



DEFENCE ESTATES

Delivering Estate Solutions to Defence Needs

Agency Annual Report

&

Accounts

2006/2007



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Annual Report and Accounts 2006/2007

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SECTION 1

CHIEF EXECUTIVE'S STATEMENT

- 1.1 This Annual Report and Accounts is my first as the Chief Executive and, in introducing it, I would first like to pay tribute to my predecessor, Vice Admiral Peter Dunt, for his leadership of *Defence Estates* over the last five years. Those five years have represented a remarkable period of change, with the Defence Housing Executive (DHE), estate management in Germany and Northern Ireland (NI) and the Defence Training Estate (DTE) merging with *Defence Estates*. This is at the same time as the rolling-out of Regional and Housing Prime Contracts (HPC) and upgrading Single Living and Service Family Accommodation (SFA).
- 1.2 The Report sets out *Defence Estates*' performance during 2006/07. It covers the second year in which *Defence Estates* has operated both as an Agency and Top Level Budget (TLB) within the Ministry of Defence (MOD). It will also be the last Agency Report and Accounts to be published as *Defence Estates* ceased being an Agency on 31 March 2007, as a logical consequence of becoming a TLB in 2005.
- 1.3 The Agency exists in direct support of the delivery of military capability which is encapsulated in its Mission.¹ Last year's Report mentioned a number of challenges that the Agency would face in 2006/07. The most important has been taking responsibility for delivering the supply side of the Training Estate. The successful creation of the DTE within *Defence Estates* has ensured the continued delivery of world class military training facilities and has allowed the development of best practice across the rural estate. *Defence Estates* has also taken responsibility for delivering estate services overseas from other parts of the MOD by using Integrated Service Provider (ISP) contracts. The Cyprus ISP went live during August 2006 and is performing well. *Defence Estates* also continues to provide, via ISPs, direct support to operations in Iraq, Afghanistan and other operational bases overseas. *Defence Estates* continues to exceed its disposal targets with accrued receipts of £394M during the year. This has allowed continued investment in the estate and expenditure on other defence priorities.
- 1.4 The delivery of good quality accommodation for both our Service personnel and their families has been an area of much interest and *Defence Estates* has continued to deliver against its Departmental targets throughout the year. This included the Single Living Accommodation Modernisation (SLAM) Project exceeding its delivery target of 1,500 by 302 bed spaces.
- 1.5 The delivery of appropriate SFA is also a key area. Regrettably the HPC, which was let in 2006, got off to a bad start in delivering the level of maintenance service it would have liked for SFA in England and Wales. As soon as this became clear, appropriate remedial measures were introduced to rectify the situation and these led to significant improvements. There is, however, no room for complacency to ensure that our occupants receive the correct standard of housing maintenance. *Defence Estates* also exceeded its Corporate Plan Target on SFA by upgrading 1,215 properties to Standard 1 for Condition.
- 1.6 Last August also saw the award of the innovative Ministry of Defence Estate in London (MODEL) contract for the consolidation of the estate in (North West) London. This will make a major contribution to the consolidation of the defence estate in Greater London, delivering the development of an integrated "Core Site" at RAF Northolt, relocating London based units, and disposing of surplus sites, thus easing pressure on the local authority's Strategic Development Plan in terms of releasing land for housing.
- 1.7 The five Regional Prime Contracts (RPCs) and the HPC are the key vehicles through which *Defence Estates* delivers maintenance services and improvements across the estate. The roll-out of the Estate Performance Measurement System (EPMS) continues with a pilot assessment carried out of RPC Scotland against the set criteria. Work also continues with the deployment of the Estate Planning Tool and the use of a new single grading methodology for accommodation across the whole of the MOD estate is underway.
- 1.8 *Defence Estates* received a Construction Industry Award in April 2006 for being the winners of the 'Integrated Supply Chain of the Year' award in recognition of the Housing Framework contract with Mansell Construction Services Limited at RAF Lakenheath.

¹"Delivering Estate Solutions to Defence Needs"

- 1.9 Our commitment to delivering sustainable solutions across the defence estate continues to gather momentum. We remain engaged in developing cross Government targets in the Sustainable Operations on the Government Estate initiative which was launched in June 2006. A major initiative to improve energy efficiency across the estate was begun, and we continue to achieve wider recognition outside of the MOD for our work on Sites of Special Scientific Interest. We have updated our Sustainable Environmental Appraisal Tool Handbook and provided a summary booklet to assist in understanding the process. In addition *Defence Estates* has made significant progress on a range of Sustainable Construction issues including the establishment of Defence Related Environmental Assessment Methodology (DREAM) as the preferred assessment method of defence construction projects.
- 1.10 The coming year will bring new challenges not least that of raising the accommodation standards for the Services. It will therefore be critical for *Defence Estates* to continue to deliver against its targets and demonstrate that we are delivering effectively and efficiently.

A handwritten signature in black ink that reads "Tim Lawrence". The signature is written in a cursive style with a long horizontal stroke at the beginning.

Vice Admiral T J H Laurence CB MVO ADC
Chief Executive

4 October 2007

SECTION 2

MANAGEMENT REPORT

- 2.1 The Chief Executive of *Defence Estates* presents the Annual Report, together with the audited financial statements for the year ended 31 March 2007.

Financial Performance

- 2.2 The net operating cost for the year of £2,331.650M (2005/06: £965.181M) has been charged to the General Fund.

Principal Activities

- 2.3 *Defence Estates* has responsibility for ensuring that the MOD estate is managed efficiently and effectively as a corporate asset to support the delivery of defence capability. From April 1999, all property scheduled for disposal in the United Kingdom and North West Europe has become the responsibility of *Defence Estates*, up to the point of sale, as soon as it ceases to be used by the former occupier and all formal requirements of the site closure procedure have been met. From April 2005, this has been extended to cover all property throughout the world. All proceeds from such sales are reflected in the Agency Accounts. With effect from 1 April 2006 *Defence Estates* became the "Single Balance Sheet Owner" for all land and building assets of the MOD and is responsible for the processing of transactions on the Fixed Asset Register on behalf of the department. All land and buildings for which *Defence Estates* has the risks and rewards of ownership are included in the Agency balance sheet.

History

- 2.4 *Defence Estates* was re-launched on 1 April 2003. The primary role of the Agency is to provide specialist support to the MOD on estate policy and the Sustainable Development (SD) in Government agenda and to maintain the estate and its infrastructure, including families' housing.

Statutory Background

- 2.5 *Defence Estates* was, until 31 March 2007, an Agency of the MOD. Its owner, from 1 April 2005, is the Permanent Under Secretary and it operates in accordance with a Service Delivery Agreement with the Department. The owner receives advice from the Defence Estate Committee on the standards of service supplied by the Agency. The composition of the Committee as at 31 March 2007 was as follows:

Sir Ian Andrews (Chairman)	2 nd Permanent Under Secretary
General Sir Timothy Granville-Chapman	Vice-Chief of the Defence Staff
General Sir Redmond Watt	Commander-in-Chief Land
General Sir Kevin O'Donoghue	Chief of Defence Materiel
Air Chief Marshal Sir Clive Loader	Commander-in-Chief Air Command
Vice Admiral Adrian Johns	2 nd Sea Lord and Commander-in-Chief Naval Home Command
Lieutenant General Nick Houghton	Chief of Joint Operations
Mr T A Woolley	MOD Finance Director
Mr S Barter	External Member
Mr R Spray	External Member
Mr W C Clark	Secretary

Equal Opportunities Policy and Employment and Training Disabled Persons

- 2.6 *Defence Estates* is committed to the MOD programme on equal opportunities and the employment of disabled persons and has produced its own equal opportunities statement. The organisation has 219 employees who have indicated that they are registered as disabled.

Accounts Direction

- 2.7 HM Treasury has directed *Defence Estates* to prepare a statement of accounts in the form and on the basis set out in an Accounts Direction dated 18 December 2006.

Management of the Agency

- 2.8 The day-to-day management of the Agency is carried out by the Agency's Management Board, which at 31 March 2007 consisted of:

Vice Admiral P A Dunt	Chief Executive
Mr D I Olney	Director General Operations
Brigadier R A Cary	Director Programming
Mr W C Clark	Agency Secretary
Mr R Jones	Director Projects
Mr M E Martindale	Finance Director
Mr R J McKinney	Director Estate Strategy and Policy
Mrs C J Nicholson	Non Executive Director
Mr C Nixon	Director Commercial
	(appointed to the Board on 3 July 2006)

Other persons who held office during the year were:

Air Commodore K J Pellatt	Director Housing (resigned from the Board on 7 September 2006)
Mr M W Pengelly	Director Commercial (resigned from the Board on 30 June 2006)

- 2.9 Vice Admiral P A Dunt resigned from the Board on 30 April 2007 and was succeeded as Chief Executive by Vice Admiral T J H Laurence.

Policy on the Payment of Creditors

- 2.10 The majority of bills are paid on behalf of *Defence Estates* by the former Defence Bills Agency (DBA), who is committed to ensuring compliance with the Government wide standard on bill paying. Following implementation of the Late Payment of Commercial Debt (Interest) Act 1998, DBA aim to ensure that 99.9% of correctly presented bills are paid within 11 calendar days. In 2006/07, actual performance achieved was 99.9% paid within 11 calendar days. No liabilities were incurred under the Late Payment of Commercial Debt (Interest) Act 1998 and no interest payments arose.

Pension Arrangements

- 2.11 These are covered in Notes 1 and 2 to the accounts and in the Remuneration Report.

Staff Involvement

- 2.12 *Defence Estates* maintains systems for the provision of information to, and consultation with, employees, and for the dissemination of necessary information regarding health, safety and welfare at work.

Auditors

- 2.13 The accounts of the Agency are audited by the Comptroller and Auditor General under section 7(3)(b) of the Government Resources and Accounts Act 2000. The notional cost of the statutory audit is £185,000 (2005/06: £125,000).
- 2.14 So far as I, as Accounting Officer of the Agency, am aware:
- there is no relevant audit information of which the Agency's auditors are unaware; and
 - I have taken all steps that I ought to have taken to make myself aware of any relevant audit information and to establish that the Agency's auditors are aware of that information.

A. KEY TARGETS – 2006/07

2.15 The performance targets laid out in the table below are consistent with the targets set out in the *Defence Estates Corporate Plan 2006/2011*.

KEY TARGETS	EVIDENCE OF PERFORMANCE	OUTCOME
KT1 – To Improve the defence estate in a sustainable manner to improve its fitness for purpose and condition.		
1a. Improve SLA to Grade 1 Project SLAM (SLA Modernisation).	Project SLAM – 2,207 (inc TLB funded) bed spaces were delivered against the target of 1,500.	Target exceeded – additional 302 core bed spaces delivered.
1b. SLA Parallel Projects (PP), including overseas.	SLA PPs ² – 3,615 bed spaces were delivered against a target of 5,800.	Target not achieved – the shortfall can be attributed to decisions on future force structures, the requirement to re-profile PFI contracts and other competing Defence priorities.
1c. Improve Service Families Accommodation (SFA) by completing the upgrade to Standard 1 for Condition ³ (S1fC).	1,215 Upgrades reported against a target of 1,200.	Target exceeded – additional 15 properties upgraded. Also completed 157 re-roofs at Weeton Barracks and 220 boiler replacements on Salisbury Plain under life-cycle maintenance programmes.
1d. To improve and maintain the defence estate through the percentage of estate assets managed by <i>Defence Estates</i> at or above target condition.	RPC Scotland shortfall of 3%-5% in target condition improvement due to in-year reductions in funding against a target of 78%. Baselines delayed on remaining RPCs.	Target not achieved – in year funding reductions affected performance.
KT2 – To provide an estate of the right size through the consolidation of assets.		
2a. Provide an estate of the right size through implementing agreed Estate Rationalisation (ER) milestones.	The Projects were formed to set in train the ER programmes mandated in STP 05 and are on track. These Projects will deliver both an estate of the right size and shape to meet Defence outputs, and financial efficiencies through disposal receipts for sites identified as surplus to requirements.	Target achieved – progress made towards estate of the right size resulting in a rationalised estate with financial receipts obtained through site disposal.
2b. Achieve Accrued Estates Disposal Receipts (Gross).	Accrued Estate Disposal Receipts (Gross) exceeded the target of £151M by £243M.	Target exceeded – £394M receipts achieved.

