



Defence Committee

Oral evidence: [The Defence Materiel Strategy](#), HC 876–ii

Wednesday 12 February 2014

Ordered by the House of Commons to be published on Wednesday 12 February 2014.

Written evidence from witnesses:

- Bernard Gray
- Jon Thompson

[Watch the meeting](#)

Members present: Mr James Arbuthnot (Chair); Mr Julian Brazier; Mr Jeffrey M. Donaldson; Mr James Gray; Mr Dai Havard; Mr Adam Holloway; Mrs Madeleine Moon; Sir Bob Russell; Bob Stewart; Ms Gisela Stuart; Derek Twigg; John Woodcock

Questions 121-279

Witnesses: **Bernard Gray**, Chief of Defence Materiel and **Jon Thompson**, Permanent Under Secretary, Ministry of Defence, gave evidence.

Q121 Chair: Good afternoon. This is a continuation, in a sense, of the evidence session we had in December, and we are most grateful to you both for coming—we do try not to keep our witnesses waiting. We are trying to get our heads around precisely what the new entity is and how it is formed, so we will be asking you lots of questions about that.

Mr Gray, may I begin with you? We have a new entity. What is its precise description? It is not a non-departmental body exactly. What is it?

Bernard Gray: It is a non-departmental body. In *Managing Public Money*, there is a set of descriptions of types of non-departmental public body, which include things such as trading funds, Next Steps agencies and so forth, and there is a classification that in other terms might be called “other” whereby they basically say that if it is none of the above, it can still be a non-departmental public body of a certain description, which is called a bespoke agency.¹

¹ Note by witness: Within the definitions of Arms Length Bodies in “Managing Public Money”, DE&S will become a bespoke central government trading entity.

Q122 Chair: A bespoke agency, Mr Thompson?

Jon Thompson: Correct. *Managing Public Money* was amended by the Treasury in 2013 to give much more flexibility on what kinds of arm's length body you can create, and this is us exploring that new freedom, which was defined in that new version of *Managing Public Money* in 2013.

Q123 Chair: How will it be better than the present DE&S?

Bernard Gray: The purpose of putting it into this kind of organisation is to give it significant additional freedoms that are not available to the mainstream civil service.

Q124 Chair: What freedoms?

Bernard Gray: The freedoms to vary pay for people within the organisation, to vary recruitment policies, and to manage inside a total cost envelope, rather than manage to the grading structures and headcount specifications that exist today.

Q125 Chair: Will it enforce any new disciplines?

Bernard Gray: The entity of itself is a sort of permissive thing. It would allow us to do things that enable us then to seek to strengthen particularly some of the specialisms within DE&S where we are short of people, such as engineering, programme management and finance disciplines, which I have spoken about in previous evidence sessions.

Q126 Chair: So, it gives freedoms rather than disciplines?

Bernard Gray: I interpreted your word “discipline” to mean a specialisation—the discipline of finance, for example. Is that not the sense in which you mean it?

Q127 Chair: Well, it does not force DE&S to do anything in particular then?

Bernard Gray: It creates an entity that allows the DE&S greater management freedoms to do things; DE&S still has to do them.

Chair: Okay.

Jon Thompson: It also enforces, if I might say, one of the three original significant issues in Bernard's report from 2009—that is: what is the interface between the Department and DE&S as an entity? What it does is force us to work how that interface works into a more commercial arrangement.

Q128 Mr Havard: I understand that disciplines can mean different things. You are going to hire and fire people, which is one set of changes that you have to manage; then there are

financial accounting processes, how you relate to the market, hard charging and all of that. Are they all included in that broader definition of the different disciplines that you can introduce, and how you relate to international accounting standards, Treasury rules, Yellow Books and whatever?

Bernard Gray: We will have to publish a plan, which then has to be endorsed by the owners council—as with other NDPBs, there would be an owners council, which would probably be chaired by Min DEST.

Jon Thompson: Yes.

Bernard Gray: We have to agree that plan with that council, and also be held to account by Jon for the execution of that plan. They would look to us to put in the hard charging, the clear interface between the front-line commands and ourselves, and then against our work plan consider how we would resource that. To pick a topical example, for some time we have been short of airworthiness engineers—I have made this point before—and Jon might say to us, “What is your plan for addressing that shortfall in aerospace engineers, using the freedoms that you have now got?”

Q129 Mr Havard: I understand the stuff about people, but are those other freedoms any different from things that you would have been able to do in the current circumstances? What are the differences? What can you do under a new regime that you could not do under the old one?

Bernard Gray: Yes, they are different. We have been trying to recruit people to disciplines such as airworthiness for a significant period of time—for the past 18 months to two years. Having tried to do that internally, about nine months ago we appointed PwC to help us with external recruitment. They are struggling against that marketplace because we are not paying enough money. We have had a variety of exchanges with central HR at the Ministry of the Defence and more widely about having freedom to pay more money to that group of critical workers that we do not have, and we have been unable to get that freedom agreed because of its potential knock-on consequences for the rest of the system. So what we are seeking to do is draw a boundary around it and to say, “Within this boundary, to get this job done, we recognise that we need to be able to vary terms and conditions in a way that we can’t today.”

Jon Thompson: DE&S will not be able to walk away from it being a central Government body, audited by the National Audit Office. It will not be able to walk away from producing annual accounts in accordance with normal central Government arrangements, or from IFRS. Those things are constant.

Q130 Chair: We will come back to several of those questions. You mentioned the owners council. Who will be the owners council?

Jon Thompson: The normal arrangement we have for arm’s length bodies, such as the Hydrographic Office as a trading fund, is that you have an owners council chaired by the relevant Minister, which includes those people who work within the Ministry of Defence who essentially “own” the arm’s length body. In this case, there would be a director

general in the Ministry of Defence headquarters who will look after all of our arm's length bodies: DE&S, the Hydrographic Office, the Defence Support Group, a range of museums and so on. That person would also be on the owners council. We would also expect the chairman, the chief executive and other relevant executives from DE&S to be on the council.

The purpose of the owners council is to review the progress of DE&S against the corporate plan, which is agreed in advance of any relevant role, looking at performance in all of its various respects.

Q131 Chair: Is it different from the board of DE&S?

Jon Thompson: Yes.

Q132 Chair: Then why is job you have just referred to not being done by the board of DE&S?

Jon Thompson: Because we would expect the board of DE&S largely to be non-executive—you may want to come back to that—and to include the executive to focus on the internal running of the organisation and the delivery against its corporate plan. The owners council looks at the performance of DE&S from the perspective of the Ministry of Defence—in other words, looking at longer-term strategy. Is it is delivering what we want it to deliver under the agreement that we reach between us? There will in the end be an agreement also, similar to a trading fund agreement, that specifies how we would work together. So it is looking at it through a slightly different lens: it is looking at the performance from the perspective of the Department, not the internal management of the organisation.

Q133 Chair: Is Mr Gray on both?

Jon Thompson: Yes.

Q134 Chair: Then how can he look at it from those two completely opposing perspectives?

Bernard Gray: My sense of that would be that, whether I am actually a member of it or asked to attend it might be a question, but the owners council would want to question me about the performance of the organisation. So the principal reason I am there, I think, is in order to provide information to the independent, effectively, representatives of the shareholder. That is a way of thinking about it.

Jon Thompson: This is totally standard practice for arm's length bodies.

Q135 Chair: We will come back to this. How will it help everybody to deliver better capability to the armed forces?

Bernard Gray: “It” meaning the owners council?

Chair: No, sorry. I mean the new entity.

Bernard Gray: The purpose of the new entity is to address the questions that we have discussed here before about having the skills and personnel to be able to get the job done that we need to do, where we are both short in number and in expertise in a whole bunch of areas. Part of the whole point of the materiel strategy—one of three core issues—is to be able to raise our capability to get the job done. This is the vehicle that has been chosen in order to execute that, and therefore we would expect this to improve the performance of the delivery of equipment and reduce the cost of supporting equipment to the armed forces.

Q136 John Woodcock: Permanent Secretary, following on from the Secretary of State’s evidence session, may I ask why you think this new model is so much better than the GoCo, given that you were prepared to request a letter of direction if the Secretary of State were to go forward with the GoCo model?

Jon Thompson: Why do I think this is better than a GoCo?

John Woodcock: Yes, so much better that you were prepared to do that.

Jon Thompson: I don’t think those two things are linked. To be clear, the GoCo did not proceed because having received one initial bid, it was our joint view that there was a lack of competitive tension to be able to conclude from initial bid to some final agreement. We agreed that well ahead of the date on which bids were to be received. When we received one bid, we discussed it with the Defence Secretary and we recommended that we stop that competition and therefore we considered alternatives.

Work had already been carried out fairly extensively about what all the other alternatives were. Some can relatively easily be dismissed—for example, a trading fund cannot apply to this model because more than 50% of the income does not come from non-MoD sources. So we ended up with recommending a model which provided two of the fundamental three issues which were in Bernard’s original report: first, a stronger interface between DE&S and the Ministry of Defence; and secondly, help Bernard to be able to get the capacity and capability he needs to be able to deal with a task.

Q137 John Woodcock: Can I press you on this? Is it really credible for you to say that you were genuinely open-minded about the GoCo right the way through and it was solely the fact that there was a single bidder which made you recommend that it ought to be stopped?

Jon Thompson: The Chairman asked me that at the last meeting I came to in relation to the accounts. I believe my answer at that time was that it was a question of whether we can demonstrate value for money. As the accounting officer and previously the finance director at the Ministry of Defence, it is all about whether we can demonstrate value for money. In our joint opinion, you could not demonstrate that in going down to one bidder; therefore, we had to recommend that it stopped. That is what the data tell you.

Q138 John Woodcock: Sure, but it is true that you had quite serious doubts, regardless of whether there was one bidder or two, as to whether the GoCo model could provide the value for money that justified the level of risk that moving to a new model was going to take.

Jon Thompson: It is my view that a GoCo is a model that could conceptually work, if you could run a competition that gave you enough competitive tension to give you the evidence that there was value for money. That remains our advice to the Secretary of State in relation to why he should keep those elements of the Defence Reform Bill, which might give enabling power to the Government at a future date.

Q139 John Woodcock: “Conceptually” is rather weak, isn’t it?

Jon Thompson: There are all kinds of good ideas that we want to explore on occasion. It seems to me that what we were trying to do was potentially a world first. I think that is the position that we have taken. We were pushing the boundaries on what a GoCo might be able to do. I do not think that we should shy away from doing something. It was a brave thing to try to explore; it didn’t work, therefore we recommended not doing it.

Q140 Chair: Courageous?

Jon Thompson: I would not have gone quite to the “Yes, Minister” statement. It was certainly innovative and we explored it and it did not quite work, and therefore we recommended that it stopped. I do not see anything wrong with that.

Bernard Gray: Can I add something in support of what Jon just said? In September last year when, as is on the public record, I think, we had a Cabinet Office review, KBR dropped out of the competition, taking the number of competitors from three to two over the course of the summer. Over the course of September, broadly speaking, the Cabinet Office reviewed the viability of the conversation. As well as talking to them, Jon and I had a meeting where we discussed our personal opinions about the viability of the competition. We were of the view at that time, with two external bidders and the internal DE&S-plus reference, we had a viable competition; but it was equally our view in that meeting that, if we dropped down to one external bidder, we would not have a viable position. We were clear about the criteria for success in September.

