







Departmental Overview, October 2018

Ministry of Defence

Ministry of Defence

This overview summarises the work of the Ministry of Defence (the Department) including what it does, how much it spends, recent and planned changes, and what to look out for across its main business areas and services.

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If you would like to know more about the National Audit Office's (NAO's) work on the Ministry of Defence, please contact:

Jeremy Lonsdale,
Director, Value for Money audit
✉ Jeremy.lonsdale@nao.org.uk
☎ 020 7798 7412

Keith Lloyd,
Director, Financial Audit
✉ keith.lloyd@nao.org.uk
☎ 020 7798 7092

If you are interested in the NAO's work and support for Parliament more widely, please contact:

✉ parliament@nao.org.uk
☎ 020 7798 7665



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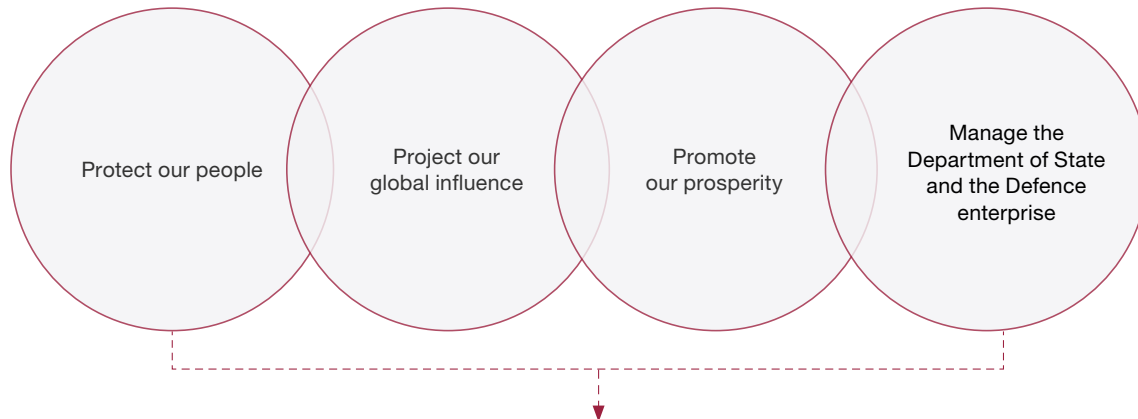
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About the Department

The Ministry of Defence (the Department) is both a Department of State and a military headquarters. It is responsible for providing the military capability necessary to deliver the government's objectives and define future military requirements. Its main purpose is to deliver, alongside other government departments, security for citizens of the UK and the Overseas Territories by defending them, including against terrorism, and to act as a force for good by strengthening international peace and stability.



The Department of State and the Armed Forces carry out six core functions:

- 1 Direct** policy, military operations and contribute to national security at the strategic level, as well as direct rules and standards applying to the whole organisation.
- 2 Operate** Armed Forces at home and overseas.
- 3 Generate and develop** Armed Forces so that they are ready for operations.
- 4 Acquire and support** the equipment, systems and other items our Armed Forces need.
- 5 Enable** defence to work properly by providing support services.
- 6 Account** for and report on defence activity and spending to Parliament and the public.

Strategic direction: The Department is subject to strategic defence and security reviews to set policy for the next five years, most recently in 2015.

Modernising Defence Programme (MDP): In 2017, the government's National Security Council commissioned a National Security Capability Review. In January 2018 the Defence Secretary launched the Modernising Defence Programme. The Department states that the purpose is to make sure that defence is configured to address the intensifying and more complex threats that the UK and its allies face. It is also looking to put UK defence on an enduringly affordable footing, and deliver better capability and value for money.

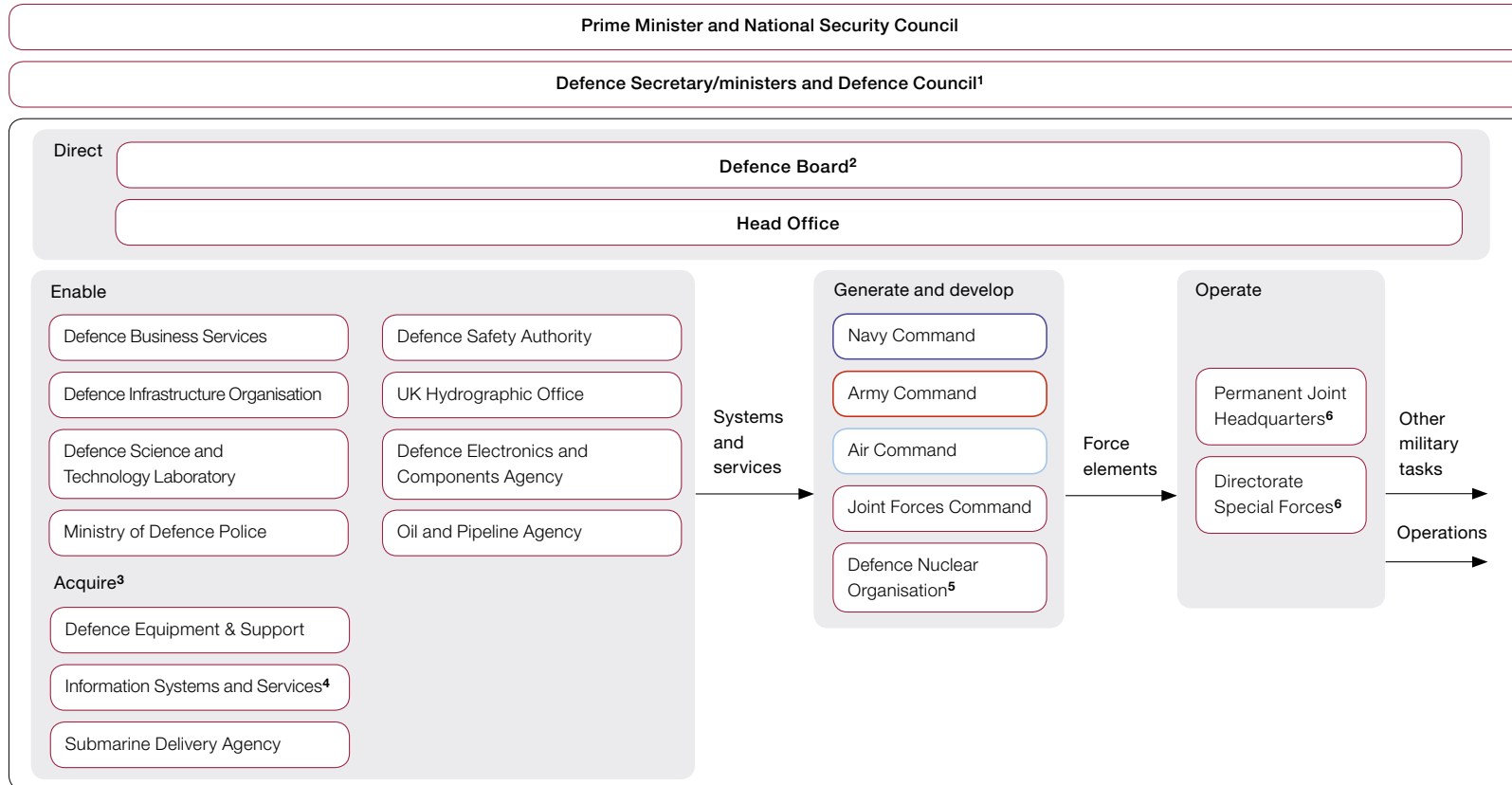
In July 2018 the Defence Secretary published a written statement outlining the headline conclusions from the programme, and setting out the direction for the next stage of more detailed analysis and cross-government discussion. He promised to update Parliament on progress but did not set a timetable for completion of the programme. Many aspects of defence will be dependent on decisions taken.

Focus of National Audit Office work

Against this background, our work has focused on the challenge of the affordability of the Department's plans; the delivery of major programmes and commercial arrangements; and whether the Department has the skills and capability it needs to deliver its defence objectives.

How the Department is structured

The Ministry of Defence's structure



Notes

- Defence Council:** Senior departmental committee chaired by the Secretary of State for Defence. Members include the other defence ministers, Chief of Defence Staff, Permanent Secretary, Vice Chief of Defence Staff, single-service Chiefs of Staff, Commander Joint Forces Command and Director General Finance.
- Defence Board** oversees the strategic direction and oversight of defence, supported by an Investment Approvals Committee, Audit Committee and People Committee.
- Acquisition bodies act as agents on behalf of their customers, such as the Commands.
- Information Systems and Services** is within Joint Forces Command.
- Director General Nuclear** directs the Defence Nuclear Enterprise; and develops nuclear systems and capabilities.
- Within Joint Forces Command.

How the Department is structured

Developments

Delegated model: Since 2014, the Department has operated to a delegated model, with responsibility for spending decisions given to the top-level budget holders including the Royal Navy, Army and RAF (the ‘front-line commands’). Recent developments include:

- in April 2018, front-line commands took on budgetary responsibility for infrastructure, to add to personnel and equipment;
- as part of the Modernising Defence Programme review, the Department is refreshing its operating model; and
- as part of the same review, the Department is addressing the finding in our report on *Ensuring sufficient skilled military personnel* that delegation of responsibility for personnel meant the Chief of Defence People – the ultimate authority for personnel – struggled to influence the commands, making a coordinated response to long-term and cross-command challenges difficult.

Organisational change: On 1 April 2018 the Submarine Delivery Agency was set up to manage submarine contracts formerly run by Defence Equipment and Support. In January 2017, UK Security and Vetting was set up to take responsibility for delivering security vetting services across government. This new body has struggled to meet its performance targets, as set out in our September 2018 report, *Investigation into national security vetting*.

Reform at the Defence Infrastructure Organisation (DIO): In 2014 the Defence Infrastructure Organisation contracted with a Capita-led consortium to act as its strategic business partner. In July 2017 the Department decided that it would terminate the 10-year contract five years early.

Functional leadership: The Department is introducing a functional leadership approach to the management of key cross-cutting functions such as Finance, Commercial, HR and Security. This is designed to improve effectiveness, coherence and professionalism.



Where the Department spends its money



In 2017-18 'total defence spending' was £36.6 billion. This is made up of both cash resource delegated expenditure limits and capital delegated expenditure limits, which includes spend on civilian and military staff costs, infrastructure costs, equipment support costs and investment in military equipment.

It does not include annually managed expenditure (AME), spending not easily controlled by the MoD, such as the impact of discounting provisions, which totals £9.7 billion. It also excludes non-cash depreciation and impairment costs of £7.5 billion.

The 'total defence outturn', which includes all these elements, was just under £54 billion in 2017-18.

Spending across major business areas

Capital expenditure, and equipment support The Department spent £9.4 billion on capital items, including equipment, and £6.6 billion on equipment support (44% of total cash spend). The Department's equipment portfolio for 2017 to 2027 is unaffordable by between £4.9 billion and £20.8 billion (see page 14).

