



National Audit Office

Report

by the Comptroller
and Auditor General

Ministry of Defence, Defence Equipment and Support

Reforming defence acquisition

Key facts

£13.9bn

Defence Equipment and Support (DE&S) (part of the Ministry of Defence) spend on buying and supporting military equipment, 2013-14

£1.3bn

DE&S's forecast operating costs in 2013-14 to achieve the Department's plan for buying and supporting military equipment (known as the Equipment Plan)

£33m

cost of the Materiel Strategy, until the government-owned, contractor-operated (GoCo) halted

£162.9 billion

value of the 10-year Plan for buying and supporting military equipment

May 2011

Department launches the Materiel Strategy, a programme to improve DE&S's skills and capabilities

December 2013

Department's preferred organisational structure to meet the Materiel Strategy's aims (the GoCo) is halted; and a decision taken to change DE&S into a bespoke trading entity instead

April 2014

DE&S set up as a bespoke trading entity

April 2017

Department's target date for DE&S becoming the leading defence acquisition organisation

Summary

1 In 2013-14, the Ministry of Defence (the Department) spent £13.9 billion buying and supporting military equipment. Over the next 10 years it plans to spend some £162.9 billion, as set out in its Equipment Plan 2014–2024.

2 Providing military equipment relies on a partnership between:

- the Department's head office, which gives strategic oversight;
- the Armed Forces (the commands), who say what equipment they need; and
- Defence Equipment and Support (DE&S), which buys and maintains military equipment, known as defence acquisition.

3 Defence acquisition is complex and demanding. It requires close partnering with industry and often working with other governments on international collaborative defence projects.

4 In 2013-14 DE&S employed some 16,000 permanent members of staff, an estimated 3,400 contractors, and had running costs of £1.3 billion. DE&S needs specialist skills, such as commercial, financial, engineering, project and programme management and supplier management.

Defence acquisition reform

5 The Department has long wrestled with problems in defence acquisition. By 2010 poor performance led to an 'overheated' equipment programme, where a gap of £38 billion emerged in the defence budget. Building on an independent report commissioned by the Department, DE&S estimated £1.5 billion was lost annually because of three systemic issues:

- to offset cost overruns in the equipment programme, major projects were routinely delayed or reduced in scope as well as impacts across other areas of defence spending;
- the Department struggled to make strategic investment decisions because of blurred roles and accountabilities between head office, the commands and DE&S; and
- poor skills and management freedoms within DE&S to maximise the value of funds allocated to buying equipment and manage projects through their life.

6 The need for change was widely acknowledged and made in a number of Department commissioned reviews, as well as in reports by the House of Commons' Committee of Public Accounts and Defence Committee. There are three strands to the Department's strategy for reforming defence acquisition. The Department has sought to:

- develop an affordable equipment programme, in the form of the Department's ten-year Equipment Plan;
- strengthen the roles and responsibilities of head office, DE&S and the commands, through a new operating model in line with Lord Levene's 2011 review; and
- improve DE&S's skills and capabilities through the Department's Materiel Strategy.

7 To improve acquisition within DE&S, the Department initiated the Materiel Strategy, designed to:

- give DE&S greater management freedoms to introduce private sector practices, skills and tools;
- formalise and introduce rigour in dealings between DE&S, the commands and head office; and
- improve DE&S's efficiency and deliver the Equipment Plan for less.

8 The Department evaluated three organisational structures to meet these objectives:

- **Trading fund**

A public corporation, government-owned and operated, financed from its trading activity.

- **Executive non-departmental public body with a strategic partner (ENDPB/SP)**

A special-purpose body that manages part of the government's work, contracting with the private sector for business support.

- **Government-owned, contractor-operated model (GoCo)**

A company where the government owns the strategic direction and assets, but the GoCo would be operated on a for-profit basis by a private company, accountable to its shareholders.

9 The Department opted for the structural reform that offered the highest evaluated benefits, but carried greater assessed implementation risks, the GoCo. This was actively pursued between 2012 and 2013, and has now been discontinued in favour of establishing DE&S as a bespoke trading entity. The Department chose the bespoke trading entity when terminating the GoCo competition in December 2013. The Department evaluated the bespoke trading entity as a lower-risk option, but with the potential to bring the functional improvements necessary without requiring complex risk transfer to the private sector.

Scope of the report

10 We examined progress in tackling the accepted weaknesses within DE&S, the Department's progress in carrying out organisational change and the challenges that remain within DE&S. The Department has set initial key performance targets for DE&S, but is yet to set out fully how it will measure whether the bespoke trading entity is improving defence acquisition. We have examined progress against the Department's objectives for reforming DE&S, which have remained the same since 2011. They are to improve:

- capabilities and skills of DE&S staff;
- systems and tools available within DE&S; and
- the interface between DE&S and the commands.

