National Audit Office

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COMPTROLLER AND
AUDITOR GENERAL

HC 292
SESSION 2010–2011

20 JULY 2010

Ministry of Defence

Independent review of reported CSR07 value for money savings

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Amyas Morse
Comptroller and
Auditor General

National Audit Office

15 July 2010

The Comprehensive Spending Review 2007 (CSR07) Value for Money (VFM) Savings Programme, covering 2008-09 to 2010-11, builds on previous programmes designed to improve the efficiency and effectiveness of government operations.

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Contents

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This report can be found on the National Audit Office website at www.nao.org.uk/VFM-savings-MOD-2010

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Summary

Introduction

1 The Comprehensive Spending Review 2007 (CSR07) Value for Money (VFM) Savings Programme, covering 2008-09 to 2010-11, builds on previous programmes designed to improve the efficiency and effectiveness of government operations.

2 During the 2004-05 to 2007-08 Spending Review period an efficiency programme across government achieved £21.5 billion of annual efficiency gains, reduced the civil service by 70,600 posts and reallocated 13,500 posts to the front line of public services.[1] Settlements made to departments under CSR07 required departments to commit to achieving further value for money savings equivalent to at least 3 per cent of their near-cash Departmental Expenditure Limits[2] by 2011. A total of £30 billion of savings are anticipated across government and local authorities. An additional £5 billion savings target was announced in the 2008 Pre-Budget Report, bringing the total anticipated savings to £35 billion. Following the 2010 General Election, the Government announced a further £6 billion of reductions in planned expenditure in 2010-11.

3 Under the CSR07 Programme, departments are required to identify projects and programmes that will generate cash-releasing savings. Savings must be calculated net of the resources invested in the projects or programmes that led to their generation. Box 1 defines some key terms.

4 Departments must report their progress in achieving savings at six-monthly intervals, in autumn and annual performance reports. Departments are also required to publish Value for Money Delivery Agreements, which set out the initiatives they plan to put in place to deliver cash-releasing savings.

1 Final report on VFM in SR04: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/pbr08_finalefficiency_612.pdf
2 Near-cash Departmental spending limits are the cash element of a Department's three-year plans for a specific part of a department's expenditure, as agreed by HM Treasury.

Box 1
Definitions of key terms

Value for money savings represent lasting improvements to the way public money is spent. They are:

Sustainable. Savings are the result of a considered change in the way a department does its business and must exist at least for the current year and continue at the same or a higher level for two subsequent financial years. This is because one-off savings, or savings which delay expenditure, do not help departments live within spending allocations in future years.

Neutral to service quality. Departments need to demonstrate that reforms have not impacted adversely on the quality of public services at the level of their strategic objectives and Public Service Agreements.

Cashable. Cashable gains involve reducing inputs without affecting service quality. Non-cashable gains, in which outputs are increased for a given level of input, cannot be reported. Departments are permitted to reinvest cash savings in other services, so in most cases cash that is released cannot be observed directly in reduced budgets.

Realised. Savings have materialised at the point at which they are reported.

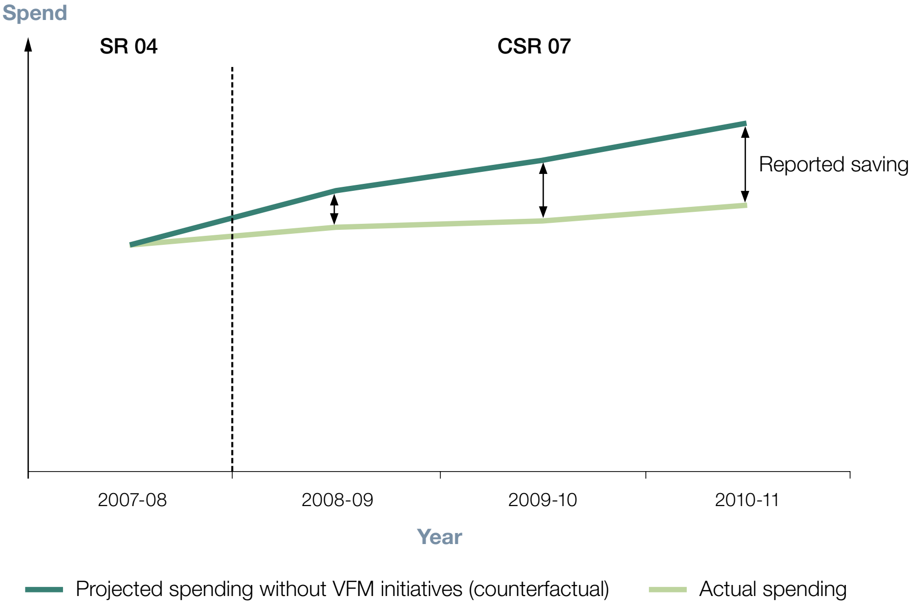
Net of costs. The upfront and investment costs and additional ongoing or running costs associated with the generation of savings must be subtracted from the value of the benefit.

5 Departments are required by Treasury to have in place robust governance arrangements that provide assurance over the achievement of the programme and the validity of publicly reported savings. Departments must describe their governance arrangements in their Value for Money Delivery Agreements.

6 In our assessment of the VFM savings claimed by departments we have used Treasury guidance establishing a credible counterfactual or what the Department would have spent if the savings measures were not introduced. This takes into account any planned increase in expenditure as, for example, the Defence budget is planned to increase in real terms over CSR07. The counterfactual is the projected increase in expenditure resulting from inflation and new spending decisions in the absence of any actions to contain the costs. The reportable VFM saving is then the difference between in-year spend and the counterfactual for that year (**Figure 1** overleaf). We have used a baseline year of 2007-08 over the spending review period.

Figure 1

Illustration of a counterfactual and its use in calculating a VFM saving



Source: National Audit Office

Ministry of Defence's savings target

7 The Government has set a target to generate £35 billion of annually cash-releasing[3] value for money savings across the public sector by 2010-11. Target savings have been built into Departments' spending agreements with the Treasury, so that achieving the savings is necessary to enable departments to meet their agreed objectives while staying within their budgets.

8 Under the 2007 Comprehensive Spending Review (CSR07), the Ministry of Defence (the Department) is committed to Value for Money (VFM) reforms generating annual net cash-releasing savings of £2.7 billion by 2010-11. An additional £450 million was agreed in the April 2009 Budget, increasing the Ministry of Defence's VFM target to £3.15 billion. In its Autumn Performance Report the Department assessed that it was broadly on track to meet this target.

3 Under CSR07, departments therefore have to deliver savings to release enough cash to meet their spending plans or reduce activity compared with the planned level.

