



House of Commons

Committee of Public Accounts

Ministry of Defence: Major Projects Report 2004

**Third Report of
Session 2005–06**



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**Third Report of
Session 2005–06**

*Report, together with formal minutes,
oral and written evidence*

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The Committee of Public Accounts

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Summary

The Major Projects Report 2004 examined the cost, time and technical performance in the year ended 31 March 2004 for the 20 largest projects where the main investment decision had been taken and the ten largest projects in the assessment phase. For the 20 largest projects, the Ministry of Defence (the Department) forecast the costs at £50 billion, an increase of £1.7 billion in the last year (compared to £3.1 billion in the previous year), bringing them to £5.9 billion over the target cost set at approval (or 13% of the total forecast set at approval). The 20 projects have also had further delays, totalling 62 months, to their expected delivery dates, bringing the cumulative delay to 206 months. Cumulatively, these in-year cost increases and delays place additional pressures on an already-stretched defence budget and mean that the Armed Forces will not be getting the most effective capability at the right time. There will be further cuts or cancellations in equipment, and the Armed Forces will have to operate older, less-capable, less efficient equipment for longer.

Although the Department's performance on delivering equipment to cost and to time is disappointing, its performance on meeting defined capability requirements continues to be good. Eighteen of the 20 projects are expected to meet their key user requirements.¹

The principles underpinning Smart Acquisition are sound, but have not convincingly improved defence procurement because they have not been consistently applied. On large complex projects, problems in the demonstration and manufacture phases have often resulted. Performing sufficient work in the earlier assessment phase would have created a better chance of identifying potential problems and putting mitigating action into place. The Defence Procurement Agency's recent reforms to reinvigorate Smart Acquisition should promote better applications of the principles but the Agency will have to work hard to ensure that the new reforms succeed where previous initiatives have failed. All stakeholders in defence procurement will need to work closely together with the shared aim of improved acquisition.

On the basis of a Report from the Comptroller and Auditor General,² our predecessors took evidence from the Department on 31 January 2005. They examined three main issues: the impact of the continuing large cost overruns and delays; the challenge of handling large complex projects; and whether the latest reform programme will succeed where previous ones have failed. Our conclusions and recommendations in this Report build upon those of our predecessors on previous Major Projects Reports, in particular, that in 2003. The Department responded positively to our earlier recommendations in the Major Projects Report 2003.³ Both sets of recommendations should now be progressed as a consistent and coherent programme.

1 C&AG's Report, *Ministry of Defence: Major Projects Report 2004* (HC 1159-I, Session 2003–04), para 1.1

2 *ibid*

3 43rd Report from the Committee of Public Accounts (HC 383, Session 2003–04), *Ministry of Defence: Major Projects Report 2003*, and Treasury Minute on the Report, Cm 6416

Conclusions and recommendations

- 1. The £4.8 billion of cost overruns recorded in the Major Projects Reports 2003 and 2004 will put further pressure on an already tightly-stretched defence budget.** Although the Department has introduced some measures to improve performance, the cost overruns in 2003 and 2004 are worse than at any time in the last decade. It is likely that the Department will have to cancel or delay projects to compensate for the substantial cost overruns, and that the Armed Forces will either not get or have to wait longer for the new equipment they need.
- 2. The Department could not say when it expected to see consistent year-on-year improvements on the cost and time performance of the 20 major projects responsible for some 75% of annual expenditure on equipment.** The Department has, however, set the Defence Procurement Agency key targets to reduce time and cost overruns on some 65 projects each costing over £20 million. This population includes the 17 projects in the Major Projects Report which have not yet achieved their in-service date. The Department will need to focus particularly closely on the 20 largest projects because they represent the real management challenge and are where most money is lost.
- 3. The amount of work undertaken in the assessment phase is still not sufficient to enable sensible investment decisions to be taken.** The Department's own Smart Acquisition guideline suggests that up to 15% of the cost of a project should be spent in the assessment phase. The actual amount of money spent in the Assessment phase is only 5%, but in any case the Department should focus less on the input and more on the actual progress achieved. It should only approve business cases if the project can be shown to have reached the appropriate level of maturity in all aspects. The Department should develop measures of maturity for procurement strategy, supplier relationships, technical risk and finance for projects.
- 4. The Department is seeking to design appropriate procurement strategies for complex projects, including innovative approaches such as the Alliance under which it plans to run the Carrier Strike programme.** Such innovations recognise that conventional approaches to assigning risk to the main contractor do not necessarily put the risk where it can best be managed. Under the Alliance, all parties work together to achieve a common objective, with a collective sharing of risks and rewards. Where Alliances are used, the Department should develop explicit criteria to select the right partners, and be ready to exclude contractors from an Alliance if they do not measure up.
- 5. In the past, the Department and industry have sought to provide the most advanced capability possible to the Armed Forces.** There has been a lack of willingness to trade off capability, time and cost to manage cost increases and to ensure more timely delivery of an effective level of capability. The Department needs to be willing to sacrifice specific elements of capability on particular programmes to meet time and cost constraints, if it is to deliver timely and cost effective capability from the defence budget as a whole.