Key findings

11 The Department has made progress in stabilising the equipment programme, and in clarifying the roles and responsibilities of head office, DE&S and the commands. There are several positive features in the 2014–24 Equipment Plan, not least the relative stability of forecast project costs of core equipment. A new operating model came into effect in 2014, and the Department continues to embed this approach. Responsibilities and accountabilities for defence acquisition are clearer, with greater separation between those requesting equipment (the commands) and DE&S as deliverer of military equipment (paragraphs 1.6 to 1.11).

12 The Department's preferred option for securing change in DE&S through a government-owned, contractor-operated (GoCo) organisation proved undeliverable. The Department chose the higher-risk option of changing DE&S into a GoCo. It assessed that greater benefits would be secured through the direct involvement of the private sector, with mutual obligations defined by contracts, as well as the capacity to offer enhanced reward packages to attract and retain key skill groups. That proposal proved undeliverable and the Department halted it in late 2013. To the point the GoCo was terminated the Department had spent £33 million and two and a half years developing the Materiel Strategy (paragraphs 1.12 to 1.19).

13 Although the GoCo option was halted, the Department gained a better insight into its business needs within the context of an affordable equipment programme. The Department's experience of dealing with the private sector and its approach to transferring financial risk during the GoCo competition has given DE&S a better understanding of its business needs. For example, DE&S has a better understanding of how staff spend their time and where key skills are needed (paragraph 2.3).

14 The bespoke trading entity structure allows the Department to retain greater control of DE&S, while meeting the objectives of the reform. The Department changed DE&S into a bespoke trading entity in April 2014. DE&S remains in the public sector but has freedoms and flexibilities from civil service pay rules. Departmental and DE&S governance structures have been enhanced, with a new board structure and initial key performance targets for DE&S. The private sector has been engaged to support continued reform in several areas within DE&S. The Department has also set DE&S a target to make savings from operating costs (paragraphs 2.7 to 2.8, 2.14, 2.16 to 2.21).

15 To assess whether the bespoke trading entity is delivering improvements to DE&S's performance, it will be important for the Department to set robust measures of success. Being able to track benefits will be essential both to establish whether the bespoke trading entity is delivering acquisition reform at DE&S, and to allow the Department to take any additional measures to improve performance should it be necessary (paragraphs 2.22 to 2.26).

Conclusion on value for money

16 Success in all three elements in the Department's strategy to reform defence acquisition is necessary to improve long-term value for money. The Department has made progress in improving the affordability of the equipment programme and clarifying roles and responsibilities. Reforming DE&S remains the most challenging of the three, but is essential nonetheless.

17 The failure of the GoCo competition and shelving of that option has cost time and money, but it has yielded some learning. If realised, the Department expected it to have given more rigour through the direct involvement of the private sector, with mutual obligations defined by contracts, as well as the capacity to offer enhanced reward packages to attract and retain key skill groups. Many of these benefits appear achievable through the bespoke trading entity. As the entity remains within the Department, a greater level of sponsorship and continuous rigour in measuring DE&S's progress against clear goals will be required from the Ministry of Defence's leadership, if the entity is to be a successful vehicle for acquisition reform.

Recommendations

18 Our recommendations are designed to help the Department gain assurance that the bespoke trading entity will address systemic weaknesses in defence acquisition:

- a** **The Department needs to show how the bespoke trading entity will address systemic weaknesses in defence acquisition.** The affordability of the Equipment Plan critically relies on improving DE&S's performance to deliver equipment within existing budgets, including more than £6 billion of savings already factored into the Plan. The Department has agreed an overarching plan for DE&S and set out expectations for the organisation. However, it has not yet demonstrated the value-for-money case for the entity. Neither has it defined what becoming the leading defence acquisition organisation will look like. We would expect the Department to set out the value-for-money case once detailed plans are available in summer 2015.
- b** **The Department should set realistic performance measures to ensure that the bespoke trading entity makes genuine improvements in acquisition.** Having defined the characteristics of a leading defence acquisition organisation, the Department must have robust metrics to monitor DE&S's progress towards achieving this goal by 2017. DE&S's corporate plan includes initial high-level performance targets, and more detailed metrics should be set by summer 2015. Head office and the commands will need to be watchful and respond quickly if sufficient improvements do not materialise.
- c** **DE&S should set metrics to ensure managed service providers are offering value for money by measuring their progress in enhancing skills and capabilities.** DE&S is placing great reliance on managed service providers to define and make improvements in projects and programmes, human resources and management information systems. In return, DE&S expects to pay around a quarter of a billion pounds over three and a half years for this business support. DE&S has agreed contracts with the managed service providers whereby part of their fees are, in principle, linked to milestones and a set of metrics. It is essential, therefore, that DE&S establish these metrics and a baseline to track progress in implementing these reforms and transferring skills and capabilities to DE&S staff. This will help it keep on schedule to become the leading defence acquisition organisation by 2017.