



Ministry of Defence

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MINISTER OF STATE FOR DEFENCE PROCUREMENT

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21st June 2022

Dear Meg,

I wanted to write following the PAC's report on the Equipment Plan published in May 2022.

We believe that, bolstered by the additional £24bn of investment in the current spending period and delivering in line with the threat-based assessment of the Integrated Review and the Defence Command paper, the Equipment Plan is in a better position than it has been for many years. We welcomed the fact that the NAO has deemed the plan not "unaffordable."

The Equipment Plan is underpinned by tough capability decisions which we have taken; by the publication of the Defence Industrial Strategy and sub-sector strategies enhancing how we will work with industry to deliver for Defence; by an historic reversal of the decline in UK investment in Defence R&D and a continuous emphasis on improving our expertise and processes, driving agility and value.

As the NAO has recognised, Defence is responsible for some of the most technically complex, risky, and costly procurement programmes in government. We recognise the need for continuous improvement and welcome constructive criticism. We trust the committee will want to recognise progress, where it is made, and we disagree with some of the conclusions the committee has made.

Affordability

We do not recognise that the Department is "complacent about the affordability of its Plan." For the first time in five years the NAO have not said the plan is unaffordable, and the Integrated Review has allowed us to balance the plan and invest more on equipment – increasing our spend on the equipment plan from £190bn to £238bn over the next ten years.

In terms of financial management, as the NAO recognise, we hold contingency and manage the financial position closely. This year, for the first time in several years, we did not run a savings exercise, meaning there were no short-term reductions for affordability reasons. Managing a portfolio of intricate procurements, some of which will suffer delays, is complex. This year we spent 99.7% of our CDEL Budget, as at Supplementary Estimates. We have also been proactive to ensure best value for money. You raised "the decision to defer purchase of new Chinook helicopters by three years which is likely to cost more in the

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Enclosure

long run.” We absolutely recognise both the need to spend within our defined envelope but also to be agile to exploit opportunities to enhance value for money where possible, in this case when a financial opportunity emerged we brought forward Chinook, reducing cost growth and addressing capability.

You state in your report that the “Department’s decisions to cut budgets in the short term have adversely affected equipment capability.” We have had to make tough decisions. We are retiring some equipment early to allow the headroom to invest in replacements with greater capability. In some cases, we have taken risk and in doing so have taken £7bn of cost from the programme including £3bn relating to changing major programmes which do not align with our strategic direction. The Plan relies on fewer lower confidence efficiency initiatives than last year (£2.8bn vs £3.7bn last year) whilst the value of higher confidence initiatives has increased since last year (£10.3bn vs. £8.2bn last year). In doing so we have invested in cutting edge new capabilities such as Future Combat Air System (FCAS), European Common Radar System (ECRS) Mk2, and autonomous mine hunting; while modernising existing capabilities including the introduction of E7 Wedgetail, budgeting to increase our buy of F-35B aircraft and establishing funding pipelines for Shipbuilding.

Development of New Opportunities

Your report comments that we “may not have identified all the modern battle-winning capabilities our Armed Forces need.” That is a concern that can of course be levied at any Defence Department at any time, however, it does not reflect the efforts being made by the department. The IR has set out the new strategic context and the threats we are addressing. We are embracing all five domains, including cyber and space and the threat in the sub-threshold.

You highlight “there is relatively little money available to exploit promising research this decade.” During the IR we prioritised investment in research and development and committed to a minimum of £6.6bn over the SR period and new investment in R&D marked a reversal of the 30-year decline in Defence R&D. On top of this early investment, we have allocated a further £4.1bn from 2025 to continue to exploit our R&D investments and develop them into military capability. We maintain programmes which ensure industry and academia have clear line of sight on our priorities and can be assisted in exploiting opportunities. We also continue to work collaboratively with our allies to maximise the value of our R&D spend, an emphasis given greater impetus in the last year through AUKUS and which has potential to grow in importance through NATO’s defence innovation project the European hub for which, it was announced earlier this year, will be jointly located in the UK and Estonia.

