



House of Commons
Defence Committee

**Gambling on
'Efficiency': Defence
Acquisition and
Procurement:
Government Response
to the Committee's
First Report**

**Fourth Special Report of Session
2017–19**

*Ordered by the House of Commons
to be printed 21 February 2018*

The Defence Committee

The Defence Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Ministry of Defence and its associated public bodies.

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Committee reports are published on the Committee's website at www.parliament.uk/defcom and in print by Order of the House.

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Fourth Special Report

The Defence Committee published its First Report of Session 2017–19, [‘Efficiency’: Defence Acquisition and Procurement](#) [HC 431], on 17 December 2017. The Government’s response was received on 16 February 2018 and is appended to this report.

Appendix: Government Response

Introduction

The Department welcomes the House of Commons Defence Committee’s report on Defence Acquisition and Procurement and appreciates the Committee’s time and recognition of the reform and improvement that has taken place in delivering effective and reliable defence equipment and support within budget.

The Government remains committed to increasing the defence budget by 0.5% above inflation each year and we agree with the Committee’s conclusions that science and technology will continue to play a central role in Defence. The Committee will also be pleased with the recent Defence Industrial Policy refresh that continues to encourage a thriving and globally competitive UK defence sector.

The Committee will note that the National Security Council (NSC) agreed on 23 January 2018 that a report on the National Security Capability Review (NSCR) will be published in spring 2018. The NSC also initiated a separate, further piece of work to modernise Defence. The Modernising Defence Programme (MDP) will build on the solid foundations laid by the Strategic Defence and Security Review (SDSR) 15 and the NSCR. MDP headline conclusions should be ready by July 2018. We aim to modernise Defence and the Armed Forces more quickly in light of the increasing threats we are facing, and to deliver better military capability and improved value for money.

The Department’s formal response to the Committee’s conclusions and recommendations is set out below. The Committee’s findings are in bold, with the Department’s response in plain text. For ease of reference, paragraph numbering follows that in the “Conclusions and Recommendations” of the Committee’s Report.

Reforming defence acquisition

1. **At least where ‘big ticket’ equipment items are concerned, such as the F-35 and the carriers, it is questionable to what extent real responsibility resides with the individual Service Chiefs, rather than remaining under central MoD control. Under such circumstances, the Service Chiefs risk taking the blame for equipment acquisition delays and cost overruns primarily caused by Ministerial or MoD miscalculation.** (Paragraph 13)

As referenced in the Report (Paragraph 13, Page 7) the Service Chiefs have been delegated the resources and decision rights to shape, own and be held accountable for the military equipment and capability that our Armed Forces require. The Commands, as intelligent customers, set the requirement for the delivery agents, including Defence Equipment & Support (DE&S), and agree the prioritisation for acquiring equipment, logistic support

and information services. The Service Chiefs undertake this within a system, not alone. Teams such as Strategic Programmes in the Department's Head Office and the Nuclear Enterprise also fulfil intelligent customer roles.

In some cases, such as Carrier Enabled Power Projection (CEPP), a Senior Responsible Owner (SRO) is appointed to oversee a wider capability package. Deputy Chief of Defence Staff (Military Capability) is the CEPP SRO, but in line with the established practice under the Defence Operating Model responsibility is delegated to where it is most effectively exercised. For CEPP, the lead responsibility for the Carrier and Crowsnest (helicopter based surveillance) components is Navy Command and for the Lightning II component it is Air Command.

It must also be noted that the Department sets the overall strategy in the context of the Government's policy and allocates resources; to do this the Head Office and Ministers take high-level balance of investment decisions and adjust plans and capability as threats to the nation evolve. The Head Office also retains central control of contingency to hedge against financial pressures; and maintains appropriate checks and balances including overseeing the final scrutiny and approval of significant equipment programme business cases.

Importantly, the Department has well-established performance management arrangements to monitor the output of the customers and delivery agents and these enable accountability and decision-making responsibility.

The Service Chiefs do, therefore, have responsibility for 'big ticket' acquisition programmes within the broader decision-making responsibilities of the Ministry of Defence where everyone owns their share of responsibility for the development and maintenance of the capability needed to defend our country.

