



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

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Report by the Comptroller and Auditor General

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Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

10 June 2016

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.

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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.

Part One

Background

1.1 In 2014-15, the Ministry of Defence (the Department) spent the majority of its £34.4 billion budget in four broad areas:

- equipment procurement and support (approximately 40%);
- military personnel and civilian staff (approximately 31%);
- infrastructure (approximately 13%); and
- inventory (approximately 5%).

1.2 In May 2012 the Department announced that the defence budget was in balance, having identified a funding gap, estimated to be £38 billion, in 2010. It closed this gap largely by reducing the numbers of uniformed and civilian staff and by cancelling some projects, and taking equipment out of service earlier than planned. Alongside this, the Department set up a new approach to prevent its budget from overheating again. For the first time, the Department developed a rolling 10-year budget for a 'core programme' of key equipment projects (both procurement and support). It set aside additional sums as contingency against growth in costs and new requirements. It undertook to make an annual statement on the affordability of the Equipment Plan (the Plan) to Parliament.

1.3 Our 2015 report on strategic financial management in the Department found that it has overhauled its financial management and improved its management structure.¹¹ It ensures greater financial responsibility at the centre and within the Commands, which are now responsible for managing their equipment budgets. However, risks to the future financial stability of the Department remain:

- **Equipment procurement and support**

There remains a risk that the cost of equipment projects may be understated by £5 billion,¹² and that the £7.2 billion of savings built into the Plan before the *National Security Strategy and the Strategic Defence and Security Review* (the Review)¹³ will not be realised.¹⁴

- **Infrastructure**

The defence estate is larger than necessary, under-used, and too expensive to maintain. The Department is able to fund only 50% of the estate infrastructure programme that the Commands believe they require to deliver the Department's strategic objectives.

- **Staff**

The Department estimated that if the current public sector pay assumptions change, workforce inflation may exceed its planning assumptions by £6.5 billion over 10 years.¹⁵

The Equipment Plan

1.4 The Plan sets out the forecast costs for procuring and supporting the equipment that the Armed Forces need to meet the objectives of the Review. The Plan aims to provide greater stability in the Department's procurement activity through developing a budget for:

- a '**core programme**' of key equipment projects where funds have been committed;
- **contingency** to offset cost growth in these projects; and
- '**headroom**' made up of uncommitted funds held by the Department and the Commands to fund new capability requirements later in the period.

1.5 The Plan is updated annually. The Department published its summary of the 2015 Plan in October 2015.¹⁶ At the same time, we reported on the robustness of the assumptions underpinning the Plan to form a judgement of its affordability.¹⁷ The Plan has consistently accounted for more than 40% of the Department's overall budget.

11 Comptroller and Auditor General, *Strategic financial management in the Ministry of Defence*, Session 2015-16, HC 268, National Audit Office, July 2015.

12 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.

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

14 See footnote 12, Figure 11.

15 See footnote 11.

16 Ministry of Defence, *The Defence Equipment Plan 2015*, October 2015.

17 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.

1.6 We will produce our report on the 2016 to 2026 Plan in autumn 2016. The Department has not yet completed its annual budget cycle process and so the figures for 2016 will be subject to some revision.

1.7 Under the Department's new operating model fiscal responsibility for the Plan is delegated to the front-line commands of Air, Land, Navy, and the Joint Forces Command, along with the Strategic Programmes Directorate within Head Office.¹⁸ Responsibility for project delivery remains principally with the Defence Equipment and Support organisation, with delivery of Information Systems and Services the responsibility of the Joint Forces Command.

Our review of the Department's Equipment Plans 2012–2015

1.8 We have reported annually on the affordability of the Plan since its inception in 2012. We have found that the Department has managed to stabilise forecast costs and in-year cost variations since 2012, but there are ongoing risks to affordability:

- sums set aside as contingencies may not be enough to offset the risk of over-optimistic forecasts of project costs (the most recent estimate of the level of possible understatement of project costs is £5 billion);
- the need to make £7.2 billion of savings on existing projects; and
- support costs of major new equipment coming into service have been continuing to escalate, with provision having to be increased 23% over the last two years.¹⁹

¹⁸ The Commands have also been given Senior Responsible Owner (SRO) responsibility for their own major projects.

