



House of Commons
Defence Committee

Ministry of Defence Annual Report and Accounts 2013–14

Eighth Report of Session 2014–15

*Report, together with formal minutes relating
to the report*

*Ordered by the House of Commons
to be printed 3 March 2015*

The Defence Committee

The Defence Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Ministry of Defence and its associated public bodies

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Publication

Committee reports are published on the Committee's website at www.parliament.uk/defcom and by The Stationery Office by Order of the House.

Evidence relating to this report is published on the [inquiry page](#) of the Committee's website.

Committee staff

The current staff of the Committee are James Rhys (Clerk), Leoni Kurt (Second Clerk), Eleanor Scarnell (Committee Specialist), Ian Thomson (Committee Specialist), Christine Randall (Senior Committee Assistant), Alison Pratt and Carolyn Bowes (Committee Assistants).

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Summary

Even though the MoD's accounts for 2013–14 have been qualified, we are gratified that the Department MoD is making substantial progress in management of its accounts. There are residual concerns, and this year's Report and Accounts were delayed by five months to resolve uncertainties around the accounting treatment of assets under construction. The accounts were eventually qualified on the grounds of the accounting for contracts likely to contain a lease and on the accounting for non-current assets, capital spares and inventory items. Whilst acknowledging the continuing challenges, we welcome the progress being made by the Permanent Under-Secretary and his team to resolve the problems that have led to these delays and qualifications, but note that the forthcoming Strategic Defence and Security Review and the management reform of the Service Commands will throw up new questions to be addressed in the administration of the MoD's accounts.

The MoD is making real improvements more broadly in its management of its assets and liabilities. Progress has been made in DIO in consolidating information systems for recording land and property and, notwithstanding the auditor's qualification, in management of inventory. The MoD has also developed a new strategic cost model that will enable it to identify the cost of changes in force structure and identify what an affordable structure would be within a given budget. This tool will be a crucial element in helping the MoD to prepare for the next Strategic Defence and Security Review and will contribute to the transparency of decision-making in the context of that Review. Successful operation of this model would mark a further step forward in the Department's management and strengthen its hand in negotiations for the next Comprehensive Spending Review.

We also welcome the steps being made by the Department to increase the transparency of its reporting on its own performance, including incorporating a number of our previous recommendations; it is essential that the information provided on the MoD's performance takes account of the changes in focus that the Department will undergo in coming years.

One of the biggest changes in the administration of the Department over the last year has been the reforms to Defence Equipment and Support. Our successor Committee will continue to follow closely changes in the Department's approach to equipment acquisition. It will wish to ensure that the arrangements for project management contractors for each of the four domains avoids the risk of "stovepiping" in acquisition decisions within each of the three Services and Joint Forces Command.

1 MoD Resource Accounts 2013–14

1. Government Departments are expected, under Treasury guidance, to publish annual reports and audited accounts at the end of each financial year and before the Parliamentary summer recess.¹ In addition to the accounts, the Annual Report contains data on the department's performance against the input and impact indicators in its business plan and a description of its activities. The MoD laid its Annual Report and Accounts for 2013–14 before Parliament on Thursday 27 November 2014.²

2. We took oral evidence from Jon Thompson, Permanent Under-Secretary at the MoD, and Mr David Williams, Director General Finance, on the MoD's Report and Accounts for 2013–14 on 7 January. The MoD also provided us with supplementary written evidence in response to further questions that we subsequently sent to them in writing.

3. The MoD delayed publication of the 2013–14 accounts to avoid qualification of the accounts on the grounds of an incorrect balance being reported for assets under construction within the Defence Infrastructure Organisation (DIO).³ In his Governance Statement in the Report and Accounts, Jon Thompson reported that the National Audit Office (NAO) had identified concerns around the “substantiation” of the £2.7 billion balance previously disclosed by DIO as Assets Under Construction (AuC). DIO had worked to resolve these concerns but this work had not been completed in time for the original publication date for the Report and Accounts. He reported that

The final outcome is an accounting write-off of £267 million and adjustment to the Annual Accounts. This write-off has been approved as appropriate by HM Treasury and the adjustments have been subject to audit by the NAO.⁴

