



Ministry  
of Defence



## Defence Equipment & Support Annual Report and Accounts

# 2016-17



Equipping and supporting UK Armed Forces

## CORRECTION SLIP

Title: DE&S Annual Report and Accounts 2016-17

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Correction: Page 19, paragraph 2

Text currently reads:

*The delivery of a budget to outturn variance of less than £3 million (2.6%) is clear evidence of the robust and effective financial management exercised by DE&S.*

Text should read:

*The delivery of a budget to outturn variance of less than £3 million (0.26%) is clear evidence of the robust and effective financial management exercised by DE&S.*

Correction: Page 57, 'Staff breakdown' table

Notes 1-3 are currently missing from the page.

Text should read:

<sup>1</sup> *Totals include all industrial and non-industrial personnel but exclude all Royal Fleet Auxiliary and locally engaged civilians for whom declaration data is currently unavailable.*

<sup>2</sup> *A breakdown of the military composition of DE&S by protected characteristic is currently unavailable.*

<sup>3</sup> *Percentages are calculated from known declarations of ethnicity, sexual orientation and religion/belief and exclude personnel whose declarations are unknown or who have chosen not to declare.*



Defence Equipment & Support

# **Annual Report and Accounts**

# **2016-17**

For the year ended 31 March 2017

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

Ordered by the House of Commons to be printed 29 November 2017



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# 2016-17 Highlights

During 2016-17 we:

- Achieved our three year Transformation Plan objectives, putting in place the building blocks designed to cement wholesale organisational changes, drive improved ways of working and embed a culture of continuous improvement.
- Signed a £271 million deal with Leonardo Helicopters to continue to support world-leading Wildcat helicopters, protecting hundreds of highly-skilled British jobs.
- Negotiated a £410 million contract that will secure at least 400 highly-skilled British jobs and provide in-service support for the UK's Atlas A400M aircraft, securing a key part of the RAF airlift fleet until 2026.
- Awarded a new £287 million contract to build two more Offshore Patrol Vessels in the UK, taking the total to five.
- Commenced construction of the UK's first new nuclear deterrent submarines under the Dreadnought programme as we cut steel and announced around £1.3 billion of new investment with BAE Systems to support the programme.
- Agreed a £100 million contract to develop the cutting-edge Protector Remotely Piloted Air System especially for the RAF, which will double our unmanned air fleet and substantially enhance the intelligence gathering and firepower of the RAF.
- Successfully completed the project to regenerate 99 Viking vehicles, which sit at the heart of the Royal Marines' amphibious capability. The £37 million worth of upgrades took 3.5 years to complete.
- Ordered 50 of the latest generation Apache attack helicopters for the British Army.
- Managed the procurement of P-8A Poseidon Maritime Patrol Aircraft (MPA) for the Royal Air Force.
- Negotiated the new Typhoon support deal, saving over £500 million through the Typhoon Total Availability eNterprise (TyTAN).
- Contracted the advanced Sea Ceptor air defence missile system, to be fitted to each of the Royal Navy's new Type 26 Global Combat Ships - £100 million contract for this key defensive weapon. We also announced that we would be cutting steel on the first of the eight Type 26 ships in Summer 2017.
- Worked closely with industry on the F-35 maintenance programme partnership enterprise, selected to be delivered in the UK and based at MOD Sealand, in North East Wales. We also awarded the contract for new air-to-air missiles to enhance the F-35 capability.
- Negotiated a £269 million deal for the cutting-edge Crowsnest helicopter surveillance system to protect Royal Navy ships, including our new Queen Elizabeth Class Aircraft Carriers.
- Announced the new deal to supply handheld target and surveillance support to the Armed Forces. By merging 20 individual support contracts into one deal, £47 million will be saved over the next six years.
- Appointed two new non-executive directors, adding new skills and experience to the DE&S Board.



# Chairman's introduction

by Paul Skinner, DE&S Chairman

This Annual Report and Accounts covers a particularly important year in the development of DE&S. It reports on the progress made in our comprehensive transformation programme - the key milestones of which were delivered, as planned, by April 2017. It also highlights the continued delivery to UK Armed Forces, of a diverse multi-billion pound per annum programme of equipment and support, which remains the central purpose of DE&S.

Managing the DE&S programme of work is a demanding and major challenge, comparable with those undertaken by the largest industrial companies. Achieving this safely and successfully, in an environment of wholesale organisational change, is an extraordinary achievement by our people. DE&S staff have risen consistently to the cultural, technical, and resource related challenges they faced, and deserve our thanks for that. From the purchase of the new Maritime Patrol Aircraft – just nine months after the Government announced its intention to procure this important capability – to signing a £271 million deal to support our world leading Wildcat helicopters; the focus and dedication of our people is absolutely clear. DE&S is embracing in full its commitment to customers and its duty to taxpayers and I believe this report reflects those efforts.

The process to agree Command Acquisition and Support Plans, effectively our contract with each customer, has continued to develop and mature, and our relationships with both customers and suppliers are generally working well. There has also been welcome acknowledgement of the need to develop and

improve our strategy and approach across the broader acquisition cycle. The Board has been particularly encouraged by the strong trend which has been established towards risk bearing contracts for both capital equipment and support services.

DE&S has succeeded in balancing significant internal change with strategic defence requirements. The delivery and sustainability of the transformation programme enhancements have been a particular focus for me, as Chairman, over the last year, together with assuring the realisation of benefits. I am delighted in the progress made so far - in project, programme, people and transformation terms. The roll out and adoption of improved project controls and the far reaching changes to market related people management policies has been significant. It is also noteworthy that, having achieved the key transformation milestones, there remains a strong commitment to ensuring continuous improvement right across the business.

DE&S has succeeded in putting in place the foundations for genuine and long lasting change towards our objective to become an outstanding procurement and support organisation. I am personally in regular touch with our team at all levels and remain very encouraged by their skills, commitment, capability and desire to be part of a successful organisation delivering consistently for our Armed Forces.



# Section One

## **Performance Report**

# OVERVIEW





# Chief Executive statement

by Tony Douglas, Chief Executive DE&S

This Annual Report and Accounts reflects the product of another extremely busy and rewarding year for DE&S. Our Transformation journey has taken great strides forward as we have introduced a range of new procedures and processes to underpin enduring change. Through this third year of our Transformation programme, we have continued to use the freedoms associated with our Bespoke Trading Entity status to implement the new ways of working, new tools and innovative people management structures that DE&S needs. The pace of change has been demanding but we have continued to deliver and adapt. Initiatives such as our Change Advocate Network demonstrate that it is our people who remain central to implementing and driving forward lasting change. It is through our people that DE&S will become increasingly more efficient, more productive, appropriately skilled and properly resourced to do the job ahead of us. It is with considerable pride that I can report that we reached our 2014-17 Transformation milestones at the end of the 2016-17 financial year. Alongside this achievement I am delighted that we have been able to remove the outstanding audit qualifications remaining on other programme costs and private sector support costs.

In parallel with meeting the challenge of widespread organisational changes, DE&S has continued to focus on its primary task: delivering to our customers in the Royal Navy, British Army and Royal Air Force. The equipment and support achievements highlighted in this document, and the many others beside, are demonstrative of this commitment. Our deal with BAE Systems to invest around £1.3 billion in the Dreadnought programme signals the start of construction work on the UK's new nuclear submarines. The early live firing of the Ajax armoured fighting

vehicle in April 2016 and the deal we struck for Wildcat helicopter support are examples of the painstaking work undertaken with industry on behalf of our customers, never losing sight of the taxpayer interest in the best value for money we can deliver. This year has seen an ongoing and robust focus on the support element of the DE&S portfolio. In February, we held the inaugural DE&S Support Day, providing the opportunity to recognise, celebrate and promote this vital element of DE&S business. We also saw the UK selected as the global repair hub for F-35 avionics and aircraft components, securing thousands of highly skilled jobs and significant financial investment. The facility in North Wales could unlock more than £2 billion of future F-35 support revenue over the lifetime of the programme.

Safety remains a key priority across all of our outputs, every hour of every day, a fact underlined by our second organisational Safety Day, which focussed on deepening and broadening the safety culture across our organisation. It was designed to share safety knowledge and experiences and – whether our people work in an office, at a munitions depot or military base – ensure that we take responsibility for our own safety; the safety of those around us; and those on the front line who use the equipment we provide.

Whilst we rightly celebrate our successes, I remain committed to continuous improvement – to 'getting better at getting better'. In financial year 2017-18 we will continue to evolve as an organisation, embedding the changes necessary to improve delivery for Her Majesty's Armed Forces, while supporting our people to be the best that they can be.



# Chief Financial Officer's report

by Michael Bradley, Director General Resources

2016-17 marked the third year of operation for DE&S as a Bespoke Trading Entity and has seen our transformation programme delivering tangible benefits both in how we conduct our business within the organisation and in the quality of output delivered to our Front Line Command customers. The year has again been incredibly busy and challenging and we have worked closely and effectively with our customers to deliver on the commitments made in the 2015 Strategic Defence and Security Review (SDSR) and in particular focusing on driving greater efficiency in our projects to help fund new equipment. The introduction by the Department of a new system to manage Contracting, Purchasing and Finance (CP&F) activities was particularly demanding for DE&S. As the Department's main procurement organisation, we had to devote significant commercial and finance functional resource in managing the transition to the new CP&F system, and I was grateful for the support of staff across the organisation who rose to the challenge, adopting a "can do" attitude and showing unstinting dedication to deliver the best possible outputs for our customers.

2016-17 saw significant progress in the transformation of our Finance & Accounting and Project Controls functions, including the development of a new organisational design, and the introduction of standardised processes and ways of working. I am confident that this will improve the quality of financial information to support business decision-making, enhancing understanding and accountability at all levels in the organisation.

## DE&S programme of work

The performance of the organisation in delivering multiple complex and long term programmes has also continued to improve as a result of our Transformation Programme and the continued professionalism of our staff. I noted in my previous report that the annual National Audit Office Major Project Report had been replaced by a project performance delivery summary published in the Department's annual Equipment Plan statement. An important distinction is that the Equipment Plan reports on delivery performance of the Department as a whole, not just DE&S. I would offer the following equipment project delivery headlines from the Equipment Plan 2016 (EP 2016) which, while reporting on 2015-16, was published in January 2017:

- **Achieving key user requirements** – reported a continuing forecast of 99% success in meeting customer requirements.
- **Time** – reported an increase of 2% (34 months) in forecast delivery timescales from a total combined approved duration of 1,737 months. The increase was driven by the Warrior (Armoured Fighting Vehicle) Capability Sustainment Programme, Astute class submarines and the complex weapons programme.
- **Cost** – reported an increase of just 0.5% (£237 million) in forecast costs, predominantly driven by two submarines projects (nuclear core production and Astute class). These two projects aside, for the remainder of the project population the overall position was actually a net reduction in cost of 0.5%.

A more detailed analysis of DE&S delivery performance to our customers in 2016-17 is provided in the Performance Analysis section from page 15.

During the year, we have continued a schedule of regular engagements with customers and stakeholders to review both in-year and longer term financial plans, providing both transparency of the latest financial position and informed discussion on any re-programming activity needed to address project risk. As a result of this careful stewardship we have been able to maintain overall stability in both the equipment procurement and equipment support elements of the plan, specifically:

- The overall cost of the 10-year Equipment Plan we manage increased by c£14 billion in 2016-17, as a result of new projects initiated during and following the SDSR. Excluding this change to the scope of the programme of work, the core 10-year equipment plan remained stable in 2016-17, with only a minor 0.8% reduction in cost.
- "In year" 2016-17 Equipment Plan expenditure outturned at £13,257 million, which was just 1.5% inside budget: this favourable variance was due to a number of factors, but most notably a £53 million saving as a result of the over-delivery of transformation benefits. This was a significant achievement for DE&S in a year of significant change within both the Equipment plan we manage and the business itself.

## Inventory management

I highlighted in my previous report that DE&S had over-achieved the target set under the Inventory Management Transformation initiative to reduce the value of holdings by 25% (£10 billion) at the end of 2015-16. We have continued to apply the processes and disciplines established to meet this target, with senior management held accountable for business decisions impacting on inventory holdings. As a result, a further reduction of £496 million in the value of holdings was achieved in 2016-17 and the value of in-year purchases of inventory was £130 million below the target of <£1 billion.

The enduring focus on inventory holdings and purchases means that we continue to meet customer demands for inventory effectively and economically.

## Operating costs

We have continued to manage our operating expenditure and associated accounting with rigour and discipline. Notable headlines in year are as follows:

- **Operating cost forecast accuracy** – DE&S operating costs (excluding communicated costs) outturned at £1,142 million against a budget of £1,145 million, a testament to the effective management control and accountability exercised across the business.

Notably, our increased focus on driving down private sector support costs is providing additional headroom to build more internal capability and a more cost effective means of delivering our programme of work. Private Sector Support (PSS) Transformation costs in 2016-17 were £82 million and in 2015-16 £69 million. When adjusting for these costs, PSS costs have reduced by 9.2% since last financial year and by 21.8% from the baseline year of 2013-14 when PSS costs were £415 million.

- **Bespoke Trading Entity (BTE) accounting** – Substantial progress has been made with improving the accuracy and consistency of the BTE accounts with a particular emphasis given throughout 2016-17 to Private Sector Support and Other Programme Cost expenditure which were subject to audit qualifications in 2015-16. We introduced a number of new management controls to ensure regular scrutiny and challenge of the accounts and engaged a support partner to undertake independent audits prior to formal presentation of the financial statements to the National Audit Office (NAO). As a result of these initiatives, the remaining audit qualifications on other programme costs and private sector support costs have been lifted by the NAO on the 2016-17 financial

figures. This outcome reflects the culmination of an accounts improvement programme initiated in the first year of BTE operation.

## Outlook

As we look forward to 2017-18, it's clear that the challenges that our customers face will require DE&S to step up and really build on the progress we have made over the last few years. Our key priorities include:

- Working with our Armed Forces customers and other stakeholders to identify opportunities for delivering the savings/efficiency targets set out in the 2015 SDSR.
- Ensuring that we maintain robust control of our operating costs, in a period of both significant change and budgetary pressure.
- Consolidation of the significant improvements made in the quality of the BTE financial accounts to ensure the unqualified audit opinion achieved in 2016-17 is maintained.
- Leveraging new technology to drive efficiency in all of our internal processes.
- Supporting the development and formation of the Submarine Delivery Agency and, in particular, ensuring an orderly accounts separation.
- Supporting our staff as we embed a number of changes across the organisation.

**In short, 2016-17 has been a successful yet challenging year for DE&S in which the major benefits of Transformation have started to take effect. The 2017-18 year will no doubt be equally difficult, but we go into the year with stronger processes, systems and capability and with the continued support of an energised and hugely supportive and capable workforce, I look forward to being able to report an even stronger set of results next year.**

## Our purpose

DE&S' purpose is 'to equip and support the UK's Armed Forces for operations now and in the future'. We deliver battle winning capability for our Ministry of Defence (MOD) customers<sup>1</sup> and our programme of work ranges from warships, aircraft and missiles, through to armoured vehicles, utility trucks, body armour and field kitchens. Providing the required capability begins with procurement and delivery of vital kit and equipment and continues with the provision of sustainable support solutions. These two aspects of our business go hand in hand. For both cutting edge technology and more simple materials, we consider the support aspects of each project or programme to identify the factors that can have an impact throughout the life of the equipment. This approach is designed to ensure that the Armed Forces have what they need, when they need it – underpinning our overarching aim of delivering a programme of work that provides the best possible support to the Armed Forces and best value for money for the taxpayer.

We are headquartered in Bristol and have our people at numerous locations across the UK and overseas, including on operations. We have a workforce of around

12,000; a mixture of talented civilian and military people who are passionate about providing the best possible service to our customers.

## How we are organised

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

We work closely with our customers to provide the materiel required by the Armed Forces. We manage our relationships through an organisational structure which interacts with our customers through our delivery domains of Ships, Land, Air and Joint Enablers, with each domain headed by a 3\* Chief of Materiel (CoM).<sup>2</sup>

Each CoM is responsible for our relationship with a Command, and accountable to the Chief Executive Officer (CEO) for delivering outputs as effectively, efficiently and economically as possible. The CoMs oversee a number of industry facing businesses, led at Director level, which contain the project and support teams. Delivery of our business is enabled by five cross cutting corporate teams: Commercial, Resources, Human Resources, General Programmes and Corporate Operations. The post of Director, General Programmes was introduced in-year, to help drive and cement improvements in project delivery and controls.

In order to deliver our business we require a range of specialist skills and, under the balanced matrix management system now in place, all our people belong to one of 11 professional functions;

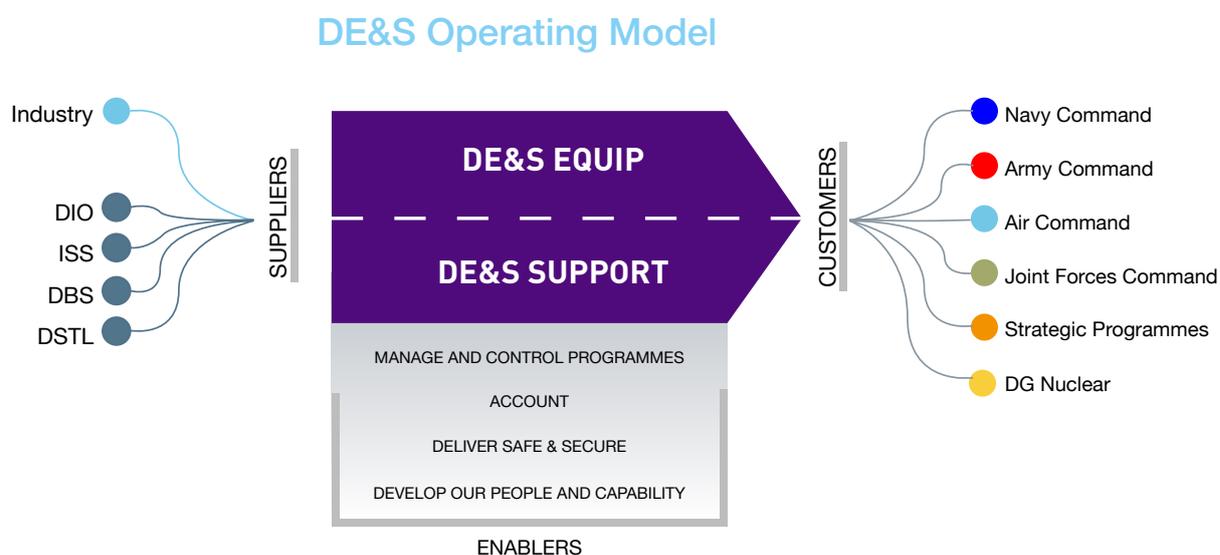
**Business Process and Assurance, Commercial, Corporate Services Group, Engineering, Finance and Accounting, HR, IM and IT, Integrated Logistics, Occupational Health, Safety and Environment, Project Controls and Project Management.**

DE&S History	
<b>April 2007</b>	DE&S begins operating following the merger of the Defence Procurement Agency and the Defence Logistics Organisation.
<b>May 2011</b>	The MOD launches the Materiel Strategy programme to examine how DE&S could operate differently to become more efficient and effective.
<b>December 2013</b>	Proposals for a Government Owned Contractor Operated (GOCO) structure halted.
<b>April 2014</b>	DE&S established as a bespoke trading entity, an arm's length body of the MOD.
<b>April 2017</b>	DE&S achieves its three year Transformation Implementation Plan milestones.

<sup>1</sup> Front Line Commands, Director Strategic Programmes and Director General Nuclear.

<sup>2</sup> Since April 2017 the Submarines domain has operated as a distinct organisation, the Submarine Delivery Agency (SDA), initially headed on an interim basis by CoM (Submarines). Ian Booth was appointed the first CEO of the SDA in September 2017. CEO DE&S remains accountable for all submarine procurement and support programmes until the SDA is formally established as an Executive Agency no later than 1 April 2018 – once its operating budget separated from DE&S is confirmed and fully funded and the accounts can be separated.

## How we are organised



## Our budget

The MOD delegates the bulk of the equipment budget to the military commands, giving them responsibility for prioritising what is most critical. As such, DE&S does not hold the budget for the equipment procurement and equipment support plans, but we do deliver against these. On behalf of our MOD customers, we manage the acquisition and through-life support of equipment in service, and undertake decommissioning and disposal when equipment reaches the end of its service life.<sup>3</sup>

We deliver the agreed programme of work to our customers as set out in the Command Acquisition and Support Plans (CASPs) – individual formal agreements with MOD Head Office and our military customers that capture the outputs against which our teams will deliver. The agreements set out the equipment, support and services DE&S will acquire on our customers' behalf, for what budget and to what timescale. MOD Head Office holds us accountable for delivery, and measures performance through the use of Key Performance Indicators (KPIs), which underpin our strategic objectives. More detail on how we performed against our KPIs in 2016-17 is on pages 15 to 21.

DE&S is directly responsible for its own operating expenses, and we carry out our business activities within an operating expenditure budget, which flows

from MOD Head Office. Our operating budget includes manpower, operating support, and private sector support costs. In addition to these three main sources of costs we also reflect within the accounts notional communicated costs, these reflect the services provided to DE&S by third parties. For 2016-17 our operating budget to support our activities was £1.145 billion.

