

Defence Committee

Oral evidence: MoD Annual Report and Accounts 2016-17, HC 571

Tuesday 21 Nov 2017

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Members present: Dr Julian Lewis (Chair); Leo Docherty; Martin Docherty-Hughes; Mr Mark Francois; Graham P. Jones; Johnny Mercer; Mrs Madeleine Moon; Gavin Robinson; Ruth Smeeth; John Spellar; Phil Wilson.

Questions 1-132

Witnesses

I: Stephen Lovegrove, MoD Permanent Secretary, Cat Little, MoD Director General Finance, and Lieutenant General Mark Poffley OBE, MoD Deputy Chief of Staff for Military Capability.



Examination of witnesses

Witnesses: Stephen Lovegrove, Cat Little and Lieutenant General Mark Poffley.

Q1 **Chair:** Good morning everybody, and welcome to this session on the Ministry of Defence's annual report and accounts. I would like to invite the three members of our panel to introduce themselves for the record.

Cat Little: Good morning. My name is Cat Little. I am the director general of finance for the Ministry of Defence. I recently joined—eight weeks ago—and came from the Ministry of Justice. I spent most of my professional career in a big four professional services firm.

Stephen Lovegrove: I am Stephen Lovegrove, Permanent Secretary at the Ministry of Defence.

Lieutenant General Poffley: I am General Mark Poffley. I am the Deputy Chief of Defence Staff, responsible for military capability.

Chair: Thank you very much indeed. Our first questioning will be from Graham.

Q2 **Graham P. Jones:** This is to Cat. Is your financial management really up to the task of dealing with your affordability challenges?

Cat Little: First off, yes, but of course financial management needs continuous improvement. There have been lots of lessons learned over the course of the last few years.

If I were to pick out two specific things that I have observed in the last eight weeks that I think we need to be much stronger at, I would say the first is our ability to quantify and mitigate financial risk. I am used to being in a world where at any point in time you are able to articulate how much financial risk an organisation is holding, and able to model and scenario-plan based on that level of risk.

The second thing we need to be much better at is forecasting with accuracy. We talk a lot about fade within the Ministry of Defence, which is quite unique to the Department. It covers a number of areas where we need to be able to predict with much more accuracy than we currently do what we are forecasting.

Q3 **Graham P. Jones:** Which obviously is helpful, but do you have sufficiently skilled staff to carry this out?

Cat Little: Yes, we do. We have 2,500 finance people within the Ministry of Defence. However, like most of Government, we need to continually ensure we have enough capacity and enough strategic finance skills, and we are currently undertaking a capability audit of our senior teams. My hunch at the moment is that we need to reduce the amount of transactional activity we have within the Department and move it from



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being very manually focused into more technology-driven and automated processes, so that we can release capacity to focus on the big strategic issues of the day. The other thing is that our head office—compared to other Government Departments of comparable scale and complexity—does not have enough time and capacity to do everything it would need to do, so I think we need to invest in more staff in our head office particularly. That is probably a consequence of the implementation of Levene.

Q4 Graham P. Jones: You mentioned the financial management capabilities of the MoD. How does that compare with your previous Department, the Ministry of Justice?

Cat Little: Without stating the obvious, my previous Department did a very different set of tasks and had a reducing budget, and was hugely reliant upon income to fund its frontline services. Already, at the Ministry of Defence, it is a great pleasure to be in a Department that has a growing budget. None the less, both Departments have similar challenges and tough choices to make about how we ensure frontline delivery is protected, and in particular, focusing on operational expenditure, how we reduce administrative cost. You will see in the annual report and accounts that admin costs have reduced in the MoD. My previous Department had a 50% reduction in admin committed to in the spending review. In the Ministry of Defence we have to reduce our civilian headcount by 30%, but that is a really tough ongoing challenge for the Department, to ensure we deliver within our means.

Q5 Chair: While I appreciate your newness in the job, can I take it a little bit further? There are quite a lot of MoD financial staff who are seconded from the military, are there not?

Cat Little: Yes. They do not necessarily work within the core finance function, to be clear. We have about 200 military qualified accountants, who largely work within the Army. My team work very closely with Lieutenant General Mark Poffley's team, focusing on military capability. The one thing I would say the MoD does very well is to integrate the people who are most affected by financial decisions into the planning and financial management of the Department. The integration of military capability with finance at the heart of the MoD is critical. We have about 200 people within the military capability teams working alongside my strategic finance function.

Q6 Chair: I would not expect you to have read this particular report, but in 2015 the National Audit Office had something to say about this point. I will just read a short quotation: "The Commands face a number of challenges professionalising their finance teams. Military staff are often posted to roles on rotations of between two and three years. This erodes the accumulated knowledge of finance teams. Few have formal financial qualifications and the percentage of finance staff who are qualified varies significantly across the Department".

We have a little bit of a problem here, haven't we? We have this constant intermingling of uniformed and civilian personnel, and sometimes we see this in the outputs. I will give you an example, if I may. A couple of years



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ago we were doing an investigation into defence expenditure as a proportion of gross domestic product and we wanted to establish a fairly simple point, namely in which year the cost of operations started to be included in the core budget in the calculation of percentage of GDP spent on defence, and nobody in the Ministry of Defence was able to tell us. This was such a basic thing, because it meant the difference between whether we were spending 2.5% of GDP or maybe only 2.2% at the relevant time, because operations had previously been met from the Treasury reserve. Is there a problem sometimes that in dealing with the day-to-day stuff we are not able to see the bigger picture?

Cat Little: I read with great interest your report “Shifting the Goalposts?” as part of my induction and preparation for this role, and I think I understand and empathise with your frustration. Although we can see that in 2009 we did include the cost of operations within the calculation, I, too, have been unable to identify an audit trail. Obviously that was eight years ago, and I would like to think that a lot has changed.

On your point about how military and civilian staff work together, I think it is critical that that is an integrated responsibility, and it is important that finance professionals understand the consequences of financial decisions. Equally, they must be professionally trained, skilled up and objective in the way that they advise both the TRBs and the Department. You are right that we currently need to increase the number of professionally qualified staff within the finance function as a whole. Although that has increased over the past few years, I still think that it is a continual challenge for us, and I personally would like to see that at a much higher level across all our function.

Stephen Lovegrove: I very much support what Cat has just said, and I understand the thrust of your questions. We are going through a review in head office at the moment, just to ensure that we have the right number of people with the right skills against our highest-priority activities. That is obviously something that any organisation has to go through at intervals, but we are doing it right now. One area where I will expect to see a strengthening would be around the finance function.

Lieutenant General Poffley: I would add a couple of things. First, it is widely recognised, particularly in TRBs—having existing in such a role in a TRB—that there is a need for us to rely on professionally qualified accountants and commercial staff. Absent the right cultures in some of those commands, that can sometimes get misconstrued. That said, the Levene reforms and the delegations that followed from them have brought into stark relief in all the commands a need for them to do two things. First, they need to ensure that they are taking the right counsel from those who are professionally qualified, and very few of us are—interestingly, those of us who are recognise that there are some boundaries to our expertise.

Secondly, we are investing considerably in ensuring that a particular cohort of the military that will be responsible for the corporate governance of these budgets have better understanding of the commercial and



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financial implications of the decisions they may be taking. Many are now looking to ensure that non-executive directors, and others who are advising them, are really bringing to bear the commercial expertise that, inevitably, they professionally will not have had, because their expertise has been in the military for x decades by the time they get into those appointments.

Q7 Ruth Smeeth: General Poffley, it is great to see you here today after some social media over the weekend—I thought I had better front up.

Can you assure us that you are not going to exceed your budget this year, given the challenges that we saw last year?

Stephen Lovegrove: Yes, I can certainly give you assurances that we will not exceed our budget. My primary responsibility as accounting officer is to make sure that that does not happen, and we have plans in place to ensure that is the case. It is probably worth saying that pretty much every defence department in the world starts off the year with what they call an over-programming position—this goes to the point that Cat Little was making earlier about fade. We expect to see over the course of the year the actual expenditure come down to the budget. We will start off with something that is a bit higher than that at the beginning of the year, and that is very much normal practice. We want to minimise that as much as possible, but that is what we are seeing at the moment. I certainly do not expect to be in a position where we are going to be breaking our budget for the year.

Q8 Ruth Smeeth: Given the challenges of last year, have you resolved your budget and cash forecasting programmes?

Stephen Lovegrove: I will maybe pass over to Cat on that, but I am not aware of any problems that have come up recently, no.

Cat Little: No, and I think it goes back to what I was saying about forecasting accuracy. A year in advance the rule of thumb is that you should drive to be within 1% accurate. In the past, we have been outside that parameter, and of course there are some lessons learned about why that is the case. If I was going to put it down to a couple of things, one is that we are overly optimistic in how much money we think we are actually able to commit, contract and spend within a financial period, and the second is that, with the over-programming that Stephen described, we need a much more evidence-based approach to each of our programmes and how we set an over-programming assumption as we enter each financial period. We are currently doing some really good work to improve our forecasting over the medium term, but I am certainly not aware of any issues in-year.

Q9 Ruth Smeeth: Okay, so where are you right now in terms of your current spending forecast against budget for this year? Are we on track?

Cat Little: We are on track to deliver within the current control total set by Parliament.

Q10 Ruth Smeeth: Okay. I am going to move on slightly, to some information



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that we have received. Can you tell us why you are not doing anything specific to mitigate against a no-deal Brexit in terms of procurement and the risk-cost of inflation in the equipment programme? Specifically, with the F-35 programme, the impact of the lack of currency hedging cost us £85 million that we were not expecting last year.

Stephen Lovegrove: It is obviously quite difficult to predict all the very complicated outcomes that might occur as a result of the Brexit negotiations. We certainly are thinking about the impact of Brexit on our budgets, and forex—foreign exchange—is clearly a very important factor there. It would be disingenuous to say that at the moment the foreign exchange rates, if they were to stay at the levels that they are at, do not constitute an additional pressure against the budgets. We are managing through that and recognising that that is the case. We are also giving some thought to what it means for our industrial base and our relationship within our industrial base. There are very important British companies that may find it more difficult to trade or form consortia with European companies in a post-Brexit world, and we are talking about that.

I think it would be fair to say that at the moment we are doing quite a lot of thinking about it, but have not got to the stage of formulating specific plans, because it is quite difficult to know against what scenario the specific plan would be enacted.

Q11 **Ruth Smeeth:** I think that is a fascinating insight, which we will come on to later. We had a debate last week on the Floor of the House about the need for a defence aerospace industrial strategy. If you are speaking to industry, I know that is one of the things that they are seeking and you are seeking, so I am not sure where the blockage is going forward and why we are not moving beyond thinking—

Stephen Lovegrove: We are obviously thinking and talking. In fact, I am having a meeting next week with the CEO of BAE, and there are a variety of things that I am going to talk to him about, but that will certainly be one of them. It may be that you want to comment on this, General Poffley.

Lieutenant General Poffley: We have been having, indeed this very day, some discussions with our international partners in Europe and elsewhere, but also with industry across the complete spectrum of our business, to tackle that sort of contingency. We have contingency inside the programme, which is set aside for those outside influences affecting the programme, and it is clearly one of the things that we are looking at very closely to see how we think that might play out. It comes back to the fact that until we know the solution that we are going to be working with in the context of Brexit, it is very difficult to back off into some numbers that you will be able to take programming action on. Therefore, we are working in broad spectrum at this stage and we will narrow down as more detail becomes available.

