



National Audit Office

**BRIEFING FOR THE
HOUSE OF COMMONS
DEFENCE COMMITTEE
DECEMBER 2010**

Performance of the Ministry of Defence, 2009-10

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This briefing has been prepared for the Defence Committee of the House of Commons to provide an overview of the work and performance of the Ministry of Defence in the financial year 2009-10 and subsequent months.

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Introduction

Aim and scope of this briefing

1 This briefing has been prepared for the House of Commons Defence Committee (HCDC) to provide an overview of the work and performance of the Ministry of Defence (the Department) in the financial year 2009-10 and subsequent months. Its aim is to help the Committee understand and consider:

- where the Department spent its budgeted resources (Part One);
- the performance information the Department produced and reported upon in the year (Part Two);
- the Department's financial management, including reasons for the qualification of the audit opinion on the 2009-10 departmental resource accounts (Part Three);
- the Department's delivery of services (Part Four); and
- the Government's recent defence and spending reviews (Part Five).

2 The brief is based entirely on publicly available documentation, including the 2009-10 departmental resource accounts and published National Audit Office (NAO) reports.

Background

3 The Ministry of Defence is both a Department of State and a military headquarters, comprising military personnel from the three Armed Services – the Royal Navy, the Army and the Royal Air Force – and civilian staff from the Civil Service. It is jointly headed by a military officer and a civil servant, and is responsible for providing the military capability necessary to deliver the Government's objectives and defining future military requirements.

4 The Department's stated aim in 2009-10 was:

"to deliver security for the people of the United Kingdom and the Overseas Territories by defending them, including against terrorism; and to act as a force for good by strengthening international peace and stability."

5 As at 31 March 2010 the Department's activities were managed through eight Top Level Budget (TLB) Holders responsible for providing forces and support services. In 2009-10 the eight TLBs were: Navy Command; Land Forces; Air Command; Chief of Joint Operations; Defence Equipment and Support (DE&S); Central; Defence Estates; and Science, Innovation, Technology (SIT). There were six Agencies, four Trading Funds, three Executive Non-Departmental Public Bodies (NDPBs) and 14 Advisory NDPBs.

6 From 1 April 2010 SIT ceased to be a TLB and became part of Central TLB. On 31 July 2010 the Defence Storage and Distribution Agency (DSDA) ceased to have Agency status and became a business unit within DE&S TLB.

Current Context

7 This briefing covers the period up to 31 March 2010 and is, as a consequence, a retrospective review. It is however important to note that a number of significant events have occurred in Defence and wider government following the end of this period. These include the 2010 Strategic Defence and Security Review and 2010 Spending Review, both of which reported in October 2010, both of which have the potential to lead to significant change in defence. The Defence Reform Unit, chaired by Lord Levene is also expected to report its fundamental examination of the way in which defence is structured and managed during 2011.

8 As a consequence Defence now faces a challenge of implementing and managing a programme of significant change in order to deliver its outputs within its budget settlement and to reduce the deficit between its forward plans and likely budget over the next ten years. While the planning undertaken by the Department to manage this programme of change does not fall within the scope of this performance briefing, the quality of that planning and the Department's performance in delivering change will be covered in future performance briefings. Over the next year we also anticipate that many aspects of the performance of the Department in delivering change will be covered in reports on the following topics:

- A review of the status and capability of financial management in Defence;
- A landscape review of governance structures and influences on decision-making in Defence;
- The Major Projects Review for 2011;
- A review of the Department's ability to deliver organisational change.

Part One

Where the Resources Went in 2009-10¹

1.1 In 2009-10 the Department spent £41.1 billion (**Figure 1**). The Department spent only a small proportion (less than 5 per cent) of its budget through other bodies.

Figure 1
Analysis of Net Resource Outturn, 2009-10

Request for Resources	£bn	Total £bn
1 Provision of Defence Capability		
Navy Command	2.2	37.4
Land Forces	6.6	
Air Command	2.8	
Chief of Joint Operations	0.5	
Defence Estates	3.6	
Defence Equipment and Support	16.8	
Central	2.3	
Science, Innovation, Technology	0.5	
Administration Costs	2.1	
2 Net Additional Cost of Operations		
Operations and Peacekeeping	2.7	2.7
3 War Pensions		
War pensions benefits	1.0	1.0
Total Net Resource Outturn		41.1

NOTE

- 1 Requests for Resources (RfRs) are voted by Parliament in Supply Estimates.
- RfR1 is for the provision of defence capability and forms the core funding for the Department's normal annual running costs.
 - RfR2 is funding for operations and peace-keeping, such as Iraq and Afghanistan.
 - RfR3 is for the payment of war disablement and war widows' benefits. The costs of administering this are borne as part of RfR1.

Source: *Departmental Resource Accounts 2009-10*

1.2 The Department employed around 76,000 civilian staff (excluding trading funds) at an annual cost of £2.7 billion. The three Armed Services comprised another 196,000 personnel with an annual cost of £9.5 billion.

1.3 During 2009-10, the Department spent £2.7 billion on the additional costs of operations, mainly those in Afghanistan and Iraq (Figure 1).

