House of Commons
Committee of Public Accounts

Defence Equipment
Plan 2018–28

Seventy-Seventh Report of Session 2017–19

Report, together with formal minutes relating to the report

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The Committee of Public Accounts

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Publication

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Committee staff

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Summary

In May 2018 we reported that the Ministry of Defence (the Department) did not have enough money to buy and support the equipment it needs. Despite committing to tackle this problem, the Department has made little progress, continuing to delay the difficult decisions needed to make the Equipment Plan (the Plan) affordable, particularly around which programmes to stop, delay or scale back. It now estimates a most likely affordability gap between its budget and its forecast costs of £7 billion across its Plan over the next ten years. It also estimates that the gap could widen to £14.8 billion, but even this looks to be unlikely and overly optimistic. The escalating and continuing affordability issues have led to short-term decision making which has only worsened the longer-term affordability risks. As a direct result, there is uncertainty for both the Department and for industry which needs to be addressed. Coupled with our ongoing concerns over the Department’s ability to forecast costs and efficiencies accurately, we remain sceptical that the Department is close to reconciling what it says it needs with the funding it has available.
Introduction

Since 2012, the Department has published an annual Statement on the affordability of its 10-year Equipment Plan (the Plan). This followed a period of poor financial management, when a significant gap developed between forecast funding and costs across defence. In its 2018 Plan, the Department forecasts £193.3 billion of equipment and support costs between 1 April 2018 and 31 March 2028. This exceeds its £186.4 billion budget, which includes a £6.2 billion contingency, by £7.0 billion. The Department estimates that, should all identified risks materialise, the budget and cost difference for the Plan would widen to £14.8 billion, although this could still be optimistic. The Plan accounts for over 40% of the entire defence budget and the Department needs to manage it effectively to ensure the Armed Forces have the equipment they need to meet their objectives. In January 2018, the government announced the Modernising Defence Programme (MDP), a review of defence capabilities, aimed at making the Equipment Plan affordable. However, the MDP has been slow to conclude, with the Department now delaying financial decisions until the Spending Review 2019. If the Spending Review is delayed until 2020, the risks to capability and the transformation agenda become critical.
Conclusions and recommendations

1. The Department’s Equipment Plan remains unaffordable as government continues to delay decisions on its priorities, and on whether to increase funding or stop, delay or scale back programmes. The Department estimates that 84% of its £7 billion affordability gap falls in the first four years of its 10-year Plan, and it therefore urgently needs to decide how to make the Plan more affordable. It is alarming that the government has not yet made these decisions, with defence capability reviews continuing since July 2017. Back in March 2018, the Department committed to sharing emerging findings from the MDP in July 2018, with the cost information available in autumn 2018. However, with both a Spending Review and Strategic Defence and Security Review likely in the next two years, we can only see continuing uncertainty and delay. The Department now says that programme-related decisions will most likely be incorporated into the Spending Review 2019, but not reflected in the Equipment Plan until 2020. Any delay to the 2019 Comprehensive Spending Review would wreak havoc on the Department’s ability to take urgently-needed decisions on its transformation agenda. While the Department confirmed it was uncomfortable with the size of its current affordability gap, it said it would always expect there to be “a prudent level of over-programming”, although did not know what level this would be.

Recommendation: As soon as possible, government must produce an affordable Equipment Plan by:

- providing clarity on its priorities and the subsequent decisions made to stop, delay, and scale back areas of the defence programme to make the Equipment Plan affordable; and

- clarifying what it considers to be a prudent level of over-programming across the 10-years and why.

2. The Department’s inability to provide certainty on its equipment and support plans, risks reducing the confidence industry needs to invest in the equipment and support required by our Armed Forces. The Department recognises it needs to prioritise how it manages its suppliers and says that it is now having more open conversations with industry about future threats and requirements. The Department needs to ensure industry retains and maintains certain skills, particularly within the UK, such as for the development of fighter aircraft. The UK needs specialist skills which may require government support to be sustained; for example, a UK-based capability to develop complex radar, which the Department says it is discussing with industry. We are pleased to hear that the Department recognises the need to discuss industrial strategy in more depth across government, particularly around aerospace.