² Top Level Budget funded bed spaces. These are projects funded and delivered by other Top Level Budgets (see note 4 next page) within the Department. Examples are Project Allenby/Connaught and the Colchester Garrison Private Finance Initiatives

³ Highest standard of accommodation

KEY TARGETS	EVIDENCE OF PERFORMANCE	OUTCOME
KT3 – To improve customer satisfaction and service delivery.		
3a. Delivery of estate services to Customer Estate Organisations ⁴ (CEstOs).	Delivery was measured using the average performance in the Customer Service Agreement (CSA) Reports over the year.	Target not achieved – performance has been variable, with some key areas of estates delivery under performing and areas such as policy development where it was higher.
3b. Increase customer satisfaction with DE service delivery to the CEstOs.	Customer satisfaction with estates services was included in more detail in the CSA this year.	Target not achieved – overall satisfaction levels indicated a need for improvement.
3c. Reduce customer dissatisfaction with the quality of service delivery to SFA.	Dissatisfaction has increased from 21% in the 2005 Customer Attitude Survey to 38% in 2006. Reasons for this are thought to include the poor start by the Housing Prime Contract for repairs and maintenance of SFA in England and Wales and the general bad press being received by Service accommodation at the time the Survey was conducted. Subsequent feedback on repairs and maintenance indicates a substantial improvement in customer satisfaction. An in-depth analysis of responses to the survey is being conducted and an action plan will be produced for addressing the other key issues they raise.	Target not achieved.
KT 4 – Achieve key milestones for implementation of key MOD Estates Change Initiatives.		
4a. Defence Training Estate Implementation (DTE).	Incorporation of Northern Ireland (NI) and Europe Training Estate agreed and implemented.	Target achieved – expansion of the DTE Review Management Model to include NI and Europe Training Estate Implementation. Associated commercial and financial arrangements and other key enablers in place to ensure continual delivery of training support.
4b. Project Alexander Deferred Scope ⁵ .	Reserve Forces & Cadet Associations - The project is on track to meet the 1 April 07 transfer of the Volunteer Estate to <i>Defence Estates</i> . Works Group Royal Engineers - due to complete July 07. Produce Procurement Strategy for	Target achieved. Target not achieved – revised Command & Control arrangements have been agreed WEF April 08. Procurement Reform strategy expected to be agreed by Project Steering Board in October/November 07. Target not achieved – final report due

⁴ Our Customers, Army, Navy, Royal Air Force, Defence Equipment and Support, MOD Head Office (Centre) and Permanent Joint Headquarters

⁵ Project Alexander was tasked by the Defence Management Board in 2001 to implement a new estate management structure, Deferred Scope initiatives are the remaining elements of that programme

KEY TARGETS	EVIDENCE OF PERFORMANCE	OUTCOME
	Germany. NI Training Estate migrated to Director General Operations by March 07.	in September 07. Target achieved.
4c. Introduce Integrated Service Providers ⁶ (ISPs).	Cyprus ISP awarded in year. Gibraltar ISP delayed.	Target achieved – contract awarded April 06 with an In Service Date of August 06. Target not achieved – due to the need to consider an In-House bid option. ISP single running due in November 07.
KT 5 – Deliver value for money efficiencies.		
5a. Deliver 30% through-life value for money output efficiencies through the introduction of Prime Contracting.	Initial data from RPC Scotland, the most mature Contract, indicates that a level improvement against the 2003/04 baseline has already been achieved. This is currently being verified through a robust validation process to ensure that data standards have been applied consistently across the estate.	Target ongoing.
5b. To deliver output efficiencies from Project SLAM.	Delivered profiled efficiency from the Departmental Efficiency Programme against target of £7.00M.	Target achieved.
5c. To deliver output efficiencies from Project Aquatrine.	Delivered profiled efficiency from the Departmental Efficiency Programme against target of £11.32M.	Target achieved.
5d. To deliver the savings from the introduction of the Housing Prime Contract (HPC).	Delivered profiled efficiency from the Departmental Efficiency Programme against target of £8.70M.	Target achieved.
5e. To deliver the savings from restructuring and the merger of <i>Defence Estates</i> and Defence Housing Executive.	Delivered profiled efficiency from the Departmental Efficiency Programme against target of £3.00M.	Target achieved.
KT 6 – Sustainable Development.		
6a. Achieve Estate related MOD Sustainable Development (SD) targets to deliver the 'Framework for Sustainable Development on the Government Estate'.	Key Achievements include: (a) introduction of a new Defence-specific assessment methodology, Defence Related Environmental Assessment Methodology, in March 06. (b) environmental ratings for new build and major refurbishment have increased significantly from 2005/06. At design phase 60% of new build assessments achieve target, and 71% of refurbishments.	Target partially achieved – new cross government SD targets were launched in June 06, with the 'Sustainable Operations on Government Estate targets' and the Government's Sustainable Procurement Action Plan in March 07. Work has progressed in all estate related SD areas of: carbon emissions offices; energy efficiency; carbon neutrality; waste arisings; recycling; biodiversity; and water consumption.

⁶ One service provider for estate related services

KEY TARGETS	EVIDENCE OF PERFORMANCE	OUTCOME
	<p>(c) 66% of <i>Defence Estates</i> offices have implemented an Environmental Management System to maturity level 4 British Standard 8555:2003.</p> <p>d) Integrated Land Management Plans are in place for all of the principal training areas.</p> <p>(e) Sites of Special Scientific Interest. 82% of sites in England, 69% in Scotland, 75% in Wales and 63% in NI at target condition.</p> <p>(f) energy use at <i>Defence Estates</i> sites has stabilised at 2005/06 levels.</p> <p>(g) 6% of MOD's electricity comes from renewable sources; 2.5% of electricity is sourced from Combined Heat and Power.</p> <p>(h) key milestones completed for Climate Change Adaptation Strategy and SD Social Impact Strategy.</p> <p>(i) participation in OGC Property Benchmarking Scheme.</p> <p>(j) 4 historic buildings removed from 'Buildings at Risk Register'.</p> <p>(k) having achieved level 1 of the Flexible Framework we are working toward the level 3 target for 2009.</p>	

B. DELIVERING TO OUR CUSTOMERS

Regional Prime Contracting (RPC)

- 2.16 Between 2003 and 2005 the Department let 5 Regional Prime Contracts for the delivery of maintenance and construction of the built estate in Great Britain, covering Scotland, the South West, the South East, the East, and Central England and Wales. These replaced over 600 individual contracts. They provide single points of responsibility for the management and delivery of projects and integrated estate services on most defence establishments. All the contracts are delivering the efficient and effective services envisaged as an outcome of the initiative and as a result are on course to deliver the Value for Money savings required over the life of the contracts.

Project Aquatrine

- 2.17 Water and wastewater management is now provided across the defence estate in Great Britain through 3 geographical contracts (one for Scotland and 2 covering England and Wales) under the 25-year Private Finance Initiative, Project Aquatrine. This has transferred environmental risk to those in the private sector best placed to manage it and enabled the Department to focus better on its core activities. It is enabling new capital investment to improve health and safety, such as new or upgraded fire mains, water and sewage treatment works at a number of locations, and will provide the Department for the first time with accurate water consumption data, thus helping to reduce consumption to meet sustainability targets.

Housing Prime Contract (HPC)

- 2.18 On 1 April 2006 the introduction of the HPC over such a wide area (around 45,000 SFA units in England and Wales) replacing a large number of Works Services Management contracts was always going to be a challenge, and so it proved. The initial service was not up to the required standard, reflecting a greater backlog of work than calculated, teething problems with the contractor's IT systems, and difficulties in reorganising the supply chain around the new arrangements. *Defence Estates* agreed a number of measures with the contractor to rectify the problems. These proved effective and performance levels improved markedly over the year. The Helpdesk service has improved greatly, the achievement of response repairs has achieved a consistency above previous contract service levels and the number of complaints has also reduced substantially. Current focus is directed to increasing the rate of First Time (meeting original appointments and making repairs to the right quality on the first visit), improvements through life-cycle and long-term maintenance and upgrades to S1fC, and coherence of output across England and Wales.

Service Families Accommodation (SFA)

- 2.19 At April 2007 59% core SFA stock in Great Britain was reported at S1fC. The Housing Directorate completed the re-organisation of its structure by 31 March 2007. The revised structure seeks to rationalise housing requirements/allocation 'soft services' and housing maintenance 'hard services' into 7 Housing Information Centres supported and directed by a single Headquarters located at RAF Brampton. This will provide a much more coordinated service to Service families and completed the overall re-organisation following the merger of DHE with *Defence Estates*.

Single Living Accommodation Modernisation (SLAM)

- 2.20 By March 2007 over 40 SLAM projects had been completed since 2003, delivering around 7,500 bed spaces. The Phase 2 SLAM Contract was announced by the Prime Minister at Commando Training Centre Royal Marines Lympstone on 11 January 2007 and formalised later that month. The Project is providing a greatly improved living environment including mostly single rooms with en-suite facilities.
- 2.21 In response to a high priority request from the Army Training and Recruitment Agency (ATRA) (now the Army Recruitment and Training Division) to facilitate a SLA project, the Defence Training Estate supplied temporary accommodation for 400 new recruits in 4 refurbished spider

⁷ A further 3,700 SFA properties are maintained by RPC Scotland

blocks at Brunswick Camp. The project cost was £2.5M and was completed by Landmarc Support Services within a challenging 6 month period and officially opened by CE *Defence Estates*. Not only did the project demonstrate the effectiveness of partnering between all involved but it also acted as a successful case study for the Carbon Trust's Low Carbon Building Accelerator initiative.

- 2.22 There are also a number of other TLB managed projects⁸ to modernise SLA in England, Scotland, NI, Germany, Gibraltar and Cyprus, which are intended to upgrade a further 26,000 bedspaces by the end of March 2013. 3,615 bedspaces were delivered in 2006/07, including over 500 overseas, against an overall target of 5,800 making a shortfall of 2,185 due to decisions on future force structures, the requirement to re-profile PFI contracts and other competing Defence priorities. This brings the total number of SLAM and TLB bed spaces upgraded to 19,891 since 1 April 2003 with a further 36,000 to be delivered by the end of March 2013.

International Operations

- 2.23 In support of the operations in Iraq and Afghanistan, *Defence Estates* has let a total of 3 ISP Contracts, to provide and maintain the majority of the accommodation, water and power supplies necessary to support the British Forces. These Contracts are operated on a day to day basis by Royal Engineers with appropriate commercial delegations from *Defence Estates*. Additionally *Defence Estates* provides support to visiting US forces based in the UK.

Vanguard Contract

- 2.24 The Vanguard Contract is a strategic partnering agreement to cover hard and soft facilities management supporting the majority of the DTE. It was designed as a comprehensive support package to replace a large number of minor multi activity contracts covering the Defence training estate. The prime requirement of ensuring availability of training areas is being delivered in excess of 90% despite the high operational tempo. The creation of DTE within *Defence Estates* increased the average number of military personnel by 69.

