

DRS Data & Research Services plc

Annual Report & Accounts 2006

DRS Data & Research Services plc is the parent company of the DRS Group which consists of two trading subsidiaries in the UK and one in the USA.

The DRS Group specialises in providing automated data capture technology and solutions to education, government, financial and commercial organisations all over the world.

1	Outlook
2	DRS Group at a glance
4	Chairman's statement
6	Financial and operating review
10	The directors
13	Directors' Report & Accounts 2006
14	Report of the directors
17	Report on directors' remuneration
21	Corporate Governance disclosure statement
24	Report of the independent auditors
26	Consolidated income statement
27	Consolidated balance sheet
28	Consolidated statement of changes in shareholders' equity
29	Consolidated cash flow statement
30	Notes to the financial statements
49	Parent Company Accounts 2006
50	Parent company balance sheet
51	Parent company statement of changes in shareholders' equity
52	Parent company cash flow statement
53	Notes to the Parent company financial statements
58	Directors and advisers

Outlook

- > May 2007 brings the Scottish Parliament and Local Authority elections and with it the most complex e-Counting project ever to be managed by DRS.
- > DRS has contracted with the Scottish Executive to provide e-Counting technology in all 32 Local Authority count centres. This will involve 320 PS900 iM2 scanners, 600 DRS staff and over 1,600 Local Authority staff.
- > 2007 is also expected to bring the largest ever e-Marker[®] project, for examining board AQA, anticipated to involve 4 million exam scripts being marked electronically.

DRS Group at a glance

- > The DRS Group consists of four companies. DRS Data & Research Services plc is the non trading holding company. There are two UK based subsidiaries, DRS Data Services Limited and Peladon Software Limited, and one in California USA, Peladon Software Inc.

Our markets

- > The DRS Group specialises in providing sophisticated scanning and software data capture technologies, and solutions to education, government, public sector, financial and commercial organisations all over the world.

Education

DRS first built its reputation as a world leader in educational data capture. DRS education software solutions are designed to automatically capture data quickly, accurately and securely. DRS is a leading supplier of OMR and Imaging technology and associated forms specially designed for schools, colleges and universities, as well as awarding and assessment bodies across the globe.

UK public and private sector

DRS' sophisticated scanning technologies coupled with its Intelligent Character Recognition software, Peladon DocXP, is streamlining document and data capture from a wide variety of applications. Financial and insurance document processing, surveys, non-political elections, membership records, questionnaires, application forms, training evaluation, registration, exam and test marking are just some of these applications.

Examinations and assessment

With its modular electronic marking technology, DRS is improving standards within the examination and assessment market. DRS e-Marker® is a scalable electronic marking solution designed to electronically mark student examinations in both the academic and professional sectors. Over 51 million GCSE marks were collected in 2006 using the full suite of e-Marker® for the Assessment and Qualifications Alliance (AQA).

International – data capture

DRS' customer base spans over many countries across the world. DRS was awarded the 2002 Queen's Award for Enterprise in International Trade demonstrating its achievements in substantial and sustained growth and commercial success in overseas trade.

Elections

DRS' impressive portfolio of electronic counting solutions covers projects that include all-postal and multi-channel elections proportional representation. DRS has also carried out over 15 national voter registration projects in countries from Sierra Leone to Malawi, typically providing scanners, forms, software and local support. DRS technologies have been proven around the world to deliver results accurately and swiftly to countries in Europe, the Middle East, Africa and Asia.

North America – document management

Through direct selling and a reseller network, Peladon Software Inc distributes DocXP into markets such as insurance, finance and banking.

During 2006 our products and services were used in over 20 countries

Our products and services

- > The DRS Group provides scalable and tailored automated data capture products, services and solutions for organisations all over the world.

Scanning equipment

DRS designs and builds its own high-volume PhotoScribe® scanning machines specifically modelled for continuous usage in time sensitive projects. Sold around the world and supported through a network of agents.

Bureau services

DRS offers a complete, secure and confidential in-house Bureau service. The Bureau establishes the aims of a customer project and manages the logistics to ensure accurate and timely results on behalf of the customer.

Document management

DocXP is a sophisticated, yet easy to use, intelligent data capture and document archive solution created by Peladon that streamlines the document data capture process. This intuitive software is proven to increase processing rates whilst reducing staff costs.

Examination marking

e-Marker® is a suite of sophisticated examination processing and marking solutions, designed to add value and improve the accuracy of the examination and assessment process. e-Marker® offers a variety of scalable electronic marking methods that can be used to streamline the entire marking process.

Software

DRS provides a range of flexible data entry and processing software solutions for use with its scanning equipment as well as end-to-end solutions for the examination and election counting markets.

Engineering and technical support

With qualified engineers on hand to answer questions via the help desk and provide on-site support, DRS ensures that all of its distributors and customers receive high quality technical support.

Design and print

Accredited to ISO 9001:2000 for Specialist Forms Printing, the DRS print division is one of the cornerstones of the complete service DRS offers. This, along with its efficient forms design service, sophisticated typesetting equipment and print plant, ensures the very best results.

Specialist advice and training

With a unique and unsurpassed level of skills and experience in the markets it operates in, DRS is ideally placed to offer specialist advice to its customers. Whether it's guidance on how best to carry out a large and complex election or advice on how to streamline document and data capture, DRS experts can help.

Chairman's statement

Malcolm Brighton
Chairman

Results

Financial results for 2006 show continued good growth in turnover. Profit has increased from that of last year but has not maintained the same rate of growth shown at the half year. Turnover for the year increased by 34% with contributions from two large projects and very strong international sales. The very good start to sales in the year unfortunately slowed in the second half and this, together with unbudgeted costs incurred in tendering for new business, affected profit.

Profitability was affected by the costs of integrating the two Peladon companies into the DRS Group structure. However, Peladon has performed well during the year with the development and release of a major new version of their DocXP product in the third quarter and the expansion of their sales and marketing team. This has led to the signing of several large resellers in the US. Although Peladon incurred a trading loss for 2006 the benefits of investment resulted in a profit in the last two months of the year and there are high expectations for 2007.

Turnover for the financial year 2006 was £16,690,000 with pre-tax profits of £233,000 compared with £12,452,000 and £17,000 respectively for 2005.

The Company paid an interim dividend during the year of 0.25p. Although the level of costs in the year have resulted in lower than anticipated full year profit the outlook for 2007 is very promising. Therefore the Board

is pleased to recommend a final dividend payment of 0.25p per share, giving a total dividend for the year of 0.5p per share (2005 total: nil).

e-Marker®

We stated in 2005 that it had been a watershed year for e-Marker® in moving from trials of the system to full scale implementation. This was indeed the case and in 2006 there was a substantial increase in both the volume of answer scripts marked and the number of examination subjects that used e-Marker®. Our main partner for this work is England's largest examination awarding body AQA (Assessment and Qualifications Alliance). Their use of the system has grown each year. We were therefore very pleased to announce at the start of 2007 that we had signed an agreement with AQA to provide them with e-Marker® services through to the end of 2010. The contract has a potential value of £25 million over the next four years.

Elections

We have now been involved in election work for more than 15 years, having started in 1991 supplying scanning equipment to Norway. Major e-Counting projects have included the national election in Bosnia and Herzegovina, and the Mayor and Greater London Authority elections in 2000 and 2004. This year we were delighted to report we had been awarded the contract to use our e-Counting systems to count the Scottish elections in 2007. These elections introduce STV (Single Transferable Vote) which, although it has well argued democratic benefits, is difficult and time consuming to count manually. The DRS e-Counting system offers significant advantages over manual counting in this type of complex election. We are also pleased to have won this contract in partnership with ERS (Electoral Reform Services). ERS are acknowledged to be a world leader in applying the many variations of STV. A large amount of work has taken place during 2006 in preparation for these elections. This has included the commissioning of a dedicated production unit in Milton Keynes to manufacture more than 300 of our PhotoScribe® PS900 scanners that will be used to count the votes.

Trials for introducing new technology in elections in England and Wales are currently controlled by the DCA (Department for Constitutional Affairs). To be involved in

e-Marker® processes 4 million AQA GCSE exam scripts

DRS e-Marker® solutions were deployed across the country in processing 50% of this summer's AQA GCSE exam series.

Involving just under 4 million scripts, DRS electronic marking technology was used by 6,400 examiners in their homes compared to 4,200 examiners last year using it to mark 2.5 million scripts.

A number of e-Marker® modules were used throughout this summer's examination marking project to collect a total of 65 million marks from student answers. One of the main modules used by examiners in their homes was CMI+ (Computer Marking from Image Plus).

“It has been a contrasting year with healthy growth in turnover and the award of a number of major, but demanding new contracts”

future trials companies needed to tender to be included on the DCA's election framework. I am pleased to report that DRS was successful at being included on all levels of the framework and we will be eligible to offer both e-Counting and e-Voting for future trials.

International

It has been a very successful year for international sales with projects in a number of countries, some involving supply of our PS900 scanners. The highlight of the year was the supply of printed forms for the Nigerian Population Census which was funded by the European Union. However many other print and scanning contracts were received, particularly from Africa, making this a record export year. Sales of PhotoScribe® scanners were higher than expected to countries in Africa and the Far East. Also, after a comprehensive customer evaluation of the PS900, we made our first sales of the product to North America for use in American elections.

Peladon

We acquired the Peladon Software Group at the beginning of the year and both the San Diego and the Andover based companies are showing great promise with both sales and product development of the DocXP range of software. The main sales and marketing thrust has been focused on the American financial markets and that has proved to be well founded. A number of value added resellers have been signed up and the launch of new products has been very successful.

Staff

During the year there has been both a significant recruitment campaign and the introduction of a number of new staff structures and procedures. The increase in e-Marker® activities and in election work has required us to create new permanent staff positions in several areas of the business. The large peaks of activity that both examination and election work generates has also meant we have needed to recruit many fixed term contract staff and temporary employees.

To manage the complex project work in which DRS is increasingly involved we have placed greater emphasis

on the formal disciplines associated with project management, quality assurance and business continuity. Programme management has been introduced to give added structure to our PRINCE2 project control and a separate quality assurance department has been created to reflect the nature of our business, which has to be 'right first time'. The critical nature of many of our projects requires us to be able to demonstrate to customers the development of robust business continuity plans and the effective use of risk registers in all levels of the Company.

Although there is much more work to be done in the above areas the progress we have made so far could not have been achieved without tremendous assistance and hard work from all staff members. I would like to thank the staff for their untiring contribution to a very challenging year.

Summary

It has been a contrasting year with healthy growth in turnover and the award of a number of major but demanding new contracts. We have expanded our capabilities in order to fulfil these contracts and others like them in the future, but this investment has unavoidably depressed this year's profits. Some further investment will be needed to meet the expanding potential business we seek to win. However, as we go into this year's work a primary focus is being placed on tighter cost control in order to secure better margins from our major contracts.

I am looking forward to an exciting year with major projects in elections, e-Marker® and International. The new business of Peladon is now fully part of the DRS Group and set to meet our expectations and be part of overall growth in the business.

Malcolm Brighton

Chairman
12 March 2007

CMI+ was used to capture 51 million marks from 80 different exam papers for 1.3 million candidates. This module enables an awarding body to analyse exam papers by the items and types of responses required of candidates. The responses are categorised according to whether they are able to be automatically marked by computer, generally marked by markers who have been trained on the mark scheme or require expert examiners to mark them. The functionality of each is suited to different examination types and has differing characteristics and complexities.

Financial and operating review

Tony Lee
Chief Executive

The profit for the year before taxation amounted to £233,000 (2005: £17,000). Earnings per share were 0.52p (2005: loss per share 0.02p). The directors recommend the payment of a final dividend of 0.25p per ordinary share payable on 25 May 2007 to all shareholders on the register at 27 April 2007.

Dynamics of the business

The profile of the Company was changed at the very start of the year with the hiving down of the trading business into DRS Data Services Limited. The new structure with DRS Data & Research Services plc as a holding company enables the company to acquire businesses with minimum disruption and cost to the organisation. Indeed this is what was achieved with the successful acquisition of Peladon Software at the end of January 2006.

Trading in the first half of the year was particularly good and was boosted by the printing contract for the Nigerian Population Census. Although the contract started in 2005 the volume of forms required increased substantially from the original requirement and necessitated printing well into 2006. The combination of the NPC contract and others awarded to us during the year led to an increase in printing business compared to previous years. Our international markets in general exceeded expectations and generated the highest annual turnover to date.

Our elections business is usually centred on the first week of May, that being the time for most UK elections. Two trials were completed in May although these were not of the scale of either previous Greater London Authority elections or the forthcoming Scottish elections. The year did benefit from a greater spread of activity, with the preparations for the Scottish elections in 2007. Thus revenue was generated in both halves of the year from initial trials, the acceptance test, and then a volume test.

The largest percentage of our business remains in education and it is spearheaded by the use of the e-Marker® for examinations and assessment. The volume of e-Marker® work continues to grow year on year. Although significant investment in the development of e-Marker® continues, it is now making considerable contribution to both revenue and profit.

Although the second half of the year started well with the summer series of examinations, sales were weaker than expected as the year progressed. A slow down of Optical Mark Reader sales to schools in particular was faster than anticipated. Also the costs of bidding for a large project in the education sector were outside of the budget and unfortunately did not result in a contract.

In other areas of education, performance was similar to that of the previous year. Local authorities continue to use our pupil admissions processing service for schools. Also steady sales continue in Further, Higher and Adult Education.

Highlights of the year

The Nigerian Population Census which was started at the end of 2005 and completed in the first quarter of 2006 has been the largest single print project the Company has completed. More than 50 million forms were printed and shipped to locations around Nigeria, accounting for more than 550 tonnes of paper. After more than 30 years of working with Nigeria, predominantly in the education sector, it was particularly pleasing to have been awarded this national project.

Our largest project in the year was the use of e-Marker® for examinations and assessment. The biggest customer for e-Marker® remains AQA (Assessment and Qualifications Alliance) and during the summer series of GCSE examinations we will have assisted in the marking of nearly 200 exams, and e-Marker® will have been used by 6,400 examiners in their homes. The volumes of examination scripts processed by e-Marker® have been increasing each year reaching 4 million in 2006 with a total of 65 million marks being awarded to students' answers. Many different variants of the technology have been used to best suit the types of assessment, from simple mark capturing on screen, to complete marking of answer scripts from on-screen images. A new module was also introduced this year called CMM (Computer Marking from Multimedia) which has widened the scope of e-Marker® to handle more examination subjects.

