



National Audit Office

A REVIEW BY THE
NATIONAL AUDIT OFFICE
OCTOBER 2008

Performance of the Ministry of Defence 2007-08

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This briefing has been prepared for the Defence Committee of the House of Commons to provide an overview of the work and performance of the Ministry of Defence (the Department) in the financial year 2007-08 and subsequent months.

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This review was conducted by
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This review can be found on the
NAO website at [www.nao.org.uk/
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Summary

Introduction

Aim and scope of this briefing

1 This briefing has been prepared for the Defence Committee of the House of Commons to provide an overview of the work and performance of the Ministry of Defence (the Department) in the financial year 2007-08 and subsequent months. Its aim is to help the Committee understand and consider:

- the Department's performance against the Public Service Agreement targets set in 2004, and the new agreements made as part of the Comprehensive Spending Review 2007 (Part 1);
- the Department's performance in fulfilling its key operational objectives (Part 2);
- the Department's work to improve for the future (Part 3); and
- a financial review (Part 4).

2 In such a short briefing, the intention is not to be exhaustive. Rather, each section begins with a brief overview of the Department's performance, followed by the examination of a small number of significant examples by way of illustration and as possible subjects for further examination by the Committee.

3 The contents of this briefing have been shared with the Department to ensure that the evidence presented is factually accurate. It is based entirely on publicly available documentation, including the Department's Annual Report and Accounts 2007-08 and a number of published National Audit Office reports. A full bibliography can be found at the end of the briefing.

Summary of Key Findings

4 The Department's aim is:

To deliver security for the people of the United Kingdom and the Overseas Territories by defending them, including against terrorism; and to act as a force for good by strengthening international peace and stability.

5 It is responsible for the formulation and conduct of defence policy, and providing the Armed Forces, who are the means by which this policy is delivered. The Defence Board, chaired by the Permanent Under Secretary, provides top level leadership and management, and is assisted by the Defence Operating Board, which ensures that decisions are implemented. Military operations are the responsibility of the Chief of Defence Staff, who draws on the advice of the single Service Chiefs of Staff.

6 In 2007-08, the Department's activities were managed through nine Top Level Budget (TLB) holders, eight Agencies and five Trading Funds. The nine TLBs were:

- Chief of Joint Operations;
- Fleet;
- Air Command;
- Land;
- Adjutant General;
- Defence Equipment and Support;
- Defence Estates;
- Science, Innovation and Technology; and
- Central.

On 1 April 2008, Headquarters Land Forces was formed from the merger of Land Command and Adjutant General's Command.

7 Public Service Agreement targets. In 2008, the Department conducted its final assessment of whether it met the Public Service Agreements (PSAs) which it made as part of the Comprehensive Spending Review 2004. As shown in **Figure 1**, of the six PSA targets, only one was met fully, four were judged to have been partly met, and one was not met. The Department also had a target to achieve some £2.8 billion of annual savings by April 2008; by making additional efficiencies it has exceeded this target by some £250 million. As part of the Comprehensive Spending Review 2007, a new set of PSAs was agreed. The Department does not have a lead role in the delivery of any PSA, but makes a substantial contribution to PSA 30, which is led by the Foreign and Commonwealth Office and seeks to 'reduce the impact of conflict through enhanced UK and international efforts'.

Figure 1

The Department's Public Service Agreement and Efficiency targets: final performance and interim assessments

PSA and Efficiency targets	Interim assessment 2005-06	Interim assessment 2006-07	Final performance assessment 2007-08
1. Achieve objective established for Operations and Military tasks.	● On course	● On course with some risk	● Met
2. Improve effectiveness of contribution to conflict prevention.	● On course	● Broadly on course with minor slippage	● Partly met
3. Generate forces which can be deployed, sustained and recovered at the scales of effort required.	● On course	● Some risk	● Not met
4. Play leading role in the development of the European Security Agenda.	● On course	● On course	● Partly met
5. Recruit, train, motivate and retain sufficient military personnel.	● On course	● On course with some risk	● Partly met
6. Deliver the equipment programme to time and cost.	● On course	● On course	● Partly met
2004 Spending Review Efficiency Target – realise total annual efficiency gains of at least £2.8 billion by 2007-08	● On course	● On course	● Exceeded – efficiency gains of £3.1 billion secured

Source: National Audit Office analysis of Departmental data

8 Operations. The Department's primary focus over the last 18 months has been to achieve its military strategic objectives in Afghanistan and Iraq, while continuing contributions have been made to operations in the Balkans and elsewhere. At the end of 2007-08, there were 7,800 United Kingdom personnel in Afghanistan and 6,000 in Iraq. These commitments are highly demanding and have required the Armed Forces to operate significantly above the level that they are resourced and structured to sustain over time for the seventh year in a row. Despite progress, the situation in Afghanistan in particular remains challenging.

9 Readiness. The level of actual operational commitments has an impact on the readiness of the Armed Forces to respond to potential future operations. During 2007-08, an average of 45 per cent of Force Elements (for example, an armoured brigade, a squadron of aircraft or a single ship) reported critical or serious weaknesses against their peacetime readiness targets. The Department is not currently able to generate the full Joint Rapid Reaction Force capability and critical standby capabilities, including the ability to mount a civilian evacuation mission, have been drawn on heavily to date during 2008-09 to deploy forces to Kosovo at short notice.

10 Current capability. There were significant additions, in the form of new equipment, to the capability of the Royal Navy and Royal Air Force during 2007-08, and enhancements to the structure of the Army were completed.

- The Royal Navy received the first new Astute class submarine, a new Falkland Islands Patrol vessel, and the third Type 45 air-defence destroyer.
- The Army's Future Infantry Structures reorganisation was completed in September 2007. The principle of these major reforms was the creation of multi-battalion regiments, in which each battalion would have a fixed role. Henceforth, personnel will be able to circulate between battalions to gain the necessary range of fighting roles whilst remaining in the same regiment.
- The Royal Air Force took delivery of a fifth C-17 transport aircraft and additional Typhoons. However, a contract to provide Typhoons to the Saudi Arabian government will mean that 24 further aircraft are received at a later date than was originally planned, as these are diverted to meet the Saudi order. There will continue to be challenges in meeting the requirement for strategic airlift capability until the new A400M aircraft delivers full capability in 2018.

11 Future capability. The Department did not issue an update to the Defence Industrial Strategy by the end of 2007, as it had planned to, and it continued to face difficulties in delivering its Equipment Programme on time and to budget. In response to this and in the light of its settlement in the Comprehensive Spending Review 2007, it has commissioned work to understand the real rate of defence inflation. A number of significant procurement decisions were also taken during the last 18 months.

- The contract was placed for two new aircraft carriers, to cost £3.9 billion and to be delivered in 2014 and 2016 respectively.
- A £13 billion PFI contract for manufacture and management of the Future Strategic Tanker Aircraft, due into service in 2011.
- A further £113 million is to be invested to revert the Chinook Mk 3 helicopters to Mk2/ 2a, which should make all eight available for current operations by May 2010.
- Contracts for over 300 Mastiff Medium Protected Transport Vehicles and VECTOR Light Protected Patrol Vehicles for use on current operations.

12 The structure of the Department. The Capability Review in 2007 found that the Department had a stretching set of objectives against which it was delivering well in difficult circumstances, but also that there was an urgent need to develop better top-level leadership. As a result of this, a new Defence Board has been created and Strategy Director appointed. Through a streamlining initiative, there will be a 25 per cent reduction in the number of staff at the Department's Head Office, with the loss of 300 military and 1,000 civilian posts. Office space at the Old War Office and St George's Court will no longer be needed.

13 Information technology. Following a number of high-profile incidents of data loss, the Department has been reassessing its data security policies and procedures. Meanwhile, implementation of the Defence Information Infrastructure programme, which will integrate and upgrade the Department's many disparate IT systems, has continued, although at a slower rate than planned. Though the Department had contracted to have 62,800 computer terminals installed by July 2007, only 29,000 had been delivered by the end of April 2008.

14 Service personnel. The Department had aimed that each of the three Services would have between 98 per cent and 101 per cent of the number of personnel it required by 1 April 2008. This is known as 'manning balance', but was only achieved by the Royal Air Force. The Department predicts that the Royal Navy will achieve manning balance by April 2010 and the Army will do so by April 2011. Particular shortages in certain trades, known as pinch points, are having a detrimental effect on operational effectiveness. The Department increased its expenditure on recruitment by 4.6 per cent in 2007-08 to £170 million, but this area remains challenging. To improve retention it operates a number of different schemes and has started to analyse which are having the greatest effect. Survey results show that satisfaction levels are not high in any of the three Services.

15 Reputation of Defence. Support for the Armed Forces in society as a whole remains high, at 77 per cent in March 2008, though respondents were less positive about some specific aspects of the Ministry of Defence's activities. A report commissioned by the Prime Minister, *National Recognition of our Armed Forces*, made a number of recommendations which are aimed at ensuring that the foundation for high levels of support for the Armed Forces amongst the public is not eroded in the future.

16 Financial Review. In 2007-08 the Department stayed within its resource and cash Estimates. The Net Resource Outturn was £36.3 billion against an Estimate of £38.0 billion with the underspend of £1.7 billion caused by factors such as lower than expected depreciation and forecast provisions which did not materialise. The Net Cash Requirement for 2007-08 was £33.5 billion against an Estimate of £34.7 billion, an underspend of £1.2 billion.

17 The audit of the Department's annual accounts for 2007-08 found that it had underspent against Estimates by £1.7 billion. This was the sixth year in a row when the Department underspent. The Resource Accounts as a whole were qualified by the Comptroller and Auditor General owing to a limitation of scope because the Department was not able to supply sufficient evidence to support payments of £920 million in allowances paid to military personnel. This was directly due to inadequacies in the new Joint Personnel Administration (JPA) computer system.

Part One

PSA Targets

1.1 In 2008, the Department conducted its final assessment of whether it met the Public Service Agreements (PSAs) which it made as part of the Comprehensive Spending Review 2004. As shown in Figure 1 on page 6, of the six PSA targets, only one was met fully, four were judged to have been partly met, and one was not met. The Department also had a target to achieve some £2.8 billion of annual savings by April 2008; by making additional efficiencies it has exceeded this target by some £250 million. A full analysis of each PSA target has been incorporated into the relevant section of this briefing.

1.2 As part of the Comprehensive Spending Review 2007, a new set of PSAs was agreed with Departments. Each of the new PSAs was to be cross-cutting, meaning that it has a lead Government Department but requires the efforts of more than one Department for success. The Department does not have a lead role in the delivery of any PSA, but makes a substantial contribution to PSA 30, which is led by the Foreign and Commonwealth Office and also supported by the Department for International Development. It seeks to 'reduce the impact of conflict through enhanced UK and international efforts'.

1.3 PSA 30 has four underpinning indicators, through which the Government will measure progress over the review period. These were agreed between the Foreign and Commonwealth Office and the Treasury with input from the other Departments. The Department will make a significant contribution to all of the indicators, which are set out below.

Indicator 1: A downward trend in the number of conflicts globally, in particular in sub-Saharan Africa, Europe, Central and South Asia, the Middle East and North Africa.

Indicator 2: Reduced impact of conflict in specific countries and regions (Afghanistan, Iraq, Balkans, Middle East, Sierra Leone, Democratic Republic of Congo and the Great Lakes region, Horn of Africa, Nigeria and Sudan).

Indicator 3: More effective international institutions, better able to prevent, manage and resolve conflict and build peace.

Indicator 4: More effective United Kingdom capability to prevent, manage and resolve conflict and build peace.

1.4 Some of these indicators are hard to measure through quantitative metrics, which could make it difficult to reach a definitive conclusion about whether the overall PSA has been met. In the case of Indicator 1, in particular, it may be hard to show the direct contribution of the United Kingdom to any reduction in the number of global conflicts that is observed.

1.5 With fewer PSA indicators than previously, the amount of information that the Department is mandated to report publicly will decrease. There is a risk that some data that the Department has routinely published in recent years will no longer be placed in the public domain; The Department told us, however, that, in practice, it does not expect any major change under the new reporting regime, which will cover much of the same ground.

1.6 The Department also makes a contribution to PSA 26, which looks to reduce the risk of international terrorism to the United Kingdom and its interests overseas. The specific details of this PSA target have been withheld for understandable reasons of national security.

1.7 Given the scope of the new PSAs, a new category of Departmental Strategic Objectives (DSOs) was created in 2007 to ensure a continued focus on delivery at the Departmental level. Each Department agrees its objectives with HM Treasury and they are supposed to reflect the full range of its core activities. The Ministry of Defence has three high-level Departmental Strategic Objectives, which are as follows:

DSO1: To achieve success in the military tasks we undertake at home and abroad. This is very similar to the old PSA 1.

DSO2: To be ready to respond to the tasks that might arise. The Department has two sub-objectives here: to maintain forces at the readiness levels it deems necessary, and to achieve manning balance. This is broadly similar to the old PSA 3 and 5.

DSO3: To build for the future. This is interpreted as the ability to procure military equipment to time and cost, which meets Key User Requirements. This is broadly similar to the old PSA 6.

HM Treasury required Departments to create detailed measurement and delivery plans for their Departmental Strategic Objectives by April 2008. The Department's detailed plans have not been published to date.

Part Two

Operations, readiness and international cooperation

2.1 The Department's primary focus in the reporting period has been to achieve its military strategic objectives. The Armed Forces have continued to be engaged on two highly demanding Medium Scale operations in Afghanistan and Iraq, while also supporting a number of smaller operations around the world. Most notably, they have provided the NATO-EU operational reserve battalion in Kosovo from May 2008. This has required the Armed Forces to operate significantly beyond the level that they are resourced and structured to sustain over time. Consequently, their readiness to conduct the full range of missions laid down in Defence Planning Assumptions remains constrained. The additional cost to the Department of conducting the operations in Afghanistan and Iraq in the last three years is shown in **Figure 2**. The current high operational tempo makes effective crisis resolution in other parts of the world even more important. Through the European Union and NATO and in its role as a member of the Government's restructured Conflict Prevention Pool, the Department seeks to tackle the causes of international conflict and mitigate its effects wherever it occurs.

