Defence Committee

Oral evidence: Ministry of Defence Annual Report and Accounts 2013–14, HC 896

Wednesday 7 January 2015

Ordered by the House of Commons to be published on 7 January 2015.

Watch the meeting

Members present: Rory Stewart (Chair); Mr Jeffrey M. Donaldson; Mr James Gray; Mr Dai Havard; Dr Julian Lewis; Mrs Madeleine Moon; Sir Bob Russell and Derek Twigg.

Questions 1-101

Witnesses: **Jon Thompson**, Permanent Under Secretary, Ministry of Defence, and **David Williams**, Director General Finance, Ministry of Defence, gave evidence.

Q1 Chair: Welcome to Jon Thompson and David Williams. This session will focus on the annual report and accounts 2013-14. On the Government's response to our last Committee report, which was on the annual report and accounts 2012-13, we put forward a number of conclusions. They included a recommendation that the Ministry of Defence improve its reported information and its risk management arrangements. We were worried about the qualifications for the accounts for the seventh successive year and about indicators. We were worried about what you were doing about the voluntary outflow from the armed forces and the shortages in trades, particularly. I will begin with the accounts.

Last year the accounts were not late. This year it appears they are late again, as they were two years ago. Why?

> ***Jon Thompson:*** We made a decision with Ministers on the basis of the National Audit Office's work on assets under construction, which is essentially a property and infrastructure issue. We made a decision that we would resolve the issues that the National Audit Office had flagged up, and delay the publication of the accounts. It is relatively simple.

Q2 Chair: Jon, it looks as though you had to write off £267 million from the category you just referred to—total assets under construction—which seems to be about 10% of the total. It is quite a large chunk of the total, anyway. Why did you have to write off £267 million worth of total assets under construction?

> ***David Williams:*** The assets under construction category—the £2.7 billion that we reviewed in detail—related to infrastructure and buildings. Essentially, building up over a number of years, we had not been sufficiently rigorous in keeping on top of the build-up of value against that category. Some of it relates to the transfer of assets from that category,

under construction, into the formal land and buildings category on the balance sheet. If you have building work done at home, you get to that point where your contractor tells you it is done, and you are still arguing about snagging and the final finish. If you imagine that on the scale of investment that we make, there is a grey area between when a building is nearing completion and fully ready to transfer.

Our Defence Infrastructure Organisation had not been applying the policies for transfer from one category to the next sufficiently consistently, or maintaining sufficient evidence to support that balance. So it is not that we have written off physical assets in that £267 million. It is just that the valuation on the balance sheet had got out of kilter with the physical assets that we had. So it is a cleansing exercise, if you like.

There is improvement in some ways. The progress we have made on inventory has taken us a number of years. At least here we have been able to clear out this issue over a period of around three to six months. It was just three to six months that we did not contain within a publication timetable before the summer break.

Q3 Chair: We will come to your inventory management system in a bit. You are pointing to what seem to be significant problems with the DIO. You are talking about a lack of evidence, a lack of consistency, and not being sufficiently rigorous. How did we end up with those problems in the DIO?

Jon Thompson: There was a National Audit Office report on the infrastructure organisation in 2011, which pointed out that there were significant issues about the management of the estate in general, and the underpinning quality of the management information about our estate. Going back to 2011, I think the National Audit Office report pointed out that we were running, at that point, 76 IT systems to try to record all the land and property that we had. We began a long programme of consolidating those information systems down to one information system, which went live just before Christmas 2014. On that journey from 76 systems to one, we significantly improved our understanding of the estate: what we owned, what we ran, what we leased, what the costs of running the estate were and so on. That also identified a number of financial challenges, of which this is one; there are others.

Q4 Chair: All this seems to be about the DIO and what we call, in the jargon, the weakening of the control environment in the DIO. I understand you changed your computer system, but does that explain why they are not being sufficiently rigorous, why they are not bringing evidence in enough? Essentially, the story you are telling, unless I'm getting it upside down, is that you have been forced to delay the publication of the accounts, which is a serious thing for which you apologised two years ago, and you did it because of having to write off bits of your total assets under construction and the reason you had to do that was that the DIO was not on top of the assets under construction. To come back to the central question, why was the DIO not on top of this and what measures have we now taken, secondarily, to ensure they will be in the future?

Jon Thompson: There is a factor around the quality of management information. This is a long-standing issue, and there is a much broader issue about the quality of management information that you may want to get to at some point and which I have highlighted in my governance statements since I have been the permanent secretary. So there is that factor. There is also the significant organisational change that we were trying to adopt in the DIO. If you go back two years, it was the Defence Estates organisation. That covered only 65% of all the land and property that we were responsible for, so we significantly expanded the organisation to cover all that. Then we had a massive organisational change programme. So you have management information and an organisational change programme and, in that, there are control weakness issues, which we have consistently flagged. In this case, it was flagged to us by the National Audit Office and we have resolved it.

In terms of where we are, going forward, the announcement of the appointment of the strategic business partner for the DIO means that we have significantly enhanced the leadership of the DIO. Again, if you go back to 2011, for example, there were only nine members of the senior civil service running an organisation that is one of the largest property and asset management organisations in the United Kingdom. That is now 21 people. We have much more of a strategic grip on what exactly the challenges that we face are. But you are right. It is a control environment weakness, which we have tried to address by the injection of better information systems and new people.

Q5 Chair: You are being wonderfully frank about the problems, but the thing that I am struggling with is this: why did it take the NAO to point these problems out? You are almost talking in a rather academic way, as though you are analysing the failings in somebody else's organisation, but this is your own organisation. Why did it take the NAO to point these things out? Why were the DIO not on top of this stuff already?

Jon Thompson: Sorry, but I don't really agree. I think that is slightly unfair. I take full responsibility for the management and leadership of the Ministry of Defence in all respects. That is my responsibility as the permanent secretary. There are a number of challenges in running an organisation of this size. This has been one. It has been consistently there. It was, as I said, flagged up in 2011 with an extensive NAO report and a PAC hearing. It has taken us three years to resolve that and it has a number of consequences for what we know about our estate, how you account for it—

Q6 Chair: Is it that you didn't have enough people, that you were starved of resources? Let's say you were a business, as opposed to a civil service Department, and you wanted to sort this out in a year instead of three years. What would you have needed to sort it out? What was lacking?

Jon Thompson: You would probably throw a lot more money and more people at it, yes. If you are saying, "Could we have done it quicker?" the answer is possibly. There are risks in consolidating. You can go back to the IT systems issue. This is a generic issue for the Ministry of Defence. If you have decades of history and you are trying to consolidate that, it is not a straightforward thing to do, and that is one of the reasons why it takes time.

Q7 Chair: You now feel that you are not going to be sitting in front of us again in a year's time with the same problems? You are confident now that you have sorted this stuff out and we are not going to be going through this again next year?

Jon Thompson: In relation to this specific issue, that will not come up again, no.

Q8 Chair: In relation specifically to total assets under construction?

Jon Thompson: Yes.

Q9 Chair: And we are not going to have a situation where the NAO will find something else which will make you delay your reports again next year?

Jon Thompson: I cannot give you that guarantee. It is worth just going back. I think that this is the fifth time I have done this hearing.

Chair: That is a great pleasure for you.

Jon Thompson: It is worth going back. If you go back to 2010-11 or somewhere around there, there were some really significant issues in relation to stock. The decision we essentially made was that there was a big focus on that issue and we would resolve it. The focus of the National Audit Office itself was on very strategic issues—the wrapping up of the SDSR, the writing off of assets and stock issues. As we go further in and as you resolve those big strategic issues, you begin to find different issues which underpin that. This issue is not new, in a sense. It had some legacy over some period of time, but as we and the National Audit Office have a better understanding, you get to more tactical-level issues. You are not suddenly trying to deal with £40 billion-worth of stock and asset issues, because that has improved significantly enough now. What you are now talking about are other, subsidiary issues.

David Williams: On this specific issue, the DIO had agreed with the NAO a simplified work-around for the last couple of years' accounts. Sampling this year relatively late in the process suggested that that simplifying assumption was not actually a reasonable one, hence the need to do a detailed project-by-project review of the category. As Jon says, we are increasingly focusing our attention on more bite-sized legacy issues. It is really important that we continue to improve our management of the balance sheets. Quite a lot of that improvement has very little direct day-to-day short-term effect on the departmental expenditure limits that we are managing, in terms of our spending agreements with the Treasury. For an asset-rich Department, it is clearly important that we are on top of our asset base. That is an area where we need to continue to improve.

Q10 Chair: What are the biggest risks that you see over the next year? What are you most likely to be apologising for next year, unless you sort them out? Where do you think the big risks are?

Jon Thompson: Financial risks?

Q11 Chair: Yes. This year, it is assets under construction. What things are you worried about in the next 12 months?