The award of the contract by the Scottish Executive to count the elections in 2007 led to trials of e-Counting

“The volumes of examination scripts processed by e-Marker® have been increasing each year reaching 4 million in 2006, with a total of 65 million marks being awarded to students’ answers”

during the first quarter of 2006. All 32 of the Scottish local authorities had hands-on experience of the DRS system with particular emphasis on STV (Single Transferable Vote) e-Counting. These trials were very successful and took the project through to the acceptance phase which was also successfully completed later in the year. Finally a volume test of the system was completed at the end of the year and this gave the green light for our e-Counting technology to be used across Scotland for the combined Parliamentary and Local Authority elections on 3 May 2007. Our election business also featured in the second quarter with the trials run by the DCA (Department for Constitutional Affairs). Two London boroughs, Westminster and Lewisham, were selected by the DCA to use the DRS e-Counting solution for their May elections. Westminster used our system to count its local council elections and Lewisham completed a combined local council and mayor count.

Sales of Peladon’s DocXP and associated products grew steadily throughout the year. The American financial market, as expected, is proving to be particularly strong. There has also been strong demand from resellers who are integrating Peladon’s technology into their own products. The introduction of new products in the second half of the year stimulated further demand in this and other markets. DRS has started to sell DocXP and has made sales in both its UK and international territories.

Research and development

The introduction of the ROHS (Restriction of Hazardous Substances) and WEEE (Waste from Electrical and Electronic Equipment) directives by the government during 2006 required significant development work to be implemented on the PhotoScribe® scanner range. This was combined with improvements to the product and led to a new version called the PS900 iM2. The iM2 has incorporated an array of sophisticated features to ensure consistent, high quality images are captured.

One particular feature of the PS900 iM2 is Dynamic Normalisation. This technique ensures the background of a form is clean and white while protecting foreground content such as faint marks and writing. Dynamic Normalisation delivers text and images with the best possible contrast and quality while allowing them to be compressed to the highest level. This reduces the data storage needs and increases the speed of image transfer.

Research and development of our e-Counting solutions continued during the year. Knowledge gained during various election trials has enabled us to improve the processes for identifying and recognising

votes on ballot papers. The ability to detect folds and creases in ballot papers, in real time while they are being scanned, has reduced the number of papers that need to be manually adjudicated which increases the efficiency of an election count. Also the previous work to enable STV (Single Transferable Vote) ballot papers to be read has been enhanced to interpret many other types of marks made by voters.

Development of our e-Marker® product continues and it is now able to be used in a wider range of examination types and supplied to more varied customers. The ability to monitor and control the quality of marking is a very important aspect of an examination process. e-Marker® now enables many different types of sophisticated ‘seeding’ techniques to be applied during the marking procedure which ensures that quality is maintained at all times. Seeding is a process which allows known answers to questions to be inserted anonymously in between the answers from real candidates and sent to markers. By monitoring the response of markers to the seeded answers, e-Marker® can instantly recognise those who do not meet the required standards and take immediate action. The system can also automatically reallocate any answers previously marked by a suspended marker so that overall quality is not affected.

The e-Marker® system has also been enhanced to provide higher levels of management reports and feedback to awarding bodies to enable them to improve examinations and assessment. One particular variant of marking enables all answers, both correct and incorrect, to be captured and stored by the system. These answers can be grouped together so that a senior examiner can judge which ones are acceptable answers and which are not. This is not only a very efficient process for marking exams but also gives valuable information about the wrong answers that candidates have given. The information can be used to improve future examinations by reducing the likelihood of ambiguous or misleading questions.

Research and development within Peladon has continued to build the excellent DocXP range of products. Work during the year culminated in the release of a major new version of the product. The existing software was already capable of recognising forms after being trained on a particular form type. New classification software allows hundreds or even thousands of different form types to be sorted into known types immediately after they have been scanned. For example, the system does not need to know whether a form is an invoice or purchase order or delivery note, it can still classify the form against any

Financial and operating review continued

number of known types. The information on the form can also vary and still be recognised as the same form type. These capabilities mean that users can process mixed batches of forms with increased efficiency and the minimum of manual intervention.

Added to the classification software, Peladon has also developed the ability to handle complex forms where tables of information contain mixed data in semi-structured formats. These types of forms occur in many varied applications such as claims for medical benefits and insurance. The volume of forms to process can be very large and to date have needed to be handled manually. Peladon's sophisticated identification and extraction techniques enable the forms to be processed accurately and in a fraction of the time previously necessary.

Funds from operating activities and current liquidity

Current investments and cash that are readily convertible to cash at 31 December 2006 were £1.4m (2005: £2.3m). Purchase of the Peladon Software Group in January 2006 accounts for the lower current investments and cash holding. Cash flow from operating activities remains positive.

Treasury policy

Surplus funds are currently invested with, and by, UK banks. The Board monitors the Company's deployment of funds with a view to minimising risk. The Company maintains funds in various major foreign currencies but does not hold, nor speculate in, such currencies at levels outside of its normal trading requirements.

Formal statement on the continuing use of the going concern basis

After making enquiries, the directors have a reasonable expectation, at the date of approval of these financial statements, that the Company has adequate resources to continue operations for the

foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

Current trading and outlook

The project to count the Scottish elections will be the most significant project in the first half of 2007. All departments in DRS will be involved in its delivery, and working in collaboration with ERS, a number of key staff in both organisations are preparing to run the e-Counting process in the 32 locations around Scotland. Recruitment of staff for the duration of the project has been occurring for some time and will continue with the recruitment and training of nearly 400 staff from Scotland to operate the scanning equipment. We have worked closely over the year with the local authorities and a comprehensive training programme is in place to ensure all of their staff are familiar with the DRS e-Counting solution. All of the ballot papers for the three contests will be supplied by DRS and this accounts for over 400 different ballot paper designs and approximately 9 million papers.

Work will continue during the year to establish our e-Counting and e-Voting solutions as part of the DCA framework. We decided not to enter any of the election trials scheduled for May 2007 because of our involvement in Scotland. However we expect there to be a number of new trials in 2008 and we believe DRS will be in a good position to win the contract for some of these.

The use of e-Marker[®] to process AQA's summer series of examinations will span the middle of the year with most of the work at the start of the second half. Volumes are expected to be greater than last year and consequently e-Marker[®] will make a large contribution to the turnover of the company. The team dedicated to running all of the e-Marker[®] projects has developed over the past few years and this range of services has become a major part of DRS.

DRS design and print forms for first Nigerian Census in 15 years

Nigeria's population is estimated to be between 120 and 150 million. Designed so that data can be electronically processed, the forms recorded everything from people's age to what kind of WC facilities they have within their home. The government says the census is to help plan development and has been planning it for three years.

The census forms were packed into over 100,000 boxes on almost 600 pallets. The majority of these were shipped in 22 sea freight containers, with the

“Trading in the first half of the year was particularly good and was boosted by the printing contract for the Nigerian Population Census”

The decline in sales of our traditional OMR scanners into schools is being addressed by the launch of two new products. Both products were launched in January 2007 at BETT, the worlds' largest educational ICT exhibition. The first product is a new pupil registration device called DRS IntelliReg. This enables students to register their attendance in school by placing their finger on a sensor. Their fingerprint is not recorded but a numeric value which is unique to each fingertip is created which identifies them. The IntelliReg system can have sensors located anywhere on the school premises and they are linked to the school's main administration system. This enables schools to get instantaneous information on students' whereabouts and can allow registration more frequently than was previously possible, including before every lesson. The increasing emphasis on reducing truancy in schools and improving security is leading to a high demand for these types of systems. IntelliReg is capable of other applications in the future including access control, cashless canteens and library control. It is also finding favour outside schools in further education.

The second product launched at BETT was the PS370, a new combined image and OMR scanner. The scanner will be capable of reading the existing OMR forms which many schools use and will want to continue to use. It will also connect directly to the school management information systems. But in addition it will be capable of processing images so that many other school administration tasks can be automated.

We are confident that the very strong product offering from Peladon will continue to expand sales in both existing and new markets. The good reseller sales during 2006 will also start to contribute to turnover with ongoing maintenance contracts. The new products launched in 2006 have already begun to show potential and we believe this will increase during the year. These factors combined with sales of DocXP

by DRS in the UK and internationally give a very promising outlook for the future.

The combination of significant election work, e-Marker® growth and increased Peladon sales gives a very encouraging picture for revenue in 2007. However, all of these markets do require ongoing investment to develop the products and maintain our market lead. Also the introduction of new products into the schools market will require both product investment and marketing. Despite this we are confident that with a firm control of costs there will be growth in both revenue and profit for the year.

Tony Lee
Chief Executive
12 March 2007

remainder being despatched by air freight and transported to the airport on six articulated lorries. The total weight shipped was over 550 tonnes.

The Nigerian National Population Commission (NPC), who ran the census, reported the project as being a success.

The directors

Malcolm Brighton OBE, DL Chairman

Malcolm Brighton was Managing Director from the company's establishment in 1969 until 2001. An Economics graduate, he previously worked in market research and served as Vice Chairman of the British Market Research Society. He is currently Chairman of Milton Keynes Primary Care Trust, and a member of Milton Keynes Economic and Learning Partnership, and Milton Keynes Partnership (the SPV for expanding Milton Keynes). He is also a Director of two small private companies; Daybright Limited and Hintlesham Hall Limited.

Tony Lee BSc, MPhil Chief Executive

Tony Lee joined the company in March 1997 as Technical Director, having previously been European Technical Director for Dolch Computer Systems. He has worked in the electronics and computer industry for more than 25 years. In the late 1980s he was Head of Research and Development for Epson and was involved in a number of international projects developing printing, communications, image scanning and recognition technologies. He was appointed to the Board in September 1997 and appointed Chief Executive in March 2001.

Mark Tebbutt ACMA Finance Director/Company Secretary

Mark Tebbutt qualified as a Chartered Management Accountant in 1984. He gained a broad operational knowledge of financial management with Bass and Grand Metropolitan before joining Misys as the Financial Director for two of its subsidiaries. Thereafter, he held an operational role for six years in Stanley Works and joined DRS in 2001 as head of finance. Mark was appointed Finance Director in March 2002 and Company Secretary in March 2003.

DRS Group organisation



Ann Limb PhD, MA non-Executive Director

Ann Limb was appointed to the Board of DRS as a non-Executive Director in March 2003. A modern linguist and teacher by profession, she worked extensively in further education for 25 years, spending over half her career as Principal and Chief Executive, firstly at Milton Keynes College and then Cambridge Regional College. Between 2001 and 2004, Ann was Group Chief Executive of the University for Industry, the government's national e-learning and e-services flagship responsible for the operation of Learndirect and UK on-line. Ann currently works as an educational advisor to government and serves on boards of a number of other companies, charities and public bodies. She is founder and Chair of the Helena Kennedy Foundation for social justice.

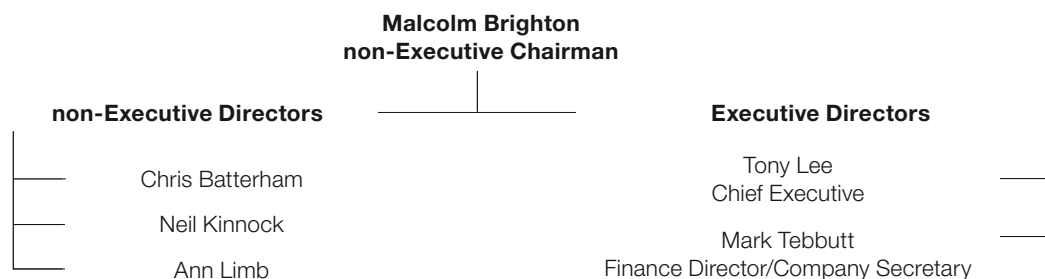
Rt Hon Lord Kinnock of Bedwellty non-Executive Director

Neil Kinnock was appointed as a non-Executive Director of DRS in March 2005. An Industrial Relations and History Graduate, he taught industrial and trade union studies before being elected Member of Parliament for Bedwellty and Islwyn in 1970. In 1979 he was appointed Labour's Chief Opposition Spokesperson on Education and was elected Leader of the Labour Party in 1983, a position he held until 1992. He was appointed to the European Commission in 1995, with the Transport portfolio to 1999 and then as Vice President 1999-2004. He was appointed to the Peerage in January 2005 and has been Chairman of the British Council since 2004.

Chris Batterham FCA, MA Senior Independent non-Executive Director

Chris Batterham was appointed as a non-Executive Director in September 2005. Chris qualified as a Chartered Accountant with Arthur Andersen. He was Finance Director of Unipalm plc, the first internet company to IPO and stayed with the company for five years following its takeover by UUnet. More recently, he was CFO of Searchspace Group until 2005 and is currently a non-Executive Director of SDL plc, The Risk Advisory Group Ltd, Iomart plc and The Sporting Exchange Group Limited (Betfair). He has also served on the Boards of Staffware plc, DBS Management plc and The Invesco Techmark Enterprise Trust plc. Chris brings a wealth of experience in the strategic development of companies within the IT sector.

DRS Data & Research Services plc Board of Directors



Directors' Report & Accounts 2006

Observers watching e-Counting process

- 14** Report of the directors
- 17** Report on directors' remuneration
- 21** Corporate Governance disclosure statement
- 24** Report of the independent auditors
- 26** Consolidated income statement
- 27** Consolidated balance sheet
- 28** Consolidated statement of changes
in shareholders' equity
- 29** Consolidated cash flow statement
- 30** Notes to the financial statements

Report of the directors

The directors present their report together with the audited Group and Company financial statements for the year ended 31 December 2006.

Principal activities and business review

The principal activities of the Group are the provision of data capture services, the manufacture and sale of Optical and Image scanning equipment and complementary services.

A review of the business during the year, likely future developments and the Company's activities in research and development are given in the Chairman's statement and the Operating and financial review.

Results and dividends

The Group profit for the year after taxation amounted to £166,000 (2005: loss £7,000).

The directors recommend a proposed dividend of 0.25p per share (2005: nil) which, together with the interim dividend of 0.25p per share paid in November 2006, makes a total dividend for the year of 0.5p per share (2005: nil). If approved at the Annual General Meeting to be held on 14 May 2007, the proposed dividend will be paid on 25 May 2007 to those shareholders on the register at close of business on 27 April 2007.

Post balance sheet events

There have been no post balance sheet events since the period end that require disclosure.

Financial risk management

Details of the Group's financial risk management objectives and policies are given in note 3 to the financial statements.

Key risks/uncertainties

A significant proportion of the Group's business comprises one-off large contracts providing tailored solutions. The nature of these contracts requires each to be managed as a unique project with project teams required to address the specific complexities and commercial risks. Group sales have a tendency to be lumpy, dependent on when these contracts occur. The Group has a high proportion of fixed overheads and consequently these fluctuations in revenue can lead to significant variations in profitability.

Financial and non-financial KPIs

Specific reference is made to performance measurement in the section on internal control and risk management within the Corporate Governance disclosure statement. Time and accuracy are often key performance requirements in addition to cost. Large contract fulfilment is achieved with tightly controlled projects and dedicated project teams who record all direct costs, availability of resource, milestones and resilience of solution to meet customer requirements.

