

**Report by the
Comptroller and Auditor General**

Ministry of Defence

**Accepting
equipment
off-contract and
into service**

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Executive summary

Introduction

1 Acceptance is the process by which the Ministry of Defence (the Department) confirm that Users' needs for military capability have been met by the systems supplied. The Department have accepted into service some 65 major equipments each of the value of £10 million or above in the past five years. Traditionally acceptance has had two main parts - acceptance off-contract and acceptance into service – reflecting differences in the responsibilities of those involved in procuring and operating the equipment. As part of the Smart Procurement Initiative, the Department are revising their acceptance procedures with the aim of introducing a single outline process for all major programmes.

2 This report examines the Department's track record and current procedures for accepting equipment off-contract and into service. Our main findings and recommendations are summarised below and are intended both to re-inforce and to inform the on-going development of the Department's "Smart Acceptance" procedures.

Getting the right equipment

3 Acceptance provides the link between the means - procurement - and the ends - operational capability - that go towards the creation of a modern and effective military capability. A survey of equipments accepted over a 5-year period revealed that, when the decision was made to accept the equipment off-contract, 40 per cent of equipments fully met the operational requirements. In half of the equipments where this was not the case, the Department made concessions which removed from the contractor the obligation to make good the shortfall either because they did not consider that shortfalls affected operational capability or because of pressure from the User. On the other hand, the other half of these equipments were subject to the contractor accepting responsibility for rectifying the shortcoming at its own expense. However, this did not always happen, and exceptionally the Department deleted parts of the Staff Requirement in order to get equipments into service. Finally, we found that in some cases equipments were accepted whilst not meeting the Staff Requirement because of poor contractual definitions, industrial or other factors, with the Department remedying the shortfalls at their own expense.

- 4** We recommend that the Department:
- Take forward their intention to work closely with industry within Integrated Project Teams to understand what is technically achievable, to identify risks to project success and to reflect these in the new Integrated Test, Evaluation and Acceptance Plans. Such actions should help to prevent nugatory effort and reduce the incidence of concessions.
 - Build on their closer relationship with industry, working as stakeholders in Integrated Project Teams. They should also develop Smart Procurement techniques, including Smart Acceptance, which offer potential for better management of the acceptance process. Finally, the Department should examine the scope to make more use of provisos to secure early operational benefits where there are performance difficulties. Such arrangements should not be seen as an excuse for not forcing industry to deliver the full capability that they have been contracted for within agreed timescales.

The acceptance process

5 The acceptance process is central to the successful delivery of an equipment or operational capability to the Front Line user and spans virtually the entire length of an equipment procurement project's life. We found that acceptance processes varied between air, sea and land environments, reflecting the different scale and nature of procurements involved and that there was only general guidance available on how to construct cost-effective acceptance strategies. However, the vast majority of projects surveyed had strategies in place for identifying, gathering and analysing the evidence required to demonstrate equipment performance. These acceptance strategies and project risk assessments tended to emphasise the importance of integration risks, while underplaying potential problems with reliability, environmental testing, the quality of individual components and human factors. And the strategies had mixed success with over half of the projects surveyed having difficulties in demonstrating aspects of performance during acceptance off-contract. Ninety per cent of projects also undertook additional trials to demonstrate performance before accepting equipments into service. In 40 per cent of these further trials, problems emerged in meeting the Staff Requirement. In general, the Department's considerable experience in testing and trialling meant that most performance defects were identified but in some cases the techniques used did not provide sufficient or accurate results before acceptance decisions were made. Such decisions were

largely qualitative and, whilst stakeholders usually reached a consensus view, there were some differences of opinion and some of the decisions had unexpected operational implications.

6 We recommend that the Department:

- Improve the clarity and quality of guidance on acceptance planning.
- Learn lessons from past experience of technical and project management difficulties and from the performance of individual contractors in managing the acceptance process and dealing with shortcomings. The results should be used to inform the design of future acceptance strategies to ensure that they are tailored to the circumstances of individual programmes.
- Build on the introduction of Integrated Project Teams to ensure that all key players, including in the future the Defence Evaluation and Research Agency, and industry, are brought in to the acceptance process at an early stage to ensure a more systematic approach to the design of acceptance strategies.
- Introduce more quantification into their decision-making on the outcome of acceptance to bring such analysis into line with that underpinning both the formulation of Staff Requirements and the evaluation of contractors' bids.
- Review and evaluate the effectiveness of the Smart Acceptance procedures when a body of experience exists.

Contractual problems in the acceptance process

7 The acceptance process will run smoothly only if the procurement contract fully reflects the objectives of the Staff Requirement and the specific characteristics of the equipment being procured. In one-third of cases examined, contract acceptance criteria did not fully reflect the Staff Requirement. In some of these cases, the Department had some success seeking financial redress, but in other cases they had to pay for remedial work themselves or sacrifice the element of equipment performance in question. There were additional difficulties in

matching contractually binding acceptance terms to the Staff Requirement where equipments were purchased from overseas and particularly when the United States Foreign Military Sales system was used.

8 Contracts should provide some means of redress for the Department if the contractor fails to achieve the objectives specified. We found that the granting of concessions to contractors was not always accompanied by any financial recompense; warranties were negotiated in just over one-quarter of projects surveyed and were invoked in all cases – albeit with mixed success – and two-thirds of projects surveyed included liquidated damages clauses in their contracts. On eight projects examined, difficulties with the acceptance process were a cause of delay and contributed to the Department’s decision to claim liquidated damages. In line with their usual practices, the Department did not pursue general damages on any of the projects we surveyed.

9 We recommend that:

- Given the Department’s mixed track record in agreeing unambiguous contract acceptance criteria and linking these to the Staff Requirement, they will need to take great care to ensure that the new Smart Acceptance procedures are rigorously applied on all major programmes, particularly where they represent a change to more traditional approaches.
- All significant procurement contracts should include clearly defined provisions to enable the Department to obtain appropriate financial redress in cases of performance or schedule shortfall. In line with the aspirations underpinning Smart Acceptance, but in contrast to their track record, the Department should make the fullest use of such powers.
- The Department consolidate their experiences to generate quantified analyses of the financial and operational merits of provisions such as warranties, liquidated damages and reliance on general damages to make sure that the contractual arrangements put in place are the most cost effective in specific circumstances.

Concluding comments

10 The Department have always had in place defined processes to judge whether the equipments which they procure have met both the terms of the contract and operational needs. This is a complex task and in most cases the Department have achieved what they assess to be satisfactory outcomes. Our

analysis has shown that in a significant minority of cases weaknesses in specifying requirements, contracting, testing or pursuing contractual remedies cost the Department one or all of time, money and capability. In theory, the Department's new Smart Acceptance process will address many of the shortcomings which we have identified but this will only be the case if it is applied with more rigour than has been apparent under the current system and if lessons are learned in the light of their emerging experience. Our report re-inforces the need for the new approach and makes recommendations to further improve the efficiency of the acceptance process and effectiveness of outcomes. In the course of our work, we have identified £60 million of costs associated with equipments accepted which did not fully meet requirements. The Department must ensure that they can demonstrate the effectiveness of their new approach in minimising such costs and in achieving effective acceptance outcomes.