Q12 **Ruth Smeeth:** I think that one of the things that seems surreal to many of us is the lack of currency hedging that there seems to have been in the initial contracts that were signed, especially for the F-35 and the P-8.



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Given the scale of those contracts, the additional burden with the fall of the pound is adding huge pressure. I don't understand why that wasn't there in the first place.

Lieutenant General Poffley: Perhaps Cat can give you the detail of how the forex and the hedge is working. From our point of view, we accepted that there was a degree of risk in whatever rate you were going to set in that hedge. Of course, that again plays into how you might draw down some of the contingencies that are sitting not just in individual programmes but at the corporate level. We would be thinking about drawing those down, specifically against a delta that was not hedged through the normal way.

Cat Little: This year, we have around 80% of our foreign exchange risk hedged against, and we layer it three years in advance so that at any one time, we are trying to purchase a good mix of forward contracts to allow us to hedge sensibly against forward risk. We have actually been quite successful at mitigating financial risk exposure within the financial period. However, it is very clear that it is going to be harder for us to purchase forward contracts that mitigate risk given the amount of volatility we are seeing in foreign exchange markets. As Mark has said, and going back to my comments about quantifying financial risk, in financial management terms we need to ensure we are holding enough contingency to be able to offset those risks as they crystallise over the 10-year period. We have increased the amount of contingency we are holding in the Department to do that.

Stephen Lovegrove: I would be surprised if there was a single company in Britain that had managed to fully hedge against the risks in forex that have happened over the last 18 months or so. The movement in the currencies has been much more extreme than anybody anticipated.

Q13 **Ruth Smeeth:** I don't doubt that at all. It is just about the scale of our hedging and how protected we are and how able to mitigate the risk. As highlighted, that is one of the pressures we will face in the budget. We are seeing daily reports at the moment about the pressure, especially on the equipment budget, and perceived black holes. Can you talk me through the process of what happens if someone does not meet their own budget? What happens to that person? Has anybody been held to account for exceeding their budget in the last 10 years?

Cat Little: It depends on why they have exceeded the delegated limits that they are given. In the most extreme circumstances, where someone has either misused funds or not complied with "Managing Public Money" or parliamentary expectation, the most extreme measure is to apply performance management measures. I am not aware of that ever happening, but two years ago we reduced the amount of delegated authority for expenditure within the Navy, and on a regular basis we do lessons learned where programmes are overspending or where we have seen cost growth.



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The vast majority of the time, from what I have seen so far, it tends to be exogenous factors or cost estimation not being quite as tight as you would expect that has led to those sorts of scenario, or it is where we have such long-term volatility that it has crystallised at a faster level than expected. I have not seen any examples of the more extreme scenarios where we have needed to take performance management measures.

Q14 **Ruth Smeeth:** So no one has been sacked for going over their budget.

Cat Little: Not that I am aware of.

Stephen Lovegrove: Not at the most senior levels. I am not aware of that. Further down the organisation, who knows? While our financial management always needs to improve—Ms Little has spoken about that, and I am completely 100% behind that—it is not completely inadequate either. We can see pressures arising. We can see pressures in equipment programme or activity programme arising. That is part of the job of the centre. Before we get to a stage where somebody has breached a total, Ms Little, General Poffley or I will have sent an instruction to say, “You will not do the following things.” Sometimes that is more welcome. We try to make sure that these sorts of situation arise as rarely as possible.

Q15 **Johnny Mercer:** But how can you expect to do that if, by your own admission in the report we have just seen, a lot of the financial staff do not have the basic accountancy and analysis skills to carry out their job? Surely it is a management function to ensure that you are correctly equipped and that the staff are trained and given every opportunity to fulfil these roles. I find it astonishing that only in 2015, after generations of pretty disastrous procurement and waste of money, do we realise that some of our staff are not even qualified to do it.

Stephen Lovegrove: I would not agree with the characterisation that we do not have staff who are qualified to exercise financial management.

Johnny Mercer: That was the report from the professional body that looked into it.

Stephen Lovegrove: I think that professional body said that there is a need for improvement. We absolutely agree with that but, as you know, it is a very large organisation and there are—

Q16 **Johnny Mercer:** Sorry, Mr Lovegrove. That is what the staff have said in a survey; that they feel that they are not trained adequately to do what is asked of them. My point is that that is a management issue.

Stephen Lovegrove: Of course it is a management issue, and it is one that we are addressing. If your point is that, within the MoD, we do not have the capacity to identify problems as they are emerging, I am afraid I must respectfully disagree. We do have the ability to identify problems as they are emerging. The point I was trying to make was that, at the centre in particular, we take action in order to ensure that we are dealing with them ahead of time, rather than after the event.

Q17 **Mr Francois:** We have already had several references to the F-35



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programme. First, can you confirm that it is the second-largest procurement programme the Department has, after the nuclear deterrent?

Lieutenant General Poffley: I can.

Q18 **Mr Francois:** Okay. You will remember that at a previous hearing when we looked into F-35, we asked the Department to provide us with a note on the total cost of the F-35 programme, and you agreed to do that. We have now had the note back and you have not given us the cost. Why is that?

Stephen Lovegrove: I will answer that, if I may. We gave you a commitment to answer that question to the best of our ability. We have answered that question to the best of our ability. As the note says, the 48 that are on order, up to 2025, will cost £9.1 billion, and that has been approved. Over the period to 2048, we estimate—it is an estimation—that those 48 will cost £13 billion.

We have discussed, with the Joint Program Office, whether or not there is any form of reasonable predictability that it would be appropriate to release without either misleading, potentially sending people in the wrong direction, or indeed compromising our commercial position for the rest of this 50-year programme. The answer is that it is very difficult, if not impossible, to do that, so we have gone as far as we reasonably can, which was the commitment that we gave at the previous hearing.

Q19 **Mr Francois:** You say that you have done it to the best of your ability. Yes?

Stephen Lovegrove: The best of our ability is to give you an estimate for the 48 that are on order at the moment.

Q20 **Mr Francois:** In other words, this is the second-biggest procurement programme in the Department's entire budget, and it is beyond your ability to tell us what it costs.

Stephen Lovegrove: It is the second-biggest procurement in the Department and it is a programme that, in the words of the NAO, is "inherently immature". Therefore, it would be imprudent to put a number into the public domain that would inevitably be wrong given the length of the period that this programme lasts for. Looking at the Government Accountability Office in America, and recognising that the contractors have not given reliable information yet, which is an observation they made last month, it would be imprudent and misleading to put out more detail than that.

Q21 **Mr Francois:** I think the general public would be pretty shocked at that. You are saying that this a massive programme; we are committed to it; in theory we are committed to buying 138 aircraft over a period of years; and we do not really know exactly how much it is going to cost us to buy them. Is it any wonder people have some scepticism about budgeting in the Ministry of Defence?



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Stephen Lovegrove: I think the position we have taken is entirely reasonable. If you were to ask the Americans, which we have, because we asked the JPO, whether they have a view themselves as to how much the whole of the F-35 programme is going to cost, over its entire 50- or 60-year life, they too would say, "No, we don't."

Q22 **Mr Francois:** Okay, but if costs go up, partly because of changes in the exchange rate, the risk is that this thing could start to eat up other programmes in the defence budget. I find it very concerning that we are committed in principle to this very large programme and yet you are not able to tell us either in a note or in public session what it will cost.

Stephen Lovegrove: Well, we have given the Committee and the public as much information as we can up to 2025 with a degree of precision and we have given an estimate to 2048. That is realistically as far as we can go at the moment. Indeed, it is as far as the American defence establishment would be able to go as well.

Mr Francois: I just think that given all the pressures that your budget is under, which are very well known, that is an absolutely extraordinary position for you to take.

Q23 **Chair:** Can I just suggest that effectively what you are saying is that you can see far enough ahead to know what it is going to cost for the first 48 aircraft and to make a reasonable estimate of what it is going to cost for the next 48 aircraft?

Stephen Lovegrove: No, we did not say that. I will pass this over to General Poffley, because he is more expert in this than I am. We have given a number—the NAO has audited the number—which is the costs of those first 48 aircraft up until 2025. We have then estimated how much those 48 aircraft will have cost including servicing, running, upgrades and all the rest of it to 2048, which is 21 years away.

Q24 **Chair:** Absolutely, so you are saying that in that period ahead, we will still only be looking at the costs of the first 48 aircraft.

Stephen Lovegrove: That is correct.

Q25 **Chair:** And when are we going to start looking at the cost of the next tranche of aircraft?

Lieutenant General Poffley: We look at the programme, as you know, 10 years out. As we gain experience on one operating—incidentally, the other partner nations gain experience on operating the F-35—there will be an annual review to confirm how those projected forecasts are changing and we will make adjustments in our programme accordingly.

Much of this is going to come through usage. There will likely be some adjustments to the aircraft that we will need to make as technologies develop and we want to put on capability enhancements or pare back, depending on our appetite and the circumstances of the day. That is why the uncertainty around the figure work, beyond realistically a 10-year horizon, is very difficult to judge. While we have made some broad



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assessments, the ability for us to refine that judgment is dependent on first, a degree of experience, and secondly, our ability to predict the future in terms of where technology is likely to take us.

Q26 **Chair:** Right, so I want to follow Mark's line of reasoning to what I think is a logical conclusion. The total number that we are committed to have is 138, is that right?

Lieutenant General Poffley: We have in principle committed to a number of 138. We have currently contracted for 48.

Q27 **Chair:** Therefore we are likely to be on a similar course to what has tended to happen when we in principle committed to 12 Type 45 destroyers and then it came down to eight and ended up as six. Isn't that highly likely? Clearly, what is likely to happen in this project is that if it turns out that the later tranches of aircraft are taking longer and costing more, and unforeseen circumstances arise, it may well be that if you cannot give an overall budget for the 138 into the indefinite future, we are going to have to adjust the numbers of the aircraft that we order. Isn't that obvious?

Lieutenant General Poffley: If you were to follow your logic through, I might be sympathetic to it. The interesting point with the first 48 is that we have committed to that 48 at a price that has been negotiated and is in contract. It delivers the capabilities for those 48. There is no recourse back to adjust those numbers in an upwards direction.

Q28 **Chair:** What is clear, then, is that the 48 are pretty much safe, secure, done and dusted, as it were, as far as the financial cost is concerned, but after that there is inevitably uncertainty. Is that what you are telling us?

Lieutenant General Poffley: I am afraid that that is the reality of the world we are living in, but it is not unique to the F-35.

Q29 **Chair:** Absolutely. Given that situation, have you made plans to keep in service aircraft that are due to be phased out and replaced by the F-35, in case it turns out that we cannot get the full total that we hoped to get in principle?

Lieutenant General Poffley: We would consider exactly that dynamic at the point at which it was evident that we were not able to pursue our original plan of 138, but that is some way off—probably about 10 years.

Q30 **Chair:** Of course, but we do not want our successor Committees to have your successors in the hot seat in future, saying to them, "Why did you dispose of all those other aircraft before you knew that you were able to replace them with adequate numbers?"

