



House of Commons  
Committee of Public Accounts

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# The Major Projects Report 2010

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Twenty-third Report of Session 2010–  
11

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

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## The Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine "the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit" (Standing Order No 148).

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Mr Stephen Barclay (*Conservative, North East Cambridgeshire*)  
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The following member was also a member of the committee during the parliament:

Eric Joyce (*Labour, Falkirk*)

### Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via [www.parliament.uk](http://www.parliament.uk).

### Publication

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 <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

### Committee staff

The current staff of the Committee is Philip Aylett (Clerk), Lori Verwaerde (Senior Committee Assistant), Ian Blair and Michelle Garratty (Committee Assistants) and Alex Paterson (Media Officer).

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## Summary

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We have reported before that the defence equipment programme is unaffordable, with commitments exceeding forecast budgets over a ten year period by £36 billion. We have also highlighted before the hugely damaging consequences of the Ministry of Defence's (the Department's) short term decisions to keep in year expenditure within voted limits and the need to understand the full cost implications of these decisions. Such decisions increased the cost of the Department's major projects by £3.3 billion in 2009-10 alone. The scale of problems created by this financial imbalance masks the improved performance of the majority of projects against cost and budget.

In October 2010, the Government published its Strategic Defence and Security Review (SDSR). The SDSR offered the Department an opportunity to bring its plans into balance with the expenditure limits set in the Comprehensive Spending Review. The Department has already cancelled projects such as the Nimrod MRA4 and Sentinel aircraft, accepting greater operational risks in some areas and writing off nearly £5 billion of taxpayer's money. We will look further at the decision to cancel the Nimrod, which is to be scrapped with £3.6 billion wasted. Looking beyond these headline decisions, implementing the SDSR will require further decisions and the renegotiation or cancellation of a significant number of existing contracts to make the programme affordable.

The Department has a poor track record in taking such decisions on the well informed basis necessary to optimise value for money. Responsibility and accountability for projects are often eroded by frequent changes of Senior Responsible Owner.

The Department failed to understand fully the financial consequences of the decision taken in December 2008 to delay the Queen Elizabeth Class aircraft carriers. In 2010, the Department reported a further cost increase of £650 million, bringing the total overrun on the aircraft carriers to £1.6 billion, a new benchmark in poor corporate decision making. We welcome the Comptroller & Auditor General's (C&AG's) announcement that the National Audit Office will undertake a review of the Carrier project. We plan to take evidence on his report later this year to understand fully the circumstances in which key decisions were made and their consequences for value for money.

In 2004 the Department removed funding for Tranche 3 of its planned procurement of Typhoon aircraft from its budget in the full knowledge of the robust contractual obligations it was under. The decision was based on the highly optimistic assumption that other partner nations would also not wish to purchase the final tranche of aircraft, so the requirement would be waived. This was another poor decision which led to additional costs for the taxpayer. In 2009-10 the Department had to commit an extra £2.7 billion on the Typhoon project, including the purchase of 16 additional aircraft, to honour its commitments. The resultant cost increase has contributed to the £36 billion gap in the defence budget. We look forward to taking further evidence on the Typhoon project in the

spring.

On the basis of a Report by the Comptroller and Auditor General<sup>1</sup> we took evidence from the Ministry of Defence on their progress in meeting cost, time and performance targets for its 15 top-spending military equipment projects.

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1 C&AG's Report, *The Major Projects Report 2010*, Session 2010-11, HC 489

## Conclusions and Recommendations

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- 1. The structural imbalance between commitments to purchase equipment and the available budget has obliged the Department to take tough decisions to manage its in-year expenditure by delaying and re-scoping individual projects. Such decisions are the root cause of the £3.3 billion in-year cost increase in the 2010 Major Projects Report.** The Strategic Defence and Security Review (SDSR) provided the Department with an opportunity to re-examine its commitments and make them affordable within the available budget. The scale of the budget shortfall has meant the Department has had to take difficult decisions to dispose of both the Nimrod MRA4 anti-submarine aircraft and the Sentinel surveillance aircraft, writing off nearly £5 billion in taxpayer's money and losing two important military capabilities. Such decisions are never desirable. The fact that the Department has been pressured to make them offers a compelling argument why it must address the problems which have affected defence procurement for decades and on which our predecessors have commented extensively. If it does not, the cycle of failure will continue, with badly needed capabilities being delivered later than planned and cost increases crowding other capabilities out of the equipment programme.
- 2. A balanced and affordable defence programme is vital to achieving value for money from defence acquisition. It is an area where the Department has failed to deliver, with adverse affects on value for money and military capability.** The Treasury agrees with us that affordability is a vital concept in any Accounting Officer's duties. The new Accounting Officer must at all times have affordability at the forefront of her mind and be prepared to act decisively if she sees it is threatened.
- 3. Senior Responsible Owners (SROs) for major defence projects typically move post every two to three years, eroding accountability. It also seems common for the Department to appoint a single individual to be responsible for a wide range of different major projects – a task no one person can properly fulfil. "Responsible" means that such individuals should be held to account for delivering the project within an agreed budget and should have the authority to direct those involved in delivering the project. Neither is true in Defence.** The Department should ensure that SROs remain in post during key phases of a project lifecycle. It should consider, as part of the work of the Defence Reform Unit, how to give them the authority and information they need to manage the delivery of the equipment for which they are accountable.
- 4. Implementing the Strategic Defence and Security Review (SDSR) will require the Department to make further difficult decisions, including cancelling projects or re-negotiating contracts, as it works out what more it needs to do to balance the defence budget.** The Department has already started to re-negotiate a large number of contracts. Transparency will be important to reassure Parliament, taxpayers and the Armed Forces that the Department is achieving value for money in making and implementing these tough decisions. We note that the Department has already committed to provide Parliament with an annual statement of the affordability of the equipment plan on which the C&AG will provide a commentary. The statement is

an important step in the right direction but will only give part of the picture. The Department should write to us with a note by the end of April 2011 setting out in detail its forecasts of the costs of implementing the SDSR, the status of contract cancellations and renegotiations and how it has assessed the value for money of the decisions it is taking.

5. **When the Department signed the contract for the aircraft carriers, it was aware that the overall defence budget was unaffordable.** The decision is a compelling example of the Department's failure to exercise adequate governance and control over its expenditure programme. In future, before entering into new contracts, the Defence Board should consider the effects of decisions on the affordability of the overall defence budget. The Treasury also has an important role here to keep the Department honest and should offer a more robust challenge to the affordability and value of such decisions.
6. **Just seven months after it signed the Carrier contract, the Department made a decision in distress in an attempt to balance the defence budget and delayed the project without understanding the £1.6 billion cost implications.** That such an important decision was taken based on inadequate information about the longer term costs and consequences points to an organisational culture in which there is a lack of clarity about accountability and responsibility. The Department should make all key decisions - about entering into, cancelling or deferring equipment acquisitions - based on a complete analysis of the financial and operational consequences. The need for such analysis becomes more, not less, vital when decisions are made under pressure.
7. **The Department is in the process of carrying out detailed costings, but the decision to fly a different type of aircraft off the carriers was not based on a full understanding of the costs.** The Department was confident that the additional costs incurred in fitting catapults and arrestor wires to the carriers would be more than offset by procuring lower-cost aircraft. An inadequate understanding of costs is indicative of more deep rooted problems in the way the Department takes decisions. If not addressed, this will jeopardise the chances of delivering better value for money from the defence budget than has been achieved to date. In future the Department, working closely with the Treasury, should only take key decisions when it has sufficient financial and other management information to demonstrate the actions it chooses to take are both affordable and represent value for money.
8. **The 2004 decision to remove the £1 billion of funding for the third tranche of Typhoon combat aircraft was a high risk decision based on over-optimism, which cost the taxpayer dear.** It did not reflect the reality that the Department would incur significant costs whatever course of action it chose to pursue. In 2009, the Department committed a further £2.7 billion to buy 16 additional aircraft, a significant contributor to the £36 billion "black hole" in the defence budget. At our hearing, officials found it difficult to justify this decision on military capability grounds. At present the Department does not hold any budgetary contingency to enable it to manage the cost implications of risks such as that which transpired on the Typhoon project. As it gets its budget back into balance, the Department should take a corporate view of risks to affordability and delivery across its equipment

programme and establish, in consultation with the Treasury, a tightly controlled financial contingency to deal with the risks which emerge.

9. **In an uncertain strategic environment and with a constrained budget, the Department is right to think in terms of delivering the so-called “80% solution” quickly.** The Department has a history of altering the planned numbers and capabilities of the equipment it requires, which delays when equipment becomes operational. These factors often lead to significant cost increases, in part due to the rigidity of the contracts, and an increased risk that the equipment, particularly when introduced late into service, will become obsolete. Instead, procurement should deliver rapid and cost-effective equipment, enabling the Department to respond with more agility to changing operational needs, while retaining the flexibility to develop the capability further should it be required. The Defence Board is the key decision-making body in the Department and it should test every proposal it receives to make sure it is not “gold plated”, does not have undue risk, is affordable within likely spending constraints and has sufficient flexibility to adapt if required.

# 1 Programme Management

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1. The Major Projects Report 2010 examined the Ministry of Defence's (the Department's) progress in meeting cost, time and performance targets for its 15 largest military equipment projects for the year ending 31 March 2010.<sup>2</sup>

2. Progress on individual equipment projects had again been overshadowed by continued Departmental failings in managing the overall affordability of the defence budget. In this Committee's 2009 report on the major projects we concluded that the defence budget was unaffordable by between £6 billion and £36 billion as a result of shortcomings in the Department's governance and budgeting arrangements.<sup>3</sup> The continuing structural imbalance between commitments to purchase equipment and the available budget obliged the Department to take tough decisions to manage its in-year expenditure by delaying and re-scoping individual projects. Such decisions were the root cause of the £3.3 billion in-year cost increase in the Major Projects Report 2010.<sup>4</sup>

3. In October 2010 the Government announced the Strategic Defence and Security Review (SDSR) which aimed to reassess the United Kingdom's defence priorities for the next ten years.<sup>5</sup> The Review offered the Department an opportunity to bring its plans into balance with the expenditure limits set in the Comprehensive Spending Review. The Department told us, based upon the future direction of defence as set out in the SDSR, that it was in a position to make rational decisions on what to cut and what to keep.<sup>6</sup>

4. Since October 2010, the Department has taken difficult decisions which resulted in many projects being scrapped or scaled down. Despite taking key decisions on equipment capabilities, the Department admitted that it had not finished costing the implications of the SDSR.<sup>7</sup> The Department did not fully understand what penalties it might be liable for, and the scope it might have for altering contracts with industrial partners.<sup>8</sup> These would not be fully understood until at least spring 2011 and even then the Department admitted it would take a number of years to rebalance the defence budget.

5. Transparency and accountability are essential to reassure Parliament and taxpayers that the Department is achieving value for money in making and implementing these tough decisions. As set out in *Managing Public Money* the role of the Accounting Officer is seamless, with each post-holder bearing responsibility for all decisions – past and present – taken by the Department. Accounting Officers also take on responsibility for project selection and appraisal as well as ensuring the value for money of an organisation's procurement projects.<sup>9</sup> Sir Nicholas Macpherson, Permanent Secretary to the Treasury,

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2 C&AG's Report, *The Major Projects Report 2010*, Session 2010-11, HC 489

3 Committee of Public Accounts Twenty-Third Report of Session 2009-10, *Ministry of Defence: Major Projects Report 2009*, HC338, conclusion 1

4 Qq 1, 109-111

5 *Securing Britain in an Age of Uncertainty: The Strategic Defence and Security Review*, October 2010

6 Q 205

7 Q 173

8 Q 175

9 Q 35 ; *Managing Public Money*, HM Treasury, October 2007

confirmed in our recent hearing on accountability that affordability remains a very important concept in an Accounting Officer's duties.<sup>10</sup> If an alternative proposal, or doing nothing, would deliver better value, for example a cheaper or higher quality outcome, the Accounting Officer should bring this to the attention of Ministers seeking a letter of direction to proceed.<sup>11</sup>

6. The Department's Accounting Officer was unable to explain adequately the decisions taken in the past which resulted in the staggering cost increase reported in the C&AG's Report.<sup>12</sup> The Accounting Officer failed to provide an adequate explanation of why no letter of direction was sought at any point despite the poor value for money decisions that have been taken in the past few years.<sup>13</sup>

7. The Department has committed to provide Parliament with an annual statement of affordability of the Equipment Plan.<sup>14</sup> The C&AG, while not making an assessment of the affordability, will provide a commentary on the process that the Department has used to cost its Equipment Plan. These statements will take into account the work the Department is doing within its planning round to cost the implementation of the decisions taken in the SDSR.<sup>15</sup>

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10 Uncorrected transcript of oral evidence taken before the Committee of Public Accounts on 19 January 2011, HC (2010-11) 740-i, Q4

11 *Managing Public Money*, HM Treasury, Box 3.2, p 20, October 2007

12 Qq 35-37

13 Qq 15, 35-36

14 *Defence Equipment 2010: Government response to the Committee's Sixth Report of Session 2009-10*, p12

15 Q 174

## 2 Project Management

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8. The Department has a poor track record in taking decisions on the well informed basis necessary to optimise value for money. The implications of this are not just about increasing costs and poor value for money on individual projects but, vitally, mean the Armed Forces will not get the operational benefits of new capabilities as quickly as expected and some equipment will only be delivered in reduced numbers.<sup>16</sup>

9. The 15 largest military projects covered in the Major Projects Report 2010 represent over £67 billion in forecast spend. Between April 2009 and March 2010, the cost of these 15 projects increased by £3.3 billion.<sup>17</sup> Despite 13 of the 15 projects having performed positively during the year, the cost savings they realised are relatively small compared with the cost increases reported on the aircraft carrier and Typhoon projects.<sup>18</sup>

10. In July 2008 the Department signed a contract to build two aircraft carriers knowing that the overall defence programme was unaffordable, but believing that by undertaking an examination across the whole equipment programme it could identify over half a billion pounds of savings elsewhere within the Defence budget.<sup>19</sup> Just seven months after signing the contract, having not found alternative savings, the Department concluded that slipping the carriers by two years represented the best way to deliver the necessary savings.<sup>20</sup> The Department initially estimated that the contract renegotiation would add nearly £1 billion to the project's total cost, with the taxpayer footing the whole bill.<sup>21</sup>

11. Subsequently, additional costing work by the Department on the delay to the carriers identified a further increase of £650 million bringing the total over-run on the aircraft carrier project to £1.6 billion.<sup>22</sup> The Department accepted that it took the decision to delay the carrier project without full knowledge of the financial implications of that decision<sup>23</sup>

12. Following the SDSR, the Department decided to change the type of aircraft which would fly off the aircraft carriers. Further modifications to the carriers, in the form of catapults and arrester wires, would be necessary in order to accommodate the new aircraft and were likely to cost several hundred million pounds. The Department claimed that the additional costs of fitting catapults and arrester wires to the carriers would be more than offset by a better value aircraft, but could not offer cost data to support its opinion. Again, the Department admitted that it took this decision despite not fully understanding the total costs.<sup>24</sup>

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16 Committee of Public Accounts Twenty-Third Report of Session 2009-10, *Ministry of Defence: Major Projects Report 2009*, HC338, conclusion 1

17 Q 1 ; C&AG's Report, para 4

18 Qq 27-28; C&AG's Report, para 5

19 Qq 1-3

20 Qq 3, 9, 13, 91

21 Qq 11-12, 16-22; C&AG's Report, para 12

22 Qq 1 -5, 12-13, 32-33

23 Qq 8-10

24 Q 23-25

13. In October 2010 BAE Systems wrote to the Prime Minister and revealed that cancelling the aircraft carriers as part of the SDSR would cost around £450 million more than the remaining procurement costs.<sup>25</sup> We questioned the Department about the costs of cancelling the carriers. Considering the cancellation of the aircraft carriers in isolation, the Department estimated that it would save in the region of £1 billion per vessel.<sup>26</sup> However the Department's figure did not take into account the wider industrial and financial impact of such a decision, including the Department's commitment to maintaining a shipbuilding industry within the United Kingdom.<sup>27</sup> The Department could not elaborate on cost when asked to use the same basis as BAE Systems.<sup>28</sup>

