



House of Commons
Committee of Public Accounts

Ministry of Defence: The Major Projects Report 2011

Sixty-eighth Report of Session 2010–
12

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

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Committee of Public Accounts

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Justine Greening (*Conservative, Putney*)
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Rt Hon Mrs Anne McGuire (*Labour, Stirling*)

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The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at www.parliament.uk/pac. A list of Reports of the Committee in the present Parliament is at the back of this volume. Additional written evidence may be published on the internet only.

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

The Ministry of Defence (the Department) continues to struggle with managing its equipment programme on an affordable basis, resulting in the cancellation or deferral of major projects and a damaging impact on value for money.

In 2010-11 the forecast costs to complete the 15 largest defence projects increased by £466 million. Since their original approvals the estimated costs of these 15 projects have increased by £6.1 billion and now stand at approximately £60 billion (an 11.4% increase). In aggregate these 15 projects are forecast to be completed 322 months later than originally planned.

We acknowledge that on more recently approved projects there have generally been lower cost increases and fewer technical problems. Projects approved since 2002 show significantly lower cost growth than those approved before this date. In particular we are encouraged by the recent improvements in reducing cost increases arising from project-specific technical issues. Technical issues have not led to increased costs on projects since 2008.

Having allowed its equipment programme to become unaffordable the Department faces unpalatable decisions. Decisions to cancel or slow projects and to reduce equipment numbers have added significant long-term costs to the whole defence programme and to unit costs within the programme. Capability has been affected and this has all resulted in poor value for money. The Department has made a number of decisions to save cash in the short term without a full understanding of long-term costs and the knock-on effect of increased costs in other areas of the defence budget.

Large defence equipment projects have contributed disproportionately to overall cost growth. In the past, the Department has repeatedly failed to challenge unrealistically low estimates for the largest and most complex equipment projects from suppliers. The Astute submarines have been delayed, leading to increased costs of £1.9 billion. Due to repeated delays, cancelling the Nimrod at this late stage has resulted in £3.4 billion being wasted with no new capability being added. In the case of the Queen Elizabeth aircraft carriers the forecast cost has so far risen by £2.8 billion since they were first approved in 2008. The taxpayer has had to pick up the bill when decisions on these projects were taken.

While we welcome the trajectory of improvement, the Department is still unable to set out openly the extent of the gap between income and expenditure it still faces, and how and by when any shortfall will be resolved. We are concerned that the assumptions the Department is making about its budget in the future may prove unrealistic. Financial contingency planning by the Department to model the impact of further budget reductions may therefore be needed.

Last year we concluded that the turnover of the Senior Responsible Owners (SROs), who oversee individual projects, was often too great and recommended that SROs remain in post and responsible during key phases of a project's lifecycle. We were also concerned that some individuals were given the impossible task of being the SRO for too many multi-billion pound projects. We are disappointed that there is little evidence of progress in this

area.

On the basis of a Report by the Comptroller and Auditor General,¹ we took evidence from the Ministry of Defence on its progress in delivering its major defence equipment projects.

1 C&AG's Report, *The Ministry of Defence: The Major Projects Report 2011*, HC 1520, Session 2010-12

Conclusions and recommendations

- 1. We welcome the Department's better performance in controlling project-level cost increases, but remain concerned that total costs of the top 15 projects continue to rise for other reasons each year.** Projects approved since 2002 have shown significantly lower overall cost growth than those approved before this date and since 2008 there has been no overall cost increase from project-specific technical issues. However, in 2010-11 the forecast costs to complete the 15 largest defence projects still increased by £466 million overall, and the Department continues to struggle to live within its means. The recommendations that follow are intended to help the Department establish a culture of realism and transparency in the way it manages its equipment programme.
- 2. Decisions to save cash in the short term – deferring spending and reducing equipment numbers – have added significant long-term costs to the defence programme and so represent poor value for money.** Taking decisions to save money in the short term invariably lead to greater costs in the longer term. Changing requirements once a contract has been signed usually leads to delay, increased unit costs, and significantly more expense over time. The Department also made decisions to cut programmes, such as the Nimrod aircraft, without a full and complete knowledge of the cost implications. As well as ensuring realistic cost assessments at the start, all requests for new defence equipment should include measures that can be taken to cut costs if budgets have to be reduced later. The Department must take account of the long-term cost and capability implications of all the decisions it takes, including the impact on other areas of the defence budget.
- 3. Despite the Strategic Defence and Security Review and two subsequent exercises to find more savings, the defence budget only remains 'broadly in balance'.** It is unacceptable that the Department still cannot identify the extent of the current gap between resources and expenditure. The Department must urgently publish information on how and by when it will balance this year's budget. The Department has committed to publishing a 10-year Equipment Plan on which the National Audit Office (NAO) will conduct an 'affordability audit'. Although the Department told us it was in discussions with the NAO on the Equipment Plan, it is yet to provide it to the NAO to review. It should do so urgently so that the NAO can assess whether the Department will live within its means.
- 4. The Department is basing its current 10-year Equipment Plan on Treasury planning assumptions that are now likely to prove over-optimistic.** The Department was told at the time of the Comprehensive Spending Review settlement that it could expect 1% real terms equipment budget increases from 2015. It is planning its budget on this basis, but in the light of current economic conditions that assumption may be unrealistic. To better understand the implications for defence of further budget cuts the Department should work with the Treasury to consider and assess the impact of a range of lower funding assumptions.
- 5. On very large projects the taxpayer has too often had to pick up the bill when the risk, complexities and therefore costs have been underestimated.** Supplier cost

estimates for both the Nimrod aircraft and the Astute submarine programmes, approved in the 1990s through open competition, significantly underestimated the risks and complexities involved. These large projects have accounted for most of the cost increases over the past decade. Overall, we accept that there are some signs of improvement; however the Department will also have to manage a £2.8 billion cost increase on the Queen Elizabeth carriers and given the technical complexities of the new programme these costs could also escalate. The Department needs to be much better in managing its contracts by identifying and managing risks. The Department should better understand their contractors' costing assumptions to ensure a sufficiently robust challenge to those assumptions.

6. **The Department has still not properly addressed our previous concerns about the high turnover and multiple responsibilities of Senior Responsible Owners (SROs).**² The Department has yet to make formal changes to ensure that SROs remain in post during key phases of a project lifecycle. We have heard evidence that some SROs still have responsibility for too many multi-billion pound projects, and are concerned that SROs are not sufficiently empowered or have the necessary authority and status. In future, we expect the Department to be able to show us that the turnover of SROs has slowed and that it is increasingly rare for an SRO to oversee too many projects.

2 Committee of Public Accounts, Twenty-third Report of Session 2010-11, *The Major Projects Report 2010*, HC 687, conclusion 3

1 Project performance

1. In taking evidence from the Ministry of Defence (the Department) on its 15 largest equipment projects, we found a welcome improving trend in project-level performance.³ Since 2008, there has been no net cost increase ensuing from technical procurement challenges at the project level, although £53 million was added in 2010-11. However overall, the total cost increase for the 15 major projects in 2010-11 was £466 million.⁴ Decisions made by the Department have contributed to a large part of this increase, although there are some factors - such as variations in foreign exchange - which are largely outside the Department's control (Figure 1). In total, forecast costs for these projects now amounts to approximately £60 billion, some £6.1 billion (11.4%) over budget. The timetable for delivering the equipment also slipped a further 30 months in the year, taking the total delay to 322 months since the original estimates were first approved.⁵

Figure 1: Breakdown of 2010-11 cost increase ⁶

Reason for cost increase	£ million
Central planning decisions made by the Department:	
Decisions to delay spending on projects	£124
Decisions to enhance equipment capabilities	£113
Macro-economic factors such as exchange rate changes	£176
Project-level difficulties such as design and contracting issues	£53
Total cost increase	£466

2. For the third successive year, central planning decisions taken by the Department to delay expenditure and reduce equipment numbers have been the major cause of cost growth.⁷ In the past three years, the Department has delayed projects to balance the defence budget in the short term. These decisions have added long-term costs to the defence programme. For example, the Department has had to extend the build programme of the Astute submarines (with extra costs) to fill the gap in production arising from deferring the introduction of the Successor nuclear deterrent programme.⁸ These decisions added to a total delay across all seven Astute submarines since 2003 of 297 months.⁹ This delay cost £1 billion and, combined with cost increases due to technical difficulties and capability changes, means that the total overspend on this project is now £1.9 billion.¹⁰

3 Q 2

4 Q 144; C&AG's Report, paragraph 3, Figure 8

5 C&AG's Report, paragraph 3, Figure 2

6 C&AG's Report, paragraph 3 & 1.5

7 Q 17

8 Qq 22, 74

9 Qq 23-26. C&AG's Report (paragraphs 11 & 3.5) notes an average delay of 28 months to each of the seven Astute Class submarines since 2009. The total delay of 297 months to the seven boats is measured from when the Astute programme was reapproved in 2003.

10 Qq 27-29, 33-37

3. Cutting equipment numbers after contracts have been signed usually represents poor value for money, as it invariably increases unit costs.¹¹ The Department has recently decided to reduce the number of Puma and Chinook helicopters by four and ten respectively, and is buying three fewer A400M aircraft. In the latter case this has contributed to an increase of 46% in the unit cost of each aircraft.¹²

4. The Department has also attempted to balance the defence budget by cancelling programmes. In the 2010 Strategic Defence and Security Review it decided to cancel the Nimrod aircraft.¹³ The Department cancelled the project to save an estimated £1.9 billion in support costs over the next ten years.¹⁴ The Department had already spent £3.4 billion on Nimrod without any benefit to the defence forces and the Department will incur new costs from cancelling contracts and from substituting alternative capabilities. We have asked the C&AG to look in greater detail at the value for money of decisions taken on both Nimrod and the Harrier jets.

5. The Department accepted that there would be additional costs to fulfilling capability shortfalls left from this cancellation, but could not tell us exactly what they were.¹⁵ This illustrates the Department taking decisions without full knowledge of the cost implications or the impact on defence capability¹⁶

6. The Department told us that once the defence budget is back in balance it will no longer defer spending and reduce equipment numbers purely for reasons of affordability.¹⁷ Until the budget is balanced, however, there remain significant risks to cutting or cancelling existing projects, such as Specialist Vehicles.¹⁸

11 Qq 105, 144

12 Qq 136-137

13 Q 59

14 Qq 75-76; C&AG's Report, paragraph 14

15 Q 76

16 Qq 78-79

17 Qq 18, 130

18 Qq 51-54

2 Affordability of the defence budget

7. The Government undertook the Strategic Defence and Security Review in 2010 to address the gap of up to £42 billion between the defence budget and forecast expenditure, including spending on the equipment programme. Since then there have been two more reviews which have further reduced the equipment programme to make extra savings.¹⁹ Despite these three reviews the Department was only able to say that the defence budget is 'broadly in balance'.²⁰

8. The Department told us that it could not confirm the size of the remaining imbalance while its work on the latest planning round was continuing.²¹ The Department explained that it is on course to achieve its aims and has made improvements in the approvals and scrutiny of projects. The Department considers that these improvements, coupled with the previous Secretary of State's personal review of major projects, should ensure that the defence budget will be in balance in the future.²²

9. The Department has committed to publishing a ten year statement on the equipment programme; the NAO will conduct an audit to test the affordability of the statement.²³ But after more than 18 months of promising, the Department has yet to publish this statement or formally invite the NAO to perform its audit.²⁴ The Department stated that they expected to invite the NAO in within 'weeks rather than months'.²⁵

10. There is still a culture of over-optimism with regard to costs within the Department.²⁶ The Department acknowledged that it will take time to change people's attitudes, but told us that it is putting the right incentives in place to change behaviours.²⁷ For example, the Department had conducted an exercise which involved reviewing the equipment programme to challenge all the assumptions underlying project teams' cost forecasts. This review led to a £5.5 billion increase in expenditure forecasts.²⁸

11. The Department is planning future expenditure on the basis of an assumption that it will receive a 1% real terms increase in funding after 2015. However, assuming this level of funding in the future is not certain, particularly in view of uncertainty about current economic conditions, the Department has not assessed the impact on its plans if this proves to be the case.²⁹ We remain concerned about the potential consequences to current

19 Q 4

20 Q 2

21 Qq 5-7

22 Qq 10, 14

23 Q 3; *The Defence Strategy for Acquisition Reform*, Cm 7796, paragraph 2.7, page 10

24 Qq 19-20

25 Qq 21-22

26 Q 11

27 Q15

28 Qq12-13

29 Qq 9, 39, 41-42, 51-54

and future defence programmes if the Department receives lower than expected funding in the future.³⁰

3 Risks and accountability

12. The vast majority of cost increases over the past decade have occurred on the Department's largest projects.³¹ Astute submarines and Nimrod aircraft are two such big projects, both of which were contracted for in the mid-1990s following open competition.³² In both cases BAE Systems had underestimated the complexity and design challenge, leading to substantial cost increases of around £900 million and £789 million, respectively.³³

13. One reason for these cost increases is the nature of the contracts. As they were fixed price, BAE Systems did not have to provide any details to the Department on the progress and problems it was experiencing. It was only in 2002-03, over five years after both projects were approved, that the Department became aware of the problems that BAE Systems was experiencing.³⁴ There is a similar story with the A400M transport aircraft project, where cost increases currently stand at £607 million.³⁵ Costs on the Queen Elizabeth carriers – the only large project conventionally procured over the past decade – have also increased by £2.8 billion, with further uncertainties on this project still to come.³⁶

14. Cost underestimates by industry have, in the main, been underwritten by the taxpayer.³⁷ Although BAE Systems suffered some losses it was able to increase the cost for subsequent boats on the Astute programme by nearly 75%³⁸ and is currently in negotiations with the Department for settlement costs following the cancellation of Nimrod.³⁹ In recent years the Department has attempted to limit the risks and potential cost increases for the taxpayer through buying in batches and increasing off-the-shelf procurement.⁴⁰ It also performs audits of company overheads and has greater access to company information, such as hourly rates, amount of work performed, and cost of components.⁴¹

15. In our Major Projects Report 2010 we concluded that the appointment terms of Senior Responsible Owners were too short, and recommended that SROs remain in post during key phases of a project lifecycle. We also noted that some SROs were given a demanding portfolio of projects to manage.⁴² Although the Government accepted our

31 Q 118, C&AG's Report, Figure 12

32 Q 57

33 Qq 27-28, 37, 56

34 Qq 58, 73, 105

35 Q 137, C&AG's Report, Figure 2

36 Committee of Public Accounts, Fifty-sixth Report of Session 2010-12, *Providing the UK's Carrier Strike Capability*, HC 1427

37 Qq 106, 112

38 Qq 29-32. Astute boat 4 was approved at £1.28 billion, whereas Boats 1-3 were approved at £2.33 billion (or £0.743 billion each).

39 Qq 75-76

40 Qq 55, 104

41 Q 32

42 Committee of Public Accounts, Twenty-third Report of Session 2010-11, *The Major Projects Report 2010*, HC 687, conclusion 3

recommendation little appears to have changed from last year.⁴³ One SRO we highlighted last year was Brigadier Paul Jacques, who had been responsible for six projects. The Department told us that he was no longer the SRO as he had been promoted. However, his replacement, Brigadier John Brittain, is still responsible for the same six projects with a value 'north of £17 billion'.⁴⁴

16. As part of Lord Levene's review, the Department told us that it is reviewing the roles and responsibilities of SROs and has agreed to consider our previous recommendation on SROs as part of this process.⁴⁵ Overall, the Department considered that it was making good progress in implementing Lord Levene's recommendations. The Vice Chief of Defence Staff and the Second Permanent Secretary hold weekly meetings where they hold people to account for the work being done in response to Lord Levene's report.⁴⁶

17. The Department explained that a number of reforms have already been made within Defence Equipment and Support (DE&S), the organisation responsible for delivering equipment for the armed forces. The DE&S Board has been restructured so that there are now four, three-star officers covering the totality of the programme, rather than a single Chief Operating Officer. All personnel between colonel and two-star rank are given four year appointments, and these posts are now subject to open competition.⁴⁷ The Department also told us that a new, more senior, Finance Director will be joining in 2012. The Department did, however, note that they face challenges in attracting appropriately qualified finance staff, with only half of their management accountants professionally qualified.⁴⁸

43 Qq 89-90

44 Qq 80-86

45 Q 88

46 Q 128

47 Qq 99-100

48 Qq 139-141

Formal Minutes

Monday 30 January 2012

Rt Hon Margaret Hodge, in the Chair

Mr Richard Bacon

Matthew Hancock

Chris Heaton-Harris

Meg Hiller

Fiona Mactaggart

Austin Mitchell

Nick Smith

Ian Swales

Draft Report (*Ministry of Defence: The Major Projects Report 2011*) proposed by the Chair, brought up and read.

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

Paragraphs 1 to 17 read and agreed to.

Conclusions and recommendations 1 to 6 read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Sixty-eighth Report of the Committee to the House.

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

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

Written evidence was ordered to be reported to the House for placing in the Library and Parliamentary Archives.

