047

16 Cash flow statement note

	2005/2006 £'000	2004/2005 £'000
(a) Detailed analysis of gross cash flows		
Returns on investments and servicing of finance		
Interest received	3,162	3,410
Interest paid	(2,297)	(2,990)
	<u>865</u>	<u>420</u>
Capital expenditure		
Assets in course of construction	(2,616)	(1,840)
Purchase of fixed assets	-	(9,250)
Disposal of fixed assets	42	-
	<u>(2,574)</u>	<u>(11,090)</u>
Financing		
With the Defence Logistics Organisation of the MOD:		
Decrease in short term borrowing	-	(2,400)
Decrease in other borrowings	(4,840)	(19,240)
	<u>(4,840)</u>	<u>(21,640)</u>

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

	At 1 April 2005 £'000	Cashflow £'000	At 31 March 2006 £'000
Cash at bank and in hand	71,139	(6,957)	64,182
Debt due within one year	(4,840)	-	(4,840)
Debt due after one year	(45,350)	4,840	(40,510)
Total	<u>20,949</u>	<u>(2,117)</u>	<u>18,832</u>

17 Operating leases

	2005/2006 £'000	2004/2005 £'000
✈ Operating profit is shown after charging for operating lease rentals as follows:		
Lease of buildings at RAF St Athan (i)	7,969	2,606
Lease of vehicles and Other Equipment (ii)	488	488
Lease of ERP IT System (iii)	-	897
Total operating leases paid	8,457	3,991

(i) Contained within note 3 - accommodation costs

(ii) Contained within note 6 - vehicle hire, and other expenses and within note 3 - supplies and services consumed

(iii) Contained within note 6 - IT and telecommunications

✈ Commitments in the next financial year (2006/07) are as follows:

	Land & Buildings £'000	Vehicles & Other Equipment £'000	Total £'000
Leases expiring within:			
One year	9	21	30
Two to five years inclusive	214	373	587
Over five years	7,851	61	7,912
Total	8,074	455	8,529

✈ Expected Rental Receipts in the next financial year (2006/07) are as follows:

	Land & Buildings £'000
Leases expiring within:	
One year	-
Two to five years inclusive	241
Over five years	-
Total	241

There are no finance leases.

18 Commitments and contingent liabilities

There are no commitments or contingent liabilities as at 31 March 2006 (and nil as at 31 March 2005). Any liabilities concerning environmental pollution are considered pre-Trading Fund events and the liability therefore falls to the MOD.

19 Financial Instruments

Treasury operations are conducted within a framework of policies, mandates and delegations authorised by the Board. DARA uses forward foreign currency sales contracts as derivative instruments for risk management purposes only. The internal control environment is regularly reviewed.

Interest Rate Risk

DARA's funding is determined by fixed rate Government loans. There are no floating rate liabilities. The weighted average rate of interest for 2005/06 was 4.70% (2004/05: 4.69%). The weighted average period for which the rate is fixed is 12 years.

Currency Risk

DARA conducts business in £ sterling, US dollars and euros and is therefore subject to foreign exchange risk. DARA manages this risk by natural hedging and entering into forward foreign exchange contracts. DARA has three active foreign currency bank accounts. DARA policy states that transactions are translated at the prior month average rate. Year-end foreign denominated net assets have been translated at the year end spot rate.

Liquidity Risk

DARA has a combination of 8 year and 20 year loans, mitigating the risk of significant liabilities maturing at the same time. Current liquidity throughout the year was strong. Cash at bank is available on demand and short term investments are conducted through the HM Treasury Debt Management Account Deposit Facility (DMADF) and the Lloyds TSB Bank plc Money Market.

Counterparty/Credit Risk

DARA's policy is to minimise counterparty risk by only entering into contracts with institutions with long term credit ratings of AA or better. DARA has one forward sales contract arrangement with the Bank of England for total value of US\$10.9m (US\$3.6m outstanding at the Financial Year End), structured as 12 biannual contracts for completion in February 2008. The principal customer is the MOD and therefore credit risk is minimal.

20 Related parties

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

21 Post Balance Sheet events

There are no post balance sheet events.

22 Losses and special payments

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

23 Redundancy

MOD has agreed to pay for DARA's redundancy costs, in 2005/06 these costs amounted to £12.396m (2004/05: £15.344m).

24 Auditors

The Government Trading Funds Act 1973, as amended by the Government Trading Act 1990, requires DARA's Annual Report and Accounts to be audited by the Comptroller and Auditor General. DARA's auditor is the National Audit Office (NAO). The cost of this audit is £92k and no payments were made to this auditor for any other service. In addition, the Key Targets within the Annual Report and Accounts are audited by the MOD Defence Internal Audit Service.

Internal audit services were provided by DARA's own internal audit team until 3 June 2005 and by BHBi Consultancy Ltd at a cost of £87k for the remainder of the year.





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