1.4 The cost of the Department's equipment acquisition and support activity in 2009-10 was £16.8 billion.

1.5 The Department also administered the Armed Forces Pension Scheme, which paid £3.5 billion, including lump sums on retirement, to around 400,000 retired veterans in 2009-10. The NAO reported on **the cost of public service pension schemes**² in March 2010. This report included the Armed Forces Pension Scheme.

1.6 The Department also administered the War Pensions scheme, which makes payments for war disablement and to war widows. This cost around £1 billion in 2009-10 (Figure 1).

1.7 The net operating costs of the Department's six Agencies in 2009-10 totalled £912 million (**Figure 2**).

1.8 The net operating costs of the Department's four Trading Funds totalled £944 million (Figure 2).

Figure 2

Defence Agencies and Trading Funds – Net Operating Costs, 2009-10



NOTES

- 1 The figures above represent net operating costs per body. These amounts reflect funding from the Department and any income from other sources.
- 2 All figures are as per each body's 2009-10 accounts.
- 3 Agencies are stand alone but reported as cost centres within the TLBs.
- 4 Trading funds are outside of the TLBs.

Source: Data taken from each body's 2009-10 Accounts

Part Two

Performance Information

Quality of information: Use of information by the Ministry of Defence

2.1 Given the wide range of activities undertaken by the Ministry of Defence, the Department needs many different types of information to manage its business. As a consequence of its structure, with three separate Armed Services, the nature of its business and the pattern of legacy investment, the Department has to contend with a large number of different information systems.

2.2 There are a number of key areas where core information systems are insufficient to meet the Department's needs. For example, the NAO report on Defence Estates (July 2010) found that central and budget holder data were held in different data systems that were difficult to reconcile, with insufficient data available centrally to make informed decisions regarding the estate.³

2.3 Through the Non-Equipment Investment Programme, the Department is undertaking information systems programmes to improve the information systems available to its staff. This includes the Defence Information Infrastructure (DII) project, and the Tri-Service Whole Fleet Management change programme.

2.4 The gaps in the Department's information about its business and activities restrict its ability to evaluate the impact of its decisions. One of the findings of the Financial Management Review of the Department published by the NAO in July 2010 was that the Department had insufficient visibility of costs to enable effective prioritisation and identification of efficiencies (see Sections 3.19 to 3.20 of this report for more details).

2.5 The NAO's audit of the 2009-10 departmental resource accounts also revealed deficiencies in information management and quality, with some key areas where information systems did not meet the needs of the organisation. These areas included the management of stock and assets, where the Department was unable to provide sufficient supporting evidence for the figures disclosed in its resource accounts (see Sections 3.8 to 3.14 below for more details).

Public Service Agreements/Departmental Strategic Objectives Reporting

2.6 Public Service Agreements (PSAs) were the agreements between the Treasury and individual departments which set out priority areas for the previous Government's work and against which departments reported their performance. Departments often contributed to only one part of a PSA with other Departments responsible for other aspects of the same PSA. The Coalition Government ended PSAs in its Spending Review Framework announced to Parliament on 8 June 2010.

2.7 Departmental Strategic Objectives (DSOs) set out a picture of what the Department aimed to achieve and provided a framework for performance management within the Department. DSOs were abolished alongside PSAs in June 2010.

2.8 Both PSAs and DSOs were set up as a series of performance indicators lying underneath a major theme. For example, PSA 26, which involved the Department, had the overarching aim of reducing the risk of international terrorism with lower level indicators aimed at contributing to this reduction.

Data Systems

2.9 The NAO carried out work across Government to test the systems used by departments to report on their performance. This work provided assurance to Parliament and the public about whether these systems were adequate and supported better performance management by Government.⁴ As part of this work the NAO found that one-third of the PSA data systems used by departments had weaknesses, and just over one-tenth remained unsatisfactory.⁵ In 2009-10 the Department did not have a lead role on any PSAs, but contributed to the Foreign and Commonwealth Office (FCO)-led PSA 30 on Conflict Prevention and the Home Office-led PSA 26 on Counter-Terrorism.

Departmental Performance Data

2.10 The Department stated the position on its PSAs, DSOs and other performance indicators in its 2009-10 departmental resource accounts⁶, as follows (**Figure 3** overleaf).

Figure 3

Public Service Agreements and Departmental Strategic Objectives Performance Data Tables