The financial statements at Section 3 have been prepared in accordance with the accounting boundary agreed with the Department, which delineates between DE&S operating activities reported in our financial statements (manpower, private sector support and other programme costs) and equipment procurement/support activities which are reported in the MOD financial statements. More information regarding the accounting boundary can be found in the Statement of Accounting Policies on page 76.

We comply with Managing Public Money and supplementary instructions issued by HM Treasury and we observe the standard financial processes and rules set out by the MOD Director General (DG) Finance as the Defence Authority.

<sup>3</sup> Any generated capital asset value is reported in the MOD Annual Report and Accounts.

## Operating as a Bespoke Trading Entity

DE&S launched as a Bespoke Trading Entity (BTE) in April 2014 under the Materiel Strategy programme, which was designed to address historical and recurring problems in Defence acquisition, particularly the cost and schedule overruns. The Strategy looked at how we could operate differently to become more effective and efficient, and, since 2014, DE&S has been operating as an arm's length body within the MOD<sup>4</sup> and effecting organisational change through its Transformation Programme.

DE&S' status gives us a strengthened customer-supplier relationship with the military and facilitates a more business-like approach. As a BTE, we also have a set of management freedoms that are unique across Government and which recognise the specialist nature of our organisation and what we deliver. Set within an operating cost envelope designed to drive efficiencies, these freedoms allow us to implement changes outside of wider Government norms, particularly around the management of our people.

The creation of DE&S as a BTE in 2014 was underpinned by a fundamental change in our governance. Our Framework Document is the agreement between MOD and DE&S which sets out the governance, policy and finance framework within which we operate. This Annual Report and Accounts sits alongside our Corporate Plan, which sets out the strategic direction for our organisation on a rolling three year basis and summarises our structure, purpose, objectives and corporate focus going forward. Our OGSM (Objectives, Goals, Strategies and Measures) framework sets out our in-year focus across DE&S as a whole, providing clarity on what we intend to do and how we will measure progress against it, linking our strategic objectives with individual contributions and performance.

## DE&S Transformation

Over the past three years, our Transformation Programme has used our BTE freedoms to change the way that we work, how we are organised, and how we manage our people. During 2016-17 we:

- Established a new Human Resources department and introduced a performance and reward regime that is designed to help us attract, develop and retain talent.
- Started moving our people functionally and flexibly to task in line with our customers' requirements.
- Standardised our ways of working to improve our efficiency, helping staff to maximise their time and minimise wasted effort.
- Began introducing a range of management information and IT tools and solutions to support our new ways of working and provide the project controls data we need to drive delivery.

Having laid these Transformation foundations, our focus for the year ahead is to fully embed these changes and establish an environment of continuous improvement.

## Working with industry

During the reporting period we introduced Project, Programme and Portfolio Management (P3M) tools and techniques, including Earned Value Management (EVM), which will contribute to improving our performance, management of our suppliers and overall value for money for our customers. We conducted a successful pilot for our Exemplar programme across a wide range of projects and contractor interfaces where these tools and techniques were put into practice, and we began to build our integrated baselines. These exemplar areas were the first projects and teams to be introduced to the new methodology and performance reporting. Financial year 2017-18 will see us build on these successes and continue to grow the use of these best practices across our organisation.

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<sup>4</sup> DE&S is classified as an Executive Agency of the MOD, which operates as a BTE in line with Chapter 7 of Managing Public Money.

Our Exemplar projects leading the way with P3M:

## Subs & Ships

- Astute
- Type 26
- Dreadnought
- Next Generation Nuclear Propulsion

## Air

- Centurion
- Hawk T1&T2
- MMA
- Mode 5
- HIOS (C130J)

## Land

- Spearfish Upgrade
- MITER
- Artillery Systems Land Ceptor
- Babcock DSG

## Joint Enablers

- GBAD
- PUMA FSA
- Merlin Crowsnest



We continued to work hard to sustain productive and robust relationships with all of our suppliers including examining ways in which we can drive improvement in these relationships including through the establishment of a new DE&S supplier account management team and through focusing the Defence Supplier Forum structure to address issues which impact both defence and industry. The supplier account management team, together with the work being undertaken through our Commercial Improvement Programme, will look to unlock greater efficiency within our supply chain, driving out non-value adding cost. Whilst open competition remains our default approach, we are focusing effort on optimising our indirect costs which, in parallel with continued application of the Single Source Contract Regulations, will drive greater cost efficiencies in our single source procurements. DE&S is also developing our market intelligence resources to examine better the domestic and global defence and security market for potential suppliers of products which may meet our future capability needs. Our primary driver remains the same however, to ensure we get the right capability

for our customers at the best value for money for the taxpayer.

In line with all Government Departments and Arm's Length Bodies, we aim to pay 80 per cent of our undisputed invoices from suppliers within five working days. This helps to ensure that the benefits of prompt payment to main contractors are felt throughout the supply chain and benefit smaller businesses. The introduction of CP&F last year saw a reduction in the percentage of invoices paid within this timescale however, DE&S has been and continues to, work closely with industry to overcome the issues and has recently seen this percentage increase to c.92%. All MOD invoices relating to DE&S BTE activities are paid through the Defence Business Services (DBS) organisation and are reported in the MOD Annual Report and Accounts. The communicated costs shown in our Statement of Comprehensive Net Expenditure on page 72, include costs incurred by DBS in supporting DE&S activities, including those relating to the processing of invoices.

## Key achievement

### **New Apache helicopters**

*The new Apache AH-64E helicopters, built by Boeing and already in service with the US Army, are being purchased via a Foreign Military Sale with the United States Government. Our commitment to invest \$2.3 billion with the US presents opportunities for UK industry in the support and training arrangements for these new attack helicopters.*



## Performance overview, risks and issues

We had three high-level objectives in our 2016 Corporate Plan for the 2016-17 financial year, which drove our behaviour and how we delivered and prioritised as an organisation: 'Delivery', 'Transformation' and 'Leadership and Engagement'. They were unchanged from the previous year. Performance of our 'Delivery' objective is formally measured through the CASPs, with specific overview KPIs outlined in our 2016-19 Corporate Plan. Performance against our 'Transformation' and 'Leadership and Engagement' objectives are measured by internal business metrics and practices.

Our KPIs are categorised under two headings: *customer-facing* focused on how we deliver to our customers and *internal* relating to the management of DE&S, inventory and safety.

- Our customer-related KPIs measure our delivery on new equipment projects and support to in-service equipment (KPI 1); the accuracy of our financial forecasts (KPI 4); and the satisfaction of our customers (KPI 5). In the main, the delivery of procurement projects met customer expectations and we achieved our targets except for a few outliers where technical challenges saw cost growth or time delay. Our performance on support outputs saw marked improvements from last year across a number of CASPs, though the Navy CASP presents challenges due to the operational programme of ships and submarines and we continue to address the shortfalls here. The overall in-year financial position was again balanced this year with some variation against the individual Commands. Our 10-year Equipment Plan forecasts also reflect good performance overall. The Customer Satisfaction survey reports as a KPI for the first time and we are pleased to see DE&S improve its rating against the baseline established in 2015-16 for four of our six customers and a fifth rating matching the baseline.
- On the other three KPIs, which look more at DE&S performance, we again met our targets for managing our operating expenditure and inventory. KPI 6, the new safety KPI, reports for the first time and provides a benchmark for this and future years.

*An overview of our performance against each of the strategic objectives follows in the next section.*

Delivery performance against our high-level objectives, including our KPIs, is monitored each month by the Executive Committee and DE&S Board. Performance is also reviewed in detail in the monthly Performance Committees, which are individual performance conversations between the CEO and each Chief of Materiel, where delivery against the CASP and KPIs are standing agenda items. In addition we provide quarterly reports to our Owner's Council and we hold regular reviews with each of our customers. Defence Internal Audit conducted a review of our KPI reporting process between March and May 2016, returning an assessment of 'substantial assurance'.

Our Corporate Plan, refreshed annually and presenting a rolling three year strategic outlook, sets our current strategic objectives for 2017-20. The document also sets out the OGSM framework which sits beneath our strategic objectives and provides the 2017-18 in-year focus for the organisation. The Corporate Plan is published on gov.uk and can be found at:

<https://www.gov.uk/government/publications/defence-equipment-and-support-corporate-plan-financial-years-2017-to-2020>

Information on the key risks and issues that have faced DE&S over the past year are in the Accountability Report on page 42.



# PERFORMANCE ANALYSIS

## STRATEGIC OBJECTIVE 1: DELIVERY

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

This objective means that DE&S will:

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

Delivery to our customers remains our purpose and our priority, and this has been reflected over 2016-17 in a clear focus on delivering CASP requirements. This is the second year in which we agreed CASPs with each of our customers (six in 2016-17), which continues to support a more disciplined customer-DE&S interface. Within each CASP are detailed metrics and targets used to measure our delivery performance. It is our aggregate performance against these metrics that determines how well DE&S performs against its six corporate KPIs and these are explained further on the following pages.

Overall we continue to perform well on delivering procurement projects, and for the first time we have been able to measure DE&S' contribution to the support of equipment across all CASPs. With the exception of Navy Command where the support metrics were impacted by the unexpectedly high tasking rates of singleton aged platforms, our level of support across the CASPs has been very good.

## KPI 1 – CASP DELIVERY PERFORMANCE

1.1 Achievement of CASP milestones	Metric	Navy	Army	Air	Joint Forces Command	DG Nuclear	Strategic Programmes	DE&S
	Green ≥90% Amber ≥80% <90% Red <80%	85% (17 of 20)	90% (9 of 10)	83% (15 of 18)	100% (4 of 4)	57% (4 of 7)	100% (6 of 6)	85% (55 of 65)

Each CASP included a number of strategic milestones that were due to be delivered in-year and were agreed as significant with our customers. These milestones are on a project's critical path, or significant to a project's success, and in total DE&S delivered 55 of the 65 milestones on time or early.

### Procurement projects

While we monitor the delivery performance of all of our procurement projects, our KPIs measure performance on projects with a procurement value of more than £20 million. Procurement projects are approved with quality, cost and time parameters and are categorised by their phase in the procurement cycle. We monitor separate cost and time KPIs for Demonstration and Manufacture phase projects (those projects that have passed the main investment decision) and Assessment phase projects (those which are yet to reach that point) as an average per project in the population. Variances to forecasts can arise from technical challenges or opportunities encountered by the supplier, commercial and procurement processes, international collaboration, accounting adjustments and dependencies in associated projects managed by other parts of our organisation.

1.2 Key User Requirements	Metric	Navy	Army	Air	Joint Forces Command	DG Nuclear	Strategic Programmes	DE&S
	Green ≥97% Amber ≥96% <97% Red <96%	100% (57 of 57)	100% (57 of 57)	100% (51 of 51)	100% (30 of 30)	100% (56 of 56)	100% (50 of 50)	100% (301 of 301)

We measure the quality of new equipment through how well it will fulfil its Key User Requirements (KURs). KURs are agreed when a project is approved and specify the essential core characteristics the equipment must fulfil when in operational use. KURs will be achieved when an equipment enters into service. Under all six CASPs we are forecasting to achieve 100% of KURs.

1.3 Cost	Metric	Navy	Army	Air	Joint Forces Command	DG Nuclear	Stragic Programmes	DE&S
1.3.1 Demonstration and manufacture phase projects – aggregate cost variance	Green ≤ 0% Red >0%	0% (-£1.6M)	+2% (+£138.6M)	-0.5% (-£49.1M)	-0.4% (-£0.5M)	+6.1% (+£505.2M)	-1.4% (-£41.1M)	+1.4% (+£551.5M)
1.3.2 Assessment phase projects – aggregate cost variance	Green ≤ 0% Red > 0%	0% (£0.0M)	0% (£0.0M)	-4.5% (-£5.3M)	-8% (-£2.0M)	0% (£0.0M)	-3% (-£7.6M)	-0.2% (-£14.9M)

In 2016-17, DE&S managed 39 large Demonstration & Manufacture phase projects, with a total combined forecast of nearly £40 billion. The cost variances under this KPI show how much the forecast cost to complete this phase of work changed over the year. In four of the six CASPs the aggregate forecast costs reduced, reflecting DE&S' success in managing the programme of work. The only CASPs under which we reported cost increases were the Army and DG Nuclear CASPs.

There were 26 Assessment phase projects in our programme of work in 2016-17 with a combined forecast value of over £7 billion. The aggregate forecast costs were lower or unchanged for the year under all six CASPs.

1.4 Time	Metric	Navy	Army	Air	Joint Forces Command	DG Nuclear	Strategic Programmes	DE&S
1.4.1 Demonstration and manufacture phase projects – aggregate time variance	Green ≤0.6 months Amber >0.6 months ≤0.8 months Red >0.8 months	+2 months (14 months total)	+4.8 months (29 months total)	+3.3 months (23 months total)	0 months (0 months total)	-1 month (-8 months total)	-0.1 month (-1 month total)	+1.5 months (57 months total)
1.4.2 Demonstration and manufacture phase projects – time variance per project	Green ≤15% Amber >15% <25% Red ≥25%	16.7% (1 project)	33.3% (2 projects)	14.3% (1 project)	0% (0 projects)	0% (0 projects)	0% (0 projects)	10.5% (4 projects)
1.4.3 Assessment phase projects – aggregate time variance	Green ≤2 months Amber >2 months ≤3 months Red >3 months	0 months (0 months total)	0 months (0 months total)	0 months (0 months total)	+0.5 months (2 months total)	0 months (0 months total)	0 months (0 months total)	+0.1 months (2 months total)

In 2016-17 there were 38 Demonstration and Manufacture phase projects with an approved In-Service Date, one fewer than the related cost KPI 1.3.1. We achieved our target of no increase to aggregate project duration under three of the six CASPs. We encountered some significant challenges elsewhere which is a reflection of how complex and challenging procuring new defence equipment can be. The remaining three CASPs show time increases due to four projects reporting delays to achieving their In-Service Date. The four projects reporting delays to achieving their In-Service Date also tripped the time slippage threshold under KPI 1.4.2.

Across the Assessment Phase project population we declared no variances under five of the CASPs. Only two of the 26 projects forecast minor variances against their time to complete, both projects under the Joint Forces Command CASP.

## Support projects

In conjunction with DE&S, each of our customers determines how it defines Availability, Reliability, Sustainability and Safety Process Administration and negotiates its own performance thresholds. When combined, these four measures provide an overview of our performance supporting in-service equipment, but, because of the individual nature of how they are negotiated separately with each customer, it is important to note that direct comparisons of performance between the CASPs is not possible. Building on how these metrics were measured during 2015-16, it is worth noting that the performance of DE&S and the customer has been successfully separated for most of the metrics, the only exception being Reliability within the Navy Command CASP. This means that the performance assessment now more accurately reflects the delivery performance of DE&S.

1.5 In-Service Equipment	Metric	Navy	Army	Air	Joint Forces Command
1.5.1 Availability	Green ≥80% Amber ≥70% <80% Red <70%	72%	95%	94%	96%
1.5.2 Reliability	Green ≥80% Amber ≥70% <80% Red <70%	76%	99%	99%	100%
1.5.3 Sustainability	Green ≥80% Amber ≥70% <80% Red <70%	63%	87%	93%	100%
1.5.4 Safety Process Admin	Green ≥ 90% Amber ≥80%<90% Red <80%	36%	96%	66%	94%

DE&S delivery performance to in-service platforms was consistently good throughout the year under the Air, Army and Joint Forces Command CASPs. Under these three CASPs all KPIs were met with one exception, that being Safety Process Administration under the Air CASP. Improving Safety Process was a key priority as we sought to provide Air Command with a more consistent quality output. Not meeting this KPI highlights weaknesses in the safety administration and not issues affecting the safety of the equipment in service. We continue to actively address the issues that affect this KPI score and expect the assessment to improve through next year.

Under the Navy CASP, DE&S' performance was impacted by the unexpectedly high tasking rates of singleton aged platforms, providing less opportunity for regular maintenance. In agreement with Navy Command, our current focus on long-term low-level capability defects and a targeted long-term recovery programme to improve contract cover and drive down the number of stores received past their delivery due dates is fundamental to driving improvement. Again, the low assessment for Safety Process Administration is principally a process issue and does not mean that platforms are unsafe to operate, and a programme designed to support an overall improvement in safety performance has made a positive contribution this year.

**KPI 2 – OPERATING EXPENDITURE EFFICIENCY**

	Performance
Reduce the total DE&S operating expenditure in line with agreed resource profile in the DE&S Corporate Plan	<p>Our target was to spend less than our operating cost budget, which we achieved. Our final costs were £1,142 million against a revised budget of £1,145 million. During the year measures were taken to deliver £41 million of savings against the original budget, which was also adjusted to reflect a number of budgetary transfers as part of normal business. These figures exclude communicated costs which are notional, non-budgetary items of expenditure.</p> <p>The delivery of a budget to outturn variance of less than £3 million (2.6%) is clear evidence of the robust and effective financial management exercised by DE&amp;S. This small variance reflected lower workforce and other operating costs, offset by higher Strategic Maritime private sector support costs. The core operating cost budget excluding Transformation expenditure has fallen by some 21 per cent between 2013-14 and 2017-18, so a continuing drive to reduce expenditure on private sector support will be important, along with rigorous control of other forms of operating expenditure. In addition further work was undertaken to improve the robustness of the accounting boundary between DE&amp;S operating and programme activities in order to address NAO audit qualifications.</p>

**KPI 3 – INVENTORY MANAGEMENT**

	Metric	Performance
3.1 Reduce inventory holdings (including fuel)	Green ≤£27.3Bn Amber >£27.3Bn ≤£27.5Bn Red >£27.5Bn	£27.254Bn
3.2 Spend on Inventory Purchases (RMC, excluding fuel)	Green ≤£1Bn Amber >£1Bn ≤£1.025Bn Red >£1.025Bn	£0.870Bn
<p>Both targets were achieved in 2016-17:</p> <ul style="list-style-type: none"> <li>→ Closing inventory: As at 31 March 2017, the MOD had achieved a £13.1 billion overall reduction from the 2011-12 baseline position of £40.3 billion giving a closing position of £27.3 billion. In achieving this, £18.8 billion of inventory has been disposed of at the end of its useful life since the start of the project.</li> <li>→ Raw materials and consumables purchasing: In 2016-17, there was a further purchasing saving of £130 million against the £1 billion target.</li> </ul>		

**KPI 4 – FORECAST ACCURACY AND STABILITY**

	Metric	Navy	Army	Air	Joint forces command	Strategic programmes	DG Nuclear	Other EP	Total <sup>5</sup>
4.1 Forecast accuracy (in year) – outturn below baseline	Baseline	£3,182M	£1,541M	£3,567M	£685M	£1,038M	£3,259M	£188M	£13,460M
	Overspend: Red Underspend: Green <0% ≥-1.5% Amber <-1.5% ≥-2% Red <-2%	-3.0% (-£95M)	-1.1% (-£17M)	-0.9% (-£31M)	+1.0% (+£7M)	-10.0% (-£104M)	+1.2% (+£38M)	-0.2% (-£0M)	-1.5% (-£204M)

The equipment programme outturn was £13,257 million against a budget of £13,460 million, which includes adjustments for foreign exchange movement. The total underspend of £204 million is within the KPI at 1.5% of the baseline.

	Metric	Navy	Army	Air	Joint forces command	Strategic programmes	DG Nuclear	Other EP	Total <sup>5</sup>
4.2 Forecast stability – 10 year equipment procurement plan – variance to baseline	Baseline	£9,651M	£16,996M	£7,201M	£4,987M	£8,485M	£24,592M	-	£71,911M
	≤ 0%	+0.4% (+£40M)	-0.1% (-£21M)	-0.8% (-£55M)	-0.5% (-£25M)	-1.6% (-£134M)	+3.8% (+£929M)	-	+1.0% (+£734 M)

The 2016-17 forecast of DE&S’ 10 year equipment procurement plan was £72,645 million against a baseline of £71,911 million, an increase of £734 million. Forecast reductions have been achieved in four of the Commands and only a minor increase reported in Navy. The exception is in the DG Nuclear programme.

	Metric	Navy	Army	Air	Joint forces command	Strategic programmes	DG Nuclear	Other EP	Total <sup>5</sup>
4.3 Forecast stability – 10 year equipment support plan – variance to baseline	Target	£23,749M	£12,180M	£24,345M	£5,451M	£2,582M	£17,267M	-	£85,574M
	≤ 0%	+0.03% (+£8M)	-3.4% (-£409M)	-3.4% (-£831M)	+0.3% (+£14M)	-0.8% (-£21M)	+1.3% (+£225M)	-	-1.2% (-£1,014M)

The 2016-17 forecast of DE&S’ 10 year equipment support plan was £84,560 million against a baseline of £85,574 million, a total reduction of £1,014 million. Forecast reductions were reported in three of the Commands and only minor increases in Navy and Joint Forces Command. Again, the exception is the Nuclear programme.