2. It is clear that the MoD has made some progress in implementing the reforms recommended by the Gray and Levene reviews. While the direction of the transformation programme appears to command general support, we note the concerns raised about the pace of reform and the ability of DE&S to be truly "match fit" this year. Indeed, the MoD has itself acknowledged that it has more to do in delivering the transformation programme. It is therefore a source of concern that Mr Douglas has announced his departure, after a little more than two years in post, as Chief Executive of DE&S and the Committee is unclear as to the reasons for his departure. (Paragraph 30)

DE&S has undertaken a major transformation programme, and achievement of the Match Fit objectives by April 2017 was a significant waypoint in terms of delivering the future vision for the organisation. However, DE&S has always been clear that further work is required to fully embed the changes made and to realise all the benefits expected in efficiency and effectiveness terms. More detail is published in the DE&S Corporate Plan, which sets out a summary of the organisation's objectives, including those relating to transformation, over the next three years. Additionally, the establishment of the Submarine Delivery Agency within the Nuclear Enterprise will bring greater oversight and scrutiny of our submarine programmes and is a further example of transformation.

The former DE&S Chief Executive Officer, Tony Douglas, was offered the opportunity to take on a role in the private sector, which combined with other personal circumstances,

he decided to accept. In doing so, he left the role some eight months earlier than planned having put in place the conditions for DE&S to successfully complete its transformation journey.

3. *While DE&S has made some progress to date, it is still too soon to judge whether it has adequately matured as an organisation. We remain sceptical about how this goal can be objectively measured. The MoD should provide us with a list of the criteria which have to be met; details of which aspects of the transformation programme have yet to be completed; and an explanation of how to measure the resultant improvements. (Paragraph 31)*

DE&S achieved its Match Fit objectives by April 2017 as part of its ongoing transformation. This key milestone in the DE&S transformation journey described DE&S as being:

- Equipped to deliver its promises and on the right track to becoming a leader in defence acquisition and in-service support. Progress to date: DE&S Customer satisfaction scores increased by 10% to 6.4 out of 10,¹ and have reached a positive tipping point in DE&S relationships with intelligent customers.
- Able to deploy its people functionally and flexibly to task. Progress to date: All DE&S staff have been mapped to a function and role profile, ready for deployment by functions within a new balanced matrix structure. A comprehensive function support structure is in place.
- Able to use standardised ways of working to help staff to maximise their time and minimise wasted effort. Progress to date: New standardised ways of working have been introduced to project delivery teams. Essential processes have been defined and loaded onto a new Business Management System database.
- Supported by a pay and performance system that rewards good performance. Progress to date: A new grading, performance and reward regime has been defined and was implemented during 2017; this supports the balanced matrix and helps to attract and retain specialist staff.
- In the process of developing a management information system which is underpinned by the principle of inputting information once and using many times. Progress to date: A new management information hierarchy has been established underpinned by the introduction of enterprise management tools (e.g. Portfolio, Programme, Project Management (P3M)). These are being rolled out in parallel with improvements to the overall technology infrastructure.

To track Match Fit and beyond, DE&S has employed a range of measures; these include:

- Milestones: For each year of transformation, a detailed plan has been developed identifying the expected outcomes and the activities required to achieve them. For each activity, specific milestones are established and, on a monthly basis, progress against each is measured alongside overall programme progress in terms of schedule and cost performance indicators.

- **Maturity:** DE&S annually measures its progress against a set of industry standard maturity indices. These are:
 - Business maturity: an assessment of the maturity of DE&S delivery processes.
 - Talent: an assessment of how DE&S manages people across the employee lifecycle.
 - Human Resources (HR) user satisfaction: A measure of the performance of the HR department in the delivery of its processes.
- **Benefits:** The business case for DE&S transformation was subject to significant scrutiny and quantified the benefits expected to be delivered in terms of operating expenditure savings and equipment plan savings. The realisation of these benefits is tracked monthly.
- **Customer satisfaction:** This consists of a structured survey (conducted twice in 2016/17), supplemented by interviews with senior staff from intelligent customers' organisations, to gain additional qualitative feedback. The scores from the surveys are combined to give a Customer Confidence Index (CCI), presently 6.4 out of 10, which is an aggregated score derived from numerical responses to eight themes. Based on the CCI, action plans are drawn up and agreed or reviewed with the relevant Customer organisation.

