

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 as defined 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 2015 to 31 March 2016, its second year of operation.

I qualified my opinion on the financial statements during the Agency's first year of operation 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.

I have again qualified my opinion on the financial statements for the Agency's second year of operation due to a limitation on the scope of my audit. This arose because DE&S again did not provide me with sufficient and appropriate audit evidence to enable me to confirm whether or not the private sector costs and other programme costs recorded in the Statement of Comprehensive Net Expenditure are free from material misstatement. DE&S were however, able to provide me with sufficient and appropriate evidence to enable me to conclude that the related trade and other payables balances recorded in the financial statement for the year ending 31 March 2016 are free from material misstatement, although the opening trade and other payables balances remain unsupported.

This report explains the reasons for the qualification.

Limitation of scope in respect of private sector support costs and other programme costs

The Statement of Comprehensive Net Expenditure to the financial statements reports £434 million of private sector support costs and £65 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 still not being sufficiently developed to fully support this expenditure, I have limited the scope of my audit opinion in respect of these transactions.

Explanation for limitation of scope

DE&S maintains financial systems which record both DE&S and MOD related costs. As a result, in preparing its financial statements DE&S has to perform a manual 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 and other programme costs.

This situation was complicated by the fact that in its first year of operation, the relatively short period of time between its establishment and the requirement to prepare its initial financial statements, DE&S had limited time to establish its new processes and systems and to train its staff. Notably, there were insufficiently detailed instructions on what costs related to DE&S activities, and insufficient central review of the submissions made by Operating Centres and Project Teams.

DE&S have been investing time and resource in strengthening the systems, processes and controls that support the derivation of its private sector support and other programme costs. However, as the 2014-15 accounts were only certified in December 2015, the improvements in the control environment were not substantively implemented until the final quarter of 2015-16. As a result, the weaknesses that affected last year's figures continued into this year.

This is illustrated by the significant number of manual journals that are still relied on to create the accounts as individual lines of expenditure are analysed between DE&S and MOD activities. While an improvement on last year where journals were in excess of 100,000, the level of journals for the year ending 31 March 2016 is still significant, remaining at over 80,000 journal lines.

Given the scale of the exercise, the cleansing of data by DE&S focussed on the final quarter of the financial year, and was deliberately designed to support the trade and other payables data as derived from private sector support and other programme expenditure. The Agency has expended considerable time and effort in supporting these balances and has been able to provide me with sufficient evidence to enable me to provide an unqualified opinion on the trade and other payables balances within the Statement of Financial Position.

However, the Agency chose not undertake a similar cleansing exercise on the expenditure data for the year, nor did it revisit the opening payables information which was subject to a qualified opinion in 2014-15, choosing rather to release the balances to the in year Statement of Comprehensive Net Expenditure. Consequently, the Agency was unable to provide me with adequate evidence to enable me to confirm whether or not the private sector support costs and other programme costs shown in the financial statements are free from material misstatement. I have therefore qualified my audit opinion on the financial statements due to a limitation on the scope of my audit in respect of the £434 million of private sector support costs and £65million of other programme costs. My testing did not identify any irregularity with this expenditure.

Actions being taken by DE&S

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

During the last quarter of 2015-16 and into 2016-17, DE&S has instigated a number of initiatives in order to improve processes, with the aim of working towards a solid baseline from which the Agency can support the removal of the remaining qualifications in 2016-17. Initiatives have included: the publication of a DE&S accounting manual; increased use of exception reporting and reconciliations in order to monitor the volume of journal adjustments and coding of primary data; further updates to the instructions to Operating Centres and Project Teams; and the operation of a PSS Steering Group which discusses contracts where the boundary allocation may be unclear. DE&S feels that these steps will help support the accuracy of information going forward and build a case for the removal of the remaining qualification in relation to Private Sector Support and Other Programme Costs during 2016-17.

Sir Amyas C E Morse
Comptroller and Auditor General

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