Indicator	DSO/PSA Number	Department's Statement on Data
<p>PI 1.1: Success on Operations</p> <p>Assessed against the military strategic objectives for each operation or military task we are conducting, including counter-terrorism.</p>	<p>DSO 1: Achieve success in the military tasks we undertake at home and abroad.</p>	<p>During 2009-10 the Armed Forces sustained a high tempo of operations in Afghanistan. In Iraq the UK Training and Maritime Support Agreement came into force and the majority of forces withdrew in July 2009. They also undertook the other military tasks required of them in the year. The proportion of forces deployed on operations and other military tasks decreased from 17 per cent in the last quarter of 2008-09 to 14 per cent in the last quarter of 2009-10, largely due to the withdrawal from Iraq.</p>
<p>PI 2.1: UK Defence Contingent and Delivery of Force Elements at Readiness</p> <p>Our ability to maintain forces at the readiness we deem necessary to respond to possible threats, assessed against the requirements set out in the Defence Strategic Guidance and the Defence Plan.</p>	<p>DSO 2: Be ready to respond to the tasks that might arise.</p>	<p>The overall level of Force Elements demonstrating no SERIOUS or CRITICAL weakness was 50 per cent as at the fourth quarter. This reflected the heavy commitment to operations in Afghanistan and other Military Tasks.</p>
<p>PI 2.2: Manning Balance</p> <p>Our ability to attract, recruit and retain the military personnel we need to deliver the capability to succeed on current operations and support our future readiness, assessed against what we deem to be the appropriate size and structure of the Armed Forces.</p>		<p>As at 1 March 2010 the position was:</p> <p>Naval Service manning was at 99.2 per cent and in Manning Balance;</p> <p>Army manning was at just over 100 per cent and in Manning Balance;</p> <p>Royal Air Force manning was at 98.4 per cent and 0.5 per cent below Manning Balance.</p>
<p>PI 3.1: Procuring and supporting military equipment capability, through life</p>	<p>DSO 3: Build for the Future.</p>	<p>One of four sub-indicators (support) was reported annually for the first time. Out of the remaining three sub-indicators, two showed improvement from the end of the previous reporting year.</p>
<p>PI 3.1.1 – Key User Requirements</p> <p>Achieve at least 97 per cent of key user requirements for all category A to C Projects, that have passed Main Gate approval, to be achieved throughout the PSA period.</p>		<p>PI 3.1.1 – Achieved 98 per cent of all Key User Requirements.</p>
<p>PI 3.1.2 – Cost</p> <p>Average in-year variation of forecast costs for design and manufacture phase, for all Category A to C projects that have passed Main Gate approval, of less 0.2 per cent.</p>		<p>PI 3.1.2 – Average in-year forecast cost increase was 1.88 per cent.</p> <p>Note – In the course of preparing this brief, the Department informed the NAO that the final end of year outturn was revised to 1.63 per cent. This was following publication of the 2009-10 Departmental Resource Accounts, from which the original data was taken.</p>

Indicator	DSO/PSA Number	Department's Statement on Data
<p>PI 3.1.3 – Time</p> <p>Average in-year variation of forecast In Service Dates (ISD), for all Category A to C Projects that have passed Main Gate Approval, to be no more than 0.4 months.</p>		<p>PI 3.1.3 – Average in-year forecast ISD slippage was 0.39 months.</p> <p>Note – In the course of preparing this brief, the Department informed the NAO that the final end of year outturn was revised to 0.23 months. This was following publication of the 2009-10 Departmental Resource Accounts, from which the original information was taken.</p>
<p>PI 3.1.4 – Support</p>		<p>PI 3.1.4 – The supporting military equipment capability through life element of this measure was reported for the first time at the fourth quarter. The assessment related to key support outputs, covering that part of the support that DE&S was responsible for, but did not encapsulate the element of support that was undertaken directly by the relevant Front Line Command.</p> <p>Navy – The surface ship performance met Joint Business Agreement (JBA) targets at year end in the Capital Ships and Afloat Support groups, with minor shortfalls by Mine Patrol & Hydrographic Vessels and frigates.</p> <p>Land – Availability targets continued not to be met for some non-operational equipment, with some dips in performance. Land Forces did not report an impact on training. Most helicopters achieved the required flying hours in this quarter, and serviceability fluctuated across platforms. Merlins failed to achieve target flying hours, mainly due to the need for increased support to the aircraft deployed in Afghanistan.</p> <p>Air – Overall performance of the Air Domain at year end was forecast as a low risk with only Air Intelligence, Surveillance, Target Acquisition and Reconnaissance predicted to continue as medium risk.</p>
<p>PI 3.2: Procuring and supporting non-military equipment capability, through life</p>	<p>DSO 3: Build for the Future.</p>	<p>Not yet assessed.</p> <p>Note – The Department told the NAO that the methodology it used to measure the performance of the Non-Equipment Investment Plan (NEIP) was revised midway through the year. Due to the lack of previous data and the immaturity of the process it was not possible to assess departmental performance at this point.</p>
<p>PI 3.3: Sustainable Development</p>	<p>DSO 3: Build for the Future.</p>	<p>Five out of the seven sub-indicators forecast that they would achieve their targets.</p>
<p>PSA 26: Objective: To reduce the risk to the UK and its interests overseas from international terrorism</p>		<p>Not reported by MoD. The Home Office led on PSA 26, with the Cabinet Office, MoD, Foreign and Commonwealth Office (FCO), Department for International Development (DFID), the Department for Communities and Local Government, the Security Industry Authority, Her Majesty's Revenue Customs and Excise, The Northern Ireland Office, the Ministry for Justice, the Department for Transport, and the Department for Children, Families and Schools, all contributing.</p>
<p>PSA 30: Objective: Global and regional reduction in conflict and its impact and more effective international institutions</p>		<p>This is not reported by the Department and has been included here only for completeness. The FCO led on PSA 30, with MoD and DFID contributing.</p>

Part Three

Financial Management

Financial Review

3.1 In 2009-10 the Department again stayed within its resource and cash estimates, as follows:

- The net outturn for Total Resources was £41.1 billion against an estimate of £42.2 billion, an under-spend of £1.1 billion.
- The net outturn for Request for Resources 1 (RfR1), Provision of Defence Capability, was £37.4 billion against an estimate of £38.3 billion, an under-spend of £0.9 billion.
- The net outturn for Request for Resources 2 (RfR2), Operations and Peace-Keeping, was £2.7 billion against an estimate of £2.9 billion, an under-spend of £0.2 billion.
- The net resource outturn for Request for Resources 3 (RfR3), War Pensions Benefits, was £979 million against an estimate of £1.023 billion an under-spend of £44 million. This RfR provides for the payment of war disablement and war widows' pensions in accordance with relevant legislation.
- The Net Cash Requirement had an outturn of £38 billion against an estimate of £39 billion an under-spend of £1 billion.