Jon Thompson: The biggest challenge, sitting with you next autumn, will undoubtedly be what the SDSR has decided to do and how that impacts on our finances, both in terms of our annual finances going forward and the impact it makes on the balance sheet of the Ministry of Defence. You can see, even in these accounts, that some of the legacy of the

SDSR in 2010 is still coming through in terms of adjustments like the shortening of the lives of the Harriers, the write-off of Type 42s and so on. Those are the sorts of issue that I suspect have the biggest financial risk for the balance sheet and for the 2014-15 accounts, because there will be material post balance sheet events. There could be significant post balance sheet events that need to be recorded in the accounts.

As you can see, some of these issues take several years to resolve, but I cannot sit here and guarantee you that no new issues will come up. The point of the governance statement that I write in the accounts is to flag issues such as the quality of information. I am not pretending in any way that the Ministry of Defence is run in an ideal way. It has improved and Lord Levene says that it has improved, but there still remain significant risks.

Q12 Mr Havard: You have written and said in these reports and other letters that the financial information system is quite clearly a crucial element in what you can do. The costing of defence outputs, as I think you have said, is detailed but currently unsatisfactory. You said that you have a system for trying to address that, but you say that you are now in a situation where you can allow it to use the current force structure model to support decision making for the next SDSR. So you are now talking about what will change. Do you have confidence in that? You then go on to say that the information cost model that you are developing will come on a slower timetable than that, so how are you putting together a proper financial information base for that defence and security review? Clearly it will be different, but, if the base is unreal in the first place, won't making decisions for a defence and security review be a bit problematic?

Jon Thompson: Not necessarily. You are trying to work out the finances of two different things. The accounts record a balance sheet and a flow of financial transactions in a year, whereas, separately costing up adjusting a programme is a somewhat different skill. Classically, in accounting terms, that is the difference between financial accounting and management accounting. They are different skills that require different sets of people—there are different professional institutes for those two sets of people.

What you get from the annual report and accounts is the flow from a financial accounting system. That does not necessarily directly impact on costing up adjustments in management accounting terms or project accounting terms about future costs.

Q13 Mr Havard: I appreciate that they are different skills and that different organisations govern them—they have different standards as well. You have already said that you are abandoning the IFRIC 4 standard and apparently you have got agreement to do that. You have got an inventory system that apparently will be okay next time round, but there will be some other reason. So you have got information coming out of the organisation badly, which you are trying to address with an information system. You have got management accounting information and financial accounting information, but you say that your cost model will give you a decent base on which to do a defence and security review costing—is that right? Some of that sounds implausible.

Jon Thompson: Perhaps we can step back from the information question. At the moment, the Ministry of Defence has approximately 3,000 IT systems that all have information that is relevant to our running. Even given the scale of our organisation, that still strikes me as—

Mr Havard: Too many.

Jon Thompson: Too many by some considerable degree.

Mr Havard: That has been blindingly obvious for a long time.

Jon Thompson: If you take stock, for example, which you may want to go on to and on which the National Audit Office commented, there were more than 70 systems, but they have been consolidated to four over the last five years. On property and asset management, there were more than 70, but they have been consolidated to one. So you have still got a significant landscape of further change.

We have separated the information systems organisation from DE&S and set up a separate organisation. We brought in a professional chief information officer to manage this consolidation and, over a period of time, the quality of information will improve. But, to quote Lord Levene, quality of information remains one of the "significant strategic issues" that the organisation faces.

Mr Havard: I didn't require him to tell me that; that has been obvious for a while as well. Doubtless, he is a good boy.

David Williams: The strategic cost model that you referred to is run for me and Air Marshal Steve Hillier by analysts from DSTL, our science and technology lab. It is a high level cost model that essentially allows you to answer two questions.

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

Mr Havard: They sure do.

Q14 Sir Bob Russell: I would like to talk about the deployment of members of Her Majesty's armed forces to Sierra Leone. I am sure I speak for all the Committee when I put on the record my appreciation of all that they are doing at this time in difficult circumstances. Can you tell me how many members of Her Majesty's armed forces are currently in Sierra Leone?

Jon Thompson: Just over 600.

Q15 Sir Bob Russell: Of those, how many are medics?

Jon Thompson: Off the top of my head, I cannot answer that question, sorry.

Q16 Sir Bob Russell: If there are 600—it has been as high as 800, so I am assuming that there are people coming and going the whole time—clearly a large number of our armed forces are deployed there. If we have not got a figure for the medics, do we know about the rest of the contribution, what skills and disciplines?

> ***Jon Thompson:*** A range of military planners and logisticians work with the Government of Sierra Leone and DFID and FCO colleagues on planning and doing a lot of the necessary logistics, Royal Engineers have designed and supervised the construction of the various medical facilities, there are the medical personnel themselves, RFA Argus is providing the logistical lift capacity and the RAF is providing some air transport in the local area. It is a mix of those that gets you to the 600. I do not have a breakdown with me, but if you wish for that, I am sure that we can provide it to you.

Q17 Sir Bob Russell: Obviously, knowing how many are medics is significant. If we could have that figure subsequently, it would be very helpful. Are you able to tell us, looking at those 600 and others gone before, what percentage are reservists?

> ***Jon Thompson:*** No, I am sorry, I cannot give you that information off the top of my head either.

Q18 Sir Bob Russell: I have to say that I am disappointed that you are unable to answer about the number of either medics or reservists. The reason I say that is that the Minister for reserves has talked about the deployment of reservists to crucial work in Sierra Leone, so we know that the Government are of the view that we need to increase the number of reservists, because the number of regulars is going down. I would have thought it was a fundamental part of the evidence to this Committee for you to be able to say, as the top man there, what the numbers and the breakdown are—not only that, but what the reservist percentage is and what the numbers are.

> ***Jon Thompson:*** I apologise to the Committee if you were expecting me to be able to answer detailed questions about Sierra Leone in a session on the conduct of the annual report and accounts, but we can provide the information to you in writing.

Q19 Sir Bob Russell: I am sorry to press the point, but a major plank of Government policy is to increase the number of reservists while reducing the number of regulars. There are those who feel that that is a flawed policy. Therefore, I think it is perfectly legitimate for members of the Defence Committee to press the point if that cannot be answered today.

In the spirit of joined-up Government, to change the subject a bit, is the Department for International Development funding the armed forces' contribution to the treatment of Ebola in Sierra Leone?

> ***Jon Thompson:*** Yes.

Q20 Sir Bob Russell: Are you able to say whether it is 100%?

> ***Jon Thompson:*** Yes.

Q21 Sir Bob Russell: Do I assume then that there is no MOD financial contribution?

Jon Thompson: That is my understanding, yes.

Q22 Derek Twigg: Why have you suspended the implementation of the base inventory warehouse system?

Jon Thompson: I could answer that if you allow me just to find my notes.

This is one of the four fundamental systems that we talked about in relation to stock management and consolidation of—

Q23 Chair: To refresh your memory, Mr Thompson, in previous evidence to the Committee, that system was emphasised to us as one of the key planks of what was going to transform management of the MOD, so we are a little bit surprised to find that, after we were told that this was going to be the answer to a lot of our problems, it has now been suspended.

David Williams: If it helps, I signed off the next tranche for the MOD's Investment Approvals Committee on Monday. So we pause, I think, just to check that the programme is properly aligned against the latest requirements, in particular for management of RAF inventory. We need some minor adjustments to the focus and scope. A case came to the Investment Approvals Committee just before Christmas and, as chair of the Committee, I signed off this week.

Q24 Derek Twigg: Sorry, I did not quite catch that. Did you say that the system had only been paused? Is it mainly an RAF issue?

David Williams: For review of requirements is my understanding, but we can let you have an update.

Jon Thompson: You are correct that it is an air domain base inventory management system, primarily for the RAF.

Q25 Derek Twigg: What is its cost? What is its value to the MOD?

Jon Thompson: I do not have the costs off the top of my head. I can tell you that the four systems—

Q26 Derek Twigg: Is it significant, or minor?

Jon Thompson: I can put it together with the other three, so the four fundamental systems which you are trying to get to are the base inventory and warehouse management system, the one that you referred to; the management of the joint deployed inventory; the joint asset management and engineering solutions—that is largely a vehicle solution; and then a logistics and warehouse management system. Those are the four we are trying to get towards.

Q27 Derek Twigg: Are they paused as well, at the moment?

Jon Thompson: No. And the cost of implementation of all four together is just over £1 billion.

Q28 Derek Twigg: So this is just the inventory for the warehousing system that is being paused at the moment?

Jon Thompson: Yes, but I think David said that he had now approved that to proceed.

Q29 Derek Twigg: Sorry; I did not pick up what you said.

David Williams: On BIWMS I have approved, as chair of the investment committee, progress on the next phase. That approval went through this week.

Q30 Derek Twigg: When does that start?

David Williams: I imagine that it will start pretty promptly.

Jon Thompson: The IOC is December; the initial in-service date is currently planned for December 2016.

Q31 Derek Twigg: How far is that from the original date?

David Williams: I think the original date was the middle of 2016, so it has slipped back a few months.

Chair: JAMES and MJDI are due to be implemented in March 2015; is that right?