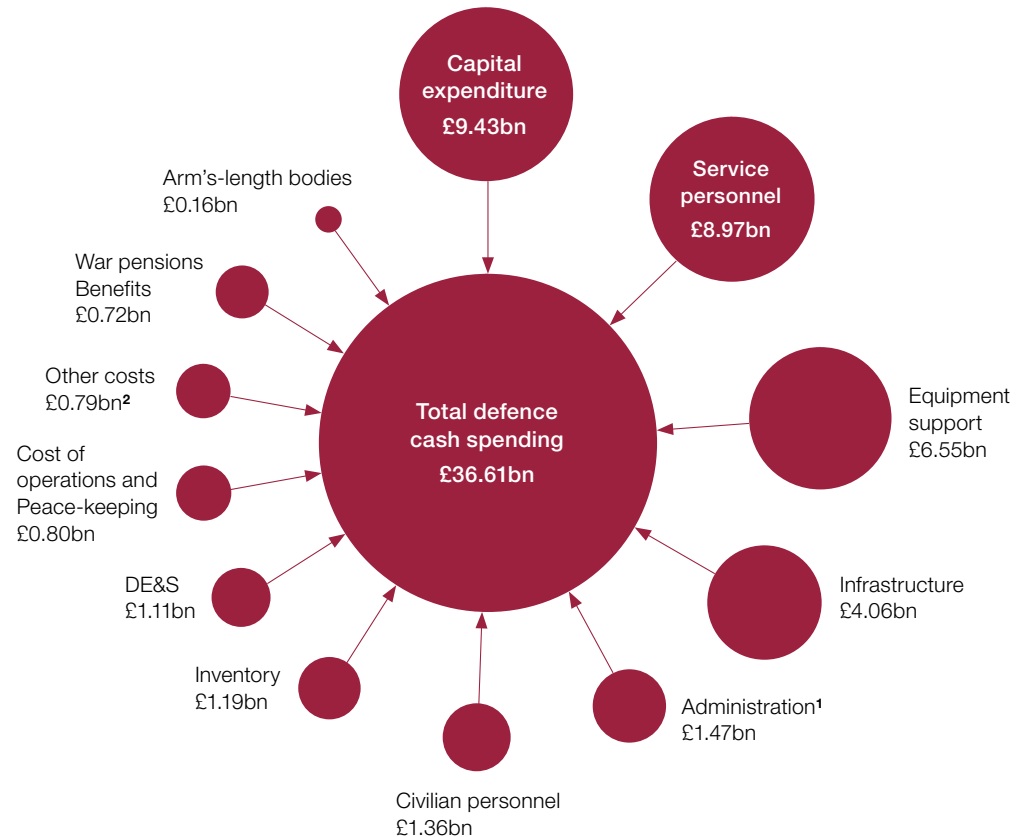
People The Department spent £12.3 billion (34% of total cash spending) on personnel, of which £9.8 billion was for service personnel (see Part Three for more details).¹

Defence capability Other key areas of spend include £4.1 billion on infrastructure, £1.5 billion on administration, and £1.2 billion of inventory consumption.

Operations The cost of operations and peacekeeping in 2017-18 was £0.8 billion (see page 12).

In 2014 NATO members set a goal of spending a minimum of 2% of their GDP on Defence by 2024. In July 2018 NATO estimated that the UK would spend 2.1% in 2018, one of five member states to achieve the goal.

Breakdown of total defence spending, 2017-18



Notes

- 1 Includes all administration costs relating to Other Costs and Services, Cash Release of Provisions and cost of Military and Civilian personnel who perform an administrative role.
- 2 Includes Other Costs and Services, Receipts and Other Income, Cash Release of Provisions and Research and Development Costs related to Provision of Defence Capability.

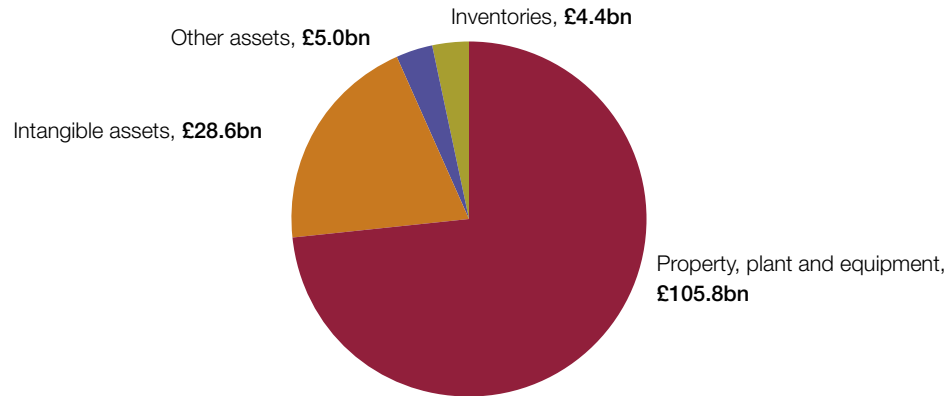
Source: Ministry of Defence, *Annual Report and Accounts 2017-18*

¹ The £12.3 billion figure does not reconcile directly to 'personnel' spend in the figure opposite, as a number of other categories within the figure also contain personnel spend, including DE&S and other arm's length bodies, and war pensions.

Where the Department spends its money

The Department's financial position

Departmental asset breakdown, total £143.8 billion



Property, plant and equipment

The Department's property, plant and equipment had a net book value of £105.8 billion at 31 March 2018. This included:

- Land and dwellings valued at £31.9 billion.
- Military Equipment valued at £37.7 billion, of which £5.8 billion related to capital spares for repairing assets.
- Assets under construction (AUC) valued at £20.9 billion.

Intangible assets

The Department held intangible assets valued at £28.6 billion. Of this, the largest items relate to military equipment development costs.

Inventories

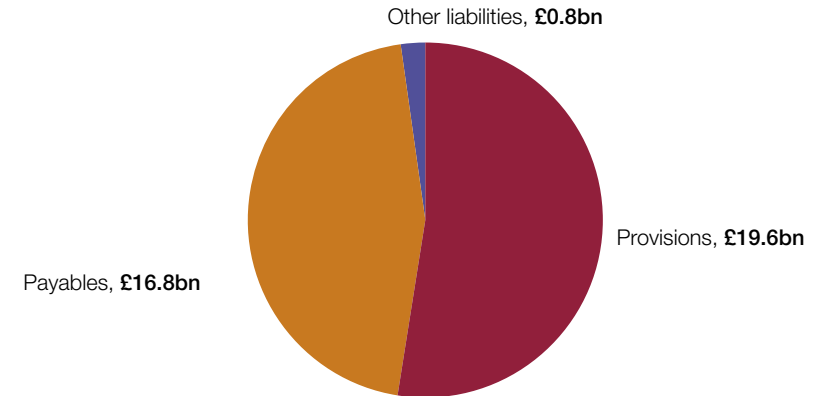
Inventories, relating to such items as munitions, clothing and fuel, valued at £4.4 billion.

Other assets

Other assets included £1.9 billion of cash and £2.8 billion due from creditors.

Source: Ministry of Defence, *Annual Report and Accounts 2017-18*

Departmental liabilities breakdown, total £37.2 billion



Provisions

The majority of the Department's provisions relates to decommissioning the Defence Nuclear Programme, costed at £18.5 billion as at 31 March 2018. These costs are significant but also uncertain, with more than £17 billion of the total due later than five years' time. The nuclear decommissioning provision has risen by £8.5 billion during 2017-18, mostly due to a change in the HM Treasury discount rate used to value the provisions. Only £137 million of the balance was utilised in 2017-18.

Payables

£10.5 billion of the £16.8 billion of amounts payable to contractors and others is due within one year.

Other liabilities

Other liabilities include £0.6 billion relating to retirement benefit schemes for overseas employees and £0.2 billion in relation to hedging carried out by the Department against changes in foreign exchange rates.

Major programmes and developments

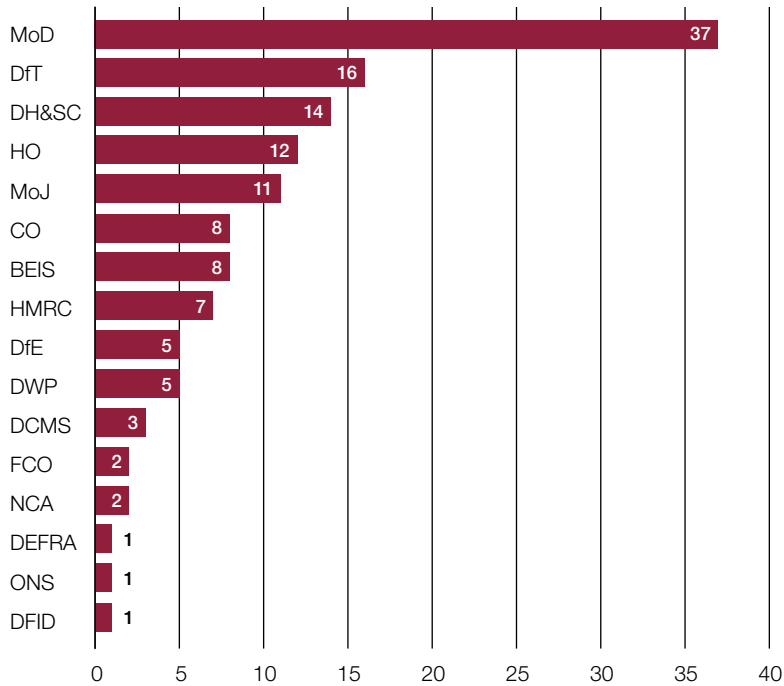
Major programmes



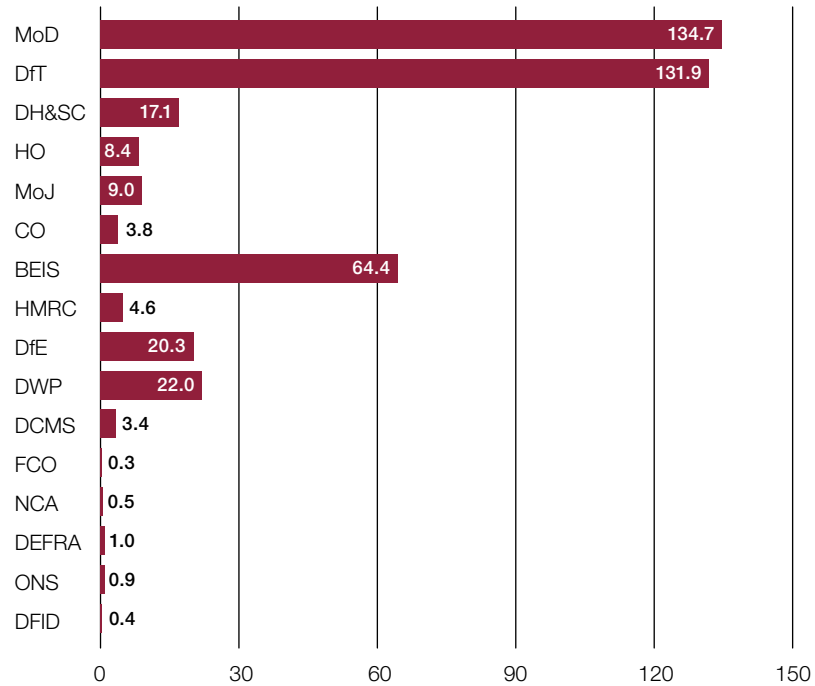
The Department has 37 projects in the Government Major Projects Portfolio (see figure below), the largest number for any department, and a quarter of the total projects. Five are rated low risk (amber/green) while five are high risk (red). We set out on page 9 developments in major projects of continuing parliamentary interest.