Lieutenant General Poffley: As you introduce any form of modernisation to your capability suite, there is clearly a judgment to be made about the lapsing out of older technologies and older capabilities and growing new ones. There is frequently an overlap—indeed, in the majority of cases—whereby you are preserving your confidence in the delivery of those capabilities. That is the normal way we do things.



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Q31 **Mr Francois:** Of the 138, how many will be the B variant and how many the C variant?

Lieutenant General Poffley: We have committed to 48 as the B variant. A judgment will be taken on whether other variants are used downstream.

Q32 **Mr Francois:** So you do not yet know what the final mix will be.

Lieutenant General Poffley: We have not made that judgment yet.

Stephen Lovegrove: Can I just make two very quick points? I totally agree with you, Chair, that we would not want to foreclose the option if there were movements, in terms of running on old variants. Of course that must be a prudent thing to do, and we would not want to foreclose that.

On the cost, as we would have expected—indeed, the Joint Programme Office is there to do this—the experience to date has been that the cost of the aircraft per copy is coming down the more of them that are made. We expect to see that trend continue.

Q33 **Leo Docherty:** General, you mentioned adjustments. Will you clarify exactly what that might mean? Presumably it means having fewer aircraft than initially planned.

Lieutenant General Poffley: Not necessarily. When I talk about an adjustment, it may be that you are going to change our portfolio of capabilities to meet the threats and scenarios in which the country might wish the military to be engaged.

Q34 **Leo Docherty:** What do adjustments mean with regard to the F-35 then?

Lieutenant General Poffley: You may take a slightly different capability mix. You might configure it for a new weapon that is introduced, or you might look at it operating in a slightly different configuration. When we come back to the number of variants, clearly the B model is what is required to operate off our carriers. There is a judgment to be taken about the mix of the fleet downstream, based on the experience of how we wish to operate the aircraft and the operational scenarios of the day.

Q35 **Leo Docherty:** On that note—just to be clear—for our carrier strike concept to be viable and deployable, precisely what number of aircraft do we need, and of what nature?

Lieutenant General Poffley: We have committed for the carrier to operate with two squadrons, which means 24 aircraft embarked, with the ability to maximise that to 36. Clearly, not all the 48 will be in frontline squadrons, because we will have to have an operational conversion unit and we will need to maintain some form of attritional reserve. The planning figure at the moment is two squadrons, each of 12 aircraft, capable of being embarked in the carrier for our full operating capability, which we are anticipating at the back-end of the next decade.

Q36 **Mr Francois:** How will you ensure that the programme does not start to eat everything else?



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Lieutenant General Poffley: The programme is very set. The rest of the programme circulates around it and other major programmes.

Q37 **Mr Francois:** But it cannot be very set, because you cannot tell us how much it costs. It clearly is not very set, is it?

Lieutenant General Poffley: It is absolutely set in a 10-year period.

Chair: I will move on now and ask John Spellar to talk to us about billions of pounds of savings.

Q38 **John Spellar:** Yes, and the vexed question of what savings means, and in particular what efficiency savings means. Permanent Secretary, your Department's note sets out how it is planning to make £20 billion of savings, but you told us last time that you were aiming for £30 billion.

Stephen Lovegrove: First of all, I should apologise if at any stage I have misled the Committee.

John Spellar: Inadvertently, I am sure.

Stephen Lovegrove: I certainly did not propose to do so. The misunderstanding arises from the fact that there are—as the NAO note published on the website the other day points out—multiple savings programmes with multiple timelines that were set off at different times. Perhaps I can try to be as clear as I can on the three main savings programmes that we are dealing with at the moment.

There was one in 2010 that was set off with a five-year target horizon that aimed to get £4.3 billion out between 2010-11 and 2016. There was one that was set off in 2013 that had a five-year horizon of saving £6 billion, and then there was one that was set off in 2015 that had a five-year horizon of saving £7.4 billion.

The £20 billion number was my extrapolation, because somebody asked me how big the saving target was over a 10-year period; I should probably have given a fuller answer, but I was trying to be brief. The 10-year saving target, extrapolated for the 2015 programme, is £20 billion. That is basically the situation at the moment.

Q39 **John Spellar:** I worry a bit about the terminology of a "target". I remember from being a Minister people talking about "stretch targets", which were basically numbers plucked out of the air. Projections I understand—"This is what we are doing, this is how we are doing it and this is what we intend to save." That can end up right or wrong. I understand projections. What is the underlying data that justifies the figures for these targets—or is it just a Treasury aspiration?

Stephen Lovegrove: I do not think it is a Treasury aspiration. I was not in the Department in 2015, but the Department accepted that savings target and therefore felt that it was achievable. There certainly is a stretch target, which I think is £7.8 billion over five years and there is a central target of £7.4 billion over five years. I think the former Secretary of State



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was in front of you a couple of weeks back and said that there was line of sight to about 79% of those savings, which is the case.

When you have multi-year programmes, I think it is reasonable that, on day one, you do not know exactly what every single last detail of the savings programme is going to be. Inevitably, some new ideas will emerge over the course of the months and years, and that is effectively what has happened.

- Q40 **John Spellar:** That is true, but you must have some rough approximation. The NAO seems to believe that it is finding it difficult to work out, from published sources, how much you need to save and, indeed, how much you can save. I am sure that there will be a single place, like in an annual report, that would set out current savings programmes, targets—or, as I prefer, projections—timescale, the actual sources of those savings within the programme and also, therefore, how far you are towards achieving that.

Stephen Lovegrove: I absolutely accept that the layering on of efficiency programme after efficiency programme leads to a degree of confusion that I think we really ought to address. That is actually one of the reasons why we are just about to welcome a new chief operating officer into the Department: so that we can not only have a more aggressive grip of our efficiency programmes but are actually capable of expressing them perhaps a bit more clearly than we have been able to so far.

- Q41 **John Spellar:** You said that the Department accepted the target. That does not mean that there is any underpinning to it. It means that in the negotiations between the Department and the Treasury, a strong Chancellor, in collusion with the Prime Minister, basically puts a gun to their head and they say, "Yes, I accept." Therefore, that does not mean that they have actually worked out where those savings would be.

Stephen Lovegrove: As I say, I was not around at the time. I would say that a couple of years into the programme we have line of sight to 79% of the target, so I guess it cannot have been that far off.

- Q42 **John Spellar:** Okay. You talked about efficiency. One of the concerns that some of us on this Committee have is that efficiency is really shorthand or euphemism for cuts. Proper efficiency is doing the same with less or doing more with the same. For example, I think you have lost about 28% of your civilian staff. We know that in other parts of Government that has been sleight of hand, because those roles have been replaced by agencies, often hiring the same people for more, but on another part of the balance sheet. Is that the case here?

Stephen Lovegrove: On that last point, I am deeply conscious of the cost implications of replacing civil servants with contractors. That lies at the heart of the recent reporting about a slight uptick in civil servants in the Ministry of Defence. That comes from a specific situation at DE&S—Defence Equipment and Support—where they have a lot of contractors in, costing, on average, about three times more than getting a civilian or civil servant to do the same work. As you say, as employees, those contractors



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don't count. Tony Douglas has taken the decision—I think it is the correct decision—that, for the sake of efficiency, he wants to replace those expensive contractors with civil servants. That also has the benefit of embedding the knowledge into the system. That has meant a very small uptick in the number of people who are actually in DE&S and therefore in the MoD. So the point you make is well taken.

Q43 **John Spellar:** It might have been better to have kept the institutional memory at that earlier stage.

Stephen Lovegrove: That is true.

Q44 **John Spellar:** You talked about something like 20% that we don't have sight of. What particular programmes are not on track?

Stephen Lovegrove: Colleagues will have views on this as well. I think we can do quite a lot more with our inventory management than we have done at the moment. We haven't fully embraced a digitised model of that. I think that there is probably quite a lot more that we can do on some of the transport costs that we incur. How much we spend on fuel is, for instance, a very important cost for us. Those are a couple of examples of areas where I think there is going to be quite a lot more work that we will need to do in the coming months.

Q45 **Ruth Smeeth:** All of the projects you are talking about will have up-front costs—invest to save.

Stephen Lovegrove: Not all of them.

Ruth Smeeth: Some of them will.

Stephen Lovegrove: Some of them.

Q46 **Ruth Smeeth:** In terms of computer systems, in terms of additional staffing resource, or so that you can hedge fuel costs, there will be additional resources. Given how tight the budget is, where are you going to get the extra money to do the invest-to-save programme?

Stephen Lovegrove: First of all, not all of them will.

Ruth Smeeth: The big ones are going to.

Stephen Lovegrove: As I say, quite a number of them will. If we make a big investment in digital to save money in the longer term, clearly we will need to free up money for that. There are investment funds in the Department that will allow this. If we decide, in the medium to long term, that the programme in question really needs to happen and we really need to invest up front, we will have to take programming action elsewhere in order to free up the funds.

Cat Little: You are absolutely right that there are certain types of savings that do need up-front investment, whether that is in systems, business process re-engineering or people costs. We have just started a piece of



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work to identify and answer the exam question, "If you had additional investment, would you be able to either accelerate or deliver greater efficiencies on a faster timetable?"

To respond to your point about "Where would you get the money from?", we do have some investment funds available, which are set aside specifically for this sort of work. Also, quite a lot of the TRBs that we work with have set aside in their own financial plans a good proportion of what they believe they need to invest and deliver those savings. There is both a top-down and a bottom-up approach to how we are doing it.

- Q47 **Ruth Smeeth:** Obviously, given the history of Government IT programs and how much they have gone over budget in every area, there are significant IT programs that could be rolled out across the military and the MoD. There are still huge gaps where in other areas we would automatically use those technologies. They are not cheap, and historically in Government they have been even more expensive than originally projected. How much money do you have in your investment funds?

Cat Little: IT investment is not always needed to deliver those sorts of efficiencies. I look at what we have done in finance in particular, where we have already implemented a new general ledger system; there are some real efficiencies not just in technology but in simplifying, standardising and streamlining our business processes. For example, instead of having 20 different control points, having just one that does it really well generates greater productivity in how we use our staff. That would be the first thing. We are currently in the middle of our planning exercise for the next 10 years, as you know, and we are setting a budget next year. We are looking to set aside some money as part of that, but that is still subject to ministerial decision.

Stephen Lovegrove: The point you make is accepted, obviously. There is a quite unhappy history of these kinds of projects in Government, and we are very conscious of that. Information, data and networks are very much the central nervous system of defence in a profound way. At the most senior level, we have probably under-invested in knowledge; that goes to Mr Mercer's point about skills. We are just in the process of appointing a chief information officer for the first time in the UK MoD. Most other defence departments have had one of those for quite a long time. We will look to him or her not only to bring together a much more forward-looking and holistic view of how our information systems and data work with each other, but, importantly, to control and manage the costs of these programs, in a way that hitherto probably we could have done better.

- Q48 **Chair:** How do you define the difference between an efficiency saving and a capability cut?

Stephen Lovegrove: I think Mr Spellar put his finger on it: an efficiency saving is doing a task more effectively—possibly faster but usually cheaper—with the same effect. It does not necessarily have to be the task itself; we are trying to achieve an outcome more efficiently, faster and quicker. A cut is something compromising a particular defence outcome. I



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should be honest: we make cuts and prioritisation decisions pretty much every hour of every day. You will all be aware of that. There are some defence outcomes that we decide are, at the moment, lower down the hierarchy of importance than others. That is effectively the difference.