Figure 2

The additional cost of operations in Afghanistan and Iraq, 2005-2008

Year	Afghanistan (£ million)	Iraq (£ million)
2005-06	199	958
2006-07	738	956
2007-08	1,504	1,457
Total	2,441	3,371

Source: National Audit Office analysis of Departmental data

PSA Target 1

Achieve the objectives established by Ministers for Operations and Military tasks in which the United Kingdom's Armed Forces are involved, including those providing support to our civil communities. The Department assessed that it had MET this target.

The NAO carried out work to provide assurance on the quality of the data with which the ongoing assessment of this PSA target was made in November 2006. It concluded that the overall assessment was subjective but fit for purpose, because the objectives for each operation were agreed explicitly in advance and the outcomes were reviewed by internal scrutineers.

The Department publishes useful information about the conduct of operations in Iraq and Afghanistan in its Annual Report, and faces understandable constraints related to classified material. However, the Department says little about how it makes its assessment against the PSA target, writing only that 'over the year the Armed Forces continued successfully to sustain a continuing high tempo of operations and overcame significant armed opposition, especially in Afghanistan achieving their policy and military objectives. They thus continued to deliver the overriding defence priority of supporting the Government in achieving strategic success in current operations'.

Afghanistan

2.2 With 47,000 troops in March 2008, the International Security Assistance Force (ISAF) in Afghanistan is NATO's largest ever mission. Between May 2007 and February 2008, the United Kingdom led the Regional Command (South), as well as carrying out its ongoing duties in Helmand Province. Partly for this reason, the number of United Kingdom personnel in the region rose from around 6,300 to some 7,800 by the end of 2007-08. Although it is seven years since coalition forces first entered the country, the effort to create a secure and stable future is still at an early stage. The Department's Permanent Under Secretary wrote in the Annual Report that the 'scale of the task is of course very large, so we have made little more than a start in Afghanistan. But it is an encouraging start'.¹

2.3 Fighting against Taliban forces, sometimes fierce, has continued throughout the reporting period, obliging ISAF to divide its attention between disrupting insurgency and rebuilding the country. Sixty-five Service personnel have been killed in the country since April 2007, bringing the total number of deaths since the start of Operation HERRICK to 120 [at 13 September 2008]. The use of improvised explosive devices, in particular roadside bombs, by enemies of ISAF has been a persistent challenge. The Department is improving its ability to detect and deal with such devices through a major countermeasures research programme. The number of helicopter flying hours available to commanders in Afghanistan was increased by over a third during the year, reducing the journeys that need to be made by road. A £30 million contract was awarded in September 2007 for the production of over 200 Supacat "M-WMIK" road vehicles, which offer greater protection to forces on patrol through enhanced speed and firepower.

¹ Annual Report and Accounts 2007-2008, p. 8.

2.4 The Armed Forces have contributed to the training and equipping of Afghan National Army and police force personnel, and to projects such as the reconstruction of the Kajaki Dam. The Department's Annual Report has no coverage of drug reduction activities in Afghanistan, which is covered in the Foreign and Commonwealth Office Annual Report, as the lead Department, but other sources show that decreasing opium poppy production has proved difficult.²

Iraq

2.5 During 2007-08 the number of United Kingdom personnel deployed in the Gulf region, under the United Nations mandate, decreased from some 8,100 to 6,000, of whom around 4,100 remained in Iraq. However, the net additional cost of the operation grew in 2007-08, in large part because of work to improve the infrastructure at Basra Air Station, where the vast majority of United Kingdom troops are now garrisoned.

2.6 By December 2007, security responsibility for all provinces in the Multi-National Division (South East) area had transferred to the Iraqi authorities. This was as a result of improvements in the security situation and the multinational coalition's positive assessment of the Iraqi Security Forces' increased capability. The handover of former coalition bases to the Iraqis has also involved the gifting of equipment and infrastructure. The British forces at Basra Air Station now operate in an 'overwatch' role, monitoring the situation and providing assistance to the local Armed Forces on request. This has allowed a greater focus on training and reconstruction activities, including:

- training and mentoring the 10th and 14th Divisions of the Iraqi Army;
- developing the Iraqi Navy and Marines at Umm Qasr Naval Base;
- training and mentoring the Iraqi Department of Border Enforcement;
- redeveloping Basra International Airport;
- constructing social facilities, including a health centre and girls' primary school;
- building a new market in Al Basra; and
- restoring the Al Ashar Bridge, one of the main routes into Basra.

2.7 Within the context of increased calm, serious acts of aggression have occurred. Violent clashes between local groups erupted in January 2008, following the Shia Ashura festival, but were dealt with by the Iraqi Security Forces, requiring only limited support from the multinational coalition. Since April 2007 [as at 13 September 2008], 41 Service personnel have been killed, bringing to 176 the total number of Armed Forces personnel or MoD civilians who have died since the start of Operation TELIC in 2003.

2 Afghan Winter Rapid Assessment Opium Survey, Preface.

2.8 In January 2008, Brigadier Robert Aitken's report was published, looking into a small number of cases of deliberate abuse and unlawful killing by British forces in Iraq in 2003 and 2004. It found that widespread changes had been made to ensure that all members of the Armed Forces will be aware in future of legal and illegal behaviour with regard to civilian prisoners. It acknowledged that court cases had, in most cases, failed to find any British soldier guilty of the crimes committed, but warned that, since Iraqis had died in circumstances that obviously involved British forces, there was a clear risk that 'those decisions could now be interpreted as the Army having in some way failed to discharge its duty to maintain professional standards'.³ In May 2008, a full Public Inquiry was announced by the Government into the death of Baha Mousa. In June 2008, there were only 10 Iraqi citizens in British custody in Iraq and there have been no substantiated instances of abuse since April 2004.

Kosovo

2.9 Kosovo declared independence from Serbia in February 2008. As part of the United Kingdom's commitment to supporting Kosovo's development as a stable, secure and prosperous place, the Department deployed 2nd Battalion, The Rifles at short notice in late May 2008, under the auspices of the joint NATO-EU operational reserve force. The one-month deployment provided KFOR Commanders with extra flexibility and surge troops to reinforce anywhere in the country following its formal emergence as a constitutional state on 15 June. The forces have now returned.

NATO

2.10 In addition to contributions to NATO-led missions, as described above, the Department has continued to play a central role in the Alliance's political development and is determined to ensure that it has a robust and sustainable future. The culmination of these efforts in the most recent period was the Summit held in Bucharest in April 2008, which saw movement towards the United Kingdom's objectives in all key areas.

- **The involvement of all members in the full range of NATO's activities.**
The leadership of France signalled that the country now intends to re-engage fully in the Alliance's military structure, following 42 years when it did not participate in the integrated military command.
- **A fair distribution of effort in member states' contributions to operations in Afghanistan.** The UK welcomed the clear and unambiguous reiteration by the representatives of the international community of their long-term commitment to work together with the Government of Afghanistan to build an enduring, stable, secure, prosperous and democratic state.

³ The Aitken Report, p. 20.

- **Enlargement.** Albania and Croatia were invited to commence the accession process, while a similar invitation to Macedonia was delayed. Georgia and Ukraine were given a commitment that they will one day become members.
- **Modernisation.** The Department believes it essential that NATO reforms to become more efficient in meeting its key objectives. A meeting of Defence Ministers was held in London in September 2008 to look at this issue specifically.

European Union

2.11 Although a unified European Security and Defence Policy is still at a developmental stage, the European Union, with Departmental support, has been able to launch significant missions to Chad and the Central African Republic during the reporting period. Political differences remain about a future EU defence policy, in particular regarding the relationship that should exist between the EU and NATO.

2.12 Progress has been made towards meeting the requirements of the EU Headline Goal 2010. This target, set in 2004, aims, by 2010, to make the EU able to respond 'with swift and decisive action [and] a fully coherent approach' to a spectrum of crisis operations. A Progress Catalogue, published in November 2007, presented and analysed the contributions that member countries are currently prepared to make. It found that:

- the capabilities offered broadly met the level of ambition;
- there are gaps in some key enabling capabilities, such as strategic lift, intelligence, surveillance, target acquisition and reconnaissance, and protected fighting vehicles; and that
- until the shortfalls are reduced, there would be an over-reliance on the capabilities of larger EU countries.

As a first step to closing these gaps, the European Defence Agency is revising its Capability Development Plan to recommend to EU member states where they should concentrate their efforts in capability development. However, such efforts tend to have a long lead time because of procurement and manufacture cycles.

PSA Target 4

Play a timely role in the development of the European Security Agenda, and enhance capabilities to undertake timely and effective security operations, by successfully encouraging a more efficient and effective NATO, a more coherent and effective European Security and Defence Policy operating in strategic partnership with NATO, and enhanced European defence capabilities. (This is a joint target with the Foreign and Commonwealth Office).

The Department assessed that it had **PARTLY MET** this target. It cited progress in the three areas that make up the target – NATO effectiveness, European Security and Defence Policy coherence, and the enhancement of European defence capabilities – but made it clear that there is more to be done in each area as well.

Arms Control and Conflict Prevention

2.13 The Department contributes to international efforts to reduce the quantity of arms in the hands of rogue states and to reduce overall the amount of nuclear, biological and chemical weapons in existence. The Department reported that a particular achievement during 2007-08 was the progress made in destroying stockpiles of chemical weapons created by the former Soviet Union before 1990.

2.14 The Russian Federation has the world's largest declared stockpile of chemical weapons: 40,000 tonnes comprising mostly nerve agents such as Sarin. Under existing treaty commitments it must destroy these by 2012. The Department has a lead role in international efforts to build a chemical weapons destruction facility at Shchuch'ye in time to meet these commitments. On behalf of international partners it has placed contracts worth more than £75 million for work at Shchuch'ye; more than £20 million is United Kingdom funding. Progress during the last year has meant that a target to complete construction of the facility by the end of 2008 is due to be met.

2.15 Until April 2008, the United Kingdom ran two separate conflict prevention pools, one specifically for Africa and the other for the rest of the world. Their role was to bring together the Department, the Foreign and Commonwealth Office and the Department for International Development. The two pools have now been united in a single Conflict Prevention Pool, which will focus more on a small number of long-term programmes in an effort to have greater impact. A new Stabilisation Aid Fund was also created with £269 million to invest in projects in areas where conflicts have occurred, including in Afghanistan and Iraq. Capacity building amongst the legitimate security forces of vulnerable countries and better control of small arms are to be particular areas of attention.

Concurrency

2.16 The Armed Forces have been operating at, or above, the routine level of operations that the Department is structured and resourced to deliver in every year since 2001. This measure is calculated by an examination of the number and size of different military activities that are being undertaken simultaneously, and is known as concurrency.

See Figure 4 on page 19.

2.17 The Department acknowledges that achieving this has only been possible at the expense of the readiness of the Armed Forces to undertake contingent operations, and with an unavoidable impact on Service personnel. The current level of commitment is understandable given the scale of operations in Afghanistan and Iraq; however, in its Annual Report, the Department writes:

*'Although the force structure is designed to be resilient, it cannot sustain indefinitely the nature, scale and intensity of operations being conducted in Iraq and Afghanistan over the last two years. We therefore continue to analyse the qualitative impact this is having and to develop and cost a programme designed to restore full capability once commitments return to levels anticipated within Defence Planning Assumptions.'*⁴

⁴ Annual Report and Accounts 2007-2008, p. 43.

PSA Target 2

By 2008, deliver improved effectiveness of United Kingdom and international support for conflict prevention by addressing long-term structural causes of conflict, managing regional and national tension and violence, and supporting post-conflict reconstruction, where the United Kingdom can make a significant contribution, in particular Africa, Asia, the Balkans and the Middle East. (This is a joint target with the Foreign and Commonwealth Office and the Department for International Development.)

The Department, in consultation with Other Government Departments, assessed that it had **PARTLY MET** this target.

It provided an analysis against each of the twelve regions and issues where it has sought to have an impact. **See Figure 3.**

The Government does not act on its own in these areas and many initiatives are undertaken through international bodies or in conjunction with allies. Conflict regions are volatile places, where the environment can deteriorate at short notice and for reasons that may be complex and opaque. It is, therefore, important to recognise that failure to meet these targets may not indicate straightforwardly a failure of British Government policy.

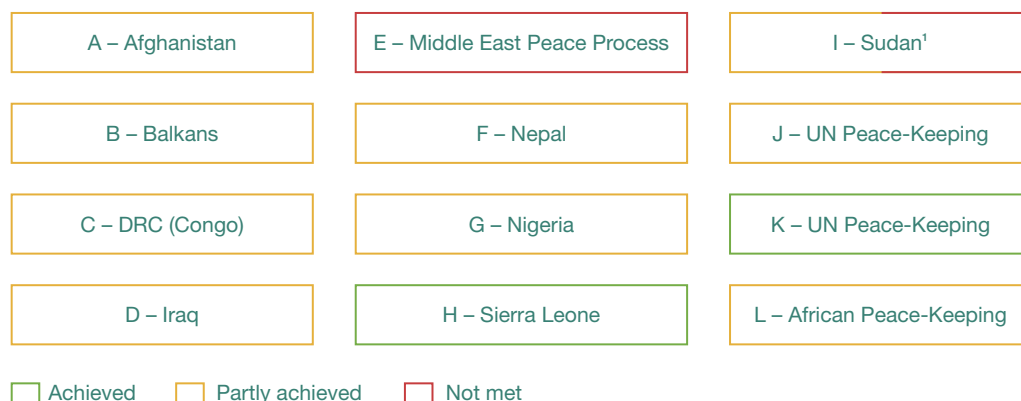
The Government met its targets with respect to the situation in Sierra Leone and on increasing the number of effective United Nations peacekeepers.