¹⁹ 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.

Part Two

Changes to equipment announced in the 2015 Review

2.1 Our recent work on the Equipment Plan (the Plan) indicates that the Ministry of Defence (the Department) is in a better starting position than it was at the time of the 2010 Strategic Defence and Security Review (the 2010 Review).²⁰ In 2010 the Department needed to carry out an additional exercise afterwards to ensure resources were available to meet its objectives. This resulted in a significant reduction in Army regular numbers. It is vital, therefore, that sufficient resources are made available to meet the capability commitments in the *National Security Strategy and Strategic Defence and Security Review 2015* (the 2015 Review).²¹ This will prevent the risk of a return to past ways of working, with short-term concerns about affordability impacting on longer-term value for money.

2.2 The 2015 Review came after HM Treasury's announcement in the 2015 Budget that there would be a minimum funding level for equipment based on a 1% increase above forecast inflation until 2020-21, and a commitment to meet the NATO target of spending 2% of GDP on defence for the rest of the decade.²² As well as equipment, the 2015 Review also announced that the number of service personnel will stabilise at around 145,000, having fallen from 178,000 in 2010. There will be small increases in Royal Navy personnel (400) and the Royal Air Force (300). Army numbers will be maintained at 82,000. In addition the Department will cut civilian numbers by 30% to 41,000, on top of the 30% decrease since 2010.

²⁰ *Securing Britain in an Age of Uncertainty: The Strategic Defence and Security Review*, Cm 7948, October 2010.

²¹ *National Security Strategy and Strategic Defence and Security Review 2015*, Cm 9161, November 2015.

²² Forecast inflation is represented by HM Treasury's GDP deflator measure.

Significant equipment announcements in the 2015 Review

2.3 Summarised below are the most significant equipment commitments made in the 2015 Review:

Air Command

- An additional two Typhoon squadrons, increasing the number of squadrons to seven. This will be delivered through enhanced productivity by extending the life of some earlier Typhoon aircraft and maintaining a larger number of pilots. The Review also announced investment in Typhoon's capabilities, including ground attack, a new radar and a 10-year life extension.
- An increase in the number of F35 Lightning aircraft available for deployment from the new Queen Elizabeth class aircraft carriers in the early 2020s, from 15 to 24.
- Nine new Boeing P-8 Poseidon aircraft will be purchased to fill a capability gap left by the decommissioning of Nimrod MRA4 maritime patrol aircraft in the 2010 Review.
- More than 20 new Protector armed remotely piloted aircraft will be procured – more than double the number of the Reaper aircraft that they replace.
- The Royal Air Force's Intelligence Surveillance and Reconnaissance platforms – Rivet Joint, Sentinel, Shadow and E-3D Sentry – will be equipped with enhanced capabilities, additional crews and be extended in service from 2018 to beyond 2020.

Joint Forces Command

- The Special Forces equipment budget will receive an additional £2 billion.
- Sustained investment in satellite communications and new cyber and space capabilities.

Land Command (Army)

- Two new strike brigades of up to 5,000 personnel will be established, based on the Ajax (previously Scout) armoured vehicle.
- The Apache attack and Chinook support helicopters will be upgraded.
- Warrior armoured fighting vehicles will be upgraded, and the life of the Challenger 2 tanks extended.

Navy Command

- The Review confirms that the two new Queen Elizabeth class aircraft carriers will enter service from 2018. One of these will be enhanced to support an amphibious capability.
- Three new logistics ships will be procured to support the fleet, in addition to two further Offshore Patrol Vessels.
- The review also announced the Department would build eight of the new Type 26 Global Combat Ships (which are replacing the current Type 23 frigates), rather than the 13 originally planned, and instead develop and build a new class of lighter general purpose frigate. The cost implications of this change are still being considered by the Department.

