House of Commons
Defence Committee

Ministry of Defence
Annual Report and Accounts 2012–13

Eighth Report of Session 2013–14

Report, together with formal minutes, oral and written evidence

Additional written evidence is available on the Committee website at www.parliament.uk/defcom

Ordered by the House of Commons
to be printed 18 December 2013
The Defence Committee

The Defence Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Ministry of Defence and its associated public bodies.

Current membership

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Mr Julian Brazier MP (Conservative, Canterbury)
Mr James Gray MP (Conservative, North Wiltshire)
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Ms Gisela Stuart MP (Labour, Birmingham, Edgbaston)
Derek Twigg MP (Labour, Halton)
John Woodcock MP (Labour/Co-op, Barrow and Furness)

The following Members were also members of the Committee during this inquiry.

Thomas Docherty MP (Labour, Dunfermline and West Fife)
Penny Mordaunt MP (Conservative, Portsmouth North)
Sandra Osborne MP (Labour, Ayr, Carrick and Cumnock)

Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via www.parliament.uk.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at www.parliament.uk/parliament.uk/defcom.

The Reports of the Committee, the formal minutes relating to that report, oral evidence taken and some or all written evidence are available in a printed volume. Additional written evidence may be published on the internet only.

Committee staff

The current staff of the Committee are James Rhys (Clerk), Dougie Wands (Second Clerk), Karen Jackson (Audit Adviser), Ian Thomson (Committee Specialist), Christine Randall (Senior Committee Assistant), Rowena Macdonald and Carolyn Bowes (Committee Assistants), and Sumati Sowamber (Committee Support Assistant).

Contacts

All correspondence should be addressed to the Clerk of the Defence Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 5745; the Committee's email address is defcom@parliament.uk. Media inquiries should be addressed to Alex Paterson on 020 7219 1589.
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Conclusions and recommendations

Overall Conclusion

1. The Ministry of Defence has made some improvements to its reporting of information since last year but much work is still needed before it meets the standards we would expect to see in its Annual Report. We have set out the areas where the MoD needs to provide more extensive information on its performance. (Paragraph 51)

2. The MoD has been reviewing its risk management arrangements and we look forward to seeing the results of its review. We are concerned that structural changes have led to a lack of clarity in aligning roles and responsibilities with risk management structures. Our major concern and, apparently the Defence Board’s second strategic risk, is shortage of key personnel. This was evidenced by the increase in the number of pinch point trades, the high level of voluntary outflow and the continuing breaches of harmony guidelines. The Defence Board should take these shortages seriously. (Paragraph 52)

3. The provision of reliable management information is critical to the effective management of an organisation. It is crucial that the MoD improves its management information systems and the quality of the management information produced. In particular, the MoD should concentrate on improving its financial management information. (Paragraph 53)

4. For the seventh successive year, the Comptroller and Auditor General (C&AG) qualified the Ministry of Defence (MoD) Accounts for 2012–13. The qualifications were:
   - The regularity of the treatment of the impairment of the valuation of the German estate resulting from the withdrawal of UK Forces from Germany;
   - Non-compliance with international reporting standards on the treatment of some contracts; and
   - The valuation of inventory and non-current assets.

The latter two problems are likely to persist beyond 2014–15. The MoD needs a clear plan and timetable as to how and when it will achieve a clear audit opinion from the C&AG. (Paragraph 54)

Performance and risk management in the MoD

5. We welcome the MoD’s implementation of the recommendation in our last report on the Annual Report and Accounts that it provide a useful commentary on the input and impact indicators. We are, however, unhappy with the quantity and quality of performance information available to us and to the public. We recommend that more information of the type provided to the Defence Board should be provided to us and put in the MoD’s Annual Report and Accounts. We
have identified those areas where we expect the MoD to provide information in its Annual Report and Accounts or where it should develop an improved set of indicators. These areas are set out in an annex to this Report. (Paragraph 6)

6. We are concerned that structural changes in the MoD have led to a lack of clarity in roles and responsibilities. The MoD should report to us on the results of its work looking at this problem. We also wish to know how responsibilities are aligned with risk management structures and, how it is improving business continuity arrangements. We do not accept the assertion that because the detailed Strategic Risk Register is produced as advice to the Defence Secretary and the Defence Board, that fact should preclude members of the Committee from being able to see it. The Register is an important document with several functions, and it needs to be open to Parliamentary scrutiny. At the very least, the MoD should provide us with a commentary on the reassessment of the risks presented to the Defence Board and with the new Risk Framework documentation. (Paragraph 12)

7. We recommend that the MoD should tell us what it is doing to manage the risks resulting from the volume of change presently being undertaken in the MoD alongside business as usual. (Paragraph 14)

8. We are concerned that the rate of voluntary outflow from the Armed Forces is above the long term average. The MoD should identify the causes of this increased outflow and determine what measures it needs to put in place to reduce the outflow. (Paragraph 15)

9. The MoD should support the Services in addressing shortages in pinch point trades—key shortages which leave the Armed Forces vulnerable now and in the future. The MoD and the Armed Forces should explore ways of filling these gaps by offering financial or other incentives to Service personnel to encourage those in pinch point trades to continue in service and to encourage others to undertake training in these trades or by using reservists and private sector contractors. (Paragraph 20)

10. It is unsatisfactory that harmony guidelines are still being breached for some Armed Forces personnel, in particular that over five per cent of the Army is away from home in excess of the recommended time. The MoD should provide us with the annual figures for breaches of harmony guidelines over the last ten years. We call on the MoD to set out a timetable for reaching a point where no Armed Forces personnel are in breach of harmony guidelines. (Paragraph 23)

11. As Lord Levene said in his second annual review of the Defence Reform programme, management information is critical for the effective management of Defence. The MoD should update us on its proposals to improve its management information systems in particular its financial management information systems. It should also describe in detail its planned work on costing defence outputs, in particular, operations. It should tell us the planned future level of investment in cost modelling and data and systems exploitation. (Paragraph 27)

12. The MoD has presided over significant cost increases in the Carrier Programme mainly caused by repeated changes to the requirement. We ask the MoD to confirm
whether the Carrier programme is now on track and whether it now expects the programme to proceed without further significant cost or time overruns. (Paragraph 32)

Annual Report and Accounts 2012–13

13. We are concerned that the MoD is still so dependent on external accountancy support to produce its annual accounts. The amount it spent on external accountancy support to produce the accounts is excessive. We ask the MoD to provide us with a timetable setting out milestones for progress towards producing its annual accounts without significant external resources. (Paragraph 34)

14. We call on the MoD to report the finding of its review of contracts likely to be affected by the International Financial Reporting Issues Committee Interpretation (IFRIC) 4. We also ask the MoD to inform us about the cost and manpower implications of the work required to ensure compliance with IFRIC4 and provide us with an undertaking that the steps it has taken would fully addressed the grounds of the qualification. (Paragraph 43)

15. We are pleased to see that the MoD is finally taking inventory management seriously. However, there is still much work to be done. We expect to see the relevant IT systems delivered on time and making a valuable contribution to inventory management by 2014–15. In response to this Report, the MoD should tell us what further measures it needs to take to remedy the poor state of inventory control in the MoD and the timetable to introduce them. (Paragraph 50)
1 Introduction

Background

1. Government departments are expected to publish annual reports and audited accounts at the end of each financial year and before the parliamentary summer recess. As a result of changes to government-wide reporting requirements at the start of this Parliament, the Ministry of Defence (MoD) sets out, in its Annual Report and Accounts, data on its performance against the input and impact indicators contained in its business plan. Information on its annual performance against these indicators was reported for the first time in the Annual Report and Accounts 2010–11. The MoD also reports quarterly against its business plan.1 This inquiry is the latest in a series of inquiries into the MoD Annual Report and Accounts; this one deals with the Annual Report and Accounts 2012–13 which were published in July 2013.2

Evidence

2. We held an oral evidence session with Mr Jon Thompson, Permanent Under Secretary (PUS) to the MoD and Mr David Williams, MoD’s Director General Finance on 10 September 2013. Mr Thompson took up post as PUS in September 2012; prior to that he was the Director General Finance in the MoD. On 21 November 2013, the MoD provided a memorandum following up on areas not fully covered in the evidence session. We examined the expenditure, financial management and performance of the MoD. We also questioned the Permanent Under Secretary on the accountability arrangements for the potential Government owned, contractor operated (GoCo) organisation to manage the acquisition of defence materiel. This information is likely to be dealt with in a future report on the GoCo.

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2 Ministry of Defence Annual Report and Accounts 2012–13, HC 38
2 Performance and risk management in the MoD

Reporting of performance to Parliament and the public

3. The MoD has now implemented the recommendation in our Report on the Annual Report and Accounts 2011–12\(^3\) that the Annual Report and Accounts should include an explanation of the input and impact indicators and performance against the indicators (see Table 1 below). However, the MoD has not reviewed its performance reporting to identify further and more useful information in line with that used by the Defence Board.\(^4\) The Defence Board is the main corporate board of the MoD, providing senior level leadership and strategic management of Defence, driving forward delivery and change. The Defence Board is chaired by the Secretary of State for Defence. Other current membership is the Armed Forces Minister, the PUS, the Chief of the Defence Staff, the Vice Chief of the Defence Staff, the Chief of Defence Materiel, the Director Finance and three non-executive Board members.

4. Performance indicators should provide a coherent and consistent view of the performance of the MoD. The high level indicators used by the Management Board of an organisation should form the basis of the indicators reported to Parliament and the public. In the oral evidence session on 10 September, Jon Thompson, the Permanent Under Secretary (PUS), suggested that the Committee should identify those areas where it would like to see further information.\(^5\)

5. When asked if he agreed with the NAO assessment that the MoD input and impact indicators did not cover ‘structural reform priorities’ such as the Defence Reform Programme, the PUS said:

> I think that that is fair. There are challenges with those [indicators] […] in that they do not match to any large degree those indicators that we use for running the Ministry of Defence. […] The Defence Board receives a monthly report on the defence transformation programme and our progress against the 53 recommendations that Lord Levene made in his report. We could issue some of that information on an annual basis if that would assist the reader of the annual report.


\(^5\) Qq 1–2
<table>
<thead>
<tr>
<th>Indicators</th>
<th>2012–13</th>
<th>2011–12</th>
<th>Comment</th>
</tr>
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<tbody>
<tr>
<td><strong>Input Indicators</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Additional cost of operations in Afghanistan, per Service person deployed</td>
<td>£297,025</td>
<td>£364,000</td>
<td><em>This is the total Net Additional Cost of Military Operations (including Urgent Operational Requirements (UOR)) over the year, divided by the endorsed manpower level (9,900 for all of 2012–13). It is slightly lower this year due to reductions in the amounts spent on infrastructure and equipment prior to draw down.</em></td>
</tr>
<tr>
<td>Additional cost of new equipment (Urgent Operational Requirements (UOR)) for operations in Afghanistan, per Service person deployed</td>
<td>£37,000</td>
<td>£60,012</td>
<td><em>This is the total UORs over the year, divided by the endorsed manpower level (9,900 for all of 2012–13). It is slightly lower this year due to sizeable reductions in the amounts spent on equipment prior to draw down.</em></td>
</tr>
<tr>
<td>Average percentage by which the cost of the Department’s Equipment Programme (EP) varies compared to forecasts in year</td>
<td>0.26%</td>
<td>1.41%</td>
<td><em>This figure is the average slippage across the Department’s largest projects (Category C and above) in the last year. It is a continuation of a long term trend of reduced programme delays, reflecting improvements in project and programme management.</em></td>
</tr>
<tr>
<td>Cost of major Force Elements (FE):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ship</td>
<td>£33.5m</td>
<td>£34.0m</td>
<td><em>This figure is calculated by attributing Defence expenditure to each of the major Force Elements. The costs have remained roughly constant.</em></td>
</tr>
<tr>
<td>Brigade</td>
<td>£654m</td>
<td>£661m</td>
<td></td>
</tr>
<tr>
<td>Aircraft (fixed wing)</td>
<td>£8.34m</td>
<td>£8.05m</td>
<td></td>
</tr>
<tr>
<td>Helicopter</td>
<td>£3.62m</td>
<td>£3.41m</td>
<td></td>
</tr>
<tr>
<td>Direct personnel costs, per Service person.</td>
<td>£55,024</td>
<td>£52,000</td>
<td><em>This is the total spend on military manpower divided by the number of Service personnel over the year. It rose slightly this year, in part reflecting the increase in pay for military personnel.</em></td>
</tr>
<tr>
<td><strong>Impact Indicators</strong></td>
<td></td>
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<tr>
<td>Progress toward a stable and secure Afghanistan</td>
<td>96%</td>
<td>105%</td>
<td><em>This is the percentage of Afghan National Security Forces against the NATO target. The strength of the ANSF has increased this year from 330,000 to 336,000 but the target for this year also increased from 312,000 to 351,000.</em></td>
</tr>
<tr>
<td>Number of Service and MoD civilian personnel deployed on all operations in a year</td>
<td>11,476</td>
<td>15,582</td>
<td><em>This is the total number of personnel deployed on operations both in the UK and overseas. The figure is lower this year due to the end of operations in Libya.</em></td>
</tr>
<tr>
<td>Percentage of Service personnel that are deployable.</td>
<td>91.1%</td>
<td>92.0%</td>
<td><em>This figure has remained constant from last year.</em></td>
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Number of Force Elements (FE) (typically ships, ground force sub-units and aircraft) showing critical or serious weakness against the total number of FE for Strategy for Defence (Sfd) priorities

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<th></th>
<th>8%</th>
<th>10%</th>
<th>This figure is slightly better than last year’s. We expect it to improve substantially as forces return from Afghanistan.</th>
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Percentage of Service personnel (split by Officers and Other Ranks (OR)) who are satisfied with Service life in general

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<th></th>
<th>59%/50%</th>
<th>62%/56%</th>
<th>The significant drop from last year is likely to be due to a combination of pay restraint and the announcement of redundancies.</th>
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Overall public favourability of the UK Armed Forces

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<th></th>
<th>85%</th>
<th>85%</th>
<th>This figure remains encouragingly high.</th>
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Source: MoD Annual Report and Accounts 2012–13

6. We welcome the MoD's implementation of the recommendation in our last report on the Annual Report and Accounts that it provide a useful commentary on the input and impact indicators. We are, however, unhappy with the quantity and quality of performance information available to us and to the public. We recommend that more information of the type provided to the Defence Board should be provided to us and put in the MoD’s Annual Report and Accounts. We have identified those areas where we expect the MoD to provide information in its Annual Report and Accounts or where it should develop an improved set of indicators. These areas are set out in an annex to this Report.

**Risk management by the Defence Board**

7. In its Annual Report and Accounts, the MoD reports that there are 16 risks over which the Defence Board has decided it wishes to have particular oversight. These risks include:

- That the MoD does not have the right numbers of people with the right skills;
- That the MoD cannot generate future leadership;
- That the MoD does not retain the confidence and commitment of its people, causing them to leave;
- Matters surrounding the withdrawal from Afghanistan;
- That transformation does not deliver the required way of working;
- Risks to the delivery of operational capability;
- Threats to its information systems, including from cyber attack; and
• Risks from a disruptive event such as a flu epidemic or terrorist attack.

The MoD said that it does not publish a full list of risks for reasons of national security.7 A review of these risks was scheduled for Autumn 2013 to ensure the risks and process remain up-to-date and relevant.8

8. Following last year’s Internal Audit review of risk management, the MoD is changing its arrangements over the next two years to include:

• An updated Risk Management Framework that supports the delegated operating model;

• A consistent approach to Impact and Likelihood criteria to allow comparisons across TLBs [top level budget holders];

• A redesigned report to the Defence Board to allow better focus on escalated risks that need attention, and better visibility of risks for profiling purposes;

• The introduction of ‘target’ risk assessments, that will improve consideration of risk appetite;

• Refreshed risk management training within the Defence Academy; and

• Improved communications on risk matters.9

9. The PUS said that when he took up his post, he identified that the management of strategic risks needed to be improved. Since the Autumn of 2012, the Defence Board has undertaken a process of improvement of its risk management. The MoD formed a new strategic risk register which comes to the Defence Board quarterly. The PUS acknowledged that there was still much to be done in assuring a consistent approach to risk across the MoD.10

10. The PUS undertook to look at how much of the strategic risk register could be shared with the Committee.11 The MoD replied:

The Defence Board strategic risks are those risks identified as being specifically within the remit of the Defence Board to understand, monitor and manage. By their nature, the detail and assessment of those risks is classified. Notwithstanding the classification, we will not be able to share the detailed Strategic Risk Register with members of the Committee as it is produced as advice to the Defence Secretary and the Defence Board.12

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7 Ministry of Defence Annual Report and Accounts 2012-13 HC 38 Governance Statement, page 87
8 Ibid
9 Ibid
10 Qq 13–18
11 Q 25
12 Ev 18
The MoD, however, did agree to give us the new Risk Framework documentation in the New Year when it had been approved.\textsuperscript{13}

11. In his Governance Statement, the PUS said that he shared “the Defence Audit Committee’s view that the structural changes we are undertaking are leading to some lack of clarity in roles and responsibilities, particularly in business continuity”.\textsuperscript{14} The PUS said that the MoD was trying to work out the internal control framework of responsibilities and delegations.\textsuperscript{15} He added:

We have to make sure that we are clear about all those issues. [...] They are not only about finance or HR information or safety. There are more than 200 areas where we have to be clear about how accountability and responsibility work in a delegated organisation. We are doing that work, and it is coming to the board at the end of September.\textsuperscript{16}

The Defence Board is carrying out a reassessment and review of risk management arrangements which is due to finish before the end of the year.\textsuperscript{17}

12. We are concerned that structural changes in the MoD have led to a lack of clarity in roles and responsibilities. The MoD should report to us on the results of its work looking at this problem. We also wish to know how responsibilities are aligned with risk management structures and, how it is improving business continuity arrangements. We do not accept the assertion that because the detailed Strategic Risk Register is produced as advice to the Defence Secretary and the Defence Board, that fact should preclude members of the Committee from being able to see it. The Register is an important document with several functions, and it needs to be open to Parliamentary scrutiny. At the very least, the MoD should provide us with a commentary on the reassessment of the risks presented to the Defence Board and with the new Risk Framework documentation.