Sustainable Development (SD)

- 2.25 *Defence Estates* has made significant progress on a range of SD initiatives. These included the publication of a revised and improved Sustainability and Environmental Appraisal Tools handbook with a summary booklet that will provide practical advice across the MOD along with establishing DREAM as the preferred assessment method for defence construction projects. We have undertaken the climate change adaptation strategy which will assist in identifying changes that need to be undertaken across the defence estate. We are working towards attainment of level 3 of the Sustainable Procurement Flexible Framework. *Defence Estates* has also increased the number of projects achieving targets for environmental assessment and reduced the number of buildings on the Buildings at Risk register and met the target for Sites of Special Scientific Interest. The focus on MOD energy usage will reduce the overall energy usage through action at 220 MOD energy using sites - representing 76% of non operational energy consumption. There has been significant progress in the area of SD over the last year, which we intend to build upon over the coming years to meet our commitments.
- 2.26 The Prestigious Building Magazine award for 2006 was won by the *Defence Estates* Projects Directorate for the integrated supply Team of the Year. This was for the Housing Framework Contract with Mansell Construction Services Ltd for the US Air Force's Liberty Village at RAF Lakenheath.
- 2.27 The British Association of Landscape Industries award 2006 for a collaborative project with Ground Control Ltd and Otley College was won by the United States Forces (USF) Division for the landscaping project for the hospital garden at RAF Lakenheath.

Security Services Group (SSG)

- 2.28 SSG continued to provide successful solutions to the security requirements of government departments and other public sector organisations. 2006/07 saw continued sustainable growth in the organisation resulting in total sales of £22M.

⁸ Known as Parallel Projects. See also footnote 2 on page 5

Support to Ministers, MOD and the Public

- 2.29 2006/07 has been a very busy year, with particular emphasis on the quality of Service accommodation. *Defence Estates* handled 191 Oral and Written Parliamentary Questions; and 703 items of other Ministerial business (including 112 briefs). 79% of Parliamentary and Ministerial business was handled within the set timescales.
- 2.30 223 Freedom of Information requests were received of which 90% were responded to within the set time limits.

C. BEING EFFICIENT IN THE DELIVERY OF OUR OUTPUTS

Estate Rationalisation

- 2.31 A key aim of the Estate Strategy launched in March 2006 by the Secretary of State for Defence, is to provide an estate of the right size to support Defence outputs. Funding was allocated in the last planning round to enable a number of projects to proceed. These projects included the co-location of the Headquarters of the former Defence Logistics Organisation and the Defence Procurement Agency (now combined into the Defence Equipment and Support Organisation) in North Bristol and the co-location of the 2 TLB Headquarters within each of the Services. Further projects included the Chief of Defence Intelligence Staff's estate, and the rationalisation of the estate used by the Defence Medical Education and Training Agency, the Royal College of Defence Medicine and the ATRA. All of these projects are progressing according to their respective schedules and remain on target. The programme to dispose of surplus estate has continued during 2006/07.

Supplier Management

- 2.32 *Defence Estates* recognises that effective and constructive engagement with Industry is central to improving performance, generating the best Value for Money and cementing collaborative relationships. In order to help facilitate effective engagement with Industry, *Defence Estates* has developed a Supplier Management Strategy which focuses on Supplier Associations (SAs), collaboration at project level and relationships with wider industry.
- 2.33 *Defence Estates*, in collaboration with its principal suppliers, launched SAs in November 2005. The Prime Contracting SA includes *Defence Estates* and representatives from all of the 5 RPCs, Project SLAM, HPC, DISC Chicksands and Project Vanguard. The Aquatrine SA includes *Defence Estates* and Service Provider Representatives from all 3 Aquatrine Packages.
- 2.34 The overarching purpose of these Associations is to create an environment where shared business improvement work, resourced by all parties, provides tangible benefits to *Defence Estates*, to Industry and to our Customers. To date over 10 collaborative projects including health and safety, SD and Communications and public relations have been launched with a number of benefits realised through the sharing of best practices.
- 2.35 *Defence Estates* recognises that there are a number of strategically important suppliers who are critical to its performance as a whole. *Defence Estates* aims to achieve coherence in MOD interactions with these key suppliers. This approach is also underpinned at the individual project level where *Defence Estates* and industry teams work collaboratively to deliver customer requirements.

Relationships with Wider Industry

- 2.36 *Defence Estates* recognises the importance of maintaining a relationship with wider industry and aims to do this through a number of forums and activities. There is also a move towards greater transparency with industry, capturing future estate and infrastructure requirements. It is anticipated that this should allow industry to undertake bid, resource and investment planning whilst also allowing *Defence Estates* to understand industry capacity for accommodating these future requirements.

Fraud Prevention

2.37 The *Defence Estates*' Fraud Prevention Unit (FPU) objective is to assist and provide evaluations of suppliers' Fraud Prevention proposals. The creation of the FPU Committees has enhanced working relationships with contractors as well as providing an increased visibility of potential fraud risk areas. In support of this, the FPU has conducted 21 Audits and Reviews within this period and achieved recoveries of approximately £1.60M. The FPU has additionally provided Fraud Awareness training to approximately 1,000 *Defence Estates* staff during this period as well as approximately 300 personnel employed by our partners within the RPCs. We have also seen the creation of the Defence Irregularity Reporting Cell. The cell is a collaborative effort between *Defence Estates* FPU, Defence Fraud Analysis Unit and Ministry Defence Police (MDP) Fraud Squad with the future addition of Service Police support.

D. EQUIPPING OUR PEOPLE TO DELIVER

2.38 This year has been a watershed for our Human Resources (HR) teams. As MOD's People, Pay and Personnel Agency took over a large element of our transactional work through a shared service centre, *Defence Estates* HR staff numbers reduced. The *Defence Estates* Business Partner team was launched in April 2006 and has been concentrating most of its efforts in developing a strategic programme of work aimed at mitigating the major risk - an inability to recruit and retain suitably qualified and experienced staff to deliver the business objectives.

2.39 As part of the risk mitigation work an Estates Talent Management Scheme has been created to help identify and develop our people with a career anchor already in MOD and also to attract sufficient good quality technical staff as graduates or technicians at the start of their careers. A review of our ability to recruit and retain key skills has also been undertaken as work has begun to align post profiles to ensure that the *Defence Estates* workforce needs, and those of the wider estates community, are met.

2.40 We continue to work towards steady state training provision for estates management and successful programmes have been delivered to support the introduction of the HPC. We have also started work to carry out a needs analysis for a number of roles in the estates management process.

SECTION 3

REMUNERATION REPORT

(All details contained in this report have been subject to audit)

- 3.1 Members of the *Defence Estates* Management Board, with the exception of Mrs C Nicholson, hold substantive civil service contracts or are in the armed forces. Appointments may be terminated in accordance with the Civil Service Management Code or Single Service Military Appointment procedures. Mrs C Nicholson receives a fee for attending meetings based on an agreed daily rate.
- 3.2 Salaries of the Board are determined through the Senior Civil Service Salaries Review Body, the Armed Forces Pay Review Body (AFPRB), the Senior Salaries Review Body or as part of the Departmental pay award, as appropriate. The only exception to standard salary levels being Mrs C Nicholson who was subject to separate negotiation and received a fee based on the number of days spent on the affairs of the Agency.
- 3.3 The salary and pension entitlements of the Management Board are shown below.

	Year	Salary Including Performance Pay £'000	Real increase In pension £'000	Accrued pension at 31 March 2007 £'000	Lump sum at 31 March 2007 £'000	Real increase in lump sum £'000	CETV* at 31 March 2007 £'000	Real increase In CETV £'000
Current Board members								
Vice Admiral P A Dunt Chief Executive	2006/07 2005/06	125 – 130 110 – 115	5 – 7.5 0 – 2.5	62.5 – 65 55 – 57.5	192.5 – 195 170 – 172.5	15 – 17.5 5 – 7.5	1,110 1,079	103 40
Mr D I Olney Director General Operations	2006/07 2005/06	85 – 90 75 – 80	0 – 2.5 0 – 2.5	25 – 27.5 25 – 27.5	80.0 – 82.5 75.0 – 77.5	2.5 – 5.0 2.5 – 5.0	510 479	16 23
Brigadier R A Cary Director Programming	2006/07 2005/06	85 – 90 5.0 – 7.5	2.5 – 5 0 – 2.5	35 – 37.5 32.5 – 35	110 – 112.5 97.5 – 100	7.5 – 10.0 0 – 2.5	360 785	(414) 1
Mr R J McKinney Director Estate Strategy & Policy	2006/07 2005/06	60 – 65 45 – 50	0 – 2.5 0 – 2.5	12.5 – 15 10 – 12.5	37.5 – 40 35 – 37.5	2.5 – 5 5 – 7.5	186 172	12 24
Mr W C Clark Agency Secretary	2006/07 2005/06	75 – 80 70 – 75	0 – 2.5 0 – 2.5	30 – 32.5 27.5 – 30	90 – 92.5 85 – 87.5	0 – 2.5 2.5 – 5	651 620	7 24
Mr M E Martindale Finance Director	2006/07 2005/06	105 – 110 105 – 110	0 – 2.5 0 – 2.5	5 – 7.5 2.5 – 5	15 – 17.5 12.5 – 15	2.5 – 5 2.5 – 5	113 88	21 23
Mr C Nixon Commercial Director (appointed 3/7/06)	2006/07 2005/06	45 – 50 N/A	0 – 2.5 N/A	25 – 27.5 N/A	75 – 77.5 N/A	0 – 2.5 N/A	531 N/A	8 N/A
Mr R Jones Director Projects	2006/07 2005/06	80 – 85 80 – 85	0 – 2.5 0 – 2.5	10 – 12.5 7.5 – 10	– –	– –	192 164	19 24

	Year	Salary Including Performance Pay £'000	Real increase In pension £'000	Accrued pension at 31 March 2007 £'000	Lump sum at 31 March 2007 £'000	Real increase in lump sum £'000	CETV* at 31 March 2007 £'000	Real increase In CETV £'000
Former Board members (resigned during 2006/07)								
Air Commodore								
K J Pellatt	2006/07	35 – 40	0 – 2.5	40 – 42.5	125 – 127.5	2.5 – 5	464	(383)
Director Housing (resigned 7/9/06)	2005/06	80 – 85	0 – 2.5	42.5 – 45	120.0 – 122.5	2.5 – 5	852	20
Mr M W Pengelly	2006/07	20 – 25	0 – 2.5	22.5 – 25	72.5 – 75	0 – 2.5	497	1
Commercial Director (resigned 30/6/06)	2005/06	65 – 70	0 – 2.5	22.5 – 25	70 – 72.5	2.5 – 5	406	21

* CETV – Cash Equivalent Transfer Value. The factors used to calculate the CETV for members of the Principal Civil Service Pension Scheme (PCSPS) were revised for 2006/07, following advice from the Cabinet Office. The figures for 31 March 2006 have been recalculated using the new factors and this has led to changes to the figures published last year.

- 3.4 No lump sum is shown in respect of **Premium** members.
- 3.5 The note above reflects the relevant remuneration appropriate to the period of tenure as members of the Management Board and includes gross salary, performance pay (that paid during the year but based on performance in an assessment period ended prior to the start of the financial year) and allowances paid. Mrs C Nicholson received fees of £11,600 in the year to 31 March 2007 (2005/06 £14,800). In addition to the salaries shown above Brigadier R A Cary was eligible to a taxable allowance in respect of school fees for his child at boarding school in secondary education. The amount paid during the year was £14,301 with the tax on the allowance also settled by the MOD.
- 3.6 All salaried non-military members of the board are eligible to receive performance related bonuses subject to a maximum payment of £10,000. Recommendations are made by the Chief Executive to the Permanent Under Secretary who determines whether an award is made. The performance related bonuses are included within the salaries disclosed above based on the amount paid during the year but based on the performance in an assessment period ending prior to the start of the financial year.