2009-10 Departmental Resource Accounts⁷ – Qualified Opinion due to Material Error

3.2 In preparing its departmental resource accounts the Department must comply with HM Treasury's *Financial Reporting Manual* which, for the first time in 2009-10, was based on International Financial Reporting Standards (IFRS) rather than UK Generally Accepted Accounting Practice (UK GAAP). The Comptroller and Auditor General (C&AG) qualified his opinion on the Department's 2009-10 departmental resource accounts because the Department's accounting policies did not fully comply with IFRS and, in the C&AG's opinion, this non-compliance had a material effect on the financial statements.

3.3 The qualification related to the application of the International Financial Reporting Interpretations Committee (IFRIC) 4, which requires preparers of accounts to establish whether lease-type contracts form leases in substance. The Department did not comply with accounting requirements for determining whether a contract contains a lease. Only PFI and PPP contracts were reviewed to assess whether IFRIC 4 applied, with other preliminary work concluding that there was a significant number of contracts held that were likely to include lease-type arrangements.

3.4 Given the substantial number and high value nature of the contracts involved, the NAO concluded that material values of assets and liabilities had been omitted from the Department's 2009-10 financial statements. In the view of the NAO, this non-compliance had a material effect on the financial statements, although the exact extent was unquantifiable as the Department had not maintained the necessary records or obtained the necessary information.

3.5 In order to comply fully with IFRIC 4 the Department would need to review all of its contracts. The Department told the NAO that the cost of reviewing all of its existing contracts to determine whether they contain leases would exceed the benefits of compliance. In particular, the complexity of the contracts and the perceived difficulty in obtaining information from third parties would make any such work both costly and time-consuming. The Department indicated, however, that it intended to account for new contracts entered into from 2010-11 in accordance with the new requirements with a view to achieving full compliance over time.

3.6 Whilst noting this commitment, the NAO believed that a serious and concerted effort should still be made to become compliant. Since the long-term nature of a number of departmental contracts means that material compliance is likely to be a number of years away, the NAO recommended that the Department should carry out further work to identify those contracts where the risk of inappropriate accounting treatment is highest, and should develop a programme of work with a clear timetable to achieve compliance.

2009-10 Departmental Resource Accounts – Limitations of Scope

3.7 The C&AG issued a limitation of scope opinion on the Department's 2009-10 resource accounts due to the Department's being unable to provide sufficient evidence on certain issues, as follows:

1 The existence and value of certain assets and inventory balances reported in the financial statements⁸

3.8 The C&AG limited the scope of his opinion relating to £6.3 billion of assets reported on the Department's Statement of Financial Position valued at £45.2 billion. Insufficient evidence was provided for:

- capital spares and inventory to the value of £5.5 billion; and
- £752 million of military equipment, including £568 million of grouped assets such as firearms and £184 million of BOWMAN radios.

3.9 The C&AG also limited the scope of his opinion in relation to weaknesses in controls over inventory and BOWMAN radios. Whilst the Department had undertaken remedial work in the year on these issues following a 2008-09 qualification, the problems identified were systemic and deep-rooted, with the main areas of weakness as follows:

Discrepancies between inventory counts and warehouse management records, meaning warehouse management systems did not form a reliable basis for inventory records

3.10 Following the NAO's limitation of scope in 2008-09 over the same concerns, the Department implemented key controls over inventory, operated by the Defence Storage and Distribution Agency (DSDA). The Department also established the Material and Financial Accounting Project Board, which reviews processes for all areas of asset management and accounting. The routine inventory checks now carried out by DSDA comply with the Department's mandated requirements. However, these checks indicated that inventory recorded on the system did not match the stock count at 29 per cent of locations.

3.11 The NAO's audit work identified significant levels both of stock recorded on the system that could not be found on the shelves and stock on the shelves that was unrecorded. It was not possible to estimate with sufficient accuracy the change in value that would result if these discrepancies were to be rectified.

3.12 These issues were more extensive than those identified in the 2008-09 resource accounts. This was due to the Department's actions to address previously raised concerns, and to the NAO's further audit work bringing more issues to light.

Inadequate assessment for impairment of inventory

3.13 Limitations in management information and a lack of clarity in departmental guidance had led to significant weaknesses in the process for assessing for impairment. The information in the warehouse data systems suggested that there were significant levels of inventory held at DSDA depots that were unlikely to be used. These included 47 per cent of non-explosive inventory being recorded as being in a condition which prevented the immediate use of the item. The Department said it was looking into improving the monitoring of inventory conditions through the development of inventory plans for Project Teams.

