



National Audit Office

Performance of the Ministry of Defence 2006-07



Briefing for the Defence Committee | November 2007

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Summary

Aim and scope of this briefing

- 1 This briefing has been prepared for the Defence Committee of the House of Commons to provide an overview of the work and performance of the Ministry of Defence (the Department) in the financial year 2006-07 and subsequent months.
- 2 The aim of this briefing paper is to help the Committee understand and consider:
 - The Department's performance against Public Service Agreement targets and key internal targets during 2006-07 (Parts 2 to 6).
 - A financial review of the Department's activities in 2006-07 (Parts 7 and 8).
 - The Department's internal capability and Change Programme (Part 9).
- 3 The contents of the briefing have been shared with the Department to ensure that the evidence presented is factually accurate. Conclusions on the matters that the Committee may wish to explore are the sole responsibility of the National Audit Office.

Source documentation:

Our briefing was compiled by reviewing the Department's *Annual Report and Accounts 2006-07* and the *Cabinet Office's Capability Review of the Ministry of Defence*, as well as other publicly available documents including National Audit Office reports on *Assessing and Reporting Military Readiness*; *Managing the Defence Estate: Quality and Sustainability*, and the *Major Projects Report 2006*. See Bibliography on pages 49-50 for a complete listing.

Role and structure of the Department

- 4 The Defence 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.

- 5 The Department aims to provide a 'Force for Good in the World' by working to produce 'battle-winning people and equipment' that are:
 - Fit for the challenges of today.
 - Ready for the tasks of tomorrow.
 - Capable of building for the future.
- 6 The Department is responsible for the formulation and conduct of defence policy, and providing the means by which it is delivered – the Armed Forces. It constitutes both a Department of State and a joint military headquarters.

7 The Defence Management Board, chaired by the Permanent Under Secretary, provides senior level leadership and top level management of Defence. Military operations are the responsibility of the Chief of Defence Staff, drawing on the advice of the three single Service Chiefs of Staff and the support of the Department.

8 In 2006-07, Defence activity was managed through nine Top Level Budget (TLB) holders and five Trading Funds¹, and a range of Agencies. The Department delivers a wide range of activities in support of operations and readiness, including: recruiting and training personnel; maintaining a science and technology base; acquiring and supporting defence equipment; and running a large and diverse estate.

1. The nine TLBs are: Chief of Joint Operations, FLEET, Air Command, Commander-in-Chief Land, Adjutant General, Defence Equipment & Support, Defence Estates, Science Innovation and Technology, and Central. The five Trading Funds are: ABRO, Defence Aviation Repair Agency (DARA), Defence Science and Technology Laboratory (DSTL), Met Office, and UK Hydrographic Office (UKHP).

Operational activity

9 Throughout 2006-07 the Armed Forces have been engaged in operations in Afghanistan, Iraq and the Balkans, as well as standing military tasks in the Falklands, Northern Ireland, Gibraltar and Cyprus.

10 The Department is structured during peacetime to provide a force capable of operating most effectively at a funded level and combination of military activity, known as the Defence Planning Assumptions. The Department has operated above these Assumptions for the six years covered by its Annual Report. Operational activity has probably not been as high and intense, and over such a sustained period, for fifty years. This has placed a significant strain on the Department, including its Service and civilian personnel, equipment and logistic support.

11 Force levels have gradually reduced in Iraq: from 10,000 in October 2003 to 7,200 by May 2006. By May 2007 force levels had reduced further in Southern Iraq to 5,500, although total numbers involved in operations throughout Iraq were around 6,800. However, the intensity of operations in southern Afghanistan increased substantially over 2006, raising force levels there from approximately 3,300 in April 2006 to roughly 5,800 by April 2007 (and rising above 7,700 by summer 2007).

12 The Department accepts that operational activity has put at risk less immediate tasks, such as preparing for potential conflict. This is illustrated by a reduction in the peacetime readiness of the Armed Forces measured by Public Service Agreement Target 3, below.

Department's performance against Public Service Agreement targets during 2006-07

13 As part of its performance against the 2004 Spending Review Public Service Agreement and Efficiency Targets the Department has three Objectives encompassing six Targets and the Efficiency Target.

14 Overall, the Department assesses that three Targets are, including the Efficiency Target, currently '*On Course*' to achieve their goals by 31 March 2008; two are '*On Course with some Risk*'; one is '*Broadly On Course with Minor Slippage*', and one is at '*Some Risk*'.

2. Definition of a Serious weakness: Force Elements fall substantially short of the single-Service performance standards criteria for funded readiness levels. There is a medium risk to force generation within required timescales or to the available capability. Definition of a Critical weakness: Force Element is unable to provide the required funded readiness levels. Generation of Force Elements in its primary role would attract high risk or it would not be possible to generate the Force Element in the required timescale.

15 Although some Targets, such as Target 3 (on readiness), are metric-based, others are largely subjective, for example Target 1 (on operational success), and therefore difficult to scrutinise externally. Also, the Department does not provide any guidance to differentiate between terms such as: *'On Course with some Risk'*; *'Broadly on Course with Minor Slippage'* and *'Some Risk'*. Other Departments, such as Health, Work and Pensions, and Culture, Media and Sport, use a smaller number of more clearly defined terms. The use of more clearly defined terms, supported by specific statistical performance information, makes the link between the departments' performances and the stated grades more easily understood.

16 Compared to the Department's Annual Report 2005-06 there has been deterioration in progress towards achieving some Public Service Agreement targets. **Figure 1** compares Departmental progress in 2005-06 and 2006-07 against the six Public Service Agreement Targets and the Efficiency Target.

17 Public Service Agreement Target 1 focuses on achieving objectives set for various 'Operations and Military Tasks'. The Department has increased the amount of qualitative information in support of its assessment of performance as *'On Course with some Risk'* against Target 1 since last year's Annual Report. However, it is difficult to link the statement of performance to the narrative. The Department does provide a chart indicating the percentage of each Service's forces undertaking 'Operations and Other Military Tasks,' but this does not directly address Target 1. (PSA Target 1 is covered in more detail in paragraph 1.3).

18 Public Service Agreement Target 2 measures conflict prevention, and is a joint target with the Foreign and Commonwealth Office and the Department for International Development. Progress is assessed by the Department as *'Broadly on Course with Minor Slippage'*. Some additional detail across a range of operational activity is provided. Conflict prevention progress in the countries with the United Kingdom's two principal military operations, Iraq and Afghanistan, are judged to be *'Not on Course – Major Slippage'* and *'Broadly on Course – Minor Slippage'*, respectively. (PSA Target 2 is covered in more detail in paragraphs 1.4–1.5).

19 Public Service Agreement Target 3 measures force generation and, after steady improvement over recent years, took a downturn in 2006-07. Progress towards achieving 73 per cent of Force Elements with no Serious or Critical weaknesses² in their peacetime readiness levels by 31 March 2008 peaked at 77 per cent (averaged across the most recent four quarterly reports) in Q4 2005-06. By Q4 2006-07 (the last quarter covered by the Annual Report) this figure had declined to an average of 67 per cent.

20 The Department assesses that Public Service Agreement Target 3 is now at *'Some Risk'* of not meeting peacetime readiness levels by 31 March 2008. The Department had previously assessed the Target to be *'On Course'*. (PSA Target 3 is covered in more detail in paragraphs 1.7–1.9).

21 Public Service Agreement Target 4, a joint target with the Foreign and Commonwealth Office, measures progress in developing the European Security Agenda. In both 2005-06 and 2006-07, the Department was assessed as being *'On Course'* to meet this Target.

1 Departmental progress against Public Service Agreement targets: 2005-06 versus 2006-07

PSA Target	Performance 2005-06	Performance 2006-07
1. Achieve objectives established for Operations and Military tasks	On course	On course with some risk
2. Improve effectiveness of contribution to conflict prevention	On course	Broadly on course with minor slippage
3. Generate forces which can be deployed, sustained and recovered at the scales of effort required	On course	Some risk
4. Play leading role in the development of the European Security Agenda	On course	On course
5. Recruit, train, motivate and retain sufficient military personnel	On course	On course with some risk
6. Deliver the equipment programme to time and cost	On course	On course
2004 Spending Review Efficiency Target – realise total annual efficiency gains of at least £2.8 billion by 2007-08	On course	On course

Source: MoD, Annual Report and Accounts, 2005-06 and 2006-07

3. Manning Balance is defined as: 'the prevailing trained strength requirement within tolerance band of +1% to -2% to reflect routine structural and organisational change within the Armed Forces. Whilst this tolerance level excludes periods of major structural change to the Armed Forces, the Services will continue to aspire to remain within Manning Balance throughout the current drawdown period to 1 April 2008'.

22 Public Service Agreement Target 5 covers the recruiting, training, motivating and retaining of Service personnel. Since the 2005-06 Annual Report progress towards Target 5 has eroded. A combination of continuing high operational activity, an increase in the number of personnel choosing to leave early, and a challenging recruitment environment meant that at the end of 2006-07 all three Services were outside Manning Balance.³ There is some risk that they may not return to within Manning Balance by 1 April 2008, and the Department considers the Target to be 'On Course with Some Risk'. (PSA Target 5 is covered in more detail in paragraphs 4.2–4.14).

23 Public Service Agreement Target 6 measures whether the equipment programme is delivered to time and cost. Performance has improved since 2005-06 and the Department met all of the acquisition targets in 2006-07 for the second consecutive year, despite some of the targets being more challenging than those set in 2005-06.

24 However a number areas for improvement to equipment acquisition remain, including the delay of major projects and using reductions in capability to produce savings. (PSA Target 6 is covered in more detail in paragraphs 2.4–2.6).

Financial review of the Department's activities in 2006-07

25 Across the period 2003 to 2007, the Department's overall expenditure has remained fairly constant (**Figure 2**). However, 2006-07 saw an increase in Request for Resources 2 (RfR2) for Conflict Prevention which includes the additional costs of current operations in Iraq and Afghanistan.

26 According to the Cabinet Office's Capability Review of the Department, at 2.2 per cent of Gross Domestic Product, defence spending in the United Kingdom is above the NATO European average – about the same proportion as France, and more than Italy and Germany.

27 Under the July 2007 Comprehensive Spending Review settlement, the Department's agreed budgets for the next three years are £34 billion in 2008-09, £35.3 billion in 2009-10, and £36.9 billion in 2010-11. This represents a £7.7 billion increase by 2011, a real annual increase of 1.5 per cent, excluding the costs of operations.

28 The Department is committed to making 2.5 per cent efficiency gains over the 2004 Spending Review period – known as the Efficiency Target. This equates to total annual efficiency gains of at least £2.8 billion by 2007-08, of which 75 per cent will be cash releasing.

29 The Department reports that, by 31 March 2007, over £2 billion of efficiencies had been delivered, of which 84 per cent were cash releasing. This included: a fall in civilian staff numbers of 11,020; of military posts by 10,000; and the relocation of 1,885 posts out of London and the South East. Additional information is provided in paragraphs 3.15 and 7.14.

30 The Department's expenditure in 2006-2007 was £34.0 billion, including a net cash requirement of some £31.5 billion. The additional cost of operations was just under £1.8 billion, covering operations in Iraq, Afghanistan and the Balkans.

31 Although total defence expenditure in 2006-2007 remained within the total cash and resources voted by Parliament, the Department exceeded by £21 million the resources voted to cover the additional cost of operations (Request for Resources 2). The Comptroller and Auditor General (C&AG) therefore qualified his audit opinion on the Department's 2006-2007 annual resource accounts in this respect. The excess was primarily the result of operational activities in Afghanistan and Iraq being higher than originally forecast.

2 Defence Expenditure: 2003-2007

£ billion	2003-04	2004-05	2005-06	2006-07
RfR1 – Provision of Defence Capability	32.3	30.6	32.7	31.5
RfR2 – Conflict Prevention	1.2	0.9	1	1.5
RfR3 – Pensions	1.1	1.1	1.1	1
Total	34.6	32.6	34.8	34

Source: Ministry of Defence, Annual Report and Accounts 2004-05 and 2006-07

32 Details of losses and special payments are disclosed in the Notes to the Department's annual resource accounts. Losses do not necessarily mean that there has been a failure of control. The total value of losses and special payments which arose in 2006-2007 was £417 million which compares with total expenditure of £34 billion.

33 The Department disclosed 51 Private Finance Initiative (PFI) schemes in the 2006-2007 departmental resource accounts, unchanged from 2005-2006. Thirty nine out of the 51 PFI contracts were entered into prior to 2003 and since then the tempo for entering into new PFI commitments has reduced. A new PFI contract was signed in July 2006 for the rebuild, refurbishment, management and operation of facilities at the Permanent Joint Headquarters at Northwood, Middlesex. This project has a capital value of £161.5 million and will run until October 2031.

The Department's internal capability and Change Programme

34 In March 2007 the Cabinet Office undertook an independent 'Capability Review of the Ministry of Defence'. Overall the Review found that the Department has a stretching set of objectives and is delivering well on these in the face of challenging operational commitments. The Review found that the Department:

- a** has made good progress towards its Public Service Agreement targets since 2004;
- b** is ahead of schedule on its Gershon efficiency savings;
- c** has maintained the pace of change in the face of sustained operational commitments beyond its planning assumptions since 2002; and
- d** has successfully delivered on a number of standing commitments.

35 However, the Review found that sustained operations have a cumulative impact, diverting attention away from less urgent activities. The Review set out the key challenges to future delivery that the Department faces, and brigaded areas for action under three headings: Review leadership behaviours, governance and accountability; Promote the defence agenda more effectively, Address insularity and refresh strategy; Build human capability.

36 The Department accepted the Review's findings and the Defence Management Board itself had identified its corporate leadership role as an issue which required addressing. The Permanent Under Secretary had also introduced a project to streamline the head office role.

37 The Department has made progress in implementing the Defence Industrial Strategy. Maintaining a sovereign capability in certain sectors, a key priority during the year, will be further reinforced by Defence Industrial Strategy 2 later in 2007. Other aspects of acquisition reform include the merger, on 1 April 2007, of the Defence Procurement Agency and the Defence Logistics Operation to form Defence Equipment and Support (DE&S).

38 The Department has an ambitious and wide-ranging change programme which also covers Departmental infrastructure, people, and management and organisation. Many of the elements of this programme are significant change programmes in their own right (see Part 7).

39 During 2005-06, the Department continued to take forward the People Programme to implement its 2002 Civilian Personnel Strategy. This aims to develop the skills and behaviours individuals will need in future; develop managers' ability to deliver through teams; and modernise human resources to focus on strategic planning and support.

Potential areas of interest to the Committee

40 The following potential areas of interest to the Committee are a selection from the main Parts of this briefing:

Operational activity and military readiness (Part 1)

- What metrics underpin the Department's assessments of performance under Public Service Agreement Target 1 on operational effectiveness.
- Why the Department does not include all measures of readiness in the Public Service Agreement target.
- What work the Department has done on expected achievements against readiness targets given that Defence Planning Assumptions are being exceeded.

Equipment Acquisition (Part 2)

- The Department's confidence about achieving timely delivery for future large projects.
- The Department's view on progress against the Defence Industrial Strategy, and what it expects to focus on during the second phase of the strategy.
- The extent to which the Department is reliant on cutting equipment numbers to remain within budget, and what impact this has on capability.

The Defence Estate (Part 3)

- How the Department plans to address the single living accommodation for which upgrades are not currently funded.
- Whether, in relation to housing, the Department has considered spreading its investment more widely, for example by upgrading more properties to Standard 2 rather than a smaller number to Standard 1.
- What progress has been made on the Estate Development Plan and how the Department is likely to take the strategy forward.

Service Personnel (Part 4)

- What the Department is doing to address the impact of 'overstretch' on Service personnel.
- When the Department expects to achieve Manning Balance.
- How the Department intends to increase recruitment and retention in the Reserve Forces.

Excess Vote on Operational Expenditure (Part 5)

- The reasons for variation between the estimates and outturn, including attribution between unpredictability in activity levels and the timeliness of the Department's internal reporting process.
- Whether the Department is confident that its accounts will not need to be qualified on this basis for 2007-08.