Jon Thompson: MJDI went live in July 2013. We accepted it fully in March 2014.

David Williams: And JAMES around the turn of this financial year.

Jon Thompson: JAMES went live in April '14.

Q32 Derek Twigg: So there are no other—you are meeting your timetable for all the system changes at the moment.

Jon Thompson: The fourth one, which was the logistics and data warehousing system, went into service in June 2014.

Q33 Derek Twigg: Just for the record: you are meeting all the other timetables?

Jon Thompson: The other three systems are, just so we are really clear, the logistics and data warehousing—June 14 it went live; JAMES in April '14; and MJDI, which is the deployed inventory, we accepted on 27 March 2014.

Q34 Chair: And MJDI for naval vessels?

Jon Thompson: I am told it has been fully rolled out for the Army and the Navy ashore; we are rolling it out to naval vessels over the current financial year, so it is supposed to be in fully, in naval vessels, by 31 March 2015.

Q35 Chair: And you believe you will meet that target?

Jon Thompson: The note that I have here says it is on target.

Q36 Derek Twigg: Can I change tack now and go into another issue in the annual report and accounts: the reserves basing announcement. You remember this was made in 2013. The assumption there was, as a consequence of the plan, over 51 reserve sites were declared surplus to requirements, consisting of 48 Army Reserve and three Navy Reserve sites. Now, as I am aware that for at least one of those sites the decision has been reversed, and they are not closing, would you tell us how many of those—the original number that were to close—have been reversed and will remain open now, and what is the financial consequence? It is all part of the financial and funding arrangement for reserves.

Jon Thompson: I am sorry. Off the top of my head I could not tell you how many of those 51 have been reversed, but if there are any it will be a very small number.

Q37 Derek Twigg: If you do not know, how can you say it is a small number?

Jon Thompson: Because if it had been all 51 we would have—

Q38 Derek Twigg: I am not suggesting all 51; I am asking how many.

Jon Thompson: Off the top of my head I could not tell you.

Q39 Derek Twigg: Could you write to the Committee?

Jon Thompson: We can.

Q40 Derek Twigg: Because I assume you accept there would be a financial implication as well, particularly if it was significant; it may be one or two—it may be 10 or 20. I do not know.

Jon Thompson: Yes, it has not had any significant financial implications for us because, the current budget setting we are going through, the infrastructure organisation is not identifying any financial pressure as a result of that.

Q41 Derek Twigg: But it is all part of the original plan for the reserves?

Jon Thompson: Sure.

Derek Twigg: Okay; if you let us have a note on that it will be helpful.

Q42 Mr Havard: I want to ask you some questions about impact indicators, but can I ask you a question first about stuff that appeared in the press on new year's day, about the Harrier aircraft? A report that you probably know about—in *The Sun*, as I understand it—suggested that the savings on the aircraft fleet were due to be £2.8 billion but there was going to be a loss of £1.3 billion. I am trying to get to the bottom of this. My colleague Madeleine Moon asked a question about it back in 2012, and we were given information about the projected situation from the then Minister, Peter Luff. Lord Astor answered a question in the Lords about it on 24 November last year and said that the estimated savings from the withdrawal of the Harrier force were "around £1.225 million over the ten years from 2011-12 to 2020-21". That was the last official stuff done in Parliament, but then we had this report in a newspaper that seems to suggest something slightly different. Can you clarify the position for us?

Jon Thompson: It can't possibly have cost us anything.

David Williams: I think it has been propagated in part by the fact that the pages in the annual report and accounts that get a little bit of attention are on losses and special payments. What we are showing there in this year's accounts is the write-off of the capital value of the aircraft that we disposed of. The fleet was valued at around £1.25 billion at the time of disposal. It is not a cash cost; it is an accounting adjustment to the balance sheet.

For the saving in terms of support costs and manpower over the 10-year period, £1.2 billion is the figure I have in mind. That figure has been validated with the NAO. The only other cost elements of the early retirement of the aircraft were some commercial costs with BAE Systems and Rolls-Royce in exiting contracts early; the detail of that is commercially sensitive so I do not want to go into it in open session, but those costs were more than offset by the receipt of around £112 million that we got selling surplus aircraft and spares to the US marine corps.

Q43 Mr Havard: You will appreciate why I asked the question. It appeared as though it was going to save £2.8 billion but was actually going to cost £1.3 billion. It might have been cheaper to keep them flying rather than stop them flying.

David Williams: I don't recognise the £2.8 billion figure.

Q44 Mr Havard: If you could give us some further and better particulars on that it would be helpful, so that you can clarify for us what the accounting criteria are. It seems that there is a mix of different things here that is creating confusion.

Jon Thompson: Yes, there is. We can explain that now, if you wish. When we purchased the Harriers, the money was spent at that particular point and the assets were put on to the balance sheet.

Mr Havard: This is amortisation stuff.

Jon Thompson: Yes, that's correct. They then have a life time on which you depreciate the asset. By pulling them out of service earlier you crystallise all that future depreciation in a write-off that is recorded in the accounts. That is how you get the write-off. That saves you the running costs, going forward, which are real cash that counts against the public sector borrowing requirement and our DEL expenditure, if you are familiar with that. It mixes non-cash balance sheet transactions with actual running costs for running the Ministry of Defence.

Q45 Mr Havard: It makes a good story in *The Sun*. If you could write to us to put that down on paper for us and explain it, that would be helpful.

Jon Thompson: I am happy to try to do that.

Q46 Mr Havard: Thank you very much. I will return to what I was going to ask you about mainly, which is impact indicators. You know that we, as a Committee, have made all sorts of suggestions to the Ministry of Defence over the years. In our last Report we made suggestions in a list. There must have been about a dozen things, which I won't read out, that we suggested would be useful indicators that would enable people—not least the general public—to understand the accounts, and said that the current indicators perhaps needed revision. You say yourself now, in the report, that you need revisions. Some of them cannot be calculated any more and have become outdated because of changes that have taken place. What are you going to do with these indicators to make them useful?

Jon Thompson: We have a genuine problem, I think. If I may go back, the Committee made 11 recommendations this year and last year, and we have implemented nine. You are obviously—rightly—picking on the impact indicator one, which if anything has reduced. There were 10 and now there are six, and we are indicating that that will go down to five; once we are out of Afghanistan it will go down to four, because one is currently the impact of NATO training of Afghan national security forces. If we are being completely up front about this, it is quite difficult to express the impact of the Ministry of Defence because we are given money to develop standing commitments and contingency capability. We take one sort of input, which is money, and turn it into another input—military capability. We can measure that very clearly. Interestingly, we do not publish that but it is available and is reviewed by the board every month.

We can tell you what sort of military capability we have but then the question is: what impact does that have if you then have to go and do an operation? We are struggling with what you can publish in that particular space in terms of impact. There are, in relation to standing commitments, a whole series of statistics that we publish and that we could say had an impact—for example, search and rescue or the number of times that you did Operation ADANA in relation to the security of the airspace of the United Kingdom, or so on. We publish most of that and we could publish a bit more.

I am genuinely struggling with what our equivalent of A and E hospital rates or GCSE pass levels is. It is quite difficult to understand what the measure is. We have discussed how to measure it with many different international colleagues. We measure one input and another input, but we do not have a third input. It is really quite difficult for all Ministries of Defence. That is not to say that I am complacent about it; we continue to wrestle with it. Ministers continue to be interested in it and there is a public interest in what you get for a £34 billion spend on defence. At the minute, our expression of that is that you get this number of carriers, that number of troops, and this number of fast jets, but that is still another input into something else.

Q47 Mr Havard: We have struggled with it as well, and have tried to make some suggestions. From the point of view of having less of the bean counting and the metrics, it is about whether the public understand whether they are getting value for their money. We need to be able to measure what the performance is and whether that is improving or deteriorating, so that Joe and Josephine public have a way of understanding what it is fairly regularly. How can they tell?

Jon Thompson: I am accepting your point fully. I can—in fact, the Defence Board does—every month get a report on the number of military personnel that are deployed. In answer to Sir Bob's question, I say 600 in Sierra Leone, but I could go away and bring back a map of where all military personnel are deployed in the world and how that changes month on month. Maybe we could publish that.

Q48 Mr Havard: We will return to this and will try to make similar suggestions but it strikes me, from what you were saying earlier on about things such as contribution to search and rescue, that these things are more readily understandable as a valuable thing to do, and they are the contribution that relates to other services so that the MOD is not seen to stand alone and is part of the general resilience of the country. Can you look at measures that might be softer in the sense that they are not so hard metrically, but that give us a better understanding of whether you are doing better or less well in those areas? That would be helpful.

Jon Thompson: We certainly could do that. I am still left with the question: if the number of search and rescue operations goes up or down, what does that tell us? I have got that information.

Q49 Mr Havard: You're giving me an accountant's answer now. There are always reasons why you can produce a flaky piece of information. I am trying to say that we have no benchmark against which to measure change, so the individual number in any given circumstance is less important than the ability to decide whether or not, for whatever reason—because demand is greater or less—there has been an improvement in the process between A and B.