Recommendation: The Department should report back to us by July 2019 on how it has engaged with industry, and whether the Department and industry are signed up to a coherent plan to maintain the UK-based capability to develop and deliver the equipment required in the future.
Recommendation: The Department should report back on how it is working with industry to purchase off the shelf equipment rather than pursue unnecessarily complex kit, to maximise value and drive the transformation agenda.

3. The Department still lacks the capability to accurately cost programmes within its Equipment Plan, making it more difficult to plan effectively. Although there have been some improvements to cost forecasting, for example across nuclear programmes, the Department recognises that more progress is needed. The Department’s independent cost assurance team considered project teams’ cost forecasts in the latest Plan were underestimated by £3 billion. While the Department sees the independent review as a useful challenge, it clearly also raises questions about the accuracy of project teams’ costs. The Department hopes that its financial skills strategy, launched in the summer of 2018, will help develop cost forecasting and risk skills over the next three years. However, we remain sceptical given the number of similar promises we have heard before.

Recommendation: By July 2019, and each year after, the Department should provide the Committee with a progress report on the development of financial skills and performance against the metrics that the Department will be using to measure success.

4. The Department is assuming it will achieve significant efficiency savings, despite not having a coherent and credible plan for monitoring and delivering them. The Department accepts that its efficiency plans have been optimistic and that it has found it difficult to provide a clear and comprehensive view of progress towards efficiency targets. It has a £13.4 billion efficiency savings target over the 10 years of the Plan. It is confident of achieving £7.3 billion of these, and has assumed a further £2.2 billion of ‘less certain’ efficiency savings in its forecast costs. However, this leaves a residual £3.9 billion for which it still needs to develop plans. Even if the Department achieved this amount of additional efficiencies, it would not reduce forecast costs enough to completely close the Plan’s £7 billion affordability gap. It hopes the increased use of digital technology and business modernisation, which requires up-front investment, will help bridge the gap. The Department has given us a commitment that it will provide a more transparent assessment of efficiencies for when we examine next year’s Equipment Plan.

Recommendation: In compiling its Equipment Plan 2019 position, the Department must ensure that it only includes efficiencies that it can realistically expect to deliver, and that it discloses in future Plans a detailed and robust statement of how it will deliver them.

5. The Equipment Plan still does not fully outline the level of risks and uncertainties within the Plan. The Department remains committed to producing a 10-year Equipment Plan and we are pleased that the 2018 Plan was produced quicker than in the past. The presentation of the Plan has also improved with, for example, the gap between forecast cost and budget being quantified for the first time. However, more can be done to improve transparency, particularly around large programmes and future risks. For example, there remains uncertainty on the plans for F-35 beyond the procurement of the first 48 jets, with clarity on future support and maintenance costs dependent on the results of current trials.
Recommendation: The Department’s future Equipment Plans should include more information on the cost, maturity and risks of the largest projects (including, in particular, the F-35 and Type 31e frigate), as well as being more transparent about its costing approach.

6. HM Treasury’s requirement for departments to live annually within their means hinders the Department’s ability to plan for the long-term. The Department recognises the trade-off between the short-term decisions needed to ensure spending stays within its means and longer-term value for money of programmes. It has set out to HM Treasury the case for greater funding flexibility and multi-year settlements for long-term complex programmes such as the nuclear programme. The Department considers that the Budget settlement in October 2018, when some additional money was given to the Department, reflected HM Treasury’s initial acceptance of the difficult choices needed to tackle the affordability gap. The Department told us it has recently introduced a programme looking at defence-wide options to find further savings through the increased use of digital technology and business modernisation. It explained that this work will need upfront investment, and it will present its plans as part of the Spending Review 2019.1

Recommendation: The Department should use the Spending Review 2019 as an opportunity to explore longer-term budgeting arrangements in certain areas such as nuclear programmes and shipbuilding maintenance and improvements planning.