The report says that MOD “is not developing its existing large programmes with sufficient urgency” and references FCAS: “The Future Combat Air System, for example, has concept and development stages which are set to take many years before manufacture can begin.” The FCAS programme is proceeding at pace; the Concept and Assessment phase began in 2021 and is due to complete in 2024. This period is crucial to defining the capability and ensuring we have the right skills and international partnering arrangements to proceed quickly. We have invested early in developing the technologies and skills needed to ensure the FCAS programme proceeds at speed and on a sure footing. To this end, we are investing £2bn in the FCAS Technology Initiative, a research and development programme,

and have invested half of this to date. At the same time, our industrial and international partners are making further investments. This thorough early work is needed for us to meet our in-service target date of 2035. FCAS is a platform unlike any other and will be in service for decades after its introduction. It is critical it is set up for success. That means harnessing a strong relationship with industry and strong international partnership. It is absolutely appropriate that we have a proper concept and assessment phase. We are within schedule to produce FCAS on time while continuing to invest in Typhoon.

The Department is criticised in the report for investing in new radar for Typhoon but not expecting it to enter service until 2030. The ECRS2 is a state of the art radar, that requires specific qualified personnel. To significantly accelerate the delivery of this capability would increase the overall cost very substantially. The capability will be integrated through the Typhoon/Eurofighter P4E programme agreed and co-funded with our partners. Were the UK to advance this programme independently it would cost the UK again very substantially more. From our analysis of the conflict in Ukraine, while not being complacent, we see no operational rationale to believe that the current Typhoon radar is uncompetitive, nor any rationale as to why the established upgrade timetable should be brought forward requiring the cancellation of more urgent requirements.

On Dreadnought, the PAC states the contingency should be specifically allocated. A contingency was established for Dreadnought as due to the scale, complexity and length of time involved in the project, not all costs could be known. The flexibility of the current mechanism allows opportunities to be grasped to reduce ultimate cost and time. The government's Major Projects Review Group has already placed an action on Her Majesty's Treasury, as the holder of the contingency funding, to set out updated guidance on accessing the Dreadnought contingency. We see no need to essentially alter how the contingency operates. To reduce the flexibility of the contingency by specifically allocating it in advance we believe would reduce agility, increase siloed thinking and have a negative impact on the programme.

Scrutiny

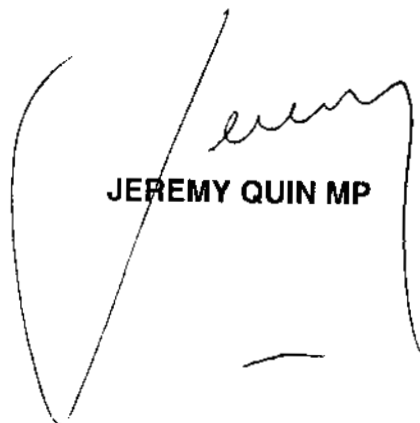
The department has a robust scrutiny process and approvals processes with dedicated teams who produce the independent costings which not only the Department, but the NAO use to understand the risk in the Plan. We also have a robust approvals process to scrutinise major programmes. Our financial performance and controls do not mean the department is complacent about risks and indeed much of the analysis used by the NAO is our own. The taxpayer would and should expect this Value for Money management. This has been in part achieved through a highly professional workforce; across the Department's finance profession at middle and senior management (e.g. at Grade 7/6) there are 73%, and at SCS 84%, with qualifications to ensure the necessary expertise and oversight. In addition, over 500 staff are currently studying for professional qualifications, of which 184 are on apprenticeship programmes. Inflation, where rates are at their highest for forty years, is a key concern which the department has historically managed through contracts, forward buying and planning assumptions. We also have a contingency for urgent requirements or challenges to projects.

The Department continues to update our processes to speed them up and be more agile, while maintaining appropriate control of government funds. We are continuing to drive improvements in acquisition through category management techniques, increasing the capacity and capability of our SROs; streamlined processes and improving costings; and our underlying financial and project delivery management information. This work will continue alongside the Defence and Security Industrial Strategy (DSIS) as the crucial framework for a deeper, more sophisticated, and strategic relationship with industry. Since DSIS was published over a year ago, Government and industry have made significant progress on more than 50 DSIS commitments, and many of our commitments are focused on shifting behaviours and effecting cultural change across Government and industry to ensure long lasting improvement.