Financial Review (Part 6)

- How challenging the Department believes it will be to deliver the remaining efficiency savings targeted by March 2008, and where it will be pursuing future savings following the Comprehensive Spending Review 2007.
- The level of the Department's current financial commitment to PFI.
- Whether the CSR 2007 settlement for the Department will ease its affordability challenges or whether it will continue to face difficult decisions over priorities.

The Department's Internal Capability (Part 7)

- The Department's progress in implementing the specific recommendations of the Capability Review.
- How the Department manages priorities on a complex and interdependent change programme, and whether the tempo of change has any adverse impact on operational delivery.
- How the Department balances civilian staff reductions with building future capacity and skills.

Operational activity and military readiness

Operational Activity

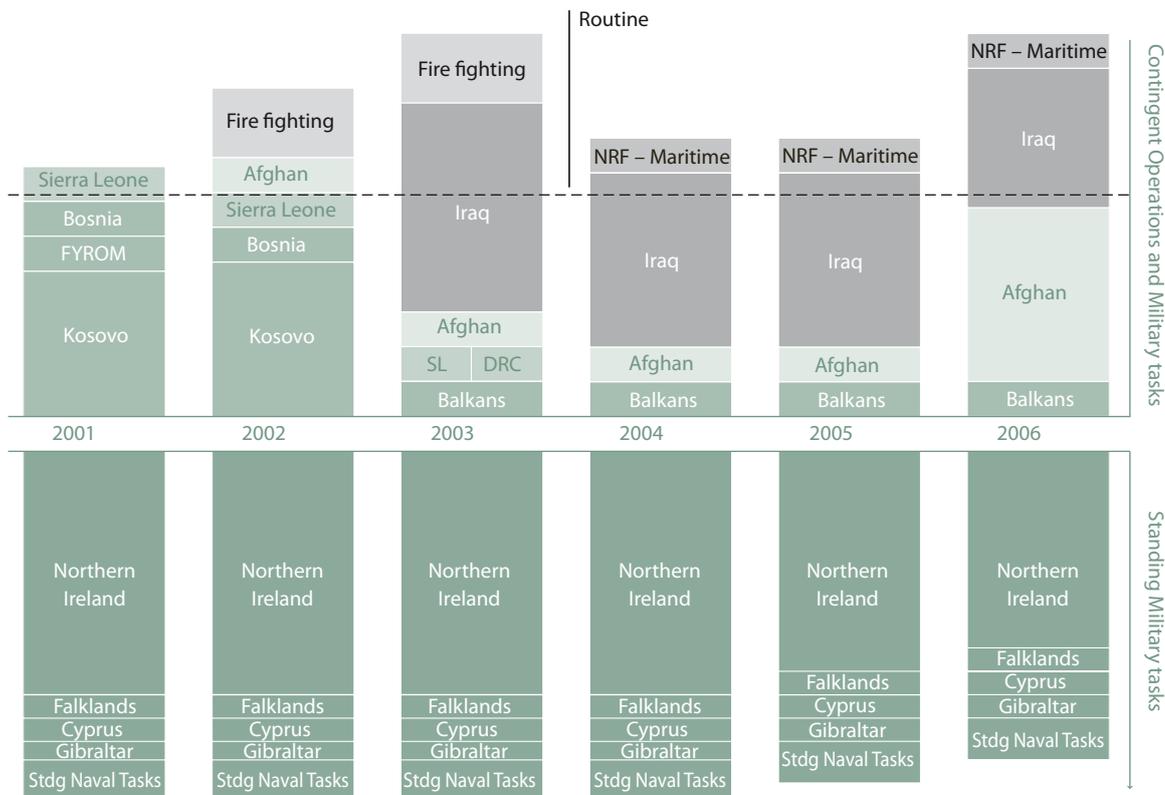
1.1 The Armed Forces have been operating at, or above, the maximum routine level of operations that the Department is structured and resourced to deliver in all six years covered by the Department's Annual Report (**Figure 3**). These planned levels of operational activity are known as Defence Planning Assumptions. Until 2003, the most demanding set of Assumptions were two, Medium-Scale concurrent operations, but in 2003 this increased to two Medium-Scale as well as a Small-Scale concurrent operation.⁴ Figure 3 indicates the level of operational commitment against Defence Planning Assumptions since 2001.

1.2 The Department recognises that the impact of this commitment to current operations is that the Armed Forces' ability to take on additional operations that are more than Small Scale... is now limited.⁵

1.3 Public Service Agreement Target 1 measures the ability of the Department to undertake successfully its assigned military operations. Given the intensity of current operations in Iraq and Afghanistan, and the increased risk it places on other operations, the Department assesses that it is 'On Course with Some Risk' to achieve Target 1. The Department has increased the amount of qualitative information in

⁴ Depending upon the nature of the operation, for the Land component a Small-Scale operation is defined as approximately battalion-sized (500–1,000 personnel); brigade-sized (3,500–5,000) for a Medium-Scale operation; and roughly division-sized (10,000–20,000) for a Large-Scale operation. Iraq and Afghanistan are, therefore, both currently Medium-Scale plus operations.
⁵ Annual Report, Target 3, p 16.

3 Armed Forces' Level of Operational Commitments against Defence Planning Assumptions since 2001



DRC: Democratic Republic of Congo
 FYOM: Fomer Republic of Yugoslavia
 NRF: NATO Reaction Force
 SL: Sierra Leone
 Source: MoD, Annual Report and Accounts, 2006-07

support of its assessment of performance; however, it is difficult to link the statement of performance to the narrative. **Figure 4** is provided to indicate the percentage of Trained Strength deployed on operations between April 2005 and March 2007.

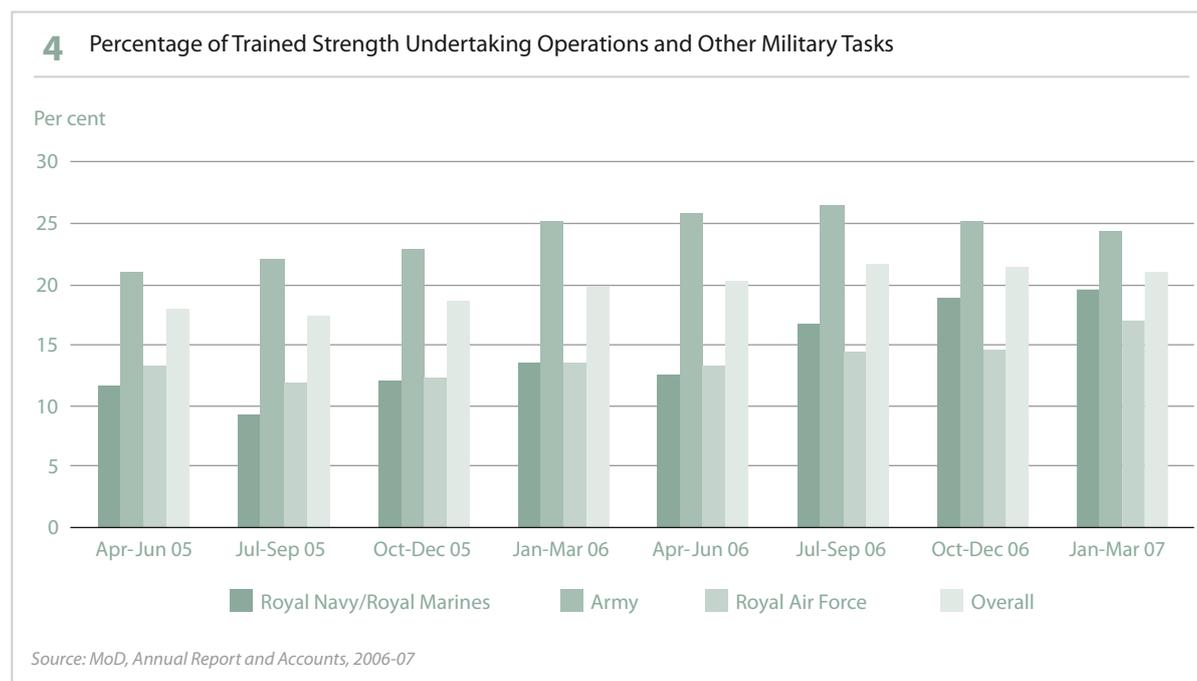
1.4 Public Service Agreement Target 2 measures an element of operational activity – the effectiveness of the United Kingdom’s contribution to conflict prevention. This is a joint target with the Foreign and Commonwealth Office and the Department for International Development.

1.5 The Department, together with the Foreign and Commonwealth Office and the Department for International Development, assesses that they are ‘Broadly On Course with Minor Slippages’ to achieve the joint Target 2. Conflict prevention progress in the countries with the United Kingdom’s two principal military operations, Iraq and Afghanistan are judged to be ‘Not on Course – Major Slippage’ and ‘Broadly on Course – Minor Slippage’, respectively. Progress is

summarised in **Figure 5 overleaf**, which shows UN Peacekeeping as Green (objective ‘Met’); Iraq and the Middle East Peace Process as Red (‘Not on Course, Major Slippage’), and Afghanistan and all other progress as Amber (‘Broadly on Course with Minor Slippage’). The Department provides a more detailed commentary underpinning its assessment for each area of activity.

Military Readiness

1.6 Readiness is the term used to describe the means by which the Department holds its military forces at varying levels of preparedness to respond to future operations (known as ‘contingent operations’). An effective system for assessing and reporting readiness is essential for all Armed Forces. A readiness system gives a snapshot but also indicates trends which enable action to be taken to mitigate risks, tackle any deficiencies and plan for the future.



1.7 Measuring and aggregating readiness is complex. For 'peacetime' readiness requirements the three Services each set specific parameters for key elements of readiness such as manning levels, equipment support and collective training (training units collectively to ensure they can fight effectively as part of a larger force) which, if achieved, should allow them to deploy for their primary role within a set period. Assessments can be made against this firm baseline, as measured by Public Service Agreement Target 3.

1.8 Public Service Agreement Target 3 measures the ability of the Armed Forces to generate Force Elements (for example, an armoured brigade, a squadron of aircraft or single ship) which can be deployed, sustained and recovered from operations. The Department measures the Target as an average over the previous four quarters, which it refers to as a rolling average. Although three Readiness

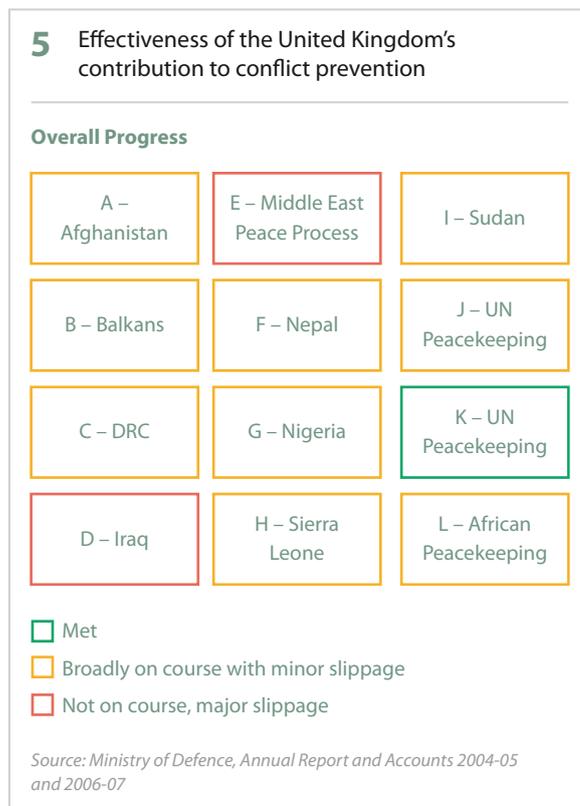
assessments are compiled, achievement of Target 3 is exclusively based on ensuring that 73 per cent of Force Elements show no Serious or Critical weaknesses to their peacetime readiness levels by 31 March 2008, referred to as Target 3a in the Annual Report.

1.9 Having witnessed steady improvement against PSA Target 3a in recent years, figures in the Annual Report reveal a downturn. Progress towards achieving 73 per cent of Force Elements with no Serious or Critical weaknesses in their peacetime readiness levels peaked at 77 per cent in Q4 2005-06. By Q4 2006-07 (the last quarter covered by the Annual Report) this figure had declined to 67 per cent. The Department's Annual Report assesses Target 3a at 'Some Risk' of not meeting peacetime readiness levels by 31 March 2008. **Figure 6** indicates progress towards achieving PSA Target 3.

Additional Measures of Readiness

1.10 Two other Readiness assessments are collated by the Department, which do not count towards PSA Target 3 but have separate targets. Target 3b assesses the ability of Force Elements to move from peacetime to immediate readiness to deploy on operations. The target is 71 per cent of Force Elements without Serious or Critical weaknesses by 31 March 2008. Target 3c assesses the ability of Force Elements to move from immediate readiness to deploying, sustaining and recovering from any contingent operation. The target is 82.5 per cent of Force Elements without Serious or Critical weaknesses by 31 March 2008. **Figure 7** outlines the inter-relationship between Targets 3a, 3b and 3c:

1.11 Against the ability to generate from peacetime to immediate readiness (Target 3b), the percentage of Force Elements without Serious or Critical weaknesses declined from 70 per cent in Q4 2005-06 to 55 per cent in Q4 2006-07. **Figure 8 on page 16** indicates the ability of Force Elements to move from peacetime to immediate readiness.



6 Progress towards achieving PSA Target 3



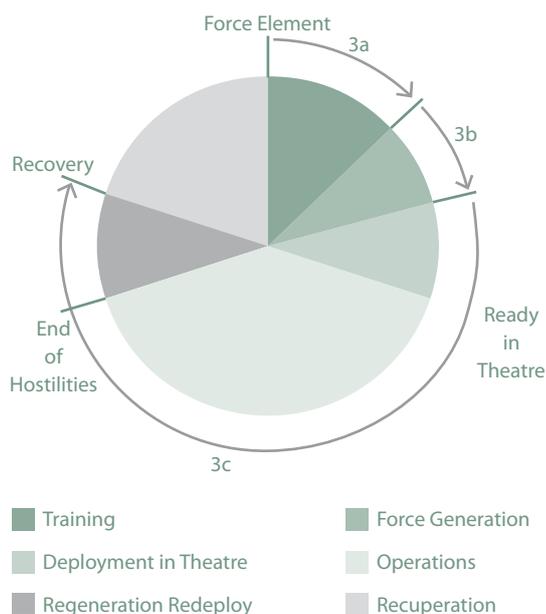
Source: MoD, Annual Report and Accounts, 2006-07

1.12 Against the ability to move from immediate readiness to deploying, sustaining and recovering from any contingent operation (Target 3c), the percentage of Force Elements without Serious or Critical weaknesses improved from 78.7 per cent in Q4 2005-06 to 79.6 per cent in Q4 2006-07. (It should be noted that the Department has only recently been able to collect sufficient data to measure target 3c). **Figure 9 overleaf** indicates the ability of Force Elements to move from immediate readiness to deploy, sustain and recover from a contingent operation.