Q141 Chair: That is interesting, because it took some time for the Secretary of State to announce that, as a result of dropping down to one bidder, the competition was over. Why was that?

Bernard Gray: There is a variety of issues in that. One issue on which I gave evidence the last time I was here was that the one bid was very attractive.

Q142 Chair: You were tempted?

Bernard Gray: I don't know that one has to put it in emotional terms. You look at it and you say, "Just before I throw this away, is this potentially interesting? Is there enough in it to make us revise our previous view?" We have more data than we had in September—there are 1,200 pages of documentation here. You want to look at it and figure out whether you can deliver that outcome and the saving that is implied by it. We had that debate over a couple of weeks. Before you make a decision of that moment, you might say, "We are pretty clear what the boundary conditions are for success," yet, with 1,200 pages of documentation, you want to check that your original assumptions are correct before you make a decision.

Jon Thompson: It was certainly worth reading. It supports my view to Mr Woodcock that it was conceptually worth exploring.

Q143 Mr Donaldson: Mr Thompson, what steps do you need to take to become a trading entity?

Jon Thompson: There are two fundamental issues that we need to agree about the relationship between the Ministry of Defence and DE&S. One of those is similar to a trading fund agreement and the other is a corporate plan. The agreement sets out between us what our respective roles and responsibilities are and the plan sets out the performance of the entity going forward. Both of those will be required.

We are also working on how the governance of the new organisation works both internally and in relation to the owners council. That is a stream of work that needs to be completed. Separately, Bernard is working on the capacity and capability issues—that is not particularly relevant to whether it is a trading entity or not, but you may want to come back to what injection of capacity and capability he needs. And we are in negotiation about potential HR freedoms, which, in my opinion, will be essential in order to operate the organisation in the way we would like to.

Q144 Mr Donaldson: Mr Gray, what challenges and risk do you face as the move towards a trading entity goes forward? Can you also advise whether the Comptroller and Auditor General and the National Audit Office will audit the accounts?

Bernard Gray: Taking the second question first, the answer is yes. We remain a part of the Ministry of Defence and we will be audited as part of the Ministry of Defence for those purposes, and we will go the PAC on the equipment plan, as now. So nothing basically changes in relation to the audit and holding-to-account process.

As far as the challenges that we face are concerned, apart from the mechanical things that Jon is describing of writing the stuff down and getting it agreed between Government Departments, which is more of a bureaucratic challenge than a business challenge in a way, those are the things that we have to get done. We have to get our business plan together, we have to get the freedoms agreed and so on and so forth. Therefore, in getting the organisation stood up, we have to get over those hurdles, so those are the risks in a sense.

As far as the migration of the business is concerned, I think it is a much more straightforward issue, because effectively everybody in the organisation remains as civil servants: they are not being TUPE-ed into a different type of organisation in that sense. We carry on with business as usual in that organisation over this transition at the end of March. Effectively, the business plan we will be creating will be giving effect to a lot of things that we have been trying to do anyway. We will go through how we are going to try to address the skills shortfalls that I have talked about before. We need to stand up our own independent HR organisation and so forth, because that was largely centralised some years ago. There is a set of other challenges. We then need to target everybody around the plan. I see that as a continuation of a journey we are already on, rather than a major transition.

Q145 Mr Donaldson: When will you be in a position to deliver a set of annual auditable accounts?

Bernard Gray: In the normal course of business over the year. I do not anticipate us changing the audit schedule that exists today.

Jon Thompson: So it is the summer of 2015. The end of the first trading period will be the end of 2014-15, so it is the summer of 2015.

Bernard Gray: Typically, we put them in three months after the close of the financial year, or thereabouts.

Q146 Mr Donaldson: And how confident are you that you will be able to implement hard charging by April 2015?

Bernard Gray: That is a significant piece of work that we have to do. We are confident about it, but there is a lot of work to do. To be clear, if that proves a difficult task—it has been implemented elsewhere in the MoD without it being particularly difficult, at DSTL and other areas for example—we can also run it in a shadow form for a period of time. It is a useful discipline, but it is not absolutely essential to have it on 1 April 2015. If it did not happen for some reason, the business does not stop.

Q147 Chair: You say “run it in a shadow form”. The entire entity will be run in a shadow form, according to the MoD evidence given to us recently.

Bernard Gray: My point is only really about the attribution of people’s time, which is what we are talking about here. The hard charging relates to how much of people’s time, in a professional services firm kind of way, goes into particular projects. I think that this is a useful discipline on team size so that customers can understand how much effort is going into any particular team activity, but it is a relatively small proportion of the total. If it was not available for some reason, we would carry on with that in its current form, whereby people’s time is not attributed in that way, so we would be no worse off than we are today. That is my point.

Q148 Chair: Okay, I accept that, but going back to running something in a shadow form, how long would you envisage the possibility of running hard charging, to start with, in a shadow form from April 2015?

Bernard Gray: Our plan is not to do that, but to execute it for April 2015. My point is that if, for argument's sake, the IT development or the systems integration—because it has to sit on DII and there is some complexity in all that—took longer and we ran hard charging in a shadow form for 12 months, that would not be the end of the world.

Q149 Chair: Okay. Your answers to our recent questions over the past few weeks have suggested that the entire entity will be run in a shadow form from April 2014 to April 2015.

Bernard Gray: That is correct.

Q150 Chair: When was that decided?

Bernard Gray: In December when we made the decision to implement this plan.

Q151 Chair: When will the accounts be auditable by the National Audit Office? In other words, will the shadow entity's accounts be auditable by the National Audit Office in the same way as the full entity's?

Bernard Gray: Can I draw a distinction between two blocks of money? There is the block of money that is the equipment plan—the new equipment plan, the EPP—and the support plan, the ESP. That totals up to about £14 billion, and that is obviously the bulk of what we spend. That is unaffected by all this, because we are not shadow charging that. The accounting for that exists inside a billing to Navy Command or Air Command today: “Here's your share of the equipment plan.” The bit we are talking about here is the operating costs of DE&S, which are of the order of £1 billion. That will be audited essentially as it is today, as part of the Ministry of Defence's overhead in the shadow year, and it would then chop over to the new basis of time charging, if that is available, from 2015.

The hard charging question is about attribution of cost, not about the totality of cost, so I see the NAO process as largely undisturbed by all this. The major issue around the equipment plan is invariant through the process: the NAO audits it exactly the same now as it will in future. The form of the accounts for the operating cost will change as we move to hard charging, but again, I do not think that that represents a significant problem for the NAO, which would audit them in the normal frame, whereby we have to submit accounts just after the end of the financial year, and it audits them in the few months thereafter.

Q152 Mr Brazier: Could I shift the spotlight to the customer function, which figured prominently in the original Gray report? Mr Thompson, who sits on this new customer board?

Jon Thompson: We would expect it to be essentially the five customers of the organisation: the three front-line commanders, who everyone will be familiar with, plus the joint forces, and we have kept a number of so-called strategic programmes in the head office. I think that the Committee is familiar with the fact that we have delegated the equipment plan down to the four military commands, but we have kept a small number of so-called strategic programmes in head office under the Deputy Chief of the Defence Staff for Military Capability. So you end up with five customers.

Q153 Mr Brazier: In the 1960s, the decision was taken to bring them all together with the Department, so that there is always one customer. Mr Gray commented in his report on how complicated the interface was with one. Will this make it easier?

Jon Thompson: No, it potentially makes it more complicated, as it has done with the budget management of the organisation, so we need to be transparent about this.

The recommendation of Lord Levene's report on defence reform was that we should delegate the budget from the head office into the commands, and that is what we have done: we have moved from a financial relationship of one to one to one of five to one. On the back of that, we are, if you like, changing the business relationship to reflect the flow of money. It potentially makes things more complicated.

Q154 Mr Brazier: Let's look at some of the examples from the '60s of why they put the four organisations together. Let us suppose tomorrow you had, speculatively, a query over a medium-size troop-carrying helicopter. The Army has one solution and the RAF has another solution. Who will pull it together before it goes near Mr Gray to decide who it will belong to?

Jon Thompson: The role of the Deputy Chief of the Defence Staff for Military Capability, working back to back under the Levene model with the director general of finance, is to run the Military Capabilities Board, which is a coherence organisation that looks at the individual plans of the front-line commands, which they have to do annually for a 10-year forecast and make sure they are coherent. He is responsible for making sure that if that scenario were to arise, he resolves the issue himself as a three-star. If he cannot resolve it himself, he now has direct access to the Armed Forces Committee, also created on the back of Lord Levene's report, which is charged by the Defence Board to resolve those kinds of issues and prioritise defence investment.

Q155 Mr Brazier: Who sits on that Committee?

Jon Thompson: On the Armed Forces Committee it is the Chief and the Vice-Chief of the Defence Staff, the four military commanders, Mr Gray and myself.

Q156 Mr Brazier: Right. Moving on from the structure of where we are now, how much of this is established and in place? Are the new five-part capability arrangement and the structures you mentioned all in place now?

Jon Thompson: We implemented all of those changes in April 2013. The Armed Forces Committee came into being slightly before that, in late 2012, but we implemented those changes in 2013. We delegated the budget in 2013. The Military Capabilities Board has been running since then.

Q157 Mr Brazier: This is perhaps the one question that is for both of you. Has this yet delivered any concrete benefits? Have we seen some changes? There have been hints that there have been fewer changes to the plan and so on. Have any measurable changes taken place in terms of that crucial customer relationship?

Jon Thompson: From my perspective—Bernard will undoubtedly want to add to this—there is much more stability in the equipment plan. We are not seeing the board or the Armed Forces Committee being asked to make the kinds of scales of changes that were being asked for pre-2012 and definitely pre-2010.

Bernard Gray: I agree. When I arrived at the beginning of 2011, still in the outwash of some of those issues coming into the budget setting for 2011-12, the Defence Board, which was the only competent body, in EU-speak, to deal with that, was spending its time going through line items of £5 million and £10 million, arguing about whether we should have this, that or the other thing. The combination of the cuts in the forward programme, which balanced the programme that we went through in the defence review into PR12 and the way in which—to pay tribute to Steve—Air Marshal Hillier ran that central organisation not only meant that the programme was very stable but he exercised significant discipline in avoiding constantly changing our mind. We have not faced the first problem of trying to get a quart into a pint pot. We are getting a pint into a pint pot and Steve has done a very good job of disciplining us to not change our minds about that.

My personal observation would be that the chiefs working on the Armed Forces Committee work in a very collegiate and coherent way to come up with a settled view about what the approach to any individual issue is, including under circumstances where there is tension about the allocation of resources. My observation would be both that the Defence Board, the Armed Forces Committee and Steve's military coherence organisation are working very well.

Q158 Mr Brazier: A quick final question: who will chair this owners council?

Jon Thompson: The Minister for Defence Equipment, Support and Technology—Mr Dunne currently.

Q159 Mr Gray: I am no sluggard. I have done 17 years in Parliament, I was a civil servant for five years before that and I spent donkeys' years at university, but I find all of this stuff incredibly byzantine—Schleswig-Holstein incomprehensible, not to put too fine a point on it. I am glad that you don't. That is why you are here, I suppose. What concerns me is that if someone like me cannot understand it, and therefore nobody else can—

Chair: Does that follow?

Mr Gray: No, that doesn't follow, Chairman, thank you very much. How on earth is it all going to be accountable? How are you going to be held to account so that we know that the things that you are doing are the right things financially and practically?