In eight of the remaining areas targets have been partly met. In the Annual Report, a wealth of information to support this conclusion is included in respect of Afghanistan and Iraq. However, in the case of other countries, the Department has limited itself to a short narrative summary, which is generally positive. It is, therefore, difficult to understand in what way progress falls short of the target in these countries.

The specific target regarding the implementation of the 2004 Comprehensive Peace Agreement on Sudan was also partly met, but Darfur was not included when the target was set in 2004. If it is included, the sub-target would not have been met since progress to resolve the Darfur conflict was limited. The Sudan box in Figure 3 shows this position.

Continuing violence and stalled negotiations meant that the target for the Middle East Peace Process was judged not to have been met.

Figure 3
Performance against sub-targets on conflict prevention

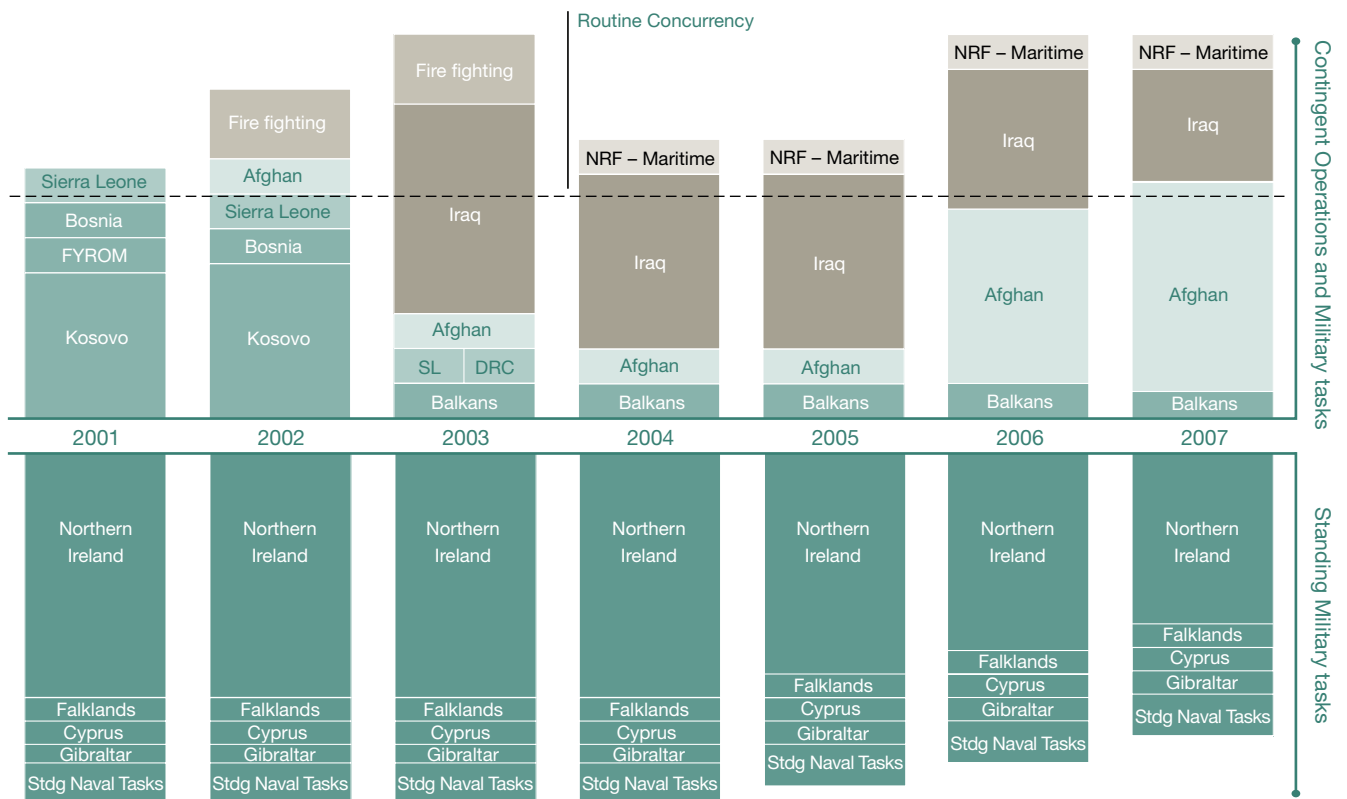


Source: Ministry of Defence Annual Report and Accounts, 2007-2008

NOTE

1 See PSA Target 2 Box.

Figure 4
 Armed Forces' Level of Operational Commitments against Defence Planning Assumptions since 2001



DRC: Democratic Republic of Congo
 FYROM: Former Yugoslav Republic of Macedonia
 NRF: NATO Reaction Force
 SL: Sierra Leone

Source: Ministry of Defence Annual Report and Accounts, 2007-2008

PSA Target 3

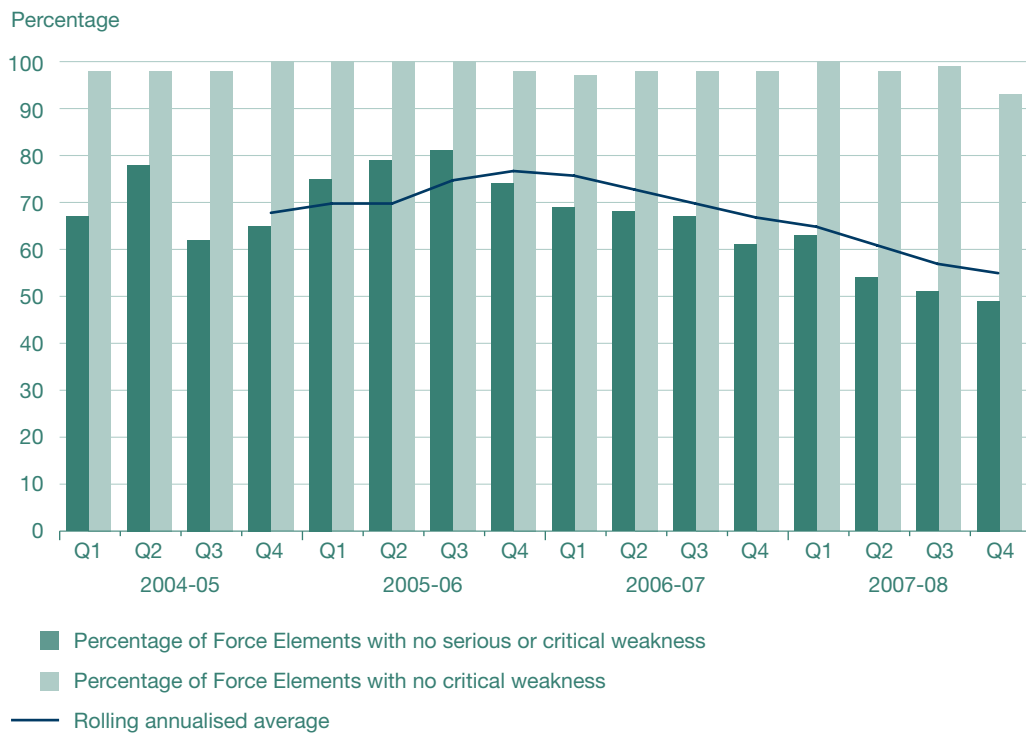
Generate forces which can be deployed, sustained and recovered at the scales of effort required to meet the Government's strategic objectives. The Department assessed that it had **NOT MET** this target.

Its goal was that, by April 2008, more than 73 per cent of Force Elements would show no serious or critical weakness against their required peacetime readiness levels.

During the period since the Comprehensive Spending Review 2004, the target was met in only five of 16 quarters and for the last time between January and March 2006. As shown in **Figure 5**, between January and March 2008, only 49 per cent of Force Elements showed no serious or critical weakness against peacetime readiness targets. The number exhibiting critical weaknesses reached its highest level in four years between January and March 2008, at seven per cent of all Force Elements.

Figure 5

Percentage of Force Elements showing serious or critical weakness against peacetime readiness levels, 2004-2008



Source: Ministry of Defence Annual Report and Accounts, 2007-2008

Readiness

2.18 The level of actual operational commitments has an impact on the readiness of the Armed Forces to respond to future, or contingent, operations. The real commitments of the Armed Forces at the moment mean that they cannot simultaneously be ready for the full range of potential operations described in planning assumptions, though this situation brings obvious risks. During 2007-08, an average of 45 per cent of Force Elements (for example, an armoured brigade, a squadron of aircraft or a single ship) reported critical or serious weaknesses against their peacetime readiness targets. This means that one of the Department's 2004 PSA targets has not been met.

2.19 In particular, the Department is not currently able to generate the full Joint Rapid Reaction Force capability, which is intended to be a pool of agile and trained forces, ready to deploy in support of Britain's foreign and security policy objectives. Critical standby capabilities, which include the ability to mount a civilian evacuation mission, were maintained in 2007-08, but have been drawn on heavily in 2008-09 to deploy the Operational Reserve Force to Kosovo.

2.20 The challenges to achieving readiness are different in each of the three Services.

- In the Royal Navy, the readiness of the surface fleet for the full range of potential future operations has been reduced primarily because of the Department's decision to reduce the amount of money spent on supporting some ships between 2004 and 2006.
- In the Army, the main cause of reduced readiness has been operations, with the entire deployable force of the Field Army having been committed to operations at least once between September 2006 and October 2008. Overall, the Army continued to run close to the limits of the level of actual operational activity it is able to sustain. When force elements that would normally be held at high readiness for potential operations have to be committed to actual operations, other non-deployed units take on these high-readiness responsibilities in addition to their existing roles. This is known as "double-hatting", and increases the theoretical risks of the Department not being able to fulfil an operational requirement.
- In the Royal Air Force, the majority of force elements have been reporting some weaknesses in their ability to meet readiness targets. This is due to a combination of lack of training opportunities and the fact that there are shortages of personnel and equipment, because of the numbers committed to actual operations. Operational losses of aircraft and planned modification and maintenance programmes have had a particular impact.

Exercises

2.21 The provision of high-quality basic and specialist training to new recruits and of mission specific training for current operations have understandably been the Department's main priorities during the reporting period. This includes collective training, which is also known as exercises, where a unit or group of units practice battle formations in an environment that is as close to likely realities as possible. With limited resources, the Department has had to take difficult decisions about the relative priority of conducting exercises which are designed to test the skills needed in current operations and others which are meant to test the full range of skills that might be needed on future operations.

2.22 As shown in **Figure 6**, some 10 per cent of military exercises in the Defence Exercise Programme had to be cancelled in 2007-08. Although the total number of exercises held has been increasing year by year recently, the Department stated in its Annual Report that this was mainly the result of better recording of collective training events. When exercises have to be cancelled, this can have a detrimental effect on readiness levels.

Figure 6

The number of exercises scheduled and cancelled since 2004-05

Year	Scheduled training events	Cancelled events	Cancelled events as a percentage of all training
2004-05	379	79	20.8
2005-06	533	58	10.8
2006-07	680	64	9.4
2007-08	722	76	10.5

Source: Ministry of Defence Annual Report and Accounts, 2007-2008

Part Three

An Effective Future

3.1 In order to ensure that it has the capabilities required to meet the tasks of tomorrow, the Department needs to be successful in developing itself on several different fronts. The last year has seen changes to the structure of the three Services near maturity, while ambitious programmes have been initiated to streamline and improve the leadership skills of the Department's civilian staff. Important change programmes – the Defence Information Infrastructure and Joint Personnel Administration in particular – have brought some benefits but also faced significant difficulties. The Department has recently acknowledged serious weaknesses that it must address in the areas of health and safety and data handling.

3.2 The Department continues to struggle to deliver the Equipment Programme to cost and on time, though it believes the principles underpinning the Defence Industrial Strategy remain valid. Important procurement decisions were reached about the construction of new aircraft carriers and the conversion of Chinook Mark 3s.

3.3 The recruitment and retention of a sufficient number of suitable personnel is an ongoing challenge, with manning balance being achieved only in the Royal Air Force during 2007-08. However, the Department reports that personnel serving in the Armed Forces are benefiting from a renewed focus on care and assistance. The Department also enables the smooth integration of ex-Service personnel back into civilian life through training and support.

The Capability of the Royal Navy

3.4 As at 1 April 2008 the Royal Navy, including the Royal Marines, had a total trained strength of some 35,000 officers and sailors against a requirement of 36,260, a shortfall of 1,260 personnel. During 2007-08, the Royal Navy decided that it would continue to run three Naval Bases at least until 2018, and a number of new vessels were launched: the first new Astute class submarine; HMS Clyde, the Falkland Islands Patrol vessel; and Diamond, the third Type 45 air-defence destroyer. The contract was also signed in 2008 for two new aircraft carriers. A few weeks earlier, the Department confirmed that it would now only be buying six Type 45 ships in total, two fewer than it had most recently intended to procure and half as many as originally planned.

3.5 The year also saw the delivery of RFA Lyme Bay, the fourth and final Landing Ship Dock (Auxiliary). In November 2007, the NAO published the findings of an investigation it had carried out into this programme, which had faced significant difficulties. Costs had increased from an estimated £332 million at the start in 2001 to an actual outturn of £596 million, and the four ships entered service between 12 and 29 months later than originally intended.

3.6 The report concluded that the programme got off to an unrealistic start, in particular in terms of estimating how much the four ships would cost. Independent benchmarking commissioned by the NAO found that a cost of between £521 million and £656 million was always more likely for a project of this type. The decision to build the ships at two different yards, owned by different companies, also added complexity and made the original schedule unachievable. However, the ships, now in service, are delivering a new level of capability and have met eight out of ten Key User Requirements.