1.13 The Department stated in its Annual Report that the principal reason for the reduction in both peacetime readiness and immediate readiness (Targets 3a and 3b) has been the need to ‘support and sustain current operations’ rather than prepare for future contingent operations.⁶

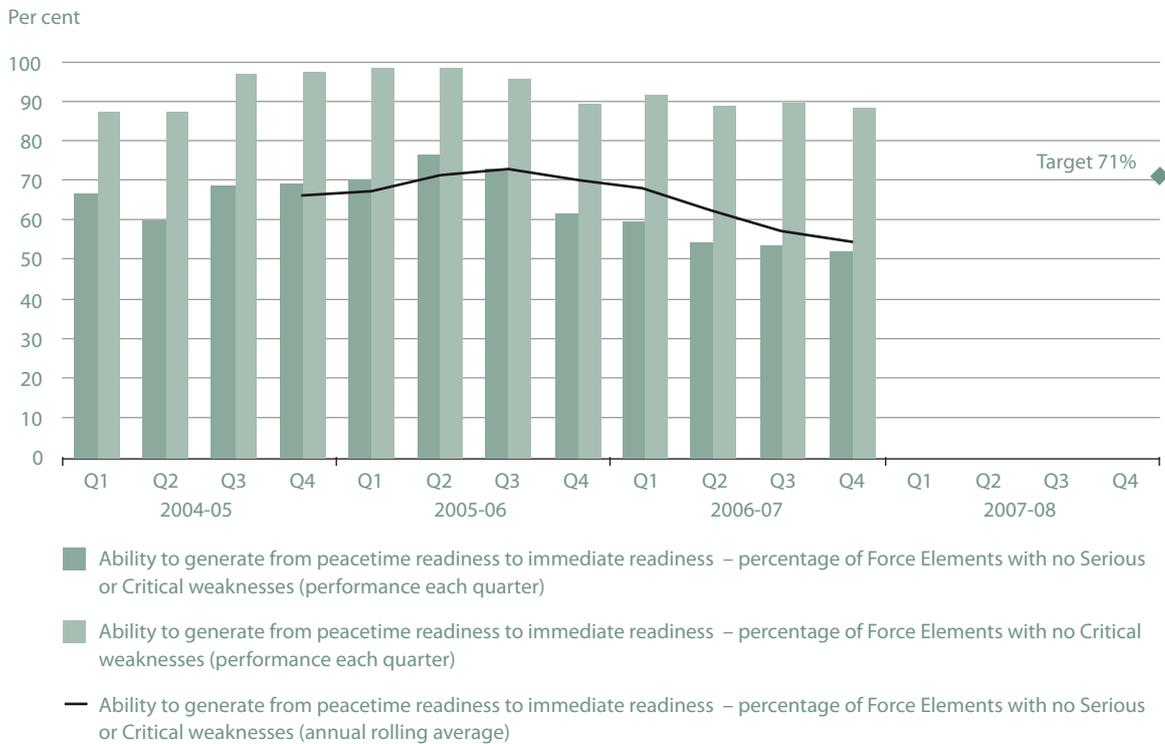
7 The Readiness Cycle and Public Service Agreement Target 3

Logistics support and sustainability is required for all elements of the readiness cycle.



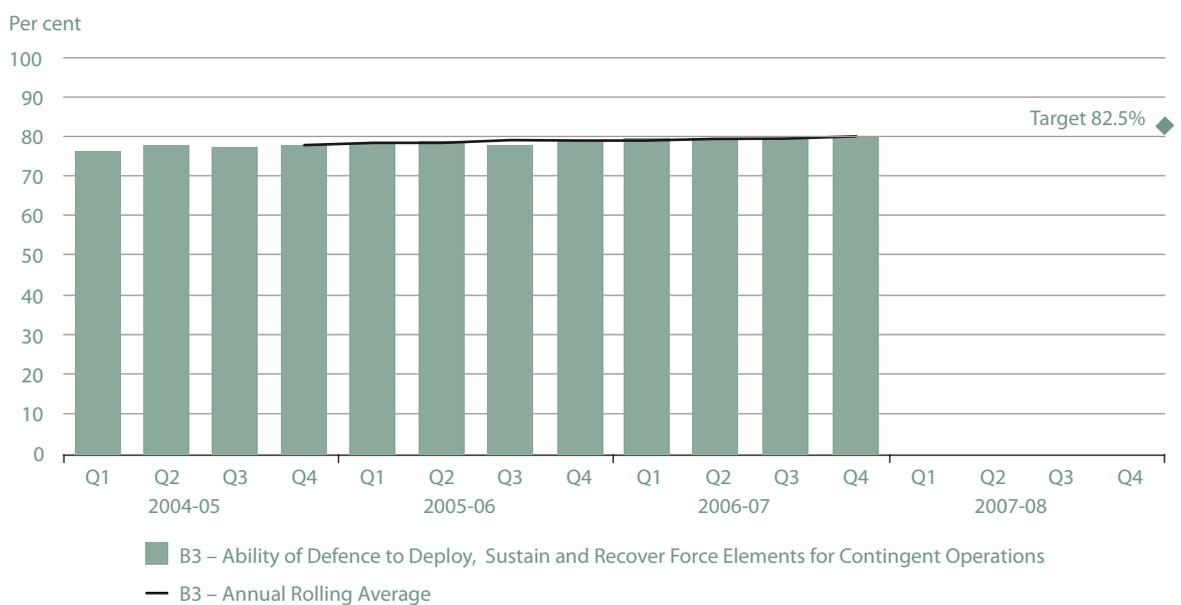
Source: Ministry of Defence

8 Assessed Ability to Generate Force Elements from Peacetime to Immediate Readiness



Source: MoD, Annual Report and Accounts, 2006-07

9 Assessed Ability to Move from Immediate Readiness to Deploy, Sustain and Recover Force Elements for Contingent Operations



Source: MoD, Annual Report and Accounts, 2006-07

Potential areas of interest to the Committee

1.14 What metrics underpin the Department's assessments of performance under Public Service Agreement Target 1 on operational effectiveness.

The Department has increased the amount of qualitative information in support of its assessment of performance as 'On Course with some Risk' against Target 1 since last year's Annual Report. However, it is difficult to link the statement of performance to the narrative.

1.15 Why the Department does not include 3b and 3c in the readiness Public Service Agreement target, as well as measuring the ability of Force Elements to undertake actual operations.

Because of the diverse nature of potential operations, Force Element readiness is measured against a generic set of operational scenarios. For actual operations, such as Iraq, a Force Element's required capabilities may well differ. For example, additional theatre-specific equipment (Urgent Operational Requirements) and Pre-Deployment Training may well be required to prepare Force Elements for operations. Success, or failure, to achieve peacetime readiness targets does not therefore necessarily measure the capability of Force Elements to undertake actual operations.

1.16 Whether the Department plans to measure the readiness of the Reserve Forces.

The Department expanded the coverage of its readiness reporting system from high readiness forces to all regular forces in April 2003. Reserve Forces, however, are not included, though they provide a vital capability to reinforce regular Force Elements. One reason is that the Reserve Forces have not recently deployed at unit (battalion) level, and only rarely at sub-unit (company) level for recent operations, so assessing capability is more challenging.

1.17 What work the Department has done on expected achievements against readiness targets given that Defence Planning Assumptions are being exceeded.

The Armed Forces have operated at or above maximum scales of effort outlined in the Planning Assumptions for the six years covered by the Annual Report. However, PSA Target 3 (Readiness) was agreed as part of the 2004 Spending Review – before the current high level of operational activity in both Iraq and Afghanistan. It is, therefore, difficult to assess, against the current PSA Target 3, what level of achieved readiness represents a good performance.

1.18 How long the Department expects to take to improve performance against readiness targets once it returns to operating within Defence Planning Assumptions.

The Department's readiness reporting system is designed to prepare and shape the Armed Forces for contingent operations, not current operational demands. However, operating consistently above Defence Planning Assumptions is eroding the ability of the Armed Forces to reconstitute as insurance against the unexpected: currently the Armed Forces can only conduct an additional operation up to Small-Scale.

1.19 Which elements of readiness will be the most difficult to recover once the Department is operating within Defence Planning Assumptions.

The Department is funded to prepare forces for operations, receiving additional resources for actual operations. Similarly, the Urgent Operational Requirements' process can deliver additional equipment and specific training can be provided through pre-deployment packages. Appropriately trained manpower, however, cannot easily be generated, including from the Reserve Forces.

Equipment Acquisition

Background

2.1 The Equipment Programme costs for procurement are between £5.5–6.0 billion a year and have the key objective of delivering battle-winning equipment. The programme is reviewed every two years as part of the Department's overall planning and programming process.

2.2 As part of the Enabling Acquisition Change Report 2006, the Defence Procurement Agency and the Defence Logistics Organisation merged to form Defence Equipment and Support on 1 April 2007.

2.3 The key objective of this organisation is to buy and support weapons systems and platforms and manage major upgrades – delivering projects to defined performance, time and cost.

Public Service Agreement Target 6

2.4 Public Service Agreement Target 6 measures the ability of the Department to deliver equipment to time and cost. Performance against Target 6 is measured against all Category A to C projects, with a capital value greater than £20 million, that have passed Main Gate (the main investment decision) and are yet to achieve In Service Dates at the start of the financial year – a total of 44 projects in 2006-07. Three assessments are compiled against the following acquisition targets:

a Achieve at least 97 per cent of Key User Requirements for all Category A to C Projects that have passed Main Gate approval, to be achieved throughout the Public Service Agreement period (Target 6a).

b Average In-Year variation of forecast In-Service Date to be no more than 0.5 months in 2006-07 and 0.4 months in 2007-08, for all Category A to C Projects that have passed Main Gate Approval, (Target 6b).

c Average In-Year variation of forecast costs for Design and Manufacture phase of less than 0.3 per cent in 2006-07 and 0.2 per cent in 2007-08, for all Category A to C projects that have passed Main Gate approval (Target 6c).

2.5 There has been an improvement against all three of these targets since 2005-06, with a steady improvement in Target 6c. A number of the savings claimed by the Department within the Major Projects Report 2006 are not overall savings to the Ministry of Defence but a reallocation of budgets. In the Major Projects Report 2006, the majority of all cost reductions were achieved by reallocating money to other projects or corporate budgets.

2.6 Targets 6a and 6b have fluctuated in recent years but have shown an improvement year on year as shown in **Figure 10**. The Department met all of the acquisition targets in 2006-07 for the second consecutive year, despite some of the targets being more challenging than those set in 2005-06.

Additional Measures of Efficient Acquisition

2.7 Since 2004-05, the Defence Procurement Agency has measured its achievements against further internal targets. The Agency met these key targets during 2006-07. Three of these targets were the same as the PSA measurements although the parameters were less stringent than the PSA targets. However, there were additional targets specific to the Defence Procurement Agency. These were:

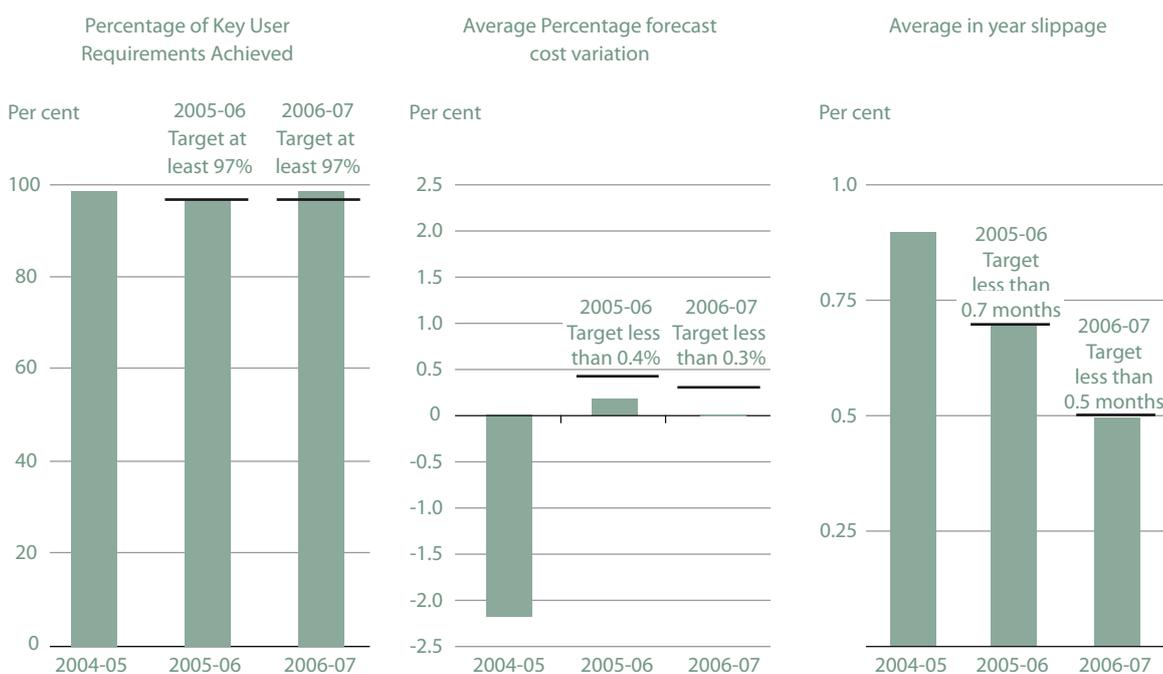
- a An asset delivery achievement of greater than 93 per cent** which was exceeded with a performance of 102 per cent. This is an indicator of how much has been delivered compared with what was planned, in terms of a percentage by value of planned asset deliveries.
- b An asset turnover ratio of less than 52 months** which was exceeded with an average of just 47 months over the year. This is an indicator of how long assets or equipment sit on the Defence Procurement Agency's balance sheet before they are finished and delivered. Performance has improved from 70 months in 2005-06, which represents an increase in Agency efficiency.
- c Assets delivered per £ of Operating Costs of greater than £15.44**, which was exceeded with a result of £18.58. This measures the value of assets or equipment delivered to the Defence

Procurement Agency's customers against the Defence Procurement Agency's operating costs – the more assets delivered per £ of operating costs, the more efficient the Agency is. As value has increased from £15.29 in 2005-06, this represents an increase in Agency efficiency.

- d Assets produced per £ of Operating Costs greater than £18.01**, which was exceeded with an average of £20.63. This indicator measures the assets added to the balance sheet over the Defence Procurement Agency's operating cost – the higher the ratio between assets built per £ of operating cost the more efficient the organisation. As value has fallen from £23.87 in 2005-06, the Agency has become less efficient in 2006-07, but still exceeded its target.

2.8 All of the targets set for the Defence Procurement Agency are outlined in **Figure 11 overleaf**.

10 Public Service Agreement Target 6



Source: MoD, Annual Report and Accounts, 2006-07

Defence Industrial Strategy

2.9 The Department has made progress in implementing the Defence Industrial Strategy. The Defence Industrial Strategy aims to “provide greater transparency of our future defence requirements and, for the first time, set out those industrial capabilities we need to retain in the United Kingdom to ensure we can continue to operate our equipment in the way we choose”. The Strategy looks at the different sectors within Defence and sets out the approach needed in each area in order to maintain operational sovereignty; maximise future battle-winning capability; meet the challenge of globalisation and dominance of a largely closed United States’ market; give a long-term strategic framework, including: clear prioritisation of particular capabilities, and provide industry with better clarity over future priorities.

2.10 Success of the Defence Industrial Strategy will be measured as:

- a** The right equipment being delivered at the right price for the Armed Forces.
- b** A valued premium on United Kingdom defence companies and high skill, worthwhile jobs being maintained within the United Kingdom.
- c** Demonstrating the Strategy in action in the procurement decisions the Department takes.
- d** Greater working partnerships with industry and closer ties meaning more efficient ways of working and the ability to drive costs down.

2.11 Although the Department does have some metrics to assess elements of the Defence Industrial Strategy, there is no overall framework to quantify success.

11 Public Service Agreement and Defence Procurement Agency Key Targets and Achievements

	2006-07	2005-06	2004-05
Predicted achievement of Key User Requirements	97%	97%	n/a
Met	99%	97%	
<i>Equivalent DPA Key Target</i>	97%	97%	97%
Met	99%	97%	99%
Average In-Year variation of costs not to exceed	0.3%	0.4%	n/a
Met	0.0%	0.2%	
<i>Equivalent DPA Key Target</i>	0.5%	0.6%	0.0%
Met	0.0%	0.2%	-2.2%
Average in-Year slippage of in-Service Dates not to exceed	0.5 months	0.7 months	n/a
Met	0.5 months	0.7 months	
<i>Equivalent DPA Key Target</i>	0.9 months	1.0 months	0.9 months
Met	0.5 months	0.7 months	0.9 months
<i>Asset delivery achievement (percentage by value of planned asset delivery)</i>	>93%	>90%	85%
Met	102%	107%	100%
<i>Asset Turnover Ratio</i>	<52 months	<83 months	<70 months
Met	47 months	70 months	59 months
<i>Assets delivered per £ of Operating Costs</i>	>£15.44	>£13.20	>£10.72
Met	£18.58	£15.29	£14.36
<i>Assets produced per £ of Operating Costs</i>	>£18.01	>£23.10	>£16.23
Met	£20.63	£23.87	£19.13

Source: MoD, Annual Report and Accounts, 2006-07

2.12 Areas of progress, however, include the roll forward of a Defence Acquisition Change Programme; aimed at embedding a through-life approach, the publication of a Defence Technology Strategy, and the appointment of the Department's first Defence Commercial Director, with a remit to transform the Department's relationship with industry. The Department signed strategic partnering agreements with Agusta Westland in the helicopter sector in June 2006 and with BAE Systems for the fixed wing sector in March 2007, and industry has also pursued greater alignment in other areas, for example through the formation of 'Team Complex Weapons'.