Strategic Programmes

- The government reiterated its commitment to maintain the UK's Continuous At Sea Nuclear Deterrent. The four current Vanguard submarines will be replaced under the Successor programme. Although not part of the enhancement package, the Review estimated the manufacturing cost of the four Successor submarines to be £31 billion (including inflation over the lifetime of the programme), and set a contingency of £10 billion. The updated estimate reflects an improved understanding of the costs and timescales which the MoD believes it has gained from the design phase. There will be a further investment of just over £600 million in the assessment phase, taking the total cost of the phase to £3.9 billion.
- The in-service Vanguard class submarines, which the Successor class will replace, require revised maintenance schedules to keep them in service to around the 40-year point, which will be managed within existing budgets.

Forecast costs of the additional commitments announced in the 2015 Review

2.4 **Figure 1** shows how the commitments are currently split between the Armed Forces' Commands. The Department is still refining the costings of the commitments in the Review and so these figures are likely to be revised as they progress this work.

2.5 Not all of the funding streams for major projects in the Plan have been affected by the Review. The Department is continuing its work to balance funding with need, and we expect to be able to report on its progress in our 2016 Equipment Plan report. Our current understanding of how the Department intends to fund this investment in equipment is set out in the next section.

Figure 1

Funding commitments arising from the Strategic Defence and Security Review, split by Command

Front-line Command	Funding (£bn)	Proportion of total commitment (%)
Air	6.2	24
Joint Forces	10.6	41
Land	4.4	17
Navy	2.6	10
Strategic Programmes	1.8	7
Investment package total	25.6	

Notes

- 1 These figures are estimates based on the current position and are subject to change as the Department refines the detailed packages of the Plan and continues programming and allocation into the Commands.
- 2 Figures may not reconcile exactly because of rounding differences.

Source: National Audit Office analysis of Ministry of Defence data

Part Three

Funding the additional commitments announced in the Strategic Defence and Security Review

The 2016 Equipment Plan following the Review

3.1 The announcements in the *National Security Strategy and Strategic Defence and Security Review 2015* (the Review)²³ mean that the 2016 Equipment Plan (the Plan's) budget will now be £178 billion. The spending commitments for equipment in the Review total £25.6 billion as shown in Figure 1. The reason why the Plan total hasn't increased by the same amount is that these commitments are being funded to a large degree from inside the Plan, from savings and reallocating 'headroom' (see paragraph 3.5). The 'external' funds are from additional investment from the Joint Security Fund and allocating some of the savings being made in the wider department to equipment within the Plan.

3.2 **Figure 2** shows that, within this, the core programme has increased by around £20 billion. **Figure 3** on page 18 shows the 2015 Plan prior to these new commitments.

Where the new investment will come from

3.3 To ensure the £25.6 billion of commitments in the Review are fully funded the Ministry of Defence (the Department) is using: additional funding from the Joint Security Fund (£6.4 billion), funds reallocated from 'headroom' into the core programme (£10.8 billion), and savings, both from within the plan (£5.8 billion) and the wider department (£2.8 billion).