The Capability of the Army

3.7 Headquarters Land Forces was formed on 1 April 2008 from the merger of Land Command and Adjutant General's Command. As at 1 April 2008 the Army had a total trained strength of 98,270 officers and soldiers, a shortfall of 3,530 personnel against the requirement of 101,800. The Future Infantry Structures programme was completed, in September 2007, with the creation of the Mercian Regiment from three smaller regiments. The organising principle of the reforms was the creation of multi-battalion regiments, where each battalion would have a fixed role. Thus, personnel can now circulate between battalions to gain the necessary range of fighting skills whilst remaining in the same regiment, which the Department accepts is a vital factor in maintaining morale and *esprit de corps*. The largest regiments, the Rifles and the Royal Regiment of Scotland, are now made up of five battalions each; previously, the largest was the Parachute Regiment with only three battalions. **Figure 7** shows how the structure of the infantry has changed since 2004.

Figure 7
Changes to the structure of the Infantry by April 2008

	2004	2008
Guards Division	Grenadier Guards (1) Coldstream Guards (1) Scots Guards (1) Irish Guards (1) Welch Guards (1)	Grenadier Guards (1) Coldstream Guards (1) Scots Guards (1) Irish Guards (1) Welch Guards (1)
Scottish Division	Royal Scots (1) King's Own Scottish Borderers (1) Royal Highland Fusiliers (1) Black Watch (1) Argyll and Sutherland Highlanders (1) The Highlanders (1)	Royal Regiment of Scotland (5) (Note: each of the five battalions has a name linking it with one of the disbanded regiments.)
King's Division	Green Howards (1) Duke of Wellington's Regiment (1) Prince of Wales's Own Regiment of Yorkshire (1) Queen's Lancashire Regiment (1) King's Own Royal Border Regiment (1) King's Regiment (1)	Duke of Lancaster's Regiment (2) The Yorkshire Regiment (2)
Prince of Wales' Division	Cheshire Regiment (1) Royal Welch Fusiliers (1) Royal Regiment of Wales (1) Royal Gloucestershire, Berkshire and Wiltshire Regiment (1) Devonshire and Dorset Regiment (1) Worcestershire and Sherwood Foresters Regiment (1) Staffordshire Regiment (1)	Mercian Regiment (3) Royal Welsh (2)
Queen's Division	Princess of Wales's Royal Regiment (2) Royal Regiment of Fusiliers (2) Royal Anglian Regiment (2)	Princess of Wales's Royal Regiment (2) Royal Regiment of Fusiliers (2) Royal Anglian Regiment (2) Royal Gibraltar Regiment (1)
Light Division¹	Light Infantry (2) Royal Green Jackets (2)	
The Rifles¹		The Rifles (5)
Other Regiments	Royal Irish Regiment (1) Parachute Regiment (3) Royal Gurkha Rifles (2) Royal Gibraltar Regiment (1)	Royal Irish Regiment (1) Parachute Regiment (2) Royal Gurkha Rifles (2)

Source: National Audit Office analysis of Departmental data

NOTE

¹ The number in brackets after each regiment refers to the number of battalions within it. The Rifles Regiment was newly formed from the existing Light Infantry and the Royal Green Jackets.

3.8 To allow it to respond to the demanding tempo of current operations, the Army has also made a number of temporary structural changes to reduce the proportion of troops breaching harmony guidelines and provide specific capabilities to operational theatres. The most significant changes are as follows:

- Formation of 6 Division Headquarters in York to provide a third deployable two-star headquarters until the end of 2011 for deployment to Afghanistan;
- Formation of 11 Light Brigade Headquarters in Aldershot in November 2007 to command UK forces in Afghanistan between October 2009 and April 2010;
- New arrangements for the three Armoured Infantry battalions based around the edge of Salisbury Plain to support training there, in order to enable the Warminster Battalion to deploy on operations;
- Augmentation of Headquarters 104 Logistic Support Brigade to enable it to deploy on operations;
- Temporary new roles for a number of regiments to offer different capabilities in Afghanistan. For instance, five Artillery System 90 batteries are deploying Tactical Unmanned Aerial Vehicles.

The Capability of the Royal Air Force

3.9 A single, integrated Air Command was created on 1 April 2007. As at 1 April 2008 Air Command managed 40,620 trained officers, airmen and women, a shortfall of 690 against a requirement of 41,210. In response to the changing role of the Royal Air Force on operations, a new Force Protection headquarters was formed at RAF Coningsby and a new Field Squadron regiment at RAF Honington in May 2008.

3.10 During the period, Typhoon squadrons continued to increase in size. However, the decision to sell Typhoons to the Saudi Arabian government, announced in September 2007, means that the Royal Air Force will now receive 24 of its Typhoons at a later date than was originally planned, as these are diverted to fulfil the Saudi order. The capability gap will be met by retaining more Tornado aircraft for longer. Predator Unmanned Air Vehicles were also introduced into service, providing the capability to mount long-distance surveillance and reconnaissance missions.

3.11 A fifth C-17 transport aircraft was delivered, strengthening the air-bridge between the United Kingdom and Afghanistan and Iraq. This was, in part, a response to the impact of operations on the Department's fleet of 43 Hercules aircraft, which provide tactical and strategic lift. The Hercules fleet was the subject of an NAO study published in June 2008. The study's main findings were as follows:

- The Department is meeting the current requirement for Hercules aircraft in Afghanistan and Iraq despite a declining fleet size resulting from the retirement of the Hercules C-130K (the older of the two models) and losses on operations. This is being done, in part, by placing greater reliance on the Hercules C-130J, which will ultimately have the effect of shortening that aircraft's service life if the pattern of current use continues.
- The Department also spent £130 million to charter additional airlift in 2007-08.
- Understandably, operational tempo has also led to a reduction in routine training flights and participation in exercises by the aircraft. There was a tenfold increase in the number of training flights cancelled in 2007 compared to 2005.
- The last Hercules C-130K will retire in 2012, while the first batch of its replacement aircraft, the A400M, is unlikely to be delivered to the United Kingdom before the end of 2011, two years later than planned. However, there will be a reduction in the availability of tactical fixed wing airlift capability around this time because the C130-J fleet will begin a programme of upgrades decreasing the number of aircraft available to fly. While some of the United Kingdom's A400M fleet should be in service by then, it will not deliver the full range of operational benefits until 2018.

The Structure of the Department

3.12 In 2007-2008 the Department's activities were managed through nine Top Level Budget (TLB) Holders, eight Agencies and five Trading Funds, as shown in **Figure 8** overleaf.

3.13 The independent Capability Review of the Ministry of Defence in March 2007, commissioned by the Cabinet Office, found that overall the Department had a stretching set of objectives, on which it was delivering well in the face of challenging operational commitments. However, it found a need for urgent development in the area of leadership, concluding that the Defence Management Board had not consistently presented a unified corporate front, but rather acted as a group of representatives for the interests of different parts of the Department. A need for greater clarity about the roles, responsibilities and accountabilities of Departmental staff was also identified.

3.14 As a result, the Department has embarked on a two-year programme to address these areas of relative weakness. From January 2008 under the Head Office Streamlining Programme, the Defence Management Board was replaced by the Defence Board, placing greater emphasis on the Board's strategic oversight and the direction of defence. Its principal function is to make the high-level decisions necessary to ensure that defence delivers its final outputs. It also provides strategic direction to the Department and manages performance. From April 2008, a simplified supporting board and committee structure was created to strengthen personal authority and accountability at senior levels within Head Office. A new Defence Operating Board was established as the means by which the decisions of the Defence Board and Chiefs of Staff Committee are seen through.

3.15 The most radical changes are to come at the Department's Head Office in Whitehall. Under the Streamlining initiative, an important part of the Department's follow-on work to the 2007 Capability Review, there will be a reduction in the size of Head Office of 25 per cent by April 2010, with the associated loss of some 300 military and 1,000 civilian posts. The Department will no longer need office space at the Old War Office and St George's Court, its other two Central London office buildings.

Figure 8

The Structure of the Department 2007-2008

Top Level Budget (TLB) Holders (9)

Chief of Joint Operations	Fleet
Air Command	Land
Adjutant General	Defence Equipment and Support
Defence Estates	Science, Innovation and Technology
Central	

Defence Agencies (8)¹

Defence Analytical Services Agency (DASA)	Defence Medical Education and Training Agency (DMETA)
Defence Storage and Distribution Agency (DSDA)	Defence Vetting Agency (DVA)
MoD Police and Guarding Agency (MDPGA)	People, Pay and Pensions Agency (PPPA)
Service Children's Education (SCE)	Service Personnel and Veterans Agency (SPVA)

Trading Funds (5)²

Army Base Repair Organisation (ABRO)	Defence Aviation Repair Agency (DARA)
Defence Science and Technology Laboratory (DSTL)	Met Office
UK Hydrographic Office (UKHO)	

Other Bodies

The Department also sponsored five executive and eleven advisory Non-Departmental Public Bodies (NDPBs), two Public Corporations, a Stakeholder Advisory Board and an independent Monitoring Board.

Source: Ministry of Defence Annual Report and Accounts, 2007-2008

NOTE

- 1 On 1 April 2008 Agency status was removed from the Defence Analytical Services Agency and the Defence Medical Education and Training Agency.
- 2 On 22 May 2007 Ministers announced the intention to create a new defence support organisation by merging the Army Base Repair Organisation, retained business units from the Defence Aviation Repair Agency and certain other defence support facilities. The new Trading Fund, the Defence Support Group (DSG), began formal trading on 1 April 2008.

3.16 These developments build on the staffing and organisational changes made between 2004 and 2007, which were largely aimed at meeting the efficiency target set by HM Treasury as part of the 2004 Comprehensive Spending Review. These are summarised in **Box 1**.

3.17 On 1 April 2008, the Department removed Agency status from the Defence Medical Education and Training Agency (DMETA), leaving eight executive agencies (2006-07: 17, 2005-06: 20 and 2004-05: 26). Two Trading Funds, the Army Base Repair Organisation (ABRO) and the Defence Aviation Repair Agency (DARA), were merged to form a new single Trading Fund, the Defence Support Group (DSG).

Defence Industrial Strategy

3.18 The first Defence Industrial Strategy, published in December 2005, had the intention of improving relations between the Department and industry in the procurement of defence equipment. It has been instrumental in deciding the shape and size of the United Kingdom's defence industrial base. In the last year, the greatest progress has been seen in the area of naval shipbuilding, where, motivated by the order for aircraft carriers, BAE SYSTEMS and VT Group have agreed to form a joint venture. The Department also sees as a particular achievement the formation of Team Complex Weapons in July 2008, an innovative partnership with industry to design the next generation of guided, precision weapons.

Box 1

Comprehensive Spending Review 2004 Efficiency Target.

The Department agreed that it would realise total annual efficiency savings of at least £2.8 billion by 31 March 2008, of which 75 per cent would be cash releasing. In the event, the Department reported a higher achievement, realising efficiencies of some £3.1 billion, of which 85 per cent were cash releasing. Other elements of the efficiency goal included the following.

- A target to reduce civilian staff by at least 10,000. By the end of the period, civilian staff numbers had fallen by 17,500.
 - A target to reduce military posts in administrative and support functions by at least 5,000. Reductions of nearly 5,500 have been made.
 - A target to relocate 3,900 posts from London and the South East by 2010. The Department is on target to achieve this with a net relocation of 2,700 posts out of the targeted area at the end of 2007-08.
-

3.19 The Defence Industrial Strategy was to have been superseded by a revised strategy within two years. However, delays in finalising its spending plans for the full period covered by the Comprehensive Spending Review 2007 have led the Department to postpone issuing the new version, with no date set for publication as yet. Though it may be appropriate to wait until there is clarity about spending plans into the future, there is a clear risk that continued postponement in issuing the new strategy may mean that the Department's relationship with industry becomes unfocussed or less relevant. Decisions taken in the absence of an updated strategy, whilst sensible for individual projects, may have detrimental effects on the long-term sustainability of a range of existing and planned capabilities.

Future Equipment Procurement

3.20 The Department currently spends some £6.5 billion per year to procure military equipment for the Armed Forces. Due to their scale and complexity, most projects in the Equipment Plan last for a number of years. Contracts that are signed now will have budgetary consequences for a long time to come and the Department must, therefore, plan its expenditure well into the future.

3.21 Figure 9 lays out the main developments in terms of equipment delivered and contracts let since April 2007. The next sections deal, in greater detail, with the contract for new aircraft carriers and the project to revert eight Chinook Mark 3s to Mark 2s.

3.22 The Department secured an annual increase in its budget above the rate of general inflation for the three years covered by the Comprehensive Spending Review 2007. However, for a number of reasons, including potentially the higher rate of defence-specific inflation, its Equipment Plan is facing affordability challenges in the future. Some short-term problems were eased in the Department's Planning Round 2008, but a number of issues remained unresolved in the medium term and were the subject of further examination over the summer of 2008. The results of this work are being used in Planning Round 2009, which should produce firm equipment spending plans for both 2009-10 and 2010-11 and new projections over ten years. Speaking in a debate on Defence Procurement in the House of Commons in June 2008, the Minister for the Armed Forces accepted that 'the uncertainty about our future equipment programme has been unsettling' and added that 'the equipment examination is designed to give us the clarity we need to move forward with industry, confident that we are heading in the right direction'. See paragraph 4.3 below for a more detailed discussion of defence inflation.