4. In our Report on the Armed Forces Covenant: Accommodation we expressed concern about the management of the DIO, given the major transformation that it was undergoing, including the reduction of staff from 7,000 to 2,000, and the significant programmes it was undertaking, including the return of the Army from Germany, rebasing and the renegotiation of major contracts. The Government reassured us in its response to that Report that the Transformation Programme was subject to internal review and would be held properly to account within MoD.⁵

5. In his Governance Statement on the Annual Report and Accounts, Jon Thompson noted the MoD's Internal Audit conclusion that it could only give limited assurance on the management of strategic and operational risks, and that, given the transformation that DIO was undergoing, “the reduction of resources has led to a weakening of the control

1 [HM Treasury DAO\(GEN\) 03/13](#)

2 [Ministry of Defence Annual Report and Accounts 2013-14](#) HC 764

3 [Q 1](#)

4 [Ministry of Defence Annual Report and Accounts 2013-14](#) HC 764 Certificate of the C&AG page 97

5 [The Armed Forces Covenant in Action? Part 2: Accommodation Government Response](#) Third Special Report 2012-13 HC 578

environment.”⁶ However, he added that steps were being taken “to improve the quality of the control environment.”⁷ We questioned Jon Thompson about the problems in the DIO. He told us that a NAO report on the DIO had raised significant concerns about the management of the estate, including the operation of 76 different information systems to record land and property. These systems had now been consolidated into one system which went live in December 2014.⁸

6. We sought reassurance that the delays in publication of the accounts would not be repeated and asked about future financial and accounting challenges for the MoD. Jon Thompson told us that the new challenges would arise from the next Strategic Defence and Security Review in respect of its impact on the annual finances of the MoD and the management of balances in terms of writing off assets or shortening the lives of equipment.⁹

7. The MoD also provided us with further details on future accounting challenges, including the sales of the Defence Support Group (DSG), the Government Pipeline Storage System and Marchwood military port, future estate rationalisation and the hand-back of the German estate.¹⁰ The MoD also told us that the move to the new Defence Operating Model, with greater authority, responsibility and accountability for budget holders, had inevitably increased complexity and the consequential risk of inconsistent identification and treatment in the financial accounts.¹¹

8. It is disappointing that, once again, the MoD was some five months late in laying its Annual Report and Accounts before Parliament. While it may have been appropriate to delay the laying of the Accounts to ensure the balance sheet figure for assets under construction was accurate, it was concerning that this problem was identified by the National Audit Office rather than by the MoD itself. We were also concerned that the resolution of the problem required a write-off of £267 million, some ten per cent of the total valuation of assets under construction. However, we are satisfied that steps are being taken to reduce the risk of such problems arising again.

9. In response to this Report, the MoD should tell us what planning it is doing to ensure that it appropriately manages the impact of the likely changes to asset balances, such as write-offs of assets or shortening the effective operational lives of equipment, that will arise from the forthcoming Strategic Defence and Security Review. It should also tell how it intends to manage the impact of the continuing management reform of Service Commands.

6 [Ibid page 96](#)

7 [Ministry of Defence Annual Report and Accounts 2013-14](#) HC 764 Certificate of the C&AG page 97

8 [Q 3](#)

9 [Q 11](#)

10 [Ministry of Defence Memorandum: Response to follow-up questions](#)

11 [Ministry of Defence Memorandum: Response to follow-up questions](#)

Qualification of the Accounts 2013–14

10. The Comptroller and Auditor General (C&AG) qualified his audit opinion on the Department's 2013–14 Resource Accounts for the eighth successive year. The principal reason for qualification is the accounting treatment of single source contracts that may contain leases (under International Accounting Standard 17), but a qualification was also recorded in respect of the impairment (write-off) of the valuation of the estate in Germany and inventory and non-current items.¹²

Accounting for contracts that may contain leases

11. The C&AG again qualified the MoD Accounts on the grounds that the MoD is likely to have omitted a material value of leased assets and associated liabilities from its Statement of Financial Position.¹³ The C&AG explained that the accounting requirements for lease type arrangements were particularly relevant to the MoD as, by necessity, it enters into a number of strategic arrangements with particular contractors to procure specialist defence platforms on a non-competitive basis. These arrangements could entail exclusive, or near exclusive, use of industrial assets making it reasonable to allow recovery of fixed costs other than through market rate or unit cost pricing.¹⁴ The C&AG could not quantify the impact on the financial statements because, as a result of its accounting policies, the MoD had not maintained appropriate records or obtained the information to do so.¹⁵