Military Equipment: Vehicles, Grouped Assets and BOWMAN Radios

3.14 The Department made a number of improvements from 2008-09 in maintaining adequate records for military equipment, including vehicles, grouped assets and Bowman Radios. These assets are tracked on Management Information Systems (MERLIN and MAESTRO), with an annual census undertaken to confirm the figures held. The improvements are as follows:

- Vehicle numbers as reported by the MERLIN census were better supported, thus enabling the C&AG to remove his limitation of scope over this area.

- The level of control exercised by the Department was insufficient to enable the C&AG to provide an opinion on grouped assets reported via the MAESTRO census. On the MAESTRO census, return levels had declined from 2008-09, with only 81 per cent of the census forms being returned. Of those returned, 38 per cent of line items showed an error.
- In 2008-09 the NAO reported that the Department had 35,800 radio sets recorded that could not be adequately verified, and the number of BOWMAN assets in service was uncertain. In 2009-10 the value reported for BOWMAN assets was £1.4 billion. The Department continued to address these weaknesses, developing a BOWMAN Asset Management Improvement Plan and completing in March 2010 the first full BOWMAN reconciliation. This reconciliation showed 44,940 BOWMAN radios in existence. The Department held serial number records for the majority of radios and considered further radios to be 'visible', although serial number information was not available. The NAO considered that the quality of the Department's information was insufficient for 2,561 radios, with a further 3,400 radios for which no visibility data was available. As a result, the Department was unable to demonstrate satisfactorily the existence and location of 5,961 or 13 per cent of BOWMAN radios, representing £184 million of assets as reported in the Statement of Financial Position.

2 Allowances and expenses paid to Service personnel⁹

3.15 In 2007-08 and 2008-09 the C&AG limited the scope of his opinion due to, respectively, inadequacies in the evidence available to support allowances paid to military staff and material error in the calculation of basic pay, allowances and expenses made via the JPA payroll system. Improvements undertaken by the Department, including the establishment of an Assurance and Controls Working Group, led to improvements in management information and, as a result, the C&AG did not qualify his audit opinion in this area in 2009-10. During 2009-10, the JPA system was used to administer £9.5 billion of staff costs.

3 Income from charges made to Service personnel

3.16 Deductions to pay for accommodation and food costs are made in the JPA system based on data input by Units. The Department had no way of assessing whether the resulting income was complete. As a result, the C&AG limited the scope of his opinion due to the inadequacy of evidence to support the completeness of this income recorded at £87 million in the 2009-10 accounts.

4 Votes A – Approved maximum numbers of Service personnel

3.17 The Department is required to present Votes A annually to Parliament to seek statutory authority for the maximum numbers of personnel to be maintained by the Armed Forces in all active and reserve categories. The Department was unable to obtain the information to disclose the maximum numbers in two categories of reserve: the Army Service Reserves and the Royal Navy Reserve “List 7”. As was the case in 2008-09, the C&AG was unable to obtain sufficient evidence to support the accuracy of the numbers in these two categories, and limited the scope of his opinion in this area.

Financial Governance and Reporting

2009-10 Statement on Internal Control

The Statement on Internal Control is signed by the Department’s Accounting Officer and reflects the particular circumstances in which the Department is operating, with focus on the internal control environment in place.

3.18 The Department was fully engaged with the NAO in reviewing its Statement on Internal Control to ensure that it was supported by robust evidence and complied with the Treasury’s guidance. Significant issues raised by the Department in the Statement on Internal Control on its 2009-10 departmental resource accounts included:

- The Department moved rapidly to implement the recommendations of the Review of the Nimrod Accident. The Department set up the Military Aviation Authority on 1 April 2010 to provide the regulatory framework within the Defence aviation environment, but acknowledged that there would still be some residual safety risk within the Department, for example, due to shortages of suitably qualified personnel within certain specific safety environments. The Department is working to ensure that forward plans build capacity for the future in this area.
- The Department made significant progress to address the issues raised by the NAO in its audit report for the 2008-09 departmental resource accounts using a working group set up in August 2009. Whilst its work had gone a long way towards creating a better assurance regime, the Department acknowledged that fully effective controls were not yet in place. In particular, there were still concerns over the quality of elements of the underlying data set, notably the numbers of Army reservists. In order to address these concerns the Army was to undertake a major data cleansing exercise.
- In 2008-09 the NAO had reported on stock management processes and systems because of the number of different lines of stock and locations at which they were held.¹⁰ The Department had set a longer-term vision for tackling these weaknesses and made some immediate improvements, including establishing a baseline position of BOWMAN radio assets to ensure visibility can be accurately retained and correcting over 50 per cent of identified discrepancies on the MERLIN and MAESTRO inventory systems.

- In 2009-10 the Department had to take significant in-year management action to ensure it remained within the amounts voted to Defence by Parliament. Much of this budgetary pressure was due to the wider fiscal environment, including lower than expected receipts from estate disposals, adverse changes in exchange rates and significant fluctuations in the price of fuel. The Department acknowledged that it also carried a significant level of in-year financial risk, and had set in hand work to improve the understanding of financial risk during the budget setting process.
- In response to the issues raised in both the Data Handling Review and Sir Edmund Burton's report into the loss of MoD personal data, the Department had undertaken considerable further work to prohibit the use of unencrypted data and to improve data handling generally. In addition to addressing these risks, the Department was working to improve awareness of the risks of cyber attack and the capability to respond to it.