Breakdown by department – project number and whole-life cost

Number of projects



Total budgeted whole-life costs (£bn)



Source: Infrastructure and Projects Authority, *Annual Report on Major Projects 2017-18*, p10

Major programmes and developments

Queen Elizabeth-class Carriers

In August 2017 the first of the two aircraft carriers, HMS Queen Elizabeth, sailed into Portsmouth. The second carrier, the Prince of Wales, is being built in Scotland and is due to sail for Portsmouth in late 2019.

Dreadnought and Astute submarines

In July 2016 Parliament supported the Department's plans to build four new ballistic missile submarines. The Department estimates the Dreadnought-class will cost £31 billion, with an additional £10 billion of contingency funding, and enter service from the early 2030s. In May 2018 the Department announced the letting of the construction contract for the seventh and final submarine in the nuclear-powered, conventionally armed Astute class, HMS Agincourt.

Warships

In July 2017 BAE Systems began construction of the Type 26 frigate, which is due to enter service from the mid-2020s. In June 2018, the BAE Systems Global Combat Ship-Australia, based on the Type 26 design, was selected by Australia as the preferred design for their Hunter Class Frigate Programme.

In September 2017 the government accepted the recommendations of the National Shipbuilding Strategy. It started procurement of the Type 31e frigate, designed with the export market in mind. In July 2018 the Department announced that it was restarting the competition to build the Type 31e frigate due to a lack of compliant bids. It still plans for the first ship to enter service in 2023.

Fighter aircraft

The UK now has 15 F-35 Lightning jets, and they have begun to arrive in the UK from the United States, where they were built. It plans to buy 138 aircraft in total. In July 2018 the government launched its Combat Air Strategy, which set out continued investment in existing capabilities such as the Typhoon and how the UK intends to deliver a next-generation combat air capability. It also unveiled the Tempest '6th generation' concept fighter, intended to be operational from 2035 and to complement the F-35.

Armoured vehicles

In March 2018 the government announced that it would buy the Boxer armoured fighting vehicle to satisfy the Army's requirement for a Mechanised Infantry Vehicle through OCCAR (Organisation Conjointe de Coopération en matière d'Armement/ Organisation for Joint Armament Cooperation), which manages international cooperative equipment programmes. In the 1990s the UK had been one of the originators of the Boxer programme, but withdrew from the programme in 2003.



Exiting the European Union



In March 2019 the United Kingdom is set to leave the European Union. This is not expected to affect many of the UK's multinational and bi-national defence arrangements, but has other implications.

Things that will not change

- Permanent seat on the UN Security Council.
- Relationships with NATO and roles in its missions, such as NATO's Enhanced Forward Presence and Response Force.
- Commitment to European security.
- Intergovernmental arrangements (for example, defence intelligence sharing).



Things that may change

- Membership of the European Defence Agency (a Council of the European Union intergovernmental agency).
- EU Common Security and Defence policy role, which included global and European missions.
- Departmental activities governed by European agreements, for example defence research funding.



Work in preparation for EU Exit

HM Treasury has allocated the Department £12.7 million in 2018-19 for work on EU Exit.

The Department has 12 active workstreams relating to leaving the EU, as set out to the Committee of Public Accounts by the Department for Exiting the EU in April 2018. These cover defence cooperation, defence procurement, defence capability and people, and overseas territories. Specific examples include planning the UK's post-EU Exit relationship with the EU's Common Security and Defence policy and future European Defence Agency cooperation.



Possible implications for defence

During the Committee of Public Accounts (PAC) hearing on our landscape report on the *Defence Nuclear Enterprise* in July 2018, witnesses from the Department:

- agreed that prices of imported material might be affected, depending on the trade arrangements agreed;
- acknowledged that EU Exit could affect the supply chain for UK defence projects, and it was examining the potential risks;
- stated that it was working with its suppliers to consider the impact, for example, of changes to chemical regulations, and discussing with some suppliers their concerns over possible changes to material standards; and
- considered it might make it more difficult to bring engineers from the continent.

During the Committee hearing on our 2018 report on *Ensuring sufficient skilled military personnel*, the Department said that Brexit could indirectly affect Armed Forces' recruitment and retention if it increased demand for scarce skills in the UK.

During the Committee hearing on our 2017 report on *Improving value for money in non-competitive procurement of defence equipment*, the Permanent Secretary said that the UK did not have the ability indigenously to supply all of the equipment needed. He added that it was important to be vigilant as the country left the EU that UK defence contractors were not disadvantaged in selling their products or entering into international alliances.

Managing public money

Expenditure



The defence budget is planned to grow but continues to be under pressure. The government has committed to increase the defence budget by 0.5% above inflation annually during this Parliament.

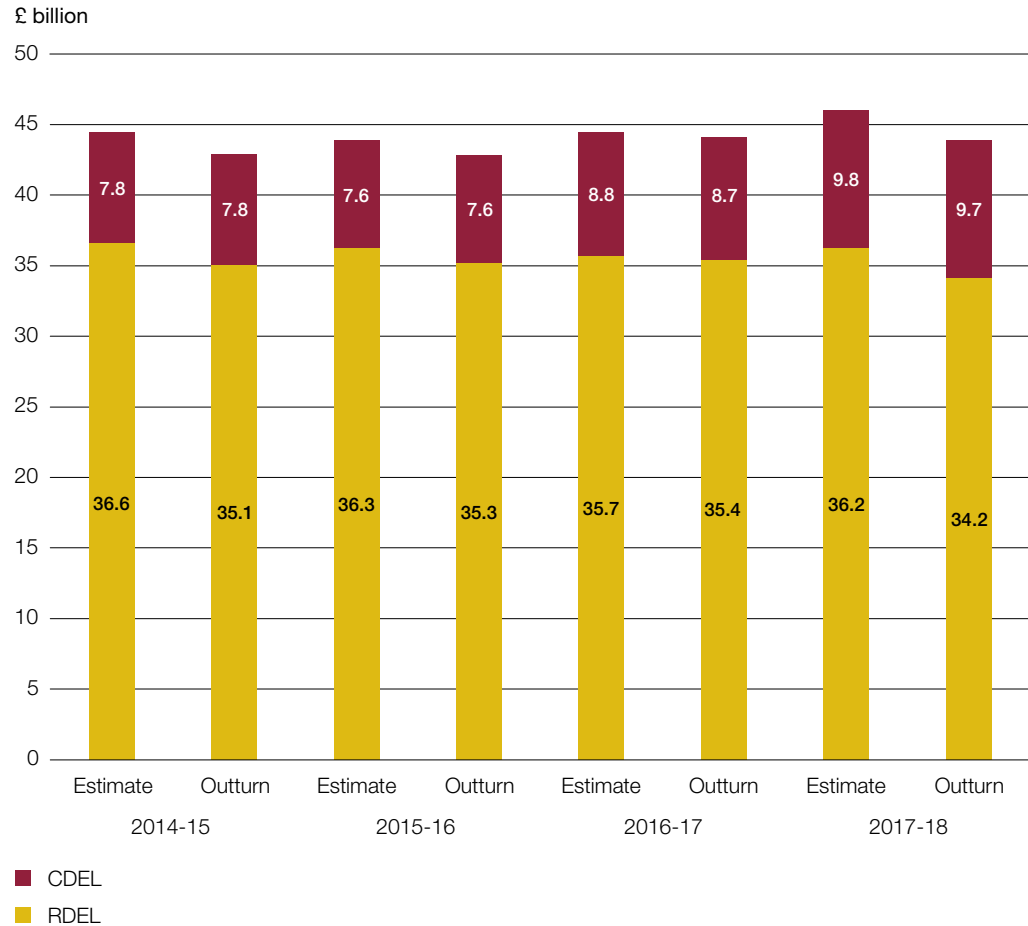
In 2017-18 the Department spent a total of £53.6 billion.

This consisted of Departmental Expenditure Limit (DEL) spend of £43.9 billion and £9.7 billion of Annually Managed Expenditure (see page 6).

The Department underspent against its total resource DEL budget by 5.6%, compared with 0.7% in 2016-17. The Department's governance statement comments on weaknesses in the Department's control environment, including the accuracy of forecasting, as outlined on page 13.

The Department has spent on or close to its capital DEL budget in each of the past four years. The Department would be vulnerable if the outturn cost of planned equipment exceeded budgets over the lifetime of projects, and the value of sterling continues to decline.

