

Public Accounts Committee

Oral evidence: Strategic financial management in the Ministry of Defence, HC 392

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Members present: Meg Hillier (Chair), Mr Richard Bacon, Deidre Brock, Kevin Foster, Nigel Mills, David Mowat, Stephen Phillips, Karin Smyth, Mrs Anne-Marie Trevelyan

Sir Amyas Morse, Comptroller and Auditor General, Adrian Jenner, Director of Parliamentary Relations, National Audit Office, and Lee Summerfield, Director, NAO, and Richard Brown, Treasury Officer of Accounts, were in attendance.

Witnesses: Jon Thompson, Permanent Under Secretary, Ministry of Defence, Louise Tulett, Director General Finance, Ministry of Defence, Jonathan Slater, Director General Head Office and Commissioning Services, Ministry of Defence, gave evidence.

Q1 Chair: Welcome back, Jon Thompson. This is the second half of today's hearing about the overall financial management in the MOD. Joining Jon Thompson is: Jonathan Slater, Director General, Head Office and Commissioning Services at the MOD; and Louise Tulett, CBE, Director General Finance at the MOD. Louise, I guess you have replaced Jon Thompson at Finance—you have got his old job.

Louise Tulett: Yes, but there was one in between.

Chair: There was one in between, that is true.

Jon Thompson: Mr Williams.

Chair: That is right. I will hand over to David Mowat.

Q2 David Mowat: Good afternoon—again to Mr Thompson. When you read the NAO Report, in many ways it is complimentary, in fairness, about what has been done over the last few years since 2010, in particular on the £38 billion and the £10 billion black hole. Its hesitation is that it may not be totally clear the extent to which that black hole has been

filled by just delaying equipment procurement into the future rather than by genuine efficiency decisions and other hard decisions. Is that your view?

Jon Thompson: Getting the defence budget under control has been a combination of three things. First, we had a series of genuine efficiencies. Secondly, there were some deferrals of programmes. Thirdly, frankly, we had to cut some outputs because overall the programme was 20% overheated. It is a combination of those three things. It is all mapped out, but you are right that it is a combination of those three things.

Q3 David Mowat: You are saying it is all mapped out, so you understand how much of each component has been delivered by each of those three things, in core terms?

Jon Thompson: Yes, but you can debate what falls in which category.

Q4 David Mowat: Because they made a criticism about not tracking savings on all projects, didn't they? I guess that was getting at that point. Was it a fair point?

Jon Thompson: The fair criticism is that between 2010 and 2012 the Department was working very actively with two different Secretaries of State to ultimately get to a balanced budget. In that original package of savings, there were £4.3 billion-worth of efficiencies under the Treasury accounting methodology. It is a fair criticism that we did not track all of those in some detail. We think we have a good handle on 70% of that.

In the spending review in 2013, there was a further efficiency package worth £1.1 billion. Only six things made that up, and we have a good handle on those six. It is still a fair criticism that we need to continue to drive that. Our solution post this spending review will be the creation of an efficiency delivery board to track every single one of those measures to the detail that is probably required. It is worth reminding the Committee of the 2010 NAO Report that estimated that there was a £36 billion black hole. If one might be completely frank about it, the 2010 to 2012 period was essentially trying to rescue the Ministry of Defence from technical financial collapse, as it were. For part of that, did we track absolutely everything? No. Have we learned some lessons from that? Yes.

Q5 David Mowat: That rescue having been completed, you now have a 10-year programme to deliver £164 billion, which is a huge number¹. It is twice the deficit and is clearly a difficult thing to do. Much of it is being done by what we might generally call contract management—using contractors a lot, and all that goes with that. In your view, as the chief executive of the whole thing, have you got the skills in-house to manage those contracts? We had that exercise a few minutes ago, in which—at certain times, at least, in the past few years—that has not been evident. You have even bigger contracts, going forwards, so do those skills exist in managing contracts, understanding and aligning accountabilities, and all that goes with that?

¹ Note from witness: The £164bn is the size of the Equipment Programme (as in the EP document). This is therefore referring to the delivery of that programme, whereas what we're trying to do is deliver the whole defence programme, which is £360bn+ over the ten years.

Jon Thompson: I do not think that they exist in sufficient volume in the civil service, no. We took to the engagement, to some degree, of so-called managed service partners in defence equipment and support to teach us and our own people how we can go about improving contract management. It is a three-year engagement to try to transfer skills to us. We have been trying to recruit, extensively, additional contract managers. We are making some progress on that, but am I satisfied that we are there yet? No. We definitely need to continue on that journey.

We had an independent review of the state of the procurement and contract management function a year ago, which produced an extensive series of recommendations. We are making good progress on implementing those, but is this a journey that is complete? No.

Q6 David Mowat: One of the solutions you came up with at one time, at least, was this GoCo model, was it not?

Jon Thompson: Yes.

Q7 David Mowat: You went full for that, with Bechtel, and a consortium and all the rest of it, and in the end you pulled away from it and are now doing something completely different, because, as I understand it, you didn't feel as though the procurement was sound.

Jon Thompson: It was my view as the accounting officer at that time that we could not demonstrate value for money if we proceeded with a GoCo. Therefore my recommendation to the Defence Secretary at that time was that we cease that competition and try to find a different way forward, which we did.

Q8 David Mowat: Presumably you thought the GoCo model was the right way to go, otherwise you would not have gone into a two-year process to try to select contractors for it, with all of the effort the contractors had to put in to bid, and so on. You then decided not to do it and have gone forward with the model of your own people plus consultants.

Jon Thompson: Our view was that, conceptually, it could have been the model that demonstrated the most benefits but the only way of testing that was to take it to market and see whether it could be contracted for. In the end, it was my view that it could not and therefore I recommended to Mr Hammond at the time that we stop that and we did something else. I think that was a fair and reasonable exploration of a market solution that did not work. I think that was the right call as the accounting officer.

Q9 David Mowat: And you are happy now as accounting officer. How many consultants have you hired on a time and materials type of contract to replace what you would have done under the GoCo umbrella?

Jon Thompson: None is the answer to that. The managed service part of the contract is not largely on time and materials. The value for money case that was made in relation to the injection of managed service providers was that to inject that additional capacity, we would reduce the overall running costs of DE&S by 25% in a four-year period, and that was agreed with the then Chief Secretary. If you like, the total cost of running DE&S came down by a quarter, but in there we created enough room to inject the managed service providers to give us that capacity and capability.

Q10 David Mowat: And you are happy that is working.

Jon Thompson: I am content that we are in the early days of that. It is a three-year deal, and we are less than a year into that. We will need to be able to demonstrate that it is delivering what we wanted.

Q11 David Mowat: As chief executive, as you described yourself earlier, of the MOD, how much of your time is spent on DE&S as an area, and that £165 billion procurement programme that they have?

Jon Thompson: We ought to clarify the second half of your question. The delegated model that we have implemented does not actually put the budget with DE&S. It puts it with the military commands. The military commands are effectively using DE&S as their agent in procurement and in equipment support, so 82% of the budget actually rests with the military commands who then use DE&S as their agent in order to manage it. It is not that DE&S is running that programme; it is the agent for the Department.

Q12 David Mowat: Does that mean you do not feel that you are accountable for that as chief executive? Or are you just making the point that it is between DE&S and the commands?

Jon Thompson: No, I am totally clear that my accountability to Parliament is for the full £34.4 billion of the Ministry of Defence's budget. We have made the chief executive of DE&S a separate accounting officer for the administrative cost of running DE&S, which is £1.156 billion from memory. I am totally the accounting officer for the equipment plan and how that flows through the budget and into the accounts, yes.