9 We reviewed the Department's reported savings to October 2009 as detailed in its 2009-10 Autumn Performance Report. The terms under which we undertook this work and the methods used, including how we selected our sample, are set out in Appendix One. We used nine audit criteria (set out in full in Appendix Two) to assess whether the reported savings:

- fairly represent realised cash savings (**Green**);
- may represent realised cash savings, but with some uncertainty in one or more areas (**Amber**); or
- do not represent, or significantly overstate savings made, or fail on one or more criteria (**Red**).

The uncertainty partly relates to measurement difficulties, as over the period the Department did not have established systems which provide evidence across the range of criteria we have used to assess savings.

Our opinion on reported savings

10 The Department has reported VFM cash-releasing savings totalling £1.2 billion to October 2009. Of these savings, £944 million are new and £267 million represent over-delivery of savings from the Spending Review 2004 (SR04) period. This equated to 10 per cent of the Department's CSR07 target, the maximum amount Treasury permitted departments to carry forward. We did not review the over-delivery in detail as this would have required us to sample closed years for which different rules applied on which savings could be counted. The Department expects the majority of its VFM savings to be realised in the final year of the CSR07. The reported savings were comprised of a number of separate strands:

- reprioritisation of planned spend;
- reform of corporate enabling services (and other central efficiency programmes);
- more efficient equipment support; and
- normalisation in Northern Ireland[4] and changes in other overseas bases which will deliver savings in running costs.

11 We sampled £712 million (75 per cent) of the £944 million new savings reported by the Department (**Figure 2** overleaf). **We rated £616 million (86 per cent) of the sampled savings as Green or Amber but have significant concerns over £96 million (14 per cent) of the sampled savings (Figure 3 on page 9).**

4 Normalisation in Northern Ireland refers to the process the Department has undertaken to reduce its operations and footprint in Northern Ireland, following the signing of the Good Friday agreement in April 1998.

Figure 2
Assessment of VFM savings by type

	Savings rated (£m)			Reason for the rating
	Green	Amber	Red	
Corporate Enabling Services	164.0	–	64.6	Some double-counting and non-realised savings
Planning Round and Additional Efficiencies savings	64.0	218.0	16.3	Insufficient evidence that the majority of the saving measures had been implemented as intended, making it difficult to assess sustainability or the impact on outputs
Nuclear Warhead Capability Sustainment Programme	48.0	–	15.0	Incorrect baseline used to calculate saving
Northern Ireland Normalisation	12.4	91.1	–	Majority of the saving represents a continuation of savings initiated prior to the CSR07 period
Other Projects	9.1	8.9	0.3	Insufficient evidence to substantiate whether the saving was properly calculated or new to the period
Totals	**297.6**	**318.0**	**96.3**	**Total examined £712 million**

Source: National Audit Office

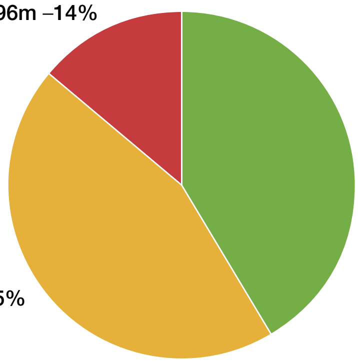
12 **We assessed that the Department's overall governance arrangements over its Value for Money Savings programme had improved.** Improvements in procedures have been put in place since Defence Internal Audit reviews in 2009 which found that the overall governance and control arrangements for the capture and monitoring of VFM efficiency savings were inadequate. We found that individual savings were not tracked and reported on in sufficient detail in 2008-09, and to a lesser extent the first half of 2009-10, to allow the Department to challenge individual savings claims centrally. In particular, this resulted in a large proportion of the savings from Planning Rounds[5] 2007 and 2008 in our sample being rated as Amber. New procedures introduced for tracking and monitoring savings should, if consistently applied by the Department, enable future savings under subsequent Planning Rounds to achieve a Green rating.

13 **The main reasons for our Amber and Red assessments were:**

- The majority of savings reported from Northern Ireland Normalisation are rated as Amber because they represent a continuation of savings first initiated in the previous spending review period. While staff reductions were initiated during SR04, substantial implementation costs were incurred, and as a result the first net savings took place and were claimed in the CSR07 period.

5 The Planning Round is the process the Department undergoes annually to reprioritise its expenditure.

Figure 3
Assessment of sampled Ministry of Defence savings[1]



NOTES

1 Percentages shown on Figure 3 do not total 100 per cent due to rounding. Percentages to one decimal place: Green 41.8 per cent, Amber 44.7 per cent, Red 13.5 per cent.

2 Green – Figures fairly represent savings which in all material respects meet the criteria set out in Appendix Two to this report. Nothing has come to our attention that causes us to believe that the savings are not sustainable or will impact adversely on strategic objectives.

Amber – There may be realised cash savings which meet the criteria set out in Appendix Two, but there are areas where we either could not obtain sufficient evidence or were not satisfied that certain criteria had been fully met.

Red – Reported figures may significantly overstate savings made. Savings do not meet one or more criteria or the Department was unable to provide evidence across a range of criteria to support the saving.

Source: National Audit Office

- The savings reported for the Nuclear Warhead Capability Sustainment Programme had an out of date baseline, meaning that part of the saving failed on the 'properly calculated' criteria.

- A large proportion of savings rated Amber, in particular 'additional efficiencies' in Planning Round 2007, were not tracked and, although the Department could illustrate a reduction in spending, there was no evidence to assess whether the output of the activity had been affected by the efficiency saving.

- Some savings reported by the Department as part of the £1.2 billion savings in the 2009 Autumn Performance Report were subsequently not realised. At the time of our review, following the Autumn Performance Report, the Department had proposed to remove these from future claims. In addition, some of the savings claimed under Corporate Enabling Services were offset by the unexpected need to establish new teams thereby increasing staff costs. Similarly, the Department also identified double-counting between the Performance, Agility, Confidence, Efficiency (PACE) programme and the Equipment Support programme.

Recommendations

a **Establish clearer budgetary baselines for major savings.** In order to demonstrate that reported savings have released cash as claimed, the Department should be able to reconcile actual spending to a counterfactual calculated using Treasury guidance, based on its spend in 2007-08.

b **Strengthen the tracking and monitoring regime** that the Department already has in place for savings options that are selected for inclusion in the Value for Money programme to ensure that Top Level Budget holders take action to implement the option, that the expected savings are realised and sustainable, and to track the effect of the savings on key outputs.

c **Include an assurance statement in its annual report stating explicitly the impact of the measures** it takes to meet its Value for Money savings target on its key outcomes. This brief statement should be designed to provide overall assurance that the package of savings measures do not reduce the Department's ability to meet its objectives. By exception, the Department would report on those savings which are likely to put key objectives at risk.

d **Review all material reported savings prior to publication to ensure savings are sustainable and are likely to be realised.** We recommend that as well as the Internal Audit review of reporting systems required by Treasury guidelines, the Department needs to ensure that all significant savings are publicly defensible. If possible, this management review should take place before the figures are published in autumn and annual reports; where this process raises concerns the savings should not be publicly reported until fully validated.