6. **The Department's latest programme of reform to improve defence procurement, DPA Forward, will require better joint working amongst various Departmental stakeholders to ensure success.** Strong leadership will be crucial in determining the success of the reform programme. The Department needs to be able to evaluate the strength and consistency of the leadership of the programme at all levels using, for example, performance against targets and 360 degree reporting mechanisms.
7. **The placing of Financial Controllers in project teams should support better financial management and decision making on projects.** The Department should consider whether it lacks other key skills required to deliver a complex acquisition programme, such as project financing and relationship management, in the light of its increasing use of innovative procurement strategies.
8. **This Report once again records the woeful performance of the Department in procuring defence equipment, and its inability even to follow its own, broadly sensible, procurement rules.** To all appearances however, no-one is ever held responsible for these failures, and the careers of those involved remain unaffected.

1 The impact of continuing large cost overruns and delays

1. Six years since the introduction of Smart Acquisition, there is still little evidence of the Department having improved its performance in delivering projects to cost and to time. Smart Acquisition is at risk of becoming the latest in a long line of failed attempts to improve defence procurement.⁴

2. The in-year increase of £1.7 billion in the forecast costs of the projects in the Major Projects Report are in addition to the £3.1 billion recorded in the previous year, and the Department will have to cut or cancel projects to compensate for these overruns. The combined value of overruns in these two years alone is £4.8 billion. For comparison, this sum would have paid the illustrative costs of the programmes shown in **Figure 1**.⁵

Figure 1: Illustrative potential impact of cost overruns

Military equipment	Cost
Six Type 45 destroyers (cost estimated at approval)	£5 billion
Eighteen Nimrod Maritime Patrol and Attack aircraft (currently forecast)	£3.6 billion
Three Astute Class submarines (currently forecast)	£3.5 billion

3. Similarly, the in-year delay of 62 months to the forecast in-service dates for those projects in the Major Projects Report is in addition to the 144 month delay recorded in the previous year. Taken together these figures mean that the 20 projects have each slipped by an average of more than 10 months in the last two years. These delays mean that the Armed Forces will have to operate existing equipment which is often less capable and less efficient, for considerably longer than planned.

4. The Department's planning process is designed to deliver the optimum capability within the resources available. Its Equipment Plan is updated annually to reflect changes in policy, technology, the means for dealing with a threat, in the allies' intentions and to cope with cost growth.⁶ The large cost growth and delays in the last two years have resulted in changes in the Equipment Plan, but the Department has found it difficult to identify those programmes which have been directly cancelled or delayed because of other cost overruns. Typically, the Department considers the following actions in response to a cost overrun or delay⁷:

4 Qq 19–20

5 Qq 42–45; C&AG's Report, Figure 2, p6

6 Ev 16 and Ev 9, footnote 4

7 Q 18; Ev 16 and Ev 9, footnote 4

- reduce the capability of equipment being procured within the project;
- reduce the quantity of equipment being procured within the project;
- introduce the capability more slowly than originally planned within the project or programme; or
- try to offset overruns or delays on an individual project by savings or under-runs elsewhere.