[Adjourned till Wednesday 1 February at 3.00pm]

Witnesses

Wednesday 30 November 2011

Page

Ursula Brennan, Permanent Under-Secretary, **Bernard Gray**, Chief of Defence Materiel, **Vice Admiral Paul Lambert**, Deputy Chief of Defence Staff (Capability), and **Commodore Mark Beverstock**, Senior Responsible Owner for Nimrod and Astute, Ministry of Defence

Ev 1

List of printed written evidence

1 Ministry of Defence

Ev 19: Ev 24

List of Reports from the Committee during the current Parliament

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

Session 2010–12

First Report	Support to incapacity benefits claimants through Pathways to Work	HC 404
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
Seventh Report	Funding the development of renewable energy technologies	HC 538
Eighth Report	Customer First Programme: Delivery of Student Finance	HC 424
Ninth Report	Financing PFI projects in the credit crisis and the Treasury's response	HC 553
Tenth Report	Managing the defence budget and estate	HC 503
Eleventh Report	Community Care Grant	HC 573
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Fourteenth Report	PFI in Housing and Hospitals	HC 631
Fifteenth Report	Educating the next generation of scientists	HC 632
Sixteenth Report	Ministry of Justice Financial Management	HC 574
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Eighteenth Report	HM Revenue and Customs' 2009-10 Accounts	HC 502
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Twentieth Report	Ofcom: the effectiveness of converged regulation	HC 688
Twenty-First Report	The youth justice system in England and Wales: reducing offending by young people	HC 721
Twenty-second Report	Excess Votes 2009-10	HC 801
Twenty-third Report	The Major Projects Report 2010	HC 687

Twenty-fourth Report	Delivering the Cancer Reform Strategy	HC 667
Twenty-fifth Report	Reducing errors in the benefit system	HC 668
Twenty-sixth Report	Management of NHS hospital productivity	HC 741
Twenty-seventh Report	HM Revenue and Customs: Managing civil tax investigations	HC 765
Twenty-eighth Report	Accountability for Public Money	HC 740
Twenty-ninth Report	The BBC's management of its Digital Media Initiative	HC 808
Thirtieth Report	Management of the Typhoon project	HC 860
Thirty-first Report	HM Treasury: The Asset Protection Scheme	HC 785
Thirty-second Report	Maintaining financial stability of UK banks: update on the support schemes	HC 973
Thirty-third Report	National Health Service Landscape Review	HC 764
Thirty-fourth Report	Immigration: the Points Based System – Work Routes	HC 913
Thirty-fifth Report	The procurement of consumables by National Health Service acute and Foundation Trusts	HC 875
Thirty-seventh Report	Departmental Business Planning	HC 650
Thirty-eighth Report	The impact of the 2007-08 changes to public service pensions	HC 833
Thirty-ninth Report	Department for Transport: The InterCity East Coast Passenger Rail Franchise	HC 1035
Fortieth Report	Information and Communications Technology in government	HC 1050
Forty-first Report	Office of Rail Regulation: Regulating Network Rail's efficiency	HC 1036
Forty-second Report	Getting value for money from the education of 16- to 18-year olds	HC 1116
Forty –third Report	The use of information to manage the defence logistics supply chain	HC 1202
Forty-fourth Report	Lessons from PFI and other projects	HC 1201
Forty-fifth Report	The National Programme for IT in the NHS: an update on the delivery of detailed care records	HC 1070
Forty-sixth report	Transforming NHS ambulance services	HC 1353
Forty-seventh Report	Reducing costs in the Department for Work and pensions	HC 1351
Forty-eighth Report	Spending reduction in the Foreign and Commonwealth Office	HC 1284
Forty-ninth Report	The Efficiency and Reform Group's role in improving public sector value for money	HC 1352
Fiftieth Report	The failure of the FiReControl project	HC 1397

Fifty-first Report	Independent Parliamentary Standards Authority	HC 1426
Fifty-second Report	DfID Financial Management	HC 1398
Fifty-third Report	Managing high value capital equipment	HC 1469
Fifty-fourth Report	Protecting Consumers – The system for enforcing consumer law	HC 1468
Fifty-fifth Report	Formula funding of local public services	HC 1502
Fifty-sixth Report	Providing the UK's Carrier Strike Capability	HC 1427
Fifty-seventh Report	Oversight of user choice and provider competition in care markets	HC 1530
Fifty-eighth Report	HM Revenue and Customs: PAYE, tax credit debt and cost reduction	HC 1565
Fifty-ninth Report	The cost-effective delivery of an armoured vehicle capability	HC 1444
Sixtieth Report	Achievement of foundation trust status by NHS hospital trusts	HC 1566
Sixty-first Report	HM Revenue and Customs 2010-11 Accounts: tax disputes	HC 1531
Sixty-second Report	Means Testing	HC 1627
Sixty-third Report	Preparations for the roll-out of smart meters	HC 1617
Sixty-fourth Report	Flood Risk Management	HC 1659
Sixty-fifth Report	DfID: Transferring cash and assets to the poor	HC 1695
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Sixty-seventh Report	Whole of Government Accounts 2009-10	HC 1696
Sixty-eighth Report	Ministry of Defence: The Major Projects Report 2011	HC 1678

Oral evidence

Taken before the Committee of Public Accounts on Wednesday 30 November 2011

Members present:

Rt Hon Margaret Hodge (Chair)

Stephen Barclay
Matthew Hancock
Chris Heaton-Harris
Fiona Mactaggart

Austin Mitchell
Nick Smith
Ian Swales

Amyas Morse, Comptroller and Auditor General and **Ross Campbell**, Director, NAO gave evidence. **Gabrielle Cohen**, Assistant Auditor General, NAO and **Marius Gallaher**, Alternate Treasury Officer of Accounts were in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

The Major Projects Report 2011 (HC 1520-i)

Examination of Witnesses

Witnesses: **Ursula Brennan**, Permanent Under-Secretary, Ministry of Defence, **Bernard Gray**, Chief of Defence Materiel, Ministry of Defence, **Vice Admiral Paul Lambert**, Deputy Chief of Defence Staff (Capability), and **Commodore Mark Beverstock**, Senior Responsible Owner for Nimrod and Astute, gave evidence.

Q1 Chair: Thank you very much indeed. Can I thank Mark Beverstock in particular, because I gather you put off going on a trip or to a meeting to be present? Thank you very much for making yourself available to us.

Commodore Beverstock: Thank you.

Q2 Chair: The context is one where, in terms of running the actual projects, it looks as if we are on a trajectory of improvement. Let's start by saying that we welcome that. That has come over the last few years, and is a welcome development. I ought to ask, to start, have you balanced the budget?

Ursula Brennan: No, we have said that it is broadly in balance, which means that it is not yet there. The former Secretary of State made an announcement on 18 July, and that was the expression he used, "broadly in balance". He had said on a number of occasions that the scale of the problem that we were tackling would take time to address, and we would not do it all in one go. He said in that announcement that we had made very great progress, but there was still work to be done in the current planning round—planning round 12.

Q3 Chair: You will appreciate that that is a little bit gobbledygook, because at the moment we do not know how much you are predicting to overspend unless you take some decisions.

Ursula Brennan: We have discussed before that how much money we have available, how much things are going to cost, and therefore what the scale of the problem is, is a factor of the choices about where we spend our money, and the analysis that we do about the costs. We are discussing this currently with our new Secretary of State, so I cannot comment on where

we have got to in closing the gap, but we have said that we will publish a 10-year statement of the Equipment Programme, and that the NAO will examine that. There will be an opportunity, when we have completed this work, for the NAO to do that.

Q4 Chair: We have had the SDSR, and since then I understand you have done three reviews, or whatever you call them, of your budget.

Ursula Brennan: We had the SDSR and we had the announcement that was made in July. In the announcement that was made in July, we said there was further work to be done in the planning round, which is the work that we are doing now.

Q5 Chair: How many planning rounds have you had?

Ursula Brennan: There is a planning round every year.

Q6 Chair: One?

Ursula Brennan: One planning round every year, yes.

Q7 Chair: When you talk about affordability of the budget, what years are you looking at?

Ursula Brennan: We look across the 10 years.

Q8 Chair: You do not know, because you have no idea what your next CSR settlement will be.

Ursula Brennan: We do not know what the next CSR would be, and that is part of the reason why it is very difficult to say, but we were given some planning assumptions that we could plan on in that July announcement.

Q9 Chair: Anybody in their right mind would recognise that the changing economic circumstances make it highly unlikely that assumptions you were given in July will hold good for the next year and so on. That is one thing that has gone out of the window probably now.

Ursula Brennan: We have to have some kind of base case from which we work, otherwise you could just wash your hands and say there is no point trying to estimate, because who knows what the numbers will be.

Chair: Yes, but your base case is unrealistic: what was promised in July is probably unrealistic now in December.

Q10 Chris Heaton-Harris: You have obviously moved forward and, as the Chairman said, that is very much welcomed by everyone on this Committee. Does “broadly in balance” mean you are on a trajectory to where you want to be in 10 years’ time all things being equal?

Ursula Brennan: Yes, absolutely

Q11 Matthew Hancock: The whole Committee recognises and supports the work that you have done moving in this direction. However, when we have talked about this in the past, the Department has acknowledged a culture of over-optimism in cost. Do you think that that has gone away?

Ursula Brennan: You might want to ask Bernard Gray about that, because the people who do the estimating work in DE&S—

Q12 Matthew Hancock: That is a very good idea, because in the past you have been at the realistic end of the spectrum of witnesses from the Ministry of Defence.

Bernard Gray: Some people’s realists are other people’s pessimists.

Q13 Matthew Hancock: Do you think that over-optimism has gone away?

Bernard Gray: It is not a black and white distinction when you are talking about a large group of people behaving in particular ways. Moving people’s attitudes is a bit like a super-tanker: it is not that one day they are like this, and another day they are like that. We have certainly made progress on changing people’s attitudes to it. One of the events that is part of that process is that Admiral Lambert, the Finance Director and myself conducted an exercise six months ago to go back and look at the programme with the Cost Assurance and Analysis Service, which we have beefed up over the course of the last two or three years to challenge all the teams about the sets of assumptions they are making. We have made a number of adjustments, which have been publicised, to the tune of about £5.5 billion additional into the programme.

That is as a result of not a mechanical exercise, but saying, “History would say that it is going to cost X plus 20%, you are saying it is going to cost X, let’s have a dialogue about that.” That is part of a process of shifting people’s attitudes. You have to keep at that,

with the right incentives in place, over a number of years, to get fundamentally changed behaviours.

Q14 Matthew Hancock: Are you going to keep at that?

Ursula Brennan: I can understand that the Committee is interested in evidence, not promises, but there are a number of things we have put in place that will help us keep our feet to the fire. One is the bringing in of Bernard Gray, who was critical of our organisation and has now come in to help us sort it out. One is that the previous Secretary of State set up his own personal review of the major projects so that people had to come up and say why they were going off course. There is a set of things we have done about the approvals process, and the scrutiny around that. Our present Secretary of State has sent some very clear signals to people. There is a whole set of things that are helping us go in the right direction. Then we have the NAO who are going to run the rule over it.

Q15 Matthew Hancock: I approve of what the previous Secretary of State has done, I am not surprised by your comments about the new Secretary of State, and I certainly approve of you having brought Mr Gray in, because of his well-known realism. This cannot be dependent upon three individual people; it is about changing the process and culture of a Department. It sounds like that is moving in the right direction, but not yet a success.

Bernard Gray: Turning the mindsets of organisations is the work of years, not days, but it is a leadership issue. You have to demonstrate leadership in your behaviours, in what you are demanding of people, in the kind of ways that you measure, promote, reward that orient people in one direction rather than another. People have to believe that you are for real about that, so your actions have to match up with your words. It is a matter of time, but it is going in the right direction.

Q16 Fiona Mactaggart: Can I ask a question about leadership, in the Department, between people who are in the Services and people who are not? Is it possible for Civil Servants, particularly from outside, like you Bernard, to provide that kind of leadership?

Bernard Gray: You would have to ask the people who work for me. We have a Board inside of DE&S, my organisation, and we have been working forward in detail on a reform package for DE&S as a Board, with a considerable amount of unity, over the course of the last six or eight months. I would claim—you can talk to other people—that we had a significantly greater degree of unity and purpose aligned around significant change as a result of that. I personally do not have any problem getting along with the Services, nor they me, I think.

Q17 Nick Smith: According to our briefing, for the third successive year central planning decisions taken by the Department to delay spending have cost £124 million, and enhanced equipment capabilities cost an extra £113 million. That is a big impact. What are you doing about delaying spending, introducing enhanced capabilities and boosting costs there?

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Ursula Brennan: Those are three distinct things. Deferred spending, where we consciously defer expenditure for affordability reasons, is one of the things we are trying to get out of. It is the reason we have taken some difficult decisions to cancel things, so that we get the programme down to size and do not have to defer things. That exact path, when I said we are “broadly in balance”, has been about reducing the size of the programmes so we do not have to defer things for affordability reasons.

Q18 Nick Smith: Are you still deferring spending?

Ursula Brennan: Until we complete this process, we will have to take a set of decisions where we will balance value for money and affordability. I cannot yet guarantee that we are out of the woods on that, but when we get the programme in balance then we will not need to defer expenditure for affordability reasons. Sometimes expenditure slips to the right for other reasons, for good reasons, but we are on target, on path, to stop it happening for that reason—that we just do not have the cash. You talked about capability improvements. If we have a capability improvement, it is because we said we need some extra capability and are prepared to pay for it. I would not say we would want to stop choosing to spend more on improvements; whether it is value for money is important, but it is a conscious choice to say we needed that capability.

Q19 Chair: Can I take you to specifics now? You said you were asking the NAO in. I gather that you asked them 18 months ago, and they have not heard from you since. When can they come in and audit the affordability?

Ursula Brennan: That is not quite right. We are in dialogue with them.

Q20 Chair: Prior to this, they told me that 18 months ago it was suggested that they could come and audit the affordability of the programme; they have not yet been invited to do that.

Ursula Brennan: It is absolutely true that we do not have a firm date. We are in dialogue with NAO.

Q21 Chair: Give us a firm date, or a feel of a date.

Ursula Brennan: I cannot give you a firm date because, apart from anything else, our new Secretary of State wants to take a view about this, but we are in discussion with the NAO and we are expecting to be able to do this certainly within weeks rather than months.

Q22 Chair: “Within weeks rather than months”—we will hold you to that. By the time this Report comes out, we would hope to have heard from you. Our Report will come out within weeks rather than months.

At the moment we have only got specifics. Let’s look first at the Astute programme. Thank you for coming and talking about that. The Astute programme is a bad example of where delays are costing money. My understanding, correct me if I am wrong, is that this is a programme that was approved in 1997. Is that right?

Commodore Beverstock: Some aspects of the programme were approved in 1997. We had not approved the entirety of the programme.

Q23 Chair: I understand that you are approving it bit by bit, but it was given a first go-ahead in 1997. I also understand that there have been, cumulatively, 297 months of delay since 1997.

Commodore Beverstock: That is certainly the figure in the NAO’s Report. We have to take the Astute delays into context. In the early part of this decade, most of the delays in the Astute programme were down to the fact we had taken a conscious decision to gap the production of submarines up at Barrow, between the completion of the construction of the Vanguard class and starting to rebuild up the Astute class.

Q24 Chair: I understand that too, but delay costs money.

Commodore Beverstock: Indeed.

Q25 Chair: I understand, in the last three years, we have had 196 months of cumulative delay.

Commodore Beverstock: The 196 months is a result of an accumulation of each of the boat programmes added together. It is not necessarily a delay to each boat. If we take it from the MPR 2010, the delays reported this year and those in the planning round the previous year had been done at submarine enterprise level.

Q26 Chair: At what?

Commodore Beverstock: When we were considering the programme as an enterprise. You have to put the Astute delays into the context of the submarine enterprise. When we looked—which we did very closely—at the introduction of the Successor Deterrent as part of the coalition Government’s Value for Money Review, which was then reported as part of the SDSR, we looked at the Submarine Enterprise Programme. That programme includes the seven boats we are planning to build on Astute, and up to four successive boats that we are planning to build from that point. We determined that we could defer the Successor Deterrent in service date to 2028.

When we considered the entirety of the submarine enterprise, we found it was better value for money, providing a minimum sustainable drum beat, to avoid the problems we had in the Vanguard to Astute gap, and to ensure that we could run a proper sustainable programme. You will recall, in the value for money study, that we introduced the Submarine Enterprise Performance Programme to drive efficiency into the programme.

Q27 Chair: You have not questioned my delay; I assume you will not question, as it is in the Report, that the delays so far have cost us, the taxpayer, £1.9 billion—delays because of both technical issues and deliberate decisions taken by the Department.

Commodore Beverstock: Yes.

Bernard Gray: We are definitely not disputing the numbers. The question might be around the association of delay equalling cost. Some of the cost

increase is as a result of delays for a variety of reasons, and some of it is as a result of technical problems.

Q28 Chair: I understand that. My understanding from the Report is: £900 million is a result of technical problems; £1 billion is a result of deliberate decisions to delay?

Bernard Gray: Either deliberate decisions to delay, or delay caused by technical problems.

Q29 Chair: Whatever the good reasons—that you want to keep capability going until if and when you build a new nuclear deterrent, which is, as I understand, the purpose behind this—nevertheless, the cost to the taxpayer, some of which is technical, some of which is deliberate, is £1.9 billion to date. I think that is pretty shocking. No blame, but it is shocking. If you look at the table on page 28, figure 14, it then leaves you with: when we ordered the first three boats you had a bill for £2.23¹ billion for them. You then order the fourth in 2003²—I might have that date wrong—and that one boat cost you £1.28 billion. That looks gbsmacking to me.

Bernard Gray: One has to ask oneself whether the contract for the first three boats was appropriately priced, which, as it turned out, was not the case.

Q30 Chair: Were you spending more than £2.23 billion on the first three?