12. In 2013–14, the MoD agreed with HM Treasury not to gather the further management information required to understand the impact on these contracts as it would not represent value for money.¹⁶ In written evidence, the MoD told us that it planned to undertake further work with the support of a commercial accounting firm to “assess the implications of determining whether an arrangement contains a lease (IFRIC 4) and the subsequent accounting under IAS 17”.¹⁷

13. The MoD Annual Report and Accounts 2013–14 have again been qualified on the balances for contracts likely to contain a lease. The MoD should report to us on the results of its latest review of contracts.

12 [Ministry of Defence Annual Report and Accounts 2013-14](#) HC 764 Certificate of the C&AG page 97

13 The FReM requires preparers of accounts to comply with International Accounting Standard (IAS) 17, Leases, to establish whether contracts contain lease-type arrangements and whether those are, in substance, either a finance or operating lease. A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. An operating lease is any other type of lease. The classification made by preparers of accounts could have a significant impact on the financial statements.

If the contract is classified as a finance lease then the value of assets used to deliver the service would be recognised in the Statement of Financial Position alongside a liability for the minimum lease payments due under the contract. As an operating lease, no assets would be recognised and the payments made under the lease would be reflected in the Statement of Comprehensive Net Expenditure as spend is incurred.

14 [Ministry of Defence Annual Report and Accounts 2013-14](#) HC 764 Certificate of the C&AG page 102

15 [Ministry of Defence Annual Report and Accounts 2013-14](#) HC 764 Certificate of the C&AG page 102

16 [Ministry of Defence Annual Report and Accounts 2013-14](#) HC 764 Certificate of the C&AG page 102

17 [Ministry of Defence Memorandum: Response to follow-up questions](#)

Inventory

14. For the 2013–14 Accounts, the C&AG was satisfied that the MoD had provided sufficient evidence that the closing balances of non-current assets, capital spares and inventory items were correct but there was not sufficient evidence on the opening balances or to which periods the impairment of £860 million belongs.¹⁸ The C&AG said that challenges remained in respect of systems, inventory checking procedures, inventories held off system, changes to the business and embedding good practice. In particular, he drew attention to the fact that investment in the new Base Inventory Warehouse Management System (BIWMS) had been suspended while the MoD re-assessed its user requirement. He also said that “the full implementation of BIWMS was to be a significant step in enhancing the Department’s ability to efficiently manage and control its inventory”.¹⁹ David Williams told us that the suspension of the BIWMS had been reversed by the investment committee in early January.²⁰

15. In response to our written questions, the MoD told us that a detailed review of inventory items had resulted in the £860 million impairment for events which had not been properly accounted for in previous years and should be seen as a one-off correction. Many of these events had resulted from the outcome of the last Strategic Defence and Security Review.²¹ The MoD also told us:

A further detailed line item assessment will be conducted following the outcome of the next SDSR to ensure that decisions arising from the review are identified and reflected within inventory valuations in a timely manner.²²

16. We are pleased to see that the MoD is finally managing to get to grips with the management and control of its inventory and capital spares and welcome the PUS’s assertion that the MoD Accounts will no longer be qualified on this basis. We also welcome the commitment by the PUS to a detailed item by item impairment review following the outcome of the next Strategic Defence and Security Review. The Comptroller and Auditor General (C&AG) does, however, point to ongoing challenges in respect of systems and embedding good practice. The MoD should tell us how it will address these challenges.