Jon Thompson: I accept your point that we need to do something about it. Our contribution to the security of—to use an American phrase—"the homeland" is not understood by the general public of the United Kingdom. Thousands of military and civilian colleagues are working hard every day to protect the homeland and I do not think that we promote, measure or publish that enough.

Mr Havard: Two things: please do not use American language, but please do address it, because getting more reservists, and the relationship with the public, is of increasing importance to you.

Q50 Dr Lewis: In response to my colleague Dai Havard, you said that you take the money that the Government give you and turn it into military capability. In an earlier answer, you said that the single biggest headache that you are likely to face in 12 months' time will be whatever it is you get as a result of the next strategic defence and security review. So, from the point of view of the Committee, we have to wonder whether, if there is a further cut in the defence budget, you will be able to absorb that cut through greater efficiency or whether it will have a direct and possibly disproportionate effect on the strength of the front-line forces. Would you comment on that?

Jon Thompson: I will try. This is a speculation, but on the basis that it is a theoretical question that you are asking, it depends on the level of the reduction. There are clearly further financial efficiencies that the Ministry of Defence should continue to chase. I think we have done remarkably well over the lifetime of this Parliament to deliver £4.3 billion-worth of financial efficiencies in areas such as renegotiating contracts. I can set some of those out if you wish. It is perfectly natural that we should continue to continuously improve our financial efficiency, but there is a limit to how far that can go. So the answer to your question is that it rather depends on what the reduction is. If it were to be a reduction on the scale of what happened in 2010, which in the end was 20%—I can explain how you get to 20% if you want, but it was 20%—then I think that that would be very difficult to bridge only by financial efficiency. You would naturally expect for us to be able to save money through financial efficiency measures. All organisations should be able to do that, and we will be able to do it.

Q51 Dr Lewis: We are going on to discuss Defence Equipment and Support. Before I ask you a couple of specific questions about its organisation, may I give you an opportunity—I hope—to tell a good news story? I am looking at the section of the report from pages 61 to 64, which lists—quite impressively, I think—all the new equipment that has been delivered in the course of the last year, or progress made on the way to delivery, at each of the three armed services. It is often the case that very few military equipment projects come in on time and within budget. Are there any particular success stories out of this list that we have on these pages to which you would like to draw our attention as models of the way in which DE&S has been delivering?

Jon Thompson: Not on specific capabilities, but thank you for the opportunity. I will just speak generally. We are on the brink of publishing the latest National Audit Office report on major projects. They produce an annual report, and they have done for some considerable time. We both know, because I cleared it today, that it will be the most positive major projects report that the NAO have ever produced. We have spent the last four years working on Bernard Gray's original diagnosis of the problem, which was an overheated programme, a lack of DE&S capacity and capability to deliver, and a smarter customer. That was the original diagnosis of what the problem was. We have sorted out the overheated programme. We have stabilised that, so we are not doing ourselves damage. We have had a stable programme since April 2011, and I think that that stability has really helped.

We are slowly improving the quality, capacity and capability of DE&S as an organisation—you may want to ask further questions about that—and we have now delegated the budget into commands. We are doing significant work with the four military commands on their capacity to be smarter customers and to set smarter specifications and so on. So we are making some progress on the management of the equipment programme. Page 61 and so on sets that out. Overall, the next NAO report will show no overall cost growth in the equipment programme. It is the first time for some considerable time.

Q52 Dr Lewis: Given that you have got this new report coming out on the major projects, can you just give us a quick highlight of one or two of the examples where you feel things are beginning to work properly?

Jon Thompson: I think the systemic issue—David, you are the chairman of the Investment Approvals Committee, so you might want to add some specific projects—is that once we have committed to doing something and signed a contract, we have tried never to open that up again. We have kept that discipline since April 2011, and that is creating significant benefits for the taxpayer. If you open up a contract, you destroy public value, as we saw with the delay of the aircraft carriers. The maintaining of that iron discipline has been a good thing. David, are there any specific abilities that you—

David Williams: Building on that specific point from Jon, one element is the announcement that was made last September around the next stage of the Scout armoured vehicle programme. Rather than bending a commercial position to a set of MOD programming and planning assumptions, we have used the commercial leverage we have with our contractor to get a better deal than we would have got otherwise. We got an increase in the number of vehicles delivered earlier at lower overall cost. To be fair, that reverses some assumptions that we made previously, but that recognition that playing the commercials, in a way that gives us leverage is really important.

The second element I would highlight, which plays to our delivery of efficiency savings agreed in SR '13, is that with support from McKinsey we have made some real progress in getting behind equipment support contracts, being a more demanding customer and generating some substantial potential savings from that engagement. Again, it is the proper interplay of capability planning and commercial skills that drives that impact.

Q53 Dr Lewis: I take it that the forthcoming report will give us a fairly clear indication, project by project, of what has been working well and what has been lagging behind.

David Williams: Yes. That is a fair expectation.

Q54 Dr Lewis: I won't press that any more; I am glad to hear that you are optimistic about it. On the reconfigured board of Defence Equipment and Support and the fact that it has a new Chair, can you explain to us your relationship with the board and with the new Chair, whether the main relationship is with the Chair of the board or with the chief executive and how those interact?

Jon Thompson: My personal relationship is as follows: we appointed Paul Skinner as a chairman and created the board with four non-executives. I am on the board of DE&S, as well as on the main Defence Board. Paul Skinner and the chief executive are obviously members of the DE&S board and are currently members of the Defence Board too, so you have a flow both ways. The management information reporting, which goes to the Defence Equipment and Support board, is then included in my own pack for the main board. Whatever is being told to the DE&S board is fully transparent to me and then fully transparent to the Defence Board. That is the relationship.

In accounting officer terms, we have separated the DE&S to be its own entity, and it will have to produce its own accounts. The chief executive is an accounting officer and, should you wish, once they produce their first set of annual accounts that person can introduce them to you and explain them. I think we are reasonably clear on governance and how it is supposed to work. The introduction of some proper corporate governance and a majority non-executive board has been a good step forward. Paul Skinner is doing an excellent job as the first Chair.

Q55 Sir Bob Russell: If I may follow up on an earlier question from Dr Lewis on procurement, I detect signs from the MOD that when it comes to procurement, there is something of a silo mentality, where people say, "This contract is what we are looking at." Unfortunately, depending on where that contract is placed, it may have consequences for other aspects of the Ministry of Defence in terms of maintenance and the servicing of contracts of a longer duration. How do you ensure that the long-term defence capability and long-term interest of taxpayers are taken into account, if you are just looking at that contract in isolation from everything else?

Jon Thompson: Are you thinking of a specific industry?

Q56 Sir Bob Russell: I could well be. It is a general principle. If you have contracts of a nature that relates to a skilled work force, that work force needs a continuous stream of work. If it is not getting that continuous stream of work, that skilled work force could be lost to this country, and thus to the defence capability of the United Kingdom.

Jon Thompson: I won't speculate about what industry you might be thinking of, because that would not be appropriate. In general, we try to approach it on three different levels. So there is the individual contract level; there is then the supplier level—so, what is our overall relationship with, say, Babcock or BAE Systems or Lockheed Martin or whatever? You could see the individual contract in the context of that overall relationship with the defence industry.

Then we think about it in terms of the overall strategic coherence of the programme. There is a military three-star, in fact, working very closely with David. Deputy Chief of Defence Staff (Military Capability) Stephen Hillier came before the Committee in the run-up to Christmas. He is responsible for cohering the whole programme and pointing out that "If you do that over there, that may impact over there." That is part of his responsibility. He chairs a board that you, David, are on that thinks about military capability in the round and the coherence of it.

We need to be very conscious of that, given that we have now delegated equipment planning down to the front-line commands. So it does operate on three different levels. Sometimes, in terms of value for money, it is actually better to proceed with a contract at this level in order to maintain a defence industry or supplier at a different level.

Sir Bob Russell: I am grateful for that reply, Chair. I am sure we will revisit that on another occasion.

Q57 Mrs Moon: May I quickly go back to your answer to Sir Bob's question about Ebola? You said 100% of the cost of the efforts in Sierra Leone would be met by DFID. Does that mean that costs of equipment and their operation and personnel are also being met by DFID?

Jon Thompson: I think it is the standard marginal costing model.

David Williams: So it is the additional costs.

Q58 Mrs Moon: So they are being met by DFID as well.

Jon Thompson: It would be the method that we normally use for access to the special reserve from the Treasury in the event of a major conflict.

Q59 Mrs Moon: I wanted to get that clear in my head. Thank you. I want to talk about the management services provided by DE&S. What are the challenges posed by the appointment of three managed services? We have got CH2M Hill doing Land and Joint Enabler, Bechtel doing Air and Fleet and PricewaterhouseCoopers doing human resources. I understand that the IT is till to be let. Can you talk about the difficulty of managing in effect four companies instead of one?