Jon Thompson: As I said earlier in relation to Mr Havard's question, the current arrangements within the Treasury for IFRS and accounting and so on would apply. We have a new set of accounts that defines the organisation that is subject to separate National Audit Office scrutiny. You have an owners council. You now have a definable five-year corporate plan. You have an agreement about how the two entities work together. Some of those pieces of the machinery are new. The primary responsibility within the Department for holding DE&S to account would be with the owners council, but at the entity level, clearly it would be with the chairman and the non-executives of the organisation to hold Bernard to account for the delivery of the performance, too. So there are new methods of accountability in the system that are not there now.

Bernard Gray: Can I have a go at that?

Mr Gray: Please.

Bernard Gray: On the levels of accountability, clearly I would be accountable to the chairman for the running of the organisation. I also still work for Jon, so in routine meetings and in holding-to-account meetings, and into an annual assessment of what we are doing, there would be an accountability into my executive line management, as well as to the chairman. We would be accountable to the owners council. I am assuming that this Committee would want to continue to call me and that I would come.

Q160 Mr Gray: You or the chairman, or both?

Bernard Gray: I rather think that's your choice. For argument's sake, let us assume that you choose both.

Jon Thompson: The options are for you to choose one or the other, or both.

Bernard Gray: Additionally, although we have not talked about it, I think the proposal is that I would be an additional accounting officer for the purposes of the overheads—£1 billion of DE&S operating costs. In that guise, I would attend the PAC. I attend now anyway, in relation to the equipment plan, but I would also have to attend and account for the operating overheads of DE&S as well.

Q161 Mr Gray: But you wouldn't be the accounting officer for the actual spend; just for the overheads within DE&S.

Bernard Gray: That is correct. Jon is currently the accounting officer for all of it, and I would become, under the way that *Managing Public Money* works, the accounting officer for the bit for which I am directly responsible, which is the overhead.

Q162 Mr Gray: And Ministers? Where do they come in all this?

Bernard Gray: We account to Ministers as and when they ask us. There is a Defence Board every month, where we are accountable to the Secretary of State and we provide a lot of management information that goes into that. If they have particular issues on particular topics, we attend at their pleasure.

Jon Thompson: What the agreement between the Ministry and DE&S in future will do, and the corporate plan, is allow the Minister to have a regular monthly meeting to go through performance as the chairman of the owners council. That is what we would expect. The Minister has now got the actual mechanic of how he holds Bernard and the organisation to account for its performance.

Q163 Mr Gray: I really haven't got the remotest idea of what we are talking about, quite frankly. It seems remarkably confusing. If I cannot understand it, how can the people out there listening understand it? However, hopefully our learned advisers will understand it and they will be able to give us tough questions to ask for next time. That is all I can hope for.

Q164 Ms Stuart: The reference to the Schleswig-Holstein question tempts me to ask which one of you is dead, which one is mad and which one has forgotten. I remember that that was the answer to the Schleswig-Holstein question. Occasionally, Committees are faced with witnesses who are not terribly keen to appear in front of them, and then they have to, kind of, coerce them. You say it is our choice. Will there be a stage at which you can provide us with a grid as to where the buck stops when? If you say it is our choice whom we ask to come, that puts us in a position when one or the other does not want to come. Where precisely in the grid does the buck stop? I still do not understand it.

Jon Thompson: We can provide you with a grid.

Q165 Ms Stuart: Which actually says what kind of stream of decision making will ultimately end up with which one of you, so that if neither of you, or the Minister, wish to appear in front of the Committee, we know exactly who to pin down.

Jon Thompson: I don't think that is particularly difficult. We can provide you with a grid to show you who is responsible for what. Chairmen of arm's length bodies regularly appear before Select Committees with or without chief executives. I am happy to do the grid.

Q166 Ms Stuart: No, no. When you make a decision, quite frankly neither of you are terribly comfortable with answering in public. If you are in the position of the Chairman of the Defence Select Committee, and you want to be assertive in demanding who appears in front of us, it would be quite useful to know with whom the buck finally stops.

Chair: I am content with Mr Gray's answer that we shall decide who we want in front of us, and I think that Mr Gray is content with his answer. Let us move on to John Woodcock.

Q167 John Woodcock: Briefly, as a follow-on from that, isn't there a danger that this relatively more complex accountability structure under the revised organisation will be a brake on progress compared with the relative commercial freedom of a GoCo?

Bernard Gray: I think there are different challenges in the two.

Q168 John Woodcock: Yes, but this is one of the challenges of the new organisation.

Bernard Gray: There are always complexities in any change, and there are problems associated with the status quo. You have to look at all the counterfactuals in all those situations and ask what would have happened if you had carried on and didn't make any changes. On the one hand, you would not have any of the problems of change; on the other hand, I would not have enough airworthiness engineers and others to do the job.

Q169 John Woodcock: Forgive me, I was not talking about the process of change, but rather the revised accountability structure once changes are made, which, as you have described, is a relatively complex thing. That must be a danger to manage, compared with the, I presume, relatively greater freedom to operate from a GoCo.

Bernard Gray: I do not see it that way. The Levene process that Jon described is a genuine additional piece of complexity that we have to deal with that is designed to force the individual services to make trade-offs about their priorities within their budgets. That is the thrust of that process, but I do not think that the owners council will be a particularly complex or onerous structure.

Jon Thompson: If your question is whether the accountability systems would be significantly different if we compare and contrast the two models, the answer is no. The GoCo would have created something like an owners council—it would have created a governor function; that is what we envisaged. It would have been an arm's length body owned by the Government; that is what a GoCo is. Therefore, the accountability arrangements would have been broadly the same.

Chair: Moving on to commercial partners, Madeleine Moon.

Q170 Mrs Moon: Mr Gray, can you explain what strategic partners you are seeking from the private sector? Who are you looking for?

Bernard Gray: We are looking for three types of entity or company: first, a programme management organisation, which will give us greater skills in formatting and then managing the complex programmes on our way through; secondly, an IT system set of firms or firm, which will implement some changes to the management information systems—we can talk about that in a bit more detail—and thirdly, an HR-type support organisation, which will be brought in to help us stand up our stand-alone HR function, which at the moment we do not have in house.

Q171 Mrs Moon: How will you procure them?

Bernard Gray: We are going to run competitions over the course of the first half of this year, running from about now to about the recess—that kind of time—and we are currently in consultations with the marketplace about the exact form of those packages, how we put those procurements together, how we sequence them, and so on, in order to ensure that we have the best possible competitive opportunities for ourselves when we go to market.

Q172 Mrs Moon: How many staff are we talking about?

Bernard Gray: Being provided from the outside?

Mrs Moon: Yes.

Bernard Gray: We have not determined that, so we are looking partly for people to bid to us what they think that the job will be worth. We have some ideas in our mind. It's not a huge number. I am kind of reluctant to go there, because I don't want to prejudice the competition in a sense, but I could maybe write to you privately with what our ballpark figure is.

Q173 Mrs Moon: I think that would be helpful, because otherwise, if you don't actually have a figure in your head, they could sell you whatever they want to sell you.

Bernard Gray: I do have figures in my head; I just don't want to say them.

Q174 Mrs Moon: No, no, I appreciate that. I think the Committee is happy with that response; that's not a problem.

How long are these contracts with the three different types of private sector companies?
How long will they be for?

Bernard Gray: That is part of what we are consulting about. We imagine at the moment—our central assumption going into this is that we would have an initial period of three years, which might be extendable by one year and then, potentially, another year, so in our jargon, 3 + 1 + 1. That's our initial assumption. However, they differ in type, I think.

We think that the second and third packages—so a package around IT and a package around HR—would actually be a job-and-finish thing. There would be an implementation of some changes and it would then be left with us, and therefore that is a one-shot operation by those people. There is some question about, I guess, updating those systems; but broadly speaking, we think about those as a one-shot.

The programme management organisation, I think, is more likely to be an enduring relationship, because we want to make sure that those disciplines are applied to the business on an ongoing basis. So we might well let a contract for that period, but I imagine that the second and third packages would then fall away and the first one might endure.

Q175 Mrs Moon: So you are going to procure them in a different order, so, actually, you procure HR first. Is that what you're saying?

Bernard Gray: No, we will probably procure the programme management company first, but it is possible to run them all in parallel. One possibility, however, is to run the programme management one first and then have a debate with whoever the selected partner is on the programme management side about their views about which of the IT packages were relevant, because there is quite a close interaction between the two, and then there is a choice, which is fairly open to us, about whether to run with the HR package at the beginning or to wait and consult on that.

Q176 Mrs Moon: So you consult the project management company on the HR package. I can understand what you are saying about the IT system. I've got no problem with that. It just seems a little bizarre to consult people who you employ about the HR package about their employment.

Bernard Gray: No, it is not about their employment. There are a relatively small number, which are actually about, that would sit in there. They are employed under a contract as contractors, so they are not in our structure. What I am concerned about is the part of what is currently DE&S, which is, in scope—ballpark— we'll call 10,000 people. It's how do we set up the HR system, grade our organisation, because at the moment it exists on a sort of standard civil service grading structure? That may or may not be the most appropriate way for us to run in future, because we think that it does not sufficiently recognise the specialisms that we've got and the market demand for those specialisms. So it's a moot question at the moment about whether we just determine that in advance and go now, or whether there is any merit in picking the brains of people who in large programme management organisations around the world are doing this all the time. We may get more data from them because we might assume that we do it in this way and they say, "Actually, we tried that, but it turned out that it was better to do it some other way." It is six and two threes in my mind at the moment about which is the better course.

Q177 Mrs Moon: How much preliminary conversation are you having with these sort of contracting companies? Are you already saying, "This is the sort of people we're looking at."? How much are you putting the specification in their hands and guidance about what it is you are looking for?

Bernard Gray: Against all three work packages, we have already put out a skeleton structure to the marketplace, and we are consulting on that right now. As I say, for fairly obvious reasons, our main focus is on the programme and project management stream. That is the most important stream. We are in very significant dialogue with about eight companies in that field. We are saying, “This is what’s in our mind.” We are asking them in a variety of ways. We have had industry open days, we have had some questionnaires, and we have had, or are in the process of having, one-on-one meetings with each of the firms where we say what is in our mind, they say what is in their mind and we then try to synthesise a view that drives what we want in the way that will get us the best market response.

Q178 Mrs Moon: How willing are contractors to work within the framework agreement for technical support? Are they happy with that?

Bernard Gray: This would not fall under that.

Mrs Moon: It wouldn’t?

Bernard Gray: No. At the moment, people who are already registered under that framework agreement can bid in packages. The procurement method we will use for this is an open competition through the *OJEU* process. We are not using FATS for this purpose.

Q179 Mrs Moon: Okay. On the companies that you are hoping to procure, are you going to be looking for any particular technical expertise in defence procurement and working in that field?

Bernard Gray: What we are really looking for is complex programme management that spans a number of disciplines. We have a lot of expertise in-house on defence issues. What we need is more of the programme management and finance expertise to synthesise the two together. I feel I am short on programme management finance expertise; I do not feel I am short on defence expertise.

Q180 Mrs Moon: Is there any nervousness in the private sector about the fact that the GoCo is effectively not dead but just sleeping quietly and could be brought back? Is that of any concern? Will it influence people’s capacity to bid?