The Joint Security Fund

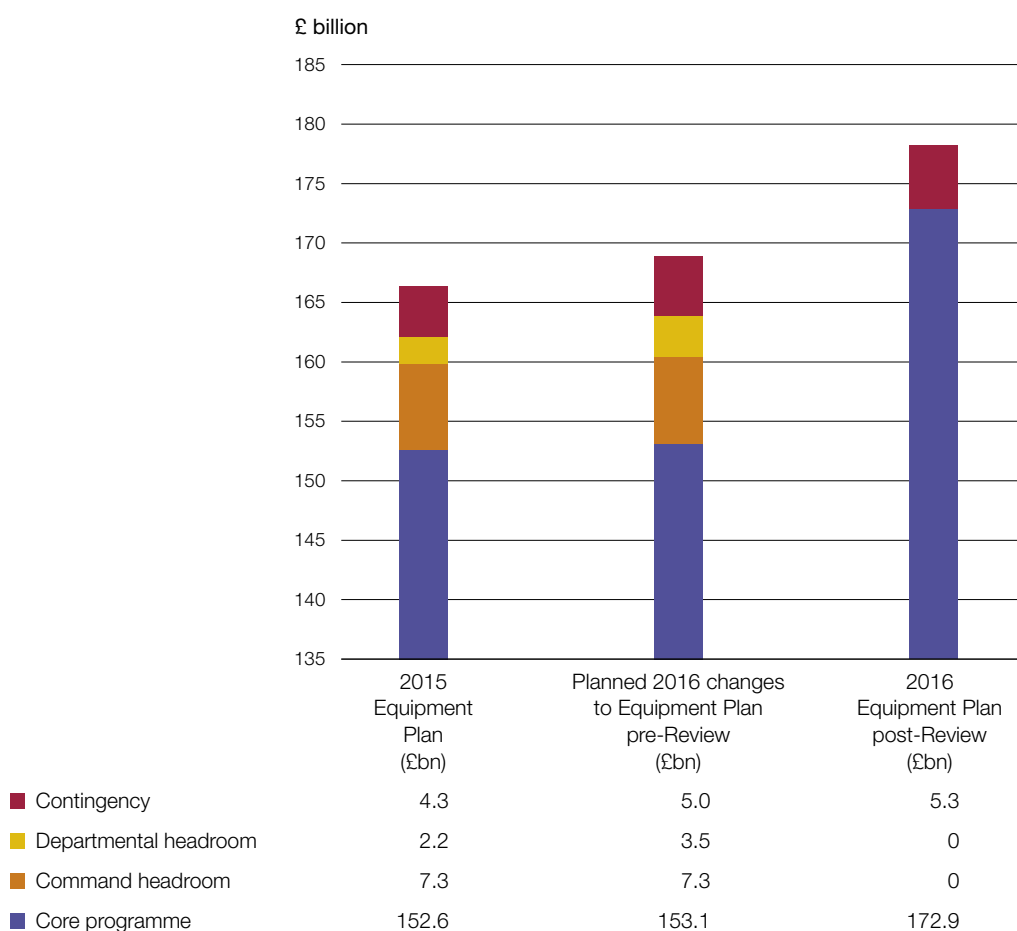
3.4 The Equipment Plan will be allocated £6.4 billion from the newly created Joint Security Fund, this is in addition to the funding announced in the July 2015 Budget which secured a 0.5% rise in the defence budget above inflation each year. The fund was announced in the Review and provides additional funding to the Department and the security and intelligence agencies. The agencies and the Department bid for funding from the fund, and it is allocated to specific projects. The size of the fund after the 2015–2020 Parliament will not be known until the next Spending Review, therefore the contribution of the fund towards the Plan will be subject to change, particularly in the latter years of the Plan.

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

Figure 2

Comparison of the 2015 and 2016 pre- and post-Review Equipment Plans

How the composition of the Plan changed between 2015 and 2016

**Notes**

- 1 The middle column was calculated by 'rolling forward' the Plan by a year, using the 'year 11' figure produced in the 2015 Equipment Plan. Before the Review the Department had already planned to increase the level of contingency and headroom. It is this headroom value which was reallocated to the core programme following the Review (see Figure 4).
- 2 £1.3 billion of contingency ring-fenced for the Nuclear Enterprise.
- 3 Figures may not reconcile exactly because of rounding differences.