Costing information for the next Strategic Defence and Security Review

17. Given its problems with financial and management information, we asked how well the MoD would be able to cost defence outputs for the next Strategic Defence and Security

18 [Ministry of Defence Annual Report and Accounts 2013-14](#) HC 764 Certificate of the C&AG page 103

19 [Ministry of Defence Annual Report and Accounts 2013-14](#) HC 764 Certificate of the C&AG page 105

20 [Q 29](#)

21 [Ministry of Defence Memorandum: Response to follow-up questions](#)

22 [Ministry of Defence Memorandum: Response to follow-up questions](#)

Review. David Williams explained that the strategic cost model was a high level cost model which would answer two questions:

First, if you change the force structure in big handfuls—at the level of brigades or frigates or fast jet force elements—roughly speaking, what does that do to the cost of defence? Secondly, if you fix the defence budget at a particular level, depending on which aspects of defence capability you want to prioritise, what would an affordable force structure look like? It is a high level tool to aid decision making. The implementation of those decisions will then require a lot more detailed financial modelling to allocate budgets and so on.²³

18. The strategic cost model is a crucial tool for preparation of the next Strategic Defence and Security Review. Decisions about which capabilities the UK can afford have to be taken on the basis of the most robust information and a clear understanding of the cost drivers behind capabilities. The MoD should provide us with a description of the strategic cost model, its accuracy and any limitations that it has identified in its utility.

2 MoD performance and risk management

Reporting of MoD performance to Parliament and the public

19. The MoD reports its performance against certain input and impact indicators in its Annual Report, see Table 1 below. We have frequently criticised these indicators and asked the MoD to review its performance reporting and recommended that the MoD include additional information in the Annual Report and Accounts to cover:

- Readiness levels
- Manning levels for each Service by officers, non-commissioned officers and other ranks
- Pinch point trades, both operational and manning
- Harmony guidelines for each Service
- Voluntary outflow statistics for each Service
- Recruitment level and targets for each Service
- Indicators reflecting the delivery of Defence Transformation and structural reform priorities including the New Employment Model
- Performance against Future Force 2020
- Performance of DE&S including Major Projects
- Performance of Defence Infrastructure Organisation in managing the estate including personnel accommodation
- Other efficiency, effectiveness and sustainability measures of the MoD's performance in supporting the Armed Forces²⁴

²⁴ [Defence Committee Report: Ministry of Defence Annual Report and Accounts 2012-13](#), Eighth Report of Session 2013-14, HC 653

Table 1: MoD Input and impact indicators for 2013-14

Indicators	FY 2013-14	FY 2012-13	Comment
Input indicators			
Additional cost of operations in Afghanistan, per Service person deployed.	£233,151	£297,025	This is the Net Additional Cost of Military Operations in Afghanistan (including urgent Operational Requirements) over the year, divided by the average endorsed manpower level (9000 from 1 Apr 13 to 31 Dec 13 reducing to 5200 from 1 Jan 14 to 31 Mar 14). This figure is lower this year due to authorised reductions in manpower and base closures as a result of progress on the ground, increased Afghan National Security Force capability and the rate of transition.
Additional cost of new equipment (Urgent Operational Requirements (UOR)) for operations in Afghanistan, per Service person deployed.	£11,065	£37,000	This is the total spend on UORs over the year, divided by the average endorsed manpower level (9000 from 1 Apr 13 to 31 Dec 13 reducing to 5200 from 1 Jan 14 to 31 Mar 14). This figure is significantly lower this year representing the completion of the major UOR projects (such as protected mobility vehicles) and in line with authorised reductions in manpower and base closures as a result of progress on the ground, increased Afghan National Security Force capability and the rate of transition.
Average percentage by which the cost of the Department's Equipment Programme (EP) varies compared to forecasts in year.	-0.22%	0.26%	This figure is the average percentage by which the forecast costs of the Department's largest equipment procurement projects have varied over the year. This year the figure is negative, meaning that the forecast cost of these projects has fallen on average by 0.22%.
Cost of major Force Elements (FE): Ship Brigade Aircraft (fixed wing) Helicopter	£33.74M £668M £7.56M £3.74M	£33.5M £654M £8.34M £3.62M	This figure was previously calculated by attributing Defence expenditure to each of the major Force Elements. It can no longer be calculated as a consequence of changes under the delegated operating model. The figures provided for 13/14 are therefore estimates.
Direct personnel costs, per Service person.	£52,552	£55,024	This shows the average costs of each of the armed forces personnel who have been employed on a full time basis over the financial year. It has remained similar between 2012-13 and 2013-14.
Impact indicators			
Progress towards a stable and secure Afghanistan.	97%	96%	This is the percentage of Afghan National Security Forces against the NATO target.
Number of Service and MOD civilian personnel deployed on all operations in a year.	8,529	11,476	This is the total percentage of personnel deployed on operations both in the UK and overseas as at 30 March 2014.
Percentage of Service personnel that are deployable.	90.5%	91.1%	This is the total percentage of personnel deployed on operations both in the UK and overseas at 30 March 2014.
Number of Force Elements (FE) (typically ships, ground force sub-units and aircraft) showing critical or serious weakness against the total number of FE for Strategy for Defence (SfD) priorities.	—	8%	This indicator can no longer be calculated as a consequence of changes under the delegated operating model.