2.13 More recently, the Department has announced Defence Industrial Strategy 2. According to the Department, this will provide an update on current thinking, clarifying the Department's commercial approach and will again examine the military industrial capabilities that need to be retained on-shore for security of supply and operational sovereignty reasons.

Potential areas of interest to the Committee

2.14 The Department's confidence about achieving timely delivery of future large projects.

The 20 projects for which time is analysed within the Major Projects Report 2006 are now predicted to achieve their In-Service Dates 433 months later than at approval. Much of this delay is due to historic problems on legacy projects, with three large projects – the Nimrod MRA4 aircraft (89 months), the Astute Class Submarine (42 months), and the Typhoon aircraft (54 months) – accounting for over 40 per cent of this total.

2.15 How the Department has achieved better control over slippage against In-Service Dates, and whether this is sustainable.

The Major Projects Report 2006 has demonstrated that there are signs that schedules are being controlled. Thirty-three months of the total of 433 months delay occurred within the year 2005-06 – a lower contribution to the total than in any Major Projects Report since 2002.

2.16 Overall cost of slippage in the equipment acquisition programme.

Delays may result in a gap in the capability of the Armed Forces, and the Department may need to extend the out of service dates of other equipment until the replacement is ready. For example, the delay to the out of service date of the Type 42 destroyer, caused by the expected 42 month delay of the Type 45 destroyer entering service, is estimated to have cost the Department £199 million to date.

2.17 The Department's view on progress against the Defence Industrial Strategy, and how this will be measured.

The Department reports that it has made considerable progress over the last year, with significant developments in helicopter, fixed wing and complex weapons sectors. The Strategy will be further refreshed with the Defence Industrial Strategy 2 programme. The Department intends to pursue progress in the Maritime, Armoured Fighting Vehicles and General Munitions sectors during 2007-08. Although the Department does have some metrics to assess elements of the Defence Industrial Strategy, there is no overall framework to quantify success.

2.18 The extent to which the Department is reliant on cutting equipment numbers to remain within budget, and what impact this has on capability. An example in the Major Projects Report 2006 is the Guided Multiple Launch Rocket System. Initially expected to deliver 6,204 rockets, this was reduced to 4,780 to produce a saving. Following the Departmental Review, the Defence Management Board considered that it was tolerable to reduce the number of rockets further to ensure there was a nil programme cost increase. 4,080 rockets will now be ordered. This has created a capability shortfall which the Board considers acceptable as the Indirect Fire Precision Attack project will assess whether more rockets should be bought in future. The project is currently in the Assessment Phase, and there is no guarantee of funding.

2.19 How the Department envisages the newly formed Defence Equipment and Support delivering better equipment Through-Life Management.

2.20 Whether the Equipment Plan can deliver all currently forecast projects to cost, time and performance within the existing budget, without further action to manage the programme's affordability. In the Major Projects Report 2006 there are several projects reaching their peak years of procurement expenditure over the next four years, creating a potential "bow wave" of expenditure in the near future, with a slowdown in the period after 2011-12.

The Defence Estate

Background

3.1 The Department has a worldwide Defence Estate valued at some £18 billion and is the second largest landowner in the United Kingdom with 240,000 hectares. The built estate (80,000 hectares) includes offices, living accommodation, aircraft hangars and naval bases. The rural estate (160,000 hectares) comprises mainly training areas and ranges on undeveloped rural land which is often of particular environmental significance. The NAO estimated that the total annual operating cost of the estate was some £3.3 billion in 2005-06. The Department states that its estate-related assets totalled some £18.9 billion in April 2006 and that it invested over £2 billion in the estate each year, representing about one per cent of the United Kingdom's construction industry's annual turnover.

3.2 As a result of its increased role in managing the estate and its merger with the Defence Housing Executive, Defence Estates has, as anticipated, nearly trebled in size since 2001-02. It now employs nearly 4,200 civilian and military personnel. Separately, the Department maintains some 850 personnel in other estate-related roles.

3.3 The Defence Estate is crucial to the delivery of operational capability and the welfare and morale of Service personnel. The Department's vision for the estate is: *'To have an estate of the right size and quality to support the delivery of defence capability, that is managed and developed effectively and efficiently in line with acknowledged best practice and is sensitive to social and environmental considerations'*.

Assessment and performance measures

3.4 The Department has a number of non-Public Service Agreement measures relating to the Estate. These include:

- Improving the Estate: Service Families Accommodation:
 - a** Upgrade 1,200 houses to Grade 1 in 2006-07 (achieved 1,215).
 - b** Maintain 59 per cent of total stock at Standard 1 for condition (achieved 57 per cent by April 2007, up from 41 per cent in April 2001).
 - c** Maintain 95 per cent of total stock at Standard 1 or 2 for condition (achieved 95 per cent by April 2007).
- Improving the Estate: Single Living Accommodation:
 - a** Deliver 2,000 Grade 1 new-build bed spaces through Project SLAM (Single Living Accommodation Modernisation) in 2006-07 (achieved 2,207).
 - b** Deliver 5,400 Grade 1 new-build bed spaces through parallel projects in 2006-07 (achieved 3,615).
- Managing the Estate: Relocation: Move 3,900 posts outside of London and South East by 2010 (1,885 posts relocated by April 2007)

- Managing the Estate: Improved routine maintenance:
 - a Achieve 30 per cent through life value for money improvements in estate management by 2012. The Department estimates that it has so far achieved 3–5 per cent against the 2003-04 baseline.
- Sustainable Development:
 - a 90 per cent of new buildings to be rated 'Excellent' for sustainability and 90 per cent of refurbishments rated at least 'Very Good'. The new Defence Related Environmental Assessment Method, introduced in March 2006, rated around 60 per cent of new buildings as 'Excellent'.
 - b By 2010, 95 per cent of Sites of Special Scientific Interest (SSSIs) sites on MoD land must either be in a 'Favourable Condition' or 'Unfavourable, but in a Recovering State'. The Department estimates that 82 per cent of its SSSI's in England in 2006-07 achieved this status, along with 75 per cent in Wales, 69 per cent in Scotland and 63 per cent in Northern Ireland.
 - c Establish by April 2008 the condition of listed buildings and scheduled monuments owned by the Department. As at March 2007, 73 per cent of scheduled monuments and 70 per cent of listed buildings were in 'Fair' or 'Good' condition, with a further 16 per cent of listed buildings and 5.5 per cent of scheduled monuments of 'Unknown' status.

Service accommodation

3.5 The Department owns or manages over 72,000 houses worldwide and 168,000 single living units, spread across 16 countries. The Department notes that too much of the stock is old, not well adapted for modern lifestyles, or in a poor physical condition. Recognising this, around the end of the last decade the Government substantially increased the base standards required for living accommodation. £700 million was spent on housing and other accommodation in 2006-07 and over £5 billion more is planned over the next decade. The Department has been setting up better long term maintenance arrangements, taking forward a substantial rationalisation programme, and is exploring whether there are further ways to help Service personnel buy their own property.

3.6 Some £1.3 billion has, or is planned to be, invested in Single Living Accommodation through the Single Living Accommodation Modernisation (SLAM) programme and other projects. Project SLAM phase one should upgrade 10,000 single bed spaces in the United Kingdom by April 2008. 2,207 bed spaces were delivered in 2006-07, against a target of 2,000, bringing the total delivered by Project SLAM by March 2007 to nearly 7,800. The second phase was awarded in January 2007, with a minimum commitment to upgrade 3,800 bed spaces by April 2013. Subsequent announcements by the Department, most recently on 25 September, have increased funding by £95 million, allowing a further 1,300 bed spaces to be upgraded.

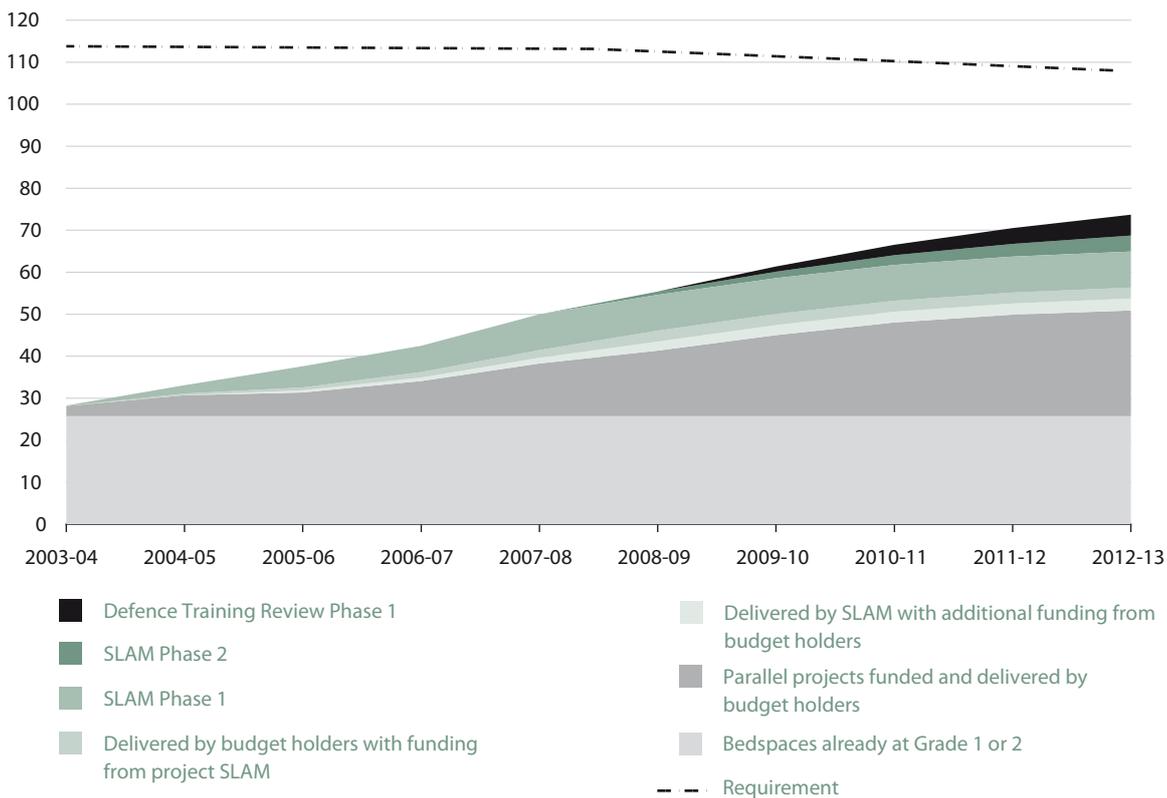
3.7 Other projects to modernise Single Living Accommodation at specific locations in the UK and overseas delivered 3,615 bed spaces during 2006-07, including over 500 overseas, against a target of 5,400 bed spaces. Assuming no deterioration of the existing stock, by 2012-2013 the number of bed spaces at the required standard will have risen to around 75,000. Given the predicted fall in requirement, this will leave a shortfall of around 35,000. **Figure 12** indicates the delivery of Grade 1 Single Living Accommodation in the United Kingdom.

3.8 There are 49,000 Service Family houses in the United Kingdom, of which 45,000 are regarded as core stock. Over 12,000 of these properties have been upgraded over the last six years, and the percentage of housing stock at Standard 1 has risen from 41 per cent in April 2001 to 59 per cent in April 2007. Thirty-six per cent are at Standard 2, and only 0.3 per cent of the total are at Standard 4.

12 Grade 1 Single Living Accommodation in the United Kingdom

Cumulative Delivery of Upgraded Single Living Accommodation

Bedspaces (000s)



Source: National Audit Office analysis of Ministry of Defence data

NOTE

1 Figures for SLAM Phase 2 and the Defence Training Review Phase 1 assume an equal delivery of bedspaces each year from contract commencement.

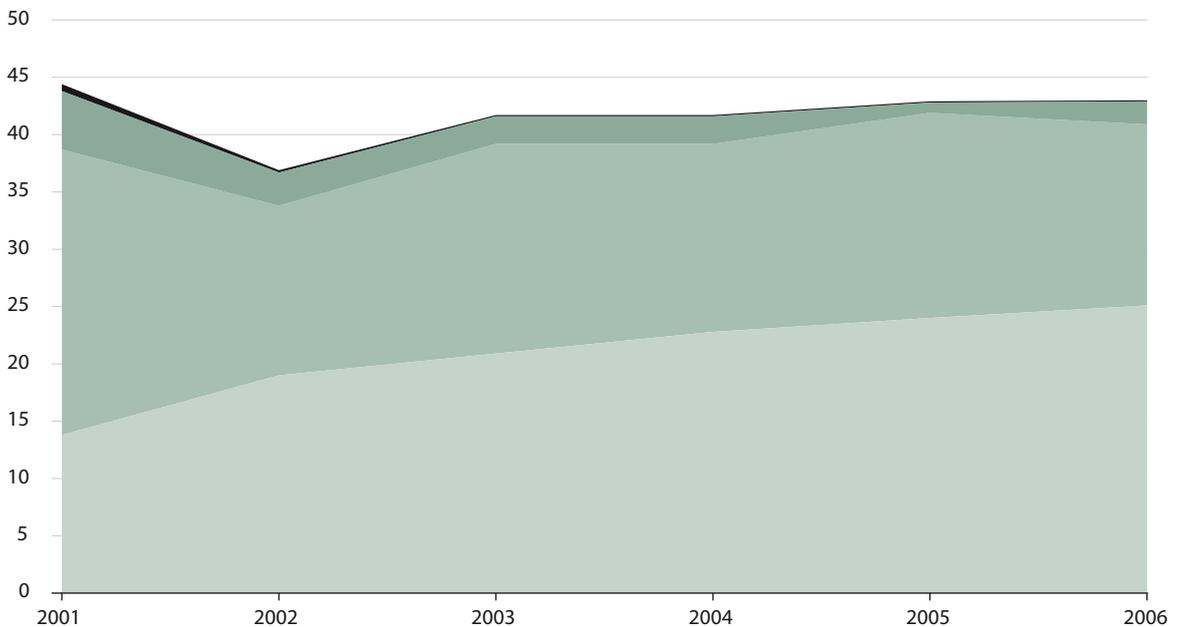
3.9 During 2006-07 1,215 properties were upgraded to Standard 1 for Condition against an increased target of 1,200. On 1 April 2007, the long-term core stock comprised about 26,900 properties at Standard 1, 16,000 at Standard 2, 1,800 at Standard 3 and about 140 at Standard 4. **Figure 13** indicates the delivery and condition of Service Family Accommodation in the United Kingdom.

3.10 The Department plans to upgrade up to a further 900 properties by April 2008, and to conduct a full condition based survey of all its Service Family Accommodation to inform future investment priorities, but is currently uncertain how long it will take or how much it will cost to upgrade the majority of Service Family Accommodation to Standard 1.

13 Condition of Service Family Accommodation

Service Family Accommodation upgrades planned and achieved (Great Britain only)

Number of properties (000s)



	2004-05	2005-06	2006-07	2007-08 onwards
Target for number of properties to be upgraded by Defence Estates	500	600	1,200	900 per annum
Number of property upgrades achieved	2,610	1,705	-	-

- Standard 4 for Condition
- Standard 3 for Condition
- Standard 2 for Condition
- Standard 1 for Condition

Source: National Audit Office analysis of Ministry of Defence data

NOTE

Figures in the graph are for properties which the Department requires in the long-term, currently around 43,000, and do not reflect the total stock of properties held. Total stock of properties in Great Britain on 1 April 2006 was 48,900.

Regional and Housing Prime Contracts

3.11 Regional Prime Contracts provide estate services, such as grounds, building maintenance and some new building work, across a defined geographical region. The National Audit Office found these Contracts are improving the way the estate is maintained but it is too early for this to have had an impact on the overall quality of the estate. Internal customers are pleased with the delivery of reactive and planned maintenance; health and safety issues have been identified and are being addressed; and progress is being made towards measuring the baseline quality of the estate.