**Challenge from the quantity of change in the MoD**

13. We note that the PUS was sufficiently concerned with the level of change in the MoD to refer to it in his Governance Statement in the Annual Report and Accounts. He said in relation to ‘Transforming Defence’ (the reform introduced following the Report commissioned from Lord Peter Levene by the Secretary of State on the need to reform the structure and management of the MoD) that:

The sheer volume of change underway in the Department also presents a challenge, especially given the importance of delivering ‘business as usual’, which in our case includes success in operations in Afghanistan and procuring cutting edge military equipment. We are actively managing these risks, but they will require sustained

\textsuperscript{13} Ev 18
\textsuperscript{14} Ministry of Defence Annual Report and Accounts 2012–13 HC 38 Governance Statement, page 88
\textsuperscript{15} Qq 18–21
\textsuperscript{16} Q 20
\textsuperscript{17} Q 22
attention from the Defence Board, especially as the drawdown from Afghanistan and the return of the Army from Germany gather pace.  

14. We recommend that the MoD should tell us what it is doing to manage the risks resulting from the volume of change presently being undertaken in the MoD alongside business as usual.

Risk from reduction in manpower

15. One of the strategic risks considered by the Defence Board is whether the Armed Forces and the MoD have sufficient capable personnel to carry out the tasks required. The Board is concerned about the rate of voluntary outflow. Voluntary outflow for officers is currently 4.1 per cent and for other ranks is 5.8 per cent which is above the long term average for ten years at a time when the economic situation might suggest it should be lower than the average. We are concerned that the rate of voluntary outflow from the Armed Forces is above the long term average. The MoD should identify the causes of this increased outflow and determine what measures it needs to put in place to reduce the outflow.

Pinch Point trades

16. Operational Pinch Point trades are those where there are insufficient trained personnel against an operational requirement. In the Royal Navy, the number of Operational Pinch Point trades has increased from 11 to 15 since 2011–12, see Table 2 below for detail. In the Army, the number of Operational Pinch Point trades has increased from 19 to 26, see Table 2 for details. The number of Operational Pinch Point trades in the RAF reduced to just one.

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19 Q 51 and Q 56
20 Q 51
21 Ministry of Defence Annual Report and Accounts 2012–13, HC 38, pages 40–41
Table 2: Operational Pinch Point trades 2012–13

<table>
<thead>
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<th>Naval Service Operational Pinch Point Groups – Quarter 4 2012/13</th>
<th>Liability</th>
<th>Shortfall</th>
<th>% Diff</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Anti-Submarine Warfare Aircrewmen</td>
<td>90</td>
<td>15</td>
<td>15%</td>
</tr>
<tr>
<td>2 General Service Mechanical Engineer—Rank: Warrant Officer Class 2</td>
<td>160</td>
<td>10</td>
<td>5%</td>
</tr>
<tr>
<td>3 Strategic Weapon System Watch Keeper—Rank: Senior Rate</td>
<td>120</td>
<td>20</td>
<td>15%</td>
</tr>
<tr>
<td>4 Medical Assistant Operating Department Practitioner</td>
<td>35</td>
<td>10</td>
<td>30%</td>
</tr>
<tr>
<td>5 Seaman Specialists—Rank: Leading Rate to Petty Officer</td>
<td>265</td>
<td>65</td>
<td>25%</td>
</tr>
<tr>
<td>6 Royal Marine Other Ranks—Rank: Corporal to Warrant Officer Class 2</td>
<td>2175</td>
<td>190</td>
<td>10%</td>
</tr>
<tr>
<td>7 Mine Warfare—Rank: Leading Rate to Petty Officer</td>
<td>135</td>
<td>40</td>
<td>30%</td>
</tr>
<tr>
<td>8 Category A2 Nuclear Watch Keepers</td>
<td>140</td>
<td>20</td>
<td>15%</td>
</tr>
<tr>
<td>9 Category B Nuclear Watch Keepers</td>
<td>355</td>
<td>40</td>
<td>10%</td>
</tr>
<tr>
<td>10 Diver Specialist—Rank: Petty Officer</td>
<td>55</td>
<td>5</td>
<td>10%</td>
</tr>
<tr>
<td>11 Medical Assistant Submarines</td>
<td>30</td>
<td>~</td>
<td>15%</td>
</tr>
<tr>
<td>12 Nurses</td>
<td>50</td>
<td>15</td>
<td>30%</td>
</tr>
<tr>
<td>13 Warfare Specialists—Rank: Leading Rate</td>
<td>430</td>
<td>20</td>
<td>5%</td>
</tr>
<tr>
<td>14 Hydrographic</td>
<td>30</td>
<td>10</td>
<td>40%</td>
</tr>
<tr>
<td>15 Commando Aircrewman</td>
<td>90</td>
<td>25</td>
<td>25%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Army Operational Pinch Point Groups – Quarter 4 2012/13</th>
<th>Liability</th>
<th>Shortfall</th>
<th>% Diff</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Advanced Explosive Ordnance Disposal Operator</td>
<td>55</td>
<td>20</td>
<td>35%</td>
</tr>
<tr>
<td>2 Royal Engineers Explosive Ordnance Disposal Operators—Rank: Corporal to Staff Sergeant</td>
<td>65</td>
<td>15</td>
<td>20%</td>
</tr>
<tr>
<td>3 Royal Army Veterinary Corps Dog Handler</td>
<td>220</td>
<td>35</td>
<td>15%</td>
</tr>
<tr>
<td>4 Int. Corps Operator Military Intelligence—Rank: Corporal</td>
<td>605</td>
<td>225</td>
<td>35%</td>
</tr>
<tr>
<td>5 Interrogators</td>
<td>70</td>
<td>20</td>
<td>25%</td>
</tr>
<tr>
<td>6 Int. Corps Operator Military Intelligence—Rank: Sergeant</td>
<td>370</td>
<td>150</td>
<td>40%</td>
</tr>
<tr>
<td>7 Int. Corps Operator Military Intelligence—Rank: Staff Sergeant</td>
<td>185</td>
<td>25</td>
<td>15%</td>
</tr>
<tr>
<td>8 Int. Corps Operator Military Intelligence—Rank: Warrant Officer Class 2</td>
<td>165</td>
<td>20</td>
<td>10%</td>
</tr>
<tr>
<td>9 Int. Corps Operator Military Intelligence—Rank: Private to Warrant Officer Class 2</td>
<td>230</td>
<td>115</td>
<td>50%</td>
</tr>
<tr>
<td>Rank and Type</td>
<td>Number</td>
<td>Shortfall</td>
<td>% of Shortfall</td>
</tr>
<tr>
<td>---------------</td>
<td>--------</td>
<td>-----------</td>
<td>----------------</td>
</tr>
<tr>
<td>Human Intelligence Operator</td>
<td>245</td>
<td>105</td>
<td>45%</td>
</tr>
<tr>
<td>Int Corps—Rank: Captain</td>
<td>155</td>
<td>14</td>
<td>10%</td>
</tr>
<tr>
<td>Int Corps—Rank: Major</td>
<td>140</td>
<td>40</td>
<td>27%</td>
</tr>
<tr>
<td>Royal Engineers Engineer Logistic Specialist—Rank: Lance Corporal</td>
<td>80</td>
<td>30</td>
<td>35%</td>
</tr>
<tr>
<td>Radiologists</td>
<td>5</td>
<td>–</td>
<td>50%</td>
</tr>
<tr>
<td>Int Corps—Rank: Captain</td>
<td>155</td>
<td>14</td>
<td>10%</td>
</tr>
<tr>
<td>Int Corps—Rank: Major</td>
<td>140</td>
<td>40</td>
<td>27%</td>
</tr>
<tr>
<td>Royal Engineers Engineer Logistic Specialist—Rank: Lance Corporal</td>
<td>80</td>
<td>30</td>
<td>35%</td>
</tr>
<tr>
<td>Radiologists</td>
<td>5</td>
<td>–</td>
<td>50%</td>
</tr>
<tr>
<td>Royal Artillery Fire Support Team Commanders</td>
<td>140</td>
<td>10</td>
<td>10%</td>
</tr>
<tr>
<td>Royal Artillery Integrated Unmanned Air System Operator—Rank Bombardier to Sergeant</td>
<td>275</td>
<td>20</td>
<td>10%</td>
</tr>
<tr>
<td>Emergency Nurse</td>
<td>100</td>
<td>40</td>
<td>40%</td>
</tr>
<tr>
<td>Intensive Care Nurse</td>
<td>85</td>
<td>20</td>
<td>25%</td>
</tr>
<tr>
<td>Anaesthetist</td>
<td>50</td>
<td>20</td>
<td>45%</td>
</tr>
<tr>
<td>Infection, Prevention and Control Nursing Officer—Rank: Captain to Major</td>
<td>15</td>
<td>5</td>
<td>40%</td>
</tr>
<tr>
<td>Electronic Warfare System Operator—Rank: OR4</td>
<td>145</td>
<td>55</td>
<td>35%</td>
</tr>
<tr>
<td>Electronic Warfare System Operator—Rank: OR6</td>
<td>85</td>
<td>35</td>
<td>40%</td>
</tr>
<tr>
<td>Military Engineer Fitter—Rank: Lance Corporal</td>
<td>105</td>
<td>–</td>
<td>5%</td>
</tr>
<tr>
<td>Veterinary Officer—Rank: Major</td>
<td>15</td>
<td>–</td>
<td>30%</td>
</tr>
<tr>
<td>Army Air Corps Aircrew—Rank: Major</td>
<td>135</td>
<td>55</td>
<td>40%</td>
</tr>
<tr>
<td>Royal Engineers Professionally Qualified Engineers</td>
<td>90</td>
<td>30</td>
<td>35%</td>
</tr>
</tbody>
</table>

**RAF Operational Pinch Point Groups – Quarter 4 2012/13**

<table>
<thead>
<tr>
<th>Liability</th>
<th>Shortfall</th>
<th>% Diff</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Technician (Mechanical)—Rank: Senior Aircraftman to Sergeant</td>
<td>825</td>
<td>15</td>
</tr>
</tbody>
</table>

Notes: Figures have been rounded to the nearest 5, those marked ‘~’ are less than 5.

17. We were concerned by the number of trades in which there were shortages. In particular, we were worried about shortages in engineering and other technical subjects and in medical specialisms. We questioned the PUS about what the Defence Board were doing to address these shortages.

**Defence Board action on shortages**

18. The PUS acknowledged that the increased number of pinch point trades was not ‘an ideal situation’\(^22\). He acknowledged that the MoD needed more of certain trades such as nuclear safety engineers, air worthiness certifiers and engineering specialisms.\(^23\) There were

\(^{22}\) Q 52  
\(^{23}\) Qq 50–52
also significant shortages in medical areas such as emergency nurses, intensive care nurses and anaesthetists, specialisms also in short supply in the NHS.  

19. On dealing with shortages, the PUS said:

The three Services own the primary responsibility, but the board may be able to assist. If there is a common problem, is there something the board could do, for example, on nuclear matters, that would enable us to give additional funds to those services to say, “Apply some financial retention incentives? Is that something the board could help with?” The board should try to stay out of managing individual services as much as it can, but where the board can assist, we should try to.

We decided that manpower planning, manpower responsibility and recruitment are largely delegated matters for the services to manage, and that they do not require the board to manage. But if the board can assist, that is a perfectly reasonable thing to consider.  

20. The MoD should support the Services in addressing shortages in pinch point trades—key shortages which leave the Armed Forces vulnerable now and in the future. The MoD and the Armed Forces should explore ways of filling these gaps by offering financial or other incentives to Service personnel to encourage those in pinch point trades to continue in service and to encourage others to undertake training in these trades or by using reservists and private sector contractors.

**Breaches of Harmony guidelines**

21. We were concerned that repeated deployments and breaches of harmony guidelines (the recommended maximum amount of time spent away from home by members of the Armed Forces) might be exacerbating the voluntary outflow. The PUS agreed that this was a concern:

That is absolutely the risk that we are running. Interestingly, I tried to get where we were with current harmony and how many people were breaking harmony, because that is one of those data points that is not in the report but used to be in there before. It is still available, but I could not get it this morning. That risk is absolutely there for some pinch-point trades. The risk is that somebody comes off a deployment and then we ask them to do something fairly shortly after that. That is the risk that this system runs and we therefore have to address the underlying problem, which is to get more people into those pinch-point trades.  

22. The MoD told us that the latest figures for breaches of harmony guidelines were 0.6 per cent for Naval personnel, 5.1 per cent for the Army and 3.7 per cent for the RAF. 

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24 Qq 59–62  
25 Q 53  
26 Q 60  
27 Ev 20
23. It is unsatisfactory that harmony guidelines are still being breached for some Armed Forces personnel, in particular that over five per cent of the Army is away from home in excess of the recommended time. The MoD should provide us with the annual figures for breaches of harmony guidelines over the last ten years. We call on the MoD to set out a timetable for reaching a point where no Armed Forces personnel are in breach of harmony guidelines.

Financial management information

24. When asked about the state of the MoD management information systems, the PUS acknowledged that information on costing did not drop out of their financial information systems but that they had been working on developing a cost of defence process. The Government Response to the Committee’s Report on the Annual Report and Accounts 2011–12 stated that a business case would be put forward on work to improve financial management information by Autumn 2013.

25. In response to our follow-up questions, the MoD provided us with more detail on plans to improve its financial and management information in the Defence Equipment and Support organisation and in the rest of the MoD. With regard to the next defence review, the PUS said that they were already planning to provide relevant costing information.

26. In his second annual review of the Defence Reform Programme announced on 5 December 2013, Lord Levene stressed the importance of management information as he had in his previous review. He said:

I would also reiterate the concern I highlighted in last year’s stocktake about Management Information (MI). It is absolutely critical for the effective management of Defence that MoD radically improves its MI and MI systems, and in particular that it achieves a single Department-wide version of the financial truth. This was always going to take time to come to fruition, and some progress has been made over the last year. But much more is needed.

27. As Lord Levene said in his second annual review of the Defence Reform programme, management information is critical for the effective management of Defence. The MoD should update us on its proposals to improve its management information systems in particular its financial management information systems. It should also describe in detail its planned work on costing defence outputs, in particular, operations. It should tell us the planned future level of investment in cost modelling and data and systems exploitation.

28 Q 73
30 Ev 24
31 Q 74
32 Written Ministerial Statement: Defence Reform Programme, 5 December 2013
Carrier programme

28. We did not set out to review major equipment programmes but given the strategic importance of the Carrier Programme, we asked the PUS to tell us of the latest state of play. The PUS explained that the cost overrun of the Carrier programme was because earlier estimates had not included Value Added Tax (VAT) as the joint strike fighter was expected to have been a Government to Government deal with the USA which would not attract VAT. In response to our written question about whether VAT had been omitted from the costs of other projects, the MoD told us that “we do not believe we have an endemic problem with VAT on purchases from the USA”.

29. The PUS told us that the Carrier programme was still categorised as a red programme because the MoD was trying to re-baseline the programme following the decision to revert to the short take-off and vertical landing (STOVL) version of the joint strike fighter last May. He also said that the MoD had almost completed the negotiations to finalise the budget and timetable for the two carriers and that a statement would be made to Parliament when this was certain.

30. After our hearing with the PUS, the Secretary of State announced on 6 November 2013 the results of the renegotiations—a total capital cost of procuring the carriers of some £6.2 billion, a cost increase of some £0.74 billion over the cost reported in the Major Projects Review 2012. The sea trials of the first carrier, HMS Elizabeth, will commence in 2017 and flying trials with the joint strike fighter will start in 2018. He also announced that the costs of nugatory design work, to introduce catapults and arrestors to function with a carrier variant of the joint strike fighter because of the decision to revert to a STOVL version of the plane fighter, currently stood at £62 million.

31. Some extra resources have been put into the Crowsnest project (providing radar for the carriers) to bring forward the in-service date from 2022. The MoD provided further information on Crowsnest subsequent to the evidence session:

   The in-service date for CROWSNEST will not formally be approved until it reaches its Main Gate decision point. However, the Department has recently adopted an accelerated programme delivery strategy, re-allocating funding from later years to 2015–16, and bringing forward the Main Gate investment decision to 2016. This now gives a planned in-service date in 2018, 18 months earlier than the previous assumptions. The earlier in-service date provides a CROWSNEST Initial Operating Capability in time for Carrier Strike Initial Operating Capability in 2020. The re-profiling of CROWSNEST funding will result in an overall saving to Defence of at least £22 million over the years 2013 to 2024.
32. The MoD has presided over significant cost increases in the Carrier Programme mainly caused by repeated changes to the requirement. We ask the MoD to confirm whether the Carrier programme is now on track and whether it now expects the programme to proceed without further significant cost or time overruns.
3 Annual Report and Accounts 2012–13

External support

33. The MoD was again heavily reliant on external support in producing its annual accounts 2012–13, as it was in 2011–12. It spent £362,000 on external accountancy support in order to prepare the 2012–13 Accounts. In 2012–13, the MoD spent a total of £1,967,000 on overall external accountancy support and some £855,000 in the first six months of 2013–14.39

34. We are concerned that the MoD is still so dependent on external accountancy support to produce its annual accounts. The amount it spent on external accountancy support to produce the accounts is excessive. We ask the MoD to provide us with a timetable setting out milestones for progress towards producing its annual accounts without significant external resources.