Q13 David Mowat: You mentioned that you have devolved that to command. That is coming out of what they call the Levine model, isn't it? The reason for that, as I understand it, is that they wanted to align better accountability for making decisions on changes to the budget and all of the rest of it. That is critical, because that has not worked very well, has it? For the past 20 years it has been quite poor.

Jon Thompson: I have expressed my view to this Committee a number of times. The idea that you could run a 250,000 person, £34 billion organisation from a building along Whitehall was rather ridiculous.

Q14 David Mowat: So do you see it as rather better now? Is it working better now in relation to command?

Jon Thompson: I think the alignment of authority, responsibility and accountability is absolutely the right thing to do. Who could argue with the principle that the best people to run the Army are the Army Board, with delegated authority, working within a framework?

We require the Army to produce a command plan that sets out how they will go about meeting the Government's and Ministers' targets, what projects they have, how much manpower they have, how much money they have. Then we can use that to hold them to account.

There are plenty of examples of where military commanders have used that flexibility to their benefit within their delegated model, and I continue to believe that is the right way to run the MOD. It has a number of different risks from running it centrally, but I continue to believe that is the right in-principle way to run the MOD.

Q15 David Mowat: One of the points the NAO made for a potential weakness in that structure is that where a command makes a decision to reduce scope—to take something out—there was not clarity that they would get the budgetary credit for that. It might just be sucked up and used somewhere else. What is your view on that?

Jon Thompson: That part of the Report is technically correct. As is visited upon us by the Treasury, I'm afraid, we have to have some flexibility in that you cannot guarantee that all seven major budget holders at the MOD are behaving in the same way. I need some flexibility to be able to say, "You are underspending here, as are colleagues, but unfortunately you are overspending here." I need to be able to take the overall position of the MOD into account, therefore I cannot give you complete certainty. The general principle is that you can recycle your underspends, but I need to be able to have at least the opportunity to take the overall position into account, so if you do underspend, I may need that to be able to counter an overspend in another area of the budget. That is the element that I need to be able to control.

Q16 David Mowat: So your view is that the National Audit Office observation is theoretical and that the alignment works in practice and that if people do reduce scope, they will get the credit for that.

Jon Thompson: I am saying that it is absolutely possible that they could use it. It is subject to an agreement with my good friend to my left, Louise Tulett, because it depends on what it is that they are doing. We continue to hold a function called the military capabilities function. Air Marshal Hillier regularly attends this Committee to talk about the equipment plan. His role is to make sure that the equipment plan is coherent overall and that people do not change their programmes significantly because of the financial incentives and then not deliver the outputs. You can, as it were, flex the system for your benefit and then not produce

the outputs, but we need both financial discipline and outputs to be produced. His job is to cohere all of that and check that it actually does work.

Q17 David Mowat: Just to be clear, following the problems that have existed for the past two decades with defence procurement in this country, you think that the way forward, with this new model that has been put in place, is better, although it is early days, than it was.

Jon Thompson: I think it is better than it was, but, as I said in answer to Mr Phillips's question earlier, all models of running the Ministry of Defence have risks because of the inherent nature of the programme. The model that we are running has different risks, but it is a better overall model.

Q18 David Mowat: That is true. An issue might be the extent to which you benchmark yourself against others. There are not very many. There's the French and perhaps the Americans and the Germans. Do you do any of that? If so, what are the results?

Jon Thompson: Yes, we do international benchmarking of the health of our organisation and also of various capabilities, such as the ratios of pilots to planes and so on, because we need to improve the productivity—to use that word—of military forces. Typhoons are expensive and you want to buy the minimum number necessary to produce the outputs, therefore benchmarking yourself against—

Q19 David Mowat: I am interested now that you have said that you do that. In a way, it is a measurement of bang for buck. How would you compare the bang for buck that you achieve versus that which the French achieve? There may be many comparisons, but are there certain areas in which you believe yourself to be better than them and others in which you need to catch up? That would be good to share.

Jon Thompson: We have used McKinsey, as do the Treasury and the Cabinet Office, to benchmark us against a basket of 20 different countries. We generally come out of that well. Are there areas where we could improve our productivity? Yes, there definitely are.

Q20 Chair: Such as? Do you have any examples?

Jon Thompson: Ratios of people to equipment is particularly relevant. One of the financial efficiencies that we think we can drive—the Defence Secretary has begun to talk about this in various speeches in the run-up to the SDSR—would be to try and reduce to the minimum the amount of kit necessary to be able to produce the outputs. Essentially, equipment is much more expensive than—

Q21 David Mowat: Is that McKinsey report something that you can share with us?

Jon Thompson: I can certainly go and have a look at whether it is or not. We would certainly be able to make it available to the NAO.

Q22 David Mowat: Can I ask Louise Tulett a question on a slightly different tack? How much inventory does the MOD have?

Jon Thompson: Net or gross?

David Mowat: Either. Start with gross.

Jon Thompson: Gross, it is a shade over £30 billion on the balance sheet of what would traditionally be called stock, plus capital assets that essentially are in an inventory because we capitalise inventory.

David Mowat: So you have £30 billion of inventory.

Jon Thompson: It has been steadily coming down.

Q23 David Mowat: Net?

Jon Thompson: Net is very much lower than that. It is something like £12 billion.

Louise Tulett: I've got £6.8 billion in the accounts.

Jon Thompson: It's significantly distant.

Q24 David Mowat: Never mind the accounts then. Of that £30 billion, how much is obsolete?

Jon Thompson: Less than it was the last time the Committee asked me.

Q25 Mr Bacon: Do you still have the spare wings for the Nimrods? The NAO did a Report specifically on this, didn't they?

Jon Thompson: I think we have disposed of the Jaguar parts in the past few years. On the financial accounts audit, if you go back four years, I think, the gross value was £40 billion, so we have been, rightly, rationalising the amount of stock because there are ongoing savings to be made from warehousing, people and so on. We have been on a journey.

Q26 Mr Bacon: While we are on this—this is absolutely relevant—the NAO did a Report specifically on infantry management. One of the fears we had at the time was that there would be an attempt to outsource the management of the infantry before you knew what it was that you had. It is a maxim that if you have a problem and you outsource it, you don't

solve it, you relocate it. We were very concerned, I seem to remember from whenever the NAO Report was—a couple of years ago, perhaps?

Lee Summerfield: 2012.

Mr Bacon: 2012, thank you. We were very concerned that you not do that, so where are you now compared with where you were when the NAO looked at that and published its Report and we took evidence on it in 2012?

Jon Thompson: I am sure that the Comptroller and Auditor General will be able to assure you that we have been on a very fruitful journey. We have cleared up the—*[Interruption.]* Well, we had three qualifications of the accounts in this respect, and last year eventually got to no qualifications of the accounts on this particular issue; overall, we have gone from five to one. We think that the rationalisation of £30 billion has taken us far enough to now be able to outsource, so we have announced an outsourcing of this to an American organisation, whose proposition is to build a so-called supershed in the West Midlands.

Q27 Mr Bacon: Which American organisation?

Jon Thompson: Leidos, I believe it's called. This is called the logistics and commodity services transformation programme. We think we have come far enough on the journey to get someone else in to rationalise the remainder.

Q28 David Mowat: I don't think you said how much of your £30 billion was obsolete.

Jon Thompson: No, I didn't. Given that the net number on the balance sheet is £6 billion, you would have to assume that a good deal of it remains obsolete. There is definitely an opportunity for us to further rationalise and sell.

Q29 David Mowat: So you have £24 billion in obsolete inventory—is that what you just told me?

Jon Thompson: No, no, I did not say that. I said that we had written down the value, so there is definitely some that is going to be obsolete that needs to be disposed of.