14. On the Typhoon project the Department entered into a contract in 1998 which committed it to buying 232 Typhoon aircraft over three tranches. In 2004 the Department decided that it no longer required the third tranche of 88 aircraft. Despite knowing the extent of its obligations, the Department removed nearly £1 billion of funding for these aircraft from its budget, believing the money could be better spent elsewhere within the defence budget.<sup>29</sup> This decision was based on an over-optimistic judgement at the time that if any of the other partner nations also did not wish to pursue the final tranche of aircraft, the obligation would be avoided.<sup>30</sup> It was not supported by the contract already in place.<sup>31</sup>

15. In 2009, the Department spent an additional £2.7 billion on this project fulfilling contractual obligations, which included the purchase of 16 additional aircraft.<sup>32</sup> Despite the fact that the Typhoon aircraft was built to fight a Cold War threat which has now diminished, the Department stated that there was an operational need for the 16 aircraft. The Department failed to convince us that the decision to purchase the 16 additional aircraft was a military requirement rather than a contractual one which it should have foreseen.<sup>33</sup> In order to afford the extra Typhoon aircraft, the Department has been forced to find savings in other equipment areas, including from the Tornado and Harrier fleets.<sup>34</sup>

16. Since October 2010, the Department has had to take difficult decisions as part of the SDSR to cancel a number of projects, including Nimrod MRA4 anti-submarine aircraft and the Sentinel surveillance aircraft. This has resulted in writing off nearly £5 billion of taxpayers' money while realising little of the expected benefits from the equipments.<sup>35</sup> In so

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25 Qq 135-136

26 Qq 85-90

27 Qq 89-90

28 Q 90

29 Qq 52, 72

30 Qq 52, 63-64, 67-68, 72

31 Qq 64, 66

32 Q 50

33 Qq 61-62, 64, 72-73

34 Qq 69-71

35 Qq 92-93, 98-106

doing, the Department has accepted greater operational risk and will have to find other ways of delivering the capability.<sup>36</sup>

17. The Nimrod MRA4 aircraft, which was to provide Anti-Submarine and Anti-Surface Warfare capability, had spent 15 years in development and was nearly ten years behind schedule. The decision taken within the SDSR that the Nimrod MRA4 aircraft was to be scrapped, wrote off over £3.6 billion of taxpayers' money.<sup>37</sup> Further costs associated with the closure of the Woodford facility which was dedicated to building the Nimrod aircraft would also be incurred sooner.<sup>38</sup> The Department refused to state in the hearing, for reasons of commercial confidentiality, the full extent of these costs as negotiations were ongoing, but hoped to reach a settlement figure by the end of this financial year.<sup>39</sup>

18. The Sentinel surveillance aircraft provides long range radar coverage for the Armed Forces on operations, and is currently being used in Afghanistan.<sup>40</sup> At the time of the hearing, the Department had already spent over £1 billion on the system that was expected to remain in service until at least 2035.<sup>41</sup> The Department decided in the SDSR that it will be taken out of service around 2015, or at the end of the current conflict.<sup>42</sup> Having only recently entered service, and with over £1 billion spent on the project, the aircraft will be disposed of some 20 years earlier than originally planned.<sup>43</sup>

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36 Qq 117-120

37 Qq 92-93

38 Qq 94-97, 112

39 Qq 94-98

40 Q 106

41 Qq 98-107

42 Q 98

43 Q 100

### 3 Learning from past mistakes

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19. The Department has a long history of changing the numbers of equipment to be procured, which has had a considerable impact on unit costs. For example, the number of Support Vehicles had decreased by 1300 and the number of Nimrod aircraft decreased from 21 to nine - tripling the aircraft's unit cost.<sup>44</sup> In-Service Dates have also been delayed, such as on the aircraft carriers, leading to a cost increase of £1.6 billion, as well as on other projects including the Astute Class Submarine and the Type 45 Destroyer. Capability requirements have been modified on numerous projects, including the aircraft carriers and the Future Strategic Tanker Aircraft, which in future will be used to carry passengers.<sup>45</sup>

20. We have reported previously that the end cost of the Department's projects is often substantially more than the initial cost.<sup>46</sup> We suggested that the Department was either not capable of effectively estimating the cost of a project, or was deliberately underestimating the cost to the Treasury to get the project started.<sup>47</sup> The Department disputed this. It told us that it had a new regime around project start-up which provides a tough and rigorous review of the validity of the costing of the project when it enters the Equipment Programme. In relation to cost growth, the Department explained that many of the projects have lengthy timeframes and over their lifetime the Department changes them in response to changing circumstances, including operational necessity. The Department continued to expect changes in the shape and cost growth of the programme, but expected to see better control because of the changes it had put in place.<sup>48</sup>

21. Given the long lead times to design and build equipment, the Department has to negotiate contracts years before equipment comes into service. It does so aware of the fact that the strategic environment is likely to have changed by the time equipment comes in to service, and it must therefore retain the flexibility to modify the equipment throughout the life of the contract. Historically, in negotiating procurement contracts, the Department has left very little room for changing the scope of contracts without incurring significant penalties.<sup>49</sup> Following an evaluation of Defence requirements in the SDSR there will be a significant number of changes that will need to be made to contracts, not only to reflect the capability required but also to try to rebalance the Defence budget. The Department regretted the way contracts had been negotiated in the past and believed that current contracts do now have flexibility to change without penalties being incurred.<sup>50</sup> For example, on the recently negotiated Joint Strike Fighter contract, the Department did not have to decide on the actual numbers required until a couple of years before they were needed.<sup>51</sup>

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44 Q 121

45 Qq 181-187

46 Committee of Public Accounts Twenty-Third Report of Session 2009-10, *Ministry of Defence: Major Projects Report 2009*, HC 338, Summary and conclusion 4

47 Qq 26, 2941-43

48 Q 43

49 Qq 127-128

50 Qq 126-128, 155

51 Q 127

22. In the past, equipment requirements have been ‘gold plated’ to ensure that the United Kingdom got the best available capability.<sup>52</sup> Requirements were set, and equipment designed, based on preparedness for future risks. This often led to increased costs, risks and delays, which frequently resulted in equipment becoming rapidly obsolete when it finally entered service. The Department are now looking at an 80% solution with a plan to get to a 100% capability through development updates, if required.<sup>53</sup>

23. At a project level, senior responsible owners (SROs) should be held accountable for delivering projects within an agreed budget and timeframe and should have authority to direct those involved in delivering the project. This is not true in the Department. SROs only have oversight, and not the authority and information they need, to manage the delivery of the project for which they are accountable. According to the Department’s own guidelines each project should have an SRO.<sup>54</sup> The Department could only confirm that each of its major projects, those with budgets of over £100 million, had an SRO, and that some SROs had responsibility for more than one project. It told us that projects with expenditure of less than £100 million had a single point of accountability.<sup>55</sup> The Department was working to ensure that all major projects have an SRO in place.<sup>56</sup>

24. Despite defence projects lasting a decade or more, SROs stay in post usually less than three years, and at the time of the hearing there were inadequate records kept of who had been responsible throughout a project’s life.<sup>57</sup> The Department confirmed that, across the top 100 projects, a project manager averages just 40 months in post.<sup>58</sup> The Department argued that spending a very long time in a given project would detach someone from the military knowledge that brought them into the project in the first place.<sup>59</sup> The Department failed to convince us that a posting of three years was long enough to take personal ownership and accountability of a long project and to manage a project properly over time.<sup>60</sup>

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52 Q 130

53 Qq 130-134

54 Qq 139-141

55 Qq 156-160

56 Q 140, 156-160

57 Qq 139-141

58 Q 170

59 Q 171-172

60 Q 170

# Formal Minutes

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**Tuesday 15 February 2011**

Members present:

Rt Hon Margaret Hodge, in the Chair

Mr Richard Bacon

Mr Stephen Barclay

Matthew Hancock

Chris Heaton-Harris

Jo Johnson

Nick Smith

Ian Swales

Draft Report (*The Major Projects Report 2010*) proposed by the Chair, brought up and read.

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

Paragraphs 1 to 24 read and agreed to.

Conclusions and recommendations 1 to 9 read and agreed to.

*Resolved*, That the Report be the Twenty-third 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.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till Tuesday 1 March at 10.30 am

## Witnesses

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**Wednesday 15 December 2010**

*Page*

**Ursula Brennan**, Permanent Under Secretary, **General Sir Kevin O'Donoghue KCB CBE**, Chief of Defence Materiel, **Vice Admiral Paul Lambert CB**, Deputy Chief of Defence Staff (Capability), and **Dr. Andrew Tyler**, Chief Operating Officer, Defence Equipment and Support, Ministry of Defence

Ev 1

## List of printed written evidence

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- 1 Ministry of Defence
- 2 HM Treasury

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Ev 21

# List of Reports from the Committee during the current Parliament

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

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| Second Report        | Delivering Multi-Role Tanker Aircraft Capability  | HC 425 |
| Third Report         | Tackling inequalities in life expectancy in areas with the worst health and deprivation | HC 470 |
| Fourth Report        | Progress with VFM savings and lessons for cost reduction programmes                     | HC 440 |
| Fifth Report         | Increasing Passenger Rail Capacity  | HC 471 |
| Sixth Report         | Cafcass's response to increased demand for its services                                 | HC 439 |
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| Twenty-third Report  | The Major Projects Report 2010  | HC 687 |



# Oral evidence

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## Taken before the Committee of Public Accounts on Wednesday 15 December 2010

Members present:

Mrs Margaret Hodge (Chair)

|                    |                  |
|--------------------|------------------|
| Mr Richard Bacon   | Mrs Anne McGuire |
| Stephen Barclay    | Austin Mitchell  |
| Dr Stella Creasy   | Nick Smith       |
| Jackie Doyle-Price | Ian Swales       |
| Matthew Hancock    | James Wharton    |
| Joseph Johnson     |                  |

### REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

#### The Major Projects Report 2010 (HC 687-i)

#### Examination of Witnesses

*Witnesses:* **Ursula Brennan**, Permanent Under Secretary, **General Sir Kevin O'Donoghue KCB CBE**, Chief of Defence Materiel, **Vice Admiral Paul Lambert CB**, Deputy Chief of Defence Staff (Capability), and **Dr Andrew Tyler**, Chief Operating Officer, Defence Equipment and Support, Ministry of Defence, gave evidence.

**Amyas Morse**, Comptroller and Auditor General, **Martin Sinclair**, Assistant Auditor General, **Tim Banfield**, Director, and **Marius Gallaher**, Alternate Treasury Officer of Accounts, were in attendance.

**Q1 Chair:** Thank you all very much for attending this afternoon's hearing. We have a lot to cover, so the Committee would really appreciate it if answers were short, sharp, to the point and direct. I will interrupt you, so apologies if I do that, if I feel that you're straying a little bit, and we just want to concentrate. We will deal with some of the specific projects to start with and then we'll move into more general discussion about control of the procurement of defence equipment, and then the future and the implications of the SDSR.

Most of us here, bar Richard Bacon and Austin Mitchell, are pretty new to this, but this is the third hearing in our short life that we've had with the MOD and the Report does make for pretty depressing reading. Whilst I recognise that more and more projects are now being managed more efficiently and effectively, the truth is that the decisions that you guys take at the centre around affordability or otherwise, or increased cost or change, impact in a bad way on the country's capability in providing appropriate and good defence equipment. A £3.3 billion overspend in a year is just plain shocking. It really is shocking. I don't think we have seen a figure as bad as that. I think we've all been reading *The Times* coverage over the last few days, which picks up on a lot of the projects that are here. Just to put it into context again, we are determined that this is going to stop, right, to the extent that we have responsibility for ensuring value for money. We will haul you back, I'm afraid, time and time and time again because what we don't want is just a series of reports that tell the same story, which appears to be what has happened in the past. We really want to help you to ensure that we get change.

Can I start with the aircraft carrier, which is a long saga? We looked at this when we looked at the budget, at your expenditure last time. My understanding is that this was a project we decided would go ahead in 1998. The estimates in about 2002 were £2.4 billion. The last time we looked at it, which was a bare month ago, the overspending largely attributable to the delay was £1 billion. Today we have new figures here, which add a further £760 million to the cost, of which £650 million comes out of a further assessment of the delay. There are a whole lot of questions that arise out of that. When you first signed the contract, you clearly agreed that you would find savings elsewhere. I suppose the question is: why didn't you find them?

**Ursula Brennan:** Could I just clarify? When you say "find savings elsewhere", do you mean elsewhere in the carrier contract?

**Q2 Chair:** I assume, having just signed the carrier contract, you wouldn't want to find savings in that, but you had signed a contract that took you over budget. You clearly must have signed that contract on the understanding that there would be savings identified elsewhere in the budget. Why didn't you find them?

**Ursula Brennan:** Ah, sorry, I think I understand. You're talking about the fact that we said that when we signed the contract we would undertake an equipment examination to look elsewhere in the equipment programme, to see where we could make savings?

**Q3 Chair:** You had to find cash elsewhere to pay for the contract.

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**Ursula Brennan:** We did make a number of savings in the equipment programme, but, having weighed up the choices in terms of the amount of savings to be made and the capability that we needed to have, we did conclude that slipping the carriers was actually the best way of delivering those savings.

**Q4 Chair:** So seven months into the contract you decided to slip?

**Ursula Brennan:** That was the decision and that was the cost growth that was reported last year in the major project reports.

**Q5 Chair:** That in itself is outrageous. Was Downing Street involved in that decision?

**Ursula Brennan:** This is the decision that was taken in 2008, which we reported to you last year.

**Q6 Chair:** Yes. Was Downing Street involved in that decision?

**Ursula Brennan:** I don't know whether Number 10 was involved in that. Ministers were involved in it, and certainly the Chancellor was involved. Whether the Prime Minister was involved, I don't know.

**Q7 Chair:** Mr O'Donoghue?

**General Sir Kevin O'Donoghue:** I don't know. It would be the Secretary of State's office that would involve the Prime Minister.

**Q8 Chair:** You decided within seven months to delay. Why didn't you understand the full consequences in terms of the increased costs to the taxpayer when you took that decision?

**Ursula Brennan:** We made an estimate at the time that we said that we would delay the project, but we made it at a time that was on the cusp of last year's and this year's reporting for the Major Project Review. In terms of the figures that we reported to you in MPR '09, which was the £908 million, we hadn't completed the process of estimating the cost at that time.

**Q9 Chair:** You take such a momentous decision, you sign a contract, you decide seven months later, having not found alternative savings, you are going to delay it, and you took that decision without full knowledge of the financial implications of that decision to delay?

**Ursula Brennan:** It is true that at the time we took it, our estimate of the figure was lower. That is correct.

**Q10 Mr Bacon:** So when you say "took it"; took the decision to sign the contract or took the later decision seven months later to delay it?

**Ursula Brennan:** No, sorry. The point when we took the decision to defer the carriers. Subsequent to that, we discovered that the cost would be higher, yes, that's correct.

**Q11 Mr Bacon:** Just to be clear—we did discuss this with Sir Bill Jeffrey back at the beginning of this year, as you know—at the time you took the decision to delay the contract seven months after signature, you originally believed that the total costs, including the cost of capital, would be £908 million. Is that right? Yes?

**Ursula Brennan:** That is certainly the figure.

**Q12 Mr Bacon:** We just need a "yes" or a "no". Either you believed that or you didn't. We've got a lot to cover here, so short answers would be helpful. I just want to be clear. At the time you took the decision to delay the contract, you believed that the total extra costs would be £908 million. Now you know that those extra costs, in addition to that £908 million, are a further £650 million on top of the £908 million, making a total of roughly £1.56 billion. Is that correct?

**Ursula Brennan:** That is correct.

**Q13 Mr Bacon:** Let's park that for a second; somebody else may come back on how you could get that estimate at the time of taking the decision to delay, seven months after the signing of the contract, so horribly wrong. You somehow missed £650 million of additional costs. I want to go back a little earlier than that. When you signed the contract, why didn't you know that you had the wherewithal to pay for it, according to the contract? To have to make a decision so shortly afterwards is the thing that I find so extraordinary, that resulted in an increase purely because of the delay so shortly, seven months after the signing of the contract in the first place. Why weren't you ready at the time you signed the contract with all the information, so that you weren't presented with a position where you had to take a decision to delay?

