



MINISTRY OF DEFENCE
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Prime Minister (2)

M/S 17/9

MO 21/8/16

17th September 1982

Dear Michael,

MS

The House of Commons Defence Committee's Second Report 1981-82 on Ministry of Defence Organisation and Procurement was published on 22nd July 1982. My Secretary of State ~~proposes to publish~~ the Government Observations as a Command Paper on 6th October 1982. The text of the observations, which are not controversial, is enclosed.

I am copying this letter to David Heyhoe, Bernard Ingham and Richard Hatfield.

Yours ever
Nick Evans

(N H R EVANS)

M C Scholar Esq

SECOND REPORT FROM THE DEFENCE COMMITTEE 1981-82

HC 22-I-II

MINISTRY OF DEFENCE ORGANISATION AND PROCUREMENT

Observations presented by the Secretary of State for Defence

1. The Second Report from the Defence Committee Session 1981-82 was published on 22 July 1982. The Government concurs in the Committee's identification of two major themes emerging in the inquiry (the emphasis on the role of the Centre as a policy source coupled with greater delegation of authority for the execution of policy decisions; and the increasing need to associate contractors more intimately with the planning of operational requirements) and welcomes the Committee's general support for the Ministry's current and evolving policy on both these issues. The Government regards the Committee's investigations as important and timely, particularly in view of the initiatives which the Ministry has been undertaking, often in consultation with industry, to improve its procurement procedures and practices. The Committee's views on this significant element of the Ministry's affairs have been helpful. The Government presents the following observations on particular issues singled out by the Committee for comment and recommendation.

Size of the Ministry of Defence

2. The size of the Ministry of Defence will continue to reduce in line with Government policy and in relation to the task. By April 1982, Headquarters numbers had been reduced by some 22% since 1974 and further reductions are planned to take place by April 1984. Reductions in the size of British defence establishments cannot, of course, be the sole criterion governing HQ numbers. The scale and complexity of the defence programme is also relevant. In contrast, between 1974/5 and 1981/2 the Defence Budget increased in real terms with a rising proportion going on equipment. It is the continuing aim of the Ministry of Defence to increase effectiveness and efficiency by simplifying its organisation and procedures wherever this is possible, and clarifying lines of responsibility and accountability. As part of this process, the role of the central organisation of the Ministry of Defence is being enhanced to bring a sharper focus on to major defence policy issues.

The Central Equipment Committees and the Fisher Report

3. The Minister of State for Defence Procurement has informed the Committee about progress in implementing the recommendations of the Fisher Report, in particular the decision to raise the financial thresholds for projects requiring scrutiny by the Central Committees from £25M to £50M for development expenditure and from £50M to £100M for production expenditure. Limits above which projects require Ministerial approval (£25M development and £50M production) will remain unchanged to enable Ministers to maintain a close interest in the equipment programme. The Ministry will keep the Committee informed about progress in implementing the remaining recommendations of the Fisher Report including, in particular, the proposal to amalgamate the DEPC and the ORC which is still being considered.

Organisational Changes and Delegated Powers

4. The decisions on organisational changes in the Central Staffs of the Ministry of Defence and on the raising of delegated financial powers are intended to improve the central overview of the Ministry's procurement programme and the responsibility of the Service Departments, the Systems Controllers and their Project Managers for implementing procurement decisions within constraints laid down centrally.

5. The Chief of Defence Procurement has delegated to his three Systems Controllers "full authority over the technical and financial management" of their respective programmes, the major limitations being that they keep within their available funds, and must report to him anything which bears on his responsibility as Accounting Officer for Vote 2. CDP has also told the Controllers that he wishes to encourage the maximum degree of delegation within the Controllerates consistent with efficiency. Officers at or above the level of Project Manager are entrusted with full management accountability for their projects, and may where appropriate sub-delegate to their staffs.

6. As regards the Ministry's project managers, the Government notes the Committee's views on the seniority, experience and responsibilities which they consider appropriate. It is Ministry policy to ensure that Project Managers have adequate seniority and experience, that appropriate authority is delegated to them to achieve approved project targets, and that they remain in post for reasonable periods of time, subject to individual career needs and the requirements of the Services.

Resource Allocation in the Ministry of Defence

7. The allocation of resources within the defence programme is a fundamental task of the Ministry of Defence, and the Government agrees that the means by which it is determined are crucial to the Ministry's effectiveness. It is, however, necessarily a highly complex task and there can be no simple method of determining the optimal allocation of limited resources between the many diverse commitments and roles of the Forces. Future manpower and equipment plans need to be formulated by the Service staffs within centrally determined guidelines and against the likely availability of future financial resources. These plans must be assessed in the light of their contribution to the effectiveness of defence expenditure. This is achieved by the decision of Ministers advised by their staffs, both military and civilian. Operational analysis can make a useful contribution to this process, and as much use as possible will continue to be made of the resources of the Defence Operational Analysis Establishment for this purpose. At the end of the day, however, major resource allocation decisions are and must be determined by Ministerial judgements, in the light of all relevant factors, political, strategic, scientific, industrial and financial.