Recommendation: The Department should report back to the Committee on how the extra funding settlement for nuclear and anti-submarine warfare in October 2018 was allocated and spent.”

Given the size of the projected shortfall in the Defence Equipment Plan of at least £7 billion, we recommend that the Department work more closely with HM Treasury to produce a procurement plan, including realistic costing of “unknowns” and support and logistics costs, which puts the Department on the same realistic financial planning as all other Government Departments.

Recommendation: We expect the Department to report to the Committee on substantial progress within 12 months
1 Addressing affordability of the Plan

1. On the basis of a report by the Comptroller and Auditor General, we took evidence from the Ministry of Defence (the Department) on its Equipment Plan 2018 to 2028 (the Plan).²

2. The Plan sets out the Department’s 10-year budget for its equipment and support programmes. Following a period of poor financial management, the Department has published this annual statement since 2012.³

3. The Department sets the Plan budget as part of its defence-wide annual budgeting exercise. Its Head Office oversees this process, while fiscal responsibility for projects within the Plan is delegated to the four front-line military commands, the Defence Nuclear Organisation, and the Strategic Programmes Directorate, collectively known as Top Level Budgets (TLBs). Head Office can adjust these budgets to achieve a balanced position across the whole of defence. Delivery organisations such as Defence Equipment & Support (DE&S) and the Submarine Delivery Agency (SDA), manage equipment and support projects on behalf of the TLBs.⁴

4. For the 10 years from 1 April 2018 to 31 March 2028, the Equipment Plan budget is £186.4 billion, including procurement (£88.8 billion), support (£91.1 billion) and contingency (£6.2 billion). For the same period, the Department estimates the forecast cost to be £193.3 billion, which results in a most likely £7.0 billion ‘affordability gap’ or difference between costs and budget. This gap is after taking into account contingencies and expected efficiencies. However, the Department estimates that, should all identified risks materialise, the budget and cost difference for the Plan would widen to £14.8 billion, although this could still be optimistic. The Plan is funded from the Department’s overall budget and makes up more than 40% of its planned expenditure.⁵

5. In January 2018, the Government announced the Modernising Defence Programme (MDP). Among other things, the Department expected that this work would address the affordability challenge. At the time of our evidence session, the MDP had not concluded and so had not fed into the 2018 Plan.⁶ In March 2018 the Department indicated to us that it would publish initial financial implications of the MDP in Autumn 2018, but this is now likely to form part of the Spending Review 2019. In December 2018, the Department issued ‘a final update’ on the MDP.⁷

Making the decisions needed

6. The Equipment Plan remains unaffordable, and with 84% of the £7 billion difference between costs and budget falling in the first four years of the 10-year Plan, the Department faces an immediate affordability challenge.⁸ The Department recognised this and told

² Report by the Comptroller and Auditor General, The Equipment Plan 2018 to 2028, Session 2017–19, HC 1621, 5 November 2018
³ C&AG’s Report, paras 1.2–1.3
⁴ C&AG’s Report, paras 1.4–1.6
⁵ C&AG’s Report, paras 1–2, 8, 1.10, 2.1, 3.2
⁶ Q10; C&AG’s Report, paras 3–6
⁷ Q 16; C&AG’s Report, para 3.9; Ministry of Defence, Mobilising, Modernising and Transforming Defence: A report on the Modernising Defence Programme, 18 December 2018
⁸ Q 1
us it must either be given increased funding, run more efficiently or do less with the money available. Without a fundamentally different financial settlement, the Department described how it would have to 'de-scope, defer or delete' projects. Its preference would be to do the latter, given that delaying programmes often increased costs and complexity. Although the Department confirmed it would have to stop some projects it was unwilling to give specific examples.9