Figure 9

Key New Contracts Let and Equipment Delivered in 2007-08

	Key Equipment Delivered	Key New Contracts Let
Royal Navy	<p>RFA Lyme Bay, the fourth and final Landing Ship Dock Auxiliary.</p> <p>HMS Diamond, the third Type 45 Destroyer.</p>	<p>A contract for two new aircraft carriers, HMS Queen Elizabeth and HMS Prince of Wales, to be delivered at a cost of £3.9 billion in 2014 and 2016 respectively.</p> <p>A contract for the support of Portsmouth Naval Base for six years at a cost of £496 million.</p> <p>A ten-year partnering contract with Rolls Royce, worth £1 billion, to provide support to nuclear propulsion equipment for the Navy's submarines.</p>
Army		<p>A contract worth £100 million with Lockheed Martin UK INSYS for Land Environment Air Picture Provision, which will provide ground forces with a detailed local picture of activity in the air, thereby reducing 'friendly-fire' incidents and improving combat effectiveness. The system is due to enter service in 2012.</p>
Royal Air Force	<p>Eight Typhoon combat aircraft delivered.</p> <p>Delivery of the fifth C-17 Globemaster III strategic transport aircraft.</p>	<p>A £130 million contract for a sixth C-17 Globemaster III strategic transport aircraft.</p> <p>A £13 billion PFI contract for manufacture and management of the Future Strategic Tanker Aircraft, which will be Airbus A330-200s. The first aircraft is due to enter service in 2011 and will serve for thirty years.</p> <p>The £635 million Military Flying Training Systems Partner contract with ASCENT.</p>
Tri-Service	<p>The launch of the second and third Skynet 5 communications satellites in November 2007 and June 2008.</p>	<p>A contract for the deployable version of the Defence Information Infrastructure, costing £270 million and intended to deliver 3,300 terminals for commanding military operations. The first terminals are due to be delivered in January 2009.</p> <p>A Long Term Partnering Agreement with QinetiQ for Test, Evaluation and Training Support Services over five years, worth £952 million.</p>
Urgent Operational Requirements		<p>174 additional Mastiff Medium Protected Transport Vehicles and Ambulance variants for delivery from July 2008 onwards.</p> <p>166 VECTOR Light Protected Patrol Vehicles and 12 Ambulance variants.</p> <p>60mm ammunition production.</p> <p>Armouring of Warrior vehicles.</p>

Source: National Audit Office analysis of Departmental data

PSA Target 6

Deliver the equipment programme to cost and time.

The Department assessed that it had **PARTLY MET** this target.

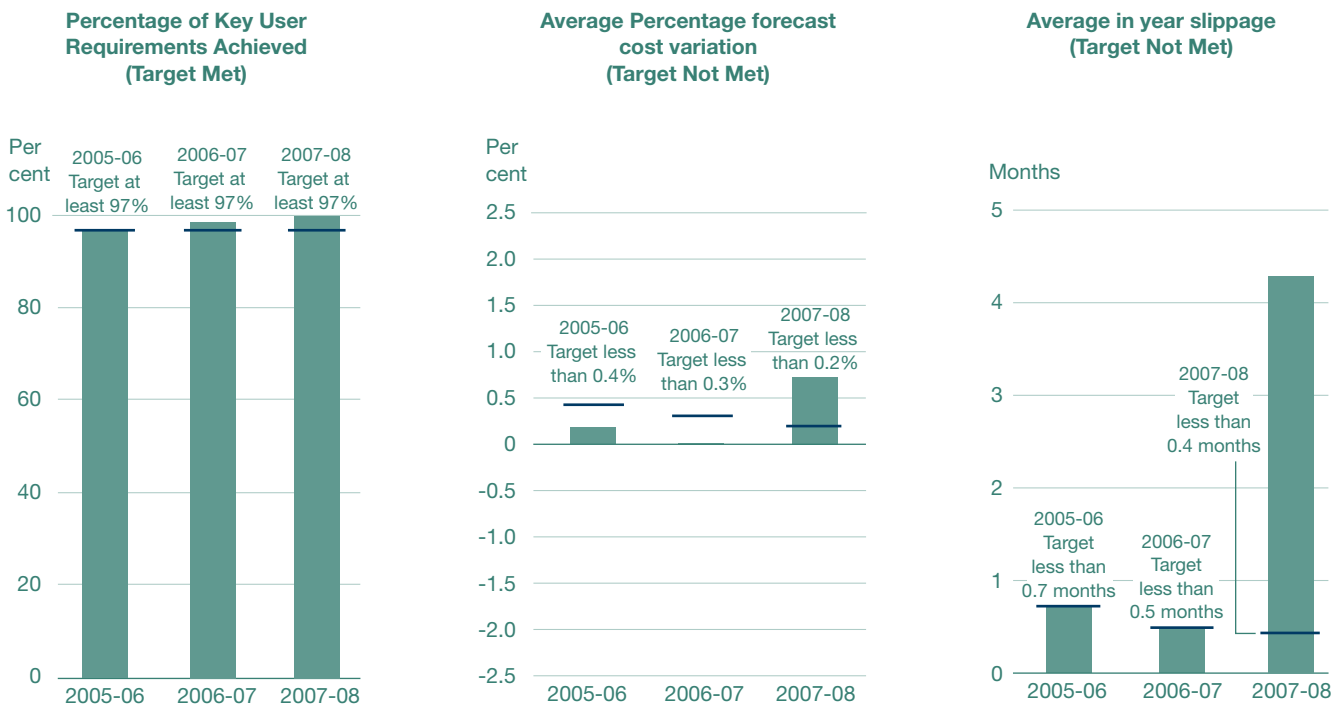
This target looks at performance across the three main categories of equipment projects:

- Category A, worth more than £400 million;
- Category B, £100 million to £400 million; and
- Category C, between £20 million and £100 million.

This is different to the annual Major Projects Report, which looks at the top twenty most expensive equipment projects.

The Department sought to achieve three sub-targets related to key user requirements, cost and time, but only succeeded in meeting the one which measures key user requirements. See Figure 10.

Figure 10
Public Service Agreement Targets and Achievements



Source: Ministry of Defence Annual Report and Accounts, 2007-2008

NOTE

Average Percentage Forecast Cost Variation – Achievement in 2006-07 was 0.0%.

New Aircraft Carriers

3.23 On 3 July 2008, the Department placed a contract for the manufacture of two new aircraft carriers, which will be named the HMS Queen Elizabeth and HMS Prince of Wales and will be ready in 2014 and 2016 respectively. It will cost £3.9 billion to build these ships, while the work to determine the scope of the project and shape of the contract has already cost £300 million.

3.24 The new carriers are necessary to enable the Armed Forces to maintain and enhance their ability to deploy rapidly and self-sufficiently to any part of the globe. They will be vital in supplying offensive air power, including for the support and protection of future land-based operations; the carriers are, therefore, being designed to operate the largest possible range of aircraft in the widest possible range of roles. Its main aircraft will be the Future Joint Combat Aircraft.

Chinook Reversion

3.25 Due to a general shortage of helicopters in the United Kingdom Armed Forces and those of its allies, the Department decided in March 2007 to revert its eight Mk3 Chinooks, which had never been able to fly operationally, into the simpler Mk2/2a Chinooks. This would boost capability in operational areas such as Afghanistan and Iraq. It estimates that the first of these helicopters will be available to commanders by the end of 2009, with the remainder in service by May 2010. The NAO published a report into the context and consequences of this decision in June 2008.

3.26 The eight helicopters were first delivered in 2001, designed to be used on special operations. At an initial cost of £259 million, they had been fitted with special avionics software, which, although in line with the contract, did not pass United Kingdom military airworthiness standards. They had also received a package to allow them to fly at night, at a cost of £32 million. From 2004 until 2007, the Department pursued a project to try to make the helicopters fit for use on special operations. The additional cost of preparing this project, known as 'Fix to Field', had reached some £17 million by the time it was cancelled in early 2007; it would have cost a further £215 million to complete. Delays meant that the first airworthy Chinook Mk3 would only have become available in 2011-12, too late to help plug the current shortfall in overall helicopter numbers. By contrast, the reversion programme will make helicopters available two years earlier and is estimated to cost only a further £113 million. If this estimate proves correct, the total cost of designing, building and bringing these eight helicopters into service will have been some £420 million.

Researching and Developing Future Capabilities

3.27 In October 2007, the Department received the results of a review it had commissioned into the effectiveness of its research and development activities, which are aimed at identifying equipment solutions for the future and on which £2.6 billion is spent each year. The review, *Maximising Defence Capability through Research and Development*, found excellence in many of the Department's activities. However, because those activities are not presently managed as a coherent whole, it also concluded that 'there is no unifying vision or clear strategic direction' to them.

3.28 The review found that:

- most research and development contracts have clearly defined milestones and are delivered in an effective way;
- the technical quality of the vast majority of research and development meets the Department's needs;
- there is no central repository for the capture of findings from research and development funded by the Department and therefore a risk that knowledge gained on one project is not applied everywhere where it might be of value; and
- the Department does not do enough to catalogue and then exploit Intellectual Property which is owned by industry, but to which it enjoys user rights.

Data Security

3.29 In addition to ensuring the availability of high-quality military equipment, the Department must manage and exploit information in a way that gives it superiority over adversaries. This means sharing intelligence with everyone who needs to know, whilst keeping it from everyone who does not. At a working level, in common with other Government Departments, it must be a reliable steward of data, complying with legislation and putting in place robust systems to protect itself from unintended disclosure.

3.30 A number of events that have come to light during the last year have led the Department to reassess the quality of its data management procedures. A summary of the most important instances of data loss is given in **Figure 11**.

3.31 In response to the theft of a Royal Navy laptop in January 2008, the Department commissioned Sir Edmund Burton to conduct an independent review of its data handling policies. This review reported in April 2008 and arrived at the following principal conclusions:

- The Department is not treating information, knowledge and data as key operational and business assets and, with few exceptions, risks to information are not being formally managed at executive boards.
- There is little awareness of the current, real threat to information and, consequently, there can be little assurance that information is being effectively protected.
- Since January 2008, the emergency measures introduced by the Department have so far been successful in preventing further damaging losses of data.
- Those organisations within the Department for whom handling of large volumes of personal data is core business – most notably the Service Personnel and Veterans Agency (SPVA) – have good security, data protection and information risk management procedures.
- Outside the Department's Headquarters in Whitehall and the specialist personnel agencies, staff have very little understanding of their obligations under the Data Protection Act.
- The Department, like other bodies in the public and private sector, is finding it difficult to recruit sufficient trained accreditors, whose job it is to ensure that computer systems and data handling procedures are safe and secure.

Figure 11
Instances of data loss in 2008

Date	Incident
January 2008	A laptop computer belonging to a Royal Navy officer was stolen from his car in Birmingham. It contained personal details of 600,000 people who had expressed interest in joining the Services. The data stolen included some passport numbers, National Insurance numbers and bank details. The information was not encrypted.
July 2008	<p>The Department announced statistics for the number of laptops and memory sticks that have been lost or stolen since 2004:</p> <ul style="list-style-type: none"> ● 121 memory sticks went missing, of which 81 contained material classified as Restricted and five contained material classified as Secret. ● 747 laptops went missing. This figure was greater by 400 than the statistics previously provided in response to Parliamentary Questions. The discrepancy was caused by anomalies in the reporting process, which have since been rectified. Fifty-five of the laptops were stolen from unattended vehicles. Only 32 of the missing laptops had been recovered up to that point.

Source: National Audit Office analysis of Departmental data

3.32 The Department has accepted the recommendations made in the Burton Report, and responded formally in June 2008 by publishing details of its Action Plan. In particular, it undertook to do the following:

- to issue fresh guidance to staff and Armed Forces personnel on the rules governing the reporting of missing data by the end of June 2008;
- to appoint a new head of profession for security accreditors by the end of July 2008;
- to make data security a standing risk on the agendas of all executive committees by the end of September 2008; and,
- to review and revise disciplinary procedures and punishments for losing data by the end of March 2009.

Defence Information Infrastructure

3.33 The Defence Information Infrastructure Programme (DII) was conceived in 2000, as a means to integrate and upgrade the Department's many, disparate systems and give all its staff access to modern ways of working. Since 2005, contracts for the bulk of DII have been let to the ATLAS consortium, which will design, install and operate the new infrastructure. Work is now in progress to supply DII to most United Kingdom and overseas defence sites and to operational theatres, including Afghanistan and Iraq. If the full scope is put on contract, it will cost some £7 billion to deliver.

3.34 As an NAO report of July 2008 showed, to date, the DII programme has delivered some significant benefits, but has suffered considerable problems and is running late. Its main findings were as follows:

- The concept and planning of the programme were good, but a poor understanding of the true condition of many defence sites and an attempt to use an inflexible implementation methodology have caused significant delays.
- Though the Department had contracted to have 62,800 DII terminals in place by the end of July 2007, only 29,000 had been delivered by the end of April 2008.
- There have also been delays in the development of the software that will run on terminals. All software should have been available in June 2006, but to date less than half has been delivered. DII still cannot handle Secret material.
- The contractor is already looking after most of the Department's legacy IT systems and its Single Point of Contact telephone helpline is a significant innovation, which has enhanced the standard of service available to users.

Recruitment and Retention

3.35 The people who serve in the Armed Forces are of central importance to the Department's success. As part of the 2004 Comprehensive Spending Review, targets were agreed for manning levels. These stipulated that, by 1 April 2008, each of the three Services was to have between 98 per cent and 101 per cent of the number of personnel it required, a state known as 'manning balance'. As shown in **Figure 12**, this Public Service Agreement target was met by the Royal Air Force, but missed by the Royal Navy and the Army.