Percentage of Service personnel (split by Officers and Other Ranks (OR)) who are satisfied with Service life in general.	58 / 48%	59 / 50%	This drop is likely to be the continued effect of pay restraint and redundancy implementation.
Overall public favourability of the UK Armed Forces.	85%	85%	The 2013–14 figure is consistent with the percentage reported for 2012–13.
All indicators will be reviewed and updated for Annual Report and Accounts (ARAc) 2014–15			

Source: Ministry of Defence²⁵

Jon Thompson told us that the MoD had implemented nine of the 11 recommendations made by the Committee in this area although he acknowledged that the MoD was struggling to assess the MoD's impact and devise appropriate indicators.²⁶ Work was underway to review the data that the Department publishes to identify topics likely to be of interest to the general public for inclusion in the indicators table within the 2014–15 Annual Report and Accounts. Decisions in the next Defence and Security Review and Comprehensive Spending Review were likely to require the Department to develop a new set of indicators, reflecting its changing priorities over the next five years.²⁷

20. We recognise the difficulties that the MoD has in devising a relevant and comprehensive set of input and impact indicators. We welcome PUS's confirmation that the MoD has implemented most of our recommended indicators and look forward to seeing further details. We reiterate our recommendation that more of the information provided to the Defence Board should be provided to us and incorporated in the Annual Report.

The future defence budget

21. We asked Jon Thompson whether the MoD could absorb further cuts in the defence budget. He replied that it would depend on the level of reduction required but that the MoD was continuing to pursue efficiency savings delivering efficiencies of £4.3 billion over the lifetime of this Parliament (illustrated in Table 2 below).²⁸

25 [Ministry of Defence Annual Report and Accounts 2013-14](#) HC 764 page 8

26 [Q 46](#)

27 [Ministry of Defence Memorandum: Response to follow-up questions](#)

28 [Q 50](#)

Table 2: Achievement of savings

<p>Military Manpower (£1.646 billion) These savings were within the ‘non-front line’ structures of the Armed Forces, such as in Headquarters functions and Regional Command structures. The savings also include changes made to military allowances.</p>
<p>Civilian Manpower (£1.414 billion) These savings reflect the Strategic Defence and Security Review (SDSR) decision to reduce the MOD civilian workforce by 25,000, as well as reflecting savings made to civilian allowances.</p>
<p>Equipment Procurement (£88 million) There were a number of relatively minor contractual renegotiations, which were assessed at the time to save the Department £88M.</p>
<p>Equipment Support (£210 million) These savings were projected to come from a range of efficiency measures in the Equipment Support Plan (ESP), rather than savings from reducing particular fleet sizes (or deleting fleets in total, e.g. Harrier and Nimrod). This work is being taken forward with Private Sector Support to help identify cost savings across the largest support projects and develop enduring methodologies for reducing the cost of equipment support. Nearly £3Bn of potential savings over the next ten years have already been identified. £210 million</p>
<p>Estates and Utilities (£629 million) We have recently appointed a strategic business partner in the Defence Infrastructure Organisation. They are contracted to deliver significant savings over the next ten years building on almost £500M of savings achieved in running cost savings since 2010/11</p>
<p>IT and Communications (£154 million) These savings reflect decisions taken in the SDSR, including the reduction in IT terminals required (to reflect a reduced workforce) as well as the consolidation of the number of IT inventory systems as part of the Department’s efforts to improve the management of its inventory.</p>
<p>Other (£205 million) Our Spending Review 10 settlement included key asset sales, such as the sale of the Met Office, sale of Marchwood port, and the sale of the Defence Support Group. The Met Office has now transferred to BIS and is no longer the responsibility of the MOD. We are progressing innovative options to make better use of spare capacity at Marchwood Port, as opposed to an outright sale. The recent sale of the Defence Support Group to Babcock in December 2014 for £140M is a particular success, and will provide the organisation with the investment it needs to support defence equipment more effectively.</p>
<p>Total £4.346 billion</p>