Statement of responsibilities

The directors are responsible for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards (IFRS) as adopted by the European Union.

The directors are required to prepare financial statements for each financial year which give a true and fair view of the financial position of the Group and the Company, the Group and Company financial performance and the cash flows for that period.

In preparing each of the Group and the Company financial statements, the directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable International Financial Reporting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the financial statements comply with the Companies Act 1985, as amended, and Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

In so far as the directors are aware:

- there is no relevant audit information of which the Company's auditors are unaware; and
- the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

The directors are responsible for the maintenance and integrity of the website and accordingly the auditors accept no responsibility for the information published.

Information published on the website is accessible in many countries and legislation in the UK concerning the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors

The current members of the Board, together with biographical details of each director, are set out on pages 10 and 11.

Steve Beats, Gary Brighton and Simon Day resigned from the DRS Data & Research Services plc Board on 16 January 2006 having taken up similar positions on the Board of DRS Data Services Limited.

Nigel Turnbull was a director until his resignation on 30 September 2006.

All the other directors served throughout the year.

Details of directors' service contracts and a statement of the interests of the directors and their families in the ordinary shares of the Company is given in the report on director's remuneration on pages 17 to 20.

No director has any material interest in any contractual agreement subsisting during or at the end of the year which is or may be significant to the Group.

Retirement and re-election of directors

In accordance with the Company's Articles of Association, one-third (or nearest whole number below one-third) of the directors of DRS Data & Research Services plc are required to retire at each AGM, together with directors appointed since the previous AGM. In addition, under the Combined Code on Corporate Governance, directors are required to submit themselves for re-election by shareholders every three years.

M Brighton and A M Tebbutt retire by rotation and, being eligible, offer themselves for re-election at the 2007 AGM.

Substantial shareholdings

At the date of this report the Company has been notified under the provisions of the Companies Act 1985 of the following shareholdings of 3% or more in the issued share of the Company:

	Ordinary shares of 5p each	Percentage holding
Malcolm Brighton	7,079,697	20.45
S D Stewart	2,200,000	6.35
Gary Brighton	2,000,000	5.78
J A Brighton	2,000,000	5.78
Mark Brighton	2,000,000	5.78
DRS Data & Research Services plc	1,930,000	5.57
HSBC Global Custody		
Nominee (UK) Ltd	1,585,000	4.57
J P MacArthur	1,139,400	3.29

Charitable donations

Charitable donations in the year amounted to £11,141 (2005: £19,520).

Creditor payment policy

The Company's normal practice is to agree terms and conditions with all suppliers before business takes place. Payment is then made on these terms subject to satisfactory performance by the supplier. Trade creditors at the year end represented 32 days (2005: 40 days) of average supplies for the year.

Treasury shares

The Company continues to hold 1,930,000 ordinary shares of 5p purchased between 3 June and 15 July 2004 for a total consideration of £1,166,000 as treasury shares. This represents 5.57% of the Company's called up share capital.

Annual General Meeting

The Annual General Meeting of the Company will be held on Monday 14 May 2007 at 3.00pm at the Group's Registered offices, 1 Danbury Court, Linford Wood, Milton Keynes, MK14 6LR at which shareholders will be asked, as items of special business, to give power to the directors to allot shares and to give power to the directors to disapply the pre-emption requirements of Section 89 of the Companies Act 1985.

Report of the directors continued

Renewal of authority to allot

The current authority to allot relevant securities within the meaning of Section 80 of the Companies Act 1985 will expire on 30 June 2007 or at the 2007 Annual General Meeting, if earlier. Resolution 7 as set out in the Notice of the Annual General Meeting, will be proposed as an Ordinary Resolution to authorise the directors to allot ordinary shares in the capital of the Company up to an aggregate nominal amount of £568,920. The authority (unless previously varied, revoked or renewed) will expire on the 30 June 2008 or at the 2008 Annual General Meeting.

Disapplication of pre-emption rights

The current authority for directors to allot equity securities for cash without first being required to offer such securities to existing shareholders in proportion to their existing holdings expires on 30 June 2007 or at the 2007 Annual General Meeting, if earlier. Resolution 8 as set out in the Notice of the Annual General Meeting, will be proposed as a special resolution to renew the authority of the directors under Section 95 of the Companies Act 1985 to allot shares for cash otherwise than on a pre-emptive basis. The number of shares which may be allotted will be limited to an aggregate nominal value of £86,554 (representing 5% of the issued share capital of the Company). The authority (unless previously varied, revoked or re-worked) will expire on the earlier of 30 June 2008 or the 2008 Annual General Meeting.

Although there is no present intention of issuing any shares (other than pursuant to the Company's share option schemes), the directors consider it is desirable to maintain the flexibility afforded by these provisions.

Going concern

The Board's review of the accounts and the subsidiary companies' budgets, leads the directors to believe that the Group has adequate resources to continue in existence for the foreseeable future. For this reason the financial statements have been prepared on a going concern basis.

Auditors

The auditors, Grant Thornton UK LLP, have indicated their willingness to continue in office and a resolution re-appointing them as auditors will be proposed at the 2007 Annual General Meeting.

By order of the Board

Mark Tebbutt

Company Secretary
12 March 2007

Report on directors' remuneration

The Board has prepared this report in accordance with the requirements of Schedule 7A of the Companies Act 1985 and the Listing Rules of the UK Listing Authority.

Remuneration Committee

The Remuneration Committee comprised of all the independent non-Executive Directors of the Company. Up to his resignation from the Board in September 2006, Nigel Turnbull was Chairman of the Committee, at which time Ann Limb took over the role of Remuneration Committee Chairman and its membership was reduced from four to three. None of the Committee members have any personal financial interests (other than as shareholders), potential conflicts of interest arising from cross-directorships, or any day-to-day involvement in running the business. The Chairman and Chief Executive, at the invitation of the Committee, attend the meetings but are not present when their own remuneration is discussed.

The Committee meets formally at least once a year in January, but it is the practice of the Committee to meet on an ad hoc basis throughout the year to address matters that arise. As well as considering the conditions in the Company as a whole, the Committee takes into account the position of the Company relative to other companies and is aware of what companies are paying, although comparisons are treated with caution to avoid remuneration escalation. The Committee met on two occasions in 2006.

Advisers

During 2005, external independent professional advice was sought from Halliwell Consulting by the Board and the Committee on remuneration issues in respect of the structure and appropriateness of the total remuneration packages of the Executive Directors. In 2006, advice for managers was sought from Croner's Reward.

Remuneration policy

The Company's policy on directors' remuneration is that the packages are designed to attract, motivate and retain directors of the calibre necessary to maintain the Company's position as a market leader and so reward them for enhancing shareholder value. The Remuneration Committee determines the contract terms, basic salary and other remuneration for each of the Executive Directors, including performance-related share options, bonuses and pension rights.

Remuneration packages

The Executive Directors' remuneration package includes fixed and variable elements to provide rewards for both the short and long term. Details of the individual elements of the remuneration package and employment contracts are:

Basic salary and benefit

An Executive Director's basic salary is determined by the Remuneration Committee in January of each year, having regard to individual responsibilities, performance and comparative information. In addition the Company provides benefits comprising a company car fully funded for business mileage, or a cash allowance in lieu of company car, settlement by the Company of professional fees in respect of personal tax affairs, private healthcare arrangements, life assurance cover and permanent health insurance.

Performance related cash bonus

The Remuneration Committee, in awarding annual bonuses, considers the Group's financial performance during the year in respect of turnover, profitability, EPS and an assessment of the individual Executive Director's performance against non-financial criteria presupposing that the Group's profit targets have been achieved.

Long-term equity based incentive plans

The Remuneration Committee's policy has been to grant to Executive Directors share options that relate to the Group's growth in EPS, in order to align the interests of directors more closely with those of the shareholders. The Group's policy is now to reward senior executives by way of options up to a total of £30,000 and by the grant of a Long Term Incentive Plan (LTIP).

In February 2005 HM Revenue & Customs approved a Share Incentive Plan (SIP) for all employees of the Company including the directors. The SIP allows participants to invest up to £1,500 per annum by way of salary deduction in the Company's shares. For every two partnership shares purchased by the participant, one additional matching share is gifted by the Company. The scheme is operated in accordance with HM Revenue & Customs rules.

In November 2005, at an Extraordinary General Meeting, the shareholders approved a Long Term Incentive Plan (LTIP) for Executive Directors and key senior executives. Awards under the scheme are based on the Company's EPS and Total Shareholder Return (TSR) performance being at least at the median compared to the companies constituting the FTSE All Share Software & Computer Services Index.

Report on directors' remuneration continued

Pensions

Each of the Executive Directors is a member of one of the Company's money purchase pension schemes. Pension arrangements for each Executive Director provide for a pension on retirement at the age of 65 based on a contribution by the Company of a sum equivalent to 20% of basic salary. Base salary is the only component of remuneration which is pensionable. There is no requirement for an individual director to contribute to his pension scheme. Their dependants are eligible for Dependant's Pension and the payment of a lump sum equivalent to four times basic salary in the event of death in service.

Directors' contracts

The Executive Directors have rolling contracts with six months' notice which are in line with the recommendations of the Combined Code 2006. The contracts date from the dates of appointment to the Board as set out in Directors' interests below. There is no defined provision for compensation payable upon early termination of the contract.

It is the intention of the Remuneration Committee that any future Executive Director appointment will be based on contracts similar to those in effect for the current Executive Directors.

The non-Executive Directors each have letters of appointment, which refer to the re-election requirements under the Company's Articles of Association. Each appointment is for a period of three years, or when individual directors are required to offer themselves for retirement by rotation, whichever is the earlier. The appointment may, however, be terminated by three months' notice from either party at any time. There is no provision for compensation payable upon early termination. Copies of the letters of appointment will be available for inspection at the AGM.

Directors' interests

The interests of directors (including their spouses' holdings) in the ordinary shares of the Company as recorded in the register maintained by the Company in accordance with the provisions of the Companies Act 1985 were as follows:

	Date of appointment to Board	Ordinary shares of 5p		
		As at 12 Mar 2007	As at 31 Dec 2006	As at 1 Jan 2006
C M Batterham	12.09.2005	40,000	40,000	40,000
M Brighton OBE (Chairman)	16.09.1969	9,079,697	9,079,697	9,079,697
Lord Kinnock	14.03.2005	–	–	–
A C Lee	15.09.1997	110,718	109,727	103,820
A G Limb	17.03.2003	15,000	15,000	15,000
A M Tebbutt	25.03.2002	470,432	469,441	463,534

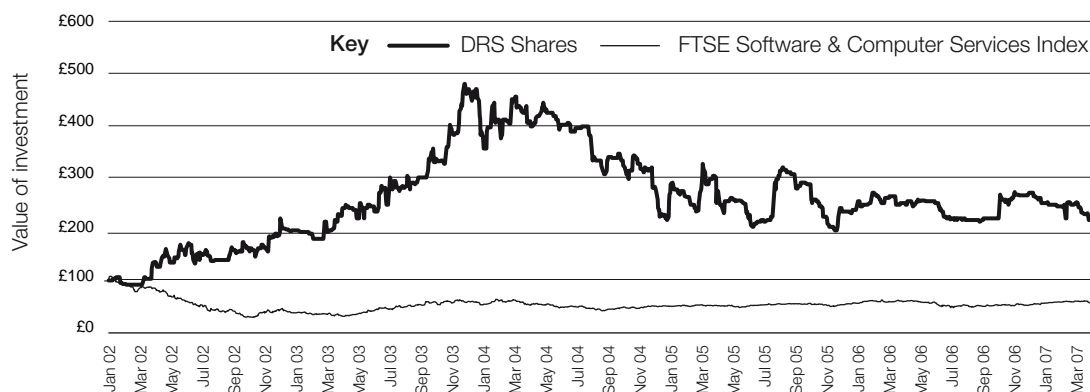
On 16 January 2006, S M Beats, S J Day and G Brighton resigned from the DRS Data & Research Services plc Board to take up similar positions on the subsidiary DRS Data Services Limited Board.

Performance graphs

The graph below compares the Company's total shareholder return performance against the FTSE All Share Software & Computer Index. The FTSE All Share Software & Computer Index is considered the most appropriate for comparison purposes.

The graph shows the change in hypothetical value of £100 invested in the Company's ordinary shares on 1 January 2002 compared with the change in hypothetical value of £100 invested in the FTSE All Share Software & Computer Index.

DRS Share Performance versus FTSE Software & Computer Services Index



Directors' remuneration

The remuneration of the individual directors listed is as follows:

	Salary and fees £000	Annual performance-related bonus £000	%	Benefits £000	Total 2006 £000	Total 2005 £000	Money purchase pension contributions 2006 £000	2005 £000
Executive								
S M Beats	–	–	–	–	–	89	–	16
G Brighton	–	–	–	–	–	81	–	14
S J Day	–	–	–	–	–	89	–	15
A C Lee (CE)	97	–	–	13	110	108	19	19
A M Tebbutt	84	–	–	12	96	94	17	17
	181	–	–	25	206	461	36	81
non-Executive								
C M Batterham	20	–	–	–	20	6	–	–
M Brighton (Ch)	28	–	–	–	28	25	–	–
Lord Kinnock	20	–	–	–	20	13	–	–
A G Limb	20	–	–	–	20	20	–	–
N V Turnbull	15	–	–	–	15	20	–	–
	103	–	–	–	103	84	–	–
Total	284	–	–	25	309	545	36	81

Annual performance-related bonus is expressed as a percentage of annual salary. The maximum bonus achievable is, for the Chief Executive, 50% of salary and for the Finance Director, 40%.

Report on directors' remuneration continued

Share option schemes

Share options are awarded by the Remuneration Committee. There are four Company share option schemes currently in operation for Executive Directors and employees: 1996 DRS Restricted Share Scheme, the DRS Data & Research Services plc Enterprise Management Incentive Scheme, the DRS Data & Research Services plc Executive Share Option Plan 2003 and the DRS 2005 Long Term Incentive Plan.

During 2006 options have been granted to the Executive Directors under the terms of the DRS 2005 Long Term Incentive Plan. The performance criteria is based on the level of EPS in the most recently reported financial year on the third anniversary of the date of grant and the TSR over these three years being at least at the median compared to the companies constituting the FTSE All Share Software & Computer Services Index. The proportion of the award that shall be released is set out on a sliding scale dependent upon the EPS reported in the 2008 audited annual accounts being greater than 3.0p per share. 25% of the qualifying option will be exercisable if the EPS equals 3.0p and 100% will be exercisable if the EPS is 6.0p per share, with pro-rata award between these levels. In any financial year a participant may not be awarded options over ordinary shares with an aggregate value of more than their basic salary calculated by reference to the market value of the ordinary shares at the time of the grant.

Directors' share options

Details of directors' share options are given below.