**Ursula Brennan:** This is the ground that you went over with Sir Bill Jeffrey earlier in the year, in which, I believe, you discussed with him the fact that, at the time that the contracts were signed, there was an agreement that we would conduct an equipment examination to look across the equipment programme as a whole. On the basis that the decision to proceed with the carriers was going to put pressure on the equipment programme, that was recognised, and it was agreed that we would conduct an examination of the entire equipment programme. I think that is the process that he described.

**Q14 Mr Bacon:** You must have had numbers attached to that in your mind when you took this decision to sign the contract that would give you what you needed, so that you didn't have to take this further decision to delay only seven months later, which it's now proved is costing even more than you thought. You thought it was going to cost £900 million extra, and it's turning out to cost £1.5 billion extra. This is pretty basic stuff. I just don't understand why you weren't fully informed when you signed the contract. You were around; you were in the MOD.

**Ursula Brennan:** Not at the time we signed the contract, as it happens, but I was around later, yes.

**Q15 Chair:** Would you have sent a letter of direction to Ministers?

**Ursula Brennan:** I wasn't there at the time. I really don't think I can comment on what I would or wouldn't have done.

**Q16 Chair:** What have you done in your negotiations with BAE to try to screw down these additional costs?

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**Dr Andrew Tyler:** The first thing that we did in establishing the procurement and acquisition strategy for the carrier contract is we established an alliance, not just with BAE Systems but with BAE Systems, the two other major contractors and the MOD, which was sharing the risk in the programme between all four parties, and with an incentive system built into the contract, which incentivises the reduction in cost as the project matures.

**Q17 Chair:** Have they lost money with this delay?

**Dr Andrew Tyler:** To this point, no, but they have the potential of losing their profit if they don't perform as the contract continues.

**Q18 Chair:** That means they've lost money. Presumably they had a profit figure in. They've lost that, have they?

**Andrew Tyler:** No, because the cost growth has been down to programming decisions within the Ministry of Defence, not a failure in industry to control their costs.

**Q19 Chair:** But nevertheless, given the financial situation in which we find ourselves as a country, have you gone back to them and negotiated with them, so that we don't face a £1.56 billion additional bill for a delay that should never have occurred, or a contract that should never have been let?

**Dr Andrew Tyler:** The contract and the negotiation, post the equipment examination and the growth in costs by delaying the carriers, yes, we have put further—

**Q20 Chair:** Have you taken money off them? If they hadn't lost money, would the £1.56 billion be higher? Is there a sharing of the pain of the delay?

**Dr Andrew Tyler:** There is no sharing of the decision of the MOD.

**Q21 Chair:** Sharing the pain?

**Dr Andrew Tyler:** There is no sharing of the pain of the MOD's decision to delay.

**Q22 Chair:** Should there be?

**Dr Andrew Tyler:** I think industry would reasonably argue that that was not a decision that they made. It was our choice to delay the carriers at that point and industry didn't have an involvement in that. In fact, on the contrary, they were very helpful and accommodating in minimising the impact on the programme, bearing in mind that the programme was already in quite a mature state with advanced manufacture, and what we'd asked them to do was effectively to re-baseline all of their plans.

**Q23 Chair:** I've got one more question and then two Members want to come in. There has now been a Strategic Defence and Security Review and there was a decision to add in catapults and arresters—whatever they are—to allow other sorts of aeroplanes to come on and off these aircraft carriers. How much is that going to cost?

**Dr Andrew Tyler:** We are doing the detailed costing of that at the moment, but it's going to cost several hundred million.

**Q24 Chair:** Can you afford that? What is going to go?

**Dr Andrew Tyler:** We've changed the variant of the aircraft and so therefore we've got a balancing off between the aircraft capability on the carriers and the cost of adapting the carriers for catapults and arrester gears.

**Q25 Chair:** So there should be no net additional cost?

**Dr Andrew Tyler:** For the carrier strike capability, which is the ship and the aircraft on it, holistically, there will be a significant cost reduction.

**Q26 James Wharton:** I find it staggering that you can enter into a contract and then so soon afterwards institute a delay that will cost such a large amount of money. One of the things we're seeing with this project, where costs have run out of control, we're seeing with a lot of projects that we see from the MOD: the end cost is often very substantially more than the initial cost. I want to understand. When you're doing your cost estimates—I don't know, Mrs Brennan, who the most appropriate person is to ask from the witnesses—is the MOD actually capable of effectively, on its own, without relying on industry to feed it information or too much information, estimating the cost of projects?

**Ursula Brennan:** Could I make an initial point on that? Others may want to come in. I think it is worth noting—the NAO themselves point it out—that in the Report that you have before you there are two big problem projects, the Typhoon and the carriers. On the other projects, both in terms of slippage in time and in terms of cost, the story is positive. I don't think it's quite true to say that there is a consistent story of—

**Q27 James Wharton:** Is the story more positive than it has historically been, rather than positive? My reading of it is things are looking better for those other projects, and they are coming more into line with where they should be, but there is still slippage and there are still some overruns in there, but those are less than in previous years.

**Ursula Brennan:** There is some slippage but, for instance, out of those 15 projects nine had no delay at all. So I don't think it's a case of being bad, but really, really bad. There are some areas where it is actually positively good, I think.

**Q28 Matthew Hancock:** I'm sorry, I can't let that go without referring to figure 3, which shows that the aircraft carrier has an in-year increase in cost of £767 million and the Typhoon of £2.3<sup>1</sup> billion and, yes, there are some negative figures, but they're £54 million, £51 million, £15 million, £3 million, £1 million. They are peanuts compared with these two enormously over-costed projects. In the context of the

<sup>1</sup> C&AG's Report states that the in year cost increase of Typhoon is £2.7 billion, Figure 3 page 11

very difficult decisions that are having to be made across Government, the complacency of answering by saying that there are some projects that have come in at a lower cost is astounding.

**Ursula Brennan:** I'm sorry. I was asked whether we were consistently having a problem and I said we have two big projects that are a problem, but it is not consistently the case that we have a problem. That is all I was attempting to say.

**Q29 James Wharton:** I haven't actually had the answer to my original question, which is about the MOD's capability to estimate the cost of these projects.

**General Sir Kevin O'Donoghue:** The answer is yes, we do have the capability. We didn't have enough of the capability. I am recruiting over 200 professional cost-assurers and cost-estimators over the two years, since the Bernard Gray Report, which you may be aware of. The answer is, yes, we were quite good at it, but we didn't have enough capacity.

**Q30 Mr Bacon:** I'm interested in this. You didn't have enough estimating capacity. It says the Department now estimates that partly as a result of the deferral it will incur a further £650 million. Which is the biggest equipment programme? For the single entity that you get at the end of it—obviously if you buy 36 or 360 planes you might get more—but it's correct that the single biggest programme in terms of getting something is the carrier, isn't it?

**General Sir Kevin O'Donoghue:** No, deterrent. It will be successor deterrent.

**Q31 Mr Bacon:** Oh, you mean Trident? The successor to Trident? Okay. But the carrier is next biggest. In terms of one lump of metal it's pretty damn big.

**General Sir Kevin O'Donoghue:** Oh, yes.

**Q32 Mr Bacon:** Yet this was the one where you got the estimates wrong. So whichever estimators you had around—let's accept, because you just told us it was the case, that you didn't have enough—you weren't deploying them on the most important things because this is the one where you missed £650 million of extra cost, on top of the £900 million of extra cost.

**General Sir Kevin O'Donoghue:** I'm not sure that's strictly true. The imperative was to save nearly half a billion in the equipment examination; that was the imperative.

**Q33 Mr Bacon:** Hang on. You said it's not strictly true. The Report says it's true. The Report says that originally you estimated it was £900 million extra. It now says, last sentence of paragraph 12, "The Department now estimates that"—blah blah blah—"it will incur a further"—that's on top of the £908 million—"£650 million." So it is true?

**General Sir Kevin O'Donoghue:** No, what I'm saying is not strictly true is that we didn't apply any cost-assurance, cost-estimating to the problem. I thought that was your question.

**Q34 Mr Bacon:** No, I didn't say that. I said that wherever your estimators were going, you weren't applying enough of them to the most important projects, of which the carrier is plainly one of the most important of all.

**General Sir Kevin O'Donoghue:** They were applied to it, but the imperative was to save nearly half a billion pounds in the equipment examination and it took a lot longer than that to work out the costs of that overrun.

**Chair:** I don't think any of us can properly conceive how you can take a decision knowing you don't have the money, seven months later, stop it, incur nearly £1 billion and then—I don't know how many months later—£1.56 billion. It's just mad.

**Q35 Stephen Barclay:** My question flows exactly from that, and it's to Mrs Brennan really. Everyone looks at HM Treasury *Managing Public Money*, which sets out the rules for accounting officers. Paragraph 3.1.2 says: "The accounting officer is someone who may be called to account in Parliament for the stewardship of the resources within the organisation's control." What I'm struggling with is the fact that no letter of direction was sought on affordability grounds at the point when the contract was entered into, and yet no letter of direction was sought on value for money grounds at the point of the contract extension. I actually pressed Sir Bill on this very issue of affordability at our last hearing. In his reply to me—I've got the extract here—he said, "There is an issue about the extent to which the affordability issue, which does not really get mentioned in the existing accounting officer guidelines at all, ought to be one that can give rise to directions." Yet, following the hearing, we've had a letter from Sir Nicholas Macpherson, which says, "I should first confirm that accounting officers' duties do involve questions of affordability." He goes on to say, "I hope this letter will reassure you that affordability remains an important concept in an accounting officer's duties." First, I'd be interested in your thoughts on the importance of accountability and whether one should have been sought when the contract was signed. Secondly, following up on Mr Bacon's question, you were in post at the time of contract extension. I would have thought that seven months after a contract was signed, extending that contract, which has then lost the taxpayer £1.56 billion, has an impact on value for money. So why was a letter of direction not sought at that point?

**Ursula Brennan:** I was in post as the Second Permanent Secretary at the time—I think it was my fourth week—when the letter of contract extension was sought. You did discuss the subject of accounting officer directions. I really don't think I can comment on what the accounting officer at the time chose to do. I'm perfectly happy to talk about accounting officer directions looking forward, but I don't think it's appropriate for me to talk about decisions that were taken prior to my being the accounting officer.

**Q36 Stephen Barclay:** You are here to answer for the Department, so would you have sought a letter of direction?

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**Ursula Brennan:** I really would prefer not to answer a hypothetical question about the past, when I wasn't the accounting officer.

**Q37 Joseph Johnson:** None the less, even though you were Deputy Permanent Secretary, you were a very influential figure in the Department. Looking back on the sequence of decisions that were taken, in hindsight, what would you have done differently?

**Ursula Brennan:** I don't know what I would have done differently. What I'm very conscious of is that this decision was particularly unusual in a number of respects. First of all, to take a decision to defer such a large programme when it was already on contract is a very unusual thing to do. Number two, this decision was taken at a point when people were beginning to be aware that we were heading towards having a strategic defence and security review. I know that the conversations that were being had were around the imperative of keeping options open for the strategic defence and security review. Carrier strike capability is a major capability for defence, and decisions about carrier strike capability would not normally get taken outwith a strategic defence and security review. I am conscious that that weighed very heavily in the discussions that were going on about whether or not to defer the carriers, rather than to cancel them.

**Q38 Joseph Johnson:** In your experience of defence procurement, can you think of any other instance in which the cost of delaying a project has been so high as a proportion of the initial forecast project cost?

**General Sir Kevin O'Donoghue:** No.

**Ursula Brennan:** I can't imagine that there would be one of that scale.

**Q39 Joseph Johnson:** This, then, has to set the benchmark for poor procurement within the MOD, by that yardstick?

**Ursula Brennan:** It was certainly a very major cost for a deferral.

**Q40 Joseph Johnson:** Could you please just clarify for me exactly what it was in the contract that triggered such a large increase in the cost, due to the delay, as a proportion of the forecast project cost?

**Dr Andrew Tyler:** What we essentially did was delay the project by two years. The two major components of that cost were the fact that we were using facilities and infrastructure for an additional two years beyond that which we were planning. It is specialist and expensive fixed-cost infrastructure, so you are effectively trapped in those overheads for an additional two years. Because the size of the contract is so large, there was a significant time-value of money additional cost, simply because you were buying things in two years' time, rather than buying them now, and therefore they were likely to be more expensive.

There is another factor, which I do think goes some way to giving you an understanding as to why it appears that we had a badly estimated initial cost estimate, followed by, a year later, another additional cost estimate. It was to do with the timing of the estimate as to how much it was going to cost us to

delay. There was a time imperative because we needed to rebalance the programme, but the actual exercise—because we were so deep into the programme—of doing the whole estimation, re-planning, costing it all through, took something over a year to do, so it bridged two MPR years. One of the biggest cost elements of the £650 million reported in this year's MPR was that within the original contract structure, we had identified a whole series of opportunities that we and industry were looking to exploit to reduce the cost of the contract. We were incentivising industry to exploit those opportunities. We will put our hands up here and say that we should have appreciated this, but when we got into the real detail we realised how many of those opportunities we now didn't have the opportunity to realise, so they effectively become cost growth because we were banking on them originally to deliver savings within the programme.

Can I just make one other quick point to help the Committee with its understanding? The placing of the contract that you are referring to was simply a point in time in what was a continuum of a project. This project had been going on for many years previously and this contract marked the point when we, as a Department, committed to the major expenditure through to getting the ships into service. We had already spent hundreds of millions of pounds to that point and there was an industrial imperative to need to place contracts to allow them to take the project forward. We couldn't simply pause the project and say, "Please will you all go home for a year, while we make up our minds about exactly how this is going to fit together."

**Chair:** In general, this went up from £2.4 billion in your budget in 2002 to at present £5.9 billion, with uncertainty about the additional equipment that you're now going to add in. I am really conscious it's far different now.

**Q41 Nick Smith:** I have been reading *The Times* these last few days and it has been shocking. I just want to quote from today's newspaper: "The biggest game that gets played by the MOD is lying to the Treasury about the potential costs of a new programme," the"—unnamed—"industrialist said. "We [the Defence Industry and the MOD] both know that if we can get a project started it will rarely be cancelled. That means that everybody is keen to get a project through the main gate [the final point of approval] because it gives momentum and cannot be stopped." This, it seems to me, is what's happening here. What is your comment about those points?

**Ursula Brennan:** Could I say, first of all, that inviting us to comment on something an "unnamed industrialist" said rather suggests that the person isn't willing to put their name to it, and I don't know on the basis of that that I would be willing to acknowledge that we were in the business of lying to the Treasury.

**Q42 Nick Smith:** According to *The Times*, this industrialist has had millions of pounds' worth of contracts with the MOD in the past.

**Ursula Brennan:** So he says without giving his name.

**Q43 Joseph Johnson:** Well he wouldn't give his name. What sensible industrialist with a commercial relationship would?

**Ursula Brennan:** Well, indeed, but, on the basis of someone not giving their name and saying that we lie to the Treasury, I would first of all dispute and deny that we lie to the Treasury. The second thing is that in relation to projects getting into the programme and then their costs growing, I would say two things. One is that we have taken a lot of steps recently to control the way in which projects come into the programme. We have a new regime around project start-up, which is giving a very tough and vigorous review of the validity of the costing at the point when the project enters the programme. The second point I would make is that, when we talk about cost growth on these programmes, many of these are very lengthy programmes, and over their lifetime we change them in response to a whole raft of things, including the operational necessity. Changes in the shape and cost growth of the programme are something that we will continue to expect to see. But what we are also expecting to see is better control over it because of the changes that we have put in place.

**Chair:** If that's how you run your budget, you have contingencies in your budget to deal with that. That's the real point.