Bernard Gray: We have not heard that. My assessment would be that people are looking at the attractiveness or otherwise of this initial 3 + 1 + 1 package, and they are debating that. I have not heard anybody say, “I don’t want three to five years’ work, because something else might happen later”.

Q181 Chair: Conversely, is there any nervousness among those who say, “Oh no, we’ve just been through all this”?

Bernard Gray: I think money speaks, and business is business. People want to do business, and we have significant positive engagement from a whole variety of firms about a desire to do work for us.

Q182 Chair: Some of whom, presumably, were involved in the GoCo negotiations.

Bernard Gray: That is correct.

Q183 Chair: And those who put in a bid might feel that they had a bit of an in, mightn't they?

Bernard Gray: They might do, and of greater concern to us is that people who didn't put in a bid feel that they might not have an in.

Q184 Chair: How can you reassure them?

Bernard Gray: That is part of the consultation process that we are going through. We need to make sure that we structure this competition in such a way as to minimise both the fact and the perception of that bias.

Q185 Chair: But they will say, "Yes, of course he says that."

Bernard Gray: I appreciate that. We need to do more than that. We are looking at a number of things in order to try to do that—what additional information could we disclose to the market more generally to give everybody a common information baseline, so that they all feel equally well informed? How can I reduce the costs to people of participating in the process? A factor in this is, "Do I feel I'm going to have to invest a lot in the bid process in order to potentially win the work?" Therefore, we consider what we can do that simplifies the competition and makes it more about saying, "Tell me what kind of skills you can provide that would be useful in a complex management system", rather than "Tell me what you would do with the Navy". It is about asking them about their skills, not asking them about our problem directly.

There is also a question for us—I don't really want to go into it at this time, but I would be happy to answer questions on it next time I came, or possibly in a note—about how we might structure that competition. We are thinking about ways in which it would be structured that would give people reassurance that there was something worth competing for.

Q186 Chair: Another way you could deal with it this time would be to say, "We have led them, Duke of York-like, up the hill, and this time we will pay their bidding costs." Have you considered that?

Bernard Gray: That has been raised, but I think the Ministry of Defence is reluctant to set a precedent in that direction. I also do not think it will be necessary. I think we can structure something that gets a competition going without going that far, but I am very interested in making sure that we reduce people's bidding costs as far as possible.

Q187 Mr Havard: Can I ask where you are currently? You have put forward an argument that you need project management skills and all that. I understand all that in general. For various reasons, I have had discussions about your organisation with certain individuals in different places in the last few weeks. I understand you currently employ contractors. For example, you have a contract with Capita, I understand. Within that, people from Capita then get work to you and all the rest of it. You have a strange community of people that you have to buy in currently and manage, as I understand it. Could you say something about what that currently costs? It seemed to me from the discussions that the flow of work that goes to these people is not necessarily as predictable as you might like it to be. Therefore you have to buy people and keep them on the books, but they are not 100% productive to you, for various reasons. Would you say something about what that is currently? As you move in transition over the next 12 months, how will that be managed?

Bernard Gray: I think the situation is as you describe. I think Mrs Moon referenced the FATS structure. FATS is one dimension of how we get contractors of the type that you suggest. There are other contracts which are not. This is a framework agreement, so, permit me 30 seconds of Schleswig-Holstein. We are either obliged to run an open competition, which is the kind of thing we would do for these business partners, where we run through a process that can take between four and six months, in a relatively straightforward case, to appoint somebody. We have a bunch of contractors that we appoint on that basis.

In order to try to short circuit that for the availability of some things that we know we need on a reasonably regular basis, we effectively pre-qualify quite a few firms who apply. I cannot remember, but I think we run this every two years and say: "Can you pre-qualify to be on this framework?" We are then able to appoint them in a 10-week process rather than a 20 to 30-week process. Taking the FATS, which is the fast track, and the wider body together, there is about £400 million worth of that kind of activity going on annually, and has been going on for a long time inside DE&S.

Mr Havard: And about 1,500 people, I understand.

Bernard Gray: I don't know the number, but I know the money, so I would not be surprised. One of the points about the freedoms and where we intend to put the boundary, is around our current operating costs, which is largely around our staff and around that £400 million. We then say: "How do we make best use of all that money as a single entity?"

Why have we ended up with £400 million worth of work going to outside firms? Part of that is a trend that has been in place for a long time, around trying to squeeze down the number of people inside our organisation. Effectively, we have then ended up with jobs that still needed doing, which we have then bought in as part of an equipment programme. So we will have a programme to buy a vehicle, or whatever it is, and we would appoint

outside people who had the skills and increased the number of available people to do particular specialist jobs.

Part of what I am trying to do is be able to employ some of those people rather than pay contractors. It would be cheaper for me in some cases if I could actually hire somebody permanently, rather than pay contractors, but I have, until now, been bound not only by the total pay bill but the number of people we can employ. So a significant freedom that we would get is to make or buy decisions about skills. We would probably hire some people and cut our bill by being able to do so, because we would have a total cap on the amount of money we spent, not on the number of people we employ.

At one end of the scale, though, there will be some jobs where we just don't have enough work to have people on staff. We have a few ship architects, for example, but we are probably always going to want to go out to the market for ship architects from time to time, because we have occasional peaks in our work when we are designing a new ship. But, in some other areas of general finance or programme analysis or construction, we could bring that in-house. I would see that the number of people actually being employed inside DE&S as permanent employees is more likely to go up than down and our external consultancy spend would come down.

Mr Havard: Luckily, I speak fluent Schleswig-Holstein—it's one of the things we do in the valleys.

Q188 John Woodcock: Briefly to go back to the Chairman's line of questioning, you must accept that the damage done to your commercial reputation from the aborted GoCo process will make it harder to drive value from your strategic commercial partners in the revised entity.

Bernard Gray: I do not accept that at all. I do not think that that is a logical conclusion.

John Woodcock: Not logical?

Bernard Gray: Why is that true?

Q189 John Woodcock: The very fact that you are considering paying the bidding costs in future suggests—

Bernard Gray: I think I just said that I was not.

Q190 Chair: I think he said it was raised.

Bernard Gray: I think people raised it and I said I was not going to do it.

Q191 John Woodcock: You know far more about commercial practices than me, of course, but the private sector commercial operators will price in risk and uncertainty. Do you not

accept that there is an added level of risk and uncertainty from the way that the GoCo process ended up collapsing that will be priced in and come back to the public sector?

Bernard Gray: No, I do not accept that. My view is that the process that we are going through now of examining what the proposition that we will then put to the market is specifically designed to make sure that we are able to run an effective competition that people are interested in participating in. I am going through, in some detail, with all eight firms—including in the course of this week—what their interests are, what their red lines are, what their concerns are and what our issues are in order to describe a centre of gravity, so that, by the time we launch the competition, we will have something that everybody has confidence in.

Q192 John Woodcock: Okay, let me try one last direction on that. One of the reasons that the Secretary of State cited for abandoning the GoCo process was lack of confidence in the financial baselining of the Department. That is quite a stark admission of the Department's inadequacy, is it not? That is information that is now known, which was not known. Do you not think that the commercial sector will price in that lack of knowledge and that that will come back to us?

Bernard Gray: No, because we are not contracting for the same thing. To take the question in two parts—I think I have described this here before—the GoCo arrangement would have put the private sector in the lead, with the public sector in support. They, therefore, would have been on the hook for the financial performance of the business, so the baseline was incredibly important to them. I will come back to the question of the baseline in a second.

This arrangement puts the public sector in the lead, with the support of the private sector. We are asking them to supply us with people, skills, capabilities in particular areas and some organisational ability. There will be a question around driving performance on some parts of their fee, which we are currently discussing with them, but it is not dependent on the baseline in the same way as it was in the previous structure, because it is different.

As far as the baseline is concerned, I think, to be clear, the issue is not particularly about what the baseline is around a relatively small margin. The question is, in my understanding, if you contract on that baseline, can you be definitively sure that some deviation from that, if we appear to be saving money, is attributable to the GoCo contractor, or might it either have happened anyway or represent a programme slip, the money for which might have to arise later? I think the problem that Jon perceived from a finance and accounting officer perspective was the second-order effects around the margins, not what the totality of the programme cost.

I do not think, therefore, that it is a stunningly bad admission of a lack of understanding on our part. We have a very good track on where the Department's expenditure is, and I think in the previous Major Projects Report, the one about to be published and in the one after that, you can see a lot of stability in that programme. That is because we have done a lot both to size the programme appropriately and to manage it better.

Jon Thompson: Just to be clear, I agree with all of that.

John Woodcock: That takes us on to earned value management. Given the question about the baseline, what makes you think you are going to have the capacity and the degree of sophistication that earned value management is going to require in DE&S?

Chair: I want to come on to earned value management in a more expanded way, first, to talk through precisely what it means. Your enthusiasm is running away with you.

Q193 Sir Bob Russell: Mr Gray, did I hear you correctly when you said that you expected the number of staff to increase and that you would bring in-house some of the work from outside, as it were?

Bernard Gray: I do not definitely know that. In the total balance, I think I can reduce costs by in-sourcing some jobs.

Q194 Sir Bob Russell: Of course, that would fly in the face of 30 years of Government policy—Thatcherite, Blairite and the current Government—of outsourcing, and the Prime Minister’s boast that he has reduced the power of the state, with fewer state employees and expansion of the private sector. Does the Secretary of State for Defence agree that there should be a reversal of 30 years of successive Government policy?

Bernard Gray: I don’t think this is a policy question. It is practical question about where money best goes. I am saying that we would make a set of make-or-buy decisions in individual cases about where that work best sits. We are going in both directions. We are saying that, in the case of programme management, we definitely do not have enough of that and probably cannot afford enough of it all in-house, so we are going to buy in some of that from the outside. I am also saying that there are some lower-value routine tasks that currently the headcount control totals oblige us to put outside that we could take inside and get done.

I think it will be a mixed market and a more rational basis on which to allocate resources, to have the freedom to say what counts as the money. We will undoubtedly be under some imperative to reduce our costs over time—a discussion yet to be had. We will have some kind of pressure downward on costs and we will have to accommodate the cost of employing business partners and try to rationalise what we are doing, as Mr Havard referred to. Effectively, it is a tactical patchwork quilt of contracting arrangements at the moment. I want that to be rationalised to reduce our costs. One way to reduce costs may be to in-source some jobs.

Sir Bob Russell: The thinking behind my question was not that I agreed with the Government policy of the past 30 years, but the freshness that there is another side to job creation and retention that is not always outsourcing. I just make the observation that this could be the beginning of a new direction after 30 years of outsourcing.

Chair: Thank you very much for that observation. Moving on to Julian Brazier.

Q195 Mr Brazier: I have a quick supplementary. With two earlier sets of questions, you mentioned a shortage of finance people. The last time I saw a table, which was several years ago, it showed every single category of employment in procurement. Each of the main technical disciplines, scientific and engineering, had declined. It showed a decline in the number of qualified contract staff. The one thing it showed was a significant increase in the number of finance staff. Could I ask for an updated table? Could you send us a table showing us overall, compared with where we were 10 years ago, say, how many you have got in each of the major categories, including finance, within your empire?

Bernard Gray: Within DE&S, I am happy to provide some analysis.

Q196 Mr Brazier: Within DE&S, yes, thank you.

Jon Thompson: Obviously, we would encourage more finance staff in the Ministry of Defence, given the challenges that we have got. I would say that as a qualified accountant, wouldn't I?