Qualification of accounts

35. The Comptroller and Auditor General (C&AG) qualified his audit opinion on the Department’s 2012–13 Resource Accounts for the seventh successive year. He gave a qualified opinion on regularity as he disagreed with the MoD’s accounting treatment in respect of part of the impairment of its German Estate which was charged against the revaluation reserve instead of operating costs. Had the impairment been treated in accordance with the Government Financial Reporting Manual, the MoD would have exceeded the authorised expenditure limit set by Parliament by £395 million.40

36. The C&AG gave a qualified opinion on the financial statements in relation to the impairment of the estate in Germany following withdrawal of UK Forces, contracts that may contain a lease and the valuation of inventory and non-current assets.41

37. The Ministry of Defence’s Votes A is presented annually to Parliament to seek statutory authority for the maximum numbers of personnel to be maintained for service within the Armed Forces. The maximum numbers for the Naval, Army and Air Force Services in all active and reserve categories were within the numbers voted by Parliament in 2012-13, except for the Reserve Naval Forces. The C&AG, therefore, reported on Votes A in that Special Members of the Reserve Naval Forces during the year was 1,950 against a voted limit of 1,940.42

Germany

38. In March 2013, the Secretary of State for Defence announced the Regular Army Rebasing Plan which set out plans for the Army’s move back from Germany. The MoD

39 Ev 22
41 Ibid, page 91
42 Ibid, page 92
plans to hand back the garrisons and training facilities to Germany on a phased basis by 2019. It has, therefore, impaired the value of the estate by some £1,504 million as the previous valuation assumed continued use of the estate beyond the drawdown. The MoD chose to account for this by reducing the estate’s revaluation reserve to zero, some £907 million, and accounting for the remaining £598 million as an expense on the operating cost statement. The NAO believes that the entire impairment of £1,504 million should have been charged to the operating cost statement as it arose from “a loss of service potential”, that is, the reduced value is caused by a decision to use the assets for a much shorter period than originally envisaged. If the MoD had charged the entire amount to the operating cost statement, it would have exceeded the resources voted to it by Parliament for 2012–13 by some £395 million. The C&AG consequently qualified his opinion on the regularity of the Accounts on the excess vote and on the incorrect accounting treatment. The Treasury agreed with the MoD’s accounting treatment of the impairment.43

39. When asked about the qualification, the PUS said:

[...] In the light of previous experiences, given the fact that we were clearly coming out of Germany and the value of the assets we have in Germany would be lower, we did everything, we thought. We went through a process with the Treasury and we had Treasury backing of our position, and then the National Audit Office disagreed. Interestingly, and possibly very unusually, the NAO’s opinion states: “Firstly, I disagree with the accounting treatment adopted by the Department, and endorsed by HM Treasury”. That is a direct quote from page 91 of the annual report and accounts.

From my perspective as the accounting officer, we think we did what was right. We went to the Treasury and it endorsed our position, and then there was a disagreement between the Treasury and National Audit Office, which resulted in us getting two qualifications. I feel as though we did everything we possibly could to do the right thing, and then it didn’t occur.44

Contracts that may contain a lease

40. The C&AG qualified the MoD Accounts for the fourth time because of non-compliance with certain international reporting requirements on lease type arrangements. These arrangements which are now standard practice for Government Accounts are International Financial Reporting Issues Committee Interpretation 4: Determining whether an arrangement contains a lease (IFRIC4) and International Accounting Standard 17 Leases. The extent of this issue is likely to be significant for the MoD Accounts as strategic arrangements with key contractors for specialist defence platforms on a non-competitive basis may provide for the exclusive use of industrial assets. The C&AG could not quantify the impact on the financial statements as the MoD had not maintained appropriate records but given the number and size of contracts involved there is likely to be material understatement of the assets and liabilities. The C&AG said:

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44 Q 104
The accounting requirements for lease type arrangements are particularly relevant to the Department. It necessarily enters into strategic arrangements with certain contractors to procure specialist defence platforms on a non-competitive basis, for example in relation to surface ships, submarines and aircraft. These arrangements may provide for the exclusive, or near exclusive use of industrial assets and capability which have only limited utility to other customers. Consequently, the contractual terms, which are covered by the Government Profit Formula and its Associated Arrangements (GPFAA)\(^3\), may give rise to the Department controlling the significant majority of the outputs of the supplier’s assets involved in the arrangement. For example, where shipyards are used exclusively on defence contracts and the pricing of the contract recognises this by allowing recovery of fixed costs other than through market rate or unit cost pricing. As such, these arrangements may be considered to contain a lease under IFRS, and may have the characteristics of a finance lease.\(^45\)

41. In response to the Committee’s Report on 2011–12 Accounts, the MoD said that it was undertaking a study to identify contracts which have the potential to fall within the scope of International Financial Reporting Issues Committee Interpretation (IFRIC) \(^4\) and to assess the manpower and external cost implications.\(^46\)

42. The C&AG reported:

Since I last reported the Department has conducted a review of its contracts to identify those which have characteristics indicating that they contain lease type arrangements not currently recognised as leases. Through that review the Department has identified 27 contracts which they consider require a detailed assessment against the standards. The Department has committed to completing an assessment of all of these contracts, and for a small sample of these contracts, obtaining the necessary information and calculating the accounting entries required to comply with accounting standards by September 2013. Based on the results of this exercise, including the cost and time involved, the Department will consider whether to extend compliance to all relevant contracts.\(^47\)

The PUS said that he agreed with the recommendation in our Report on the Annual Report and Accounts 2011–12 that the MoD should ensure that its accounts were no longer qualified on the basis of IFRIC 4 by 2014–15.\(^48\)

43. We call on the MoD to report the finding of its review of contracts likely to be affected by the International Financial Reporting Issues Committee Interpretation (IFRIC) \(^4\). We also ask the MoD to inform us about the cost and manpower implications of the work required to ensure compliance with IFRIC4 and provide us with an undertaking that the steps it has taken would fully addressed the grounds of the qualification.

\(^{46}\) Government Response to the Defence Committee’s Report on the MoD Annual Report and Accounts 2011–12, HC 292  
\(^{48}\) Q 106
Inventory

Limitation on the scope of the C&AG’s opinion

44. For the 2012–13 Accounts, the C&AG limited the scope of his opinion\(^49\) on certain assets in the Statement of Financial Position. He said:

I have limited the scope of my opinion in relation to certain non-current assets recorded within the SoFP [Statement of Financial Position], in the form of non-current asset capital spares (£7.2 billion) and inventory (£3.3 billion). The limitation arises as a result of the Department having an insufficiently robust and systematic process to assess impairment and the consequent impact on the valuation of these assets. Due to the lack of a systematic assessment the Department has been unable to provide me with sufficient evidence to support the valuation of these balances and the associated accounting entries which have been made in the accounts.\(^50\)

MoD Review of stock-lines

45. The C&AG described the MoD review of its stock and the results of the NAO audit of that review:

During the year the Department established an exercise to systematically review stock-lines which represented the most significant elements of the Capital Spares and Inventory balances. The exercise required a review of each stock line for impairment against criteria set out in centrally issued guidance. The Department estimated that by covering the top 1% of stock-lines they would cover around 75% of their total reported inventory balance of £15bn and that a portion of other balances would also be assessed to provide a suitable analysis on which management could draw conclusions over the remainder. The exercise represented a significant commitment by the Department to address my previous recommendations and to write down the relevant assets to their fair value.\(^51\)

He also said that “the results of my audit have led me to conclude that the process is not yet sufficiently robust to provide management with the necessary assurance over the valuation of capital spares and inventory”.\(^52\)

46. Last year, the PUS told us that the MoD was improving its management of the defence inventory:

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\(^{49}\) A limitation on the scope of the audit opinion is given where the auditor has not been able to obtain sufficient and appropriate evidence to support material balances in the accounts. It relates only to the area described, not the entire account.

\(^{50}\) Ministry of Defence Annual Report and Accounts 2012–13, HC 38, Report of the C&AG, page 95

\(^{51}\) Ibid

\(^{52}\) Ibid, page 96
We have an inventory management plan and strategy. There is a group that oversees it at the three-star level at DE&S. There is a specific full-time two-star military officer who runs this, who appeared in front of the Public Accounts Committee. There is a significant amount of work going on in terms of people, time, investment, training, IT systems and so on in order to improve the situation.

He also said that the MoD was rationalising the IT systems dealing with stock and inventory control with an aim of reducing the 78 IT systems to four by 2015. The MoD later told us about the four IT systems being implemented.

47. In our report on the 2011–12 Annual Report and Accounts, we concluded:

Being able to identify and record the condition of inventory and assess its value is important for operational reasons as it enables the repair and replenishment of items needed and the disposal of those items no longer required. It is also critical in making value for money decisions about the amount of inventory to be purchased and held.

48. The PUS described what the MoD was doing to improve its inventory management:

There was an NAO report on managing the defence inventory, which we gave evidence to the PAC about. I am absolutely with you. We have to turn off the taps. In April 2012, we introduced a new control regime so that people could not order without the explicit agreement of the Director General of Resources, who works directly for the CDM. In the last financial year, the amount of inventory ordered was £300 million less on a £2 billion number, so there was definitely some impact from turning off the taps. In the current year it will probably be £500 million. So you are absolutely right: reducing the inflow is definitely one of the things we need to do. Recording the inventory, appropriately valuing it and getting better information is absolutely fundamental to this. As the National Audit Office point out in the annual report when they are doing their various reports on inventory, the underpinning business systems of inventory and finance are hampering our progress, and we have to do something about that. The Department has announced significant investment in new information systems. It has appointed Boeing as a partner in this area to help us with that. There are four core systems we have to change and reduce from more than 70 down to four. The first one has gone in and we anticipate the second one going live in October. So we are trying to get a handle on this. I think we are making some reasonable progress. Indeed, we agreed with all the further recommendations that were made by the Public Accounts Committee in 2012. We can see some visible impact.

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53 Q 135, Defence Committee Evidence Session on MoD Annual Report and Accounts 2011–12, 12 December 2012
54 Ev 22
56 Q 111
49. We asked the MoD for an update on the four principal IT systems. A comparison of the position in 2012 with that of 2013 is shown in Table 3 below.

Table 3: Comparison of relevant IT systems in 2012 and 2013

<table>
<thead>
<tr>
<th>Description of the systems by the MoD in 2012</th>
<th>Description of the systems by the MoD in 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>JAMES (Joint Asset Management Engineering Solutions):</strong></td>
<td>This new capability is primarily designed to manage and track all assets across the Land Domain, including vehicles, ground equipment, and radios. Implementation of JAMES will enable the retirement of 5 legacy systems. JAMES implementation is due to be completed (for all major units) by 31 March 2014.</td>
</tr>
<tr>
<td><strong>MJDI (Management of the Joint Deployed Inventory)</strong></td>
<td>This new capability will provide a single system for managing the Defence Inventory in the Deployed Environment, and is currently being rolled-out to support Op HERRICK (operations in Afghanistan). Implementation of MJDI will enable the retirement of 6 legacy systems, with implementation due to be completed in March 2014.</td>
</tr>
<tr>
<td><strong>BIWMS (Base Inventory and Warehouse Management Services)</strong></td>
<td>This is a new capability to replace 40 legacy systems (some of which are over 40 years old) to provide unified inventory management processes across Defence. It is scheduled to be delivered in a number of phases between 2013 and the end of 2015/2016. Current planning assumptions have 10 legacy systems being retired in March 2014, and a further 30 systems due retirement by March 2015.</td>
</tr>
</tbody>
</table>
Logical Data Model (LDM)

This is a new capability, which builds on Data Warehousing capabilities, to bring together, for the first time, information relating to base inventory, deployed inventory and consignment tracking to improve the quality of management information in support of operational decision making. Implementation is due to commence in January 2013, with full roll-out completed by March 2014. It does not replace any legacy systems.

This is a new capability which builds on logistic data warehousing capabilities to bring together, for the first time, information relating to base inventory, deployed inventory and consignment tracking to improve the quality of management information in support of operational decision making. Delivery of initial capability is expected in December 2013. The efficacy of the LDM depends on increasing the feeds to the LDM and improving the quality of the data within these feeds. The replacement of obsolete, legacy IS, will enable greater feeds to the LDM and the Department is improving the quality of data within its systems. There will be a progressive enhancement of the LDM capability as it matures and as the requirements for data evolve.

Source: Analysis of MoD information

50. We are pleased to see that the MoD is finally taking inventory management seriously. However, there is still much work to be done. We expect to see the relevant IT systems delivered on time and making a valuable contribution to inventory management by 2014–15. In response to this Report, the MoD should tell us what further measures it needs to take to remedy the poor state of inventory control in the MoD and the timetable to introduce them.

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4 Conclusion

51. The Ministry of Defence has made some improvements to its reporting of information since last year but much work is still needed before it meets the standards we would expect to see in its Annual Report. We have set out the areas where the MoD needs to provide more extensive information on its performance.

52. The MoD has been reviewing its risk management arrangements and we look forward to seeing the results of its review. We are concerned that structural changes have led to a lack of clarity in aligning roles and responsibilities with risk management structures. Our major concern and, apparently the Defence Board’s second strategic risk, is shortage of key personnel. This was evidenced by the increase in the number of pinch point trades, the high level of voluntary outflow and the continuing breaches of harmony guidelines. The Defence Board should take these shortages seriously.

53. The provision of reliable management information is critical to the effective management of an organisation. It is crucial that the MoD improves its management information systems and the quality of the management information produced. In particular, the MoD should concentrate on improving its financial management information.

54. For the seventh successive year, the Comptroller and Auditor General (C&AG) qualified the Ministry of Defence (MoD) Accounts for 2012–13. The qualifications were:

- The regularity of the treatment of the impairment of the valuation of the German estate resulting from the withdrawal of UK Forces from Germany;
- Non-compliance with international reporting standards on the treatment of some contracts; and
- The valuation of inventory and non-current assets.

The latter two problems are likely to persist beyond 2014–15. The MoD needs a clear plan and timetable as to how and when it will achieve a clear audit opinion from the C&AG.
Annex

Areas where the MoD should provide additional information in its Annual Report and Accounts (as recommended in paragraph 6)

1. Readiness levels
2. Manning levels for each Service by officers and non-commissioned officers and other ranks
3. Pinch point trades, both operational and manning
4. Harmony guidelines for each Service highlighting any subgroups which are regularly breaching the guidelines
5. Voluntary outflow statistics for each Service by officers and non-commissioned officers and other ranks
6. Recruitment levels against targets for each Service by officers and non-commissioned officers and other ranks for regulars and reservists
7. Indicators reflecting the delivery of Defence Transformation and structural reform priorities including the new employment model
8. Performance against Future Force 2020 targets
9. Performance of DE&S including the Major Projects Report projects and the supply and maintenance of equipment, all set against robust targets
10. Performance of the Defence Infrastructure Organisation in managing the estate including that of Service personnel’s accommodation set against robust targets
11. Other efficiency, effectiveness and sustainability measures of the MoD’s performance in supporting the Armed Forces
Formal Minutes

Wednesday 18 December 2002

Members present:

Mr James Arbuthnot, in the Chair
Mr Julian Brazier
Mr James Gray
Mr Dai Havard
Adam Holloway
Sir Bob Russell
Bob Stewart
Derek Twigg

Draft Report (Ministry of Defence Annual Report and Accounts 2012-13), proposed by the Chair, brought up and read.

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

Paragraphs 1 to 54 read and agreed to.

Annex agreed to.

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

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 8 January 2014 at 2.00 pm]
Witnesses

Tuesday 10 September 2013

Jon Thompson, Permanent Under-Secretary and David Williams, Director General Finance, Ministry of Defence

List of printed written evidence

1 Ministry of Defence Ev 17: Ev 18

List of published written evidence

The following written evidence was received and can be viewed on the Committee’s Publications page under Written Evidence at www.parliament.uk/defcom

1 National Audit Office (NAO)
List of Reports from the Committee in Session 2013–14

The reference number of the Government’s response to each Report is printed in brackets after the HC printing number.

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Oral evidence

Taken before the Defence Committee
on Tuesday 10 September 2013

Members present:
Mr James Arbuthnot (Chair)
Mr Julian Brazier
Thomas Docherty
Mr Jeffrey M. Donaldson
Mr Dai Havard
Mrs Madeleine Moon
Sir Bob Russell
Ms Gisela Stuart
Derek Twigg

Examination of Witnesses

Witnesses: Jon Thompson, Permanent Under-Secretary, and David Williams, Director General Finance, Ministry of Defence, gave evidence.

Q1 Chair: Permanent Under-Secretary, Mr Williams, welcome back to the Committee to give evidence about the report and accounts. We will begin, unusually perhaps, with the report. Last time we put in a recommendation that you should provide a commentary on your input and impact indicators. You have helpfully done that, so thank you very much. We also made a recommendation that you should review your performance reporting to see whether you could provide further and more useful information to the public. Have you done that?

Jon Thompson: We have gone back through several annual reports. The Committee’s view that the annual report has slimmed down is obviously right. If you go back to 2008–09, it was over 600 pages long. We would like to know whether there is something that you would particularly like, but also we would like to make a comparison with 2008–09 and say that in 2008–09 we gave this kind of data, the vast majority of which we think is still there, but these are the pieces that are missing. Then maybe you could make a decision about whether you would like us to put them back. We have not put them back in this but we would be prepared to do that analysis. I am open to a conversation about whether it would help the Committee further if we put that information back in.

Q2 Chair: That is an extremely helpful and constructive approach. When we produce our report on this maybe you will be able to consider that.

Jon Thompson: Certainly.

Q3 Chair: The NAO says that your input and impact indicators do not cover your structural reform priorities. What do you say about that?

Jon Thompson: I think that that is fair. There are challenges with those that are set out on page 8 of the annual report in that they do not match to any large degree those indicators that we use for running the Ministry of Defence. In relation to reform, we probably could produce more information than is currently in sections 4 and 5 of the annual report. The Defence Board receives a monthly report on the defence transformation programme and our progress against the 53 recommendations that Lord Levene made in his report. We could issue some of that information on an annual basis if that would assist the reader of the annual report.

Q4 Chair: They receive a monthly report about that?

Jon Thompson: The board does. It would be relatively straightforward to tell the reader of the annual review how far we thought we had come on the 53 recommendations. Lord Levene himself will do a second update of progress against his recommendations. It is due at some point before Christmas.

Q5 Chair: Would you say that your performance was improving? When I say “your”, I mean the Ministry of Defence’s.

Jon Thompson: I’ve had my annual appraisal. Indeed, you can measure me against my public objectives should you wish. We have announced a very large number of reforms since April 2012 and I could run through those if you wanted. The vast majority of what we planned to do in terms of change in the organisation and improving it—either those which were announced in Lord Levene’s report or those that we subsequently added to it: the materiel strategy, the Defence Reform Bill, the Single Source Regulations Office and so on—in the end, are the ultimate measures of success of the Ministry of Defence improving? Well, some are and some are flat. So there is a set of indicators, some of which are public and some of which are not, which cause the board some concern. My guess is that you might want to talk about some of those—for example, manning levels, pinch points, voluntary outflow are not heading in the right direction, and that is clearly a concern. You would have to worry about that from the perspective of the Ministry of Defence’s performance, but in some regards we have made massive progress. We balanced the budget, we renegotiated it, we balanced it again and we have made some of that information transparent. We seem to be making great strides in some places, and there is a mixed bunch of indicators available to David and me and the board.