Source: Ministry of Defence

22. The MoD told us that it was on track to achieve the majority of these savings; and where savings have not been made, it had been able to continue to operate within the budget provided by HM Treasury through savings made elsewhere in the Defence Programme.²⁹

Ebola

23. The Armed Forces have made a significant contribution to the treatment of Ebola in Sierra Leone. Jon Thompson outlined the extent of the UK’s commitment:

29 [Ministry of Defence Memorandum: Response to follow-up questions](#)

A range of military planners and logisticians work with the Government of Sierra Leone and DFID and FCO colleagues on planning and doing a lot of the necessary logistics, Royal Engineers have designed and supervised the construction of the various medical facilities, there are the medical personnel themselves, RFA Argus is providing the logistical lift capacity and the RAF is providing some air transport in the local area.³⁰

24. As at 12 January 2015, there were 680 military personnel including 37 members of the Canadian Armed Forces working on this operation. These included 340 in Sierra Leone, 324 on RFA Argus just off the coast of Sierra Leone, 12 in the UK, three in Ghana and one in Liberia.³¹ Jon Thompson told us that the entire cost of the operation was being met by the Department for International Development.³²

30 [Q 16](#)

31 [Ministry of Defence Memorandum: Response to follow-up questions](#)

32 [Qq 57-58](#)

3 Defence Equipment and Support

25. In April 2013, the then Secretary of State for Defence launched a competition to find a private sector organisation to run defence acquisition in the Defence Equipment and Support organisation (DE&S) as a Government-owned, Contractor-owned entity (GoCo). The commercial competition to appoint a GoCo failed in November 2013 when one of the two consortia remaining in the competition declined to submit a bid. In December 2013, the Government decided not to continue with the competition but to reform DE&S as a 'bespoke trading entity'. Defence Equipment & Support (DE&S) was established as a trading entity on 1 April 2014.

26. We asked Jon Thompson about his relationship with the new DE&S Board. He explained that he sat on the Board of DE&S and that the Chair of the DE&S Board and the DE&S Chief Executive were members of the Defence Board. Paul Skinner had been appointed as chairman and the board had been established with four non-executives. Jon Thompson explained that all management information provided to the DE&S Board was fully transparent to the Defence Board. He added

[...] I think we are reasonably clear on governance and how it is supposed to work. The introduction of some proper corporate governance and a majority non-executive board has been a good step forward. Paul Skinner is doing an excellent job as the first Chair.³³

27. He explained that DE&S would produce its own accounts from 2014–15 covering its own expenditure but not the procurement and support costs of equipment. The Chief Executive had been appointed by HM Treasury as the Accounting Officer for DE&S and he would be accountable to the Committee for the performance of DE&S.³⁴

28. Under the new arrangements for DE&S, the MoD has appointed three strategic partners: CH2M Hill for the land environment and joint enablers; Bechtel for the air and fleet environments; and PriceWaterhouseCoopers for human resources. We asked Jon Thompson about the challenge of managing multiple contractors. He explained the risks and arrangements for such a radical change:

[...] The key strategic risk is whether you can integrate CH2M Hill and Bechtel and PricewaterhouseCoopers and a fourth to come, the finance and management of information systems provider. In order to ensure that there is a clear focus on integrating those, DE&S has appointed a director who takes responsibility for integrating those partners with our own work force. We are very cognisant of the risk but, so far, working relationships between ourselves and Hill and Bechtel have been extremely good.³⁵

33 [Q 54](#)

34 Qq 54 and 66, [Ministry of Defence Memorandum: Response to follow-up questions](#)

35 [Q 59](#)