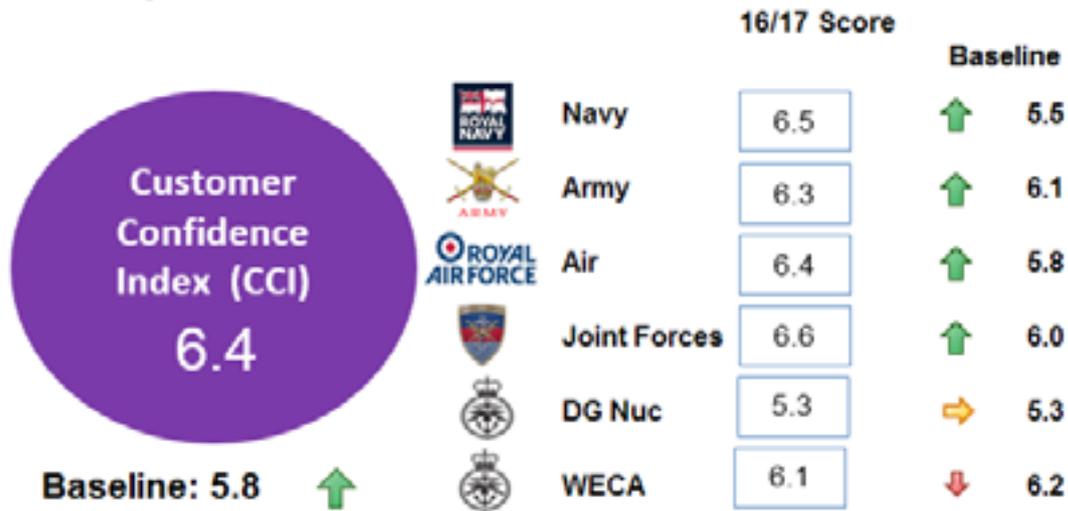
<sup>5</sup> Rounding means some totals may not equal the sum of its rounded parts.

**KPI 5 – CUSTOMER SATISFACTION**

The Customer Confidence Index baseline was established during 2015-16 as the average of two scores gained through customer surveys undertaken in April and October 2016. The 2016-17 results, based on two surveys run during the year, highlight that the overall DE&S Customer Confidence Index (CCI) has increased by 10 per cent. Senior customer interviews were also undertaken to inform response plans to improve customer confidence.

For 2017-18 a single customer satisfaction exercise will be undertaken (to collect quantitative scores through the survey and qualitative insight through structured interviews), rather than the bi-annual process adopted in 2016-17. Our aim is to achieve a year-on-year increase in the overall customer satisfaction score.

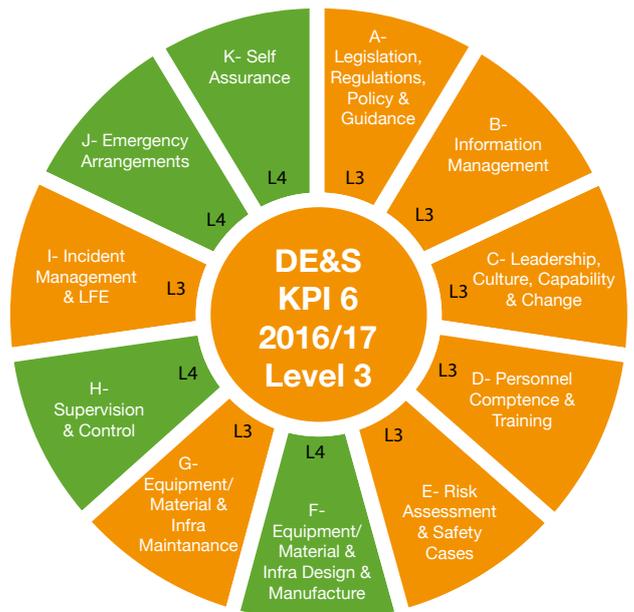
**Results by Customer**



**KPI 6: HEALTH, SAFETY & ENVIRONMENTAL PROTECTION**

This KPI was formally monitored and reported for the first time during 2016-17 having been shadow run the previous year. Our self-assessment against the scoring criteria has remained unchanged at Level 3 (minor weakness), leading to an Amber assessment. DE&S is reporting compliance in four of the 11 criteria.

Despite the overall assessment remaining unchanged, there has been some improvement reported in year, most notably in the Ships Operating Centre. However, there remains room for improvement across the business and a number of activities are underway. The inclusion of a target under our OGSM framework to reach Level 4 by April 2018 should help drive this forward.



## STRATEGIC OBJECTIVE 2: TRANSFORMATION TO A MATCH FIT ORGANISATION

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

This objective means that DE&S will be:

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

The 2016-17 financial year has seen our Transformation Programme mature, as we use our management freedoms to develop the policies and processes needed to transform the organisation.

In 2016 we published The DE&S Way, a document for both the DE&S workforce and our external stakeholders, which encompasses the scope of change in DE&S and sets out how Transformation is being taken forward across our organisation.

By the end of financial year 2016-17, our Transformation Programme has changed the way that we work, how we're organised, and how we manage our people. We have achieved our Match Fit objectives of transforming DE&S to be:

- Equipped to deliver its promises and on the right track to becoming a leader in Defence acquisition and in-service support
- Able to deploy its people functionally and flexibly to task
- Using standardised ways of working to help staff to maximise their time and minimise wasted effort
- Supported by a pay and performance system that rewards good performance
- Developing a Management Information system underpinned by the principle of input once and use many times

We have also established a bespoke Human Resources function through our People Model, designed to help us attract, develop and retain talent. The introduction of a balanced matrix management system allows us to move our people functionally and flexibly to task in line with our customers' requirements. This new way of managing our people will help us augment existing skills and reduce our private sector support expenditure. Alongside this we have introduced P3M as part of a new process and control framework to add rigour to our delivery of programmes and enable us to work more efficiently. We will continue to roll out the new ways of working in the 2017-18 financial year.

### Over the last year we have:

- Aligned all our staff to one of the 11 new professional functions
- Moved to a fully operational balanced matrix
- Introduced standardised ways of working
- Established a Business Management System (BMS) which is home to our essential processes
- Defined a new grading, performance and reward regime – moving all our people to five new levels in place of the previously 11 different grades and introducing a career and reward framework linked to individual performance.
- Started rolling out technology improvements and agile new tools including P3M and management information dashboards
- Increased our customer satisfaction score by 10%

## STRATEGIC OBJECTIVE 3: LEADERSHIP AND ENGAGEMENT

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

This objective means that DE&S will:

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

### Leadership

The DE&S People Strategy has been a central element of the Transformation Programme over the last three years, taking forward the changes required to ensure DE&S is able to attract, develop, deploy and retain the skilled personnel needed to improve our delivery for Defence. Whilst our civilian employees remain Civil Servants and military personnel remain a core part of our workforce, a lot has changed. Over the last year we have introduced a new grading structure; we now have five levels with five broad salary bands. The new Senior Leadership Group level encompasses our Senior Civil Service (SCS) colleagues and there are no longer any differentiating pay bands within the group; reward is determined by the performance of the individual and the role profile taking into account market benchmarks.

The new market-informed, performance-based reward focusses on DE&S holding our people to account; whilst we are offering our people more competitive pay, this will be firmly linked to performance and more stringent measures will hold each individual to account for the work that they do.

The DE&S Way, published in May 2016, supports our organisational goals and underpins the behaviours our leaders are expected to work to. We have set out how we will develop our people and capability more widely, through the People Strategy, Employee Value Proposition and the DE&S Professional. During the year we also put in place the apparatus to enable the balanced matrix to operate, with every employee

being assigned a Function Development Officer (FDO) who supports their performance, development and deployment. Our FDOs received training in performance and pastoral management techniques and we will continue to enhance this capability in line with business needs through a continuous cycle of assessment and blended learning approaches.

In addition, we exercised our freedom to work outside the Civil Service Learning framework to pilot middle-management training materials with 100 managers, this pilot was successful and has led to the Aspire programme which will launch in 2017 providing consistent training to the Delivery Manager population.

For our employees who have demonstrated strong potential to become the next senior managers (part of the Senior Leadership Group) we have improved the DE&S Catalyst talent scheme; and for those with potential to be Delivery Managers running our most complex projects, the Advance talent scheme has been created. These actions will help us to foster strong, inspiring leaders at all levels of the organisation, helping us to enhance DE&S' reputation, support our delivery of the programme of work and keep our staff engaged. We continue to value our deep technical expertise as we recognise this powers our success.

In recognition of this, and to support the existing Fellowship and Senior Fellowship scheme, we have created a pathway to identify, support and develop our future technical specialists; the Associate Fellowship Scheme. Up to 100 places on these schemes will be funded in 2017-18.

The past year has seen us make particular use of our freedoms to help us build our leadership capability. Through judicious use of our ability to employ up to 25 staff at salaries higher than the senior salary cap, we have sought to attract the highest quality leaders with the necessary skills to improve delivery of business objectives and transform DE&S.

### Staff engagement survey

In October 2016, we conducted our annual staff engagement survey - the People Survey - which enabled all staff, civilian and military, to tell us what we are doing well and where we need to improve. This survey remains part of the Civil Service-wide staff engagement exercise. 73% of DE&S staff completed the survey this year (compared to 67% in 2015) and our overall engagement score was 53% - an improvement of 4% from the previous year's survey.

While staff reported improvements across all of the key drivers of engagement, and specifically in leadership visibility (up 7% to 46%) and having a clearer vision for the future of DE&S (up 11% to 43%), the survey highlighted that there are four main issues that staff would like the leadership team to focus on: improving our working environment (including IT); changing our approach to performance and reward; addressing bullying, harassment and discrimination, and continuing to improve our communications. We have taken a number of steps over the year to address these, specifically:

## Working environment (including IT)

The programme of work we started last year to improve our working environment at Abbey Wood and our satellite sites continues. This includes improving site safety and security as well as cosmetic improvements and increasing desk availability. We have also expanded Wi-Fi access across the site, enabling staff using laptops to work in a wider range of spaces, helping to alleviate the pressures on accommodation.

## Performance and reward

We introduced a new approach to performance management to support the high performance culture we want to see in DE&S. We used new bespoke competencies for our business, to set out how our staff should deliver, and emphasise that this is as important as what they deliver. These compliment the overarching DE&S Way behaviours, and we will build on this approach during the 2017-18 financial year.

## Bullying, harassment and discrimination

The Executive Committee were concerned to find some members of staff have experienced bullying, harassment and discrimination in DE&S. We took steps to address these behaviours, which are not in keeping with the DE&S Way or the inclusive culture we wish to create, developing policy to make it easier for our people to raise a concern and a peer network to provide resolution guidance. We are also training all our leaders and managers in inclusive leadership to reinforce the positive behaviours we expect from them and their teams.

## Communications

- The Executive Committee hold regular roadshows and town hall events to update staff on the issues which matter most to them.
- We have introduced an internal communications business partner best practice model to help drive up communications and engagement across the business.
- We have improved our cascade process for our monthly face-to-face leadership briefings to ensure that leaders have the information they need to keep staff updated on what's changing in DE&S.
- We have introduced personal impact training for our leaders to help support them in delivering our change messages.
- We have run a number of impactful communications campaigns and products to positively influence behaviours.

The next DE&S People Survey will take place during autumn 2017.

## Processes and tools

We introduced our OGSM framework this year, which sets out the strategic level in-year focus of business activity. OGSM objective 6 is focused on developing our people and improving our processes, both of which involve significant investment through two key strands of our Transformation Programme: the Balanced Matrix – designed to ensure that the right person is in the right job at the right time; and the roll out of our spirals programme, designed to improve and standardise the processes and tools we use to deliver and manage our business.

Our new Business Management System (BMS) has also been developed over the year; it will contain the set of interrelated processes that describe why and how work is to be undertaken across the business. Each professional function to which our people are aligned now has a function leadership team in place to support it, and each leadership team will use the BMS to identify policy and process and communicate how work is to be undertaken in order to satisfy the requirements of all our stakeholders. This in turn allows our people to undertake their day-to-day activities in a consistent and predictable manner. We will capture best practice from around the organisation and feed it back into the BMS, so we can continually evaluate and improve what we do as part of our commitment to achieving world-beating performance.

## Safety, sustainability and security

### Safety and environmental protection

We are committed to ensuring that we provide safe equipment to the Armed Forces and protect the environment in which our equipment operates. In parallel, we also ensure the potential harm presented to people and the environment by our business activities and infrastructure is minimised so far as is reasonably practicable. Embedding an effective safety culture throughout the organisation continues to be a priority, as does the provision of accurate and meaningful statistics through the introduction of performance dashboards this year to the DE&S Safety, Executive and Performance Committees and the DE&S Board. We recognise that our performance can always be improved and we strive to ensure that we take appropriate action to deliver these improvements.

DE&S Transformation dominated the safety agenda in 2016-17, with preparations for the standing up of the OHSE Function and formation of the Acquisition Safety & Environmental Protection (ASEP) discipline (part of the wider Engineering Function) continuing throughout the year. All areas of safety and environmental protection have come under scrutiny resulting in a significant improvement to our procedures, processes and products which has already had a positive impact on how we discharge our safety and environmental responsibilities. Standing up the ASEP discipline is providing DE&S with a significant opportunity to upskill individuals in this area. A full review has been undertaken to identify potential improvements to the suite of System Safety courses with recommendations now being implemented. Training requirements for ASEP members have also been identified and, for the first time, DE&S has a roadmap for training its safety and environmental community which will see them achieve 'Practitioner' status and membership of a recognised professional body within defined timescales.

A major achievement was the review, update and re-issue of the DE&S Acquisition Safety & Environmental Management System (ASEMS). The result is a system with a modern interface that allows users to quickly and efficiently navigate to the mandated DE&S policy document for acquisition safety and environmental protection. We have also continued to develop our Defence Standards for improved contracting of safety within the procurement process, and further developed the tools that define and capture the data that supports the safety and environmental management systems across all areas. This work will form the basis for standardised approaches within project areas and support a unified DE&S way of delivering safety across the organisation.

In June 2016, DE&S held its second Safety Day. This built on the success of the inaugural event in October 2015, by significantly expanding participation across the whole of the DE&S estate where all staff were actively encouraged to take part. Safety Day is now firmly embedded in the calendar, and demonstrates our commitment to the safety of our staff and customers. To coincide with this, an updated Safety Culture Survey was also rolled out, incorporating a revised question set produced with input from a recognised specialist in the field. The changes ensure the survey addresses all key safety culture indicators, and allows a quantitative measure of performance to be generated which can be benchmarked against external industry sectors. A series of safety-related 'learning from experience' events were also held during the year, identifying lessons learned and ensuring that best practice was shared across all areas of the business.

Across the DE&S estate, all DE&S sites now have environmental management systems in place which are regularly assessed and audited although improving overall maturity remains the goal. To assist this work, as part of DE&S Transformation, the OHSE Function is developing an organisational Safety and Environmental Management System (SEMS) which will be integrated into the new and over-arching Business Management System (BMS). Our main challenge remains trying to ensure that our fuels infrastructure is, and remains, compliant, and we are working with both the Defence Infrastructure Organisation (DIO) and the Fuels and Gases Safety Regulator to ensure this is achieved.

### Key achievement

#### Project delivery excellence

*The DE&S Chemical, Biological, Radiological and Nuclear (CBRN) team was recognised at the Civil Service Awards Ceremony in November 2016 for their outstanding work putting in place specialist capabilities to support contingent military planning following chemical attacks in the Middle East in August 2013.*

## Sustainable development

We recognise how important sustainable development principles are to delivering defence capabilities safely and effectively. DE&S is committed to achieving the revised Greening Government Commitment (GGC) targets and has worked to establish a DE&S GGC Steering Group (SG) which will be a committee consisting of empowered domain and function representatives from the Senior Leadership Group strata with the authority and accountability to agree and deliver GGC targets within their area. DE&S has also been working with customers in the Front Line Commands and wider MOD on how to meet key sustainable development targets under the GGC as well as making progress against other MOD sustainability requirements including capability energy efficiency.

We continue to work closely with our suppliers through a joint MOD-industry Sustainable Procurement Working Group. This provides a forum to update partners with changes in DE&S and MOD policy, identify sustainable procurement risks and mitigations, innovation and best practice as well as exploring opportunities for adopting a whole life approach to procurement and supply chain reporting.

DE&S, as a consumer of energy, contributes to the delivery of MOD sustainability targets, however, in the majority of cases, DE&S is a lodger unit within MOD sites, where responsibility for energy use on site sits with the DIO. Details of DE&S performance in all key areas is included in the Sustainable MOD Annual Report available at the attached link <https://www.gov.uk/government/publications/sustainable-mod-annual-report-2016-to-2017>.

## Security

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

We have established a 'security specialism' under our Transformation, and engaged with the Security and the Business Continuity Institutes. We are offering career pathways, support networks and associated training and development to ensure that security and resilience improvements are delivered by professionals at all levels throughout the acquisition and support of defence equipment.

Nuclear security, of course, remains a priority and, as such, a Submarine Delivery Agency security governance meeting, chaired by the Chief of Strategic Systems Executive, oversees the security risks related to the nuclear enterprise within DE&S. The DE&S Principal Security Advisor also sits on the Independent Police Committee working closely with the MOD Police and MOD Guard Service to ensure effective policing and guarding arrangements are in place to meet site requirements. This committee ensures that any staffing or capability issues are managed effectively and any impact on nuclear infrastructure is mitigated.

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

Physical security capability across DE&S was audited by Defence Internal Audit this year, and an assessment of Limited Assurance was given, agreeing with the earlier assessments of the Principal Security Advisor and the Security Committee. The report recognised the limitations on delivery by DIO of infrastructure improvements and effective guarding through the MOD Guard Service. It also noted the more limited MOD Police capability which is expected to further reduce next year. It was these three areas that prevented DE&S from having more than Limited Assurance of its physical security capability, and the report recognised that these outputs were beyond the direct control of DE&S.

We are expanding staff awareness of security risks and will continue to do so in 2017-18, using means other than the regular General Threat Briefs. The "Yours to Deliver" security awareness campaign has already successfully launched the Citizen Aid app, and the poster and video campaign have raised awareness, producing a measurable positive change in the highlighted behaviour.

The DIA report concluded that the Assurance programme delivered by the Principal Security Advisor was comprehensive and addressed the specific security requirements in the Defence Manual of Security. The audit also established that the Security Breach risk was well understood by appropriate individuals at senior executive level in DE&S and could be effectively managed at the Security Committee.

## Looking forward

We have set out our new strategic objectives for the organisation in our Corporate Plan, which was published at the start of the 2017-18 financial year and provides a three year look ahead in terms of our focus, challenges, budget and significant projects.



Our OGSM sets out our in year delivery focus, underpinning our strategic objectives. The OGSM is cascaded throughout the organisation providing a bridge between our strategic objectives and our detailed individual contributions, and provides a mechanism to measure our progress. For 2017-18 our focus is on:

## 1 Objective Hitting our numbers



Delivering our elements of the Equipment Procurement Plan (EPP) and the Equipment Support Plan (ESP) operating within our Operating Expenditure budget

## 2 Objective Perform to plan



Delivering our equipment and support safely, on time and on budget

## 3 Objective More "S" in DE&S



Improving support performance for our customers

## 4 Objective Satisfy our Customers



Delivering to our customers as required in the Defence Plan and wider Government agenda; achieving customer satisfaction across all Domains and optimising processes and our organisation to enhance customer satisfaction

## 5 Objective Transformation delivers benefit



Deliver the plan and communicate change effectively, to secure benefits

## 6 Objective Develop our people & improve our processes



By driving a high performance culture deploying the balanced matrix and improving employee engagement

The strategic leadership of DE&S has undergone some structural changes with effect from 3 April 2017 to best suit the delivery of our commitments. The Submarine Delivery Agency (SDA) has been formed and will operate alongside DE&S for the procurement, in-service support and decommissioning of the UK's nuclear submarines. The establishment of the new body reflects the Government's commitment to the nuclear enterprise and the unique scale, complexity and importance of this national endeavour. The year ahead will see the transition from DE&S once members of the senior team have been appointed and the necessary safety and regulatory approvals and service provision agreements are in place and a funding envelope separate from DE&S is confirmed.

During 2017-18 we will continue to progress our good work to deliver against the CASPs with our customers and build on our work to date to further increase our customer satisfaction levels. The continued use of CASPs introduced in addition to KPIs illustrates the journey as the overall acquisition system matures. Our customers are in the process of growing their experience and expertise as intelligent customers. During the year ahead we will continue to work hard to support our customers and MOD deliver SDSR 15 and Equipment Plan 16 priorities against the programme our customers agree and fund.

Building on the momentum of our transformation, we are driving innovation throughout our internal processes; behaviours and skills and close working across our strategic interfaces to allow us to intelligently inform and deliver the right projects for the customer, and to get better at delivering them. Our internal Innovation Strategy supports our strategic objectives, making it a priority focus area for 2017.

Transformation activities continue in the organisation; our plan for 2017-18 takes forward the work required to fully embed the changes made up to April 2017 and to realise all the expected benefits. The plan for 2017-18 is focussed on: enhancing delivery performance at a team level, increasing efficiency and productivity through the roll-out of new organisational designs and functional deployment, and implementing the new performance and reward framework. The overall focus remains on building a high performance culture that delivers the expected financial benefits as we become more agile. I look forward to leading DE&S through another challenging and rewarding year.