Part One

Value for Money savings under CSR07

Ministry of Defence objectives and expenditure

1.1 The Department's aim is to deliver security for the people of the United Kingdom and the Overseas Territories by defending them, including against terrorism, and to act as a force for good by strengthening international peace and stability. The Department no longer leads on any Public Service Agreements (PSAs), but contributes to both the Foreign and Commonwealth Office-led PSA on Conflict Prevention, and the Home Office-led PSA on Counter Terrorism. The Departmental Strategic Objectives (DSOs) are:

- achieve success in the military tasks undertaken at home and abroad (DSO1);
- readiness to respond to the tasks that might arise (DSO2); and
- build for the future (DSO3).

1.2 In October 2009, the Strategy for Defence[6] set out the priorities for Defence resource allocation focused on current operations. Where choices have to be made between competing priorities, support to operations in Afghanistan takes precedence. A Defence Green Paper 'Adaptability and Partnership: Issues for the Defence Review'[7] in February 2010, set out the issues facing the Department which will be considered in a Defence Review early in the next Parliament. The Green Paper showed that the core Defence budget had grown by 10 per cent since the 1998 Strategic Defence Review with an additional £18 billion provided from the Reserve to fund military operations. However, above inflation increases in the cost of equipment and military personnel have put further pressure on the budget, as have fluctuations in the exchange rate and the price of fuel.

6 Link to strategy: http://www.mod.uk/NR/rdonlyres/32421DC3-CA13-49BC-88F4-2F77E973CB67/0/strategystatement.pdf

7 Defence Green Paper http://www.mod.uk/NR/rdonlyres/790C77EC-550B-4AE8-B227-14DA412FC9BA/0/defence_green_paper_cm7794.pdf

1.3 In the case of the Department, we found the criteria assessing any adverse impact of the savings on Departmental Strategic Objectives particularly challenging to assess, chiefly because its objectives are at such a high level in comparison to the reported savings.

1.4 Our review is limited to the savings reported under CSR07 in the 2009 Autumn Performance Report. It does not cover the wider decisions taken to make the defence programme more affordable in the short term, or the likelihood of achieving future savings.

1.5 The Department has two Parliamentary Supply Estimates, each split into Requests for Resources which are voted by Parliament. The first Supply Estimate covers the following:

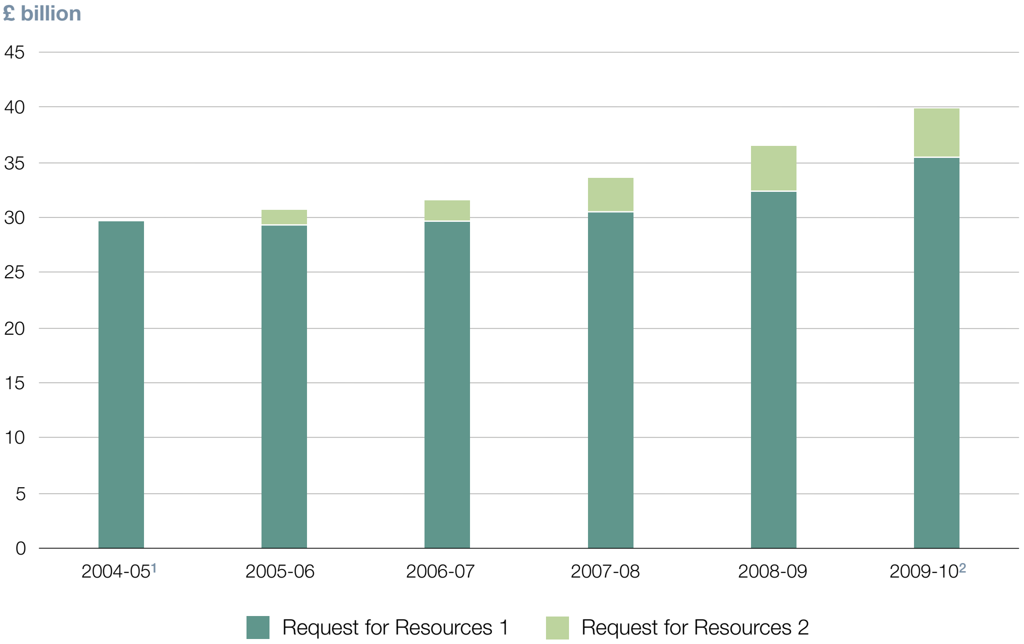
- Request for Resources 1: Provision of Defence Capability (to cover normal running costs);
- Request for Resources 2: Operations and Peace Keeping (to cover net additional costs incurred on operations); and
- Request for Resources 3: War Pensions and Allowances (to cover the payment of war disablement and war widows' pensions in accordance with relevant legislation).

The second Supply Estimate has one Request for Resources (Request for Resources 1: Armed Forces Retired Pay, Pensions etc).

1.6 While the Department receives funding in these areas, its CSR07 value for money savings programme is only taken against Request for Resources 1 in the first Supply Estimate. During 2008-09, the Department's expenditure was £36.4 billion of which Requests for Resources 1 was £32.3 billion, and £4.1 billion was to cover the additional costs incurred on operations (**Figure 4**). The Department is projected to have a combined expenditure of £39.9 billion during 2009-10.

Figure 4

Ministry of Defence cash expenditure (core and operational), 2004-05 to 2009-10 (projected)



NOTES

1 Figure includes operational expenditure.

2 Projected spend in 2009-10.

Source: Defence Analytical Services and Advice http://www.iraqinquiry.org.uk/media/45655/pm-letter-20100317.pdf

1.7 In 2008-09, the Department managed its activities through eight Top Level Budget holders, six Agencies and four Trading Funds. The eight Top Level Budget holders were: Navy Command, Land Forces (the Land and Adjutant General's Commands merged to form a single organisation in April 2008), Air Command, Chief of Joint Operations, Defence Equipment & Support, Central, Defence Estates and Science Innovation Technology (SIT).