- Q49 **Chair:** If you have to make those decisions almost every day, do you accept that, at least in principle, a point ought to come when we can say that there are no more significant efficiency savings to be had, and that any more savings that will be made will necessarily be cuts?

Stephen Lovegrove: I do not think I would necessarily accept that. There are two reasons. One is that we are not perfect, and we absolutely accept that. If we have better insight into the way in which we are doing things and more expert people to help us get to the right answer, then we can probably always go further.

Also, particularly in this area, technology does not stand still. Who would have thought, 10 years ago, that we would do an awful lot of our shopping in the way that we do at the moment, with Amazon delivering things on a next-day basis? It would make a big difference to us if we were to adopt that technology wholesale. We have not done so yet; maybe we should. I think technology has a very big role to play in this as well, but I think General Poffley will have a view on this.

Lieutenant General Poffley: Yes. In my view, there may be some very legitimate reasons for taking a cut in the pure sense. I think the distinction here is absolutely an important one. We will need to prioritise those outputs, but where there is an output reduction, that is quite clearly a cut. Where you are delivering the same output for a more efficient input, that is an efficiency. That is a real distinction.

- Q50 **Chair:** Okay. We will be coming on to discuss some of the more controversial possible cuts shortly, but I have a couple more points first.

This is the eighth year in succession that the MoD's accounts have been qualified. I understand that this is largely to do with existing contracts and whether or not they have the features of a lease. Can you anticipate a time when enough of these old contracts will have expired for the National Audit Office to finally stop qualifying your accounts? I think that is one for you, Cat.

Cat Little: The accounting standard that requires us to identify embedded leases within all of our contracts is due to be superseded. What we call IFRIC standard No. 4, the International Financial Reporting Interpretations Committee, will in April 2019 be superseded by IFRS standard No. 16, the International Financial Reporting Standard. In effect, that will fundamentally change the way in which we identify and account for leases. That applies to the whole of the private and the public sector.

IFRS provides for where the cost of compliance is excessive or is not value for money. We agree with the conclusion of both the NAO and the Department that at the moment, the costs to comply would be preclusively excessive. We have made, I think, the right call in ensuring that we are



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working with the Treasury and the National Audit Office to comply with the future standard when it comes in in 2019.

I do not think that, in that timescale, there will come a time when the legacy issues with contracts will become immaterial to the Department. I cannot tell you how disappointing it is to have a set of qualified accounts. As an ex-audit professional, I think it is an absolute given that we should have unqualified financial statements, but I am afraid that in this circumstance, I do not believe it is a good use of taxpayers' money to seek that compliance in the timescales that we are talking about.

Q51 Chair: So you cannot put any sort of future date on when it might expire.

Cat Little: I would like to think that when the new standard comes in during 2019—that would be for the 2019-20 financial year—all of our effort will go into making sure that we comply with it at that point. Subject to the NAO's opinion, I would like to think that that is the target date, but I would not underestimate the complexity of that standard, especially when we are the Government Department with the most contracts and leases and are the most affected.

Q52 Chair: One other point that has been put to me by our advisers is that the term "fade" applies to when a Department, for example, over-budgets at the start of the year but then reduces expenditure to meet the end-year budget. I understand that this is fairly common practice pretty much worldwide in defence departments, but is starting with over-optimistic plans good financial practice, and does it mean that one inevitably makes short-term decisions at the expense of long-term value for money as the year progresses?

Cat Little: To go back to some of my earlier comments, fade as applied within the Ministry of Defence covers three things in financial management terms. First, it looks at forecasting accuracy—how accurate your view is of how much money you are going to spend over a period of time. It looks at over-programming; every programme and every infrastructure-based organisation will estimate a certain level of optimism in the amount of over-programming it has undertaken. Finally, in the way in which we cost our actual programmes, there is always an element of optimism bias and really good, robust financial management requires us to get those levels of optimism bias, over-programming and forecasting down to as accurate a level as possible, and to make sure that we have got the evidence, science and financial rigour behind it to justify it. I, personally, am of the view that we should not talk about fade. We should talk about the disciplines of forecasting accuracy, over-programming and optimism bias.

We are doing quite a lot of work to look at what we have learned from the past trends of expenditure, and the trends of over-programming it, particularly within equipment, to make sure that we are adjusting and reducing the amount of inaccuracy in the way in which we have built it into our financial plans. So as we go through the financial planning exercise at the moment, I would like to think that we are setting much tauter and more realistic assumptions in the way we expect expenditure to be



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applied. You are absolutely right to say that, unless you get that right and unless you do that in a disciplined way, you are likely to end up taking much more short-term decisions.

Stephen Lovegrove: I absolutely echo and support all of that. I was a different type of finance professional from Ms Little, but I had never heard the word “fade” used in this context before I joined the Department. It is a feature, it turns out, of defence departments, but that does not mean that we need to accept it as a mere fact of life. We need to be much more precise about it and try and minimise the amount of it that we have.

Q53 **Gavin Robinson:** Following the review in 2011 the non-competitive procurement process was seen to be outdated and ineffective, so the SSRO was birthed. Since that time we have had the resignation of the SSRO’s chief executive. My question is simply this: did she resign because of disagreements with the remit of the SSRO?

Cat Little: Not as far as I am aware. The previous chief executive spent three years both successfully establishing the SSRO and ensuring that it was left in a really good, strong position. I actually think, from what I have seen, that the working relationships in the SSRO and the way in which it has established itself have been incredibly effective, so I am not aware of any disagreement. Of course, we are about to conclude a review, as required by statute, into the effectiveness of the SSRO, and learn from practice. We will complete that review in December, and I am sure there will be some recommendations, based on how we predicted it would operate and where it currently is, to be taken forward as part of that review.

Q54 **Gavin Robinson:** I think there has been some publicity around tensions over the role and remit of SSRO internally within the MoD. You are in the midst of a review—can we anticipate that the SSRO will have both the remit and powers and the resource that it needs to do its job?

Cat Little: When we established the SSRO I understand that quite a lot of thought and attention was put into the powers and remit of the SSRO, and a lot of comparisons were drawn between powers that other regulators have. My understanding is that they do have broadly comparable powers to other comparable regulators. Of course, if that is not borne out in practice, and there is evidence to suggest that we need to go further, we will need to consider that as part of the review.

Q55 **Gavin Robinson:** Mr Lovegrove, the *Financial Times* was quite concerned at the loss of senior staff within the Department, and that their professionalism, knowledge and so forth was lost. Obviously Ms Little is a product of recruitment to upscale the capacity at senior level. Are you satisfied that you have, or are going to have, the senior staff around you necessary for the Department going forward?

Stephen Lovegrove: I am satisfied. I had, actually, the *Financial Times* reporting that story almost word for word when I ran my previous Department, so maybe there is a common factor there. Since I joined, 18 months ago, we have sought to strengthen the team. I have taken a hard



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look at whether or not at the most senior levels we had enough bandwidth for this very big and complex organisation. I looked at a lot of international comparators to see where we were and I came to the conclusion, actually, that we didn't. As I have mentioned, we have inbound a CIO and a COO, we have strengthened our capacity on the pure policy side, and Ms Little has joined recently, so I am confident that we are strengthening the team appropriately.

Q56 Gavin Robinson: You referred earlier to Tony Douglas, who was head of DE&S. You referenced at the Public Accounts Committee that you are working towards a replacement, but it may be ambitious to expect a replacement individual to be in post come Christmas.

Stephen Lovegrove: Yes, that is absolutely right.

Q57 Gavin Robinson: So where are we now?

Stephen Lovegrove: I was talking to the chair of DE&S about this a couple of days ago—over the weekend, in fact. We are just about to appoint the headhunter, but headhunters have been working on it without a formal appointment anyway. There are some names that are coming forward, and we will absolutely try to get a permanent replacement in place as quickly as we possibly can. Mr Douglas's announced departure was a surprise to us. We did not have any expectation that he was going to be leaving in that timescale, so that obviously put a bit of a hiatus into the process. We have a very able interim arrangement, so I am not concerned about it in the short term, but in the long term we absolutely do want to get the best possible person to run that very important part of the enterprise.

Q58 Gavin Robinson: Can you put a timescale on it?

Stephen Lovegrove: I would be disappointed if we did not have somebody in place by the end of the first quarter next year.

Q59 Gavin Robinson: So an additional three months are required.

Stephen Lovegrove: Well, I don't think I ever thought that we were likely to be able to get anybody by Christmas. That was never my anticipation. I have done a lot of senior appointments in my career and in Government, and when you are talking about people at that kind of level, they typically have to have a bit of time to extract themselves from where they are. Sometimes there are gardening periods and all the rest of it. It is never as fast as you would like, in my experience.

Chair: It will not surprise you to hear that we are going to stretch our remit a little now to talk about the capability review, particularly in the light of the fact that when we tried to get Mark Sedwill, the national security adviser, to come before this Committee, he basically said that you are the responsible person, with the Secretary of State, for the defence strand of what he says is not a defence review as such. I am going to start off with Johnny Mercer.

Q60 Johnny Mercer: Mr Lovegrove, has the Secretary of State actually asked



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the Treasury for more funds?

Stephen Lovegrove: No, he has not asked the Treasury for more funds.

Q61 **Johnny Mercer:** So where did the story in *The Sun* on the weekend that he had asked for increased money from No. 11 come from?

Stephen Lovegrove: I'm afraid I don't know the answer to that question.

Q62 **Johnny Mercer:** But it is not true.

Stephen Lovegrove: I am not aware at all of a formal request going from the Department to the Treasury for more funds.

Q63 **Johnny Mercer:** I understand that that came from the very top of the Ministry of Defence, but you are telling me that that is not true, or that, as the Permanent Secretary, you are not aware that that has happened.

Stephen Lovegrove: I am not aware of a formal request going from the Department to the Treasury for more money, and I am afraid I really do not know the provenance or authority of the *Sun* article, which I of course have read. I know little more than—in fact, I know nothing more than I have read in *The Sun*.

Q64 **Johnny Mercer:** I understand. I think that is something we need to take up.

What approach have you been taking to managing your strand of the capability review?

Stephen Lovegrove: As you know, there are 12 strands. I would say that the defence strand is probably the most substantial of them, merely because defence is the most substantial part of the national security and defence apparatus. From the moment at which the idea was mooted and our Secretary of State agreed that this was a sensible thing to do, which was back in July, we have had our planning teams stood up. I went to see them the other day. They are working very hard. There are about 25 people working on a pretty much constant basis in this area. We have started from a sense of, "Okay, well let's have a look at what we said in SDSR '15." It is our view, and it is probably shared by the Committee as well, that the types of threats identified in 2015 were correct but that they have intensified and accelerated. We wanted to evidence that, and we have evidenced that.

We then moved into thinking about what types of capability choices that kind of analysis implied, all the time speaking to Cabinet Office and No. 10 so that it was not getting out of step with the other strands of the NSCR. As we refine that analysis, clearly we start moving into specific programming choices. Clearly, we were not expecting to have a new Secretary of State join us three and a half weeks ago. The Secretary of State clearly has wanted to take a little bit of time to get up to speed with the work that had been being done over the previous few months, to see whether that accorded with his own view of where he wanted to take defence. So we are in that process at the moment, but it is fully resourced.