The DE&S Corporate Plan is available at: <https://www.gov.uk/government/publications/defence-equipment-and-support-corporate-plan-financial-years-2017-to-2020>



Tony Douglas  
Accounting Officer  
26 October 2017





# Section Two

## **Accountability Report**

# CORPORATE GOVERNANCE REPORT



## Directors' report

### Management

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

### Directorships and significant interests

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

### Personal data related incidents

No personal data related incidents were reported to the Information Commissioner's Office in 2016-17. Any incidents suspected of relating to personal data were investigated thoroughly but none were found to be in breach of the Data Protection Act. They were, nonetheless, used to formulate awareness in order to reduce the risk of re-occurrences. Small, localised incidents, assessed as such using Data Protection Act and Information Commissioner's Office guidance, are not recorded centrally and are not cited in this report.

### Statement of Accounting Officer responsibilities

Under the Government Resources and Accounts Act 2000, HM Treasury has directed DE&S to prepare, for each financial year, resource accounts detailing the resources acquired, used, held or disposed of during the year, and a statement of accounts in the form and on the basis set out in the Accounts Direction issued by HM Treasury on 20 December 2016. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of DE&S and of its net resource outturn, application of resources, changes in taxpayers' equity and cash flows for the financial year.

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

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

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

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

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

### Governance statement

I, Tony Douglas, Chief Executive and Accounting Officer of DE&S, am responsible for maintaining a sound system of corporate governance and internal control to support DE&S’ purpose and high level objectives, while safeguarding the public funds and MOD assets for which I am personally responsible. I have sought assurances from my teams that enable me to conclude that the system of internal control in DE&S complies with the HM Treasury Code of Good Practice on Corporate Governance in Central Government Departments.

This Governance Statement represents my assurance that, as Accounting Officer, I am satisfied that DE&S finances are adequately controlled and that significant progress has been made in addressing the audit qualifications reported by the NAO in 2015-16.

### Our governance structure

The DE&S governance hierarchy starts at the Owner’s Council and the DE&S Board and its associated sub-committees, each of which is established with the objective of providing suitable assurance that DE&S is fulfilling its responsibilities to its stakeholders, and its management is operating within the framework, procedures and plans that have been set.

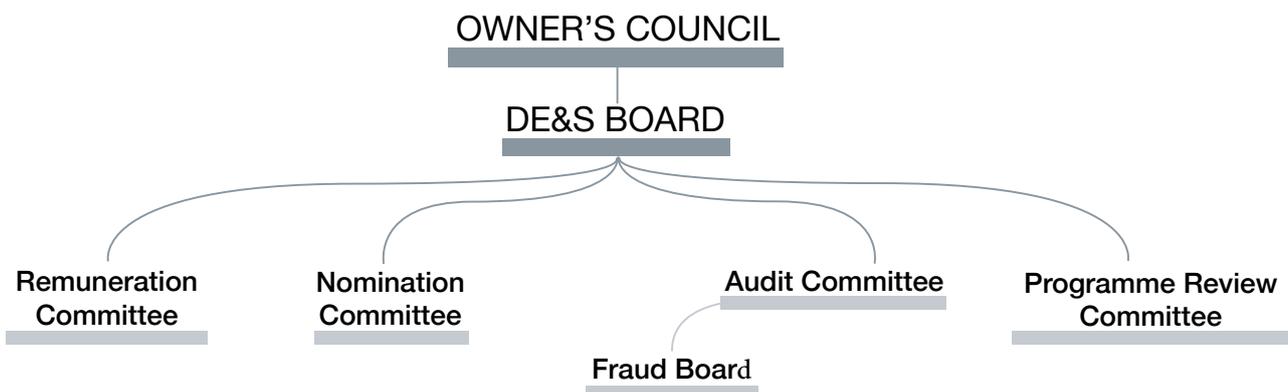
To strike the right balance of skills, experience and objectivity, the Chair agrees the size and composition of the Board with the CEO, taking into account guidance and best practice on boards in the public and private sectors, subject to approval from the Ministerial Owner.

### DE&S Board

The DE&S Board provides the strategic leadership for DE&S in delivering its objectives. As such it enables non-executive approval of the Corporate Plan for submission to the Owner’s Council and oversight of the delivery of DE&S business. The DE&S Board provides a forum for independent, non-executive, support and constructive challenge to the DE&S CEO and Executive Committee.

### Membership

- Mr Paul Skinner, DE&S Chair
- MOD Permanent Secretary (with MOD Director General Head Office and Commissioning Services attending as his representative)
- DE&S CEO
- DCDS Military Capability
- DE&S Director General (Resources)
- Mr Andrew Wolstenholme, NED
- Mr Paul Smith, NED
- Mr James Dorrian, NED
- Dr Ros Rivaz, NED
- Mr Iain Lanaghan, NED



**Owner’s Council**

Departmental interest and governance at Ministerial level is reflected through the DE&S’ Owner’s Council. The Owner’s Council supports and advises the Owner on the review and setting of DE&S’ strategic objectives, the approval of the Corporate Plan and novel or contentious decisions, and on performance.

The Owner’s Council is an internal MOD committee chaired by Minister Defence Procurement (Min(DP)) and meets as necessary, and at least quarterly. Membership

includes MOD Permanent Secretary, MOD Director General Finance, MOD Director General Head Office and Commissioning Services and Deputy Chief of the Defence Staff (Military Capability) as the customer representative. The DE&S Chair and DE&S CEO attend. The Cabinet Office Chief Procurement Officer has a standing invitation to attend.

**DE&S Board as at March 2017**



Paul Skinner CBE - Chairman



Stephen Lovegrove  
MOD Permanent Secretary



Tony Douglas  
DE&S Chief Executive Officer



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



Michael Bradley CB  
DE&S Director General Resources



Iain Lanaghan  
Non-Executive Director



Dr Ros Rivaz  
Non-Executive Director



James Dorrian  
Non-Executive Director



Paul Smith  
Non-Executive Director



Andrew Wolstenholme  
OBE  
Non-Executive Director

## DE&S Board activity

The Board met eight times during 2016-17.

Number of meetings attended 2016-17 <sup>6</sup>	
Mr Paul Skinner	8(8)
Mr Stephen Lovegrove or Julie Taylor as his representative	8(8)
Mr Tony Douglas	8(8)
Lt Gen Mark Poffley	6(8)
Mr Michael Bradley	7(8)
Mr Andrew Wolstenholme	5(8)
Mr Paul Smith	8(8)
Mr James Dorrian	8(8)
Dr Ros Rivaz	1(2) <sup>7</sup>
Mr Iain Lanaghan	2(2) <sup>8</sup>

### DE&S Board processes

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

### Board performance

By Paul Skinner, DE&S Chairman

As Chairman I have overseen the continued evolution of the Board during its third year of operation, this being an important period for the organisation's Transformation programme. We have sought to implement those improvements to Board effectiveness that were identified by the review conducted last year. These included: developing a stronger input by the non-executive members on the strategic decisions to deliver Transformation; increasing the focus of the Board on the important equipment support agenda; ensuring greater Board resilience through the appointment of additional non-executive members; and providing additional opportunity for non-executives to engage with DE&S events (for example, town hall briefings). The change in Board composition during 2016-17, with the appointment of two additional non-executive members, has also enhanced its effectiveness, and I am confident that the combined knowledge and experience of its members has been harnessed effectively during Board discussions. A third effectiveness review has begun to identify further enhancements to the Board's operation as we mature to support the transformed DE&S business; we will again work hard to implement these. My intention is to conduct a formal, external, review of Board effectiveness after the fourth year of our operation.

<sup>6</sup> The figures displayed are the number of meetings attended by each individual, with the total number of meetings available to attend in brackets.

<sup>7</sup> Dr Ros Rivaz was appointed to the DE&S Board on 2 January 2017.

<sup>8</sup> Mr Iain Lanaghan was appointed to the DE&S Board on 2 January 2017.

## Key business discussed at the DE&amp;S Board during 2016-17

Subject	Discussion	Outcomes
<b>Strategy</b>	The Board held a strategy day in February 2017 to explore the contextual issues affecting DE&S, principally from a Defence perspective. The Board discussed the outcomes from SDSR 2015 and its consequences for future decision-making, and the DE&S strategic objectives.	The Board reviewed the strategic context and financial outlook within DE&S from both the Equipment Programme and operating expenditure perspectives; leading to agreed steps on commercial approach and routes to market work to progress, and agreeing the focus for DE&S' strategic objectives.
<b>Risk</b>	DE&S strategic risks were scrutinised and discussed throughout the year. The Board ensured that the risk relating to the establishment of the Submarine Delivery Agency was identified and recorded appropriately. The positive progress made on risk management was recognised with the intention to evolve this further.	A strategic risk workshop, involving Executive Committee members and Board Non-Executive Directors, was held on 10 October 2016. This reviewed the scope and nature of the risks managed by the business at Executive Committee and Board level.
<b>Transformation</b>	At all meetings, the Board received updates on the progress toward implementation, and achievement of, Transformation benefits.	The Board evaluated Transformation delivery against the milestone plan. The new approach to Pay and Reward was endorsed.
<b>Managed Service Providers (MSP)</b>	The Board regularly reviewed the MSP performance against milestones and realisation of Transformation benefits within the Transformation Plan. It reviewed the business case for funding the MSP for 2017/18.	The Board approved the Executive's intention to continue the resource commitment on Managed Service Providers and to commit additional resource to the Strategic Savings Initiative.
<b>Corporate documents</b>	The Board tracked the progress and publication of the DE&S Annual Report and Accounts and contributed to the development of the DE&S Corporate Plan 2017-20.	The DE&S Annual Report and Accounts for 2015-16 was published in November 2016. The Board noted the progress made in addressing the NAO qualifications and the further management action that would be necessary.
<b>DE&amp;S Committees</b>	The Board received reports on the progress, themes and membership of its sub-committees and considered the work being taken forward.	The Board recruited two additional NEDs to strengthen the support provided to the Audit Committee and Remuneration Committee.
<b>DE&amp;S Business Updates</b>	The Board received regular business updates from the Domain Chiefs of Materials and from function leads in Security, Commercial, HR, Information Technology and Innovation and Prosperity.	The Board engaged with the business and evaluated the IT Strategy, HR People Strategy and HR Organisation Plan and Commercial Good to Pay progress enabling appropriate challenge to the Executives.
<b>Submarine Delivery Agency (SDA)</b>	The Board received regular updates on the progress made on the establishment of the SDA.	Minimisation of the risks to the delivery of submarines programmes, and possible adverse implications on the DE&S Transformation Programme, were minimised.

## DE&S Board sub-committees

The DE&S independent Non-Executive Directors (NEDs) attend the following sub-committees:

Name	Committee (meetings attended) <sup>9</sup>
Mr Paul Skinner <sup>10</sup>	Nomination Committee Chair (1/1) Remuneration Committee (2/2)
Mr Paul Smith	Audit Committee Chair (5/5) Fraud DE&S Board (2/4)
Mr Andrew Wolstenholme	N/A
Mr James Dorrian	Remuneration Committee(3/3)
Mr Iain Lanaghan	Audit Committee (2/2) Fraud DE&S Board (1/1)
Dr Ros Rivaz	Audit Committee (1/1) Remuneration Committee(1/1)

### Audit Committee

The Audit Committee's remit is to review and challenge the adequacy of internal controls and risk management assurance processes within DE&S. Where assurance is ineffective, the Committee will make recommendations to the DE&S Board for appropriate action to be taken.

The Audit Committee met five times during 2016-17 and all members were in attendance. All meetings were chaired by Mr Paul Smith who was also a Non-Executive member of the Defence Audit Committee during this period. As well as the Chair, formal membership consisted of a MOD NED, Director General Head Office and Commissioning Services<sup>11</sup>, and Mr Iain Lanaghan, DE&S NED, who was appointed in January 2017.

The meetings were attended by the Director General Resources, the Director Corporate Affairs<sup>12</sup>; Director Financial Plans and Analysis; Director Commercial Capability and the Head of Financial Accounting. The National Audit Office and Defence Internal Audit were also in attendance.

The Audit Committee's programme of business over the course of the year primarily focussed on DE&S' contribution to the MOD's Annual Report and Accounts and Governance Statement and also the DE&S Annual Report and Accounts. During the year the DE&S Audit Committee monitored the progress of implementing the recommendations raised in National Audit Office management letters and has monitored the various initiatives underway to support the removal of the remaining qualifications. It also reviewed the DE&S Annual Assurance Report and agreed improvement targets where required. It reviewed the Defence Internal Audit outputs and findings and also considered the DE&S 2016-17 audit programme, monitoring the progress of agreed management actions. In addition, the Audit Committee reviewed strategic risk, the government furnished equipment process, losses and special payments, and whistleblowing cases. On the latter, the whistleblowing champion for DE&S, Director Corporate Affairs, informed the Committee that good progress had been made and no endemic problem or trend had emerged. A summary report of Audit Committee activity was provided to the DE&S Board after each meeting.

### Fraud Board

The Fraud Board is a sub-committee of the Audit Committee with a remit to oversee a risk-based approach using the available management information to protect DE&S' business reputation, assets and finances from fraud, corruption, theft and misappropriation.

The Fraud Board met four times during 2016-17. Two meetings were chaired by Mr Paul Smith and two by Mr David Johnson, the DE&S Director of Financial Plans and Analysis. With effect from January 2017, the Fraud Board's membership included Mr Iain Lanaghan, NED. Additionally attending were those responsible for managing fraud risks in DE&S and representatives from the DE&S corporate financial team, the MOD Director Defence Audit, Risk and Assurance, Defence Internal Audit, Fraud Defence and the MOD Police.

The Fraud Board's programme during 2016-17 primarily focused on assessing fraud risks, in particular Bribery and Corruption, Conflicts of Interest and Expenses and Allowances. It also received updates on fraud, corruption and theft investigations and advised on

<sup>9</sup> The number in brackets represents the number of meetings attended/the number of meetings available to attend.

<sup>10</sup> As Chairman, Mr Paul Skinner has an open invitation to all Committees.

<sup>11</sup> Mark Preston attended the first meeting, all subsequent meetings, with the exception of the meeting held on 22 March 2017, were attended by Julie Taylor who was appointed Director General Head Office and Commissioning Services in May 2016.

<sup>12</sup> Now Director Corporate Operations.

improvements to the Management Information provided by Fraud Defence relating to reported suspicions and closed cases. The Fraud Board also considered the development of the DE&S Commercial Fraud Prevention Plan. A summary report of Fraud Board activity was provided to the Audit Committee after each meeting.

### Remuneration Committee

The Remuneration Committee advises the Owner, the DE&S Board and the CEO on matters relating to the proper development and application of the DE&S total compensation strategy, including its pay structures, as set out in the DE&S Framework Document. It also advises the Board on the remuneration of the CEO, the top civilian executive team and other senior staff as appropriate, where these are not set by Senior Civil Service or Departmental guidelines.

During the 2016-17 period the Remuneration Committee met three times. Discussion included a broad range of People Strategy issues, including succession planning, senior executive performance assessment and outcomes; and the development of the new pay and reward strategy for the business.

### Nominations Committee

The Nominations Committee meets as necessary to advise the DE&S Board and the CEO on appointments to the DE&S Board (except for the Chair, whose appointment is the responsibility of the Owner) and on senior leadership roles in the Executive.

Issues covered by the Nominations Committee during the 2016-17 period include senior workforce requirements, the division of the SDA from the business and the appointment of CoM Ships.

### Programme Review Committee

The requirement for a Programme Review Committee (PRC) was re-assessed during 2016-17 with the conclusion that, with the advent of the CEO chaired Performance Committee, the PRC could be disbanded.

## DE&S Executive Committee

The DE&S Executive Committee advises and supports me in the discharge of my delegations and responsibilities as set out in my CEO Letter of Delegation as Accounting Officer and Letter of Authority from the MOD Permanent Secretary – to ensure that DE&S delivers its purpose to equip and support the UK's Armed Forces for operations now and in the future. In delivering this remit, my Executive Committee's considerations will include:

- The development of strategy (in preparation for DE&S Board consideration)
- The establishment of business plans and their context
- The review of plans presented from its sub-committees
- Monitoring performance against all approved plans
- The primary coordination of the operating model and the satisfaction of end user requirements
- The review of the plan delivery set out by the Performance Committee
- The signature of the commercial strategy
- The management of the issues in the strategic risk register

### Membership

I chair the Executive Committee, which, within the reporting period, consisted of Director General Resources as Chief Finance officer, Director General Commercial and our four Chiefs of Materiel, spanning the Fleet, Land, Air and Joint Enabler domains.



### Key achievement

#### **The Change Advocate Network – supporting Transformation in DE&S**

*During the year we established the Change Advocate Network (CAN) to support our Transformation. The CAN drives and embeds change at all levels of the organisation in four key areas: learning, communications and engagement, leadership and behaviours, and change. Change Advocate activities range from talking to their teams and providing information on Transformation, to deep involvement with some of the core Transformation work streams, in addition to their main roles. The CAN now numbers over 800 people across DE&S locations and teams and continues to grow.*



## DE&S Executive Committee as at 31 March 2017



On 3 April 2017 a revised '5 by 5' structure was launched to reflect our move to a balanced matrix and the establishment of the Submarine Delivery Agency. The Executive Committee membership now comprises of the five domain leads and the five cross-domain enabling leads, namely:

- Chief of Materiel Ships
- Chief of Materiel Submarines<sup>13</sup>
- Chief of Materiel Land
- Chief of Materiel Air
- Chief of Materiel Joint Enablers
- Director General (Resources) as Chief Finance Officer
- Director General (Commercial)
- Director, General Programmes
- Director, Corporate Operations
- Director, Human Resources

During 2016-17 the Executive Committee considered the following key issues:

**Transformation:** The Committee reviewed and agreed the financial assessment of the pay and reward package. The Committee finalised the new leadership model which has since been implemented throughout DE&S, ensuring each Operating Centre understands the OGSM structure. Throughout the year, the Committee reviewed the implementation of MODNET across DE&S.

**Safety and Security:** The Committee continuously reviewed DE&S' safety culture and emphasised the need for all staff to engage with this. Following previous success, the Committee agreed to hold a further DE&S Safety Day. The Committee also reviewed the absorption of the Security Specialism within the Corporate Services Group Function.

**Communications:** Over the course of the year, Committee members reviewed the corporate communications dashboard. The Committee highlighted the requirement for the Face to Face briefs to provide greater focus on the consistent delivery of Transformation messaging across the domains.

**DE&S People:** As a part of Transformation, staff pay and performance were discussed throughout the year. Staffing levels were reviewed regularly. Continued proposals to improve facilities across DE&S were also reviewed. Skills shortages and retention issues were discussed throughout the year.

**DE&S Performance:** The Committee discussed progress against KPIs and CASP metrics at each meeting and regularly reviewed financial forecasts. The CFO Report was developed further to provide further detail on CASP milestones and Accounting period data for Equipment Support Projects. Management activities to mitigate DE&S strategic risks were considered at every meeting.

<sup>13</sup> The Submarine Delivery Agency (SDA) programme shall remain under the DE&S Executive Committee's scrutiny until such time as the new body is stood up as a separate accounting body with the CEO SDA designated as the SDA Accounting Officer.

## Executive Committee sub-committees



A number of subordinate committees are in place to support the Executive Committee.

The **Performance Committee** reviews the programme in each Domain, providing the forum to review progress on each Domain's programme – that is, performance of each Domain against its delivery of equipment and support to agreed plans, including the financial status of delivery against plan and any risks and contingency plans.

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

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

The **Transformation Committee** continues to report to the Executive Committee on driving the transformation of DE&S forward, focussing now on the 2017-18 plan and ensuring that the programme delivers the agreed outcomes and benefits.

Other Executive Committee sub-committees include the **Business Case Review Committee**, the **People Committee** and the **Innovation and Prosperity Committee**. These meet regularly, and update the Executive Committee as necessary on matters within their jurisdiction.

Outside of this formal governance structure, I hold regular one-to-one meetings with the members of my Executive Committee. I also meet regularly with the DE&S Senior Leadership Group (the highest grade in our new structure incorporating our Senior Civil Servant and military rank equivalent population) to keep DE&S' leaders apprised of developments as our transformation continues, and providing a forum for discussion and feedback.

### Key achievement

#### **F-35: contract award for Advanced Short Range Air to Air Missile (ASRAAM) and UK success for future repair work is confirmed**

In August 2016, we contracted MBDA to manufacture the latest air-to-air missile – ASRAAM – an advanced heat-seeking weapon which will give the Royal Air Force and Royal Navy F35 aircraft pilots the ability to defeat current and future air adversaries. The contract to update the weapon is worth around £184 million and will secure this cutting edge air power, providing vital offensive and defensive options for UK F-35 pilots against a wide range of air-to-air threats. In November 2016, we announced that DE&S had been working closely and successfully with industry on the F-35 bid with the UK chosen by the F-35 Program Office to be a global repair hub providing maintenance, repair, overhaul and upgrade services for F-35 avionic and aircraft components. Over the lifetime of the programme, components for hundreds of European-based F-35 aircraft will be serviced and maintained in North Wales. The new global avionic and aircraft component repair service is expected to be operational from early 2018.