8. Changes have been made in the central machinery for advising Ministers on resource allocation questions. Under the Chief of Defence Staff, and reporting to him through the Deputy Chief of Defence Staff, the central military staffs responsibility for programme matters and operational requirements have been grouped, together with a new concepts cell, under a post of Assistant Chief of Defence Staff (Programmes). Similarly on the civilian side, the staffs responsible to the Permanent Under Secretary for advice on resources and programme matters have been brought together under a new post of

Assistant Under Secretary (Resources and Programmes), which combines two existing Under Secretary charges. These changes are intended to improve effectiveness while achieving staff economies.

Reeves Report and Financial Control

9. The Ministry of Defence has been proceeding as quickly as staffing and other constraints allow to implement the recommendations of the first Reeves Report along the lines noted by the Committee. Many have already been put into effect. In particular the practice, begun in 1981/2, under which managers were notified as appropriate of cash allocations and told of their responsibility to monitor and control cash against them, has been continued in 1982/3.

10. The Ministry of Defence welcomes the Committee's view that the Government should agree a satisfactory scheme which would afford the Department end-year flexibility by the end of the 1982/3 financial year. The main problem perceived by the Government has been one of cost. The Ministry of Defence currently enjoys more flexibility in-year than most Government Departments, but believes that the constraints of annuality bear particularly harshly on a Department of such size and complexity, and that end-year flexibility could be introduced in the case of MOD at no extra cost in terms of public expenditure. As the Committee has noted, the issue of flexibility between years is currently receiving consideration; and the Government will take all relevant factors into account when reaching its decision.

Procurement Procedure and Relationships with Industry

11. As the Ministry stated in both oral and written evidence, more thorough liaison with industry is being developed with special emphasis on the early stages of consideration of possible new projects; care is being taken to avoid over-sophistication in equipment specifications wherever possible; overseas sales potential and the availability of off-the-shelf equipments are given particular attention as is the timely and responsible adoption of fixed price or incentive contracting and the need for delegation of authority and the simplest administration consistent with public accountability is fully recognised. The Ministry will continue to seek further improvements to its processes where these are clearly justified, in consultation with other Government Departments and the defence industry as appropriate.

12. The Ministry is mindful of the need to look to the position of its smaller contractors and sub-contractors as well as larger companies. Small firms or their representatives are regularly invited to briefing meetings for industry held by the Ministry. Moreover, although it remains the Ministry's general policy to utilise the Prime contractorship System of project management wherever it is appropriate, the Ministry has evolved a range of measures aimed at protecting the interests of their sub-contractors; these are set out in Sections E and F of the MOD Memorandum on Defence Procurement Arrangements (DP 37).

Project Monitoring

13. The Government notes the Committee's endorsement of the need for monitoring by the Ministry of Defence of the progress of projects. The Ministry's Guides to Defence Contracting (DEFCON Guides) set out

the Ministry's requirements for the planning and cost management of defence development and production contracts, and prescribe the frequency with which information is to be reported to the Ministry by contractors for the purposes of project monitoring, and the detail and form in which it is to be reported. These prescribed factors depend not only on the type of contract, but also on the value and technical complexity of the project. The overall intention is not to impose upon contractors' staff a burden in providing information for the Ministry's monitoring purposes which is out of proportion either to the value of the project or to its technical complexity, but simply to seek sufficient information for the Ministry to discharge its responsibility as custodian of the taxpayer's money in an adequate manner. The Ministry has recently undertaken a revision of the financial thresholds set out in the appropriate DEFCON Guides to bring them more fully into line with current economic conditions. The new thresholds are in the process of being promulgated: as an example, the level below which development contracts are defined for reporting purposes as "minor", and hence subject to considerably simplified monitoring procedures, has been increased from £1M to £3M.

The Design of Future Warships and the Management of Ship Procurement

14. The Government notes the Committee's recommendation that future warship designs should normally be produced by the appropriate British Shipbuilders yard after the Ministry have, in consultation with them, drawn up the specification. This is current practice. The Ministry and industry have their respective areas of expertise and responsibility. The Ministry's primary role in ship design is the conceptual one of defining the essential characteristic of what is

required. Industry translates these broad design characteristics into a fully developed detailed design suitable to form the basis of a controllable production contract. These roles necessarily interlock and the Ministry's practice is to maintain the closest possible contact with industry from the earliest stages in a ship programme. In the case of the Type 23, Yarrow Shipbuilders Ltd have been closely involved from the initial conceptual stage onwards and a contract for the detailed design stage has now been placed with them.