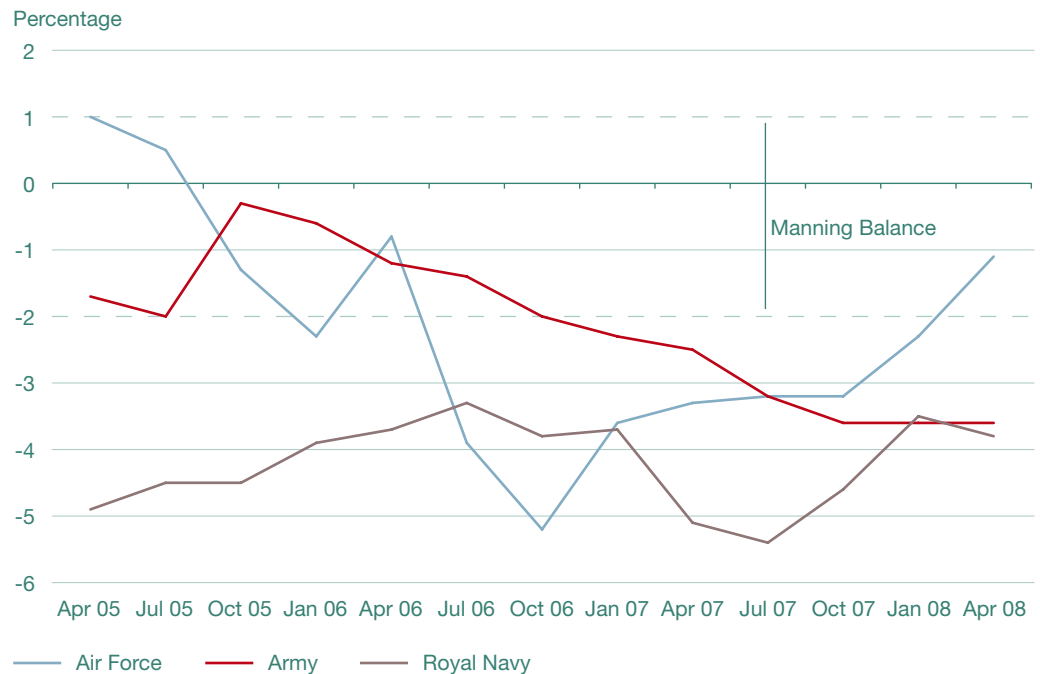
PSA Target 5

Recruit, train, motivate and retain sufficient military personnel to provide the military capability necessary to meet the Government's strategic objectives.

- For the reasons described below, the Department assessed that it had **PARTLY MET** this target.

Figure 12

Personnel levels in relation to manning balance, 2005-08



Source: Ministry of Defence Annual Report and Accounts, 2007-2008

3.36 Difficulties in recruitment and retention mean that this situation is unlikely to improve quickly. In its Annual Report, the Department predicts that the Royal Navy will achieve manning balance by April 2010, mainly due to further reductions in the personnel requirement. The Army will follow only in April 2011. The Royal Air Force will see its trained strength fall between 2008 and 2010 before recovering again to achieve manning balance by April 2011.

3.37 As well as overall shortfalls, the three Services suffer from particular shortages of personnel in some areas. These are known as Manning Pinch Points. In some areas, the skills practiced by personnel in these posts can be of such importance or in such short supply that the lack of them has a detrimental impact on operational effectiveness. Personnel may be required to exceed Harmony Guidelines, which is known to make it more difficult to retain them in the long term. Overall, the number of pinch point trades remained stable over the last year at 73.

3.38 The Department is particularly concerned about the following pinch points in each of the three Services.

- **Royal Navy.** Shortages in a range of trades in the Submarine and Fleet Air Arms are worrying, as is a lack of trained junior rates to conduct force protection in the General Service Warfare Branch.
- **Army.** Eight pinch points are having a direct impact on operations, including infantrymen, gunners, military intelligence operators and a number of mechanic trades.
- **Royal Air Force.** The main areas of concern are in the Operational Support branches, including intelligence staff and RAF Regiment force protection posts. There remain shortages of fire-fighters, gunners and weapon system operators.

3.39 The Department understands the critical importance of maintaining personnel numbers through improved recruitment and retention, but its efforts continue to have mixed success. This was not least because of a difficult context of high employment, long-term decline in the numbers of young people, who are increasingly likely to suffer from obesity and health problems, and who are more likely to pursue further and higher education. The Department reports that the tempo and content of current operations are having an increasingly negative effect on overall interest in a Service career.

3.40 In answer to these challenges, recruiting expenditure was increased by 4.6 per cent in 2007-08 to £170 million, and a number of programmes and initiatives were undertaken, as was described to the Committee in evidence given for its report on Recruiting and Retention. Market research has been used to inform media recruitment campaigns; the Army has introduced the online Pathfinder tool, which helps interested young people to find career paths tailored to their specific interests and needs.

3.41 The Department accepts that, wherever possible, it is more efficient to retain staff rather than to recruit and train new personnel. However, due to the rank structure of the Armed Forces a degree of turnover of staff in mid-career is necessary to maintain balance and promotion opportunities. The Department does not set retention targets, but seeks to monitor Voluntary Outflow closely against guideline figures derived from long-term historic trends. These statistics have been produced on a provisional basis following the introduction of the Joint Personnel Administration System which necessitated a revalidation and review of data.

3.42 A wide range of measures can be used to improve retention, including investment in accommodation, short-term periods of leave to promote work/life balance, and enhancements to core pay for those deployed on operations. In March 2008, the Department announced that the Commitment Bonus would be significantly increased from 2009 to a maximum of £15,000 (currently it is £5,500) for those who deliver nine years service in total. In trades with large manning gaps, Financial Retention Incentives are used. The Department has started to conduct cost benefit analyses of each incentive scheme to ascertain which are most effective.

Medical Care and Fitness

3.43 The fitness of the Armed Forces and the quality of treatment received by injured personnel are vital for the successful conduct of operations. A report by the Committee published in February 2008 largely endorsed the approach of Defence Medical Services, concluding that the quality of care given to seriously injured personnel was 'second to none'. In particular, the decision to embed defence medicine within the National Health Service was seen to have been correct.

3.44 Nonetheless, the proportion of Armed Forces personnel reported as 'fit for task' – meaning that they are fully able to carry out the task that they were posted to their unit to perform – fell from 85.9 per cent to 85.4 per cent over the year to 1 April 2008 against a target of 90 per cent. This reflected the continuing high operational tempo, the effect of which has been, for understandable reasons, most acute in the Army. New initiatives to improve the management of sickness and injury have not reduced the numbers of personnel presenting with medical problems.

Satisfaction and Dissatisfaction

3.45 The results of the three Services' Continuous Attitude Surveys (CAS) have been useful to the Department in assessing the satisfaction levels of personnel. Having run for many years, they provided information about long-term trends, as well as current issues. However, in 2007, the Department decided to create a single tri-Service survey. Although some questions included in the previous surveys are similar to those in the new one, differences and changes in sampling and analysis methods and in the contexts within which the questions were asked mean that the results are not directly comparable.

3.46 In broad terms, the results of the new survey show that satisfaction levels are not high in any of the three Services. **See Figure 13.**

3.47 Although some of the specific sources of dissatisfaction differed across the Services, the most commonly expressed in all three was the insufficiency of the 13 per cent X factor that personnel receive in their pay as compensation for the dangers of their job. Similarly, a significant number of respondents in all three Services cited low morale amongst personnel as a whole as a cause of their dissatisfaction. The lower ranks of the Royal Navy and the Army were more likely to find that Service life frustrated their attempts to plan their lives in the long term. Perceived inadequacies with the Joint Personnel Administration computer application were a source of irritation for members of the Royal Navy and Royal Air Force. Consistently, personnel stated that the fairness with which they were treated by the Services was a source of satisfaction, as were job security and the quality of dental treatment. **See Figure 14.**

Support to Service Leavers

3.48 The majority of members of the Armed Forces – even those who stay to complete a full military career – leave at least 25 years before the current national retirement age. Therefore, a robust and effective system of resettlement provision is fundamental both if the Department is to remain an attractive employer and if it is to discharge its duty of care to its staff.

Figure 13

Satisfaction with Service life. Percentage of respondents who are 'Very Satisfied' or 'Satisfied'

Service	Rank	2007-08	2006-07	2005-06
Royal Navy	Officers	60	65	63
	Other Ranks	40		
Royal Marines	Officers	78	76	Included within Royal Navy
	Other Ranks	56		
Army	Officers	68	70	73
	Other Ranks	45	57	56
Royal Air Force	Officers	57	62	65
	Other Ranks	45	55	55

Source: Ministry of Defence Annual Report and Accounts, 2007-2008

Figure 14

Main sources of satisfaction and dissatisfaction in the three Services

	Top indicators in 2007 surveys Officers	Top indicators in 2007 surveys Other Ranks	Top indicators in 2006 surveys Officer and Other Ranks
Sources of Satisfaction			
Royal Navy	Members of my team get on well together (94 per cent) Military discipline system is fair (92 per cent) I am treated fairly in the Royal Navy (89 per cent)	Members of my team get on well together (86 per cent) Satisfied with dental treatment (83 per cent) Security of employment (82 per cent)	Security of employment (RN 87 per cent, RM 91 per cent) Amount of responsibility (RN 80 per cent, RM 84 per cent) Accuracy or assessment of appraisal report (76 per cent) Variety of tasks in current role (RM 77 per cent)
Army	Feeling proud to be in the Army (93 per cent) In the Army I am treated fairly (91 per cent) In the Army I am treated with respect (89 per cent)	Feeling proud to be in the Army (76 per cent) I respect my senior leaders (70 per cent) Satisfaction with notice given for operational tour (67 per cent)	Job security (Officers 79 per cent, Other Ranks 72 per cent) Excitement (Officers 69 per cent) Pension entitlements (Other Ranks 62 per cent)
RAF	Fair treatment in the RAF (86 per cent) Fairness of Military discipline system (85 per cent) Service dental treatment (84 per cent)	Service dental treatment (84 per cent) Adequacy of notice for last notice (77 per cent) Leave entitlement (76 per cent)	Enjoyment of life in the RAF (86 per cent) Tour length of Operational deployments (81 per cent) Number of days annual leave (71 per cent) Adequacy of training for your Service job (71 per cent)
Sources of Dissatisfaction			
Royal Navy	Disagreement that the 13 per cent X factor is sufficient compensation for RN lifestyle (63 per cent) Morale of RN as a whole (53 per cent) Ability to do all necessary admin tasks on JPA (52 per cent)	Disagreement that the 13 per cent X factor is sufficient compensation for RN lifestyle (70 per cent) Morale of RN as a whole (66 per cent) Ability to plan life in the long term (62 per cent)	Current X factor rate of 13 per cent (RN 54 per cent, RM 66 per cent) The quality of equipment (RN 46 per cent) Amount of fun in the Service (RN 41 per cent) The X factor method of payment meets its objectives (RM 53 per cent) Ability to plan their own long term life (RM 50 per cent)
Army	Disagreement that the 13 per cent X factor is sufficient compensation for Army lifestyle (71 per cent) The effect of Service life on spouse/partners career (62 per cent) Efforts made to maintain/improve your current service accommodation (51 per cent)	Disagreement that the 13 per cent X factor is sufficient compensation for Army lifestyle (68 per cent) The ability to plan your own life – long term (64 per cent) The morale of the Army as a whole (61 per cent)	Impact of Army lifestyle on personal and domestic life (Officers 62 per cent, Other Ranks 49 per cent) Effect of operational commitment and overstretch (Officers 59 per cent, Other Ranks 42 per cent)
RAF	Disagreement that the 13 per cent X factor is sufficient compensation for RAF lifestyle (73 per cent) Ability to do all necessary admin tasks on JPA (65 per cent) Morale of RAF as a whole (60 per cent)	Disagreement that the 13 per cent X factor is sufficient compensation for RAF lifestyle (73 per cent) The standard of equipment (54 per cent) The amount of equipment (50 per cent)	Effects of overstretch (85 per cent) and gapping of posts (71 per cent) on the RAF as a whole; Effects of civilianisation and contractorisation (73 per cent) Effects of overstretch (63 per cent) and gapping of posts on own working groups (53 per cent)

Source: National Audit Office analysis of Departmental data

3.49 In July 2007, the NAO published a report into the experience of leaving the Services, which concluded that the Department offers a good range of resettlement support and that the majority of Service leavers are happy with the quality of resettlement services. More detailed findings included the following:

- Nearly three-quarters of Service leavers found the return to civilian life as expected or easier, but it was those who had served a shorter time who found transition most difficult. We recommended that the Department should extend the support available to leavers who have served less than four years, and who currently receive a reduced level of assistance.
- The existing provision of an expert career consultant for each Service leaver during resettlement and for two years after leaving is very beneficial.
- The range and quality of courses and training available to Service leavers are, in general, very good.
- The Army has to contend with particular challenges because of the large number of recruits it draws from educationally and socially disadvantaged backgrounds, because of the current high operational tempo, and because of the number of other duties that its resettlement officers have to perform. These can mean that resettlement is often seen as a lower priority than operational tasks.
- A small number of Service leavers have difficulty in securing eligibility for social housing from a small number of local authorities on leaving the Armed Forces because of procedural differences between the different organisations. These local authorities can require the Department to institute eviction proceedings in court against the Service leaver as evidence that he or she has not made themselves intentionally homeless. This can be a cause of unnecessary stress and trauma.