Bernard Gray: No, it has cost the companies an enormous amount of money, because they had severely underestimated the complexity of what they were trying to do.

Q31 Chair: I accept that might well be the case, but that is their lot. They are a private company; if they miscalculated in estimating what they charged Government, fine, but they should not then pick up extra money by charging more for the fourth boat at £1.28 billion.

Bernard Gray: We had a contract for three boats, which was placed after a competition in 1996/1997. For a variety of reasons that we can go into, that has cost both them and, to an extent, us, a considerable amount of money to put right. When, a decade later, they come to negotiate further boats, they are not going to make the same mistake they made last time of significantly under-costing the issue. We cannot force them by saying, “You made this mistake of charging too little the last time we had a contract with you, now you must charge us too little again”. They are going to come to the table with what they believe to be a realistic price to do that job, and that is what has been in negotiation.

Q32 Chair: The question I am asking is: have you screwed them down hard enough? It is such a difference: £2.23 billion for the first three and £1.28 billion for one. It strikes me that they are picking up the underpayment on the first three in the charge on

the fourth. It does not seem to me appropriate for the taxpayer to pay that bill.

Bernard Gray: That is not the case. As part of the sole source negotiations we have significant access to all of their hourly rates, amounts of work put into it, the cost of the Government furnished equipment and of the components, including the steel and so on and so forth, and we get to audit their overheads. That Astute number represents the real cost of and maintaining building that boat. One of the problems we have with it is we are building boats more slowly than we were intending to 10 years ago, so the overhead of maintaining the Barrow shipyard falls across a much lower level of overall work, increasing the individual unit prices of the boat as well.

Q33 Chair: Can I ask you a question around that? Sorry to interrupt. You got £1.9 billion extra cost of delay; did you figure into that any additional costs that arise out of deliberately choosing to slow down the rate at which we are building boats? I am now being told that is reflected in the £1.28 billion. Did you deliberately reflect that in, or is that on top of, the £1.28 billion?

Ross Campbell: It is in the costs of delay³, Chair.

Q34 Chair: That is in the £1.9 billion?

Ross Campbell: Yes.

Amyas Morse: If it takes longer—

Q35 Chair: I understand of course it takes longer, but in this much higher figure for the fourth one, are we double counting?

Bernard Gray: No. In agreement with the numbers, we have more overheads in this because we are building boats more slowly, as well as the technical cost of building this boat turning out to be more expensive than the company originally estimated. That has cost them hundreds of millions.

Q36 Chair: You have delayed contracting 5, 6, 7, haven't you?

Bernard Gray: Yes. Some of those are in process, but they have been delayed from previous plans.

Q37 Chair: For the record, the £1.9 billion extra historical cost that has arisen out of delays to date represents more than the cost of this expensive £1.28 billion. If we had done them all on time, we could have got another submarine out of it. That is one way of looking at it.

Bernard Gray: It is a way of looking at it, but the reality of the situation is a mixture of technical reasons—where it would not have been possible to do that work in that time, because the company had underestimated the complexity of what they were doing, and we had lost some skills—Departmental cash flow assumptions around the middle of the decade, and the decisions around the availability date of the successor deterrent. All of those add up to increase that cost in a way that says: if all of those

¹ The figures from the MPR !! (NAO report) are £3.4Bn for the first 3 boats

² Astute Boat 4 was approved in 2007

³ £1.28 Billion is the Approved Cost for Boat 4, which does not include the cost of deferral. The actual forecast costs reported in the MPR11 (NAO VFM report) including the deferral costs, are £1.40Billion.

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things had not happened, you might have been able to buy an additional boat. Whether you would have or not, bearing in mind what the requirement of the Navy is, and the costs of running a boat, is another question.

Q38 Chair: What happens if the next CSR does not give you the additional uplift you want?

Bernard Gray: We have a planning assumption we are told to work to by the Treasury.

Ursula Brennan: Yes.

Q39 Chair: Given where we are now and what the Chancellor has said yesterday in the House, would think it highly unlikely you are going to get an increase in your CSR settlement. One of the things I am trying to tease out of you this afternoon is that all sorts of assumptions in the SDSR and forward planning were on the basis of a more generous settlement in 2014/15. There is a big question mark; I think anybody in their right mind would agree with that. Therefore, what happens to this sort of a programme, were that to happen?

Bernard Gray: If we wish to deliver continuous at-sea deterrents as a nation, we have to have a successor deterrent boat on station in 2028. Therefore, we do not have any further slack in this programme in order to be able to reduce the levels of activity through that yard.

Q40 Chair: This is one of your top priorities.

Ursula Brennan: It is, yes, absolutely.

Q41 Chair: What would give? Practically everything else has given anyway.

Ursula Brennan: The thing that we are trying to do is get the programme back in balance. When you say “in balance”, that is against a set of forward assumptions. Unlike other people, we have to plan a very long way ahead.

Q42 Chair: I do understand all that, I am just questioning—

Ursula Brennan: So, if the assumptions change, we would be in a better place than we were last year or the year before—or anywhere, frankly, over the last decade—in that we will not start from an overhang of unaffordable commitments, we will have a set of choices from a baseline that matches, but has now gone down. We would have to take the kind of choices that we have been taking, saying that if the assumptions change, if Ministers decide they want to spend less on defence, then we will buy less from Defence, and we will cancel things.

Q43 Chair: But you would buy this anyway?

Ursula Brennan: I do not want to say what choices Ministers will make, faced with a different set of planning assumptions in 2015 or 2016.

Q44 Chair: In that context is it sensible to have spent £2 billion, which does not arise here, on a nuclear warhead?

Ursula Brennan: Ministers have been clear that there is a commitment to continuous at-sea deterrence, and we are continuing to invest in the long lead items of

investment that we need to keep that programme going.

Q45 Chair: Were there a decision not to go ahead with the successor to Trident, how much of that £2 billion that we have spent on the warhead is preparing for the next generation rather than this one?

Bernard Gray: The reason I am looking slightly quizzical is that we are spending money on the infrastructure to support the warhead programme.

Q46 Chair: There is some design expenditure.

Bernard Gray: There is some design work, but that is not anything like the order of magnitude of the number we are talking about here. The sum of money I think you are talking about relates to the infrastructure works to maintain our nuclear weapons facilities—which were built, broadly speaking, in the 1950s and 1960s—as being fit for purpose for handling hazardous materials in the 2020s and beyond. We have had a process, over most of the last decade, of renewing that infrastructure. That is what is going on.

Q47 Chris Heaton-Harris: I just wanted to ask you about the cost of boats 5 and 6. I can understand what you said about the initial three boats being underpriced; you said they underestimated the complexity of what they were doing. You saw the man hour sheets and everything, so you can work out why you have got to that cost on boat 4. I am concerned by the words in the Report that say, “initial items only”. This is page 28, figure 14. You have a figure for the boats of £0.88 billion.

Ross Campbell: If I can interject, that does not represent the cost of a full submarine; that only represents the cost of the long-lead items—things like the nuclear reactor that will power it—which have been approved to date.

Q48 Chris Heaton-Harris: On boats 5 and 6, as things stand now, knowing the costs that you do, do they fall in your broadly balanced budget term? They are all going to work out fine; you are not going to come up needing another £0.5 billion.

Vice Admiral Lambert: Yes, the programme that we have for the future has seven Astute submarines, the deterrent coming in in 2028, and that is within the broadly balanced programme.

Bernard Gray: We have a forecast assumption for what the last four boats will cost us in our programme. We will clearly be in negotiation over coming months and years, depending on which boat, for what their prices will be.

Q49 Chair: Your forward programme at the moment is based on an assumption that there will be a real terms increase in the Defence budget?

Ursula Brennan: In the Equipment Programme or within the whole of the Defence budget?

Bernard Gray: A 1% increase in the Equipment Programme from the end of the CSR period is the planning assumption that we have been given by the Treasury. One helpful point to add: the Commodore also mentioned the cost base reduction work that is

going on. There are three main contractors in the initial production of the boats: BAE Systems, Babcock and Rolls Royce, who do the power plant. We are trying to de-duplicate activity between those three companies in order to substantially reduce the cost base going forward for the whole of submarine building. That is a piece of work we started 12 to 18 months ago, and we are now beginning to get into the thick of detailed work with them about that.

Q50 Nick Smith: A while ago we talked about armoured vehicles. I came away thinking a good project had not been taken forward because bigger, more expensive projects, and overspends on those big, expensive projects, crowded out other quite chunky, but smaller, proposals. How are you trying to ensure you have a balanced approach to procurement for the future, so that does not happen?

Vice Admiral Lambert: If I can start on that, we are trying, with a whole series of programmes, to get to a point where we have more choice. In the aircraft world, if we go ahead with joint strike fighter, we can buy as many or as few as we like moving forward, and that will give us more choice in the future if the circumstances around the world change and we need more tanks and less aeroplanes. We are doing that as a first step. With the armoured fighting vehicle programme, as we brought to the Committee last time, we are looking at a spending envelope, and trying to keep the spend of the armoured fighting vehicles within that spending envelope, so they do not get crowded out. We are still working that through.

Bernard Gray: As a general process, part of the problem that the ground vehicles face is that the lead times for aircraft and ships are much longer than they are for ground vehicles. If the Equipment Programme is allowed to get overlarge, the ships and the aircraft tend to be contracted for, and the ground vehicles are not. Therefore, in contractual terms it is an easier thing to delay or put off a decision about ground vehicles than it is to reopen a contract about sea or air systems. That has been a characteristic: one of the downsides of having an overlarge Equipment Programme is the ground systems get squeezed. One of the benefits of getting it back into balance is that you do not put that pressure on shorter lead time programme.

Q51 Chair: I am going to keep saying it: "back into balance" on an assumption that I think will be overturned fairly quickly. If we look at the Specialist Vehicles, which I assume is your ground stuff, you are putting £1.4 billion into the prototypes.

Bernard Gray: Development⁴.

Q52 Chair: The development stuff. You have so far not committed to buying anything beyond that. My recollection from when we looked at armoured vehicles is over the next 10 years you will have £5.5

billion to spend in that programme. If there is any future pressure from, let us say, a change in your planning assumption, that could easily go, because of the basis, which you have talked about, that they are easier things to cut because the contractual commitment is less. We will have wasted again, potentially, £1.4 billion developing a Specialist Vehicle. Am I right?

Bernard Gray: There are a set of assumptions contained in that. If we should work to a different planning assumption that says we should plan to spend less, then we will have to make a set of decisions to cut further. However, it must be the case that if we were over programme before, reducing to something close to the planning total we have been given now is at least travel in the right direction. Exactly where one chooses to land that programme, should we be cancelling things today and paying termination costs today, when we do not know that we are going to have to terminate those contracts? If it turned out that we got the money we had been expecting to get, then we would have paid termination costs unnecessarily.

Q53 Chair: I bet you your predecessors said exactly the same thing around armoured vehicles, when they put the money into the development cost of the FRES, or whatever the hell it was, which ended up being development money invested without any vehicles on the ground. My concern is £1.4 Billion is a heck of a large development cost against a pretty small budget of £5.5 billion, which is probably one of your more fragile budget heads should there be any changes in the planning assumption.

Ursula Brennan: There is one difference in terms of your suggestion that this is no doubt what we used to say in the past; I understand your point that our planning assumption may be wrong, but we are at least planning the budget against a planning assumption. We are no longer planning against a budget that is overheated, which is different from where we have been in the past.

Bernard Gray: It is not clear to me what one should do with that assumption. Are you saying to me that I should cancel the Scout programme tomorrow?

Q54 Chair: All I am saying is it is a slight feeling of plus ça change when I look at it. If I look at the armoured vehicles, where we have recently had an inquiry, it is not a lot of money. There is a history there of cutting the contracts, because they are easy to cut. I am taking a common sense view on the economy as a whole, and therefore the likely impact on your defence budget. I then come to look at this and think it is a lot of money to put into developing a new so-called Specialist Vehicle. I think it is in danger of being money wasted; that is what it looks like to me. However, I am not you, and I do not know what these toys do across the piece.

Q55 Matthew Hancock: Could I ask the same question in a different way? Nobody knows what the policy decision over the Defence settlement will be, but there is a set of planning assumptions. You are working to those planning assumption; of course, you

⁴ The £1.4Bn costs reported against Specialist Vehicle includes: the development costs and prototypes for Recce Block 1 and the common base platform for all other roles (£500M on contract); long lead production items for RB1 (circa £500M, not yet on contract); and training system development and project support costs. All costs include vat @20% and forecast inflation adjustments.

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need to work to planning assumptions, everybody assumes that. Are you also looking at contingencies for a different planning assumption in either direction?

Vice Admiral Lambert: When we look at what we take forward and how we put the programme together, it is always a mix between capability, priorities, and pragmatism. It has to be: as CDM pointed out, when things are on contract it is quite difficult to get out of it. We are trying to go far more to batch systems, buying off the shelf, because if the policy does change it gives us the ability to change direction and go for something else. That change does not happen overnight, but where we can we will go for batches and buying batches, so we can then stop where we were going, and go in a different direction.

Bernard Gray: To have some greater flexibility inside of this, and to be inside a planning total, is a more comfortable place than either outside or on it, but we are on a journey. There has been very significant progress made. Is it all done yet? No. There will then be an argument about, if one was sitting inside a planning total, what is a reasonable contingency, against either technical problems or a set of budget assumptions someone might have to make. To say that we are heading in a direction to get to a more conservative place around what we plan to buy cannot be a bad thing. Bearing in mind the amount of equipment that is already programmed in, you cannot get there overnight. So we are heading in the right direction. We must agree with the general principle that says we should be planning prudently around all of this, and we are working as fast and as hard as we can to get there.

Q56 Austin Mitchell: I want to move onto Nimrod, which is something of an enigma to me. The project was approved at £2.8 billion; it was eventually over budget by £789 million. The Report says that some of this was due to “the design challenge being hugely underestimated by industry”. Why was that? I thought it was a development of an existing Nimrod, which was rather old, but still serviceable, just like me.

Vice Admiral Lambert: The Nimrod MRA4 was a very different aeroplane.

Q57 Austin Mitchell: Was it totally new?

Vice Admiral Lambert: It took the original Nimrod airframe, it took the wings off, it stripped it down, it added new wings, a new combat system, new flight control systems etc. It used the basic framework of the old Nimrod, but to all intents and purposes it was a new aeroplane. It was procured back in the 1990s following a competition, and this was, at that time, valued as best value for money.

Q58 Austin Mitchell: The Report also says that these design challenges were “compounded by a weak programme management culture, which lacked transparency, neglected or overrode project control systems and disciplines, and produced forecasts that ‘lacked depth and reality’.” Why was that? That was the Department’s responsibility.

Vice Admiral Lambert: CDM has done an awful lot improving the project management side of it. It is

probably more appropriate you talk about the project management.

Bernard Gray: There are two sets of project management, one by the Ministry of Defence, and the other by the company. Both would be found wanting, and part of the reason for having to change the way that we do business is to get a better grip around these things. Part of the problem with this in contractual terms at the time—ironically Astute and Nimrod were let within 12 months of one another in the mid to late 1990s—was we ran a competition with a fixed price contract, and the company after that said, “We do not have to tell you anything about what we are doing, because we have a contract to deliver this thing”.

It took quite a long time to penetrate through a wall of, “We do not have to tell you what we are doing”, until they got into some significant difficulties with both programmes, by about 2002/2003, before the Ministry of Defence could get in behind it. From a technical point of view, running a competition with a fixed price, unlike the current situation in submarines, you do not have as much visibility of the ability of the contractor to deliver.

They are people like everybody else, so they have an “I am sure it is all right” optimism bias, some level of denial. It took them and the Ministry of Defence some time to break through that. By the time that had happened in 2002/2003, all of the problems were entrenched. It is then a matter of how you sort those out from a problem that has already been created over the previous half dozen years.

Q59 Austin Mitchell: The final renegotiation—of which there were three—was October 2003. It was not cancelled until October 2010. What was the reason for that long delay?

Bernard Gray: A decision was made in 2003 that it was better to continue than to stop, because the capability was wanted, and it was felt the programme could be fixed. A decision was made at that time, which, with the benefit of hindsight, was not a good one, to continue to put money into it.

Q60 Chair: Except there is a real capability gap now, isn’t there?

Vice Admiral Lambert: If we had money we would have carried on with Nimrod.

Q61 Chair: That does not answer the question. I understand that it was cancelled because we did not have the money, but is there now a capability gap?

Vice Admiral Lambert: There is a capability shortfall; it is a risk.

Q62 Chair: You cannot tell whether there is stuff coming round close to it?

Vice Admiral Lambert: In many areas, we try to mitigate that risk by a number of other capabilities. We will use our frigates, anti-submarine helicopters, etc, to mitigate some of that risk. Will it mitigate all of it? No, it will not.

Q63 Austin Mitchell: Is it not more than a risk? This aircraft serves a very useful purpose, and 3.21 tells us what its purposes are: it is long-range search and

rescue, maritime counter-terrorism, gathering strategic intelligence, and protecting the nuclear deterrent, not to mention spotting all of these foreign fishing vessels pinching our fish, which is an extremely important use I think. Were those risks in not having a Nimrod accurately surveyed, when it was cancelled?

Vice Admiral Lambert: Yes, they were.

Q64 Austin Mitchell: The Hercules, insofar as it is a lumbering great thing, is not going to be adequate at doing those jobs. Some of the witnesses to the Defence Committee said that the other assets would provide only a “substandard replacement” of the Nimrod’s capability. How accurate was your study of the risks? Are they not still serious?