Jon Thompson: Yes, you are absolutely right. The key strategic risk is whether you can integrate CH2M Hill and Bechtel and PricewaterhouseCoopers and a fourth to come, the finance and management of information systems provider. In order to ensure that there is a clear focus on integrating those, DE&S has appointed a director who takes responsibility for integrating those partners with our own work force. We are very cognisant of the risk but, so far, working relationships between ourselves and Hill and Bechtel have been extremely good. There was a strategic decision made in relation to the project programme and portfolio management contractors, Hill and Bechtel, that we would split it up into packages, in order to keep a very diversified market. Remember, if you go back to the GoCo, we were going for one organisation running the whole of DE&S. We broke it up consciously. Philip Hammond, when he was Defence Secretary, was very consciously wanting to break it up. But that gives us the integration risk. We are very conscious of that risk, and we have appointed somebody to manage that risk. So far, so good, but we need to keep on top of it, because we are attempting a fairly radical change to the organisation.

Q60 Mrs Moon: Have we, in effect, got four mini GoCos?

Jon Thompson: No, absolutely not. We specifically were trying to avoid that, so we have created a boundary around DE&S and we have given it appropriate corporate governance, which Dr Lewis was asking me about. We have put it at arm’s length, we have created a separate accounting officer who is responsible for that organisation, and then we are injecting the additional capacity and capability you need through those separate organisations. You are absolutely right that the risk then is: can you integrate all that change and all these additional partners in terms of improving the quality of the performance of the organisation?

Q61 Mrs Moon: Will you produce a new risk register to take on board all those risks so that they are actually identified?

Jon Thompson: Yes. The DE&S board does have a risk register that they look at every month. In relation to the transformation of DE&S, that is the No. 1 issue: can you integrate all of these together? I think that that is fairly swiftly followed by: what do we do with the pay freedoms that have been given—how do we implement those? That has significant risks in terms of implementation of a very different kind of pay model. We will get to that, I think, at some point in 2015.

Q62 Mrs Moon: Who is responsible for investment appraisals?

Jon Thompson: My good friend is the chairman of the investment committee. Do you want to explain how the process works?

David Williams: It depends on precisely what for, but—

Q63 Mrs Moon: Who produces them?

Jon Thompson: Do you mean for equipment?

Mrs Moon: Across the board. Who is actually looking at investments and appraising whether or not those investments are sound and whether they are going to produce income for the Department, and income for the four mini GoCos that we are not going to call mini GoCos, but which in effect are? How are we going to assess what is happening with the assessments that are going into these four different units?

David Williams: Specifically in terms of the investment appraisal around the MSPs—the partners—that is an investment appraisal that is produced by the DE&S executive team, overseen by my opposite number within DE&S, Michael Bradley, and reviewed by the DE&S board. The business case, as it were, for the appointment of the MSPs went through that process. That was, within the delegation and the freedoms that we have set up, effectively delegated to the DE&S, so my investment committee did not specifically engage on that decision.

More generally, project teams, where they are seeking an investment decision, all have to produce an investment appraisal. It is subject to central, independent scrutiny and the approvals process is run corporately by me through the investment approvals committee, which includes military representatives, our chief scientific adviser and commercial and legal leads. That model is replicated in the delegated operating model within defence within each front-line command and TLB area.

Q64 Mrs Moon: Are you happy with the investment appraisals—their quality?

David Williams: There are always areas where you can look to improve them, but on the whole the standard of appraisals is, I think, fit for purpose.

Jon Thompson: I think that the long-standing independent scrutiny of business cases, which then goes into the investment committee, is a good principle. It allows the committee to qualify approval as well as turn down business cases and ask for them to be resubmitted on the basis of these kinds of improvements. I think it is very well run. The NAO did a review in 2012 and found that it was in rather good shape.

Q65 Mrs Moon: We have got land, we have got air and fleet, we have got human resources and then we are going to have IT. Are we at risk of stove-piping, in the way that we stove-piped when we had budgets for three separate forces and Joint Forces Command? Are we in fact going to do that again? Instead of having one company, we have got four mini companies, each with their own budgets and each with their own investment appraisals. How are we going to ensure that we do not have four separate organisations going off in different directions? How are we going to protect against that?

Jon Thompson: You are right to highlight the risk. If you go back to the pre-delegation model, there was one customer in the head office who cohered the whole equipment plan and there was one DE&S. We have now made that model five customers. We have delegated the four military commands, but we have kept some programmes in head office, such as the deterrent programme. Then, DE&S has the four domains, but as I said, there are those safeguards that exist with Steve Hillier to cohere that overall programme. I think that system has worked so far, but you are right to say there is a risk.

It is also worth saying that there is an Executive committee on the DE&S side, so those domains come together. The four domains that you highlighted are still led by public servants—three military officers and a civil servant. We have not taken the Army element of DE&S and given it away. It is still run by an Army general. What happens is that CH2M Hill or Bechtel come in, if you like, at the chief operating officer level, not at the chief executive level. We still have responsibility in DE&S, reporting through an Executive committee and up to the chief executive, and then to the board. So you still have that coherence at their end, but the responsibility of the Deputy Chief of the Defence Staff for military capability is to cohere the overall programme. So I think there are sufficient safeguards. It is a risk—Sir Bob highlighted potential areas where it is a risk and we need to keep on top of that, and that is the point of some of the new governance that exists at the headquarters end.

David Williams: To emphasise some of Jon's points, in the next week or so, we are going to publish the defence equipment plan, not five subordinate equipment plans. The investment appraisals around investment in individual equipment capabilities are subject to this sort of central scrutiny and approvals approach that I am responsible for and delegate through my finance directors in the front-line command. So that is done to a consistent set of standards and approach.

It is also worth remembering that although this is a bit of a simplification, some procurement challenges in the individual domains within DE&S are quite different. The maritime environment is dominated by large contracts, largely on a sole source basis. The Army domain—the land domain—is a larger number of smaller contracts, often let competitively. The air domain is often where more of our international collaborative projects sit. So being able to bring different approaches to bear where they are required, while managing within the whole in a consistent way where that is needed, is the challenge.

Q66 Mrs Moon: How will this new structure be reflected in next year's annual report and accounts?

Jon Thompson: There will be two—one for DE&S that covers the cost of running DE&S, and therefore, this one would be slightly smaller in that regard, because we are taking out the operating costs of running DE&S. They produce their own accounts. We will still retain responsibility for the balance sheet, so that is still an MOD corporate responsibility, so you will not see any significant changes in that particular area, but you will get a separate governance statement from the chief executive of DE&S that will highlight the kinds of risks that you are flagging up. As is appropriate, given that they are an accounting officer, if you want to engage and ask that person questions, you can do so.

David Williams: The DE&S accounts will focus on the £1 billion or so a year that it costs to run the organisation. The £14 billion that they spend on equipment and equipment support is corporate money, but that £1 billion a year will be consolidated in these accounts as well. If you look at the accounts currently, there is a core column and a group column, which plays in our arm's length bodies. We have not quite decided whether we will show DE&S as a separate column or play them into one of those two existing ones.

Q67 Mrs Moon: Finally, DSG has also been sold off, to Babcock. Looking at the company's accounts, it said: "Despite continued uncertainty over the timeframe for the drawdown of facilities and services at MOD Ashchurch and no clear plan indicating where the DSG activities will transfer to, the DSG employees based there continued delivering improvements in performance and output." At what point are we going to get a clear picture of what is happening with DSG, and in particular to Ashchurch, which as you may know, I take a particular interest in? When will we know how it is going to be carved up and what is going to happen?

Jon Thompson: The Ministers, I thought, had announced the fact that we were selling the majority of DSG to Babcock. Then, as it were, with that sale of the business there is also a 10-year service contract to buy services from the privatised business. There is the retention of a kind of electronics components business, so it is essentially the vehicle maintenance business that has been sold, and we have retained some. The work force is very clear about which side of that they fall. Under the TUPE regulations, everyone is protected on day one. We are not selling the land and the assets; it is just the business that we are selling. In relation to Ashchurch, that will remain a Ministry of Defence property and the facilities made available to Babcock on a licensed basis. There are no planned closures of any sites on the sale date.

Mrs Moon: But Ashchurch contains a controlled environment for vehicle storage, which is nowhere else in the UK.

Jon Thompson: Correct. Ashchurch is the main site for controlled environment for vehicle storage in the UK.

Q68 Mrs Moon: So how are we going to maintain our vehicles in a controlled temperature environment if we are not selling the land and the environment to Babcock and are closing Ashchurch?

Jon Thompson: Sorry, but I do not think that Ministers have announced that we have made a final decision to close Ashchurch.[1] On the DGS sale, I am fairly clear—I think I was clear in the answer I just gave you—that we are not selling any land or assets as part of the DSG transaction and there are no planned closures on the date of the DSG sale.

[1] Note by witness: On 25 March 2013, a Written Ministerial Statement set out that it was the MoD's intention to withdraw from the Ashchurch site unless retention proved better value for money. The work is yet to conclude.

In relation to the controlled humidity environment, which, as you say, is in Ashchurch, it is for the Army to decide whether it wishes to continue at that particular site or whether it wishes to reprovision. If a decision was made like that, it would be appropriately announced.