The above measures are reported monthly to the DE&S transformation committee, which is chaired by the DE&S Chief Executive Officer. Corporate performance is also reviewed by the Department's Head Office.

4. *With a National Security and Defence Capability Review underway and due to report early in 2018, the Department must act swiftly to appoint an interim Chief Executive of DE&S, while a full competition is run for a permanent successor to Tony Douglas. The appointment process should also include a pre-appointment hearing with this Committee. (Paragraph 32)*

Michael Bradley, DE&S Director General Resources, has been appointed as the interim Chief Executive Officer and will remain in place to provide continuity of leadership until a permanent successor is appointed. The recruitment process for the new Chief Executive Officer is well under way. Applications for the post closed on 5 February 2018 and candidates who successfully pass the sift process will be interviewed in March. The post of DE&S CEO is not a public appointment so would fall outside the scope of posts subject to a pre-appointment hearing as defined by the Cabinet Office guidelines on pre-appointment scrutiny.² However, once the new CEO has been confirmed, Secretary of State is happy for the Committee to invite them to give evidence before they take up their post.

2 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/259686/Guidance_publication.pdf

The Defence Equipment Plan

5. We endorse the NAO's overall conclusion that the "affordability of the plan is now at greater risk than at any time since reporting was introduced in 2012", warning that the MoD "faces the risk that in future it may have to return to a situation where affordability of the portfolio is maintained by delaying or reducing the scope of projects". (Paragraph 48)

The Committee rightly highlights the pressure in the Equipment Plan, which has been brought about by several factors. Due to the size and complexity of the Equipment Plan, and the significant enhancements in capability investments resulting from SDSR decisions, it was recognised in last year's Equipment Plan that there was increased uncertainty and financial risk within the 10-year programme. As part of the annual review of the Defence Programme, the Department initiated work to identify ways of reducing the risk and so maintain an appropriately balanced budget as threats to the nation evolve. This work continues and is being informed by the NSCR and the MDP.

The Government remains committed to the defence budget increasing by 0.5% above inflation each year and the Department is focusing on where best to invest across the entire Defence programme to remain on top of an ever-changing and increasing threat environment.

6. We concur with the NAO that much more information is required from the MoD regarding the 'efficiency savings' proposed by the 2016 Equipment Plan. The number of savings required and their importance to the overall affordability of the Equipment Plan, make transparency of the utmost importance. This is particularly the case when, only two years after the SDSR 2015, the full range of defence capabilities are facing re-examination as part of the broader National Security Capability Review being undertaken by the National Security Adviser, Mark Sedwill. (Paragraph 57)

We recognise the Committee's point regarding the realisation of efficiency savings, how central these are to the affordability of the Equipment Plan, and the need for improved transparency around the delivery of these efficiencies. As part of the MDP, the Department is conducting an assurance exercise of the financial data underpinning our efficiency assumptions.

Currently, the Department reports annually on how the Equipment Plan will deliver and support the capability required by the Armed Forces—and this includes a breakdown of the efficiency savings targets within that plan which has been shared with the National Audit Office (NAO). It is vitally important that we continually review the defence capabilities that the nation requires to counter the evolving and increasing threats to our country and our interests.

7. SDSR 2015 allocated £178 billion to defence procurement over ten years. While this represents a sizable increase on previous budgets, it must be seen in the context of an ambitious equipment plan which includes major projects such as the replacement of the Royal Navy's frigates, the purchase of the P-8A maritime surveillance aircraft, the F-35 fighters and the Ajax fighting vehicle. It is therefore a cause for alarm that the NAO has concluded that the affordability of the plan is at greater risk now than at any

time since the introduction of annual reporting in 2012. Above all, delivery of the plan is heavily dependent upon achieving cost-saving 'efficiencies' and will have to operate with minimal 'headroom' and contingency provision. (Paragraph 61)

The Department is committed to both delivery of the Equipment Programme and the realisation of efficiencies and we have robust governance and oversight to manage this. The efficiencies agreed in the Spending Review in 2015 are at an early stage as we are less than two years into the 10-year programme. Furthermore, we are conducting an assurance exercise of the data underpinning our efficiency plans as part of the MDP commissioned by the NSC. Currently the Department has a central risk provision of £6 billion and, within our projects, a risk provision of £12 billion over the 10-year planning period.