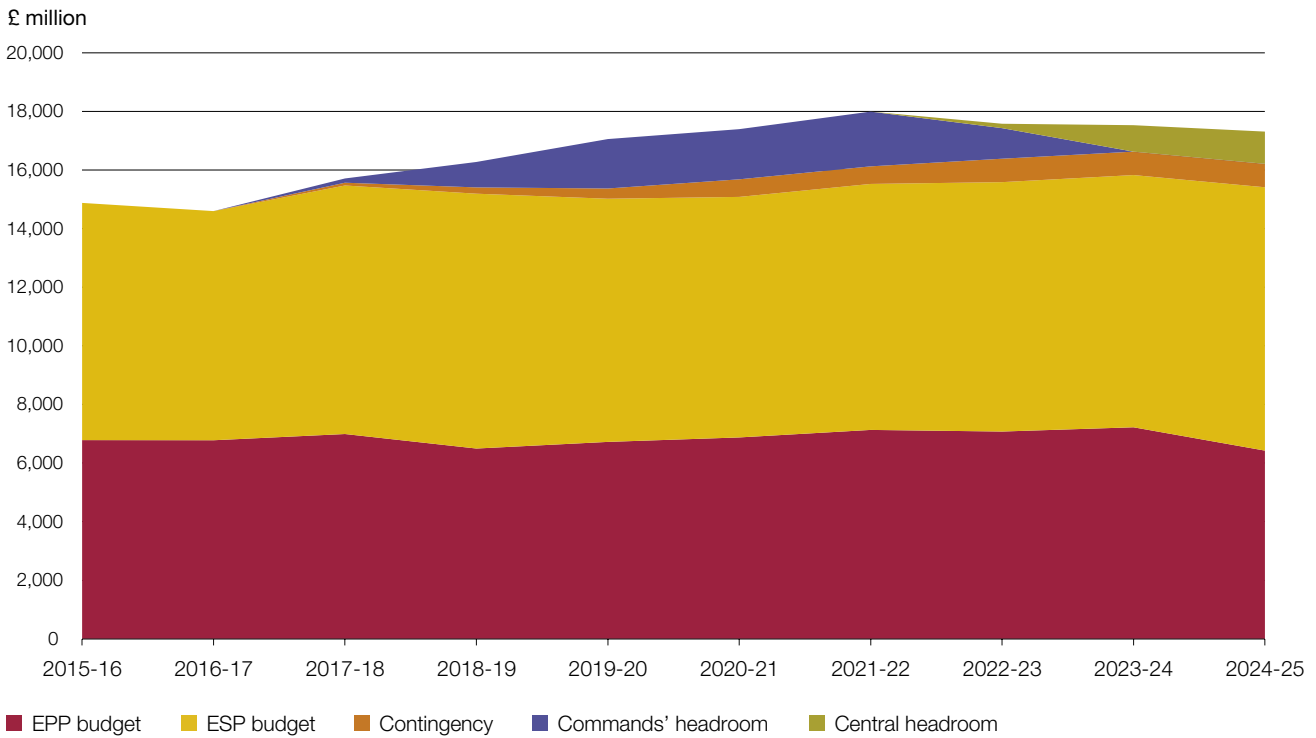
Source: Ministry of Defence

Reallocation of 'headroom'

3.5 As a result of the Review the Department has now committed to specific high priority projects funding (known as 'headroom') that it was previously holding back for future capability improvements. Three quarters of this 'headroom' was previously notionally allocated to specific projects by Commands. In some cases the Department has now formally committed the money to those projects; in others the money has been committed to projects now deemed higher priority.

Figure 3
Breakdown of planned spending on equipment, 2015 to 2025

Procurement and support budgets are supplemented by contingency and headroom



£m	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2015 Plan Total	2014 Plan Total
EPP budget	6,784	6,779	6,992	6,497	6,723	6,876	7,132	7,077	7,222	6,426	68,506	68,854
ESP budget	8,096	7,821	8,483	8,698	8,299	8,209	8,396	8,512	8,608	8,988	84,110	80,576
Contingency	0	0	95	215	350	600	600	800	800	800	4,260	4,600
Command headroom	0	0	145	868	1,686	1,712	1,869	1,043	0	0	7,324	8,003
Central departmental headroom	0	0	0	0	0	0	0	150	902	1,100	2,152	1,152
Central over-programming												(300)
Total	14,880	14,600	15,714	16,277	17,059	17,397	17,996	17,582	17,532	17,314	166,352	162,885

Notes

- 1 Annual breakdown of costs is not yet available as this is part of the Department's ongoing work and will be examined as part of the NAO review of the 2016 to 2026 Equipment Plan.
- 2 EPP = Equipment Procurement Plan; ESP = Equipment Support Plan.
- 3 Figures may not reconcile exactly because of rounding differences.