	Scheme	Options granted to 01.01.07	Granted in year	Lapsed	Exercised during year	Options held at 31.12.06	Exercise price	Exercisable date	Expiry date
A C Lee	RSS	100,000	–	–	–	100,000	18.0p	10.09.03	10.09.10
A C Lee	EMI	239,437	–	239,437	–	–	35.5p	28.05.06	28.05.13
A C Lee	EMI	24,793	–	–	–	24,793	60.5p	26.03.07	26.03.14
A C Lee	ESOP	53,719	–	–	–	53,719	60.5p	26.03.07	26.03.14
A C Lee	LTIP	195,000	–	–	–	195,000	nil	04.11.08	04.11.15
A C Lee	LTIP	–	196,419	–	–	196,419	nil	28.03.09	28.03.16
A M Tebbutt	EMI	186,413	–	186,413	–	–	35.5p	28.05.06	28.05.13
A M Tebbutt	EMI	41,322	–	–	–	41,322	60.5p	26.03.07	26.03.14
A M Tebbutt	EMI	17,889	–	–	–	17,889	60.5p	26.03.07	26.03.14
A M Tebbutt	LTIP	113,000	–	–	–	113,000	nil	04.11.08	04.11.15
A M Tebbutt	LTIP	–	113,716	–	–	113,716	nil	28.03.09	28.03.16

Directors' other rights to shares

The market price of the Company's shares at 31 December 2006 was 37.0p (2005: 37.5p) and the high and low values during the year were 41.25p and 32.5p respectively.

On behalf of the Board

Ann Limb

Chairman of Remuneration Committee
12 March 2007

Corporate Governance disclosure statement

The Board is committed to high standards of corporate governance and this statement sets out how the Board has complied with the provisions set out in Section 1 of the Combined Code on Corporate Governance issued by the Financial Reporting Council in July 2003 (the Code).

Compliance with the Combined Code

The Board believes that the Group has been in compliance with the provisions of the Combined Code during the year other than the following items detailed below:

A.2.2 The Chairman does not meet the independence criteria set out in the Combined Code (2003). He is one of the founding directors of the parent company who continues to have a significant role owning 20% of the Group's share capital.

A 6.1 The Group started a performance evaluation of the Board and its Committees during 2006, which will be completed in 2007.

C.2.1 The Group is not fully compliant with the standards outlined in the 'Internal Control Guidance for Directors on the Combined Code'. The directors believe that a Group of this size cannot justify the cost of putting in place all the formal review procedures.

D.1.2 The responsibility of communicating with the major shareholder and institutional investors rests with the Chief Executive and the Finance Director. It is the Group's policy to make the directors available at the shareholders' request.

Board of directors

The Board of directors are responsible for determining overall Group strategy; establishing policies and objectives; ensure that necessary financial and human resources are in place to enable these objectives to be met; and review management performance. The Board provides leadership of the Group within a framework of prudent and effective controls which enables risk to be assessed and managed and it ensures that obligations to shareholders and others are understood and met.

The Board met seven times in 2006 and has a schedule of matters specifically reserved to it for decision.

Management supply the Board with appropriate and timely information and the directors are free to seek any further information they consider necessary. The Chairman meets at least once a year with the non-Executive Directors without other members of the executive management being present. All directors have access to advice from the Company Secretary and independent professionals at the Company's expense.

At 31 December 2006 and at the date of this report, the Board comprises the Chairman, who has no executive responsibilities, two Executive Directors and three non-Executive Directors. With the exception of the Chairman, the Board considers all the non-Executive Directors are independent under the Code. The names and biographical details of the current directors are given on pages 10 and 11.

The non-Executive Directors possess broad business and commercial experience with independent and objective judgement in markets that DRS operates and as part of their role as members of the Board, they constructively challenge and help develop proposals on strategy. They satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are adequate. They are responsible for determining appropriate levels of remuneration of Executive Directors and have a prime role in appointing, and where necessary removing, Executive Directors, and in succession planning.

The roles of the Chairman and Chief Executive are separated and their responsibilities are clearly established. The Chairman, Malcolm Brighton, is responsible for the leadership and workings of the Board, and ensuring its effectiveness, and the Chief Executive, Tony Lee, is responsible for the running of the business and the implementation of the Board strategy and policy.

The Board has named Chris Batterham as the Senior Independent Director and he is the contact for arrangements by which Group employees may, in confidence, raise concerns about possible wrongdoing in financial reporting or other matters (so called whistleblowing procedures) and is responsible for ensuring that arrangements allow proportionate and independent investigation of such matters and for appropriate follow-up action.

Corporate Governance disclosure statement continued

Attendance at meetings

The following table details the number of Board and Committee meetings held during the year ended 31 December 2006 and the attendance record of each Director.

	Board meetings	Committee meetings		
		Audit	Remuneration	Nomination
Number of meetings held in year	7	3	2	2
C M Batterham*	6	3	2	2
M Brighton*	7	3 [#]	2	2
Lord Kinnoek*	6	3	1	2
A C Lee	7	3 [#]	2 [#]	2
A G Limb*	7	3	2	2
A M Tebbutt	7	3 [#]	–	–
N V Turnbull*	4	2	2	2

* non-Executive Director

[#] Attendance by invitation (for all or part of meeting)

Board Committees

The Board has established three main Committees: Nominations, Remuneration and Audit. The terms of reference of each Committee is reviewed annually by the Board and are available upon request from the Company Secretary, or from the Group's website at www.drs.co.uk

Nominations Committee

This Committee meets as required to initiate the selection process and the appointment of members to the Board. The members of the Nominations Committee are the Chairman, the Chief Executive, and the three other non-Executive Directors. The Committee is chaired by Malcolm Brighton. Two Nomination Committee meetings were held during 2006.

Remuneration Committee

The Remuneration Committee is responsible for determining the remuneration of the Executive Directors and for recommending and monitoring the level and structure of remuneration for certain senior executives.

The report on directors' remuneration set out on pages 17 to 20 provides more information on the Remuneration Committee and the Company's remuneration policy for Executive and non-Executive Directors.

The remuneration of the non-Executive Directors is determined by the Executive Directors.

Audit Committee

The Committee consists solely of independent non-Executive Directors. Up to his resignation from the Board in September 2006 Nigel Turnbull was Chairman of the Committee, at which time Chris Batterham took over the role of Audit Committee Chairman and its membership was reduced from four to three. Chris Batterham has recent and relevant financial experience as required by the Combined Code.

The Committee's duties include reviewing the effectiveness of the Group's external auditors, review half yearly and annual financial statements before they are presented to the Board, focusing on accounting policies and compliance. The Committee considers areas of management judgement and estimates, and the effectiveness of internal control procedures.

The Audit Committee reviews the nature and extent of all services supplied by the external auditors to ensure independence is not impaired and makes recommendations to the Board on the external auditors' remuneration. The Audit Committee is responsible for overseeing the appointment and removal of external auditors.

The external auditors continue to operate procedures to safeguard against the possibility that their objectivity and independence could be compromised. They provide a report annually to the Audit Committee confirming their independence and the scope of their non-audit services.

Internal control and risk management

The Board has overall responsibility for maintaining a sound system of internal controls which cover all aspects of the business. Underlying this process is the Board's aim to safeguard shareholders' investments and the Company's assets and to enable the Company to achieve its objectives.

The Board and senior managers are involved in an ongoing process of risk assessment and evaluation of internal controls and procedures in accordance with the guidance in the Turnbull Report. During 2006 the Board placed particular focus on implementing an improved formal risk management framework throughout the main operating company, DRS Data Services Limited. PRINCE 2 methodology (Projects In Controlled Environments is a structured method for effective project management) has been adopted and an operational risk register is maintained by a project team on each major customer contract or internal development. The project teams are cross functional to reflect the needs of the project and to encourage the interaction of skills and knowledge throughout the business.

Operational risks and issues are assessed by the project teams and the key risks that might hinder the achievement of the Group's objectives are recorded in a Group risk register that is distributed to the directors prior to each Board meeting to ensure that at least one issue of strategic risk is reviewed in detail at each Board meeting.

Internal financial controls are based upon a budgetary process which involves senior managers working with the Executive Directors to prepare an annual budget that is in line with corporate objectives. Senior managers' performance is then monitored against the agreed financial targets in management accounts that are prepared on a monthly basis. The overall approach is supported by detailed internal financial controls operated on a day-to-day basis on all aspects of the business.

The risk assessment framework is structured to promote processes being documented; appropriate and proper use of resources; proper accounting records are maintained; the reliability of management information; compliance with appropriate legislation and regulation and the identification and control of business risks. The Board believes that such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurances against material errors, losses or fraud.

The Board has considered the need for an internal audit function but has decided the size of the Group does not justify it at present. However, it will keep the decision under annual review.

Details of the financial risk management objectives and policies of the Group, and exposures to financial risks are given in note 3 to the financial statements.

Environmental policy

It is the Group's policy to support and encourage environmentally sound business operations. Recognising that the Company's own operations have minimal direct environmental impact, our policy is to:

- meet all statutory obligations placed on us;
- where sensible, encourage working practices, such as electronic information exchange, that reduce environmental load; and
- recycle waste products wherever possible, encourage use of environmentally friendly materials and dispose safely of any non-recyclable materials.

Health and safety

The Group recognises and accepts its responsibility to ensure a high standard is adhered to in the provision of health, safety and welfare for its employees at work, its customers and the general public. The Group will take all steps necessary and work within its power to meet this responsibility by regularly reviewing, amending and improving all relevant policies and procedures, meeting its obligations and exceeding best practice standards wherever possible.

Relations with shareholders

The Company is committed to ensuring that there is effective communication with all shareholders. The Company operates a well developed and up-to-date website which provides all regulatory news announcements, press releases and initiatives of direct interest to shareholders. An electronic version of the Annual Report and Accounts is available to allow this information to be easily downloaded. That website address is www.drs.co.uk.

Following the publication of the interim and full year results, the Chief Executive and Finance Director meet with the major institutional shareholders. Fund managers and analysts are also given the opportunity to meet with a member of the executive Board, if they so require.

The AGM is used to communicate with private investors and they are encouraged to participate. It is attended by all Board members. Shareholders are invited to ask questions and are able to meet the directors informally. Separate resolutions are proposed on each issue so that they can be given proper consideration and there is a resolution to adopt the Annual Report and Accounts. The Company counts all proxy votes and will indicate the level of proxies lodged on each resolution before it has been dealt with by a show of hands.

By order of the Board

Mark Tebbutt

Company Secretary
12 March 2007

Report of the independent auditors to the members of DRS Data & Research Services plc

We have audited the Group and parent company financial statements (the 'financial statements') of DRS Data & Research Services plc for the year ended 31 December 2006 which comprise the consolidated income statement, the consolidated and parent company balance sheets, the consolidated and parent company cash flow statements, the consolidated and parent company statements of changes in members' equity, and notes 1 to 47. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the report on directors' remuneration that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the report on directors' remuneration and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted for use by the European Union are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements and the part of the report on directors' remuneration to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the report on directors' remuneration to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements. The information given in the directors' report includes that specific information presented in the Chairman's statement and financial and operating review that is cross referred from the business review section of the directors' report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance statement reflects the Company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the directors' report, the unaudited part of the report on directors' remuneration, the Chairman's statement and the financial and operating review and the Corporate Governance disclosure statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the report on directors' remuneration to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the report on directors' remuneration to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the report on directors' remuneration to be audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2006 and of its profit for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2006;
- the financial statements and the part of the report on directors' remuneration to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation; and
- the information given in the Directors' report is consistent with the financial statements.

Separate opinion in relation to IFRSs

As explained in note 1.2 to the Group financial statements, the Group and parent company in addition to complying with their legal obligation to comply with IFRSs as adopted by the European Union, have also complied with the IFRSs as issued by the International Accounting Standards Board.

In our opinion the Group and parent company financial statements give a true and fair view, in accordance with IFRSs, of the state of the Group's and parent company's affairs as at 31 December 2006 and of the Group's profit for the year then ended.

Grant Thornton UK LLP

Registered Auditors
Chartered Accountants
Central Milton Keynes
12 March 2007

Consolidated income statement

for the year ended 31 December 2006

	Notes	2006 £000	2005 £000
Revenue	5	16,690	12,452
Cost of sales		(10,782)	(7,835)
Gross profit		5,908	4,617
Other operating income	7	44	146
Selling and marketing costs		(1,329)	(1,266)
Administrative expenses		(4,136)	(3,420)
Finance costs	9	(254)	(60)
Profit before income tax		233	17
Tax charge	10	(67)	(24)
Profit/(Loss) for the period		166	(7)
Earnings/(Loss) per share for profit attributable to the equity holders of the company during the year (expressed in pence per share)			
– basic	24	0.52p	(0.02p)
– diluted	24	0.51p	(0.02p)
Dividends			
– interim paid	25	81	–
– final proposed		81	–
		162	–

Consolidated balance sheet

at 31 December 2006

	Notes	2006 £000	2005 £000
Assets			
Non-current assets			
Property, plant and equipment	11	4,045	4,103
Intangible assets	12	2,021	788
Goodwill	13	1,894	–
Deferred income tax assets	20	185	20
		8,145	4,911
Current assets			
Inventories	14	1,700	1,517
Trade and other receivables	15	3,812	3,133
Other financial assets at fair value through profit or loss	16	–	1,063
Cash and cash equivalents	17	1,441	2,284
		6,953	7,997
Total assets		15,098	12,908
Equity			
Capital and reserves attributable to the company's equity holders			
Share capital	18	1,731	1,731
Share premium account	19	5,377	5,377
Capital redemption reserve	19	115	115
Treasury shares	18	(1,166)	(1,166)
Own shares reserve	19	(113)	(120)
Translation reserve	19	(248)	–
Profit and loss account		2,536	2,411
Total equity		8,232	8,348
Liabilities			
Non-current liabilities			
Borrowings	23	2,250	–
Deferred income tax liabilities	20	268	30
Provisions and other liabilities	21	312	–
		2,830	30
Current liabilities			
Trade and other payables	22	3,751	3,477
Current income tax liabilities		285	53
Borrowings	23	–	1,000
		4,036	4,530
Total liabilities		6,866	4,560
Total equity and liabilities		15,098	12,908

The financial statements were approved by the Board of Directors on 12 March 2007 and signed on its behalf by:

