



National Audit Office




REPORT

# The Equipment Plan 2022 to 2032

Ministry of Defence

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# The Equipment Plan 2022 to 2032

**Ministry of Defence**

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## **Report by the Comptroller and Auditor General**

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This report has been prepared under Section 6 of the  
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of Commons in accordance with Section 9 of the Act

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**Gareth Davies**  
**Comptroller and Auditor General**  
**National Audit Office**

**23 November 2022**

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## Key facts

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**£242.3bn**

the Ministry of Defence's (the Department's) equipment procurement and support budget for the period 2022–2032

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**£2.6bn**

the Department's assessment of the Equipment Plan's (the Plan's) surplus of budget over forecast costs (equivalent to 1% of the equipment budget) – based on financial data at 31 March 2022

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**Work in progress**

the Department is working to quantify the impact of inflation on the affordability of its Plan

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**The Department considers a range of factors that affect the Plan's affordability, estimating best-case and worst-case scenarios:**

**£7.3 billion** the Department's estimated budget **deficit** for 2022–2032 if all identified risks materialise

**£7.0 billion** the Department's estimated budget **surplus** for 2022–2032 if all opportunities materialise

**The Department retains central contingency:**

**£4.3 billion** centrally-held contingency for equipment projects – equivalent to 2% of the Plan's budget – to help fund new capabilities and absorb any unexpected cost increases

**The Plan is based on assumptions that all savings will be delivered and new savings will be found:**

**£30.4 billion** adjustments the Department has made to gross project costs, to produce its estimate of the Plan's forecast costs. These reflect planned savings and its ability to deliver equipment projects

**£3.4 billion** low-confidence efficiency savings, where delivery plans are still in development, but that the Department will need to find on equipment projects between 2022–2032

**£1.6 billion** additional cost reductions on equipment projects that the Department will need to find, but does not yet have credible plans to achieve

# Summary

**1** The Ministry of Defence (the Department) publishes its Equipment Plan (the Plan) report each year, setting out its spending plans on equipment procurement and support projects over the next 10 years.<sup>1</sup> The Department introduced the Equipment Plan in 2012. Its aim was – and remains – to produce a reliable assessment of the affordability of its equipment programme. By doing so, it seeks to demonstrate to Parliament how it intends to manage its equipment funding. Each year the National Audit Office has published a report examining the Department’s assessment of the Plan’s affordability and its response to the financial challenges it faces.<sup>2</sup>

**2** The latest Plan covers the period from 2022 to 2032. The Department has allocated a budget of £242.3 billion to equipment procurement and support projects, 46% of its entire forecast budget. This includes the projects it has chosen to fund in response to the 2021 Integrated Review of security, defence, development and foreign policy.<sup>3</sup> In total, the Plan includes forecast costs of some 1,800 equipment projects. This includes equipment in early-stage development, equipment that is already in use and budgets to support and maintain military capabilities.

**3** The Department must manage expenditure effectively to ensure the Armed Forces get the equipment they need to meet their military objectives. It makes choices about the funding available for equipment projects and assesses which capabilities it should fund. The latest Plan is based on financial data at 31 March 2022. The Plan does not therefore reflect the current pressures and uncertainty facing the Department, most notably the Ukraine conflict and external economic environment, which will affect future spending plans. However, it is working to understand and manage these pressures alongside delivering its equipment programme within current budgetary limits.

## Our report

**4** This report therefore examines:

- the Department’s assessment of affordability in its 2022–2032 Plan (Part One); and
- how the Department has reflected and is managing the risks to the affordability of its equipment programme (Part Two).

<sup>1</sup> The Plan summarises the Department’s investment programme over a 10-year period because of the long-term nature of large, complex defence projects.

<sup>2</sup> In 2012 the Secretary of State for Defence invited the Comptroller and Auditor General to examine the robustness of the Equipment Plan’s underlying assumptions. We have provided assurance each year since.

<sup>3</sup> HM Government, *Global Britain in a competitive age: The Integrated Review of Security, Defence, Development and Foreign Policy*, CP 403, March 2021; Ministry of Defence, *Defence in a competitive age*, CP 411, March 2021.

**5** We do not consider in this report the value for money of the Department's equipment expenditure or the specific projects mentioned. Nor do we comment on the policy choices that the Department makes to develop an affordable Plan which meets its future needs. Our review examines the Department's approach to producing the Plan. We focus on its approach to cost forecasting and the reasonableness of the assumptions underpinning its assessment of affordability. We also examine its quality assurance arrangements for testing the consistency and reliability of data in the Plan. Our methodology is shown in Appendix One.