Bernard Gray: My observation would be, that whatever trends you might have seen in the numbers—and I don't know if Jon would agree—that while the position is improving, the level of financial literacy across the Ministry of Defence still leaves something to be desired.

Jon Thompson: This is one of those areas that is a good illustration of what Bernard was talking about. Given what we can pay for certain grades of staff, it is extremely difficult to recruit, and therefore we go down the route of temporary labour. What these flexibilities may allow us to do is to recruit more openly in the open market and employ more people. It is a classic example of that.

Q197 Chair: We now come back to the issue of earned value management, which you are bringing into DE&S—you were about to say something, Mr Gray.

Bernard Gray: I was not sure whether Mr Brazier had a substantive question that got lost then.

Q198 Mr Brazier: No, that was all I was going to ask. I am slightly surprised, though, that, in terms of losing money in the process, the record keeping end of it, if you like—the financial end of it—is seen as a bigger problem than the absolutely critical shortage of qualified commercial staff who are up against some of the best commercial lawyers in the world.

Bernard Gray: I don't remember saying that it was a higher priority. I just gave it as a “for instance”.

Q199 Chair: I think Mr Brazier may have heard that from Mr Thompson. Let's move on, shall we?

Bernard Gray: But that was a joke.

Jon Thompson: It was a bad attempt, obviously.

Q200 Chair: On earned value management—talking about financial literacy—you are bringing it in to the DE&S. What is it?

Bernard Gray: It is a methodology that is quite widely used inside large programme organisations. To try to simplify into common English, it is used to track how far through a project you are against what percentage of the budget you have spent. It disassembles the project into quite a lot of individual steps and says, “Have we passed this point or that point or the next point?” That tells you how far through you are and then allows you to track that against the amount of money you have spent to understand whether you are on track with the programme.

Q201 Chair: And how do you bring it in?

Bernard Gray: Well, we need a number of things. That includes having enough people who understand at the beginning how to work that system, which is a reason for recruiting a programme management company—we have pockets of people who use this, but that is not by any means universal. We need a framework and an agreed way of doing it, because there are a variety of flavours of how people do this behind the basic methodology. We need to adopt a methodology and have enough people inside the organisation who can then start to train the rest of the organisation. We put in place some IT systems and some management information; we adopt a methodology for doing it; we have some people inside the organisation who know how to do it at the strategic level; and then we go through a set of training programmes about implementing it with us and, I have to say, with industry. We are critically dependent on the information we get from industry to be able to populate that system, so if industry can’t do it, we can’t do it.

Q202 Chair: You mention putting in place IT systems and financial systems. You will remember from your 2009 report that you said that the IT systems and financial systems simply weren’t there.

Bernard Gray: Yes.

Q203 Chair: Are they there now?

Bernard Gray: No, which is why we need work package two to implement them. The core of work package two around the IT systems is to implement both a programme management system and a finance system that will allow us to have much better granularity about all that.

Q204 Chair: And when will all that be in place?

Bernard Gray: It is probably a two-year job—something of that order. Perhaps two to three years to have it fully up.

Chair: I think it is time for your question, John Woodcock.

Q205 John Woodcock: First of all, as a prelude, as I was asking before, this is just like smart acquisition, from 1998, isn't it? You don't have a very good track record with doing that, so why are you going to be able to do this?

Bernard Gray: I don't think that it is just like smart acquisition in 1998, as somebody who was around at the time. The principal focus there was around the creation of project teams. Prior to that, DE&S had sat in the finance directorate, the engineering directorate and so on and so forth, and that file was passed round. We didn't have an integrated project team structure. That was changed under smart procurement and, by and large, that change has been very successful, I think.

There are some other changes, where, as a result of that, we did not place enough emphasis on functions. So, on Mr Brazier's comment about engineering and so on, in focusing down on the teams and the delivery of projects right now, we slightly let go—the Department—of managing careers inside those streams. We let it be a free market thing where it allocated itself and there was not much emphasis on the disciplines. One of the things we are dealing with here is putting much more emphasis back on the disciplines. There is also the need for the appropriate separation between the front-line commands and the DE&S as an appropriate boundary. That boundary was eroded over time. I don't think that there was the same emphasis on trying to get more skills in or particular skills like EVM—

Q206 John Woodcock: EVM?

Bernard Gray: Earned value management—and on career development of people. One of the risks in this structure is whether the entity's freedoms and flexibilities survive over time. Does the Government allow it to continue to exist in that form? We debated this a lot over the last two or three years. One of the attractions of the GoCo is that it puts that body at arm's length, and therefore there is a contractual boundary which makes it more difficult for the Government to fiddle. We clearly don't have that under these circumstances. We have other advantages. It is less of a transition, but it requires disciplined behaviour on behalf of the Government not to pull up the plant as soon as it starts to grow. It is a different iteration on from smart procurement.

Q207 John Woodcock: And do not the problems that you have acknowledged with the financial baseline beg the question that you will be able to achieve this level of sophistication. Secondly, should you not be focusing on using the extra capacity to sort out the baseline, rather than on this new venture?

Bernard Gray: I do not really see them as distinct activities. The new body is a way of executing the next steps of the plan. Jon and I would say that we have made a significant

amount of progress over the last three or four years in sorting out the financial problems of the Ministry of Defence and the programme management problems of the Ministry of Defence. We are now moving to the next step of a journey. We have made significant improvements. That shows in a whole variety of statistics, which we can go into if you want. I think there is strong evidence that the situation has improved. It is our job as managers to move this on to the next level and say, "How can we improve it further?"

Q208 Derek Twigg: Mr Thompson, I am trying to get to grips with what happens if something goes wrong and it does not get its trading status in 2015. What review mechanism do you have in place in the Department as the accounting officer? What are those milestones? We have heard about skill shortages and so forth. What is your biggest concern as the accounting officer?

Jon Thompson: Just to be clear about the question: my concerns about the performance of the organisation?

Q209 Derek Twigg: About whether it can meet the 2015 deadline.

Jon Thompson: The way in which we have changed the overall governance of this programme since the Defence Secretary made his announcement is that the matériel programme was being run and chaired by Bernard, who under the GoCo model would become the governor, so it was logical that he would have been the architect of that and created the arrangements. Because of the way that this reform is now changing, I have taken over as the chairman of the Acquisition Architecture Board which runs the programme. Bernard leads on the delivery of DE&S and we have introduced other parties in terms of building up the customer and/or running the trading fund agreement and all of that. So every two weeks, I am aware of all of the moving parts of what is going on to deliver this programme over the forthcoming period.

From 1 April, we will put in the owners council. Ministers are then involved on what I would regard as being a monthly basis in terms of the conversations I have had. I have plenty of information that is flowing to me on a fortnightly basis and, from 1 April, on a monthly basis.

Q210 Derek Twigg: So Ministers will be involved monthly?

Jon Thompson: They will be involved monthly in terms of the setting up of the owners council from April 2014. So there is much more information available to me as the accounting officer about the development and the delivery of the plan that we have agreed and we are working on together.

Q211 Derek Twigg: What are the key milestones during the next 12 months from April onwards? You must have a plan that says you expect to achieve X, Y and Z by certain dates.

Jon Thompson: There are key milestones about agreeing a corporate plan and about setting out the agreement and reaching an agreement through a process of clarification and negotiation. There is clearly a milestone about appointing an independent non-executive chair, and that is something that I am leading on myself. Those are all key milestones for us. Appointing the partners is clearly a milestone through 2014. Those are all indications, I think, that we are getting on with the delivery of the Defence Secretary announcements. Those are all key milestones for me.

Q212 Derek Twigg: So all of them would have to be delivered, then, to go forward as a trading entity in 2015.

Jon Thompson: I think those are all essential requirements for us to deliver the reform, yes.

Q213 Derek Twigg: Yes, we just wanted to be clear on that.

You mentioned—maybe Mr Gray could answer as well—the issue around negotiations with the Treasury about freedoms, particularly on pay. I assume you have market-tested the levels of pay that are paid in the private sector, which you may need to go to, to attract people in the organisation. I wonder where you are with those negotiations yet, and are you confident that you will get that sort of freedom?

Jon Thompson: We are not currently negotiating at that level with the Treasury. What we are trying to negotiate with the Treasury is two things: first, a financial envelope in which the Treasury and I can understand what the current cost is of employing staff and temporary labour under the various contracts and—

Q214 Derek Twigg: But we do not know that now.

Jon Thompson: No, we do know that now.

Chair: We are just about to come on to that, yes.

Jon Thompson: We do know that and we can define that, and there will be an expectation that that would go down over a period of time, as part the arrangements that we would reach.

The second part of the negotiation is about giving us as much freedom, if you like, so the DE&S Board has as much freedom to operate within that envelope as we can negotiate. Let us be frank about it: we are in the space of trying to negotiate as much freedom within that envelope as possible, but with some appropriate controls which we would operate through a remuneration committee of the organisation.

I am trying to give the DE&S Board as much freedom to operate within the civil service pay system as we can.

Q215 Derek Twigg: Mr Gray, you mentioned before, when we discussed the IT systems, that they are not in place currently, but might take two to three years to get sorted, which were your words. I wonder how that sits with ensuring that the organisation will be fit to go ahead as a trading entity in 2015.

Bernard Gray: We have IT systems in place; they are just not adequate, so it is not true to say that our—

Q216 Derek Twigg: But they are not the IT systems you want to be in place.

Bernard Gray: We have financial control systems that are there to make sure that payments that are made are appropriate, and so on. It is a question around financial modelling, so how are we able to estimate and understand where we are in individual programmes and how far through the budgets are, and what risks we are exposed to—in particular, not only within the programme, but then aggregating that up to the portfolio corporate level?

So we need to improve on the situation that we have had for a long time. We can only do that as fast as we can do it, and we will do it as fast as we can do it, but if I could wave a magic wand and say, “That’s in place tomorrow,” I would, but it will take a period of time.

The important point, which I think I went into a bit before, was around what the trading nature of the entity is that would be dependent on this. The only area which is directly affected by this is: are we taking the cost which we know for the overhead of the organisation—for the cost of the staff and so on—and do we attribute that out to our customer base or not? That is the part that is required for the trading entity to be fully effective as a trading entity, so it is looking at the overhead. That is not the issue that I am talking about, which is around control of the programme.

So I need better management information to be able to get better value out of the £14 billion a year programme and that is a period work. The issue around is a much more narrow IT task of time recording and time attribution for the overhead of the business, which would need to be in place before you could fully stand it up as a trading entity.

Q217 Mr Havard: On earned value management and all the rest of it, these value management systems have been around for years—McKinsey and others have been making a fortune out of them. I understand what they are for. You want to transition from that to hard charging, which we talked about earlier—or the one helps to inform the other. You have a series of techniques and processes trying to help you with both management information systems and financial information systems, to give you internal knowledge that you can then use to charge and to contract properly with others, but others need to understand what those processes are, so they can properly relate to you. Essentially, that is it, is it not?

Can you explain how that works? You are saying that you need computer systems to help you to do it, so the level of sophistication, in terms of your ability to do this at the moment, is not as great as you would like it to be. Why are you doing it the way you are doing it? Would it not be better to concentrate just on improving the existing management information and

financial systems? Why are you going down these routes to do it? People understood the old system and they might not understand the new one.