Pension Arrangements – Civil Service

- 3.7 Pension benefits 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**). New entrants after 1 October 2002 may choose between membership of premium or joining a good quality "money purchase" stakeholder based arrangement with a significant employer contribution (**partnership pension account**).

(a) Classic Scheme

- 3.8 Benefits 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. Members pay contributions of 1.5 per cent of pensionable earnings. On death, pensions are payable to the surviving spouse at a rate of half the member's pension. On death in service, the scheme pays a lump sum benefit of twice pensionable pay and also provides a service enhancement on computing the spouse's pension. The enhancement depends on length of service and cannot exceed 10 years. Medical retirement is possible in the event of serious ill health. In this case, pensions are brought into payment immediately without actuarial reduction and with service enhanced as for widow(er) pensions.

(b) Premium Scheme

- 3.9 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 commute some of their pension to provide a lump sum up to a maximum of 3/80th's of final pensionable earnings for each year of service or 2.25 times pension if greater (the commutation rate is £12 of lump sum for each £1 of pension given up). For the purposes of pension disclosure the tables assume maximum commutation. Members pay contributions of 3.5 per cent of pensionable earnings. On death, pensions are payable to the surviving spouse or eligible partner at a rate of 3/8ths the member's pension (before any commutation). On death in service, the scheme pays a lump-sum benefit of three times pensionable earnings and also provides a service enhancement on computing the spouse's pension. The enhancement depends on length of service and cannot exceed 10 years. Medical retirement is possible in the event of serious ill health. In this case, pensions are brought into payment immediately without actuarial reduction. Where the member's ill health is such that it permanently prevents them undertaking any gainful employment, service is enhanced to what they would have accrued at age 60.

(c) Classic Plus Scheme

- 3.10 This is essentially a variation of **premium**, but with benefits in respect of service before 1 October 2002 calculated broadly as per **classic**.
- 3.11 Pensions payable under **classic**, **premium**, and **classic plus** are increased in line with the Retail Prices Index.

(d) Partnership Pension Account

- 3.12 This is a stakeholder-type arrangement where the employer pays a basic contribution of between 3% and 12.5% (depending on the age of the member) into a stakeholder pension product. The employee does not have to contribute but where they do make contributions, these will be matched by the employer up to a limit of 3% (In addition to the employer's basic contribution). Employers also contribute a further 0.8% of pensionable salary to cover the cost of risk benefit cover (death in service and ill health retirement). The member may retire at any time between the ages of 50 and 75 and use the accumulated fund to purchase a pension. The member may choose to take up to 25% of the fund as a lump sum.
- 3.13 For 2006/07 employers' contributions of £14,946,952 were payable to the PCSPS (2005/06 £13,748,157 [restated]) at one of four rates in the range 17.1 to 25.5% of pensionable pay, based on salary bands. The scheme's Actuary reviews employer contributions every four years following a full scheme valuation. Rates increased in 2006/07.
- 3.14 Civilian employees joining after 1 October 2002 could opt to open a partnership pension account, a stakeholder pension with an employer contribution.
- 3.15 Employers' contributions of £8,922 (2005/06 £7,820 [restated]) were paid to one or more of a panel of four appointed stakeholder pension providers. Employer contributions are age-related and range from 3 to 12.5% of pensionable pay.

Pension Arrangements – Armed Forces

- 3.16 Employer contributions of £1,968,542 were payable to the AFPS (2005/06 £1,015,754) at rates of 34.3 per cent of total pay or 36.3% of pensionable pay for Officers and 21.3% of total pay or 21.8% of pensionable pay for other ranks. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme. The last actuarial valuation was carried out as at 31 March 2005.
- 3.17 Salary costs also include taxable payments attributable to a special bonus scheme whereby civilian staff are paid a bonus in recognition of a well performed one-off task. Currently, there is no limit on the number of awards which can be made within a financial year, although the total value of these bonus payments should not exceed 0.4% of the overall civilian payroll.

- 3.18 No compensation payments were made to former members of the Board and no amounts were payable to third parties for the services of past or present Board members.

A handwritten signature in black ink that reads "Tim Lawrence". The signature is written in a cursive style with a long horizontal stroke at the beginning.

Vice Admiral T J H Laurence CB MVO ADC
Chief Executive

4 October 2007

SECTION 4

STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

Under Section 7(2) of the Government Resources and Accounts Act 2000, HM Treasury has directed *Defence Estates* to prepare for each financial year a statement of accounts in the form and on the basis set out in an Accounts Direction dated 18 December 2006. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of *Defence Estates*' and of its income and expenditure, recognised gains and losses and cash flows for the financial year.

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

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

The Departmental Accounting Officer for the Ministry of Defence has designated the Chief Executive of *Defence Estates* as the Accounting Officer for the Agency. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding *Defence Estates*' assets, are set out in the Accounting Officers' Memorandum, issued by HM Treasury and published in 'Government Accounting'.

SECTION 5

STATEMENT ON INTERNAL CONTROL

1. Scope of responsibility

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of the *Defence Estates* policies, aims and objectives. The Permanent Under Secretary (PUS), as the Department's Principal Accounting Officer, is responsible for the overall organisation, management and staffing of the Department and for ensuring that there is a high standard of management in the Department as a whole. I am accountable directly to the PUS for safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting. In exercising this responsibility, I report through the 2nd Permanent Under Secretary who has delegated responsibility from the Under Secretary of State for Defence and Minister for Veterans.

Defence Estates provides complete estate and housing management services to the MOD to support the delivery of defence capability. As part of the continued development of Project Alexander and the restructuring of the defence estate, the Army Training Estate (ATE) and other rural training sites from across the Armed Forces joined *Defence Estates* from 1 April 2006. The responsibility is contained within the DTE and is accountable, in the first instance, to Director General Operations. On 1 April 2006 *Defence Estates* also became the balance sheet owner for the majority of Defence Land and Buildings as part of the MOD Finance Director's Simplify and Improve initiative.

2. 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 adopted is based on an ongoing process designed to identify and prioritise the risks to the achievement of *Defence Estates'* policies, aims and objectives. Through the risk regime *Defence Estates* is able to evaluate the likelihood of risks being realised, the impact should they be realised, and to manage them efficiently, effectively and economically.

3. Capacity to handle risk

Overall responsibility for Corporate Governance, including risk management, within *Defence Estates* lies with me through the Management Board with advice from the Audit Committee. The Agency Secretariat, Fraud Prevention Unit and Internal Control Audit Teams provide assurance to the Management Board on the integrity of corporate governance processes and controls within the Agency.

4. The risk and control framework

An underpinning Risk Strategy supplemented by a Risk Mitigation Planning Strategy, Risk Implementation Plan and simplified Business Risk Management guidance document detail the processes by which *Defence Estates* identifies, evaluates and controls risk. This policy is in line with Government best practice. *Defence Estates'* staffs have been equipped to manage risk through the project management training programme and risk workshops, and to ensure risk remains focused Risk Co-ordinators have been established at all levels within the Agency. The Finance Director is the nominated Risk Champion at Management Board level with Assistant Director Internal Control being the nominated senior level Risk Implementation Manager who champions risk, disseminates guidance, facilitates discussion and provides an independent review of the risk management framework.

Defence Estates' process for gaining assurance on any given risk is to identify an owner who determines the various ways the risk may be realised and subsequently managed with an action plan being used to address any gaps in controls.

Involvement of stakeholders is an integral part of the *Defence Estates* project management principles. All our major projects conduct regular review meetings to discuss risk and issues affecting both parties.

5. Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. In line with Departmental Guidance I have established the following governance procedures:

- A Management Board that normally sits monthly to review the performance of the business and the risks to it, take corrective action as necessary and to consider plans and strategic direction. The Management Board currently comprises of myself as Chair, seven Directors and a non-executive Director (NED).
- An Executive Committee of the Management Board, chaired by Director General Operations, normally sits monthly and provides assistance to me in exercising my in-year financial management responsibilities as Agency Accounting Officer.
- An Audit Committee chaired by my Management Board NED and supported by other independent members, exists to provide advice on the adequacy of audit arrangements (both internal and external) and on the implications of assurances provided in respect of corporate governance, risk management, fraud and internal control systems.
- Internal audits conducted on behalf of *Defence Estates* by Defence Internal Audit (DIA) use a risk-based approach. The Internal Control Audit Team has adopted a cross section of compliance and risk based auditing techniques to provide a full range of assurances. All risk audits are linked to the Corporate Risk Register and Strategic Objectives contained within the Balanced Scorecard. Audit activity reports are presented to the Management Board and Audit Committee at least three times a year. 'Control Self Assessment' provides further assurance on *Defence Estates*' compliance with basic processes and an Annual Assurance Report, approved by the Audit Committee, is provided to the Department.
- Office of Government Commerce led Gateway reviews in order to provide valuable assurance on high profile projects.
- Risk has been intrinsically linked, managed and reported through the performance management system that fully complies with Departmental requirements.
- A Business Continuity Management Strategy, endorsed by the Management Board is in place and has been issued to all Business Continuity Planners within *Defence Estates*. Business Continuity Site Recovery Plans have been refreshed to take account of the Strategy and testing has taken place at both desk level and through a live exercise in October 2006. However *Defence Estates* Site Recovery Plans are yet to be produced for the Defence Training Estate sites, which transferred to *Defence Estates* in April 2006. Existing Site recovery Plans have been proactively identified and addressed to ensure that critical business functions can continue to operate in the event of a disruptive event, however detailed Information Technology requirements have yet to be produced so as to ensure the continuity of critical Defence estate business by Defence Communication Services Agency.
- Principal Security Adviser (PSyA) delivery responsibility was transferred from Central Top Level Budget to an Agency team in October 2006. A strategic action plan has been formulated to consider successful application of effort, due focus and adherence towards all additional PSyA responsibilities. This plan is being followed diligently, with significant and evident progress.
- An effective governance and management information system is in place to meet requirements arising from the general right of access to information under the Freedom of Information Act.
- Requirements laid out in my Directive for safety management are being adhered to across the Agency. Audit ratings have improved from last year. There has been significant progress in developing a Safety Culture. Enablers to improve performance and management of Safety, Health and Environmental Protection (SHEP) both within *Defence Estates* and across contractor operations have been put in place through engagement with *Defence Estates* senior managers and our supply chain partners. Improved arrangements for performance reporting are in place,

and cross customer and industry partner forums established. There has been a substantial increase in the number of Safety Advisors embedded at all levels throughout *Defence Estates*. This will ensure that information and advice is readily available in all areas and at the point of delivery. SHEP responsibilities within *Defence Estates* have increased in 2006 with the transfer of DTE. The former ATE, which forms the majority of the DTE, has well established and robust processes in place for both a safe system of training and environmental management.

- Following the migration of assets to *Defence Estates*, as Single Balance Sheet Owner for Land and Buildings, a number of difficulties were experienced in the processing of fixed asset data within the Oracle fixed asset accounting module during the year. Whilst these were satisfactorily resolved for the purposes of the 2006/07 Agency accounts, the MOD has a programme of work to ensure that some of these longstanding issues are permanently resolved to prevent any recurrence in the future.
- *Defence Estates* accounts for all income received by the MOD from personnel occupying both SLA and SFA. Whilst sufficient controls exist within *Defence Estates* to ensure the completeness and accuracy of income from SFA, the controls over income from SLA are exercised in various parts of the MOD. There is currently no central database to ensure that all SLA income due to the department is being collected from personnel and this issue is being addressed within the MOD.

6. No significant internal control problems

Within the 2005/06 Statement on Internal Control it was noted that *Defence Estates* had taken responsibility for the delivery of estate services in a number of overseas locations during the year and a single consistent system of internal control had not been in place for the whole period. I can report that *Defence Estates* is continuing to work to achieve common processes across the overseas estate. Progress has, however, been delayed due to the late agreement of the Infrastructure Support Provider in Gibraltar.