Chair: We shall come back to some of those issues, as you suggest, during the course of the afternoon.
Q6 Mr Brazier: How well is transformation progressing? You have just given us a hint on that. In particular, how should we measure it? There do not seem to be any measurables in the defence transformation process.

Jon Thompson: The transformation of the Ministry of Defence is essentially in two parts. There were the 53 recommendations in Lord Levene’s report on defence reform. We can fairly easily provide you with some assessment of progress on those 53. By the end of the current calendar year, we will have implemented 52 of the 53. The outstanding one will be in relation to financial information systems; we think that it will take us until at least 2017 to reach the threshold which Baroness Noakes left us in chapter 8 of Lord Levene’s report.

Mr Brazier: I want to come on to that in a moment.

Jon Thompson: Certainly, and I am sure David can talk to you about financial management reform. In relation to the recommendations—the new operating model, creating the joint forces command, a new way of thinking about senior military talent, creating the senior appointments committee to think about succession planning, removing the second permanent secretary and so on—we have implemented all those. I am expecting Lord Levene’s second report to confirm that progress. His first annual report said that we making immense progress so that is clearly good.

The second set is those reforms of the Ministry of Defence that are outside and beyond Lord Levene’s report, and there are 16 of those. I am including some with which I think you would be familiar—the materiel strategy, the recruitment of the strategic business partner to run the defence infrastructure business, the Army 2020 plan, the rebasing from Germany, the New Employment Model and so on. We have a portfolio of 16. Again, that information is available on a quarterly basis to the board to see where those major projects are. Is it possible to share some of that? Well, many of them are in the Government major projects portfolio, which is now made transparent by the Cabinet Office, so there is an overlap between one and the other. I have not actually checked to see whether they are all covered. I do not think that they are, so that would leave me with the question of what we are short of and whether we could provide you with some further information about that, or in the annual report.

Q7 Mr Brazier: May I ask you about one in particular of Peter Levene’s recommendations? For me it was arguably the most important of all. That was increasing the length of tenure of senior posts, which has historically been preposterously short for many of them in MoD. Has there been any progress on that? Looked at from the outside, there appears to have been no slowing down at all. What tenure, for example, are the current chiefs of staff on?

Jon Thompson: There has been some limited progress on this. You may be familiar with Deputy Chief of the Defence Staff (Military Capability), who works very closely with David, Air Marshal Hillier. He is on a longer tour. There are some in DE&S who are on a longer tour. But is it, in general, the case? No, it is not. It is not yet a systemic norm that they do a longer tour, but some do. There is beginning to be some movement, but I think it will take some time for that to be a systemic norm.

Q8 Mr Brazier: Who is on the senior appointments committee, which presumably determines the length of tour, as well as picking the individuals?

Jon Thompson: It is the six four-star military officers—the three service chiefs, the commander of joint forces, the vice-chief and the Chief of the Defence Staff—and myself. One of the major changes recommended by Lord Levene was that the permanent secretary also sat on the committee. To be fair to General Richards and then General Houghton, they have done a lot of work on thinking ahead about potential appointments to posts, what the tenure would be, and whether some of them could be longer or shorter. Some of the factors that are in play here include the degree to which people are exposed to operations versus the degree to which they are running businesses. In Air Marshal Hillier’s case, there is more of an argument for some tenure, but in relation to the Deputy Chief of the Defence Staff (Operations), that is a very intense post.

Q9 Mr Brazier: Is any effort being made to prevent damaging simultaneous changes of posts? The report we did on Afghanistan identified that, at one point in 2006, the Secretary of State, the Chief of the Defence Staff, the head of PJO and a couple of other key jobs all changed within four weeks of each other. Has any mechanism been put in place to make sure that does not happen again?

Jon Thompson: I cannot say that there is something explicit that would now prevent that. I think there is significantly more awareness in the senior military, particularly those who sit on the senior appointments committee, as to that chain of events. But could I actually say there was a mechanism that would stop it? I could not go that far.

Q10 Mr Brazier: In an organisation with no institutional memory, it will happen again within a year or two.

Jon Thompson: I am suggesting that it is possible that it might; I cannot give you a guarantee that it will not. What I am trying to recognise is that there is some progress in the development of the senior appointments committee. Is it a mature system? No, but there is definitely some progress.

Q11 Mr Brazier: The last question for the moment is, with all this change going on, should we be looking at whether some of these things should be taken more slowly? An awful lot is changing at once, and that is very often how mistakes are made.

Jon Thompson: It is possible. Following General Richards’s retirement, there has clearly been a significant shift at the top, and that will then ripple down the military in a way that it normally does in systems. I think there might be an argument to go somewhat slower in some particular places, particularly in relation, for example, to planning military capability or in DE&S—I would not want to stimulate too much further change in the senior
Q12 Chair: Are you saying there might be a reduction in the speed of the move towards GoCo, if you are talking about DE&S?

Jon Thompson: No, I am not suggesting that; I am simply suggesting, in relation to Mr Brazier’s question, that there may be an argument for more continuity of the senior military in relation to the DE&S, in terms of personnel.

Q13 Derek Twigg: In your report, you describe the risk management process as “adequate”. That is an interesting word; you do not say “excellent” or “good”. Would you like to expand on where you think you are in terms of improving things?

Jon Thompson: Yes, sure. When I took up the post, I did a fairly lengthy analysis for the Secretary of State of the issues I thought we needed to improve on, and one of those was the management of strategic risk by the board. We engaged PricewaterhouseCoopers to work with the Defence Board on analysing strategic risks; they had previously done some work for the Department of Health on a similar basis. The board significantly changed its view about strategic risk in the autumn of 2012—it must have been roughly the time that I was here last. We formed a new strategic risk register, which comes quarterly to the Defence Board. We analyse those risks, and you will undoubtedly want to talk about some of those in due course, like manning, again, or information systems. Those are the top two strategic risks.

The reason that we put it in as “adequate” is frankly that quality of thinking about risk needs to penetrate all the way down the organisation, so when you come down to managing one of the 400 equivalent programmes that we manage, is there a consistent approach to risk, down at that level? I think there is still quite a journey for us to travel, having seen what best practice is from working with PricewaterhouseCoopers; so it was my judgment that it is adequate, but it needs to continue to improve.

Q14 Derek Twigg: The Defence Audit Committee said “The Committee was concerned, however, that the articulation of certain risks was not sufficiently precise to enable effective, targeted management.” Would you like to expand on that?

Jon Thompson: We have an independent Defence Audit Committee of four members. Previously all parties agreed four. They have been working with the board and PricewaterhouseCoopers and various other advisers—internal audit and the National Audit Office. You can articulate a risk, but how do you make it smart enough so that somebody can eventually say “Can you measure it?” in that sense—so measure your progress. Some of the work that we have done, the Audit Committee felt, needed some further clarification, so that we are clear about what exactly is the risk.

We have been doing some further work with the Audit Committee in that regard, and I think that is a perfectly natural process of maturing. You go from not really having a very robust strategic risk register; you develop one. It needs to continue to mature, and it is appropriate for the Audit Committee to express its view. I think that is perfectly natural.

Q15 Derek Twigg: Would you say it is sufficiently precise now to enable effective, targeted management? As we speak?

Jon Thompson: I think it has developed in the time. One of the difficulties in conversations like this is that you can’t publish it, so I am slightly struggling with how I put this. It would be an opinion that some of the risks that we are trying to manage are still not clarified sufficiently, so we need to continue to work on it, and I am being up front in the annual accounts about where we are—in an adequate place, but we need to continue to develop. Part of that is clarifying those risks, and what actions are we going to take to manage and mitigate those risks.

Q16 Derek Twigg: When was this report produced?

Jon Thompson: It would have been produced late spring, so not that long ago.

Q17 Derek Twigg: I am sure you have an action plan, which you are working on: there must be an end date to that.

David Williams: The coverage in the Government statement in the annual report and accounts relates to the risk framework we had in place for 2012–13. As part of the financial management reform process we have had a strand of work about improving risk management, including the development of a consistent set of risk criteria and thresholds for escalation of risks in our operating businesses up to Defence Board level. That is being rolled out this autumn and we expect to have a focused board discussion around the top-down strategic-level board risks to allow us to refresh the ones that we were looking at last year, to tighten up some of the language, bring some in, take some out, where that is appropriate during the course of this autumn as well. So there is a programme of improvement that is in place through 2013.

Q18 Derek Twigg: One of the key areas in terms of managing risk and improving that is basically people knowing who is responsible. I note in the report it says that “part of Transforming Defence had led to some lack of clarity on where responsibilities in this area lie.”

Jon Thompson: Responsibilities for risk management?

Q19 Derek Twigg: Responsibility is one of those key areas—so people know what the responsibility is.

Jon Thompson: We have been trying to work out—in fact, David is leading; he is coming to the board at the end of September—what exactly is the internal control framework that runs the Ministry of Defence: who is responsible for what, and how it works. As we have delegated from head office down into the military commands, both manpower and equivalent planning, we have to sort out who exactly is responsible for what. The Ministry of Defence has, over a large period of time, defined a significant
number of corporate policies, which do not, when you put them all together, provide real clarity about who is responsible for what, as it were, delegating down the authority, from me, say, to the Chief of the General Staff, against those people, like the finance director or the HR director, who set policies that run all the way across the organisation. How does that matrix work? Who exactly is responsible for setting financial policy? My friend, Mr Williams, how does that work in a budget area—it is the responsibility of the budget holder, but it is not that clear on some other aspects, for example, in setting corporate policies. One of the manifestations of that in relation to safety was Haddon-Cave’s conclusion about how safety works at the Ministry of Defence. We have had a very long journey of improving how safety works, and the people who set the rules and who operate them. We have to continue to clarify who is responsible for what, in a very complicated organisation where there are a significant number of corporate policies.

Q20 Derek Twigg: One of the biggest risks is any change in an organisation. We have gone ahead with change and we have been actually clarifying who has responsibility for the big issues of safety. Jon Thompson: Haddon-Cave did indeed conclude that safety management within military aviation was not sufficiently robust, and there has been a significant improvement plan in relation to military aviation. We publish an annual report. The director general of the Military Aviation Authority produces a public report about how far we have improved on that. We now think that we are in a fairly mature place, but if you go back a couple of years, we were not in that place. That is a fact. It is on the public record, and it is set out in that report. We have to make sure that we are clear about all those issues. We estimate that there are more than 200 of these kinds of examples. They are not only about finance or HR information or safety. There are more than 200 areas where we have to be clear about how accountability and responsibility work in a delegated organisation. We are doing that work, and it is coming to the board at the end of September.

David Williams: If it helps as part of clarity, there is a development this year that I have formal responsibility as the board member for the risk management framework, so the chief risk officer, if you like. But it is responsibility for the framework, rather than for each risk—

Q21 Derek Twigg: I want just to be clear. Structural change has been introduced but, in doing that, you did not clarify who had responsibility, particularly in some areas of safety. Do you think that was a mistake? Jon Thompson: Sorry, I have given you that impression. The reforms which Lord Levene asked us to carry out, and which we did, would delegate the finances. That is the implementation that we did made in April 2013, for financial management, for manpower and for equipment. That is what we did. I am simply extrapolating from that one example that there is a whole range of other corporate areas where we need to continue to improve and align accountability, authority and responsibility. We need to continue to work our way through that. I was simply trying to say that a good example of where the Ministry of Defence got that wrong was the events which lead to Haddon-Cave’s report. We have come a long way in that particular area, but there are still other areas where we need to continue to mature the way the organisation works. However, I am happy that, in delegating the equipment plan and the financial responsibility for manpower planning, we did the right things and we are clear about how responsibility works. That was a requirement. I am simply flagging that, as a complicated organisation, there are other issues that we need to continue to mature.

Q22 Mr Havard: Regarding risk management, my understanding is that the Defence Board have taken particular oversight of a number of issues. I think there is a list of about 16 issues, of which I have about eight listed here. Obviously, a lot of the reasons are not published for financial security purposes, but these are risks which the board are going to reassess. This reassessment and review is scheduled for the autumn—whatever autumn or spring means to the civil service; I am not sure. Perhaps you could enlighten me as to when the autumn is, what you will be able to publish and what we will be able to see of that Defence Board reassessment.

Jon Thompson: Do you want to answer the question about when, and what we are doing?

David Williams: The autumn is between now and the end of the calendar year.

Q23 Mr Havard: Careful, now. That’s this year, is it?


Q24 Mrs Moon: Isn’t that winter?

David Williams: We can argue about December, but—

Jon Thompson: It will be in the course of the current calendar year.

Q25 Mr Havard: Yes, but it is fairly imminent; there is a review. What will we be able to see of the reassessment of the position?

Jon Thompson: I will be up front. I am not sure we shall be able to publish anything. At the minute, the strategic risk register is part of a pack of information which goes to the Defence Board each quarter. That pack is currently classified as top secret. Your challenge to me is to what degree we could give some of that information either to your Committee or to the public.

Q26 Mr Havard: That is why I have carefully not itemised the 16 items that I have got written down here. It would be helpful to have some idea as to what their assessment and that reassessment was. Can I leave you to think about that?

Jon Thompson: Can we think about what you might possibly have?

Q27 Mr Havard: Yes. Thank you very much.

The second part concerns the internal audit that was done and the risk management framework for which I
think you, Mr Williams, said you had some responsibility. I think I was originally told that this process is developing over two years. Within that, there is a series of processes. Is there any way in which we could see how that process works, for example, delegation and the mechanics of how that operates? That would be helpful. For example, one part is the introduction of “target risk assessment” that will improve consideration of “risk appetite”. Could somebody translate that into English: what does that mean? What is being asked of people? How is the process intended to work?

**David Williams:** I can have a go. What is meant by the “risk appetite” is to try to be explicit, first at board level and then throughout the organisation, about the level of risk that we are willing to tolerate. It provides a context for decisions on development of military capabilities and on resource allocation. Just because something is risky, it does not necessarily mean that it needs to get all the attention, because you may be comfortable with that level of risk. This is the degree level end of the programme that we are rolling out. We are starting with some more basic risk management fundamentals around the description and categorisation of risk. Getting people to think about what level of residual risk they are willing to tolerate once you have put mitigating action in place is quite a sophisticated judgment. It will take us a while to get there, but the aim is to get that built in, particularly into the Defence Board consideration of those top-down strategic risks.

**Q28 Mr Havard:** As it develops over the two years of the programme, are you eventually building it into the defence academy training process, through which you say you are going to implement it? How does that process work? What does it look like? We want to understand the mechanics of your procedures better.

**Jon Thompson:** Sure, we can happily provide you with some information.

**Mr Havard:** Thank you.

**Q29 Mr Donaldson:** What involvement will you have in the proposed GoCo arrangements? Who will get the final say on whether we proceed to GoCo?

**Jon Thompson:** Mr Williams has taken over from me as the chairman of the investment approvals committee, the committee of seven individuals within the organisation which considers business cases. For this particular case, at the end of the market process for the GoCo, a business case will be constructed. That will make some recommendations. It will go to the investment approvals committee that David chairs. I anticipate it would then go to the Defence Board. Ultimately, given that the underpinning contract would be above our delegated authority, it would go from our Ministers to Treasury Ministers. That is the approvals route—agreed?

**David Williams:** I agree with that.

**Q30 Mr Donaldson:** What are the challenges of balancing accountability to Parliament with your responsibility as accounting officer, given the freedom that the new organisation would have?

**Jon Thompson:** This could get a little technical. I shall try to be clear. It depends on how the GoCo is classified by the Office for National Statistics. If a GoCo is created, the Office for National Statistics decides what kind of body that is. If it is classified as a central Government body, which is the probable outcome, the full rigour of managing public money—the financial reporting manual and so on—would apply, because it would still be a central Government body within the boundary of the Ministry of Defence, and therefore the chief executive of the GoCo would probably be an accounting officer in their own right, working through me as the principal accounting officer and still accountable to Parliament, and the National Audit Office would probably then also be the requisite audit body. I am using the word “probably” because we cannot be definitive about the classification of the body until you actually get to the proposition and the Office for National Statistics decides. If what I have set out is the plausible, probable scenario, there would still be full accountability to Parliament.

**David Williams:** If I might add to that, at the other end of the spectrum, if the GoCo was very arm’s length, spend on defence equipment projects would still be core defence budget money, so we would look to provide the same reporting to Parliament through the publication of the annual equipment plan and through the major projects report, as we do now, and the NAO would have access to the GoCo for performance and spend on the equipment plan. What we might handle differently are the operating costs and the internal systems investment that the GoCo was making in the organisation itself.

**Q31 Mr Donaldson:** Isn’t there a potential conflict of interest? If you have a chief executive who, in the end, is accountable to the shareholders of the GoCo or for the profitability of the company, and at the same time is an accounting officer who is accountable to Parliament, where does his or her priority rest? Is it with the shareholders or with parliamentary accountability?

**Jon Thompson:** That is a rather excellent question, which we are trying to wrestle with at the moment.

**Q32 Chair:** Sorry, I did not hear that.

**Jon Thompson:** That is a rather excellent question that we are trying to wrestle with at the moment. It is reasonable to assume that 100% of the turnover of a GoCo comes from the Ministry of Defence. Under various accounting financial rules, that looks like an organisation controlled by the Ministry of Defence. There is separately the question of who the shareholders are in that organisation. How does it work? That is not a matter that is currently settled. I am trying to answer your questions in a spirit of openness and trying to respond to what you are asking me, but it is quite difficult, given that the body is not classified, to say what accounting rules apply, what control rules apply, and what accountability and governance applies. It is a live issue as part of this process at the moment.
Q33 Mr Donaldson: What is likely to be the role of the Defence Infrastructure Organisation?

Jon Thompson: The market process, which we are undertaking for the Defence Infrastructure Organisation, is that bidders can bid four different times. They may bid both in compliance with our terms and conditions and contract requirements and with a variation against that, and they may bid with essentially no change in its current operating model. In other words, it just remains part of the Ministry of Defence. If they wish to create an arm’s length body, they have to give us a proposition for it: what kind of arm’s length body and what might be the additional value to the taxpayer from creating that. They would need to give numbers. So it is theoretically possible that under that model, bidders might propose the creation of a GoCo for the infrastructure organisation. That is theoretically possible and it is allowed under the market process.