## DE&S risk and control framework

### Risk management

Managing risk is all about reducing the uncertainty in our delivery to a level that allows successful management through the life of our projects and programmes. In DE&S, successful risk management is achieved through proactive identification, assessment, mitigation, monitoring and control, and takes place at all levels in the organisation. The DE&S Board and Executive Committee determine the governance and controls we have in place to manage risk, with a focus on strategic risk. We also continue to design and implement a dedicated Risk Discipline as part of our Transformation. Achievements in 2016-17 included development of a single risk management process, an upgrade of our customised risk management tool – Active Risk Manager™ – and identification of priorities for the Risk Discipline following its formal Stand Up on 1 April 2017.

The DE&S Board examines DE&S risk and the controls that are in place to manage risks and address opportunities. It pays particular attention to strategic risks facing DE&S, that is, those risks which might have a negative impact on the achievement of our strategic objectives, or have serious legal, financial, reputational or health, safety and environmental implications.

Management of strategic risks is delegated to the Executive Committee. The Committee regularly reviews, supports and challenges risk owners to manage and reduce the risks as far as is reasonably practical. We continue to apply the MOD’s risk management policy to our strategic risks, including reporting significant risks to the Defence Risk Committee and Defence Board. In 2016-17 we held our second annual strategic risk stocktake, and also invited Defence Audit, Risk and Assurance to observe the risk items at an Executive Committee.

### Principal strategic DE&S risks and their mitigations during 2016-17

Risk	Potential impact	Progress in 2016-17
<p><b>Government Furnished Equipment (GFE)</b> The risk that ineffective management of MOD equipment and assets provided to contractors, and failings in DE&amp;S systems and processes may result in a material over/under statement of DE&amp;S asset holdings and distorted operating costs.</p>	<p>In addition to damage to DE&amp;S reputation for the efficient management of assets it could lead to financial losses and the qualification of the financial accounts by the NAO.</p>	<p>We have introduced senior management quarterly reviews of the work by project teams to verify contractor records. This has increased inventory management, commercial and finance function engagement. We have also initiated a comprehensive review of our GFE processes that will deliver improvements as required during 2017-18 and Defence Internal Audit have continued to undertake GFE audits of our contractors.</p>
<p><b>Transformation</b> The risk that insufficient clarity and unity of purpose, and weak programme leadership by the DE&amp;S Executive team, cause the failure of DE&amp;S Transformation.</p>	<p>Inadequate DE&amp;S performance, loss of customer confidence, reputational damage to the MOD, and erosion of DE&amp;S freedoms.</p>	<p>We have delivered the 2016-17 plan leading to the achievement of the Match-Fit objectives/criteria. An integrated plan for 2017-18 is now being implemented which is designed to embed the changes made and deliver the expected benefits. The programme is managed through the Transformation Committee which meets on a monthly basis and is chaired by the CEO. The Committee tracks progress and reviews risk areas and the associated mitigation plans.</p>

Risk	Potential impact	Progress in 2016-17
<p><b>Equipment Safety</b> The risk of serious accident or incident attributable to a failing in the DE&amp;S safety management system.</p>	<p>Apart from causing harm to people or property, a serious accident or incident may damage DE&amp;S' reputation, and incur legal and other costs.</p>	<p>The DE&amp;S Safety Committee ensured that safety was considered throughout the DE&amp;S Transformation process. Opportunities presented by the move to a balanced matrix to develop a highly-skilled community of system safety practitioners have been fully exploited, and the suite of DE&amp;S-sponsored safety products reviewed and comprehensively revised to provide the organisation with the tools it requires.</p>
<p><b>Poor Equipment Support</b> The risk that a tendency to focus on equipment procurement over equipment support activities, and the relative difficulty of measuring those activities, delivers poor equipment support for our customers.</p>	<p>Damage to DE&amp;S' reputation for both delivery and efficient use of resources.</p>	<p>Significant development has been made in improving the focus on support activities relative to equipment procurement led by the CEO's More 'S' in DE&amp;S initiative. The inaugural DE&amp;S Support Day successfully brought all areas of the business together to address support issues while Domain-led activity such as the Maritime Common Support Model delivers coherence and improved equipment support.</p>
<p><b>Cyber</b> A successful cyber-attack against Defence equipment and/or infrastructure.</p>	<p>Reduced safety, impaired military capability, loss of intellectual property or information asset, loss of business services, financial impact, and reputational damage to Defence.</p>	<p>The Security Committee has led on the response, commissioning a cross-cutting Equipment Cyber Resilience Programme, augmented by additional dedicated resource. A Cyber Security Review of critical IT systems, focussed on systems hosted by third party suppliers, has been conducted delivering comprehensive supplier assessment reports.</p>
<p><b>Infrastructure Compliance</b> Inability to provide a safe, secure, resilient DE&amp;S estate that supports our outputs to the FLCs; inability to successfully implement future delegation of funding from the centre to manage the DE&amp;S estate. Insufficient resource, MI and fit for purpose commercial arrangements to meet DE&amp;S business need. Lack of assurance of a DE&amp;S compliant estate; failure to deliver Command Acquisition and Support Plan arrangements to our customers.</p>	<p>Reputational impact with Regulatory and Government bodies.</p>	<p>We have expanded the DE&amp;S Infrastructure Intelligent Customer capability to meet growing responsibilities and requirements. We have improved infrastructure governance and compliance via the introduction of Infrastructure Performance and Delivery Boards and membership of the Infrastructure Compliance Steering Board. We have delivered a 10 year prioritised Infrastructure requirements submission introducing a robust risk based prioritisation process.</p>

## Update on principal risks identified in 2015-16

The risks outlined in the table above are those that were identified as a principal strategic risk during 2016-17. In the 2015-16 Annual Report and Accounts, we reported two further principal risks, as follows:

### → **Security Breach**

Keeping our people, facilities, assets and equipment safe and secure remains our priority and across all areas of responsibility, we have continued to develop and improve safety and security management. During 2016-17, we published the DE&S Security Strategy setting out our plans for effective and proportionate security risk management, enabling the safety and security of our people, facilities, assets and equipment. We continue to build a robust and effective security culture, improving security education at all levels of the organisation reminding staff of the importance of this which is beginning to influence behaviours. Under the DE&S Transformation plan we have established a security specialism within the Corporate Services Group, developing career pathways and training, and delivering SQEP throughout the business, enabling supply chain security. Business continuity management and resilience issues continue to be reported to the quarterly Security Committee and our central Business Resilience team provides strategic direction on business continuity and resilience. Business Continuity Plans have also been developed across DE&S to ensure we can maintain and support an effective level of service. We recognise that we need to continue to improve the business continuity process and a programme of activity, including a business continuity exercise, is in place to improve and assure business continuity management across the business. Following our annual strategic risk stocktake, taking account of the outcome of the DIA audit, this risk was considered to be most effectively managed through the Security Committee.

### → **Occupational health, safety and environment**

Keeping our people, facilities, assets and equipment safe and secure is of critical importance to DE&S, and during 2016-17 we continued to develop and improve safety and security management across all our areas of responsibility. Significant resource was expended on preparing for Transformation, in particular standing up the Occupational Health, Safety & Environment (OHSE) Function which will provide DE&S with a dedicated community of specialists and subject matter experts. A major focus in 2016-17 was the continuing development of our robust and effective Safety Culture; in June 2016 we held our second annual DE&S Safety Day, with a range of activities for teams to choose from. To coincide with Safety Day, we rolled out a revised Safety Culture survey, and towards the end of the year a communication campaign was launched, focusing on known risk areas such as winter driving and slips, trips and falls. Following our annual risk stocktake this risk is no longer considered a DE&S strategic risk, but has been overtaken by the new risk on Infrastructure Compliance.

## Principal internal controls

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

### Financial

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

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

We implemented our finance internal controls and assurance framework, bringing greater structure to and increased confidence in our financial management processes. This included the introduction of a new Contracting, Purchase and Finance (CP&F) system in year. During 2015-16, as part of a cross-Government NAO review on the acceptance of gifts and hospitality, DE&S records and processes were reviewed. Though the review identified no serious weaknesses we took the opportunity during this financial year to refresh our policy and make it as robust as possible; our new policy will launch at the start of the 2017-18 financial year. We also held a review of travel and subsistence policy as part of a wider examination of our controls and assurance processes, taking the opportunity to provide comprehensive advice to the business, and the issue of updated guidance. These actions combined ensure that staff had reinforced guidance regarding propriety, ethics and personal accountability.

We have worked closely with KPMG this year and the DE&S BTE accounts for 2016-17 have now been

audited and concluded with an unqualified opinion. Since 2015-16 DE&S have introduced a new control framework to address previous audit issues. This has resulted in a number of new processes and controls aimed at improving the quality of our financial information and record keeping.

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

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

### Programme and project management

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

The assurance and endorsement of Investment Appraisals for Category A, B and centrally-approved Category C projects rests with Defence Economics. For Category C and D projects delivered by DE&S and approved by the Commands, responsibility rests with the Cost Assurance and Analysis Service Approval Team. The Defence Economics team regularly reports on the quality of a sample of DE&S-endorsed cases. In 2016, 100% of DE&S-approved Investment Appraisals were judged good or adequate.

Moving forward, we have already increased the use of P3M tools and techniques including EVM across a range of exemplar projects this year to measure and improve our performance and the management of our suppliers. EVM helps us to manage integrated baselines and against our commitments to the Front Line Commands to schedule, time and cost. We use these tools in accordance with the Association for Project Management methodology and industry best practice.

Industry engagement on the first wave of exemplar projects which span a wide range of project types and contractor interfaces was positive, we look to build on this during the year ahead.

### Commercial

Across DE&S, our teams proactively monitor and manage contracts with our suppliers, holding them to account for their committed obligations. If a supplier falls short of its commitments, or if it outperforms in a way that delivers additional benefit to the MOD, we act promptly and use the relevant remedy or reward provisions in the contract. We also continue to aim to pay all of our suppliers within five days to comply with the Government's prompt payment initiative. We continue work on the refinement of our contract management information processes – an ongoing key area of development in DE&S. During this financial year we have through Transformation activity improved our commercial processes and guidance. The central team established last year is driving this work forward in parallel with a broader commercial improvement programme aimed at driving efficiencies and greater effectiveness in how we conduct our business. Contract management is a whole team activity and this work has strategic level oversight, regularly reported at the DE&S Executive Committee.

We continue to build our overall capability under the Commercial Professionalism programme, our Commercial Function – long established as a defined function in DE&S – has 'stood up' in accordance with DE&S Transformation to be able to deliver the fundamental tenets of the Transformation Programme. We have made good progress during the year on the development and retention of commercial skills. Our new freedoms mean that we have been able to adapt how we recruit on a competitive basis, to successfully bring in a greater number of external candidates, in addition to nurturing and upskilling our existing people. At the end of 2016-17, 87 commercial staff had progressed through Chartered Institute of Purchasing and Supply Level 4. During 2017-18 we will be working on developing internal commercial measures to drive further performance improvements. This is likely to be an evolving process as it will involve truly understanding the management information we have available and our information needs as an organisation. This is to ensure that a robust, accurate and appropriate set of metrics are developed which are coherent with our management information strategy and can be interrogated to identify where performance improvements are required within the business, utilising one version of the truth.

## Safety, security and resilience

Keeping our people, facilities, assets and equipment safe and secure is of critical importance and, as such, across all areas of responsibility, we aim to continually develop and improve safety and security management. During 2015-16, to ensure rigorous review of our performance in this area, we introduced a corporate safety KPI to supplement our existing safety and environmental protection business performance indicators. Performance against this KPI was measured for the first time this year and more information is on page 21. More generally, we have sought to improve safety and security education at all levels of the organisation, reminding staff of the importance of an effective and robust culture, through both a dedicated annual event, now in its second year, and communication opportunities.

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

## Manpower and resources

We had a number of highlights this year further to the delivery of Transformation milestones. Our People Strategy, a key Transformation activity launched in March 2016, is designed to help us attract, develop, deploy and retain the skilled people we need. Progress against delivery of our People Strategy is being measured as part of the Transformation Programme governance. The People Committee, established during the last financial year meets regularly to consider and approve changes which are specific to DE&S people. We have seen the implementation phase of the balanced matrix construct and stand up of the functions – working to maximise our effectiveness and professional performance driven environment. Our people are now being deployed functionally and flexibly to task, according to their skillset and availability. This system will continue to mature over the coming year.

The next financial year will also see us embark on a new pay and reward system to further drive behaviours at an individual and organisational level and move to the performance driven culture we seek.

## Transformation

The DE&S Transformation Programme has been determined by the DE&S Transformation Committee, which reports to the Executive Committee and drove the programme to meet the match fit milestones by April 2017. The Committee will continue to manage the work to embed DE&S' transformation and realise planned efficiency savings. The Transformation Committee reviews progress, provides operational control and initiates actions to resolve barriers to progress of the delivery of project milestones, and this remains ongoing with a 2017-18 Transformation Plan in place focussed on enhancing delivery performance, increasing efficiency and productivity, implementing the new performance and reward framework and driving the delivery of financial benefits.

The Transformation Committee approves any changes to the milestone plan and provides assurance to the Executive Committee and the DE&S Board that any such change is manageable and risk has been properly assessed. The Committee also oversees the performance of the Managed Service Providers (MSPs).

## Information management

As part of the DE&S Transformation Programme, there has been an extensive review of information requirements, including reviewing how we attribute people's time, improved project information, and changes to workforce planning, skills and experience information. We are working on ways to identify practical measures that can be implemented to continue improving information management. During the past year we had an active program of work to improve information assurance maturity. This area remains one of our key improvements for our organisation.

## Quality assurance of analytical models

Recommendation four of the MacPherson review requires Accounting Officers' governance statements to confirm that an appropriate quality assurance framework is in place for analytical models. The MOD has been implementing the MacPherson report recommendations and DE&S has been part of the Department's Action Plan to strengthen the approach to quality assurance. The 2017 published list of business critical analytical models, including those in use in DE&S, is available

online at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/608067/2017H1\\_BCML\\_Amalgamated\\_OS\\_FINAL.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/608067/2017H1_BCML_Amalgamated_OS_FINAL.pdf)

The DE&S Cost Assurance and Analysis Service (CAAS) Modelling Centre of Excellence conducted a review of the quality assurance of the Business Critical Models listed for 2016-17. The review concluded that there is substantial assurance that the quality assurance of DE&S models has been conducted in a way that satisfies the requirements of HM Treasury and the recommendations from the MacPherson Review. This maintains the level of assurance given by CAAS for the 2015-16 and 2014-15 reviews. The CAAS Modelling Centre of Excellence works closely with the wider MOD on quality assurance, actively participating in a monthly MOD MacPherson Working Group.

### Annual assessment of governance

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

For 2016-17, whilst I am satisfied that we have in place an overall system of internal control in DE&S, we recognise that there are individual elements that require development. In this respect, I note the DE&S

Defence Internal Audit 2016-17 Annual Internal Audit Report and Government Furnished Equipment (GFE) Industry Annual Report which, although providing an overall substantial audit opinion, nevertheless reported issues in our operational processes, such as travel and subsistence expenses and gifts and hospitality. These issues are being addressed; new DE&S policies and processes regarding hospitality, travel and subsistence responsibilities have been put in place this year to reinforce appropriate behaviour and provide guidance and advice. GFE remains an area of significant risk, and to address this, changes plans are being developed and the end to end process being reviewed.

Improvements are largely due to work in the following key areas:

- Further strengthening our internal executive governance structure to enhance accountability. I also reviewed the effectiveness of our overall governance structure and concluded this is working well.
- Contracts management continues to be improved through Transformation activities with commercial policies and guidance issued.
- Implementation of the finance Internal Control and Assurance Framework- providing greater structure and increased rigour in our financial management processes.
- Risk policies and procedures updated; improving standards and our expectations for risk management across the organisation. The new project controls function will also improve risk management discipline. More information on strategic risk can be found on page 42.

Work will continue strengthening our internal governance and control mechanisms in 2017-18 and beyond, with the aim of further raising the level of assurance that we can provide.

## Chairman's assessment

By Paul Skinner, DE&S Chairman

I am satisfied that DE&S is operating within a solid governance and control framework. We have continued, over the course of the year, to embed further changes to our governance framework to ensure clear accountability and I am pleased that our internal auditors have, once again, recognised that our arrangements are suitably robust and effective. As this report shows, we acknowledge that, while we have continued to make progress, certain management controls require further development. In my view, this is reasonable given that DE&S is in its third year of operation as a BTE. I have seen, through the Board and relevant committees, that the necessary work is ongoing to address areas for improvement, including those identified by the NAO in the 2014-15 and 2015-16 financial statements and - importantly - to embed changes into our everyday way of working. We have revised our approach to risk management, financial internal control and have made assurance improvements. Overall, I remain confident that DE&S can deliver its objectives while complying with agreed standards, within delegated budgetary responsibility and accountability.

# REMUNERATION AND STAFF REPORT



## Remuneration policy

The following remuneration policy refers to the employment of the DE&S Directors on the DE&S Board and Executive Committee. Remuneration details for Min(DP) and MOD representatives on the Owner's Council and other DE&S Committees are not included as they are not paid by DE&S. Information on their remuneration can be found within the MOD Annual Report and Accounts. During 2016-17, three members of the DE&S Executive Committee were members of the Senior Civil Service (SCS), one was on secondment from Network Rail and three were senior officers of the Armed Forces.

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

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

The Committee advises Min(DP), the DE&S Board and the CEO on matters relating to the proper development and application of the DE&S total compensation strategy, including its pay structures, and as set out in the published Framework Document. It also advises the Board on the remuneration of the CEO, the top civilian executive team and other senior staff as appropriate, where these are not set by SCS or Departmental guidelines. More details of the responsibilities of the Remuneration Committee are on page 39.

## Performance and reward

The 2016-17 Statement of Comprehensive Net Expenditure reflects payments made or due to directors during the financial year. Salary and reward for the CEO was considered by the Permanent Secretaries' Remuneration Committee and, in common with that for other members of the SCS, was subject to the rules and regulations imposed by the Senior Salary Review Body and the Cabinet Office.

For staff in SCS pay band 1, we implemented separately negotiated performance-based base pay increases and non-consolidated performance award arrangements. Performance awards in 2016-17 were 5.4% of the total SCS pay band 1 salary costs.

For staff in SCS pay bands 2 and 3, we implemented separately negotiated performance-based base pay increases with potential to earn a non-consolidated performance award based on how well an individual had performed against their peers. Awards were made to individuals judged to have made the highest in-year contribution to business objectives. There is no restriction on the nature of the contribution; the only requirement is that it benefits DE&S, the Department or Defence more widely. Recommendations for awards, which are considered by moderation committees, must therefore be supported by demonstrable evidence of delivery. Performance awards in 2016-17 were 36.7% of the total SCS pay band 2/3 salary costs. Awards reported in the Remuneration Report tables for 2016-17 relate to performance in 2016-17, and comparative bonuses reported for 2015-16 relate to performance in 2015-16.

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

All senior (2\* and above) military officers are paid under the Performance Management and Pay System (PMPS). Depending on their performance, time in rank, and position on the pay scale, individuals can be awarded a single increment or no increment, and

progress accordingly up the incremental pay scale for their rank. The average value of one incremental rise under the PMPS was 2.6% in 2016-17 (it was also 2.6% in 2015-16).

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

## Senior manager contracts

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

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

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

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

Tony Douglas, CEO, from 1 December 2015, was appointed through open competition under the terms of the Civil Service Management Code on 15 September 2015. He was originally appointed with a three-year contract, with the possibility of an extension (subject to conditions) for a maximum of five years. Under the terms of his contract he is also eligible to earn a non-pensionable performance related payment of up to £250,000 per annum.

Mr Michael Bradley, Chief Financial Officer, was also appointed through open competition under the Civil Service Management Code on 3 January 2012. His initial contract of employment was for four years, it was extended on 3 January 2016 until 2 January 2020 with an option to extend, by mutual agreement, and subject to satisfactory performance.

Mr Nick Elliott, Director General Commercial took up post on 28 June 2016, he transferred into the Department on loan from Network Rail for a period of two years with an option to extend by a year at a time for an additional two years. DE&S do not pay Nick Elliott's salary, but do make a fixed sum contribution paid to Network Rail on a quarterly basis. This fixed sum goes towards covering his employment costs.