A C Lee
Chief Executive

A M Tebbutt
Finance Director

Consolidated statement of changes in shareholders' equity

	Share capital £000	Share premium account £000	Capital redemption reserve £000	Treasury shares £000	Own shares reserve £000	Profit and loss account £000	Translation reserve £000	Total £000
At 1 January 2005	1,731	5,377	115	(1,166)	(122)	2,692	–	8,627
Loss for the period	–	–	–	–	–	(7)	–	(7)
Employee Share Based Compensation	–	–	–	–	–	47	–	47
Deferred tax on items relating to equity	–	–	–	–	–	2	–	2
Dividend	–	–	–	–	–	(321)	–	(321)
Own shares vesting	–	–	–	–	2	(2)	–	–
At 31 December 2005	1,731	5,377	115	(1,166)	(120)	2,411	–	8,348
At 1 January 2006	1,731	5,377	115	(1,166)	(120)	2,411	–	8,348
Currency translation adjustment	–	–	–	–	–	–	(281)	(281)
Profit for the period	–	–	–	–	–	166	–	166
Employee Share Based Compensation	–	–	–	–	–	47	–	47
Deferred tax on items relating to equity	–	–	–	–	–	–	33	33
Dividend	–	–	–	–	–	(81)	–	(81)
Own shares vesting	–	–	–	–	7	(7)	–	–
At 31 December 2006	1,731	5,377	115	(1,166)	(113)	2,536	(248)	8,232

Consolidated cash flow statement

for the year ended 31 December 2006

	Notes	2006 £000	2005 £000
Cash flows from operating activities			
Cash generated from operations	26	1,098	189
Interest paid		(129)	(57)
Income tax paid		(43)	(62)
Net cash generated in operating activities		926	70
Cash flows from investing activities			
Purchases of property, plant and equipment (PPE)		(635)	(496)
Proceeds from sale of PPE		18	15
Purchase of intangible assets		(867)	(960)
Peladon acquisition purchase		(2,469)	–
Purchases of financial assets at fair value through profit or loss		–	(1,032)
Proceeds from sale of financial assets at fair value through profit or loss		1,063	3,392
Interest received		44	138
Net cash (used)/generated from investing activities		(2,846)	1,057
Cash flows from financing activities			
Repayment of subsidiary loans		(73)	–
Re-mortgage on Linford Wood office		1,250	–
Dividends paid to Group's shareholders		(81)	(321)
Net cash generated/(used) in financial activities		1,096	(321)
Net (decrease)/increase in cash and cash equivalents			
Cash and cash equivalents at beginning of period		(824)	806
Exchange gains on cash		2,284	1,478
		(19)	–
Cash and cash equivalents at end of period	27	1,441	2,284

Notes to the financial statements

for the year ended 31 December 2006

1 General information

1.1 Nature of operations

DRS Data & Research Services plc is a public limited company with a full listing on the London Stock Exchange incorporated and domiciled in England. The address of the registered office is 1 Danbury Court, Linford Wood, Milton Keynes.

On 1 January 2006, DRS Data & Research Services plc transferred its operational activities to a fully owned subsidiary called DRS Data Services Limited. Up to the close of business on 31 December 2005, the principal activity of providing data capture services, the manufacture and sale of Optical and Image scanning equipment and complementary services was undertaken by the holding company. Thereafter it is undertaken by the subsidiary, DRS Data Services Limited.

On 31 January 2006, DRS Data & Research Services plc entered into an agreement to acquire the Peladon Software Group for a total consideration of \$4,865,000 (£2,745,000) excluding legal costs. The Group comprises Peladon Software Inc, which is based in San Diego, California and has a fully owned subsidiary, Peladon Software Limited, based in Andover, England. Peladon Software is a leading provider of data capture solutions designed to manage business critical information obtained from paper using its own internally developed DocXP software. The financial and operating review on pages 6 to 9 provides further details about the Peladon Software Group's operational activities.

1.2 Accounting convention

The financial statements of the Company have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union and as developed and published by the International Accounting Standards Board (IASB).

2 Summary of significant accounting policies

2.1 Basis of preparation

These financial statements are for the year ended 31 December 2006 and are presented in Pounds Sterling rounded to the nearest thousand.

The principal accounting policies of the Group are set out below and have been consistently applied to all years presented in these financial statements.

The principal accounting policies have remained unchanged from prior years except where stated.

It should be noted that accounting estimates and assumptions are used in the preparation of the financial statements. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates.

Such knowledge has been used to determine the following:

- the economic useful lives of intangible assets on which amortisation rates have been calculated;
- future profitability of Peladon Software on which the goodwill impairment evaluation was based and that deferred tax arising from losses will be recoverable; and
- establishing the carrying value of work in progress as a percentage of cost to completion for revenue recognition.

2.2 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to profit and loss in the period of acquisition.

The results of subsidiaries acquired during the year are included in the consolidated income statement from the effective date of acquisition.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

All intra-Group transactions, balances, income and expenses are eliminated on consolidation.

2.3 Revenue recognition

Turnover is the total amount receivable by the Group for goods supplied and services provided net of VAT and trade discounts.

Sales of goods are recognised when the Group has delivered products to the customer and collectability of the related receivables is reasonably assured.

Sales of services are recognised in the accounting period in which the work on the services is performed in accordance with the customer's agreed requirements.

Rental income is recognised on a straight-line basis over the period of the lease.

In the case of long-term contracts, turnover is recognised to the extent that the Group has obtained the right to consideration and is primarily the proportion of total contract value that costs incurred to date bear to total expected contract costs in accordance with appropriate accounting standards.

2.4 Leases

- The Group is the lessee
Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.
- The Group is the lessor
Scanning equipment leased to third parties under operating leases are included in property, plant and equipment in the balance sheet. They are depreciated over their expected useful lives. Rental income is recognised on a straight-line basis over the lease term.

2 Summary of significant accounting policies continued

2.5 Dividends

Under IFRS proposed dividends do not meet the definition of a liability until such time as they have been approved by shareholders at the Annual General Meeting. Therefore, DRS do not recognise a liability in any period for dividends that have been proposed but will not be approved until after the balance sheet date.

2.6 Segment reporting

Segmental data in this statement is analysed across the core functions of data handling (being scanning equipment, print, software and bureau services). The analysis reflects the work undertaken by the direct cost centres within the Group. The cost of resources managed by indirect cost centres have been apportioned to the core functions by the most appropriate methods that can be consistently applied. Many of these support services are shared.

2.7 Foreign currency translation

Sterling is the parent company's functional currency and the Group tries to deal in Sterling wherever possible in order to avoid the risk of foreign currency exchange rate movements.

Foreign currency transactions are translated into Sterling using the exchange rates prevailing at the dates of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of period-end monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

In respect of the foreign subsidiary, the income statement is translated into Sterling on a monthly basis using the exchange rate at the beginning of the month and the balance sheet is translated into Sterling using the exchange rate at the end of the financial year. The exchange difference arising from the translation of the opening net investment in subsidiaries is taken directly to the translation reserve.

2.8 Property, plant and equipment

Land and buildings relate to the Group's Head Office at Linford Wood, Milton Keynes. All property, plant and equipment are shown at cost less depreciation, except for land which is shown at cost. Cost includes expenditure that is directly attributable to the acquisition of the item.

Depreciation is provided on a straight-line basis to allocate the cost of each asset less its estimated residual value over its estimated useful life, as follows:

Freehold buildings	50 years
Computer equipment	3 years
Fixtures and fittings	5 years
Plant and machinery	3–10 years
Rental machines	3 years
Motor vehicles	5 years

Items of property, plant and equipment are subject to review for impairment where indications of impairment exist. Any impairment is charged to the income statement as it arises.

2.9 Intangible assets

(a) Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and to bring into use the specific software. These costs are amortised over their estimated useful lives of three years.

Costs associated with maintaining computer software programs are recognised as an expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Company, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets.

Computer software that has been capitalised is amortised on a straight-line basis over three years from the date it is put to operational use.

(b) Research and development

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success, considering its commercial and technological feasibility, and costs can be measured reliably. Development costs that have a finite useful life and that have been capitalised are amortised from the commencement of their use on a straight-line basis over the period of their expected benefit, not exceeding three years.

(c) Intangible assets acquired in business combination

- (i) Unpatented technology – relates to unpatented software and software products developed which are protected, so far as is practicable, by trade secret law and confidentiality agreements
- (ii) Know how – relates to technical and market orientated knowledge and experience within the management whose support is secured by service agreements. Intangible assets are recognised at fair value at the time of acquisition and amortised over their useful life.

2.10 Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition.

Goodwill is recognised as an asset and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

2.11 Inventories

Inventories are valued at the lower of cost and net realisable value. Cost is determined using the first-in, first-out method. The cost of finished goods and work-in-progress comprises raw materials, direct labour, other direct costs and, where appropriate, a proportion of attributable production overheads. Net realisable value is the estimated selling price in the ordinary course of business less applicable variable selling expenses.

2.12 Trade and other receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of the provision is the difference between the assets' carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement.

Notes to the financial statements continued

2 Summary of significant accounting policies continued

2.13 Investments – financial assets at fair value through profit or loss

The Group uses financial instruments comprising fixed interest corporate bonds and fixed interest funds which it has classified as financial assets at fair value through profit or loss. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated. Assets in this category are classified as current if they are either held for trading or are expected to be realised within 12 months of the balance sheet date. Realised and unrealised gains and losses arising from changes in fair value are included in the income statement. The fair values of quoted investments are based on current bid prices.

2.14 Cash and cash equivalents

Cash and cash equivalents include short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

2.15 Share capital

Comprises ordinary shares with a nominal value of 5p each.

Where the Company purchases treasury shares, the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the company's equity holders until the shares are cancelled, re-issued or disposed of. Where such shares are subsequently sold or re-issued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

2.16 Borrowings

The Group's only borrowing arrangements are an overdraft facility in DRS Data Services Limited secured against the current assets of the Company and a secured loan taken out by the parent company, DRS Data & Research Services plc, in February 2006 to fund the Peladon Software acquisition. The loan is shown at fair value at point of recognition, net of transaction costs incurred, thereafter at amortised cost using the effective interest rate method. Interest thereon is charged to the income statement as it accrues and all borrowing costs are expensed.

2.17 Accounting for income taxes

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated by using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the assets to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled. Deferred tax is charged or credited in the income statement, except when it relates to items credited or charged directly to equity, in which case the deferred tax is also dealt with in equity.

2.18 Employee benefits

(a) Pension obligations

The parent company operates defined contribution pension schemes under which employees of the UK based subsidiaries may participate. The Group has no legal or constructive obligations to pay further contributions after payment of the fixed contribution. The contributions to the pension schemes are charged to the income statement as they accrue, thereby matching the cost of the Group's pension obligations to the period of employment to which they relate.

(b) Bonus plans and profit sharing

The Group recognises a liability and expense for bonuses and profit sharing. Managers may be entitled to a bonus based on a formula that takes into consideration turnover, EPS, residual income in relation to employees' responsibilities and an assessment of the individual's performance which includes non-financial criteria. Employees who do not participate in the bonus scheme are entitled to participate in a profit sharing scheme based on the profitability of the subsidiary that employs them. The cost of providing these schemes is accrued against profits in the period in which the bonus is earned.

(c) Share-based employee remuneration

All share-based payment arrangements granted after 7 November 2002 and not vested by 1 January 2005 are recognised in the financial statements. The Group operates equity-settled share-based remuneration plans for remuneration of certain of its employees.

All employee services received in exchange for the grant of any share-based remuneration are measured at their fair values. These are indirectly determined by reference to the fair value of the share options or shares awarded. Their value is appraised at the grant date and excludes the impact of any non-market vesting conditions (for example, profitability and sales growth targets).

All share-based remuneration is ultimately recognised as an expense in the income statement with a corresponding credit to shareholders' funds. If vesting periods or other vesting conditions apply, the expense is allocated over the vesting period, based on the best available estimate of the number of share options or shares expected to vest. Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. Estimates are subsequently revised if there is any indication that the number of share options expected to vest differs from previous estimates. No adjustment is made to expense recognised in prior periods if fewer share options ultimately are exercised than originally estimated.

2 Summary of significant accounting policies continued

Upon exercise of share options fulfilled by the issue of new shares, the proceeds received, net of any directly attributable transaction costs up to the nominal value of the shares issued, are allocated to share capital with any excess being recorded as share premium. Options or share grants fulfilled from shares held by employee share trusts are credited to the own share reserve.

2.19 Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the entity after deducting all of its financial liabilities.

Where the contractual obligations of financial instruments (including share capital) are equivalent to a similar debt instrument, those financial instruments are classed as financial liabilities. Financial liabilities are presented as such in the balance sheet. Finance costs and gains or losses relating to financial liabilities are included in the income statement. Finance costs are calculated so as to produce a constant rate of return on the outstanding liability.

Where the contractual terms of share capital do not have any terms meeting the definition of a financial liability then this is classed as an equity instrument. Dividends and distributions relating to equity instruments are debited direct to equity.

3 Financial risk management

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

- (a) **Currency risk**
The Group operates internationally and is subject to foreign exchange risk arising from various currency exposures, primarily with respect to the US Dollar and the Euro. The Group does not hedge any transactions and foreign exchange differences on retranslation of foreign assets and liabilities are recognised in the income statement.

- (b) **Credit risk**
The Group has no significant concentrations of credit risk. Where appropriate, sales to overseas customers are usually underwritten using letters of credit unless the customer makes a significant up-front payment. A summary of all customers with indebtedness greater than £100,000 is prepared on a monthly basis for the directors and senior managers to review.
- (c) **Price risk**
The Group is exposed to a price risk on fixed interest corporate bonds which are classified on the balance sheet as financial assets at fair value through profit or loss.
- (d) **Interest rate risk**
The Group finances its operations through a mixture of shareholders' funds and bank loans. The Company's exposure to interest rate fluctuations on its borrowings is managed by the use of capped floating facilities. The Group mixes the duration of its deposits to reduce the impact of interest rate fluctuations.
- (e) **Liquidity risk**
The Group takes a prudent approach to managing liquidity risk to ensure sufficient cash is available to meet foreseeable needs and to invest cash assets safely and profitably.

4 Segment information

The principal activities of the Group continue to be the provision of data capture services, the manufacture, sale and support of Optical and Image scanning equipment, design and printing of documentation used for data capture and associated software and bureau services. Approximately half the Company's revenue relates to products and services and the other half relates to providing tailored data capture solutions. The companies in the Group are organised functionally, with each function of the business specialising in its own area of expertise. Project managers look to the functional areas in providing the appropriate tailored mix of products and services to fulfil each specific contract. In turn the functional areas are supported by indirect cost centre departments such as Research and Development, Communication and Information Development and IT Support.

The segments reflect the principal activities of the Group: Scanning equipment; Print; Software and Bureau services.

Notes to the financial statements continued

4 Segment information continued

Business segments for the year ended 31 December 2006

	Scanning equipment £000	Print £000	Software and services £000	Total £000
Revenue	4,200	5,188	7,302	16,690
Apportioned costs	(3,216)	(3,746)	(7,520)	(14,482)
Operating margin	984	1,442	(218)	2,208
Unallocated costs	–	–	–	(1,975)
Profit before tax				233
Segmented assets	3,928	2,383	7,632	13,943
Unallocated assets	–	–	–	1,155
Total assets				15,098
Segmented liabilities	(1,766)	(884)	(3,926)	(6,576)
Unallocated liabilities	–	–	–	(290)
Total liabilities				(6,866)
Capital additions	167	97	1,238	1,502
Depreciation and amortisation	244	139	1,043	1,426

Geographical segments for the year ended 31 December 2006

	United Kingdom £000	Africa £000	North America £000	Rest of World £000	Total £000
Revenue	10,553	4,314	1,437	386	16,690

Revenue of £15,898,000 was generated from UK operations and the remaining £792,000 was generated in the USA.