Q34 Mr Donaldson: You will forgive me for saying it, but it does seem that, as you have described it so far, there is a lot of development work to be done in working through some of the fundamental issues relating to accountability.

Jon Thompson: In relation to DE&S, I would have some sympathy with that view. That is a live issue. What exactly is this body? How it is classified and how it works in accountability terms is a matter that is not settled.

Q35 Chair: Would it be fair to say that you have quite strong reservations about the entire process?

Jon Thompson: Of creating a GoCo?

Chair: Yes.

Jon Thompson: You have to go back to the 2009 report that Bernard Gray submitted, in which you see that there were three fundamental problems with the Ministry of Defence. One was the overheated programme; the second was the customer and how they operate in the culture; and the third was that the organisation did not have the capacity and capability to deliver its task. Our view is that having balanced the budget, we have resolved point No. 1, which Bernard rightly put on the table. In relation to the culture, the way that the customer works, there is a significant amount of work going on to create the so-called intelligent customer in the front-line commands that would interact with a GoCo. Then there is the question of: how do you increase the capacity and capability of DE&S to do the task? A significant number of options were considered, and Ministers in the end decided that this was the route that they wished to pursue, so this is the Government’s policy.

The process is untested, as we understand it, for defence acquisition, and therefore the only way of getting any real data—the reason that I gave in support of the Secretary and State and Ministers in this—is to go to the market and see if you can actually do this. I understand that that is a process that involves trying to break some barriers, and it is a process that leads to some fundamental questions about how it works. But the only way to find out whether it could work is to go to the market and see whether it did.

Q36 Chair: As an endorsement, that sounds less than ringing.

Jon Thompson: You would not expect me, I do not think, given how complicated this transaction is and as the previous finance director, to give it an absolute ringing endorsement until I have any data. It would be nice to have some real data, and that is the whole point of the market process—to get some real data.

Q37 Chair: What happened, though, in relation to this issue about parliamentary accountability, to Bernard Gray’s original proposal that the accounting officer should certify to Parliament that the defence equipment programme was affordable?

Jon Thompson: Ministers decided that while DE&S remained within the MoD, it was not appropriate to split the Ministry of Defence into two parts so that you would have an accounting officer and an additional accounting officer.

Q38 Chair: Surely that is just what you are proposing?

Jon Thompson: Yes, but the creation of an arm’s length body separates it. It gives it a very clear separation, in the nature of any other arm’s length body. There are various different shades of those, are there not—trading funds and NDPBs and so on and so forth?

Q39 Chair: So let’s have a permanent secretary who certifies to Parliament that the defence equipment programme is affordable. What is wrong with that? You would like to do that, wouldn’t you?

Jon Thompson: If there is a GoCo with an accounting officer, that accounting officer will be given powers and will report to Parliament. As David said, the proposition is not to pass over the equipment plan. I do not think it would be fair, frankly, to say to Bernard, “Is this affordable and have you covered all the risks?” because he is not in control of the customer, is he? This is one of the systemic issues that he raised in his original report. He is trying to do something that somebody has asked him to do, and there is an interaction in that. He could certify that what he is being asked to do, he can do within the budget. It is theoretically possible under this model that he could do that, yes.

David Williams: We have, in the publication of the annual equipment plan, for the first time in January this year—the update for last year’s planning round will be out this autumn, I expect in November—started to produce an annual statement of how we consider the equipment plan to be affordable, which is subject to NAO assessment and evaluation.

Q40 Mr Havard: Can we be clear? All the various witnesses are going on to determine exactly what sort of body this should eventually be. You are then saying that once you have made this determination, you are going to talk to the Office for National Statistics, which seems to be the gatekeeper who says, “That sort of body is this sort of body.” They are not telling you that you can or cannot have it, but they are defining it for you.

Jon Thompson: Correct.
Q41 Mr Havard: Whatever one, two or three propositions you may put forward, they will define it. They are the people who will make that definition. You talked about the market rules, and what you want to work out. Where do City rules come into this? Where does the Treasury come into this in its definition of where your activity sits in relation to the public sector borrowing requirement and, goodness knows, anything else that they have got within the ‘Treasury? Who is actually defining these things for you? Are you just going to end up with a series of options? You will then put them up to these people and, depending on what they define them to be, you will have to go back and decide which one you want, if any.

Jon Thompson: The role of the Office for National Statistics is to classify bodies within the economy and where they sit in relation to the Government. A good example is academies in the education sector. The ONS makes the ultimate classification of whether it is a public body, a central Government body or a private body. The same applies in this model. We can work closely with the Treasury. We are working closely with the Treasury and the Cabinet Office team that specialises in arm’s length bodies on what kind of body this might be and, as we shape it, how that might affect the classification.

The only reason that I am planting a doubt concerns the decision on classification and, therefore, whether managing public money, parliamentary accountability and the National Audit Office apply. As I understand it, that decision ultimately rests with the ONS at the end of the process. As the process unfolds, we can shape it to try to get a particular outcome.

Q42 Mr Havard: But what you might be able to do in the real world is then governed partly by market rules and City rules and the national accounting definitions, presumably, as well. So, they do not have a monopoly of the decision; they just decide what its classification is as far as the Government or the state is concerned, but the state might find that it is not classified that way by others.

Jon Thompson: Yes, so in a sense it is a relative—

Mr Havard: Dog’s breakfast.

Jon Thompson: On the face of it, it might appear a relatively minor decision, but it could have a significant impact on the questions that Mr Donaldson asked me. If you decided that the classification was a private sector body then managing public money would not apply, the NAO would not apply, and parliamentary accountability may not apply. So those may not apply. But if it is classified as a central Government body, the decision-making process is much clearer, to answer your questions.

Q43 Mr Havard: Can it be defined one way for one group of people and another way for another group of people? When is a GoCo really an NDPB or whatever it is?

Jon Thompson: There are rules that set out what is—what is a trading fund, and so on. We are working closely, as I said, with the Cabinet Office arm’s length bodies team and the Treasury about this classification issue. It is an important issue. If you want to give the body some freedoms, you might have to think, “How does managing public money apply?” Does that make some sense?

Chair: After a couple more questions on this I want to move on, because we spent some time on this last week.

Q44 Ms Stuart: Are you anticipating any model that would not include an accounting officer within that organisation?

Jon Thompson: Yes. It is possible that the DE&S-plus model, which I think Bernard Gray previously gave some evidence about—

Q45 Ms Stuart: I was really asking about the GoCo. I wanted to go back to Mr Donaldson’s question, which you said was a very good one: the conflict between accounting officer and the CEO answerable to shareholders.

Jon Thompson: If it is a GoCo and the ONS classifies it as a central Government body, my view is that it has an accounting officer.

Q46 Ms Stuart: Are there any models you are looking towards, or examples in the real world? Because you said the only way you can make decisions and look at the market data was where the CEO role with responsibility to a shareholder and accounting officer at the same time have actually satisfactorily been brought together.

Jon Thompson: I don’t think I can answer that off the top of my head; I would need to check. I’m sorry.

Q47 Ms Stuart: Right now you are not aware of any example where that conflict has been satisfactorily worked out.

Jon Thompson: Off the cuff, I can’t answer your question. I’m sorry. I can write to you if that would help.

David Williams: I don’t believe there are any in the UK public sector.

Q48 Thomas Docherty: Would it be fair to say that you are more positive about the opportunity that DE&S-plus could be a success, than Bernard Gray was when he gave evidence? His view is much more that GoCo is the right decision and we are looking at DE&S-plus. It sounds as if you are more confident that DE&S-plus could work. Do you accept that you are asking for a huge amount of public trust? As you said yourself, what you are looking for is not settled yet.

Jon Thompson: No, I am fairly neutral to the options, to be frank. What it comes down to is the value-for-money assessment that goes through the decision-making process. I can definitely tell you that we cannot stay where we are. We are not currently delivering what we need to deliver because the organisation does not have the capacity, the capability and the information systems necessary to deliver the task. Therefore, we have to improve the organisation. You have either got DE&S-plus, which is about how far you can take it within the current construct, or you have the alternative, which is a GoCo, where there is a market process. You will end up asking, “How far can we take it ourselves, and how far can the market
Q49 Chair: Given the incredibly tight timetable—coming down to a single preferred bidder by December this year, and comparing that preferred bidder to a DE&S-plus option that has not yet been defined or exposed to any public gaze by April next year—do you think the value-for-money analysis and process can be considered to be robust?

Jon Thompson: That is the current plan and the advice that is given to Ministers. It went through to the investment approvals committee, and that is the current time scale. It takes about three months to do the evaluation. If you take the DIO as a parallel, where we are almost at the end of the market process, it concludes at the beginning of October, it will take about three months to do the assessment, and then we can give Ministers recommendations about what is value for money in terms of going forward.

Q50 Sir Bob Russell: Mr Thompson, might I ask some general questions about the right numbers of people with the right skills? I understand that Royal Navy operational pinch point trades have increased from 11 to 15 since 2011–12. In the Army, the number of trades increased from 19 to 26. Those are the categories, but the numbers for personnel, to my mind, show a shortfall that is even more dramatic. The naval service operational pinch points total 485, approaching 500. For the Army, it is 1,085, approaching 1,100.

Within those figures, I have noticed a theme. For example, in the Royal Navy there is a 30% shortfall in medical assistant operating department practitioners and a 30% shortfall of nurses. In the Army there is a 50% shortfall in radiologists, 40% in emergency nurses, 25% in intensive care nurses, 45% in anaesthetists, and 40% in infection prevention and control nursing officers, rank of captain to major. That is quite serious, isn’t it?

Jon Thompson: Yes.

Q51 Sir Bob Russell: So were the increases in the operational pinch point trades in the Royal Navy and the Army caused by earlier redundancies?

Jon Thompson: May I go back slightly, and then I will answer your question? The Defence Board believes the No. 2 strategic risk is whether we have a sufficient number of capable people to carry out the task. The board is concerned about the rate of voluntary outflow. You will be, I think, familiar with what that means. The rate of voluntary outflow has continued to rise. The board has this in its monthly information pack, so I can give you some statistics if you wish.

The voluntary outflow rate among officers is currently 4.1% per year, and for other ranks, 5.8% a year. That is above the long-term average—in the middle of what could be argued was a difficult economic situation. The board is sufficiently concerned that it has had two conversations about, “Can we do something to address this?” We do not believe that it is through VERS; we believe that the natural rate of people leaving is higher than the long-term average over a 10-year basis. We have tried to do things like financial retention incentives for particular skills, and it remains a significant issue. Again, the Defence Board will discuss some further options that we may be able to deploy at its September meeting. It seems to me that if you have a voluntary outflow rate above the long-term average in the current economic situation, that might be a really significant concern if the economy dramatically picks up.

Q52 Sir Bob Russell: When I visited Camp Bastion, I noticed that there is a large number—I welcome information pack, so I can give you some statistics if you wish. The voluntary outflow rate among officers is currently 4.1% per year, and for other ranks, 5.8% a year. That is above the long-term average—in the middle of what could be argued was a difficult economic situation. The board is sufficiently concerned that it has had two conversations about, “Can we do something to address this?” We do not believe that it is through VERS; we believe that the natural rate of people leaving is higher than the long-term average over a 10-year basis. We have tried to do things like financial retention incentives for particular skills, and it remains a significant issue. Again, the Defence Board will discuss some further options that we may be able to deploy at its September meeting. It seems to me that if you have a voluntary outflow rate above the long-term average in the current economic situation, that might be a really significant concern if the economy dramatically picks up.

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Q53 Sir Bob Russell: You are saying that the board will assist. Are you saying that the onus is on the Royal Navy and the Army to fill these posts, not the Ministry of Defence per se?

Jon Thompson: The three services own the primary responsibility, but the board may be able to assist. If there is a common problem, is there something the board could do, for example, on nuclear matters, that would enable us to give additional funds to those services to say, “Apply some financial retention incentives? Is that something the board could help with?” The board should try to stay out of managing individual services as much as it can, but where the board can assist, we should try to.

We decided that manpower planning, manpower responsibility and recruitment are largely delegated matters for the services to manage, and that they do not require the board to manage. But if the board can assist, that is a perfectly reasonable thing to consider.

Q54 Sir Bob Russell: I have highlighted a theme in both the Navy and the Army in the medical field,
although interestingly, the RAF has only one pinch point, and that is not medical. Do I assume from that that the RAF is doing something that the Army and the Navy are not, in terms of those pinch points in the medical field?

**Jon Thompson:** It might. I couldn’t answer that directly. One of the developments we made in relation to Lord Levene’s report was to create a single chief of defence personnel, who can take an overview of the services, the civilian work force and reservists to see if there are issues that you can learn from one service to another and to see how you get the right blend between the civilians, reservists and full-time regulars. It is in that space that Major-General Gregory could advise the board that the right way forward is for the board to intervene and offer some assistance.

**Q55 Sir Bob Russell:** I was going to ask you what you are doing to reduce the number of trades in this position. You are telling me that it is not you, but the three services.

**Jon Thompson:** I am saying that the primary responsibility is with the three services. I can tell you that we have a range of financial retention incentives: for particular pinch-point trades you would say, “Look, the voluntary outflow is too high; is there something you can do financially or is there something that we can do for planning people’s careers that will help?” and the board would help. But in the end, I do not think it is appropriate for the board to try to manage the careers of 170,000 people.

**Q56 Sir Bob Russell:** I don’t think I am suggesting that. However, the number of pinch points has gone up, and the buck must stop somewhere. I assumed that the buck would stop at the Ministry of Defence.

**Jon Thompson:** Yes, I am saying—and I said in answer to your first question—this is the second strategic concern in terms of running the Ministry of Defence that the Defence Board has. Its No. 1 concern is about information; its No. 2 concern is about people and getting the right people to do the job. The board is absolutely engaged in this conversation. It had a conversation in spring and is having another conversation this autumn about whether there is something that we can do.

**Q57 Sir Bob Russell:** Are you and the board satisfied that there are candidates out there who are suitable to be recruited, and that it is a question of hooking them in with whatever attractive proposal is necessary? Otherwise, in a year’s time not only will these pinch points be getting worse, but we will have new pinch points.

**Jon Thompson:** I think the offer of joining up as regulars is an attractive one, and we are trying to make it more attractive for the New Employment Model. Could I give you that guarantee? No, I am sorry, I could not give you that guarantee. It is for the board to discuss what its options are and see whether it can do something, because, as I said, it is a genuine concern. Voluntary outflow is a bit higher than we want, so if there is something we can do about that, we should try to do it.

**Q58 Mrs Moon:** Are you at all concerned that, at a time when we have 2 million unemployed, you have such a high voluntary outflow?

**Jon Thompson:** To be frank, my answer to Sir Bob Russell was yes, the board is concerned about the level of voluntary outflow.

**Q59 Mrs Moon:** How concerned should families who are thinking that their family members will join the Armed Forces—particularly the Army, though there are clearly obvious problems in the Navy—be about the high number of vacancies in the medical profession? The figures are 40% for emergency nurses; 20% for intensive care nurses; 45% for anaesthetists; in infection prevention there are 40% missing. Those figures are alarming, especially at a time when we are still seeing a lot of people sustaining injuries in Afghanistan and when we were almost at the point of taking on another theatre of operations. Is this not something that families would want you to give a great deal of attention to?

**Jon Thompson:** We prioritise the deployment of the people that we have in a three-tier system. The highest priority is current operations; if you go to Bastion you will find the highest level of medical care, and there is a fantastic hospital deployed there. That would be our highest priority: to deploy the people that we have in that space. We would then look at the UK standing commitments, and then contingent operations. We would deploy people in that kind of logical order.

I do not think there is any worry in relation to Afghanistan. But the general point that both of you are making is one I am taking on board: we need to have more of these people and we need to consider how we are going to do that while working with the services to address the shortage.

In the United Kingdom, there is a good deal of flexibility between Defence Medical Services and the national health service. We have people who go between the two, and to some degree there is therefore some resilience in the United Kingdom in that, if we were in a difficult position, we could do that. That is not something that I think we would want to do abroad; we would want to try to plug those gaps, which is the answer I gave overall. It is a worry and we will try to do something about it.

**Q60 Mrs Moon:** But aren’t you exacerbating your outflow? Members are being repeatedly told that families are unhappy with the rate of deployment of people in pinch-point trades: because you have those pinch points, they are doing deployment after deployment after deployment, because you have not got enough people to meet harmony guidelines and to give people time back home with their families. Families are therefore putting pressure on people to leave. You are in a vicious circle.

**Jon Thompson:** That is absolutely the risk that we are running. Interestingly, I tried to get where we were with current harmony and how many people were breaking harmony, because that is one of those data points that is not in the report but used to be in there before. It is still available, but I could not get it this morning. That risk is absolutely there for some pinch-point trades. The risk is that somebody comes off a
deployment and then we ask them to do something fairly shortly after that. That is the risk that this system runs and we therefore have to address the underlying problem, which is to get more people into those pinch-point trades.

**Q61 Chair:** When you say that you could not get it, was that just because of the shortness of the notice rather than it being generally unavailable?

**Jon Thompson:** It is available. I sat down this morning to re-read the annual report and accounts and the briefing note that you get from me and it did not contain the harmony figures, I just could not get it in the time that I had available this morning, for which I apologise.

**Q62 Chair:** It is one of the things that we would like to know, so if you could write to us about it, I would be grateful.

**Jon Thompson:** Sure.

**Chair:** Thank you.

**Q63 Mrs Moon:** At some point, this becomes unsustainable. Quite honestly, I would have thought that when you are almost at 50% with some of these trades in terms of pinch points it is becoming unsustainable. We are operating at a totally unacceptable level of risk.

**Jon Thompson:** I take on board the points that both of you are making and say that this is a concern for the board and is something that we are absolutely looking at to see whether we can address it. I am not disagreeing with you.

**Q64 Ms Stuart:** I want to add to Mrs Moon’s point, because you mentioned that you can fall back on the NHS. The Royal Centre for Defence Medicine is in my constituency. You cannot fall back on the NHS. It has the same pinch points as you. By the relocation of some officer accommodation, which considerably increases travel, you will lose some of the people that you have, so can we make that a double warning? It is within you and the people that you think you can fall back on.

**Jon Thompson:** I am grateful for that.

**Q65 Chair:** The tone with which you are answering questions today is extremely helpful. I hope that your recognising and acknowledging these really serious problems will not come back to bite you. We really do appreciate the fact that you are openly acknowledging these points.