Vice Admiral Lambert: There are risks. Are the provisions we put in substandard? No. We have contained the risks within each area. The main purpose of Nimrod was doing antisubmarine warfare, i.e. seeing what was below the ocean surface. The other tasks Nimrod did were because it was an aeroplane that was available to do those tasks. We are looking at a number of other aircrafts to do those tasks. As far as antisubmarine warfare goes, we have mitigated those risks within the bounds of our current capabilities and budget.

Q65 Matthew Hancock: Can I direct this line of questioning to Commodore Beverstock, because you were the SRO for Nimrod?

Q66 Chair: He is the SRO.

Commodore Beverstock: Yes.

Q67 Matthew Hancock: You are the SRO?

Commodore Beverstock: Inasmuch as it is no longer a programme.

Q68 Matthew Hancock: How come you are an SRO for a programme that is—

Commodore Beverstock: The programme has been cancelled.

Q69 Matthew Hancock: Quite. So are you the SRO for Nimrod?

Commodore Beverstock: I am the SRO for antisubmarine warfare capability.

Stephen Barclay: The capability, not the project.

Q70 Matthew Hancock: You are the SRO for the capability, so you are the SRO for Astute, because—

Commodore Beverstock: Astute forms part of the projects that contribute to antisubmarine warfare capability.

Q71 Matthew Hancock: When did you become the SRO for that capability?

Commodore Beverstock: Technically, January this year.

Q72 Matthew Hancock: We have heard about the history of why there have been overspends and delay in this area. We have heard quite a critical description. As the SRO can you give the description of why you thought that these delays happened, and whether you

are content with the decisions that were taken as a consequence?

Commodore Beverstock: Which delays?

Q73 Matthew Hancock: We have a constant frustration on this Committee that SROs are in place for a short period of time, and here we have it: you are an SRO, through no fault of your own, who is in charge of a non-project.

Commodore Beverstock: Perhaps if I answer that question dealing with the Astute programme, because that is where the bulk of my experience lies. Then I can translate that into the Nimrod programme on its own.

We had this big gap between the Vanguard class and the Astute class. What we saw at the beginning of the programme was an underestimation of the cost; as you have heard CDM articulate, that underestimation and the way we did the contracting made it very difficult to get under the skin of that particular programme.

In my previous jobs I have lived through and seen the results of that. In the early part of the programme we lacked the ability to put the submarine together technically; these are very complex pieces of equipment to construct and bring together. It is not just what BAE Systems do; it is the other two tier-1 suppliers, plus the 400-odd second and third tier suppliers, which have to contribute to that critical supplier base: the SQEP—suitably qualified and experienced people—that you need to manage the project, build the submarines and supply the equipment. It was not just BAE Systems, it was all the way through the supplier base, that we had problems, because we had effectively stopped ordering submarines, and stopped building them. What we saw in the early part of the programme was that led to the consequent delays in the project, and the cost increases. There is no doubt that that was a consequence of that.

As the programme moved through, and as we started to treat the production enterprise as a whole enterprise, tied in with the Successor, we have got to the bottom of those technical issues. What we have seen for the Astute programme is a much better delivery performance. HMS Astute has now passed its initial handover, it has yet to achieve its operational handover, but it is now out in America. It very successfully fired two Tomahawk missiles, including the most updated Tomahawk, only last month. When we re-basedlined the programme 18 months ago, that was when we expected to deliver. That is a very good delivery performance, and we are on track to deliver that submarine to the Navy when we were predicting it is going to come in to the Navy.

Q74 Matthew Hancock: When is that?

Commodore Beverstock: That is in the early part of 2013. That is reflected in the Report. In the early part of the programme we saw these unbounded cost risks, cost increases and cost delays. We then treated the submarine enterprise and did some deliberate delays in stretching out the drumbeat to match with the Successor programme, again trying to deliver the minimum sustainable net cost for the submarine enterprise. That has been characterised by better cost

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performance. CDM has outlined that the cost forecasts and the historical cost analysis we have now got in the Astute programme is better than we have had in the past, and we have certainly got evidence of that through this particular Report.

That hopefully that answers your question, certainly on the Astute programme. When I look at the Nimrod programme, all the characteristics of that enterprise—the delays and everything—are all there. Even though we cancelled the programme, although we had 95% paid out what was approved on the programme, there were still issues to be resolved with delivering that aircraft into service. Those costs and risks were not quantified.

Q75 Chair: Let us stick to the Nimrod/Astute. You said 95%. My reading of this is that you spent £3.4 billion; we ditched £3.4 billion. There was £200 million left to spend to get them into service. I hear now that you say there were some risks with that figure, but that was £200 million. You have cancellation costs; you are obviously not going to tell me what they are today, although I would love to have a ballpark figure between what you are offering and what they are asking. Do you feel able to give us that figure?

Ursula Brennan: We are happy to give you a confidential briefing on this subject.

Bernard Gray: It has been subject to negotiation between us and the company, but I would not want to say it in public.

Q76 Chair: It is pretty difficult to think it would be much below the £200 million left. Therefore it seems to me that the only value for money justification for cancelling Nimrod was the £1.8 billion⁵ that you save in running costs. Nowhere in this Report does it tell me what the alternative running costs are of all the mitigation strategies and mitigation equipment that you are putting in place. There is a £200 million figure; some, if not all, is going to be eaten up in cancellation costs—you will tell us in a confidential briefing. There is a £1.8 billion figure of running costs, some of which must be eaten up in mitigation, and there is a capability gap. It does not seem to be a great story. Of the £1.8 billion, do we know how much is going to be eaten up in mitigation expenditure?

Bernard Gray: It is a similar to your point about Scout. You are always trying to make probabilistic decisions about what you need and can afford to buy, own, and operate. As Admiral Lambert said, if we had more money, we would buy it. We do not have more money, and the money is less than people had been predicting in the past. It is a lower priority than some other things. Why is it a lower priority? Because we have a layered antisubmarine warfare defensive network; we do not depend on one thing for one job; we have layers of it.

In removing a layer, does a probability go up that a submarine might penetrate a shield? Yes, it does, but we have calculated that, against the real cost of completing it—which may well have been significantly in excess of £200 million to bring it into

service, plus, as you say, the almost £2 billion in the 10 years to run it—we made the judgement that said the additional assurance we got from fielding that was not justified by the costs that would be incurred.

Amyas Morse: Can I just help, Chair? To draw this out a bit, if you are making good the fact that that capability is not there, you are probably going to be working other assets harder, or there will be an opportunity cost to it. In other words, if you had had that asset there, you would have used the rest of your capabilities differently. That must be true, mustn't it? Therefore, even though it is not possible to quantify it—we said we did not see how we possibly could—we thought in principle there must be some costs associated. Instead of having Nimrod, let's say you have your antisubmarine helicopters in the air much more, doing submarine patrols in a more active capacity than you might have done otherwise. There are costs. I am not surprised that we could not arrive at what they were, but it is not a zero-sum game in terms of the additional operating costs, I wouldn't have thought. Is that fair?

Vice Admiral Lambert: There may well be marginal costs of keeping certain things at sea or running them slightly harder.

Chair: What are they?

Q77 Matthew Hancock: In your last answer to me, you said the future costs of completing the programme were unquantifiable because of the overruns and the technical problems that you had come up against. Are you really telling us there were unquantifiable future costs of completing the programme, and unquantifiable costs at the margin of mitigating the risks, and you did not manage to quantify or even get a risk-based analysis of this? You are shaking your head, Mr Gray?

Amyas Morse: Forgive me for a second. I am not surprised that it is difficult to quantify the additional operating costs of using other equipment, because it can be used in so many different configurations. It is quite difficult to say what assumptions you would make.

Bernard Gray: What proportion of the fixed costs do you associate with that?

Amyas Morse: While there is something there, I am not expressing personal surprise that they do not know what it is.

Q78 Chair: I disagree with the Comptroller and Auditor General. In taking a decision to junk £3.4 billion of expenditure, which is the decision you took, you have to do a proper cost benefit analysis, which tells you what your extra costs would be elsewhere.

Commodore Beverstock: I joined as SRO when the decision had already been taken to cancel this project. However, on the cost benefit analysis, what I can say in terms of the advice that was put up through Vice Admiral Lambert to the Defence Board and Ministers, the cost of the programme and the capability risks that we would be taking were properly articulated. Coming to the judgement upon which they made their decision, they had all the information about the risks we were taking across that period, against all the other

⁵ The cost saving as stated in the NAO Report is £1.9 billion, paragraph 14, page 8

assets that we have available in order to deliver an overall ASW capability.

If I can address this question about what are the marginal costs, when we looked at the programme for Nimrod, there were some elements of equipment that we are reusing and transferring into other assets. There are some things coming off the sonar and emission suite that went into the back of Nimrod, which are appearing in the Merlin Mk II Capability Sustainment programme. We are transferring some elements of capability, and that was costed as part of the overall capability.

In terms of the marginal cost of the other assets, as you have very neatly highlighted with Nimrod, this was not just a fantastically capable bespoke asset around antisubmarine warfare, but it had other uses across defence on maritime counter-terrorism, anti-piracy, and maritime C4ISTAR, etc. Look at the other assets we use for antisubmarine warfare: Merlin helicopters, Type 23 frigates, submarines of the Astute and Vanguard class, which contribute to an element of underwater surveillance themselves; they are highly capable assets, but are employed by the individual services across a wide variety of tasks, including antisubmarine warfare.

The allocation of those running costs on a day-to-day basis tends not to be: this proportion of the fixed cost of the fuel for a frigate on this particular day is for antisubmarine warfare. It tends to be done taking the intelligence we have at the time, what the actual employment patterns are and what the mission and everything is. Those costs are included in our existing programme.

Bernard Gray: I will make one final observation on this from my point of view. I accept the Auditor-General's general proposition. I was not here for this decision, so I am not defending some decision that I made or was involved in, but there was sufficient information around the right order of magnitudes of cost for what it would cost to complete, what the additional marginal costs would be, what the running costs are to justify the decision that was taken. It was the right decision that was taken, I think, and it was not close in terms of what the costs were. It was nowhere near close, because the other costs were at least an order of magnitude lower than the amount of money saved.

I personally believe—though it is a classified issue—that the level of risk being accepted in that was an acceptable one, and it was also correctly judged. Therefore this was not a close 4–3 result; this was a 5–0 result, and I am confident the Department made the right decision. The only question would be: would you make a decision earlier? It is not in question that this was the right choice.

Q79 Chair: The only conclusion from that is £3.4 billion has still been wasted.

Bernard Gray: That is true.

Q80 Stephen Barclay: What is the most projects covered by any single capability SRO?

Vice Admiral Lambert: Probably in the equipment logistics support area where Brigadier Brittain covers a whole range of programmes over all three services.

Q81 Stephen Barclay: You do not know how many your potentially most stretched Senior Responsible Owner is covering.

Vice Admiral Lambert: I know each one of the SROs; I can go through his programmes, and whether I add them up in one way or another, he and Deep Target Attack between them probably cover most of the programmes.

Q82 Stephen Barclay: We have established Commodore Beverstock is SRO for four projects, two of which are now on hold? Brigadier Jaques was responsible for six major projects with a combined valuation of £17 billion, and our exchange last year led to a recommendation by this Committee. I contacted the MOD on Monday via the NAO, and I know that message got through, because a Defence Minister made reference to it as we were voting on Tuesday, but I was not provided with the up-to-date figures for this year. It is a very simple question: how many projects is any single Senior Responsible Owner responsible for?

Vice Admiral Lambert: Brigadier Jaques has moved on, on promotion.

Q83 Stephen Barclay: It is often the way.

Vice Admiral Lambert: John Britten now has his, which is why I said he has probably got the most.

Q84 Stephen Barclay: How many is his replacement covering? Is it still the same as last year—six major projects?

Vice Admiral Lambert: Yes it is; that has not changed.

Q85 Stephen Barclay: What is the current combined value of those six projects?

Vice Admiral Lambert: I could not give you that figure off the top of my head.

Q86 Stephen Barclay: It is probably north of £17 billion, isn't it?

Vice Admiral Lambert: Yes, over a 10-year period.

Q87 Stephen Barclay: If someone is covering a multiple number of projects, how can their move be linked to a distinct phase on each of those projects? Does it not stand to reason that there cannot be a distinct phase at the same time on each project?

Vice Admiral Lambert: There is a difference between the project management that happens in Abbey Wood and the need to keep the project and the operating centres there for long periods of time. The SRO's role is to oversee what happens in Abbey Wood, watch the finances, and ensure that all the other lines of development, such as the people, the training, the infrastructure, come in on time. Quite often this Committee talks about projects and SROs where the real responsibility for the project lies with the Project Officer in Abbey Wood.

Q88 Stephen Barclay: What the Committee often talks about is the lack of clarity as to who is accountable. If I could take you to the PAC recommendation from this hearing last year, which is in Treasury Minutes for May 2011, PAC Conclusion

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Recommendation 3 says that it is “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.” It went on to say, “The Department should ensure that SROs remain in post during key phases of a project lifecycle.” The response from the Government to that recommendation at paragraph 3.1 says the Government agrees with the Committee’s recommendation. We had this discussion last year about one Brigadier covering £17 billion of spend over six projects in addition to other responsibilities, the difficulty around accountability for that and the reporting lines in from him and the fact he was not sitting on key committees; therefore, could he really be accountable? As a result of that, the Committee made a recommendation, which you accepted. I am trying to understand whether anything has changed following that recommendation.

Vice Admiral Lambert: We are in a process of change, because, following the Levene review into the Ministry of Defence, we are reviewing precisely where the SRO responsibility best sits. In the Department that I run, we are looking at the totality of responsibilities and how they are moving forward. The recommendations of this Committee will be taken into consideration as we go through that process.

Q89 Stephen Barclay: You are saying that nothing has really changed from last year?

Vice Admiral Lambert: The appointments that were in train during the year have continued. We are looking at how many of the one stars are going to remain in the main building, and what their responsibilities are during the Defence reform.

Q90 Stephen Barclay: Commodore, could you please explain to us how your executive authority has changed over the last year as an SRO?

Commodore Beverstock: I do not believe it has.

Q91 Stephen Barclay: It has not changed? Do you sit on or attend all senior level committees making decisions associated with the projects that you are Senior Responsible Owner for?

Commodore Beverstock: I would have to ask you what you mean.

Q92 Stephen Barclay: Do you report directly to the Admiral or to a civilian in between?

Vice Admiral Lambert: The Commodore is responsible to the Joint Capability Board, which I chair.

Q93 Stephen Barclay: What I am driving at is, there is a vast range of committees, and Mr Gray accepted the point when we had the exchange last year in terms of trying to have a more linear structure and greater clarity around accountability. Just to recap on what the definition of a Senior Responsible Owner is, it is the person personally responsible for the delivery of the project. I am trying to establish, where material decisions are being made on the projects for which you are Senior Responsible Owner, whenever there are committees at a senior level of the MOD

discussing your projects, are you a member of them or at least present for those discussions in order, as Senior Responsible Owner, to input into those committees?

Commodore Beverstock: In terms of the committees I have, I have to look at the responsibilities the Department places on me in terms of its use of the term SRO. My accountability is in terms of programming the money—that is technical speak for the P9 lines allocated to my various projects—to ensure that what is required to be delivered at a capability level is provided by the balance of projects in P9 lines.

Q94 Stephen Barclay: Perhaps we could have a note setting out what senior level committees there currently are in the MOD, perhaps any committee with a one star or above making decisions associated with any of the four projects of which you are Senior Responsible Owner, and whether you would attend those.

Commodore Beverstock: All the projects I am in, at the project and programme level, go through the Deterrent and Underwater Platform Board, which I chair for the Underwater programme, which is anything in the submarine enterprise. The Antisubmarine Warfare Programme Board will be making capability level decisions and looking at the resourcing of individual projects; in fact, I sit as part of the planning round process in order to do that. In terms of the senior level Ministry of Defence Committees, all I do, within those particular bounds, is forward recommendations to the Joint Capability Board.

Vice Admiral Lambert: Our SROs are responsible for delivering a capability. There is no point in delivering just a platform without the trained people, the infrastructure, etc.

Q95 Stephen Barclay: No. As I understand it, there are eight key components, and the SROs are responsible for some of those and not others. That is how we had a situation, which the Committee looked at in the past, of buying helicopters the pilots were not trained to fly.

Vice Admiral Lambert: That is what the SRO’s responsibility is: to ensure we do not have that situation again.

Q96 Stephen Barclay: I thought the Commodore said a moment ago that he is not responsible for all eight components.

Commodore Beverstock: For coordinating them.

Vice Admiral Lambert: He has oversight, and each one of those components will feed into his Programme Board.

Q97 Chair: What does oversight mean?

Ursula Brennan: We could not carve up the Defence budget so that, for instance, the training of the Navy is divided out between all the people who happen to have a project for which Naval Officers require training; that is why the SRO and project delivery roles exist. Bernard Gray has been taking action to up-gun the project delivery end of the programme and

we have been taking action to improve the management of the portfolio.

The role of the SRO is to ensure, looking across all that, that those things come together, not just that the submarine is being delivered on time but that there will be jetties, training, doctrine, weapons, all of that. It is his function in life to say, "I am not getting the support I need from Defence Infrastructure to build the jetties". If that is a problem, he should surface it with Admiral Lambert, who will, if necessary, bring it to the Defence Board.