Comparative figures for the year ended 31 December 2005 are as follows:

	Scanning equipment £000	Print £000	Software and services £000	Total £000
Revenue	3,741	4,499	4,212	12,452
Apportioned costs	(2,632)	(3,704)	(4,452)	(10,788)
Operating margin	1,109	795	(240)	1,664
Unallocated costs	–	–	–	(1,647)
Profit before tax				17
Segmented assets	3,842	3,511	2,204	9,557
Unallocated assets	–	–	–	3,351
Total assets				12,908
Segmented liabilities	(1,927)	(1,572)	(976)	(4,475)
Unallocated liabilities	–	–	–	(85)
Total liabilities				(4,560)
Capital additions	74	48	1,334	1,456
Depreciation and amortisation	215	251	457	923

Geographical segments for the year ended 31 December 2005

	United Kingdom £000	Africa £000	North America £000	Rest of World £000	Total £000
Revenue	8,101	3,739	–	612	12,452

All 2005 revenue was generated from DRS Data & Research Services plc operations in Milton Keynes, England.

5 Revenue and profit before tax

The significant categories of revenue recognised during the period are:

	2006 £000	2005 £000
Sale of goods	4,300	3,493
Rendering of services including operating lease income	12,390	8,959
	16,690	12,452

Profit on ordinary activities before taxation is stated after:

	2006 £000	2005 £000
Auditors' remuneration:		
– audit services	41	26
– advice on implementation of IFRS	19	23
– other compliance and reporting services	20	10
– other non-audit services	1	2
Depreciation	730	724
Amortisation	696	199
Hire of plant and machinery	53	34
Operating lease expense	243	285
R&D expense	1,355	1,136

6 Operating lease income

Operating lease income relates to the leasing of CD230 and CD360 scanners into UK schools. All of the machines are on a standard agreement which can be terminated on its anniversary date by the customer provided they give three months notice prior to the anniversary date of their intention to terminate the contract. The minimum future lease income at 31 December 2006 is £326,000 and is all recoverable within one year. Of this amount, £115,000 is invoiced and included in the trade debtors balance as at 31 December 2006.

7 Other operating income

	2006 £000	2005 £000
Interest income		
Other financial assets at fair value through profit or loss	10	103
Bank interest	34	35
Fair value gains (realised and unrealised)	–	7
Net foreign exchange transaction gains	–	1
	44	146

8 Directors and employee benefit expense

Staff costs during the year were:

	2006 £000	2005 £000
Wages and salaries	5,289	4,789
Social security costs	656	514
Share options granted to directors and employees	47	48
Pension costs – defined contribution plans	289	279
	6,281	5,630

The average number of employees of the company during the year was:

	2006	2005
Scanning equipment	53	55
Print	35	40
Software and services	113	70
	201	165

Notes to the financial statements continued

8 Directors and employee benefit expense continued

Remuneration in respect of directors was as follows:

	2006 £000	2005 £000
Emoluments	309	545
Pension contributions to money purchase pension schemes	36	81
	345	626

Further details on directors' remuneration and share options are set out in the report on directors' remuneration.

9 Finance costs

	31 Dec 2006 £000	31 Dec 2005 £000
Interest expense:		
– bank borrowings	(121)	(57)
– other	(8)	–
– fair value losses (realised and unrealised)	(125)	(3)
	(254)	(60)

10 Income tax expense

	31 Dec 2006 £000	31 Dec 2005 £000
Current tax – domestic	286	53
Adjustment in respect of previous period	(10)	(3)
Total current tax	276	50
Deferred tax (note 20)	(209)	(26)
	67	24

Domestic income tax is calculated at 30% (2005: 19%) of the estimated assessable profit for the year. The movement in tax rate from 19% to 30% is due to levels of profitability.

The charge for the year can be reconciled to the profit per the income statement as follows:

	2006 £000	2005 £000
Profit before tax	233	17
Tax at domestic income tax rate of 30% (2005: 19%)	70	3
Tax effect of expenses that are not deductible in determining taxable profit	45	32
Effect of marginal rate	(4)	–
Effect of change in tax rates	(34)	(8)
Adjustment in respect of previous periods	(10)	(3)
Tax expense	67	24

11 Property, plant and equipment

	Total £000	Freehold land and buildings £000	Computer equipment £000	Fixtures and fittings £000	Plant and machinery £000	Rental machines £000	Motor vehicles £000
At 1 January 2005							
Cost	9,078	2,900	1,698	1,522	2,334	624	–
Accumulated depreciation	(4,745)	(40)	(1,446)	(1,138)	(1,599)	(522)	–
Net book amount	4,333	2,860	252	384	735	102	–
For the year ended 31 December 2005							
Opening net amount at 1 Jan 2005	4,333	2,860	252	384	735	102	–
Additions	496	–	26	306	129	29	6
Disposals	(2)	–	(1)	–	–	(1)	–
Depreciation charge	(724)	(40)	(171)	(225)	(216)	(71)	(1)
Closing net book amount at 31 Dec 2005	4,103	2,820	106	465	648	59	5
At 31 December 2005							
Cost	9,238	2,900	1,403	1,828	2,452	649	6
Accumulated depreciation	(5,135)	(80)	(1,297)	(1,363)	(1,804)	(590)	(1)
Net book amount	4,103	2,820	106	465	648	59	5
For the year ended 31 December 2006							
Opening net amount at 1 Jan 2006	4,103	2,820	106	465	648	59	5
On acquisition at 31 Jan 2006	43	–	30	9	–	–	4
Additions	635	–	159	219	239	18	–
Disposals	(4)	–	–	–	–	(2)	(2)
Depreciation charge	(730)	(40)	(116)	(274)	(257)	(40)	(3)
Exchange adjustment	(2)	–	(2)	–	–	–	–
Closing net book amount at 31 Dec 2006	4,045	2,780	177	419	630	35	4
At 31 December 2006							
Cost	9,987	2,900	1,680	2,062	2,684	655	6
Accumulated depreciation	(5,942)	(120)	(1,503)	(1,643)	(2,054)	(620)	(2)
Net book amount	4,045	2,780	177	419	630	35	4

Bank borrowings are secured on Linford Wood land and buildings for the value of £2,250,000 (2004: £1,000,000). See note 23.

Notes to the financial statements continued

12 Intangible assets

	Total £000	Computer software £000	Development expenditure £000	Unpatented technology £000	Knowhow £000
At 1 January 2005					
Cost	143	143	–	–	–
Accumulated amortisation	(116)	(116)	–	–	–
Net book amount	27	27	–	–	–
For the year ended 31 December 2005					
Opening net amount at 1 Jan 2005	27	27	–	–	–
Additions	960	375	585	–	–
Amortisation charge	(199)	(96)	(103)	–	–
Closing net book amount at 31 Dec 2005	788	306	482	–	–
At 31 December 2005					
Cost	1,103	518	585	–	–
Accumulated amortisation	(315)	(212)	(103)	–	–
Net book amount	788	306	482	–	–
For the year ended 31 December 2006					
Opening net amount at 1 Jan 2006	788	306	482	–	–
On acquisition at 31 Jan 2006	1,199	4	–	340	855
Exchange adjustments	(131)	–	–	(32)	(99)
Additions	867	162	705	–	–
Disposals	(6)	(6)	–	–	–
Amortisation charge	(696)	(152)	(309)	(104)	(131)
Closing net book amount at 31 Dec 2006	2,021	314	878	204	625
At 31 December 2006					
Cost	3,032	677	1,291	308	756
Accumulated amortisation	(1,011)	(363)	(413)	(104)	(131)
Net book amount	2,021	314	878	204	625

Computer software relates to the third party software licences purchased by the Group to be used in the normal course of its business.

The capitalised development expenditure covers the cost of designing and writing the core e-Marker[®] software used to electronically mark examination scripts within the education marketplace. Due to the uncertainty of the potential benefits of investing in automated examination marking processes, the criteria for capitalising development expenditure was not met until 2005.

All intangible amortisation is charged to cost of sales within the income statement.

Unpatented technology and knowhow relate to assets acquired on the acquisition of the Peladon Software Group, details of which are given in note 32.

13 Goodwill

	2006 £000	2005 £000
At 1 Jan 2006	–	–
Created on Peladon acquisition	2,099	–
Exchange rate revaluation	(205)	–
At 31 Dec 2006	1,894	–

The goodwill relates to the acquisition of Peladon Software and is based on an assumption that the future profitability of the two companies acquired will remain at least similar to the original justification provided to DRS management in the acquisition negotiations. Using a discount rate of 15% of forecast cash flows, the above carrying values are below recoverable amounts and no provision for impairment is required.

14 Inventories

	31 Dec 2006 £000	31 Dec 2005 £000
Raw materials	1,065	602
Work in progress	496	258
Finished goods	139	657
	1,700	1,517

Provisions held against the manufacturing inventory have been created in the past when the Group over orders on raw materials used in the manufacture of its scanning machines. However, from the start of 2004 obsolescence provisions have been increased to cover the risk of holding scanning machines and materials that are obsolete or do not comply with the requirements of the Restrictions of Hazardous Substances (RoHS) legislation that came into force from July 2006.

	31 Dec 2006 £000	Movement during year £000	31 Dec 2005 £000	Movement during year £000	31 Dec 2004 £000
Inventory provision					
– PS900 scanners	–	(329)	329	(156)	485
– Other scanners	199	(3)	202	141	61
Print	6	6	–	–	–
Total	205	(326)	531	(15)	546
Related carrying value					
– PS900 scanners	1,203		941		857
– Other scanners	263		325		678
Manufacturing inventory	1,466		1,266		1,535
Print inventory	234		251		216
Total	1,700		1,517		1,751

The provision that was created in 2004 against PS900 machines reflected the potential risk of holding these scanners in light of the forthcoming legislation and future product development. The use of provision in 2005 and 2006 reflects a higher level of usage than originally expected.

There is no provision against the PS900 materials held in stock at the 2006 year end because the materials are for a new version of the machine that is being built which will be used in elections in 2007 at the Scottish local authorities.

The cost of inventories recognised as an expense and included in 'cost of sales' amounted to £1,776,000 (2005: £1,937,000).

15 Trade and other receivables

	31 Dec 2006 £000	31 Dec 2005 £000
Trade receivables	2,344	2,474
Less provision for impairment of receivables	(187)	(117)
Trade receivables – net	2,157	2,357
Amounts recoverable on contracts	925	406
Prepayments and accrued income	730	370
	3,812	3,133

The fair values of trade and other receivables are as follows:

	31 Dec 2006 £000	31 Dec 2005 £000
Trade and other receivables	2,157	2,357
Amounts recoverable on contracts	925	406
Prepayments and accrued income	730	370
	3,812	3,133

Notes to the financial statements continued

15 Trade and other receivables continued

The maximum credit risk exposure at the balance sheet date equates to the fair value of trade receivables. There is no concentration of credit risk.

The Group has not recognised any expense for the impairment of its trade receivables during the year (2005: £311). The expense in the previous year has been included in 'Administrative expenses' in the income statement.

16 Financial assets at fair value through profit or loss

	Bonds £000	Liquidity fund £000	Total company £000
Year ended 31 December 2006			
At 1 Jan 2006 – book value equals fair value	–	1,063	1,063
Additions	–	–	–
Disposals	–	(1,063)	(1,063)
Fair value adjustment	–	–	–
At 31 Dec 2006	–	–	–

	Bonds £000	Liquidity fund £000	Total company £000
Year ended 31 December 2005			
At 1 Jan 2005 – book value equals fair value	2,388	1,031	3,419
Additions	–	1,032	1,032
Disposals	(2,392)	(1,000)	(3,392)
Fair value adjustment	4	–	4
At 31 Dec 2005	–	1,063	1,063

The investments above consisted of:

- Sterling fixed interest corporate bonds and fixed interest funds confined to investment grade defined minimum rating of 'BBB+', where average rating of the portfolio is 'A' or above.
- Sterling Liquidity Fund is a UCITS certified open-ended fund with an investment objective of providing investors with daily liquidity and security of capital in a diversified portfolio of short-term securities, instruments and obligations which carry a minimum rating of A1/P1.

17 Cash and cash equivalents

	31 Dec 2006 £000	31 Dec 2005 £000
Cash at bank and in hand	337	393
Short-term bank deposits	1,104	1,891
	1,441	2,284

The effective interest rate on short-term bank deposits was 4.20% (2005: 3.125%). These deposits have an average maturity of 12 days (2005: four days).

Cash and bank overdrafts include the following for the purposes of the cash flow statement:

	31 Dec 2006 £000	31 Dec 2005 £000
Cash and cash equivalents	1,441	2,284
Bank overdrafts	–	–
	1,441	2,284

Currency risk

The Group operates in overseas markets and is subject to currency exposures on transactions undertaken during the year. The Group does not hedge any transactions, and foreign exchange differences on retranslation of foreign assets and liabilities are taken to the profit and loss account.

17 Cash and cash equivalents continued

The tables below show the extent to which the Group has monetary assets in currencies other than Sterling.

	2006 US Dollars £000	2006 Euro £000	2005 US Dollars £000	2005 Euro £000
Sterling equivalent	500	756	42	266

18 Share capital

	Number of shares	Ordinary shares	Treasury shares	Total
At 1 January 2005	34,621,600	34,621,600	(1,930,000)	32,691,600
Balance at 31 December 2005	34,621,600	34,621,600	(1,930,000)	32,691,600
Balance at 31 December 2006	34,621,600	34,621,600	(1,930,000)	32,691,600

	Ordinary shares of 5p each at 31 Dec 2006 and 2005	
	Number	£000
Authorised	46,000,000	2,300
Allotted, issued, called up and fully paid	34,621,600	1,731

The Company acquired 1,930,000 of its own shares through purchase between 3 June and 15 July 2004. The price of these shares ranged between 60p and 59p. The total amount paid to acquire these shares, net of income tax, was £1,166,000 and has been deducted from shareholders' equity. The shares are held as treasury shares. The Company has the right to re-issue these shares at a later date. All issued shares are fully paid.