Jon Thompson: I think that there is a significant difference. EVM is to be applied to the £14 billion of the equipment programme, and time recording, hard charging or whatever is to the £1 billion of the cost of running the organisation. There is no obvious and necessary hard link between those two. They are applied to different costs to improve your financial management of the organisation. Does that clarify?

Mr Havard: It does. I think the problem that not only I have, but the public and everybody else has, is that the language gets a little interchangeable. They do not understand that these things with fancy titles have meaning and the meaning is as you described it, rather than something else, and they are not conflated.

Chair: Thank you. Moving on to the issue of freedoms, Madeleine Moon.

Q218 Mrs Moon: Forgive me, but I get the impression that the reason we are going down this route is a little bit of what Bob Russell talked about in terms of successive Governments cutting the number of people who work in Government Departments. You add into that a 1% pay freeze in the public sector, so people are jumping ship and going into the private sector, and the nasty suspicion I have is that what we are going to do is buy them back in. Are you going to be keeping a record of how many ex-military staff you re-employ back into the system? I see an awful lot of senior military leaving and entering the private sector. Will you keep track of how many of them are coming back in, just so that in future we can throw parliamentary questions at you and have accurate figures if our suspicions are correct?

Bernard Gray: I am sure our HR recording system will catch that, which will allow us to report on it. Can I push back about whether it is a nasty suspicion or not? In most of the private sector today, there is a work force that moves from time to time. The market flows and people go to work in different places at different times, and nobody thinks that that is a terrible thing. Because most of the skills we have—there are some particular military ones, which we will perhaps come back to—around engineering, finance and programme management are not, generally speaking, needed in big numbers in the wider civil service, we compete heavily for them with the private sector, and we have to be able to trade on terms with the private sector, either to keep or to get those people.

We have a lot of tech firms around the Bristol ring road. To my mind, if someone came to work for us for 10 years and then went to work for Airbus for five years and then got promoted and came back to work for us for five or 10 years, I would not think that that was a bad thing. I think that is someone who has developed their career and has gone and made themselves more employable, and we have been able to be attractive as an employer. They are bringing back into us not only the skill that they had, but the expertise that they have from working outside for a period of time.

I think that the historical model, where we recruited everybody at 16 or 21, depending on whether they were an apprentice or a graduate, and we gradually got leached out over time—we lost the better people over time—but we never recruited people mid-career, was a bad thing. I think being able to hire people from the outside world, and accept that some

people are going to get promoted and get opportunities and leave us for the outside world, is a good thing.

Q219 Mrs Moon: A lovely picture, Mr Gray, but on the other hand, what we are doing is taking them in at a young age, paying an awful lot of money to train and educate them and then they get poached by the private sector, which then sells them back to us at an even higher premium. That is happening not only in Whitehall but across local government.

Bernard Gray: I don't know about local government, but today we are quite a competitive employer at 21. It is when you get to your mid-30s that we become an uncompetitive employer, particularly in specialist skills. At the moment, we are losing people, as we have described on a number of occasions here. I can see how we have hot spots in particular skills where we need more people, because we are not able to be competitive on pay and potentially in career development. Yes, we have mapped that and the more specialist a skill is and the more senior you are, the more we are adrift from the market. We have a map of that.

I cannot just rely on a youth training scheme—on developing our own football team in-house—saying, “We just recruit a lot more people at 21 and hang on to them.” We certainly need to make sure that the pay of people inside the organisation in critical skills makes them want to stay rather than leave, and that would be part of us looking at the HR grading structures, but we also have shortages of engineers in senior posts today that we need to fill. I do not have the luxury of taking a purist position, saying, “Oh well, we trained somebody, and they went and worked somewhere for five years. I am definitely not going to employ them, because I am now paying them some higher number than I was when they left.” I need the skills to run the business to drive value—the purpose of this is to drive value in the £14 billion to make sure that the taxpayer and the armed forces get the value that they want.

Jon Thompson: There was a National Audit Office report on precisely the question that you asked and on what Bernard was trying to set out. It was published after Christmas and related to the senior civil service and particularly their skill sets, so there is hard data from the NAO on the issue. I can tell you what it says if you want.

Mrs Moon: Please do.

Jon Thompson: It essentially says that on average, the senior civil service is paid 35% of its market worth, and that the more that you get into specialist skills, particularly finance and commercial skills, the bigger the gap gets. That is a systemic issue across the civil service.

Mrs Moon: Which is why some of us would argue that a flat-rate 1% pay rise across Government Departments is nonsense. But moving on—

Chair: Let's move on.

Q220 Mrs Moon: I am aware that at the moment you have an in-principle agreement with the Treasury on pay and recruitment. When is that actually going to move from being in principle to being a firm agreement? When will you know that?

Jon Thompson: We are in live negotiation every day at the moment. Bernard and I were discussing that only on Monday. We need to bring it to a head fairly soon, to the point where Ministers can have a discussion—presumably between the Defence Secretary and the Chief Secretary to the Treasury. There are ongoing daily negotiations, but they need to be crystallised to the point of what our differences are, if there are any, and that needs to be taken to the relevant Minister so that they can have a discussion about it.

Q221 Mrs Moon: But you do not have a timetable for that.

Jon Thompson: We have to be able to do it before 1 April, in my opinion. It is my opinion that we need to bring that to a head, so that Ministers can have a conversation shortly—preferably this month.

Q222 Chair: Before the Budget might be sensible?

Jon Thompson: Before the Budget would undoubtedly be sensible, yes. That is where we are.

Q223 John Woodcock: Just to follow up from that, can you tell us what you have banked so far, so we can understand how the negotiations are going?

Jon Thompson: Not really.

Q224 John Woodcock: I understand that it is a live negotiation, but you will forgive our suspicions—we do not blame you for this—that actually the Treasury may not have given up anything other than principle. We need to know that, given the time scale that there is now, so we can be helpful.

Jon Thompson: One of my desires for trying to bring it to a head—so that we can get the Defence Secretary and Chief Secretary into a room—is so that there can be a political conversation about that issue.

Q225 John Woodcock: So you are stuck. They are not giving you anything yet and you need to unblock it at a political level.

Jon Thompson: I don't think that is entirely true. There is an ongoing negotiation, but in any negotiation you get to the point where you need the two principals in a room. It is our view that we are reaching that point.

Q226 John Woodcock: Would it be fair to say that you are frustrated by the level of progress so far?

Jon Thompson: I wish it was quicker, yes.

Q227 Ms Stuart: I have a quick question for Mr Gray. My memory may be playing tricks on me, but I seem to recall that several years ago when you came before the Committee one of your greatest concerns was that as there was a set of redundancies across the MOD and a cutting down on employment, you had no control over who went and who stayed.

Bernard Gray: That is not quite true.

Q228 Ms Stuart: The real question that that leads on to is: do you feel that the new arrangement gives you the kind of freedom that at that stage you felt that you did not have?

Bernard Gray: The specific situation that we were in was that it was a voluntary scheme, so people chose to apply for it or not. The reason why I do not think it is quite true to say that we had no control over it is that we could choose which applications to go we accepted. People might be in high-skill areas. We kind of had a points ranking system whereby we could say, “Fundamentally, how desirable is this person to us?”, and we would not, broadly speaking, accept people for a voluntary severance package above a certain level of desirability to us, so we did have some control over all that.

One of the points that I am trying to make is that the way we are trying to get over this issue in the future is through a carrot rather than a stick approach. I need to make it an attractive place to work from a pay, career progression, flexibility and responsibility point of view to get people in and keep them in.

Q229 Ms Stuart: To clarify, up to this point you could say, “No, we won’t give you a severance package because we would like to keep you,” but under the new arrangements you can say, “And we will give you more.” That will be your perfect situation—to end up enticing them to stay.

Bernard Gray: I do not really want to get into negotiation with the whole work force. Conceptually we might, although I am trying to draw a distinction between a redundancy thing and an individual case on a particular day. Probably the way we would work it is to make sure that in the particular skill areas, we are competitive in the marketplace. If we move to a position in which we are competitive in the marketplace, someone says, “Give me another 20% or I’ll leave,” and we feel that we are able to recruit at that level, we might have to say, “Well, we’re terribly sorry. We can’t meet your personal ambitions on this point. If you have a job somewhere else, we wish you well. We think that we can employ people to do this job at this level, which is now competitive whereas it wasn’t before.” I think that is unlikely to happen extensively—there might be the odd individual case, but not extensively a gun-to-the-head negotiation; it would be an attempt to make sure that we were properly found in the first place.

Q230 Mrs Moon: Mr Thompson, I have this lovely little video running in my head of you running back and forth across Whitehall between the Ministry of Defence and the Treasury, getting agreement here on this and then having to run across the road to get them to agree to it.

Chair: I thought it was always like that.

Mrs Moon: Indeed. It's just that now I have Mr Thompson in the video. I will put myself to sleep with this image. Can I just clarify something? Have the Ministry of Defence and the Treasury at least agreed what the overall cost envelope for pay and consultancy is that you will operate on and, if they have, what is it?

Bernard Gray: I think that there is an agreement at ministerial level about what the envelope is. I think that people are still working through the definition of what that means—not quite post by post, but area by area. The translation of that agreement into the practical—“Okay, so this agreement in principle means this exact number of people and this exact set of circumstances”—is part of the ongoing discussion.

Jon Thompson: Just to make this conversation slightly more complicated, I think Ministers have announced that we are also descoping DE&S, so we are removing the naval bases from DE&S to return to the Navy; we are removing the information systems and services organisation to go into the joint forces command; and we are in a market process to outsource the logistics commodities and services organisation. Broadly, between 7,500 and 8,000 staff would come out of DE&S through those processes, so we need to take that into account too, to get down to what would ultimately be a much smaller DE&S.

Q231 Chair: Because there is not enough change going on in the MOD as it is.

Jon Thompson: We are attempting to do quite a lot in one go, yes.

Bernard Gray: One of the points I was making in the 2009 report was that DE&S is too large and that the management task is too great and does not allow the senior leadership of the organisation to focus on what really matters to DE&S.

At the moment, for largely historical reasons, I am the owner of the naval bases—Portsmouth belongs to me, which is quite gratifying in a way, but a bit odd. I think the First Sea Lord should be responsible for the naval base, and he agrees. At the moment, there is a large engineering community there who work for me, and there is obviously all of the Navy and the ships. From 1 April, the Navy will become responsible for managing the naval bases and their operations, which has been agreed for 12 months or so as a perfectly sensible thing to do.

Jon has given additional focus inside the Ministry of Defence to pushing IT issues, and he has appointed a CIO. It has therefore made sense to move ISS, which is effectively our IT department, under her, which allows her to focus full time on IT and stops IT being one of the 12 things that I have to do.

Mrs Moon: Mr Brazier referred to your empire. I hadn't realised that you are an empire with a navy.

Bernard Gray: For the next six weeks, anyway.

Q232 Mrs Moon: I asked how much the cost was. Are you able to share that figure with us? The cost of the envelope.

Sir Bob Russell: Not the back of the envelope.

Mrs Moon: No, not the back of an envelope; the overall operational cost envelope. Do we have a sum? Are you able to share it?

Bernard Gray: Part of the process is that, again for historical reasons, the DE&S has a top-level budget, one of seven top-level budgets inside the MOD. We have that budget today, which is our staff and associated costs, which is something over £1 billion, which we talked about before. Again, largely for historical reasons, some of the costs that are in the DE&S top-level budget do not relate to DE&S, and some of the costs that do relate to DE&S are not in the DE&S top-level budget. When the Ministry of Defence was all one thing, it did not really matter exactly where you accounted for what. Part of the benefit of clarifying all of this is to make sure that by bringing some discipline to that, my budget reflects accurately all the costs of DE&S and that other costs move to the right budgets.