Defence Estates has continued to expand its delivery responsibilities this financial year and has seen further changes to the Operations Housing internal structures. Through the processes in place I am, however, able to address any risk or control issues as they arise and I have identified no significant internal control weaknesses.

My review of the effectiveness of the system of internal control is informed by the work of DIA, my Internal Control Audit Team and Fraud Prevention Unit. This is further enhanced by my Directors and other senior managers within *Defence Estates* who have responsibility for the development and maintenance of the internal control framework. In addition, my review is also informed by comments made by the National Audit Office in their management letter and other reports. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Management Board and Audit Committee and will address any weaknesses should they occur and ensure continuous improvement of the systems in place.



Vice Admiral T J H Laurence CB MVO ADC
Chief Executive

4 October 2007

SECTION 6

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

I certify that I have audited the financial statements of *Defence Estates* for the year ended 31 March 2007 under the Government Resources and Accounts Act 2000. These comprise the Operating Cost Statement and Statement of Recognised Gains and Losses, the Balance Sheet, the Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

Respective responsibilities of the Agency, the Chief Executive and auditor

The Agency and Chief Executive, as Accounting Officer, are responsible for preparing the Annual Report, which includes the Remuneration Report, and the financial statements in accordance with the Government Resources and Accounts Act 2000 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 and the part of the Remuneration Report to be audited 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 HM Treasury directions issued under the Government Resources and Accounts Act 2000. I report to you whether, in my opinion, certain information given in the Annual Report, which comprises a Chief Executive's Statement, a Management Report and a Remuneration Report, is consistent with the financial statements. 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.

In addition, I report to you if the Agency 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 HM Treasury regarding remuneration and other transactions is not disclosed.

I review whether the Statement on Internal Control reflects the Agency's compliance with HM Treasury's guidance, and I report if it does not. I am not required to consider whether this statement covers all risks and controls, or to form an opinion on the effectiveness of the Agency'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. 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. My 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 the Agency and Chief Executive in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Agency'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

Audit Opinion

In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by HM Treasury, of the state of the Agency's affairs as at 31 March 2007, and of the net operating cost, recognised gains and losses and cash flows 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 HM Treasury directions issued under the Government Resources and Accounts Act 2000; and
- the information given within the Annual Report, which comprises a Chief Executive's Statement, a Management Report and a Remuneration Report, is consistent with the financial statements.

Audit Opinion on Regularity

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

Report

I have no observations to make on these financial statements.



John Bourn
Comptroller and Auditor General

National Audit Office
157-197 Buckingham Palace Road
Victoria
London SW1W 9SP
Date: 8 October 2007

SECTION 7

DEFENCE ESTATES ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2007

OPERATING COST STATEMENT FOR THE YEAR ENDED 31 MARCH 2007

	Note	2006/07 £'000	2005/06 £'000
OPERATING COSTS			
Staff costs	2	157,317	147,621
Accommodation costs	3a	1,982,383	970,797
Other operating costs	3c	528,403	134,080
GROSS OPERATING COSTS		2,668,103	1,252,498
OPERATING INCOME			
Proceeds from the sale of property	5	(394,158)	(257,537)
Transfer of assets to the Private Sector	6	–	(15,357)
Open Market Value of property disposals		327,634	172,840
Share of Proceeds to third parties		(1,427)	260
Surplus on sale of property		(67,951)	(99,794)
Income from United States Forces (USF)	5	(101,789)	(125,169)
Cost of services provided to USF		99,839	123,730
Surplus from providing services to USF		(1,950)	(1,439)
Income from NATO	5	(5,599)	(5,394)
Cost of services provided to NATO		5,105	4,642
Surplus from providing services to NATO		(494)	(752)
Rental Income	5	(220,613)	(137,986)
Other operating income	5	(45,445)	(47,346)
TOTAL NET OPERATING INCOME		(336,453)	(287,317)
NET OPERATING COST		2,331,650	965,181

All activities undertaken during the year are continuing.
The notes on pages 27 to 43 form part of these accounts.

STATEMENT OF RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDED 31 MARCH 2007

	Note	<u>2006/07</u> £'000	<u>2005/06</u> £'000
Revaluation of assets credited to Revaluation Reserve	17	797,537	108,284
Revaluation of assets credited to Donated Reserve	18	113,736	-
RECOGNISED GAINS DURING THE YEAR		<u>911,273</u>	<u>108,284</u>

The notes on pages 27 to 43 form part of these accounts.

BALANCE SHEET AS AT 31 MARCH 2007

		<u>31 March</u> 2007	<u>31 March</u> 2006
	Note	£'000	£'000
TANGIBLE FIXED ASSETS			
Land and Buildings	8	13,592,636	1,526,196
Other Fixed Assets	8	2,306	3,035
		<u>13,594,942</u>	<u>1,529,231</u>
DEBTORS receivable in more than one year	11	<u>475,435</u>	<u>227,120</u>
CURRENT ASSETS			
Assets held for resale	9	176,280	165,588
Stock and Work in Progress	10	8,948	8,145
Debtors	11	257,337	159,435
Cash at Bank and in hand	12	5,178	4,051
		<u>447,743</u>	<u>337,219</u>
CURRENT LIABILITIES:			
DUE WITHIN ONE YEAR			
Creditors	13	<u>(493,813)</u>	<u>(368,430)</u>
NET CURRENT (LIABILITIES)		<u>(46,070)</u>	<u>(31,211)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES			
		14,024,307	1,725,140
Creditors: amounts due after one year	13	(67,073)	(69,726)
Provisions for liabilities and charges	15	(172,133)	(103,656)
NET ASSETS		<u><u>13,785,101</u></u>	<u><u>1,551,758</u></u>
TAXPAYERS' EQUITY			
General Fund	16	8,044,431	994,681
Revaluation Reserve	17	3,877,882	557,077
Donated Asset Reserve	18	1,862,788	-
		<u><u>13,785,101</u></u>	<u><u>1,551,758</u></u>



Vice Admiral T J H Laurence CB MVO ADC
Chief Executive

4 October 2007

The notes on pages 27 to 43 form part of these accounts.

CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2007

		<u>2006/07</u>	<u>2005/06</u>
	Note	£'000	£'000
NET CASH OUTFLOW FROM OPERATING ACTIVITIES	20	(983,497)	(640,770)
Cash Payments to acquire tangible fixed assets	8	(469,217)	(446,590)
Proceeds from disposal of fixed assets		138	24
Repayments of principal under finance leases		(650)	(571)
Repayments of principal under loans		(1,796)	(1,695)
NET CASH OUTFLOW BEFORE FINANCING		<u>(1,455,022)</u>	<u>(1,089,602)</u>
FINANCING			
Payments and Receipts on Defence Resource Account	16	<u>1,456,149</u>	<u>1,089,892</u>
NET FINANCING FROM THE DEFENCE RESOURCE ACCOUNT		<u>1,456,149</u>	<u>1,089,892</u>
INCREASE IN CASH		<u><u>1,127</u></u>	<u><u>290</u></u>

The notes on pages 27 to 43 form part of these accounts.

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2007

NOTE 1 **Statement of Principal Accounting Policies**

A. Basis of Accounts

The accounts have been prepared in accordance with the Financial Reporting Manual issued by HM Treasury. The particular accounting policies adopted by the Agency are described below. They have been applied consistently in dealing with items considered material to the accounts.

These accounts have been prepared under the historical cost convention modified to account for the revaluation of fixed assets, and stocks where material, at their value to the business by reference to their current cost.

Defence Estates ceased to be an agency with effect from 1 April 2007. As a Top Level Budget the activities of the Agency continue within the MOD, and the accounts have therefore been prepared on a going concern basis.

B. Taxation and Social Security

As the Ministry of Defence charges the Agency during the year with the gross payments, inclusive of PAYE and National Insurance contributions, due to Agency employees, the Department is liable for the payment of any liabilities that may be due to HM Revenue & Customs or the Department of Works and Pensions at the balance sheet date, and these are not disclosed in the Agency's balance sheet.

C. Value Added Tax

Whilst the Agency is not separately registered for Value Added Tax (VAT), Security Services Group has a VAT registration and accounts for its own VAT. VAT collected on other activities is accounted for centrally by the MOD. The Agency's accounts include irrecoverable VAT attributable to its activities.

Input VAT on certain Contracted-Out Services is recoverable by the Agency through the MOD registration under specific HM Treasury direction. Since 1 April 2003, Contracted-Out Services VAT has been accounted for centrally by the MOD and therefore no VAT debtor is included in the agency accounts as at 31 March 2007.

D. Income

Income represents the invoiced value of transactions with the Private Sector, the Public Sector and Government Departments. In particular, income derives from:

- a. The sale of MOD properties held by *Defence Estates* for disposal;
- b. The provision of estate services to United States forces based in the United Kingdom. These services are charged out on the basis of cost plus an agreed management fee;
- c. The provision of estate services to NATO forces based in the United Kingdom. These services are charged out on the basis of cost plus an agreed management fee;
- d. The collection of rental for SFA and SLA. Accommodation charges are determined annually for each of the Services as part of Armed Forces Pay Review. Rents are collected from Service tenants by direct deduction from salary by the relevant Service payroll authorities. The remaining income relates to damages for trespass and is collected directly by the Agency. All income is VAT exempt;
- e. Profit sharing receipts from Annington Homes Limited. Profit sharing payments made by Annington Homes Limited are accounted for as and when received. Profit share receipts accrue to the Treasury and not *Defence Estates* or the Ministry of Defence;
- f. Sales made by the Security Services Group;
- g. Rent for land and buildings, and other miscellaneous income.

Income is accounted for and recognised in the Operating Cost Statement net of VAT.

E. Notional Charges

Notional amounts are included in the operating costs for charges in respect of services provided from other areas of the Ministry of Defence. The amounts charged are calculated to reflect the full cost of providing these services to the Agency.

Defence Estates is not charged an audit fee by the National Audit Office. The audit fee shown represents the notional charge to the Operating Cost Statement based on the cost of services provided.

A notional charge for interest on capital is included in the operating costs. This is calculated as 3.5% of the average value of the net assets employed during each accounting period of the financial year. Interest on capital charges on the revaluation of assets for resale are accounted for within the financial period that the information is made available.

Notional charges for Defence Estates are analysed within Note 7 of these accounts.

F. Pension Arrangements

On 1 October 2002 new Civil Service pension arrangements came into effect. From that date all new non-military entrants to the Department have the option to join either the new defined benefits (DB) scheme, known as 'Premium' or to join the new defined contributions (DC) scheme known as the 'Partnership Pension Account'.

Under the new arrangements, new entrants are not able to join the current Principal Civil Service Pension Scheme (PCSPS), which has now been renamed the 'Classic' and has become a closed scheme. Existing members of the PCSPS have been given the option of remaining within the Classic, electing to transfer to the Premium, or choosing 'Classic Plus' whereby they transfer to Premium but only in respect of service after 1 October 2002.

Military personnel serving in *Defence Estates* are part of the Armed Forces Pension Scheme (AFPS). This is non-contributory and unfunded.

The Department makes regular payments of Superannuation Contributions Adjusted for Past Experience (SCAPE) into the relevant pension schemes at rates determined by the Government Actuary. Liability for payment of future pension benefits to members is a charge on the schemes and not a liability of the Department.

Early Retirement Costs:

The Agency is required to meet the additional cost of benefits beyond the normal pension benefits in respect of civilian employees who retire early. The Agency provides in full for this cost when the early retirement programme has been announced and is binding on the Agency. The Agency may, in certain circumstances, settle some or all of its liabilities in advance by making a payment to Paymaster's account at the Bank of England for the credit of the Civil Superannuation Vote. The amount provided is shown net of any such payments.