Q98 Stephen Barclay: No one is disputing that. If there are materiel committees happening, it is difficult to have an oversight role if you are not privy to some of those. You accepted a recommendation, but it seems, on your own admission, have done nothing over the last year to implement that recommendation.

Ursula Brennan: I have not had the chance to respond to what we have done in relation to SROs. I think we have said before that we use the SRO role differently from the way that other Departments do. During the summer of this year, we undertook a study as part of the work on Lord Levene's transformation programme, because the group in which the SROs sit will be restructured, as the whole of the Head Office of the MOD will be. We wanted to look at whether we had got portfolio management correctly managed, organised and supported. We undertook some work and concluded that the notion of having SROs in the way that we do, where their job is to draw together all those capabilities, was correct.

Q99 Stephen Barclay: There is an inherent contradiction between having capability programmes where you look at multiple projects, and saying people can move at key milestones of individual projects, isn't there?

Bernard Gray: In my organisation, as far as the building of the equipment is concerned, we are responsible for that component. We have made significant changes, which we have not yet had the opportunity to discuss, in the course of the last year, to strengthen that, and to increase the tenure of people in that. I would be happy to outline that for you. Compared to most other Departments, the MoD has a large amount of project management activity: the Astute programme has its one star direct manager; there are two two-star officers in the submarine programme overall; there are several one-stars in relation to the Successor deterrent, and so on; they work all the time, every day, on delivering the specific set of projects between Astute and the Successor deterrent.

Commodore Beverstock's role, in the way that we work it, is to take the output and reporting from them, and ask whether they are on track to deliver their component of an overall plan. If we are out of sync with other components of that, there is a much lighter touch; he is able to alert Admiral Lambert and then the Defence Board about the fact we are behind, or the infrastructure might be, or some other thing. There are a lot of people in my organisation whose day job it is to deliver those components and then pass

reporting up to Admiral Lambert and Commodore Beverstock. That is how we work it.

We have done three things in my area that make a significant difference. First, I have restructured the DE&S Board so that I have four three-star officers covering the totality of the programme, where once we had one Chief Operating Officer. We now have four times as much senior time devoted to the core of that programme. Second, I have insisted that anybody taking up an appointment at anything from colonel to two-star level in that organisation serves in it for a minimum four year term: that has been agreed by the Defence Board and the Services.

Q100 Stephen Barclay: That is very welcome.

Bernard Gray: Third, we have agreed that all of those posts from full colonel through to two-star will be subject to open competition; therefore, we will get the best person for the job. We made those changes six months ago and that has significantly strengthened our project governance over the course of time. There is a further set of activities around up skilling, and so on, which we might come to later. In our part of it, we have made significant progress, which I hope will improve not only project performance, but the reporting through to Vice Admiral Lambert and Commodore Beverstock to allow them to do their oversight role, not their project management role, because they do not project manage it for us: they are the overseers.

Q101 Chair: Commodore, how long are you staying in your job?

Commodore Beverstock: Can I just clarify something to Mr Barclay before I answer that question? I do not want you to be left with the impression that I do not have oversight or membership of the committees of the individual projects that affect my capability. I am either a member or chair of the various programme and project boards across all the lines of development of all the things that affect my capability. There is a wide span of those, and it takes quite a lot of effort to keep that, but I and my team are involved in all the things that affect it. How those decisions and recommendations go through the senior levels of the MoD is a different question for the PUS. Ma'am, can I take your question?

Q102 Chair: How long are you in post for? A year.

Commodore Beverstock: I have been in this post since October last year. I am here for what will be a normal three-year appointment unless I am told otherwise. It is worth bearing in mind, if you look at my history, I came to this job on the back of a two-year appointment inside the submarine enterprise. I am effectively a poacher turned gamekeeper.

Q103 Nick Smith: Mr Gray, listening to your remarks following questions from Mr Barclay, it seems to me you provided some clarity in the bit of the organisation that you now head up. It appears to me that down the corridor it is still a little muddled; you do not have the same level of clarity or length of service for important post holders. What is your perception?

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Bernard Gray: You must understand that there is a significant restructuring of the centre of the Department going on in response to Lord Levene's report. I have the luxury that Lord Levene did not recommend anything for my area and I got on with my plans. Lord Levene has recommended significant changes to the way that the Equipment Programme is managed by the MoD, putting a lot more of it with the forces' Front Line Commands. The PUS, Admiral Lambert and everybody else are currently working through what the structural implication of that is, who should sit where and what they should be responsible for.

I would agree with them that I would not go around making a lot of interim changes when, in 12 months' time, I am going to then lay down a new structure. It may be that we were non-compliant with something over the course of the last 12 months; because Lord Levene has intervened, it may be a situation where we will be sitting here in 12 months' time saying, "This is the clarity; this is the role of the SROs in a post-Levene world." They have a degree of change I have not had.

Q104 Fiona Mactaggart: One of the most reassuring things I heard from you, Mr Gray, was your referral to the fact that, in the future, there will be more batch purchasing; I do not know if I have the language right but in my kind of shopping it is a bit of a shift from couture to high street. Am I right?

Bernard Gray: Prêt a Porter as it were.

Q105 Fiona Mactaggart: Will that change be the thing that is illustrated in figure 10, which is that when you reduce the number of any piece of equipment, the cost of each individual bit has gone up, sometimes hugely?

Bernard Gray: Unfortunately, it is not straightforward. If we buy something off the shelf, we will be paying some proportion of the development costs; it is not that we would avoid the development costs that somebody else has paid, we will just pick up some proportion of it depending on what that programme happened to be. The difficulty with just going to an off-the-shelf, batch-purchase process, which is not possible in all cases anyway, is that you may be causing industry, either here or abroad, to maintain capacity against some time when they may get an order from you, for which they are then going to charge you. What is the insurance premium and overhead that they are going to charge you for keeping something going on the basis that they might get an order?

Also, it is not completely straightforward because we have seen that just running a competition and letting a contractor build something is not always a spectacular success; we have spent most of the time debating two particular projects that have exactly those characteristics. Saying, "We will buy something from you off the shelf, and we will take your assurances about how it works" is not always what it appears to be. The move to a more flexible position is a good and sensible thing. In a tough world, being prepared to compromise our requirements somewhat—to say something that is 80% of the answer is better than

nothing—is a sensible thing for us to do, but it is not a black and white issue.

Amyas Morse: Just to be clear, you were making reference to batches earlier on, and there is a distinction with those early projects, which were not really off the shelf; they were specifically designed. That is part of the trouble. To be clear, that is different from something that has already been designed, which you might have adapted for your purposes.

Bernard Gray: Regrettably, suppliers have a way of representing a finished product as having characteristics it does not always have.

Amyas Morse: Okay.

Q106 Fiona Mactaggart: I ask this, because in your earlier response on submarine contracts, you talked about the cost of capacity at Barrow and the skills gap. I am very interested in risk. It seems to me that at the moment the Department is bearing risk, and maybe it should, for maintaining the skills that are needed in defence procurement, and is bearing risk in the capacity in relation to yards like Barrow. I want you to tell me about the cost of that risk and who bears it—is it industry, or the taxpayer? It is quite an important risk. What is the plan for it?

Bernard Gray: Ultimately, if we want a capability, the Government ends up bearing the risk at some level. If we want submarines, in the end we have to pay for it. We can put in things that try to incentivise people, but, fundamentally, if they make a mess of it, we either decide to walk away and leave them to it, or we decide how we are going to correct it. It is similar to having a builder around to your house who makes a mess of the job; you cannot say, "All the heating system has gone out of my house, therefore I will just live without it". As the house owner, ultimately you want to live in that house, you want a heating system in it, and you are going to have to either come to an arrangement with the original contractor or get another contractor in. You do not have the option of saying, "I will walk away from the house."

We are ultimately owning the risk in that sense. If we want a nuclear deterrent, we are in some sense underwriting a capability to get it. You are then down into: what is our best route? The submarine enterprise is a somewhat unusual activity in the sense that we probably could not buy nuclear submarines from anywhere else in the world, even if we wanted to. I do not think it would be possible to contract with the US, for example, to buy submarines from them, for a variety of reasons. In order to have those submarines—if, as a nation, we choose to have them—we have to build them, and we need the competence to do so.

Q107 Chair: Why is it impossible to get them from the US?

Bernard Gray: They would not sell them.

Commodore Beverstock: There are international agreements that would prevent this.

Bernard Gray: The fundamental point being: you have to be a responsible nuclear owner, and you cannot just go and buy something off the shelf and hope it works having read the manual.

Q108 Chair: I do not know who manufacturers them in the US. Is it BAE?

Commodore Beverstock: It is a combination of two yards: Northrop Grumman and Electric Boat at Groton.

Q109 Chair: In a global world, I can see that you want to protect your nuclear capability on a national boundary, but I cannot see that the industry operates nationally any more.

Bernard Gray: For a variety of reasons I do not want to get into here, I do not believe that that would be technically possible.

Ursula Brennan: There are technical, commercial and legal issues. There are things that we can buy overseas, and we do, but there are certain capabilities—and the nuclear deterrent is the prime example of this—you either have or you do not, and if you do, you build it in the UK. If you are going to build it in the UK, there is no one else in the UK buying nuclear submarines.

Q110 Matthew Hancock: Are you sure about that?

Ursula Brennan: Reasonably confident.

Q111 Stephen Barclay: You are talking about the supplier contract there. Quite, often one of the particular costs is around the maintenance contract. Are you looking, in terms of the supplier, to start to bundle, perhaps, some of the maintenance issues more with the supplier contracts, or keep them quite separate?

Bernard Gray: One of the elements of the Submarine Enterprise Performance Programme, a separate programme we have made reference to a couple of times, is—where Babcock do a lot of the support work and BAE Systems do a lot of the original construction work—to what extent we are better able to integrate those activities to share cost. The point is, if we decide that that is an activity we want to do, and fundamentally we are going to pay for it one way or another, the question is then: what is the appropriate structure that allows us to build that at optimum cost in a world where some of the constraints are not what we would want them to be? We can only afford to operate so many, and we have to build them at a slower rate than is ideal. We have to make compromised decisions in all of that to keep a capability to continue to manufacture and support a submarine base.

Chair: It might actually be better nationalising it; you control it.

Q112 Fiona Mactaggart: I am not a big nationaliser, but when I listen to your discussion about the yard and the skills base, both of which are risks, it seems to me that these are strategic interests for Britain. It is not just a purchasing decision; it is a national investment decision. I am interested in what conversations you have with others, in BIS or whatever, about the value of protecting that capability, that skills base and that capacity in the UK, and whether it can generate other income for our country, not necessarily building nuclear weapons elsewhere; the skill of building a submarine is a potentially

marketable skill in other regards. How strategic are we being? If we are bearing this risk, are we getting the value out of it? That is what I am asking on behalf of the taxpayer. The taxpayer is paying the bill, but are they getting all of the reward?

Bernard Gray: Collectively, the country has made a decision that says having limited liability companies managing aspects of this on our behalf is a better way of doing it than the Government doing it directly, because they bear some measure of risk. The Astute programme has cost BAE Systems a lot of money, and they are very focused on that not happening again; potentially, if it was owned by the taxpayer, that entity might not care quite as much. I am sure that Mr King focuses quite a lot on ensuring this problem does not recur. Even though we bear the ultimate risk, there is benefit in having an incorporated entity managing that activity. You can make a different proposition, but that is where we are today, and that is the judgement that we collectively have made over the last 30 years.

Q113 Fiona Mactaggart: Let me ask about one more aspect of risk. I am concerned about the risks for our defence from the planned reduction in the availability of the Astute class submarines. I am not sure whether we are managing that effectively. Are we confident that we are?

Vice Admiral Lambert: Yes we are. I was talking to the First Sea Lord about this only yesterday morning, and he is quite confident that the risks are manageable. We always have, with all of our platforms, a certain number at high readiness and the other platforms at lower readiness. If we do not have precisely the right number, we will do a number of other things to mitigate that problem. It is an entirely manageable risk, which is managed on a day-to-day basis by Commander Operations for the First Sea Lord, and he is quite content.

Q114 Chair: It sounds to me from what you have said that we ordered too much 10 or 12 years ago. If we can manage with less now, what the hell were we doing? I know it is past, and it is not blaming you lot, but you tot up £3.4 billion there, £1.9 billion on the Astute, the aircraft carriers we are not going to deal with today, because we have already—but £2.8 billion on that. I do not think you are going to do the vehicles; you have put £1.8 billion⁶ into that so far⁷. There is a heck of a lot you are putting in, and it is all very well now you have come back to us and said, “We can manage the risk”, but what the hell were we doing buying it? We have wasted billions.

Vice Admiral Lambert: Part of managing that risk is that our submarines stay at sea for longer.

Q115 Chair: You could have taken that decision 10 years ago, and saved us all this money.

Vice Admiral Lambert: It means that our people have to stay at sea longer, and it is not something we want

⁶ As mentioned in Q52 the amount invested in Specialist Vehicles so far in actually £1.4 billion.

⁷ To clarify if this is concerning the Support Vehicle programme referred to earlier then it should be £1.4 Billion and not the £1.8 Billion quoted. However, only £500 Million of that is committed, the remainder is a budgetary estimate and planning assumption

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to do on a day-to-day basis. The First Sea Lord is willing to do it for short periods of time to manage that risk.

Q116 Stephen Barclay: Paragraph 3.26 says, “The Department is looking at longer term solutions to address the maritime patrol capability” as well. If you are looking at this from the short term as a quick fix, there is not just the impact in terms of submarines; maritime patrols are also an issue. Can you say something about what sort of timescales and barriers there will be in terms of whether the future maritime air capability will be restored. That is going to be hit in the short term is it not?

Vice Admiral Lambert: There are no current plans to replace Nimrod with another aircraft within the 10 year programme. We are looking within the research programmes at what can come on behind that.

Q117 Stephen Barclay: When will a decision be taken on that?

Vice Admiral Lambert: It will depend on the maturity of the research over the next few years.

Chair: There will not be any money anyway.

Q118 Ian Swales: I would like to pick up something that was said earlier: figure 12 shows a nearly 20% overspend on the 10 largest projects. Clearly part of the planning assumption is what overspends or otherwise might happen. The comment was made earlier, about the Astute submarines, that hundreds of millions were wasted because, I think the expression was “We did not understand the complexity”, or “There was unexpected complexity”. I would like to understand that a bit more, because we have heard the same story on aircraft, and on helicopters. What happened there, and how can we avoid that kind of thing happening?

Bernard Gray: I remember a little of the history, if you would like? A competition was run—and it does expose some of the limits of competition—in the mid-1990s to try and get some competition in against Barrow. Barrow had built submarines forever, and the policy decision was heavily competitively weighted at that time. GEC, which was then separate to BAE, was encouraged to enter as an alternative prime contractor. The timescales of the competition, and the intensity of the competitive process, meant that the two designs that were submitted for competition, for a fixed price, were not as mature as they should have been to be buildable.

The problems were compounded by the fact that, although BAE and Barrow eventually won the competition, having effectively had their situation tensioned by the presence of somebody else, we then decided that we liked some of the characteristics of one boat, and we decided to insert them into the design of the other. That was a deeply unhelpful thing to do, but we did it anyway. BAE was then set to work on a price that they had been driven down to through a competition, with an immature design, which then got altered as a result of that process.

Q119 Ian Swales: That leads into something that we have heard in previous hearings: if I am a defence

contractor and I agree to do something, my biggest problem is the people from the MOD who are here to help me, with new thoughts, new designs, new ideas, on the thing that I have agreed to do.

Bernard Gray: This was prior to contract award. They accepted a number of amendments to all of that. This was a poor risk decision on their part, which has cost them hundreds of millions of pounds.

Q120 Ian Swales: Leading on from that to the point I just made, how do you prevent cost escalation as a result of constant changes of specification, and new ideas that are outwith the original agreement?

Bernard Gray: One of the things we are discussing at the moment is how we further reform the position, and there are a variety of proposals around that. In relation to the specific point that you are making, what we need to be able to do is flush out the cost of change. Currently, and historically, we have not been sufficiently clear, partly because of time, to say, “If you want to change this characteristic it is going to cost X. Do you really want to do it, and are you going to have your budget adjusted appropriately to say that you have accepted this increase in cost?”

We need a much sharper definition between somebody who has potentially a good idea, but nonetheless it is a change, and when you are designing something on a computer system, when it is much easier to change it than if you already built it and you want to go back and rework the metalwork. Therefore, what is it going to cost you to change something at what point, and do you really wish for this change sufficiently to incur that bill? In the construction industry this would be a classic change order system, where you would expect to get a project manager approved: this is the change, this is the cost, this is the timescale implication; do you accept, yes or no?

Q121 Ian Swales: You are tightening up that process. Using submarine as an example, how many people work at the MOD end of submarine procurement, including Abbey Wood?

Commodore Beverstock: In the Submarine Operating Centre there are about 900 people.

Bernard Gray: It is about 1,000 people.

Commodore Beverstock: In Head Office it is not that many. My team is only 20-strong.

Q122 Ian Swales: Where are the 1,000, at Abbey Wood?

Commodore Beverstock: They are at Abbey Wood.

Q123 Ian Swales: What do they do all day, I suppose is the good question? If I am one of those 1,000 and I walk in, what am I doing on that particular day, given that the submarine is being built at Barrow or wherever?

Bernard Gray: The Astute exercise neatly demonstrates that you cannot just let a contract, walk away and expect somebody to build it and deliver it on time.