**Q44 Ian Swales:** Just a quick one from me; it's back on figure 3 again. As far as I understand it, there are only three naval projects on there: the Astute submarine, £1.5 billion over-cost; the aircraft carrier, which we've talked about, £1.8 billion over original cost; and the Type 45 Destroyer, again, £1.5 billion over original cost. Does that tell us something either about the industry that builds these vessels, or does it tell us something about the MOD's ability to contract effectively with those types of suppliers?

**Dr Andrew Tyler:** Well, two out of those three, I think, very nicely exemplify the sort of things that we now try very much not to do, in the form of Type 45 and Astute. In retrospect, we feel that the idea, for example, that industry could bear all the financial risk of these incredibly complex projects was probably misguided. The idea that we could contract for them and place the full development and manufacture contract as early as we were trying to in those days was a mistake. Both of those, and others I could go into if we had more time, are what we have now built into our contracting strategies today for major complex projects that we are now committing to.

**Q45 Ian Swales:** So you don't expect to see a repeat of these kind of eye-watering percentage overspends?

**Dr Andrew Tyler:** No, I don't expect to see a repeat of them.

**Q46 James Wharton:** Very briefly, because I'm very conscious of the time, on the point that, Nick, you made about *The Times* article. They describe what they call the "conspiracy of optimism". Yes or no, and I'd like to ask all of you this question, is that a phrase that you recognise as being in use in the Department to describe the way that contracts are managed?

**General Sir Kevin O'Donoghue:** It's an expression that was in use about three or four years ago. It's factually correct. It was in use and it was a conspiracy between the user—

**Q47 James Wharton:** I'm conscious of the time. We understand the concept, but are you saying it is not in use now?

**General Sir Kevin O'Donoghue:** It is no longer in use.

**Q48 Matthew Hancock:** What phrase do you use instead?

**Dr Andrew Tyler:** I use the phrase "clinical objectivity".

**Q49 Chair:** Amyas, you wanted to say something?

**Amyas Morse:** We—I think this is known to the Committee and the MOD—have been looking the carrier project each year since 2000 as part of the defence review, but subsequent to the Strategic Defence and Security Review, we think it's the right time to do a value for money study on the carrier project as a whole. Because of my own previous time with the MOD, where the one project that I was involved in more intimately than others, which I identified to the Committee when I was in the public sector and was appointed in February 2009, was the carrier project. For that reason, I have made arrangements for us to carry out this study. The precise terms of the study and the oversight of it are to be set up independently, and I will have no role in that within the NAO. The Chairman of the NAO, Sir Andrew Likierman, will oversee that independence, and Martin Sinclair, who runs our engagement with the MOD, will run the project. We are doing a project and are already in discussion about what that will be, but I won't be directly involved for those reasons.

**Q50 Chair:** Thank you Amyas. Now can I move to Typhoon? This is equally outstanding. It's £2.7 billion of your overspend. The MOD enters into a contract and it's committed to buying three tranches. It decides after two tranches that it doesn't want to buy the third and therefore—this is the worst of it—removes nearly £1 billion out of its budget, knowing full well that under the terms of the contract you are contractually committed to buying a third. Who on earth decided that?

**Ursula Brennan:** I assume that this is a decision that was taken some years ago and I imagine it was taken by the Defence Board, but I couldn't swear to that.

**Q51 Chair:** Were any of you around?

**General Sir Kevin O'Donoghue:** That was in 2005.

**Q52 Chair:** Maybe I should ask you another question. Who had responsibility for this contract and would have known that even if you took the money out—£1 billion out of the budget—you were contractually committed to this third tranche? Somebody somewhere must have known. Who had oversight? Who was the project responsible officer for this contract?

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**General Sir Kevin O'Donoghue:** You're absolutely correct. The contract said that all four nations would buy three tranches. There was a feeling at the time, as I understand it, that the other nations probably would not buy tranche 3. Therefore it was a judgment made at the time that we probably wouldn't have to buy tranche 3 either. The money that was in the line for tranche 3 would be better spent on something else, something of a higher priority. Now, with hindsight, that clearly was an incorrect judgment, but at the time, I suspect, that was the judgment that was made.

**Q53 Chair:** In the Report, it says something to the effect that—I'm looking at page 6, right at the bottom of paragraph 10—it was also the case that the significant export orders, if achieved, could potentially alter these discussions. These were presumably orders to people like the Saudis. What happened to that? One way or another, that order was implemented, and therefore why on earth did that not impact on tranche 3?

**General Sir Kevin O'Donoghue:** It has, and it will impact on tranche 3, but in the original MOU there were two figures: one was the amount of money that each nation had agreed to spend on Typhoon—Eurofighter—and the other was the number of aircraft. The battle that I've been through in the last two or three years is persuading our partners that it's the maximum amount of money that is the key figure, not the number of aircraft. Instead of having to buy 88 tranche 3 aircraft, we have bought 16. That was the debate that was going on.

**Q54 Chair:** Can I just ask a question following that? The £1 billion that you took out of the budget is now being replaced by £2.7 billion you're putting in. So was the £1 billion insufficient to meet the financial limit?

**General Sir Kevin O'Donoghue:** Yes, it would have been insufficient to buy 88 aircraft.

**Q55 Chair:** Can I just ask two other questions? Do we need these extra 16 aircraft or are you buying them because you have to?

**Vice Admiral Lambert:** No, they are required.

**Q56 Chair:** They were always required, so why didn't you want to buy tranche 3?

**Vice Admiral Lambert:** We looked at the totality of the aircraft we had, and we looked at keeping some of the older aircraft on or whether it was more cost-effective buying the new aircraft. It's more cost effective buying the new aircraft in whole-life cost terms.

**Q57 Chair:** But you decided not to buy. You took the money out of the budget. What's changed between then and now?

**Ursula Brennan:** One of the things that it's perhaps worth noting in relation to the Typhoon contract—a contract that goes back a very long way and was done on a multi-national basis—is that, as Sir Kevin O'Donoghue said, it was a contract that had two elements in it: the number of aircraft to be bought

by each partner nation and the amount of money to be spent.

**Q58 Chair:** I think we all understand that.

**Ursula Brennan:** That meant that people fixed the number of aircraft they wanted to buy a very long time ago. Nowadays we don't buy aircraft in that way. When we buy the Joint Strike Fighter, we will be buying it on a year-on-year basis. Therefore what happened was that over time, as our operational requirements have shifted over time, assessments are made and re-made all the time about how many and what type of aircraft we want and what represents value for money.

**Q59 Chair:** Somebody made an assessment in 2004–05, whenever you took the £1 billion out, that you didn't need any more. Now, in this Strategic Defence and Security Review, you decide that you need 16 more. What's changed?

**Vice Admiral Lambert:** Looking at the total cost of ownership, it is sometimes cheaper to buy something that is more cost-effective over the long term.

**Q60 Chair:** Why did it take you six years to decide that?

**Ursula Brennan:** I think that in terms of how you work out the balance about whether it's better to buy new aircraft, in terms of their through-life cost, versus keeping on old aircraft, it hugely depends how you're using them, how much attrition you're getting in terms of the wear and tear on them and what you're using them for.

**Q61 Chair:** Can we just have some honesty? What changed between 2004 and 2010? Or was it simply that the contract forced you to buy the extra ones? That's what I'm trying to get at. What's changed? Just a bit of honesty.

**Ursula Brennan:** The contract required us to spend a certain amount of money.

**Q62 Chair:** So it's the contract requirement, rather than the military requirement?

**Ursula Brennan:** The contract required us to spend a certain amount of money. The military requirement then leads us to say how, in terms of old aircraft and new aircraft, do we want to balance that out?

**Q63 Matthew Hancock:** We have to go to vote, unfortunately. Sir Kevin, you said that it was a judgment as to whether to take the £1 billion cost out and reduce the number of aircraft. How did you make that judgment without knowing that the contract required you to do something that was different to the judgment that was taken?

**General Sir Kevin O'Donoghue:** No, I was trying to help the Committee. I assume it was a judgment made by whoever was making that judgment.

**Q64 Matthew Hancock:** But a decision was made that was contractually inappropriate.

**General Sir Kevin O'Donoghue:** There was a judgment made, I suspect, that if two or more of the other nations—possibly only one other nation—chose

not to buy its own tranche 3, all bets were off and we wouldn't have to buy tranche 3 either. That, I think, was the judgment that was made.

**Q65 Matthew Hancock:** But it turned out that the contract required the extra aircraft to be bought.

**General Sir Kevin O'Donoghue:** Yes.

**Q66 Matthew Hancock:** So a decision was made that was not supported by the contracts that had already been signed?

**Dr Andrew Tyler:** But if all the partner nations had agreed, that would have been okay.

**Q67 Matthew Hancock:** But they hadn't agreed.

**General Sir Kevin O'Donoghue:** My understanding is that there was a strong chance that there would be agreement. Germany delayed for a year, for example, in deciding whether it was going to go ahead with this contract or not. There was a strong possibility, from my reading, that other nations would have not bought tranche 3. There was then a chance that we could all agree that 620 aircraft were not needed.

**Q68 Matthew Hancock:** Let me just get this clear. The Ministry of Defence made a decision that has cost this country £2.7 billion based on a punt as to whether other nations would agree with us or not? Is that accurate?

**General Sir Kevin O'Donoghue:** No; what it's cost us is the original amount of money that was in the contract. That's what it has cost us.

**Q69 Chair:** I'm going to ask one more question, then we'll have to go. What have we lost? What are we not doing because you're spending £2.7 billion on this?

**Dr Andrew Tyler:** But when we make a decision like this, we balance it across the whole of our combat air capability.

**Q70 Chair:** We have to go and vote. What have you cut out to pay for this?

**Dr Andrew Tyler:** We might very well have taken other fast jets out in other areas of our combat air inventory.

**Q71 Chair:** What?

**Dr Andrew Tyler:** It might have been some Tornados or some Harriers or it might have been change in the weapons fit on certain aircraft, a change in their capability, or the sensors on certain aircraft, because we're talking here about a holistic capability, not individual pieces of defence hardware.

**Q72 Chair:** But it seems to me, from the silence, that you were driven by contractual commitment, not by military imperatives.

**Ursula Brennan:** There was a contractual commitment. There was a judgment made several years ago on a risk basis that this contractual commitment was entered into with other partner nations, who, at that time, were looking quite likely not to be intending to purchase more aircraft themselves either, in which case we would all have capped off the contract at a lower amount of money.

On that basis we decided to take that money and spend it on higher priorities at the time.

**Chair:** I'm really sorry to interrupt. We shall be back. *Sitting suspended for a Division in the House.*

*On resuming—*

**Chair:** There were a couple more people who wanted to come in on the Typhoon, very quickly, because otherwise we'll run out of time.

**Q73 Austin Mitchell:** I express my sympathy with you. You look like a set of guilty school kids asked about who robbed the tuck shop, so my heart goes out to you. In terms of the Typhoon contract, the Eurofighter was a thing built, as I take it, to take on the massed MiGs of the Soviet Union in a cold war that's now dead. It's something, therefore, that's less desirable now. You say there is an operational need for the 16 you're getting in the third tranche. I doubt that, frankly. Is the cutting out of the Nimrod the consequence of taking these 16 Eurofighters?

**Vice Admiral Lambert:** I think the whole of the defence budget needed rebalancing during the Strategic Defence and Security Review. Taking out the Nimrod was one part of getting it in balance.

**Q74 Austin Mitchell:** Is that a yes, really?

**Ursula Brennan:** I don't think you can attribute it directly to Typhoon, is the point that I think the Admiral is making.

**Q75 Austin Mitchell:** You'd not doubt that the Nimrod is probably a more valuable aircraft, I would hope. When it was signed it was a collective agreement with various countries and an international effort. Why are we the only country that is lumbered with these contractual obligations? What happened to the others? There have been rumours from the start that nobody wanted to buy the number of aircraft or spend the money they were contracted to pay. How did they get out of it?

**General Sir Kevin O'Donoghue:** They haven't got out of it.

**Q76 Austin Mitchell:** Are they coughing up on the same scale?

**General Sir Kevin O'Donoghue:** Oh, yes. I can't remember the numbers the other nations are buying, but they're buying a similar proportion. They are buying a similar proportion to our 16 out of the 88.

**Q77 Austin Mitchell:** And are they lumbered with sums appropriate to their population, like £2 billion, for the cost of fulfilling this contract?

**General Sir Kevin O'Donoghue:** They're paying the cost of the aircraft plus whatever provisions they decided to put in.

**Q78 Austin Mitchell:** Okay, just one final question. Why on this, and of course for the aircraft carrier, too, do we enter into such daft contracts? There's competition to supply all these armaments and with the aircraft carrier, there were two firms competing. You could have got it from America or elsewhere. The same is true of the Eurofighter. Why do we have such daft contracts?

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**General Sir Kevin O'Donoghue:** The Eurofighter is a European collaborative project that was entered into by the Administration before last, presumably for good, political reasons.

**Q79 Austin Mitchell:** To show we're honest?

**General Sir Kevin O'Donoghue:** I don't know.

**Q80 Austin Mitchell:** What about the aircraft carrier? Why do we have penalty clauses put in that make it more necessary to carry it on than to cancel it?

**Dr Andrew Tyler:** We don't.

**Austin Mitchell:** That's what the media were saying.

**Dr Andrew Tyler:** As has already been reported today, the media say a lot of things.

**Q81 Austin Mitchell:** So it wasn't necessary to buy it, to build it, to save money?

**Dr Andrew Tyler:** If your question is "can the aircraft carrier contracts be cancelled", yes, they can be cancelled.

**Q82 Austin Mitchell:** And there's a penalty?

**Dr Andrew Tyler:** There are standard Ministry of Defence terms and conditions for the cancellation of contracts.

**Q83 Austin Mitchell:** That would make it expensive to cancel it. More expensive than to build it?

**Dr Andrew Tyler:** No.

**Austin Mitchell:** Okay, thank you.

**Q84 Chair:** No?

**Andrew Tyler:** No.

**Ursula Brennan:** It is just worth being really clear about the carriers because there's been a lot of reporting and it's not necessarily that it's wrong, but it's sometimes confused. When people say "the carriers", they sometimes mean the lumps of metal that are the aircraft carriers. They sometimes mean the carrier strike construct because there's no point in having carriers unless you have all the shipping that goes with them. They sometimes mean the carriers and the aircraft that fly off them. Actually, the biggest cost, I think I'm right in saying, is in the aircraft, not in the carriers. Finally, they sometimes mean the Terms Of Business Agreement that we have to do warship building in the United Kingdom, of which the carriers were a component. Cancelling the carriers would save you money—

**Q85 Chair:** How much?

**Ursula Brennan:** It depends whether you cancelled one or whether you cancelled both.

**Q86 Chair:** What, £300 million, £400 million, something like that? That would be my guess.

**Dr Andrew Tyler:** We're talking approximately, and it changes literally day by day as we commit more money to the programme, but you would be in the order of about £1 billion if you cancelled one and about £2 billion if you cancelled both of them.

**Q87 Mrs McGuire:** Savings?

**Dr Andrew Tyler:** Savings.

**Q88 Mrs McGuire:** Well, can I ask why the impression has been created that to cancel the carriers would be more expensive than to build them?

**Dr Andrew Tyler:** Because the answer we have just given is for simply the aircraft carrier ships and their contract, in total isolation.

**Q89 Mr Bacon:** Hang on, let's be absolutely clear. All the discussion that people understand to be the case about this is net, net, net. You strip everything out and you put everything back into the hopper—net, net, net—are you worse off or better off? You're not saying that we would be net, net, net saving £1 billion, are you?

**Ursula Brennan:** It comes back to the point about whether you are looking at cancelling the carriers, or what view you take about maintaining shipbuilding in the United Kingdom. We have liabilities, which existed before we signed the Terms of Business Agreement, to shipbuilding in the United Kingdom because we are a monopoly customer. Under the Yellow Book terms, we have those liabilities.

**Q90 Mr Bacon:** I understand that. But, Mr Tyler, you are making a point purely about the carriers in isolation. You cannot of course—you would agree with this—look at it in isolation. When we're looking at the whole public purse, which is what this Committee is interested in, you would not say that we could save money net, net, net to the public purse by cancelling the carriers, taking account of all the other obligations that Mrs Brennan just referred to?