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Q65 **Johnny Mercer:** Does the Secretary of State have a view on this?

Stephen Lovegrove: He certainly has strong views about various aspects of the NSCR. Whether or not he feels that he has got a completely rounded view yet I would probably doubt, but that is really a question for him.

Q66 **Johnny Mercer:** Okay. I will take a moment to pay tribute to the teams who have worked on this. I know you, General Poffley, have worked on this tirelessly. I don't want you to think that suddenly this is becoming political to a point where we are tying hands as a Parliament. The issue we have—the Chairman has raised it time and again, and so have I—is that if you are going to come to this place and talk to us about a diversity and intensification of threats, that has to be met by No. 10 and No. 11. It is not credible for you to come here and tell us that capabilities are going to be lost because of an intensification and threat. You do understand that within the Department—is that correct?

Lieutenant General Poffley: Let me give you the absolute assurance that I see no reduction in the ambition of the chiefs to be able to say, with genuine military advice, what the capability choices will be, given a particular financial threshold, and what the implications will be given the threat scenarios that we have analysed.

Q67 **Johnny Mercer:** That is obviously a private discussion in the Ministry of Defence. Ultimately it is the nation's defences, and it is the public who pay for this. How do we get to a position where we know and have full confidence that the decisions between the Ministers at the MoD, the Prime Minister and the Chancellor will be made on that premise, and that we will be fully aware of what capabilities we are losing as a result of financial constraint?

Stephen Lovegrove: Mr Mercer, you are obviously right. At a very, very fundamental level, the questions you pose revolve around political choices about where the nation wishes to spend its resources. The role of the officials is to provide the best possible analysis of the context, the capabilities, the equipment and the consequences of any set of decisions.

Q68 **Johnny Mercer:** That is precisely what I am asking of you. You will forgive me, but I come from a generation where people at your level, Lieutenant General Poffley, did not give the advice—or, if they did, they did not ram it home clearly enough—that we could not compete on certain aspects of the world stage. But you are confident to tell us that you will make it crystal clear to our men and women what capabilities and what risks we are taking, in this—

Stephen Lovegrove: I can give you that absolute assurance that we are giving our Ministers, and indeed colleagues across Whitehall, an extremely comprehensive set of bits of advice, which definitely bring out the consequences of any decisions that they may ultimately make.

Q69 **Chair:** One problem we have with this, however, is that it is one thing to do as Johnny suggests, which is to say, "Look, we just have not got enough money in defence, and therefore we are considering losing a very



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valuable capability such as the capability that the Albion and the Bulwark supply." However, it is quite another thing to come to this Committee or speak to the wider world and try to put a gloss on the loss of that capability and say that we can well do without it. The scenario that you are outlining is absolutely logical. You are simply saying, "We are public servants. If the politicians will only give us x amount of money, these are the choices you've got." We are with you up to that point. It is different when you then start saying, "What's more, it's not such a bad thing if we lose a certain capability."

I am sure that Johnny will be coming back shortly to the Albion and the Bulwark. Only on 25 January, I had a letter from the Minister for Defence Procurement, having raised the threat to the future of the Albion and the Bulwark as early as last January. She said: "There are no current plans to decommission the ships early, and I can reassure you that their out of service dates are 2033 and 2034 respectively." It is too late for Ministers and civil servants to try to suggest that something happened between 25 January and where we are now, in November, that makes those ships any less vital than the letter explicitly spells them out to be. I invite your comments.

Stephen Lovegrove: It is absolutely not for officials, either in uniform or in a suit, to give views as to the appropriateness or otherwise of retaining specific bits of capability in advance of ministerial decisions. We will not do that. It would be against the principles of the civil service and the military to bind Ministers' hands in that way. I do not think we have come, as officials, to this Committee or any other Committee or made any other public comments about the wisdom or otherwise of keeping specific bits of capability.

Q70 **Chair:** Are you saying that if we asked you whether it would be a significant loss of military capability not to have a landing platform dock, you could not give us any estimate of the value at all?

Lieutenant General Poffley: You would need to set it against the choices you are making as the counterfactual. This is the difficulty we have. We have tried to avoid suggesting that that is a recommended course of action from the Department, because it is quite clearly not, because we have yet to finish the analysis. The difficulty is that in giving you a precise response to your question, we open up every other piece of capability as a choice about which we will then be asked a very similar question in a public forum.

From my point of view, if you do not have a landing platform dock, it is quite evidently the case that your ability to deliver troops from an amphibious platform to a shoreline using surface landing craft is less than if you do have one. That is quite evidently the case. The question as to whether that particular choice, relative to every other choice, is a sensible one is, as the Permanent Secretary says, not for us as officials to make. It is for us to give that advice and to say, "Here are the implications of the decision you are about to make, and this is the consequence," in as much detail as we can, both from a military point of view and on the other wider



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impacts. It is an incredibly complicated business, and those effects are quite profound in a number of different fields.

Stephen Lovegrove: I can assure you that when Ministers make their decisions, they will do so on the best and most complete military and civilian advice.

Q71 **Leo Docherty:** General Poffley, why on earth is this under consideration? Given that risks have increased and accelerated, as the Permanent Secretary has said, why is this amphibious capability even under consideration?

Lieutenant General Poffley: My response to the question of whether we are considering a particular set of platforms has always been, in the course of this review, that this is frankly a series of speculative remarks that have appeared in a newspaper. But it is certainly the case that we are looking at every single piece of the capability portfolio—

Q72 **Leo Docherty:** So you regard the speculation that has been in the press as unfounded or spurious.

Lieutenant General Poffley: I can confirm that we are looking at how we are intending to conduct amphibious operations into the future, and how that might best be done given the threats that we predict and are current.

Q73 **Leo Docherty:** Is one of the pressures and variables in that calculation also cost?

Lieutenant General Poffley: It is indeed, because quite clearly a judgment about the best mix of capabilities for our budget is going to be part of that calculus. That is where we will have to make some prioritisation. But outside the scenarios in which we would have an unlimited budget, we would still be in the business of deciding our national scale of ambition on an international and an operational front, which would provide some limits to that. We will always be in a prioritisation exercise.

Q74 **Leo Docherty:** So if a formal proposal is made from the First Sea Lord to you about cutting HMS Albion and HMS Bulwark, what would your response be?

Lieutenant General Poffley: My response would be that we need to be very clear that if you do that you will quite clearly limit the military options that are likely to be applied in an amphibious setting because, patently, if we do not have those platforms we are unlikely to be able to do certain things in the way that we have traditionally done.

Stephen Lovegrove: And is that a choice you want to make, against the hundreds of other choices that you might want to make too?

Q75 **Leo Docherty:** So you would agree with me that it is a critical global capability in terms of our global reach and our capacity to project power from the carrier force?



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Lieutenant General Poffley: It is an incredibly important capability and will obviously be taken account of. Is it critical? Is any one of our choices critical? Well, this is an ecosystem. Frankly, we could have various offsets to mitigate the lack of a particular capability. Is it something that we think is really important and high up in our priorities? Absolutely it is.

Leo Docherty: Thank you for that reassurance.

Chair: That is a very useful statement, to know that it is incredibly important. But I suppose you might say that other things are even more incredibly important, and that is why we need more money for defence, one might reasonably argue. Mark, you wanted to come in.

Q76 **Mr Francois:** I appreciate, Mr Lovegrove, that you said you can't prejudice the decisions of Ministers. Got that—but again referring to *The Sun*, which appears to have been rather active over the past few days, there were also reports over the weekend that the Secretary of State had effectively ruled out disposing of Albion and Bulwark, that he had already taken a decision that he was not going to do that.

Stephen Lovegrove: Final advice to the Secretary of State on this particular matter has not been proffered to him so, in that context, I think that that formally is probably not the case. Exactly where he is personally, I am afraid I am not privy to that information—maybe *The Sun* is and I am not.

Q77 **Mr Francois:** Right, because he could take a decision, in principle, without waiting for the formal advice, could he not?

Stephen Lovegrove: He could. He has not communicated to me that he has done that so far, but there again I am sure there are plenty of things that he hasn't communicated to me yet.

Q78 **Mr Francois:** All right, thank you. On a question about the mechanics of the review itself, you will complete the work on your strand, but presumably the National Security Adviser will then co-ordinate the paper, and that will then have to be taken by the NSC, and they will take a collective decision on what the outcome will be. Are you concerned at all about the ability of Defence to have a sufficiently loud voice in that system which is going to involve other Departments and other agencies of Government?

Stephen Lovegrove: I make it my job to make sure that my voice is as loud as I can possibly make it. Colleagues also have equally forthright views. I have no issues whatsoever with the way in which the National Security Adviser is conducting the review. He has been extremely open with us about all of the other work strands; we have been pretty open with him about all of our work strands. It has very much been a joint exercise. The reality is, as I said before, that the defence budget—as the MoD—is a lot bigger than everybody else's. It is a lot more complex than everybody else's. General Poffley described it as an ecosystem. It is a very big ecosystem—it is planet sized. That is fully reflected in the work that is going on at the moment. I speak to the National Security Adviser probably



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at some length every single day on the matter. I am not concerned at the moment, but I am certainly not complacent.

Q79 **Mr Francois:** With regard to your work strand, when do you think the MoD will complete it? I understand you have not quite finished.

Stephen Lovegrove: No.

Mr Francois: So can you give us two things: some idea of when you anticipate you will complete your strand and some idea of what the subsequent timings are likely to be and when we are likely to get some outcome on the review?

Stephen Lovegrove: I can give you a sense of what the original timetable was, as set out in July. It was broadly that it would be coming to a head around now, with decisions from the NSC ideally before Christmas—although exactly what we mean by decisions in that context is not 100%, because obviously the NSC is a very important and central part of it, but there are bilateral relationships and conversations and so on as well. We may see some slippage of that, principally because we have a new Secretary of State, who—in his words; I spoke to him about it yesterday—is very conscious that some of the decisions that he will be asked to make will last for generations. He feels appropriate responsibility for getting those right, so there may be some slippage, certainly in our strand.

Q80 **Leo Docherty:** Briefly, on the capability review, Mr Lovegrove, you have said that the global threats we face are increasing and accelerating. I entirely agree. Given that we most likely need more capability, not less, militarily, do you think that if, as a consequence of this review, the Ministry of Defence loses any capability, it would be illogical?

Stephen Lovegrove: I sort of refer you to my previous answer. Ultimately, the amount of money that the nation chooses, through its elected Government, to spend on defence is for the elected Government to decide. It will be for the Prime Minister, the Chancellor, the Secretary of State and the Cabinet to take a view as to what, in that context, is illogical.

Q81 **Johnny Mercer:** General Poffley, has the Secretary of State come to see you over the weekend and asked you to tear up your plans and start afresh?

Lieutenant General Poffley: Was the question “has he”?

Johnny Mercer: Yes.

Lieutenant General Poffley: No, he has not.

Q82 **Johnny Mercer:** Fundamentally, in the defence community, particularly in Parliament, we are patriots and we are trying to see this process through. How are you finding it? What can we do to help us arrive at the right answer?