Ministry of Defence savings target

1.8 The Department originally agreed with the Treasury net cash-releasing savings of at least £2.7 billion over the CSR07 period. Additional savings of £450 million were agreed in the 2009 Budget making a total of £3.15 billion over CSR07. The Department aims to achieve these savings in a number of ways, including improvements in working practices and collocation; manpower reductions in Northern Ireland and Cyprus; staffing reductions in Defence Equipment and Support; and better prioritisation of procurement and research strategies (**Figure 5**). The savings target also includes £267 million the Treasury allowed the Department to claim as 'over-delivery' of Spending Review 2004 savings, representing 10 per cent of the planned savings over CSR07; we did not examine these savings in detail as this would have required us to sample closed years for which different rules applied on which savings could be counted.

Figure 5
Ministry of Defence CSR07 planned VFM savings

Business Area/ Top Level Budget	VFM savings target (cumulative) £m		
	2008-09	2009-10	2010-11
Corporate Enabling Services	72.2	212.5	367.1
2007 Planning Round and Additional Efficiencies	284.0	408.5	602.1
2008 Planning Round	120.7	194.3	432.2
Northern Ireland Normalisation	103.5	116.5	120.8
Nuclear Warhead Capability Sustainment Programme	63.0	117.0	178.0
Equipment Support	116.0	186.0	253.0
Capability Alignment Programme	25.0	25.0	25.0
Overseas Operating Bases	3.4	4.4	4.4
Additional savings & Planning Round 2009	0.0	315.0	900.4
SR04 Over-delivery	267.0	267.0	267.0
Total	**1,054.8**	**1,846.3**	**3,150.0**

Source: Ministry of Defence

1.9 The Department reported savings of £1.2 billion towards its target in its 2009-10 Autumn Performance Report (**Figure 6**). Figure 6 also shows the total amount of savings we sampled and examined. Given the large number of smaller value savings under Equipment Support, we examined around 10 per cent of the total reported savings in this area.

Governance arrangements

1.10 Departments are required by the Treasury to have in place robust governance arrangements that provide assurance over the achievement of the programme and the validity of publicly reported savings. Departments must describe their governance arrangements in their Value for Money Delivery Agreements.

1.11 The Department's intention was to use its existing internal resource management processes to monitor and measure delivery against its VFM targets over the CSR07 period with the Secretary of State for Defence having overall responsibility for delivery and the Finance Director appointed as Senior Responsible Owner for the programme.

Figure 6
VFM savings reported to October 2009 and the NAO sample

Business Area/ Top Level Budget	Reported savings (£m)	Sample (£m)	Proportion sampled (%)
Corporate Enabling Services	228.7	228.7	100
2007 Planning Round and Additional Efficiencies	284.0	205.1	72
2008 Planning Round	120.7	93.1	77
Northern Ireland Normalisation	103.5	103.5	100
Nuclear Warhead Capability Sustainment Programme	63.0	63.0	100
Equipment Support	115.5	11.5	10
Capability Alignment Programme	25.5	3.5	14
Overseas Operating Bases	3.4	3.4	100
Total new savings	**944.3**	**711.9**	**75**
SR04 Over-delivery	267.0	–	
Grand total	**1,211.3**	**711.9**	

Source: Ministry of Defence

1.12 In 2009, Defence Internal Audit carried out a validation audit of a sample of £650 million of VFM savings and concluded in September 2009 that, overall, the governance and control arrangements for the capture and monitoring of VFM efficiency gains were inadequate and not compliant with the guidelines produced by the Treasury. They noted that there were few examples of robust processes in place within Top Level Budget areas for tracking the implementation of planned VFM reform activity, and limited knowledge and appreciation of the Treasury principles.

1.13 Good processes were noted as being in place in respect of Defence Equipment & Support. There was an issue uncovered with regard to double-counting of savings, however, the Department was aware of this and had plans in place to resolve it. Against this background, Defence Internal Audit were concerned that a significant portion of the anticipated VFM saving in the first Financial Year (2008-09) of the CSR07 period might not be substantiated to a level sufficient to withstand public scrutiny and would therefore be lost to the Department.

1.14 Following this review the Department removed £500 million of savings rated Red by Defence Internal Audit before reporting the £1.2 billion savings in its 2009-10 Autumn Performance Report. The Department considered it had sufficient contingency in place to allow them to cover the shortfall. The Department also strengthened its VFM savings regime by establishing new governance arrangements, disseminating detailed guidance and processes. The Defence VFM Cell is responsible for the coordination, management and reporting of savings, with responsibility for the identification and delivery of savings held by the Top Level Budget holders. The VFM Ministerial Board meets monthly to provide oversight of Value for Money delivery within the Department.

1.15 The new governance arrangements, if consistently applied by the Department, should meet the Strong Governance criteria set out in our framework used for assessing governance in Appendix Three. The results of our review of the savings claimed to date support this view with a significantly improved audit trail and higher accuracy noted in respect of the savings arising from the 2008 Planning Round compared to that in 2007. In addition, following its 2009-10 Autumn Performance Report, the Department has identified an additional £61.3 million of savings covered by our sample which did not meet the CSR07 criteria and will remove them from future reported claims.

1.16 While the Department had improved its governance framework at the time of our review, the changes were recent and there remains room for continued improvement. In particular, the Department now needs to monitor how these improved arrangements are working in practice so that they are implemented consistently across Top Level Budget holders. Additionally, for savings selected in the annual Planning Round process the Department needs to track and monitor the implementation and realisation of the savings measures.

Part Two

Detailed conclusions

Corporate Enabling Services

2.1 The Department has implemented a number of savings measures under the umbrella of the Corporate Enabling Services Priority project, which aims to save £367 million over the three years of the CSR07. The Department reported savings of £229 million to October 2009 under this heading in its 2009-10 Autumn Performance Report (**Figure 7** overleaf). Corporate Enabling Service savings are comprised of the following:

- the Defence Equipment & Support organisation's programme to evolve into a more effective and agile organisation, known as 'PACE';
- reorganisation of the Science Innovation Technology Top Level Budget allowing for headcount reductions of approximately 150 staff;
- reducing staffing levels and staff costs within the Central Top Level Budget through the Head Office Streamlining Programme; and
- savings in Defence Estates involving manpower reductions and the rationalisation of parts of the estate.

2.2 We assessed £164 million of the Corporate Enabling Services as Green and £65 million as Red (Figure 7). The Red ratings were because:

- The Department's Central Top Level Budget Corporate Enabling Services saving of £27.6 million was not realised or sustainable. The Department considered it had implemented most of the planned measures such as a 25 per cent headcount reduction, smarter ways of working and reductions in travel and subsistence. However, a number of other pressures and emerging new requirements offset the original saving by unexpectedly increasing staff costs during 2008-09 and the first half of 2009-10.
- The Department identified that £37 million had been double-counted as a saving in both the PACE programme and the Equipment Support programme.