5. Since 1999, projects have been approved on the basis of 'highest acceptable' costs, and 'latest acceptable' in-service dates, that is, projects are approved as long as they do not exceed either of these parameters. There is little evidence to show that projects are in fact cancelled or changed where they breach the highest and latest approved parameters for costs or in-service dates. Project teams are however required to seek re-approval when they exceed approved cost or in-service dates. The Department saw re-approval as not just a formality and pointed to the examples set out in **Figure 2**.⁸

Figure 2: Projects cancelled in the last two years

Equipment	Reason for cancellation
The Medium Range TRIGAT (third-generation anti-tank missile)	When the United Kingdom signed the Memorandum of Understanding in July 1999, stating its intention to proceed to Industrialisation and Production, the Department believed Belgium and the Netherlands would sign the Memorandum in a similar timescale. By July 2000, the Memorandum of Understanding had still not been completed and the uncertainty and open ended delay led the UK to decide not to proceed to the next phase.
The Multi-Role Armoured Vehicle	The vehicle is not ideally suited to the type of operations now envisaged under the Strategic Review New Chapter and other developing policy work. Experience gained in recent military operations around the world has demonstrated the need for rapid deployability in expeditionary operations. This vehicle cannot meet that requirement. The capability requirement will now be pursued through the Future Rapid Effect System.
Area Defence Weapon	Cancelled before approval on value for money grounds and because of operational limitations. The capability requirement will be pursued through a new project, Future Counter Mobility Capability.
Counter Anti-Radiation Missile Suite	Cancelled during the Assessment Phase on value for money grounds. The capability will now be delivered by the Automated Software Adaptive Radar programme.
Mine Detection, Neutralisation and Route Marking (Route Proving)	Cancelled during the Assessment Phase because the technical solutions did not provide adequate military capability.
Laser Identification Experiment Airborne Technology Demonstration	Cancelled after submission of final business case on affordability and value for money grounds. It is envisaged that the capability requirement will be met via other networked enabled capability linked sensors.

Source: Ministry of Defence

6. There are a number of factors which make it difficult to cancel a project when it has breached its approval. The project is likely to be well underway and have incurred significant expenditure and contractual conditions may mean that there are little, if any, future savings. Six of the projects in the Major Projects Report 2004 have breached their cost or time approvals and yet continue as before.⁹

7. It is not always clear whether changes to the scope of projects are the result of cost increases or changes to requirements or both. For example, it was originally planned to purchase 12 Type 45 destroyers when the project was approved in 2000. The Department is now planning to acquire only eight ships. The reduction in numbers was not attributable to any one factor but to a combination of getting greater capability from each destroyer; the need to contain costs after increases in parts of the project (mainly on the Principal Air-to-Air Missiles to be fitted to the destroyers); and the reduced threat from enemy aircraft and missiles.¹⁰

8. Although it had previously given assurances to the Committee on improving its performance, the Department had expected 2004 to be another poor-performing year. The bulk of the latest reform programme was introduced in April 2005, after the end of the period covered by the 2004 Report. The reforms would take time to implement, and the benefits would only progressively be apparent in improved cost and time performance.¹¹

9. The Department was not yet ready to commit to a definite timetable for consistent improvements in the results of the projects reported within the Major Projects Report. The Major Projects Report covers the 20 projects in the main investment phase which have the largest amounts yet to be spent, so many of the large projects remain in the report for many years. Where such projects had been approved on the basis of insufficiently informed business cases, the Department thought it quite possible that problems would continue to emerge in future.¹²

10. The Department has set the Defence Procurement Agency key targets to reduce time and cost overruns on a wider range of projects than the Major Projects Report. The Defence Procurement Agency's annual Key Targets prescribe timescales for controlling costs overruns and delays of some 65 projects each valued at over £20 million. Current published targets are for 2005–06, by which time the Agency expects to bring in-year delays to an average of 0.7 months, and in-year cost slippage to 0.4%.¹³

9 Qq 41–45; C&AG's Report, Figure 9

10 Qq 96–99

11 Qq 1–2

12 Qq 47–48

13 Qq 2, 50; Defence Procurement Agency, *Annual Report and Accounts 2003–04*, HC 1079

2 Handling large complex projects

11. One of the principles underpinning Smart Acquisition is to invest more in the early project phases. Under the Smart Acquisition lifecycle, projects progress through six stages: Concept, Assessment, Demonstration, Manufacture, In-service, and Disposal. The main investment decision, called Main Gate, occurs at the end of the assessment phase. Performing sufficient work in the assessment phase is essential to allow a fully-informed investment decision to be made. The Department's own guidance says that up to 15% of the overall procurement budget should be spent at this phase, although the exact amount will depend upon the complexity of the project.¹⁴ For example, the Department spent 4.7% on the assessment phase of the Successor Identification Friend or Foe system and delivered it within time and cost. Assessment phase spending should not necessarily reach 15% for each project, but the Department accepted that it ought to be significantly higher than current levels. Historic levels have been as low as 1% on complex programmes such as the Astute Class submarine and Nimrod MRA4 aircraft where significant problems have arisen in the subsequent demonstration and manufacture phases.¹⁵