15. The Government does not accept that the higher direction of naval ship procurement is not seized of the fact that time is money. As explained in evidence to the Committee, the Ministry's experience suggests that to place a contract before a detailed design is ready leads inevitably to design alterations, delay and cost escalation. Cases in point are the Type 21 and 42 first-of-class ships on which the Public Accounts Committee reported in 1976 (5th Report Session 1975/76). At that time the Ministry accepted that experience gained from these projects served to re-emphasise the need to make as much progress as possible in the design and planning of warships before placing a contract for the first-of-class, and to limit alterations during constructions to a minimum. The Ministry believes firmly that this is essential to obtain value for money and dispense public funds properly. The contrast between the Type 21 and Type 22 in this regard (as described in the Ministry's Paper, DP21) is very noticeable. Nevertheless, the Ministry is conscious of the need to press ahead with design and development work at due speed; it does not accept that this has not been shown in the progressing of the T23 and T2400 Staff Requirements and subsequent designs, having regard to the crucial importance of these projects for both the RN and the export market which required the most careful consideration of the cost-effectiveness of alternative ship and system concepts.

Criteria for Procurement Decisions

16. The Ministry of Defence's procurement procedures are designed above all to provide the Services with the equipment they need to carry out their duties. However, in taking procurement decisions the Ministry must have regard to all relevant factors, whether military, financial or industrial and it is these factors which govern the Ministry's approach to the PAC and industry. It is the Ministry's responsibility to ensure that the taxpayer's money is properly spent, and that a satisfactory account of that expenditure can be rendered to Parliament; it is also the Ministry's duty to take into account the industrial implications of procurement decisions. In this connection the Department of Industry are consulted at an early stage in the procurement cycle; consultation at appropriate levels up to Ministers is maintained throughout the decision-taking process.

Quality Assurance

17. The Government notes the Committee's support for the arrangements for a National Strategy for Quality throughout British industry. Ministry of Defence direct contractors have been informed that their responsibility to that Department to satisfy themselves about the quality control systems of their sub-contractors will be considered met if the sub-contractor they choose has been assessed by the British Standards Institution to BS. 5750 supplemented by the appropriate technical schedule. The Ministry is co-operating with the Department of Trade in order that the technical schedules may be agreed and the BSI scheme become effective as soon as possible.

Contractor Selection

18. The Ministry of Defence does not maintain lists of firms which are either "favoured" or "blackballed" in relation to their "track records" and their right to be invited to tender for particular contracts. Nevertheless the Ministry has a responsibility to ensure that contracts are placed only with firms having both the technical and the financial competence and stability to ensure satisfactory performance of the work.

Collaborative Projects with Industry and with Allies

19. The Government welcomes the support of the Committee for the concept of joint ventures with UK firms in financing the development and production of defence equipment. The application of the joint venture concept to suitable projects is being pursued as the opportunity arises. The major current prospect is the future medium

helicopter (EH 101) which is the subject of an international collaborative agreement between Westlands and Agusta of Italy; the proposed investment of private as well as Government funds in the development is a recognition of the assessment that the largest market for that size of helicopter in the future will be provided by the civil sector.

20. As regards international equipment collaboration in general, the United Kingdom plays a full and active part in efforts to identify opportunities for collaboration and will continue to pursue these wherever they are militarily and economically advantageous.

Ministerial Aerospace Board

21. Formal and informal consultation between the Ministry of Defence and the Department of Industry is well-established at all levels. The Department of Industry is represented on the Defence Equipment Policy Committee where the significant discussion takes place prior to submission to Ministers for decision. In addition, for some time now Ministers from the two Departments have been meeting to consider defence industrial subjects; this continuing dialogue has included discussions of the current position and future prospects of the aerospace industry. These meetings provide an invaluable supplement to the numerous official contacts which take place at present. In the circumstances, and given the strengthening of the Ministerial oversight of procurement within MOD, the creation of a formally structured Ministerial Aerospace Board is regarded as unnecessary.

Parliament

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10 DOWNING STREET

From the Private Secretary

30 September, 1982

Thank you for your letter of 17 September about the House of Commons Defence Committee's Second Report 1981-82 on Ministry of Defence Organisation and Procurement.

Mrs Thatcher has noted that your Secretary of State proposes to publish the Government Observations as a Command Paper on 6 October.

L. L. COLES

N H R Evans, Esq.,
Ministry of Defence

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