Conclusion

We in Defence are hugely focussed on bringing forward the right capabilities to meet current and future threats, and on risks such as the availability of skills and inflation. As we have seen this year, our understanding of the threats we face will evolve and we need to be agile while setting out clearly our long term fundamental capability requirements and working with partners to bring them forward in a timely and cost effective way. We welcome the PAC's close interest in the Plan while highlighting areas in this letter and the attached Annex where our views and analysis differs.

With best wishes


JEREMY QUIN MP

Annex A: EP21 PAC Report Commentary

PAC Report Extract	MOD Response
<p><i>"We are concerned that the Department may not have identified all the modern battle-winning capabilities our armed forces need, and also that it is not developing its existing large programmes with sufficient urgency. The Future Combat Air System, for example, has concept and development stages which are set to take many years before manufacture can begin"</i></p>	<ul style="list-style-type: none"> • We have robust processes to identify the capabilities we need in the future, including through Force Development and capability audits, and how they will meet the threats we face and complement our Allies and partners capabilities. • On FCAS the Concept and Assessment phase began in 2021 and is due to complete by 2024. This period is crucial to defining the capability we need and ensuring we have the right skills and industry and international partnering arrangements to proceed quickly. • In relation to the Future Combat Air System (FCAS), we have started work 15 years before we retire the Typhoon and plan to spend over £2bn in the SR period alone. • We plan to deliver FCAS in substantially less time than it took to deliver Typhoon/Eurofighter. • We have given the go ahead for Radar 2, which will substantially enhance the performance and adaptability of the Typhoon, complementing F-35 • We continue to invest in Meteor to allow us to broaden the use of this unique long-range capability from Typhoon to F-35. • Where we can we are looking to accelerate programmes such as BOXER in the Land Domain.
<p><i>"We recommend that there should be a clearly defined purpose for the Dreadnought contingency"</i></p>	<ul style="list-style-type: none"> • The Dreadnought programme is one of the most complex engineering projects ever undertaken by the UK. • The contingency was a prudent measure to put in place in acknowledgement that forecasting costs to a high degree of confidence for such a complex programme is simply not possible. The purpose of the contingency is to cover changes in 2015 cost estimate that by definition cannot be forecast, including for example investment in mitigations to manage the impact of emerging risks. • Access to the contingency allows for changes in both the annual spending profile and the total funding for Dreadnought without resorting to spending cuts in the wider Defence programme. • It is one of the key enablers for the Dreadnought programme, critical to our continued national security, to be delivered on schedule.

	<ul style="list-style-type: none"> • To allocate it specifically, reducing our flexibility to manage the emerging risks, issues and opportunities that drive delivery to schedule, would be counter-productive. Access to the contingency funding is controlled to ensure it does not adversely affect the cost control mechanisms within the programme, and is subject to scrutiny and agreement from Her Majesty's Treasury. • As part of the approval for the third delivery phase of the programme, Treasury has already taken an action to clarify and agree the process for accessing the contingency funding, the purpose of which remains unchanged.
<p><i>"We are also frustrated to see the complacency with which the Department assumes its Plan is now affordable for the first time in four years. This is despite its worrying inability to control costs in its large programmes, including the Dreadnought class of nuclear submarines, and its reliance on billions of pounds of future cost reductions, many of which have no plans supporting how they might actually be delivered"</i></p>	<ul style="list-style-type: none"> • The department is not complacent. We have targeted and allocated funding for spend to save in later years especially around logistics, supply chain and infrastructure. • The NAO have not said the plan is unaffordable, which marks a significant change from the last five years.
<p><i>"In reporting on the risks to affordability, the NAO has highlighted how the Department's decisions to cut budgets in the short term have adversely affected equipment capability and value for money."</i></p>	<ul style="list-style-type: none"> • The decision to stop programmes and prioritise resources is a necessary part of the effective management of a large number of complex programmes across the Department and ensuring we stay within our budget. • These decisions ensured that we could reduce our short term risk whilst simultaneously not taking on long term risk through additions to the pipeline. • We know many of the risks – much of the analysis the NAO use is our own. We have a dedicated team who produce the independent costings which we and the NAO use to understand the risk in the plan and we have a robust approvals process to scrutinise major programmes. • Unlike previous years, we have not undertaken a centrally managed savings exercise and at the point of publication there have been no savings measures taken that significantly impact operational or capability outputs or which have required Ministerial approval.
<p><i>"There is renewed importance that the Department has the right priorities in</i></p>	<ul style="list-style-type: none"> • We recognise that some elements of the procurement process can be slow, but we are working to address