**Dr Andrew Tyler:** That is a very difficult question to answer without talking more specifically about the scenarios that you're talking about.

**Q91 Mr Bacon:** Can I ask you a simpler question? When you originally signed the contract, why didn't you make sure you'd got the money? Mrs Brennan? I had to replace the roof on our house at the beginning of this year. I was rather cross about it because when I bought the house it had a roof, but it turned out it wasn't a very good roof when you poked around.

**Chair:** You should have known that.

**Mr Bacon:** There was a lot of rotting wood up there and what-not, but it's an old house and you expect these things to happen. Now I will not have to replace the roof for 50 years. The one thing I made absolutely sure of, before I agreed with the roofer to go ahead with the work and confirmed to him that I wanted him to do it, was that I had the money in place. Any person would do this. You would do it with anything pertaining to your own personal finances; so would the Chair, so would all the other members of this Committee, so would all members of the public and so would all taxpayers. That is what you would do and you're stupid if you don't. When you're signing contracts, you make sure you have the money available to do it. What I still don't understand is, when you signed this contract, why didn't you make sure you had the money?

**Ursula Brennan:** I think I said earlier that I think you went over this ground at a previous hearing, or maybe two previous hearings, in the context of the decision that was taken around the contract for the carriers and

the equipment examination that followed it, in order to ensure that it could be made affordable.

**Q92 Chair:** I agree we've been over this ground. I'm going to move us on because some Members need to get somewhere else. You did just say that if you could have got out of the contract with the carriers, it could have saved you £1 billion on one, £2 billion on two. Can I ask this question: what has been decided by the Government on the defence review is to cancel Nimrod—what is the cost of that? How much have we spent on Nimrod to date? How much have we spent to date and how much is the actual cost of getting out of that?

**Dr Andrew Tyler:** The sunk cost is about £3.6 billion,<sup>2</sup> if I recall rightly. The costs that we will not have to incur because we won't be supporting the aircraft are about £2 billion.

**Q93 Chair:** Forget about those, it's what we've spent. What have we lost? We've lost £3.6 billion.<sup>2</sup>

**Andrew Tyler:** The sunk cost is £3.6 billion.<sup>2</sup>

**Q94 Chair:** Any more?

**Dr Andrew Tyler:** You could—this goes back to the discussion we were just having about the carriers—include the liabilities that we have under Yellow Book rules for the Woodford facility, which was dedicated to building the Nimrod aircraft. But whenever we finished building the Nimrod aircraft, we would have crystallised that liability.

**Q95 Chair:** So there will more coming out of that liability?

**Dr Andrew Tyler:** We have an extant liability.

**Q96 Chair:** Can you give us an idea of what that will be?

**Dr Andrew Tyler:** No, because that's the subject of negotiation and it would not be a commercially smart thing to do.

**Q97 Chair:** When will you know that?

**Dr Andrew Tyler:** Hopefully by the end of this financial year we shall have reached a settlement figure for that.

**Ursula Brennan:** Just to clarify, I think what Andrew Tyler was saying was that it is not a liability that has arisen on account of the cancellation of the Nimrod; it is simply a liability that has been brought forward.

**Q98 Chair:** It's brought it forward, but it's money that goes out from the taxpayer for something that we're not going to have. I shall come back to what we are doing with it. Can I also ask how much it cost you to bring the Sentinels into service and how long, at that point, you planned to keep them in service?

**Vice Admiral Lambert:** We plan to keep them in service until about 2015, or on completion of Afghanistan.

**Q99 Chair:** You had always planned that?

**Vice Admiral Lambert:** No, that is the current plan.

**Q100 Chair:** I know that's the current plan. I'm asking you: before the current plan, when you built these things or brought them into service, how long were you intending to keep them in service originally? I know the SDSR has said that we don't need them after 2015. How long did you originally think you'd needed them until?

**Vice Admiral Lambert:** We would probably have kept them in service for at least 25 years.

**Q101 Chair:** At least 25 years. They came into service?

**Vice Admiral Lambert:** They arrived in service early this year, late last year, so within the last 12 months.

**Q102 Chair:** You would have kept them in service until 2035. We're now taking them out in 2015. How much did we spend on the Sentinels?

**General Sir Kevin O'Donoghue:** I don't have that figure, I'm afraid. We could let you have it. It's not in the MPR.

**Q103 Chair:** About?

**General Sir Kevin O'Donoghue:** I don't know. I genuinely don't know.

**Q104 Chair:** Billions? Do we know, NAO?

**Dr Andrew Tyler:** I've got to do my maths.

**Vice Admiral Lambert:** About £1 billion.

**Dr Andrew Tyler:** Yes, almost exactly £1 billion.

**Q105 Chair:** £1 billion. Are you into a contract for maintaining them that you're going to have to pull out of and put money into?

**Dr Andrew Tyler:** We have a contract to support them at this present moment in time, but we can get out of that contract in the period that we're currently planning to take them out of service. We don't have some long-term commitment.

**Q106 Chair:** So we've sunk in the region of about £3.7 billion,<sup>3</sup> plus £1 billion, plus probably extra. More than £5 billion has already been wasted as a result of decisions taken in the SDSR. Not that those decisions are wrong, but from the taxpayer's point of view, this is money spent that is going to be wasted.

**Dr Andrew Tyler:** The Sentinel system is being used currently on operations in Afghanistan.

**Q107 Chair:** Only until the end of Afghanistan—only until 2015—and you were planning to use it until 2035.

**General Sir Kevin O'Donoghue:** The use that the armed forces are getting out of it in Afghanistan is not wasted money.

**Q108 Chair:** I understand that, but you could say that it's 75% wasted and not 100% wasted. I'd accept that, but on the whole it is wasted.

<sup>2</sup> C&AG's Report states that the sunk cost as at 31 March 2010 was £3.4 billion, Appendices and Project Summary Sheets, page 140

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**Vice Admiral Lambert:** But when the aircraft were procured, we were not in the middle of a credit crunch.

**Chair:** But I don't take that argument, because you procure over the long term.

**Q109 Matthew Hancock:** You did, when you were procuring them, as with all these others, have an overspent budget, which ended up at £38 billion overspent, according to the NAO. It is not because there wasn't a credit crunch, but because nobody had finally brought some reality to this extremely badly organised budget. Isn't that right?

**Dr Andrew Tyler:** It was 10 years ago when we committed to the Sentinel system.

**Q110 Matthew Hancock:** You said there wasn't a credit crunch, Vice Admiral, but there was an overspent budget at that point—an over-committed budget. Is that not right?

**Dr Andrew Tyler:** It was 1999.

**Matthew Hancock:** I'm sorry, but I was addressing my question to the Vice Admiral.

**Vice Admiral Lambert:** We had just come out of a previous defence review. At that time—I wasn't around for that defence review—I would suspect that the defence budget was roughly in balance.

**Q111 Matthew Hancock:** But don't you accept that blaming all of these enormous costs to the taxpayer, £3.5 billion—that's £150 for every taxpayer in this country, and I'm not sure whether people in the MOD seem to understand how much money we're talking about—at that point, there may not have been a credit crunch, but the budget was getting out of line with the commitments.

**Mrs McGuire:** I think we've also got to recognise that between 1999 and where we are now we have had our armed forces in conflict. I'm not justifying some of the budget decisions that have been criticised, but I do think that we need to put it into a context.

**Matthew Hancock:** Of course, but I thought it was an extraordinary statement to say that this was perfectly reasonable because it was in the credit crunch.

**Vice Admiral Lambert:** But when we signed the contract for Nimrod that was two defence reviews ago; more than two defence reviews ago.

**Q112 Chair:** Are Nimrods going to mothballed, sold or scrapped?

**General Sir Kevin O'Donoghue:** Scrapped.

**Q113 Chair:** What about the Sentinels? Are they going to be mothballed, sold or scrapped?

**General Sir Kevin O'Donoghue:** Don't know. No decision yet.

**Q114 Chair:** How much are you going to spend on kitting out for alternatives to the Nimrod?

**General Sir Kevin O'Donoghue:** I don't think we are going to.

**Q115 Mr Bacon:** What happens to the electronic kit inside the Nimrods? I mean, you say "scrapped";

presumably the airframe is what you're talking about when you say "scrapped". Is that right?

**Dr Andrew Tyler:** We'll store the specialist electronic equipment in case we can reuse it on another platform of some sort in the future. Some of it will be obsolete in that time, but some of it might be reusable and we wouldn't just throw that away.

**Q116 Mr Bacon:** So it is possible you could put some of it on a "standard" passenger aircraft and get some use out of some of it?

**Dr Andrew Tyler:** Yes. Some of the things are generally usable—display systems and so on—and we could use them on other aircraft or other applications. Some of the more specialist electronic equipment we would hold on to until such time as it wasn't of any use any more. It does not cost a lot to store that sort of equipment, whereas storing large airframes costs a lot of money to keep them in any sort of condition.

**Q117 Mrs McGuire:** I'm just trying to work out what happens to replace the protection, as I understand it, that Nimrod gives our submarine fleet in terms of the value for money issue, not the political decision to do it, but how you manage that sort of protection? I may not be expressing the military terms exactly, but my understanding is that that was one of the justifications for Nimrod. I would like to know how are we going to manage that transfer to a different system of protection for our submarines?

**Vice Admiral Lambert:** The Nimrod provides one layer amongst a number of layers for the protection of the fleet. We are looking at the totality of all those layers, though I can't here go into exactly how we do it. We have accepted that there is a greater risk. I can't put a number on it, but we are better off spending the money elsewhere.

**Q118 Chair:** That you're better off spending the money elsewhere suggests to me there are modifications; you're going to put the money into something else because you haven't got the Nimrod capability.

**Vice Admiral Lambert:** What I'm saying is that we have looked at the totality of risk in the anti-submarine warfare area and we are content with it.

**Q119 Nick Smith:** Are you saying that you didn't need to get the Nimrods at all?

**Vice Admiral Lambert:** No; what I'm saying is that, having done a review of the total risk that we're facing in defence, we are prepared to carry the risk of not having Nimrod for the foreseeable future.

**Q120 Mrs McGuire:** Are you transferring some of those resources into enhancing other layers of protection? Is that what you're saying?

**Vice Admiral Lambert:** We shall be looking at how those layers of protection around the force are conducted. It's not just equipment: it is tactics, techniques and how we actually deploy things. We're looking at all of that.

**Q121 Chair:** If we take that Nimrod as an example, actually the costs went up. This point is more general

than specific. The unit costs go up because you reduce the number of items to buy because you have budgetary constraints. I picked out three from the Report. One was the Support Vehicles, where you reduced by over 1,300. The second was the Nimrod, where you reduced from 21 to nine and the costs were therefore three times higher. The third was the Lynx Wildcat helicopter, where you reduced the number by 23%, but the costs only went down 12%. Is this an honest way of doing business? It feels to me deeply dishonest because, had you known at the start that a Nimrod cost you three times more, you might never have gone down that route. Or had you known that a Lynx Wildcat helicopter cost you whatever it was more, or your Support Vehicles cost you more—i.e. had you known the true unit costs—you might never have contracted to do it. It feels to me dishonest.

**Austin Mitchell:** Or incompetent.

**Ursula Brennan:** Shall I make an initial comment? Colleagues may want to add to it. You are right that if you buy fewer of something the unit cost, which is simply the volume of units divided into the amount you pay, goes up. When we make decisions about how many of something we're going to buy, particularly when it's something that's on a very long contract, there are a number of things that we take into account when doing that. One is that we may simply decide on capability grounds that we don't need as many of something as we thought previously. Another is that we may look at the cost and say, actually, either on capability or on risk grounds, we can do with fewer of something. When we weigh up the costs, we look at the unit cost of the item and the multiplier in terms of how many we're going to buy, but we also look at the support costs and the manpower costs that go with it. Often the support costs and the manpower costs of running a piece of equipment are much more than the actual unit cost itself. So it still makes more sense in value for money terms to buy fewer of them than to carry on buying more.

**Q122 Chair:** I understand that halfway through a contract, but it happens time and time again. It seems to me to be a pattern within MOD procurement. It feels to me a dishonest way of taking your decisions. Maybe it's incompetence, but I just felt it was dishonest. Whoever your Defence Board is that takes the final decision ought to be able to look at unit costs, running costs, maintenance costs, the whole lot together. If you've not got that information when you start, you then take decisions down the line. I'm not sure whether you would have agreed to build a Nimrod or build a Lynx helicopter, or have these support vehicles if you had known the true unit cost, both capital and revenue.

**General Sir Kevin O'Donoghue:** Taking Nimrod in particular, when Nimrod was ordered, there was a buying organisation and a completely separate support organisation. We have now put the two together. I put the two together three years ago. We now take account of through-life costs and on occasion it is more cost-effective to spend more upfront to get reliability, supportability and sustainability than to buy something upfront as cheap as you possibly can and

then pay through the nose for the rest of its life. That is now taken into account.

**Dr Andrew Tyler:** An example with the helicopters—you mentioned Lynx Wildcat—is that we have managed over the last few years to increase the availability of an individual helicopter, to get more hours per helicopter. The front-line command, the user, is only interested in the number of hours they can use helicopters per day. They have some interest in numbers, but if you can provide more hours to be flown in a given helicopter by having less time of it sitting in a garage, for example, and more time available on the front line, then you do not need to buy as many.

**Q123 Chair:** Both those things are good, fine and to be applauded, but they don't get you away from the context. When you take your decision to invest, you do not have a true unit cost figure.

**General Sir Kevin O'Donoghue:** You are correct and we're moving towards that. As I was saying, we started with buying kit, worrying about how to support it somewhere else and worrying about the cost of the manpower somewhere else. All the defence lines are in development and what we call infrastructure, manpower and training. What the Admiral is now doing with my Chief Operating Officer is chairing an organisation of programme boards. The programme boards are designed to look across all the areas you were talking about and make judgments across the totality of the cost, not just equipment and support costs.

**Q124 Chair:** We shouldn't in the future see this as a recurring feature?

**General Sir Kevin O'Donoghue:** No, you shouldn't.

**Q125 Austin Mitchell:** If you know the numbers, you should know the cost. Why do you inflate the numbers in the initial order?

**Vice Admiral Lambert:** The numbers are chosen and decided upon using the best analysis at the time. If you take Nimrod, the decision to buy Nimrod and the numbers of Nimrod was made before we fought Gulf War II, before we'd been to Sierra Leone, before the fighting in Afghanistan, and the numbers were right for that time. As we've gone through the last decade, priorities have changed and therefore numbers will change.

**Q126 Chair:** It will ever be thus, so just tell me something. What is a fair figure for the taxpayer that we should waste each year because plans change?

**General Sir Kevin O'Donoghue:** You have to remain flexible. You mentioned Support Vehicles—

**Chair:** But we're wasting money on these decisions. That's the problem.

**General Sir Kevin O'Donoghue:** I am pretty sure support vehicles have come down in requirement terms because the Army has reduced in size. You have to remain flexible.

**Q127 Matthew Hancock:** Yes, and you made a very good point there about how things change. So why not write contracts that reflect the reality instead of

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writing contracts that cost all of us so much every time you have to change them?

**Vice Admiral Lambert:** I think that is happening, as the Permanent Under Secretary said. If you look at the difference between the Typhoon contract and where we're going with Joint Strike Fighter, we don't have to decide on numbers of Joint Strike Fighters until a couple of years before we buy them.

**Q128 Matthew Hancock:** Do you regret that contracts weren't written like that in the past?

**Vice Admiral Lambert:** Very much so.

**General Sir Kevin O'Donoghue:** Yes.

**Ursula Brennan:** Perhaps it is worth saying that, when one says one regrets it, for the people who were there at the time, I think one of the things that weighed heavily was saying, "If we buy a small number and have to go back and ask for more, and reopen production lines and so on, there will be increased costs." A lot of defence contracting was big numbers amortised out over a long period of time. When you then have a change in your requirements, that is difficult to manage. It is that shift from the kind of contracts that were written in the past to the kind of contracts that we're writing now that is happening at present.