8. We seriously doubt the MoD's ability to generate the efficiencies required to deliver the equipment plan. In the past, the MoD has proven incapable of doing so—for example, in 2015, when only 65% of planned 'efficiency savings' were achieved. Even if all the efficiencies are realised, there will be little room for manoeuvre, in the absence of sufficient financial 'headroom' and contingency funding. This is not an adequate basis for delivering major projects at the heart of the UK's defence capability. Our confidence in the Department's ability to deliver these savings has not been enhanced by the inconsistent set of targets referred to by the Permanent Secretary, including a £20 billion target that appeared to leave even the former Secretary of State for Defence confused. (Paragraph 62)

We recognise that the Equipment Plan efficiency targets agreed with HM Treasury and Cabinet Office in 2015 are ambitious—but we believe they are achievable and the MoD has a good performance record of efficiency delivery over many years.

The Department is two years into the five-year Spending Review 2015 (SR15) Efficiency Programme—and is currently forecasting 'line of sight' to 86% of the stretch target of £7.8 billion and 'line of sight' to 90% of the core target of £7.4 billion as set by HM Treasury. Both these figures update those provided to the Committee in the Department's Written Evidence, published on the Defence Committee website on 21 November 2017. These efficiencies will be sustainable and their enduring benefits, when carried forward a further five years, will release circa £20 billion of savings over the 10 years to 2025–26 which is being invested in new defence capabilities. Of this £20 billion, approximately £5.8 billion will be delivered through the Equipment Plan.

9. We recommend that the MoD should build on the Capability Review and undertake a comprehensive review of its efficiency plans and a detailed assessment of the likelihood of the target savings being achieved. This review should set out the basis for an adequate contingency, in the event of the current plan proving either unaffordable or undeliverable to the MoD's stated timetable. (Paragraph 63)

The Committee will recognise that, since summer 2017, we have been contributing to the NSCR which should report in spring this year. In the meantime, the Department is making good progress against its 2015 core efficiency targets, with latest forecasts suggesting 'line of sight' identifying potential to deliver 90% of this within the Spending Review period. We regularly review the amount of contingency being held by the Department and adjust it as necessary to meet our needs. Nevertheless, we recognise that there is more to do

to meet our ambitious targets. A new Chief Operating Officer, David Goldstone, was appointed to the Department in December 2017. He is playing a pivotal role in refining our approach to, and plans for, change and efficiency, including through the MDP.

The MDP has been commissioned by the NSC to consolidate and baseline Defence requirements going forward in a more sustainable and affordable way. This programme will involve four strands of work—the first three will optimise how the Department is organised, identify further efficiencies (including through a programme of business modernisation), and work to improve our commercial and industrial approach. The fourth strand will look at the capabilities that Defence requires to contribute to our three National Security Objectives.

10. *To bolster confidence in the affordability of the equipment plan, we recommend that the MoD should publish an 'efficiency tracker' which would detail when, where and how efficiencies are to be made, together with a list of risks to the implementation of all major projects. Where risks are identified, the MoD must identify alternative, deliverable, sources of funding within each relevant financial year or, in the absence of any alternative sources, indicate by how much the defence budget is falling short of what is needed adequately to equip the Armed Forces. (Paragraph 64)*

We note the Committee's recommendation regarding an 'efficiency tracker'. We have a central efficiency team overseeing and supporting the realisation of the targets. A quarterly Efficiency Delivery Board oversees this process, chaired by the Lords Minister, Earl Howe. With the recent appointment of the Chief Operating Officer, the Department will continue to refine this approach. As part of this, we will ensure consideration is given to the publication of an 'efficiency tracker', although the Committee will appreciate that this may not be feasible given the sensitivity of the subject matter, and the implications publication might have on our ability to make agile and timely decisions as we progress.