Q30 David Mowat: Why would you write down the value if it wasn't obsolete?

Jon Thompson: Because some of it is capital assets that are being depreciated; they may still have some further useful life. You are mixing together fast-moving things with slow-moving capital items. If you buy three propellers and need only two, you capitalise that propeller at whatever it is—£25 million or whatever. That goes in, you depreciate that over its life, but it may still have some use, so it is not necessarily obsolete, even though you are depreciating it.

Q31 Mr Bacon: While we are on benchmarking—it was only because Mr Mowat was talking about infantry management that I remembered the Report from three years ago—do you benchmark yourselves against the Israelis?

Jon Thompson: In the basket that you were asking me about, yes.

Q32 Mr Bacon: You do. So for all aspects of acquisition and procurement, for example, you benchmark yourselves against the Israelis.

Jon Thompson: I didn't say all aspects of acquisition.

Q33 Mr Bacon: Right, perhaps not all, but procurement in particular they do very differently and much more leanly.

Jon Thompson: Well, they have a very different underlying industrial base and approach to competition than we have.

Q34 Mr Bacon: Yes, and getting it right is also more of a survival issue for them, isn't it? They seem to do a better job—they get more bang for their buck.

Jon Thompson: There are definitely things that we can learn from a wide range of international partners. We have done some benchmarking work, but there are still things for us to look at.

Chair: We welcome the fact that you will be sharing that with the NAO at the very least, if not more widely. That is really good news.

Q35 David Mowat: I said at the start that on the whole the Report was quite complimentary. An area on which it was less than complimentary was infrastructure—or it had more concerns in that area. In particular, it highlighted a mismatch of expectation between the centre and the commands about what is needed—is it an £8 billion gap in expenditure going forward?—and then there is the whole Capita contract. Would you like to comment on that?

Jon Thompson: Yes, sure. It is worth filling in a bit of history first. Long-standing members of the Committee will remember the famous NAO Report of 2010, which frankly said that we had no data on the state of property and asset management in the Ministry of Defence. We weren't entirely sure what we owned, we had no strategy and we had no mechanics to deliver it. I am summarising the fairly hard-hitting Report of 2010, which my predecessor's predecessor tried to defend to this Committee. I think we have come a long way. For example, we have consolidated more than 70 IT systems into one IT system, and we have created one single organisation instead of a multitude of organisations that focus on infrastructure.

Q36 David Mowat: So there were 70 systems dealing with the estate.

Jon Thompson: Yes. That is in the original 2010 Report. There was a multitude of organisations, so people were under the impression that Defence Estates, as it was called then, was running all property and asset management in the Ministry of Defence, but it wasn't; it was actually covering only 65% of the estate at that point. We created the vehicle to put everything together, and we have significantly changed the IT system, which has led us to a much better understanding of the estate. We can see two things now, we think. First, we can see the opportunity to rationalise the estate on the basis of the data that we have. The flip side of that is that you can also see what the historic underfunding of infrastructure is over a number of decades.

In relation to the £8 billion, you know as well as I do that if you say to somebody, "Would you like to change your infrastructure?" they tell you absolutely everything they would like, so we don't accept that we necessarily have to tackle £8 billion. There is a process that will rationalise that down to what we actually need to do and prioritise the money we have got to tackle the gap.

Q37 Deidre Brock: Do you have an estimate of what the gap is?

Jon Thompson: It would certainly be in the low billions.

Q38 Stephen Phillips: It is £8.5 billion, just for the record.

Jon Thompson: Sorry, with the greatest respect it is not £8.5 billion.

Q39 Chair: We will let Lee Summerfield adjudicate in a minute. Jon Thompson, give us your view.

Jon Thompson: The process we have been around—Mr Slater has been part of this—is that if you say to all of the military commands, "Which of your infrastructure requirements can you cut? Can you cost it up?" you will get a bill that is more than the taxpayer necessarily needs to meet. It is correct that at this point that gap is estimated at more than £8 billion, but a process of going through what people want and saying, "I know you would like that fantastic new thing. Actually, what you need is this", will lower the bill. That is why my answer to you is that the bill will still be in the low billions, but it will not be £8 billion.

Q40 Chair: Mr Slater, you deal with the commands day to day. How do you make sure that they are not putting their needs higher than the needs of the taxpayer?

Jonathan Slater: We are, as ever, on a journey here—

Chair: Another journey.

Jonathan Slater: Yes. Apologies, but there it is. In the first instance, what we did last year with the support of our strategic business partner was to look at all the things that the commands wanted. That was about £2 billion a year. We were allocated about £1 billion a year, so if you look at it over 10 years, you get that £8.5 billion gap. We did a serious prioritisation exercise for the first time in a few years, and we prioritised the things that were most required for military capability purposes, health and safety purposes, sustainability purposes and so on. We agreed a programme that we could afford of £1 billion a year for the next 10 years². The reason why I describe it as a journey is that we need to fix the gap you have just been talking about. The way to fix it is by agreeing a sustainable size of the defence estate for the future, which is significantly less than it is at the moment. The way to fix the problem is to have less estate than we currently use.

A parallel piece of work that we are doing with the strategic business partner is working out what size the estate should be. We have looked at all 1,300 sites that we use—this is more than 1% of the UK land mass. We have identified that 300 together represent about 85% of the resource spending. We have worked with the strategic business partner and the Commands to identify which of those 300 sites we should get out of. We are in negotiation with the Treasury and the Commands at the moment, feeding into the outcome of the strategic defence review, about how much smaller the estate will be, so that we can fix the gap through a combination of disposal receipts, a more efficient estate and the fact that we will need to spend less on a smaller estate in the future.

Q41 David Mowat: Of the 1,300 sites that you have, how many do you expect to have in 10 years?

Jon Thompson: We have set ourselves a goal of reducing the estate by 30%.

Q42 David Mowat: Okay, so you expect to have 900 or so?

Jonathan Slater: There are different sizes, but we expect to reduce the estate acreage by 30% by 2040.

Jon Thompson: The point of developing a footprint strategy is so that military colleagues and, subsequently, Ministers can engage in what is undoubtedly a complicated rationalisation of that estate and make some decisions about what to move off, what not to move off, what is the value-for-money case, and so on. We are in the middle of that process now, and we have had a run around what is called the footprint strategy several times. We are preparing to put that before Ministers to see which of those sites we will recommend getting off.

² Note from witness: The £8.5 billion figure PUS and DG HOCS quote in answers 35 to 40 relates to estate maintenance and change and is thus the same figure quoted in paragraph 1.25 of the NAO report on Strategic Financial Management [<https://www.nao.org.uk/report/strategic-financial-management-in-the-ministry-of-defence/>]. This alleged funding shortfall is against the future aspirations of the Commands, not against current plans which provide funding of £8.4 billion (net) over the ten years from 2015-16. The MOD recognises that the demand for infrastructure investment is not matched by the available resources. This issue has been addressed by the introduction of a new pan-Defence prioritisation system for infrastructure investment.

Sir Amyas Morse: I have a question about the balance between capital and revenue expenditure and between what I call discretionary and non-discretionary spending. Are you in control of that? Looking back a few years, I would have said that the discretionary spending in the Department was vanishingly small, and very often what I would describe as revenue maintenance and soft programmes got sacrificed to deal with equipment variances. Have you got that under control now? In other words, the balance. We are talking about capital programmes: every capital expenditure carries with it a support and maintenance liability requirement. You cannot really have one without the other. How do you see that?

You mentioned earlier, Mr Thompson, the approach of having the minimum amount of kit possible. That presumably creates more tension in the system, because if for any reason—I am thinking about air training and other such things—that kit cannot be used efficiently, that will immediately, or much more quickly, start impacting on capability, because you do not have slack in the system. I am interested in your thoughts on those slightly managerial points.