Department's outturn against estimates 2014-15 to 2017-18



Source: Ministry of Defence's Annual Report and Accounts

Spend on operations

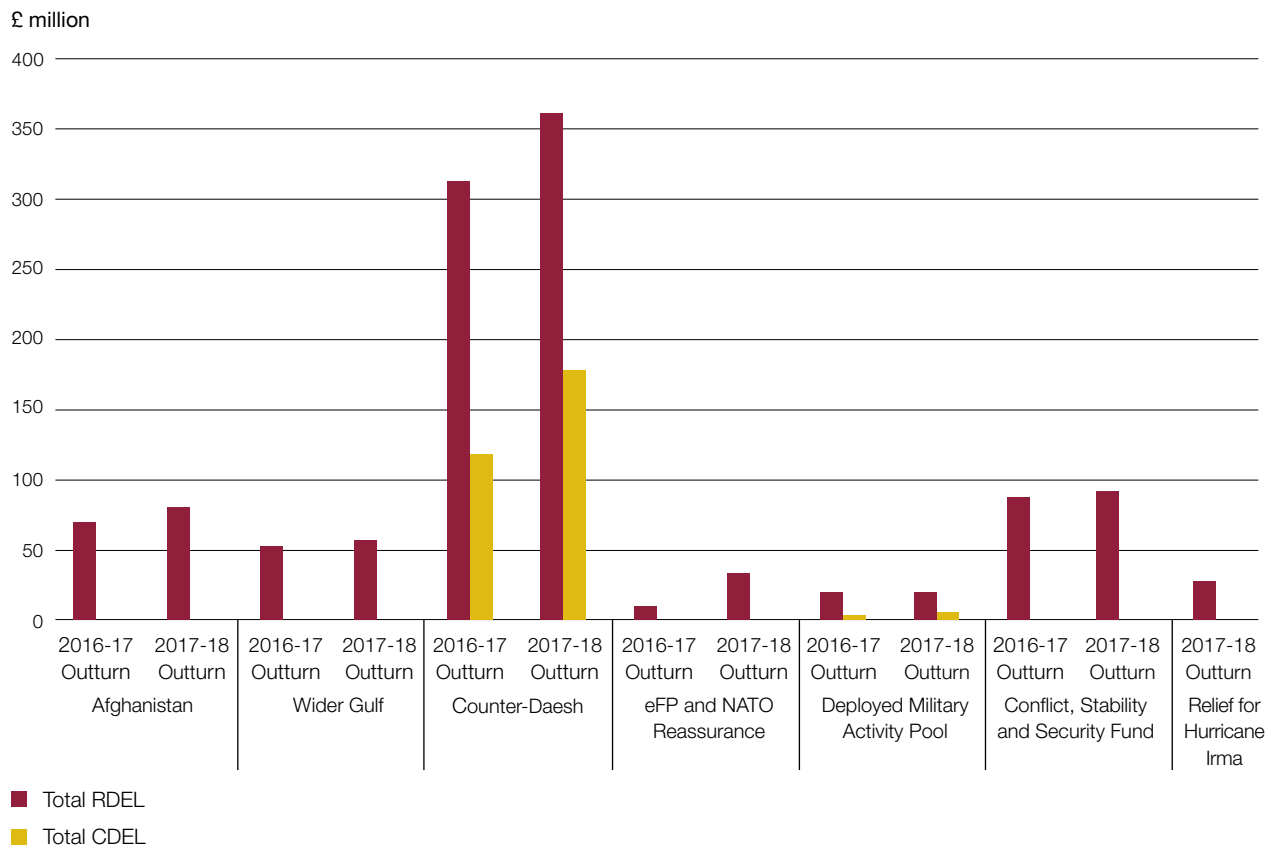
In 2017-18, the Department spent £0.8 billion on operations and peacekeeping, double the amount spent in 2016-17. These are additional costs which the Department only incurred because of these operations (for example, not including wages and salaries that would have been paid anyway). The main areas of expenditure in 2016-17 and 2017-18 are set out in the chart. Costs of operations are funded in whole or in part by HM Treasury through the Conflict, Stability and Security Fund.

The Department's accounts have been qualified for the past nine years

In 2017-18 the Comptroller and Auditor General qualified his opinion on the Department's accounts for a ninth year in succession. This was because the Department has not established whether contracts that contain lease-type arrangements constitute finance leases. As a result, a material value of leased assets and liabilities were omitted from the accounts.

A new leasing standard, IFRS 16, will become effective from 1 April 2019. The Department will need to consider the wider implications of the new standard on the full range of its activities, including the potential impact on the accounts qualification. It has begun to collect information for the contracts most likely to be affected. It will need to commit sufficient resources to enable it to manage and report lease data from April 2019 onwards, and will need to work with its suppliers to obtain better contractual information supporting the utilisation of assets.

Operations and peacekeeping



Note

1 Deployed Military Activity Pool – a joint HM Treasury and Department initiative to make available resources to fund the initial and short-term costs of any unforeseen military activity.

Source: Ministry of Defence, *Annual Report and Accounts 2017-18*

Developments in the Department's control environment

The table below describes recent developments in some of the main categories of risk endemic to the Department.

Risks identified in the Department's Governance Statement	Key themes and recent developments
Workforce and skills risk	The Department faces significant challenges with a lack of suitably qualified, experienced personnel in some areas, including engineering, commercial, information and P3M (Project, Programme, Portfolio Management). See pages 19-20.
Commercial capability and governance	The Department has a shortage of professional commercial staff given the level of procurement activity undertaken. It has delivered a Commercial Professionalism Programme to improve the quality of training, including externally recognised qualifications for staff. This is particularly important given the significance of the arrangements covered on pages 8-9.
Contingent liabilities	The Department is required to identify contingent liabilities when agreeing contracts, and to seek HM Treasury approval and provide notification to Parliament of those in excess of £300,000. At sessions in 2017 and 2018 the Committee of Public Accounts raised the issue of contracts where procedures had not been followed. In response, the Department updated its financial accounting and reporting manual, is updating the defence commercial policy statement in conjunction with HM Treasury to provide guidance on the approvals process and responsibilities, and has provided staff briefings and training. A review in the Defence Equipment & Support organisation identified 12 contingent liabilities, which required retrospective approval from HM Treasury and notification to Parliament. A wider departmental review identified a further six.
Estates	The overall condition of the built estate continues to decline. To address this, the Defence Estate Optimisation (DEO) Programme has been established and is now in its second year. In addition, from April 2018 the majority of infrastructure expenditure is being delegated to front-line commands, designed to lead to more informed decision-making on ownership or disposal.
Management information	Due to a large number of fragile systems across the Department, the lack of good-quality management information is a significant control risk, although the Department has recently implemented a new purchase to pay system (CP&F), which is having a beneficial effect on management information. The Department has published a <i>Business Intelligence Strategy</i> , but implementation remains a challenge due to lack of resources. A new chief information officer has been appointed to develop a defence-wide plan including increased use of automation and analytical tools.
National security vetting	In 2015 the government created a single vetting provider and made the Department responsible for all vetting, including that which previously sat within the Foreign and Commonwealth Office. The new organisation, United Kingdom Security Vetting (UKSV), has experienced a number of resource and system problems which have affected service delivery, impacting on clearance times and recruitment. A recovery programme is in place. In June 2018, the government announced that UKSV would transfer to the Cabinet Office, but no earlier than April 2020.
National Audit Office management letter	The NAO 2016-17 management letter reported weaknesses in the Department's financial controls relating to processes in the cash environment, estate assets valuation and impairment. The Department has undertaken significant work this year to ensure bank accounts are reconciled and adjustments journals raised.
Internal audit	The head of internal audit delivered an opinion of 'limited assurance' on the Department's internal management controls for 2017-18, while acknowledging improvements to the control environment in a number of areas. More work is needed: to deliver the required internal controls; to provide assurance on compliance with Departmental directives; to improve contract management and management information; and to mitigate the impact of resource shortages.
Business and financial planning	The Department is implementing a Financial Management Improvement Plan to, among other things, make budgeting and financial risk management more transparent, improve the accuracy of forecasting and risk identification, review approvals processes, and improve management of raw materials and consumables. The Department recognises that it is on "a journey of continuous improvement".



Affordability of the Equipment Plan

The Ministry of Defence's (the Department's) Equipment Plan is an annual statement on the affordability of its 10-year plans for procurement of new equipment and the support needed to maintain it.

It was introduced in 2012 after a period of poor financial management which resulted in over-committed plans, short-term cuts and re-profiling expenditure, leading to poor value for money.

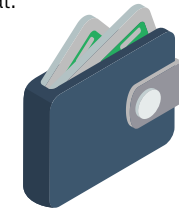
The aim of the Equipment Plan is to provide assurance annually to Parliament on the affordability of the Department's spending plans for the next 10 years. The figure below shows the forecast annual expenditure for the period 2017–2027.

We examine the underpinning assumptions. In January 2018, we concluded – for the first time – that the

Equipment Plan was unaffordable (see overleaf) by between £4.9 billion and £20.8 billion in the ten years 2017 to 2027.

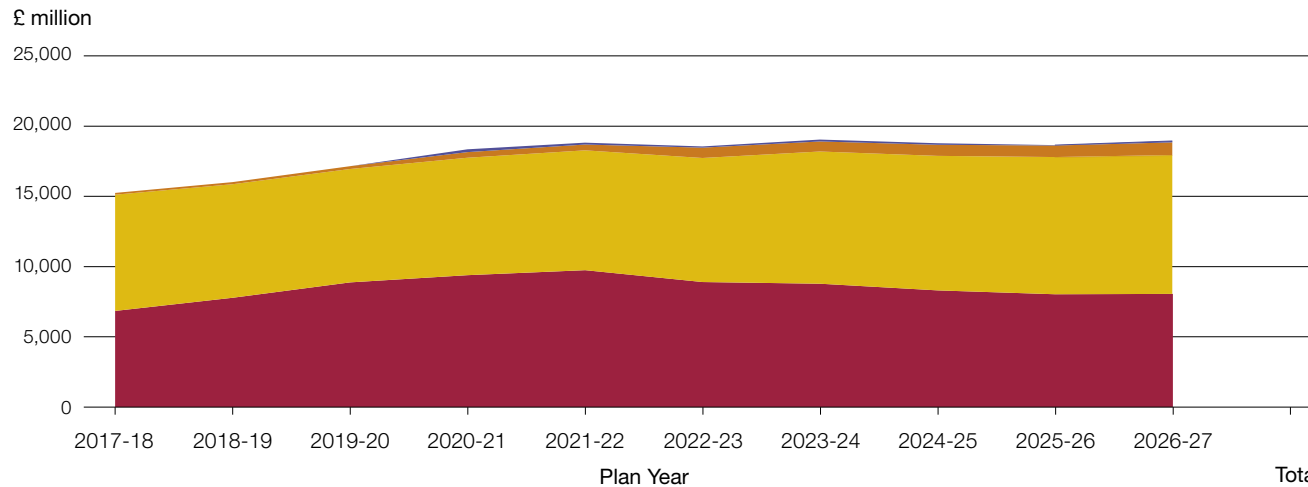
The Department is looking to the Modernising Defence Programme (MDP) to return the Plan to affordability. It has committed to publishing the 2018–2028 Equipment Plan in the autumn.

In July 2018 the Department stated that the second phase of the MDP will consider the investments needed to ensure that defence can operate effectively against all types of threat.



Breakdown of planned spending on equipment, 2017 to 2027

Equipment procurement and support budgets are supplemented by contingency



	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	Total
	(£m)	(£m)	(£m)	(£m)	(£m)	(£m)	(£m)	(£m)	(£m)	(£m)	(£m)
Equipment Procurement Plan budget	6,851	7,787	8,883	9,397	9,752	8,907	8,788	8,313	8,037	8,063	84,778
Equipment Support Plan budget	8,279	8,088	8,076	8,364	8,535	8,835	9,417	9,580	9,772	9,891	88,837
Equipment Plan general contingency	125	150	200	400	413	736	714	789	819	900	5,246
Equipment Plan nuclear contingency	0	0	0	200	134	87	136	111	31	100	799
Total	15,255	16,025	17,159	18,361	18,834	18,565	19,055	18,793	18,659	18,954	179,660

Notes
 1 'Nuclear contingency' is ring-fenced for nuclear-related projects.
 2 Figures have been rounded to the nearest £ million.