Financial Management Review¹¹

3.19 The NAO reported to Parliament on the financial management of several Government departments with its report on the Ministry of Defence published in July 2010.

3.20 The NAO's report concluded that the Department could use financial management more effectively to address those factors that are within its control. In particular the NAO found that:

- The outcome of the Department's annual planning rounds contributed to significant in-year budgetary pressure. During 2009-10, the Department had to find additional in-year savings of £800 million to bring its planned expenditure back into line with its budgets.
- The Department does not routinely prioritise individual elements of its spending programme and, as a consequence, it does not have a straight-forward basis to determine which areas of expenditure should receive priority when budgets are insufficient to fund all previously planned activities.
- Delaying projects leads to significant increases in costs. In December 2009 two-thirds of the gross cost increases reported in the NAO's 2009 *Major Projects* Report reflected deliberate decisions to slip projects, in order to balance the Equipment Plan in year. Most of the significant increase in cost related to the new aircraft carriers, which had forecast cost growth of £1.07 billion in year.
- The Department does not place sufficient emphasis on financial management in its decision making, and annual financial plans have been overcommitted. The finance function in the Department does not have a sufficiently central role in strategic planning, and thus is ineffective in countering the Department's tendency to over-commit.

- Whilst budgetary pressures are due in part to factors outside of the Department's control, the Department could use financial management more effectively to address those factors within its control and thus better manage the situation.

3.21 Recommendations made by the NAO were:

- The Department should use the Strategic Defence and Security Review (SDSR) to re-balance its programme and take action to keep it in balance in the future.
- The financial strategy should be reflected in financial plans prepared by the Department, reviewing priorities and re-visiting underpinning assumptions at least annually.
- The Department should use the financial capability it has to best effect and enhance its capability further, using professionally skilled finance staff and enhancing cost understanding and visibility, including driving out optimism bias.

Part Four

Service Delivery

Major Operations

4.1 The UK's Armed Forces are actively engaged in operational duties across the globe. The biggest deployment is in Afghanistan, where the UK currently has 9,500 military personnel. In Afghanistan, the UK's Armed Forces form part of the NATO International Security Assistance Force (ISAF), which includes personnel from 42 other countries. But the Armed Forces can also be called on to support a wide range of other activities, including crisis response, peacekeeping and support to UK civil authorities. Forces were withdrawn from Iraq in July 2009. As a result, the proportion of forces deployed decreased to 14 per cent (2009-10) from 17 per cent (2008-09).

4.2 The NAO has published a series of reports on the Department's training and operational activity, including a 2008 report on the **Support to High Intensity Operations** in Iraq and Afghanistan. This report showed that the Department had successfully provided life-saving medical treatment, provided £4.2 billion of new equipment and delivered good welfare services. But it also highlighted the need to improve its supply chain performance, saying:

"The Department's performance against supply chain targets has been variable and lower for the highest priority demands, although there are signs that the supply chain is becoming more resilient."¹²

Defence Acquisition

4.3 Approximately 40 per cent of the Department's spend is consumed on the acquisition of military equipment.¹³ The Department procures a wide range of military and non-military items, as well as using both conventional and Private Finance Initiative contracts to deliver services and manage facilities. It faces unique challenges in procuring equipment and services which may be at the leading edge of technology for inherently uncertain future activities.

4.4 Examples of its largest and most complex projects include:

- Typhoon fighter aircraft (estimated forecast cost of £21 billion);
- Future Strategic Tanker Aircraft (estimated forecast cost of £11.9 billion);
- Type 45 destroyers (£6.5 billion); and
- Queen Elizabeth Class Aircraft Carriers (£5.9 billion).¹⁴

4.5 The NAO's annual Major Projects Reports have shown persistent problems in delivering defence equipment to time and cost. The **Major Projects Report 2009** found that there was a significant gap between estimated funding and the cost of the Defence budget over the next ten years. It also noted that without action to deal with the underlying problems

*"[the Department] would not consistently deliver value for money for the taxpayer, or encourage its commercial partners to operate effectively."*¹⁵

4.6 Whilst the **Major Projects Report 2009** found that costs had increased by £733 million net in-year, it also found that, overall, project control had improved in 2009:

*"There are encouraging signs of improved performance in managing individual projects... costs over which project teams can exert more direct control – notably Technical Factors – have shown a net decrease in costs. Whilst performance by project teams in controlling time slippage has been more mixed, there has been no slippage on half of the projects in the last year. Taken together, these cost and timescale indicators suggest that project control has improved in 2009."*¹⁶

4.7 The NAO's **Major Projects Report 2010** found that while the Department made central decisions on the procurement programmes for major pieces of equipment that positively affected its short-term cash position and balanced its budget, this approach provided poor value for money in the long term. For example, reducing the number of items to be procured may mitigate cost increases on a specific project, or be a sensible response to changes in the security environment, but such reductions may also lead to significant development costs being shared across a smaller number of production units. Whilst overall cost increases totalled £3.3 billion, the majority of this increase was attributable to just two projects (Typhoon, Queen Elizabeth Aircraft Carrier). The report found that the cost performance on the large majority of projects had been largely stable in-year and the rate of timescale slippage had reduced significantly since last year.