Source: Ministry of Defence

3.6 Reallocation of funding designated as ‘headroom’ to projects in the core programme means that the proportion of the plan not committed to the core programme has fallen from 8.3% in 2015 to 2.8% in 2016, over the 10-year period of the Plan. This will leave the Department with much less room to accommodate any new capability requirements. The Department told us that, as it further refines its costings during 2016, it may reintroduce some ‘headroom’ into the Plan. Figure 3 shows the breakdown of planned spending on equipment between 2015 and 2025, which is the last period for which we have detailed spending figures. We will update these in our 2016 Equipment Plan annual report, and this will show the significant shift between the ‘headroom’ and the core programme.

Efficiency savings

3.7 Successive Plans have had ambitious savings built in to funding assumptions from the beginning; these assumptions must be met to ensure the affordability of the plan. We report on the progress of these savings as part of our annual review of the Plan. The Department programmed £7.2 billion of efficiency savings into the 2014 Plan. Our 2015 Plan report found that £3.5 billion (approximately half) of those savings had been achieved.²⁴ The Department is confident it is on track to deliver the remaining £3.7 billion.

3.8 In addition to those savings already assumed, to fund the commitments set out in the Review, the Department needs to realise a further £5.8 billion of savings within the core programme. These have been assumed within the £153 billion core programme total for the 2016–2026 Plan (**Figure 4** overleaf), the baseline from which the Department has calculated the funding of the Review commitments. These additional savings are to come from two main areas:

- £3.4 billion is to come from transformational improvements delivered by private sector support within the Defence Equipment and Support organisation. In our 2015 report on Defence Equipment and Support’s transformation activities, we pointed out the lack of a system to measure such benefits.²⁵
- £1.7 billion of savings are expected to come from the regulatory activities of the Single Source Regulation Office (the Office). The Department expects the Office to identify savings through its oversight of non-competitive contracts, but the Office was not involved in calculating this estimate. In its first annual compliance report²⁶ the Office noted that the Department and contractors still had some way to go in their understanding of the system and as a consequence they had been involved in relatively few contracts, yielding less than £30 million of confirmed and potential savings.

24 As reported in Figure 11 of 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.

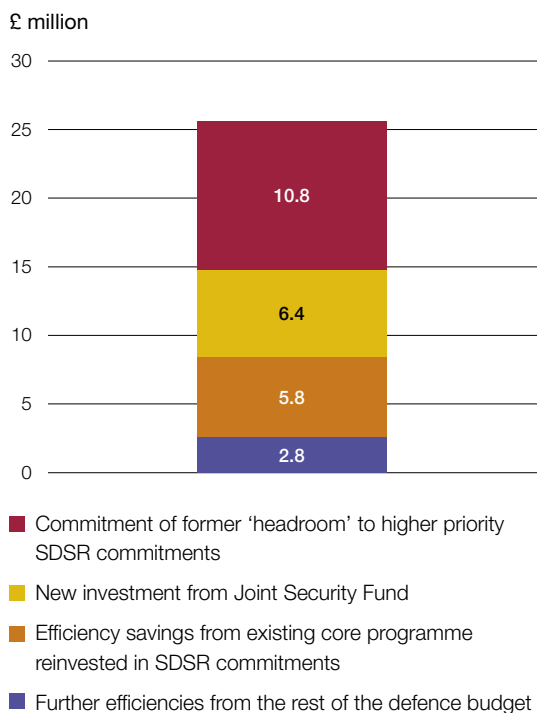
25 Comptroller and Auditor General, *Reforming defence acquisition*, Session 2014-15, HC 946, National Audit Office, February 2015.

26 Single Source Regulations Office, *Annual Compliance Report 2015*, January 2016.

Figure 4

Sources of investment for additional Strategic Defence and Security Review commitments in 2016 Equipment Plan

Funding comes from reallocation of existing funds, new money and efficiency savings



Note

1 Figures may not reconcile exactly because of rounding differences.

Source: Ministry of Defence

3.9 As well as savings within the Plan itself, the Department is reallocating savings made from elsewhere in the Department to equipment. Overall the Department expects to make some £9 billion savings from the wider department, of which around £2.8 billion is expected to fund commitments as set out in the Review. To date, the Department has announced how some of the overall savings will be achieved:

- £2 billion will come from pay restraint in the Department (the 1% cap on public sector pay announced in the July 2015 Budget);²⁷ and
- the Department will reduce civilian manpower by 30%.