Source: Ministry of Defence

Affordability of the Equipment Plan

We concluded that factors which made the Equipment Plan 2017-2027 unaffordable were:

Planned savings will need to be achieved

The Department reported that it had achieved savings of approximately £7.9 billion against an increased target of £16 billion (see table opposite). However, the full amount of savings included in the Plan was not clear and the Department did not have the evidence to show how it had achieved all the savings.

The Plan did not include £9.6 billion of forecast equipment and support project costs

This arose because the Department's budget-setting process was not able to match costs to available budgets.

The Plan did not include all forecast costs

At least £1.3 billion of planned costs associated with buying the five Type 31e general purpose vehicles were not included. The Department has committed to more comprehensive and transparent reporting in the next Equipment Plan Summary report.

There were other significant cost challenges:

- Exchange rates used to forecast costs did not reflect market rates at the date of the Plan.
- Project costings were optimistic and could increase. The Department's independent Cost Assurance and Analysis Service concluded costs could be understated by £3.2 billion.
- Nuclear-related costs continued to grow and could destabilise the Plan because of their size and complexity. The Department launched a review of the reliability of nuclear-related project costs. In the past 18 months, the Department has made some positive changes to the way it manages the Defence Nuclear Enterprise as set out in our 2018 report on the subject.
- Underlying project forecasts could change because of weaknesses in cost modelling.

The Department's reported progress towards achieving equipment savings targets

The Department's progress against savings targets has been inconsistent

Area	Target as originally set (£m)	Years left to run	Savings achieved to date (£m)	Percentage of target achieved so far (%)
Submarine Enterprise Performance Programme	879	4 of 10 years	677	77
Complex Weapons pipeline ³	2,075	3 of 10 years	1,349	65
Equipment support	4,123	7 of 10 years	3,462 ¹	84
Information and communication technology	1,564	Between 2 and 9 years	759 ¹	49
SDSR 15 efficiencies ²	5,800	9 of 10 years	1,649	28
Additional DE&S transformation savings ⁴	1,441	9 of 10 years	N/A ⁵	N/A ⁵
Additional savings	131	9 of 10 years	0	0
Total	16,013		7,896	49

Notes

- ¹ We have been unable to verify the Department's claimed savings with supporting documentation or evidence.
- ² SDSR 2015 – Strategic Defence and Security Review 2015.
- ³ The Complex Weapons pipeline target is £2.1 billion of gross savings, which gives £1.2 billion actual savings after netting off the notional additional cost of single-source procurement from the benefits of the extant procurement strategy.
- ⁴ Additional Defence Equipment & Support (DE&S) transformation savings have been added to the plan to reflect DE&S's latest assessment of the savings achievable through transformation.
- ⁵ Savings achieved against the additional DE&S target have been shown as part of SDSR 2015 efficiencies.

Source: National Audit Office analysis

Managing commercial relationships

The Ministry of Defence's (the Department's) 2018 Governance Statement acknowledged challenges around commercial relationships (see page 13). The Modernising Defence Programme has set up a transformation programme to invest in senior roles, improve systems and processes, and make efficiencies.

Non-competitive procurement

In October 2017 we reported on the Department's procurement of defence equipment and support services without the use of competition. The study found that:

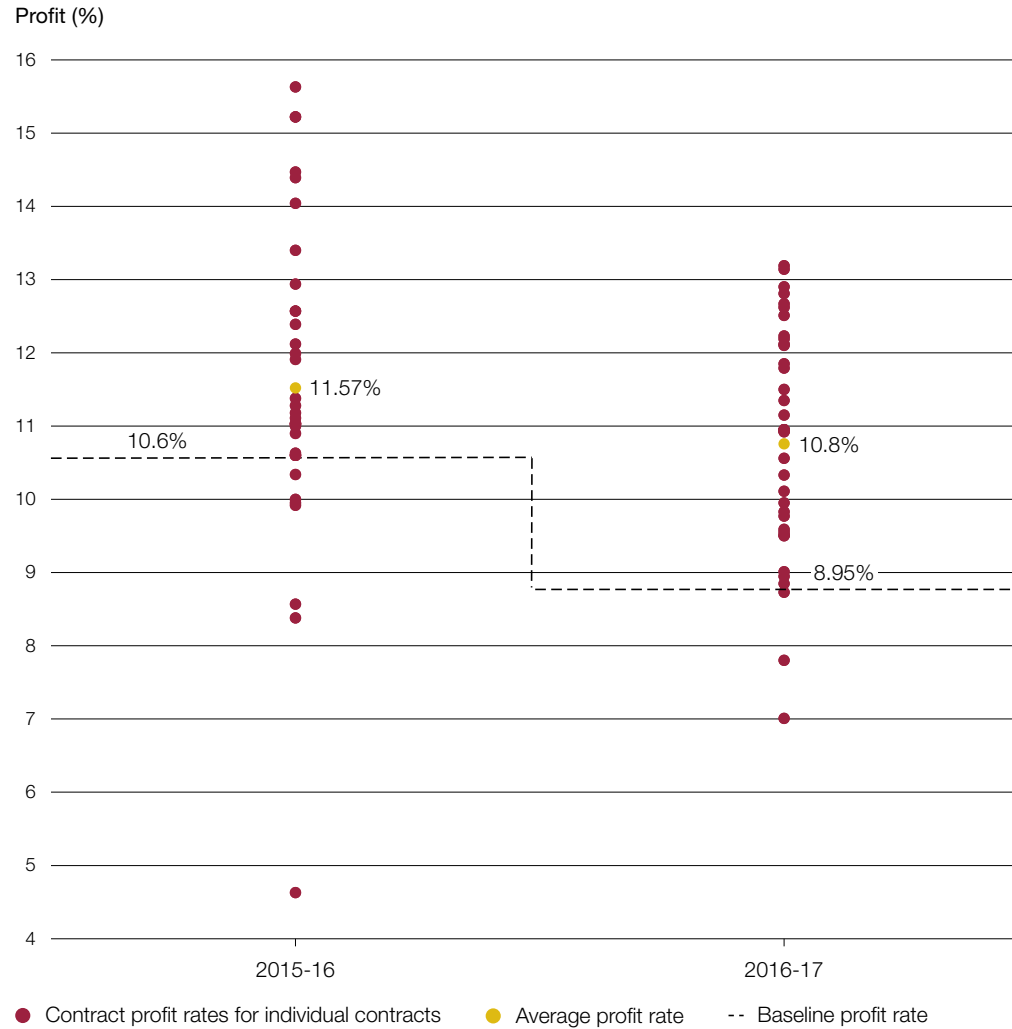
- the Department's new regulatory system for non-competitive procurement – introduced in 2014 – was starting to yield results but there was still resistance from some parts of industry; and
- the Single Source Regulations Office (SSRO), which recommends the profit rate to be applied to relevant contracts, had found the average profit rate in 2016-17 was 10.8% (see figure opposite). In June 2018, the SSRO reported that the profit rate for 2017-18 had fallen to 8.5%.

The proportion of equipment contracts let competitively is not increasing over time. In response to our report the Department has undertaken to take a more strategic approach to increasing competition, but more recent data show that in 2017 the proportion of contracts let competitively fell to 42%.



Changes in contract profit rate for contracts within the Regulations

Since the introduction of the Regulations there has been, on average, a reduction in the profit rates of contracts



Notes

- 1 Individual baseline and contract profit rates are shown for each contract by year. In some cases, single points represent several contracts with the same profit rate.
- 2 Based on profit rates declared to the SSRO by suppliers. For some contracts the baseline profit rate declared to the SSRO varied from that set by the Secretary of State for Defence.

Source: National Audit Office analysis of Single Source Regulations Office data



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Relationship with government strategic suppliers

The government's relationships with its 27 major suppliers are managed centrally by the Cabinet Office. Of these, the Department spent more than £5 billion with BAE Systems and Babcock in 2016-17.

In September 2017, Capita, another strategic supplier, lost its 10-year contract to act as strategic business partner to the Defence Infrastructure Organisation. In June 2018, the Department awarded Capita a £400 million contract to improve its fire and rescue services, although this is subject to legal challenge by another of the bidders.

The Department was the single largest government customer for Carillion PLC, spending more than £500 million in 2016. Carillion entered liquidation in January 2018. However, the Department's facilities management contracts continued without interruption, and the company's construction contracts have since been taken over by other firms.

The Ministry of Defence's arrangement with Annington Property Limited

In January 2018 we reported on the long-term impact of the Department selling and leasing back the majority of its married quarters estate to Annington Property Limited (Annington). The figure on page 18 shows how sales proceeds of £2.4 billion in 1996 have translated into a loss of value of between £2.2 billion and £4.2 billion in 2018, primarily due to the subsequent steep increase in house prices and rents (see page 18).

Our 2018 report found that even the limited objectives set for the sale at the time were only met in part.

In 2021 the way property rental payments are calculated will be renegotiated. Currently, a 58% downwards adjustment is applied to the market rent. Any changes will affect the remaining 175 years of the contracts.

The timetables for the Department's wider estate strategies and the Annington rent negotiations are misaligned. The Department is developing plans to enable more service personnel to live in private accommodation. The affordability of these plans is dependent on maintaining the current rent adjustment, while negotiations on the rent reviews depend on the plans having been finalised.

Strategic approach to equipment procurement

In 2012 the Department's strategic approach to procurement was set down in the *National Security through Technology* white paper. The Department sees competition as its default position, using products that are proven, reliable and meet current needs, with the proviso that the Department will protect the UK's technological advantage where essential for national security.

Since then, it has developed strategies for:

- **shipbuilding (September 2017):** designed to energise the UK's maritime industry, it focuses on the Type 26 frigate (procured through a single source arrangement with BAE Systems), the Type 31e frigate (to be procured through competition between UK companies) and new Fleet Solid Support ships (to be procured through international competition); and
- **combat air (July 2018):** focused on the key role of UK industry in developing technologies to maintain national advantage, while recognising the importance of international collaboration.