Q124 Ian Swales: Are they acting as a main contractor for these three level 1 suppliers? Surely not.

They are not coordinating the physical contracting, are they?

Bernard Gray: No.

Commodore Beverstock: It may sound a lot when you say 900 people, but split it down into the component parts of a submarine, which we have got to deliver, including the nuclear warhead enterprise: 900 is what is in the submarine cluster. The submarine cluster, as Mr Gray has already explained, is made up of a number of constituent components, which make up the submarine capability. It includes the production submarines that look after the Astute class, and there are about 120 people in that project team. There is the future submarines project—delivering the future deterrent—in which there are about 80 people.

There is an in-service support submarine team who look after the Vanguard class, the S class who are now being paid off, the T class—those which are in disposal—the in-service modifications, which is about 200 people. They have to deal with the torpedoes, the command systems, the weapons systems, the sonar systems and all that equipment. There is another team who deal with the nuclear warhead enterprise, with the Trident weapons system, which incorporates quite a lot, plus the warhead area.

Q125 Ian Swales: I very much understand a lot of what you are saying, both in terms of the existing fleet and the R&D for future capability. It is the 100 who are in the Astute programme: what are they doing?

Commodore Beverstock: It is a question for CDM, but there are some people in Barrow who are working with the shipbuilder on things like quality control issues, on ensuring that we have the right scheduling, and looking at the risk of the design, and some of the design changes that we are looking at, to ensure that we deliver these submarines on time and cost. There will be another group of people who are doing the contracting strategy for the future boats and the approval. There will be another group looking at the finances, then there will be a design team.

Q126 Ian Swales: I cannot possibly make a value judgement on all that. However, going back to Ms Mactaggart's question of whether this is a bespoke design or off the high street, this sounds like a heavyweight effort from the MoD against a product that we have already decided to buy.

Bernard Gray: It is a heavyweight effort, and should be, because we have to maintain a safe and reliable set of nuclear submarines in production, in operation, and in disposal. A deterrent submarine is probably the most complicated single object on the earth, which has significant safety implications. We have to be able to cost it, and we have to try and run it better than we have in the past. It may be frustrating, but I am trying to manage this on a day-to-day basis. This activity is my number one project priority. I am looking at how I can strengthen our governance project management and control of that activity so that I ensure, because of the large sums of money involved, the safety issues that we have to manage and the importance to the country of this activity around deterrents, we manage that appropriately.

In addition to that we are in a workout situation against the Astute submarines, where we are working through the backlog of problems from what happened over a decade ago, effectively. It is the appropriate thing to put significant effort against them.

Q127 Ian Swales: I was pleased with what you said a few minutes ago about looking at making sure change is properly managed, because the hidden concern I have in this line of questioning is that that number of people facing one shipyard could be part of driving the costs up rather than down, if it is not well managed.

Bernard Gray: I understand why you might be concerned about that in the general case. In this particular case I do not think that is true.

Q128 Matthew Hancock: Unfortunately, I have to go in a couple of minutes, but I want push on something that came up earlier that we then moved off, which is the Levene Report. We have discussed this before, especially with the new Secretary of State; how is progress going on the implementation of the Levene Report?

Ursula Brennan: The Levene Report is progressing well: there is an astonishing array of strands of activity going on. The Vice Chief of Defence Staff and the Second Permanent Secretary have a weekly meeting where they hold people to account. We have given people what we call in the MoD mandates to say, "You take away your slice of the business, you now have clarity about what we want you to do, go away and start making the change against that."

A chunk of it is around the business that Bernard Gray is doing in Defence Equipment and Support. A chunk of it is around restructuring the headquarters, which will impact on the size, shape, and role of the people in Admiral Lambert's responsibilities. A chunk of it is about delivering the actual SDSR deliverables and changes we have to make. A chunk of it is about the three front line commands reshaping themselves and the new joint-forces command where; we have appointed someone, and are starting to set that up. That is motoring on at a pace.

One thing we worry about is the volume of things that we are doing. Our non-executive directors are concerned about the capacity to change so many things at once. The basing changes alone are enough to keep a Department occupied for the next five years, and that is just one aspect of the changes.

Q129 Matthew Hancock: Which elements of the Report are proving to be the most difficult to push through?

Ursula Brennan: Two types of things are difficult to push through. One is the basing thing, because it is so complex: it is like a house-buying chain multiplied on a grand scale. We wanted to press ahead with that as fast as we can, but there are a lot of factors that are outside our control, including the state of the property market and the amount of money we will get from selling properties, which changes. That sometimes makes us say, "Maybe that is not such a good move if we are not going to get that return from it. Will we get planning permission on that site?" and so on. That

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is a very complex piece of the jigsaw, and it is very difficult. It is probably less true of the submarine enterprise, but elsewhere in the Equipment Programme you have some new helicopters, and you have to have places to put them, but the Basing Review may be saying we should move them out of there and put them somewhere else. The Basing Review is technically difficult to pursue.

The other bit that is difficult is something we touched on at the beginning, which is changing people's culture. The MoD is quite good at saying, "If you give us an instruction we will take it away and get on with it." If you actually want to change the way people behave to make them think about value for money and affordability in a different kind of way than the way they thought about it previously, and to have that more visible, to subject things to control, to stop having people in the centre interfering, that is harder to change.

Q130 Matthew Hancock: If it gives you any support in delivering these sorts of changes, I am sure this Committee will be holding your feet to the fire in terms of the delivery of its agenda for a long time to come.

Ursula Brennan: I do not doubt.

Amyas Morse: I thought what Mr Gray was saying in response to Ian Swales' question was key: the point about remaining as a design authority means that the MoD is responsible for every feature of the boats they are constructing, seeing that it remains integrated properly, and that it is going to work in future. It is not always done, but in this case is significant. I was agreeing with your comments about the cost of variations in projects; does that mean we have stopped having the practice of trading and deliberately putting aspects into projects that you can trade in response to annual adjustments in programmes? Has that sort of thing been stamped out now?

Bernard Gray: We are not there yet.

Ursula Brennan: That is the cultural point.

Bernard Gray: I was making the point in the context of a set of changes that we are beginning to introduce to DE&S, because Mr Swales was asking about change control effectively, and I said, "That is a particular component". There is a much wider piece of work on materiel strategy that I am doing, which has not yet gone to Ministers. We have not yet implemented all of that, of which this change and control process is part. It is currently our planning: it is not yet done.

Amyas Morse: Hopefully, as we approach balance in the programme, this process of trading each year to stay in balance should be eliminated. Is it fair to expect that?

Bernard Gray: It should be for the purpose of cash flow management: we still have to control the behaviours around specification changes—"While I am here, shall I just do X?"

Q131 Stephen Barclay: Is part of that devolving more of the decision making to the services individually, rather than doing things in the centre?

Bernard Gray: Part of the Levene process is devolving the decision making to the services. Part of

the work that I am doing is to ensure we appropriately expose to people the cost of their decisions.

Q132 Stephen Barclay: I wanted to come on to a slightly different issue. There is limited value in having equipment if you do not have the weaponry to go with it. We just had Libya, which will have used Brimstone missiles and various other bits of stock. What mechanism does the Department have to ensure its balance of weapons stocks reflects the time taken to replenish them?

Ursula Brennan: Admiral Lambert might be better to advise on this than me. There is a group that reviews weapons usage against readiness and future threats, so that we have an assessment of how we think we stand, what we have on the stocks, what we could get access to speedily, what we think we might be facing in the future.

Vice Admiral Lambert: There is a Stockpile Working Group, and it looks at not only the stockpiles of weapons that are required, but how long it takes to fill up those stockpiles.

Q133 Stephen Barclay: Is there a matrix that informs that decision?

Vice Admiral Lambert: Yes there is, and that is something that is changing. We used to procure quite a lot of our weapons as a complete stockpile, i.e. we would work out how many weapons we might use over a 30 year period and then build a huge stockpile. We are looking at doing that smarter by looking at whether, in certain areas, we can buy enough for initial use, and then enough for the time it takes to replenish, and then have some extra. That is all worked out within the Stockpile Working Group.

Q134 Stephen Barclay: If that matrix is wrong, and we do not have enough stocks, who is the individual accountable for that?

Vice Admiral Lambert: The person who is openly responsible, if we do not have a big enough stockpile for what we are involved in, is CDS.

Q135 Stephen Barclay: He sits on the group reviewing?

Vice Admiral Lambert: No, the work is reviewed at the two star level, and I can provide you the name of the person who is responsible for that working group.

Q136 Chair: We have gone round most things. I just want to quickly get answers to this: we hear that things are changing, and you have heard a general welcome in the Committee for that. However, if I look at this Report, and it is a complex one, we are still doing the old things. For example, we are buying four fewer Puma helicopters, presumably to stay in budget. We are buying three fewer A400Ms, presumably to stay in budget. Chinook aircraft: we said we were buying 22; we are now buying 12⁸. And we cannot get any sense out of you about how many Joint Strike aircraft we are buying, but we were going to buy 36, and we think you are buying 10, 12—something like that. Where is the evidence that things are changing?

⁸ The Department are purchasing two attrition replacements, therefore the original buy was 24 (22+2) it is now 14 (12+2).

Ursula Brennan: In terms of the numbers of items purchased, you went through a number of them there; I do not think all of those are decisions that we took in the past 12 months. Some of those have been taken over time. We have been clear—I hope we have—that until we get ourselves into balance, one of the things we look at is what gives us the best capability results, what gives us the best affordability and what gives us the best value for money.

We bring those three things together, under advice from Admiral Lambert, and conclude sometimes that it makes sense to stick with the capability, but to buy fewer of them; sometimes in the past we have postponed things; and sometimes, in the SDSR, we have cut things. The decision to buy fewer items is one we make if it gives us the best capability result for the cash that we have available to us.

Q137 Chair: I would scarcely describe it as a value for money decision, because if I just take the one, I do not know where the decision was taken, on the A400M—which struck me as not being one of the most radical bits of equipment to buy, but maybe you are going to tell me something else—we knocked out three of those. I cannot remember the figures; unit cost is up 46%.

Bernard Gray: Needless to say, the A400M story is complicated, but it was a fixed price contract, let with Airbus by a consortium of eight⁹ nations, if I remember correctly. A bit like the Astute story, it was more technically demanding to develop than the company had originally estimated. It has cost Airbus a considerable sum of money. I do not know precisely how much, because they have not disclosed it, but it is billions of euros and not millions. The development of that aircraft has cost them a considerable amount of money.

As part of the renegotiation process of whether or not we should recommit to a contract—this is a couple of years ago rather than now, which is why I am slightly fuzzy on it, because I was not here at the time—the relevant staff at the time did an extremely good renegotiation with Airbus to allow us to continue in the programme, reducing our off-take to manage our cash flow, but fundamentally reconfirming the prices. I cannot remember, because I was not there, why that 46% number is there—whether that is against original expectation. What I do know is that the value proposition we have on the table is extremely good, because most of the loss has been incurred by Airbus, and the price of the aircraft we are going to get represents very good value for money. I think they did a good deal. I cannot explain to you why that number increased. The increase that has occurred in the last 12 months is down to foreign exchange, because this is fundamentally fixed in euros, as a euro product.

Q138 Chair: Why don't you buy forward on foreign exchange?

Bernard Gray: We do.

Ursula Brennan: We do.

Bernard Gray: We hedge our foreign exchange exposure, but you cannot remove that risk forever. What you are doing, effectively, is averaging it over time. There has been a significant depreciation of sterling, as we know, which has many beneficial aspects as far as the UK is concerned, but one of the bad things is, if we are contracting for some euro stuff, it is going to cost us more money in the end.

Q139 Ian Swales: Can I ask a question about resources? It is not that long since the MoD finally got a financially qualified person in the top financial job. What resources do you have on this important financial side, given what you have just been talking about, and also given the point you made early on about the audit rights that we have with suppliers? What is our capability to deliver on that?

Bernard Gray: I mentioned the strengthening of the project management side, where I now have four three-star officers. The other change that I made at the same time was to up-weight the level of the financial director of my organisation from a two star to three star officer. I have run a competition, and we have just appointed a person from the private sector, who will be joining us in the New Year, as a more senior Finance Director than we have had before. That person is a qualified chartered accountant, I believe.

Q140 Ian Swales: That is just about to happen.

Bernard Gray: Yes.

Q141 Ian Swales: What about the troops underneath such people: do we have adequate qualified resources to do the kind of things that you are talking about?

Bernard Gray: You start at the top of the organisation, and work your way down on these things. Why do I say it is a matter of time? We know, in my study and in a bunch of other places, that we do not have sufficient finance-qualified staff, partly as a result of the difficulty of attracting them at the rates that we pay. So half of my management accounting staff are not CIMA qualified management accountants, because I cannot get them at that rate. I definitely have an issue with all those functional skills, and some of the changes that we will be bringing in are designed to increase our programme and project management, finance, commercial supplier management and engineering expertise—all those areas. The first step is to get myself the finance director who is going to do that.

Ian Swales: It is very important.

Ursula Brennan: One of the few areas that we have exempted from our recruitment controls has been financial experts. We have already increased the size of our cost accountants and assurance service for that reason.

Q142 Nick Smith: Ms Brennan, do you have plenty of high powered finance people down your end of the corridor too?

Ursula Brennan: I have a qualified Director General Finance, yes.

Q143 Nick Smith: What about further down the line?

⁹ There were 7 launch nations for the A400M programme: UK, Germany, Spain, France, Turkey, Belgium and Luxembourg. There are currently six Partner nations: UK, Germany, Spain, France, Turkey and Belgium.

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Ursula Brennan: He has, below him, been putting in place a structure to ensure that all the directors at the next level down are also financially qualified. That is a programme he has been undertaking since he joined us a couple of years ago. Yes, the programme is working its way through from the bottom and from the top.

Q144 Chair: I am going to draw it to a close. To sum up a bit: things look better than they did last year. However, we have not talked about aircraft carriers or

Sentinel; these are decisions that have been taken at a massive cost to the taxpayer. It is clear that scrapping, delaying, changing result in massive costs to the public purse. I hope your optimistic planning assumptions are not the only basis on which you are planning for the future, because, if they are, I dread to think what we will be looking at in two or three years' time.

Bernard Gray: I hear you.

Ursula Brennan: Indeed.

Chair: Thank you very much.

Written evidence from the Director of Commercial Services, Defence Equipment and Support, Ministry of Defence

MINISTRY OF DEFENCE: SUMMARY OF RECENT POST-COSTING RESULTS

In response to a recommendation in the Committee's Ninth Report, Session 1989–90 (HC295), the Ministry of Defence provides each year a summary of its post-costing activities, including details of repayments over £0.5 million made by individual contractors.

Accordingly, I attach a summary of the most recent post-costing results. Copies are being sent to the NAO and HMT officials, including the Treasury Officer of Accounts.

MINISTRY OF DEFENCE

SINGLE SOURCE CONTRACTS

SUMMARY OF RECENT POST-COSTING RESULTS

INTRODUCTION

1. This paper summarises the results of contract post-costing investigations recently concluded by the MOD. These investigations arise from long-standing Government and Industry arrangements for the pricing of non-competitive work, the main features of which are:

- (a) a profit formula to give contractors engaged on single source Government contracts a return comparable to the average overall return earned by relevant sectors of British industry (the formula is commonly referred to as the Government Profit Formula—the GPF);
- (b) the establishment of an independent, advisory non-departmental public body, the Review Board for Government Contracts (hereafter “the Review Board”), to carry out regular reviews and to recommend the GPF target rate of return.

2. Additionally, where prices are to be agreed on the basis of estimates at the outset of work (or as soon as possible thereafter), the arrangements also provide:

- (a) the right, up to the time prices are agreed, to equality of information, through an obligation on both parties to disclose relevant information;
- (b) the right of the MOD to post-cost contracts, to compare the costs agreed in the price with the actual costs incurred, and so determine the actual profit achieved, as compared with the target profit agreed at the time of pricing; and
- (c) if a contract cost variation is outside a pre-determined range, to share any excess profit or loss arising in accordance with a standard contract condition (DEFCON 648A); or, in certain circumstances, if either party believe that the agreement of a fair and reasonable price was frustrated by a lack of equality of information and they cannot reach a negotiated settlement, then the contract may be referred to the Review Board for Government Contracts for binding price determination.

3. The referral of an individual contract to the Review Board is a rare event: there have only been nine since the Board was formed in 1968. In last year's report we notified the PAC that the MOD had referred a contract to the Review Board in May 2009 and that the Board's decision was expected in 2011. A summary of the outcome of the referral is at paras 14–16 below.

4. The Agreement establishing these single source pricing arrangements was made between HM Treasury and the CBI in 1968. The MOD is the only operational user of the arrangements (commonly known as “the Yellow Book”), on account of the volume of its single source pricing activity. In January 2011 the Government asked Lord Currie of Marylebone to lead an independent review of the arrangements. He published his report in October 2011, making a number of recommendations which are now the subject of a further phase of consultation led by the MOD. The formal, public phase of this consultation will close in January 2012. The outcome may impact future post-costing activity by the MOD, as summarised at paras 8–10.

OBJECTIVES OF POST COSTING

5. The Department exercises its rights to seek cost information on contracts after prices have been agreed for three main reasons:

- (a) to assist in the pricing of follow-on contracts,
- (b) to assess the accuracy of estimating practices, and
- (c) to provide information for a selective scrutiny of the outcome and so that either side may refer the contract to the Review Board for a possible price adjustment, in accordance with contract conditions (SC48 or DEFCON 648). Since July 2004 there has also been provision (DEFCON 648A) for “automatic” sharing of excess profits and losses on firm/fixed price contracts over £5 million in value, without need for referral to the Review Board (although either party may still refer to the Board if they believe 648A sharing provisions would produce an inequitable outcome).