We also note the Committee's recommendation regarding the management of risks to implementation of major projects. Currently, major projects within the Department are included within the Defence Major Programmes Portfolio (DMPP) and Government Major Projects Portfolio (GMPP). Comprehensive quarterly reports are collected through the Department's Portfolio Management Reporting System (PMRS) covering a suite of performance indicators which includes an assessment of the risks facing a major project. Information from these quarterly reports is already published alongside the Infrastructure and Projects Authority annual report and within the Equipment Plan annual summary as part of the Government's transparency agenda.

The Single Source Regulations Office

11. The SSRO was established with two objectives: first, to ensure good value for money, and secondly, to ensure that suppliers are paid a fair and reasonable price. While the SSRO has played a valuable role in delivering savings for the taxpayer, it is less clear that the SSRO has effectively discharged its second objective. While industry will always seek a bigger return on contracts, it is clear that the SSRO could do more to demonstrate that it is as focused on securing a fair and reasonable price for suppliers as it is on ensuring good value for money for taxpayer. (Paragraph 78)

The Single Source Regulations Office (SSRO) has provided the Department with the following response:

“As the NAO noted in its October 2017 report, “Improving value for money in non-competitive procurement of defence equipment”, the SSRO has undertaken a good deal of work in the last year related to our aim of securing a fair and reasonable price for suppliers. The baseline profit rate recommendation provides an empirically derived benchmark of actual profits on actual costs for companies undertaking comparable work. This is fair and reasonable, and used to establish an estimated contract profit on estimated costs. Actual costs and actual profits will of course vary. It should be noted that the Contract Profit Rate (including all six steps), Regulated Pricing Method (e.g. fixed vs. cost plus) and the performance of the contractor all interact together to determine the overall price of a contract, including cost and profit.

Our June 2017 discussion paper, Developing the SSRO’s approach to calibrating profit rates in single source contracts, explains how we will consider actual profit on actual costs in our benchmarking to calibrate our recommended baseline profit rate. We published this discussion paper in June 2017 following a consultation with industry and the MoD into ways of measuring profit rates of suppliers. It explores a range of issues, including profitability, performance against public financial market indicators and the market structure. Our October 2017 Annual report on the Single Source Regime 2017 includes financial market indicators that indicate that defence companies are generally stable and healthy. Equity and credit markets are supportive with share price volatility low and companies able to borrow at competitive rates. The report found the SSRO’s profit recommendation had no discernible impact on share prices, given the wide range of other market and commercial factors.

We have recently issued a discussion paper on the risk and incentive adjustment, following extensive workshops and engagement with stakeholders.”

12. The Single Source Regulations Office was created to scrutinise single source defence contracts and deliver savings for the taxpayer. However, by its own admission, the SSRO’s ability to be a truly effective regulator has been handicapped by the narrow scope of the regulatory framework and the limited number of contracts that fall within its remit and that are referred to it. While there was a lack of enthusiasm among industry for the SSRO’s coverage to be extended, it is clear that the SSRO cannot be fully effective when only 15–20% of the MoD’s single source expenditure falls within its regulatory regime. (Paragraph 96)

The SSRO was not created to “deliver savings for the taxpayer”. The role and function of the SSRO was set out in Part 2 of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014 as follows:

- Make annual recommendations to the Defence Secretary on the Baseline Profit Rate (BPR) and capital servicing rate.
- Issue relevant statutory guidance, including on allowable costs and the way profit is set.
- Act as the impartial adjudicator over issues relating to the regulations referred to it by either the Department or by the relevant supplier.

- Review the operation of the regulations and to make recommendations to the Defence Secretary on potential changes.
- Carry out analysis on behalf of the Defence Secretary into aspects of the framework.
- Check that suppliers are complying with their reporting obligations as set out in the legislation.

It was never the Government's intention that all single source procurement should be subject to the new framework. Many single source contracts, for example, are of relatively low value and it would yield little material benefit to include these under the regulations. Extending the scope of the regulations has been examined at length by both the SSRO and the Department as part of the three-year review of the legislation completed in December 2017. The implementation of this review will be announced by the Defence Secretary shortly.