Figure 7

Assessment of Corporate Enabling Services savings

Activity	Reported saving (£m)	NAO assessment	Comment
Corporate Enabling Services – PACE (Defence Equipment & Support)	153.7 37.0	Green Red	After reporting the saving in autumn 2009, the Department identified an overlap of £37m between its PACE savings and the Equipment Support programme. The Department intends to remove the £37 million from subsequent claims.
Corporate Enabling Services (Science Innovation Technology)	0.7	Green	Manpower reduction realised within overall reduction in expenditure.
Corporate Enabling Services (Central)	27.6	Red	Saving not realised: The Department subsequently found that the reported saving was offset by the costs of unanticipated new business requirements and intends to remove £27.6 million from future claims.
Corporate Enabling Services (Defence Estates)	9.7	Green	Reduction in manpower costs and, consequently, its administration budget and outturn figures.
Total	**228.7**	**Green**	**72 per cent**
		Amber	**0 per cent**
		Red	**28 per cent**

Source: National Audit Office

2.3 We assessed the full Corporate Enabling Services savings claims by Science Innovation Technology and Defence Estates, totalling £10.4 million, and £154 million of the Defence Equipment & Support PACE programme claim as Green. Defence Internal Audit also reviewed the projects in 2009 and provided broadly similar assessments.

2.4 We also reviewed the Department's staff numbers to provide additional assurance that savings had been realised. The Department has seen increased recruitment to the Armed Forces in 2010 (**Figure 8**), closing the gap between the required and actual strength of Service personnel to around 1 per cent. The number of civilian staff employed by the Department reduced by 16 per cent between 2006 and 2009.

Figure 8
Defence manpower numbers 2006 to 2010 (military and civilian)

	2006	2007	2008	2009	2010
Military Requirement	185,290	183,610	179,270	178,860	178,740
Military Strength	183,180	177,820	173,960	173,920	176,330
Civilian Number	103,380	97,690	89,500	86,620	n/a

NOTE

1 2006 – 2009 totals as at April, 2010 total as at January.

Source: Ministry of Defence, Defence Analytical Services and Advice

2.5 Within the overall CSR07 savings target, departments are required to produce at least a 5 per cent per annum saving on administrative costs, including any savings from civil service workforce reductions.[8] To improve visibility the Department separately identifies its administration costs. Comparison of the 2008-09 audited accounts and the estimated position for 2007-08 indicates that the Department reduced its administrative costs from £2.45 billion to £2.28 billion, a real terms reduction of £241 million (11 per cent).

Centrally applied efficiency savings

2.6 The Department undertakes a Planning Round process each year which is designed to reprioritise its expenditure through, for example, reallocating funding from lower priority areas towards delivering success on current operations. The process is run by the Strategy and Resources area and looks for efficiencies, as well as enhancements and reductions in expenditure across the Department which are referred to as 'Planning Round options'. An impact statement is produced for each option and includes whether the option constitutes a saving (a reduction) or an enhancement (a rise), any costs associated with implementation and the likely impact of the option, for example, risks to operational capability.

8 Value for Money in the Comprehensive Spending Review, paragraph 3.31: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/pbr_csr07_chapter3_208.pdf

2.7 Options are reviewed centrally by the Defence Strategy and Plans Group, chaired by the Director General Strategy. Some options have to be approved by the Defence Board, for example when a measure is judged to be of significantly high impact or potentially controversial. Once the options have been approved, each budget holder's Control Totals[9] are changed by the appropriate total amount relating to the sum of the enhancements or savings in that area. Each option can be tracked back to a Control Total change with an assessment of any potential impact on the Department's activity and Defence outputs. The Defence VFM Cell determines which options can be classified as VFM savings, using the nine criteria set out in Appendix Two, and includes only these options in the Department's VFM target and reported claim.

2.8 Our review looked at the VFM savings reported as part of the 2007 and 2008 Planning Rounds, as the Department only claimed savings realised by the end of 2008-09 in its 2009-10 Autumn Performance Report. We sampled £205 million (72 per cent) and £93 million (78 per cent) of the reported savings from the 2007 and 2008 Planning Rounds respectively (**Figure 9**). The savings measures identified as part of the Planning Round 2009 are to be implemented from 2009-10.

Assessment of the 2007 and 2008 Planning Round options savings

2.9 We rated £16.3 million of the savings from Planning Round 2007 and 2008 as Red because some or all of the saving failed on one of the nine criteria (**Figure 10**).

- **Realised:** In 2007 the Department took an option to reduce a planned training capability creating a saving option of £7.3 million. In the 2008 Planning Round, however, the Department took a decision to reverse this option therefore the saving was not realised.

Figure 9

Summary of the Department's reported and planned savings arising from the 2007 to 2009 Planning Rounds

Measure	2008-09 reported savings (£m)	CSR07 planned VFM savings (£m)			
		2008-09	2009-10	2010-11	Total
Planning Round 2007 including Additional Efficiencies	284.0	284.0	124.5	193.6	602.1
Planning Round 2008	120.7	120.7	73.6	237.9	432.2
Planning Round 2009	n/a	n/a	315.0	193.8	508.9
Total	**404.7**	**404.7**	**513.2**	**625.3**	**1,543.2**

Source: Ministry of Defence

9 Control Totals represent the amount available to spend for each of the Top Level Budget holders.

- **Net of costs:** We concluded that two saving options relating to cancelling equipment worth a combined total of £6.7 million were not fully net of costs due to each having one or more linked enhancements that acted to mitigate the impact of the proposed saving.
- **Sustainability:** We rated half, £2.4 million, of the value of one saving as Red, and half as Green. Our Red assessment was because a proportion of the saving related to expenditure being re-profiled for 18 months later, against the CSR07 rules which state that savings should not result from simply transferring expenditure from one year to another.