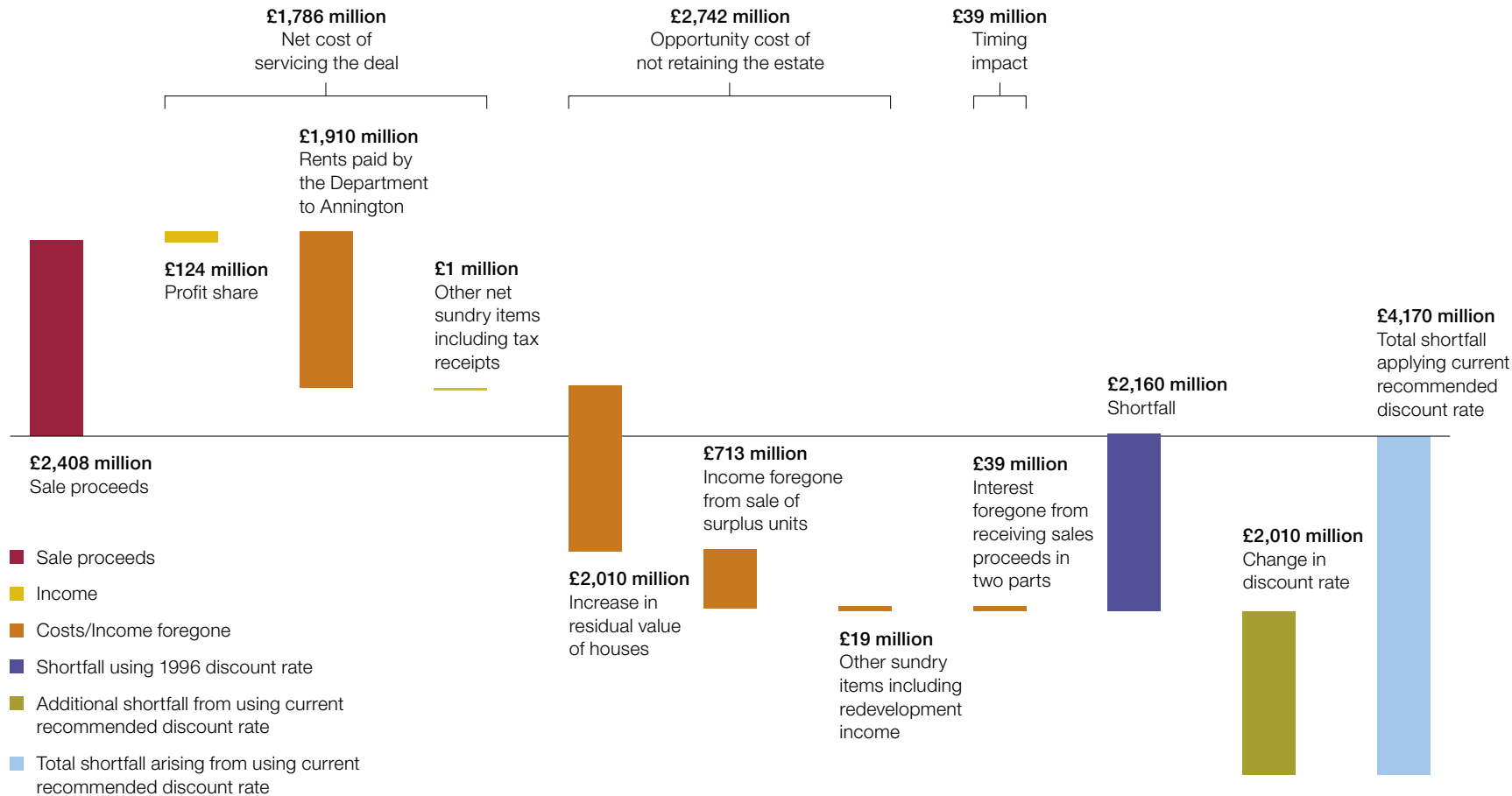


Managing commercial relationships

The sale of the majority of the married quarters estate to Annington Property Limited

Reconciliation of sale proceeds to the Ministry of Defence's current financial position regarding the estate (December 2016 prices)

The main contributory elements are a mix of cash costs and opportunity costs from benefits foregone



Notes

- 1 Costs are the discounted present values at the time of the sale and then uplifted for inflation to December 2016 prices.
- 2 The Department received a £124 million share of profits on surplus properties handed back to Annington, which ended in 2011.
- 3 Increases in property prices were calculated using the Nationwide national house price index.

Source: National Audit Office

Ensuring sufficient skilled personnel

The Armed Forces are made up of regulars and reserves, civilians and external contractors. Service chiefs retain full command of their people and work with senior budget holders on workforce planning and day-to-day people management within a framework set by the Chief of Defence People.



Military personnel

Since 2015 the Ministry of Defence's (the Department's) targets for trained regular strength has been 30,450 in the Royal Navy, 82,000 in the Army and 31,750 in the Royal Air Force.

In January 2018 the Armed Forces were 5.7% (8,200 regulars) below the existing requirement – the largest gap in recent years, with larger skills gaps in critical trades.

In April 2017 the Department identified 102 trades where there were insufficient trained regulars to maintain defence tasks without taking action to mitigate these shortfalls. Only six trades were expected to be fully resolved in the next five years. Mitigating actions may include cancelling leave or training.

Recruitment and retention problems include the following:

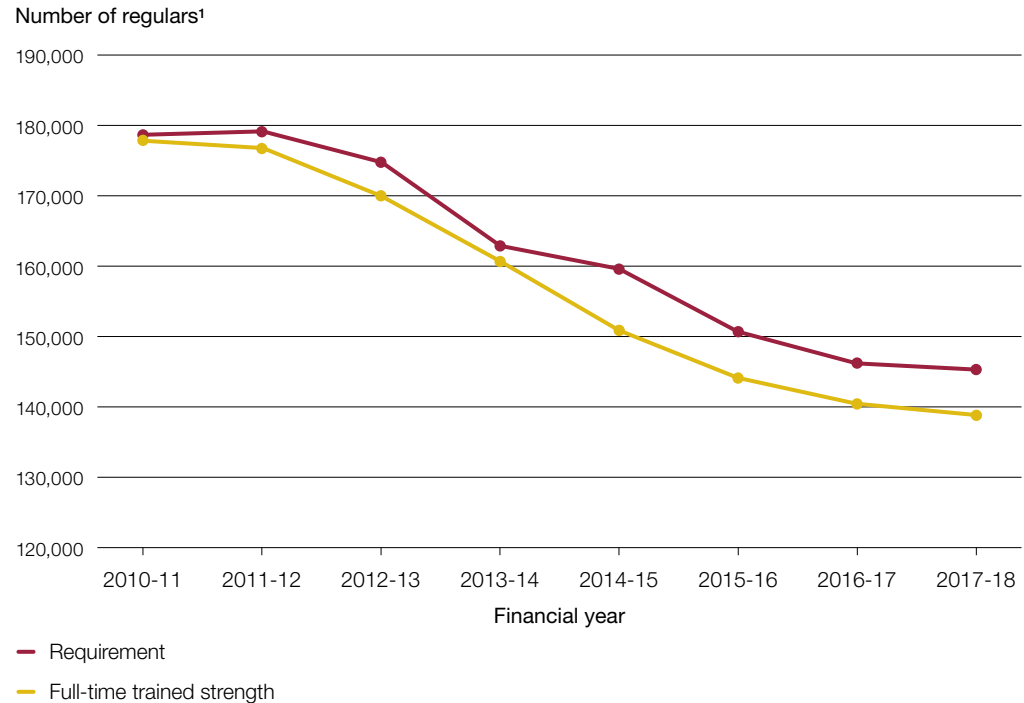
- In 2016-17 the Armed Forces recruited 24% fewer regulars than the annual target.
- The Department takes a median time of six to nine months to recruit regulars, and is targeting a reduction to three months.
- The level of voluntary departures had increased to 5.6% by the end of 2017.

The Department centrally is implementing a substantial workforce change programme. The Commands are also adapting workforce management practices to improve recruitment and retention of skilled personnel, but many initiatives are at an early stage. They have managed the consequences of shortfalls by prioritising front-line activities. They continually assess the impact of the shortfalls, but these gaps mean they routinely need to place greater demands on personnel, such as cancelling leave or training, to maintain operations.

In addition, the changing character of warfare means the Department faces an immediate and growing challenge to develop the skills it will need in the future. The new demands will increase the pressure in some trades that already have shortfalls, such as those requiring advanced technical and digital skills.

The size of the Armed Forces against target – from 2010-11 to 2017-18

The number of trained regulars in the Armed Forces has been below target since 2010-11



Notes

- 1 Full-time trained strength (Royal Navy/Royal Marines and Royal Air Force) and full-time trade trained strength (Army).
- 2 The data are at 1 April of each financial year.

Source: Ministry of Defence, UK Armed Forces personnel statistics

Ensuring sufficient skilled personnel

Civilian personnel

The Department's 2018 Governance Statement stated that: "The Department is facing significant challenges with suitably qualified, experienced personnel in some areas, including engineering, commercial, information, and project, programme and portfolio management".

The Department met its 2010 target to reduce its civilian headcount to 60,000. It has been less successful against its 2015 commitment to reduce civilian headcount by a further 30% by 2020. Civilian numbers have been largely stable during the past year (see figure). The future shape of the civilian workforce is being considered as part of the Modernising Defence Programme.

Nuclear specialists

There is a long-term shortage of both civil and military nuclear skills in the UK. This includes manufacturing, project management and highly skilled scientific and engineering roles. In 2017 government and industry predicted the need for an additional 7,000 full-time equivalent staff per year to 2021, doubling the current inflow.

The Department has long-standing gaps in skilled military nuclear personnel. In January 2018 it identified a shortage of 337 skilled personnel across seven nuclear trades and specialisms – including nuclear marine engineers and weapons engineers.

Commercial, programme management and project controls skills

The Department has struggled to attract people with commercial, programme management and project control skills. In 2016 the Department recognised gaps in financial, programme and contracting expertise.

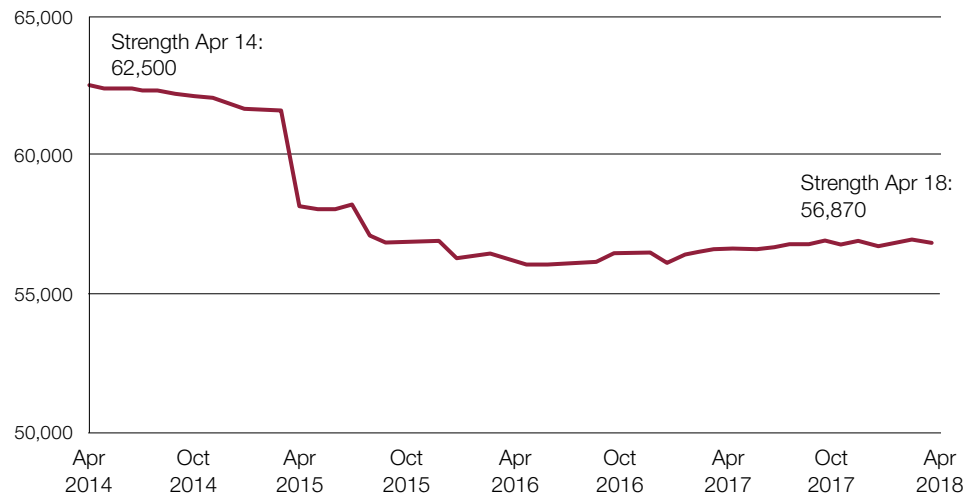
In October 2017, we reported that the Department had identified a 24% shortfall in commercial staff. The Department's management information reports that by July 2018 this figure had reduced to 15%.