13. *To be fully effective, the SSRO's scope should be extended to include the right to examine government-to-government contracts and any single source contracts that it chooses, save in exceptional circumstances. (Paragraph 97)*

In his written statement, HCWS351, to Parliament, on 14 December 2017; the Defence Secretary confirmed that:

“the Defence Reform Act (2014) requires me to carry out a review of the single source procurement legislation (the DRA and the Single Source Contract Regulations 2014) within three years of it coming into force on 18th December 2014. In meeting this obligation, I would like to express my appreciation for the work and support provided by the Single Source Regulations Office (SSRO) which undertook an extensive consultation process with stakeholders from mid-2016 onwards. I have had regard to the recommendations on changes to the legislation provided by the SSRO in June 2017.

Following further engagement with the SSRO and industry, my review of the legislation has now been completed. It identified a number of areas where changes to the legislation could improve the operation of the regime. Further work will now be needed on the detail of how these could be implemented. In particular, we will need to assure ourselves that the changes result in the intended benefits without imposing unnecessary additional burdens on the Ministry of Defence or suppliers, and that the benefits justify the use of Parliament's time. I will make a further statement on this in early 2018.”

14. *If all appropriate contracts are to be brought within the SSCR regime then there needs to be greater clarity and certainty regarding the definition of QDCs, QDCs ‘on amendment’ and QSCs. The Department should also assess whether the current ‘honesty box’ approach whereby the onus is on contractors themselves to assess whether sub-contracts qualify and to then notify the Department and the SSRO, as well as the current veto provided to suppliers on bringing a contract within the SSCR regime as a QDC ‘on amendment’, are satisfactory ways to proceed in the future. (Paragraph 98)*

As outlined in the Defence Secretary's written statement, HCWS351, to Parliament, on 14 December 2017; he will shortly make a further statement on the implementation of the single source procurement legislation review.

15. *In addition, the SSRO must be given a range of powers similar to those available to other regulators. In particular, the SSRO requires enhanced powers of information gathering, enforcement and compliance. We recommend that, following the SSRO's consultation on extending the scope of the single source regulatory regime, the MoD should bring forward proposals to align the powers of the SSRO with those of other regulators. (Paragraph 99)*

Issues relating to the powers of the SSRO have been examined at length by both the SSRO and the Department as part of the three-year review of the legislation completed in December 2017. The Defence Secretary will be announcing the way forward on implementing this review shortly.

16. *If the SSRO is to be successful, it needs to be independent of both Government and industry. At present, the boundaries between the SSRO and the MoD lack clarity, with the MoD responsible for all of the senior appointments to the SSRO's board and for the provision of half of its funding. Indeed, it is clear to us that MoD considers the role of the SSRO to be one of performing functions on behalf of the Department rather than acting as a regulator to provide fair and effective oversight of both the MoD and industry, on behalf of the public. (Paragraph 109)*

The Department is fully committed to bringing all appropriate single source contracts under the regulations and has made significant progress in bringing this about since the framework was introduced in December 2014. The Department agrees with the Committee that, to be effective, the SSRO requires the powers to carry out its statutory functions, including acting as the impartial adjudicator between the Department and suppliers on disputes referred to it and in providing the Department with an objective recommendation for the annual Baseline Profit Rate (BPR).

In line with Part 2 of the Defence Reform Act 2014, the Defence Secretary is responsible for appointing the non-executive members of the SSRO Board while with the consent of the Defence Secretary, the SSRO Board is responsible for appointing the executive members. This does not undermine the SSRO's impartiality. On 10 January 2018, Mr Neil Swift, the SSRO Interim Chief Executive Officer confirmed to the Public Accounts Committee inquiry into 'non-competitive procurement of defence equipment', the Office is "*operationally independent: we have our own board; we are funded separately; we appoint our staff; we are able to make our own operational decisions. I am entirely confident that we are operationally independent.*"

17. *The resignation of Marcine Waterman as Chief Executive is an unwelcome development. While we do not know the circumstances of her departure, we hope that a permanent appointment will be made shortly. (Paragraph 110)*

Executive members of the SSRO, including the Chief Executive and the Chief Operating Officer, are appointed by the SSRO Board, with the consent of the Defence Secretary, and so it will be for the SSRO to lead on this recruitment. The SSRO has assured the Department that the process to appoint the new Chief Executive will begin shortly. The SSRO has an interim Chief Executive, Mr Neil Swift. He has worked in the SSRO since April 2015 initially as Director of Corporate Resources and then as Chief Operating Officer.

