House of Commons
Committee of Public Accounts

The Defence Equipment Plan 2017–2027

Thirty-Ninth Report of Session 2017–19

Report, together with formal minutes relating to the report

Ordered by the House of Commons
to be printed 9 May 2018
The Committee of Public Accounts

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Publication

Committee reports are published on the Committee’s website and in print by Order of the House.

Evidence relating to this report is published on the inquiry publications page of the Committee’s website.

Committee staff

The current staff of the Committee are Richard Cooke (Clerk), Dominic Stockbridge (Second Clerk), Hannah Wentworth (Chair Support), Ruby Radley (Senior Committee Assistant), Carolyn Bowes and Kutumya Kibedi (Committee Assistants), and Tim Bowden (Media Officer).

Contacts

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Summary

Last year we reported that the Ministry of Defence’s (the Department’s) Equipment Plan was at greater risk of becoming unaffordable than at any time since its inception in 2012. These risks have now increased and the Ministry of Defence simply does not have enough money to buy all the equipment it says it needs. It is worrying that the Department is back in the position it found itself in earlier in the decade. The Equipment Plan for 2017 to 2027 is not realistic and the Department lacks cost control. A significant affordability gap has again opened up; with forecast costs at least £4.9 billion, and potentially as much as £20.8 billion, more than the £179.7 billion budget. The Department is reluctant to present openly an assessment of the affordability gap and has failed to report transparently to Parliament and the public about the financial risks it faces. The Department has put its faith in the Modernising Defence Programme to solve its affordability issues and to prepare for the continued challenges of a fast-changing defence landscape, including the UK’s capabilities for cyber, chemical, biological, radiological, nuclear and electromagnetic attacks. We are highly sceptical that the Modernising Defence Programme will be able to return the Department to a balanced position.
Introduction

Since 2012, the Department has published an annual Statement on the affordability of its 10-year Equipment Plan (the Plan). It began to report this after a period of poor financial management, during which a significant gap had developed between its forecast funding and the cost of the defence programme as a whole. The Department’s Plan forecasts spend for 10 years and is updated annually. For the 10-year period 1 April 2017 to 31 March 2027, the Department has set an equipment budget of £179.7 billion made up of equipment procurement (£84.8 billion), and support (£88.9 billion) budgets, and a central contingency provision (£6 billion). Managing the equipment and support budget effectively is critical to maintaining the stability of the wider defence budget and ensuring that the Armed Forces have the equipment they need to meet their objectives. The Plan accounts for over 40% of the entire Defence budget.
Conclusions and recommendations

1. The Department faces a significant affordability gap in its Equipment Plan for the next 10 years, but is unable to determine the size of the gap, thereby reducing its ability to make informed decisions about our national defence. There is an affordability gap of at least £4.9 billion in the Plan, rising to a potential £20.8 billion if all identified financial risks materialise and no savings assumed in the Plan are achieved. Financial risk has increased since last year, and while the Department acknowledges that the affordability gap is in the billions of pounds, it is unable to quantify the size of the gap with any degree of precision. We are concerned by the Department’s vagueness and reluctance to acknowledge its full exposure, and by the Department seeming to question the accuracy of its own numbers when giving evidence. The Department says it is confident that at end of the Modernising Defence Programme, with cost information anticipated in autumn 2018, it will have a “strategically affordable” Plan, but is unable to articulate clearly how this will be achieved.

Recommendation: The Department has committed to emerging conclusions from the Modernising Defence Programme (MDP) by early summer. The Department must report those conclusions within three months, including its assessment on timescale for concluding the MDP. At the conclusion of the Programme the Department must be able to show that it has established an affordable programme and a balanced equipment budget, and commit to reporting those results to Parliament at the earliest opportunity.