G. Tangible Fixed Assets

Land & Buildings

On 1 April 2006 the MOD transferred accounting responsibility for Land & Building fixed assets from across the department to *Defence Estates*.

Where an agency or other part of the MOD retains the risks and rewards of ownership of these assets, they are accounted for on that entity's balance sheet in accordance with FRS 5 and SSAP 21.

Other Fixed Assets

Apart from the assets held on the Fixed Asset Register of Security Services Group, accounting responsibility for all Plant & Machinery, Transport and Computer Equipment was transferred to other parts of the department on 1 April 2006. Where *Defence Estates* retains the risks and rewards of ownership it continues to account for these assets on its balance sheet in accordance with FRS 5 and SSAP 21. In other cases the costs of the use of these assets have been communicated to *Defence Estates* by the asset owner and charged to the operating cost statement.

All purchases of fixed assets over £2,500, or £10,000 in respect of land and buildings other than housing, are capitalised in the accounts. The costs of refurbishment/upgrade of housing in excess of £75,000 as part of a single project on an individual property are capitalised. The values of fixed assets are revised annually, between formal revaluation, using indices provided by the Department.

Increases arising on revaluation of fixed assets, including adjustments to previous depreciation provisions, are taken to a revaluation reserve except to the extent that they represent a reversal of a previous impairment. That element is credited to the Operating Cost Statement. Permanent diminutions in value are charged to the operating cost statement except where they represent a reversal of a previous increased revaluation. That element is offset against the revaluation reserve.

Freehold land and buildings are revalued by qualified valuers every five years or at shorter intervals if it is considered that values have changed materially.

Plant & Machinery, Vehicles and Computers are valued at their depreciated replacement cost.

H. Depreciation

Fixed Assets, other than land, are depreciated to a nil value on a straight-line basis over their estimated useful lives. The following estimated lives are used in accordance with MOD resource accounting policy.

	Life in years
a. Buildings - permanent	5-50
b. Buildings - temporary	5-20
c. Housing	5-50
d. Plant & Machinery	5-15
e. Office Equipment	5-15
f. Motor Cars	3-5
g. Computers	3-7

I. Assets held for resale

Assets held for resale comprise MOD land and buildings identified for future disposal, which are transferred to *Defence Estates* at their net book value, having satisfied the requirements of the site closure guide. Upon receipt by *Defence Estates* these properties are subsequently valued at their open market value, by professionally qualified *Defence Estates* staff, in accordance with the Royal Institution of Chartered Surveyors (RICS) 'Appraisal and Valuation' manual. The open market value of sites transferred to *Defence Estates* and not disposed of during a financial year are re-valued on an annual basis at the year-end. The last such valuation was conducted on 31 March 2007. Revaluation losses are written off to the Operating Cost Statement, revaluation gains are held against the revaluation reserve in the balance sheet and released to the General Fund upon disposal.

J. Leases

Operating Leases

Annington Homes Limited's lease agreement determined at the time of sale that the properties leased from the company should not be on-balance sheet. The agreement is treated as an operating lease and the lease payments are charged to the Operating Cost Statement. Rentals payable under other operating leases are charged to the Operating Cost Statement over the term of the lease.

Finance Leases

Assets constructed under PFI/PPP arrangements are reviewed on a case-by-case basis to determine the appropriate balance sheet treatment. Only the PFI properties at RAF Lossiemouth have been included on-balance sheet. The lease payment consists of three elements - Principal, Interest and service charges. Interest and service charges are charged to the Operating Cost Statement. The principal payment reduces the Long Term Creditor on the balance sheet.

K. Stocks and Work in Progress

Stocks comprise equipment and components on hand for resale in connection with the work carried out by Security Services Group. Stock is valued at the lower of cost and net realisable value. Work in Progress represents the value of contracts, stated at cost, which had not been completed at the year-end. Some incomplete contracts had been invoiced in part by the year-end and these amounts are shown as Deferred Income at the balance sheet date.

L. Cash at Bank and in Hand

Cash at bank represents the sums held by Security Services Group with their own account held by Paymaster. A reconciliation of operating costs to cash flows is given in the Cash Flow Statement on page 26.

M. Provisions for Liabilities and Charges

Provisions for liabilities and charges have been established under the criteria of FRS12 (Provisions, Contingent Liabilities and Contingent Assets) and are based on realistic and prudent estimates of the expenditure required to settle future legal or constructive obligations that exist at the balance sheet date.

NOTE 2 Staff Costs and Numbers

A. The average number of employees during the year was:

	<u>2006/07</u>	<u>2005/06</u>
	No.	No.
Service personnel	140	83
Non-Industrial civilian	3,084	3,201
Industrial civilian	527	540
Agency staff	270	356
	<u>4,021</u>	<u>4,180</u>

B. Staff costs incurred during the year were:

	<u>2006/07</u>			<u>2005/06</u>		
	Service £'000	Civilian £'000	Total £'000	Service £'000	Civilian £'000	Total £'000
Salaries & Wages	7,858	121,301	129,159	4,216	119,164	123,380
Social Security Costs	680	6,480	7,160	346	6,299	6,645
Other Pension Costs	1,969	14,956	16,925	1,016	13,756	14,772
Early Retirement Costs	-	4,006	4,006	-	2,722	2,722
Unwinding of Discount on Early Retirement Provision	-	67	67	-	102	102
	<u>10,507</u>	<u>146,810</u>	<u>157,317</u>	<u>5,578</u>	<u>142,043</u>	<u>147,621</u>

Civilian salaries and wages include payments of £9.769M (2005/06 £9.402M) for temporary agency staff.

Salary

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

Pensions

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded multi-employer defined benefit scheme but the Agency is unable to identify its 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 (<http://www.civilservice-pensions.gov.uk/>).

Military personnel serving in *Defence Estates* are part of the Armed Forces Pension Scheme (AFPS). The scheme is non-contributory and unfunded. The last actuarial valuation was carried out as at 31 March 2005.

NOTE 3

a) Accommodation Costs

Accommodation Costs comprise the following cash and non-cash costs:

	<u>2006/07</u> £'000	<u>2005/06</u> £'000
Depreciation on buildings	491,856	31,008
Impairment arising from a fall in market value of fixed assets*	248,665	2,996
Reversal of prior year impairment	(60,427)	(499)
Write off of land and buildings	111,006	-
Released from Donated Asset Reserve for Impairment	(122,075)	(1,248)
Released from Donated Asset Reserve for Depreciation	(49,999)	-
Diminution in value of assets held for resale (See 3b i)	25,228	17,393
Diminution in value of assets transferred & sold in year (See 3b ii)	114,480	26,707
Rent and Rates	235,110	96,375
Rent – Annington Homes Limited	141,840	136,735
Provision for dilapidation costs	3,904	2,357
Payments in respect of housing PFI contracts	21,028	19,093
Accommodation stores	7,684	10,424
Fuel & utilities	17,808	6,601
Accommodation costs on other MOD sites	3,181	3,500
Aquatrine Public Private Partnership	75,456	84,483
Works services – housing	134,926	109,247
Regional Prime Contracting core services	330,131	245,501
Army Training Estate	76,532	-
Other estate expenditure – UK and overseas	169,795	156,694
Disposal and remediation costs in respect of Estate disposals	11,394	3,957
Provision for environmental liabilities	(5,140)	19,473
	<u>1,982,383</u>	<u>970,797</u>

*Previously shown net of releases from the Donated Asset Reserve.

b) Permanent Diminution

	<u>2006/07</u> £'000	<u>2005/06</u> £'000
(i) Diminution in value of assets held for resale		
Net Book Value	50,786	56,372
Open Market Value	(25,558)	(38,979)
	<u>25,228</u>	<u>17,393</u>
(ii) Diminution in value of assets transferred and sold in year		
Net Book Value	230,289	40,930
Open Market Value	(115,809)	(14,223)
	<u>114,480</u>	<u>26,707</u>

c) Other Operating Costs

Other Operating Costs comprise the following cash and non-cash costs:

	<u>2006/07</u>	<u>2005/06</u>
	£'000	£'000
Depreciation	703	889
Impairment of other fixed assets	150	615
Travel and Subsistence	7,507	6,980
Post and telecommunications	5,589	4,568
(Profit)/Loss on disposal of fixed assets	(39)	(4)
Contracted-out professional and technical services	19,127	15,887
Stamp Duty	7,150	-
IT Services – Payments in respect of PFI Contract	6,374	6,894
Other Computer and IT costs	3,983	2,507
Entertainment & Hospitality	209	244
Miscellaneous administration expenses	4,284	3,961
Consumable materials & stores	4,548	2,038
Office machinery	882	580
Operating charges on fixed assets	520	-
Training & Recruitment	1,872	2,045
Provision for Bad debts	90	41
Other Provisions	27,405	6,825
Interest Paid – Loans	3,237	3,349
Interest Paid – On-balance sheet PFI Contract	2,825	2,903
Other interest & charges	532	-
Whitefleet – Payment in respect of PFI Contract	2,089	425
Bought in Materials and Services by Security Services Group	9,956	10,607
Headquarter charges	5,408	6,196
Audit fee	185	125
Unwinding of Discount on Provision for Environmental/Other Liabilities	2,100	3,143
Interest on capital	411,717	53,262
	<u>528,403</u>	<u>134,080</u>

NOTE 4 Interest on Capital

A charge, reflecting the cost of capital utilised by *Defence Estates*, is included in Other Operating Costs (Note 3c). The charge is calculated at the Government standard rate of 3.5% in real terms on average net assets held during the year.

NOTE 5 Operating Income

Income is derived from sales of properties held for disposal, recovery of costs and management fees for services provided to United States Forces and NATO, charges made in respect of SFA, profit share sales made by Security Services Group and rental and other miscellaneous charges.

An analysis of the proceeds from the sale of property is set out below. Clawback is a term that applies to a contractual clause within a property disposal sale agreement that entitles the agency to a share of any future increases in land value derived from changes in local authority planning consents.

	<u>2006/07</u>	<u>2005/06</u>
	£'000	£'000
Disposal Receipts	382,579	232,024
Clawback & Other Income	11,089	25,271
Interest on Deposits	490	242
Proceeds from Sale of Property	<u>394,158</u>	<u>257,537</u>

Costs relating to property disposals are included within Accommodation Costs and Other Operating Costs at Note 3.

An analysis of rental and other income is set out below:

	<u>2006/07</u>	<u>2005/06</u>
	£'000	£'000
Rental Income		
Accommodation charges – Housing	208,535	124,440
Damages for Trespass – Housing	5,764	5,922
Other rental income from land and buildings	6,314	7,624
	<u>220,613</u>	<u>137,986</u>
Other Income		
Profit sharing	15,034	18,366
Sales made by Security Services Group	22,058	18,989
Other Income	8,353	9,991
	<u>45,445</u>	<u>47,346</u>

NOTE 6 Transfers of Assets to the Private Sector

Project Aquatrine is the department-wide Public Private Partnership (PPP) to transfer responsibility for the operation and maintenance of all MOD water and wastewater systems in England, Wales and Scotland. Package A (the first of 3 packages covering the Midlands, Wales and the South West) commenced operation in 2003/04 with Packages B (covering Scotland) and C (covering the remainder of England) commencing in 2004/05. The fair value of the total assets transferred to the contractors for all 3 packages (taken to be the net book values at the time of transfer) was £197.2M of which £7.2M was transferred during 2005/06. This formed the basis for the prepayments against the unitary charges of the contracts and these amounts will be amortised over the terms of the contracts of 25 years. Details of the unamortised elements of the prepayments in respect of all three packages are included in note 11.