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Lieutenant General Poffley: First, as a personal experience, I am clearly loving every minute of it.

Johnny Mercer: As much as I enjoy being an MP.

Lieutenant General Poffley: It is a robust process. It is frequently quite tense, inevitably, because we have spent many years—indeed centuries, on occasions—building up a particular parochial ethos and particular cultures. Therefore, you will always be in conflict with some part of the organisation if you look at a piece of compromise. That is not unexpected; it is part of our job and we do not shy away from that. It comes back to the point that our job is to apply as much logic as we can bring to bear on some pretty intractable problems.

As a process, it is what it is. We anticipate it reaching a conclusion so that we can move forward, do the detailed programming and work to get on. You need to be confident, and I hope you are, that deep seated in this is that I am part of that institution. Many of us have personal equity in the future of the community. Right at the heart of this is a responsibility to ensure that when our young people—men and women—are asked to be put in harm's way, they do so in a responsible way.

Q83 **Johnny Mercer:** That is certainly very much my driving motivation as well. Nobody is expecting you to say what is right and wrong in the national interest, because as you rightly say, that is not your position. What the Chair was saying, and what I completely agree with, is that it is an issue of integrity and credibility that when those options are presented—not only to the Secretary of State, but perhaps before this Committee and in Parliament—it is done with the strict adherence to integrity that we expect from our men and women who serve.

Stephen Lovegrove: I couldn't agree with you more, and all three of us, whether in uniform or not, take our ethical responsibilities to Parliament, our Ministers, and the people we serve in the armed forces very seriously.

Q84 **Chair:** I have just had a bright idea for a positive piece of work that could easily be added to the review.

Stephen Lovegrove: Well—

Lieutenant General Poffley: Our enthusiasm knows no bounds.

Chair: Don't worry, it won't involve any extra work at all. If I understand correctly, you are saying that you are looking at the various capabilities currently in existence, and the threat is intensifying so you may need to beef up some capabilities. However, if the financial constraint is not eased, you can only beef up some capabilities at the expense of other existing capabilities. That seems a fairly sensible interpretation of everything we have heard today. Is that reasonable?

Stephen Lovegrove: Yes.

Chair: Given that, as you rightly say, it is up to the politicians to choose, what is there to prevent you in this study from saying, "Within the



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financial limitations that we have at the moment, we can fund only a certain proportion—listed below—of the capabilities that we currently have. Indeed, we might have to reduce some if we want to increase others.”? Given that you have inevitably had to ascribe financial cost to each of those capabilities, what is there to stop you saying, in an annex or two, “Well, if we were given x amount more money, we can fund more of these capabilities,” and show us what the different sums of money would buy if politicians were willing to raise the limit?

That seems not to involve any extra work because you will have to ascribe cost to each capability. This way, the nation could have a debate about whether barely scraping over 2% of GDP for defence is adequate in the light of what the capabilities would cost, and in the light of the fact—as we on this Committee never cease pointing out—that several years after we had taken the peace dividend in the early '90s, in the mid-1990s we were still spending 3% of GDP on defence. Would it involve any great difficulty when you conclude the review to have a few additional sections showing what the extra cost would be, and what capabilities could be kept that would otherwise be lost if we weren't to increase the financial limit?

Stephen Lovegrove: Aspects of that type of work are undertaken, and they are important in terms of policy formulation and Ministers' discussions. It is a very sensible idea.

Q85 **Chair:** So presumably we would have to put on pressure to get that published.

Stephen Lovegrove: Clearly, we cannot analyse every single scenario in such a complex organisation. At the moment we are focusing on the types of scenarios that the Treasury is keen for us to focus on, that the Secretary of State is keen for us to focus on and that the National Security Adviser is keen for us to focus on. Clearly, there is a Defence view as well, so there are a number of different scenarios.

Q86 **Chair:** But you could draw up a list basically saying, “These are pretty much all our main capabilities and this is how much each of them costs.”

Stephen Lovegrove: Those kinds of things can be done, absolutely.

Q87 **Chair:** Is there a generic name for that sort of list?

Lieutenant General Poffley: I don't think there is. It is something we do as a matter of routine because it comes to the heart of our ability to provide political choices.

Chair: Good. Well, I think that is very positive and helpful. Shall we now move to Phil, to talk about the Submarine Delivery Agency?

Q88 **Phil Wilson:** Will the Submarine Delivery Agency be fully up and running by April 2018? Is there anything that might prevent that?

Stephen Lovegrove: My expectation and anticipation is that it will be up and running in April 2018, and it will be established as an Executive agency of the Department. You know that we have appointed Ian Booth as



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the CEO; we did that in September. I was talking to Ian yesterday, and he confirmed to me that he had identified and secured his chief financial officer, and he has plans in hand for his chief commercial officer, which is a very important role for him. It is, in shadow form, up and running already, so yes, I am confident.

Q89 **Phil Wilson:** So you cannot see anything that might prevent that from happening?

Stephen Lovegrove: Not that I know of today, no.

Q90 **Phil Wilson:** Can you guarantee that spiralling equipment programme costs will not lead to cuts in armed forces' budgets for training and other essential activities?

Lieutenant General Poffley: Inside the equipment programme, we apply a degree of contingency for cost growth. It is part of the annual calculation to ensure that the impacts of that cost growth are mitigated as best they can be. Where it does occur, we clearly try to drive that cost out where we are able to, but it comes back to my ecosystem point: in many ways, inevitably, there is a relationship between the equipment programme and the rest of the budget, including the training and activity programme and every other category of spending that we have. You cannot guarantee it, but there is sufficient provision set aside inside the equipment programme such that we have not had to do that overtly, in my experience.

Q91 **Phil Wilson:** There was a report in *The Times* on 27 October saying that the armed forces need to absorb £300 million of additional costs in year to raise money to cover the costs of replacing the Trident submarine fleet.

Cat Little: The cost estimates for Dreadnought, as the next-generation programme, have been revised. Our previous financial plans were undertaken back in July—over the summer the DG Nuclear, Mr Julian Kelly, newly appointed into the role, quite rightly wanted to get further assurance and robustness into the understanding of costs. The £300 million reported is part of the revised estimates for the Dreadnought programme as a whole, and they are fully factored within our financial plans.

Q92 **Phil Wilson:** Has the Treasury now approved that additional £300 million?

Cat Little: There has been no agreement with Treasury about additional funding for Dreadnought.

Q93 **Phil Wilson:** Is that £300 million just for one year, or is it recurring?

Cat Little: I believe the £300 million reported relates to this financial period.

Q94 **Phil Wilson:** Was there a time when the nuclear deterrent was funded out of a separate budget rather than the equipment budget of the Ministry of Defence? Was there a special budget from the Treasury that paid for the nuclear deterrent?



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Stephen Lovegrove: I think Ms Little and I are, notwithstanding how it looks at least in my case, too young in the tooth to know the answer to that fully. I think there may have been a different budgetary arrangement pre-2010. Is that correct?

Lieutenant General Poffley: I would not be able to confirm that one way or the other, but my understanding is that there was a slightly different arrangement.

Stephen Lovegrove: We can write to you on that.

Q95 **Phil Wilson:** Could you let us know about that, because that is an interesting point? My final question is on the Astute submarines, which have experienced the highest average number of cannibalisations across ships and submarines, with 59 instances per submarine. They also experienced more defects than older equipment, with a third of defects resolved through cannibalisation. Why does so much go wrong with the Astute submarines?

Lieutenant General Poffley: The Astute submarine is an incredibly complicated machine. I think we need to get the commentary in the NAO report in some context. Cannibalisation across the Department—I will come back to Astute in a moment—is less than 0.4% of all the stores that have been issued over the course of the last five years. When it comes to Astute, that percentage is higher—it is 1.4%—but that is partly a reflection of the lead times that are associated with many of the parts and spares associated with the Astute programme. It is partly a reflection of the fact that, with such a sophisticated platform, you are seeing technical failure in a less predictable way than you might with a more conventional and simpler platform.

Is it out of kilter, and do we think it is a significant problem? The answer to that is no. It is part of our routine process—indeed, all militaries do this—to cannibalise in extremis where the lead times for bringing in the spares to fit are in excess of the operational imperative to move the platform back to an operational posture. In Astute's case, it is not exceptional for a machine of that complexity.

Q96 **Phil Wilson:** The NAO report says that 71% of parts cannibalised were of low value, but there is also the cost of moving the part. On most occasions, getting the part there is more expensive than the value of the part.

Lieutenant General Poffley: That may well be the case, but it is a reflection of the level of sophistication of some of those manufactured parts. They are not simple parts, they frequently have very long lead times and their specification is so precise. Clearly, that is the sort of judgment that leads you to cannibalise in extremis.

Q97 **Phil Wilson:** Does it concern you that the number of cannibalisations has increased by nearly 50% in the last five years? As you mentioned, between 0.3% and 1.4% of parts provided to the main classes of submarines were cannibalisations.



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Lieutenant General Poffley: It is not something we would want to be complacent about. It needs to be monitored, and if we are seeing trends in particular types of spares that are being cannibalised, we would quite clearly take provisioning action to change the orders of those parts. It is not so extreme a problem at the moment that it is thought to be something that could not be managed in our day-to-day business.

Q98 **Phil Wilson:** How many of the Astute submarines are operational at the moment?

Lieutenant General Poffley: I am not prepared to answer that question. It is a sensitive piece of information.

Q99 **Chair:** Can you give me a rough indication of the first of class cost and the most recently completed Astute submarine cost?

Lieutenant General Poffley: On Astute, forgive me, I don't have that information here, but I would be delighted to give it to you.

Chair: Permanent Secretary, a rough idea?

Stephen Lovegrove: I don't have those figures—

Chair: To the nearest billion?

Stephen Lovegrove: I would rather be a bit more exact than that, Chair, if I may. We are happy to write to you.

Q100 **Chair:** Right, well if you are going to write to us—obviously the first of class costs a lot more—we would like to have a schedule of what the cost of each boat has been, so far as we can see.

Lieutenant General Poffley: Absolutely the case. I ought to try to condition your appetite for this. When we talk about an Astute submarine, first of class is clearly an important issue, but the level of development of the subsequent platforms over many years means that, in some parts of the boat, you are actually talking about it being a first of class every time you reiterate the design, because you are learning. We need to be clear about the distinctions we make in that analysis, but I would be more than happy to provide you with as much information as we have.

Q101 **Chair:** I would be very grateful for that—basically a table—I fully accept that very important point you have just made.

The reason I asked that is that I am looking at the figure for Successor. The original estimate of 2006 prices for the Successor submarines which have since become the Dreadnought class was in the range of £15 to £20 billion for the boats, infrastructure and warheads. As recently as 2012, allowing for price inflation and comparing like with like, that figure equated to about £25 billion. Suddenly, it then shot up to £31 billion and a possible £10 billion contingency. You can see why even someone as enthusiastic for the maintenance of the nuclear deterrent as I am is keen to check that the idea that four submarines, plus infrastructure, plus warheads has inflated in price quite so much, not only from the original estimate, which is within some sort of striking distance of the £31 billion



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figure, but that the idea that we would need £10 billion contingency on top of that requires a little bit of explanation. It would be interesting to see the cost of an Astute boat versus the projected cost of a Dreadnought.