19 Other reserves

	Share premium £000	Capital redemption £000	Own share reserve £000	Translation reserve £000	Total company £000
As at 1 Jan 2005	5,377	115	(122)	–	5,370
Own shares vesting	–	–	2	–	2
Balance at 31 Dec 2005	5,377	115	(120)	–	5,372
Exchange rate differences	–	–	–	(248)	(248)
Own shares vesting	–	–	7	–	7
Balance at 31 Dec 2006	5,377	115	(113)	(248)	5,131

The Own Share Reserve represents the cost of shares purchased under the Restricted Share Scheme, less those unconditionally vested in employees. At 31 December 2006, 550,529 (2005: 570,529) shares with a market value of £203,696 (2005: £213,948) were held. Of these, 380,000 (2005: 450,000) had been conditionally gifted to employees and a further 100,000 (2005: 100,000) are vested to a director at an option price of 18p. The scheme authorises the Trustees to purchase up to 5% of the issued share capital, funded by loans from the Company. Shares so acquired are conditionally gifted to employees at the discretion of the Board.

The translation reserve represents the foreign exchange differences arising from the retranslation of the opening net investment in the subsidiary and the retranslation of the goodwill and fair value adjustments arising on acquisition, which are treated on consolidation as though they were assets and liabilities of the subsidiary.

20 Deferred income tax

	31 Dec 2006 £000	31 Dec 2005 £000
Analysis for financial reporting purposes		
– Deferred tax liabilities	268	30
– Deferred tax assets	(185)	(20)
	83	10

Notes to the financial statements continued

20 Deferred income tax continued

The movement in the year in the Company's net deferred tax position was as follows:

	31 Dec 2006 £000	31 Dec 2005 £000
At 1 January 2005	10	38
Charge to income for the year	(209)	(26)
Charge to equity for the year	282	(2)
	83	10

The following are the major deferred tax liabilities and assets recognised by the Company and the movements thereon during the period:

	Revaluation of property £000	Fair value adjustments £000	Losses £000	EBT obligations £000	Accelerated tax depreciation £000	General provision £000	Total £000
At 1 Jan 2006	22	–	–	(14)	8	(6)	10
Acquired on 31 Jan in acquisition	–	359	(44)	–	–	–	315
Charge to income for the year	(2)	(71)	(74)	(3)	(52)	(7)	(209)
Charge to equity for the year	–	(40)	7	–	–	–	(33)
At 31 Dec 2006	20	248	(111)	(17)	(44)	(13)	83

21 Provisions and other liabilities

This is a provision for the deferred consideration relating to the earn out in the Peladon Software acquisition agreement. The deferred consideration was £347,000 as shown in note 32. As the consideration is in US Dollars it was retranslated to the year end rate reducing the liability to £312,000.

22 Trade and other payables

	31 Dec 2006 £000	31 Dec 2005 £000
Trade payables	1,325	925
Deferred income	1,052	782
Social security and other taxes	218	156
Accrued expenses	1,156	1,614
	3,751	3,477

Fair value equates to carrying value.

23 Borrowings

	31 Dec 2006 £000	31 Dec 2005 £000
Non-current		
Bank borrowings – secured loan	2,250	–
Current		
Bank borrowings – secured loan	–	1,000
Total borrowings	2,250	1,000

In March 2006, the £1m loan, in the parent company, borrowed at a variable rate of 1% over base rate with a 6.5% cap repayable June 2006 was replaced with a new loan for £2.25m, secured by a fixed charge against the freehold land and buildings at a variable rate of 0.85% over base rate. In September 2006, a collar arrangement in respect of the new funding was entered into for the duration of the loan. Interest is payable on the balance at a rate equal to the average base rate for that month payable at the end of each quarterly interest period, and is capped at 6.50% with a floor of 4.92%.

24 Earnings per share

The calculation of the basic earnings per share is based on the earnings attributable to ordinary shareholders divided by the weighted average number of shares in issue during the year. Shares held in employee share trusts are treated as cancelled for the purposes of this calculation.

The calculation of diluted earnings per share is based on the basic earnings per share, adjusted to allow for the issue of shares and the post tax effect of dividends and/or interest, on the assumed conversion of all dilutive options and other dilutive potential ordinary shares.

Reconciliations of the earnings and weighted average number of shares used in the calculations are set out below:

	Earnings £	31 Dec 2006 Weighted average number of shares	per share	Loss £	31 Dec 2005 Weighted average number of shares	per share
Basic earnings per share						
Earnings attributable to ordinary shareholders	166,000	32,134,907	0.52p	(7,000)	32,111,400	(0.02p)
Dilutive effect of shares in restricted share scheme		230,000			–	
Dilutive effect of options under unapproved share option scheme		51,597			–	
Dilutive effect of options under the Enterprise Management Incentive Scheme		143,627			–	
Dilutive earnings per share	166,000	32,560,131	0.51p	(7,000)	32,111,400	(0.02p)

25 Dividends per share

	2006 Pence/ share	2005 Pence/ share	2006 £000	2005 £000
Amounts recognised as distributions to equity holders in the year:				
– Final dividend for the year ended 31 Dec 2004	–	1.0	–	321
– Interim dividend for the year ended 31 Dec 2006	0.25	–	81	–
Proposed final dividend for the year ended 31 Dec 2006	0.25	–	81	–

The proposed final dividend was approved by the Board of directors on 12 March 2007 and is subject to the approval of the shareholders at the Annual General Meeting. The proposed dividend has not been included as a liability as at 31 December 2006, in accordance with IAS 10 'events after the balance sheet date'. It will be paid on 25 May 2007 to shareholders on the register of members at close of business on 27 April 2007.

Notes to the financial statements continued

26 Cash generated from operations

	31 Dec 2006 £000	31 Dec 2005 £000
Profit/(loss) for the period	166	(7)
Adjustments for:		
– income tax (note 10)	67	24
– depreciation of property, plant and equipment (note 11)	730	724
– amortisation of intangible assets (note 12)	696	199
– IFRS 2 charge in respect of EBT	22	39
– IFRS 2 charge in respect of LTIP shares	25	8
– profit on sale of property, plant and equipment	(8)	(13)
– fair value losses (including loss on disposal) on other		
– financial assets at fair value through profit or loss	–	3
– fair value gains (including profit on disposal) on other		
– financial assets at fair value through profit or loss	34	(7)
– exchange gains on cash holdings (note 7)	–	(1)
– interest income (note 7)	(44)	(138)
– interest expense (note 9)	129	57
Changes in working capital (excluding the effects of acquisition and exchange differences on consolidation):		
– inventories	(180)	234
– trade and other receivables	(482)	(1,155)
– trade and other payables	(57)	222
Cash generated from operations	1,098	189

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

	31 Dec 2006 £000	31 Dec 2005 £000
Net book amount	10	2
Profit on sale of property, plant and equipment	8	13
Proceeds from sale of property, plant and equipment	18	15

27 Reconciliation of movements in cash and cash equivalents

	31 Jan 2006 £000	Cash flow £000	31 Dec 2006 £000
Cash at bank and in hand	393	(56)	337
Term deposits	1,891	(787)	1,104
	2,284	(843)	1,441
Other financial assets at fair value	1,063	(1,063)	–
	3,347	(1,906)	1,441

28 Contingencies

The Group has contingent liabilities in respect of bank guarantees and other matters arising in the ordinary course of business. It is not anticipated that any material liabilities will arise from the contingent liabilities.

29 Commitments

(a) Capital commitments

In respect of contracted out software development expenditure a rolling three month development commitment existed at 31 December 2006 with the supplier equating to approximately £125,000. There were no other capital commitments at 31 December 2006 or 31 December 2005.

29 Commitments continued

(b) Operating lease commitments

The company has the following lease commitments:

	Lease of land and buildings		Other leases	
	Dec 2006 £000	Dec 2005 £000	Dec 2006 £000	Dec 2005 £000
Within one year	195	142	74	83
Within two to five years	256	352	44	57
Over five years	—	—	—	—
	451	494	118	140

The Group holds five property leases which relate to seven business units occupied by operations, four of the leases are in Milton Keynes and one near Glasgow. Of the Milton Keynes property, three leases are for a period of 10 years, two of which expire 7 December 2008 and the third on 30 November 2010; the fourth lease is for a period of two years to 31 October 2008. Rent is payable quarterly in advance. The fifth lease, near Glasgow, is for a period of one year to 6 June 2007.

Other leases are all three year contracts. They relate to company vehicles that have an up-front payment of three months in advance followed by a monthly payment and a photocopier lease payable quarterly in advance.

30 Pension commitments

During 2005 and 2006 the Group operated separate defined contribution schemes for the benefit of employees and Executive Directors respectively. In all cases the assets of the schemes are administered by trustees in funds independent of the Group. Pension contributions are shown in note 8.

31 Share-based payments

	Type	Number	Vesting period	Term	Exercise price	Method of settlement
Year end 31 December 2003						
29 May 2003	Granted	932,971	3 years	10 years	35.5p	Equity
	Exercised					
	Lapsed	932,971				
	Forfeited					
Year end 31 December 2004						
26 March 2004	Granted	284,188	3 years	10 years	60.5p	Equity
	Exercised					
	Lapsed					
	Forfeited					
7 April 2004	Granted	170,000	3 years	3 years	Nil	Equity
	Exercised					
	Lapsed	20,000				
	Forfeited					
Year end 31 December 2005						
2 November 2005	Granted	616,000	3 years	10 years	Nil	Equity
	Exercised					
	Lapsed					
	Forfeited					
Year end 31 December 2006						
29 March 2006	Granted	602,973	3 years	10 years	Nil	Equity
	Exercised					
	Lapsed					
	Forfeited					

Notes to the financial statements continued

31 Share-based payments continued

Calculation of the fair value

	Valuation model	Share price at grant	Exercise price	Expected volatility	Expected life	Expected dividends	Risk-free interest rate	Fair value of 1 unit
Year end 31 Dec 2003								
29 May 2003	Binomial	35.5p	35.5p	44.36%	6 years	–	4.63%	12.75p
Year end 31 Dec 2004								
26 March 2004	Binomial	60.5p	60.5p	45.87%	6 years	–	4.64%	21.62p
7 April 2004	Binomial	60.5p	0p	45.13%	3 years	3.67%	4.92%	56.76p
Year end 31 Dec 2005								
2 November 2005	Monte Carlo	34.0p	0p	45.52%	6 years	–	4.50%	26.00p
Year end 31 Dec 2006								
29 March 2006	Monte Carlo	37.0p	0p	43.43%	6 years	–	5.12%	31.40p

Performance criteria

The EMI and ESOP share options granted to the Executive Directors are subject to performance criteria set out on a sliding scale dependent upon the increase in Earnings Per Share (EPS), based on the EPS reported in the audited annual accounts for the three years following the granting of the option. 25% of the qualifying option will be exercisable if the rate of growth equals RPI, 50% will be exercisable if the rate of growth equals RPI + 5% per annum and 100% will be exercisable if the rate of growth exceeds RPI + 10% per annum, with pro-rata award between these levels. The probability of the performance criteria being met is minimal and as a consequence, no charge has been recognised because no options are expected to vest.

The EMI share options granted to employees are subject to the employees remaining in the employment of the Group throughout the three year vesting period, after which time the shares are gifted to the employee.

The LTIP share options are based on the level of EPS in the most recently reported financial year on the third anniversary of the date of grant and the TSR over these three years being at least at the median compared to the companies constituting the FTSE All Share Software & Computer Services Index. The proportion of the award that shall be released is set out on a sliding scale dependent upon the EPS reported in the audited annual accounts being greater than 3.0p per share. 25% of the qualifying option will be exercisable if the EPS equals 3.0p and 100% will be exercisable if the EPS is 6.0p per share, with pro-rata award between these levels.

Valuation methodologies

In order to calculate fair values of the options under consideration the Group has taken into account factors that knowledgeable, willing market participants would consider in valuing the options.

The fair values of the EMI and ESOP options with no additional market conditions were estimated using a Binomial option pricing model.

The fair value of the LTIP award, where an element of the release of shares is contingent upon relative performance of the Group's Total Shareholder Return (TSR) against the TSRs of the companies in the comparator group, was calculated using a Monte Carlo simulation model.

Volatility assumptions

Annualised expected volatility of all the options was determined by calculating the average of standard deviations of daily continuously compounded returns of the Group's share price calculated over one, two and three years back from the date of grant of each instrument.

Options outstanding

	Type	Date of grant	Number	Vesting period	Exercisable	Expiry date	Weighted exercise price
At 31 Dec 2005	Ordinary	29.05.2003	932,971	3 years	35.5p	28.05.2013	12.75p
	Ordinary	26.03.2004	284,188	3 years	60.5p	26.03.2014	21.62p
	Ordinary	07.04.2004	160,000	3 years	Nil	06.04.2007	56.76p
	Ordinary	02.11.2005	616,000	3 years	Nil	01.11.2015	26.00p
			1,993,159				21.64p

There have been no movements in the brought forward options, other than the options issued in May 2003 which have lapsed, and 10,000 options issued in April 2004 also having lapsed.

31 Share-based payments continued

	Type	Date of grant	Number	Vesting period	Exercisable	Expiry date	Weighted exercise price
At 31 Dec 2006	Ordinary	26.03.2004	284,188	3 years	60.5p	26.03.2014	21.62p
	Ordinary	07.04.2004	150,000	3 years	Nil	06.04.2014	56.76p
	Ordinary	02.11.2005	616,000	3 years	Nil	01.11.2015	26.00p
	Ordinary	29.03.2006	602,973	3 years	Nil	28.03.2016	31.40p
			1,653,161				30.00p

32 Acquisition of Peladon Software Group

On 31 January 2006, DRS Data & Research Services plc acquired a 100% interest in the Peladon Software Group for £2,745,000 plus costs of £71,000 giving a total cost of £2,816,000, £2,398,000 was payable immediately and the balance of £347,000 is estimated to be payable subject to an earn out provision. This provision defines deferred consideration payable as 50% of the Peladon Group's operating profit in the first three years post acquisition up to a maximum of £347,000 and that the annual profit exceeds £250,000.

The Peladon Software Group comprises two companies, Peladon Software Inc. is based in San Diego, California and is the 100% holding company of Peladon Software Limited based in Andover in the UK.

Peladon Software provides automated Document Management Solutions by employing Intelligent/Optical Character Recognition technology (ICR/OCR).

Net liabilities acquired:

	31 Jan 2006 £000	Fair Value adjustments £000	Provisional fair value £000
Property, plant and equipment	43	–	43
Cash and cash equivalents	9	–	9
Intangible assets	4	1,195	1,199
Deferred income tax assets	14	–	14
Current assets	239	–	239
Total assets	309	1,195	1,504
Liabilities	(52)	–	(52)
Bank overdraft	(23)	–	(23)
Deferred income tax liabilities	–	(359)	(359)
Current liabilities	(353)	–	(353)
Total liabilities	(428)	(359)	(787)
Goodwill			2,099
Total consideration (provisional)			2,816

Deferred income tax assets of £14,000 relate to the pre-acquisition element of the 2006 financial year tax charge.

The cost of the acquisition reflects DRS' perceived value of the Peladon Software Group and the synergies that are expected to arise with DRS.