Figure 10
Assessment of 2007 and 2008 Planning Round and Additional Efficiency savings

Activity	Reported saving (£m)	NAO assessment	Comment
Planning Round 2007 and 2008	64.0	Green	The Department was able to provide solid evidence that the intended actions had been taken, that impacts were being monitored and that the budget was not being exceeded.
	218.0	Amber	Although there was evidence that the Top Level Budget holders had lived within their budget there was insufficient evidence to determine whether the planned saving had been taken in the manner intended, meaning that sustainability and impact on outputs were difficult to assess.
	16.3	Red	The Department indicated that the savings reported had not been realised and would be removed from subsequent claims; in addition, some of the savings were not net of costs.
Total examined	**298.3**	**Green**	**21 per cent**
		Amber	**73 per cent**
		Red	**5 per cent**
Other planned savings	106.4	Not examined	Various other savings.
Total	**404.7**		

Source: National Audit Office

2.10 We rated the majority of savings sampled from the 2007 and 2008 Planning Round Options as Amber. We were able to see evidence that Top Level Budget holders had lived within their reduced Control Totals and that savings had been realised. However, there was very little evidence to assess what specific action had been taken to realise the saving and therefore to assess whether the savings are sustainable, and the impact on outputs. Of the savings rated Amber, over half (£121 million) were Additional Efficiencies implemented during the Planning Round 2007. Additional Efficiencies involved Top Level Budgets' identifying efficiencies to contain cost growth in their programmes and identifying lower value activities that could be reprioritised. However, following the 2007 Planning Round the Department did not require Top Level Budget holders to either track or report on the measures they were taking to reprioritise their activities. This made it difficult for us to assess fully the savings under the Treasury's nine criteria.

2.11 We rated the remaining £64 million of savings as Green. In each of these cases we could substantiate the Department's reported saving because the Top Level Budget holder was able to show a reduced spend and that this was due to the implementation of the particular option. For example, the Science Innovation Technology Top Level Budget was required to make savings of £28.4 million by rationalising its research programme. The Top Level Budget had developed a Performance Assessment Framework which showed regular monitoring of the impact and risks attached to removing elements of its research and development programme.

2.12 The problems we experienced in finding evidence that tracked and reported the Planning Round option savings were also identified in the Defence Internal Audit reviews. Since these were published in 2009, the Department has taken steps to improve the tracking and reporting of the implemented Planning Round options. For example, variations in costs and savings can now be reported as part of established in-year monitoring. The Department expects this to improve its tracking of savings from the 2009 Planning Round. While the Department has made these changes, it still does not systematically track the impact of savings on outputs.

Additional comment on the Planning Round options savings

2.13 The Department is voted additional resources (Request for Resources 2) to cover the net additional cost of current military operations and peacekeeping; this amounted to £4.1 billion in 2008-09, including £2.6 billion for military operations in Afghanistan (compared to £1.5 billion in 2007-08). The cost of military operations in Afghanistan is forecast to be £3.8 billion in 2009-10. We identified a number of complexities relating to the impact of military operations in Afghanistan on our assessment of the 2007 and 2008 Planning Round options savings:

- **Quality neutral and reallocation of resources:** There were a number of options whereby the Department has planned to reduce peacetime activity to release capability to support operations, for example, by reducing peacetime flying hours in the United Kingdom. We assess that, whilst there was an increase in flying hours due to those paid for from the Reserve, the savings met the nine criteria set out by the Treasury.

- **Sustainability:** These same savings, and a number of other Defence Equipment & Support options, have been difficult to assess in terms of sustainability given that savings have been predicated on a degree of continued involvement in Afghanistan, which may or may not be sustained. For example, one option from the 2007 Planning Round stated that there would be a 'temporary reduction' in a named capability which raised some questions regarding the sustainability of the saving; however, the evidence provided by the Department made it clear that this temporary reduction had become permanent over the intervening period.

Northern Ireland Normalisation

2.14 In August 2005, the Government set out proposals to reduce the security forces in Northern Ireland to peacetime levels within two years, subject to continued progress in the peace process[10]. Operation BANNER, the military support for the Northern Ireland police, formally ended in July 2007 resulting in reductions to the civilian workforce and the disbanding of three home service battalions of the Royal Irish Regiment. The Department incurred early severance and related costs totalling £216 million during SR04 and will incur a further £20 million during CSR07. The Department estimates that the Army reduced its military and civilian payroll costs by £104 million (net of ongoing early severance costs) during 2008-09 compared to its pre August 2005 staffing levels (increasing to £117 million in 2009-10).

2.15 We assessed some of the reported annual saving at September 2009 as Green representing the salaries of staff released in late 2007-08 and 2008-09 (£12.4 million) see **Figure 11** overleaf. However, we assessed the majority of the reported saving as Amber (£91.1 million). Although this represents salary savings achieved during the previous spending review period ending March 2008, and does not therefore represent new savings for CSR07, the significant early severance costs incurred mean that reductions in overall spending have been realised only in CSR07.

2.16 The Department's CSR07 settlement agreed with Treasury separately identified savings from Northern Ireland as part of an agreed adjustment to planned spending within the VFM savings target. It is evident that both the Department and Treasury were planning on the basis of a significant stream of Northern Ireland savings during CSR07 even though the drawdown of Forces from Northern Ireland pre-dated the CSR07 period. The CSR07 settlement does not set out how the Northern Ireland savings were to be calculated, but the Department's ongoing assumption was that it was valid to use a 2005-06 baseline before the drawdown began.

10 http://www.nio.gov.uk/media-detail.htm?newsID=11919

Figure 11
Assessment of Northern Ireland Normalisation

Activity	Reported saving (£m)	NAO assessment	Comment
Northern Ireland Normalisation	12.4 91.1	Green Amber	Majority of the saving represents a continuation of savings initiated prior to the CSR07 period
Total	**103.5**	**Green**	**12 per cent**
		Amber	**88 per cent**
		Red	**0 per cent**

Source: National Audit Office

Nuclear Warhead Capability Sustainment Programme

2.17 The Nuclear Warhead Capability Sustainment Programme relates to the United Kingdom's ability to support future nuclear capability, focused on maintaining skills and resources, including staff, to ensure that the Department can utilise them when necessary. The Department reported in its 2008-09 Annual Performance Report that the programme will make savings through a number of initiatives:

- the renegotiation of the contract with Atomic Weapons Establishment to reduce costs until 2012-13;
- better use of the existing and planned estate;
- improved programme management; and
- reduced manpower overhead costs.

A number of these measures stem from a review of the programme in 2006.

2.18 The Department planned to make savings worth £178 million on this programme over the CSR period; it has reported savings of £63 million to October 2009 based on a plan for the future support for nuclear capability.

2.19 We rated the Nuclear Warhead Capability Sustainment Programme savings as part Green and part Red because the Department used an out of date baseline and therefore the savings were not properly calculated. Using a revised baseline appropriate for 2007-08, we assessed 76 per cent of the claim as Green reducing the saving to £48 million in each of the three years of the CSR07 period (**Figure 12**). The Department agreed to report this saving in subsequent claims.