Jon Thompson: The latter is definitely true; the tighter you draw individual elements—for example, you rationalise equipment—the better the value for money for the taxpayer, but it raises the risk to the running of the organisation. So you are right.

Sir Amyas Morse: It might be cheaper, but that is not necessarily better value for money for the taxpayer?

Jon Thompson: I am sure that the taxpayer would like me to rationalise fleets of equipment if we are not using them. You said it was managerial; it seems to me that it is right to try to rationalise the estate and rationalise fleets to the minimum required to produce the outputs.

On your first question, the capital budget over a very long period of time has been dominated by equipment—you reported on that extensively in 2010—to the detriment, to some extent, of the infrastructure of the organisation. I do not think we had the balance of those two things right. We are attempting to shift that balance and protect a line of capital funding into the future of £1 billion a year for us to invest in the infrastructure to improve the quality where we are staying, but also to rationalise, because in the end the number of people working in the Ministry of Defence in the United Kingdom will increase—there will be more at the end of this Parliament than there were at the beginning and our outputs will be higher if we follow this productivity route. So if we are now asked to rationalise the estate, we are almost certainly moving the task somewhere else, and that requires some transitional costs that come from the capital budget. I think we are in a reasonable place.

Q43 Deidre Brock: I want to ask a bit further on the footprint that you mentioned. Can I get clarification around whether the savings of over £1 billion from the submarine programmes and £1.2 billion from complex weapon programmes include Trident?

Jon Thompson: The submarine enterprise programme, which I think is the £1 billion that you are referring to, is submarines in the round; so, by default, yes is the answer.

Q44 Deidre Brock: Paragraph 1.23 talks about managing “a diverse and geographically dispersed estate”. I am a Scottish MP so you may expect me to ask what consideration the MOD makes or has towards defence spending and the impact that that has on the nations and regions of the UK. I understand it is common practice in Canada and the US, for example, for that to be taken into account.

Jon Thompson: The last significant rationalisation of the estate took place when Mr Hammond announced a series of changes to the reserves—in 2012, I think that was, or it might have been 2013. Ministers, I think, were very exercised by what did that mean for all nations in the United Kingdom, and they certainly took that into account. Does that answer your question?

Q45 Deidre Brock: No, but there is no sort of formal procedure that you have to go through in order to—an impact assessment, if you like, when you are looking at these?

Jon Thompson: We have to think about what is the most rational laydown and the most efficient laydown in the United Kingdom; but clearly there are aspects of those decisions that affect devolved Administrations. We do think about those carefully. I know Ministers do; and I am saying the last time we did this that Ministers were very mindful of the impact on the devolved Administrations.

Q46 Deidre Brock: But there is no standard procedure, if you like, that has to be gone through before these decisions are taken.

Jon Thompson: I am not—

Chair: That is straying a bit into policy.

Q47 Deidre Brock: Yes, okay, sorry. Can I ask, though, just with regard to the subject of defence spend, as I understand it the MOD has in recent years begun to refuse answering questions from colleagues, on Defence questions, specifically regarding regional and national defence spending. Is that your understanding?

Jon Thompson: Not that I am aware. I think it would be extraordinary if you were to lodge a parliamentary question and Ministers were to refuse to answer it. Ministers, I think, would have to clearly state why they were not answering a parliamentary question if you lodged them. We do produce regional statistics, I believe, that we publish. I think that is available on the public record. We could point you in the direction of that.

Chair: I think if questions are not being answered we can raise that elsewhere.

Q48 David Mowat: Just to finish off on the DIO stuff, I suppose I was reflecting a little bit on your answer, in terms of you said that this £8 billion, this hole that exists, is because the command have all these requirements—because they would have, wouldn’t they, and you just ask people for stuff and then you have to now go through a process of shifting it

and figuring it all out. That is exactly the process that you have got out of doing in the DES area, isn't it, by the whole reorganisation that you have done structurally, because that is the behaviour that you try to stamp out. I am just wondering why you don't try and stamp it out in the DIO.

Jon Thompson: Because we believe that a sort of grand rationalisation needs to take place, and you can only do that if you stand back at a defence level, because on that basis you can begin to integrate the services more; and it is my view that if we were at this particular point to delegate the infrastructure budget back to the commands—it is worth remembering that we took it centrally, because it was delegated to some degree—we would make much slower progress on rationalising the estate.

So I think this a moment where you look at the overall strategy; you make some big decisions about rationalising the estate; but the Report is right in that at some point—we think probably 2017—we need to incentivise the military commands in relation to infrastructure spending. So we have agreed with the Chancellor of the Exchequer that we will try to design a system which incentivises the commands and probably delegates them back with running costs, in 2017.

Q49 David Mowat: So you are saying you have brought it back into the centre to fix it and that in 2017, it will be the same supply and demand structure that you have implemented in DES. That is your vision at the moment.

Jon Thompson: That is my vision—that DIO should be the agent for the commands.

Sir Amyas Morse: So you will effectively be renting it back, more or less, to the commands. That is what you have in mind.

Jon Thompson: I think the Chancellor has announced that this is to happen to all public sector assets, and there is no reason why that should not apply to the Ministry of Defence.

Q50 David Mowat: On a separate subject that interests me a lot, are litigation costs something that has increased in your Department over the past two or three years?

Jon Thompson: Yes.

Q51 David Mowat: Do you have a sense of how much you are spending on it now? That is money coming out of the frontline, isn't it?

Jon Thompson: Because the Government runs a self-insurance system, essentially, the cost of litigation, civil claims compensation and so on has risen. I would have to give you a written answer if you wanted the exact details. From memory, all in—litigation, civil compensation, compensation for low flying that kill somebody's horse or whatever—

Q52 David Mowat: I was thinking more of the al-Sweady type stuff.

Jon Thompson: We live in a litigious society, so my general answer is yes. We do not separate it out into parts. The overall budget for that element, from recollection, is more than £100 million a year.

Q53 David Mowat: Is that £100 million a year on al-Sweady type stuff or the general area?

Jon Thompson: No, on all aspects in the answer I gave you. I am happy to give you a written answer if that would help.

Q54 David Mowat: Yes, that would be useful. On al-Sweady, the Secretary of State did say in the House of Commons that he was going to try to get some of the money back from the lawyers that had taken legal aid and perhaps should not have had it. Do you know, from an MOD perspective, whether that has happened?

Jon Thompson: I am not aware of us being able to recover any of that.

Q55 Kevin Foster: A quick declaration of interest, given that we are talking about the estate: my father is a pensioner from Babcock, where he spent 37 years working in Devonport dockyard. I am interested in how you factor in some of the wider financial objectives in terms of driving value from the estate when you are looking at the rationalisation of it—for example, changing the border wall at Devonport is releasing a very large, quite lucrative development site that will create quite a lot of jobs and, bluntly, drive other objectives for the taxpayer. What consideration is given to that when looking at the estate, much of which, let's be blunt, is second world war era and where it has been a case of "make do and mend" for some time?

Jon Thompson: You're right; some of it is in that condition, and there is a great legacy from decades past. Some of it is world-class, frankly. I can take you to some of them, if you wanted to see a world-class facility—Aldermaston, for example.

Chair: I think we know the point that Kevin Foster was trying to make.

Kevin Foster: To clarify, there are parts of Devonport and parts of the base that are absolutely world-class and doing amazing work on refitting. There are other parts that are from the 16th century.

Chair: We can take that as read; we know that.