12. The Department said it had now implemented procedures to confirm that all projects seeking Main Gate approval from the Investment Appraisals Board had undertaken sufficient assessment phase work. For all business cases submitted to the Board, the onus would be on the sponsors of the submission to demonstrate how much assessment phase work had been done, and how that amount of work had led to an informed business case for an investment decision. The amount spent on the assessment phase as a percentage of the total estimated procurement cost would be shown, and differences from the 15% target would need to be explained.¹⁶

13. The Chief of Defence Procurement acknowledged that too many inappropriate contracts for high technology projects had been let in the past. Where projects were challenging, risky or where requirements were hard to define from the outset, the Department needed to explore new avenues such as different contracting mechanisms or a different customer-industry relationship.¹⁷

14. The Department aims to match appropriate procurement strategies to individual projects on a case-by-case basis. The different strategies employed include Private Finance Initiative / Public Private Partnerships, leasing, multi-nation collaborative programmes, partnering, and Alliancing. The decision to adopt a particular strategy will be affected by factors such as affordability, technological risk, and the possibilities of sharing technology, risks or rewards with industry or other nations. But different strategies carry different risks. The multi-nation collaborative route, for example, has often led to delays while other partner nations reach agreement on the Memorandum of Understanding or the contract.

14 C&AG's Report, paras 1.15–1.16

15 Qq 74–76; C&AG's Report, Figure 8

16 Q 77

17 Q 72

This has happened on the Typhoon aircraft, Beyond Visual Range Air-to-Air Missile (BVRAAM), and the A400M heavy lift aircraft in each case resulting in significant time and cost overruns.¹⁸

15. The Department plans to run the Future Aircraft Carrier project under an Alliance strategy. Although Alliances have been used by the Australian Ministry of Defence, and in the oil and gas industries, this will be the first Departmental procurement using this strategy. Alliancing allows the customer to pool the best elements from different packages and different contractors with a joint sharing of risks and rewards amongst the Alliance members. For Alliancing to succeed, there must be a strong relationship between the Alliance members. An independent review of the Future Aircraft Carrier project by the Office of Government Commerce concluded that for a project with this high level of risk, Alliancing is an appropriate way of proceeding, and this view has been supported by the Treasury. The Future Carrier Aircraft is further complicated by the complexity of the project with high construction and integration risk, and the role of Physical Integrator has been created to specifically oversee this. Where the Department has reason to believe that prospective members of an Alliance will not be able to work smoothly with other Alliance members or stakeholders in the project, it needs to exclude them from the arrangement.¹⁹

16. Given the long timescales of defence procurements, which can span 15 years from the main investment decision to delivery of the equipment into service, planning for capabilities involves making assumptions about the nature of future military operations. The process starts with the Defence Strategic Guidance, which considers what the world will look like in the timescale. The Department then produces possible future scenarios based on the Guidance, with illustrative campaign plans. It then undertakes an audit of capability, produces a prioritised list of capabilities, and undertakes work to understand how those capabilities might be translated into platforms and equipment. It is important that all relevant stakeholders (including industry) engage in this early stage to ascertain the requirement and feasibility of projects, as illustrated in **Figure 3**. Cost increases often occur on projects where requirements are changed some way into the demonstration and manufacture phase. Early and full discussion with the capability customer and industry helps to minimise this risk.²⁰

