



National Audit Office

Report

by the Comptroller
and Auditor General

Ministry of Defence

Impact of the Strategic Defence and Security Review on the Equipment Plan

Summary

1 Between 2010 and 2012 the Ministry of Defence (the Department) focused on closing a £38 billion funding gap in the Defence programme through a programme of cost reductions and efficiency savings. It also delegated more responsibilities to the Armed Forces' Commands, reformed the Department's equipment delivery infrastructure in Head Office and the Defence Equipment and Support organisation as recommended by the Levene review.

2 Since 2012 the Department has also published an annual statement on the affordability of its Equipment Plan (the Plan). The Plan sets out the forecast costs over a 10-year period, for procuring and supporting the equipment that the Armed Forces need to meet the objectives of the National Security Strategy and the Strategic Defence and Security Review (the Review).¹ The NAO audit the Plan each year, reporting on the robustness of the assumptions underlying it. Successive annual iterations of the Plan have indicated overall stability in the costs of the programme, although we have reported that significant risks to future stability remain, including the need to deliver extensive efficiency savings.

3 The government published its latest Review in November 2015. The Review outlined the United Kingdom's defence strategy up to 2025 setting out additional funding for the Equipment Plan to address a number of existing capability gaps within operational requirements and enhancements to current capabilities.

The Equipment Plan and the Strategic Defence and Security Review

The Equipment Plan

4 The Department produces an updated 10-year Plan for spending on equipment each year. Our most recent report covered the Plan for the period 2015–2025.² The total forecast cost for the Plan in this period was £166 billion, which represents around forty-five per cent of the Department's budget.

¹ *National Security Strategy and Strategic Defence and Security Review 2015*, Cm 9161, November 2015.

² Comptroller and Auditor General, *Ministry of Defence: Major Projects Report 2015 and the Equipment Plan 2015 to 2025*, Session 2015-16, HC 488-I, National Audit Office, October 2015.

5 Since the Plan's inception in 2012, it has been composed of three main elements. The majority of the budget is given to the 'core programme' where funds have been allocated to specific projects. The second element is 'headroom', which is unallocated funding, held back to ensure the Department can meet its long-term equipment objectives. The third element is a contingency, which is held to deal with the risk of cost growth in projects.

6 The Committee of Public Accounts (the Committee) has scrutinised the Plan since its inception in 2012, alongside the Department's wider financial management. The Committee's 2015 report on *Strategic financial management of the Ministry of Defence and Military flying training*³ found that significant risks remained to the future stability of the Department's budget, and recommended that the Department remained alert to these risks and pressures on its budget. The Committee's *Major Projects Report 2014 and the Equipment Plan 2014 to 2024 and reforming defence acquisition*⁴ found that the affordability of the Plan depended on achieving ambitious cost savings and exerting tighter cost control on its largest projects than hitherto.

The Strategic Defence and Security Review

7 The Review was a cross-government effort directed and lead by the Cabinet Office in conjunction with the Ministry of Defence, Home Office, Foreign and Commonwealth Office and the security services to identify the key threats to the UK and the capabilities required to address them. It sets out three national security objectives:

- to protect the people of the UK, both at home and abroad;
- to project the UK's global influence; and
- to promote the UK's national prosperity – this is a new strategic objective for the Ministry of Defence.

8 As announced following the Review, the Department plans to spend £178 billion on equipment for the period 2016 to 2026.⁵ Significant equipment investments announced in the Review include the purchase of 9 Boeing P8 maritime patrol aircraft, additional investment in the Queen Elizabeth class aircraft carriers so one is available at all times, and increasing the number of F35 Lightning aircraft available for deployment on the carriers in the early 2020s.

9 The Department has costed the equipment commitments made in the Review as £25.6 billion. The commitments are a combination of measures to sustain or enhance, existing capabilities, as well as procuring new capabilities such as the P8 aircraft. The Department is continuing to refine the project costings and efficiency measures as part of its annual budget cycle. The Department's 2016 Plan will be the first to include the results of the Review and will cover the period 2016 to 2026.

³ HC Committee of Public Accounts: *Strategic financial management of the Ministry of Defence and Military flying training*, Eleventh Report of Session 2015-16, HC 391-392, December 2015.

⁴ HC Committee of Public Accounts: *Major Projects Report 2014 and the Equipment Plan 2014 to 2024, and reforming defence acquisition*, Forty-seventh Report of Session 2014-15, HC 1045, March 2015.

⁵ We have yet to fully audit the 2016-2026 Equipment Plan figures. We plan to publish our next annual report in autumn 2016.

Purpose of this memorandum

10 The purpose of this memorandum is to set out how the new equipment commitments arising from the Review are to be funded, and to highlight risks to affordability that may arise from this funding model, which build upon those already reported on by us and the Committee.