Lieutenant General Poffley: We can make that comparison with you. Inevitably, Mr Lewis will be a major contributor to that and he will have the figure work at this fingertips. Forgive me, I do not have that with me today.

Q102 **Mr Francois:** I believe the Astutes have gone up in cost, but they have also been late. It is a world-class capability—there is no doubt of that—but they have been late in delivery and because of that we have had to run the T-Boats for longer than originally anticipated, and that in itself has been a further cost.

There have been problems at Barrow for a number of years. What is the department doing to grip that bearing in mind that these contracts are non-competitive and that shows? What is the department doing to grip what is going on at Barrow, not least in terms of trying to make sure that Successor runs as smoothly as possible?

Lieutenant General Poffley: The whole point of the Submarine Delivery Agency was to get it after exactly the issue you are describing here. I think it is widely acknowledged that the general description you have given is an unacceptable one from our point of work with you as well, which is why we created the Submarine Delivery Agency and why we are investing so much time and effort in making sure we get after the productivity issues and the technical issues associated with the dynamics you have described. Inevitably, it is going to take a while for that delivery agency to establish facts, make sure it understands the manoeuvre space for any remedial action and put a plan together to make sure it is extinguished as an issue. We are not there yet.

Stephen Lovegrove: I mentioned earlier that I was seeing the new chief executive of BAE next week and would be talking to him about issues to do with aerospace strategies. One of the other subjects which I am going to speak to him about, which he is very seized of, is the need for an improvement in performance up in in Barrow.

Q103 **Mr Francois:** Thank you. For that conversation—I will choose my words carefully in open session—there have been occasions in the past when we have been, shall we say, operationally embarrassed by the level or otherwise of our SSN availability, because the Astutes were so late. Can we have some assurance from you, Mr Lovegrove, that you will drive that point home?

Stephen Lovegrove: You have that assurance, Mr Francois.

Q104 **Chair:** I think we have covered cannibalisation enough, so would you like to go to the other question about strategic reserves?

Q105 **Mr Francois:** Yes, when you look at equipment procurement, there is often a trade-off between capability and mass. We have had a trend in



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recent years of going for ever more capable pieces of equipment, but being able to afford fewer and fewer of them. The Type 45 destroyer is a good example: it is an incredibly capable ship that the Americans respect, but in the end we were only able to afford half of those that we had anticipated.

One way of responding to that, particularly if you acknowledge the possibility of a peer-versus-peer conflict one day, is to maintain an ability to regenerate mass if necessary by mothballing some equipment, keeping it in the inventory and maintaining it. That comes at a cost, but it means that you can reconstitute mass at relatively short notice if the skies darken and you need it. The Committee made a suggestion along those lines about mothballing some of the Tornado fleet when it leaves service in 2019. You referred to that in a memo you sent us, but to be honest it was not a particularly encouraging reply. Is this something that you are prepared to look at again in more detail? Would you also be prepared to look at mothballing other equipment, such as the Type 23 frigate?

Lieutenant General Poffley: We have taken forward the point you made at the last hearing; that Tornado analysis is under way. Candidly, when I examined it, it was not as refined as I would have wished, but it is being re-examined now. It will be part of a general theme when we play into the capability review. The conversation about resilience will be an important one, and the dynamic you describe about mothballing—putting into extended readiness the sorts of capability we imagine we may need for mass—is an important component of it.

The more sophisticated the platform being put into extended readiness, the more complicated this becomes. Clearly, maintaining currency for crews, engineers, spares and all the other associated things, particularly with platforms like fast jets, frequently becomes a cost driver into the programme. Accepting that we are a cash-limited enterprise, that means that another choice somewhere else will be forgone. But it is being considered; I will pursue further detail on Tornado and provide you with supplementary information where I can.

Q106 **Mr Francois:** I am grateful for that, because if it takes a year or so to build a Typhoon or a JSF, it is useful to have a number of aircraft—even if they are slightly ageing—that you can then reconstitute if you have to fight a come-as-you-are war. You cannot just turn to BAE Systems and say, “Knock us out a bunch of Typhoons in three months.” It doesn’t work like that.

Lieutenant General Poffley: Absolutely. Your point is well made.

Q107 **Mr Francois:** So you are prepared to provide the Committee with a note on that analysis when it has been done?

Lieutenant General Poffley: I am more than happy to provide you with a note on that analysis.

Mr Francois: Thank you very much.

Q108 **Johnny Mercer:** Before I come on to defence estates, I have a quick 30-



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second question for a yes or no answer from Mr Lovegrove and General Poffley. Have you been given any instruction, formal or informal, from the Secretary of State to look at the options for the cuts packages that are being talked about?

Stephen Lovegrove: Yes, he has given us some views on the kinds of areas that he would like us to do more work on.

Q109 **Johnny Mercer:** Okay. Moving on to the defence estate, this is a key point for places like Plymouth. How much did you get from selling land and buildings in 2016-17?

Cat Little: I don't have the figure off the top of my head.

Q110 **Johnny Mercer:** Would you send a note to us on that?

Stephen Lovegrove: Of course.

Q111 **Johnny Mercer:** The issue is that last year you laid the Better Defence Estate programme before the defence community and forces families, but since then we have heard from various ruminations, press reports and comments on the sidelines that it is going to be looked at again—for example, Chivenor is not going to close, as was once discussed. The NAO has looked at this; it states that “the success of much of this strategy is uncertain” and that “current assumed budgets will only allow for a partial reversal of the decline of its remaining estate...there will be a gap of at least £8.5 billion”. The question I want answered is: will that estate strategy actually happen? Now that we have told the families and warned them off—the kids in schools and all the rest of them, in the Citadel and Stonehouse in Plymouth and so on—is that strategy still on track to be delivered, Mr Lovegrove?

Stephen Lovegrove: The 2015 SDSR committed the Department, and indeed the Government across the piece, to a number of pretty ambitious targets.

Johnny Mercer: I know what you are going to say. One of them was around defence estates: realising the estates, turning them into cash, meeting housing building targets and things like that.

Stephen Lovegrove: Yes.

Q112 **Johnny Mercer:** My question is very clear. Is that strategy still to be adhered to, or has it been changed by the Department already?

Stephen Lovegrove: It has not been changed by the Department, but we are in discussions with the DCLG, which owns the broader strategy, as to whether some of the ambitions set out there are realistic.

Johnny Mercer: Let's take the case of the Royal Citadel in Plymouth as an example. Ever since the 1980s there have been moves: “We need to get the Army out of there. We need to get the Army out of there.” Finally, in 2014 or 2015, a formal direction of travel is set for the families who have their children in schools, etc.: the Citadel is going to close. The same details for Stonehouse barracks. Now it appears that that is again up in



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the water. What you are saying is that you have to speak to DCLG to see if that is still an issue. My point is that there are families and jobs based in Plymouth, in my constituency, and those people literally do not know whether they are coming or going. That was only announced last year as a strategic long view forward as to what we were going to do with better defence estates.

Stephen Lovegrove: I cannot comment on the specifics of that case, I'm afraid, because I do not know them. I don't know if General Poffley knows a bit more.

Lieutenant General Poffley: I will need to check the veracity of what I am about to say. My understanding is that those two sites are not going to be reviewed. The plan for them is extant, regardless of any of the options we are considering in the capability review. Therefore, the dates that have been set for their closure—I think they are around 2023 and 2024—remain extant.

Q113 **Johnny Mercer:** Great. So you are saying that on a lot of the detail, there is no substantial change from what came out in 2015.

Stephen Lovegrove: That is right. We are due to release sufficient land to be able to build 55,000 homes. That is a lot of land, and what we have discovered—as has every other Department—is that while we are pushing as hard as we possibly can on this, since it is Government policy and we take that seriously, the practical difficulties of getting through planning and getting the sites accepted by the HCA are very, very great. Some of the timetables here are in jeopardy. We are discussing that with the DCLG, as are other Government Departments. It is unlikely that we will make any changes to specific plans, where decisions have been made.

Lieutenant General Poffley: I am very happy to come back to you with a specific response on those two sites.

Q114 **Johnny Mercer:** It would be useful. We know that 90% of the rumour mill is rubbish, but if the Secretary of State goes on a visit, for example to Chivenor, and says, "Oh, this is a good base; perhaps we shouldn't be shutting this," everyone else whose lives are affected by where they live and where they are based will say, "Well, this review happened six months ago, so what is actually going to happen?" Is that a fair point?

Lieutenant General Poffley: That is an absolutely fair point. We are doing as much as we can to avoid the culture of doing strategy by visit report. At the end of the day, we must be clear about what it is to deliver certainty for our people, so your point is well made.

Q115 **Chair:** You will give us an update on where the whole thing is?

Lieutenant General Poffley: As far as the defence estates optimisations plan is concerned, we are continuing with the plan extant. If the capability review made some substantive changes to our force structure or some other dynamic within the programme, we would of course review and adjust the plan. When we talk about specific sites, particularly of the sort



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of scale you are describing here, I do not anticipate any significant change to them.

Q116 Mr Francois: The Defence Infrastructure Organisation, may its name be blessed, entered into a strategic business partnership with Capita, or “Crapita” as it is affectionately known—for good reason—throughout the armed forces. You are now sacking it as your strategic business partner. Why is that?

Stephen Lovegrove: My view, which I will try to elevate to a slightly higher level of abstraction, is that, first, we have historically, as Defence, relied too much on outsourcing our strategic management functions. We have not invested sufficiently in developing our own internal embedded management capability that we know that we can rely on come fair weather or foul.

Secondly, particularly when looking at strategic management issues such as this, it is not very easy to capture the dynamics of what goes on in life within a contract. That is a view that was shared by Tony Douglas, which is why he is doing what I said he was doing with his main contracting partners. At the highest level, that is really the dynamic going on with Capita and DIO. I do not want to be in a position where I know that the group of senior managers in DIO have a primary allegiance, no matter what the contracts say, to a company that is not the MoD.

Q117 Mr Francois: So once they are gone, you are not looking to re-let it with another partner?

Stephen Lovegrove: I am very happy to identify parts of function that we think can be done more effectively, more quickly or with different bits of capability by third-party providers. I have no problem with the idea that, where it is appropriate, we should aggressively pursue that.

My own view, having seen a lot of this over many years, is that strategic management is not where we should look to apply that kind of solution. I am not ruling it out, because there are discrete segments where you can contractualise effectively, monitor that contract and write it properly and all the rest of it. However, when it becomes too diffuse and strategic, I think that is a problem. That is the approach that we are taking.

Q118 Mr Francois: I have some sympathy with that.

I have one other question about estates and contractors, and CarillionAmey, who are your housing maintenance contractor. If you look at the armed forces continuous attitude survey, and also the families’ survey, you can see that there is a lot of dissatisfaction with the way that CarillionAmey perform. I could quote you some examples, but for brevity I will not, if you will accept that fact; I see you are nodding, Stephen.

It seems to me a tremendous frustration that we send someone halfway around the world to fight for their country, and we tell them that they are a hero, which they are, but meanwhile, back home, their wife has to fight for weeks just to get someone to come and fix the boiler. This has been going on for too long. Can you give us any confidence that the



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Department is doing something to grip it?