2. The Department’s current approach to planning for equipment does not reflect the continually changing nature of the defence landscape, reducing its ability to be well placed to deliver the future defence capability needed. There are now a number of emerging threats, such as cyber and artificial intelligence, leading to changes in the nature of the defence landscape. However, there is a lack of flexibility in the 10-year Plan, which contains no headroom or unallocated contingency, with spending dominated by a number of large platforms which take years to build. Increasingly, the UK’s military response is dependant on strong international alliances. The Department is leading the Modernising Defence Programme in response to these changing threats and this could result in some big changes in the Equipment Plan if the Department introduces new projects and de-scopes, defers or cancels others to balance the budget. When completing and implementing the Modernising Defence Programme, the Department faces the challenge of balancing the need to optimise operational capability with both value for money and the need to support UK industry. There is a need for a strong UK defence industry to underpin our ability to react to emerging threats.

Recommendation: The Department’s Modernising Defence Programme and its future Equipment Plans should set out how it will balance the need to develop long term capability with the challenges of maintaining sufficient flexibility to respond to changes in the defence landscape.
3. The Department’s Equipment Plan is characterised by significant cost optimism bias arising from weaknesses in the Department’s cost management. The Department’s failure to balance its 2017 Equipment Plan budget arises from a lack of control of the Commands by the centre, which resulted in £9.6 billion of forecast costs being excluded from the Plan. The Department lacks an understanding of what comprises that £9.6 billion, and could provide no meaningful explanation for excluding the costs of buying Type 31e frigates. The Department also needs to be clear about what contingency it is relying on.

**Recommendation:** *The Department needs to improve its management of the Plan to ensure that the next Plan is comprehensive, has much greater clarity around costs and spending, and all elements are realistically and fully costed.*

4. The biggest risk to the Equipment Plan is the cost of the nuclear programme. The costings of the nuclear enterprise in the Plan have continued to grow. The Department says that a recent review indicates that costs for the Dreadnought submarine need to be brought forward, which will further increase short term pressures in the Plan. In addition, the costs of the warhead programme have also increased. Witnesses said their biggest worry is the costing of the nuclear programme. This is a long-term programme which can experience big cost changes throughout its life cycle.

**Recommendation:** *The Department needs to improve its control of the costs of its nuclear projects and to report more transparently, including reporting the impact of cost increases and the interdependencies of projects.*

5. The Department is not sufficiently open with Parliament to allow us and the taxpayer to have a clear view of its finances. We expect to have timely, accurate and full information on the commitments and costs into which the Department enters. This year’s Equipment Plan was not published until 10 months after the start of the Plan period. It provides very little information about the many risks to affordability and the significant dependence of the Plan on assumed, and optimistic, savings targets being achieved. Beyond the Equipment Plan there is a wider transparency gap, highlighted particularly by the lack of cost information available on F-35 Lightning fighter aircraft. When challenged, the Department undertook to include more information on its equipment and wider budget in its Annual Report and Accounts, to bring forward their reporting of the Equipment Plan to early autumn, and also undertook to report on the Modernising Defence Programme cost implications in the autumn.

**Recommendation:** *The Department should write back in three months committing to the specific improvements it will make in providing information to Parliament, including how it will provide regular and informative updates on the cost and progress of the F-35s. The Department should consider an annual summary to Parliament.*

6. The Department continues to be reliant on ever increasing and optimistic savings targets. A total requirement for £16 billion of savings has been set since the Equipment Plan reporting regime began in 2012. The Department claims that it has achieved £7.9 billion so far, but given the extent of the challenge and its patchy past performance, we remain sceptical that it can achieve the remaining £8.1
billion by 2027. The majority of the remaining savings ideas are at an early stage of development, with implementation plans still to be developed. The Department recognises past weakness in recording progress against savings and that there are a number of historic overlapping efficiency programmes that have prevented appropriate management. As part of the Modernising Defence Programme, the Department has commissioned an independent review of efficiency savings. It has also appointed a new Chief Operating Officer who is looking to produce consistent guidance, and it has started to develop a more rigorous approach to tracking savings. The Committee will expect to see clear evidence of that more rigorous approach and to be informed swiftly if savings targets are not achieved.

**Recommendation:** The Department should ensure that its savings targets are realistic, and introduce transparent reporting of progress against all targets in future Equipment Plans. This should include reporting of progress against cost reductions for F-35B aircraft, including sustainment costs.
The Defence Equipment Plan 2017–2027

1 The affordability of the Equipment 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 the Department’s Equipment Plan 2017 to 2027 (the Plan).