4.8 The Department recently commissioned two independent reports from Bernard Gray¹⁷ and Charles Haddon-Cave.¹⁸ These reports identified serious shortcomings in the acquisition and management of the Department's military equipment, corroborating previous NAO findings.

4.9 An additional challenge for the Department is the shift from buying equipment to the active consideration of bringing into service an entire "capability" – meaning the coordinated development of all the personnel, training, industrial support and infrastructure required to enable the immediate use of the equipment on operations. Since the 2002 report on the **Apache helicopter**, the NAO has noted improvements in the way the Department is coordinating the introduction of capability.¹⁹

4.10 NAO reports have commented on shortages of skills and expertise in some key areas. For example, the Department has suffered from a lack of finance and commercial expertise and project and programme management skills. The NAO report on **Multi-Role Tanker Aircraft**²⁰ found that skills shortages can pose a risk to effective delivery or contribute to problems on projects. The Department's 2009 Capability Review recognised that the Department had made some progress in this area against its two-year action plan.

The NAO's Value for Money (VFM) Reports

4.11 The NAO published a number of VFM reports in the 2009-10 financial year. Summaries of these, along with reports published in the 2010-11 financial year to date, are included below starting with the most recent:

The Major Projects Report 2010 (October 2010)²¹

4.12 The Department has taken decisions that have reduced its cash flow requirements in the short term, making it easier for the Department to manage its budget in-year, but the effect has been to reduce long-term value for money across the Defence budget. A £3.3 billion increase was seen in-year, largely resulting from decisions taken centrally by the Department as a consequence of the mismatch between planned expenditure and the forecast Defence budget.

4.13 Despite this, however, the costs on the majority of projects remained broadly stable. This stability reflected the efforts the Department has made in increasing project control and introducing new practice to help control costs and provide better forecast information.

A Defence estate of the right size to meet operational needs (July 2010)²²

4.14 Whilst the NAO recognised that the Department has strengthened estate planning, particularly through a Defence-wide estate plan, the changes are not sufficient to drive value for money. The plan lacks supporting measures that would allow progress to be judged, and does not articulate what the right size of estate would be.

4.15 The Department does not match its focus on operational needs with efficient use of its estate, and it lacks sufficient data centrally to help reduce costs in a structured way.

4.16 The NAO's recommendations were:

- The Department should immediately begin to categorise sites in order to align the estate better with operational needs, and to develop data held to enable performance analysis.
- The Department should articulate what the 'right' size of estate is, including the cost, and support this with targets to allow measurement of progress on rationalisation.
- The Department should put in place levers and mechanisms that encourage aggressive driving through of structured cost reduction.

Ministry of Defence: Delivering multi-role tanker aircraft capability (March 2010)²³

4.17 The NAO was unable to conclude that the Department achieved value for money on the procurement phase of the Future Strategic Tanker Aircraft (FSTA).

4.18 Whilst the latter stages of the procurement were well-managed, there were shortcomings in the way the Department conducted the procurement and assessed alternatives. An assumption was made early on that FSTA would be delivered using off-balance sheet PFI, due to affordability pressures, with no evidence of a sound evaluation of whether this offered the best value procurement strategy.

4.19 The capability is likely to be delivered five and a half years later than planned – placing significant stress on ageing current equipment whose lives have had to be extended.

4.20 The NAO's recommendations were:

- The Department should conduct a robust assessment of the alternatives where PFI is a possible financing solution.
- The Department should develop a credible alternative solution to sustain competitive tension.
- Provisions for openness and transparency should be included in tender documentation, including provision for the Department to gain access to key supply chain/sub-contractor data.
- The Department should seek to establish early in the procurement route a common understanding with commercial partners of how the full service (i.e. support) will be delivered.

Treating injury and illness arising on military operations (February 2010)²⁴

4.21 The Department has provided highly effective clinical treatment and rehabilitation of Service personnel seriously injured on military operations. However, the rate of illness and minor injury among personnel on operations has almost doubled in three years. Contingency plans for providing further capacity in the UK for care for injured Service personnel have recently improved, but need to be developed further.

4.22 The NAO's recommendations were:

- The Department should model the capacity required under different casualty scenarios to improve further its contingency planning.
- The Department needs to take further steps to halt the rising trend of minor injury and illness, researching as to why rates have increased, improving prevention and strengthening governance.
- The Department should implement stress management processes for personnel who are at risk of developing mental health problems.
- Improvements to medical data are needed as accurate and complete medical data are currently not centrally collated, meaning the Department is unable to assess fully the impact of operations on the health of Service personnel.
- The Department needs to assess the impact of Regional Trauma Networks on the clinical experience and professional development of its medical staff, taking into account the potential benefits to the NHS of sharing military trauma experience.