18. *If the SSRO is to serve as a fully-fledged regulator, rather than just as a unit to assist the MoD, its personnel must be chosen, and its funds provided, independently of the*

MoD. We would also expect future appointments to positions of the Chair and the Chief Executive of the SSRO to be subject to pre-appointment hearings by our own Committee. The Department should start with a pre-appointment hearing for Ms Waterman's permanent successor. (Paragraph 111)

As previously explained, the Defence Secretary only appoints the non-executive Board members of the SSRO, all other personnel are selected independently of the MoD. As the sponsoring Department, we provide funding for the SSRO through an annual Grant-in-Aid. These issues were considered as part of the review of legislation, completed in December 2017 and the Defence Secretary will make an announcement on implementing this review soon.

For these appointments to be added to the list of those subject to pre-appointment scrutiny in accordance with Cabinet Office guidelines, agreement would have to be reached with the SSRO, the Defence Secretary, the Chair of the Defence Committee, the Liaison Committee and the Cabinet Office. However, once a new SSRO Chair and Chief Executive have been confirmed, Secretary of State is happy for the Committee to invite them to give evidence before they take up their posts.

Acquisition and a Defence Industrial Strategy

19. The development of a successful defence industrial policy is of the utmost importance to this Committee. This chapter's conclusions and recommendations are our preliminary thoughts and we plan to return to this issue in the future. (Paragraph 115)

The refreshed Defence Industrial Policy was published on 20 December 2017 meeting our commitment in the 2015 Strategic Defence and Security Review to set out our approach in encouraging a thriving and globally competitive UK defence sector. The policy is part of a suite of mutually reinforcing initiatives supporting the National Security objective on promoting prosperity, which also includes the Defence Innovation Initiative, the National Shipbuilding Strategy and the MoD Science and Technology Strategy. The refreshed Defence Industrial Policy describes our approach in developing key themes in the Government's Industrial Strategy, while recognising the Department's responsibility to obtain the right capability for our Armed Forces at the best overall value for money for the taxpayer. It emphasises the importance we attach to working closely with industry in implementation, without detriment to our policy on fair and open competition.

20. The combination of a defence industrial policy refresh and a new overall industrial strategy provides an important opportunity for the Government to rethink the role of, and support provided to, the defence industry as part of the wider UK economy. (Paragraph 119)

The Government's Industrial Strategy, published on 27 November 2017, sets out how we are building a Britain fit for the future—how we will help businesses create better, higher-paying jobs in every part of the United Kingdom with investment in the skills, industries and infrastructure of the future. Defence will play an important role in helping to deliver this ambitious strategy across the UK.

The approach set out in the refreshed Defence Industrial Policy reinforces the Industrial Strategy's long term plan to boost the productivity and earning power of people throughout the UK. Drawing on this and the industry-led Defence Growth Partnership competitiveness plans, we will work across Government and with industry to promote exports, skills, competitiveness and innovation.

21. *To maximise this opportunity, we recommend that those updating the defence industrial policy should consider adopting a broader definition of 'value for money' that incorporates the impact of major defence projects on local economies, skills and employment levels. Accordingly, the Department should implement the Government's revised procurement guidelines so that 'local value' can be taken into account. (Paragraph 120)*

We agree with the Committee's recommendation. Our refreshed Defence Industrial Policy makes clear that in maximising economic value for the UK, we do take potential wider economic impacts into account. The policy sets out the findings from a review of the prosperity impacts of naval shipbuilding—including in relation to innovation, skills, local economic impact and labour markets—which we judge are also relevant in developing assessments of broader economic impact from procurement elsewhere in the defence sector.

The policy further recognises that in setting strategic objectives, including for delivering wider economic value, early in the development of a business case, we can substantially improve the way we inform choices in meeting our military requirements. We are therefore committed, initially on a pilot basis in the concept phase of some higher value business cases, to undertake analysis of potential ways of delivering economic as well as international and national security value. We will work closely with industry, wider government and academia on the design of a commonly understood and accepted approach.