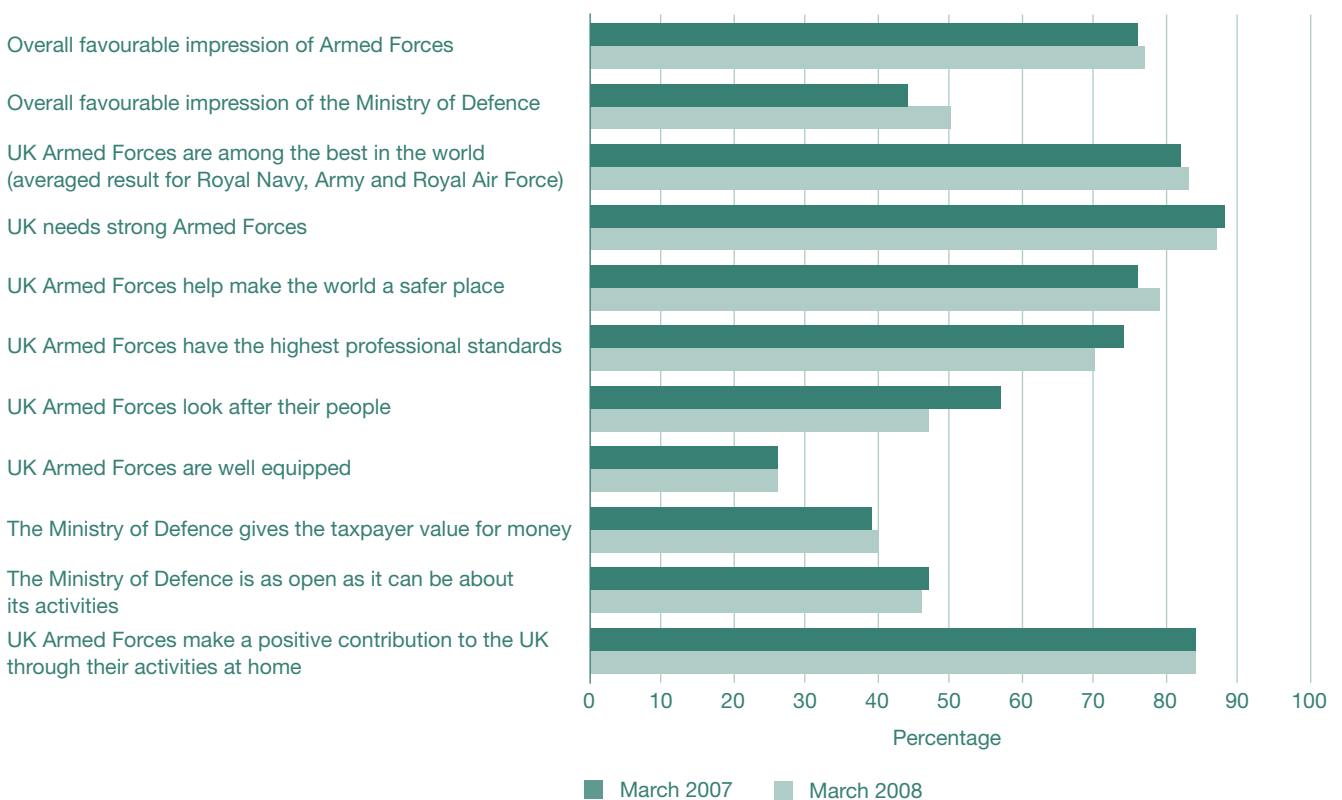
Reputation of Defence

3.50 Public support is important to the Armed Forces and, according to polling carried out on behalf of the Department, remains high at 77 per cent in March 2008, its highest level since 2002 (76 per cent in March 2007, 64 per cent in March 2006). This compares well with the police at 77 per cent and the NHS at 74 per cent. However, as shown in **Figure 15**, those questioned in the survey were less positive about some specific aspects of the Ministry of Defence, such as equipment.

3.51 Despite an encouraging level of overall support, concerns grew during 2007 that a gulf was opening up in understanding between certain sectors of society and the Armed Forces. This included reports that troops returning from service in Afghanistan and Iraq had not been welcomed back into the communities where they were based. In December 2007, the Prime Minister asked Quentin Davies MP to lead an independent inquiry into the relationship between the three Services and the rest of society. A report – *National Recognition of our Armed Forces* – was published in May 2008.

Figure 15

Opinions of the General Public about the Ministry of Defence and the Armed Forces



Source: Ministry of Defence Annual Report and Accounts, 2007-2008

3.52 The report concluded that while the Armed Forces enjoy immense respect and gratitude from the general public, the foundation on which that support is based has eroded and is likely to continue to erode unless countervailing measures are taken. Primarily, this erosion is the result of fewer people serving or knowing someone who serves in the Armed Forces and because of the terrorist threat in the 1970s and 1980s, which forced Service personnel to be more cautious in their contacts with society as a whole. The inquiry team were tasked to make recommendations which would have little or no additional cost, of which the following are some of the principal ones:

- Service personnel should be encouraged to wear their uniforms whenever possible in public and the Government should introduce legislation to make discrimination against those wearing military uniforms an offence.
- The regional chain of command should be tasked, alongside local authorities, to organise homecoming parades for units returning from operations whenever possible.
- An Armed Forces Day should be created, possibly as a public holiday.
- Rules for officers making contact with the media should be relaxed to allow local commanders to use their own judgement in reporting the activities of their own unit.
- Commanding Officers of units should be allowed to accept complimentary personal invitation to cultural or sporting events, as long as they wear their uniform on such occasions.
- The Department should send an officer on secondment to work in the House of Commons Library in uniform, answering Members' queries about the military and providing a visible presence to elected representatives.

Part Four

Financial Review

2007-08 Financial Outturn

4.1 The Department receives funding through Requests for Resources (RfRs), voted by Parliament in Supply Estimates:

- RfR 1: Provision of Defence Capability (to cover normal running costs).
- RfR 2: Operations and Peace Keeping (to cover additional costs incurred on operations). This was previously known as Conflict Prevention.
- RfR 3: War Pensions Benefits (to cover the payment of war disablement and war widows' pensions in accordance with relevant legislation).
- In addition, Armed Forces pensions and the Armed Forces Compensation Scheme are administered as a separate Request for Resources and accounted for in a separate resource account.

Each year, the Department is required to provide a summary of Net Resource Outturn (the total of RfR1, 2 and 3) and Net Cash Requirement against its Supply Estimates. The Net Cash Requirement excludes non-cash items, for example depreciation.

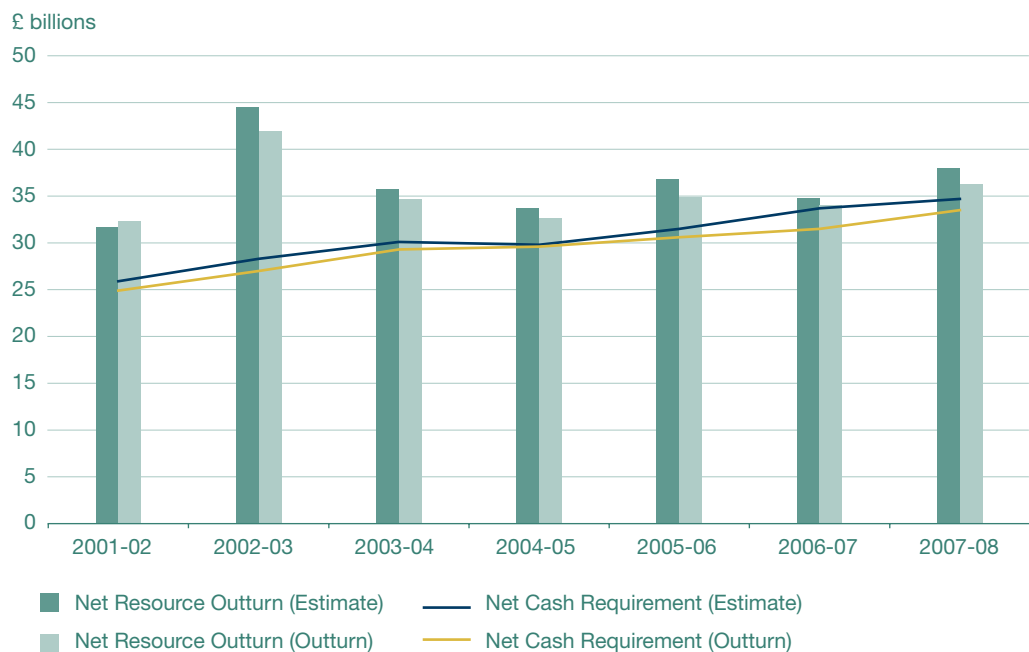
4.2 A comparison of the Net Resource Outturn and the Net Cash Requirement against Supply Estimates is shown at **Figure 16** overleaf. The trend has been for the Department to underspend against Estimates on resources and cash, with the exception of 2001-02 (when the Department overspent on resources by £602 million on RfR1 and also exceeded its total Resource Estimate) and 2006-07 (when the Department overspent on resources by £21 million on RfR2 but stayed within its total Resource Estimate). In 2007-08 the Department stayed within its resource and cash Estimates. The Net Resource Outturn was £36.3 billion against an Estimate of £38.0 billion with the underspend of £1.7 billion caused by factors such as lower than expected depreciation and forecast provisions which did not materialise. The Net Cash Requirement for 2007-08 was £33.5 billion against an Estimate of £34.7 billion, an underspend of £1.2 billion.

The Defence Inflation Rate

4.3 Analyses in recent years, including by the House of Commons Defence Committee, have suggested that the rate of inflation within defence, and in the defence industry in particular, is considerably higher than that in the United Kingdom in general. The Permanent Under Secretary, giving evidence to the Committee in November 2007, spoke of the difficulties associated with arriving at a robust measure of defence inflation. He pointed particularly to complexities in the area of defence equipment, where it can be difficult to compare new capabilities with old ones. Responding to the Committee's recommendation, the Department wrote in April 2008 that:

*'Work is under way on developing a robust measure of inflation for total defence expenditure. We note the Committee's close interest in this. It includes identification and collection of suitable data; the design of methods and applications for storing and aggregating the data; and the validation and testing of the outputs. To construct a measure for total defence expenditure we will need to collect data relevant to service and civilian pay; long-term equipment, support and construction expenditure; and shorter term commodity and service purchases.'*⁵

Figure 16
Net Resource Outturn and Net Cash Requirement against Estimate



Source: Departmental Resource Accounts 2000-01 to 2007-08

⁵ Ministry of Defence: Annual Report and Accounts 2006-07: Government Response to Committee's Fifth Report of Session 2007-08, Fifth Special Report of Session 2007-08, HC 468, p. 32.

4.4 This work is expected to take up to two years to complete, as data need to be gathered from many different sources (military and civilian pay systems, food and other consumables, office equipment and military equipment). The Annual Report 2007-08 makes clear that the greatest challenge remains the calculation of a rate of inflation for defence equipment, though this is arguably the area where such a measurement would be of greatest use.

Audit Qualification of the Department's Resource Accounts

4.5 The Department's Resource Accounts include payroll costs of £8.6 billion for the Armed Forces. This expenditure is administered via the Joint Personnel Administration (JPA) system which was rolled out in three tranches across the RAF, Royal Navy and Army (from March 2006 to July 2007) in order to modernise the administration of human resources, including all aspects of pay and allowances.

4.6 The Comptroller and Auditor General gave a qualified opinion on the Department's 2007-08 Resource Accounts owing to a limitation of scope on military allowances. A limitation of scope is given where the auditor has not been able to obtain sufficient and appropriate evidence to support material balances in the accounts. (An amount is material if its omission or misstatement could affect the understanding or decisions taken by the user of the accounts.)

4.7 The 2007-08 financial statements were qualified due to a limitation of scope because the Department was unable to supply sufficient evidence to support payments of £920 million paid as allowances to military personnel. In particular, there was a lack of evidence to substantiate:

- whether the amounts paid in relation to allowances to Service personnel were correctly stated;
- the level of error caused by known issues within the JPA payroll system; and
- whether selected payments on allowances and for expenses paid through JPA were valid due to the lack of supporting documentation.

4.8 As background, in implementing JPA the Department wanted to:

- harmonise conditions of service and associated allowances and payments across the Services;
- allow personnel direct self-service access to certain functions, such as updating bank details online;
- improve management information available to operational and strategic levels of management; and
- make cash savings of £605 million over ten years by reducing the number of staff involved in the operation of personnel administration.

4.9 However, insufficient focus was given to the need for internal controls and there have been significant problems with certain management information and financial reporting aspects of JPA. The main weaknesses identified in financial control and management information were:

- Insufficient controls within the system to prevent intentional or unintentional errors which led to regular instances of significant over- and underpayments.
- The levels of mis-postings between cost centres and lack of traceability restricted the ability of Top Level Budget Holders to make corrections.
- A substantial number of individual personnel records may not include correct information. The Department believed that some 5-10 per cent of personnel may be affected.
- Debt due from Service personnel has grown and has become more difficult to recover. As at 31 March 2008, £28.9 million was outstanding with a recovery rate of 76 per cent compared with 91 per cent under the previous system. A substantial amount may need to be written off, but the amounts involved cannot yet be estimated with certainty.
- Lack of up-to-date and accurate information on pay expenditure, debt and liabilities which has been inadequate for the purposes of the Department in terms of budget monitoring.

4.10 Actions by the Department to improve financial controls. The Department has devoted significant resources to improving the robustness of the JPA payroll systems, although NAO have recommended that the Department could take further actions, as shown in **Figure 17**.

Figure 17

Steps Taken by the Department and National Audit Office's Recommendations for Further Action

Steps Taken by the Department

Development of a detailed systems map to assess whether all necessary controls exist.

Establishment of a working group of stakeholders to ensure that issues at Top Level Budget Holder and lower accountability levels can be escalated and resolved.

Formation of a targeted team of accountants to identify the financial implication of known weaknesses, such as the need for reconciliation of control accounts.

The RAF are planning to introduce JPA specialists in each of their Units to assist staff and be a local repository of expertise.

Training in the production of regular and ad-hoc reports has been improved and on-line access has been widened to help with solving problems.

National Audit Office's Further Recommendations

The detailed systems map should be completed urgently to allow the Department to instigate the necessary mitigating controls.

The Department should produce an overall plan which prioritises the significant issues, with timescales set by which actions should be completed and adequate resources allocated to achieve the plans. The costs involved should be weighed against the risks associated with not introducing a system of input controls.

More will need to be done to prevent and detect input and processing errors.

Payroll account reconciliations need to concentrate on making corrections in sufficient time for departmental processing timetables.