## **Key findings**

**6 The Department has assessed that its 2022–2032 Plan is affordable but recognises that cost pressures are growing.** It has assessed that its 10-year equipment budget of £242.3 billion exceeds forecast costs by £2.6 billion (1% of budget). The estimated surplus has fallen from £4.3 billion (2%) in last year's Plan. The Department has strengthened its appraisal of forecast costs and established a more reliable basis to compare affordability with previous years. The Department acknowledges that it faces other cost pressures. These include needing to smooth the 10-year profile of equipment expenditure; funding large programmes such as the nuclear enterprise and future combat air system; and its response to Ukraine and inflationary cost pressures. It intends to reflect its consideration of these pressures in the next financial planning round (paragraphs 1.5, 1.6, 2.12, 2.15, 2.18 and Figure 14).

**7 The Department believes it can manage the affordability pressures on the Plan, but our assessment shows this will be challenging.** It has assessed that the Plan has a deficit of £2.6 billion across the first seven years (2022-23 to 2028-29) and a surplus of £5.2 billion in the final three years. The Department believes that this level of overprogramming across the first seven years is a manageable approach because it expects that some projects will be delivered more slowly than planned. It also holds contingency of £4.3 billion for equipment projects that it can draw upon to help fund new capabilities or address unexpected cost pressures. However, our assessment shows that the Department faces significant pressures to keep the Plan affordable, which affect its ability to deliver equipment projects as planned, including:

- the Department assumes that it will achieve its full efficiency savings of £13.5 billion over 10 years, a similar figure to last year. However, the Top Level Budgets (TLBs)<sup>4</sup> are still developing plans to deliver £3.4 billion (25%) of these efficiencies. This is an increase of £0.5 billion on last year. They will also need to find additional efficiency savings of £1.9 billion over the next 10 years but do not yet know how to achieve these.<sup>5</sup> The Department has not assessed whether the Plan's efficiency savings, which are based largely on renegotiating commercial contracts, remain realistic in the current economic climate (paragraphs 1.24 to 1.27);

<sup>4</sup> The Top Level Budgets are the Front Line Commands (Navy, Army, Air and Strategic Command), the Defence Nuclear Organisation (DNO) and the Strategic Programmes Directorate. They are responsible for delivering their agreed defence outcomes within delegated budgets.

<sup>5</sup> Head Office has devolved responsibility for achieving Defence Transformation savings to TLBs and reduced their budgets over 10 years on the expectation they would achieve these efficiencies.



- TLBs need to find further cost reductions of £3.7 billion over 10 years. These include choices between project options or reductions in project requirements. This has reduced from £7 billion last year, largely because the Department removed £2.8 billion of funding shown as ‘cost reductions’ in last year’s Plan. The Department made these reductions following disinvestment decisions in the Spending Review and Integrated Review. However, TLBs do not yet have credible plans to achieve £1.6 billion of the required reductions, with Navy and Air commands facing the greatest pressures (paragraphs 1.22 and 1.23);
- project costs could increase. An independent assessment of a sample of projects indicated that costs on those projects could be £5.2 billion higher than stated in the Plan, although there is separate contingency for the Dreadnought programme which accounts for £1.6 billion of this potential increase.<sup>6</sup> The Department is facing increasing risks in delivering equipment projects to budget and schedule, including constraints relating to the capacity of contractors and available skills (paragraphs 2.4 and 2.7);
- not all of the Department’s general contingency funding will be available for equipment projects. For example, in 2021-22, the Department allocated £5.3 billion (36%) of its total contingency to live within its budget, £1.4 billion of which addressed cost pressures relating to its workforce and estate. It will continue to face wider cost pressures – its overall budget from 2022-23 to 2031-32 shows a deficit of £4.3 billion – which could affect the funding available for equipment projects (paragraphs 2.8 and 2.11); and
- the Department’s assessment shows the largest deficits in the middle years of the Plan. However, it also faces significant cost pressures in the next three years as TLBs do not yet have plans to achieve savings of £2.1 billion and it has contingency of just £0.5 billion over this period (paragraphs 1.12, 1.23 and 1.25).

The Department considers a range of factors that affect the Plan’s affordability and estimates a deficit of £7.3 billion if all identified risks materialise.<sup>7</sup> However, in our view, this assessment does not fully reflect the uncertainty it faces and should be based on a more detailed assessment of the risks (paragraphs 2.2 and 2.3).

6 The Department’s Cost Assurance and Analysis Service (CAAS) provides independent assurance on cost forecasts on a sample of projects. It examined 61 projects this year, which account for around 53% of the Plan’s cost.

7 The Department’s assessment of the factors that affect the Plan’s affordability includes the CAAS assessment of project costs, movements on foreign currency and sensitivity analysis on some key assumptions.

**8 The Department has a good understanding of operational capability risks and continually reassesses which equipment projects to fund.** The 2021 Integrated Review set out the government's revised assessment of security risks and the capabilities that the Armed Forces need. However, the Department cannot afford to develop all these capabilities, and part-funded or unfunded projects are not fully included in the Plan. It is also seeking to develop new military capabilities, setting aside £6.6 billion for research and development from 2021-22 to 2024-25, and £4.4 billion from 2025-26 to exploit this investment. The TLBs make prioritisation decisions about which projects to include in the Plan, agreeing these judgements with Head Office. These assessments are based on the military capabilities needed to counter threats and meet the TLBs' defence objectives, while remaining within budgetary limits. However, given the pressures on delivering the existing Plan within budget, the cost of introducing new equipment projects is likely to exceed the level of contingency funding. If so, the Department will need to replace existing projects, reduce their scope, or accept later delivery of the capability (paragraphs 1.12 to 1.17).