Q69 Mr Gray: Can we move on to the question of manpower and personnel shortages? In particular, I bring your notice to the charts on pages 44 and 45 of the annual report, which are the particular trade pinch points. I am afraid to say that I am just being a bit dim and don't quite follow the figures. Let's take serial 1; it's quite straightforward. The liability, 565, I presume means that there are 565 marine engineer general service petty officers, and a shortfall of 195. Of the 565 you require, there are 195 short, which is a 35% shortfall. Is that a correct reading?

Jon Thompson: Correct.

Q70 Mr Gray: If that is the case, can I ask you to go down a bit to serial 3 on the Army, where it says "Royal Engineers - Engineer Logistic Specialist – Rank: WO1"? It says: liability, zero; shortfall, zero; percentage shortfall, 60%. Can you explain what that means?

Jon Thompson: I believe the reason there is a dash and you don't get the numbers is because the numbers are below 10. At that point, under national statistics legislation, it is possible, theoretically, to work out the names of the individuals concerned and you end up with a dash rather than a number.

Q71 Mr Gray: So you will work out the percentage shortfall, but not the numbers?

David Williams: We know the numbers, we just haven't published them.

Jon Thompson: We know the numbers, but we are not allowed to publish them under those rules. That is my understanding. It is less than five.

Q72 Mr Gray: Okay. Let's try a different one in that case. What about serial 16 on the Army? It says the liability is 10 and the shortfall is a squiggle and the percentage shortfall is 40%. I don't have to be a genius to work out that that means you are short of four.

Jon Thompson: Indeed. I am sorry, I don't make the rules here. These are set by the national statistics authority.

Q73 Mr Gray: It is slightly misleading, but not hard to follow. General points are more important than these details. What are you doing to reduce some of these? Some of these shortfalls are significant—60%, 40%, 50%. Those are very significant shortfalls in particular trades, so what are you going to do to reduce that shortfall?

Jon Thompson: It is an issue that has been discussed at the Defence Board on a regular basis. We produce a monthly report about a series of personnel issues—operational pinch points, voluntary outflow rates, harmony breakages and so on. The Department has carried out a lot of work in relation to how to solve the problem. The problem is multidimensional and in both the recruitment and in the retention. But in the retention space, some of the tactics we have deployed include the use of what I call financial retention incentives—you can put money towards it. We do that. For example, for those with nuclear engineering skills, there is an additional allowance on top of their pay as a retention mechanism.

Equally, we have to look at the recruitment of specialists; we also look at that every month to see where we are with the recruitment. Again, we are trying different approaches, such as how to access those in university and what kind of golden hellos we can offer. We pay golden hellos for some particular trades and so on. We can do as much as we can in those particular areas with financial incentives, career breaks, additional learning and development and so on and so forth, but we ought to be up front: in some trades, there are both national and European shortages of skills, particularly in engineering. That remains an issue on which the Department has engaged widely across Government, in order to see whether there is something that we can do as the UK overall: for example, for the nuclear industry. So it is both a tactical-level issue and a strategic-level issue.

Q74 Mr Gray: There is a broad spectrum of different solutions, but if you look at the Royal Marine engineers, for example, you are short about 360 out of roughly 1,000. Surely that is a pretty serious crisis. The Royal Navy is short of one third, or more than that—getting on for 40%—of its engineers. Isn't that a pretty major crisis?

Jon Thompson: I am not sure what the First Sea Lord answered when he came before you in November—

Q75 Mr Gray: Annoyingly, I failed to ask him that question. Next time he'll be for it.

Jon Thompson: I didn't think you had clocked it. We ought to be up front about this. While the Defence Board's responsibility and ours is to take a very significant interest in this, the primary responsibility here is with the Navy Board and the First Sea Lord in order to solve the problems that he has. Under the delegated model, there is significant financial and manpower freedom to address the issue, and we—David and I, and the Chief of the Defence Staff or vice-chief—meet the service chief once a quarter and discuss these kinds of issue, how they are tackling them and whether there is anything we can do corporately to engage with that.

The Defence Board also meets with the service chiefs on a regular basis to say, "Okay, you're running the Navy. What do you think are the major issues? Is there anything the Defence Board or Ministers can do?" Asks are made, and in general Ministers respond to them, but the primary responsibility remains with the Navy. I think the Navy, and indeed all the services, have wrestled with it rather well. As I said, it remains a complicated issue, but we need to be clear about who is responsible for that.

Q76 Mr Gray: Twelve months from today, you will be sitting there and we will be sitting here—well, depending on the electorate. On a scale of one to 10, how confident are you that these quite significant shortfalls in manpower in the three services will have been addressed? Is this something that you feel confident about, so that this time next year we will be saying, "Well done, Jon; top marks," or are you worried about it?

Jon Thompson: I think the number will reduce. At the moment, if you go back to 42 and 43, the overall number of operational pinch points, if you add them all up, is 43. I can tell you now that in the last monthly management information that went to the Defence Board, that number would have been under 30, so it is heading in the right direction. Can I confidently sit and here say that you can ever get to zero? I don't know if there has ever been a time when it was zero. I wouldn't say that. There has never been a time in the last six years that I have been at the Ministry of Defence—I was doing David's job previously—when there has not been a table like this. Whether it is ever possible to get it down to zero, I don't know. We would strive to get it as low as we possibly can.

Q77 Mr Gray: "Crisis, what crisis?", really.

Jon Thompson: Well, there were 43, and now I am saying there are fewer than 30. That is heading in the right direction. I am just being realistic enough to sit here and say that I am not going to come back next year and say, "It's zero," because there are some big strategic issues at play.

Q78 Chair: Okay. I have some last questions. I have two big-order questions to try to understand some of the bigger strategic issues. You are taking a big saving by getting out of Afghanistan: £1.9 billion. It would seem that there could be a case, but I just do not understand the full issue here, for keeping a contingency of that sort, because you would want to have a dynamic, energetic military frequently deployed, frequently getting into places, so that if you suddenly needed to get into Iraq, the money was available, or if you wanted to do many more UN peacekeeping operations, it was there, or if you needed to go off to deal with Ebola you did not need to dip into the DFID budget. How much thought have you put into making sure that, instead of saying, "Hooray! We're out of Afghanistan so we never need to spend that money again", we keep that money easily available without upsetting your accounts?

Jon Thompson: You are absolutely right that there are two different models by which you could run the cost of operations. The model that we have adopted in the United Kingdom is that the marginal additional cost of an operation is met by the Treasury special reserve, but there are some European countries—Denmark, for example—that do not run that system. The Danish defence budget is split 90:10 and the 10% is indeed, exactly as you say, a contingency for operations that the Danish ministry of defence can deploy—I understand—in accordance with proper ministerial approval, for the kinds of operations that you are suggesting. Therefore there are two choices and two models that operate in the world. Under the American model, their budget fluctuates in accordance with major programmes as well. So theirs flows up and down, if you take a long enough time series.

The choice that has been made, which is long-standing here, is that it is marginal additional costs, but you are right, it is perfectly legitimate policy choice. We have discussed it with our Ministers in the past. My understanding is that there is no inclination to go down that route.

Q79 Chair: Just to understand the decision there: was it set up as a marginal additional cost on the assumption that such deployments would be relatively uncommon? In other words, if we are moving into a world in which we could expect to have large, ongoing deployments in most years, would that be a reason to change the system?

Jon Thompson: It could be. At the margin—I mean, it really is at the very margin—we do run something called the Defence Military Activities Pool, which is £50 million. So if something looked like you wanted to do it and you wanted to do it in relatively short order, we could do it before you get into a conversation about, "This really is an operation that requires access to the special reserve." We created that two or three years ago with the Chief Secretary, so that at the margin at least there was £50 million that we could use. Once you get above that, you enter into a more serious conversation. But you are talking about a long-standing Government policy. That could be changed, yes. It is theoretically possible and other countries do run such a model.

David Williams: We had some slightly different models in the '90s for peacekeeping operations in the Balkans. While an Iraq or an Afghanistan would mean access to the special reserve, from memory there was one spending review where there was a cap, so anything above that we would meet. In another spending review, there was a floor, so up to first £100 million, say, we might meet and then the special reserve would kick in. I think there is a choice for the Government next year about the relative balance of presence and how much activity they expect to see the armed forces undertaking.

Q80 Chair: I want to bring in Dai and Dr Lewis, but just before I head over to Dai, the reason why I was a little bit anxious about this is that I am worried that the Government may be deterred from being proactive and energetic, because every time they want to send somebody abroad they have to go cap in hand to the Treasury to a special reserve fund, rather than people being able, quite flexibly and energetically, to say, "We are going to put a battalion into Jordan", "We're going to get involved in peacekeeping operations in Central African Republic", "We're going to deploy off to deal with Ebola", or "We're going to lean more heavily into Iraq". Would I be right in saying that this current process has a risk of creating an environment in which the default becomes not going on operations?