7. We questioned the Department about its constant cycle of reviews and the failure to make decisions. It has been formally reviewing its defence capabilities since the announcement of the National Security and Capability Review (NSCR) in July 2017. The MDP, a more detailed defence review, was subsequently announced in January 2018.10 In March 2018, the Department told us that it would publish emerging MDP conclusions in early summer, with cost information available in autumn. It also committed to achieving the Secretary of State’s ambition for a “strategically affordable” Plan by the end of the MDP.11 We expressed concern with the lack of progress. Financial information has not yet been made available, and these important decisions have been further delayed.12 Despite this, the Department’s December 2018 MDP statement did not make reference to any programme-related decisions to make the plan affordable.13

8. Following the NSCR and the MDP, the Department now expects it will make important programme decisions affecting the affordability of the Plan as part of the Spending Review 2019.14 Given the timing of this, the Department will not be able to reflect any financial decisions in the Equipment Plan 2019–2029, which is therefore likely to remain unaffordable. Concerns about delays to the Comprehensive Spending Review 2019 would exacerbate this. Instead, the Department said it aimed to have an affordable Equipment Plan in 2020.15 It was unable to confirm if there will be a Security Defence and Spending Review in 2020, despite this being less than two years away. The Department assured us that all these reviews would align.16

9. The Department said that although it was uncomfortable with the current size of the affordability gap, it did not aim for a completely balanced Plan. Instead it favoured “a prudent level of over-programming.” Other than recognising the level would be “a lot less” than presently, and would decrease year on year, it could not tell us what a prudent level might look like.17

**Impact on industry**

10. The Department recognises the importance of having clear and flexible relationships with its industrial partners, including open conversations on security threats and defence requirements. Although the Department felt it was better at this than five years ago, it highlighted improved supplier management as a key priority within the MDP. In

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9 Qq 3–6
10 Qq 10, 18, 20; C&AG’s Report, paras 3.7, 3.8, figure 13
12 Qq 1–2, 8, 10, 14, 18
13 Qq 13–14, Ministry of Defence, Mobilising, Modernising and Transforming Defence: A report on the Modernising Defence Programme, 18 December 2018
14 Qq 16, 18–21
15 Qq 27–30
16 Qq 10–13
17 Qq 34–40
particular, it considered it would get best value where industry had confidence in longer-term funding being available.\footnote{Qq 46, 54, 58} We asked the Department how the lack of timely project decisions and uncertainty affected industry. It told us there would always be uncertainty where resource constraints existed and there was a Spending Review planned, but that 95\% of its Plan was funded. It is seeking to improve its relationships with suppliers by taking a more strategic approach to them and by working with the Cabinet Office.\footnote{Qq 55–56, 58}

11. The Department wants to ensure that the UK can act independently by having a “sovereign choice” of contractors with the required skills and capabilities. It explained that in a limited number of areas, government support was needed to maintain certain contractor skills, but that this support was not offered “at any cost”.\footnote{Qq 57–60} It provided the example of maintaining the “very rare and very sophisticated skills” required to develop fighter aircraft. We also heard concerns about the lack of government investment in radar-related skills and the age-profile of those engineers working in this field. The Department told us this was one area where it needed to ensure government’s funding was available to help meet our sovereign requirements.\footnote{Qq 61, 75–80}

12. We asked the Department whether it discussed industrial strategy and support for industry with other government bodies. It confirmed it did, for example across aerospace, but acknowledged it should do more. The Department considers these discussions were more effective at a sector level such as shipbuilding but would consider more specialist discussions for critical capabilities such as radar.\footnote{Q 81}

\section*{Government budgeting framework}

13. The Department’s Permanent Secretary described his responsibility for ensuring that each year the Department spends less than the funding allocated by HM Treasury.\footnote{Q 42} For 2018–19, it expects to balance its budget by holding TLBs to account for staying within the tight budgets set, prioritising, and not incurring certain costs.\footnote{Q 31} It stated it had limited flexibility to move resources around the Department, particularly in the short-term.\footnote{Q 44}

14. The Department agreed with us that it was hampered by having to balance the budget each year, rather than being able to carry over any excess funds into later years. While it respects the principle of annularity, it considers that given many of its equipment programmes were volatile and capital-intensive, constant trade-offs were inevitable.\footnote{Q 64} The Department told us that being able to move funds between years, as is permitted for some programmes across government, would be helpful.\footnote{Q 67} The National Audit Office has reported recently that HM Treasury agreed five-year settlements with both Network Rail
and Highways England, with the aim of increasing funding certainty. The Department told us it had set out to HM Treasury its case for multi-year arrangements across nuclear programmes which would be considered as part of the Spending Review 2019.