**Jon Thompson:** Is it possible to respond?

**Chair:** Please.

**Jon Thompson:** Thank you. I do not believe in the old way of doing these kinds of hearings, which is where I try to defend absolutely everything and say that the Ministry of Defence is perfect and that nothing needs to change. I am sorry, but I am not that kind of person. It is perhaps potentially risky for me, but I would rather be frank. I have taken the same approach when appearing in front of the Public Accounts Committee.

**Q66 Mr Brazier:** I am following on from the last two, but I am going to scoop up the earlier point about managing information as well. May I put it to you, permanent under-secretary, that the situation you are describing is precisely why we should not have a centrally designed New Employment Model and central personnel officer? Having worked in a consortium, one of the things that went most badly wrong was when we tried to get mining and industrial companies with similar pay and conditions to have a centralised personnel structure. The message from outside is decentralisation. Let me pick up one of Mrs Moon’s examples. She talked about pinch points and problems within the Navy. The Navy’s problems are very different from the other two services for a whole range of reasons: the families are static; the personnel are deployed around the world. The last time I can remember the senior personnel officer being a naval officer, there was a huge drive towards trying to settle all the families in a way that was just not going to work for the other services. Surely these crisis pinch points show that we should not be having a New Employment Model, but rather that we should allow each service to take charge of its own employment model.

**Jon Thompson:** The two are quite separate. The New Employment Model does not try to harmonise all the terms and conditions across the services. It tries to say that there may be some overall approaches that we can take as an MoD, such as on housing, which would improve the offer. Is there a way in which we provide accommodation that would more reflect the nature of service life and the family now? You are absolutely right that there is somewhat more stability for the Navy, for example. Is there a way in which the Ministry of Defence could help service people purchase their own house? Is there some way that we can shift the balance between service housing and people buying their own house and having more choice about what to do? That, we think, is an essential part of the New Employment Model we ought to look for. I think the two are separate, but I agree that the New Employment Model does not seek to harmonise; it seeks to provide an additional offer on such things as housing, retention, the impact on families of moving around on deployments, training, how much overseas service is required and so on. Through that you can take an MoD perspective, but keep the unique nature of the services exactly as they are.

**Q67 Mr Brazier:** With respect, that is exactly what is wrong, because it is not the same thing at all. Let us compare a naval frigate to an infantry battalion based in the UK—let us forget the units still in Germany—as they all will be in the future. The infantry battalion that is doing its thing may get sent from time to time on an overseas exercise, but it is based where its families are. A naval warship is not based where its families are. It spends almost all its time, except when they are on leave, away from where its families are. It is about common thinking across them.

Taking an example from the other way around, the balance between pay and pensions should arguably
not be the same in the RAF as it is in the other two services, because almost everybody in the RAF can move into a better paid job when they leave. There is a case for saying, “Why not let the Air Force do some rebalancing?” That would not work in the other two services. All your terms and conditions of service are laid down centrally, and you have said yourself that the initiatives you are taking to vary that are also being produced centrally. Why not decentralise? Jon Thompson: Sorry, but the current terms and conditions and various rules are not the same in each individual service. The harmony rules are not the same in the Navy as they are in the Army. The point I am trying to make is that in the various reforms that we have announced we are trying to provide more stability for service personnel and their families. If the submarine service is largely in Scotland—fair enough, it goes overseas and back—is there some way that we could assist the families with better offers on housing, whether that is better offers from our own housing or whether that is offering to help people buy a house, so that the family has more stability and the member of the services has more stability too? We think that is a reasonable question to ask ourselves and to consult service personnel about, and that is what we are doing. We are saying, “Would you like us to look at these questions? Is there some way that we can do this?” If the answer is a strong no, then my guess is that Ministers will say, “Let’s close that idea down.” It seems to me that there would be some value in looking at how you help people with their family life and how you provide more stability in that and in relation to overseas deployment, training and housing and so on. That is a perfectly legitimate question for us to explore.

Q68 Mr Brazier: Why not let the individual services do that?
Jon Thompson: Because, if we took housing, for instance, that is not a matter that we should allow individual services to choose on. It would not be right for us to say, “If you are in the Army, you can buy your own house and we will help you, but you cannot do that in the other services.”

Q69 Mr Brazier: But that was the case for a very long time in the Navy and for a very good reason. Let me ask you three other related questions. First, you mentioned different harmony rules. Are you actually looking at comparable manning ratios across the services? Have you looked, for example, at why the average manning levels for air crew for helicopters are so different across the three services? Is anyone looking at that in terms of trying to see whether we are getting equal value for money across the board?
Jon Thompson: It was looked at in the SDSR in 2010 and some minor changes were made.

Q70 Mr Brazier: The huge disparity was basically cut away and binned.
Jon Thompson: It is something that should be revisited in SDSR 2015.

Q71 Mr Brazier: Good, we have that on record.

Jon Thompson: It was briefly looked at in 2010, but we did not make very much progress on it.

Q72 Mr Brazier: The next question is briefly back to the point on reservists. You mentioned the senior appointments board. In the Defence Reform Bill Committee, I have raised the fact that there is currently no arrangement for selecting senior reservists—it is just done through the normal, regular-dominated process. Is that really satisfactory? Do you accept that you are looking for different qualities in the people who hold the most senior reservist jobs?
Jon Thompson: That question is being looked at. I met Richard Boggis-Rolfe, who is the chairman of the advisory committee of employers with an obligation to this. Employers have suggested that we might think about whether there is a different way of addressing the question. I believe that it is being looked at. That is the limit of my knowledge at the moment.

Q73 Mr Brazier: May I bring you now to the question of how the internal management systems work in the MoD? When I was privy to serve on the commission on reserve forces, I was rather disappointed to find that your financial management system did not seem to be able to price individual units. The job of a good financial management system should be to allow you to compare apples and pears. You should be able to say, “This is a manpower-intensive unit that does something, and we are going to work out net present value, costs, or whatever—how much pay, pensions, equipment, and so on, costs.” You should be able to say, “This is an equipment-intensive one,” or “This is a reservist one.” Whatever it happens to be, you can put all the costs together, work it out and say what it is costing each year. That just did not seem to be possible under your system. Are you making any progress on management accounting?
Jon Thompson: You are absolutely right that that information would not drop out of our financial information systems. We have done a fairly extensive piece of work on the Army to see whether we can get to your answers. I think that in relation to the Army, we have, but I am not sighted on whether we have decided to roll it across the other services.

David Williams: We have two approaches. The one that Jon mentioned is being developed in Army command and looks to apportion full costs to Army units, both within the Army budget and elsewhere. That has got some internal friction, and the other two services are thinking about whether they might use that to develop something equivalent. From a corporate perspective, it needs to be a system that generates management information that the services themselves will find useful and will use, but, having developed it once, I would rather them do it in a consistent way, if at all possible.

At the corporate level, we also have a cost of defence process, which looks to sweep up on an annual basis full costs by major unit. There are some headline examples in the indicators in the documents about the costs of a brigade, a fast jet or a helicopter. So we have some reporting information. Particularly, it does not helpfully tell you what it would cost or what you
would save if you wanted to get rid of it or increase its readiness. We would then have to go back down and do some bespoke modelling.

Q74 Mr Brazier: Without those numbers it is very hard to see how the next defence review is going to be any better than the last one.

Jon Thompson: I can try to answer that question, because that is different. We have been thinking about the questions that we might be asked for some time. Lord Levene recommended that we create a strategy group. We set that up a year or so ago, and it includes the chief, the vice-chief, David, me and some of the other main building players, notably deputy chiefs. We have mapped out what we think would be some of the defence questions, and there are quite a lot of them. In the autumn, that will go to our Ministers, and then the plan is that in 2014 we will do the necessary work so that after the general election the questions are similar to the ones we thought they would be, and we will have the evidence necessary to be able to answer the questions. That is the plan.

Mr Brazier: That is very encouraging to hear.

Q75 Chair: Who is in charge of the strategy of the Ministry of Defence?

Jon Thompson: Who is, or was?

Q76 Chair: Is.

Jon Thompson: I think that it is probably me.

Q77 Chair: Don’t you think that that is essentially a military function?

Jon Thompson: I think there is a difference between military strategy and organisation strategy. On the organisational strategy operating model, I think that I am the lead. On the military strategy, clearly it is the chief’s lead. Somehow, you have to blend those two together when you come to the SDSR. The previous chief and I worked very closely together, as do the new chief and I. We have adjoining offices.

Q78 Sir Bob Russell: Moving on to the civilian side, is the reduction in civilian manpower still considered a strategic risk?

Jon Thompson: Yes, for exactly the same reasons that you asked me about in relation to the military side.

Q79 Sir Bob Russell: What is the state of morale among MoD civilian staff?

Jon Thompson: The October 2012 staff survey indicated that it was fairly low. I believe this was set out by the National Audit Office in a Report to your Committee.

Q80 Sir Bob Russell: Has it improved?

Jon Thompson: We are about to find out as the next annual survey is in October.

Q81 Sir Bob Russell: You referred to our conclusion in relation to annual report and accounts 2011–12 that we were concerned that the output of the MoD and the reforms needed within it are at risk because of the reduction in staff numbers. The somewhat complacent, in my opinion, response from the Government was that “reduction in civilian manpower is on track and has not caused any unmanageable challenges. It has been identified as one of the Department’s top strategic risks and is being actively managed by the Defence Board”. What does actively managing this risk mean?

Jon Thompson: In the same way as you reeled off a series of pinch points on the military, we have come far enough now to be able to do a similar analysis on civilian personnel. We are not in a great place, for example, in relation to the number of commercial officers or the number of engineers. Indeed, the board endorsed our recruitment campaign for DE&S to recruit another 1,200 people in the course of the current calendar year to try to fill some of those gaps in our work force.

Q82 Sir Bob Russell: So it is still a strategic risk?

Jon Thompson: Yes. The personnel risk is military and civilian.

Q83 Thomas Docherty: Mr Thompson, the Committee is always impressed when you come before us by your grasp of the Department in detail. You have an impressive CV: DG of Finance at the MoD; Head of the Government Finance Profession at HM Treasury. Were you as surprised as this Committee was that you had forgotten to add VAT and inflation to the carrier changes?

Jon Thompson: We did not forget. That was an interesting use of the word. The reality is that when Ministers decided in the SDSR to have the carrier variant of the joint strike fighter for the carrier, we assumed that the necessary American technology that we would need would be in a Government-to-Government deal. That does not attract VAT. As it turned out, we have to go down the foreign military sales route and that does attract VAT. It is simply a question of how you obtain it. It wasn’t that we forgot; our assumption was wrong.

Q84 Thomas Docherty: So you did not understand the nature of the deal rather than forgot?

Jon Thompson: The nature of our relationship with the United States of America in relation to defence equipment varies in accordance with what the equipment is. Some is Government to Government and some is through foreign military sales. One attracts VAT and the other does not. The use of the word “forgot” was excessive, frankly.

Q85 Thomas Docherty: Okay, we can disagree on that one. Have you actively checked all the other programmes in the joint equipment programme to make sure that this is not an omission that has occurred elsewhere?

Jon Thompson: I don’t know the answer to that question. I don’t know if you do either, David.

David Williams: Checking all of them, not as a specific exercise but as part of the routine review of all of the equipment programme, is undertaken on a quarterly basis. That would be one of the assumptions that is routinely checked.
Q86 Thomas Docherty: But if this was something that you had not anticipated and it is a purchase from the United States and it is brought to your attention, why have you not as a matter of course, given that you have strategic responsibility, said “Are we absolutely confident that this has not occurred elsewhere?” You said so confidently that the equipment budget is now balanced. It would add 20% to your budget and we are buying one or two pieces of equipment from the United States such as some F-35s.

Jon Thompson: Yes, I think I can confidently say that they do not attract VAT. My answer was that I could not answer your question. I am happy to go and have a look to see whether we have done some work that neither of us is aware of. I am just being transparent that, to my knowledge, I don’t know.

David Williams: Going back to the point about the use of the word “forgot”, when the initial costing was undertaken around the SDSR, there appeared to be a genuine choice about what procurement route was open to us. At the point it became clear that we would be going down an FMS route for the cats and traps, the VAT was added in. So it was not something that we had missed and had to go back for; it was added in at the point when that procurement route became clear.

Q87 Thomas Docherty: More generally, why is the carrier programme still categorised as a red project?

Jon Thompson: In light of the decision to revert to STOVL that announced last May, we are trying to re-baseline that programme so that we have more certainty about delivery schedule and cost. So CDM is almost at the end, I think, of a negotiation to finalise a price, which gives all parties more certainty and tells us exactly what the baseline is, so that Ministers can then state that clearly and then we can be held accountable to Parliament for that.

Q88 Thomas Docherty: What is the status of Crowsnest?

Jon Thompson: Crowsnest, in relation to the Government major procurements project is also not in a good place. As chairman of the IAC, do you know exactly where we are with Crowsnest?

David Williams: I think probably what is behind the question—we have earmarked some additional early years funding to pull the in-service date forward a bit in this year’s planning round. But I will have to write to you have the details.

Q89 Chair: When will that decision be made?

David Williams: I think we allocated that money in the July board. There is not an immediate approvals point for the project, but we are looking to see how we can advance the ISD from the assumptions we were making during the course of last year at the point when, I think, your Committee looked at it for part of your maritime surveillance inquiry.

Q90 Thomas Docherty: Because it is critical to carrier strike operations.

David Williams: It is critical to certain elements of carrier strike operations, but—

Q91 Thomas Docherty: I think being able to see the enemy is probably relatively critical.

David Williams: I would not disagree with that, but the radar that it has is nowhere near as good as the one you get on a Type 45, so personally I would take a Type 45 with me, but it depends on the nature of the operation and the circumstances that you find yourselves in. There are some roles for which Crowsnest is particularly suited, but it is not the only capability that we have.

Q92 Thomas Docherty: The Secretary of State—he is never wrong—says that the carrier will not be fully operational until Crowsnest enters service, so is he wrong or are you underplaying its importance?

Jon Thompson: It is our opinion. We gave this evidence to the PAC. The National Audit Office decided what they thought the policy was and then compared where we were against what they thought the policy was. We disagree with that element of their report, specifically on Crowsnest.

Q93 Thomas Docherty: My understanding is that the ISD is 2022. Is that for Crowsnest?

Jon Thompson: For Crowsnest.

Q94 Thomas Docherty: Are you bringing that forward, or is that to hit that date?

David Williams: We should write and confirm. My recollection is that we have allocated some additional funding to allow that to come forward.

Chair: Please do write and confirm, and do so in as much detail as possible, because this is an issue on which we constantly take an interest.

Q95 Thomas Docherty: Can you tell us how the broader white board is functioning, please?

David Williams: As I think we explained at last year’s annual report and accounts hearing, the white board is a list of potential capabilities and projects which we might choose to draw down from as we see available headroom in our forward equipment plans. As part of last year’s planning round, the outcome of which we will publish later this calendar year, we were able to make some additional project allocations to the first half of our 10-year planning horizon; we have added in about £1.4 billion of additional project spend. Beyond that, we have managed to preserve roughly £8 billion of headroom in the second half of the 10-year equipment planning horizon, with indicative allocations to the services. As they think about how, in due course, they will spend that money, their prioritisation of their share of the white board will be an important component of that resource allocation decision-making process.

Q96 Thomas Docherty: It sounds like you cannot tell me today whether you have financed any items through the white board since you last appeared before us. If that is the case, will you write to us again and tell us what items you are financing?

David Williams: Yes. It will be set out as part of our publication of the equipment plan, which we are currently planning to publish in November. For example, in the first half of the planning period, some
of the issues for which we were able to find headroom in the last planning round included some specific allocations to Army command for bringing UORs into call, and investment in CPRA capabilities in rotary wing safety and in some aspects of Typhoon capability enhancement.

Q97 Mrs Moon: Just under two months ago the Cabinet Office started a review on Government contracts and G4S and Serco. Are you part of that review?
Jon Thompson: We are; there are quite a number of contracts with Serco that meet the Cabinet Office’s threshold. I am one of the two permanent secretaries who sit on the Cabinet Office board that is overseeing our work.

Q98 Mrs Moon: Do you have any concerns about Serco, particularly in part of the GoCo applications? I believe that one of the companies has Serco as part of its consortium.
Jon Thompson: I do not personally have any concerns about Serco but, following the events at the Ministry of Justice, I think that the Government are doing absolutely the right thing, which is to review their position with Serco. That review will take place and we will see what the outcome is.

Q99 Mrs Moon: How many contracts do we currently have with the two companies—do you know?
Jon Thompson: Off the top of my head, I don’t. I have that information at the office.

Q100 Mrs Moon: Could you write to us on that?
Jon Thompson: Yes, I definitely can. It is in the high hundreds of millions per year with Serco, but we can set that out for you—it is not terribly difficult.

Q101 Chair: Last year you published the report and accounts in December; this year you managed to do that in July. What was it that you put in place in order to achieve that huge improvement?
Jon Thompson: I decided to change the director general of finance. It is largely about accruals, but David can explain.
David Williams: There are a number of factors. Partly based on last year’s experience, we put in place a harder close of our financial data at our month 9 reporting point. Particularly in terms of ENS engagement, there was a clearer and earlier structured plan of engagement between project teams, DE&S management and the NAO reviewers, which meant that we had earlier sight of a range of issues. We did not have a late-breaking issue of the equivalent type to the accruals issue last year, not least because we put measures in place to make sure that we were on top of those basic financials. The additional qualifications, for instance, around the Germany estate were not ones that lent themselves to resolution by spending more time on them; it was a question of agreement or not. Essentially, however, finance staff across the Department and particularly in my corporate finance team worked very hard to hit that earlier deadline of the summer recess. That is where we need to be, routinely, each year.

Q102 Chair: What did you spend on external support in order to bring in the report and accounts?
David Williams: I would have to check the precise levels of spend. As we discussed last year, we engaged external support to assist us on the accruals issue, which got us through to publication of last year’s report and accounts. There was some follow-up work from that, which helped in the preparatory stages of this year’s annual report and accounts. Otherwise, we didn’t engage any other specific external support to get us to hit the July deadline.

Q103 Chair: Could you write to us about the amount of external accountancy support you spent?
David Williams: Yes.
Chair: Shall we ask about impairment or shall we leave this question?