<p><i>delivering capability, and that it manages its expenditure effectively to ensure the Armed Forces can secure all the equipment that they need in the quickest possible time."</i></p>	<p>these through our Acquisition and Approvals Transformation Portfolio work.</p> <ul style="list-style-type: none"> • Procurement costs often have a direct correlation to time. Suppliers producing new equipment with a guaranteed delivery time will seek to offset that significant financial risk through the costs charged up front to the Department.
<p><i>"other countries are rapidly developing new capabilities such as hypersonic weapons"</i></p>	<ul style="list-style-type: none"> • And so is the UK. The UK is seeking to develop long-range precision strike capability more broadly, and hypersonic weapons need to be considered in this context. Defence has already invested in capabilities that help to counter the threat from hypersonics, including evolving the Royal Navy's Sea Viper missile system on the Type 45 and in S&T programmes to understand High Speed Weapon (HSW) technology. • We are also working with others to understand and develop hypersonics as part of AUKUS. • We have prioritised investment in R&D to ensure the UK continues to maintain technical advantage in areas such as Laser Directed Energy Weapons. • We have launched the Defence Space Strategy and are investing a further £1.5bn in the acquisition and development of new technologies.
<p><i>"there is relatively little money available to exploit promising research this decade"</i></p>	<ul style="list-style-type: none"> • In the IR we deliberately allocated billions of pounds in reserve to be able to exploit research. The £6.6bn ringfence shows the level of priority this is being given, and is the minimum we intend to spend on R&D, rather than the limit. • We have also set aside funding and established plans to maintain this investment beyond 2025 to continue and exploit this work.
<p><i>"Rising inflation means the cost of delivering projects is likely to rise, particularly if they experience delays."</i></p>	<ul style="list-style-type: none"> • We are well aware of this risk and are establishing a plan to work with industry to mitigate the impact • The department has in place some controls for inflation, notably forward buy for fuel, some long lead items and the use of firm price contracts. • We monitor the impact of inflation closely and will seek to manage this through rigorous cost control
<p><i>"We are not convinced that the Plan is as stable as the Department believes, or that it will be able to avoid short-term budget-driven changes to the Plan."</i></p>	<ul style="list-style-type: none"> • We're making good progress in the first year of delivery and expect to live within budget. We've held a contingency, Ministers have not been required to take any in year savings decisions and head office has not run central saving exercises. • In 21/22 we have increased capital spending by 21% delivering £2.5bn of the Spending Review uplift, have