15. The Department recognised the challenges of balancing short-term budget decisions against longer-term value for money considerations and accepted that it did not always get this right. It could not give us assurance that the short-term decisions needed to balance the Plan would never have a detrimental impact on military capability, although it said it did what it could to ensure this did not happen.

16. The Department considered that HM Treasury’s autumn 2018 statement showed it recognised the difficult decisions the Department has to make. It told us that it approached the Budget with the aim of being “transparent and clear” on the severe financial challenges it faced, and would look at this as part of the spending review next year. It recognised that the additional money announced in the autumn statement did not balance the Plan. It felt it secured enough funding to avoid having to make decisions in 2018–19 and 2019–20 that would impact on the Joint Force 2025 programme.
2 Producing the Plan

Generating Equipment Plan costs

17. The Department told us that the longer-term thinking the 10-year Plan requires has
enhanced its understanding of the costs and risks in the Plan, which has improved the
planning processes. We commended the Department on meeting its commitment to
bring forward publication of the Equipment Plan. It published its 2018 Plan in November
2018, three months earlier than last year.

18. Around 2,000 cost lines feed into the Equipment Plan relating to specific equipment
and support projects. In developing its 2018 Plan, the Department has adopted a more
realistic approach to forecasting than in previous years but has more to do. Forecast project
costs now incorporate a more detailed bottom-up review of nuclear projects, better reflect
US dollar exchange rates and, in the Department’s opinion, capture all expected projects.

19. For the 2018 Plan, the Department’s Cost Analysis and Assurance Service (CAAS)
concluded that the Department could have under-estimated the cost of equipment
and support projects by £3 billion (£3.2 billion in 2017), when compared with its own
independent assessment. The Department considers that CAAS provides a useful
challenge to project teams’ costings, with teams investigating the causes of differences.
It believes that, although the differences in the costings would never be zero, they are
narrowing as the Department develops its approach to costing.

20. In July 2018, the Department set out a five-year financial skills strategy which it
hoped would lead to significant improvements in the next three years. The Department
has recognised the broader challenge of financial skills shortages across government,
and its strategy focused on improving forecast cost accuracy, and managing costs and
financial risks. We asked for clarity as to what “significant” improvements meant.
The Department advised that, for example, it aims to increase the number of financially
qualified staff from the current level of 41% to 60%. It told us that its efforts to improve
the accuracy of forecast costs had already played a significant role in it expecting to stay
within budget during 2018–19. It also felt that if forecasting continues to improve at the
same rate, it would be able to reduce the level of “over-programming” that it would be
prepared to deal with.

Efficiency savings

21. The Department reduces its equipment and support budget to reflect the levels of
efficiencies it hopes to achieve over the 10-year period of the Plan. The Department
acknowledged that in the past it had included large efficiencies, partly to pay for investment,
which were not fully substantiated.\textsuperscript{45} For the 2018 Plan, the Department found it difficult to provide a clear and comprehensive view of its progress towards its efficiency targets, and could not routinely track progress. Consequently, the National Audit Office could not provide assurance over the efficiency figures included in the Plan.\textsuperscript{46} The Department committed to having a more mature assessment of efficiencies by the time we next take evidence on the Equipment Plan, and stated it will report more transparently on its confidence in delivering these efficiencies.\textsuperscript{47}