**Dr Andrew Tyler:** You have to remember that the basis for the calculation is to take the initial development cost. Most military hardware is bespoke hardware, which has a development programme and is then followed by a production run. It is not like going to the Vauxhall dealership and saying: "How much is one car? How much is 20 cars?" and 20 cars is 20 times one car. It is saying: "What was the development cost for the car and now, if you're only going to buy one, then the cost of that car is the total development cost plus the unit one, or if it's 20, you can divide the development costs across the 20 cars."

**Q129 Matthew Hancock:** Lots of our allies also have armies and navies.

**Dr Andrew Tyler:** They do and that's why we have collaborative programmes like the Typhoon programme.

**Q130 Mrs McGuire:** Our defence procurement system has the reputation of always going for the gold-plated. I took part in the armed forces parliamentary scheme some moons ago—that's put my credibility in front of the Committee. I remember part of the discussions that we had at that time, frankly, mainly from the boys and girls on the front line, was that you guys never said "Snap" because it was always, "Let's go for the next best," whereas some of our allies—now our colleagues and collaborators in procurement—came to a point when they said, "This is the best that's on offer in 1997 and let's go for it," or whatever the year was. Have we gone away from that approach, which said: "Unless we can have the best for the day after tomorrow, we're not going to go down that road"?

**General Sir Kevin O'Donoghue:** The answer is yes. Absolutely, yes. What we're now looking at is an 80% solution, now, tomorrow.

**Q131 Mrs McGuire:** And is that comparable with how other countries operate that we would be allied with?

**General Sir Kevin O'Donoghue:** Yes; but bear in mind that not all nations—I need to be very careful here—are in conflict.

**Mrs McGuire:** Not all nations are?

**General Sir Kevin O'Donoghue:** Are fighting wars.

**Q132 Mrs McGuire:** Alright, then. The comparison was always made with the Americans, right? They went "Snap" while we were still thinking about it because we wanted to add on and add on and add on.

**General Sir Kevin O'Donoghue:** We now look for an 80% solution, as I said.

**Q133 Mrs McGuire:** Is that comparable to what they do in the States?

**General Sir Kevin O'Donoghue:** The Americans will have what is at the top of the market.

**Mrs McGuire:** At that point in time?

**General Sir Kevin O'Donoghue:** At that point in time.

**Vice Admiral Lambert:** We are looking a lot more at the spiral development of procuring and being able to upgrade cost-effectively, rather than buying big lots and then doing upgrades halfway through.

**Q134 Mrs McGuire:** They go for upgrades?

**General Sir Kevin O'Donoghue:** Yes, as do we—now. As I said, what I look for is an 80% solution, with a plan to get to 100% when we know what the 100% is and when we decide we need it and we can afford it.

**Q135 Matthew Hancock:** I have one specific point. Thanks to the wonders of modern technology, I can follow up on an answer that you gave earlier. You said that if the Prince of Wales were cancelled, then there would be a saving. There's a letter from BAE to the Prime Minister, which you'll be aware of, that was published. It said that if both carriers are completed the cost will be £5.25 billion. If Prince of Wales is cancelled, the direct cost of the programme would be £4.8 billion. So I make that £450 million less. "However, in these circumstances...there would be consequential costs, including those relating to rationalisation, which we estimate would amount to £690 million." This letter therefore states that it would cost more to cancel the Prince of Wales than to build it. You stated the opposite.

**Dr Andrew Tyler:** What you have nicely illustrated is Mr Bacon's point about net, net, net and how net do you want to be? It depends what factors you take into consideration.

**Q136 Matthew Hancock:** Can I suggest that the reason that, as you put it, the media have given the impression that it would have cost more to cancel than to build it is because BAE have written that and it's in the public domain, and that is an accurate summary of the situation?

**Chair:** I think what would be really helpful for the Committee, rather than to-ing and fro-ing—because that's a BAE letter—would be if you set down in a

note to us, for us to incorporate into this Report, how you get to your £1 billion and your £2 billion. Then we've all got the letter from BAE, so we can compare it to that. Now, Stephen wants to take us on to a new area.

**Q137 Stephen Barclay:** I wanted to look at whether the MOD is following its own guidelines in terms of generally how projects are being run. I tabled a parliamentary question a month ago, asking for the project histories of four of the projects covered by today's hearing. These are documents that your own guidelines say you already have, and I was told that they would be tabled in the House of Commons Library, but none of the four has been. Allowing for redactions, it just surprises me that not one of these documents can be produced, given that you already have them.

**Dr Andrew Tyler:** What did you mean by project histories?

**Q138 Stephen Barclay:** Project histories: well, to give you the specifics—for the anoraks—it's project history volume 4, dated August 2007, which stipulates that the MOD must keep a project history of all major projects. It is to pick up on many of the findings of previous PAC hearings.

**Dr Andrew Tyler:** I don't know if that's the same as a project diary, which is something we would expect good projects to keep, which is a log of the significant events and the basis on which decisions are made, usually at a fairly tactical level. It's something that you would expect the delivery team leader to keep. I'm sorry, I wasn't conscious that you had made a specific request for that.

**Q139 Stephen Barclay:** I did make a request for that; it's not been delivered. Related to that, and again flowing from previous PACs—I'm a new member of this Committee but it just seems that the same issues keep coming up—one of the issues that I asked for was the history of the senior responsible owners on these major projects. I forget—Tim may refresh my memory—something like point L or point I of that document says that the history of the SROs must be recorded to see that there is continuity; again, a perfectly sensible recommendation. The MOD's response to that parliamentary question was to say that can only be produced at disproportionate cost. That seems surprising, given that your own guidelines require you to keep a log of the SROs who are managed. One of the projects that I was asking for was the aircraft carrier, which relates to today; another was Nimrod. It seems odd that we cannot see who the SROs have been on this project. Does anyone have any clarity?

**Ursula Brennan:** I believe we gave you the names of the individual SROs who are in post at present.

**Q140 Stephen Barclay:** I'm just about to come on to that, but the question was the history, which flows, Mrs Brennan, from that. In terms of those in post, one of the things that surprised me was that you gave me eight names, and six of the eight SROs covering a whole multitude of projects were appointed on the

same day, 29 October 2009, and that covers a whole range of projects. What I was trying to gather was how quick the turnover is: is it every two or three years? How generalist are the people day to day, as the SRO, managing these projects, such as the air carrier project? You are saying you cannot provide the history to me because it would be a disproportionate cost, but your own guidelines say that you keep a log of this.

**Vice Admiral Lambert:** We had SROs for the major programmes, such as Network-Enabled Capability and Carrier Strike, etc. What we have been doing over the last two years is making sure that quite a lot of the other major programmes have a senior responsible owner. The date given in that reply is probably the date that I appointed them as SRO. Before that time they were doing de facto the SRO task without the formal authority.

**Q141 Stephen Barclay:** There's just no visibility of any earlier names other than those currently in post, but perhaps we can have a note on that. We'll come on to one of those. I'm not even sure if he reports directly to you, Vice Admiral, or whether he reports to someone else between him and you, but I do think he is rather a heroic figure. This is Brigadier Paul Jaques, who is Head of Capability and Expeditionary Logistics. He is the SRO for the FSTA, which is a £12.3 billion, highly complex PFI project, but he's also the SRO for the £2.7 billion A400M project; he's the SRO for the Mars project and he's the SRO for the OUVS project. He also covers the C-vehicle PFI project, and he picks up the Support Vehicles, an £8 billion Approved cost for Demonstration and Manufacture is £1.6bn—which is on a consistent basis with the other costs disclosed.

project, which itself has 42 variants of Support Vehicles. As a Brigadier, I am sure he is a figure of the highest ability, but it seems quite a big ask for any one person to be the SRO of what is £19 billion if you add up the figures which go before (FSTA (£12.3bn), A400M (£2.7 bn) MARS (£3.9bn estimated but not approved), OUVS (costs for the project have not yet been approved), C-Vehicle (£0.7 bn) and Support Vehicles (£1.6bn)) the approved costs are £17.3 bn.

—worth of approved expenditure. Given that the MOD guidelines say that the SRO must take "personal responsibility for the successful delivery of the programme", if he is only there for two to three years, how realistic is it for an SRO to have a real grip on such a wide range of projects?

**Vice Admiral Lambert:** I have no doubt that the Brigadier Jaques has a wide span and is capable of doing that task. As the SRO within the Ministry of Defence, what he is doing is making sure that the programme delivers across all the lines of development: if you take the A400M, that the Air Force is delivering the pilots, that they're doing the training; that down in DE&S the operation centre director is delivering the equipment programme to cost and time. What he is not responsible for is delivering that equipment line. That is a DE&S responsibility. He is responsible for the oversight.

**Q142 Mr Bacon:** Sorry, could you repeat that? That is what responsibility?

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*Vice Admiral Lambert:* The DE&S.

*General Sir Kevin O'Donoghue:* My responsibility.

*Ursula Brennan:* Defence, Equipment and Support.

**Q143 Mr Bacon:** If you could speak English rather than in military acronyms it would help.

*Vice Admiral Lambert:* Sorry. Sir Kevin's team is responsible for delivering that equipment line and Brigadier Jaques will oversee that, but make sure that all those other lines come in at the right point.

**Q144 Stephen Barclay:** Because the MOD is a hierarchical organisation, rank is significant. I asked about what sort of pay because I think this guy is doing an absolutely amazing range of work. On the 2008 pay range, he is paid less than £100,000, so I submitted a parliamentary question asking how many press officers are paid more than £100,000, but no one has been able to tell me even though it was a named day question. I guess my question is why is that classified information? How many press officers are earning more than £100,000 in the MOD? Have we got the priorities right when someone who is personally responsible for the successful delivery of £19 billion-worth of project spend, is getting paid less than goodness knows how many press officers in the Department?

*Ursula Brennan:* Information about the pay of civil servants and the military isn't classified. We now publish information in bands, so I'm honestly not sure why we haven't been able to give you that information.

**Q145 Stephen Barclay:** I've got the 2008 band for the Brigadier; that's what I quoted—it's less than £100,000.

*Ursula Brennan:* Sorry, what I meant was that in terms of the press officers, we should be able to tell you what grade the press officers are and then one can read across from that what pay they're on. I'm not sure why it has been difficult to provide that for you.

**Q146 Stephen Barclay:** It was a named day question, which hasn't been answered. The Home Office has provided the information. They actually publish it on the web. Admiral, could I just clarify something? Does the Brigadier report directly to you or does he report to someone else?

*Vice Admiral Lambert:* No, he reports directly to me.

**Q147 Stephen Barclay:** And he's on a two to three-year posting?

*Vice Admiral Lambert:* He has been there for three years, I believe, and it is his second tour.

**Q148 Stephen Barclay:** I think this actually pre-dates Austin and Richard on this Committee: I was struck by the Fulton Report in 1968. In terms of SROs, or around the management of these things, it identified the need for more management training and project expertise. I did ask this question to Sir Gus O'Donnell at our last hearing, but I'm still waiting for the answer: what sort of qualifications do SROs have, and what sort of evidence are you looking for, in terms of them having managed similar, big projects before?

Again, I suspect the Brigadier is a career soldier and a generalist. I'm wondering how the MOD is supporting him in his duties, in terms of giving him specific training and perhaps him going for some qualifications.

*Vice Admiral Lambert:* As I said, this is his second tour in the capability area. We have a training scheme for senior responsible officers. I know that he has completed at least 75% of all those modules.

**Q149 Stephen Barclay:** In terms of reform, because I know that there's quite a long reform agenda within the MOD—and we may come on, Chair, to the Deloitte study in a moment—Lord Levene, I think, is looking at certain elements of reform. Could you just clarify for us how many days he's working and how many times the reform committee has met?

*Ursula Brennan:* The review of Defence Reform which Lord Levene chairs, meets monthly as a reform group, and it is divided into three sub-groups. They also each meet monthly.

**Q150 Stephen Barclay:** So have we had three monthly meetings, or have we had more or less? How many monthly meetings have we had?

*Ursula Brennan:* They meet once a month as the reform group, and the three sub-groups each also meet once a month. I think we're now on about our fourth meeting.

**Q151 Stephen Barclay:** About four times. Lord Levene is working how many days a week?

*Ursula Brennan:* He works chairing that group, and he has a team of officials who support him and do the work for that group.

**Q152 Stephen Barclay:** What is his time involvement?

*Ursula Brennan:* His time involved is the time that he devotes to coming in to chair those groups. He also put in some time initially before that, and he puts in extra time on top of that.

**Q153 Stephen Barclay:** So it's reading the papers and attending once a month, in essence?

*Ursula Brennan:* No, it's more than once a month because he's on a sub-group as well. So it's twice a month in terms of meetings, and there is other contact that he has on a regular basis. But he is not being employed, as it were, on a daily basis or a retainer or anything like that.

*Dr Andrew Tyler:* He came to see us for half a day.

**Q154 Stephen Barclay:** I'm delighted to hear it. On the subject of guidelines, Anne touched very pertinently on whether the Army is looking for 100% capability, or perhaps 85% or 90% capability. I would have thought that has quite a significant impact also on exportability, which then goes to the heart of value for money as well. I was wondering what guidelines there are within the Department setting out objectively which countries we can export to and what we can export. Is there a document setting that out? How do you empower the person making the decision, who presumably has to balance conflicting demands from

the Treasury and BIS, so that they're making the right call on saying, "Yes, we'll have 100%. It includes US technology; we can't flog that to certain countries," or, "We'll take 90% capability, but we can then look at exporting that and using that money to put back into the MOD budget"?

**General Sir Kevin O'Donoghue:** If I may, it's the other way round. The Investment Approvals Board, to which all projects go before the money is approved to be spent, is quite clear that everything has to be exportable unless there is very good reason for it not to be.

**Q155 Stephen Barclay:** Again, I'm surprised. For me, listening to the evidence earlier, I thought what bound a lot of the short-term decision-making was the absence of the Defence Review. It sounded to me like a lot of the short-term fixes were being taken because there wasn't a Defence Review, which goes back to the earlier point I was trying to make about how that then informs the Accounting Officer and at what point they seek a letter of direction. With the Harrier, I was amazed to discover that just a year before the general election in April 2009, we entered into a £0.5 billion Harrier platform availability contract. Could I just clarify on that, given that we are now getting rid of Harriers, that there are no penalty clauses attached to that contract? Also, could you clarify, perhaps in a note, what the first-year costs of the contract were?

**Dr Andrew Tyler:** There are liabilities, of course, because when you close out either an engine plant or a platform support plant, you've got things that you're closing down, at whatever point you choose to do it. When we renegotiated those specific contracts on the Harrier—both the platform contract and the engine contract, which we had to do at that point in time because the previous contracts were lapsing—we did so very much in the knowledge that we had a SDSR coming up. So we made sure that the contract was fitted with what we call "off-ramps"; i.e. points at which we could come off the contract at a time of our choosing without having any sort of additional penalty over and above what would be our natural liability. So we had thought through that one.

**Q156 Mr Bacon:** While we're still on the subject of SROs, two very quick questions: Admiral, you said we're making sure that we've got quite a lot of the projects with an SRO. Are you saying that some of them still don't have an SRO?

**Vice Admiral Lambert:** The minor projects—the very small projects—will have a single point of accountability. So there will be a named person.

**Q157 Mr Bacon:** Minor is below what number, in terms of value?

**Vice Admiral Lambert:** All of the major programmes have senior responsible officers. If we're talking about a single point of accountability, that is for the Cat C and D projects.

**Q158 Mr Bacon:** Could you just remind us what value you are talking about for a project that is not large enough to have an SRO? How small? £10

million, £100 million, £50 million? At what level do you not need an SRO?

**Vice Admiral Lambert:** As I say, they will have a single point of accountability and a named person.

**Q159 Mr Bacon:** I understand that. Where is the threshold where they don't have an SRO and instead have a single point of accountability?

**Vice Admiral Lambert:** All the Cat A and B programmes, which we went through in the last Public Account Committee, which is both done on cost and risk, will have an SRO.

**Q160 Mr Bacon:** For the third time, that's not the answer to my question. I'm not asking which ones do have SROs; I'm asking which ones don't have an SRO and instead have a single point of accountability, and where is the line—I think you've said Cat C and Cat D—in terms of number value, or millions of pounds, below which you don't have an SRO, but instead have a single point of accountability?