2. Since 2012, the Department has published an annual Statement on the affordability of its Equipment Plan. It began to report this after a period of poor financial management, during which a significant gap had developed between its forecast funding and the cost of the defence programme as a whole. The Plan covers forecast spend for 10 years and is updated annually. For the period 2017 to 2027, the budget is £179.7 billion, made up of equipment procurement (£84.8 billion) and support (£88.9 billion) budgets, and a central contingency provision (£6 billion). The Plan is funded from the Department’s overall budget, and makes up more than 40% of its planned spend.

3. The Department’s Head Office is responsible for overseeing the Equipment Plan. Fiscal responsibility for projects within the Plan is delegated to the four front-line military commands of Air, Army, Navy and Joint Forces, and the Strategic Programmes and Nuclear Directorates within the Department’s Head Office (collectively known as the Commands). The Commands specify their equipment requirements and manage equipment budgets to secure those requirements. Head Office adjusts costs and budgets to achieve a balanced position across defence. Defence Equipment and Support (DE&S) and Information Systems and Services (ISS) manage equipment projects on behalf of the Commands.

4. In July 2017, the government announced a review of national security capabilities in support of the ongoing implementation of the National Security Strategy and the Strategic Defence and Security Review 2015. This recommended that a programme of further work, known as the Modernising Defence Programme, be undertaken, including an assessment of defence capabilities. The Department aims to publish the outcome of this Modernising Defence Programme, the findings of which might impact on the Department’s future plans for equipment.

The affordability gap

5. The Department is facing a minimum affordability gap of £4.9 billion, which could rise to £20.8 billion if all identified financial risks of cost growth materialise and the Department does not achieve any of the savings assumed in the Plan. The Department agreed that there is an affordability challenge and set out that there is significant financial risk in the Equipment Plan, which has increased from previous years and has become more difficult to manage and mitigate against. We asked the Department to set out their

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1 Report by the Comptroller and Auditor General, The Equipment Plan 2017 to 2027, Session 2017–19, HC 717, 31 January 2018
2 C&AG’s Report, paras 1–3
3 C&AG’s Report, paras 1.3–1.4
4 C&AG’s Report, para 5
5 C&AG’s Report, para 6
6 Q 21
assessment of the size of the affordability gap, but were informed that this is “an impossible question to answer”, although it is “likely that the affordability challenge sitting here in the next 10 years is in the billions—that is for sure”.

6. The Department felt that it had enough money to cover the risks within the Equipment Plan, although it stated that it did not “fundamentally disagree with the ranges and the plausible scenarios” that the National Audit Office (NAO) had highlighted in its report. The Department’s own Cost Assurance and Analysis Service (CAAS) assessed that costs in the Plan could be understated by £3.2 billion, but the Department said it expected to only consume around a third to half of this. The Department also set out that while it is likely to use some of the £9.6 billion additional forecast costs it would not be a large amount. As the Department was providing us with numbers and descriptions concerning the affordability gap that were not clearly the same as those in the NAO report, we asked again if the Department agreed with the numbers and ranges in the NAO report, to which it confirmed that it did.

7. The National and Security Capability Review had 12 strands. The defence strand was the biggest and has been extended and expanded into the Modernising Defence Programme which is due to report emerging findings in the summer. The Modernising Defence Programme is in part a response to the challenge the Department faces with growing financial pressures. The Department set out that it is committed to achieving the Secretary of State’s ambition of the Plan being “strategically affordable” by the end of the Modernising Defence Programme, which is expected to feed into the Autumn Budget.