3.12 The service provided to military families in England and Wales changed significantly during January 2006 with the roll-out of the new Housing Prime Contract for repair and maintenance. The initial service was not up to the required standard but the Department's measures to rectify this proved effective and the performance level improved markedly over 2006-07.

Rationalisation

3.13 As set out in The Defence Estate Strategy 2006, the Department is working towards an estate of fewer but larger sites. Since 1999, the Department has achieved accrued disposal receipts of nearly £2.1 billion, including accrued gross Estates disposal receipts of £394 million during 2006-07 (£258 million in 2005-06). Work has also begun on producing an Estate Development Plan looking forward over the next 20 years, to be completed by the end of 2007. This will enable the Department and the Armed Forces to plan estate requirements across defence in a more geographically coherent manner, with defence establishments mainly located away from London and the South East of England.

3.14 The number of defence civilians in and around London fell from nearly 50,000 in 1993 to about 24,000 in 2006, and the number of headquarters buildings in London from more than 20 in 1990 to three. In 2006 a contract was awarded for Project

MoDEL to rationalise a number of defence sites in Greater London at RAF Northolt and Woolwich. In Spring 2007 a streamlining study was set up to identify how to reduce the Department's Head Office in London following the Capability Review and taking account of the new Top Level Budget (TLB) headquarters arrangements (see Part 7).

3.15 Under the Lyons review, the Department plans to relocate about 5,000 defence posts out of London and the South East of England between April 2005 and March 2010, against a target of 3,900. 656 posts were relocated during 2006-07, for a total of 1,885 as at 31 March 2007. These reductions will be offset to some degree by the establishment of the new Army and RAF headquarters at Andover and High Wycombe, respectively, both of which involve moving posts into the South East.

Sustainability

3.16 During 2006-07 the Department published its Biodiversity Strategic Statement for the Defence Estate. The estate includes 174 Sites of Special Scientific Interest. The quality of these continued to improve, with 81 per cent in England, 68 per cent in Scotland, 75 per cent in Wales and 57 per cent in Northern Ireland meeting target condition against the Government target of 95 per cent by 2010.

3.17 The Department owns over half the Government's historic assets, including over 800 historic buildings in the United Kingdom of which 782 are listed. In the 2005 English Heritage Biennial Conservation Report there were 28 defence entries in the Buildings at Risk register. Four have since been removed: two by repair or reuse, and two by disposal. The Department is also responsible for 1,056 scheduled monuments. At 31 March 2007, 70 per cent of the Department's listed buildings and 73 per cent of Scheduled Monuments were in good or fair condition. The condition of a further 16 per cent of listed buildings and 5.5 per cent of scheduled monuments was unknown and the Department is committed to establishing this by April 2008.

Potential areas of interest to the Committee

3.18 How the Department plans to address the single living accommodation for which upgrades are not currently funded. The Department estimates that, on current funding, it will have just over 70,000 Single Living Accommodation bed spaces at Grade 1 or 2 standard by 2012-13, against a requirement for 110,000. Recent additional funding for Phase 2 of Project SLAM has been released from sale of surplus estate.

3.19 Whether, in relation to housing, the Department has considered spreading its investment more widely, for example by upgrading more properties to Standard 2 rather than a smaller number to Standard 1.

The Department is currently uncertain how long it will take or how much it will cost to upgrade the majority of Service Family Accommodation to Standard 1. There are 19,000 houses still to be upgraded and at an upgrade rate of 900 per year, this will take some 20 years.

3.20 The Department's current strategy on providing loans to Service personnel to purchase their own homes. The development of Super Garrisons, where soldiers are likely to serve for longer periods in one location, is likely to encourage more Service personnel to want to buy their own home. The Department has given eligible Service personnel £8,500 towards purchase of their own home. However, house prices have risen considerably in recent years, eroding the benefit.

3.21 What progress has been made on the Estate Development Plan and how the Department is likely to take the strategy forward. The Estate Development Plan, looking forward over the next 20 years, is to be completed by the end of 2007. This will enable the Department and the Armed Forces to plan estate requirements across defence in a more geographically coherent manner.

3.22 The measures the Department has in place to manage effectively a complex programme of estate rationalisation and target investment at sites required to meet future needs. The Royal Navy and Royal Air Force are already concentrated around main naval bases and main operating bases but may pursue further rationalisation. The Army's long term goal is coherence across the formations in which it deploys, centred around 'Super Garrisons' along the lines of Aldershot, Catterick, Colchester and around Salisbury Plain. Major rationalisation programmes also relate to the TLB Headquarters restructuring.

3.23 How the Department's London Headquarters Streamlining Project will impact on the number of staff being relocated out of the South East. The Department has reduced to three headquarters buildings in London and plans to relocate some 5,000 defence posts out of London and the South East by March 2010 (against a target of 3,900) and is working on further reducing its Head Office.

3.24 How stretching it will be for the Department to meet its sustainability targets. Although in most areas the Department's performance against its sustainability targets is improving, performance falls well short of that planned in some areas. For example, the Department has much further to go to increase from 60 per cent to 90 per cent of newly constructed buildings being rated highly for sustainability.

Service Personnel

Background

4.1 The combination of continuing high operational tempo, an increase in the number of personnel choosing to leave early, and a challenging recruitment environment meant that at the end of 2006-07 all three Services were outside Manning Balance. According to the Department there is 'Some Risk' that the Services may not return to Manning Balance by 1 April 2008.

Public Service Agreement targets

4.2 The Department's Public Service Agreement Target 5 focuses on personnel. Target 5 is to 'Recruit, train, motivate and retain sufficient military personnel to provide the military capability necessary to meet the Government's strategic objective'. Performance against this target will be assessed against the achievement of manning balance in each of the three Services, considered separately, by 1 April 2008. Manning Balance gives a picture of the overall strength of the Armed Forces against the requirement, and therefore subsumes both recruitment and retention of personnel.

4.3 Target 5 has five sub-targets measuring;

- a** The trained strength of the three Services to be within minus two per cent and plus one per cent of the overall manning requirement.
- b** 'Gains to Trained Strength' (i.e. the number of trained recruits).
- c** The percentage of trained strength who are Medically Fit For Task.
- d** Voluntary outflow rates.
- e** Harmony guidelines – the amount of time personnel spend away from home.

Trained Strength

4.4 The Department's Public Service Agreement requires all three Services to achieve manning balance by 1 April 2008. Manning Balance is defined as trained strength between 98 per cent and 101 per cent of the requirement, which itself changes over time to reflect changes in the equipment and structure of the individual Services. From April 2006 to April 2007, reflecting the programmes to transform and restructure the Services, the total trained strength of the Services fell by over 5,400 personnel (3.0 per cent) from over 183,000 to under 178,000. At the end of the year all three Services were outside Manning Balance, and there is some risk that they may not return to balance by April 2008. **Figure 14 overleaf** illustrates recent manning surplus/deficit levels.

4.5 Within these overall manning totals there are a number of identified skills areas with insufficient trained strength to meet the specified requirement for that skill – Manning Pinch Points. This can reflect a shortage of people against the peacetime requirement, a temporary operational requirement greater than the peacetime requirement, or a combination of the two. A recent National Audit Office report found that Manning Pinch Points had shortfalls of personnel ranging from 1.6 per cent (Royal Air Force General Technicians – Electrical) to 70 per cent (Tri-Service Intensive Therapy Unit Nurses).⁷

Recruiting environment

4.6 The NAO's November 2006 report concluded that since 2000-2001 the Services had recruited 98 per cent of their target for intake from civilian life.⁸ During 2006-07 the Department recruited 97 per cent of their target intake.⁹

4.7 The NAO found that past cuts in recruitment activity have had a damaging longer term effect on manning in some areas. Such cutbacks are almost impossible to recover from, as budget and capacity constraints prevent the Department from over-recruiting to make up for shortfalls in previous years.

7. Report by the Comptroller and Auditor General, *Ministry of Defence: Recruitment and Retention in the Armed Forces* (HC 1633-1 Session 2005-2006) Figure 3, p.14.

8. Report by the Comptroller and Auditor General, *Ministry of Defence: Recruitment and Retention in the Armed Forces* (HC 1633-1 Session 2005-2006) para 3.2.

9. House of Commons Hansard Debates for 16 July 2007 (part 0002).

10. Source: Ministry of Defence Annual Report and Accounts 2006-2007 p20.

4.8 During 2006-07 the Royal Navy and the Army each combined their Regular and Reserves recruiting operations under single professional organisations to ensure high quality and consistent branding.

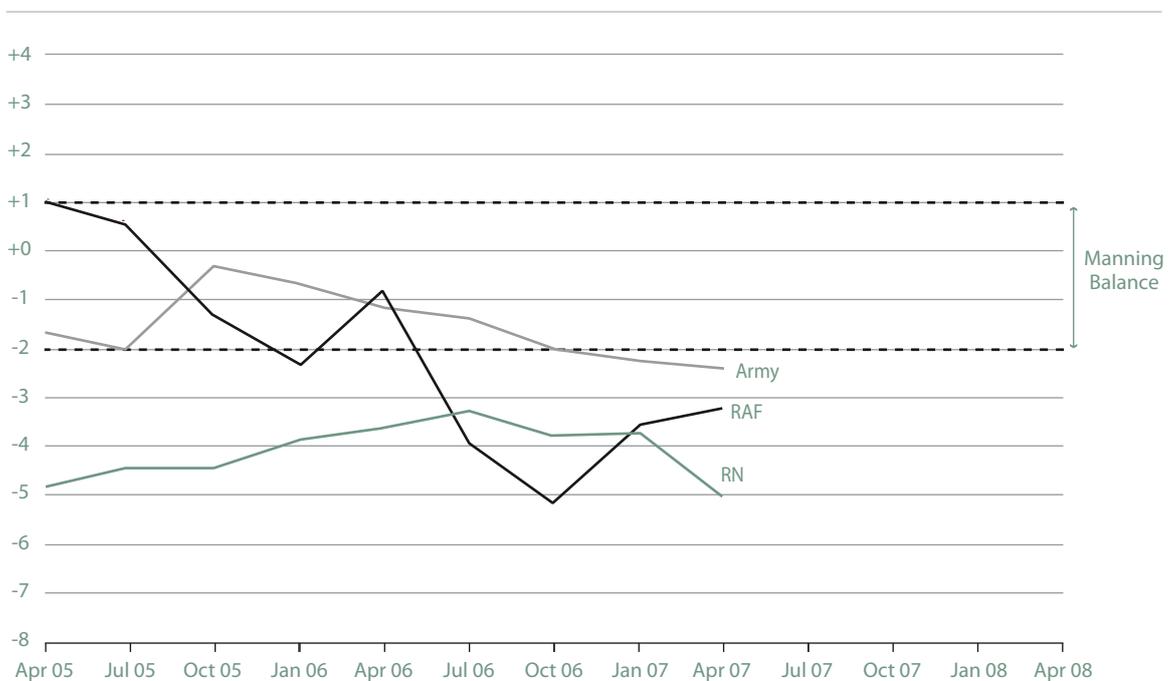
4.9 In 2006-07 only the Royal Navy succeeded in training sufficient officer recruits, and none of the Services trained sufficient numbers of other ranks.

Figure 15 illustrates Gains to Trained Strength: 2005-06 and 2006-07.

Medically fit for task

4.10 The target is for at least 90 per cent of Service personnel to be medically fit for task by 1 April 2007, an increase of 1 per cent from the performance at 31 March 2005. The proportion of Service personnel medically downgraded continued to increase during 2006-07, in part due to the high operational tempo. At 31 March 2007 85.9 per cent of the overall Armed Forces personnel were reported as fit for task.¹⁰ The vast majority of personnel unfit for task are working normally but their deployability is limited.

14 Service manning surplus/deficit



Source: MoD, Annual Report and Accounts, 2006-07

15 Gains to Trained Strength

	Target	2006-07		Target	2005-06	
		Achieved			Achieved	
Naval Service Officers	410	450	110%	410	370	90%
Naval Service Other Ranks	2,960	2,320	79%	2,700	2,330	86%
Army Officers	1,020	960	95%	810	750	93%
Army Other Ranks	9,050	7,640	84%	9,230	7,770	84%
Royal Air Force Officers	500	400	81%	370	380	103%
Royal Air Force Other Ranks	1,200	1,010	84%	1,800	1,860	103%

Source: MoD, Annual Report and Accounts, 2006-07

Voluntary outflow rates

4.11 The Armed Forces require sufficient turnover of personnel to maintain promotion opportunities. A certain level of early exits each year is therefore important. However, it costs significantly more to recruit and train new personnel than it does to retain existing ones.¹¹ The Department does not set retention targets, but monitors the level of Voluntary Outflow closely against guideline figures derived from long term historic trends.

4.12 The NAO found that the Department's short term financial measures to improve retention have had some success, but do not address the key drivers for leaving such as Service personnels' inability to plan ahead and the impact on their family life. **Figure 16** below shows that numbers leaving early are above the long term outflow in Royal Navy, Army and Royal Air Force Officers.

Harmony guidelines

4.13 The Department has operated above the most demanding level of operations under Defence Planning Assumptions since 2001, but has not adjusted its manning requirements.¹² There are indicators of overstretch in specific areas, such as severe shortfalls of personnel in some specialist trades, and the routine breaking of harmony guidelines on amount of time spent away from home. The Department accepts that the Armed Forces are significantly stretched, but does

not consider that they are overstretched, and would only be overstretched if there was a failure to meet the military commitments.¹³

4.14 The continuing high operational tempo has meant that the Army and the Royal Air Force did not meet individual or unit harmony guidelines. All three Services breached their unit harmony guidelines during 2006-07, with the Army most affected. During 2006-07, 13.4 per cent of Army personnel were exceeding the guidelines.¹⁴ Some 4 to 6 per cent of Royal Air Force personnel had exceeded the guidelines in every year since 1998, against a guideline of 2.5 per cent. Although the Royal Navy met its harmony guideline targets, ships have sailed with an average level of "gapped" frontline posts of 12 per cent.¹⁵

Other Departmental targets

Diversity in the Armed Forces

4.15 The Armed Forces are committed to becoming more representative of the society they serve. But despite continuing efforts, recruitment from United Kingdom ethnic minority groups remains challenging. All three Services fell short of their ethnic minority recruiting goals but overall ethnic minority representation within the Armed Forces continued to increase slowly. Overall Service ethnic minority strength (including Commonwealth recruits) increased to 5.8 per cent at 1 April 2007 (5.5 per cent at 1 April 2006)¹⁶ against a target of eight per cent by 2013.

11. Report by the Comptroller and Auditor General, *Ministry of Defence: Recruitment and Retention in the Armed Forces* (HC 1633-1 Session 2005-02006) Exec Summary paragraph 18.

12. Report by the Comptroller and Auditor General, *Ministry of Defence: Recruitment and Retention in the Armed Forces* (HC 1633-1 Session 2005-2006) Exec Summary paragraph 18.

13. House of Commons Committee of Public Accounts *Recruitment and Retention in the Armed Forces* Thirty-fourth Report of Session 2006-07 – conclusions and recommendations paragraph 3.

14. Source: Ministry of Defence Annual Report and Accounts 2006-2007 p120 para 217.

15. Report by the Comptroller and Auditor General, *Ministry of Defence: Recruitment and Retention in the Armed Forces* (HC 1633-1 Session 2005-2006) paragraph 2.16.

16. Source: Ministry of Defence Annual Report and Accounts 2006-2007 p166.

16 Actual and Stable Outflow Rates

	Stable Long term Voluntary Outflow %	Year ending 31 March 2007 %	Year ending 31 March 2006 %	October 1999 to October 2006 %
Naval Service Officers	2.0	3.0	3.0	2.5
Naval Service Other Ranks	5.0	6.0	6.0	6.4
Army Officers	4.1	4.3	4.3	3.9
Army Other Ranks	6.2	5.8	5.5	5.7
Royal Air Force Officers	2.5	3.0	2.5	2.4
Royal Air Force Other Ranks	4.0	4.9	4.8	3.8
Tri-Service Officers	N/A	3.6	3.4	3.2
Tri-Service Other Ranks	N/A	5.6	5.4	5.4

Source: MoD, *Annual Report and Accounts, 2006-07*

17. Source: Ministry of Defence Annual Report and Accounts 2006-2007 p165.

18. Report by the Comptroller and Auditor General, *Ministry of Defence: Reserve Forces* (HC 964 Session 2005-2006) Exec Summary paragraph 7.