David Williams: Personally, I think that would be overstating it. I think that we have been quite agile over the last couple of years with short-notice deployments, but there is a degree of complexity about sorting out the funding arrangements, which you have to work through quite quickly, as we are making a decision to go into various operations in various theatres. If that is going to be the pattern of activity over, say, the life of the next Parliament, the SDSR next year would be an opportunity to revise or refine those funding arrangements. We can certainly look at that.

Q81 Mr Havard: Part of the reason why the question was asked is that if defence engagement is going to be the doctrine that is developed and deployed—alongside any reactive activity that you want to do or any discretionary expeditionary activity in terms of coalitions and so on—that speaks to defence planning. Defence planning, and all the money, was based on having a long war over here and a short war over there, and when we had finished that one, doing this one. You know that you are going to be involved in concurrent activities, some out of choice and some not, so how do you deal with the financial agility—to use your words—in order to do that? I think the question has arisen because it speaks to the defence planning assumption process. What thought is being given to that in relation to the discussion about defence planning that is going into the broader discussion about the defence and security review?

Jon Thompson: Your question is slightly different from the Chairman's, but to respond positively to what you are saying, you are right that we could change the defence planning assumptions so that defence engagement—capacity building in wherever—was a standing commitment that we were obliged to do in the core budget, or we could have some flexibility about it. That is definitely something that we would want to explore with Ministers in the SDSR in order to further enable defence engagement in capacity building.

Q82 Mr Havard: This is an NSC-type discussion, isn't it? Because if you have the doctrine of forward defence in DFID and so on, it is about how you relate them all together. Is that how it is being done? Is that an active discussion within that process?

Jon Thompson: There will be an active discussion—we need to be really careful about when the SDSR starts—and we have certainly done some of that thinking. You have to get the right balance between standing commitments in the United Kingdom and dependent territories; defence engagement—building up the capacity of, capability of and training in other countries; and conflict. How do you try to get the balance between those elements right? If you do more defence engagement, you might stop conflict that you would otherwise have become involved in. Both the Chief and I are certainly of the view that how to get the right balance between those paths must be discussed in the SDSR.

Q83 Mr Havard: But it involves money, and on the basis that you keep your friends close and your enemies closer, the Treasury is involved in the discussions in the NSC, is it not?

Jon Thompson: There is a good deal of defence engagement that is relatively marginal cost and actually really rather good training for our people. Going overseas and, say, engaging with other armies is a good thing for a brigade to do. Of course, that is relatively marginal—we are not talking about it being on the scale of billion pound enterprises. That is my opinion.

Q84 Dr Lewis: I want to come at the aspect of the Treasury reserve from a slightly different angle. Over a period of about six or seven years, there has been a blurring, by successive Governments, of the division between the money that is spent on defence from the core budget and that which comes from the Treasury reserve. I remember the previous Government saying that their defence expenditure over a 10-year period had been roughly constant, at about 2.5% of GDP, if the cost of operations, which was of course largely coming from the Treasury reserve, was included. Am I right in thinking that if an adjustment is not made to the core budget, when Afghanistan is absolutely concluded and removed from the accounts and we take away the contribution of the Treasury reserve to the overall percentage of GDP spent on defence, we will drop below 2%?

Jon Thompson: No, I'm sorry. The NATO definition of defence spending does include operations, and it is perfectly reasonable to include them, but in 2014-15 and 2015-16, even if you ignore what might be a call on the reserve—we do not currently have any plans to call on the reserve next year, 2015-16—we are still meeting the 2% NATO target in 2015-16.

Q85 Dr Lewis: That is really helpful. We are therefore saying that even though there will be no Treasury reserve component after the end of this major conflict, any decision to drop below 2% of GDP on defence, spent by whatever Government is in place, will be a conscious decision to cut the core budget—it will not happen by default just because the Treasury reserve is no longer being included in the overall total. That seems the obvious consequence of what you are saying.

Jon Thompson: You use the word "cut". I suspect whether it was a cut or not will be widely debated. It is perfectly possible for the defence budget to continue to rise. The question is whether it rises in line with GDP growth.

Q86 Dr Lewis: All right, let me rephrase my question without the word "cut". Any decision to allow the proportion of GDP spent on defence by the next Government to fall below the NATO recommended minimum of 2% will be a conscious decision by that Government; it will not happen purely as a result—this seems the obvious consequence of what we have been saying—of us no longer having to add in the money from the Treasury reserve that was being spent on operations. Surely, your answer to that has to be yes.

Jon Thompson: Yes.

Q87 Dr Lewis: Good.

Jon Thompson: I just needed to think about it, to be clear.

Q88 Dr Lewis: Finally, may I just ask you for your opinion? You mentioned the management board a couple of times and having discussions from time to time with the Chiefs of Staff because, of course, they are not on the board. Some of us have concerns on the operational side about the fact that the Chiefs of Staff Committee is no longer the focus of attention, shall we say, and decision making. Would it be helpful or make little difference whether the heads of each of the three services had closer contact with the board or were even members of it?

Jon Thompson: I think that the reforms to the Defence Board were absolutely right. Just so we are clear, under General Richards's chairmanship, the Armed Forces Committee was also created. The Defence Board generally meets on the last Friday of every month and the Armed Forces Committee meets on a Wednesday afternoon and discusses exactly the same papers and issues so that the Chief and Vice-Chief, who are members of the Defence Board, have a unified military view, which they take into the Defence Board, which subsequently meets.

The Armed Forces Committee, of which I am also a member—in fact, I jointly chair it with the Chief—has been a rather excellent development under General Richards's chairmanship, and now under General Houghton's. It discusses all the same issues. You get to a unified military view. Its main benefit is that it prevents the single service issues from floating up to the Defence Board, which is particularly important in relation to issues such as the ones that Sir Bob raised about the coherence of the equipment programme. You have to take a unified military view, otherwise what you get at the Defence Board level is simply single service lobbying, rather than a coherent view. That has worked really rather well for us.

On the operations side, a Chiefs of Staff Committee still exists and all the operational matters are discussed on Monday afternoons with Ministers, senior officials, and the Chiefs. There are enough mechanisms in the governance for Chiefs to express their views if they have particular ones.

Q89 Dr Lewis: And is it your personal opinion that the individual service Chiefs are happy with how their views are represented by the Chief of the Defence Staff when he goes up to the management board?

Jon Thompson: I think they are. I see the service Chiefs on a regular basis, given that I am on several governance forums with them. I do not hear any significant complaints. Lord Levene's report is really interesting. The new cadre of service Chiefs—you met all four of them in the run-up to Christmas—have taken on the delegated model and the responsibility. If you talk to General Carter, he would describe himself—he has done publicly—as the chief executive of the Army. That seems to be the kind of approach that we want. He is running an £8 billion organisation with more than 100,000 employees, and I personally fundamentally believe that the right place to take major decisions about the Army is at the Army Board level, with the Defence Board standing back and cohering it. There are different opinions about that model, but so far, I think, over the past four years, it has been very successful, and Lord Levene says it has.

Dr Lewis: Thank you very much.

Q90 Sir Bob Russell: Gentlemen, for my benefit, if nobody else's, so that I can fully understand this, if the Ministry of Defence sells an asset it no longer requires—a former barracks, a disused airfield or whatever—where does the money from that capital sale go? Does it go all to the Treasury, or does it stay with the Ministry of Defence?

Jon Thompson: It stays with us. As long as we remain within our estimate of income from such sales, it remains with us.

Q91 Sir Bob Russell: Would that apply also to the sale of spare MOD radio frequencies, which may appear in the annual report for 2014-15 if things happen in the next three months?

Jon Thompson: Sale of the spectrum is a receipt that we will retain within the budget.

Q92 Sir Bob Russell: That will all be retained by the MOD—

Jon Thompson: No, sorry; there is a special deal. Up to £350 million, we retain. Is it? You may have adjusted it.

David Williams: Or I may be reluctant to discuss what assumptions I am making about a valuable sale.

Q93 Sir Bob Russell: Well, if not for today—the reason I ask that, gentlemen, is that it strikes me there is not much of a point in you guys selling off surplus assets if the Treasury gets it. So if the answer is the MOD keeps the benefit—

David Williams: The receipts do flow to us, but through successive spending reviews, our budget has been reduced on the assumption that we will deliver a certain level of estate disposal receipts or other asset sales. If we can beat those assumptions, we can keep the difference. We keep all of it, but the money has already been mortgaged, if you like.

Jon Thompson: The default is that we keep it, but there are exceptional circumstances when the asset sale is so significant that a different deal is done. Was it Chelsea barracks that sold for £1 billion to the Qataris? There was a different deal done there: that went to the Treasury, because it is such an exceptional one. The default is that it is retained with us, and we have every incentive to sell assets and keep the money.