Ministry of Defence: Major Projects Report 2009 (December 2009)²⁵

4.23 The Defence programme was found to be unaffordable as at December 2009. Although the Department has already reduced the deficit between the Defence budget and planned expenditure, it is difficult to conclude on the effectiveness of the delivery of individual projects. The Department needs to address the underlying budgetary and governance issues in order to deliver value for money.

Support to High Intensity Operations (May 2009)²⁶

4.24 The Department does not consistently meet its targets for delivering supplies to troops in a timely fashion, although measures to improve the effectiveness of its supply chain have been implemented. The welfare services provided by the Department are generally well delivered but provisions at smaller, more remote bases are lower than that provided at main operating bases.

4.25 The NAO's recommendations were:

- The Department should provide training equipment that resembles that used in theatre to make training more realistic.
- Pressure should be alleviated on the supply chain by smoothing the trend in demand from theatre and enabling greater use of lower priority deliveries.
- The compendium of assets in theatre should be used to verify that the Department can properly account for all assets and reconciling them against its fixed asset registers.
- The Department should roll out more welfare provision to personnel in forward positions in line with its existing planning ratios. If this is impracticable, it could introduce more flexibility about the balance of provision between different items.

Part Five

Reducing Costs and Spending

Initiatives to reduce costs in 2009-10

Comprehensive Spending Review 2007

5.1 The NAO has undertaken a programme of work to validate the value for money savings reported by major Government departments from 2008-09 to 2010-11, with a report on these published in July 2010.²⁷ This included those claimed by the Department.

5.2 The Department was committed to value for money reforms generating annual savings of £3.15 billion by 2010-11, with the Department reporting an achievement of over £1.8 billion at the end of March 2010.²⁸

5.3 The NAO reviewed the Department's claimed savings as reported to October 2009, sampling £712 million of the savings claimed to date (75 per cent) and finding that 42 per cent fairly represented cash savings, 45 per cent may have represented cash savings and 13 per cent did not represent, or significantly overstated, savings made.

5.4 Issues with the Department's information systems were a problem for this review, as the Department did not have established systems with which to support the savings claimed. As a result, where uncertainty existed over the validity of the saving claimed, this uncertainty generally related to these information issues.

2010 Budget (March 2010)

5.5 As part of the 2010 Budget under the previous Government, the Department committed to making £550 million of efficiency savings between 2010-11 and 2012-13.²⁹ These planned savings were the latest in a series of efforts to reduce administrative expenditure in order to provide more resources to operations in Afghanistan. The Department envisaged that the savings would be delivered through greater use of collaborative procurement on construction, food and IT, better management of the estate, and greater efficiency in equipment support.

5.6 The Department also implemented a range of major corporate change initiatives, such as its “streamlining” project, designed to simplify the organisation and work of its Head Office and the Defence Equipment & Support TLB’s change programme, known as “PACE”. The Department claimed that it had reduced the size of its civilian workforce by around 50,000 since 1997 and it expected the number to fall further, with numbers having fallen by 2,000 in-year.³⁰

The Strategic Defence and Security Review, 2010³¹

5.7 The outcome of the Strategic Defence and Security Review (SDSR), the first since 1998, was published on 19 October 2010.

5.8 Whilst Defence spending is set to fall by 8 per cent over the next four years, the Government intends to adhere to the NATO target of spending 2 per cent of GDP on defence. The review will lead to reductions in manpower across all three Services and civilians, but frontline units in Afghanistan will be protected.

5.9 The following headline decisions were taken as part of the SDSR:

Air

- RAF personnel will be reduced by around 5,000 to about 33,000 by 2015;
- The Nimrod MRA4 reconnaissance aircraft will not be brought into service;
- Harrier jump jets are to be withdrawn from service and Tornados will continue to operate in Afghanistan; and
- Twelve new heavy lift Chinooks will be procured.

Army

- Army personnel will be reduced by around 7,000 to about 95,000 personnel by 2015, but with no changes to combat units involved in Afghanistan;
- The holdings of Challenger Tanks will be cut by around 40 per cent and heavy artillery by around 35 per cent; and
- The number of deployable brigades will be reduced by one.

Navy

- Naval personnel will fall by around 5,000 to a total of around 30,000 by 2015;
- HMS Ark Royal is to be taken out of service immediately (instead of in 2014 as previously planned);

- The number of frigates and destroyers is to drop from 23 to 19 by 2020;
- Continuation of Astute Class submarines and Type 45 destroyers procurement was confirmed along with the intention to start to procure new Type 26 frigates; and
- The Royal Navy estate will be rationalised.

Reserves

- A study will be undertaken into the future role and structure of the Reserves.

Civilians

- Civilian staff will fall by 25,000; and
- The Department will be required to sell off surplus land and assets and re-negotiate contracts with industry to find efficiencies.

5.10 The procurement of the nuclear Trident submarine was confirmed, with some savings measures such as a reduced number of warheads per boat, although the final decision to approve it was deferred until 2016.

5.11 The result of the decommissioning of the Ark Royal aircraft carrier and Harrier jump jet means the Department will not have the capability to launch manned planes at sea until at least 2019.

Affordability of Equipment Plan

5.12 The Department recently undertook to report annually to Parliament on the affordability of its ten-year equipment plan, intended to help deter the corporate practices which have adverse value for money implications. The NAO will submit an assurance opinion alongside this report.

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