Q104 Mrs Moon: I think there needs to be a question in relation to the large article that, as you will be aware, The Mail on Sunday ran. Can I just give you the opportunity to clarify and put on the record why you did not charge the entire impairment to the operating cost statement? Was there a reason? Would it have made any difference?
Jon Thompson: Frankly, no. In the light of previous experiences, given the fact that we were clearly coming out of Germany and the value of the assets we have in Germany would be lower, it didn’t occur.
David Williams: I don’t engage any other specific external support to assist us on the accruals issue, which got us through to publication of last year’s report and accounts. Otherwise, we didn’t engage any other specific external support to get us to hit the July deadline.

Q105 Mrs Moon: Do you consider that money to have been lost?
David Williams: No, it is simply an accounting adjustment.
Jon Thompson: Definitely not lost.
David Williams: In terms of cash, as we surrender the estate in Germany, there are a range of considerations where we might have to pay “make-good” charges to...
10 September 2013  Jon Thompson and David Williams

German authorities. They need to make payments to us for betterment of the estate, however, and largely speaking those cancel out. I would expect there to be a small payment in our direction rather than the other way when the pluses and minuses are sorted out.

**Jon Thompson:** It is not cash, and it does not impact our spending power at all.

**Q106 Chair:** Another qualification of the accounts, which is a regular occurrence, occurred—as last year—because of these contracts that may contain leases. When do you think this problem will go away?

**How long will it take to ensure that your accounts are no longer qualified on that basis?**

**Jon Thompson:** I think the Committee’s recommendation was that we should try to do it by ‘14-’15, and I think the Government agreed with that.

**Q107 Chair:** Do you think that that is likely to happen?

**Jon Thompson:** Is this the inventory?

**Chair:** This is the IFRIC, not the inventory.

**Jon Thompson:** In relation to IFRIC 4, I think the recommendation was ‘14-’15. We have now completed the initial analysis work, and that needs to go through the decision-making process to see how we are, or whether we are, going to try to address it. But we have got all the initial analysis of which contracts it may apply to. The question now is: are we going to try and do it or not?

**Q108 Chair:** Are you going to give me a date?

**Jon Thompson:** If we are going to do it, ‘14-’15 feels probably about right, but we still need to make a decision about whether we are going to do it.

**Q109 Chair:** But if you are not going to do it, does that not mean that your accounts are going to be qualified until kingdom come?

**David Williams:** Possibly. I think the question is whether it is doable. Depending on how difficult it is to do, there is a conversation to be had with the Treasury about whether the UK Government accounting standards are changed in a way that means we are not required to do it.

**Q110 Chair:** Either you do it, surely, or those accounting standards need to be changed.

**Jon Thompson:** Yes, that is correct. That is exactly right.

**David Williams:** If it helps, here is a bit of additional context. We said last year that we would run a review through to September, and, as Jon says, the data collection and analysis element of that work is now largely complete. My team are engaging with Treasury and NAO colleagues to consider issues around the completeness of the evidence base and what the options are for moving forward. As we touched on last year, the challenge here is not simply identifying that there might be an asset held by industry that is really only held for our benefit and we should simply put a number on it. It is about getting inside industry’s own asset registers and understanding the value of that asset: when it was built, how the lease element of it might be valued, and, as the German estate shows, not valued in accordance with international accounting standards, but in accordance with Government accounting standards.

The external advice that we have had around this is that it is a considerable amount of work to clear it out once, but then we need to put in place procedures to capture the extent to which industry adds to or disposes from that asset base, and indeed whether they are generating third-party business, so that we can understand the extent to which the lease relates to us as opposed to other parties. The question is simply whether the increased transparency of our asset base is worth the effort, and indeed whether we can get to a point where the NAO will be able to give us a clean set of accounts, or whether we will simply trade, not having tried, or not having succeeded, and still get a qualification for that.

**Chair:** I want to move on, because there is a risk of a relatively early vote. There are a few questions on inventory.

**Q111 Mrs Moon:** It is an area where you get criticised on two fronts. One is loss of stock, and the other is over-ordering. You do not seem to be particularly good at that, either. Where you already hold a large amount of stock, you order more. How are you going to improve on that?

**Jon Thompson:** There was an NAO report on managing the defence inventory, which we gave evidence to the PAC about. I am absolutely with you. We have to turn off the taps. In April 2012, we introduced a new control regime so that people could not order without the explicit agreement of the Director General of Resources, who works directly for the CDM. In the last financial year, the amount of inventory ordered was £300 million less on a £2 billion number, so there was definitely some impact from turning off the taps. In the current year it will probably be £500 million. So you are absolutely right: reducing the inflow is definitely one of the things we need to do.

Recording the inventory, appropriately valuing it and getting better information is absolutely fundamental to this. As the National Audit Office point out in their annual report when they are doing their various reports on inventory, the underpinning business systems of inventory and finance are hampering our progress, and we have to do something about that. The Department has announced significant investment in new information systems. It has appointed Boeing as a partner in this area to help us with that. There are four core systems we have to change and reduce from more than 70 down to four. The first one has gone in and we anticipate the second one going live in October. So we are trying to get a handle on this. I think we are making some reasonable progress. Indeed, we agreed with all the further recommendations that were made by the Public Accounts Committee in 2012. We can see some visible impact.

**Q112 Mrs Moon:** Just two responses to that. When Members visit bases, we still get a lot of criticism that critical pieces of kit and platforms are not able to be...
used, because they cannot get a particular spare. They are being told, “You are not holding it and it will take six months, eight months, nine months or a year to get it.” Meanwhile, a platform cannot be utilised. I appreciate your saving £300 million by turning the taps off, but how do you make sure that that tap at least allows a drip, so that we are not also losing valuable assets that cannot be utilised, because we cannot allow critical spares to be purchased and held?

**Jon Thompson:** I am not aware that that is a problem that is sufficient to reach board level, but I am happy to look at it. There might be times when that is the case, but I am not aware that it is a systemic problem. If anything, we have the reverse problem. No disrespect, but we look like organisational hoarders. We have £40 billion worth of stock in capital spares. If any of you have been to sites, there are vast warehouses full of things. Some of them have not been in service for some considerable time but we have not cleared them out. That looks like a real problem to me. I am not aware that the further one that you quote is a systemic issue, but I shall happily look to see if it is. There will undoubtedly be cases where that is true, but I am not aware that it is happening across the board.

**Chair:** We have a number of questions that we could write about. Is there any burning question which needs to be asked?

**Q113 Thomas Docherty:** If you accept that you could do inventory better, which nations do it well and what are you doing to learn from them?

**Jon Thompson:** I am sorry, I do not have the answer to that question, but what we are exploring and expecting to bring before Ministers before Christmas is the injection of some private sector expertise in this area, because there are excellent examples of how to do this in the private sector. We are not in that particular category. If anything, what we are looking at is how it is done by the DHLs of the world, as opposed to where could we look overseas. I am not sighted on whether we have done that.

**Q114 Thomas Docherty:** Can you write to us?

**Jon Thompson:** Yes, we can do. I know we are looking at the private sector.

**Q115 Mrs Moon:** I was interested in your comment about capability in the private sector. Bernard Gray told us that he thought one of the reasons that the GoCo was attractive was because we were not able to keep staff because of the public sector wage freeze. Do you think that perhaps part of the issue is that people are leaving because pay is higher in the private sector, or is it just that the people we employ do not have those capabilities?

**Jon Thompson:** No, I think that there is some evidence that some of the voluntary outflows are because people can earn significantly more in the private sector in some particular trades. There are in extremis cases of people leaving who can double the amount that they can earn. That is not a normal situation for us, but there are definitely some trades where that is the case. Some of our recruitment of senior staff has not been successful because of that. There can be a significant gap at senior levels for commercial, finance, IT and engineering posts between what we pay and private sector pay.

**Q116 Mrs Moon:** Does that mean that in the longer term, that pay freeze will cost us more because we shall have to buy back the expertise of those same people from the private sector?

**Jon Thompson:** Theoretically, that might be but we are approaching this in a different way, which is to say I think that it is a broad truism that private sector organisations would have fewer people, pay them more, and get more from them because of the way their incentives are set. That is one of the arguments Bernard is exploring in the materiel strategy.

**Q117 Mr Havard:** We have been pursuing some of these asset tracking related issues since 2003. You talk about systems. There are systems in terms of what things do, there are systems in terms of computers, there are processes, maybe capturing expertise and bedding it into systems. Can you write to us and set out what each of these things are? Could you please explain which bits are which, why you are doing what and when, and how they relate together as a programme?

**Jon Thompson:** Certainly. We did try to do that with the Public Accounts Committee. They asked exactly that question, so we can do that with ease.

**Q118 Mr Havard:** This is hardware, middleware, all this sort of stuff: you can explain that?

**Jon Thompson:** Yes, no problem.

**Chair:** We shall now draw this evidence session to a close. Thank you both very much.
Written evidence

Written evidence from the Ministry of Defence

MOD ANNUAL REPORT AND ACCOUNTS

In advance of the Committee’s hearing on 10 September, I would like to offer the Committee some background information to the Comptroller and Auditor General of the National Audit Office’s qualifications to the MOD’s Accounts for the financial year 2012/13.

The Committee will be familiar with the two longer-standing qualifications on inventory and the accounting treatment of contracts containing a lease. The Department continues to make progress on these issues, which is recognised by the NAO and I will be able to update you on this at hearing if required. The purpose of this letter is to provide an explanation of the three new qualifications, which we expect to be one-off occurrences.

The Department’s Accounts have been qualified on our accounting treatment of the valuation of the Germany Estate. This is the first time we have been qualified on this topic, which follows the announcement by the Defence Secretary in March 2013 that we would proceed with the withdrawal of British forces from Germany such that drawdown would be complete by 2019.

We record the Germany Estate as an asset and give it a representative current value on our Statement of Financial Position. That value gradually reduces (depreciates) over time, at a rate which previously reflected our expectation that the presence of UK forces in Germany would continue in the long term. However, since we have now put in place a firm outline plan to withdraw, with a clear date for the drawdown process to be completed, our accounts need to reflect the revised value this implies for the estate we hold in Germany.

We therefore reduced our assessment of the representative current value to MOD of the Germany Estate by around £1.5bn in 2012/13, so that the overall value reduces in line with our drawdown plans. We have not spent or lost this sum, which we have never held in cash—it simply represents the consequent change in the value of one of our assets. The Department’s spending power is entirely unaffected.

The reason that the NAO have qualified our Accounts on this is because of a difference of opinion over the technical accounting treatment of this revaluation. Our view was that it should be reflected by a reduction in the ‘revaluation reserve’ which was created when the value of the Germany estate was previously revised upwards. This is because the Department does not believe that these impairments are due to clear consumption of economic value nor loss of service potential. This is also consistent with the position that the Germany Estate was given a value as an “in-use” asset for book-keeping purposes, the Department was not free to dispose of it as it wished and the return of the estate to the Germans does not represent a financial loss that should be crystallised as an expense to the Department. Officials here consulted HM Treasury experts on the accounting treatment for this situation, and confirmed it at the very highest level of HM Treasury. The NAO disagreed with the HM Treasury view and the treatment on the basis that they felt there was a loss of service potential, the revaluation reserve should not be used and the reduction in value treated as a genuine financial loss. The second qualification reflects the NAO’s opinion that if the revaluation reserve had not been used the Department would have breached its AME limit.

I have discussed this situation at length with the Secretary of State and with the Comptroller & Auditor General and consider that following the advice of HM Treasury, who set the accounting rules and Managing Public Money, is a reasonable judgement for me to make as the Accounting Officer. I found myself in the situation that the NAO and HM Treasury do not agree on the accounting treatment with the result that we have two new qualifications which I considered I should alert you to before the hearing of the Committee.

Finally, as the Committee will be aware, Parliament annually sets limits on the number of personnel retained for service in the Armed Forces. These limits are sub-divided by regular and reserve and by a number of special categories. It has now become clear that the limit on Special Members of the Reserve Naval Forces was breached during 2012/13. On 1 April 2012 the Department employed 1,950 against a limit of 1,940. By 1 May 2012 that number had fallen back below 1,940, where it remained for the rest of the year.

As the NAO have acknowledged, the Department has made good progress this year on the resolution of the long-standing issues. The IFRIC 4 issue is inherently complicated and will take more time to resolve, including careful negotiations with our contractors and the NAO on the value of the assets under consideration, if indeed it can ever sensibly be resolved. We intend to resolve the inventory issue in time for next year’s ARAC.

I hope this letter is appropriate and helpful before my appearance at the Committee.

Jon Thompson
Permanent Under-Secretary Of State
August 2013
Further written evidence from the Ministry of Defence

GOVERNMENT RESPONSE TO FOLLOW-UP QUESTIONS FROM THE DEFENCE COMMITTEE
ARISING FROM THEIR ORAL EVIDENCE SESSION ON THE MINISTRY OF DEFENCE’S 2012–13
ANNUAL REPORT AND ACCOUNTS

INTRODUCTION

The Ministry of Defence has prepared this memorandum as the formal response on behalf of the Government to the House of Commons Defence Committee’s follow up of the Oral Evidence Session on the Ministry of Defence’s 2012–13 Annual Report and Accounts on 10 September 2013.

The Government’s formal response to the Defence Committee’s questions is set out below. The Committee’s questions are in bold italics; the Government’s response is in plain text. For ease of reference, question numbering follows that in the transcript of the Oral Evidence.

Questions 22 to 27: the PUS agreed to look at what information he could provide to the Committee on the strategic risk register and the Defence Board’s reassessment of the risks

The Defence Board strategic risks are those risks identified as being specifically within the remit of the Defence Board to understand, monitor and manage. By their nature, the detail and assessment of those risks is classified. Notwithstanding the classification, we will not be able to share the detailed Strategic Risk Register with members of the Committee as it is produced as advice to the Defence Secretary and the Defence Board.

Some information on strategic risks is set out in the annual Governance Statement within the Annual Report and Accounts.

Question 28: information about building the risk management arrangements into the Defence Academy training process

The Defence Academy is currently developing a plan which will enable the requirements of the new Risk Framework to be incorporated into existing Risk Management training and education (T&E). The Academy currently offers three key Risk Management training interventions which enable appropriate skills to be developed, from awareness through to advanced practitioner. These Risk Management training courses are well attended, with some 302 Military and Civilian delegates completing this training in 2012–13. The Academy also provides specific strategic risk education for the MOD’s Senior Leaders, in the form of a one-day Risk Management master class which is part of the Senior Responsible Owners’ Programme. The Academy’s current Risk Management T&E has a particular focus on acquisition, but our intention is to improve business Risk Management and decision-making skills across the Department through enhanced Risk Management T&E.

We take a principles-based approach in the new Risk Framework, setting a limited set of requirements rather than mandating a process and how Top Level Budgets should embed it. In the delegated model, budget holders will be held to account for their risk management, just as they are for other elements of their management, but we shall mandate a consistent approach to escalating risks to the Head Office and the Defence Board. This includes a mandated approach to assessing and reporting risks. We are currently reviewing the new Risk Framework documentation and would be happy to share that with the Committee once it has been approved, early in the New Year.

Questions 30 to 32: Could the Committee have an explanation of the issues determining the classification of the GoCo by the Office of National Statistics

When a new body is created it is for the Office of National Statistics (ONS) to determine its classification for National Accounts purposes, ie whether it is in the private sector or public sector.

The UK Government bases its budgeting rules and fiscal statistics on National Account principles; consequently ONS makes decisions independently on how transactions are treated, which underpin both financial forecasts and outturn figures produced and used by HMT and the Office of Budget Responsibility. This also extends to determining the boundary of the public sector used in the production of Whole of Government Accounts and the Central Government boundary.

The first decision for ONS when considering a new body is whether the body is in the public or private sector. This is largely determined by where ultimate control lies, as opposed to simply based on ownership of the body, and whether or not the body is publicly funded. Control is broadly defined as the ability to determine the corporate policy of the body. For example, control can be exercised through appointment of directors, control over shareholder voting rights or through legislation or regulation. There is a further consideration depending on how active or passive these controls are.

The ONS applies a comprehensive list of indicators in judging whether public sector control exists over a body:

— The ability to determine aspects of how the body delivers its outputs;
— The ability to have a final say in sale/acquisition of fixed assets;
— The ability to be entitled to a share of proceeds of asset disposals that goes beyond the repayment of previous government support for capital formation;
— The ability to close the body;
— The ability to prevent the body from ending its relationship with the public sector;
— The ability to veto any takeover (except in the case of an conventional special share);
— The ability to change the constitution of the body, or veto changes to it;
— The ability to decide what sort of financial transactions the body can undertake, or limit them;
— The ability to prevent the body from receiving certain types of income from other sources;
— The ability to exert numerous minor controls over how the body is run;
— The ability to exert financial control (this is different from funding) as part of a general system of controlling public expenditure;
— The ability to control dividend policy;
— The ability to set pay rates; and
— The ability to (for non-regulatory reasons) approve acquisitions.

Given these tests, it is not straightforward at this stage of the Materiel Strategy GoCo competitive process to be definitive about the judgement that will ultimately be made.

The second aspect ONS then looks at is whether the body is a market or non-market body. Public sector market entities are classified as Public Corporations (eg Channel 4 and London Underground). Non-market entities are classified into the general government sector (eg local or central government).

The borderline between market and non-market bodies is defined in the guidance as whether more than 50% of production costs are covered by sales of goods and services.

Questions 46 to 47: the PUS said he would write to the Committee with examples where a CEO (or Chair) had responsibilities to shareholder and the Accounting Officer at the same time. In particular, the Committee would like examples where the CEO or Chair has been appointed as an additional AO

Our research indicates that there are no completely analogous examples of where the CEO or Chair has been appointed as an additional Accounting Officer, and no specific example of where a conflict has been resolved. The nearest example we have found of such an arrangement is UKFI which is limited company (wholly owned by the Treasury) where the private sector CEO is responsible to the independent board but is also the Accounting Officer as appointed by the Treasury’s Accounting Officer. Examples are recorded in the accounts where members of that board have withdrawn from certain decisions because of a conflict of interests.