Cost forecasts

8. The Department did not account for £9.6 billion of forecast costs in the Plan. This variance arose as a result of the Department’s 2017 budget setting process not being able to match costs to available budgets. The Department did not complete the budgeting exercise for the Plan until May 2017, two months after the start of the 2017–18 financial year, due to significant difficulties in reaching agreement on the best approach to manage the affordability gap that had arisen in the defence programme. The Department admitted that it has not assessed which projects are in that £9.6 billion and what “TLBs [Top Level Budgets—the frontline commands and other operating units] are actually doing to bring down those costs”. The Department told us that it is implementing a different approach to capturing these costs within the current planning round. The Department blamed timing for not including the Type 31e costs in the Plan, but gave assurance that these costs would be included in the subsequent Equipment Plan. The Department also told us that
it has also reviewed its policy of costing at the P50 and is now updating its guidance.\textsuperscript{18} It said that it has not been explicit in the past about where a different approach to percentile costing should be adopted and there is inconsistency in how data is being collected and how it is applying its P50 policy.

9. The Department told us that the projects they worry about most within the Equipment Plan are the nuclear programmes including Dreadnought and Astute. It set out that there are some very complicated and immature assumptions in these programmes, and because of the nature of the long-term design and implementation of those programmes, it is very easy for them to experience big cost changes throughout their life cycle.\textsuperscript{19} As costs have increased for Dreadnought and Astute by £941 million since the 2016 Plan, we asked if we should expect further cost increases. The Department informed us that it has just been through a lessons learned process for Dreadnought and Astute in particular, and has identified some issues, including: project control; the way in which it has used commercial contracts; and the need to engage further with suppliers.\textsuperscript{20} The Department told us that Dreadnought will not cost more than the expected £31 billion, although it could not guarantee that it would not call on the additional £10 billion contingency. The Department said that the Dreadnought project needed to be re-profiled, with more being spent in the earlier years.\textsuperscript{21} The Department told us that it would be “very transparent” in its reporting to Parliament about seeking to bring money forward across the 30-year programme.\textsuperscript{22} We also asked about the risk of cost increasing for the weaponry that goes on Dreadnought. The Department agreed that the costs were more than just the submarine and that there had been “well-documented cost increases in some of the facilities at AWE, which are fundamentally about building the UK’s independent nuclear warheads, and those can be very big”.\textsuperscript{23}

10. The rates the Department used to forecast costs in the Plan denominated in foreign currency were 24% above the US dollar rate at 1 April 2017, and 2% above the rate for the euro at the same date.\textsuperscript{24} We asked the Department when it will start using realistic foreign exchange rates in the Plan, given the more volatile situation since the vote to leave the EU. The Department told us it mitigates foreign exchange risk in the Plan through hedging and also holds a contingency provision in head office of £1.8 billion for foreign exchange risk. The £1.8 billion contingency sits outside the Plan, but worryingly this information was not shared with the NAO during its audit.\textsuperscript{25} We have previously raised concerns about foreign exchange exposure and asked the Department where it has got to in discussions with HM Treasury in its attempts to mitigate against this. The Department set out that there has been no movement from HM Treasury and it has not been successful in getting any central relief.\textsuperscript{26}

\textsuperscript{18} Qq 49, 54; P50—Where costs are modelled to calculate a range of possible costs, the Department normally determines project cost estimates in the Plan to be set at the median of the potential cost range (50th percentile). At this point, each project is considered to be equally likely to cost less or more than this estimate.
\textsuperscript{19} Q 46
\textsuperscript{20} Q 47
\textsuperscript{21} Qq 81–85
\textsuperscript{22} Q 86
\textsuperscript{23} Q 97
\textsuperscript{24} C&AG’s Report, para 9
\textsuperscript{25} Qq 24, 37–38, 42
\textsuperscript{26} Qq 39–42; Committee of Public Accounts, The Defence Equipment Plan, Fifty-sixth Report of Session 2016–17, HC 957, 25 April 2017
Transparency for Parliament and the taxpayer

11. The Department’s Equipment Plan Statement for 2017 to 2027 was published at the end of January 2018, 10 months after the start of the Plan. The Plan does not provide sufficient information about the affordability challenges the Department faces and there is insufficient detail to understand the Department’s progress in identifying the source of the savings assumed within the Plan. The Department mentioned two particular areas where it needed to improve significantly its monitoring and analysis, which were around the £9.6 billion additional costs not included in the Plan and in relation to the management of its savings targets. We asked if the next Plan would be a full and honest Plan, without the gaps we have seen this year. The Department responded that it commits to being as “forthright, honest and straightforward as we must be to the nation and Parliament when we are putting these plans forward.”