Jon Thompson: It is certainly in our interests to be able to reduce the footprint to release other economic value—for example, selling land for house redevelopment, which I guess you will ask me about in a minute. I have that answer.

Chair: It will be the first, if you have.

Jon Thompson: Devonport is a really good example of where we have reduced our footprint and released it for further economic activity. That is absolutely part of what we will want to do.

Q56 Nigel Mills: Can I just ask a couple of questions about the single-source contract rate methodology consultation that was published relatively recently? It looks, on first reading, to someone who does not really understand this kind of thing, that about £8 billion-worth of spend goes through that a year. It looks like you have been giving the contractors far too high a profit level. Is that a concern you are trying to fix with that change?

Jon Thompson: The historical system that regulates the monopoly-monopsony arrangements between us and defence industries was originally set out in a Treasury document—not ours—called the Yellow Book. I am sure you will all be familiar with that. The last Government got to a position where we were the only Government Department in a monopoly-monopsony situation. That led to the creation of the Single Sourcing Regulations Office, and primary legislation was passed to create it. The current headline profit rate on single-source contracts is 10.6%. The consultation we are running is for five different rates in accordance, essentially, with the complexity of the contracts. There are some contracts which are inherently significantly more complicated than others, even in the monopoly-monopsony situation. So we are consulting on adopting a five-rate model. Now, you can apply a subjective judgment to whether 10.6% is or is not too much.

Q57 Nigel Mills: Well, the consultation suggests that the comparables that were used to get that 10.6% were far too broad, when you were comparing tobacco companies and pharmaceutical companies, and all manner of high-risk, high-return ventures.

Jon Thompson: Yes, and it was absolutely at the forefront of our minds when we brought forward the reform in the Defence Reform Act that the creation of an independent body would bring further transparency. That, indeed, is what the SSRO has done, and that has led on to the consultation. If the Minister for Defence Procurement was here, I think he would say that that was absolutely part of his drivers for that reform.

Q58 Nigel Mills: But how much did you overpay in profit? I mean, 10 point something percent of £8 billion means you have been giving £900 million a year profit on these contracts. If 5% was the right number, you would have been losing £450 million a year, wouldn't you?

Jon Thompson: You can simulate whatever rate you like.

Nigel Mills: I just did.

Jon Thompson: Indeed, you did, but I am afraid that I have to return to my first point: you can apply a subjective judgment to whether 10.6% is too much, enough or not enough, depending on your—

Q59 Nigel Mills: I am asking about your subjective judgment. You're the one who pays the bill.

Jon Thompson: My judgment is that the SSRO consultation is right: we should adopt a multi-tiered system which reflects more the nature of the relationship between us and the defence industry. This is a long-standing issue, which has been the subject of much debate between the Department and the defence industry over many decades. But it seems to me that the consultation is right: I don't think people should get 10.6% for relatively straightforward monopoly-monopsony arrangements, and that is what we are consulting on. I think it will release some additional value to the taxpayer.

Q60 Nigel Mills: How much?

Jon Thompson: We are not yet modelling which contracts go in which of the five. Of course, those in the industry think they will all get the top rate, but that would not be what we want to do. There may be some test of this legislation point.

Q61 Nigel Mills: You are thinking there may be a couple of hundred of million pounds of savings a year? That is what you would hope to get out of this?

Jon Thompson: I think it is perfectly possible that we would see £100 million a year in due course, when everything goes through. It is also worth being really transparent that the arrangements do apply between us and the primary contractor, but if the primary contractor then competes subcontracts, this arrangement does not apply to the subcontracts. The £8.6 billion is the headline relationship between us and the prime, but the number will reduce if the prime then competes various supply contracts. So it is not really £8 billion; the headline is £8 billion, but the actual number will be lower.

Q62 Nigel Mills: Do you anticipate that it will be quite transparent which contracts get which new profit rates, so that we can have a look at whether these people are being remunerated fairly for the work they are doing?

Jon Thompson: We will be transparent internally. I think everything is made available to colleagues from the National Audit Office; I have no problem with doing that. I think we will get further transparency about what exactly we are being charged for in terms of things like corporate overheads. An element of corporate overheads flows into our contracts, and one of the ideas of the SSRO, on which they are very focused, is: how much of the corporate overheads of all organisations are we paying for, and is that an appropriate cost? I am expecting that, over time, the SSRO will begin to knock out, as it were, disallowable costs. The additional transparency of the legislation is to the benefit of the taxpayer.

Q63 Stephen Phillips: Time is pressing, so I am going to try to keep my questions short; if we could just have straightforward answers, that would greatly help. Mr Mowat has

dealt to some extent already, Mr Thompson, with the new operating model and the delegation of greater responsibility to the commands. This Report tells us in the summary that “there remain significant gaps in their skills and expertise in this respect.” Do you agree?

Jon Thompson: They all need to continue to improve their ability to handle the relationships and the responsibilities they have. We have a reasonable handle on where they are. We have appointed a so-called acquisition support partner to help them with that. I am sure Mr Slater can go into that if you want. Are we where we need to be yet? No.

Q64 Stephen Phillips: So there remain significant gaps in their skills and expertise. You are agreeing with me.

Jon Thompson: I am saying they all need to improve.

Q65 Stephen Phillips: It is a serious risk for public money, given that a very large percentage of your £34 billion budget is now being spent by the commands, isn't it?

Jon Thompson: Eighty-two per cent of the MOD budget is being spent by the five military elements of the Ministry of Defence. We have some safeguards in relation to the function that I talked about earlier—the military capabilities function. We have a Command plan that transparently sets out what they propose to do and how much money they have. I have a quarterly holding-to-account process that says, “We agreed a plan. How are you doing?” So we make it all transparent.

Q66 Stephen Phillips: I am sure you do, but you have accepted that, to use the words that have been repeatedly used in this hearing, we are on a journey. In other words, their skills and expertise need to improve, and they are spending, I think you said, 82% of your £34 billion, so that is a serious risk for public money. It is a risk out there. It may not eventuate, but it is a risk out there, isn't it?

Jon Thompson: Yes. I think in answer to the questions to my right, I was clear that this model has different risks, and you are definitely highlighting one of them. If you delegate responsibility down an organisation, you risk losing transparency and you definitely need to increase the capacity of people in the delegated model to be able to handle the responsibility.

Q67 Stephen Phillips: Let's look at some of those specific risks. Could you look at figure 9 on page 29 of the Report, please? Here is the figure that identifies the “percentage of finance staff”—people who are responsible for money—“who hold, or are working towards, a professional accountancy qualification”. We could run through each of the commands and head office or main building—whatever you want to call it—but let's look at the numbers for the Department as a whole. Of the finance staff who one assumes need accountancy qualifications or at least some knowledge in this area, 20% have them, 22% are part-qualified and 58%—over half—have no accountancy qualification. That is extraordinary, isn't it?

Jon Thompson: No, not necessarily. It is perfectly possible to—not everyone who works in a finance function is a qualified accountant.

Q68 Stephen Phillips: Okay, but could you look at paragraph 3.14 on page 36 of the Report? This deals with achieving benefits from financial management. Paragraph 3.14 states: “The Department does not use the skills of its finance staff to best effect.” You conducted a survey about this. If you look at the penultimate sentence, the survey “found that staff report that they have gaps in the basic accountancy and analytical skills they need for their roles.” So here you are. Of the finance staff who work for the MOD—I have the numbers for the Department, not just the percentages—58% of people have not qualified, and your own survey has told you that your own staff think they are not up to the task. That is a significant risk, isn’t it?

Jon Thompson: I think you are potentially over-emphasising the risk. There are a significant number of very good qualified or part-qualified people, including members of the Association of Accounting Technicians. Do we need to further increase our capacity to do the task? Yes. I am sure Mrs Tulett could tell you about the programme for increasing financial skills in the organisation.