4.16 Most roles, with the exception of selective combat units, submarine and mine clearance diving, are now open to women. As of 1 April 2007, women comprised 9.3 per cent of the United Kingdom's Regular Forces, and 11.2 per cent of the total 2006-07 intake.¹⁷

4.17 In June 2005, the Secretary of State and the Chief of Defence Staff signed an Agreement with the Equal Opportunities Commission on Preventing and Dealing Effectively with Sexual Harassment in the Armed Forces. In phase one the Department conducted extensive research, including a survey of all Servicewomen. The results made clear that the Department had a serious problem requiring urgent attention. An Action Plan was agreed with the Commission in May 2006 and it reviewed progress with the Chiefs of Staff in May 2007.

Other personnel issues

Operational welfare package

4.18 In October 2006 The Secretary of State for Defence and Chancellor of the Exchequer announced that military personnel would receive a tax free bonus of up to £2,240 for deployment on operations in Iraq, Afghanistan or the Balkans. This payment is equivalent to the amount of tax a private soldier would pay over a six month period. On 25 September the Department announced that Council Tax relief of up to £140 would also be available to those on six-month operational tours.

4.19 Other key improvements to the operational welfare package during 2006-07 included a 50 per cent increase in the welfare telephone allowance from 20 to 30 minutes per week and a 700 per cent increase in welfare internet connection speeds. Work continues to replace and upgrade all internet machines and infrastructure at main bases occupied by United Kingdom forces in Iraq; increase the number of welfare telephones available by 20 per cent and the number of welfare internet terminals by 50 per cent; and trial Wi-Fi by the Navy, Army and Air Force Institutes (NAAFI) and Services Sound and Vision Corporation (SSVC).

Service personnel satisfaction

4.20 All three Services run continuous attitude surveys to assess and monitor the attitudes of serving personnel. **Figures 17 and 18** indicate the Top indicators of satisfaction and dissatisfaction of serving personnel:

Reserve Personnel

4.21 The Government aims to have capable, usable, integrated and relevant Reserve Forces supporting their Regular counterparts on operations overseas. The Reserves are not a contingency force but an integral part of defence capability to be drawn upon for use on enduring operations where necessary. As a matter of policy the Services seek only to mobilise willing personnel, and not to call out individuals more than one year in five. The Department has used Reserves at unprecedented levels in the last ten years.

4.22 The continuing use of Reserves to augment the Regular Forces requires a sufficient supply of Reservists to be available to undertake these tasks. The Department faces a number of challenges in sustaining the future use of the Reserve Forces. None of the Volunteer Reserve Forces met their manning balance target of at least 95 per cent of the trained strength requirement:

- Royal Navy Reserve – 77 per cent on 1 April 2007;
- Royal Marines Reserve – 77 per cent;
- Territorial Army Volunteer Reserve – 70 per cent;
- RAF Auxiliary Air Force – 66 per cent.

4.23 The Department has more recently been successful in increasing the number of recruits, but turnover is still high, which has a knock on effect on the number of personnel trained and available for deployment.

4.24 The NAO found that there are difficulties in providing training for Reservists, caused by problems with scheduling, resource constraints and the lower priority they are given.¹⁸

17 Top indicators of satisfaction

	Top indicators in 2006-07 surveys	Top indicators in 2005-06 surveys
RN + RM	Security of employment (RN 87%, RM 91%) Amount of responsibility (RN 80%, RM 84%) Accuracy of assessment of appraisal report (76%) Variety of tasks in current role (RM 77%)	Security of employment (86%) Amount of responsibility (78%) Accuracy of assessment of appraisal report (73%)
Army	Job security (Officers 79%, Other Ranks 72%) Excitement (Officers 69%) Pension entitlements (Other ranks 62%)	Job security (Officers 73%, Other Ranks 71%) Challenging job (Officers 71%) Pension entitlements (Other ranks 61%)
RAF	Enjoyment of life in the RAF (86%) Tour length of Operational deployments (81%) Number of days annual leave (71%) Adequacy of training for your Service job (71%)	Enjoyment of life in the RAF (85%) Adequacy of training (72%) Leave Allowance (68%)

Source: Continuous Attitude Survey results quoted in Annual Report and Accounts 2006-07, p. 125

18 Top indicators of dissatisfaction

	Top indicators in 2006-07 surveys	Top indicators in 2005-06 surveys
RN + RM	Current X factor rate of 13% (RN 54%, RM 66%) The quality of equipment (RN 46%) Amount of fun in the Service (RN 41%) The X factor method of payment meets its objectives (RM 53%) Ability to plan their own long term life (RM 50%)	Current X factor rate of 13% (RN 48%, RM 58%) Amount of fun in the Service (RN 46%) Ability to plan their own long term life (RN 44%) Medical treatment in units (RM 63%)
Army	Impact of Army lifestyle on personal and domestic life (Officers 62%, Other Ranks 49%) Effect of operational commitment and overstretch (Officers 59%, Other Ranks 42%)	Impact of Army lifestyle on personal and domestic life (Officers 62%, Other Ranks 47%) Effect of operational commitment and overstretch (Officers 55%, Other Ranks 38%)
RAF	Effects of overstretch (85%) and gapping of posts (71%) on the RAF as a whole Effects of civilianisation and contractorisation (73%) Effects of overstretch (63%) and gapping of posts on own working group (53%)	Effects of overstretch (85%) and gapping of posts (72%) Effects of civilianisation and contractorisation (75%) Impact of change on the RAF (56%)

Source: Continuous Attitude Survey results quoted in Annual Report and Accounts 2006-07, p. 125

Potential areas of interest to the Committee

4.25 Whether manning levels should be revised to reflect ongoing operational commitment.

Since 2001, the Armed Forces have consistently operated at or above the most demanding combination of operations envisaged by Defence Planning Assumptions. Manning requirements have not been adjusted to reflect the current levels of activity.

4.26 What the Department is doing to address the impact of 'overstretch' on Service personnel.

The most recent Continuous Attitude Surveys state the top areas of dissatisfaction are effects of operational commitments and overstretch. A survey conducted by the NAO showed the key drivers for leaving included the inability of Service personnel to plan ahead, and the impact of Service life on their family life.

4.27 When the Department expects to achieve Manning Balance. As at 1 April 2007 all three Services were outside Manning Balance. The Department estimates that there is *'Some Risk'* that it may not return to Manning Balance before 1 April 2008. During 2006-07 the Department recruited 97 per cent of their target intake, however the Department's *Annual Report and Accounts, 2006-07* reflects that during the year only the Royal Navy succeeded in training sufficient officer recruits, and none of the Services trained sufficient numbers of other ranks.

4.28 How is the Department mitigating the effect of the increasing numbers of the Armed Forces who are medically unfit for task? The increase reflected the continuing high operational tempo, as the level of fitness required for personnel to be able to deploy on combat operations is both more demanding and more strictly enforced than that required in a less challenging environment.

4.29 What more can the Department do to reach ethnic minority recruiting targets?

All three Services fell short of their ethnic minority recruiting goals in 2006-07 and the likelihood of achieving 8 per cent representation by 2013 appears remote. This is against the backdrop of a wide range of measures taken by the Department, such as organisational culture changes, high-level communications with community and religious leaders, and specialist Diversity Action Recruiting Teams.

4.30 What is the Department's assessment of progress in meeting the June 2005 Agreement with the Equal Opportunities Commission on 'Preventing and Dealing Effectively with Sexual Harassment in the Armed Forces'? Departmental research made clear that the Department had a serious problem that required urgent attention. An Action Plan was agreed with the Commission in May 2006 and progress was reviewed with the Chiefs of Staff in May 2007.

4.31 How the Department intends to increase recruitment and retention in the Reserve Forces.

The Department's Annual Report and Accounts for 2006-07 highlights that none of the Volunteer Reserve Forces met their Manning Balance target of at least 95 per cent of the trained strength requirement. The NAO's Report on the use of the Reserve Forces stated that there are difficulties in providing training for Reservists, caused by problems with scheduling, resource constraints and the lower priority they are given.

Excess Vote on Operational Expenditure (Request for Resources 2)

5.1 In 2006-07 the Department expended more resources than Parliament had authorised on Request for Resources 2. Request for Resources 2 comprises the additional incremental costs of current operations being undertaken in Iraq and Afghanistan and other parts of the world such as the Balkans. The Department breached Parliament's control of expenditure and incurred what is termed an "excess" for which further parliamentary authority is required. The Comptroller and Auditor General therefore qualified his opinion on the Department's 2006-07 resource accounts as the Department incurred expenditure that was unauthorised by Parliament and thus not 'regular'.

5.2 The Department receives funding through three Requests for Resources: one to cover normal running costs; a second to cover additional costs incurred on operations; and a third to meet the costs of pension and compensation claims.

5.3 The limits described above for the Department were set out in the Main Supply Estimates for 2006-07, as amended by the Winter and Spring Supplementary Estimates. The limit for Request for Resources 2 was set at net expenditure of £1,427,526,000 together with a limit on Appropriations in Aid of £15,557,000.

5.4 The accounts show net expenditure on Request for Resources 2 of £1,448,420,000 which is £20,894,000 (1.44 per cent) in excess of the amount authorised. The Department also earned excess Appropriations in Aid of £5,047,000. Parliament will be asked to increase the limit on Appropriations in Aid by £5,047,000 to allow this amount to be used to meet part of the excess and for the remaining £15,847,000 to be authorised as an additional use of resources by an Excess Vote.

Reasons for the excess

5.5 The excess was primarily the result of operational activity in both Afghanistan and Iraq being substantially higher than originally forecast. The unpredictability in activity levels is a significant cause of the underlying difficulties in forecasting Request for Resources 2 and in particular gave rise to additional depreciation and cost of capital charges. The main items were the firing (and consequent accelerated depreciation) of more missiles than expected, particularly in Afghanistan, and the incomplete capture of depreciation costs associated with the operational use of capital.

5.6 The nature of the operations whose resources are attributed to Request for Resources 2 makes it difficult to anticipate the final costs as the tempo of operations fluctuates. Some of the costs of operations are able to be assessed with a high degree of accuracy, for example the additional costs of equipment support and additional personnel costs as well as the costs of activities foregone. However other significant costs such as the levels of stock consumption will depend in part on information provided by personnel in operational theatres and this increases the complexity of the reporting process where there may be more urgent operational priorities.

Action being taken by the Department

5.7 The Department has advised the National Audit Office that it is undertaking a detailed review of the treatment of asset depreciation and stock consumption in operations, focusing particularly on Urgent Operational Requirements, in order to understand the origin of the issues which gave rise to the excess. Urgent Operational Requirements are used to procure additional equipment urgently needed for specific operations.

5.8 The Department will be:

- a** Reissuing relevant guidance to its major departmental groupings and budget holders as well as stressing the importance of accounting properly for even urgent requirements.
- b** Increasing its focus on accurate forecasting at the mid-year point, in time for Spring Supplementary Votes.
- c** Carrying out, at the mid-year point, a robust review of stock and spares consumption charged to Request for Resources 2, and the depreciation of equipment damaged or destroyed in conflict and of weapons fired, to ensure that the accounting is accurate and provides a firm basis for forecasts. The Department has invited the National Audit Office to review the results of this exercise.

Potential areas of interest to the Committee

5.9 The reasons for variation between the estimates and outturn, including attribution between unpredictability in activity levels and the timeliness of the Department's internal reporting process. Fluctuations in the tempo of operations and therefore stock and munitions consumption make it difficult to anticipate final costs. The reporting process from theatre is also subject to competing operational priorities.

5.10 How the Department's review will impact on the 07-08 Estimates. The Department is increasing its focus on accurate forecasting at the mid-year point, in time for Spring Supplementary Votes.

5.11 Whether the Department is confident that its accounts will not need to be qualified on this basis for 2007-08.

Financial Review

Efficiency savings

6.1 As part of the Spending Review 2004, the Department agreed that it would realise total annual efficiency gains of at least £2.8 billion by 2007-08, of which 75 per cent will be cash releasing. Specific objectives to be achieved by 31 March 2008 are: reduce civilian staff by at least 10,000; reduce the number of military posts in administrative and support functions by at least 5,000; be on course to have relocated 3,900 posts out of London and the South East by 2010.

6.2 The Department reported that by 31 March 2007 over £2 billion of efficiencies had been delivered, of which 84 per cent were cash releasing. This included: a fall in civilian staff numbers of 11,020; of military posts by 10,000; and the relocation of 1,885 posts out of London and the South East.

CSR 2007 Settlement

6.3 As part of the July 2007 Comprehensive Spending Review, the Department agreed the budget for the next three years. The expenditure limits agreed are: 2008-09 – £34 billion; 2009-10 – £35.3 billion; 2010-2011 – £36.9 billion. This represents an additional £7.7 billion by 2011, equating to 1.5 per cent average annual real growth. This excludes the costs of operations and the Defence Modernisation Fund.

Significant internal control issue: Joint Personnel Administration

6.4 The Department's Accounting Officer reported in his 2006-07 Statement on Internal Control on one significant internal control issue. During the year the Armed Forces Personnel Administration Agency (now the Service Personnel Veterans Agency) achieved significant milestones in rolling out the Joint Personnel Administration system to the three Services.

Following initial teething problems with Royal Air Force specialist pay and expenses, there are now no systemic problems with the delivery of Royal Air Force and Royal Navy pay. The Army roll out began from the end of March. However the Department reported that, following the roll out to the Royal Air Force, a number of weaknesses had a temporary impact on the Department's ability to exert full financial control, although this was re-established by the end of the financial year. The Department reported that it continues to work to resolve the outstanding issues.

Organisational changes

6.5 On 1 April 2007, the Armed Forces Personnel Administration Agency (AFPAA) merged with the Veterans Agency to form the Service Personnel and Veterans Agency and the Department removed agency status from eight Agencies.¹⁹

19. The eight organisations which lost their agency status on 1 April 2007 were: British Forces Post Office, Defence Bills Agency, Defence Communication Services Agency, Defence Estates, Defence Procurement Agency (which also merged with the Defence Logistics Organisation to form Defence Equipment & Support), Defence Transport Movements Agency, Disposal Services Agency, Duke of York's Royal Military School.

Losses and special payments

Background

6.6 When Parliament votes for a Department's supply estimates there is no provision made for losses and special payments. Therefore this expenditure is subject to additional authorisation and disclosure requirements. The rules on losses and special payments provide additional transparency and accountability for expenditure by a public body.

6.7 The requirement to disclose losses and special payments is unique to government accounting and provides additional disclosure over and above commercial accounting practice. The purpose is to ensure that a Department is accountable for spending outside the limits voted by Parliament. It should be noted that this expenditure is not irregular or *ultra vires* – it is simply unplanned expenditure outside the normal course of the Department's business.

6.8 Losses are classified into several categories for disclosure purposes. Examples of losses which must be disclosed include: physical losses of cash or stores; bookkeeping losses, such as those arising from the write-off of erroneous balances; abandoned legal claims; failure to charge for the use of public property; and payments for which no goods or services were received.

6.9 Special payments which must be disclosed include: extra-contractual payments – where payment is not due under the terms of the contract but is an obligation which the courts might uphold (see Example C below); ex-gratia payments – payments usually to a contractor which are not legally due (see Example D below); and compensation payments including for unfair dismissal or an accident in the workplace.

6.10 Losses and special payments are recorded when the expenditure ‘hits’ the control totals – that is when the expenditure is recorded in the resource accounts. This can often take several years from the point the Department first identifies the loss. Losses and payments over £250,000 need to be separately disclosed with an explanatory narrative. Below this threshold only the total losses and payments need to be disclosed.

Treatment of losses and special payments by the Department

6.11 Losses and special payments are disclosed either as “closed cases” or “advance notifications”. Closed cases meet the definition given above and are recognised when the expenditure is recorded in the resource accounts. Advance notifications record losses and special payments as soon as the Department knows about them but before the expenditure is recognised. This provides a greater level of transparency to the Department’s accounts.