Figure 12
Assessment of Nuclear Warhead Capability Sustainment Programme savings

Activity	Reported saving (£m)	NAO assessment	Comment
Nuclear Warhead Capability Sustainment Programme	48.0	Green	The Department used an out of date baseline, the £48 million represents the reprofiling of the savings over the CSR07 period using an appropriate baseline.
	15.0	Red	
Total	**63.0**	**Green**	**76 per cent**
		Amber	**0 per cent**
		Red	**24 per cent**

Source: National Audit Office

Other Projects

2.20 The Department has reported a number of other project savings, totalling £207 million to October 2009, of which we reviewed £18.4 million (**Figure 13** overleaf). Our assessment covers the following projects.

- **Equipment Support Savings:** the measures the Department has taken to improve the way in which it supports military equipment. Most savings relate to manpower and equipment maintenance, aimed at improving effectiveness and efficiency. We reviewed five projects relating to £11.5 million of the reported savings, 10 per cent of the £115 million claimed to October 2009.
- **Overseas Operating Bases:** the reduction in the number of civilian and military posts at Headquarters British Forces Cyprus, and reducing the costs in supporting the airport at Akrotiri. We reviewed all of the Department's reported savings of £3.4 million to October 2009.
- **Capability Realignment Study:** whereby lower priority projects have either been stopped or realigned following the Science Innovation Technology Top Level Budget holder's reprioritisation of its research programme. We reviewed £3.5 million of the reported savings, 14 per cent of the £25.5 million claimed to October 2009.

Figure 13
Assessment of Other Projects savings

Activity	Reported saving (£m)	NAO assessment	Comment
Equipment Support (Defence Equipment & Support)	4.1 7.0 0.3	Green Amber Red	We rated one saving as red because there was insufficient evidence that it was new to the period or properly calculated. We assessed three savings as amber because of concerns that the impact of savings had not been fully understood, primarily in terms of sustainability and effect on quality.
Overseas Operating Bases (Chief of Joint Operations)	1.5 1.9	Green Amber	There was insufficient evidence to determine whether one of the planned measures had been fully implemented, meaning that we were unable to conclude on the sustainability of the saving.
Capability Alignment Study – Information Management (Science Innovation Technology)	3.5	Green	The research project has been stopped following realignment of the research programme leading to the saving being realised.
Total examined	**18.4**	**Green** **Amber** **Red**	**50 per cent** **48 per cent** **2 per cent**
Other Equipment Support	104.0	Not examined	Other Equipment Support savings.
Other Capability Alignment Study	21.5	Not examined	The remainder of the Capability Alignment Study.
Total	**143.9**		

Source: National Audit Office

2.21 We assessed £4.1 million of reported savings (relating to the rationalising communications support to the Department project) as Green but assessed the majority of reported savings, £7.0 million, from the Equipment Support programme as Amber for the following reasons:

- Two of the projects related to reducing the costs of support for availability and capability of ships: one relating to the docking and refits of Type 23 Frigates and the other relating to the Department's responsibility for ensuring ships are habitable. We were unable to assess at this point whether the cost reductions were sustainable or quality neutral, given that maintenance not carried out may be merely delayed until after the CSR07 period.

- It was also unclear whether the savings relating to the future cost reductions of the Defence Information Infrastucture were sustainable; in addition, although the Top Level Budget holder lived within its budget, it was not clear if these savings have been realised.

2.22 We rated one saving, worth £0.3 million, as Red because the Department had insufficient evidence to substantiate whether the saving, relating to manpower reductions in Defence Clothing, was properly calculated or new to the period. However, the saving fell below the Equipment Support materiality threshold of £0.5 million and consequently the Department did not require the Top Level Budget to be able to produce evidence on savings below the threshold.

2.23 We assessed the reported £3.4 million of savings relating to Overseas Operating Bases as part Amber and part Green for the following reasons:

- We were unable to assess whether or not the £1.9 million of reported savings relating to Project Montgomery were sustainable and therefore gave an Amber rating. This project plans to reduce costs at HQ Cyprus through converting a number of previously military posts into locally-employed civilian posts during 2007.
- We assessed the reported savings of £1.5 million as Green relating to Project Wavell. This project has reduced costs relating to support of the airport at Akrotiri in Cyprus by £1.5 million.

2.24 We assessed one project under the Science Innovation Technology Top Level Budget (Information Management) as Green as the evidence provided assurance that the planned rationalisation of research and non-research projects had taken place, that the Top Level Budget had reduced its expenditure within the period looked at and that savings had been recycled back into the research programme. Our findings on this project imply that a similar rating would likely be given to all of the projects either stopped or realigned as a consequence of the Capability Alignment Study which prioritised 52 research projects.

Appendix One

Terms under which we undertook this engagement

The National Audit Office has agreed to review departments' reported value for money (VFM) savings during the 2008-2011 spending period. Departments are responsible for delivering savings in accordance with targets agreed with Treasury, and must report progress in annual departmental reports and autumn performance reports.

We have reviewed the savings reported by the Ministry of Defence as reported in its 2009 Autumn Performance Report. Our reviews have involved an examination of the evidence supporting the savings against the criteria set out in Appendix Two to this report. These criteria are based on Treasury's guidelines on what can and cannot be reported, and have been agreed with the Treasury. We have not concluded on whether the departments are delivering value for money in the round with all their resources. Rather, our reviews are specifically focused on the savings the departments have reported in the period, and the risk that these do not meet the criteria established by Treasury. Our review is based on historic information, and we have not assessed in detail the likelihood of the Department meeting its overall savings target for the spending period.

We have conducted this review in accordance with the principles set out in the International Framework for Assurance Engagements. We have performed sufficient work to provide reasonable assurance over the extent to which departments' reported VFM savings meet the criteria. Our conclusions are stated in the main report.

What we did

Our approach to reviewing reported savings has been to:

- Review and assess the calculation, methodology and audit evidence behind the 2008-09 reported savings of each initiative against the criteria set out in Appendix Two, taking into consideration the size of the saving with regard to the detail of the work performed.
- Assess the departments' governance of the programme, including a review of the controls in place to ensure that savings are properly calculated and meet all other criteria.
- Examine financial information within the departments' resource accounts and other relevant reports to check for consistency.
- Understand the departments' design of their programmes for generating VFM savings over the three-year period, through interviews and document review.

Within some of the savings initiatives, the reported saving covered several smaller savings. In these cases, we initially evaluated the calculation and overall methodology and then looked in more detail at the evidence supporting individual savings where this was necessary to come to a conclusion on the overall saving.

The Ministry of Defence has reported in their 2009-10 Autumn Performance Report annual value for money savings totalling £1.2 billion towards their updated CSR07 target of £3.15 billion by 2010-11. We examined a selection of the Department's reported savings, including samples of savings reported by:

- Projects; and
- Top Level Budget holders.