Stephen Lovegrove: The first couple of hearings that I did when I joined the Department in April last year were on exactly this subject. I was sitting next to the CEO of CarillionAmey, who looked after this. I think that looking back at the transcripts would give you confidence that we are taking this very, very seriously. We are in absolute agreement that we need both to look after our serving men and women to the highest possible degree when they are on our estate, and to make their lives and their families' lives as good as we can reasonably make them.

As a result of that, CarillionAmey, certainly when I arrived, were definitely underperforming and failing on most of the metrics we had put in place. They were effectively put on a remediation plan. We withheld quite a lot of money from them. The individuals at CarillionAmey didn't meet any of their bonus targets, so they felt it in their pockets as well.

The last time I looked—I will happily go back and check—CarillionAmey were doing better and indeed were hitting their target performance indicators. I would like to go back and check and make sure that they are continuing to do that.

Q119 **Mr Francois:** One other point on that: following a number of profit warnings, the share prices of the parent company absolutely collapsed, and it was reported over the weekend that they are now at risk of breaching their banking covenants. If they go bust, corporately, do you have a plan B?

Stephen Lovegrove: We do have contingency plans, yes.

Q120 **Chair:** In relation to the DIO, do we have any remaining financial obligations to Capita or to Annington Homes?

Stephen Lovegrove: I cannot answer the question very fully on Capita. We certainly do have financial obligations to Annington Homes. The deal that I think was signed in 1998 was for 999 years, I think. So they are the landlord for 999 years, and I think we have a leaseback for 200. We will need to continue to pay Annington for the property that we lease back off them. We are not that far away from a crucial moment in the contract where there will be a degree of renegotiation of some of those sub-leases. We are in intensive discussions with Annington to make sure that the deal that we get as a result of that is as good as it possibly can be for Defence and everybody who works in Defence.

Cat Little: On Capita, the contract will continue until June 2019, so there will still be some ongoing financial commitments to meet that contract.

Q121 **Johnny Mercer:** Really briefly, you left one part of your answer slightly open, General Poffley. In that rebasing strategy, is Plymouth still going to remain the centre for the Royal Marines as stipulated in that document?

Lieutenant General Poffley: It is.

Q122 **Phil Wilson:** Do you think that the MoD is doing enough to tackle skill



shortages?

Stephen Lovegrove: There are two aspects of that—basically, the civilian and the military. I will let General Poffley talk about the military. The start of this is to recognise that we have skills gaps, and we do recognise that. Ms Little spoke earlier about beefing up some of the financial skills, both in the centre and out in the commands. I am conscious myself that we need some more commercial, as opposed to financial, skills. I was speaking to Ian Booth, the chief executive of the SDA, about that; it is something he is working on at the moment. I used to be a corporate financier and used to run the corporate finance unit of the Government. We have some need for that in the Department, so I have got an embedded unit now, dealing with those kinds of corporate situations—Annington Homes among them, actually—in the Department. We need to really seriously beef up the way in which we think about our digital presence and the way in which we manage ourselves.

Am I confident that we have absolutely the full suite of skills in the Department that we need? No. Will I ever be confident that we have absolutely the full suite of skills in the Department that we need? No, because the world will move on and we can always do better. Am I confident that we have a clear plan for getting those skills in and for improving capabilities? Yes, I am: some of the senior hires that I was talking about earlier on are really directed in that area.

Q123 **Phil Wilson:** The NAO said that there were 30 “pinch points” in all three services. In 2017 there is actually a reduction from the year before, which is good news. But the one service that has not reduced the number of pinch points is the Army. The Navy is down to 15; the Air Force is at 11 and the Army is at four. It might be more difficult for them to actually get down to zero. Is there anywhere in the Army where those pinch points cannot be resolved?

Lieutenant General Poffley: I recognise the data you are describing.

Phil Wilson: I think it is logistics—

Lieutenant General Poffley: It is—many of them are logistics specialists. It is more an issue about volume than about skills shortages. Therefore it is about training throughput. The Army is actively looking to make sure that it slaves its recruiting and training engine to attend to that volume problem.

In the other services, it tends to be about more technical trade groups, particularly in specialist engineering and very specialist engineering, and some of the obvious areas that you see as a systemic problem across the country at large. This is why, again, in both those contexts, we are engaging actively with other Government Departments to see where we can make sure we are not creating fratricide in our relationship with them. That is most obvious in things like the nuclear industry, for example. There is an active programme to reduce it, and while I think the Army problem is an issue, it is being actively managed at the moment.



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Q124 **Phil Wilson:** On the civilian side as well, how will you resolve the need to reduce staff numbers yet resolve the skills shortfalls, particularly around commercial staff?

Cat Little: Right here today, we have a 12% vacancy in the number of commercial staff that we need. One of the critical answers to how we reduce headcount at the same time as upping skill is that we need to be less reliant on consultants and commercial support, which we are currently drawing down through quite expensive managed service contracts. We have seen some of that within DE&S, and I have recently appointed a new chief commercial officer, who is overseeing the overall approach to how we get that balance right over a period of time. And of course, we are working very closely with the Government commercial office to do so.

Q125 **Phil Wilson:** Do you have any realistic and achievable plans to reduce your civilian headcount, considering that it has been increasing at the moment? How do you justify increasing the number of senior civil servants when you need to reduce headcount?

Cat Little: The Permanent Secretary alluded earlier to there being headcount increases specifically in DE&S and DIO. As I have just described, that is perfectly legitimate where you are shifting the balance of use of contractors and interims in order to boost capability. In fact, across the rest of the Department, we are seeing decreases across the board around the whole of the back office and head office functions.

My personal view for the functions I am responsible for is that I think we need to be much more automated, much more focused on use of technology, much more efficient and much more productive in the way in which we use our workforce. That is likely to need us to move from a classic pyramid structure into one that is more rhombus-shaped, with probably more highly skilled people at the top of the chain, who are more capable, but probably fewer people lower down the echelons of the organisation. From what I have seen so far, there are very good plans in place to achieve that.

Q126 **Gavin Robinson:** What is the impact across Government of delays in vetting staff?

Stephen Lovegrove: At its most general, the impact is that within the full range of functions that staff who need vetting clearance are being charged to do, they may find themselves not being able to do as much of it as they should be. That is a particular problem at the moment because the need for vetted staff has grown exponentially in Government, principally as a result of Brexit and the need for them to be able to see lots of very sensitive material. There has been another pressure, which has been the need for vetted staff around the Grenfell Tower fire. That has coincided with a long-planned rationalisation of the two vetting organisations that used to exist in the UK, one run by the MoD and one run by the Foreign Office, which have been deemed to be inefficient for a long time. Those organisations are coming together.



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At the same time, there has had to be an upgrade in some of the technology that underlies the vetting systems, and there has been a great deal of extra demand. As a result of that, frankly, earlier this year we saw vetting targets being missed to, I think, an unacceptable degree. We acted on that pretty much as soon as we saw it happening, and I am anticipating that the vast majority of the targeted levels will be reached again in January 2018—so quite soon.

We have had a dip off. There have been reasons for it—but not excuses—and we are acting on trying to get it back where it needs to be.

Q127 Gavin Robinson: Is there an identifiable geographical difficulty in vetting staff? I ask that because in Parliament, if a member of staff is from Northern Ireland, it can sometimes take three or four times longer to get sufficient clearance to join the networks and get a pass.

Stephen Lovegrove: I am not aware of that, although I have spoken to my peers at the Foreign Office, the NSA and other associated permanent secretaries about whether aspects of our vetting policy are really as up to date with the modern world as they might need to be. That may be a feature of this. One particular, strange thing about our vetting is that we take a snapshot of somebody at a key moment and then we do not think about them at all for seven years, and then we take another snapshot. Quite a lot happens in people's lives in seven years, so there are quite profound things to think about at the moment. Another workstream is working through that, but that is more to do with policy. I will certainly take away the point about Northern Ireland to see whether there is a specific issue there.

Q128 Gavin Robinson: Thank you. What are you doing to stop thefts of your equipment?

Lieutenant General Poffley: Clearly, it is something we are actively looking to pursue. A number of remedial measures are in play. First, the accounts bring out the fact more management action needs to be applied to that, so we are conducting a review of the physical security of sites where we see a particular prevalence or where particular value items are likely to go missing. We are looking definitely at the processes under which we maintain stores and accounts to ensure that they are being rigorously applied. Frequently, if you do not apply the materiel regulations, you tend to find that lapses in process lead to opportunities that people will exploit.

Finally, we are clearly looking to make sure that where we can find culpability for those losses, they are being pursued vigorously in the discipline chain to act as a deterrent downstream. Those three or so initiatives will clearly take some time to work through. From the physical security point of view, there will be a cost judgment to be taken associated with the investment in that security relative to the loss. Clearly, if the material is sensitive or is going to present a security challenge to the wider community, that will condition our response.

Q129 Gavin Robinson: Sure. You have a spectrum where on one level,



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there are pens, pencils and so on, but on another, there was the dissident republican Royal Marine who was storing materiel at Carnfunnock Country Park near Larne. Have lessons been learned from that incident, and has the review on the dissident republican concluded?

Lieutenant General Poffley: Some of the recent cases have highlighted the need for us to improve the relationship between the police forces inside the Ministry of Defence and the national security and intelligence databases, and indeed to make sure that there is a closer connection with the wider policing community across the country. That is an active part of the review of this area at the moment.

Q130 **Gavin Robinson:** For a number of years now, the MoD police have raised their capacity concerns about the numbers of officers or personnel that they have to secure sites. Do you share those concerns? Is there a fear that future funding cuts will make the situation worse?

Lieutenant General Poffley: Again, like any part of the structure, you are making a judgment about whether you need to increase resource into this place or not. At the moment, quite clearly, the MDP the Ministry of Defence police—forms part of a portfolio of capabilities. We will look at that and make sure, if we believe that there are some major compromises that need to be attended to, that we do so.

Stephen Lovegrove: The Ministry of Defence police are not manned to liability—they are 200 officers off where they theoretically need to be—and they have been like that for some years now. Indeed, the number of officers that they have has gone up very slightly over the last few years. The question really is whether we have the liability—the actual theoretical number—right. Possibly, the number needs to be closer to where they are actually manned today and have been for some years.

Q131 **Gavin Robinson:** Again, a curveball for Northern Ireland is the Northern Ireland guard service, which involved armed civilians assisting in the security of sites. Is that twin-track process that operates in Northern Ireland considered for the rest of the United Kingdom when looking at MoD police?

Stephen Lovegrove: It is separate.

Q132 **Gavin Robinson:** But are you considering a parallel arrangement in the rest of the United Kingdom?

Stephen Lovegrove: To have an armed guard service like the NIGS? No; I was in Northern Ireland the other day and I met some of the guards out there. There are obviously still operating in a very, very different environment to colleagues on the mainland. It was borne in on me very clearly that there are patterns of life and procedures that they and their colleagues right across the civilian workforce in Northern Ireland still have to adopt in a way that is probably rather invisible to people on the mainland. The context is very different, and we are really cognisant of trying to make sure that our arrangements respect that.

Chair: It only remains for me to thank the three members of the panel



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today for dealing with so many issues over quite a long period and in such a forthright way. We are all very grateful to you.