

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

I certify that I have audited the financial statements of Defence Equipment & Support for the year ended 31 March 2015 under the Government Resources and Accounts Act 2000. The financial statements comprise: the Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity; and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

Respective responsibilities of the Accounting Officer and auditor

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

Scope of the audit of the financial statements

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

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

Opinion on regularity

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

Basis for qualified opinion on financial statements

I have qualified my opinion on the financial statements because the audit evidence available to me was limited. Defence Equipment & Support could not provide me with sufficient and appropriate audit evidence to support the private sector support costs and other programme costs recorded in the Statement of Comprehensive Net Expenditure and the related trade and other payables balance in the Statement of Financial Position. The period 1 April 2014 to 31 March 2015 was the first year of operation of Defence Equipment & Support as a separate agency of the MOD, and the first year it has had to prepare separate financial statements. In my view, the Agency's financial management systems, processes and controls for these transactions and balances are not yet sufficiently well developed; as a consequence, management were unable to provide me with all the information, explanations and evidence I needed for my audit.

Qualified opinion on financial statements

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

- the financial statements give a true and fair view of the state of the Defence Equipment & Support's affairs as at 31 March 2015 and of the total net expenditure for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions issued thereunder.

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

Opinion on other matters

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with HM Treasury directions made under the Government Resources and Accounts Act 2000; and
- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I report by exception

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

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

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

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

Sir Amyas C E Morse
Comptroller and Auditor General

15 December 2015

National Audit Office
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REPORT OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSE OF COMMONS

Introduction

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

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

Purpose of Report

The financial statements on the following pages represent the results of DE&S for the period from 1 April 2014 to 31 March 2015, its first year of operation. I have qualified my opinion on the financial statements due to a limitation on the scope of my audit. This arose because DE&S were unable to provide me with sufficient and appropriate audit evidence to enable me to confirm whether or not the private sector support costs, other programme costs, and the related trade and other payables balance recorded in the financial statements are free from material misstatement. This report explains the reasons for the qualification.

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

The Statement of Comprehensive Net Expenditure to the financial statements reports £439.638 million of private sector support costs and £73.769 million of other programme costs. The private sector support costs represent external support procured by DE&S to supplement the management of its work programme and encompasses contracts for the employment of manpower support, consultancy assistance and technical support in the areas of project management and logistics capability. The other programme costs include travel and subsistence, training, safety and other office running costs. As a result of the DE&S financial systems and processes not being sufficiently developed to support the creation of a new accounting boundary, DE&S have been unable to provide adequate evidence to fully support this expenditure and the related trade and other payables figure of £122.214 million reported in the Statement of Financial Position; I have consequently limited the scope of my audit opinion in respect of these transactions and balances.

Explanation for limitation of scope

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

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

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

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

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

Actions to be taken by DE&S

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

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

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

DE&S recognises however, given the limited time before the close of the next financial year, that there remains a credible risk that the improvements they are striving to achieve may not have reached a level of

maturity necessary to secure an unqualified audit opinion on the 2015-16 financial statements, given the sheer volume of data currently generated through its present cost reallocation processes and the challenges of providing support and assurance to the recorded transactions.

Sir Amyas C E Morse
Comptroller and Auditor General

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