Q69 Stephen Phillips: I am just trying to identify what the risks are. You agree with me that it is a risk that people do not feel that they have the skillset necessary to do the job, yes?

Jon Thompson: It is a risk that we do not have enough capacity in the finance function to handle the overall situation, but we have significantly improved the situation.

Q70 Stephen Phillips: The second risk, I suggest—tell me if you disagree—is that if you need to make savings from the defence budget, and we know that you do, money has to be taken away from the commands that otherwise they would be spending. That somewhat undermines the model that you have now put in place, doesn’t it? There is a risk that money will have to be taken away from them that had been promised to them.

Jon Thompson: Not necessarily.

Q71 Stephen Phillips: “Not necessarily” is not an answer to the question. Is it a risk or not?

Jon Thompson: You asked the question, so let me see whether I can answer it. The model we have run for the spending review is to ask the commands how they could be more efficient and then to take that answer to Ministers so that we are not doing this from the top down. Now that potentially reduces the risk if what that is saying is that they can improve their efficiency and productivity in this way.

Q72 Stephen Phillips: The next risk, I suggest, is this: you have explained why the commands do not manage their own infrastructure budgets. That relates to paragraph 2.15 of the Report, but the NAO notes that: “The Commands told us that they have limited influence on prioritising estate investment and no ability to hold DIO to account for delivery.” That is another risk inherent in the model that currently exists, albeit that you want to give them back responsibility by 2017, I think you said.

Jon Thompson: What do you think the risk is there?

Q73 Stephen Phillips: The risk at the moment is that they do not manage their own infrastructure budgets.

Jon Thompson: Yes, and I think I have explained clearly why they do not run their own infrastructure budgets. When they were run by the various military commands, it was consistently deprioritised in exchange for other elements of the budget, leading to the situation that Amyas Morse asked me about. We are trying to achieve some overall goal of rationalising the estate, and that has to be good news for the taxpayer. Their influence on prioritising estate investment is through the so-called infrastructure joint committee. They all have representatives at three-star level. They bring forward the prioritisation of capital spending. Does it meet everyone’s needs? No, but they are on that committee and they influence the outcome.

Q74 Stephen Phillips: I think you have already accepted that delegating down to the commands creates with it an inherent risk. Obviously you are still the accounting officer. You have referred to quarterly meetings just to check that they are spending the money well. Is that right?

Jon Thompson: No, there is a significant number of elements of the corporate governance model that we have enhanced along the delegated route, and I can go through that if you wish.

Q75 Stephen Phillips: I am not sure it is necessary. If you look back at the summary at paragraph 10, if they save money, they do not necessarily get to keep it, do they?

Jon Thompson: No, and I think I answered that question earlier.

Q76 Stephen Phillips: That is a risk, though, is it not? You are not incentivising them, therefore, to save money and to spend taxpayer money well because there is no incentive for them to do so, because they do not get to keep it.

Jon Thompson: And I think my answer was not that, in relation to the question over there. It is absolutely in their interests to try to save money, and it will largely be returned to them, but I need the safeguard given the overall financial position.

Q77 Stephen Phillips: Turning to the equipment budget, you need to find savings of about £6 billion over these 10 years. There was a little bit of discussion about that earlier, but is that right?

Jon Thompson: Yes.

Q78 Stephen Phillips: The Report tells us that you have identified £3.3 billion of potential savings. There is an assumption that you will find another £3 billion. Where will that come from?

Jon Thompson: You are about to get a further report on that, I think. Although I am not quite sure when that will be—I think it will be in the next two weeks—it will give you some further information in relation to that question.

Q79 Stephen Phillips: Fine, but what the Report tells me—I can find the paragraph if necessary—is that you need to save £6 billion. You have identified £3.3 billion. There is a shortfall of about £3 billion and where those savings will come from is as yet unidentified.

Jon Thompson: That does not mean that in nine years' time I cannot necessarily identify those savings. We were asked to find £3.5 billion in the last spending review over a 10-year period. That has been widely reported. In the previous NAO Report, it was £350 million a year. Against that target, we have passed £3 billion, but we need to continue to drive the savings in the supply chain. We have been through 40% of the equipment plan to get more than £3 billion.

Q80 Stephen Phillips: I am looking at where we are today. You still have £3 billion to find. Is that right?

Jon Thompson: Sure, and my answer is that on the basis of reviewing 40% of the equipment plan, we have identified more than £3 billion of savings. There is a remaining 60% of the equipment plan to go.

Q81 Stephen Phillips: All I am trying to identify is what the shortfall is in the equipment budget at the moment. You have to find £3 billion of savings that are as yet unidentified and you are confident that you can identify them.

Jon Thompson: Yes. You are definitely pointing out one of the risks inherent in the forward budget, yes.

Q82 Stephen Phillips: The trouble is that there is an assumption built in here that you will find that £3 billion. We talked about assumptions in the first part of this hearing. The problem with MOD assumptions—for example, the carrier programme is going to cost £3 billion, but it ends up costing £6 billion—is that they very often seem to prove wrong. So

there is an assumption in there. There is £3 billion more in savings to be found in the equipment budget from the remaining 60%. You are confident that you can do it, but it is an assumption.

Jon Thompson: But there is a range of assumptions, and you are definitely picking one. Counter-controls built within the equipment plan overall mean that if you do not deliver that saving then you have sufficient safeguard on the spend side of the equation. So, for example, the primary problem with the carrier decision was that you could not afford the short-term expenditure and so the project was delayed. I think I said to this Committee at a previous hearing that we had introduced some discipline, so that once we have something on contract you do not change that contract, because it destroys the taxpayer's—

Q83 Stephen Phillips: Fair enough, but all I am doing is pointing out that other assumptions made in the past have turned out not to be correct. I could give you as an example the 30,000 reservists that we do not have, but let us leave it to one side.

If we look at staffing costs, you are looking to reduce military and civilian staff to 196,350 by 2020—that is what the Report says—but there is also a risk of £6.5 billion of costs as a result of workplace inflation, which at the moment are unfunded. That is right, isn't it?

Jon Thompson: No.

Stephen Phillips: Paragraph 1.22, just above the first bullet, three lines up: "It"—the Department—"has estimated that if the current public sector pay assumptions change, workforce cost inflation may outstrip its planning assumptions by £6.5 billion over ten years." Is that wrong? Is that not what the Department told the NAO?

Jon Thompson: If the current public sector pay assumptions change, then it is true that it would outstrip assumptions by £6.5 billion. If the current public sector assumptions reduce, actually the cost to us would go down against what we have assumed. For example, we have assumed in the forward estimate of costs that pay increases for the military would return to normal running rates. If the Government's pay policy, yet to be announced, is not to do that, then the cost will come down. So that is correct if it goes up, but equally if it comes down the cost will come down.

Q84 Stephen Phillips: Worst-case scenario, just for a change—you might have to find an extra £6.5 billion that you do not yet have.

Jon Thompson: No, I am confident that that is not going to happen.

Q85 Stephen Phillips: Are you predicting what the Chancellor's public sector pay settlement will be for the next few years?

Jon Thompson: I think that it is quite a difficult question to answer in the middle of a spending review negotiation.

Q86 Stephen Phillips: Okay. All I am suggesting to you, and you are disagreeing with me, which is fine, is that there is a £6.5 billion potential shortfall, which is what the NAO found. You do not think that it will eventuate—that is all you are saying.

Jon Thompson: No, the NAO has not found a shortfall; the NAO has pointed out a risk.