22. *While we understand the factors that may lead to off-the-shelf procurement, the MoD must have a clear understanding of the impact of those procurement decisions on the UK's labour force, skills base and sovereign capability. Without that understanding, the difficulties that blighted the early stages of the Astute programme—which arose from a ten-year gap in submarine-building in Barrow—could easily be repeated, to the detriment of UK skills and industrial capability. (Paragraph 129)*

Competition and strategic choice continue to be at the heart of our approach to Defence procurement, while being ready to act by keeping our analysis of defence industrial sub-sectors under regular review. Where we can demonstrate value for money and a national security requirement to deliver and sustain defence capability, we will refresh or review our industrial approaches for doing so. The Defence Industrial Policy published in December 2017 sets the framework for doing that.

The publication of the National Shipbuilding Strategy, 6 September 2017, heralded a shipbuilding enterprise that, with clear Defence direction, and with greater certainty about the Royal Navy's procurement plans, has the confidence to invest for the long term in its people and its assets to raise productivity and innovation and improve competitiveness in the domestic and overseas markets. In this way, the sector can become more resilient to the peaks and troughs of Royal Navy business, bringing more sustained growth and prosperity to the regions in which those businesses are based.

23. We therefore recommend that the new defence industrial policy emphasises the importance of a regular drumbeat of activity to sustain a successful and high-skilled work force and to maintain the UK's sovereign capabilities. It should also look at the types and quantity of defence equipment that is currently sourced externally, with a view to identifying where such equipment could be sourced domestically. (Paragraph 130)

In the SDSR 15, MoD committed to a more vigilant and systematic approach in certain sectors, particularly those which provide the assurance to use our capabilities effectively when required (operational advantage) or the ability to find and maintain an edge over our potential adversaries (freedom of action). As described in the refreshed Defence Industrial Policy, we continue to strengthen the process for managing these critical capabilities. This includes a clearer mechanism for nurturing, sustaining and monitoring, particularly at the lower levels of the supply chain. In a very few cases, further analysis may be required to establish if a specific sector or sub-sector level approach is required to deliver this in the long term. We have already shown our willingness to do so with the National Shipbuilding Strategy.

The Government remains committed to a thriving and internationally competitive defence sector. The Department continues to work across Government, including through the National Industrial Strategy to improve productivity and competitiveness. Where our procurement does involve an international element, we work closely to identify and promote opportunities for the UK supply chain. The strength of the UK supply chain means that UK companies can benefit from these arrangements and this is something that we are looking to grow as part of our Defence Industrial Policy.

24. We agree with our predecessor Committee's conclusions that the UK needs to invest more in defence science and technology and research and development. Such investment is of key importance to the sustainability and future success of the UK's technical skills base. It is therefore regrettable that the Government have continued with the 1.2% commitment, rather than agreeing to pledge to spend at least 2% of the defence budget on science and technology. (Paragraph 133)

We note the Committee's conclusions and agree that science and technology plays a central role in Defence, directing and applying innovative research to meet the UK's current and future strategic needs. Published in October 2017, the MoD Science and Technology Strategy sets out the vision and approach to place science and technology and collaboration with industry at the heart of UK Defence: shaping Government policy, sustaining strategic national capabilities, countering emerging threats, and supporting new ways to operate in new environments using novel capabilities. This strategy emphasises working with academia and industry to develop innovative solutions in UK priority areas, for example space, cyber and advanced materials. This will enable the Department to harness technological advances, sustain talent and support growth and productivity in the UK economy.

25. The defence industrial policy refresh and development of an industrial strategy provide an important opportunity for the Government to change direction and invest more in defence innovation and the UK's technical skills base. We recommend that the Government should make a commitment, as part of the defence industrial policy refresh and the overall industrial strategy, to spend at least 2% of the defence budget on science and technology. (Paragraph 134)

The level of funding allocated to science and technology is kept under review to ensure that it is suitable. The MoD Science and Technology Strategy 2017 emphasises a collaborative approach with industry and academia to continue to develop technology in the UK's priority areas in order to meet Defence's needs.

16 February 2018