Some £267 million of these savings represented claimed over-delivery against savings targets in 2007-08 and earlier years. We did not review individual over-delivery savings as this would have required us to sample closed years for which different rules applied on which savings could be counted.

Appendix Two

The criteria against which reported savings were evaluated

Treasury has set out guidance for departments on how to calculate VFM savings and rules about what can and cannot be counted towards the £35 billion target. We have translated this guidance into a series of criteria which savings must meet. This list has been agreed with HM Treasury. In summary, reported savings must meet the following criteria:

- Properly calculated
- Net of costs
- Quality neutral in high priority and strategically important areas
- New to the period
- Costs have not been reallocated
- Cash-releasing
- Realised
- Sustainable
- Scored only once

Criteria	Explanation of criteria
Properly calculated	Savings must be accurately calculated. The calculation is likely to be based on baseline cost information, a counterfactual spending profile (which may well involve estimates and assumptions) and outturn spending data.
Net of costs	All upfront and investment costs and additional ongoing or running costs have to be netted-off from VFM savings.
Quality neutral in high priority and strategically important areas	Savings must not adversely impact on the achievement of a department's strategic priorities, as set out in DSOs and PSAs. Departments should be able to demonstrate and explain that as a result of their VFM reforms, the department and sector is delivering better VFM overall. Departments are responsible for explaining how VFM reforms relate to improved overall effectiveness in high priority areas and delivery of PSA outcomes.
New to the period	Savings must be the result of changes in the way a department does its business compared with the previous spending period. They should be new to the period and not already reflected in the baseline, except for up to 10 per cent of the CSR07 savings target, which can be met through over-delivery against SR04 targets where this has been agreed in advance with the Treasury.
Costs have not been reallocated to another part of the organisation or the public sector	Savings cannot be scored if spend on a particular activity or initiative has simply been reallocated to another similar activity or initiative which is not adding more value.
Cash-releasing	Savings must increase budgetary flexibility by releasing near-cash resources that can, if desired, be redeployed to meet other pressures. Non-cashable gains are not being counted towards the CSR07 VFM savings target. Departments are encouraged to explain how they are making non-cashable and service improvement gains, but these should be separately presented in savings reports.
Realised	Savings must have been realised by the point at which they are reported.
Sustainable	Savings must be sustainable and the result of a considered change in the way a department does its business. They should not be the result of simply shifting expenditure from one year to another. A VFM saving must exist at least for the current year, and continue at the same or a higher level for two subsequent financial years.
Scored only once	Savings cannot be double-counted under separate categories or initiatives.

Appendix Three

The framework used for assessing governance

We examined six areas of the Departments' governance, to assess the controls that they had in place to provide assurance that:

- Reported savings meet the criteria set out in Appendix Two;
- The Department's planned savings programme will be delivered and the Department's target for 2010-11 will be met.

The six areas of examination are:

- oversight and leadership;
- delivery plan and targets;
- risk management;
- structures, roles and reporting lines;
- guidance and training; and
- monitoring.

This framework has been designed to reflect Treasury's guidance to departments on governance in relation to the CSR07 VFM savings programme and the principles of the Chartered Institute of Public Finance and Accountancy's Good Governance Standards for Public Services.

Governance area	Weak governance	Strong governance
Oversight and leadership	There is no board overseeing the VFM programme A board exists but meets infrequently and/or does not scrutinise delivery and risks to delivery There are no sufficiently senior members of staff on the board Senior managers have not demonstrated their commitment to the programme	A senior management team, supported by skilled advisers, oversees the VFM programme A programme board has been established and meets regularly The programme board is chaired by an appropriately senior member of staff (e.g. Finance Director) Senior managers demonstrate their commitment to the programme
Delivery plan and targets	There is no overall plan bringing together details of how the target will be achieved A plan exists but does not give any detail about savings initiatives/projects The programme is not sufficient to meet the department's target No contingency is built into the plan The programme cannot be reconciled to the department's overall settlement	An overall plan brings together details of how the target will be achieved The programme is sufficient to meet the department's target An appropriate level of contingency is built in For each initiative or body responsible for delivering savings, the timetable for delivery, governance arrangements, risks and measurement issues are set out Planned CSR07 savings can be reconciled back to overall resource allocations
Risk management	The department has no explicit risk management processes in place Risks have been identified, but there are no plans for their mitigation and/or inadequate monitoring against them Lessons have not been learned from the results of previous assessments There is no recognition of the critical projects for achieving the department's target There is no recognition or management of risks relating to double-counting There is no recognition or management of risks relating to adverse impacts on strategically important/high priority outcomes The role for Internal Audit has not been considered	There is risk management at the programme-level and for individual component projects Each risk has a documented plan for mitigation Results of previous assessments of efficiency savings have been factored into the risk analysis and lessons from SR04 have been learnt Double-counting risks have been explicitly recognised and addressed at a programme-level Priority or critical projects have been identified There is explicit recognition of the risk that strategically important/high priority outcomes may be adversely impacted and monitoring and management of this The role for Internal Audit in managing and mitigating risks has been considered

Governance area	Weak governance	Strong governance
Structures, roles and reporting lines	Roles and responsibilities for delivering savings and progress reporting are unclear Reporting on progress is done on an ad hoc basis and no clear guidelines have been set for how it should be done	There are named individuals responsible for delivering component projects There are clear arrangements for reporting progress against plans to senior management, including savings delivered vs. forecast savings; projections for the year; explanations of major variances; proposed actions to address variances
Guidance and training	No or limited guidance has been provided to those responsible for delivering savings The Treasury's criteria for CSR07 VFM savings have not been properly interpreted or not fully communicated Those at the centre have not checked understanding at a local level about responsibilities and interpretation of guidance No guidance has been provided on how to identify savings	Clear guidance has been provided to those responsible for delivering savings, about appropriate governance structures; risk management; how savings should be reported; Treasury's criteria The Treasury's criteria for CSR07 VFM savings have been properly interpreted in the context of the department and clearly communicated Those at the centre have checked understanding at a local level about responsibilities and interpretation of guidance Where appropriate, guidance has been provided on how to identify savings Training has been provided as necessary
Monitoring	There is no or limited monitoring of progress against targets Evidence suggests that more frequent monitoring would have alerted the department to delivery or measurement problems Internal Audit's role in assessing progress against targets and compliance with criteria has not been considered	There is regular monitoring of progress against targets. The frequency of monitoring takes into account the assessment of risks to the programme. Priority Project reporting is being done in accordance with Treasury requirements The role for Internal Audit in assessing progress against targets and compliance with criteria has been considered

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