Q87 Stephen Phillips: All right, it is a risk—I called it a shortfall, but it is the risks that I am trying to identify. I have £3 billion in the equipment budget, that is a risk; I have £6.5 billion here in staff pay, that is a risk; now let us come back to the defence estate. Mr Mowat has already tackled you on the £8.5 billion potential shortfall if the commands got everything they wanted and you described it as “low billions”—so that would be another few billion pounds. So there are potentially risks here that I have managed to identify through the NAO Report of £3 billion in the equipment budget, £6.5 billion on staff and low billions on the estate, you say, or £8.5 billion, the NAO says if they got everything they wanted. So we are up at the £20 billion potential risk of black hole by the end of this Parliament again. Is that right?

Jon Thompson: No, it’s not going to happen.

Chair: Will you expand, Mr Thompson?

Jon Thompson: It is not going to happen because, with the greatest of respect—I have no disagreement with the way in which the NAO does this—the sentences here start with “if”. Well, you know, if inflation reaches 10% then the Ministry of Defence budget will be in significant difficulty. There are a number of risks—we are always running a number of risks—and this is one of them. If that happens, then that may be the quantification of the financial impact, but I do not believe that that risk will materialise.

Q88 Chair: Mr Thompson, Mr Stephen Phillips is right. We have talked about this beforehand, about the assumptions in the savings, the risks that are there. You are a candid witness. Can you tell us the assumptions that keep you awake at night: the ones that you worry might not be on target? As you say, there are many ifs and buts here, but there must be some that really worry you. What are they? What are the things that really are a risk to the budget?

Jon Thompson: The project that I worry about most in relation to future financial risk is the nuclear enterprise, which is a significant element of the overall equipment plan and is in the equipment plan review report that is to come in couple of weeks. That is the project that most keeps me awake at night. It is the biggest project the Ministry of Defence will ever take on. The annual cost of the annual nuclear enterprise is in excess of £3.5 billion. If the Government proceed with renewing the deterrent, in due course that would exceed £5 billion a year. That is a significant proportion of the defence budget and is an incredibly complicated area. There has been a significant change in the governance of the nuclear enterprise. I am now chairing the nuclear enterprise board, reporting directly to the Defence Secretary and

other interested Ministers, including the Chancellor of the Exchequer. That is the single biggest future financial risk we face. I am content that I can manage this one. I think I can drive more in the supply chain on the equipment support plan, but that project is a monster and it is an incredibly complicated area in which to try to estimate future costs. That is the one I worry about.

Q89 Stephen Phillips: All I really want to know is from the perspective of public money. In 2010, the NAO did its report and a £36 billion black hole was suddenly found in the MOD's budget over a 10-year period. Obviously, we never want to be in the position again where there is a black hole of anything like that. Are you confident and can you tell Parliament through this Committee that that will never happen again?

Jon Thompson: I am reasonably confident—I will stick my neck out—that while I remain the accounting officer we can control the finances. You have pointed out a number of potential downsides, but the Report from NAO colleagues will highlight the fact that we are holding a contingency and various risk provisions of many billions of pounds. We have not forward contracted the equipment plan at the rate we used to, so in the current financial year only 70% of the equipment plan is on contract. By the time we get to 2021, it will be only 23%. We have created a mechanic that gives enough room to manoeuvre, so that if you did lose control you could still remain within the overall parliamentary limits. You can debate those risks and you are obviously highlighting some of those we face. We think we can manage them.

I also advance to you that I think the Ministry of Defence can be more financially efficient. There is more taxpayer value to be driven out. I would expect us in the spending review to come forward with a significant further financial efficiency package of between £15 billion and £20 billion over the next 10 years, and then you will definitely need a track of whether you are delivering those over time. The Ministry of Defence's budget is a hugely complicated number of interacting variables that Louise and I must manage, and you are definitely picking up some of the ones we have to match.

Q90 David Mowat: Two things happened to you this summer. One, you were asked to provide another £0.5 billion of savings this year. The other is that you were told that you would get 2% of GDP which, presumably, potentially works in the other direction. On the £0.5 billion, where will that come from? Presumably that is identified.

Jon Thompson: Yes. We have deferred a range of programmes. You have that flexibility because you are not on contract and can defer some programmes and say, "I will not start in 2015; I will start in 2016 or 2017."

Q91 David Mowat: So you have taken it out of the DE&S budget by just putting something back a bit?

Jon Thompson: We have deferred a series of programmes, the budget for which is with the military commands, with the agreement of Ministers to move those projects back.

David Mowat: That is not an efficiency saving, is it? It is just a timing difference.

Jon Thompson: Correct.

Q92 David Mowat: What do you envisage happening with the 2%?

Jon Thompson: Just so we are clear, 2% for defence is not the same as 2% of GDP for the Ministry of Defence. There is a difference between the two. The Chancellor also announced that the Ministry of Defence budget will increase by flat real plus 1%. That is not the same as 2% of GDP. Sorry, I meant to say 0.5%. I was being ambitious and I almost got that on the record.

Chair: Good try.

Jon Thompson: Defence, for the purposes of the 2% calculation, is in accordance with the NATO definition of defence. That is not the same as the Ministry of Defence, which is the lion's share of that number, but it is not the same. I am happy to go through the methodology.

Q93 David Mowat: Does that mean that the area that you are chief executive of will get more money?

Jon Thompson: We are going to get a real terms increase in the defence budget.

Q94 David Mowat: How much more? Do you know that number yet?

Jon Thompson: We are negotiating that number in cash terms because I think that, in the spending review, there is an update on the GDP deflator. That then defines flat real.

Q95 David Mowat: There has been some discussion that there was an accounting illusion—that some of the 2% would be achieved by moving things that were not in your budget into it and counting different things. But you are telling us that there is clearly extra money at your disposal for the area that you lead and that you will work through, with Ministers, how that will most effectively be spent.

Jon Thompson: Yes, that is absolutely my understanding. Do you want me to be transparent about the difference between the Ministry of Defence and the 2% GDP?

David Mowat: Yes.

Jon Thompson: There is a NATO standard definition of what can be counted against defence for the purposes of the 2% calculation. It is set out in a brief summary on two pages, supported by a 200-page technical document.

Q96 Chair: Great. You can send us the two pages. The NAO can have the 200 pages.

Jon Thompson: I have one here. It reflects the nature of the coalition. The 28 countries have slightly different defence and security arrangements. In the UK's case, you take the Ministry of Defence's DELs and add on various pension funds. For example, the armed forces pension scheme is not within my DEL—it is separate set of accounts. You gross up our budget for the fact that we have £1.3 billion of income. You add on the net additional cost of military operations, which is about £0.5 billion in the current year. You can add on various elements of the single intelligence account, the conflict, security and stabilisation pool, and various cross-Government programmes such as the cyber programme. Adding all those together, we are currently at 2.1% of GDP in 2015-16, and if that calculation continues to hold throughout the lifetime of this Parliament, my understanding is that the Government will continue to meet 2% of GDP.

Q97 David Mowat: What I do not understand is that that answer seemed to imply to me that you get from where they were to 2.1% just by adding in all the things that NATO allows you to—that is, without changing anything on the ground in terms of more money for defence.

Jon Thompson: There is more money for defence because it is flat real plus 0.5%, so our budget will rise in real terms but you have to remember that the whole economy will rise faster than that.

Q98 David Mowat: I thought what you told me—maybe I did not understand it—was that NATO has a different definition of what is in defence from the one that you would read, but, by taking all the different components that NATO allows you to take, last year the defence budget as defined by NATO was 2.1% anyway. If that is the case, why has there been such a big political issue about all of this? In your view—maybe this is a hard question for you to answer—how has the Chancellor made a big concession if all you had to do was add things up differently?