**Vice Admiral Lambert:** Cat C programmes, if they are not technically complex, will be £100 million. Cat D programmes, if they are not technically complex, will be £20 million and we'll have a single point of accountability.

**Q161 Nick Smith:** I want to come back to Eurofighter Typhoon, which I understand is a good fighter. Given we went from contract to delivery for a period of 19 years, the cost has gone up from £7 billion to £20 billion. I want to know if you can give the Committee assurances that the reported cost now reflects the full extent of the Department's liabilities. I haven't got that assurance from you.

**General Sir Kevin O'Donoghue:** I think you've probably quoted 1996 prices.

**Nick Smith:** I'm quoting this wonderful *Times* article.

**General Sir Kevin O'Donoghue:** Yes, well, I don't know on what basis they are quoting.

**Q162 Nick Smith:** It's cost a lot of money over a lot of time.

**General Sir Kevin O'Donoghue:** It has, and that will cost no more for what we have already asked for. It will of course cost more because, into the future, we'll need to upgrade it. As the opposition's weapons systems improve, so we will need to improve our weapons system.

**Q163 Nick Smith:** Have you got an estimate of that? Can you let us know how much you think it will be?

**General Sir Kevin O'Donoghue:** No, because until we know what the threat is and how the threat has changed, it's quite difficult to toss a coin in the air and say, "We need that amount of money." We will need to integrate some of our current weapons systems on it.

**Q164 Nick Smith:** Have you put money aside for how much you think it might cost?

**General Sir Kevin O'Donoghue:** There is money within that £2.7 billion for what I called "provisions", which is some of the wiring, the power of the

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computing, which will allow us to integrate some different systems.

**Q165 Nick Smith:** Is it a closed line of expenditure now, or do you think that it will mushroom for ever?

**General Sir Kevin O'Donoghue:** It's closed in so far as we could stop spending money on it at any time. However, if the threat increased because of what we wanted to use it for, the capability area might well decide that we needed to spend some more money on it to increase its capability in the future.

**Q166 Chair:** Okay. I want to move us to the future. I just want to ask Mrs Brennan one question arising out of the questioning from Mr Barclay. Are you content with the arrangements you've got for project managing your defence procurement?

**Ursula Brennan:** Are we content? I'm content that we have a programme for improving it.

**Q167 Chair:** What would change?

**Ursula Brennan:** There's a whole raft of things that we're doing, in terms of, effectively, a programme of change that we have ongoing, in response to the report from Bernard Gray.

**Q168 Chair:** This might be easier than going through it: what strikes me, from the questioning that Mr Barclay had, is: one, have you got people with the right project management skills; two, do you leave them on the job long enough? It's just as simple as that. If I were running your programme, I'd want people who knew how to manage projects and I'd want them to remain accountable for more than two or three years.

**Ursula Brennan:** What I meant by that was that we have a programme of changes to do things like upskilling project and programme managers, and improving our commercial skills and our accounting skills. We have a programme for military people who work in acquisition around ensuring that we get the right military skills, that we keep them long enough and that they rotate around and remain in the job for long enough. So, yes, those strands of activity are things where we have a programme of improvements.

**Q169 Chair:** Take Trident; how long would you expect a senior responsible officer to stay on that job?

**Ursula Brennan:** Three years would be a minimum. Some of them will stay longer than that.

**Q170 Chair:** I think that's outrageously small; it's too small. I think one of the problems for the MOD procurement programme is that you change people too often. I've got no doubt that that will be a conclusion of our Report. That personal accountability and ownership has to come from actually managing a project properly over time.

**Dr Andrew Tyler:** Within the equipment delivery teams we have been very focused on this over the last few years. At the moment our average tenure of a delivery team manager, delivering the equipment and the support, is 40 months over the top 100 projects.

**Chair:** 40? That's just over three years. In every project we deal with it is nine years, 10 years, 11 years, but actually until you take a decision.

**Dr Andrew Tyler:** A lot of those individuals, when they're promoted, remain in the responsibility line for the delivery of that project.

**Chair:** Well, we leave you with that thought.

**Q171 Mrs McGuire:** To clarify this, why do you think in three-year cycles? Is that to do with the Civil Service changing people around every three years to make sure that these generalists become even more generalist? Or is it to do with the military approach—you dig up your tent every so often and move around? I don't understand why, given the length of time that some of these projects take, you are still thinking in three-year periods of time for your senior officials, whether they be military or civil service, managing some of these complex issues that will take a lot of time to get to grips with. I can only say, as a Government Minister in the previous Government, frankly it used to take you at least 18 months to understand what the hell was going on, what the civil servants were trying to do to you, and then to get to grips with what you were supposed to be doing. But you're managing complex contracts and projects, and yet it's three years.

**Ursula Brennan:** Can I just clarify? The point about how long a project manager has been in a place on a project is one thing. One of the things that we have been doing is developing people who will develop expertise in this area and will work on different projects over a longer period. They may stay for three years on a particular project. They then may move off into the capability area and then come back and work on another project.

**Q172 Chair:** Why?

**Ursula Brennan:** One of the things that we have to balance—and it's one of the strands of work that we're doing in relation to getting the military expertise into acquisition—is that there is a trade between the expertise in the particular project that you build up and the lack of expertise in terms of experience of the front line and wider knowledge of what's going on. If you spend a very long time in a given project, you may become very knowledgeable about that particular project, but to some extent you get detached from the military knowledge that you brought to it in the first place. We have been seeking to make a balance between those things and in terms of incentivising—

**Q173 Chair:** We don't buy that argument, but we hear it. Can we now move to the SDSR? The SDSR has been published. Do you understand accurately and in full the financial consequences of the decisions that have been taken?

**Ursula Brennan:** We're in the planning round, which is implementing the decisions from the strategic defence and security review. So, no, we haven't finished the work of working that through.

**Q174 Chair:** When will you know that?

**Ursula Brennan:** Well, our planning round usually works its way through to the spring, so spring next year.

**Q175 Chair:** Will you, by the beginning of the next financial year, know three things: the penalties for which we will be liable; the scope for altering the contracts; and whether or not your programme for the next year and beyond is affordable?

**Ursula Brennan:** We've got a programme of work under way in terms of re-negotiating contracts. Certainly, a huge number of those we will know by next spring. There may be knock-on consequences where we want then to stop, and say, "We've got to here on this particular contract; that makes us want to re-think another one." This process is not a binary thing where we do something and then we stop and the world carries on as normal. It will continue to develop over time. The size of the over-commitment that we had in the defence budget will take us time to work our way through and to get ourselves back into balance.

**Q176 Mr Bacon:** On that point, assuming that you do manage to get it back into balance and get it affordable—you mentioned that the size of the imbalance, the gap, was so big that it will take you time to sort it out, which one understands—once you get it back into balance, what is going to stop it growing wider again? The gap is somewhere between £6 billion and £36 billion, depending on which assumptions you make, but those are the parameters. Once you get that back into balance, why won't it get out of balance again?

**Ursula Brennan:** There are two things that will help us to keep it in balance and one thing that will always be a problem. The two things that will help us to keep it in balance are that we will look to ensure that we retain space for contingency, which we didn't have previously, so that we don't over-commit or commit right up to the line further out; that's number one.

**Q177 Mr Bacon:** And the Treasury's happy with that, are they?

**Ursula Brennan:** The Treasury's happy for us to get our budget into balance, certainly.

**Q178 Mr Bacon:** No, I'm talking about, in future, are they happy for you to have a general contingency?

**Ursula Brennan:** Well, whether you call it a general contingency, we haven't yet reached that happy state where we've got that, so no doubt there will be discussions with them about precisely how we manage that. One of the things we don't want to do is to have every single project line having contingency. We need to manage risk and contingency across the programme as a whole. We will have, I'm sure, a lively debate with the Treasury about that. So that is one point.

The second thing is that we've done a whole set of things, which I think—I come back to the point that I made right at the start—you can see beginning to bear fruit in the other programmes apart from these two really big, difficult ones that we've spent most of today talking about. You can see the things bearing

fruit that we have been doing to control the entry of projects into our programme bearing fruit.

**Mr Bacon:** Absolutely, and we should acknowledge that.

**Ursula Brennan:** We know that if we grip things properly at the start; if we have a really good understanding of costs and benefits; and if we have a really good understanding of through-life costs and of risks, we have a much better chance of managing for the future. We know also about things like the different ways of contracting—contracting for availability, as opposed to buying lumps of kit, increasingly in the unmanned aviation arena. That's the sort of thing we're doing, as with the Joint Strike Fighter, which we talked about. Those things will ensure that stuff that is coming on to our programme now will be better managed. I think that isn't just a vain hope; there is some evidence of that. The "but" that I simply put in place is that, as Admiral Lambert pointed out, with regard to some of these pieces of capability, he listed a whole raft of operations that we've been engaged in that people would not have been expecting at the time that they bought them. We always have to reckon that the role of defence, in a way, is to be a kind of insurance policy and you don't know what claims are going to be made on it.

**Q179 Mr Bacon:** That's true, but you do know that if you build a tanker to refuel your military aircraft, it's very likely you're going to have to take it into a war zone. I mean, there are some basic things like that that you do know that you still managed to get wrong.

**Ursula Brennan:** I'm not sure that it is actually quite as straightforward as that.

**Q180 Mr Bacon:** We all know about the hospital that Sir Humphrey thought was fine, although it didn't have any patients in it. But it is fairly obvious to most of us that if you build military aircraft and fuel tankers to fuel them up so they can fly and get where they're going, the fuel tanker may have to go there as well.

**Ursula Brennan:** I know, this is the Ministry of Defence, and saying "We can't fly them into a war zone" sounds a bit peculiar. But actually I think it is worth being clear about this. When we think about where we're going to be using equipment and how we're going to be using equipment, we look at the range of choices of things we might want to use it for. One of the things that we do try to avoid is the gold-plating of saying, "What's the worst possible scenario that we might want to use this in?" and then equipping it with all the bells and whistles that are necessary for that.

**Q181 Mr Bacon:** When did you stop gold-plating?

**Ursula Brennan:** Across all of these horribly named lines of development, there's a whole raft of things that you can do to say, "Facing this threat, what is the most effective and cost-effective way of addressing it?" It might be that you put a lot of stuff on an aircraft so that you can fly it into a hot war zone. Or it might be that you don't do that; you choose to use it in a different kind of way, on a hub-and-spoke basis.

**Vice Admiral Lambert:** If one's talking about tankers, the role of the tanker has changed over the last 10

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years. We now use tankers a lot more for carrying passengers, which we didn't even envisage 10 years ago.

**Q182 Chair:** But you must have envisaged taking it into a war zone. What were you building it for? You were building it to carry troops and refuel.

**Dr Andrew Tyler:** If you're refuelling with a tanker at high altitude, which is normally where they would be doing their job, then you're not coming under the sort of threats that you would be if you were flying it at low level. So you wouldn't fit it with the Defensive Aid Suites required to protect it from ground-based launches.

**Q183 Stephen Barclay:** It was a dual-purpose aircraft, wasn't it, to transport troops? I think as late as 2006—I've got the Report of 2008; I'll check it in a moment—you signed a contract without it being able to fly to Afghanistan. So I don't think it was beyond the wit of man to realise that if you're transporting troops, you might want to fly it into a conflict area.

**Dr Andrew Tyler:** But as Mrs Brennan pointed out, there are many ways of getting troops into theatre. You can use hub-and-spoke models, where you use planes that are fully equipped to go in at ground-level in a threat zone.

**Q184 Stephen Barclay:** It wasn't really that, was it? I think we all know it was a highly complex PFI deal, and it was the complexity of the PFI deal that was driving the spec. It wasn't a military decision as to where you wanted to fly it.

**Andrew Tyler:** No, that's not true. We could fit defence evade suites for any threat of the day for the usage that we were putting it to that day.

**Q185 Stephen Barclay:** But you didn't.

**Dr Andrew Tyler:** We haven't done so far.

**Q186 Chair:** Are you going to?

**Vice Admiral Lambert:** With the Defence Aide Suites, we are looking at all the options at the moment.

**Q187 Chair:** Can you afford to?

**Dr Andrew Tyler:** If that's the military priority, yes.

**Q188 Matthew Hancock:** I do think it's important that we recognise—where we've been pushing on the value for money side for not necessarily gold-plating—the consequences of those decisions. I'm sure that that will be taken into account. You mentioned the Bernard Gray Report into this whole area. The Bernard Gray Report said, if I recall correctly, that £2 billion could be saved from improving MOD procurement. Do you recognise that figure?

**Ursula Brennan:** I can't recall whether that was a particular figure that was quoted.

**Q189 Matthew Hancock:** That was the figure in the Report. How far down the track are you in implementing the Gray recommendations?

**General Sir Kevin O'Donoghue:** Quite a long way down the track in implementing the recommendations. I'm not actually sure where he got that £2 billion from.

**Q190 Matthew Hancock:** What figure do you think that you can get out of improving your procurement?

**General Sir Kevin O'Donoghue:** If we streamline the procurement process, which is what is going on at the moment—and Lord Levene, I'm sure, will get there—I am quite sure that we can make the savings predicated by a reduction in numbers of people and still deliver our output.

**Q191 Matthew Hancock:** Do you have that in a nominal value?

**General Sir Kevin O'Donoghue:** I don't have a figure.

**Q192 Matthew Hancock:** Similarly, the bureaucracy at the MOD, which is legend, is also being streamlined. Do you recognise the Deloitte Report figure of £4 billion wasted on bureaucracy?

**Ursula Brennan:** I have not seen the Deloitte Report and therefore I don't recognise that £4 billion.

**Q193 Matthew Hancock:** Okay, what's the estimate of what you could save on bureaucracy?

**Ursula Brennan:** The SDSR committed us—

**Q194 Chair:** You commissioned the Deloitte Report.

**Ursula Brennan:** I don't think we did commission that report.

**General Sir Kevin O'Donoghue:** I read the same *Times* that you were reading, and I had to hunt for this report and I can't find anybody who commissioned it.

**Q195 Mr Bacon:** Have you phoned up the journalist asking for a copy?

**General Sir Kevin O'Donoghue:** I've got a copy. I've now seen a copy, but I had to find it.

**Q196 Mr Bacon:** Who commissioned it? Now you've got a copy, doesn't it say in the front who wrote it?

**General Sir Kevin O'Donoghue:** It doesn't say who commissioned it.

**Amyas Morse:** Our information is that Deloitte commissioned it.

**Q197 Mr Bacon:** But you have read it?

**General Sir Kevin O'Donoghue:** No. I've got a copy.

**Ursula Brennan:** I've got a copy but I haven't read it yet. I acquired it.

**Q198 Matthew Hancock:** Do you recognise the £4 billion figure in it?

**General Sir Kevin O'Donoghue:** Well, I haven't read the Report, so I can't—

**Ursula Brennan:** If you tell me that's what it says, that's what it says.

**Q199 Matthew Hancock:** Okay. What would be the figure that you put on the savings that you can get out of improving the bureaucracy?

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15 December 2010 Ministry of Defence

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**Ursula Brennan:** We are committed in the SDSR to taking out 25,000 civil servants from the Ministry of Defence.

**Q200 Matthew Hancock:** How much will that save you?

**Dr Andrew Tyler:** Over £1 billion, that'll be, won't it? Per year. I think that's right.

**Q201 Matthew Hancock:** Would you say that that has been money that has been badly spent in the past, given that you don't need it in the future?

**Ursula Brennan:** It's not so much a matter of it having been badly spent or it wasn't needed. Of the civil servants, some of them will come from doing less, from projects that we are cutting. They won't be working on the Harrier, or whatever. Some of them come from streamlining the efficiency of our processes, so that will be an improvement in efficiency. Some of them will come from de-layering some of the bureaucracy, in terms of who reports to whom within the system. Some of them will come from changing the way we think about our estates. Some of them will come from changing the way we do our back-office processing—things that across the whole of Whitehall, Departments are setting up and doing. We've been on course to do these things; this gives it a further shove and takes out a further 25,000 people. If you look at the graph, which I don't have in front of me, the number of civilians in defence has been coming down by very sizeable numbers. This is just a further stage on the glide path.