He also explained that the MoD had made a deliberate decision to maintain a diversified market for project and portfolio management given that the plan to appoint a strategic business partner to run a GoCo had been abandoned.³⁶ We asked whether, in selecting different contractors for each of the environments (land, air, fleet and the joint enablers), the MoD had reinforced any tendency towards the ‘stovepiping’ that might have emerged from the creation of each of the Services as budget holders. He replied that this was not the case but acknowledged that this was certainly a risk of the creation of five customers (the four domains and MoD head office):

We specifically were trying to avoid that, so we have created a boundary around DE&S and we have given it appropriate corporate governance. [...] You are absolutely right that the risk then is: can you integrate all that change and all these additional partners in terms of improving the quality of the performance of the organisation?³⁷

29. Jon Thompson told us that on the DE&S side, the programme was brought together at Board level and, on the MoD customer side, Deputy Chief of Defence Staff (Military Capability) had responsibility to ensure that the overall programme was coherent.³⁸ David Williams emphasised that all programmes were subject to the same central scrutiny and approvals process to a consistent set of standards and approach. He also said that the procurement challenges in the four domains were quite different:

The maritime environment is dominated by large contracts, largely on a sole source basis. The Army domain—the land domain—is a larger number of smaller contracts, often let competitively. The air domain is often where more of our international collaborative projects sit. So being able to bring different approaches to bear where they are required, while managing within the whole in a consistent way where that is needed, is the challenge.³⁹

30. As part of the establishment of the new trading entity, DE&S was given freedoms to recruit and pay its staff differently from the civil service:

- The Department [MoD] will agree with DE&S an operating cost envelope. The cost envelope will include an agreed level of efficiency [...] Within this cost envelope, DE&S will have the freedom to manage all aspects of its workforce as necessary to meet its business needs. [...]
- DE&S will have the freedom to pay 25 members of its staff more than the senior salary cap set by HM Treasury without further agreement. Should DE&S wish to appoint additional staff (above the 25), at salaries higher than the senior salary cap, individual cases will be made to seek the appropriate agreement.

36 [Q 59](#)

37 [Qq 60 and 65](#)

38 [Q 65](#)

39 [Q 65](#)

- To meet its business needs, DE&S will be exempt from relevant Cabinet Office Controls such as those on strategic supplier management, external recruitment, redundancy and compensation and consultancy.⁴⁰

31. We asked whether there was a new risk register to accommodate the changes in DE&S. Jon Thompson said that the DE&S Board considered its risk register monthly. He acknowledged that the major risk was the transformation of DE&S and the integration of DE&S and its strategic business partners. The second biggest risk was the implementation of the new pay model.⁴¹

32. Inherent in the appointment of project management contractors for the four domains is the risk of ‘stovepiping’ equipment acquisition into the three Services and Joint Forces Command at a time when the MoD is looking to develop a more integrated future force. We are sure that our successor Committee will wish to follow progress in the continuing reform of defence acquisition and will look to ensure that this risk doesn’t materialise. In response to this Report, the MoD should provide further details of how it intends to integrate the two project and portfolio contractors; the contractor providing human resource support; the yet to be appointed contractor providing the finance and management of information systems provider; and the Defence Infrastructure Organisation. It should also inform us of the current state of play on the introduction of new pay and reward arrangements.

33. The MoD should set out how it intends to judge the success or otherwise of the arrangements it is currently developing. It should also determine how it will judge whether it is appropriate to return to the market for a GoCo solution and tell us what its timetable is for making these decisions.

40 [Defence Equipment and Support, Framework Document, 13 May 2014](#)

41 [Q 61](#)