## Management

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

## Key achievement

### **P-8A Maritime Patrol Aircraft**

*In July 2016 we committed to the purchase of nine new Maritime Patrol Aircraft (MPA) for the RAF. This key procurement – coming less than nine months after the Government announced its intention to buy these aircraft – demonstrated agility, professionalism, and drive by DE&S, working closely with colleagues across MOD and the US Navy to secure this solution to fill our MPA capability gap.*

*The MPA will protect the UK's nuclear deterrent and the UK's two new aircraft carriers. They will also be able to locate and track hostile submarines, and will enhance the UK's maritime Search and Rescue capability. This capability will also bring economic benefits to Scotland and the wider UK, with an additional 400 personnel based at RAF Lossiemouth.*



## DE&amp;S Board and senior executive remuneration, taxable benefits-in-kind and pension benefits (subject to audit)

DE&S Executive Directors	2016-17					2015-16				
	Salary <sup>1</sup> (£000)	Annual performance <sup>3</sup> award (£000)	Benefits- in-kind (nearest £100)	Pension benefits <sup>2</sup> (£000)	Total (£000)	Salary (£000)	Annual performance <sup>3</sup> award (£000)	Benefits- in-kind (nearest £100)	Restated Pension benefits <sup>2</sup> (£000)	Restated Total (£000)
Mr Tony Douglas <sup>4</sup> (from 1 December 2015)	285-290	220-225	-	110	620-625	95-100 [285-290]	90-95	-	37	225-230
Sir Bernard Gray <sup>5</sup> (from 1 April 2014 to 30 November 2015)	-	-	-	-	-	145-150 [220-225]	45-50	16,700	56	270-275
Mr Michael Bradley (from 1 April 2014)	180-185	85-90	-	74	340-345	165-170	50-55	-	69	290-295
Vice Admiral Simon Lister (from 1 April 2014)	140-145	-	-	149	290-295	135-140	-	-	46	180-185
Lieutenant General Paul Jaques (from 3 April 2016)	130-135	-	-	141	270-275	-	-	-	-	-
Lieutenant General Sir Chris Deverell <sup>6</sup> (from 1 April 2014 to 4 April 2016)	0-5 [150-155]	-	-	1	0-5	145-150	-	-	52	200-205
Air Marshal Julian Young (from 29 April 2016)	120-125 [130-135]	-	-	128	245-250	-	-	-	-	-
Air Marshal Sir Simon Bollom <sup>7</sup> (from 1 April 2014 to 23 June 2016)	30-35 [145-150]	-	-	23	55-60	140-145	-	-	57	200-205
Mr Pete Worrall (from 1 April 2014)	150-155	55-60	-	67	270-275	140-145	40-45	-	197	380-385
Mr Nick Elliott <sup>8</sup> (from 28 June 2016)	170-175 [220-225]	80-85	-	-	250-255	-	-	-	-	-
Ms Susanna Mason <sup>9</sup> (from 1 July 2014 to 29 February 2016)	-	-	-	-	-	160-165 [175-180]	30-35	-	-	190-195

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

<sup>2</sup> The value of pension benefits accrued during the year is calculated as the increase in pension multiplied by 20, plus the real increase in any lump sum less the contributions made by the individual. The real increase excludes increases due to inflation or any increase or decrease due to a transfer of pension rights.

<sup>3</sup> Military terms and conditions do not include provision for a performance award. Bonuses are based on performance levels attained and are made as part of the appraisals process. The bonuses reported in 2016-17 relate to performance in 2016 and the comparative bonuses reported for 2015-16 relate to the performance in that year.

<sup>4</sup> The 2015-16 salary banding for Mr Douglas reflects the actual salary received from his appointment as CEO on 1 December 2015. The value in brackets reflects his annual equivalent salary. Mr Douglas was paid a salary between £70,000 and £75,000 between September 2015 and his formal appointment as CEO on 1 December 2015 encompassing a handover period. Salary in 2016-17 reflects his full annual salary. 2015-16 remuneration totals have been updated to reflect the fact that Mr Douglas received a performance award in 2015-16 for work undertaken after he became CEO on the 1st December 2015, this information was not available at the time the accounts were formally published.

<sup>5</sup> Sir Bernard Gray has been included in the table for comparison only, his formal appointment came to an end on the 30 November 2015 at which time Tony Douglas took up the position of CEO. The salary banding for Sir Bernard Gray shown in 2015-16 reflects actual salary received until 30 November 2015 when he left his role as CEO. The value in brackets reflects his annual equivalent salary.

<sup>6</sup> Lieutenant General Sir Chris Deverell's salary reflects the actual remuneration received from his appointment as Chief Material of Land until 4 April 2016. The value in brackets reflects his annual equivalent salary.

<sup>7</sup> Air Marshal Sir Simon Bollom's salary and pension costs reflects the actual salary received from his appointment as Chief Material of Air until 23 June 2016. The value in brackets reflects his annual equivalent salary.

<sup>8</sup> Salary value for Nick Elliott reflects the contribution DE&S makes towards his Network Rail remuneration package, the value in brackets reflects his annual equivalent salary following his appointment on the 28th June. In addition to his salary DE&S make further contributions towards his Network Rail allowances (total value £17,000) and paid a performance award of £94,000. There are no pension costs included as his pension costs are included in the Network Rail pension scheme as part of the department for Transport's Annual Report and Accounts.

<sup>9</sup> Susanna Mason's salary has been included in the table for comparison only, her formal appointment came to an end on the 29 February 2016.

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

DE&S Non-Executive Directors <sup>1</sup>	2016-17 Salary (£000) <sup>2</sup>	2015-16 Salary (£000) <sup>2</sup>
Mr Paul Skinner <sup>3</sup>	-	-
Mr Paul Smith	25-30	25-30
Mr Andrew Wolstenholme <sup>3</sup>	-	-
Mr James Dorrian	25-30	25-30
Mr Stephen Lovegrove <sup>4</sup> (from April 2016)	-	-
Mr Jon Thompson <sup>5</sup> (from April 2014 – April 2016)	-	-
Lt General Mark Poffley <sup>6</sup>	-	-
Dr Ros Rivaz <sup>7</sup> (From January 2017)	5-10 (25-30 annually)	-
Mr Iain Lanaghan <sup>7</sup> (from January 2017)	5-10 (25-30 annually)	-
Air Marshal Sir Stephen Hillier <sup>8</sup> (from April 2014 to January 2016)	-	-
Ms Kathleen Harmeston <sup>9</sup> (from February 2015 to January 2016)	-	10-15 (25-30 annually)

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

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

<sup>3</sup> Mr Skinner and Mr Wolstenholme waived their fees for their DE&S Board membership.

<sup>4</sup> Mr Lovegrove received no remuneration for DE&S Board membership as he is a MOD employee. His salary details are reflected in the MOD Annual Report and Accounts.

<sup>5</sup> Mr Jon Thompson has been included for comparison purposes only; he left his role as permanent Secretary in April 2016 and was replaced by Stephen Lovegrove.

<sup>6</sup> Lt Gen Poffley received no remuneration for DE&S Board membership as he is a MOD employee. His salary details are reflected in the MOD Annual Report and Accounts.

<sup>7</sup> Dr Ros Rivaz and Iain Lanaghan joined the DE&S Board in January 2017 – their remuneration reflects amounts paid in 2016-17.

<sup>8</sup> Air Marshal Sir Stephen Hillier has been included for comparison purposes only; he left his role in January 2016 and was replaced by Lt General Mark Poffley.

<sup>9</sup> Ms Kathleen Harmeston has been included for comparison purposes only; she recused herself from DE&S Board membership in January 2016.

## Key achievement

### **Dreadnought programme**

*In October 2016, the Defence Secretary announced that the lead boat and class name for the first of the UK's new nuclear deterrent submarines will be Dreadnought. This followed our work to move the programme on to the delivery phase, agreeing around £1.3 billion of investment with BAE Systems to construct the most advanced nuclear-armed submarine ever conceived by the Royal Navy.*

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

	Total accrued pension at pension age [and related lump sum] as at 31 March 2017 [£000]	Real increase in pension [and related lump sum] in 2016-17 [£000]	CETV <sup>1&amp;2</sup> as at 31 March 2016 or last date if later [£000]	CETV as at 31 March 2017 or on cessation of employment if earlier [£000]	Real increase in CETV <sup>3</sup> [000]
Mr Tony Douglas	10-15 [Nil] <sup>5</sup>	5-7.5 [Nil]	46	129	58
Mr Michael Bradley	20-25 [Nil] <sup>5</sup>	2.5-5 [Nil]	238	301	36
Vice Admiral Simon Lister	80-85 [240-245]	5-7.5 [17.5-20]	1,889	2,025	136
Lieutenant General Paul Jaques	65-70 [195-200]	5-7.5 [17.5-20]	1,524	1,659	135
Lieutenant General Sir Chris Deverell (from 1 April 2014 to 4 April 2016)	70-75 [220-225]	0-2.5 [0-2.5]	1,873	1,874	1
Air Marshal Sir Simon Bollom (from 1 April 2014 to 23 June 2016)	70-75 [215-220]	0-2.5 [2.5-5]	1,771	1,796	25
Air Marshal Julian Young (from 29 April 2016)	65-70 [200-205]	5-7.5 [15-17.5]	1,633	1,755	122
Mr Pete Worrall	65-70 [200-205]	2.5-5 [10-12.5]	1,296	1,416	60
Mr Nick Elliot <sup>4</sup>	-	-	-	-	-

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

<sup>2</sup> Military CETV as at 31 March 2016 is different to that reported in the 2015-16 accounts due to retrospective changes in basic salary details with effect from 1 April 2016 that were applied after the pension calculations were provided for the 2015-16 accounts.

<sup>3</sup> This reflects the increase in CETV that is funded by the employer. It does not include the increase in accrued pension due to inflation or contributions paid by the employee and uses common market valuation factors for the start and end of the period.

<sup>4</sup> Mr Nick Elliott is on loan from Network Rail and is a member of the Network Rail Pension Scheme. Details and costs of the pension scheme are separately reported in the Department for Transport's Annual Report and Accounts.

<sup>5</sup> Mr Tony Douglas and Mr Michael Bradley are both members of the Alpha pension scheme; this scheme does not give an employee an automatic right to a lump sum payment, should the employee choose to take a lump sum they will be able to do so at a rate of £1 of annual pension in exchange for every £12 lump sum, subject to HMRC limits.

## Pay multiples (subject to audit)

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

The civilian multiple uses a median based on civil service pay, agency staff covering permanent posts are excluded due to a lack of available data. Annual equivalent remuneration includes salary, benefits in kind allowances (if any) and non-consolidated performance-related pay. It excludes severance and compensation payments, employer pension contributions, compensation payments and the Cash Equivalent Transfer Value (CETV) of pensions.

	2016-17	2015-16
Mid-point of the £5,000 band for the annual equivalent remuneration of the highest earning military Board member in the tables above	142,500	147,500
Median total remuneration of armed forces personnel	48,359	51,609
Military pay ratio	2.95	2.86
Mid-point of the £5,000 band for the annual equivalent remuneration of the highest earning civilian board member in the tables above	512,500	297,500
Median total remuneration of civilian staff	33,452	32,644
Civilian Pay Ratio	15.32	9.11

In 2016-17 the remuneration of military employees (annual equivalent salary) ranged from £20,939 to £152,500. Two members of the Board had full time equivalent salaries in excess of £142,500. Both were in post for less than three months of the beginning of the financial year. The highest paid senior military member who was in post and held this position in DE&S for the full financial year has, therefore, been used in the median pay calculation. The military pay ratio has increased due to a decrease in the median pay of the rest of the Armed Forces as a result of a reduction in the number of higher paid personnel.

In 2016-17 the remuneration of civilian employees (annual equivalent salary) ranged from £15,681 to £512,500, and no civilian employees received remuneration in excess of the highest paid director (nil in 2015-16 as well). The civilian pay ratio has increased due to an increase in the remuneration of the highest earning Civilian Board member which has increased to £512,500. The increase in the civilian median is both as a result of the standard pay award implemented in 2016-17 plus higher starting salaries for new employees.

## Staff report

### Staff numbers

The number of full time Senior Civil Servant (SCS) staff employed by pay band as at the end of the financial year:

SCS Pay Band	2016-17	2015-16
Band 1	109	77
Band 2	16	12
Band 3 and above	3	3
<b>Total</b>	<b>128</b>	<b>92</b>

The increase in the number of SCS continues to reflect the implementation of the organisational design requirements for delivery and forward management of the DE&S Transformation Programme. The increases have largely been in HR as a result of DE&S standing up its own HR function and SCS staff supporting the creation of Domains and Domain accounting.

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

	2016-17	2015-16
Permanent Staff	11,498	11,406
Contingent Labour	358	292
<b>Total</b>	<b>11,856</b>	<b>11,698</b>

The increase in the reported numbers of permanent staff is linked to the organisational design requirements and the fact DE&S are aiming to build up workforce resilience to reduce dependency on private sector support. Contingent labour increased in 2016-17 as many of the Transformation Programmes supported by

the Managed Service Providers (MSPs) were concluded, resulting in an increase in activity and costs in order to complete this activities in line with the agreed timetable .

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

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

Staff costs comprise:	2016-17			2015-16		
	Permanently employed £000	Contingent labour £000	Total £000	Permanently employed £000	Contingent labour £000	Total £000
Salaries and wages	461,318	42,584	503,902	454,562	27,119	481,681
Social security costs	47,077	-	47,077	35,457	-	35,457
Other pension costs	112,261	-	112,261	109,099	-	109,099
<b>Total</b>	<b>620,656</b>	<b>42,584</b>	<b>663,240</b>	<b>599,118</b>	<b>27,119</b>	<b>626,237</b>

Staff costs have increased as a result of an overall increase in the number of individuals employed by DE&S in 2016-17. The increase in social security costs is as a direct result of a 3.5% increase in employer NI contributions due to the abolishment of the NI rebate in 2016-17.

#### Principal Civil Service Pension Scheme

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

Contributions to the PCSPS in 2016-17 were calculated at one of four rates in the range 20.0% to 24.5% of pensionable pay, based on salary bands. The scheme's Actuary reviews employer contributions every four years following a full scheme valuation. The salary bands and contribution rates were revised for 2015-16 and will remain unchanged in 2017-18. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme.

Employees can also opt for a partnership pension account; employer contributions are age related and range from 8-14.75% depending on the age of the member. Employers also match employee contributions up to 3% of pensionable pay. Further details about the Civil Service pension arrangements can be found at the website <http://www.civilservicepensionscheme.org.uk/>.

## Armed Forces Pension Scheme

The Armed Forces Pension Scheme (AFPS) is an unfunded, non contributory, defined benefit, salary related, contracted out, occupational scheme. As such, this scheme is not consolidated in the accounts, separate accounts are prepared details of which can be found at <https://www.gov.uk/government/publications/armed-forces-pension-scheme-annual-accounts-2016-to-2017>.

Employer's contribution rates are determined by the Government Actuary. For 2016-17, the employer's contribution rates remained the same as 2015-16 at 53.4% of pensionable pay for officers and 52.0% of pensionable pay for other ranks. These include a contribution towards the Armed Forces Compensation Scheme (AFCS) at 1% for officers and 2.4% for other ranks. No changes to the contribution rates are expected until 2019-20. Further information on the AFPS and the AFCS can be found at: <https://www.gov.uk/guidance/pensions-and-compensation-for-veterans>.

Scheme members are entitled to a taxable pension for life and a tax-free pension lump sum if they leave the regular Armed Forces at or beyond normal retirement age. Those who have at least two years' service and who leave before age 55 will have their pensions preserved until age 60 or 65 depending on the scheme. The Scheme also includes an Early Departure Payment (EDP) scheme for those who leave before age 55 providing they have at least 18 years' service and are at least 40 years of age. The EDP Scheme pays a tax-free lump sum and income of between 50% and 75% of preserved pension between the date of the individual's departure from the Armed Forces and age 55.

## Staff sickness

We are committed to the health and wellbeing of our staff and have a comprehensive sickness absence policy. During 2016-17 the average number of days for sickness absence was 6.2 days per employee, compared to 6.5 days in 2015-16. This is a drop from last year and compares favourably with the MOD average of 7.6 days. The launch of a revised sickness policy in February 2015 has ensured that we now have a robust, clearly understood procedure for managing sickness absence, and our HR Business Partners continue to work closely with staff to ensure that sickness absence is dealt with appropriately and in accordance with our policy.

## Staff policies

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

During 2016-17 we strengthened our Inclusion, Diversity and Outreach approach in DE&S, with clear objectives and a governance structure headed by COM (Land) and reporting into our People Committee.

Our Inclusion, Diversity and Outreach strategy looks to:

### Inclusion:

- Ensure staff regardless of who they are, where they come from or how they think are able to be themselves and achieve their potential.

### Diversity:

- Seek to increase diversity across our organisation to improve individual and organisational performance.

### Outreach:

- Develop and deliver a unified corporate outreach strategy and approach attracting and engaging with a greater diversity of future talent.

This year our employee networks continued to provide support and guidance to their membership, improving inclusiveness for staff at DE&S and engaging new and diverse talent. These include the Multi-Cultural Communities, LGBT, Gender and Disability Networks. During 2016-17 two new networks were established: the Neuro-Inclusion Network for people who think differently (covering conditions such as Autism and dyslexia); and the Next Generation Network, which provides support and development opportunities for early career professionals.

We are part of the wider Defence Youth Engagement Programme delivering initiatives through outreach. This year for the first time we were at the Big Bang Fair in the NEC engaging with the 80,000 students who attended. sharing our equipment and technical experience to inspire our next generation. We have over 100 Science Technology Engineering and Maths Ambassadors supporting various initiatives in local schools. During the year DE&S was also proud, for the first time, to be at Pride Bristol.

We have improved the way we make decisions introducing inclusive decision making approaches to maximise the success of delivery where any changes impacts on people. This has covered all our new policies and major people decisions to improve the lived experience of our staff.

The tables below reflect changes to the civilian composition of the organisation by protected characteristics over the year.

### Staff breakdown

	1 April 2016	1 April 2017
<b>Civilian total<sup>1,2</sup></b>	<b>9,845</b>	<b>10,799</b>
<b>Gender</b>		
Female	3,056	3,468
Percentage female	31%	32%
<b>Ethnicity<sup>3</sup></b>		
Black and minority ethnic	360	432
% Black and ethnic	4%	4%
<b>Disability<sup>3</sup></b>		
Declared a disability	648	692
	6.6%	6%
<b>Sexual orientation<sup>3</sup></b>		
Lesbian, gay, bisexual	106	158
	1%	1%
<b>Religion or belief<sup>3</sup></b>		
Non Christian	279	305
% Non Christian religion	3%	3%
Secular	2,293	2,582
	23%	24%
Christian	3,721	3,803
	38%	35%

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

	1 April 2016	1 April 2017
Total DE&S Board and Executive Committee <sup>4,5</sup>	12	19
Female	0	2 <sup>6</sup>
Male	12	17
% Female	0%	11%
% Male	100%	89%

### Gender breakdown over the year at SCS level

	1 April 2016	1 April 2017
Total DE&S SCS	92	128
Female	20	31
Male	72	97
% Female	22%	24%
% Male	78%	76%

<sup>4</sup> The April 2016 figures do not include Ms Kathleen Harneston, who recused herself from Board duties in January 2016.

<sup>5</sup> The April 2017 figures include DG HOCS, who attends in place of the Permanent Secretary. The new Executive Committee structure is explained on page 40.

<sup>6</sup> Including Julie Taylor when representing the Permanent Secretary at the DE&S Board.

## Civil Service and other compensation schemes exit packages

The figures in the following table include redundancy and other departure costs paid in accordance with the Civil Service Compensation Scheme (CSCS). Where DE&S has agreed early retirements, the costs are met by DE&S and not by the Civil Service Pension Scheme. There were 39 non-compulsory redundancies in 2016-17, none of these were individuals retiring early on ill health grounds.

For staff leaving under voluntary exit or voluntary redundancy terms the cost includes any top-up

compensation provided by DE&S to buy-out the actuarial reduction on an individual's pension as well as the compensation payments.

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

## Civil Service and Other Compensation Schemes exit packages<sup>1</sup> (subject to audit)

Numbers in brackets are 2015-16 comparators restated

Exit package cost band	Number of compulsory redundancies	Number of other departures agreed	Total number of exit packages by cost band
<£10,000	-	1	1
	-	(5)	(5)
£10,000 - £25,000	1	14	15
	-	(9)	(9)
£25,000 - £50,000	2	11	13
	-	(11)	(11)
£50,000 - £100,000	-	17	17
	(1)	(15)	(16)
£100,000 - £150,000	-	5	5
	-	(-)	(-)
£150,000 - £200,000	-	-	-
	-	(2)	(2)
£200,000 - £250,000	-	-	-
<b>Total number of exit packages</b>	<b>3</b> <b>(1)</b>	<b>48</b> <b>(42)</b>	<b>51</b> <b>(43)</b>
<b>Total resource cost (£000)</b>	<b>98</b> <b>(62)</b>	<b>2,446</b> <b>(2,037)</b>	<b>2,544</b> <b>(2,099)</b>

<sup>1</sup>Five individuals with agreed exit packages who were included in the 2015-16 accounts but did not leave the Department until 2016-17 (total value £515,000); the 2015-16 values have been restated to reflect the delay in leaving dates. During 2016-17 DE&S was informed by MyCSP of two individuals who had left in 2014-15, and two who left in 2015-16, where DE&S had not been notified at the time. The total value of these exit packages relating to each year was £50,000 and £46,000 respectively, and these individuals and their respective costs are included in the 2016-17 figures above. One individual included in the 2015-16 accounts was charged in 2015-16. MyCSP have notified DE&S that this individual did not leave the Department, as such the 2015-16 figures have been restated to reflect this and other adjustments.

In addition to the exit packages detailed above, DE&S may occasionally make use of early release schemes to reduce the number of civilian staff who are not members of the CSCS. No such usage was made during 2016-17.