SELECTION OF CONTRACTS FOR POST-COSTING

6. Since the 1990s the Department’s internal guidance has set a default threshold for post-costing of single source contracts, at £10 million. This does not preclude the inclusion of contracts of lesser value, nor the exclusion of contracts above £10m where there is no utility to the MOD in conducting a post-costing. An increase in the average length and value of contracts over the past two decades, combined with a decrease in the staff resources available for post-costing, has led to a downturn in recent years of the numbers of post-costed contracts.

7. The MOD is addressing this issue and increasing the level of resource targeted at post-costing. The emphasis will be on selection of contracts for their utility in future pricing but the value of a contract will also remain a significant factor in the decision to request post-costing data from a contractor, particularly as the relatively new DEFCON 648A allows for the sharing of excess profits and losses.

LORD CURRIE’S INDEPENDENT REVIEW OF SINGLE SOURCE PRICING REGULATIONS

8. Lord Currie’s report was published in October 2011 and is accessible at <http://defenceconsultations.org.uk/category/independent-review-of-single-source-pricing-regulations/link-to-pdf-document/>. One of the reports main recommendations is that MOD should receive from its single source contractors more regular and consistent pricing data, actual cost information and variance analysis. If implemented, this should significantly improve the quantity, quality and timeliness of contractor data received by the MOD on non-competitive contracts. Rather than the selective approach to deciding what contracts to seek outturn costs on, the Currie recommendations would give the MOD actual outturn data (including actual versus target profit) on all single contracts over £5 million. By definition, this data will be less skewed than a selective sample and will enable more accurate conclusions to be drawn about MOD’s pricing performance, leading to better informed pricing of subsequent contracts.

9. Although MOD would be able to include this data when reporting the outturns on single source contracts to bodies such as the PAC, HMT and the NAO, it does not envisage a full “post-costing” type investigation of every contract over £5 million. The MOD will in many cases rely on the fact that the contractor’s statement of actual costs/profits will require company Board level certification. For this reason Lord Currie recommends the retention of the MOD’s formal post-costing rights, where the Department believes it needs to examine the outturn in more detail, to verify the contractor’s explanation of cost variances. He also recommends a relaxation of the terms of DEFCON 648A, allowing contractors to make greater returns on individual contracts where efficiencies deliver cost reductions (and greater losses where performance is poor). Lord Currie’s recommendations are all aimed at driving greater efficiency into single source procurement and improving value for money to the taxpayer.

10. Lord Currie’s recommendations are now the subject of further consultation across Government and industry, led by MOD with the involvement of the CBI and other stakeholders. Following consultation the MOD is planning to make a public response to Lord Currie’s recommendations in spring 2012.

SUMMARY OF RECENT POST-COSTING RESULTS

11. Pricing accuracy as revealed by selective post-costing is measured by expressing the total profit variation as a percentage of the costs estimated at pricing. These latest results comprise eight contracts, six of which yielded profits higher than the contract target profit. The total variation of profit on all eight contracts amounted to £42.3 million, being 3.26% on the total estimated cost of £1,296 million. However, £11.4 million of this additional profit was recovered by MOD (see para 13 below), bringing the variation down to £30.9 million, or 2.38% on the total estimated costs.

12. The GPF arrangements provide that where outturns exceed a “trigger figure”¹, contracts may be referred to the Review Board for Government Contracts for a possible price adjustment, binding on both parties. The trigger figure is expressed in terms of a variation between estimated and outturn costs of 10% or more.

¹ See explanation at Annex C

13. On three of the eight contracts the variation between estimated costs and actual outturn costs exceeded the Review Board's +/-10% trigger figure. One of these contracts was referred to the Review Board, and a £9 million repayment achieved for the MOD. On another contract which exceeded the trigger figure a contractual gainshare arrangement was in place, giving MOD a £2.4 million (58%) share of a £4.2 million profit variation.

THE MOD CONTRACT REFERRAL, MAY 2009—JUNE 2011

14. Following post-costing of a high value contract (£191 million), which had been priced over a number of years in successive tranches, the MOD concluded its contractor had not met their obligation to provide the Department with equality of information at the time of pricing. As a result, the MOD believed it had agreed a price it would not otherwise have agreed to pay. The contractor disputed this interpretation and despite an extended period of discussion was unwilling to negotiate a repayment to the MOD. The Department therefore made a decision to refer the contract to the Review Board for a binding decision, under a condition of the contract (Standard Condition 50).

15. After receiving formal written submissions and hearing oral evidence from the parties the Review Board reached its decision in June 2011, in an extensive written report that is confidential to the two parties. The Review Board also produced for the public record an "anonymised report" detailing its decision, a copy of which has been deposited in the House of Commons library (DEP2011-1762 dated 6 Sep 2011).

16. The Review Board found that the contractor had not fulfilled its obligations to provide the MOD information of which it was aware and which was pertinent to the pricing of the contract. However, the Board also found that the MOD did not make appropriate enquiries about certain matters of which it ought reasonably to have been aware. Taking account of all these circumstances the Board ordered the contractor to repay the MOD a sum of £9M. The contractor accepted the decision and has repaid this amount to the MOD.

CONCLUSION

17. The MOD has completed eight post-costing investigations since last year's report to the PAC, which also reported eight results. The total value subject to post-costing has increased from £1.1 million to £1.4 million. The variance between the estimated costs in these contracts, as compared with actual outturn costs, can be taken as an indicator of original pricing accuracy. The variance has reduced from the 8.01% variance in last year's sample, to 3.26% in this year's sample. This variance reduces to 2.38% when taking account of the £11.4 million repaid to MOD on two of the contracts.

18. As an indicator of trends in post-costing results, the 10-year rolling average variation for cases post-costed in the period 2000–2010 (excluding nil results reported for year 2007) has reduced to +2.69%, compared to +2.84% for period 1999–2009. Further analysis of the eight post-costing results covered by this report is shown in Annexes A & B.

ANNEX A

SUMMARY OF RECENT POST-COSTING RESULTS

Results from 2010 (with 2009 figures for comparison)

1. Eight contracts priced at £1.404 billion were investigated, as follows:

	2010 <i>Number of contracts</i>	2010 <i>Value £M (contract price)</i>	2009 <i>Number of contracts</i>	2009 <i>Value £M (contract price)</i>
Total	8	1,404	8	1,057
a. Contracts yielding profit higher than target return agreed in contract price	6	1,227	7	1,043
b. Contracts yielding profit less than target return agreed in contract price	2	177	1	14
	2010 <i>Number of contracts</i>	2010 <i>Value £M (contract price)</i>	2009 <i>Number of contracts</i>	2009 <i>Value £M (contract price)</i>
Contracts at (a) above which involve profit variation in excess of the 10% "trigger figure"	3	240	2	153
Contracts at (b) above which involve losses in excess of "trigger figure"	1	23	0	0

2. The overall results for all contracts, prior to any repayment to the MOD (report para 11 refers), are as follows:

	<i>2010</i>	<i>2009</i>
Profit included in prices	8.33%	7.38%
Actual profit on actual costs	11.99%	16.72%
Variation as % on agreed costs	3.26%	8.01%

* “Trigger figure”: see Annex C

ANNEX B

2010 POST-COSTING RESULTS: SUMMARY OF OVERTURN CATEGORIES

<i>Outturn Category</i>	<i>Explanation</i>	<i>No. of Contracts</i>	<i>Estimated Costs (£)</i>	<i>Target Profit (£)</i>	<i>Actual Profit (£)</i>	<i>Variation (£)</i>	<i>Variation % on Estimated Costs</i>
A	Cost overrun, loss in excess of trigger figure	1	21,485,095	1,275,433	-2,643,598	-3,919,031	-18.24%
B	Cost overrun, loss below trigger figure	0	0	0	0	0	0
C	Cost overrun, loss of profit only	1	148,048,124	6,793,433	5,131,304	-1,662,129	-1.12%
D	Cost underrun, profit below trigger figure	3	908,567,839	77,869,959	85,236,934	7,366,975	0.81%
E	Cost underrun, profit in excess of trigger figure	3	218,285,698	22,090,537	62,609,131	40,518,594	18.56%
All Categories		8	1,296,386,756	108,029,362	150,333,771	42,304,409*	3.26%*

* The profit variation was reduced by repayments of £11.4M made to the MOD—report para 11 refers.

THE REVIEW BOARD “TRIGGER FIGURE”

1. The Government Profit Formula arrangements provide that where outturns exceed certain “trigger figures”, cases may be referred to the Review Board for Government Contracts for a possible price adjustment, binding on both parties. This has been incorporated into defence contract conditions (specifically, DEFCONs 650 and 650A). The trigger figure is expressed in terms of a variation between estimated and outturn costs of 10% or more, although the figure does not of itself involve a presumption of reimbursement, nor does it preclude a referral of contracts where the cost variation is less than 10%, if the variation is believed to have arisen from an inequality of information at the time of pricing (ie one party knew something that could be expected to materially impact the contract outturn but did not share that information with the other, as required by the pricing process).

2. The importance of ensuring that there is full equality of information between the parties at the time of pricing is recognised by the Department and industry. In order to implement improvements in the achievement of equality of information and following consultations with industry, the Department adopted an Equality of Information Pricing Statement (EIPS) in 1995. This was introduced to improve the confidence on both sides that the principle of equality of information was fully observed during pricing negotiations. The EIPS is signed by both sides after the conclusion of pricing negotiations and provides an agreed record of the basis of the settlement. It becomes a contractual document through the inclusion of DEFCON 652.

3. Cost variations may arise from a variety of reasons, eg increased efficiency, over or under provision in estimates made in good faith, management of risk etc. In other words, cost variations do not automatically indicate an inequality of information between the parties.

2 December 2011

Written evidence from the Permanent Under-Secretary, Ministry of Defence

MINISTRY OF DEFENCE: MPR 11

Thank you for your letter of 5 December covering a copy of the uncorrected transcript of oral evidence from the PAC hearing on “MPR11”, held on 30 November 2011.

I enclose a version of the transcript with corrections shown as tracked changes. I would be grateful if you would arrange for the corrected version of the transcript to be posted on the PAC website.

I also enclose a note providing the supplementary material which we undertook to provide at the Hearing. As there was much debate on the role of Senior Responsible Owner, attached is a PDF document which explains the roles and responsibilities in more detail, which I hope the Committee will find useful.

I am copying this to the Comptroller and Auditor General and the Treasury Officer of Accounts.

14 December 2011

MPR11 PAC HEARING—SUPPLEMENTARY INFORMATION

During the PAC hearing, it was agreed that we would provide two items of supplementary information to the Committee as follows:

(1) *A note on the committees that Cdre Beverstock was a member (or not) of. If we could supplement this with a fuller note on SROs that explains clearly what their role is and how decisions on capability are made within the Dept. (Question 94)*

RESPONSE

Cdre Beverstock

The principle governance committee for Astute is the Deterrent and Underwater Programme Board which is charged with ensuring that all of the defence lines of development will be delivered. This Committee is chaired by Cdre Beverstock and attended by key stakeholders from the DE&S delivery teams, Naval Command and the Nuclear Safety Regulator. Its key responsibilities are:

- to develop the plans for the delivery of deterrent capability across all Defence Lines of Development, including submarine, weapons system, warhead, C4, infrastructure, personnel, and training, and measures to ensure continued delivery of Continuous at Sea Deterrence by the Vanguard Class up until the handover to Successor;
- to develop and maintain the plans for delivery of Underwater Warfare capability including submarine, weapons system, C4, infrastructure, personnel, and training, to ensure the delivery of submarines at high readiness; and

- to consider balance of investment issues across the programme and optimize the allocation of resource (financial/non-financial) to ensure the efficient and timely delivery of the required capability, endorse project business cases and agree funded and unfunded risk levels/exposure.

Cdre Beverstock also chairs the Anti Submarine Warfare Programme Board which has similar responsibilities for that capability. Beneath the two programme boards, individual projects will run their own project boards to review progress against the performance, time and cost boundaries. These boards would normally be chaired by the respective project team leader with Cdre Beverstock or his representative attending. Functional or organisational boards (eg the Defence Nuclear Regulatory Committee and the Submarine Operating Centre Executive Board) are attended on the same basis.

Beyond programme governance, the capability area of the Ministry of Defence has responsibility for identifying long term military capability requirements. In this capacity, Cdre Beverstock chairs the Deterrent and Underwater Capability Management Group, various Technical Programme exchange agreements with the US Navy and attends the UK/France Submarine Steering Group.

Above the programme and capability groups, pan MOD capability prioritisation decisions are taken by the Joint Capabilities Board. When matters relevant to his capability areas are discussed Cdre Beverstock would be expected to attend. Similarly, the Investment Approvals Committee provides the final authorisation for investment decisions and Cdre Beverstock would attend where appropriate. The Defence Board is ultimately responsible for agreeing budgetary allocations made through the Department's planning round. Cdre Beverstock would not routinely be required to attend the Board for those discussions but his views would be represented by Vice Admiral Lambert.

Fuller note on SROs

The SRO oversees all aspects of programme delivery to ensure that it is successfully implemented, that risks are managed, that the potential of the change or capability is fully exploited and that the benefits are delivered. The SRO is responsible for overall cost/benefit trade-offs and must ensure that the business case for continuing with the programme remains robust at all stages from inception to delivery. The SRO establishes and chairs the Programme Board and should seek appropriate assurance, from Defence Internal Audit and through OGC Gateway reviews, that risk management, control and governance issues are being managed in an appropriate and effective manner. The MOD guidance for SROs which details their roles and responsibilities is attached.

Although the SRO is responsible for coordinating the delivery of an Equipment Capability, ultimately decisions on investment in Capability rest with the Defence Board. The Strategic Force Development process translates policy and Defence Strategic Direction into a head mark force structure within a financial envelope. This then informs Defence Planning Assumptions which, supplemented by long-term capability and requirements, are used by Heads of Capability to put together their Capability Management Strategies and Plans, in conjunction with the MOD Unified Customer to ensure stakeholder views are taken into account. These plans are used to inform bids for future equipment capability programmes through Genesis Options. A Genesis Option is an initial proposition to the Joint Capabilities Board (JCB) for a programme of work (a Candidate Project) to meet an identified capability shortfall or opportunity. Genesis Options are considered by the JCB which determines whether a candidate programme is accepted into the future Equipment Plan.

Once a programme forms part of the Equipment Plan, the Head of Capability (HOC) is then responsible for setting detailed requirements and for establishing the programme and any associated projects for delivery. Under current arrangements, the HOC usually then also, but not always, becomes the Senior Responsible Owner for the programme and is responsible in this guise for assuring delivery of the programme and its associated projects including seeking any approvals to commit expenditure on projects within the programme during each stage of the procurement cycle. Approvals are governed and determined by the Investment Approvals Committee.

During the annual Planning Round, options are raised for changes to the existing Equipment Plan and the Force Structure. These options are then considered as part of a process to adjust the overall shape of the Defence Programme with final decisions resting with the Defence Board. Once decisions have been taken, adjustments are reflected in changes to the Equipment Plan and Force Structure. This is then reflected in the Defence Plan which feeds through into Management/Command Plans, Capability Management Strategies and Plans and adjustments to Programme Mandates.

The other way in which Capability decisions are made is through the SDSR and CSR processes where changes in policy, strategy or resource levels are again reflected in options taken by the Defence Board to adjust both the existing and future force structure to reflect these changes.

In order to address overall short-term affordability challenges, the Department also introduced a Comprehensive Commitment Control Regime to consider individual projects approaching major commitment points to determine, against a set of criteria related to the Department's strategic objectives and priorities, whether activity should be stopped, deferred or allowed to proceed and any conditions that should be set. Decisions are communicated back to Resource Directors, Heads of Capability and Project Team leaders and are then reflected back through the Planning Round process by options to make necessary changes to project schedules and to change the associated resource profile.

In July 2011 the MOD Programme & Project Management Centre of Excellence (PPM COE) conducted a review of the SRO role in Defence at the instigation of MOD's 2nd Permanent Under Secretary (2nd PUS). The review made five headline recommendations intended to improve the effectiveness of the SRO role in the MOD:

- (1) Establish effective Strategic Portfolio Management including identifying those Departmental changes that are to be run as Programmes.
- (2) Ensure all Programmes have effective Sponsoring Groups.
- (3) Appoint SROs on the basis of the scale and span of the Programme, ensuring appropriate training, experience, seniority and a compelling personal stake in the success of the programme.
- (4) Provide suitable and sufficient professional support to the SRO in the Programme Team.
- (5) Ensure that project governance recognises the SRO as the key decision-maker.

The SRO review findings were fully endorsed by 2nd PUS and Director General Finance (DG Fin), and are being taken forward as part of Defence Reform. Defence Reform is currently considering what changes should be made to existing structures and processes to implement the Levene Report and to better align responsibility and accountability.

(2) The name of the 2 individual responsible for Weapons Stockpile Capability. In addition it would be of benefit to the Committee if we could provide a fuller answer that explains how we do this in planning. (Question 135)*

RESPONSE

Munitions stockpiles are set by the Stockpile Planning Steering Group, informed by expert maritime, land and air working groups. They also take account of Defence Strategic Direction, force structures and operational analysis. The current stockpile review, which will include analysis of Op ELLAMY, is due to report in March 2012. Major General Mark Poffley, the Assistant Chief of Defence Staff (Strategy & Plans) is the Senior Responsible Officer for this planning process, and stockpile levels are endorsed by the Defence Strategy and Plans Group (DSPG), which is chaired by Director General Finance.