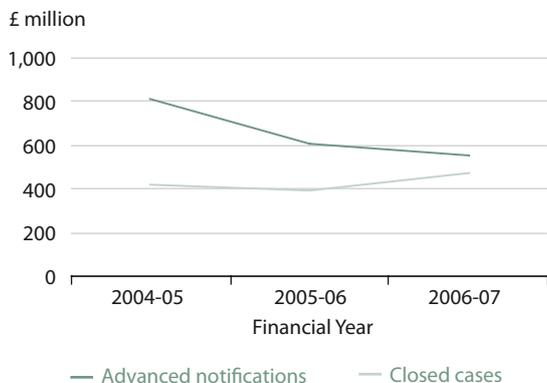
6.12 Examples of Losses and Special Payments from 2006-07:

- a** Losses of **£41.2 million and £44.9 million** were recorded in 2006-07 relating to the transfer of assets to Single Balance Sheet Owners. This initiative, known as “Simplify and Improve” involved all Top Level Budget Holders transferring their assets to a single asset holder – Defence Estates for Land and Buildings, the then Defence Logistics Organisation for equipment. The write-off related to unsupported balances which did not relate to an identifiable asset.
- b** A loss of **£195 million** was notified in previous years and closed in 2006-07 relating to the Government’s decision not to proceed with the TriGAT long-range anti-tank weapons system. Instead the Government ordered Javelin, which has now entered service.
- c** A special payment of **£32 million** was made to Swan Hunter to allow the Landing Ship Dock (Auxiliary) ships to be transferred to BAE Systems for completion.
- d** The ex-gratia element of the Royal Irish Regiment redundancy package was recorded as a special payment (**£26.9 million**)

6.13 Figure 19 shows that the number of closed cases has remained steady over the last three years. The slight increase in 2006-07 is compensated by the equivalent decrease in the advance notifications, as a result of the Department’s efforts to close these cases during the year.

6.14 The total losses and special payments are a small proportion of the total annual expenditure of the Department; just over 1 per cent of total expenditure for 2006-07.

19 The Department's losses and special payments, 2004-2007



Source: Ministry of Defence Annual Report and Accounts 2006-07

Private Finance Initiative (PFI)

Background

6.15 Since the 1995-96 financial year the Department has made increasing use of PFI arrangements to meet its service requirements. In its 2006-07 resource accounts the Department has disclosed 51 PFI schemes, of which 13 are classified as 'on balance sheet', meaning that the assets and liabilities relating to the schemes are on the Department's balance sheet. For the remaining contracts, as the risks and rewards of ownership are deemed to lie with the private sector contractor, the assets sit on their balance sheets.

6.16 The Department's PFI schemes cover: accommodation (for example, Family Quarters at Bath, Bristol and Portsmouth); training (for example, the Attack Helicopter Training Service); equipment (for example, Tri-Service Material Handling Equipment); and other support services (for example, Strategic Sealift – Roll-On Roll-Off ferries). Projects vary significantly in terms of size, with capital values ranging from £1 million to £1,361 million.

The Department's use of PFI compared to other Government departments

6.17 Figure 20 overleaf, based on HM Treasury data, shows a considerable difference between departments, in terms of the number of PFI schemes and total capital value of schemes, even allowing for the differing budgets and nature of their services. The Department is the fifth largest in terms of number of projects, and the third largest in terms of total capital value.²⁰

The Department's level of commitment to PFI

6.18 The Department has already seen several of its shorter PFI contracts expire. However, some contracts financially commit the Department until as late as 2041. Thirteen of the contracts expire in 2030 or after.

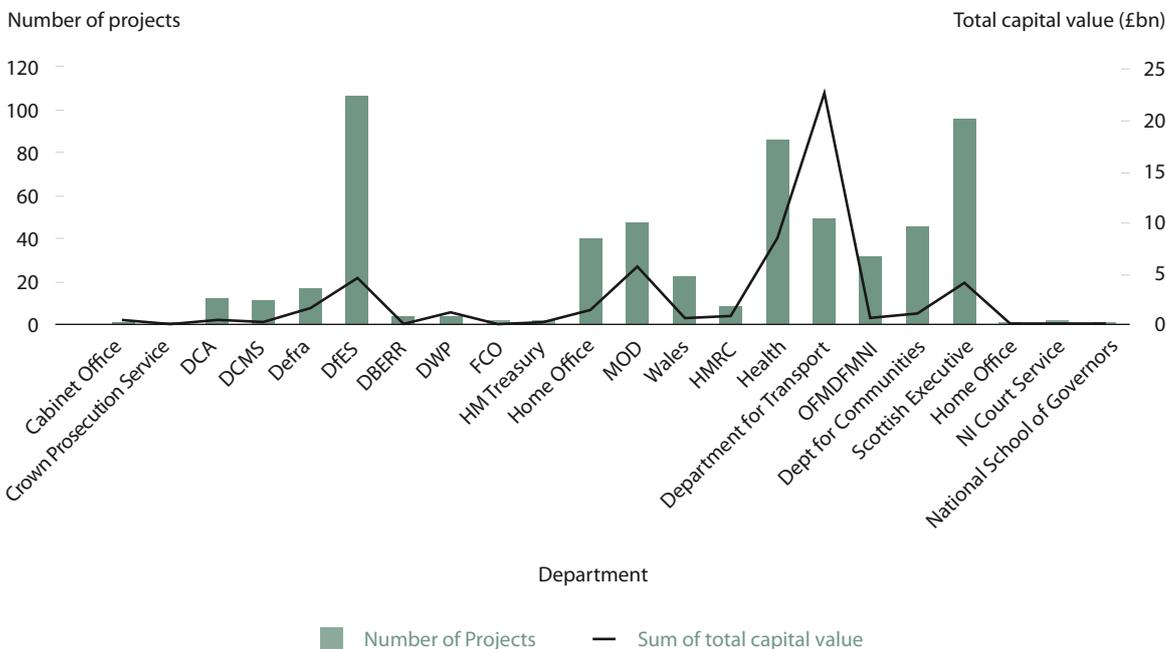
6.19 The Department's operating cost statement expenditure on PFI has shown a steady increase over recent years (**Figure 21 overleaf**). Operating cost expenditure is composed of the charges for the use of assets and services for off balance sheet PFI schemes, and charges for services for on balance sheet PFI schemes. In 2006-07, the Department incurred £1,148 million in PFI charges (5.5 per cent of operating costs), a significant increase over 2000-01 when the Department incurred £458 million in PFI related charges (2.3 per cent of operating costs).

6.20 The commitment to new PFI contracts in recent years has reduced (**Figure 22 on page 41**). The tempo of new contracts reached a peak in 2000-01, with the signature of ten new contracts. In 2006-07 only one new deal was signed. The Department is however pursuing other major deals, including the Future Strategic Tanker Aircraft and the Defence Training Rationalisation programme.

6.21 A new contract was signed in July 2006 for the rebuild, refurbishment, management and operation of facilities for the Permanent Joint Headquarters at Northwood. This project has a capital value of £161.5 million and will run until October 2031.

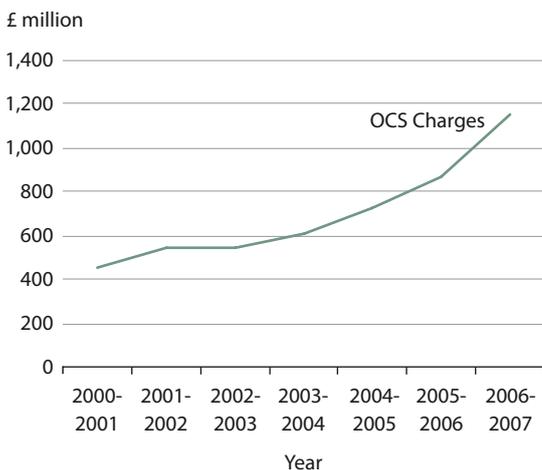
20. The MOD Resource Accounts disclose 51 PFI deals, while the HMT data only includes 47 as it omits smaller projects.

20 Number of PFI projects and total capital value by Government department



Source: HM Treasury Website

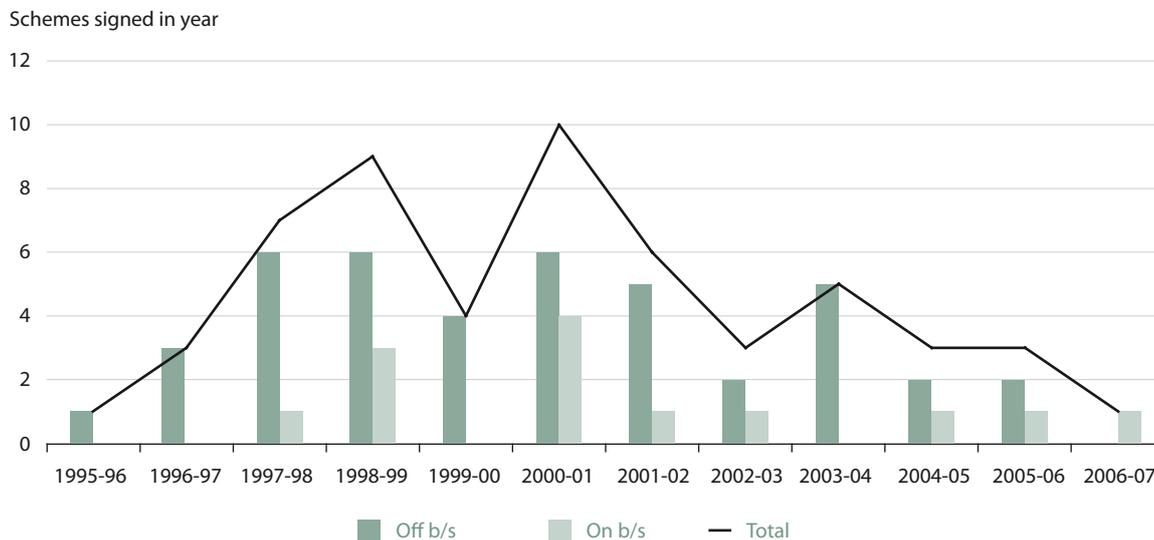
21 The Department's expenditure on PFI 2000-2007



Source: MOD Resource Accounts 2000-01 to 2006-07

6.22 The Northwood contract involves the demolition of the current buildings on site, the building of replacements, and the provision of services and maintenance up until the contract end date. Payments commenced in October 2006 and a total of £9.6 million was charged to the operating cost statement in respect of this scheme in 2006-07. Payment commitments for 2007-08 are £22.6m. Current expenditure is largely in respect of maintenance costs of existing assets, as the new buildings are not forecast to become fully operational until 2011.

22 Commitment to new PFI contracts in recent years has reduced



Source: MOD Resource Accounts

Potential areas of interest to the Committee

6.23 Whether the Department believes it can achieve its efficiency targets by April 2008, and where it will be pursuing future savings following the 2007 Comprehensive Spending Review. By 31 March 2007 over £2 billion of efficiencies had been delivered (target: £2.8 billion), of which 84 per cent were cash releasing (target 75 per cent); a fall in civilian staff numbers of 11,020 (target: 10,000); of military posts by 10,000 (target: 5,000); and the relocation of 1,885 posts out of London and the South East (target: 3,900).

6.24 Whether the recent Comprehensive Spending Review (CSR 2007) settlement for the Department will ease its affordability challenges or whether it will continue to face difficult decisions over priorities. The expenditure limits agreed are: 2008-09 – £34 billion; 2009-10 – £35.3 billion; 2010-2011 – £36.9 billion. This represents an additional £7.7 billion by 2011, equating to 1.5 per cent average annual real growth.

6.25 Whether the roll out of the Joint Personnel Administration system to the Army avoided problems experienced elsewhere, and whether the Department has resolved outstanding control issues. Following the roll out to the Royal Air Force, a number of weaknesses had a temporary impact on the Department's ability to exert full financial control, although this was re-established by the end of the financial year. The Department reported that it continues to work to resolve the outstanding issues.

6.26 How the Department sees itself as maintaining the degree of transparency previously afforded through agencies reporting to Parliament. The Department removed Agency status from eight organisations on 1 April 2007. In response to the previous concerns raised by the Defence Committee, the Department said that it would "consider how best [it] can respond to the Committee's reasonable wish that the amount and quality of [its] public reporting should not be materially reduced as a result of any removals of Agency status and make further proposals."

6.27 Whether the Department believes it can reduce the level of losses and special payments, and what has enabled the closure of more losses this year. The number of closed cases has remained steady over the last three years. The slight increase in 2006-07 is compensated by the equivalent decrease in the advance notifications, as a result of the Department's efforts to close these cases during the year.

6.28 The Department's plans to ensure that all balances are fully supported in future, and whether any further losses are anticipated as a result of ongoing restructuring. A total loss of £86.1 million was recorded in 2006-07 relating to the Simplify and Improve initiative, as a result of writing-off unsupported balances.

6.29 The level of the Department's current financial commitment to PFI. The Department has committed over 5 per cent of its expenditure, some of which is tied up for periods of up to 35 years, in a world of rapidly changing threats and defence requirements.

6.30 To what extent the Department will have further expenditure committed to PFI charges in the future. The number of new commitments to PFI has reduced, but the Department potentially has major deals in the pipeline.

The Department's Internal Capability

Capability Review findings

7.1 In March 2007 the Cabinet Office led an independent "Capability Review of the Ministry of Defence", with a review team drawn from the private sector, board-level members of other Government departments and the wider public sector. The aim was to provide an assessment of the Department's future capabilities in order to identify the specific measures required to enable the Department to cope with the challenges of the future.

Current delivery challenges

7.2 Overall the Review found that the Department has a stretching set of objectives and is delivering well on these in the face of challenging operational commitments. The Review found that the Department:

- a** has made good progress towards its PSA targets since 2004;
- b** is ahead of schedule on its Gershon efficiency savings;
- c** has maintained the pace of change in the face of sustained operational commitments beyond its planning assumptions since 2002;
- d** has successfully delivered on a number of standing commitments, such as providing military assistance in disaster zones like the Pakistan earthquake and Asian tsunami, maintaining the United Kingdom's nuclear deterrent, and developing the Defence Industrial Strategy which set out an ambitious vision of new ways of working with industry.

7.3 However, the Review found that sustained operations have a cumulative impact, diverting attention away from less urgent activities. Examples include the dip in progress towards military peacetime readiness interim targets, slippage in meeting "manning balance" requirements, the breach by the Army and

Royal Air Force of guidelines for the intervals between operational deployments of units and individuals, and delivery of equipment to cost and time.

Future delivery challenges

7.4 The Review identifies flexibility as vital. Balancing the demands of high levels of short-term operational activity and long-term capability development will demand tough prioritisation and resource allocation decisions.

7.5 The importance of the Department understanding its own future people requirements is emphasised. The complexity of the operational environment for both military and civilian staff will increase and the Department will need to attract and retain individuals with a diversity of skills.

7.6 Access to sophisticated equipment is key to future success. The Defence Industrial Strategy provides a framework for this and recognises the need to form partnerships with a range of suppliers and international consortia. The Review found that the Defence Acquisition Change Programme should contribute towards increasing value for money; however, benefits will only be realised if the Department successfully embeds these initiatives into Departmental culture, builds appropriate relationships and conducts relevant horizon scanning and planning.

7.7 Globalisation has had the effect that domestic and foreign policies are increasingly linked. As a consequence, departments must co-ordinate their responses and activities to a greater degree than previously. The Review noted that the Department will have to become more proactive in working towards an integrated and complementary cross-departmental strategy, delivery planning and operations, both overseas and in respect of issues of domestic national security.