### **Expenditure on consultancy and temporary staff**

The DE&S operating cost envelope includes the engagement of contingent labour (also known as manpower substitution) and other external support defined as Private Sector Support.

Contingent labour relates to individuals who are employed by DE&S on a demand basis to fill vacancies within the organisation. This includes independent contractors and consultants who are excluded from the DE&S payroll because they are not permanent employees of the Department. The costs of contingent

labour are shown as a separate entry in the staff costs at note 2 to the accounts.

Private Sector Support is defined by DE&S as external support to supplement DE&S capacity and capability to manage its programme of work. This includes packages of work aimed at delivering business improvements in line with DE&S Transformation initiatives. Private Sector Support within DE&S includes consultancy assistance and other external support provided through the MOD Framework Agreement for Technical Support (FATS). Private Sector Support is also used within DE&S to address resource and skills gaps in our projects and logistics management capability. A breakdown and prior year comparator is shown at note 3 to the accounts.

## **Key achievement**

### **Type 26 frigates**

*The 2015 Strategic Defence and Security Review (SDSR15) set out the UK Government's commitment to build eight Anti-Submarine Type 26 Global Combat Ships. In November 2016, we announced that construction will begin in summer 2017. The new generation of warships for the Royal Navy will also be fitted with the Sea Ceptor self-defence missile system – the result of a further £100 million contract we negotiated with MBDA to deliver the defensive weapon for the ship.*



## High paid off-payroll appointments

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

Government policy is that individual departments must exercise governance over such appointments where the appointees are not engaged directly on departmental payrolls. DE&S senior off- payroll appointees have been requested to provide assurance that they paid the right amount of tax and National Insurance contributions in 2016-17.

There were no off-payroll engagements of Board members or senior executives with significant financial responsibility between 1 April 2016 and 31 March 2017.

The following table provides an analysis of all extant off-payroll engagements as of 31 March 2017, paid more than £220 per day and have been in place for more than six months.

	Defence Equipment & Support Bespoke Trading Entity
Number of existing arrangements as of 31 March 2017	198
<i>Of which</i>	
No. that have existed for less than one year at time of reporting.	128
No. that have existed for between one and two years at time of reporting.	58
No. that have existed for between two and three years at time of reporting.	9
No. that have existed for between three and four years at time of reporting.	3
No. that have existed for four or more years at time of reporting.	0

The following table provides an analysis of all new off-payroll engagements, or those that reached six months in duration, between 1 April 2016 and 31 March 2017, paid more than £220 per day and that last for longer than six months.

	Defence Equipment & Support Bespoke Trading Entity
No. of new engagements, or those that reached six months, between 1 April 2016 and 31 March 2017	262
No. of the above which include contractual clauses giving the department the right to request assurance in relation to income tax and National Insurance obligations	262
No. for whom assurance has been requested	262 <sup>1</sup>
<i>Of which</i>	
No. for whom assurance has been received	85
No. for whom assurance has not been received	177 <sup>2</sup>
No. that have been terminated as a result of assurance not being received.	0

<sup>1</sup> DE&S sought assurance from all its high-paid off-payroll appointees that they paid the right amount of income tax and National Insurance contributions on work undertaken for DE&S during the 2016-17 financial year, except where they were also in scope of governance in 2015-16 and either;

a) Provided satisfactory assurance and left post early in the 2016-17 financial year (by 31 July 2016) or

b) Were referred to HM Revenue and Customs for failing to provide satisfactory assurance and have already left the Department.

In the interest of good governance, we have also sought assurance from appointees engaged under legacy contracts which do not include specific provision to seek evidence of compliance with the tax legislation. All new appointees on these legacy contracts are being asked to sign a declaration on taking up a DE&S engagement that they are compliant with the tax legislation and that they agree to provide the appropriate evidence of compliance when asked.

<sup>2</sup> In relation to the outstanding 177 for whom assurance has not been received, all off-payroll staff have either left the organisation or have been moved onto payroll to comply with the new Off- Payroll intermediaries legislation, introduced from 6 April 2017. This activity was supported by an extensive PwC review exercise of our manpower substitute base. In the interests of further governance, where satisfactory assurance is not forthcoming, DE&S will refer the appointees to HMRC.





# PARLIAMENTARY ACCOUNTABILITY AND AUDIT REPORT

## Parliamentary accountability report

In 2016-17 we responded to 318 Parliamentary Questions and 488 pieces of Ministerial and Treat Official correspondence from Members of Parliament, Peers and the public, meeting our departmental targets for on-time delivery. We also provided briefing in support of a range of Parliamentary business including House of Commons Defence Committee inquiries into Defence Acquisition and Naval Procurement, and a Public Accounts Committee inquiry into the Defence Equipment Plan. Key subject areas were shipbuilding, steel procurement, helicopters, legal claims, the sale of the former HMS Illustrious, Atomic Weapons Establishment pensions and contingent liabilities.

We continue to fulfil our statutory responsibilities under the Freedom of Information Act 2000 in responding to requests for information from members of the

public. During 2016-17 we answered 819 requests for information, again meeting our departmental target for on-time delivery. Interest in DE&S activities remains high, with requests covering a wide range of DE&S business, with particular interest in submarines, nuclear issues and defence contracts.

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

## Remote contingent liabilities (subject to audit)

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

## Regularity of expenditure (subject to audit)

All material expenditure and income incurred by DE&S during 2016-17 was in accordance with the requirements of Treasury and other Government guidance.

## Losses and special payments (subject to audit)

Losses and special payments are unpredicted, as such Parliament cannot envisage when funding is required

to cover these costs. They are emergent in nature arising as a result of an unexpected incident or failure of process, as such they are subject to a higher level of scrutiny and approval than would be the case for normal business transactions.

Losses during the year totalled £200,000 these costs were predominantly related to low value fruitless payments related to late hotel cancellations and unused rail tickets. There were no significant or separately reported losses requiring separate disclosure in 2016-17.

## Losses statement

	2016-17	2015-16
<b>Volume of Cases</b>		
Fruitless Payments (volume of cases)	556	518
Fruitless Payments (value £000)	199	643
Cash Losses (volume of cases)	1	3
Cash Losses (value £000)	-	-
Stores Losses (volume of cases)	9	1
Stores Losses (value £000)	1	1
Claims Waived or Abandoned (volume of cases)	-	2
Claims Waived or Abandoned (value £000)	-	4
<b>Total number of losses</b>	<b>566</b>	<b>524</b>
<b>Total value of losses (£000)</b>	<b>200</b>	<b>647</b>

<b>Details of Closed Cases £300,000:</b>	2016-17	2015-16
Fruitless payment	-	-
Penalty fine from HM Revenue and Customs on Value Added Tax	-	536

## Special payments

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

	2016-17	2015-16
Total number of special payments	5	7
Total value of special payments (£000)	45	281

## Long term expenditure trend by category

	Estimate 2018-19	Estimate 2017-18	Outturn 2016-17	Outturn 2015-16
Total Departmental Expenditure Limit DE&S BTE (£M)	1,018	1,083	1,141	1,111



Tony Douglas  
Accounting Officer  
26 October 2017

## Key achievement

### Young Project Professional of the Year Award

Our Helicopters Operating Centre built on their success at the 2015-16 Association for Project Management (APM) awards, which showcase project management talent and delivery success. DE&S's Josh Macey from the Special Project Multi Air Platform team won the prestigious national Young Project Management Professional of the Year award - beating talented young project managers from across the public and private sector. The award recognised Josh's leadership and project management skills, demonstrated in the on-time delivery of a 10-year, £180 million Search & Rescue and Support Helicopter capability in the Falkland Islands. Josh showed commitment to overcome challenges and skilfully navigated risks and emergent issues to see the project delivered.

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

I certify that I have audited the financial statements of Defence Equipment & Support for the year ended 31 March 2017 under the Government Resources and Accounts Act 2000. The financial statements comprise: the Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity; and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration and Staff Report and Parliamentary Accountability disclosures that are described in those reports as having been audited.

#### **Respective responsibilities of the Accounting Officer and auditor**

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

#### **Scope of the audit of the financial statements**

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

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

#### **Opinion on regularity**

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

#### **Basis for qualified opinion on the financial statements**

In 2015-16, Defence Equipment and Support was unable to provide me with sufficient and appropriate audit evidence to support the private sector support costs and other programme costs totalling £499 million recorded in the Statement of Comprehensive Net Expenditure. My audit opinion on the financial statements for the year ended 31 March 2016 was qualified because the audit evidence available to me was limited.

In response, Defence Equipment and Support implemented an improvement programme which strengthened its financial management systems, processes and controls over private sector support costs and other programme costs. Consequently, Defence Equipment and Support was able to provide me all the information, explanations and evidence that I needed to conclude that the 2016-17 private sector support costs and other programme costs are

free from material misstatement. The improvement programme was not designed to revisit the 2015-16 costs, and as a consequence I have qualified my opinion on the 2015-16 comparative figures for private sector support costs and other programme costs recorded in the Statement of Comprehensive Net Expenditure.

## Qualified opinion on the financial statements

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

- the financial statements give a true and fair view of the state of the Defence Equipment & Support's affairs as at 31 March 2017 and of the total net expenditure for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions issued thereunder.

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

## Opinion on other matters

In my opinion:

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

## Matters on which I report by exception

In respect solely of the limitation of scope on my work relating to the 2015-16 private sector support costs and other programme costs, as described in the basis of qualified opinion paragraph above:

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

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

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

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

**Date 23 November 2017**

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

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

### Introduction

Defence Equipment & Support (DE&S) is a key part of the Ministry of Defence (MOD) Operating Model, responsible for managing the acquisition and through-life support of the MOD Equipment Programme. It was established in April 2014, classified as an Executive Agency of the MOD, and operates as a Bespoke Trading Entity (BTE), a status designed to strengthen the customer-supplier relationship with the military, provide it with freedoms over recruitment and reward, and to support the identification of efficiencies in costs. These financial statements report the costs incurred by DE&S in delivering its programme of project and logistics management in line with its operating cost boundary as defined by the Framework Document and the Letter of Delegation issued by the MOD Permanent Secretary to the DE&S Chief Executive.

DE&S maintains financial systems which record both DE&S and MOD related costs (the latter being outside the DE&S accounting boundary). As a result, in preparing its financial statements DE&S has to perform an analysis of its accounting records to identify and include only those costs that relate to DE&S. This particularly impacts the calculation of private sector support costs (external procurement to support project management and logistics capability) and other programme costs (travel and subsistence, training and office running costs). For the first two years of operation the control framework was insufficiently developed to support the accurate allocation of costs and I qualified my opinion on the first two years financial statements.

This report explains the steps that DE&S have taken to remove these previous qualifications.

### Action taken by DE&S in response to my previous qualifications

In 2014-2015 I qualified my opinion on the financial statements due to a limitation on the scope of my audit. This arose because DE&S were unable to provide me with sufficient and appropriate audit evidence to enable me to confirm whether or not the private sector support costs, other programme costs, and the related trade and other payables balances recorded in the financial statements were free from material misstatement. In response, DE&S engaged in a programme designed to remove the qualifications in a staggered manner, focussing initially on the trade and other payable balances.

During the last quarter of 2015-16 and into 2016-17, DE&S introduced a number of additional controls including: the publication of a series of financial instructions; the increased use of exception reporting and reconciliations in order to monitor the volume of journal adjustments and the coding of primary data; enhanced staff training; and the operation of a Private Sector Support Steering Group to discuss contracts where the allocation between DE&S and MOD costs may be unclear, supported by business case reviews and supplier validation exercises that focus on boundary definition.

As a result of these initiatives, in 2015-16 DE&S was able to support the closing trade and other payables balances, enabling me to remove my qualification in this area. However, as the new controls were only introduced in the last quarter of 2015-16, DE&S was not yet able to provide me with sufficient evidence to support the in year expenditure, and so my opinion was again qualified because of a limitation of scope.

The operation of the new control environment for the entire 2016-17 financial year has resulted in DE&S being able to provide me with adequate evidence to enable me to confirm that the 2016-17 private sector support costs and other programme costs shown in the Statement of Comprehensive Net Expenditure are free from material misstatement. As such I have been able to remove my qualifications on these transactions.

## **Explanation for limitation of scope in respect of comparative figures**

Given the considerable time and effort expended by DE&S in supporting this year's figures, DE&S decided not to revisit the comparative private sector support costs and other programme costs which were subject to my qualified opinion in 2015-16. Consequently, DE&S was unable to provide me with adequate evidence to enable me to confirm whether these costs are free from material misstatement. As a consequence, I have qualified my opinion in respect of the 2015-16 comparative figures of private sector support costs and other programme costs totalling £499 million reported in the Statement of Comprehensive Net Expenditure.

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

**Date 23 November 2017**

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



# Section Three

## **The Financial Statements**

**STATEMENT OF COMPREHENSIVE NET EXPENDITURE  
FOR THE YEAR ENDED 31 MARCH 2017**

	Note	2016-17 £000	Restated 2015-16 £000
<b>Expenditure - Direct Programme Costs</b>			
Direct staff costs	2	663,240	626,237
Private Sector Support costs	3	406,389	426,729
Other programme costs	4	81,425	72,758
<b>Total Direct Programme Costs</b>		<b>1,151,054</b>	<b>1,125,724</b>
<b>Income - Direct Programme</b>	5	<b>(20,380)</b>	<b>(14,823)</b>
<b>Net Direct Programme Expenditure</b>		<b>1,130,674</b>	<b>1,110,901</b>
<b>Expenditure - Non-Cash Items</b>			
Communicated costs from other MOD organisations	6	107,892	111,568
Auditors' remuneration	7	215	219
		<b>108,107</b>	<b>111,787</b>
<b>Total Net Expenditure</b>		<b>1,238,781</b>	<b>1,222,688</b>

The notes on pages 76-89 form part of these accounts.

**STATEMENT OF FINANCIAL POSITION  
AS AT 31 MARCH 2017**

	Note	2016-17 £000	2015-16 £000
<b>Non-current assets</b>			
Intangible Fixed Assets	8	11,731	5,941
<b>Total Non-current assets</b>		<b>11,731</b>	<b>5,941</b>
<b>Current assets</b>			
Trade and other receivables	9	8,091	5,813
<b>Total Current Assets</b>		<b>8,091</b>	<b>5,813</b>
<b>Total assets</b>		<b>19,822</b>	<b>11,754</b>
<b>Current liabilities</b>			
Trade and other payables	10	(198,717)	(146,017)
<b>Non-current assets less current liabilities</b>		<b>(178,895)</b>	<b>(134,263)</b>
<b>Non Current Liabilities</b>			
Payables due after more than 1 year	10	(176)	-
<b>Total Non Current Liabilities</b>		<b>(176)</b>	<b>-</b>
<b>Assets less Liabilities</b>		<b>(179,071)</b>	<b>(134,263)</b>
<b>Reserves</b>			
General fund		(179,071)	(134,263)

The notes on pages 76-89 form part of these accounts.



Tony Douglas  
Accounting Officer  
26 October 2017

**STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED 31 MARCH 2017**

	Note	2016-17 £000	2015-16 £000
<b>Cash flows from operating activities</b>			
Net operating cost		(1,238,781)	(1,222,688)
Adjustments for non-cash transactions		108,107	111,787
Amortisation		371	239
(Increase) in trade and other receivables		(2,278)	(2,477)
Increase/(Decrease) in trade and other payables		52,876	(12,895)
Less movements in payables not passing through the Statement of Comprehensive Net Expenditure		2,694	(5,373)
<b>Net cash outflow from operating activities</b>		<b>(1,077,011)</b>	<b>(1,131,407)</b>
<b>Cash flows from investing activities</b>			
Purchase of intangibles		(8,855)	(807)
<b>Net cash outflow from investing activities</b>		<b>(8,855)</b>	<b>(807)</b>
<b>Cash flows from financing activities</b>			
Net Parliamentary Funding - Drawn Down		<b>1,085,866</b>	<b>1,132,214</b>
<b>Net increase/(decrease) in cash and cash equivalence in the period</b>		<b>-</b>	<b>-</b>

The notes on pages 76-89 form part of these accounts.

**STATEMENT OF CHANGES IN TAXPAYERS' EQUITY  
FOR THE YEAR ENDED 31 MARCH 2017**

	Note	General Fund 2016-17 £000	General Fund 2015-16 £000
<b>Balance at 1 April</b>		<b>(134,263)</b>	<b>(155,576)</b>
<b>Changes in taxpayers equity for 2016-17</b>			
Total Net Comprehensive expenditure for the year		(1,238,781)	(1,222,688)
Non-Cash Adjustments	6,7	108,107	111,787
Net Parliamentary Funding - drawn down		1,085,866	1,132,214
<b>Balance at 31 March</b>		<b>(179,071)</b>	<b>(134,263)</b>

The notes on pages 76-89 form part of these accounts.

## Notes to the Accounts

### 1. STATEMENT OF ACCOUNTING POLICIES

The financial statements contained within the Annual Report and Accounts relate to the financial year 1 April 2016 to 31 March 2017 (2016-17) with comparative analysis for the prior year 2015-16. They have been prepared in accordance with the Accounts Direction given by HM Treasury under Section 7 of the Government Resources and Accounts Act 2000 and in accordance with HM Treasury guidance as set out in the Financial Reporting Manual (FReM).

The accounting policies contained in the FReM apply International Financial Reporting Standard (IFRS) as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of DE&S for the purpose of giving a true and fair view has been selected.

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

DE&S is classified as an Executive Agency which operates as a Bespoke Trading Entity in line with Chapter 7 of Managing Public Money'. The 2016-17 financial statements are the third set of published accounts for DE&S.

#### 1.1 Accounting Convention

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

#### 1.2 Basis of preparation of annual accounts – accounting boundary

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

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

The operating cost envelope specifically encompasses staff (including travel and training), other operating and private sector support (PSS) expenditure and any associated revenue and capital expenditure. The financial statements also include costs incurred by other MOD organisations in support of DE&S operations as non-cash communicated costs (see item 1.8 below and Note 6 to the financial statements). PSS is defined as external support to supplement DE&S capacity and capability to manage our programme of work including those elements of external support that are being employed to deliver business improvement and transformation within the organisation. It encompasses contracts for the employment of manpower support, consultancy assistance and technical support activities. As such, PSS addresses resource and skills gaps in our project and logistics management capability.

DE&S has developed and implemented accounting treatment policies defining those activities that are to be treated as PSS. PSS undertaken within overarching equipment procurement/support arrangements with our main industrial contractors and international collaborative partners are not treated as DE&S operating costs as they are considered integral and indivisible from equipment programme activities. Note 3 provides a breakdown of PSS expenditure

and includes PSS in support of demonstration and manufacture phase programmes which are capitalised on the MOD accounts but correctly recorded here as operating costs. Activities that DE&S cannot undertake due to requirements for independent review and specialist one off/short term technically complex activities are treated as Equipment Programme expenditure and not PSS.

### 1.3 Critical accounting judgements and key sources of estimation uncertainty

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

- **Accounting boundary:** DE&S BTE in its third year of operations has well-established policies and governance arrangements supporting decisions on the types of revenue and expenditure that would fall within the operating envelope (particularly in respect to PSS) from those that are MOD equipment programme related. These policies and governance arrangements have been paramount in the preparation of these accounts by DE&S finance staff. Decision making continues to be supported by the Private Sector Support Group (PSSG), which is chaired by a senior finance manager, providing structured consideration of accounting boundary decisions.
- Activities undertaken with our main industrial partners continue to be excluded from our DE&S operating costs in recognition of the fact the PSS activities within these arrangements continues to remain integral and indivisible from equipment programme activities.
- **Communicated costs:** DE&S receive a number of benefits driven by the activities of other parts of MOD which support our operations. There is no mechanism in place for these costs to be directly charged to DE&S so these costs are recognised within the DE&S so accounts as notional communicated costs. These costs reflect the best estimates available and the majority are allocated based on an apportionment of costs based on staff number ratios. Where allocation methods have changed in 2016-17 the accounts have been re-stated for 2015-16, Note 6 provides further detail on communicated costs.
- **Accruals – payables and receivables:** In instances where revenue/expenditure has been earned/incurred but not invoiced, an estimate is made of the amount to be accrued as a payable or receivable item. DE&S review annually the appropriateness of the materiality level set to ensure it continues to remain relevant. For 2016-17 a guideline materiality threshold of £15,000 has been applied in the recognition of payables and receivables.

### 1.4 Changes during 2016-17 which have affected preparation of these annual accounts

There have been no significant changes in 2016-17 which have required a change in the way the annual accounts have been prepared. However, due to enhanced information relating to Private Sector Support and other programme costs, 2015-16 costs have been re-stated.

### 1.5 Going concern

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

The MOD has demonstrated its commitment to continue funding DE&S while process/system developments are undertaken and rolled-out to support the future charging for DE&S operating activities.

## 1.6 Revenue and expenditure recognition

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

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

The main sources of DE&S revenue are from contractual arrangements with industrial and international partners, for example those generated through the Defence Munitions teams where spare capacity is used to undertake work on behalf of third parties for which DE&S receives income for.