In November 2017 we reported that Defence Equipment & Support (DE&S) had staff shortages in specialist logistics and commercial roles, which affected its ability to respond quickly to demands for parts for ships and submarines, or understand and plan requirements.

DE&S is investing in skills and within Ships Operating Centre, staff numbers increased 26% between 2014 and 2017.

Ministry of Defence departmental civilian personnel strength (full-time equivalent)

Full-time equivalent



Source: Ministry of Defence, *Annual Report and Accounts 2017-18*

Management of the Defence Nuclear Enterprise

Recently, the Department has reorganised how it manages the activities necessary to maintain a submarine-based nuclear deterrent. The figure opposite shows the organisations involved in the Defence Nuclear Enterprise. The Defence Nuclear Organisation (DNO) was set up in 2017 and the Submarine Delivery Agency (SDA) started formal operations in April 2018.



Four contractors receive 97% of the Defence Nuclear Enterprise's contract payments. These contractors employ around 1,500 sub-contractors.

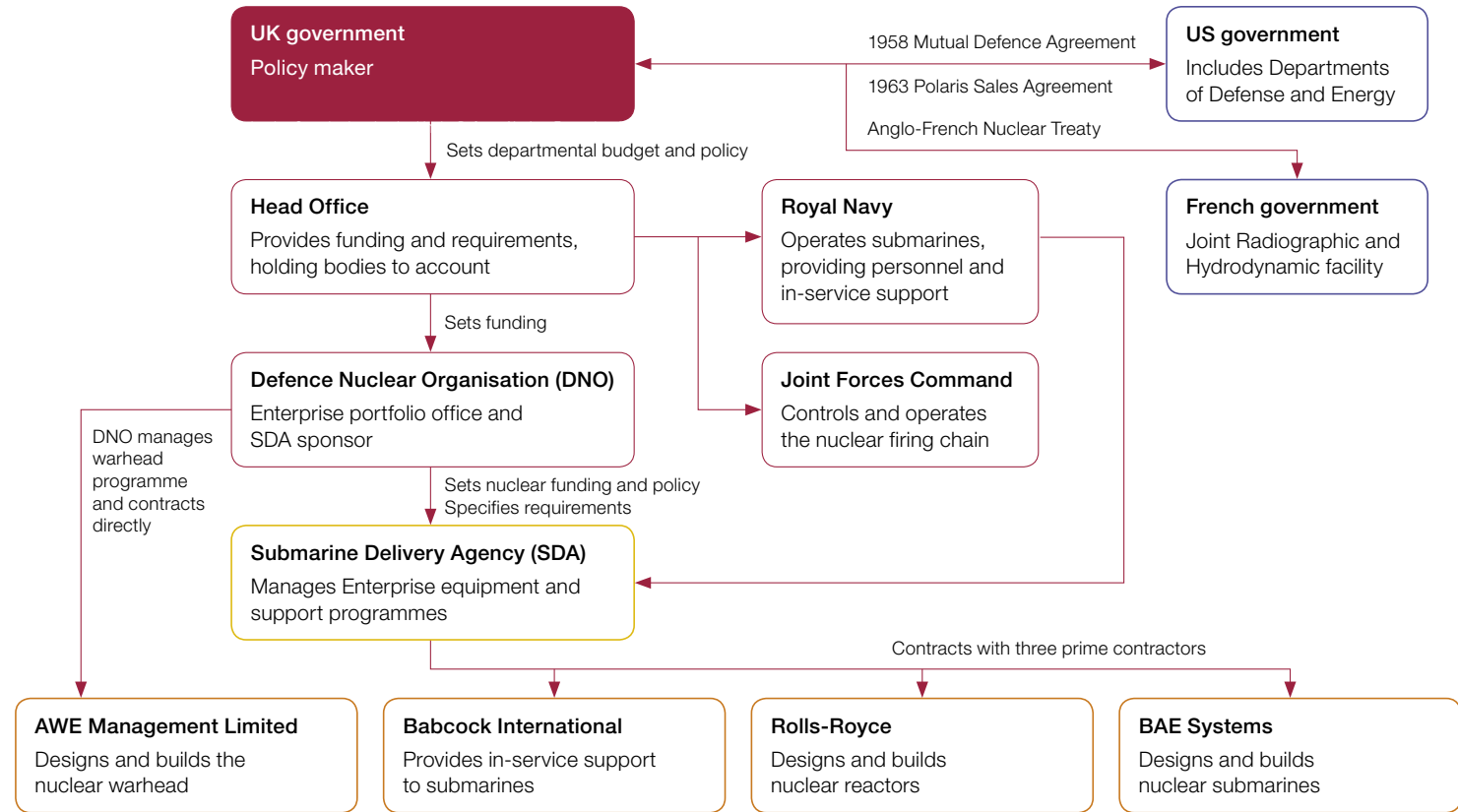
The Department has introduced new ways of working with its contractors to try to address historic poor performance.

Delivering and operating programmes across the Defence Nuclear Enterprise requires a wide range of military and civilian skills that are in short supply nationally. Both the DNO and SDA are still filling recognised skills gaps, including some senior positions.

The Department must coordinate around 75 programmes, and manage knock-on effects between them (see figure overleaf). For example, the timeframe for Dreadnought submarine production will be affected by progress with other submarine builds and will influence the support and maintenance requirements for in-service submarines.

Organisations involved in the Defence Nuclear Enterprise, April 2018

A number of organisations contribute to the Defence Nuclear Enterprise



- Organisations within the Department
- Departmental agency
- Contractor
- International partner

Notes

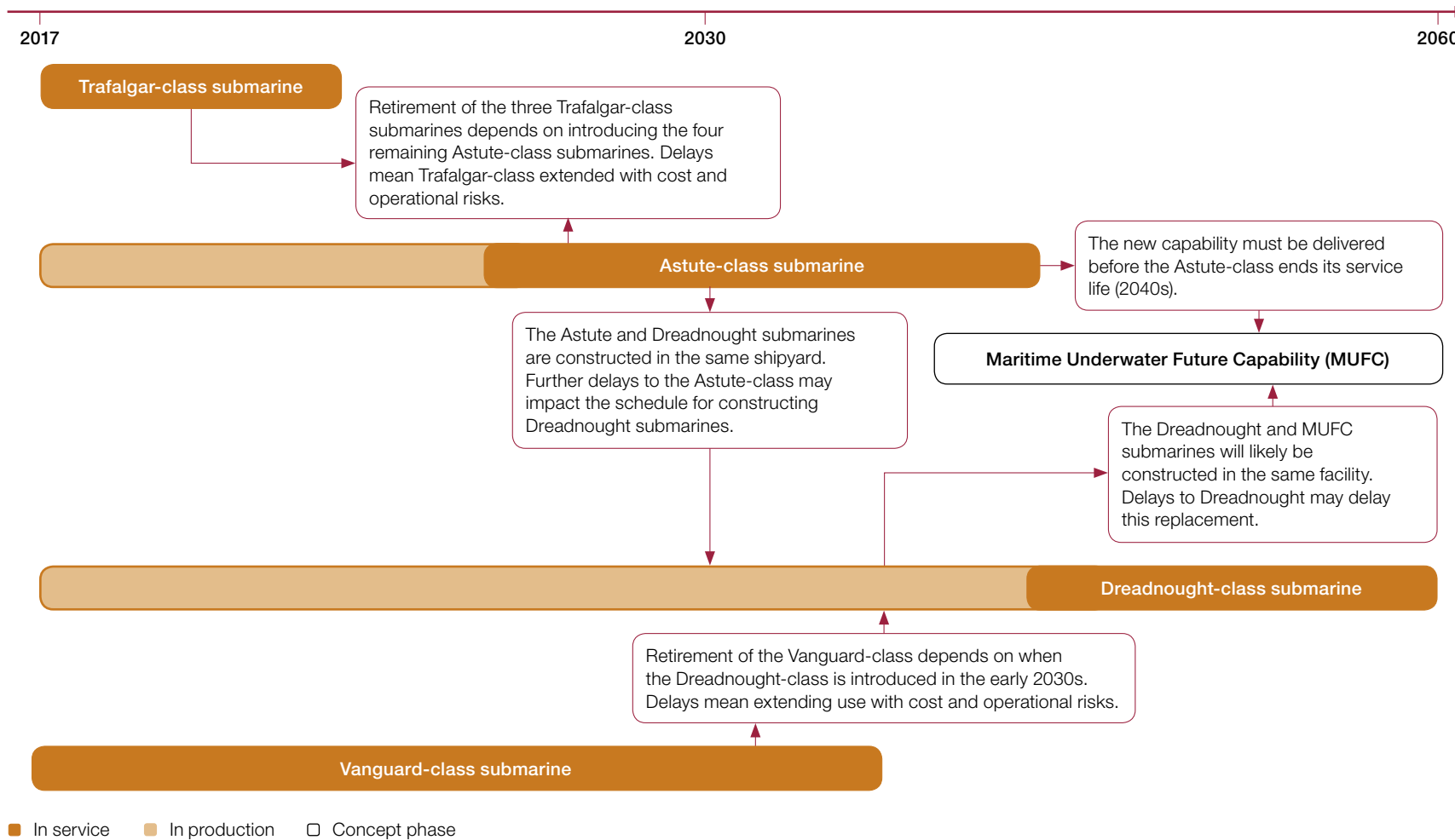
- 1 Shows Defence Nuclear Enterprise funding flows rather than working-level engagements.
- 2 During 2017-18, SDA operated in shadow form alongside Defence Equipment & Support (DE&S). Until March 2018, AWE Management Limited was a DE&S supplier.
- 3 The three prime contractors contract with hundreds of sub-contractors not shown.

Source: National Audit Office analysis of Ministry of Defence information

Management of the Defence Nuclear Enterprise

Interdependencies between submarine production timetables

The Defence Nuclear Enterprise programmes have a large number of interdependencies



Note

1 Submarine service dates are indicative.

Source: National Audit Office

The cost of the Defence Nuclear Enterprise

The Department maintains a submarine-based nuclear deterrent to support the government's national security policy. It relies on a network of programmes, equipment and people, often referred to as the Defence Nuclear Enterprise.