22. The Department has included a £13.4 billion efficiency target in the Plan, with forecast costs reflecting its assumption that it can achieve £7.3 billion of this figure.\textsuperscript{48} We asked the Department how confident it was in delivering the remaining savings. It said that it has included an additional £2.2 billion of efficiencies it was 'less certain' it could achieve in its costs where it was confident that it has plans in place to deliver them. However, this still leaves a gap against its efficiency target of £3.9 billion.\textsuperscript{49}

### Setting out the uncertainties within the Plan

23. The 2018 Equipment Plan publication presented risks and uncertainties more transparently than in previous years. For the first time, the Department set out and quantified the gap between forecast costs and budget, and provided an explanation and quantification of the cost risks included in the Plan.\textsuperscript{50} However, the Department outlined to us continuing uncertainties and risks. For example, it had more confidence in its short-term, rather than longer-term, forecasting, with some of the less mature costs five to 10 years into the Plan potentially being materially wrong.\textsuperscript{51}

24. More specifically, the Equipment Plan describes some of the Department’s major programmes, but does not outline the associated uncertainties, for example with the F-35 jets.\textsuperscript{52} The Department told us there remains uncertainty about the support arrangements associated with running two F-35 fleets if the UK was to buy different variants.\textsuperscript{53} It considered that it did not yet have to decide which variant to purchase after procuring the first 48 jets.\textsuperscript{54} It also told us that the first aircraft carrier, HMS Queen Elizabeth, will conduct her first operational deployment in 2021, by when it would better understand the workings and costs of the global support packages available.\textsuperscript{55}

25. Given the uncertainties resulting from the external environment, the Department plans for a range of scenarios but accepts it can be difficult to mitigate all risks, in particular changes to foreign exchange rates. It told us that it had put aside what it considered a sensible contingency at the time to manage the foreign exchange exposure that has not been hedged. But if exchange rates remain similar to those at the time of our evidence session then the risk could be significantly over its estimates, and it did not have bottomless reserves to cover such a situation.\textsuperscript{56}

\textsuperscript{45} Qq 118 - 120
\textsuperscript{46} Q 122; C&AG Report para 2.15
\textsuperscript{47} Q 121–123
\textsuperscript{48} C&AG Report para 2.13
\textsuperscript{49} Qq 118–120; C&AG Report para 2.17
\textsuperscript{50} C&AG’s Report paras 4, 1.13
\textsuperscript{51} Q 153
\textsuperscript{52} C&AG’s Report, para 1.13
\textsuperscript{53} Q 90–91
\textsuperscript{54} Qq 83–85
\textsuperscript{55} Qq 125–127
\textsuperscript{56} Qq 43
Formal Minutes

Wednesday 23 January 2019

Members present:

Meg Hillier, in the Chair

Sir Geoffrey Clifton-Brown  Layla Moran
Chris Davies               Anne Marie Morris
Chris Evans                Bridget Phillipson
Caroline Flint            Anne-Marie Trevelyan
Shabana Mahmood

Draft Report (*Defence Equipment Plan 2018–2028*), proposed by the Chair, brought up and read.

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

Paragraphs 1 to 25 read and agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

*Resolved*, That the Report be the Seventy-Seventh of the Committee to the House.

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

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

[Adjourned till Monday 28 January at 3:30pm]
Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the [inquiry publications page](#) of the Committee’s website.

Monday 3 December 2018

**Sir Simon Bollom**, CEO, Defence Equipment and Support, **Cat Little**, Director General Finance, Ministry of Defence, **Stephen Lovegrove**, Permanent Secretary, Ministry of Defence, and **Lieutenant-General Sir Mark Poffley**, Deputy Chief of the Defence Staff, Ministry of Defence

Published written evidence

The following written evidence was received and can be viewed on the [inquiry publications page](#) of the Committee’s website.

DEQ numbers are generated by the evidence processing system and so may not be complete.

1. Patel, Jag ([DEQ0001](#))
# List of Reports from the Committee during the current Parliaments

All publications from the Committee are available on the [publications page](#) of the Committee’s website. The reference number of the Government’s response to each Report is printed in brackets after the HC printing number.

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