	<p>bought forward spending to reduce capability risks and budget exchanged £488m into future years to align with delivery plans. As a result, we have spent 99.7% of core CDEL budget¹</p>
<p><i>"Without a realistic plan to achieve savings, the Department risks remaining caught in a trap of short-term, affordability-driven decisions "</i></p>	<ul style="list-style-type: none"> • This is already being addressed and which is exactly why we moved to find savings, including in high profile programmes in order to avert poor behaviour. • The Department's top level budget holders (TLBs) have planned £7bn of cost reductions over ten years, including c£3bn of savings decisions taken in the Integrated Review. A further £4bn out of the £7bn are reductions in costs in areas of spending consisting of many smaller projects and further savings. • Based on previous experience, the Department judges the scale of savings as achievable, and are now developing more detailed plans to build confidence in delivery.
<p><i>"Likely additional costs in other areas of departmental spending, such as on its workforce and sizeable estate, may squeeze the Plan's budget in future years"</i></p>	<ul style="list-style-type: none"> • Notwithstanding the highlighted concerns, current figures suggest that our proposed cuts in workforce are proceeding as planned.
<p><i>"The Department's plans to make substantial reductions to its military and civilian workforces over the next 10 years are already harder than expected as fewer personnel have left the armed forces than normal since 2020 because of the pandemic."</i></p>	<ul style="list-style-type: none"> • The latest figures now suggest that the post-pandemic outflow is now matching the forecasted plan.
<p><i>"The condition of the Department's estate is set to continue to decline despite an additional £500m to be spent on 'preventative' maintenance."</i></p>	<ul style="list-style-type: none"> • Fix on fail was a damaging short-term policy that is precisely the kind of activity the Department is moving away from in our new defence estates optimisation plan.
<p><i>"The Department has made little impact in its efforts to change its longstanding cultural resistance to change or criticism, which has for many years hindered a clear-eyed view of its equipment procurement performance"</i></p>	<ul style="list-style-type: none"> • We have made significant cultural change, including bring prepared to divest equipment and using our SR settlement funding to invest for the long term. • We received £24Bn yet we cut a significant number of programmes, properly funded others for spiral development and invested in R&D and spend to save measures. • Programmes such as our Acquisition and Approvals Transformation Portfolio work, as well as our work on

¹ As at Supplementary Estimates, subject to audit.

	<p>empowerment, go to show that we are trying to bring about genuine and lasting change in our approach and behaviours.</p> <ul style="list-style-type: none"> • We have bought into and supported that change precisely because we do not want to repeat past behaviour. • DE&S, for example, have also created a unique, in-depth, tracking dashboard for every major programme, checking the history, the performance and allowing us to identify trends or issues.
<i>"The Department has only implemented approximately half of the NAO's Equipment Plan report recommendations since 2015."</i>	<ul style="list-style-type: none"> • We are working through responses to NAO recommendations and have agreed that many of these recommendations are repeated or have been overtaken by events. We will be updating responses shortly and expect there to be a much smaller number of outstanding recommendations. • Lasting change takes time if done properly, and in many areas we will always want to be continuously improving.
<i>"In particular it highlighted the decision to defer purchase of new Chinook helicopters by three years which is likely to cost more in the long run."</i>	<ul style="list-style-type: none"> • That decision was subsequently reversed when our financial envelope allowed. We have managed our budget prudently to utilise the headroom generated by cash not being spent on Ajax to bring forward capability and maximise value for money. • It will now revert to the original cost profile.
<i>"The Department also told us it intends to buy more F-35 aircraft. It had previously told us that the 48 F-35 aircraft it is currently purchasing would not be enough to sustain Carrier Strike operations throughout the life of its two aircraft carriers. We heard that it now intends to buy an additional 26 aircraft, but these will not start being delivered until the end of the decade. The total of 74 F-35s that the Department is purchasing is considerably less than the 138 it originally planned."</i>	<ul style="list-style-type: none"> • We have indicated our intent to procure more F35s • We also want to increase our understanding of the whole life costs of F35 before making further commitments and have been clear we want to see reductions in support costs and faster integration of British weapons. • This is an example of the department not making short term cuts but long-term changes in order to avoid short term cost cutting measures. We are adapting to the threat, reflecting on criticism and implementing recommendations. • The Carriers are expected to be in service until at least the 2060s. There is every reason to expect that further purchases will be made as the capability develops.
<i>"The Department told us that the Spending Review settlement allowed it to fund the programme, and since we took evidence has written to us to report that by the end of February 2022 it had spent £701 million"</i>	<ul style="list-style-type: none"> • As highlighted previously, there is a direct correlation between time and cost in defence procurement.