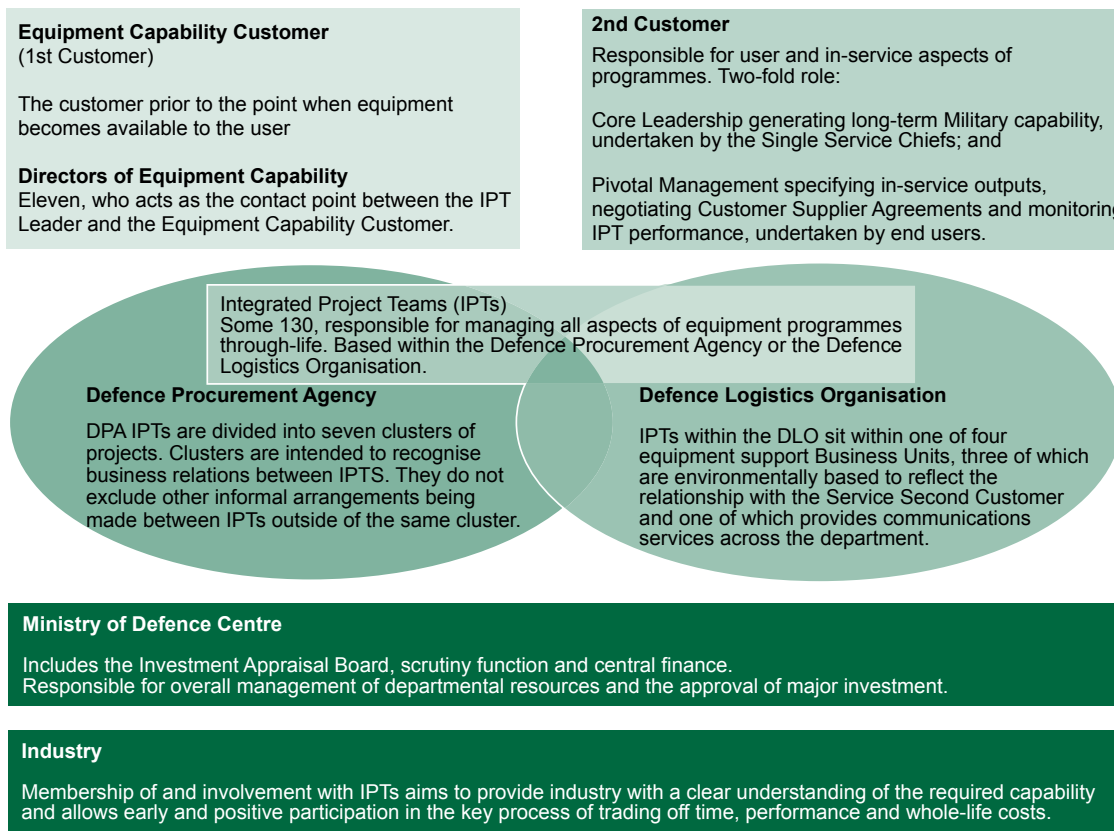
18 C&AG's Report, Figure 8

19 Q 13

20 Qq 32–33

Figure 3: The key stakeholders in the Department’s acquisition community

Through-life management involves all the key stakeholders



Source: National Audit Office

17. The setting of capability is further complicated by the need to balance cost effectiveness with the complexity of the project. Equipment which can fulfil more than one role may be more effective than buying different types of equipment which are single role. However, building more roles into a piece of equipment will increase its complexity.²¹ Typhoon, for example, was originally designed to be an air-to-air superiority fighter to combat the Soviet threat. Since it was approved in 1988, the shape of the world and military operations has changed, and there is now a greater need for aircraft which can perform precision attack of surface targets. The updating of capabilities on Typhoon has been designed to deliver a multi-role capability with air-to-air and air-to-surface attack, but has also resulted in some large cost overruns.²²

18. The role of Senior Responsible Owner is another mechanism designed to aid the running of large complex programmes. The post has been created for projects which have novel elements, high integration risk or cover an unusually large number of stakeholders. The Carrier Strike capability, for example, comprises the Future Aircraft Carrier, the Future Joint Combat Aircraft and the Maritime Airborne Surveillance Control platform.

21 Qq 37-39

22 C&AG's Report, Volume 2, HC 1159-II, p111

Rotorcraft, similarly, involves a number of different helicopters. The Department has limited the number of Senior Responsible Owners to a few, to highlight the extra level of complexity on the programme. On all other programmes, there are single points of accountability. They perform the same role filled by the directors of equipment capability who manage clusters of project teams.²³

3 Whether the latest reform programme will succeed

19. The Defence Procurement Agency's programme of reform to reinvigorate Smart Acquisition, DPA Forward, has been rolling out since April 2004. The Chief of Defence procurement acknowledged that none of the principles of Smart Acquisition were intellectually difficult, but it was a "question of leadership and consistency across a very wide community".²⁴ DPA Forward is the latest of various attempts to improve defence procurement. The Chief of Defence Procurement explained that he was bringing pressure to bear in ensuring the consistent application of Smart Acquisition through the mechanisms set out in **Figure 4**.²⁵ The Chief of Defence Procurement has recognised that there is much to do to achieve this change. As he put it, there is a need to "win people's hearts and minds...and that is a major leadership challenge".²⁶