In round terms, we have a staff cost of around £1 billion and we have consultancy, FATS and technical support of around £400 million, which today is mostly in the equipment plan. Those are the round numbers, but we have to see the detail as well as the big blocks that Jon has talked about. There is some debate, for example, on how many of the commercial staff sit within DE&S and how many of the commercial staff sit in the front-line commands or in the centre of the Ministry of Defence. That is an ongoing debate, and it needs to be reconciled. The cost of those people therefore needs to be allocated. We are talking about between tens and hundreds of people, but we need to nail that down from within this rough envelope.

Jon Thompson: We would be happy to let you know when it is done.

Q233 Mrs Moon: Thank you. We could have got there so much quicker.

Bernard Gray: I am just trying to give you the information that I have.

Q234 Mrs Moon: No, what you have given me is how difficult it will be in the future for parliamentary questions to pin down where people have to go for a particular answer. You said that they were going to lose 7,500 people in logistics. Where are they going?

Jon Thompson: Sorry, I said 7,500 by adding three functions together: information systems and services, the naval bases and the logistics commodities and services. Those three functions add up to roughly 7,500. The logistics commodities and services are about 2,500 people.

Bernard Gray: Naval bases are about 2,500, and ISS is about 2,000, or something like that.

Q235 Mr Brazier: Where is logistics going, though?

Jon Thompson: We have launched a market process to outsource logistics. We have shortlisted, and the bidding is currently live, I believe.

Q236 Mrs Moon: So 7,500 people are going to go into the private sector, and we are going to—

Jon Thompson: No, sorry. Let me be really clear. The naval bases are moving from DE&S to the Navy. There is no privatisation in that move. The information systems and services organisation is moving from DE&S to the joint forces command under the new chief information officer, so that is within the Ministry of Defence. It is only the logistics piece, the 2,500, that is subject to the current outsourcing.

Bernard Gray: And that is largely the storage and distribution activity: logistics, storage and transportation within the UK, currently to Germany and over to other training establishments, like Canada. In the 2010 defence review, the Department decided it did not need to own all that activity but could effectively have that service supplied.

Q237 Mrs Moon: So, again, when we ask you questions about the people in these new management consultant companies that you are bringing in, we will be able to pin down how many of those are ex-military? I just want to be clear on that.

Bernard Gray: Yes.

Q238 Mrs Moon: Thank you. Finally, in case there is something that we have missed, has the Treasury placed any other constraint on you that we are not aware of now? Is there anything else that you would like to tell us about now that is a constraint from the Treasury?

Jon Thompson: I am not aware that there are new constraints that the Treasury is trying to impose on us. Over and above the current arrangements as set out in *Managing Public Money*, the framework for public reporting and all the Cabinet Office controls, I am not aware of any new things being put forward. We are trying to remove ourselves from some of those controls, not add new ones.

Q239 Chair: Mr Thompson, you said that over time, there would be a reduction in the overall operating cost envelope. Is the logic of that based on the descopeing that you are talking about? If not, what is it based on?

Jon Thompson: No. If you add together the operating costs of the organisation and the technical support, in making some of the changes that Bernard has talked about in terms of

the “make or buy” decision around people, we would expect overall value for the taxpayer to be demonstrated through a slow reduction in the operating costs over time. It would be for us to demonstrate to the Treasury and within the Department that you are getting better value for money overall. It may be that the two proportions will change, which was the answer to Sir Bob Russell’s questions.

Q240 Chair: So, in essence, do you expect the problem of the mismatch between the public and private sectors to go away?

Bernard Gray: I don’t understand, I’m sorry.

Q241 Chair: You are saying the freedoms that you need to pay those who do the work within the DE&S are not there at the moment, therefore you need more freedoms within that overall operating cost envelope, but that overall operating cost envelope is going to be coming down, so your freedoms will therefore be restricted, yes? Or is that not right?

Jon Thompson: No, sorry. At the moment, if we are currently spending broadly £400 million a year through the framework agreement for technical support and we have £1 billion worth of people, then the overall envelope would be £1.4 billion, subject to us clarifying and removing and so on. What we would expect is that the balance between those two numbers will shift between the £400 million and the £1 billion, in answer to the various questions from Sir Bob Russell, and that the overall cost of £1.4 billion would slowly reduce to demonstrate better value.

Bernard Gray: Partly that might come through the fact that we can employ people, because we are not paying agency fees or whatever, more cheaply than the current day rate we are paying for them, in some cases, on technical services, and partly there will be a general impulse, as in most organisations, to become more efficient generally. You would expect, not to negotiate in public, but a 0.5% decline in our total envelope just for efficiency reasons.

Jon Thompson: I was thinking more like flat cash, but there you go.

Bernard Gray: It’s a discussion to be had.

Chair: Now we are going to move on to the issue of the appointment of the chair and chief executive of the trading entity.

Q242 Bob Stewart: Mr Thompson, what qualities are you looking for in the chair of the new trading entity? What do you think this person should be like?

Jon Thompson: I have here a job description, which I will happily provide—

Q243 Bob Stewart: That would be excellent. Do you want to say a bit about it, or do you want just to give it to us on paper?

Jon Thompson: I am happy to send it to the Committee. It will become a public document fairly shortly when we advertise for the role of non-executive, but I am happy to send it to the Committee in the wake of that.

Chair: Yes please, if you would.

Q244 Bob Stewart: That was my first question. My second is about the appointment process. Do you anticipate any pre-appointment screening by the Defence Committee of the person?

Jon Thompson: Of the chair?

Bob Stewart: Of the chair.

Jon Thompson: That is not currently envisaged, unless the Defence Secretary told you otherwise.

Q245 Chair: The Defence Secretary has not told us otherwise. That, I suspect, it is a matter still for negotiation between us and others, but we will certainly wish to take evidence from the new chair, whatever arrangements are reached. Will you be on the interviewing panel?

Jon Thompson: I will. It will be myself, the Department's lead non-executive, Mr Gerry Grimstone, chairman of Standard Life, and the director general of commissioning services, which is a post we are creating to manage a whole range of arm's length bodies. We are in conversation with the Cabinet Office about whether it wants to put someone forward to represent Lord Browne's overall interest in non-executives in government.

Q246 Bob Stewart: Will the Minister be involved in any way with the selection board?

Jon Thompson: No. We do not envisage a Minister being on the selection panel. We envisage it making a recommendation to Ministers.

Q247 Mrs Moon: Will there be an open competition to find a new chief executive for this trading entity when Mr Gray's contract ends in December 2014?

Jon Thompson: There will be a competition in 2014 for a chief executive of DE&S.

Q248 Mrs Moon: Interesting. Then will the chair of the new organisation also be running the competition?

Jon Thompson: I would envisage the chair absolutely being involved. I would not anticipate delegation to the chair. The role is currently graded at permanent secretary level. It will remain within the civil service, so the civil service's rules for such appointments will apply. I would expect to be on the panel with a civil service commissioner and the chairman of DE&S. Other arrangements are yet to be defined, but I would expect the standard arrangements for this grade of post within the civil service to apply.

Q249 Ms Stuart: You said there would be a recommendation to Ministers. Will that be like the Archbishop of Canterbury when the Prime Minister gets two names, or will there be one name, or three names? What shape will the recommendation take?

Jon Thompson: In relation to the chair?

Ms Stuart: Yes.

Jon Thompson: I would expect to put forward one candidate, but I would also expect to consult the Defence Secretary, as we move through the processes of longlisting and shortlisting who is being interviewed and the ultimate recommendation.

Q250 Ms Stuart: So a recommendation will be one name, which Ministers can say yes or no to. That is not much of a choice, is it?

Jon Thompson: Those are broadly standard arrangements that will apply.

Q251 Ms Stuart: It is not a broadly standard arrangement we are contemplating at the moment, is it?

Jon Thompson: It is certainly—

Q252 Mr Havard: Do you want to revise what you were going to say about the consultation?

Jon Thompson: No.

Q253 Mr Havard: Okay. You mentioned a post and one of the people who will be on the panel to appoint the chair will be in a new post within the Ministry of Defence to draw together relations with outside bodies or something, and you mentioned the director general of something or other.

Jon Thompson: We are creating a post of director general of service commissioning.

Q254 Mr Havard: Could you say a little more about that please, and whether that person is in post already?

Jon Thompson: We are increasingly in the business of managing delivery services through arm's length bodies or outsourcing. There will be an announcement shortly on where we are going with the Defence Infrastructure Organisation. We already have the Defence Science and Technology Laboratory, the United Kingdom Hydrographic Office and the Defence Support Group, and we have talked about our current plans in the market for outsourcing. We think that what we need on post-Levene structure for the Ministry of

Defence is someone who focuses on all those delivery arrangements in arm's length bodies. That is a new post, but it requires us to delete two other director general posts. All round, there will be a rationalisation from two posts to one. We have not yet started that process of rationalising two director generals to one.

Q255 Mr Havard: But that will take place and it is envisaged that that person will be in position by the time you get round to doing the interviews for the chair. When will that be? If the new shadow organisation is being helpfully established in April, when will all that happen?

Jon Thompson: We have had head-hunters working on potential candidates for chair for some time, but we have not been through the public advert process. I am expecting that to be next week. We will conclude the recommendation of a chair to Ministers by 31 March. It is tight.

Q256 Mr Havard: But on that other internal re-organisation that you are doing, to have the director general looking at the outside bodies, you said that the director general would be part of the interview process. They are likely to be in place before then, are they not?

Jon Thompson: They are.

Q257 Mr Havard: It will be some time in March or something.

Jon Thompson: That post—the director general of commissioning—will be in place in time to be able to participate in the process, yes.

Chair: Moving on to morale in DE&S, James Gray.

Q258 Mr Gray: You will recall, Mr Gray, that when you came for the first time with the Secretary of State, we were very concerned about morale within the organisation. Subsequent to that visit, you sent us a bit of paper describing something called the “defence engagement score”. Can you tell us what that is?

Bernard Gray: Sure. Throughout the civil service, an employer attitudes survey is conducted every year, which we participate in. That contains a number of questions that are designed to measure morale inside of the organisation. The engagement score is made up of an average from responses to five questions. I will send them to you.

Q259 Mr Gray: A quick summary will do.

Bernard Gray: One of the questions is: “I am proud when I tell others I am part of my organisation.” The second is: “I would recommend my organisation as a great place to work.” The third is: “I feel a strong personal attachment to my organisation.” The fourth is: “My organisation inspires me to the best in my job.” The final one is: “My organisation

motivates me to help it achieve its objectives.” Each of those is scored at one of five levels, from “strongly agree” to “strongly disagree”. That is then given a numerical rating.

Q260 Mr Gray: How many people does that survey go to?

Bernard Gray: It goes, in our case, to everyone inside of the Ministry of Defence who is a civil servant.

Jon Thompson: It goes to everyone in the civil service.

Q261 Mr Gray: So if everyone replies to it, how many is that?

Bernard Gray: Our response rate, from memory, was about half of the Department.

Jon Thompson: We had 26,000 responses overall for the Ministry of Defence.

Bernard Gray: So we have about 50,000 staff who are civil servants.

Q262 Mr Gray: What about DE&S?