27 This is over 5 years – 2016 to 2021, rather than the full 10-year period covering the Equipment Plan.

Implications of additional commitments to the Equipment Plan for the wider Department

3.10 The savings set out above could exacerbate existing problems for the wider department:

- **Civilian manpower reductions**

Numbers have reduced from just under 86,000 in 2010 to 58,000 in 2015. A further 30% reduction as announced in the Review would see numbers reduced to 41,000. These reductions will likely be more challenging to find than previous reductions, and could impact on the deliverability of projects and programmes.

- **Defence infrastructure**

The Department plans to raise £1 billion of capital receipts over the current Parliament which will be reinvested by the Defence Infrastructure Organisation, which operates the Defence Estate. The Department recognises that demand for infrastructure investment by the Commands is not matched by available resources, creating a potential gap of up to £8.5 billion in the estate maintenance and change budget in the years 2015–2025.²⁸ We will be reporting on the Department's management of its estate at a later date.

- **Pay restraint**

The 1% annual pay cap, which applies to uniformed services as well as civilians, mixed with an improving labour market, will present additional challenges to the Department's plans to achieve its recruitment targets, which have already proved problematic.²⁹

- **Project scale**

The Department manages a small number of very large procurement projects. Relatively small time or cost overruns in these projects can have a significant effect on the Plan's affordability. Our 2015 Equipment Plan report showed that the Defence Equipment and Support organisation had rated two of the largest equipment projects, the Astute Submarine and Type 26 warship, as high risk. The report also found that four projects accounted for 75% of the total underestimate on equipment procurement projects. The Review reported that the forecast cost of procuring the Trident successor submarines had risen from £25 billion to £31 billion (including inflation over the life of the programme), plus a £10 billion contingency.

- **Support costs**

We have reported that, while the Department has a better understanding of equipment procurement costs within the Plan, the costs of supporting this equipment, which represent just over 50% of the 2015 Plan, are not as well understood.³⁰

28 Comptroller and Auditor General, *Strategic financial management in the Ministry of Defence*, Session 2015-16, HC 268, National Audit Office, July 2015.

29 Comptroller and Auditor General, *Army 2020*, Session 2014-15, HC 263, National Audit Office, June 2014.

30 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.

Appendix One

Committee of Public Accounts Defence report recommendations

Theme	<i>Major Projects Report 2014 and the Equipment Plan 2014 to 2024, and reforming defence acquisition¹</i>	<i>Strategic financial management of the Ministry of Defence and Military flying training²</i>
Realising significant efficiencies	The Department should report annually in its Major Projects Report on its progress delivering the savings it requires to maintain an affordable Equipment Plan.	<p>[The Department] should put in place a clear process for monitoring how it is achieving savings and whether these are through efficiency measures, cutting programmes or moving costs to future years by delaying planned expenditure. Where it achieves savings by moving costs to future years the Department should ensure it does so only following a thorough assessment of the risks to operational capability and the potential for increased costs overall.</p> <p>The Department should, as a matter of urgency, produce a coherent plan setting out how it will transform the estate to address the forecast gap in funding.</p>
Managing cost growth		<p>The Department should be alert to the risks and pressures on its budget and report regularly and transparently to Parliament about how it is managing them.</p> <p>The Department should put in place strong assurance mechanisms to identify and address urgently any risks arising from its new delegated model, such as poor project management by the Armed Forces. It should also report regularly to Parliament on how the new model is working in practice and how it is managing any associated risks.</p>
Balancing costs of existing and future requirements	<p>Whatever the Department's funding position, it is important that it consolidates the current improvements in affordability and maintains focus on a balanced budget.</p> <p>The Department should continue to seek improvements in the consistency of its approach to forecasting costs, and clarify the appropriate treatment of VAT and inflation, to give it greater certainty that its Equipment Plan remains affordable.</p>	

Notes

- 1 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.
- 2 HC Committee of Public Accounts: *Strategic financial management of the Ministry of Defence; Military flying-training*, Eleventh Report of Session 2015-16, HC 391-392, December 2015.

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