Figure 4: Measures in the reform programme – DPA Forward

Ensure that there is a Departmental-wide understanding of the importance of improving the procurement performance, and the importance of recommendations made by the Committee of Public Accounts
Frame the Key Targets in a way to challenge and motivate project teams to improve and force continued improvement
Measure Key Targets against the 'most likely' cost and time approvals from 2004–05, a more meaningful and challenging target
Key Targets will cover all projects in the demonstration and manufacture phase with a procurement value over £20 million. Some 65 projects will be included, in contrast to the current 20 projects, giving a more accurate and meaningful picture of the Department's performance and a more challenging overall target
Change the culture and behaviour in the Department by the establishment of a Ministerial group
Create good working relationships with internal and external stakeholders
Place greater emphasis on the need for realistic proposals and greater pragmatism
Strengthen the level of financial expertise. Financial Controllers have been placed on some of the more complex project teams such as Typhoon, Astute Class submarine, Nimrod MRA4 aircraft, and the Type 45 destroyer. Some of the larger, more complex projects are the size of large business enterprises, and did not have the appropriate level of senior financial control

Source: Ministry of Defence

20. In addition, in Autumn 2004, the Department established the Acquisition Policy Board to direct and drive forward acquisition and industrial policy. It is chaired by the Minister for Defence Procurement and includes the Vice Chief of the Defence Staff, Permanent

²⁴ Qq 20, 72

²⁵ Qq 64, 89–93

²⁶ Qq 20, 65

Under Secretary of State, Second Permanent Under Secretary of State, Chief Scientific Advisor, Chief of Defence Logistics, Chief of Defence Procurement and Deputy Chief of the Defence Staff (Equipment Capability). The Board was established in recognition of the need to change behaviour and culture not just in the Defence Procurement Agency, but elsewhere in the Department.²⁷

21. The Department considers that the Acquisition Policy Board will ensure that there is more realism in forecasting. There should be a better appreciation of the design and technical difficulty involved, more realistic and informed estimates of cost and time, and a better assessment of the competence, experience and financial viability of the supplier. There is to be more pragmatism in planning, and acceptance by the Department as a whole of not wanting a whole range of capabilities to be delivered in an unrealistically short timescale. The Board is currently redefining guidance on what constitutes a mature business case prior to the main investment decision.²⁸

22. The Department has also changed the way in which it measures project performance, which now aligns with the Office of Government Commerce's guidelines. The Department and its project teams have measured performance against the 'highest and latest acceptable' parameters, rather than the 'most likely' targets. As a result, many projects have been too ready to allow their costs or in-service dates to slip towards the highest and latest acceptable, sometimes in order to enhance the capability. The Chief of Defence Procurement has now insisted that projects be measured against their 'most likely' forecasts. Costs or in-service dates should only move towards the upper limits if risks materialise.

23. In the past, project teams have placed emphasis on providing the best capability to the capability customer, who in turn has wanted to provide the best to the end user, often at the expense of realism.²⁹ For example, the Department was planning to bring into operational use the Type 45 destroyer before industry was contracted to deliver it. The original offer from industry had created an expectation that the Navy would be able to take beneficial use from the warship before it had completed all of the trials and testing of systems. The Department has since revised the programme to provide increased but more realistic estimates of time and cost.³⁰

24. As part of a wider consideration of skills within the Agency, it has placed an increased focus on the right skills and training.³¹ There may still be an absence of other skills needed for the delivery of successful procurement, especially with the use of innovative procurement strategies. The Agency will need to monitor its skills base to identify and fill gaps in areas such as project financing and relationship management.

27 Qq 24–28; Ev 15

28 Q 59

29 Qq 89–92

30 Q 14

31 Qq 67–68; C&AG's Report, Box 2, p18

Formal minutes

Monday 18 July 2005

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Mrs Angela Browning
Greg Clark
Helen Goodman
Ms Diana R Johnson

Mr Sadiq Khan
Sarah McCarthy Fry
Jon Trickett
Mr Alan Williams

Draft Report (Ministry of Defence: Major Projects Report 2004), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 24 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Third Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

[Adjourned until Wednesday 12 October at 3.30 pm

Witnesses

Monday 31 January 2005

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Sir Peter Spencer KCB, and Lieutenant General Sir Robert Fulton, Ministry of Defence

Ev 1

List of written evidence

Ministry of Defence

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