11 This is an early opportunity to assess the long-term impact the Review will have on the Plan's affordability. The Committee has, in successive reports, emphasised the importance of the Department being alert to the risks and pressures on its budget, and reporting regularly and transparently to Parliament about how it is managing them (see Appendix One).

12 The figures in this document are drawn from the calculations underpinning the Review. They may be subject to revision as the Department matures its funding plans for the Review.

Impact of the Review on the Equipment Plan

13 The Review commits the Department to increase spending on the Plan by £12 billion compared with the 2015 Plan. The total Plan for 2015–2025 was £166 billion, made up of a core programme of £153 billion, 'headroom' of £9 billion and a contingency of £4 billion. The total Plan budget for 2016–2026 after the Review commitments are included is £178 billion, with a contingency of £5 billion. The value of the core programme has therefore increased by £20 billion. The Department plans to fund the new commitments announced in the Review from several sources (see Figure 4):

- additional funding of £6.4 billion from the newly created Joint Security Fund;
- £10.8 billion formally allocated to the core programme which was held as 'headroom' in previous Plans;⁶ and
- the balance to come from reinvesting efficiency savings from equipment procurement and support, and from across the wider defence budget.

This funding is based on the assumption that the Department will make a further £5.8 billion of savings from projects it is already committed to, which it has integrated into the core 2016–2026 Plan, as well as pre-existing savings plans.

⁶ This figure differs from the £9 billion of headroom in the 2015 Plan as it uses the headroom built into the rolled forward 2016–2026 Plan, against which commitments within the Review have been compared.

Challenges for the Department in managing the Equipment Plan following the Review

14 The sources of funding that the Department is using to deliver the commitments set out in the Review,⁷ will increase the pressure on it to manage several existing challenges to the affordability of the Equipment Plan:

- **Realising significant efficiencies**

Much of the funding to support the additional capability requirements within the Review will have to come from efficiencies in departmental equipment procurement and support activities. The Department has existing assumed savings within the Plan worth £7.2 billion.⁸ The 2016 Plan requires the Department to achieve a further £8.7 billion of savings, £5.8 billion from within the core equipment programme and £2.8 billion reallocated to equipment from a wider programme of savings from across the Department. As previously recommended by the Committee, the Department needs a clear process for monitoring how it is achieving savings and whether these are through efficiency savings, cutting programmes or moving costs to future years by delaying planned expenditure.

- **Managing cost growth**

The Department will retain £5 billion of contingency reserve (although some of this is ring-fenced for the Nuclear Enterprise).⁹ This is equivalent to the 2015 estimate of the extent to which costs were understated in the pre-Review core programme.¹⁰ We previously noted that there continued to be upward pressure on costs on the existing core programme, for example the increasing costs of supporting new equipment entering service from the core programme.

- **Balancing costs of existing and future requirements**

The Department plans to incorporate £10.8 billion of existing 'headroom' into the core programme. This will considerably reduce the resources available within the Plan to fund new requirements in the future. This is a test for the new delegated model. The Committee has previously recommended that the Department puts in place strong assurance mechanisms to identify and address urgently any risks arising from the model, and report regularly to Parliament on how the new model is working in practice and how it is managing any associated risks.

⁷ *National Security Strategy and Strategic Defence and Security Review 2015*, Cm 9161, November 2015.

⁸ Comptroller and Auditor General, *Ministry of Defence: Major Projects Report 2015 and the Equipment Plan 2015 to 2025*, Session 2015-16, HC 488-I, National Audit Office, October 2015, Figure 11.

⁹ This covers a range of related projects around the Trident Successor and Astute submarine programmes.

¹⁰ Comptroller and Auditor General, *Ministry of Defence: Major Projects Report 2015 and the Equipment Plan 2015 to 2025*, Session 2015-16, HC 488-I, National Audit Office, October 2015, Figure 7.

15 The 2016 to 2026 Equipment Plan will be the first time that the Department has the opportunity to demonstrate how it is going to manage these challenges within an affordable Equipment Plan. We will be carrying out our annual review of the assumptions underlying the Equipment Plan later in 2016 and will use the opportunity to explore these challenges in more depth.

Next steps

16 The Review has had a material impact on the Plan, requiring savings from within the Plan and across the wider department, providing, perhaps, the biggest challenge to the affordability of the Plan since its inception. As the Department goes forward it will be important for it to remain alert to these risks and report regularly to Parliament on how it is assuring itself that:

- departmental cost estimates for new commitments are robust;
- the Department has sufficient controls in place to restrict cost growth, when there is a risk the Plan is understated by around £5 billion, and with £1.3 billion of the contingency ring-fenced for the procurement of the Nuclear Enterprise; and
- the Department can identify and track the efficiency savings required to fund new commitments, including the contributions of the transformed Defence Equipment and Support organisation and the Single Source Regulation Office.