## 1.7 Programme costs

DE&S expenditure and revenue is reported as Programme costs in line with MOD Annual Accounts reporting requirements. Where DE&S staff are temporarily reassigned to work in other areas of the MOD, for example in support of operations, their salary costs are not charged to those other areas given the low materiality involved. Similarly, where other areas of the MOD temporarily reassign their staff to support DE&S management activities, salary costs are not charged to DE&S on the basis that the values involved are immaterial to the DE&S operating envelope. The movement of manpower from or to other MOD organisations is subject to the agreement of funding transfers between DE&S and the other transacting party before implementation. The exporting organisation continues to record expenditure until this agreement has been reached.

## 1.8 Communicated Costs

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

## 1.9 Value Added Tax (VAT)

Most of the operating activities of DE&S are deemed to be outside the scope of VAT as they relate to direct manpower costs. Irrecoverable VAT is charged where appropriate to other expenditure categories. Expenditure associated with recoverable VAT is treated as excluding VAT in the DE&S accounts with formal recovery administered by MOD. DE&S is not separately registered for VAT and VAT collected or any associated recoveries are processed centrally by MOD.

## 1.10 Non-current assets

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

## 1.11 Tangible non-current assets

Various areas of MOD provide DE&S with support services under central support contracts. These infrastructure support services include DE&S usage of MOD non-current assets, such as property and office furniture. The underlying risks and rewards of ownership of these assets are deemed to reside with MOD and therefore not reported in the DE&S Statement of Financial Position. The costs incurred by other MOD organisations in the routine maintenance of these assets are reported as communicated costs in the Statement of Comprehensive Net Expenditure (SOCNE). Where DE&S has incurred any direct costs for additional refurbishment/provision of such



assets, DE&S expenses these costs in year. In accordance with this policy DE&S does not report any tangible Property, Plant and Equipment assets on the basis of these being immaterial.

### 1.12 Intangible non-current assets

DE&S continue to recognise as intangible non-current assets those investments in development and delivery of new information, system software and licenses that are aimed at improving DE&S' organisational performance.

DE&S recognised such assets for the first time in 2015-16 and during 2016-17 further investments in software and licences have been made to enhance or increase system capability. All software and their associated licences continue to be capitalised as intangible assets in accordance with IAS38 where they continue to directly contribute to the delivery of DE&S business services and transformation activities.

Once initially recognised, intangible non-current assets are periodically assessed and where appropriate re-valued to current value in existing use, using a market value where an active market exists. In 2016-17 software assets were not revalued as the depreciated asset value was judged to be the current value in use. Where no market exists, indices are used to revalue the intangible asset to Depreciated Replacement Cost (DRC) Intangible non-current assets under construction are not subject to indexation where the contract payments capitalised during the period of construction are deemed to reflect fair value. Intangible non-current assets are amortised, on a straight line basis, over the planned DE&S operational life of the software application.

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

### 1.13 Impairment

During 2016-17 DE&S have reviewed all existing assets and can confirm that no impairment events have arisen in 2016-17. Reviews continue to be undertaken periodically in order to establish whether there have been any impairment events that may result in a requirement for impairment action to be taken in respect of the recognised Non-Current Assets.

### 1.14 Cash and cash equivalents

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

### 1.15 Inventories

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

## 1.16 Financial instruments – receivables and liabilities

IAS 32 defines a financial instrument as “any contract that gives rise to a financial asset of one entity and financial liability or equity instrument of another entity”. Trade and other receivables have been classified as current assets and measured at the invoiced amount as the impact of discounting, in the context of DE&S, is not deemed to be material. Given the short term nature of DE&S liabilities, this is considered equivalent to fair value. Goods or services received but not yet invoiced are accrued at estimated fair value.

Trade and other receivables are tested annually for impairment with any identified losses charged to the Statement of Comprehensive Net Expenditure. The carrying value of trade and other receivables in the Statement of Financial Position is shown net of any impairment provisions. Provisions are only made for specific bad debts. DE&S receivables and liabilities are de-recognised when the receivable or liability has been discharged, that is the payment required for settlement has been made or has been determined to no longer exist.

## 1.17 Employee benefits

A charge is made in these accounts for the value of employees’ annual leave entitlements earned, but not yet taken at 31 March each year. This has been valued by reference to DE&S average staff costs, by grade, based on a 365 day year, in line with MOD policy on recognition of untaken leave. The 2016-17 value of employee performance bonuses reflected within the Statement of Comprehensive Net Expenditure reflects those earned for performance in 2016-17.

DE&S continue to recognise costs of voluntary and compulsory redundancies and exits for departures arising from decisions taken since BTE vesting day. The assumption that departures in 2014-15 pre-vesting are not relevant to the BTE accounts remain extant.

## 1.18 IFRS8 Segmental Reporting

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

## 1.19 Reserves

The General Fund reserve represents the balance of taxpayers’ equity. Specifically the General Fund reflects the net assets less liabilities entered into during financial year 2016-17.

## 1.20 IFRS in Issue but not yet effective

There are a number of IFRSs, amendments and interpretations that have been issued by the International Accounting Standards Board that are effective for future reporting periods. Those with relevance to the Agency are outlined below. The Agency has not adopted any new IFRS standards early.

- IFRS 15 – Revenue from Contracts with Customers. This is effective from 1 January 2018. This standard replaces all existing IFRS guidance on revenue recognition.
- IFRS 9 – Financial Instruments. This is effective from 1 January 2018. This standard brings together all three phases of the financial instruments project: Classification and Measurement; Impairment and Hedge Accounting.
- IFRS 16 – Leases. This standard is effective from 1 January 2019. It will supersede all existing IFRS standards on leases. It is likely to result in a uniform accounting treatment for all leases, with the distinction between operating and finance leases removed.

DE&S (BTE) will apply the standards upon formal adoption in the FReM. It is not anticipated that material adjustments to the financial statements will be required following the introduction of these standards.

## 2. STAFF NUMBERS AND RELATED COSTS

### 2.1 Staff costs comprise:

	2016-17			2015-16		
	Permanently employed staff	Contingent Labour	Total	Permanently employed staff	Contingent Labour	Total
	£000	£000	£000	£000	£000	£000
Salaries and wages	461,318	42,584	503,902	454,562	27,119	481,681
Social security costs	47,077	-	47,077	35,457	-	35,457
Other pension costs	112,261	-	112,261	109,099	-	109,099
<b>Total</b>	<b>620,656</b>	<b>42,584</b>	<b>663,240</b>	<b>599,118</b>	<b>27,119</b>	<b>626,237</b>

### 2.2 Average number of persons employed:

	2016-17			2015-16		
	Permanent staff	Contingent Labour	Total	Permanent staff	Contingent Labour	Total
<b>Employed by DE&amp;S</b>	11,498	358	<b>11,856</b>	11,406	292	<b>11,698</b>

## 3. PRIVATE SECTOR SUPPORT (PSS)

	2016-17 £000	Restated 2015-16 £000
Manpower support	75,569	115,460
Manpower Support - Transformation	81,666	69,028
PSS for programmes in demonstration and manufacture phase	75,232	86,736
Consultancy support (project management, organisation design, finance, legal)	107,371	79,436
PSS for programmes in in-service support and disposal phases	52,230	50,358
PSS for programmes in concept and assessment phase	14,321	25,711
<b>Total</b>	<b>406,389</b>	<b>426,729</b>

Private Sector Support costs includes costs relating to DE&S transformation activities. Manpower support – Transformation was previously recognised within manpower support. However, it is now separately disclosed. The 2015-16 comparative has been restated accordingly.

Fees and professional services were previously recognised within PSS consultancy support. However they are now included in other programme costs because these relate specifically to professional fees and costs incurred maintaining or upskilling DE&S employees. The prior year comparative has, therefore, been restated to £79,436. The year on year variances are due to changes in requirement, whereby in 2016-17 DE&S has engaged in more consultancy support than manpower support but overall there has been a decrease in PSS costs when stripping out transformation costs of 9.2%.

### 4. OTHER PROGRAMME COSTS

	2016-17 £000	Restated 2015-16 £000
Staff travel and subsistence costs	27,387	24,055
IT and telecommunications	19,227	12,767
Other infrastructure expenditure	8,498	7,989
Staff training costs	7,504	8,050
Rentals	6,460	6,590
Regulatory safety costs	1,922	2,063
Other costs	10,427	11,244
<b>Total</b>	<b>81,425</b>	<b>72,758</b>

IT and telecommunication costs have increased primarily due to the fact that DE&S have been upgrading and modernising the IT and telecommunication systems, this includes the introduction of WIFI across the DE&S site and upgrading Local Area Networks (LAN).

OPC Other costs 2015-16 have been re-stated to adjust for Fees for professional services which are now treated as OPC other costs, likewise PSS consultancy support in note 3 has also been adjusted in 2015-16 to reflect this change in treatment.

### 5. PROGRAMME INCOME

	2016-17 £000	2015-16 £000
Defence Munitions commercial revenue	14,279	12,502
Logistics Commodities Services revenue (including British Forces Postal Office)	1,621	1,471
DE&S BTE corporate receipts (including revenue from technical publications)	3,655	329
Other programme income	825	521
<b>Total</b>	<b>20,380</b>	<b>14,823</b>

There has been an increase in 2016-17 in programme income, this is driven by two main factors. Firstly an increase in the volume of business put through Defence Munitions that generates commercial revenue for DE&S. Secondly an increase in corporate revenues as a result of Commercial exploitation levies the largest of which was related to the RAF AMPA system which brought revenue into DE&S of £1.9 million in 2016-17.

## 6. COMMUNICATED COSTS

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

MOD organisation	Description of activities	Method of apportionment	2016-17 £000	2015-16 £000
Joint Forces Command	Information System and Communication Services	Number of DE&S users relative to total MOD users.	49,568	50,927
Defence Infrastructure Organisation	Infrastructure and Facilities Management costs	Cost per employee at DE&S headquarters extrapolated to total DE&S headcount.	19,516	20,230
Joint Forces Command	Training Services through the Defence Academy and Surgeon General Services	Number of DE&S training days relative to total MOD training days.	11,867	14,829
Defence Infrastructure Organisation	MOD Guard Service	Costs of main DE&S geographical locations extrapolated across total DE&S headcount.	13,689	13,463
Defence Business Services	Personnel and Payroll Services	Number of DE&S employees relative to total MOD employees.	11,884	10,928
Head Office and Corporate Services	Various	Based on actuals.	1,368	1,191
<b>Total</b>			<b>107,892</b>	<b>111,568</b>





Communicated costs have remained stable during 2016-17 with an overall reduction of just under 1% when compared to 2015-16. There have been minor changes in cost allocation methodologies Within Defence Academy and Defence Business Services otherwise cost allocation methods have remained the same during this financial year.

Defence Academy (DA) and Surgeon General (SG) costs have reduced by approximately 20% compared to 2015-16, this has been driven by the fact the DA now have better visibility of costs by training establishments. This has allowed cost allocation on the basis of the number of DE&S employees attending training courses at each of the training locations whereas previously costs were apportioned across training establishments irrespective of whether DE&S employees attended training at that location. A further factor has also been as a result of an overall decrease of between 8-10% in DE&S student numbers in 2016-17 compared to 2015-16.

Head Office and Corporate Services costs have increased by approximately 15%, this is primarily due to a change in the cost apportionment methodology, and for example DV clearances were previously allocated based on the number of DE&S employees relevant to the overall costs. In 2016-17 this has changed, costs are now charged on the basis of the number of actual developed vetting clearances completed on behalf of DE&S. DBS costs have increased by 8% as a direct result of costs booked to management group (100) which solely pertains to the BTE that were excluded in 2015-16 as we did not have visibility of these and which have now been reported in 2016-17.

### **7. AUDITORS' REMUNERATION**

DE&S is audited by the Comptroller and Auditor General. The charge is notional reflecting the costs incurred by the auditor in respect of the audit of the DE&S 2016-17 Annual Report and Accounts. This notional charge is reflected in the Statement of Comprehensive Net expenditure to ensure completeness of the accounts.

**8. INTANGIBLE FIXED ASSETS**

	<b>Software £000</b>	<b>Assets Under Construction (AUC) £000</b>	<b>Total £000</b>
<b>Cost or valuation</b>			
At 1 April 2015	-	-	-
Additions	807	5,373	6,180
Disposals	-	-	-
Impairments	-	-	-
Revaluations	-	-	-
Reclassifications	-	-	-
<b>Balance at 31 March 2016</b>	<b>807</b>	<b>5,373</b>	<b>6,180</b>
Additions	<b>686</b>	<b>5,475</b>	<b>6,161</b>
Disposals	-	-	-
Impairments	-	-	-
Revaluations	-	-	-
Reclassifications	-	-	-
<b>At 31 March 2017</b>	<b>1,493</b>	<b>10,848</b>	<b>12,341</b>
<b>Amortisation</b>			
Balance at 1 April 2015	-	-	-
Charged In Year	(239)	-	(239)
Disposals	-	-	-
Impairments	-	-	-
Revaluations	-	-	-
Reclassifications	-	-	-
<b>Balance at 31 March 2016</b>	<b>(239)</b>	<b>-</b>	<b>(239)</b>
Charged In Year	(371)	-	(371)
Disposals	-	-	-
Impairments	-	-	-
Revaluations	-	-	-
Reclassifications	-	-	-
<b>At 31 March 2017</b>	<b>(610)</b>	<b>-</b>	<b>(610)</b>
<b>Net Book Value</b>			
Balance at 1 April 2015	-	-	-
Balance at 31 March 2016	568	5,373	5,941
<b>Balance at 31 March 2017</b>	<b>883</b>	<b>10,848</b>	<b>11,731</b>

Software values include the DE&S time recording and charging (TRaC) system, as reported in 2015-16, additional Expenditure reported in year relates to the purchase of Active Risk Manager (ARM) licences. This tool has been deployed within DE&S to record and report on DE&S risks.

AUC balances reflect existing and new investments made by DE&S in the P3M (Project, Programme and Portfolio Management) suite of Oracle tools (including Primavera) for rollout in support of DE&S transformation. New expenditure incurred in 2016-17 relates to the implementation and introduction of the Business Management System (BMS). This system holds all DE&S key policies and processes, and acts as a single point of reference of key information across the business.

Additions reflect prior year (£588,000 – not previously reported) capital expenditure costs on the purchase of Active Risk Manager (ARM) licences for DE&S.

### 9. TRADE RECEIVABLES AND OTHER ASSETS

	<b>2016-17 £000</b>	<b>2015-16 £000</b>
<b>Amounts falling due within one year:</b>		
Accrued Income	524	3,479
Other Receivables	7,493	2,191
Trade Receivables	-	-
Prepayments	73	142
Staff loans and advances	1	1
<b>Total current receivables</b>	<b>8,091</b>	<b>5,813</b>
<b>Amounts falling due after more than one year:</b>	-	-



## 10. TRADE PAYABLES AND OTHER LIABILITIES

	2016-17 £000	2015-16 £000
<b>Amounts falling due within one year</b>		
Private Sector Support accruals	(110,887)	(80,336)
Direct Staff Accrual	(59,677)	(41,384)
Trade payables	(25,931)	(9,077)
Sundry payables	(2,222)	(15,220)
<b>Total current liabilities</b>	<b>(198,717)</b>	<b>(146,017)</b>
<b>Amounts falling due after more than one year:</b>	<b>(176)</b>	-

Direct Staff Accrual includes £30 million for liabilities to the principal Civil Service Pension Scheme, the Armed Forces pension scheme, HMRC and other payroll related liabilities. The Direct Staff Accrual has increased in 2016-17 predominantly due to an increase in the accrued value of Pay Award to DE&S employees. In 2016-17 there has been a change in allocation method for calculating PCSPS & AFPS and other payroll liabilities.

Overall there has been an increase in payables, key factors being new projects introduced in 2016-17 which includes Warrior Capability Sustainment Programme. Enhanced information has led to a more accurate representation of PSS accruals. As a result, balances that previously would have recognised as Sundry Payables are now recognised as PSS accruals.

## 11. ESTIMATE OF STATEMENT OF COMPREHENSIVE NET EXPENDITURE (SOCNE) VALUE OF THE LOGISTICS & COMMODITIES SERVICE (LCS) FUNCTIONS TRANSFERRED TO INDUSTRY PRIOR TO CONTRACT PLACEMENT WITH TEAM LEIDOS ON 1 AUGUST 2015

The following analysis is provided to aid comparison of SOCNE costs from 2015-16 to 2016-17 noting the inclusion of LCS costs in the first 4 months of the comparison year.

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

	2016-17 £000	2015-16 £000
<b>Expenditure - Direct Programme Costs</b>		
Direct Staff Costs	-	14,575
Private Sector Support costs	-	11
Other Programme Costs	-	965
<b>Total Direct Programme Costs</b>	-	<b>15,551</b>
<b>Income - Direct Programme</b>	-	<b>(268)</b>
<b>Net Direct Programme Expenditure</b>	-	<b>15,283</b>
<b>Expenditure – Non-Cash Items</b>		
Communicated costs from other MOD organisations	-	3,058
<b>Total Net Expenditure</b>	-	<b>18,341</b>

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

## 12. PROVISIONS, CONTINGENT LIABILITIES AND ASSETS

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

## 13. RELATED PARTY TRANSACTIONS

DE&S is a bespoke trading entity, an arm's length body of the Ministry of Defence, as such and for the purpose of these accounts MOD is regarded as a related party. Funding continues to come in the form of Net Parliamentary funding with all payments and receipts relating to DE&S operations being processed by MOD on our behalf.

MOD continue to undertake a number of transactional activities on behalf of DE&S, the most significant of which relate to direct staff costs including the calculation and processing of taxation with HM Revenue and Customs and pension benefits for both the Armed Forces Pension Scheme and the principal Civil Service Pension Scheme.

No senior employees of DE&S have undertaken any material business transactions in the period to 31 March 2017.

## 14. BUDGET RECONCILIATION NOTE

DE&S is responsible for its own operating expenses, and carries out its business activities within an agreed operating expenditure budget. The budget comprises both revenue and capital expenditure and DE&S has full control over how it is utilised. For 2016-17 this was £1.145 billion, however our outturn position for the year was £1.142 billion, a reduction against budget of £3 million.

The net revenue outturn position of £1.131 billion is captured within the Statement of Comprehensive Net Expenditure and is made up of Direct Staff Costs, Private Sector Support costs and other programme costs of £1.151 billion and offset by the income generated by DE&S in 2016-17 of £20 million.

The capital outturn position of £11 million represents investment in software assets. Of this, £6 million relates to the 2016-17 in-year additions reported in the Intangible Fixed Assets note. The other £5 million relates to items that were part of the 2015-16 capital additions of £6 million, but, owing to timing delays, were not recognised in the 2015-16 outturn budget.

## 15. EVENTS AFTER THE REPORTING PERIOD

### Submarine Delivery Agency

A decision was made in 2016-17 to strengthen arrangements for the procurement and in-service support of nuclear submarines, by establishing a new delivery body alongside DE&S. The Submarine Delivery Agency was launched in April 2017 and will be formally established as an Executive Agency no later than 1 April 2018. This has not impacted on the 2016-17 accounts, as all submarines associated expenditure and revenue relating to its business activities is correctly captured and recorded within the DE&S BTE accounts. The operating costs associated with staff and other costs incurred by the previous DE&S Submarines Operating Centre will be transferred to the new agency, which will present a separate annual report and accounts from 2018-19.

### Resignation of the DE&S Chief Executive Officer

In October 2017, Tony Douglas announced that he was resigning from his role as Chief Executive Officer and would leave DE&S at the end of the year. The recruitment process to determine his successor is underway, led by the DE&S Chairman and MOD Permanent Secretary.

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





## Glossary

ARM	Active Risk Manager <sup>TM</sup>
AUC	Assets Under Construction
BMS	Business Management Systems
BTE	Bespoke Trading Entity
C&AG	Comptroller and Auditor General
CASP	Command Acquisition and Support Plan
CEO	Chief Executive Officer
CETV	Cash Equivalent Transfer Value
CoM	Chief of Materiel
CP&F	Contracting, Purchase and Finance
DBS	Defence Business Services
DE&S	Defence Equipment and Support
DIA	Defence Internal Audit
DIO	Defence Infrastructure Organisation
DG	Director General
DRC	Depreciated Replacement Cost
DSF	Defence Supplier Forum
FReM	Government Financial Reporting Manual
FTE	Full Time Equivalent

GFE	Government Furnished Equipment
GOCO	Government Owned Contractor Operated
HM	Her Majesty's
HMRC	Her Majesty's Revenue and Customs
HMS	Her Majesty's Ship
HR	Human Resources
IAS	International Accounting Standard
IFRS	International Financial Reporting Standards
ISO	International Standards Organisation
KPI	Key Performance Indicator
Min(DP)	Minister for Defence Procurement
MOD	Ministry of Defence
MSP	Managed Service Provider
NAO	National Audit Office
NED	Non-Executive Director
OGSM	Objectives, Goals, Strategies and Measures
P3M	Project, Programme and Portfolio Management
PMPS	Performance Management and Pay System
PSED	Public Sector Equality Duty
PSS	Private Sector Support
RAF	Royal Air Force
RFA	Royal Fleet Auxiliary
SCS	Senior Civil Service
SDSR	Strategic Defence and Security Review
TRaC	Time Recording and Charging



# Equipping and supporting UK Armed Forces