POLICY & GUIDANCE FOR STAFF UNDERTAKING SENIOR RESPONSIBLE OWNER ROLES IN MOD

INTRODUCTION

1. This document sets out the policy and guidance on the role & responsibilities of:
 - (a) Designated Senior Responsible Owners (SROs) who are appointed personally by PUS and in charge of the Department's most significant programmes and projects.
 - (b) Other staff performing an SRO role appointed by the Sponsor. For example, by DCDS(Cap) for Capability delivery programmes or by a TLB Holder.
2. This policy applies to all programmes and projects across MOD and replaces SRO guidance issued in December 2006.²

BACKGROUND

3. The role of Senior Responsible Owner (SRO), as the individual responsible for ensuring that a programme or project meets its objectives and delivers the projected benefits, is acknowledged as best practice across Government. The SRO role aligns with Office of Government Commerce (OGC) programme and project management methodologies where the SRO, as owner of the business change, would chair the programme or project board. Detailed guidance on the role is published by the OGC in the Successful Delivery Toolkit.³ An individual's SRO responsibility should be explicitly included in personal objectives.

THE SRO ROLE IN MOD

4. In line with Government best practice, all programmes and projects in MOD should have an SRO. The SRO oversees all aspects of programme⁴ delivery to ensure that it is successfully implemented, that risks are managed, that the potential of the change or capability is fully exploited and that the benefits are delivered. The SRO is responsible for overall cost/benefit trade-offs and must ensure that the business case for continuing with the programme remains robust at all stages from inception to delivery. The SRO establishes and chairs the Programme Board and should seek appropriate assurance, from Defence Internal Audit and through OGC Gateway reviews, that risk management, control and governance issues are being managed in an appropriate and effective manner. MOD SRO responsibilities are described in Annex A.

² D/VCDS & 2nd PUS/7/13/1 dated 20 December

³ Available at www.ogc.gov.uk. MSP and PRINCE2 methodologies further define the role.

⁴ For simplicity, from here guidance refers to programmes and programme SROs but is equally applicable projects and project SROs.

5. The SRO must be suitably senior, have clear authority, be recognised as the owner throughout the organisation and take personal responsibility for the successful delivery of the programme. The SRO is accountable to the Departmental Board or to the Sponsor for establishing clear programme governance arrangements which include roles, responsibilities and authorities for those supporting the SRO,⁵ the reporting arrangements for sub-ordinate projects and interactions/relationships with associated programmes. As a result, all Programme and Project Managers within the MOD should be able to identify their SRO.⁶

6. The Sponsoring Group, chaired by the Sponsor, represents those senior managers who are responsible for: defining the strategic direction of the business; ensuring alignment of the programme to the strategic direction and investment decisions. This involves co-ordination across programmes to ensure cohesive strategic alignment and prioritisation with the provision of top-level endorsement of the particular programme in relation to others within the Department. In addition to advising and supporting the SRO, the responsibilities of the Sponsor will include:

- (a) Confirming the Programme Mandate and resolving any strategic and directional issues;
- (b) Providing continued commitment;
- (c) Approving progress against strategic objectives;
- (d) Confirming successful delivery and then closure of the programme.

7. For the most significant programmes it may be necessary to establish a new post specifically as SRO; the normal assumption is that the role will be undertaken as part of an existing post. SROs do not have to “own” the area undergoing the change or be the sole beneficiary of the programme. Nor do they necessarily need to have full financial, command or line management authority over all those delivering the change or capability, or those who are subject to its implementation. However, they must be empowered, have a good knowledge of the business or capability requirement, be competent to resolve conflicting priorities and be able to exert influence outside traditional management or command chains.

8. SROs should remain in place throughout the programme or be replaced only when a distinct phase of delivery is completed. For SCS and military equivalent postings, the relevant senior appointing authorities should take this factor into account when considering candidates for any post that includes an SRO role.

APPOINTMENT

9. Designated SROs are responsible for the Department’s most significant business change and military capability programmes. They are formally appointed by PUS and are responsible to the Defence Board as their Sponsoring Group. The criteria used to determine which programmes are of strategic interest to the Board, and hence the focus of its attention, do not solely relate to the size of the investment. They might also relate to the significance of successful delivery to the Department (ie where failure would threaten strategic operational or business objectives or could potentially damage its reputation) and the extent to which coordination across TLB boundaries is required.

10. A Designated SRO is personally appointed by PUS:

- (a) For all business change programmes in the Defence Change Portfolio (DCP). Responsibility for assessing which programmes should be included within the DCP rests with Hd of Centre RP for agreement by 2nd PUS.
- (b) For the most significant capability programmes, as proposed by DCDS(Cap) and agreed by VCDS.
- (c) For other programmes not included in (a) or (b) which are subject to additional external reporting, scrutiny and assurance by HM Treasury/OGC,⁷ or other programmes at the discretion of the Defence Board.

11. Designated SROs will in most cases be 2-star level or higher. For capability programmes, where the capability is large and/or politically sensitive but is less complex (for example programmes which predominantly impact on a single environment or Service) and is managed as a single delivery programme under Through Life Capability Management (TLCM), PUS may choose to appoint a 1-star SRO (the Programme Board Chair).

12. Proposals to change a Designated SRO should be submitted to Head of Cap CI (for Capability programmes) or Head of Centre RP (for business change programmes), who will seek PUS’ approval and prepare an appropriate letter of appointment setting out the individual’s responsibilities and reporting arrangements. The current list of Designated SROs can be found on the Defence Intranet in *How Defence works—Who does what*.

⁵ Recognising that, whilst other terms may be used, e.g Chair of Programme Board, the SRO role remains the same.

⁶ Project Managers may find that their project forms part of more than one Programme and will have more than one individual in an SRO role. In such circumstances, the project governance should detail which programme has the lead for that project.

⁷ Additional reporting as part of OGC’s Major Projects and Programmes (MPP) portfolio, additional scrutiny by HMT’s Major Projects Review Group (MPRG); external assurance through OGC-led Gateway reviews.

13. For other SROs, the general principle is that an SRO is appointed by the Sponsor. DCDS(Cap) is the Sponsor for capability delivery programmes: TLB Holders (or seniors within their business) are the Sponsor for business change programmes outside the DCP.

14. At whatever level an SRO role is undertaken, the individual should follow the guidance in this document and have roles, responsibilities and authorities consistent with this guidance included in their job description, terms of reference, directive or programme mandate as appropriate, and in their personal objectives.

ACCOUNTABILITY & AUTHORITY

15. Within MOD, Designated SROs are accountable to the Defence Board, as the Sponsoring Group, for delivering the required changes or capabilities. For other programmes, SROs will be accountable to their Sponsoring Group, for example:

- (a) The Joint Capabilities Board (JCB) for chairs of capability delivery Programme Boards.
- (b) TLB management boards for those staff undertaking non-DCP major business change programmes.

16. An SRO's authority will be spelt out in the letter of appointment. Given the complexity of MOD programmes and projects, including the possibility of a project being part of several programmes, and the relationship with TLB holders and Process Owners, this is not trivial. These relationships are further described in Annex B.

SKILLS, TRAINING AND SUPPORT

17. The Defence Board will look to 2nd PUS and VCDS, through the Defence Operating Board (DOB) and the Joint Capability Board (JCB), to ensure that Designated SROs take advantage of training and are personally fully engaged in their programmes. In a similar manner, programme Sponsors or the Sponsoring Group will ensure that other staff undertaking the SRO role are personally engaged with their programmes and take advantage of SRO training.

18. An individual selected for a post that includes an SRO role must have the necessary skills and attributes. The behaviours and characteristics that an SRO should display are detailed in the OGC Successful Delivery Toolkit. The individual should demonstrably be able to exercise authority and deliver results outside the normal command or management chain in a programme or project management context. The Defence Academy Leadership & Management division has identified the following skill sets as the most important:

- (a) Leadership (including, team working, interpersonal skills & communications).
- (b) Risk management.
- (c) Programme and project delivery (programme management, project management, managing business change and benefits management).

19. Where an individual undertaking an SRO role has significant gaps in skills or experience, he or she will need to fill these by training and/or by ensuring access to appropriate expert support. However, as training cannot fully substitute for hands-on experience, the background and experience of an individual is to be taken into account in the succession planning and selection process.

20. The Defence Academy College of Management and Technology (DA-CMT) runs a regular SRO induction course and master classes and can provide tailored training or assistance to Designated SROs based on individual SRO and programme requirements. Designated SROs must attend the induction course and relevant master classes, or arrange equivalent tailored training, unless he or she has already received equivalent training elsewhere. Additional sources of training include an SRO Master Class run by the National School of Government (NSG) and programme management training from NSG or DA-CMT.

21. The MOD Programme and Project Management Centre of Excellence (PPM CoE) provides common Departmental standards, acts as a central authority for disseminating PPM good practice and leads the PPM Skills and Professionalism agenda. The PPM CoE supports SROs by providing the independent Gateway peer review service.

22. All SROs are encouraged to become accredited OGC Gateway™ reviewers⁸ and to lead or participate in such reviews for other Government departments, the wider public sector or other areas of the MOD as appropriate. This will bring benefits in terms of personal development and lessons learned to individuals, their programmes and projects, the Department and the wider Government community.

FURTHER ADVICE

23. Further advice on this policy and guidance can be obtained from the following:

- *For general enquiries and business change programmes/projects* Centre RP Deputy Head Change.
- *For military capability programmes/projects* DCDS(Cap)—Head of Capability Improvement.

⁸ DN 2009 DIN01-047: Recruitment of OGC Gateway Reviewers

- *MOD PPM CoE:*
Deputy Head of Programme and Project Management Centre of Excellence.
- *Gateway reviews* Programme and Project Management Centre of Excellence Assistant Head of Gateway reviews.
- *Training*
DA-CMT: Defence Intranet at www.defac.r.mil.uk/colleges/cmt
NSG: www.nationalschool.gov.uk

Annex A

RESPONSIBILITIES OF AN SRO IN MOD

GENERAL RESPONSIBILITIES⁹

Ensure that the programme of change meets its objectives and delivers the projected benefits

- Ensure agreement amongst stakeholders as to what the objectives and benefits are.
- Ensure strategic fit of the project or programme objectives and benefits.
- Obtain commitment from stakeholders to the delivery of the benefits.
- Monitor delivery of the objectives and benefits taking appropriate action where necessary to ensure their successful delivery.

Ensure that the programme is subject to review at appropriate stages

- Ensuring that the programme is subject to review at the key decision points identified for the OGC Gateway™ Process and at other points he/she considers necessary.
- Making certain that any recommendations or concerns from reviews are met or addressed before progressing to the next stage.

Own the programme brief and business case

- Oversee development of the brief for change and business case.
- Ensure that the aims of the planned change continue to be aligned with the business, and establish a firm basis for the programme during its initiation and definition.
- Secure the necessary investment for the business change.

Develop the programme organisation structure and logical plans

- Ensuring that there is a coherent organisation structure and logical plan(s).
- Engaging with the work of either project initiation (in a project environment), or establishing the programme (in a programme environment).

Monitor and control of progress

- Monitoring and controlling the progress of the business change at a strategic level (at an operational level this is the responsibility of project or programme managers): the project or programme manager is responsible for providing regular reports to the SRO on progress of the business change. There will be inevitable issues that arise requiring the SRO's advice, decision-making and communication with senior stakeholders.
- Chairing the programme board.

Formally close the programme

- Formally closing the programme and ensuring that the lessons learned are documented within the "end of project" or "end of programme" evaluation report: closure requires formal sign-off by the SRO that the aims and objectives have been met and that lessons learned are documented and disseminated.
- Planning the post programme/project review(s) when the entire benefits realisation process will be assessed.

Review the programme post implementation

- Ensuring that the post implementation review takes place, the output is forwarded to the appropriate stakeholders and the benefits have been realised: the SRO is responsible for commissioning and chairing these reviews and ensuring the relevant personnel are consulted and involved in the review process.

⁹ General Responsibilities are taken from OGC Guidance

Resolve or refer problems

- Referring serious problems upwards to top management and/or Ministers as necessary and to suppliers in a timely manner.
- Regular consultation will be required between those delivering the change and the stakeholders and sponsors.
- Ensuring that the communication processes are effective and linkages are maintained between the change team/s and the organisation's strategic direction.
- Regular dialogue with the suppliers to minimise customer-supplier problems by timely resolution.

*Specific Responsibilities*¹⁰

In addition to these general responsibilities (defined by OGC), MOD SROs have the following specific responsibilities:

- Ensuring that business cases presented for approval by the Investment Approvals Board (IAB) and/or Defence Board are objective, soundly based and sufficiently mature to allow the approving bodies to reach clearly defensible decisions. This is key to the robustness of the Department's decision making process and hence an important aspect of the SRO's task.
- Learning lessons and avoiding common causes of failure¹².
- Taking responsibility for Programme Reports submitted to the DOB/JCB (which inform the Department's performance reporting and provide external public visibility of performance by informing the Defence Plan and the Annual Report and (for selected programmes) accountability cross-government and to Ministers through OGC's Major Projects and Programmes Portfolio.
- For DCP programmes, ensuring that the programme continues to meet the Defence Council criteria.¹¹
- Ensuring that the programme is subject to OGC Gateway™ reviews at appropriate points in its lifecycle; taking appropriate actions in response to the review team's recommendations; and reporting the results of reviews and actions taken to the IAB at approvals points, to the Defence Operating Board (for DCP programmes and projects) or the JCB at regular reviews, and to the relevant TLB holder. *Note: in the event of "red" review reports, the individual undertaking the SRO role will be required to provide a report to the Defence Operating Board, JCB or TLB holder as appropriate copied (for all major programmes or projects with Designated SROs) to PUS.*
- Engaging in the OGC Gateway peer review process in accordance with MOD policy.¹²
- Ensuring that the programme addresses all the relevant Defence Lines of Development on a through-life basis and takes account of issues concerning process and culture or behavioural change.
- Ensuring the realisation of benefits to Defence, including those that fall outside the SRO's own management or command chain.
- Helping the Department to build delivery capacity and capability for the future by identifying implications for skills and training of staff and trainers and reporting these to the DOB, JCB and/or Director Civilian Personnel and Director Training & Education as appropriate.
- Learning lessons and avoiding common causes of failure.¹³

Annex B

RELATIONSHIP WITH TLB HOLDERS AND PROCESS OWNERS

1. The roles of TLB holder, Process Owner and SRO are distinct and complementary. A TLB holder is responsible for output delivery. A Process Owner is responsible for ensuring that key cross-cutting enabling business activities are carried out on a coherent and consistent basis across Defence, where this is necessary to maintain or improve overall effectiveness, efficiency and/or compliance with legislation and other external requirements. An SRO is responsible for the delivery of a specific, time-bounded programme and the realisation of its expected benefits.

2. Unless specifically authorised by the Defence Board, the establishment of an SRO for a major programme will not interfere with established lines of accountability, either for day-to-day output delivery or process ownership. However, most major change and capability programmes cross TLB and other organisational boundaries and require the orchestration of various Defence Lines of Development. An individual performing the SRO role must be able to exercise influence and authority across these areas to enable him or her to ensure

¹⁰ Specific Responsibilities apply to SROs in MoD

¹¹ Defence Change Programme Version 2.0 dated 31 October 2005

¹² D/VCDS&2nd PUS/7/3/1/ 17 Dec 08

¹³ OGC/National Audit Office common Causes of Failure can be accessed on the OGC website

the success of the programme for which he or she is responsible. Project Team Leaders and others, while remaining accountable to their TLB holders, will answer to the SRO role for delivery of the specific equipment and non-equipment lines of development required by a programme. TLB holders must ensure that, in exercising their responsibilities for the delivery of outputs, they operate within the agreed framework of Departmental processes and corporate standards, which includes giving all necessary support to SROs to enable them to meet their objectives.

3. An individual in the SRO role will need to exercise his or her influence and authority in a variety of ways. These may include programme governance arrangements, customer supplier agreements or management plans. An individual in the SRO role will also need to be able to persuade, negotiate and influence across boundaries, outside his or her normal management or command chain. A key part of the role will be to resolve conflicting priorities and demands in order to achieve the required objectives and benefits. This will include conflicting priorities where a project contributes to more than one programme. Where a project contributes to more than one programme, the project's governance arrangements need to identify which programme is its "lead". The lead programme should co-ordinate the negotiations with other programmes: the objective being to identify the optimal way forward for Defence (not necessarily for the lead programme). Once agreement (or Sponsoring Group direction) has been achieved, the lead programme should produce/amend the Project Mandate and approve the Project Brief (in consultation with the other programmes as necessary).

4. The Defence Board is the ultimate authority on behalf of which the roles of TLB holder, Process Owner and SRO are exercised, and will hold those responsible for them to account. In cases where it is not possible to reconcile the respective priorities of designated SRO for a major programme, Process Owners and TLB holders, referral to the Defence Board may therefore ultimately be necessary. However, other mechanisms exist to resolve such issues below Defence Board level, for example: the DOB for business change programmes and projects; and the JCB for military capability programmes. The Chiefs of Staff can also help to support the SRO role, especially within their areas of responsibility for generating integrated military capability and for the effectiveness, ethos and morale of their Service.

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