<p><i>on its development. But it does not expect the radar to enter service until 2030."</i></p>	<ul style="list-style-type: none"> • There is a balance to be had. We can push for programmes to be delivered earlier but that would drive up cost and be poor value for money. • Skills, industrial base, responsible financial profiles and balancing requirements are all factors that one needs to be aware of when developing complex equipment. • While we are not complacent, from what we have seen in the Ukraine conflict confirms that our Typhoon fleet remains highly competitive with the existing radar system.
<p><i>"It noted the NAO's example of the three-year delay in purchasing a new model of Chinook helicopter which will result in a net cost of £295 million."</i></p>	<ul style="list-style-type: none"> • This has been addressed above.
<p><i>"The Department also claimed that there had been significant improvements in management of the nuclear projects in the last two years, primarily as a result of setting up the Submarine Delivery Agency and the Defence Nuclear Organisation, which act effectively as a contractor and client"</i></p>	<ul style="list-style-type: none"> • Data show that those improvements in SDA are still continuing and that our work is headed in the right direction.
<p><i>"This is despite the fact that contractual commitments limit TLBs' flexibility to make savings, for example 62% of Air Command's spend is already committed over the next ten years"</i></p>	<ul style="list-style-type: none"> • The nature of long term programmes in defence leads to a large proportion of costs being committed. • This is entirely consistent with the profile of the RAF expenditure and the nature of their equipment life cycle. • While large amounts of funding is committed in big acquisition programmes, in the longer term we haven't committed to any other major RAF programmes so there is a great deal of flexibility that allows savings. • Air Command is an example of a TLB who have worked hard to live within their means in the short term by enacting difficult choices in the IR such as C-130 retirement, Typhoon T1 retirement, Hawk T1 retirement, E-7 re-evaluation and thus allowing them to invest to save in the longer term.
<p><i>"The Department plans to make substantial reductions to its military and civilian workforces over the next 10 years. These include reducing the Army from 82,000 to 73,000; other savings equivalent to reducing trained military workforce by</i></p>	<ul style="list-style-type: none"> • As before, data now conclusively shows that we are hitting our targets for service personnel post covid.

<p>6,350 (and their untrained workforce by 1,450) by 2030; and a 10% further reduction in the cost of the civilian workforce by 2024–25. As reported by the NAO report, the targets are already harder than expected as the uncertain economic outlook of the past two years caused by the pandemic has meant that fewer personnel have left the armed forces than normal.”</p>	
<p>“Service accommodation remains in a very bad way which risks harming recruitment and retention of personnel with key skills”</p>	<ul style="list-style-type: none"> • We have invested £350m over the past 2 years in enhancing SFA via the Fiscal Stimulus programme. • 96% of SFA meets or exceeds the Decent Homes standard; we do not allocate SFA which does not meet this standard. • The new Future Defence Infrastructure Services contract for SFA is expected to deliver additional improvements to the repair and maintenance of SFA once it achieves Full Operating Capability later this year.
<p>“The Chief Executive of Defence Equipment and Support told us that, while he did not pretend his programmes were perfect, there has been significant improvements in controlling their costs, making efficiencies and delivering to time. This is at odds with the Infrastructure and Projects Authority’s assessment of the Department’s performance, where, in its latest report, it rated the majority of large defence equipment projects as either red or amber.”</p>	<ul style="list-style-type: none"> • These two statements are not contradictory. Sir Simon talked about where we have seen improvements in cost control and delivery. We are continually updating our processes to speed them up and be more agile, while maintaining appropriate control of government funds. We are continuing to drive improvements in acquisition, including through category management techniques, increasing the capacity and capability of our SROs, streamlined processes and improving costings and our underlying financial and project delivery management information. • This work will continue alongside the Defence and Security Industrial Strategy (DSIS), as the crucial framework for a deeper, more sophisticated, and strategic relationship with industry. Since DSIS was published over a year ago, Government and industry have made significant progress on more than 50 DSIS commitments, and many of our commitments are focused on shifting behaviours and effecting cultural change across Government and industry to ensure long lasting improvement. Whilst it is the case that the majority of MOD programmes Amber or below, only 2 out of 32 were red at that time. • All government departments were in a similar position with the majority at Amber or below. • PUS also wrote to the Committee on 21 March this year setting out more of the background on the exchange between Rt Hon. Mark Francois MP and Sir

	Simon Bollom, and the differences between the datasets to which they were referring.
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