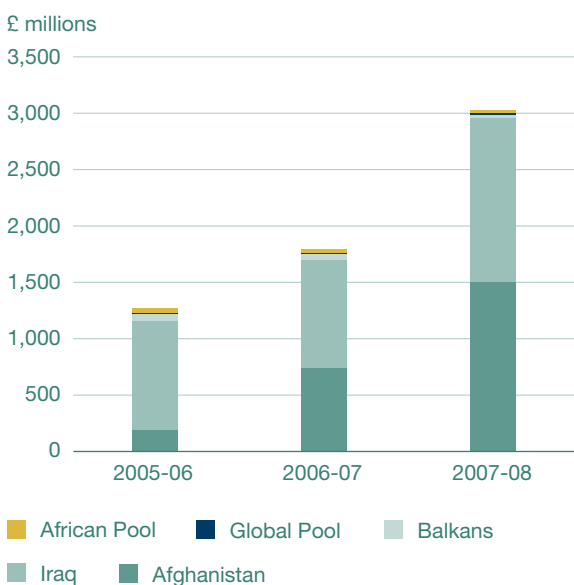
Operations and Peace Keeping (RfR2)

4.11 The Department has identified the costs of Operations and Peace Keeping (Afghanistan, Iraq, Balkans, Global and African pools) on the basis of net additional costs. RfR2 costs include direct costs (for example, Service and civilian manpower, infrastructure support, equipment support and stock consumption), indirect costs (for example, depreciation and cost of capital) and capital costs (for example, Urgent Operational Requirements). Expenditure such as wages and salaries of permanently employed personnel are not included as these costs would have been incurred in the normal course of business. A breakdown of the net resource outturn and capital expenditure incurred in the main areas of operation is shown in **Figure 18** while **Figure 19** compares the net resource outturn and capital expenditure against the Estimate for the last three years.

4.12 Total RfR2 expenditure (resource and capital) in 2007-08 was £3.0 billion, mainly comprising £1.46 billion for operations in Iraq and £1.50 billion for operations in Afghanistan.

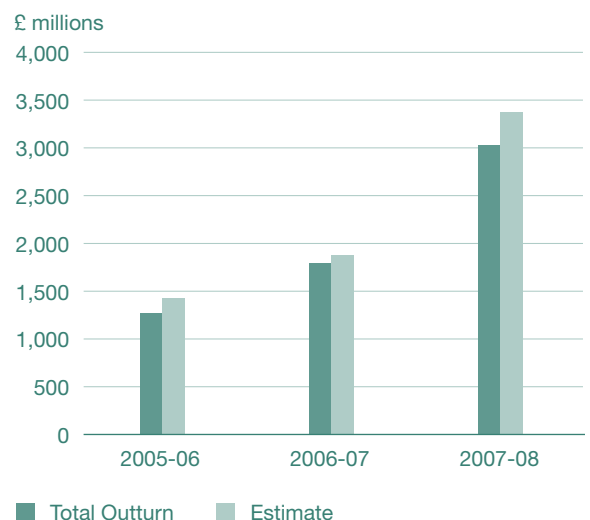
- **Afghanistan.** Between 2006-07 and 2007-08, costs incurred in Afghanistan have doubled as a result of increased operational activity. The increased tempo of operations resulted in additional personnel costs, the increased use of ammunition and increased support costs.

Figure 18
Operations and Peace Keeping
Expenditure Broken Down by Area
of Operation



Source: Ministry of Defence Annual Report and Accounts, 2007-2008

Figure 19
Operations and Peace Keeping
Expenditure against Estimate



Source: Ministry of Defence Annual Report and Accounts, 2007-2008

NOTE

Expenditure and Estimates include resources and capital. In 2006-07 the Department incurred an excess of £21 million on the Net Resource Outturn (see para. 4.2 above) which was offset by capital savings.

- **Iraq.** Manpower reductions in Iraq have been offset by additional costs related to increased force protection measures. Infrastructure costs and increased spend on Urgent Operational Requirements have resulted in higher costs for 2007-08.
- The Department reviewed and improved its procedures for identifying indirect costs incurred on operations following a £21 million resource overspend on RfR2 in 2006-07 (see paragraph 4.2 above) and a qualified audit opinion and Report from the Comptroller and Auditor General.
- Expenditure includes resources and capital. In 2006-07 the Department incurred an excess of £21 million on the Net Resource Outturn (see paragraph 2 above) which was offset by capital savings.

4.13 The RfR2 allocation in the Main Estimates does not cover the costs of operations in Iraq and Afghanistan because the Department considers that it is inappropriate to request large sums about which it is still uncertain. Funds for operations come from the Treasury Reserve until Parliament approves the request from the Department for funds in the Spring Supplementary Estimates. In response to the House of Commons Defence Committee's concerns, the Department began in 2006-07 to make a request for funds in the earlier Winter Supplementary Estimates and agreed to provide a forecast for the cost of operations in Iraq and Afghanistan, including Urgent Operational Requirements, at the time of the Main Estimates. The Committee welcomed these developments, although it requested a breakdown between theatres and for various costs within theatres.

Losses, Write-Offs and Special Payments

4.14 When Parliament votes for a Department's Supply Estimates there is no provision made for losses, write-offs and special payments. Therefore this expenditure is subject to additional authorisation and disclosure requirements. The rules on losses, write-offs and special payments provide additional transparency and accountability for expenditure by a public body.

4.15 The requirement to disclose losses, write-offs and special payments is unique to government accounting and provides additional disclosure over and above commercial accounting practice. The purpose is to ensure that a Department is accountable for spending outside the limits voted by Parliament. It should be noted that this expenditure is not irregular or indicative of a failure of control – it is simply unplanned expenditure resulting from management decisions taken in response to changing circumstances.

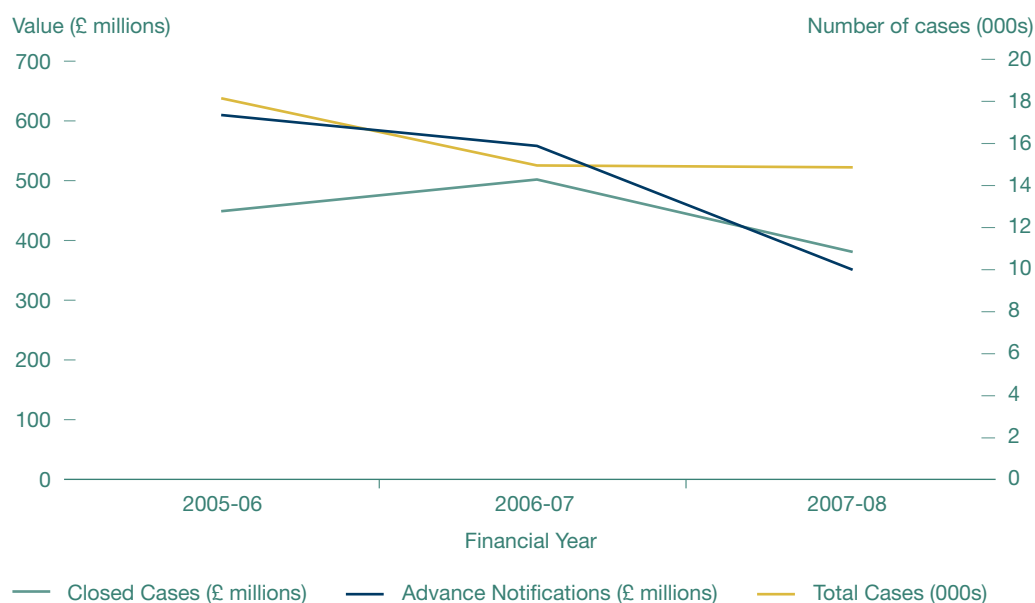
4.16 Examples of losses and write-offs which must be disclosed include: physical loss of cash or stores; bookkeeping losses and abandoned legal claims. Special payments which must be disclosed include extra-contractual payments, such as those where payment is not due under the terms of the contract but is an obligation which the courts might uphold; and compensation payments, such as for unfair dismissal or an accident in the work place.

4.17 Losses and special payments are recorded when the expenditure ‘hits’ the control totals – that is when the expenditure is recorded in the Resource Accounts. This can often take several years from the point the Department first identifies the loss. Losses, write-offs and special payments are disclosed either as “closed cases” or “advance notifications”. The following are some important examples of losses, write-offs and special payments from 2007-08:

- A loss of £10 million was recorded in 2007-08 relating to duplicated assets on the Fixed Asset Register following an asset verification exercise.
- A loss of £112 million was notified in previous years and closed in 2006-07 relating to the Oslo Declaration on dumb cluster munitions which resulted in the Multiple Launch Rocket System being declared as out of service by the Secretary of State for Defence.
- Special payments totalling £46 million were made during 2007-08 relating to the Northern Ireland Royal Irish Regiment (£38 million) and the Northern Ireland Civilian (£8 million) redundancy packages.

Figure 20 shows that both the value and number of cases of losses and special payments have decreased over the last three years. Total losses and special payments are a relatively small proportion of the total annual expenditure of the Department: less than 1 per cent of total expenditure for 2007-08.

Figure 20
Value and number of Losses, Write-Offs and Special Payments



Source: Ministry of Defence Resource Accounts, 2005-06 to 2007-08

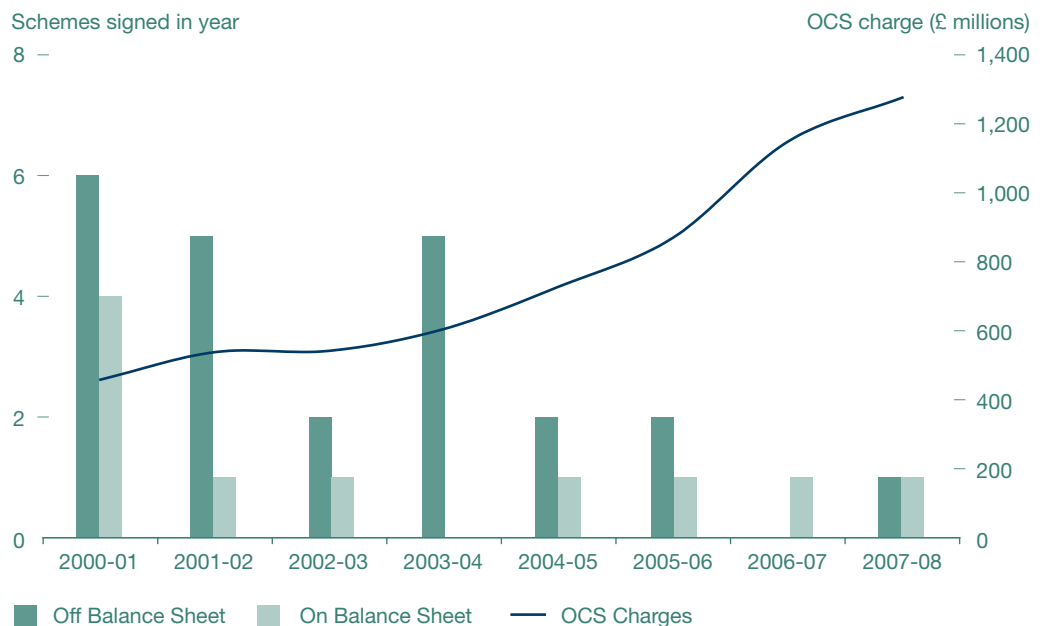
Private Finance Initiative (PFI)

4.18 Since 1995-96, the Department has made increasing use of Private Finance Initiative (PFI) arrangements to meet its service requirements. In its 2007-08 Resource Accounts MOD has disclosed 53 PFI schemes (2006-07: 51), of which 14 (2006-07: 13) are classified as on balance sheet, meaning that the assets and liabilities relating to the schemes are on the Department’s balance sheet. For the remaining contracts, the risks and rewards of ownership are deemed to lie with the private sector contractors and consequently the assets do not feature on the Department’s balance sheets.

4.19 The Department’s PFI schemes cover: accommodation (for example, Family Quarters at Bath, Bristol and Portsmouth); training (for example, Attack Helicopter Training Service); equipment (for example, Tri-Service Material Handling Equipment); and other support services (for example, Strategic Sealift – Roll-on Roll-off ferries). Projects also vary significantly in terms of size, with capital values ranging from £1 million to £2,688 million.

4.20 The Department’s level of commitment to PFI. The Department has already seen several of its shorter PFI contracts expire. However, thirteen of the contracts expire in 2030 or after, one of which financially commits the Department until 2041. The Department’s operating expenditure on PFI has shown a steady increase over recent years (see **Figure 21**). Operating cost expenditure is composed of the charges for the

Figure 21
Department’s PFI Schemes Signed In Each Year and Charges to the Operating Cost Statement (OCS)



Source: Ministry of Defence Resource Accounts, 2000-01 to 2007-08

use of assets and services for off balance sheet PFI schemes, and charges for services for on balance sheet PFI schemes. In 2007-08, the Department incurred £1,276 million in PFI charges (2006-07: £1,147 million), representing 5.6 per cent of operating costs (2006-07: 5.5 per cent). This is a significant increase over 2000-01 when the Department incurred £458 million in PFI charges (2.3 per cent of operating costs).

4.21 The commitment to new PFI contracts has reduced since 2000-01 when ten new contracts were signed. A new contract was signed in March 2008 for the Future Strategic Tanker Aircraft (FSTA) programme to provide modern air-to-air refuelling and passenger air transport capabilities. This project has a total value of £13 billion and will run until March 2035.

4.22 During 2008-09, the Department will be committed to £1,243 million of service charge payments for off-balance sheet and on-balance sheet PFI transactions (see Figure 22). These payments continue for varying lengths of time, until the expiry of each PFI contract.

Figure 22

Payments to which the Department is committed during 2008-09 analysed by the period when the commitment expires

	As at 31 March 2008 (£000s)
Expiry within 1 year	15,064
Expiry within 2 to 5 years	286,469
Expiry within 6 to 10 years	289,078
Expiry within 11 to 15 years	135,850
Expiry within 16 to 20 years	55,162
Expiry within 21 to 25 years	228,259
Expiry within 26 to 30 years	24,540
Expiry within 31 to 35 years	208,726
TOTAL	1,243,148

Source: Ministry Of Defence Resource Accounts 2000-01 to 2007-08

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