In the GoCo scenario the Operating Company (OpCo) is likely to be controlled by the MOD while the issued share capital (excluding the special share) is held for the duration of the management contract by the Management Company (ManCo). The nature of the OpCo board has yet to be finalised although the majority of appointees will not be public appointments, which distinguishes it from an NDPB. The OpCo board structure has also still to be finalised but will comprise employees of the OpCo appointed by the ManCo, together with NEDs.

Managing Public Money acknowledges the sensitivities about the role of the Accounting Officer in an Arms Length Body (ALB) which is governed by an independent Board (eg a charity or company). The ALB’s Accounting Officer, who will normally be a member of the board, is required to take care that personal legal responsibilities do not conflict with board member duties. In particular, the Accounting Officer is enjoined to vote against any proposal which appears to cause such a conflict; it is not sufficient to abstain.

Managing Public Money also stipulates that if the chair or board of such an ALB is minded to instruct its Accounting Officer to carry out a course inconsistent with the standards required, the Accounting Officer should make his or her reservations clear. If the board is still minded to proceed, the ALB Accounting Officer is required to ask the Accounting Officer of the sponsor department to consider intervening to resolve the difference of view.

If the board’s decision stands, there must be a written direction to carry it out and the sponsor department must inform the Treasury. In such circumstances, the Accounting Officer must copy relevant papers to the Comptroller & Auditor General (C&AG) and the Treasury Officer of Accounts and arrange for the existence of the direction to be published. The C&AG will normally draw the matter to the attention of the Public Accounts Committee.

Question 51: can we have the voluntary outflow figures for officers and other ranks split between the three Services

Questions 61 to 62: the PUS agreed to provide the Committee with the latest figures on the achievement or otherwise of harmony guidelines for each Service

Breaches of harmony are measured in percentages. The latest figures (1 October 2013) show that 0.6% of Naval Service personnel, 5.1% of Army personnel and 3.7% of RAF personnel were in breach of harmony guidelines.

Individual Harmony Guidelines are different for the three Services, equating to no more than 660 days away from home over a rolling 36-month period for the Naval Service, no more than 415 days away in a 30-month rolling period for the Army and no more than 280 days away over in the previous 24 months for the Royal Air Force. In July 2013, however, we introduced the same baseline of a rolling 36 months for all three Services.

This adjustment affects the maximum number of days away from home over the rolling period as follows: Army 498 days and the RAF 468 days (the Naval Service metrics are unchanged). We plan to start reporting against the revised metrics by April 2014.

Questions 79 to 80: the Committee would like to see the next annual survey of civilian morale when it is completed

We shall be happy to give the Committee a copy of the summary of this year’s Your Say employee engagement survey which we conducted in October. This covers civilian staff, military line managers of civilian staff and military staff managed by civilian staff. The Permanent Under Secretary will write to the Chairman of the Committee when the summary is available, probably over the turn of the year. The results of the survey will be published by the Cabinet Office on Gov.UK at the end of January.

Question 86: the PUS agreed to go back and look whether VAT had been omitted from any other purchases from the USA

We do not believe we have an endemic problem with VAT on purchases from the USA. As PUS advised the Committee during the Evidence Session, the omission of VAT for the aircraft launch and recovery equipment was the result of a revised assumption about the procurement route rather than an omission in financial management. Our original assumption was that the equipment (catapults and arrestor gear) would be acquired Government-to-Government, which would not attract VAT. Following subsequent discussions with the US between late 2010 and early 2011, the procurement route was confirmed as a Foreign Military Sales (FMS) arrangement which would attract VAT. With the decision to revert to Short Take-off and Vertical Landing (STOVL)-configured carriers in May 2012, the Department no longer needed to procure this equipment from the US.

We routinely and regularly review the planned costs and assumptions of defence programmes, including the treatment of VAT. Indeed, Departmental instructions and guidance stress the importance of considering the impact of VAT and require that all programme costs must be produced inclusive of VAT where the tax is payable and not recoverable. Where there is uncertainty about the treatment of VAT, we consult HMRC.

Question 88 to 93: David Williams agreed to let the Committee know if money had been allocated to the Crowsnest project to bring forward the in-service date. Could he also let the Committee know the amount of additional money and the revised in-service date

The in-service date for CROWSNEST will not formally be approved until it reaches its Main Gate decision point. However, the Department has recently adopted an accelerated programme delivery strategy, re-allocating funding from later years to 2015–16, and bringing forward the Main Gate investment decision to 2016. This now gives a planned in-service date in 2018, 18 months earlier than the previous assumptions. The earlier in-service date provides a CROWSNEST Initial Operating Capability in time for Carrier Strike Initial Operating Capability in 2020. The re-profiling of CROWSNEST funding will result in an overall saving to Defence of at least £22 million over the years 2013 to 2024.

Joint Strike Fighter: the Committee would like to know if there is any more certainty on the price/cost and time of the JSF. It would also like to know if there has been any redefinition of the capabilities of the JSF and how access to particular technologies is going.

As the Joint Strike Fighter programme progresses, we are becoming increasingly confident in the costs and the schedule. Rigorous cost control measures are being applied to the programme, which have led to reducing aircraft production costs which are within programme cost estimates. The US announcement of Initial Operating Capability dates for all three US Services that will fly the Joint Strike Fighter is an indication of the growing confidence in the programme schedule.

The Joint Strike Fighter will deliver a fifth generation capability that will be developed through life to overcome emerging threats. UK requirements include the integration of UK weapons such as PAVEWAY IV. A key tenet of our participation in the programme is visibility and access to the technologies and systems to provide an autonomous operational capability, and we are confident that the relationship we have forged with the US will enable us to achieve this aim.
A good indication of our progress is the fact that we have had sufficient confidence to allow our first three aircraft to fly at Eglin Air Force Base having been certified by UK authorities. STOVL Joint Strike Fighters participated in successful sea flight trials on board a US warship in August 2013.

Questions 99 to 101: the PUS agreed to provide the Committee with the number of MOD contracts with SERCO and separately with G4S and the value of the contracts with each of them.

I summarise below: (a) the total expenditure and the total number of contracts against which payments were made in the past four years to Serco and G4S and (b) our estimate of the total expenditure against current contracts over the next ten years.

(a) HISTORICAL EXPENDITURE AGAINST SERCO AND G4S CONTRACTS

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<td><strong>Serco</strong></td>
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<tr>
<td>Number of open contracts during FY</td>
<td>93</td>
<td>94</td>
<td>107</td>
<td>93</td>
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<tr>
<td>Payments made (£ million)(^{(1)(2)})</td>
<td>549.0</td>
<td>539.8</td>
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<td>545.8</td>
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<td>Number of open contracts during FY</td>
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<td>13</td>
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<td>Payments made (£ million)(^{(1)})</td>
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<td>7.4</td>
<td>8.7</td>
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(b) FUTURE ESTIMATED EXPENDITURE AGAINST CURRENT SERCO AND G4S CONTRACTS

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<tr>
<td>Number of open contracts during FY(^{(3)})</td>
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<td>34</td>
<td>23</td>
<td>15</td>
<td>11</td>
<td>9</td>
<td>8</td>
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<tr>
<td>Estimated payments based on current plans (£ million)(^{(1)(2)})</td>
<td>518.2</td>
<td>527.1</td>
<td>505.2</td>
<td>440.0</td>
<td>450.1</td>
<td>479.3</td>
<td>456.8</td>
<td>417.6</td>
<td>374.2</td>
<td>380.6</td>
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<td><strong>G4S</strong></td>
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<td>Number of open contracts during FY(^{(3)})</td>
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<td>Estimated payments based on current plans (£ million)(^{(1)})</td>
<td>1.6</td>
<td>0.7</td>
<td>0</td>
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Notes:

1. These figures include expenditure by MOD Trading Funds for completeness, but do not include payments or estimated payments which may be made on behalf of other Government Departments, by the MOD’s executive non-departmental public bodies, locally by the Department, through third parties such as prime contractors or other Government Departments and in relation to collaborative projects where the payments are made through international procurement agencies or overseas Governments. Payments and estimated payments made by Government Procurement Card are also not included. The figures do not include contracts where Serco and G4S provide goods and services under subcontract to other defence suppliers.

2. Under longstanding convention, the figures include Serco’s share and estimated share of payments made against contracts with AWE, a Government-Owned Company-Operated company in which Serco have a third stake with two other private companies.

3. Future procurement competitions and decisions will have an impact on the number of contracts held by Serco and G4S in the future (for example, some contracts may be re-competed or renewed). The figures given therefore represent estimates of payments against existing contracts only.
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Question 102: David Williams agreed to let the Committee know the levels of spend on external support to produce the Annual Report and Accounts 2012–13. The Committee would also like to know the total expenditure on external accountancy support in 2012–13 and in the first 5 or 6 months of 2013–14.

We spent £362,000 on external assistance to help produce the 2012–13 Annual Report & Accounts. This was to provide independent assurance on the accuracy of accrual values in DE&S.

Total departmental expenditure on external accountancy support was £1,966,652 in 2012–13 and £855K over the first half of 2013–14.

Question 107: the Committee would like to know when final decisions will be made on whether or not the MOD will address the IFRIC 4 qualification and if so when.

We are discussing the next steps with the Treasury and the NAO and expect an indication of the Treasury view at the end of September. We expect that a decision on how the MOD will address the IFRIC 4 qualification will be taken by the end of December. We are happy to update the Committee on progress in advance of next year’s accounts.

Questions 111 and 117: could the Committee have the latest position, including expected delivery dates, on the following IT systems?

— JAMES (Joint Asset Management Engineering Solutions): This new capability is primarily designed to manage and track all assets across the Land Domain, including vehicles, ground equipment, and radios. Implementation of JAMES will enable the retirement of 5 legacy systems. JAMES implementation is due to be completed (for all major units) by 31 March 2014.

— MJDI (Management of the Joint Deployed Inventory): This new capability will provide a single system for managing the Defence Inventory in the Deployed Environment, and is currently being rolled-out to support Op HERRICK [operations in Afghanistan]. Implementation of MJDI will enable the retirement of 6 legacy systems, with implementation due to be completed in March 2014.

— BWMS (Base Inventory and Warehouse Management Services): This is a new capability to replace 40 legacy systems (some of which are over 40 years old) to provide unified inventory management processes across Defence. It is scheduled to be delivered in a number of phases between 2013 and the end of 2015/2016. Current planning assumptions have 10 legacy systems being retired in March 2014, and a further 30 systems due retirement by March 2015.

— Logical Data Model: This is a new capability, which builds on Data Warehousing capabilities, to bring together, for the first time, information relating to base inventory, deployed inventory and consignment tracking to improve the quality of management information in support of operational decision making. Implementation is due to commence in January 2013, with full roll-out completed by March 2014. It does not replace any legacy systems.

JAMES (Joint Asset Management Engineering Solutions): This new capability, which entails adopting new business processes supported by an information system, is primarily designed to manage assets and engineering for all equipment in the Land environment that requires maintenance, modification, repair and overhaul, including vehicles, ground equipment, and radios. Implementation of JAMES will enable us to retire five legacy systems. It is already playing a vital role in Op HERRICK, tracking the condition and configuration of redeploying vehicles and major equipments. JAMES implementation is due to be completed for all major units by 31 March 2014, with RAF Ground Support Equipment management being enabled by the end of March 2015.

MJDI (Management of the Joint Deployed Inventory): This new capability, which also involves the adoption of new business processes across a large swathe of the MOD, supported by an information system, will provide a single authoritative system for pan-Defence inventory management in the deployed environment (ie forward of base warehouses). It is currently being rolled out to support Op HERRICK. MJDI will enable us to retire six legacy systems and implementation is due to be largely completed in March 2014. The complexities involved in integrating the system onto ship-based networks mean that implementation on RN vessels and boats will be completed by March 2015.

BWMS (Base Inventory and Warehouse Management Services): Legacy base inventory systems are due to be replaced by the BWMS project. Release 1 of BWMS, which replaces the Foreign Military Sales inventory order placement system, went live on 5 September 2013. Initial operating capability of the Air Domain Inventory System (release 2 of BWMS) is expected to be achieved in late 2014. Further development of the BWMS capability to encompass the entirety of the base inventory (release 3 of BWMS) is dependent on the approval of a Main Gate Business Case by the Investment Approvals Committee and endorsement from the Cabinet Office. Roll-out of BWMS to cover the non-Air Inventory is currently scheduled to take place between mid-2015 and end-2016.

Logical Data Model (LDM): This is a new capability which builds on logistic data warehousing capabilities to bring together, for the first time, information relating to base inventory, deployed inventory and consignment tracking to improve the quality of management information in support of operational decision making. Delivery of initial capability is expected in December 2013. The efficacy of the LDM depends on increasing the feeds
to the LDM and improving the quality of the data within these feeds. The replacement of obsolete, legacy IS, will enable greater feeds to the LDM and the Department is improving the quality of data within its systems. There will be a progressive enhancement of the LDM capability as it matures and as the requirements for data evolve.

Question 113: the PUS agreed to provide the Committee with information about which nations do inventory management well. The Committee would also like to know about the work being done to look at best practice in the private sector

The MOD’s main focus is on emulating best practice in the private sector, which we see as the benchmark (we have therefore made no recent comparison between how we manage our inventory and how other nations do so). In November 2012, DE&S began implementing the Inventory Strategic Plan to control inventory within the future Defence supply chain. This work is intended to provide high quality inventory management throughout the Department to deliver and maintain an optimised inventory across Defence. The first stages of intervention work, led by a senior official with substantial industry experience, have already delivered significant reductions in unnecessary holdings leading to a significant fall in the gross book value of inventory. We are also working with an external consulting partner and have recruited more than 30 interim managers from a range of recognised industry logistics specialists.

PUS has approved a new senior post of Director Inventory Management which combines the current role of the Director Joint Support Chain with a developing role to improve the inventory function across the MOD.

On financial management information, the Committee would like answers to the following questions that it was unable to ask because of time pressures: How are DE&S progressing on the improvements to financial management set to be delivered this month?

Defence Reform recommended improvements of financial information systems, which are being managed under the Finance Military Capability Transformation programme.

The first phase of this is the introduction of a suite of new financial management reports to enable Commands to review DE&S performance, drawing together information from both management accounting and performance management systems. Both DE&S and Command staff can use this information to fulfil their responsibilities under Defence Reform to review project performance and focus on emerging issues, enabling them to tackle issues early and control costs more effectively.

To meet Initial Operating Capability, Defence Business Services have delivered an in-year project forecasting tool which, with the supporting business processes represents a significant enhancement for DE&S. This means that, for the first time, DE&S will have corporate and fully coherent access to information on, for example, in year forecast positions, planned cost commitments in future periods, performance against approved costs and in service dates and Key User Requirements. The information can be aggregated and mapped to the individual Commands or presented at individual project level. DE&S are reviewing the data to improve its quality.

The MOD’s Cost Assurance and Analysis Service has also been under-going a significant capability transformation programme to deliver improvements in the costing of projects. This programme runs until 2015 with a clear vision to be the MOD’s professional provider of choice for independent cost assurance and analysis services. To date the programme has delivered:

- A high level Demand & Operations Planning process;
- Improved cost management tools and techniques;
- Improved information and knowledge management;
- Technical Support Management with joint working between the Cost Assurance and Analysis Service and its strategic partner KPMG; and
- An improved organisation design with an effective customer relationship management approach.

New products and services have been introduced and the Cost Assurance and Analysis Service now plays a pivotal role in the MOD’s budgeting process through the provision of independent cost estimates. The organisation itself has also been strengthened and is now better placed to meet Defence customer demands.

When is the project to deliver further improvements?

Following the delivery of the Finance and Military Capability Transformation Initial Operating Capability, it is the intention to deliver further improvements in DE&S management information within the next 18 months. Those improvements will include expansion of the data store to allow Commands access to a breadth of DE&S project related information, giving them greater visibility. In addition, the development of existing visualisation and business tracking tools will be accelerated to strengthen the Commands’ capability to make fully informed investment decisions.
What are your plans to improve financial management and financial management information in the rest of the MOD?

As part of the implementation of Chapter 8 of the Lord Levene report on Defence Reform, the Department has implemented a number of measures to improve financial management. The Finance Director of the Department is now a permanent member of the Defence Board and Chair of the Departmental Investment Improvement Committee to ensure that finance is at the heart of decision making. Directors of Resources have been appointed in each TLB with Terms of Reference that will ensure that finances are properly monitored and controlled across the Department. An end-to-end review of the scrutiny and approvals process is also under way.

The Service Chiefs and Joint Forces Commander have been given full delegation for the planning and delivery of their capability portfolios. A new joint Finance and Military Capability Operating Model will ensure that responsibility, authority and accountability are properly aligned. To support this, we have implemented joint Finance and Military Capability training in the form of practitioner and advanced courses delivered by the Defence Academy.

A programme of improvements to financial management information across the Department will enhance the functionality of corporate systems, including the Defence Financial Management system, to enable Commands and Head Office to have improved access to financial information. Initial Operating Capability has already delivered new financial management reports that enable Commands to access and view DE&S financial performance. Further incremental improvements will include information on personnel, commercial and infrastructure to facilitate the construction of Command/TLB plans and the management of the TLB portfolios. The increased access to financial management information held on Defence corporate systems will improve the transparency and consistency of information used for financial management and decision making.

The Department is also introducing a new Control Framework with the Finance Director becoming the authority for financial and risk management with clear responsibility for: financial planning, policy and assurance; departmental regularity and propriety arrangements; leading on the next Spending Review negotiations on the future size of the Defence Budget; and oversight and governance of efficiency and value for money work across Defence.

When will the MOD be able to cost its activities?

For Strategic Balance of Investment purposes, the Department already has the capability to assess the gross affordability of a given Force Structure by costing Force Elements and their support functions. There is also a Cost of Defence process, which provides full costs by major unit on an annual basis.

At the Command level, the Finance and Military Capability Transformation programme will allocate costs across organisational units to inform Cost Leadership strategies. Army Command has developed an approach to calculate the full cost of Army elements; this continues to be developed and the other two Services are considering further options.

The examples above focus on the use of force elements as building blocks for output costing. Specific ‘activities’, for example a training exercise, continue to be costed on a bespoke basis as and when required for decision making points. Finally, the Department has recently endorsed a Costing and Cost Management Strategy to ensure further deliver improvements in the Department’s costing capability. There are three work strands: (a) Costing Outputs; (b) Improving Forecasting; and (c) Implementing Cost Leadership. They are due to report early in 2014.

21 November 2013