Bernard Gray: Our response rate was almost identical to that of the Ministry of Defence. We have almost 15,000 civil servants inside of DE&S, and half of them responded.

Q263 Mr Gray: Okay, I am with you now. So 53% is how many people responded—

Bernard Gray: No. Although the numbers are very similar, I have not given you the response rate. It happens that they are similar numbers.

Q264 Mr Gray: All right. I am puzzled by the paper we have got, because it says that the DE&S engagement index was 53%, which was up by one percentage point on the previous year. That is broadly similar to the general MOD, which was 54%. So, broadly speaking, morale in DE&S is the same as in the rest of the MOD.

Bernard Gray: That is correct.

Q265 Mr Gray: If that is the case, why did the bit of paper go on to say: “We recognise that the transformation of the organisation and the associated uncertainty is unsettling for individuals. We take these results seriously and seek to address any areas of particular concern. Progress on these issues is monitored and discussed at the Board level to ensure appropriate action is taken”? If morale is just as good in DE&S as it is in the MOD, why does that bit of paper say that you are worried about these things, that you take them seriously and that the uncertainty is unsettling for individuals?

Bernard Gray: Because we want to drive the score in future years higher than it currently is.

Q266 Mr Gray: So you are saying that the morale of the whole MOD is low.

Bernard Gray: No, I am saying that the morale at the MOD and in DE&S is at a kind of mid point. The purpose of conducting the survey is to address people's concerns. We therefore measure morale every year. I think we have given you the back numbers over the past four or five years and the scores of other relevant large Departments to show that we are kind of in the middle of the pack in terms of our morale.

We are not just conducting the survey in order to be able to answer questions in places such as this; we are trying to ask what we are getting back from our work force and how we can improve things. That ranges all the way from hygiene factors such as logging on to the IT system, which is a major irritant to a lot of people, to car parking in Abbey Wood, through to the strategic uncertainties about where the organisation is going. We sit there as the board and we have discussed it—I think that the last survey came out in November, and since then we have had two board discussions within DE&S about how we engage with some of the issues that people raised. That would be our standard operating procedure for addressing such issues.

Q267 Mr Gray: In your response the last time we saw you, you said that you were going to take appropriate actions on staff uncertainty and questionable morale, although you are now saying that morale is not bad.

Bernard Gray: I think I said that then as well.

Q268 Mr Gray: Okay, but you said you were going to take appropriate actions, so what actions have you taken?

Bernard Gray: As I have described, we have had the board discussion. We have an ongoing set of conversations with the staff that ranges from things such as town hall meetings, where I meet several hundred people—the maximum number of people we can fit in our gym, which is the largest space we have in which to hold those sorts of discussions—to “talk to the board” sessions, where other board members will hold similar kinds of meetings in our main conference area, through to my line reports, where my three-star director generals and directors talk to their staff about either the local or strategic concerns from their business. We take the responses to all that and see what we can do about any issues.

Q269 Mr Gray: Are those new actions you have taken since you saw us, or were they actions that you took anyhow? That is your normal procedure, isn't it?

Bernard Gray: What I am saying is that there is a mixture of two things. We have a normal process to ask what we get back. Many of the issues people have are consistent year on year. They talk about issues such as pay—

Q270 Mr Gray: Sure. Sorry, but those are normal things that any company or organisation would do. What I am getting at is that when you saw us in November—wasn't it?

Bernard Gray: December.

Mr Gray: You said that you were going to take action to address our concerns—in other words, do things that you did not do previously but would now be doing. The question is about what you have done since December.

Bernard Gray: Not arising out of your questions, I have a process for managing the staff of DE&S, generally speaking. I think we got slightly tangled up in what the engagement survey was or was not about, but I am clear that it is a priority for our board to ensure that we are trying to meet the legitimate concerns of the work force, where we can, in order to improve their working lives. That is an ongoing process.

Q271 Mr Gray: Let me be mildly anecdotal then, and you will probably answer my question by saying that it is not the same as your engagement survey, or whatever it is. I have spoken to quite a lot of people in and around, and they say to me that the morale in DE&S is a broken machine; it is rock bottom. It is finished. There is no direction or satisfaction. People hate their jobs and are leaving. They are fed up and have had enough. Morale in DE&S is the worst that I have ever heard of any organisation that I have ever been in contact with. The people I speak to around the place tell me that it is absolutely rock bottom, appalling, disgraceful and shocking, but you tell me that it gets 53% in the engagement score. Is what I have described completely mysterious and strange to you, or are you actually saying that morale in DE&S is fine?

Bernard Gray: I am saying, and I think I did say, that morale in DE&S and the MOD is in a kind of middling position. It is better than it was, and it still has—

Q272 Mr Gray: No, I am not talking about the rest of the MOD; I am talking specifically about DE&S at Abbey Wood.

Bernard Gray: And I am saying that the analysis, which was conducted by third-party polling companies—it is not done by us and so is not subject to being interfered with—says that DE&S is almost exactly identical to the rest of the MOD and other large Government Departments, as a statistical fact.

Arising out of our last conversation and anticipating that you might want to talk about this again, I have looked up other measures—we can talk about the qualitative thing, but that inevitably gets a bit anecdotal on all sides—of how you might score whether people feel okay. The first measure is voluntary outflow—are people choosing to leave in greater numbers? That number is absolutely flat across the last six years, and we can send you the

statistics if you are interested. A second measure would be whether people are taking more time off sick. On that score, our days off due to sickness have fallen from about 8.75 on average to some 6.9 over the last five years, so absences through sickness are falling and not rising, which is what you would expect in an organisation where morale was poor. The proportion of days attributed to stress or other things is completely flat over the last six years. There is no upwards trend in any of that. All this has happened under a set of circumstances where we have had to reduce staffing from over 21,000 before the general election to around 17,500 now, where our work load has not decreased and where we are trying to implement significant change programmes.

If you like, we can also get anecdotal. For example, I had a meeting of my 25 most senior managers last Friday. We do this once a month on a Friday and in this case it was at Abbey Wood, where we went through a lot of the implementation challenges that come out of the change programme. Everybody agreed that it was a highly engaged, positive interaction of the 25 people who lead the organisation figuring out what we are going to do. We actually came to a whole bunch of decisions about how we were going to organise ourselves. People were happy to be open and to say, “My problem here is x,” or “My problem here is y,” which you do not get in an organisation that is concerned about such things. People were happy to share and debate issues and to come to decisions.

Are you going to find people around the place who do not like change, who do not like what I am doing and who do not like the fact that I am trying to get the organisation to perform at a higher level? I am sure that you can. What we are actually getting, however, is an organisation that is growing in self-confidence, because we are actually achieving some things that we were not achieving before. I can go into the statistics of some of the things that are happening within the programme—

Q273 Mr Gray: You would say that, wouldn't you? I have one last question—

Bernard Gray: They are facts.

Q274 Mr Gray: Ish. Suppose that I passed a piece of paper around every single employee—all 17,500—in DE&S and the heading was, “Your boss, Bernard Gray, says that morale in DE&S is perfectly all right. Do you agree? Yes or no.” What percentage of people would answer yes?

Bernard Gray: I think the answer is 53%.

Q275 Mr Gray: Right. Can we try it? If you are confident that 53% of your employees would say that morale is fine, let's do it.

Chair: I am now going to move on to the final question—

Bernard Gray: We have done it. We do it every year.

Q276 Chair: But with a sophisticated set of polling results, which lead to the engagement score.

CDM, in 2009, you brought out the Bernard Gray report, in which you set out a number of the concerns that you felt about the DE&S process and you were then put in charge of putting them right. To what extent have you succeeded?

Bernard Gray: I think it is a work in progress. This is a large organisation with a set of endemic concerns that we have talked about on many occasions here, but the statistics show that we are making progress. For example, I spend money in three broad ways. I buy consumable stocks that we use and run through. Over the last two years, I have put in controls that did not previously exist to curb the purchase of excess stock. Previously, people were able to go around and order pretty much whatever they liked, with no countersigning officer able to intervene. That did not hit our accounts until we used the stock. It did not hit our accounts when we bought it. As a result, our stocks had been rising about £1 billion a year since this accounting system was introduced in 2001-ish, and our stocks had risen by about £10 billion over the course of the previous decade. In the past two years, we have reined that back to the extent that against the previous patterns, we have saved £1.05 billion in the past two financial years. That is public money that has not gone out to pay for things to go in our warehouses. We have also written off or disposed of £6 billion of redundant surplus stock that had accumulated over previous decades, which was taking up warehouse room, guarding and all those kinds of costs as well.

In the second area where we spend money, we are working to drive down costs in the equipment support plan, which has been something of a Cinderella child of the acquisition area. We have a challenge on us from 2015-16 to save money against that, and I started work about 12 months ago with Air Marshal Hillier to devise the plan. We have so far scored about £1 billion-worth of savings over the coming five years, with the entry year to when we have the wedge, where we are estimating at the moment we have achieved £200 million a year of savings. We are one year into a two-year programme to drive performance on that.

On the new equipment plan, the MPR 12, which was published about 12 months ago, showed the position broadly static, although in my view there was a misclassification of the cost of fuel for Voyager, which added £250 million because people had projected in what the cost of oil would be over 30 years—not something under my control, unfortunately—where we do not estimate it for any other system. If you strip that out, the cost increase across the totality of the programme, with £150 billion of forward money, was about £150 million. A major projects report is due to be published tomorrow, and I obviously cannot breach the embargoes around that but I think it will show significant progress. I am 10 months into a financial year that would report at the end of this year, and I know that we will make further progress beyond what is in MPR 13 to be published tomorrow. That has not been audited yet, but I am confident that we will deliver those results. So we are making significant headway against all the three major areas of activity where we spend more than £14 billion of public money. We are also improving the overall performance of the acquisition system in a way that we have talked about a lot. I think that we have, collectively—it is not just me; it is the team who work for me and the team in the centre—made a hell of a lot of progress over the past five years.

Q277 Chair: The collapse of the GoCo competition, however, was a significant setback, was it not?

Bernard Gray: I would not have had it happen. Yes, it was a setback.

Q278 Chair: At the end of December, your job will be up for grabs again. Will you apply to renew it?

Bernard Gray: That rather depends on what the permanent secretary makes it. It is open to the permanent secretary to vary the current job in some new competition. In principle, I want to finish the job that I have started and to tie together the whole morale, uncertainty and turbulence issue. I have turned around a number of companies in the private sector in the past, and I am not surprised by the trajectory that we are on. You get people invested in the status quo, you get arguments about the status quo and you get disruption and uncertainty about that. You get down to—Jon and I were talking about this earlier—a position where instead of standing on a weak position and everybody defending it, which is where the Department used to be, you go through a whole transition, which is uncomfortable and difficult, but you find yourself standing on solid ground with actual achievements that you can talk to rather than using smoke and mirrors to describe things. That is the position that we have moved to. Sure, it is pretty uncomfortable for some people, and it has not been a bundle of joy from my perspective either. I am not expecting any sympathy for that; I am just saying that it is quite hard work. In principle, I am interested in carrying on, but it kind of depends what Jon writes down.

Q279 Chair: Do you think you are the best person to do it?

Bernard Gray: Well, the competition will determine that, won't it? I think I have a pretty good track record of actually delivering here, and I will go up against whoever it is that people want to put up.

Chair: There are no further questions. Gentlemen, thank you very much indeed for a very interesting and helpful evidence session.