**9 The Department has not reflected the impact of growing external cost pressures, such as inflation and the Ukraine conflict, on the Plan's affordability.** Rising inflation, higher utility costs and adverse exchange rate movements will affect the Plan's affordability. The Department seeks to manage these risks using a range of measures, such as forward purchasing foreign currency and using firm-price contracts. However, it has not reflected inflationary cost pressures in the Plan's affordability as its assessment is based on financial data at 31 March 2022 and it did not fully understand the impacts at that point. The Department acknowledged in its own report that project costs could be up to £2.1 billion higher, referencing the inflation forecast published by the Office of Budgetary Responsibility in March 2022, but it did not reflect these pressures in its assessment. Further, forecast inflation has increased since March 2022 and the impact on defence projects may be higher than the headline inflation rate. The rapidly changing economic environment means that the affordability position reported by the Department is out of date, despite it publishing the Plan earlier than in previous years. The Department is quantifying the scale of inflationary cost pressure and will reflect this – and the level of uncertainty surrounding it – in the next financial planning round. It is also assessing the implications of the Ukraine conflict, considering the capabilities, stockpiles and level of resilience needed to respond to changing threats (paragraphs 2.12 to 2.14, Figure 14).

**10 The Department's financial planning and reporting process is not responsive to a more volatile external environment.** The Department monitored expenditure closely during 2021-22 to remain within its annual budgetary limit, avoiding the need for central in-year savings measures on its equipment programme. It also exploited opportunities to bring forward expenditure on some equipment projects. However, our assessment of the supporting processes that underpin production of the Plan has raised questions over the extent to which they enable the Department to respond to the growing external pressures it faces:

- The Department's annual financial planning cycle is well-established and understood but has not enabled it to report a timely or full assessment of external cost pressures in the Plan. The Department is working to quantify the impact of inflationary cost pressures and understand how these affect the affordability of equipment projects. It will reflect these in next year's Plan.
- The Department could reflect project risks more fully in the assessment of the Plan's affordability and deliverability. For example, the Department does not reflect independent project costings in its cost forecasts. It is developing new dashboards, drawing management information together, to provide a clearer view on project risks. This will be particularly important as growing supply chain pressures have the potential to delay projects and increase cost pressures.
- The Department's ability to reflect changing capability requirements promptly is constrained. For example, the Department will only complete its annual capability audit in January 2023. Until then, it must rely on working with TLBs on the military capabilities they need without a central assessment since the Integrated Review almost two years ago. Further, the Department has limited headroom in the Plan to reshape its equipment programme to respond promptly to new threats. TLBs have over-programmed against their budgets, equipment contingency is less than 2% of the Plan's budget and exploitation funding for research and development investment is not available until 2025-26 (paragraphs 1.11 to 1.13, 2.7, 2.12 to 2.14 and 2.20).

## **Conclusion**

**11** The Department has assessed that the Plan is affordable over the period 2022-2032. This is based on financial data from 31 March 2022 and reflects ongoing improvements to its affordability assessment. However, its assessment continues to be based on optimistic assumptions that it will achieve all planned savings. It will also take some important decisions that affect the Plan's costs in the next financial planning round. While the Plan continues to serve a useful purpose in reporting to Parliament on planned expenditure, the volatile external environment means this year's Plan is already out of date.

**12** The Department faces significant and growing cost pressures which will have an immediate impact on its spending plans. The Department believes it can manage these pressures but has left itself limited flexibility to absorb any cost increases on equipment projects. It needs to address the financial challenges promptly to avoid falling back into old habits of short-term cost management, which do not support longer-term value for money. The cost pressures are also likely to undermine the pace at which it can modernise the Armed Forces. The Department will need to make difficult prioritisation decisions to live within its means and retain enough flexibility in its Plan to respond promptly to changing threats.

### **Recommendations**

**13** We have assessed the Department's progress in implementing the recommendations from our previous reports (Appendix Two). This shows that the Department is taking action to make further improvements to its approach and the reliability of its assessment. This year we recommend that the Department assesses whether its planning processes are responsive and flexible enough for the rapidly changing context in which the Department is now operating. This includes:

- assessing how to provide a timelier assessment of affordability – including bringing forward publication of the Plan – and capture uncertainty more realistically to understand the full extent of cost pressures and any 'real-time' mitigations that might be needed; and
- ensuring that it has sufficient flexibility to adapt its equipment programme to respond to changing threats. For example, it should consider how to better integrate its departmental assessment of capability risks and consider its ability to respond promptly to new demands.