12. The Department set out that it is important to have timely, transparent reporting to Parliament, with more information in the annual report and accounts on future spending commitments, and reducing the gap between the start of the financial year and when Parliament receives the Equipment Plan. The Department committed to a timetable of producing the Equipment Plan in early autumn (September). It also set out that it has committed to emerging conclusions from the Modernising Defence Programme by early summer, suggesting this may coincide with the NATO summit in the second week of July. The Department acknowledged that transparency is a real area for the Department to do better on, recognising a need to present information more intelligibly. We specifically raised questions on the provision of cost information on the F-35 Lightning fighter aircraft, frustratingly having received more information during a recent discussion with the Joint Programme Office in the United States of America than we have from the Department itself.
2 The challenges ahead

Reliance on future savings

13. We asked The Department has regularly increased the amount of savings required to fund the Equipment Plan. This year, the Department has added £1.6 billion of further savings to the Plan, meaning that a total requirement for £16 billion of savings has been set since the Equipment Plan reporting regime began in 2012.36 The Department reports that it has achieved savings of approximately £7.9 billion, with approximately £8.1 billion still to be achieved by 2027. The full amount of savings included in the Plan is not clear and the Department does not have evidence that shows how it has achieved all the savings it claims to have made to date.37 The Department set out that it needs to improve significantly its monitoring and analysis in the area of efficiencies and how it captures savings. It told us that it has recently appointed a new Chief Operating Officer, who has as one of his primary objectives to “grip and enforce programme discipline in benefits realisation across the Department” and who is making sure there is consistent guidance across the Department. The Department also acknowledged that it needs to do better on information monitoring and to this end has appointed a Chief Information Officer.38

14. The Department informed us that it has recently commissioned Oliver Wyman to assess independently the baseline of its efficiency plan. It described how it needed good, forensic, detailed analysis to ensure that it is able to see fully over the next 10 years whether or not it thinks its savings are credible and achievable. This work is in response to the Department having a number of overlapping efficiency programmes, which has created capacity for confusion. We asked the Department when it is likely to have as it described a “clean house”, and it set out that it hopes to have completed this work, which forms strand two of the Modernising Defence Programme, before early summer.39

15. The Department has started to develop a more rigorous approach to identifying and managing the £8.1 billion of outstanding savings assumed in the Plan. The new process is managed on behalf of the wider Department by Defence Equipment and Support, and consists of project teams identifying savings ideas and developing these through a four-stage process. The majority of the savings that have been identified are at an early stage with implementation plans to be developed.40 The Department stated that they have confidence in their efficiency plans and that there will be an improvement going forward in terms of tracking performance.41

Responding to changes in equipment requirements

16. In previous years, the Department maintained headroom in its Plan to fund extra projects beyond the core programme according to emerging military priorities. This has now been allocated and funding for any further emerging requirements will have to be found from within Commands’ existing budgets, reducing the Department’s flexibility to
respond to future equipment needs.\textsuperscript{42} The Department has set aside a central contingency provision of £6 billion within the Plan (representing 3\%).\textsuperscript{43} We asked how the Department was managing its contingency as it was insufficient to cover the difference between likely costs and available funding. The Department set out that beyond the Equipment Plan there is a general contingency, but that contingencies are not directly funded and the Department has to generate savings in order to hold a contingency at head office. We asked the Department if it has a sufficient safety net for planning over the medium and long term. The Department responded that “There is for the short term”, and that a conversation was needed about the level of risk prepared to be accepted over the longer term.\textsuperscript{44}

17. We asked the Department about multiple risks in the defence landscape. The Department spoke about the changes in terms of geopolitics and technology over the last two years since the Strategic Defence and Security Review 2015, which led to the Defence Modernisation Programme being extended and expanded from the National Security and Capability Review (NSCR).\textsuperscript{45} We questioned the Department about the growing threats to the UK particularly in the form of cyber attacks. It responded that work in this area is a very active part of the work that was done under the NSCR, and the Department expects to make capability choices that will typically favour cyber activity. The Department might also need to take a different view about its chemical, biological, radiological and nuclear capabilities.\textsuperscript{46} The Department spoke of the changing nature of warfare and conflict including artificial intelligence and robotics.\textsuperscript{47} It set out that it needs to “continually look at our capabilities, and make sure that they, nested within an alliance construct, are sufficient to defend the citizens of this country.”\textsuperscript{48} The Department stressed that it would typically operate as part of an alliance, most notably as part of NATO.\textsuperscript{49}