Q94 Chair: There is just time to come back to one of the big issues that the Committee has been pursuing over the last two or three years. The danger of what we are hearing, of course, is that there is an increasingly—apparently—well-administered and rigorous organisation, but the gap in the whole thing is strategy: big strategic thought; big ambition; Britain's place in the world, leaning into conflicts. I suppose if we had an anxiety it would be that your description of the Chief of the General Staff as the chief executive of the Army, and indeed perhaps your description of yourself, is great in dealing with one aspect, which is management, but that we are not absolutely convinced that the shape of the whole thing is really creating the exciting, creative thought about doctrine and strategy—whatever—ahead. Is that something you recognise as a potential risk? Is it something that one could think about addressing?

Jon Thompson: First of all, I would like to take it as a compliment if you think that we are a better run organisation.

Chair: And, if I can add to the compliment, in this session you have been remarkably nuanced, honest and frank about the problems, so thank you for that, too.

Jon Thompson: We ought just to reflect on the fact that this Government obviously took what was the previous Government's governance model and developed on the National Security Council, the national security adviser and the necessary supporting Cabinet mechanisms that support the national security adviser. I think that that has been in general a good development, because it brings a more holistic approach across the Government to whatever the issues are. So, if you take Ebola in Sierra Leone, there has been some incredibly good work between ourselves and DFID and the Foreign Office to address that particular problem—and, indeed, with Save the Children and others. I think it was a good development to create the NSC, the NSA and everything that goes with that. If your question is whether that has reduced our strategic capacity to think, what we did in Levene was to create the defence strategy group, a strategy function that thought some of those big thoughts. That is currently chaired by the Chief of the Defence Staff and me. It includes the Vice-Chief and General Barrons, who you have met, David, and a couple of others. It meets on a regular basis and thinks about what the state of the world will be in 2050, what will happen as and when the ice caps of the north melt, and what that will do in terms of the security position. It can think longer and it can think bigger thoughts, and that has been a good development.

Q95 Chair: But in comparison, for example, to where we used to be, the Committee has been a bit struck that the Chief of the Defence Staff seems to be taking increasing responsibility for strategy away from the service Chiefs, so when the service Chiefs testify, they have a slight tendency to say, "Well, that's something for my employer." They were very reluctant, in fact, to talk confidently about the mission in Iraq when they were before the Committee.

In addition, there seems to be a sucking up of power—I don't know whether that is to the National Security Council or the Prime Minister—somehow away from the Ministry of Defence itself so that even the Secretary of State does not speak with the kind of confidence that, for example, a US Secretary of Defence would have in talking about such issues. Am I right in saying that in comparison to where we were during the second world war, with how our service Chiefs operated, or in comparison to the situation that the United States is in at the moment, we have created a situation in which what I would call big, grand ambitious strategy is increasingly being made at the NSC or the No. 10 level, as opposed to the service Chief level?

Jon Thompson: I would not disagree with that. A positive advantage of the National Security Council is to integrate the whole of Government when thinking about security and defence issues on a pan-Government basis, although I understand that others may have a different view. My experience of the National Security Council and the underpinning NSC officials, which is the permanent secretary level, has been that it is generally good at joining people together. It is rare to have a defence-only issue because, in general, our approach to solving problems is about governance, security and development. Unless you get those three together, countries such as Afghanistan will not succeed; they could be more stable, but they are not well run.

Q96 Chair: But Jon, the risk is that the kind of issues that you are dealing with—if we take Iraq as a case study—are very specific and require a deep level of knowledge. Working out whether the operation against Mosul will work, whether the UK contribution in air strikes is likely to be decisive, and whether the Shi'a militia are upsetting the apple carts in Iraq are things which, with the best will in the world, those sorts of grand stratospheric people—the National Security Council, the Prime Minister, and even you—simply do not have the information or qualifications to deal with. They are much more likely to come, as they do in the US system, from a much more vigorous, confident conversation in the Pentagon and the military where the CENTCOM commander considers a table and powerfully produces a vision of what is going on. They do not create a system where everybody is saying, "Hey, that's a call for the President or the National Security Adviser. I'm just here to do my job." There is a risk that although you get more coherence, you are achieving that by essentially putting the responsibility on to somebody who is unlikely to have the depth of experience and expertise to be able to challenge conventional wisdom in relation to Iraq or Afghanistan.

Jon Thompson: Sorry, who do you think that individual is in that particular sense?

Chair: My sense—correct me if I am wrong—is that, increasingly, it is the Prime Minister. Increasingly, the decision, for example, on whether to deploy very small number of troops—let's say a couple of hundred—to Iraq would be made by the Prime Minister, rather than in the US system, where it would be increasingly be made by someone down at the CENTCOM commander level.

Jon Thompson: I suppose what I am trying to adjust that view to is that there is a National Security Council that includes a wide range of Ministers. It has its principal defence adviser in the Chief of the Defence Staff. He is a member of the National Security Council and goes along to every one. He can give a defence perspective together with the national security adviser, but I think it is right to think about defence and security in the round with the Home Secretary, the Foreign Secretary and so on. I do not really accept that—

Q97 Chair: But the danger is that he is diluted, isn't it? The danger is that you have got one guy, the Chief of the Defence Staff, sitting around a table with a lot of other people. The same is true of the Defence Board. The same is true even for the sounding board you described. Every time you describe the structure, we seem to end up with one guy, perhaps with the Vice-Chiefs, sitting at a table surrounded by as many people who are really management and finance specialists, politicians or energy specialists.

Just in terms of human relations and the way an organisation works, if you really wanted to give a big voice and confidence to the military and how the military think, you would have more of those people around the table, rather than that guy just being one voice alongside the head of MI6, the Energy Secretary, the Deputy Prime Minister, the Chancellor and so on, no?

Jon Thompson: I can understand that you might think like that; I simply reaffirm my view that the National Security Council has been rather good and works really rather well.

Q98 Chair: Okay, let me pinpoint you on that. What has it done? How would we assess that it is really good? What is great about it is that everybody talks about coherence. Everybody says, "The National Security Council is great, because we've got coherence," which seems to mean that instructions go down and nobody disagrees; there are no people briefing to the press or the like.

But what has it actually done in Iraq? Let's take the biggest conflict that we are facing. There is a bigger mess in Iraq than we have had at any time since 2003. The Australians are putting in 400, and the Spanish and Italians are putting in 300. The last time we went around, we had about three British soldiers outside the Kurdish areas. Britain is barely to be seen there, and all we can see the National Security Council doing is taking an extremely non-proactive, cautious civil service approach. We are not getting the sense that the National Security Council is generating ambition or energy, or that the United Kingdom is leaning into things.

Jon Thompson: Sorry; if one might observe, you switched from "What are the mechanics and are they fit for purpose?" to "What is the policy?"

Chair: The two things are connected. My argument is that if we were to change the mechanics and the processes—if you were to put more people around that table who were genuinely excited by these kinds of issue, rather than people who come from a different background—you would be more likely to have a more proactive, energetic British foreign and defence policy.

Jon Thompson: You chose Iraq, but let me switch back to Sierra Leone. I think the integration of the Government in responding to an international crisis in west Africa has been fantastic. Whether it would have happened like that pre the NSC, I don't know, but I think the joined-up response of this Government to that crisis has been superb.

Q99 Dr Lewis: With respect, you have just chosen an example that is entirely different from the scenario that the Chairman is envisaging. Naturally, if you are getting involved with a medical disaster in a country like Sierra Leone, the fact that all these effectively civilian experts in various Ministries are sitting around the table is, of course, a great advantage, but what we are concerned about, as the Select Committee on Defence, is whether or not defence is itself being best served by having the defence voice encapsulated in large committees by a single individual or two rather than by a heavy defence presence commensurate with the emphasis on—let's put it frankly—a shooting war capability such as we are talking about whenever we talk of deploying troops. We feel—at least I think we feel—that the defence voice is, as the Chairman said, being diluted too much, or is in danger of being insufficiently regarded when it is brought into these very large committees which seem to have sucked up power in the way that the Chairman has described.

Jon Thompson: We could continue this conversation. I don't really agree with that. I don't find either the Defence Secretary or the Chief of the Defence Staff to be shrinking wallflowers who cannot express their views in the National Security Council. I am absolutely defending the mechanism—I think it has been successful—and I will continue to do so. If you want to question the policy, I am the wrong person to ask, sorry.

Q100 Mr Havard: Part of the reason why we are taking advantage of asking those questions is due to the decision-making inquiry that we are doing. Perhaps there is a bit of confusion about why we went off the money. I am not off the money; I will ask you two questions, if I may. You said that a report will be published next week on major equipment. Can you give us a clue when that will be: Tuesday, Wednesday, Thursday—that sort of thing?

David Williams: No. It depends on the grid.

Jon Thompson: It will certainly be this month.

Q101 Mr Havard: Fine. The other question is about the Budget on 18 March. Am I looking to see any major effects for the Ministry of Defence in the final Budget before the general election?

Jon Thompson: Well, if there are, we are not aware of them.

David Williams: Plenty of time still to think about that.

Mr Havard: Okay. Keep my left up and my elbows in and keep moving, is it?

Jon Thompson: Yes.

Chair: Thank you very much for your time and, again, thank you for being frank and open on the challenges surrounding cuts.