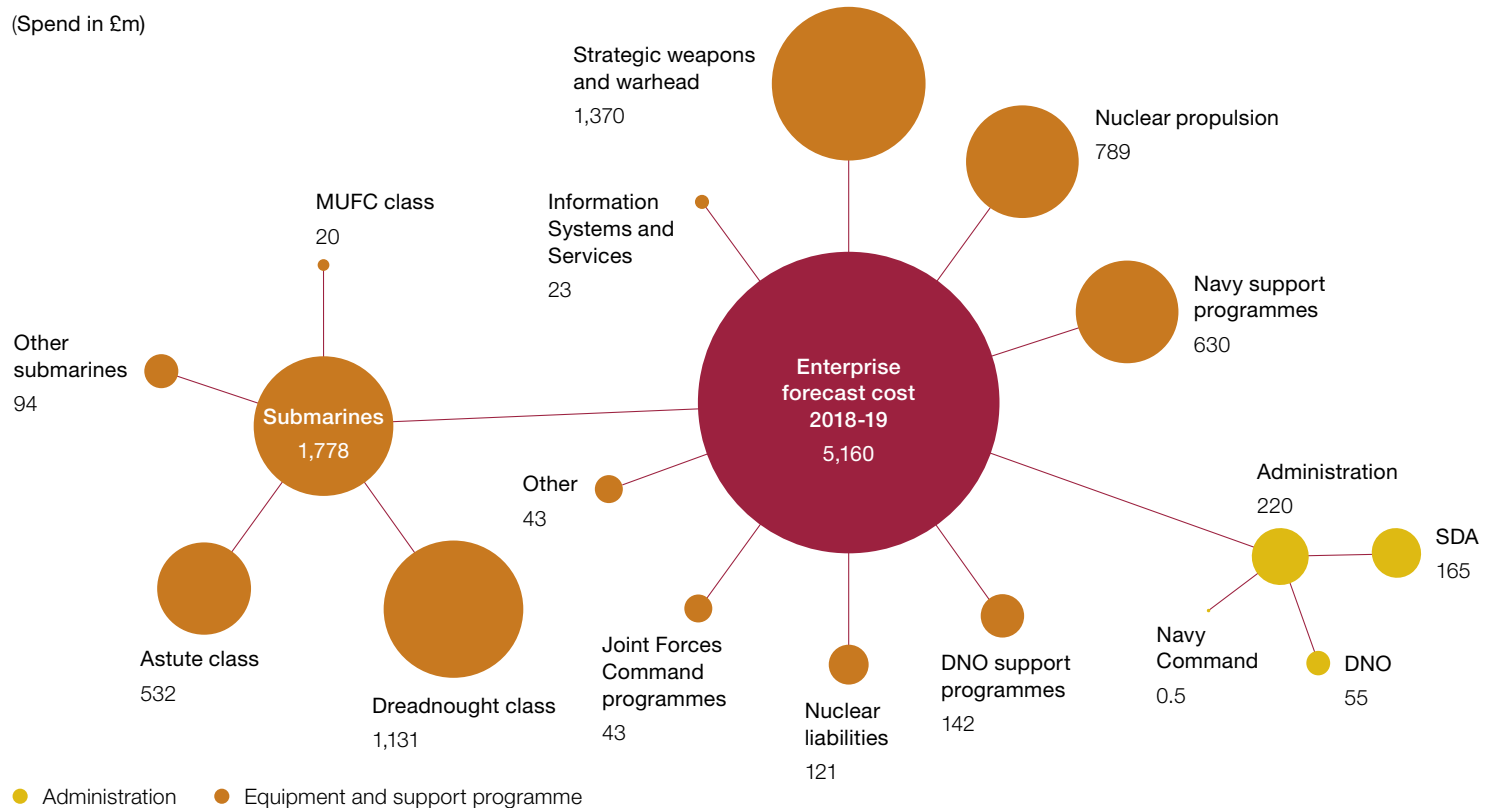
- Work includes designing, producing and maintaining submarines and nuclear warheads, and providing the necessary estate, people and support.
- In 2018-19 it forecasts to spend £5.2 billion across the Enterprise (see figure opposite), and £50.9 billion between 2018 and 2028 (see page 24).
- It has had to cut costs and re-programme work and will need to realise £3 billion of efficiencies, but there remains an affordability gap of £2.9 billion over the next 10 years.

In spring 2018 the Department forecast that DNO would spend £43.9 billion on long-term equipment procurement and support programmes between 2018 and 2028, with Navy Command spending £6.7 billion and Joint Forces Command £355 million.

Breakdown of Defence Nuclear Enterprise agreed forecast spend, 2018-19

The Department forecasts to spend £5.2 billion across the Enterprise in 2018-19

(Spend in £m)



Notes

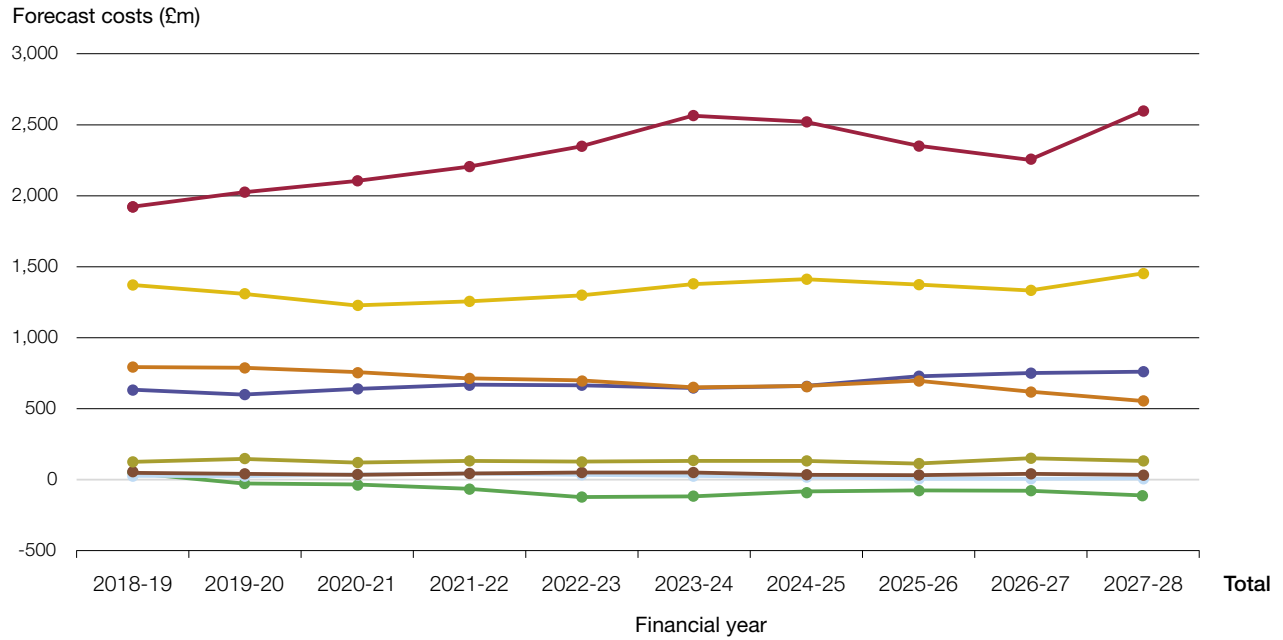
- 1 Categorisation of costs does not necessarily reconcile with the Department's broader definition of some programmes, such as its description of Dreadnought class in the Strategic Defence and Spending Review 2015.
- 2 Excludes Joint Forces Command administration spend and non-civilian Royal Navy staff spend.
- 3 MUFC, the Maritime Underwater Future Capability, will replace the Astute class.
- 4 SDA – Submarine Delivery Agency; DNO – Defence Nuclear Organisation.
- 5 Navy support covers in-service submarines, combat systems and spares.
- 6 Other includes £45 million of efficiencies and an £88 million forecast spend.
- 7 Figures do not sum due to rounding.

Source: National Audit Office analysis of Ministry of Defence data

Management of the Defence Nuclear Enterprise

Defence Nuclear Enterprise equipment and support programmes 10-year forecast costs, 2018–2028

The Department expects to spend £50.9 billion across its programmes



	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	Total
● Submarines	1,920	2,022	2,101	2,203	2,346	2,562	2,521	2,352	2,251	2,593	22,872
● Strategic weapons and warhead	1,370	1,307	1,225	1,254	1,295	1,374	1,408	1,373	1,329	1,448	13,384
● Nuclear propulsion	789	785	755	711	695	645	655	694	615	550	6,893
● Navy support programmes	630	594	635	666	660	641	655	724	747	756	6,707
● Nuclear liabilities	121	140	115	127	122	126	127	107	146	126	1,257
● Joint Forces Command programmes	43	35	29	37	46	46	29	27	35	28	355
● Information Systems and Services	23	19	30	39	29	20	12	1	1	2	175
● Efficiencies, adjustments and other	43	-33	-40	-70	-127	-123	-88	-82	-85	-117	-722
● Total	4,939	4,869	4,850	4,966	5,065	5,293	5,318	5,195	5,039	5,386	50,920

Notes
 1 Support costs included in 'Submarines'.
 2 Figures do not sum due to rounding.

Source: National Audit Office analysis of Ministry of Defence data



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Area	Future developments, risks and challenges
01 Modernising Defence Programme (MDP)	In July 2018, the Secretary of State for Defence told Parliament the first phase of the MDP (see page 3) had reviewed the changing strategic context and how the UK's Armed Forces needed to be able to respond, including shaping new policy approaches and identifying investment priorities. The Ministry of Defence (the Department) has now moved on to the next phase, although there is no set timetable for its completion.
02 Equipment Plan 2018-2028	The Department expects to publish its Equipment Plan in October 2018 . Decisions from the MDP will be too late to influence the 2018–2028 Plan, and therefore we expect it to remain unaffordable. However, we would expect to see progress, particularly with respect to realism about the value of exchange rates used to cost equipment purchased in foreign currency; management of efficiencies; and accuracy of cost forecasts.
03 Progress with major programmes	<p>Developments during the coming year with new equipment include:</p> <ul style="list-style-type: none"> ● further progress in development of the Carrier Strike capability, with flying trials on HMS Queen Elizabeth leading to achievement of 'initial operating capability' for the F-35 Lightning by the end of 2018. HMS Prince of Wales is due to be handed over to the Royal Navy in 2019; ● the competition for the building of the Type 31e frigate will need to be restarted quickly if the Department's in-service date of 2023 is to be met; ● after a slippage of more than two years, Marshall, the £1.5 billion project to transform air traffic management services, is now due to be operational from June 2019; and ● the Watchkeeper reconnaissance drone has yet to receive its 'release to service' certification from the UK military aviation regulator, prompting the Department's accounting officer to write to the chair of the Committee of Public Accounts in January 2018.
04 Levels of morale	This year we highlighted that morale within the Armed Forces continues to be an area of concern. The latest Departmental survey results found that morale had lowered and just two in five personnel were satisfied with Service life in general. Satisfaction with pay has been decreasing since 2010, although satisfaction with service accommodation is largely unchanged. The Department publishes monthly personnel statistics and the next Armed Forces survey results will appear in May 2019 .