In 2005/06 land valued at £8.2M was transferred to the Private Sector in respect of an Off Balance Sheet Private Finance Initiative for the provision of Family Quarters at Portsmouth. This is treated as a prepayment against the unitary charge of the contract to be amortised over 25 years and is included within note 11.

NOTE 7 Notional Charges (Communicated and Non-Cash Costs)

The MOD does not charge for services provided by other parts of the Department. The cost of services provided are communicated and included in the Accounts as non-cash costs. These costs, and other notional charges and income, are included in Note 3 Other Operating Costs or Note 5 Operating Income shown above:

	<u>2006/07</u>	<u>2005/06</u>
	£'000	£'000
Income received by other parts of the MOD on behalf of the Agency	-	(124,440)
Income received by HM Treasury on behalf of the Agency	(15,034)	(18,366)
Headquarters Charges	5,408	6,196
Operating charges on fixed assets	520	-
Audit Fee	185	125
Interest on Capital	411,717	53,262
Fuel & utilities	2,881	2,199
Post and telecommunications	4,430	3,690
Administration charges	3,457	2,677
Accommodation costs	3,181	3,500
Hospitality	39	71
Early Retirement costs in Year	4,006	2,722
Unwinding of Discount on Early Retirement Provision	67	102
	<u>420,857</u>	<u>(68,262)</u>

NOTE 8 Fixed Assets

An analysis of the balances and movements of the cost and depreciation on the main categories of fixed assets is shown below. Fixed Assets are valued on the basis of existing use:

a. Land and Buildings

	Land & Buildings Non-Dwellings £'000	Land & Buildings Dwellings £'000	Assets under Construction (AUC) £'000	Total £'000
Cost or Valuation:				
At 1 April 2006	348,684	815,020	475,369	1,639,073
Additions	11,535	–	456,922	468,457
Transfers from other parts of MOD	11,693,280	2,329,729	99,955	14,122,964
Transfers from AUC	223,505	137,058	(360,563)	–
Revaluations	1,017,798	151,697	36,331	1,205,826
Transfer to Assets Held for Disposal	(365,296)	(68,446)	–	(433,742)
Impairment	(223,875)	(49,183)	–	(273,058)
Impairment reversal	46,064	25,385	–	71,449
Asset write off	(148,722)	(11,440)	–	(160,162)
Asset write on	76,190	–	–	76,190
At 31 March 2007	12,679,163	3,329,820	708,014	16,716,997
Depreciation:				
At 1 April 2006	46,322	66,555	–	112,877
Transfers from other parts of MOD	1,856,933	386,415	–	2,243,348
Charged in Year	389,579	102,277	–	491,856
Impairment	(22,714)	(1,679)	–	(24,393)
Impairment reversal	10,090	932	–	11,022
Transfer to Assets Held for Disposal	(36,372)	(11,682)	–	(48,054)
Asset write off	(45,928)	(3,228)	–	(49,156)
Revaluations	353,690	33,171	–	386,861
At 31 March 2007	2,551,600	572,761	–	3,124,361
Net Book Value:				
At 31 March 2007	10,127,563	2,757,059	708,014	13,592,636
At 1 April 2006	302,362	748,465	475,369	1,526,196

b. Other Fixed Assets

	Plant & Machinery £'000	Transport £'000	Computer Equipment £'000	Total £'000
Cost or Valuation:				
At 1 April 2006	801	1,435	3,546	5,782
Additions	15	514	231	760
Revaluations	17	7	–	24
Transfers to other parts of MOD	(52)	–	(915)	(967)
Transfers to Disposals	–	(354)	–	(354)
Permanent Diminution	–	–	(150)	(150)
At 31 March 2007	781	1,602	2,712	5,095
Depreciation:				
At 1 April 2006	383	535	1,829	2,747
Charged in Year	63	314	326	703
Disposals	–	(254)	–	(254)
Revaluations	5	3	(65)	(57)
Transfers to other parts of MOD	(28)	–	(322)	(350)
At 31 March 2007	423	598	1,768	2,789
Net Book Value:				
At 31 March 2007	358	1,004	944	2,306
At 1 April 2006	418	900	1,717	3,035

All land and buildings assets are subject to a quinquennial review by external professional valuers in accordance with FRS15. All properties owned by the Agency have been valued on a rolling programme over the three year period ending on 31 March 2007. Valuations are carried out by the Valuation Office Agency or GVA Grimley in accordance with the revaluation timetable and the RICS 'Appraisal and Valuation' manual and these values are reflected in the above figures. The values of fixed assets are revised annually, between formal revaluation, using indices provided by the Department.

The European Centre for Medium-Range Weather Forecasting was granted occupancy of Shinfield Park by the Government in 1979 until such time as the centre is closed or transfers from the UK. *Defence Estates* maintains the site under a maintenance undertaking expiring in 2019. Shinfield Park is included in Fixed Assets at a nominal amount as, although owned by the MOD, *Defence Estates* does not have beneficial use of the site.

Land and Buildings (Dwellings) include amounts in respect of RAF Lossiemouth Family Quarters which is treated as an on-balance sheet PFI transaction. The cost/valuation at 1 April 2006 was £35.861M with revaluations in year of £2.946M giving a revised cost at 31 March 2007 of £38.807M. Depreciation at 1 April 2006 was £8.424M with in year depreciation of £2.269M and revaluations of £0.692M giving revised depreciation at 31 March 2007 of £11.385M. The net book value of the assets at 31 March 2007 was £27.422M (2006: £27.437M).

NOTE 9 Assets Held for Resale

The following analysis is intended to reflect the timing of future disposals and the current valuation of properties identified for disposal:

	<u>31 March 2007</u>	<u>31 March 2006</u>
	£'000	£'000
Land and Buildings held for disposal:		
Within One Year	95,500	63,000
Between Two to Five Years	80,780	102,588
Over 5 Years	-	-
	<u>176,280</u>	<u>165,588</u>

NOTE 10 Stock and Work in Progress

	<u>31 March 2007</u>	<u>31 March 2006</u>
	£'000	£'000
Stock	1,803	1,346
Work in Progress	7,145	6,799
	<u>8,948</u>	<u>8,145</u>

NOTE 11 Debtors, Prepayments and Accrued Income

	<u>31 March 2007</u>	<u>31 March 2006</u>
	£'000	£'000
<u>Due in more than one year:</u>		
Trade debtors	285,287	28,000
Prepayments relating to Aquatrine Private Finance Initiative	176,600	184,890
Prepayments relating to other Private Finance Initiatives	13,548	14,230
	<u>475,435</u>	<u>227,120</u>
<u>Due within one year:</u>		
Trade debtors	81,879	64,281
Accrued Income	48,613	54,701
Sundry Debtors	721	762
VAT debtor	148	147
Prepayments	119,758	33,363
Prepayments relating to Aquatrine Private Finance Initiative	8,290	8,290
Prepayments relating to other Private Finance Initiatives	682	573
Provision for Bad Debts	(2,754)	(2,682)
	<u>257,337</u>	<u>159,435</u>

NOTE 12 Cash at Bank and in Hand

	<u>31 March 2007</u>	<u>31 March 2006</u>
	£'000	£'000
Cash held at Bank – Security Services Group	5,173	4,046
Cash in hand	5	5
	<u>5,178</u>	<u>4,051</u>

NOTE 13 Creditors, Accruals and Deferred Income

	<u>31 March 2007</u>	<u>31 March 2006</u>
	£'000	£'000
Amounts falling due within one year:		
Trade creditors	114,048	67,809
Loans	1,904	1,797
Current part of imputed finance lease element of PFI contract	749	650
Deferred Income	14,745	16,425
Accruals	362,188	280,844
Sundry creditors	179	905
	<u>493,813</u>	<u>368,430</u>
Amounts falling due after one year:		
<u>Loans</u>		
Amount payable in 1 – 2 years	2,019	1,904
Amount payable in 2 – 5 years	6,818	6,430
Amount payable after 5 years	37,594	40,001
	<u>46,431</u>	<u>48,335</u>
<u>Imputed finance lease element of on-balance sheet PFI contract</u>		
Amount payable in 1 – 2 years	842	749
Amount payable in 2 – 5 years	3,301	2,892
Amount payable after 5 years	16,499	17,750
	<u>20,642</u>	<u>21,391</u>
	<u>67,073</u>	<u>69,726</u>

Under the Armed Forces (Housing Loans) Acts 1949, 1958, & 1965, the Ministry borrowed £94m from the National Loans Funds for the construction of married quarters over the period 1950/1951 to 1967/1968. These loans are fully repayable between 2012 and 2028, with the last instalment due on 20th February 2028. Interest on the loans is payable at rates ranging from 4% to 7% per annum.

NOTE 14 Intra-Government and Other Balances

	Debtors due within 1 year £'000	Debtors due within 1 year £'000	Creditors due within 1 year £'000	Creditors due within 1 year £'000
Balances with central government bodies	26,193	14,000	1,944	46,431
Balances with MOD Trading Funds/QinetiQ	1,284	-	-	-
Balances with overseas governments	10,784	-	-	-
Other balances	219,076	461,435	491,869	20,642
At 31 March 2007	<u>257,337</u>	<u>475,435</u>	<u>493,813</u>	<u>67,073</u>
Balances with central government bodies	25,466	28,000	2,225	48,335
Balances with MOD Trading Funds/QinetiQ	1,656	-	644	-
Balances with overseas governments	13,182	-	-	-
Other balances	119,131	199,120	365,561	21,391
At 31 March 2006	<u>159,435</u>	<u>227,120</u>	<u>368,430</u>	<u>69,726</u>

NOTE 15 Provisions for Liabilities and Charges

Environmental Liabilities

During the year *Defence Estates* made specific provisions for future environmental and other remediation works. These provisions were on properties held for disposal and other approved remediation expenditure for which *Defence Estates* is responsible. The provision is based on the Agency's current assessment against contractual and legal obligations that satisfy the requirements of FRS12: Provisions, Contingent Liabilities and Contingent Assets.

Other Liabilities

Provisions for other liabilities have been established under the criteria of FRS12 and are based on realistic and prudent estimates of the expenditure required to settle future legal or constructive obligations that exist at the balance sheet date. It is not considered appropriate to disclose details of the purpose of provisions made on the grounds that such disclosure would be prejudicial to the Agency's legal position.

Early Retirement Costs

A provision has been set up to represent the future liability to pay early pensions and lump sum payments. The provision has been charged to the Operating Cost Statement for the year.

The full cost of early retirements provided during the year was £4,005,827 of which £1,735,066 has been paid, and the balance carried forward as a long-term provision. Other payments of £863,272 were made in respect of retirement costs provided in previous years. In addition a number of civilians left *Defence Estates* as part of the MOD early departure scheme. Total lump sum compensation payments of £585k were paid by the MOD but these amounts are not reflected in the Operating Cost Statement.

A summary of the provisions for liabilities and charges is as follows:

	Environmental Liabilities £'000	Other Liabilities £'000	Early Retirement £'000	Total £'000
Balance at 1 April 2006	74,634	25,951	3,071	103,656
Provided in year	11,815	31,546	4,006	47,367
Transfers	32,252	24,945	-	57,197
Release of provision	(16,955)	(237)	-	(17,192)
Unwound Discount	1,703	397	67	2,167
Paid in year	(10,354)	(8,110)	(2,598)	(21,062)
Balance at 31 March 2007	93,095	74,492	4,546	172,133

The table below analyses total costs still to be incurred at current prices, and discounted at 2.2% (2005/06 2.2%) to the balance sheet date.