Assessment of capability for future delivery

7.8 Figure 23 illustrates the Review’s assessment of the Department’s capability for future delivery.

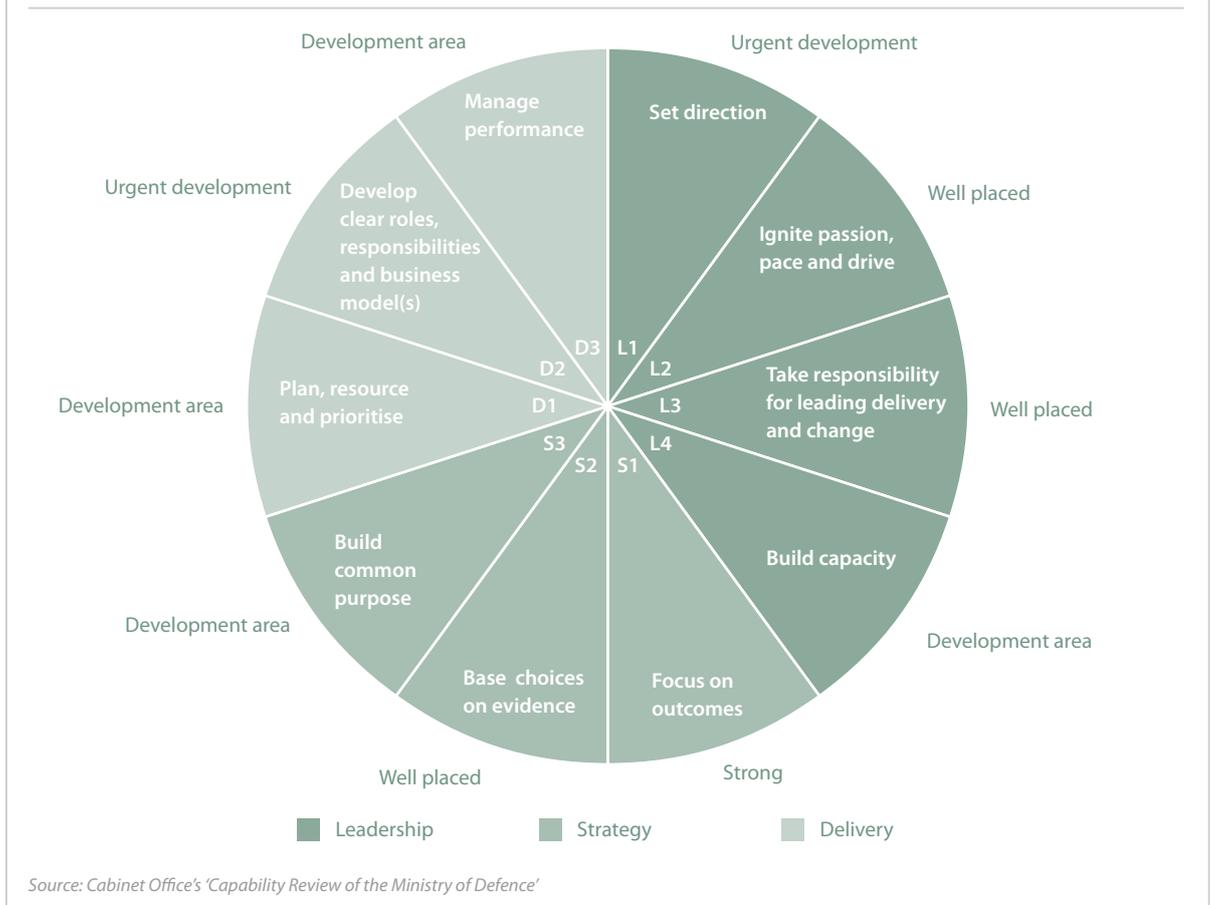
7.9 The Review noted that the Defence Management Board itself had identified its corporate leadership role as an issue which required addressing. The Permanent Secretary had also introduced a project to streamline the Head Office role.

Key issues identified by the Review

Leadership

- The Defence Management Board has not clearly articulated how its overarching vision links to strategy and delivery throughout the organisation, and needs to take a stronger corporate role in directing strategy, and developing and allocating resources.
- Lack of diversity and talent development in staff are recognised as blocks to building adequate and sustainable future capability, and there needs to be more focus on building future people capability and investing effectively in career management.

23 Capability Review’s assessment of the Department’s capability for future delivery



- The Defence Management Board has not consistently presented a unified corporate front rather than acting as a group of representatives of interests within the Department.

Strategy

- The Defence Strategic Guidance, linking policy to plans, is an excellent framework, but does not do enough to link real world developments to long-term aspirations.
- Short-term policy and long-term strategy are not being managed in a way that enables the Department to respond quickly enough to rapid changes in the security environment.
- In non-operational activities there is a lack of shared vision and agendas both within the Department and between it and other Government departments. A wide variety of external stakeholders perceive insularity and reluctance to consult and work with others in the formulation of strategy and policy.

Delivery

- Approvals processes and decision making are often multi-layered and paper-heavy, leading to frustration and preventing effective scrutiny of programmes.
- The Department's reluctance to say "no" puts pressure on a busy department and adversely impacts upon delivery.
- The Department is very focused and successful in delivering its short-term outcomes, but this can impact upon longer term planning.
- Whilst processes and systems are in place to manage performance and inform decision making, there is a lack of clarity around roles, accountability and authority.

Key areas for action

7.10 Three key areas for action were identified that would help the Permanent Under Secretary to achieve the desired Departmental changes.

- **Review leadership behaviours, governance and accountability.** Specific recommendations included: adopt a strategy board, executive board and operations board governance structure; appoint an external facilitator and coach to develop more corporate behaviours at the governance level; make a clear leadership statement; carry out a cull of committees and processes; and create a target Head Office operating model that everyone can work towards.
- **Promote the defence agenda more effectively, address insularity and refresh strategy.** Specific recommendations included: take the initiative in working more effectively with other departments and actively engage with other Departments to improve their understandings of the Department and the context in which its operations take place. In particular, the Department should: market its work; be more open and assertive across Government; establish priority areas for a forward programme with target outcomes with the Department for International Development and Foreign and Commonwealth Office; open its borders to people from other departments; embed working with industry throughout the strategy and procurement systems; and review its strategic processes.
- **Build human capability.** Specifically: support the implementation of a target operating model by properly funded early departure schemes to make staff and cost savings; introduce greater flexibility into reward structures so that pinch points in skills can be addressed; recognise management of people as a valuable skill and use an appraisal approach more akin to the military model than the current civilian approach; and improve succession planning and review practices against contemporary top companies.

Major change programmes

7.11 In addition to the changes the Department is pursuing under the Defence Industrial Strategy and Defence Acquisition Change Programme (see Part 3), the Department has an ambitious programme of reform.

7.12 The wide-ranging change programme is the means by which the Department has sought to manage the challenges of meeting the current high level of operational demands, as well as being capable of meeting the challenges of the future. **Figure 24** shows the component programmes and projects of the Defence Change Programme. The projects can be shaped into four main headings: Departmental infrastructure, people, acquisition, and management and organisation. Most of these components are significant undertakings in their own right – not only large in financial terms, but significant in scope and effect. For example, Defence Logistics Transformation comprises over 1,200 discrete sub-projects; Defence Information Infrastructure will be used by around 300,000 users; and between them the Joint Personnel Administration and the PeopleSoft Application (HRMS) will affect every member of the Department. The majority of these programmes will be completed by 2011.

7.13 In December 2006 an Office of Government Commerce Gateway Review of the Defence Change Programme, which incorporates all of the Departments major non-equipment acquisition change programmes, found it to be an exemplar of good practice within Whitehall. The Review suggested a reappraisal of Defence Change Programme governance and management arrangements to reinforce the focus on portfolio management in view of the complexity and interdependencies associated with such extensive changes.

Civilian personnel

7.14 As part of the 2004 Spending Review, the Department agreed to achieve total annual efficiency gains of at least £2.8 billion by 2007-08. This included reducing civilian staff numbers by at least 10,000, reducing the number of military posts in administration and support roles by at least 5,000 and being on course to have relocated 3,900 posts out of London and the South East by 2010. The Department is on course to achieving its Efficiency Target.

24 The Department's Defence Change Programme



Source: Ministry of Defence

7.15 Reductions in the number of civilian posts were achieved through rationalisation of the Ministry of Defence, including:

- a** The establishment of Defence Equipment and Support, to carry out integrated defence equipment procurement and support. Defence Equipment and Support was formed by merging the activities carried out by the Defence Procurement Agency and the Defence Logistics Organisation.
- b** The collocation and rationalisation of the operational command headquarters and the personnel and training headquarters of the Services. The merger of the Royal Navy's Fleet and Second Sea Lord in April 2006 was followed by the collocation of the Royal Air Force's Strike and Personnel and Training Commands, in October 2006, and their merger to form a single Air Command with its Headquarters at RAF High Wycombe, on 1 April 2007. Project Hyperion is taking forward the re-organisation of the Army's Land and Adjutant General Commands with progressive collocation to a new Land Forces Headquarters planned to be completed by March 2009.
- c** The introduction of the Joint Personnel Administration system which modernised the personnel management and administration of the Armed Forces by harmonising and simplifying a range of personnel policies and processes and by introducing new information systems. Roll-out of Joint Personnel Administration to the Royal Air Force in April 2006 was followed by the Royal Navy in November 2006 and the Army by the end of March 2007.²¹

7.16 With the formal end of Operation BANNER on 31 July 2007, there was no longer a military requirement for the Royal Irish (Home Service) battalions and the civilian staff to support them, and an estimated 1,500 Ministry of Defence civilians in Northern Ireland will be made redundant during the period to 31 December 2008.

7.17 The total number of civilians employed by the Department (including its Trading Funds and Locally Engaged Civilians) fell by 5.6 per cent from 103,930 Full Time Equivalents on 1 April 2006 to 98,050 on 1 April 2007. This represented a reduction of nearly 5,000 staff based in the United Kingdom and some 900 Locally Engaged Civilians elsewhere. The Department continued to make every effort to minimise and, where possible, avoid compulsory redundancies. The majority of the planned reductions are being delivered through resignations, normal retirements and transfers out of the Department (including staff transfers to private contractors on Transfer of Undertaking and Protection of Employment terms), supplemented by recruitment limitations and voluntary early release schemes.

7.18 During the year, the Department continued to take forward the People Programme to implement its 2002 Civilian Personnel Strategy. The Programme aims to develop the skills and behaviours individuals will need in future; develop managers' ability to deliver through teams; and modernising Human Resources to focus on strategic planning and support. During the year, the Department:

- a** launched its Support to Operations programme for civil servants who deploy to military theatres to recruit the best people for these roles, provide improved support, and meet the challenge of maintaining the flow of volunteers;
- b** maintained a considerable focus on skills for acquisition through the development of Skills Growth Plans, a new training programme launched by the Defence Academy in partnership with LogicaCMG and Cranfield University, and a new website-based framework establishing professional doctrine for the acquisition community; and
- c** launched a review of how civilian talent was managed at a corporate level, working closely with the Cabinet Office.

21. Ministry of Defence Annual Report and Accounts 2006-07 p194.

7.19 Recent NAO reports have also highlighted explicit areas where capability gaps exist or where there is a risk that needs to be managed. These include:

- a** A shortage of quantity surveyors, safe skills at work staff and facilities managers (*Managing the Defence Estate: Quality and Sustainability, March 2007*); and
- b** A need for the Department to assess whether it had the relevant commercial, cost-modelling and project management skills to develop commercially viable support solutions and negotiate contracts, given the increasing complexity and likely volume of logistics support (*Transforming Logistics Support for Fast Jets, July 2007*).

Potential areas of interest to the Committee

7.20 The Department's progress in implementing the specific recommendations of the Capability Review. The Department accepted the results of the Review. The Review made specific recommendations under three headings: Review leadership behaviours, governance and accountability; Promote the defence agenda more effectively, address insularity and refresh strategy, and; Build human capability.

7.21 The Department's progress in improving corporate leadership and streamlining the Head Office role. The Department is reviewing this as part of its response to the Capability Review.

7.22 How the Department manages priorities on a complex and interdependent change programme, and whether the tempo of change has any adverse impact on operational delivery. The Department is pursuing an ambitious programme of reform. The Office of Government Commerce recommended a review of the Defence Change Programme's governance and management arrangements.

7.23 How the Department balances civilian staff reductions with building future capacity and skills. During 2006-07 the total number of civilians employed by the Department fell by a further 5.6 per cent. During the year, the Department continued to take forward the People Programme to develop the skills and behaviours individuals will need in future.

Part One: Operational Activity and Military Readiness:

- 1 Ministry of Defence, *Annual Report and Accounts 2006-07*, HC 697, 23 July 2007.
- 2 Report by the Comptroller and Auditor General, *Assessing and Reporting Military Readiness*, HC 72, Session 2005-2006, 15 June 2005.
- 3 Treasury Minutes on the Twenty-Sixth Report from the Committee of Public Accounts, *Assessing and Reporting Military Readiness*, 2005-06, April 2006.
- 4 Committee of Public Accounts, *Assessing and Reporting Military Readiness*, Twenty-Sixth Report on Session 2005-06, HC 667, 30 January 2006.

Part Two: Equipment Acquisition

- 1 *Defence Industrial Strategy*, Defence White Paper, December 2005.
- 2 Ministry of Defence Policy Paper, Paper No 5, *Defence Industrial Policy*, October 2002.
- 4 Select Committee on Public Accounts Twenty-Sixth Report.
- 5 Select Committee on Defence Eleventh Report.

Part Three: The Defence Estate

- 1 Ministry of Defence, *Annual Report and Accounts 2006-07*, HC 697, 23 July 2007.
- 2 National Audit Office, *Managing the Defence Estate*, HC 25, Session 2005-06, 25 May 2005.
- 3 National Audit Office, *Managing the Defence Estate: Quality and Sustainability*, HC154, Session 2006-07, 23 March 2007.
- 4 Evidence to Public Accounts Committee, *Managing the Defence Estate: Quality and Sustainability*, 14 May 2007, to be published as HC 537.
- 5 Evidence to House of Commons Defence Select Committee, *The Work of Defence Estates*, 15 May 2007, to be published as HC 535-I.
- 6 *2007 Stewardship Report on the Defence Estate* available at www.defence-estates.mod.uk (publication date September 2007).
- 7 The Defence Estate Strategy 2006 – In Trust and On Trust.
- 8 Defence Estates *Corporate Plan 2006-2011*.
- 9 Defence Estates *Annual Report and Accounts*, www.defence-estates.mod.uk.
- 10 Defence Estates *Framework Document*, www.defence-estates.mod.uk.
- 11 Ministry of Defence, *Sustainable Development Action Plan – 2/2006*, revised 7/2007.

Part Four: Service Personnel

- 1 DASA-TSP04 Full time trained strengths and requirements, 1 July 2007.
- 2 Ministry of Defence, *Annual Report and Accounts 2006-07*, HC 697, 23 July 2007.
- 3 Report by the Comptroller and Auditor General, *Ministry of Defence: Recruitment and Retention in the Armed Forces*, HC 1633-1, Session 2005-2006.
- 4 *House of Commons Hansard Debates* for 16 July 2007, Part 0002.
- 5 House of Commons Committee of Public Accounts *Recruitment and Retention in the Armed Forces*, Thirty-fourth Report of Session 2006-07.
- 6 *Royal Navy, Army and Royal Air Force Continuous Attitude Surveys*.
- 7 Report by the Comptroller and Auditor General, Ministry of Defence: *Reserve Forces*, HC 964, Session 2005-2006.

Part Five: Finance: Excess Vote on Operational Expenditure (Request for Resources 2)

- 1 Ministry of Defence, *Annual Report and Accounts 2006-07*, HC 697, 23 July 2007.

Part Six: Financial Review

- 1 Ministry of Defence, *Annual Report and Accounts 2000-01 to 2006-07*.
- 2 HM Treasury Website: http://www.hm-treasury.gov.uk/documents/public_private_partnerships/ppp_pfi_stats.cfm.
- 3 <http://www.mod.uk/defenceinternet/defencenews/defencepolicyandbusiness/newcarriersconfirmedindefencebudgetincrease.htm>.

Part Seven: The Department's Internal Capability

- 1 Cabinet Office Capability Review Team, *Capability Review of the Ministry of Defence*, March 2007.
- 2 Ministry of Defence, *Annual Report and Accounts 2006-07*, HC 697, 23 July 2007.
- 3 Report by the Comptroller and Auditor General, Ministry of Defence: *Transforming Logistics Support for Fast Jets*, HC 825, Session 2006-07, 17 July 2007.
- 4 Report by the Comptroller and Auditor General, Ministry of Defence: *Managing the Defence Estate: Quality and Sustainability*: HC 154, Session 2006-07, 23 March 2007.

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