18. The Department told us that the rapid changes in the defence landscape mean it potentially envisages some quite big changes to the Equipment Plan.\textsuperscript{50} The Department intends to publish the emerging conclusions from the Modernising Defence Programme in early summer.\textsuperscript{51} It set out that the Modernising Defence Programme could bring in other capabilities and funding, and that it might also decide that there are certain capabilities that the Department has at the moment that are placed on a lower priority and deferred.\textsuperscript{52} In terms of next year’s Equipment Plan, the Department felt that it might increase the number of projects in the plan that are at an early stage.\textsuperscript{53} In the context that there is already a stretch on the current plan and the Modernising Defence Programme could increase the number of projects, we asked if the Department had sought more money from the Treasury for the current Plan and were told that the Department is currently in discussions with the Treasury about the 2018–19 budget.\textsuperscript{54}

\textsuperscript{42} C&AG’s Report, para 3.3
\textsuperscript{43} C&AG’s Report, para 4.5
\textsuperscript{44} Qq 70, 72
\textsuperscript{45} Qq 3, 4, 7
\textsuperscript{46} Qq 2, 7, 35
\textsuperscript{47} Q 89
\textsuperscript{48} Q 2
\textsuperscript{49} Q 1
\textsuperscript{50} Q 35
\textsuperscript{51} Qq 67, 68
\textsuperscript{52} Q 74
\textsuperscript{53} Q 93
\textsuperscript{54} Q 94
19. We asked the Department what its biggest worries were. It told us that a particular area of concern in risk terms was resilience against a changing threat profile that accelerates beyond its capacity to adapt to it. The Department also described how it has an increasingly small number of increasingly sophisticated platforms. It set out that in the coming era it is going to have a smaller amount of very complicated kit, which are often one of a kind. This raises questions as to how it sustains them given the reduced transferability of parts between different platforms. Another area of concern for the Department was the trade-off it sees between short-term decision-making to live within its means versus the long term suitability of programmes.

20. We asked how the Defence Modernisation Programme links to the prosperity of the UK. The Department stated that the third strand of the Modernising Defence Programme is about the nature of the Department’s supplier relationships and how they can drive best value for money for the taxpayer while at the same time supporting British industries. The Department informed us that at times the best piece of kit may come from a non-British supplier. It told us that it is now putting into its requirement setting overt and explicit consideration of what the prosperity components of any requirement would be.
Formal minutes

Wednesday 9 May 2018

Members present:

Meg Hillier, in the Chair

Bim Afolami                      Shabana Mahmood
Sir Geoffrey Clifton-Brown       Layla Moran
Chris Evans                      Anne Marie Morris
Caroline Flint                   Bridget Phillipson
Luke Graham                      Lee Rowley
Gillian Keegan                   Gareth Snell

Draft Report (The Defence Equipment Plan 2017–2027), proposed by the Chair, brought up and read.

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

Paragraphs 1 to 20 read and agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Thirty-ninth 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 14 May 2018 at 2.30pm]
Witnesses

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

Wednesday 14 March 2018

Stephen Lovegrove, Permanent Secretary, Cat Little, Director General of Finance, Lieutenant-General Mark Poffley, Deputy Chair of Defence Staff, Military Capability, and Michael Bradley, Chief Executive Officer, Defence Equipment and Support, 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.

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

1  Jag Patel (DEP0001)

Published correspondence

The following correspondence was also published as part of this inquiry:

1  Correspondence with Ministry of Defence, relating to a clarification of oral evidence, dated 11 March
2  Correspondence with Ministry of Defence, relating to Forex, dated 11 April
### List of Reports from the Committee during the current session

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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