Conclusions

MoD Resource Accounts 2013–14

1. It is disappointing that, once again, the MoD was some five months late in laying its Annual Report and Accounts before Parliament. While it may have been appropriate to delay the laying of the Accounts to ensure the balance sheet figure for assets under construction was accurate, it was concerning that this problem was identified by the National Audit Office rather than by the MoD itself. We were also concerned that the resolution of the problem required a write-off of £267 million, some ten per cent of the total valuation of assets under construction. However, we are satisfied that steps are being taken to reduce the risk of such problems arising again. (Paragraph 8)
2. In response to this Report, the MoD should tell us what planning it is doing to ensure that it appropriately manages the impact of the likely changes to asset balances, such as write-offs of assets or shortening the effective operational lives of equipment, that will arise from the forthcoming Strategic Defence and Security Review. It should also tell how it intends to manage the impact of the continuing management reform of Service Commands. (Paragraph 9)
3. The MoD Annual Report and Accounts 2013–14 have again been qualified on the balances for contracts likely to contain a lease. The MoD should report to us on the results of its latest review of contracts. (Paragraph 13)
4. We are pleased to see that the MoD is finally managing to get to grips with the management and control of its inventory and capital spares and welcome the PUS's assertion that the MoD Accounts will no longer be qualified on this basis. We also welcome the commitment by the PUS to a detailed item by item impairment review following the outcome of the next Strategic Defence and Security Review. The Comptroller and Auditor General (C&AG) does, however, point to ongoing challenges in respect of systems and embedding good practice. The MoD should tell us how it will address these challenges. (Paragraph 16)
5. The strategic cost model is a crucial tool for preparation of the next Strategic Defence and Security Review. Decisions about which capabilities the UK can afford have to be taken on the basis of the most robust information and a clear understanding of the cost drivers behind capabilities. The MoD should provide us with a description of the strategic cost model, its accuracy and any limitations that it has identified in its utility. (Paragraph 18)

MoD performance and risk management

6. We recognise the difficulties that the MoD has in devising a relevant and comprehensive set of input and impact indicators. We welcome PUS's confirmation that the MoD has implemented most of our recommended indicators and look forward to seeing further details. We reiterate our recommendation that more of the

information provided to the Defence Board should be provided to us and incorporated in the Annual Report. (Paragraph 20)

Defence Equipment and Support

7. Inherent in the appointment of project management contractors for the four domains is the risk of 'stovepiping' equipment acquisition into the three Services and Joint Forces Command at a time when the MoD is looking to develop a more integrated future force. We are sure that our successor Committee will wish to follow progress in the continuing reform of defence acquisition and will look to ensure that this risk doesn't materialise. In response to this Report, the MoD should provide further details of how it intends to integrate the two project and portfolio contractors; the contractor providing human resource support; the yet to be appointed contractor providing the finance and management of information systems provider; and the Defence Infrastructure Organisation. It should also inform us of the current state of play on the introduction of new pay and reward arrangements. (Paragraph 32)
8. The MoD should set out how it intends to judge the success or otherwise of the arrangements it is currently developing. It should also determine how it will judge whether it is appropriate to return to the market for a GoCo solution and tell us what its timetable is for making these decisions. (Paragraph 33)

Formal Minutes

Tuesday 3 March 2015

Members present:

Rory Stewart, in the Chair

Richard Benyon

Mr James Gray

Mr Dai Havard

Dr Julian Lewis

Sir Bob Russell

Ms Gisela Stuart

Derek Twigg

Draft Report (*Ministry of Defence Annual Report and Accounts 2013-14*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 33 read and agreed to.

Resolved, That the Report be the Eighth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

[Adjourned till Tuesday 17 March 2015 at 2.00 pm]

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the Committee's inquiry page at www.parliament.uk/defcom.

Wednesday 7 January 2015

Question number

Jon Thompson, Permanent Under Secretary and **David Williams**, Director
General Finance, Ministry of Defence

[Q1-101](#)

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page at www.parliament.uk/defcom.

Ministry of Defence ([MoD0001](#))

List of Reports from the Committee during the current Session

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

List of Reports in Session 2014–15

First Report	The Ministry of Defence Main Estimates 2014–15	HC 469 (HC 681)
Second Report and First Joint Report	Scrutiny of Arms Export and Arms Controls (2014) First Joint Report of the Business, Innovation and Skills, Defence, Foreign Affairs and International Development Committees of Session 2014–15	HC 186 (Cm 8935)
Third Report	Towards the next Defence and Security Review Part Two: NATO	HC 358 (HC 755)
Fourth Report	The Armed Forces Covenant in Action Part 5: Military Casualties, a review of progress	HC 527 (HC 953)
Fifth Report	Armed Forces (Service Complaints and Financial Assistance) Bill	HC 508 (HC 900)
Sixth Report	Pre-appointment hearing for the Service Complaints Commissioner	HC 832
Seventh Report	The situation in Iraq and Syria and the response to al-Dawla al-Islamiya fi al-Iraq al-Sham (DAESH)	HC 690