**Q202 Chair:** Some people are going to vote, although I don't think there's a need to vote on this one because I think it's a funny vote. Are you now

clear that after the SDSR and all the planning round, you are going to have an equipment programme that is properly costed, properly affordable and appropriate to meet the defence needs of the country? Yes or no?

**Ursula Brennan:** At the end of the planning round, we will have a properly costed defence programme. The size of the over-commitment that we had in the defence programme means that, if you look at the long-term life of the defence programme, it will take us more than one planning round to get that completely back into balance. It's not all going to disappear in one round. It will take us longer than that.

**Q203 Chair:** Because so much is committed?

**Ursula Brennan:** We're working through commitments that we've made and reviewing the extent to which we can change those.

**Q204 Chair:** Does it meet the defence needs?

**Ursula Brennan:** I'm afraid the previous Chief of Defence Staff always used to say that the enemy has a vote. So it will meet the defence needs of the SDSR that we have set out, but we will be perpetually alert to the fact that defence needs change.

**Q205 Chair:** Will you be in a position to take rational decisions on choosing what to cut and what to keep?

**Ursula Brennan:** We do believe that we are in a position to take those rational decisions because we have set out in the SDSR what our future direction is. It gives us the ability to be able to say, painful though it is, that the Nimrod MRA4 is less important than some other things given the strategic direction that we have now set out.

**Chair:** Thanks very much. You're saved by the vote.

### Written evidence from The Ministry of Defence

#### ACCOUNTING OFFICER DIRECTIONS: AIRCRAFT CARRIERS

Sir Gus O'Donnell has shown me your letter of 21 October to him and Sir Nicholas Macpherson about my evidence to your Committee on 13 October.

Since the session ranged widely over Departmental financial management and estates, there was limited opportunity to go into the issue raised in your letter, and I thought the Committee might find it helpful to have my own explanation of events in 2007 when the then Government committed to the aircraft carriers, and in particular why I did not seek formal Ministerial direction.

At the end of the 2007 Spending Review, in July 2007, Ministers were keen to progress the future aircraft carrier project by signing the naval shipbuilding and support Joint Venture Head of Terms. The project was at the point of Main Gate decision, and (on my advice) the decision had been deferred until the outcome of the Spending Review was known. On the estimate of the cost of the Defence programme on which we had been working through the Spending Review, the outcome left us short over the whole programme by several hundred £million a year in the first two years of the spending period. In a budget of over £30 billion, this might have seemed manageable by conventional means, but at the time we thought it likely that a recosting of the programme which we were about to undertake as part of the Department's annual planning round would reveal a wider gap. We were also aware of emerging pressures in the Equipment Programme beyond the Spending Review period, but we could not be definitive about the implications of these for affordability, if only because we did not know what future spending settlements would provide.

Against that background, the Main Gate decision on the Future Aircraft Carrier was put to Ministers with the advice that for the project to be affordable would require reprioritisation within the Equipment Plan to create the necessary headroom, which was likely to have significant impact on key capability areas. I recommended, and the then Defence Secretary agreed, that there should be an urgent re-examination of the Equipment Programme over the following few months.

At the time, I thought hard about whether to seek a formal direction. The Main Gate business case was in itself well made, had been properly appraised and had been approved by the Treasury. There were no issues of regularity or propriety. Nor did the Terms of Business Agreement in itself raise issues affecting value for money. The only issue was therefore whether the concerns about affordability to which I have referred in themselves warranted a formal direction. My conclusion was that they did not. The aircraft carrier project was clearly a very high priority for the then Government, and Ministers' agreement to undertake an examination of the Equipment Programme with a view to reducing its cost provided a means by which the programme could be brought into better balance before long.

I might add that I did not intend in my evidence on 13 October to give the impression that the affordability of the programme is not a concern of the Accounting Officer. It clearly is, and that is why—as I said in my evidence—over the period in question the Department regularly drew the scale and nature of the budgetary challenge as we assessed it to Ministers' attention and identified measures which could be taken to address it. As I said to the Committee, some of these were taken, and some were not. But on the specific issue of seeking formal direction on the aircraft carriers, the position is as I have described it above.

November 2010

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### Written evidence from HM Treasury

#### ACCOUNTING OFFICER DIRECTIONS: AIRCRAFT CARRIERS

Thank you for your letter of 21 October in which you drew attention to a recent PAC hearing involving the MoD, about the decision to invest in aircraft carriers.

I should first confirm that Accounting Officers' duties do involve questions of affordability. Our standard handbook *Managing Public Money* clearly envisages that Accounting Officers should make sure that their departments "meet the Treasury's requirements about limits on use of public resources" (box 3.1). These terms were deliberately timeless. They comprehend respecting not just budgets, but any other protocols that may be used to control public expenditure from time to time.

From the Treasury's viewpoint, this is more than a matter of good order in planning and controlling public expenditure, important as that is, especially when retrenchment is required. Affordability also bears on regularity and value for money. As you say, overcommitting budgets can be undesirable but it is rarely a black and white assessment since Accounting Officers need to take account of a range of issues including sustainability as well as the possible damage to value for money if postponement is the only adjustment mechanism left.

However, I do not question Bill Jeffrey's judgement in this case. He was on the spot and best able to form the Accounting Officer judgement in the round. That is the value of the Accounting Officer discipline. Bill has written to you to explain his reasons for his decision, and I have no reason to second guess him on this. It seems to me reasonable for him to have taken into account as he did the steps that Ministers had agreed to take with a view to bringing the Defence programme into better balance.

I hope this letter will reassure you that affordability remains an important concept in any Accounting Officer's duties. But in assessing any real case, your committee does need to remember that all aspects need to be taken into account. The right interpretation is not always obvious.

December 2010

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### Supplementary written evidence from the Ministry of Defence

#### STRATEGIC DEFENCE AND SECURITY REVIEW CAPABILITY IMPACTS

The SDSR announced a new set of Defence Planning Assumptions, which envisage that the Armed Forces in the future will be sized and shaped to conduct:

- an enduring stabilisation operation at around brigade level (up to 6,500 personnel) with maritime and air support as required, while also conducting;
- one non-enduring complex intervention (up to 2,000 personnel); and
- one non-enduring simple intervention (up to 1,000 personnel);

OR alternatively:

- three non-enduring operations if we were not already engaged in an enduring operation;

OR:

- for a limited time, and with sufficient warning, committing all our effort to a one-off intervention of up to three brigades, with maritime and air support (around 30,000, two-thirds of the force deployed to Iraq in 2003).

The Forces available to deliver this include:

- **Royal Navy:** the deterrent; a new carrier strike capability, routinely operating a mix of aircraft including 12 Joint Strike Fighter fast jets; three Commando specialist high readiness brigade and amphibious shipping which can land and sustain up to 1,800 marines from the sea; 19 frigates and destroyers, and maritime helicopters that can operate from them; seven hunter-killer submarines; 14 mine countermeasure vessels; ISTAR and logistic support vessels.
- **Army:** one specialist high readiness brigade; five multi-role brigades (one at high readiness) for intervention and stabilisation operations; a new range of medium weight armoured vehicles including the Scout reconnaissance vehicle and in due course the Future Rapid Effects System Utility Vehicle; Precision Guided Multiple Launch Rocket System; Army helicopters including Apache and Wildcat. A range of ISTAR capabilities including Watchkeeper unmanned aerial vehicles; and a range of capabilities to counter explosive ordinance and Improvised Explosive Devices.
- **Royal Air Force:** a fast jet fleet of the most capable combat aircraft based around Typhoon and Joint Strike Fighters, armed with a range of sophisticated air launched weapons including the Storm Shadow cruise missile; a modernised transport and tanker fleet based on C-17, A400M and A330; support helicopters including Chinook, Merlin and Puma; a range of manned and unmanned aircraft for ISTAR tasks; and RAF Regiment Force Protection squadrons at high readiness to protect deployed aircraft and personnel in hostile areas.
- **Service Manpower:** by 2015, the Royal Navy will have c.30,000 personnel, the Army will have c.95,000 personnel and the Royal Air Force will have c.33,000 personnel.

**1. The Deployed Force:** The Deployed Force consists of those forces engaged on operations. Today, this includes the forces deployed in Afghanistan from the High Readiness Force. It also includes those forces which conduct permanent operations essential to our security. These include, for example, the aircraft providing UK air defence, our maritime presence in the South Atlantic and the nuclear deterrent.

**2. The High Readiness Force:** The High Readiness Force allows us to react rapidly to crises. This could include the UK's contribution to a multinational operation. But the forces are held principally to allow us to respond to scenarios in which we act alone to protect our national security interests, for example to conduct hostage rescue or counter-terrorism operations. The force includes a balanced range of highly capable land, air and maritime capabilities able to meet our Defence Planning Assumptions.

**3. The Lower Readiness Force:** The Lower Readiness Force includes those forces recently returned from operations which are focused on recovery and those preparing to enter a period of high readiness. These forces support enduring operations and can provide additional flexibility, including where we have discretion over the scale or duration of our contribution to multinational operations.

#### KEY IMPACTS ON MPR PROJECTS

**Astute:** The Submarine Enterprise Efficiency Programme will improve commercial arrangements and efficiency across the whole submarine construction programme, including Astute, over the next decade, delivering substantial savings. The numbers of Astute submarines remains unchanged.

**Joint Strike Fighter:** We have decided to change JSF variant from the Short Take Off Vertical Landing model to the Carrier Variant. We will plan for up to twelve of these aircraft to be routinely embarked on the future carrier at any one time.

**Future Carrier:** We will complete the construction of the Future carriers (CVF) but will plan to operate only one. CVF will be fitted with catapults and arresting gear, delaying the in service date from 2016 to 2020.

**Tornado GR4:** A reduced Tornado GR4 fleet will be retained, and the commitment to Op HERRICK will be maintained.

**Nimrod MRA4:** The Programme has been deleted.

**Airborne STandOff Radar (ASTOR):** The ASTOR system and the Sentinel aircraft which carries it will be withdrawn from service once no longer required for Operations in Afghanistan.

The above capability and programme changes form part of the agreed SDSR package and are being taken forward as part of the Planning Round. It is possible that the precise terms of the measures will change during the formal costing process. The SDSR announcement included no other measures with direct impact on MPR programmes, although additional measures will be raised during the remainder of the Planning Round in order to meet the savings targets set in the Comprehensive Spending Review (CSR) and these may include additional impacts on MPR projects.

### Supplementary written evidence from the Ministry of Defence

#### QUESTION 136—NOTE ON THE CARRIER PROCUREMENT

The contract to build two Queen Elizabeth Class (QEC) aircraft carriers was signed in July 2008 and is being delivered by an Aircraft Carrier Alliance (ACA) consisting of MOD, BAE Systems, Thales and Babcock Marine.

The baseline cost for building two carriers, pre-SDSR, was reported in MPR10 as £5,900 million, excluding Assessment Phase costs and including cost of capital. Removing cost of capital and adding back Assessment Phase costs gives the MPR10 Capital DEL baseline cost of £5,254 million. The agreed Final Target Cost (FTC) position (post MPR10) is slightly lower at £5,241 million. Agreement of FTC is a key point in the QEC contract as it sets the parameters against which the ACA's final cost performance will be measured. These figures exclude any costs arising from SDSR decisions on the Carrier programme.

The cost for building the first carrier only (HMS QUEEN ELIZABETH) was assessed during SDSR as £4,275 million, which was £979 million lower than the equivalent MPR10 baseline for building two carriers (this equates to the roughly £1 billion saving explained at the Hearing). This was based on assessments made by MOD cost engineers and an external consultancy team working independently of the MOD project team. The savings represent cancellation of approximately £1.3 billion worth of programmed expenditure for the second Carrier (HMS PRINCE OF WALES), together with receipts from the sale of surplus equipment, offset by some cost increases due to, for example, loss of economies of scale on HMS QUEEN ELIZABETH and additional VAT payments that become payable on expenditure to date for the cancelled Carrier (VAT exemption only applies to completed ships).

If we had decided to cancel both the Carriers and immediately cease all build activity, the costs were assessed during SDSR to be in the region of £3,156 million, or £2,098 million lower than the equivalent MPR10 baseline (this equates to the roughly £2 billion saving explained at the Hearing). This is based on internal MOD estimates. The savings represent cancellation of approximately £2.8 billion worth of programmed expenditure for both Carriers, together with receipts from the sale of surplus equipment, which is then offset again by VAT payments that become payable on project expenditure to date.

In terms of the carrier contract itself, therefore, cancellation of either one or both carriers would have saved broadly £1 billion or 2 billion in total respectively.

However, as the cancellation costs would have had immediate effect, the costs in the short term would have been significantly higher than proceeding with both carriers as planned; nearly £1 billion more in Financial Year 11/12 if both carriers had been cancelled.

In making its SDSR decisions on the carriers the MOD also had to take into consideration the wider impact on the UK warship industry. Put simply, if one or both of the carriers were cancelled, and if the Government wished to retain a UK capability for the design and manufacture of complex warships, then alternative replacement work would need to be found. Or, the Government would be faced with the costs of industrial rationalisation. These rationalisation and redundancy liabilities pre-dated the carrier contract (and the later Terms of Business Agreement) and arise from the mandated Treasury Yellow Book costing rules.

Although often linked, it is important to stress that the decision to build carriers has always been separate to the decision to sustain a longer term UK warship building industry that was the rationale behind the agreement to the TOBA.

#### *BAE Systems Surface Ships (BAES SS) Terms of Business Agreement (TOBA)*

The TOBA, signed in July 2009, provides MOD guarantees to BAE Systems of a minimum level of ship build and support activity of around £230 million/year. This level of work was independently verified as the minimum level of work possible to sustain a credible warship building industry in the UK. The TOBA has been designed to incentivise major reductions in the size of the industrial base on a managed basis to minimise the rationalisation cost for which MOD was already liable under historical Yellow Book rules.

The TOBA can be cancelled at anytime. Cancellation crystallises the extant rationalisation costs, leaving MOD liable for remaining industry closure costs and compensation to BAE Systems for their lost investment. During the SDSR, cancellation of the TOBA would have been expected to cost in the order of £630 million. A key element of the TOBA is that it ensures that this figure reduces year on year against an agreed formula and bounds MOD's liabilities.

#### *Related programmes*

The financial impact on other related programmes such as the Joint Strike Fighter (JSF), and Type 26 Global Combat Ship (GCS) has also been excluded here, but was taken into account in the decisions taken during SDSR.

QUESTION 141—SENIOR RESPONSIBLE OFFICERS

The Department has already stated, in response to a Parliamentary Question, that determining whether there had been a gap in succession of Senior Responsible Officer (or equivalent) for all thirty projects in the MPR, some of which were initiated many years ago, would incur disproportionate cost. We will provide this information in response to the Committee's request, but it will take some time to do so, and we aim to provide it by the end of January 2011.

QUESTION 146—DEPARTMENTAL PRESS OFFICERS

The answer to the Parliamentary Question on press officers, which was answered shortly after the hearing, was as follows:

**20 Dec 2010 : Column 986W**

DEPARTMENTAL INFORMATION OFFICERS

**Stephen Barclay:** To ask the Secretary of State for Defence how many press and communication posts in his Department are remunerated at (a) between £50,000 and £99,999 and (b) £100,000 or over. [30400]

**Mr Robathan** [*holding answer 13 December 2010*]: Our records indicate that in March 2010, 52 press and communication posts across Defence were remunerated at between £50,000 and £99,999. These posts are across the military and civilian defence community, in the UK and overseas in Headquarters and in the single Service units.

A further 109 posts were filled by military ranks or civilian grades for which the salary range straddled £50,000. The range of salaries that these posts could have been paid is between £45,190 and £56,078. It is not possible to say how many of these individuals were paid more than £50,000.

**20 Dec 2010 : Column 987W**

There was one press and communications post remunerated at £100,000 or over, which is a military two-star appointment.

We are taking a number of steps to reduce expenditure on defence media and communications. This will include further post reductions.

*January 2011*

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