Jon Thompson: Because as the previous Chairman of this Committee pointed out to me on I think every single occasion I appeared, there is no guarantee that the Ministry of Defence's budget will continue to rise. Indeed, in 2010 it did not—it fell by 8.1% in real terms over the lifetime of the Parliament. We were making an assumption, but it was pointed out to me that one of the significant risks was whether I would be able to get that funding. You cannot necessarily say that we will always get that funding.

Q99 David Mowat: So the impact of the announcement for you is that it gives you a floor, rather than an increase?

Jon Thompson: No, it has got genuine additional headroom in it.

Jonathan Slater: Half a percent a year.

Q100 Chair: We have one point to pick up from what you were just talking about there: pushing savings to future years. As we have touched on, they are not really savings, so how will you make sure that you really get the money out of the budget? Does that not just cause you problems down the line? Isn't that one of the risks that keeps you awake at night?

Jon Thompson: Yes. It is a continual risk that you have a quite complicated equipment budget. It is a long-term programme, but you do have genuine choice about how far you want to contractually commit and exactly when something needs to come into service. As long as you keep the discipline of never opening a contract once you are on contract, you can at various budget cycles say, "Well, I know I wanted it in 2020, but I can live without having it until 2021." And then you can move the funding back.

Q101 Chair: But you are just moving the problem, aren't you? You are not making a base saving from the budget; that is the point.

Jon Thompson: In answer to the first question, I said that there were three things that you could do—that's one of them, but there are two others.

Q102 Chair: I think we have had a good two hours now. I know for you, Mr Thompson, that it has been long haul in front of us; I guess you're used to this.

I want to touch on one other issue, while you are in front of us. I think we gave you notice of this. You were the largest Department for disposing of land for building housing, which was a major Government initiative at the beginning of the previous Parliament. You released 153 sites for sale, and those sites were earmarked for 38,778 homes. Can you tell us how much you sold the sites for and how many of those homes have been built?

Jon Thompson: The answer to your first question is £427 million.

Q103 Chair: Fantastic. You are the first one who knows the answer to that question, so you get a gold medal on your first appearance before this new Committee.

Jon Thompson: That is the second time I've got the gold medal from this Committee.

Q104 Chair: Do you know the number of homes built?

Jon Thompson: We track the state of the development after we have disposed of it, so we can tell you whether houses are being built or where we are in the planning process and so on and so forth. We do not track—nobody has ever asked us to—exactly how many houses have been built, but we can tell you site by site whether it is being built out, and whether they have or haven't got planning and where they are in the process. Jonathan and I were talking about it last week; we went through all the sites we disposed of.

Q105 Chair: It would be great if you could provide that.

Jonathan Slater: We have a list of all of sites that we sold. We have the estimate, which we made at the point at which we sold them, of how many houses could be built. We have an agreement that planning permission had been achieved and a partnership in place to deliver them. Clearly, the longer ago that took place, the more information we have about whether the houses have been built and how many. We do not track exactly how many have been built, but I can tell you that at a particular RAF site, in a particular financial year, where we expected 500 houses, the development has been completed and those properties are occupied. I cannot tell you that it is exactly 500. We do not have a full list of exactly how many have been built so far, because we are not asked to collect that data, but we have got the next—

Q106 Chair: With the sites and the addresses, that data is pretty much in the public domain—the start and the finish of a home. I have to say that it is shocking really that that is good news, because you would expect every Department to be able to answer that, but you have been the first that has so far, so thank you.

That of course brings us to the building of the next wave of homes, which the Government have announced. How is the land disposal going? We have talked a bit about the infrastructure and so on, but how are land disposal plans going? Are all those land sites as valuable for housing? For instance, I wouldn't want to say that you are going to sell RAF Valley, but somewhere in north Wales would be a different prospect from a very fancy property in central London in terms of value for housing. Have you got plans afoot for the release of that land for the next wave? Can you tell us anything about that?

Jon Thompson: We are in the middle of the negotiation of exactly that right now, because it is an essential element of the spending review. We've produced what we think can be delivered. That has gone to Ministers. There are cross-Government meetings where we are being held to account, which will eventually result in us being given a further target for the lifetime of this Parliament.

Q107 Chair: There have been some changes in other MOD issues, which are operational, which, as we were discussing, might affect what you can release. Is the target that you have put forward something that you can still stick to?

Jon Thompson: We are in negotiation.

Chair: Yes—but no and gold medals for that.

Jon Thompson: Let me give you a two-part answer then. There are some sites that it is fairly obvious we do not need anymore. That gives you a baseload. The negotiation is about how far beyond that baseload you can go and where you have some choice about moving off site A, B or C. We would want to be able to rationalise the estate, but that is clearly in a negotiation.

Q108 Mr Bacon: You said at one point that rationalising the estate has got to be good news for the taxpayer. There must surely be an “if” around that, which is about how it is

done. If you look at the Graven Hill site, which you sold to Cherwell District Council, or the Aldershot site, there are two very different approaches. Cherwell District Council borrowed the money and paid you £27 million—I think that was what the consideration was. In the case of the Aldershot site, you’ve got a development partnership and ownership is retained by the MOD until a house is sold to the homeowner. From what you have just been saying, I take it that there is a number somewhere—I don’t want to know what it is—that you are hoping, or even being expected, to achieve, in terms of disposals, to contribute to overall revenue by a particular date. Is that correct?

Jon Thompson: That that is part of the negotiation?

Mr Bacon: Yes.

Jon Thompson: They are clearly linked.

Q109 Mr Bacon: Do you recognise that, in a separate space, there are institutional investors, landowners and developers who are looking at creating partnership arrangements whereby the landowner might stay in for longer and get more out in the long run—in other words, more of an equity kicker, therefore producing better value for the landowner in the long run? The same is, of course, true of any landowner, so if you stayed in for longer and got more of an equity kicker, you would be producing a better deal for the taxpayer. Are you conscious of all that, and is it something that you are playing into these negotiations?

Jon Thompson: You could do that, or you could take the much more straightforward route of having some kind of overage on the land development values.

Mr Bacon: Yes, you could.

Jon Thompson: Your route is somewhat more complicated, one might say.

Q110 Mr Bacon: Possibly, yes. You could just get an overage, but the overage that you end up getting on a conventional development model may still be less than a part equity owner would end up getting if you stayed in for longer.

Jon Thompson: It is theoretically possible that that’s true, but it is also possible that that might not be true, because land values—

Q111 Mr Bacon: Yes, but it is not just about land values. The Government have other policies, which this land sales issue is part of, that are designed to produce more housing for people. This land disposal programme is part of that policy, as well as about producing more revenue for the MOD, so integrating your land disposals with the Government’s wider objectives would make sense, would it not?

Jon Thompson: Yes.

Q112 Mr Bacon: Good. Would you be happy to have a briefing about that? The Graven Hill site is a poster child for these alternative models and I want to make sure you are aware of them.

Jon Thompson: I think we have agreed with our friends to the left that they might do a review of the Defence Infrastructure Organisation in the round, and therefore, you could explore that issue in that review, if you wanted, in due course.

Chair: When you next appear before us, after this negotiation is over, we will want to ask you a couple more questions on this issue, because we as a Committee are very keen to see these homes built, and we have not had an answer yet from the Government as a whole about how many homes have been built, if indeed any have. So thank you, because you have given us the first answer on that, for which we are pathetically grateful, which shows the state of play really.

Thank you very much, Mr Thompson, Mr Slater and Ms Tulett, who didn't get to speak very much, although I am sure your support to Mr Thompson was very welcome. Thank you for sitting through such a long hearing and for your answers. Our report will be out in the next month or six weeks or so.