	31 March 2007 £'000	31 March 2006 £'000
<u>Environmental Liabilities</u>		
– Undiscounted	98,295	79,884
– Discounted	93,095	74,634
<u>Other Liabilities</u>		
– Undiscounted	76,292	26,923
– Discounted	74,492	25,950
<u>Early Retirement Costs</u>		
– Undiscounted	5,752	3,849
– Discounted	4,546	3,071

NOTE 16 Statement of Movement on General Fund

		<u>2007</u> £'000	<u>2006</u> £'000
General Fund brought forward as at 1 April		994,681	760,683
Net Financing from Defence Resource Account	Page 26	1,456,149	1,089,892
Communicated and non-cash costs	Note 7	416,784	(71,086)
Transfer of land and buildings from other parts of the MOD	Note 8a	11,879,616	–
Transfer of other fixed assets to/from other parts of the MOD	Note 8b	(617)	20
Transfer of Revaluation Reserve from other parts of the MOD	Note 17	(3,182,407)	(17,310)
Transfer of Donated Asset Reserve from other parts of the MOD	Note 18	(1,917,791)	(1,248)
Transfers of Assets for Resale from other parts of MOD and Other Non-cash transactions		68,556	59,704
Released from Revaluation Reserve in Year	Note 17	659,139	139,207
Released from the Donated Asset Reserve	Note 18	1,971	–
Net operating cost	Page 23	(2,331,650)	(965,181)
General Fund Carried Forward as at 31 March		<u>8,044,431</u>	<u>994,681</u>

NOTE 17 Movement on Revaluation Reserve

	Assets for Resale £000	Fixed Assets £000	Total £000
Revaluation Reserve at 1 April 2006	88,883	468,194	557,077
In Year Movement			
Reclassification	14,758	(14,758)	–
Transferred In Revaluation	203,416	2,978,991	3,182,407
In Year Revaluation	79,573	1,081,732	1,161,305
End of Year Revaluation	12,654	–	12,654
	<u>399,284</u>	<u>4,514,159</u>	<u>4,913,443</u>
Released to General Fund Revaluations	(300,860)	(358,279)	(659,139)
	–	(376,422)	(376,422)
Revaluation Reserve at 31 March 2007	<u>98,424</u>	<u>3,779,458</u>	<u>3,877,882</u>

NOTE 18 Movement on Donated Asset Reserve

	<u>2007</u> £'000	<u>2006</u> £'000
Donated Asset Reserve as at 1 April	–	–
Transfers from other parts of MOD	1,917,791	1,248
Released to the Operating Cost Statement for impairment	(122,075)	(1,248)
Released to the Operating Cost Statement for depreciation	(49,999)	–
Revaluation	113,736	–
Released to the General Fund	(1,971)	–
Reclassification	5,306	–
Donated Asset Reserve as at 31 March	<u>1,862,788</u>	–

NOTE 19 Related Party Transactions

Defence Estates is an Agency of the Ministry of Defence. The MOD is regarded as a related party. During the year *Defence Estates* had various material transactions with the MOD and with other entities for which the MOD is regarded as the parent Department. These included QinetiQ (the former Defence Evaluation and Research Agency), the Meteorological Office, the Defence Aviation Repair Agency, the Defence Science and Technology Laboratory and the Hydrographic Office.

In addition, *Defence Estates* had a number of transactions with other Government Departments and Central Government bodies.

No member of the Management Board or the Defence Estate Committee nor key managerial staff or other related parties has undertaken any material transactions with the Agency during the year.

NOTE 20 Reconciliation of Net Operating Cost to Operating Cost Cash Flows

	Note	<u>2006/07</u> £'000	<u>2005/06</u> £'000
NET OPERATING COST		2,331,650	965,181
Adjustments for non-cash items			
Depreciation	8	(492,559)	(31,897)
Profit on disposal of fixed assets	3c	39	4
Impairment arising from a fall in value of fixed assets	3a	(248,815)	(3,611)
Release from Donated Asset Reserve	3a	172,074	1,248
Write off of land and buildings	3a	(111,006)	-
Reversal of prior year permanent diminution	3a	60,427	499
Diminution in value of assets held for resale	3b	(25,228)	(17,393)
Diminution in value of assets transferred and sold	3b	(114,480)	(26,707)
Open market value of property sold	Page 23	(327,634)	(172,840)
Notional charges (excluding early retirement)	7	(416,784)	71,086
Movements in working capital			
Increase/(decrease) in debtors	11	346,217	(28,356)
(Increase) in creditors	13	(122,730)	(83,574)
Increase in stock and work in progress	10	803	1,867
Movement in provisions for liabilities & charges			
(Increase) in provisions	15	(68,477)	(34,737)
NET CASH OUTFLOW FROM OPERATING ACTIVITIES		983,497	640,770

NOTE 21 Capital Commitments

Capital Commitments for which no provision has been made in these financial statements, were as follows:

	<u>2007</u> £'000	<u>2006</u> £'000
Contracted at 31 March but not provided for	596,300	322,500

The majority of capital commitments are in relation to numerous accommodation upgrade projects in the UK and Europe, specifically £203.1M for SLAM and £71.5M at Catterick. In addition in August 2006 Vinci/St Modwen Estates Ltd were awarded the contract for Project MODEL, the rationalisation of the London estate. The Project will initially invest over £150M in the redevelopment of RAF Northolt.

NOTE 22 Contingent Liabilities

Within the transfer of legal title on disposal sites, clauses exist that provide for potential future claims and liabilities against the Agency, in the event of additional remediation works being required above those determined at the point of sale.

Defence Estates hold a number of sites where it may be necessary to carry out remediation work in respect of contamination. It is not cost effective or practicable to identify all levels of contamination at individual sites nor to assess the likely cost of any remediation work necessary. As any liability cannot, therefore, be quantified it is not appropriate to include a provision in accordance with FRS 12.

Defence Estates has no other specific contingent liabilities as at 31 March 2007. There are, however, contingent liabilities to the MOD estimated at £17.5m (2005/06 £17.5m) relating to potential claims in respect of the cost of providing utilities as a result of the sale of the Married Quarters Estate to Annington Homes Limited.

NOTE 23 Gifts and Write Offs

During the year book keeping losses totalling £2.606M arose from the write-off of unsupported land and building asset balances following the 2006/07 asset verification exercise. The write-off will take place in 2007/08.

Stores losses of £40k were identified by Security Services Group in respect of obsolete/slow moving items of stock. The write-off is included in Note 3(c) Other Operating Costs under Bought in Materials and Services for Security Services Group.

Claims abandoned during the year totalled £276k. These related to rentals from SFA where it was not economical to pursue recovery from the former tenant. In addition payments of £10k were made for "fruitless" purposes following the late cancellation of hotel accommodation, a conference, travel arrangements and attendance on training courses.

NOTE 24 Commitments under PFI Contracts and Operating Leases

At 31 March 2007, *Defence Estates* was committed to making the following payments in 2007/08 under non-cancellable PFI contracts and operating leases. These were in respect of buildings and equipment for Annington Homes Limited operating lease rental, Project Aquatrine PFI, Housing PFIs and other office equipment and vehicles.

	<u>31 March 2007</u>	<u>31 March 2006</u>
	£'000	£'000
PFI Commitments		
<u>Land and Buildings</u>		
Expiry within 1 year	–	–
Expiry after 1 year but not more than 10 years	–	–
Expiry after 10 years but not more than 15 years	4,255	3,826
Expiry after 15 years but not more 20 years	3,989	2,058
Expiry after 20 years but not more than 25 years	95,327	93,765
<u>IT</u>		
Expiry within 1 year	–	–
Expiry after 1 year but not more than 5 years	6,184	7,004
Expiry after 5 years but not more than 10 years	–	–
<u>Plant and Machinery</u>		
Expiry within 1 year	–	–
Expiry after 1 year but not more than 20 years	–	–
Expiry after 20 years but not more than 25 years	1,835	280
Obligations under Operating Leases comprise:		
<u>Land & Buildings</u>		
Expiry within 1 year	8,669	8,850
Expiry after 1 year but not more than 5 years	9,952	10,061
Expiry thereafter	154,100	147,894
<u>Other</u>		
Expiry within 1 year	141	63
Expiry after 1 year but not more than 5 years	405	295
Expiry thereafter	67	30
	<u>284,924</u>	<u>274,126</u>

The total amount charged in the Operating Cost Statement in respect of off-balance sheet PFI transactions and the service element of the on-balance sheet PFI transactions was £102,858,435 (2005/06 £110,469,657). The RAF Lossiemouth Family Quarters project is treated as on-balance sheet.

The total amount charged in the Operating Cost Statement in respect of operating leases, including rents paid to Annington Homes Limited, was £172,709,497 (2005/06 £165,433,501).

The following information is in respect of all PFI schemes (except White Fleet, which is a MOD-wide contract from which *Defence Estates* values are not separated).

Description of Scheme	Estimated capital value £'000	Contract signature date	Contract end date
Land and Buildings			
Project Aquatrine Package A	154,032	Apr 2003	Nov 2028
Project Aquatrine Package B	86,440	Sep 2004	Mar 2030
Project Aquatrine Package C	363,604	Oct 2004	Mar 2030
Family Quarters at RAF Lossiemouth	24,745	Jun 1998	Aug 2020
Family Quarters at Yeovilton	8,200	Jul 1998	Jul 2028
Family Quarters in Central Scotland	24,713	Aug 1999	Jan 2021
Family Quarters at RAF Cosford/RAF Shawbury	15,083	Mar 1999	Jun 2025
Family Quarters at Wattisham	34,200	May 2001	Mar 2028
Family Quarters at Bristol/Bath/Portsmouth	78,010	Nov 2001	Sep 2028
Family Quarters at Portsmouth	27,092	Oct 2005	Oct 2030
IT Equipment			
Provision of IT services in the Housing Directorate	11,600	Oct 2001	Sep 2010

NOTE 25 Financial Instruments

FRS 13, Derivatives and Other Financial Instruments, requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities.

Because of the largely non-trading nature of its activities and the way in which government agencies are financed, the Agency is not exposed to the degree of financial risk faced by business entities. Moreover, financial instruments play a much more limited role in creating or changing risk than would be typical of the listed companies to which FRS 13 mainly applies.

Financial assets and liabilities are generated by day-to-day operational activities and are not held to change the risks facing the Agency in undertaking its activities, or for trading. The fair values of all the Agency's financial assets and liabilities approximate to their book values. In line with FRS 13, short term debtors and creditors (those which mature or become payable within 12 months from the balance sheet date) have been excluded from these disclosures (except for those relating to currency risk).

Interest rate risk

All the Agency's financial assets carry nil rates of interest. All the Agency's financial liabilities carry nil or fixed rates of interest and *Defence Estates* is not, therefore, exposed to significant interest rate risk.

Currency risk

The Agency does not hold significant assets or liabilities denominated in a foreign currency. Overseas expenditure of around £110M and income of around £3M was denominated in foreign currencies. The Agency is therefore not exposed to significant currency risk.

The Ministry of Defence, through whose Resource Account the Agency is financed, enters into forward purchase contracts annually with the Bank of England to cover the majority of its foreign exchange requirements for the following year. The details of the outstanding foreign currency contracts are given in its Departmental Resource Account.

Liquidity risk

The Agency is not exposed to significant liquidity risk, as liquidity requirements are met by financing from the MOD Resource Account, and it has no borrowing facilities. The Department's resource requirements are voted annually by Parliament.

NOTE 26 Post Balance Sheet Events

The financial statements were authorised for issue on 10 October 2007 by the Chief Executive. On 28 March 2007, the Minister of State (Armed Forces) for the MOD announced to the House of Commons with a written ministerial statement, that from 1 April 2007 *Defence Estates* would cease being an Agency. Consequently, these are the last set of accounts to be prepared on the Agency basis. The activities of the Agency will continue within the MOD and therefore it remains appropriate for these accounts to be prepared on a going concern basis.

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