Notes to the financial statements continued

32 Acquisition of Peladon Software Group continued**Basis of fair value calculation**

The valuation of intangible assets is based on the cash flow forecasted to be generated by the unpatented technology and knowhow assets over their estimated useful economic lives, discounted at 15%. On this basis the fair value of intangible assets amounts to:

	£000
Unpatented technology	340
Knowhow	855
Intangibles	1,195

Unpatented technology is amortised over three years and knowhow over six years.

The Peladon Software Group already report to a 31 December year end. The Group's results for 2006 are:

	11 months to 31 Dec 2006 (post acquisition) £000
Sales	1,048
Loss before tax	(200)

Had the Peladon Software Group been acquired from the beginning of the period the consolidated revenue and profit before tax for DRS Data & Research Services plc would have been £16,745,000 and £191,000 respectively.

Parent Company Accounts 2006

Distributing census papers in Africa

- 50** Parent company balance sheet
- 51** Parent company statement of changes in shareholders' equity
- 52** Parent company cash flow statement
- 53** Notes to the Parent company financial statements

Parent company balance sheet

for the year ended 31 December 2006

	Notes	2006 £000	2005 £000
Assets			
Non-current assets			
Property, plant and equipment	36	2,814	4,103
Intangible assets	37	–	788
Investment in subsidiaries	38	6,630	–
Deferred income tax assets	45	17	20
		9,461	4,911
Current assets			
Inventories		–	1,517
Trade and other receivables	39	1,647	3,133
Other financial assets at fair value through profit or loss		–	1,063
Cash and cash equivalents	40	117	2,284
		1,764	7,997
Total assets		11,225	12,908
Equity			
Capital and reserves attributable to the company's equity holders			
Share capital	41	1,731	1,731
Share premium account	42	5,377	5,377
Capital redemption reserve	42	115	115
Treasury shares		(1,166)	(1,166)
Own shares reserve	42	(113)	(120)
Profit and loss account		2,478	2,411
Total equity		8,422	8,348
Liabilities			
Non-current liabilities			
Borrowings	43	2,250	–
Deferred consideration	44	312	–
Deferred income tax liabilities	45	42	30
		2,604	30
Current liabilities			
Trade and other payables	46	113	3,477
Current income tax liabilities		86	53
Borrowings	43	–	1,000
		199	4,530
Total liabilities		2,803	4,560
Total equity and liabilities		11,225	12,908

The financial statements were approved by the Board of Directors on 12 March 2007 and signed on its behalf by:

A C Lee
Chief Executive

A M Tebbutt
Finance Director

Parent company statement of changes in shareholders' equity

	Share capital £000	Shares premium account £000	Capital redemption reserve £000	Treasury share £000	Own shares reserve £000	Profit and loss account £000	Total £000
At 1 Jan 2005	1,731	5,377	115	(1,166)	(122)	2,692	8,627
Loss for the period	-	-	-	-	-	(7)	(7)
Employee Share Based Compensation	-	-	-	-	-	47	47
Deferred tax on items relating to equity	-	-	-	-	-	2	2
Dividend	-	-	-	-	-	(321)	(321)
Own shares vesting	-	-	-	-	2	(2)	-
At 31 Dec 2005	1,731	5,377	115	(1,166)	(120)	2,411	8,348
At 1 Jan 2006	1,731	5,377	115	(1,166)	(120)	2,411	8,348
Profit for the period	-	-	-	-	-	108	108
Employee Share Based Compensation	-	-	-	-	-	47	47
Deferred tax on items relating to equity	-	-	-	-	-	-	-
Dividend	-	-	-	-	-	(81)	(81)
Own shares vesting	-	-	-	-	7	(7)	-
At 31 Dec 2006	1,731	5,377	115	(1,166)	(113)	2,478	8,422

Parent company cash flow statement

for the year ended 31 December 2006

	Note	2006 £000	2005 £000
Cash flows from operating activities			
Cash (used)/generated from operations	47	(1,757)	189
Interest paid		(114)	(57)
Income tax paid		(43)	(62)
Net cash (used)/generated in operating activities		(1,914)	70
Cash flows from investing activities			
Purchases of property, plant and equipment (PPE)		-	(496)
Proceeds from sale of PPE		-	15
Purchase of intangible assets		-	(960)
Peladon acquisition purchase		(2,469)	-
Purchases of financial assets at fair value through profit or loss		-	(1,032)
Proceeds from sale of financial assets at fair value through profit or loss		1,063	3,392
Interest received		57	138
Net cash (used)/generated from investing activities		(1,349)	1,057
Cash flows from financing activities			
Repayment of subsidiary loans		(73)	-
Re-mortgage on Linford Wood office		1,250	-
Dividends paid to company's shareholders		(81)	(321)
Net cash generated/(used) in financial activities		1,096	(321)
Net (decrease)/increase in cash and cash equivalents			
Cash and cash equivalents at beginning of period		(2,167)	806
Exchange gains on cash		2,284	1,478
Exchange gains on cash		-	-
Cash and cash equivalents at end of period		117	2,284

Notes to the Parent company financial statements

for the year ended 31 December 2006

33 Accounting policies

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and as developed and published by the International Accounting Standards Board (IASB).

The principal accounting policies adopted by the Company are the same as the Group's accounting policies, see note 2 for details, subject to the following addition:

33.1 Investment in subsidiaries

Investment in subsidiaries are shown at cost.

34 Profit for the year

DRS Data & Research Services plc has not presented its own income statement and related notes as permitted by section 230 of the Companies Act 1985. The profit for the financial year dealt with in the financial statements of the parent company is £108,000 (2005: loss £7,000).

35 Auditors' remuneration

	2006 £000	2005 £000
Auditors' remuneration		
– audit services	11	26
– advice on implementation of IFRS	19	23
– other compliance and reporting services	20	10
– other non-audit services	1	2

36 Tangible assets

	Total £000	Freehold land and buildings £000	Computer equipment £000	Fixtures and fittings £000	Plant and machinery £000	Rental machines £000	Motor vehicles £000
At 1 January 2005							
Cost	9,078	2,900	1,698	1,522	2,334	624	–
Accumulated depreciation	(4,745)	(40)	(1,446)	(1,138)	(1,599)	(522)	–
Net book amount	4,333	2,860	252	384	735	102	–
For the year ended 31 December 2005							
Opening net amount at 1 Jan 2005	4,333	2,860	252	384	735	102	–
Additions	496	–	26	306	129	29	6
Disposals	(2)	–	(1)	–	–	(1)	–
Depreciation charge	(724)	(40)	(171)	(225)	(216)	(71)	(1)
Closing net book amount at 31 Dec 2005	4,103	2,820	106	465	648	59	5
At 31 December 2005							
Cost	9,238	2,900	1,403	1,828	2,452	649	6
Accumulated depreciation	(5,135)	(80)	(1,297)	(1,363)	(1,804)	(590)	(1)
Net book amount	4,103	2,820	106	465	648	59	5
For the year ended 31 December 2006							
Opening net amount at 1 Jan 2006	4,103	2,820	106	465	648	59	5
Transferred to DRS Data Services Limited on 1 Jan 2006	(1,203)	–	(106)	(385)	(648)	(59)	(5)
Additions	–	–	–	–	–	–	–
Disposals	–	–	–	–	–	–	–
Depreciation charge	(86)	(40)	–	(46)	–	–	–
Closing net book amount at 31 Dec 2006	2,814	2,780	–	34	–	–	–
At 31 December 2006							
Cost	3,128	2,900	–	228	–	–	–
Accumulated depreciation	(314)	(120)	–	(194)	–	–	–
Net book amount	2,814	2,780	–	34	–	–	–

Bank borrowings are secured on Linford Wood land and buildings for the value of £2,250,000 (2005: £1,000,000). See note 23.

Notes to the Parent company financial statements continued

37 Intangible assets

	Total £000	Computer software £000	Development expenditure £000
At 1 January 2005			
Cost	143	143	–
Accumulated amortisation	(116)	(116)	–
Net book amount	27	27	–
For the year ended 31 December 2005			
Opening net amount at 1 Jan 2005	27	27	–
Additions	960	375	585
Amortisation charge	(199)	(96)	(103)
Closing net book amount at 31 Dec 2005	788	306	482
At 31 December 2005			
Cost	1,103	518	585
Accumulated amortisation	(315)	(212)	(103)
Net book amount	788	306	482
For the year ended 31 December 2006			
Opening net amount at 1 Jan 2006	788	306	482
Transferred to DRS Data Services Limited on 1 Jan 2006	(788)	(306)	(482)
Closing net book amount at 31 Dec 2006	–	–	–
At 31 December 2006			
Cost	–	–	–
Accumulated amortisation	–	–	–
Net book amount	–	–	–

38 Investment in subsidiaries

At 31 December 2006, the principal subsidiary undertakings of the company are as follows:

Name of company	Country of and operation	Shareholding incorporation	Main activity	Value of investment £000
DRS Data Services Limited	UK	100%	Provision of data capture services, manufacture and sale of Optical and Image scanning equipment	3,814
Peladon Software Inc.	California, USA	100%	Distribution of document management software within North America	2,816
Peladon Software Limited	UK	100%*	Computer software development relating to document management	–
			Total	6,630

*Shares held by Peladon Software Inc.

39 Debtors

	31 Dec 2006 £000	31 Dec 2005 £000
Trade receivables	–	2,474
Less provision for impairment of receivables	–	(117)
Trade receivables – net	–	2,357
Amounts owed by subsidiaries	1,583	–
Amounts recoverable on contracts	–	406
Prepayments and accrued income	64	370
	1,647	3,133

The fair values of trade and other receivables are as follows:

	31 Dec 2006 £000	31 Dec 2005 £000
Trade and other receivables	–	2,357
Amounts recoverable on contracts	–	406
Amounts owed by subsidiaries	1,583	–
Prepayments and accrued income	64	370
	1,647	3,133

40 Cash and cash equivalents

	31 Dec 2006 £000	31 Dec 2005 £000
Cash at bank and in hand	117	393
Short term bank deposits	–	1,891
	117	2,284

Currency risk

The company operates in overseas markets and is subject to currency exposures on transactions undertaken during the year. The company does not hedge any transactions, and foreign exchange differences on retranslation of foreign assets and liabilities are taken to the profit and loss account.

The table below shows the extent to which the company has monetary assets in currencies other than Sterling.

	2006 US Dollars £000	2006 Euro £000	2005 US Dollars £000	2005 Euros £000
Sterling equivalent	21	6	42	266

41 Share capital

See note 18 for details of the share capital of the company.

42 Other reserves

See note 19 for details of the other reserves of the company.

43 Borrowings

See note 23 for details of the borrowings of the company.

44 Deferred consideration

This is a provision for the deferred consideration relating to the earn out in the Peladon Software acquisition agreement. The deferred consideration was £347,000 as shown in note 32. As the consideration is in US Dollars it was retranslated to the year end rate reducing the liability to £312,000.

Notes to the Parent company financial statements continued

45 Deferred income tax

	31 Dec 2006 £000	31 Dec 2005 £000
Analysis for financial reporting purposes		
Deferred tax liabilities	42	30
Deferred tax assets	(17)	(20)
	25	10

The movement in the year in the company's net deferred tax position was as follows:

	31 Dec 2006 £000	31 Dec 2005 £000
At 1 January 2005	10	38
Charge to income for the year	15	(26)
Charge to equity for the year	–	(2)
	25	10

The following are the major deferred tax liabilities and assets recognised by the company and the movements thereon during the period:

	Accelerated tax depreciation £000	Revaluation of property £000	EBT obligations £000	General provision £000	Total £000
At 1 January 2006	8	22	(14)	(6)	10
Charge to income for the year	14	(2)	(3)	6	15
Charge to equity for the year	–	–	–	–	–
At 31 December 2006	22	20	(17)	–	25

46 Creditors

	31 Dec 2006 £000	31 Dec 2005 £000
Trade payables	–	925
Deferred income	–	782
Social security and other taxes	–	156
Accrued expenses	113	1,614
	113	3,477

Fair value equates to carrying value.

47 Cash generated from operations

	31 Dec 2006 £000	31 Dec 2005 £000
Profit/(loss) for the period	108	(7)
Adjustments for:		
– income tax	92	24
– depreciation of property, plant and equipment (note 36)	86	724
– amortisation of intangible assets (note 37)	–	199
– IFRS 2 charge in respect of EBT	22	39
– IFRS 2 charge in respect of LTIP shares	25	8
– profit on sale of property, plant and equipment	–	(13)
– fair value losses (including loss on disposal) on other financial assets at fair value through profit or loss	–	3
– fair value gains (including profit on disposal) on other financial assets at fair value through profit or loss	–	(7)
– exchange gains on cash holdings	–	(1)
– interest income	(57)	(138)
– interest expense	114	57
Changes in working capital (excluding the effects of acquisition and exchange differences on consolidation):		
– inventories	–	234
– trade and other receivables	(1,600)	(1,155)
– trade and other payables	(547)	222
Cash generated from operations	(1,757)	189

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

	31 Dec 2006 £000	31 Dec 2005 £000
Net book amount	–	2
Profit on sale of property, plant and equipment	–	13
Proceeds from sale of property, plant and equipment	–	15

48 Intra-Group transactions

DRS Data & Research Services plc provided £905,000 of services to its subsidiaries during 2006. It did not make any purchases from them.

DRS Data & Research Services plc is owed a total of £5,397,000 from its three subsidiaries, of which £3,814,000 relates to the value of assets hived down to DRS Data Services Limited on 1 January 2006. DRS Data & Research Services plc does not plan on requesting payment of this debt in the foreseeable future.

Directors and advisers

Directors

Malcolm Brighton * OBE, Chairman

Chris Batterham **

Lord Kinnock of Bedwelty *

Anthony Christopher Lee

Ann Limb *

Arthur Mark Tebbutt

* non-Executive

senior Independent Director

Company Secretary

Arthur Mark Tebbutt

Registered Head Office

1 Danbury Court

Linford Wood

Milton Keynes

Buckinghamshire

MK14 6LR

Stockbrokers

KBC Peel Hunt Ltd

3 Brindley Place

Birmingham

West Midlands

B1 2JB

Auditors

Grant Thornton UK LLP

Registered Auditors and Chartered Accountants

Grant Thornton House

202 Silbury Boulevard

Central Milton Keynes

Buckinghamshire

MK9 1LW

Principal Bankers

Barclays Bank plc

669 Midsummer Boulevard

Central Milton Keynes

Buckinghamshire

MK9 3BQ

Registrars

Capita Registrars

The Registry

35 Beckenham Road

Beckenham

Kent

BR3 4TU

Notes

Notes

DRS Data & Research Services plc

1 Danbury Court
Linford Wood
Milton Keynes MK14 6LR
United Kingdom

Registered in England: 959401

Telephone: +44 (0)1908 666088
Fax: +44 (0)1908 607668
Email: enquiries@drs.co.uk
Web: www.drs.co.uk