D/PUS/13/4(108)  16 April 2018

Rt Hon Dr Julian Lewis MP
Chair of the Defence Committee
Sent electronically

Dear Chair,

MOD SUPPLEMENTARY ESTIMATES 2017/18

Thank you very much for your letter of 13 March in which you raise several questions regarding the Department’s expenditure during the 2017/18 financial year.

The Defence Committee’s first point relates to £200M budget adjustment made in conjunction with the Treasury during Supplementary Estimates. The adjustment reflects the Ministry of Defence (MOD) and HM Treasury working together to proactively manage our financial position. While £200M is a material sum in its own right, it represents c.0.6% of the MOD’s overall budget and was a receipt agreed with the Treasury to generate flexibility in the defence programme. The money was ear-marked to be spent in the 2017/18 financial year on costs which would otherwise have needed to be covered in 2018/19, thereby reducing financial pressure in the new financial year. This means that, together with the £600M for Dreadnought announced by the Prime Minister at Prime Minister’s Questions on 28 March, the MOD will benefit from up to £800M financial relief in 2018/19.

During the Supplementary Estimates process, the MOD also reviewed and updated provisions for future liabilities in the nuclear domain. Certain estimated future costs were increased by £2.9Bn. The balances in question relate to outgoings due to occur towards the end of this century for preparing the irradiated fuel from defueled submarines for disposal into the UK’s Geological Disposal Facility as part of the long term disposal strategy. The change ensures the provision is more accurately recorded in the Department’s accounts and reflects the HM Treasury discount rate at the time.

I would like to assure you we are taking our performance in cash forecasting very seriously. You will be aware, however, that we have a complicated portfolio of payments and receipts. As the Defence Committee will know, the MOD recently introduced a new Purchase to Payment system which will offer opportunities for us to improve our performance in this area.
We are developing a suite of reports at supplier and contract level (which will be more detailed than those previously available) to provide an early indication of likely cash outflows. We continue to monitor our business units closely to identify those areas with forecasting challenges and providing them with support to improve.

The letter also notes a material movement in the Department’s “receipts and other income” (the negative figure means receipts are increasing rather than decreasing). The increase is primarily due to a change in the accounting for the Defence Science and Technology Laboratory’s (DSTL) receipts. In the prior financial year, when the entity was a Trading Fund, DSTL’s income and receipts were not included in the MOD’s central figures. Due to a change in DSTL’s status in 2017/18, those balances are now included, hence the change noted in your letter.

When the memorandum for Main Estimates was prepared early in 2017, the deadline for completion meant that the final budgets for service and civilian personnel costs were not available. An estimate was used which was based on historic data and the best information at the time. At this point in the financial cycle, we can see that actual Service pay has remained broadly stable and within forecasted thresholds at c.£9Bn per year, including SCAPE, ERNIC and allowances.¹

The shortfall in Armed Forces recruitment is kept under constant review and reflects a difficult recruiting environment given increased competition for skills in the economy and a strong national employment picture, particularly for young people. Defence has been working closely with Capita on a recruitment improvement plan which is being implemented. Initial signs are promising and we expect Capita to deliver on improvements in converting applicants to enlistees. We will be monitoring progress closely in the coming months, including ensuring that the new Defence Recruiting System reaches full operating capability as quickly as possible. We continue to pursue a range of initiatives across the three Services to improve recruitment including targeting of specific skills, improved candidate management and engagement to improve Black, Asian and Minority Ethnic (BAME) recruitment.

Civilian personnel costs in the main MOD have increased slightly from c.£1.8Bn to c.£1.9Bn in 2017/18. The material element in this movement is the inclusion of DSTL staff costs in the calculation (as noted above, DSTL has previously operated as a Trading Fund outside the Departmental boundary).

The Equipment Programme comprises the costs of supporting and procuring equipment as well as the relevant contingency balance. While the table in the memorandum splits spend into different departmental expenditure limits (“DELs”), the overall amount of the budget allocated to the Equipment Plan for 2017/18 is £15.3Bn and we are confident that the MOD’s spend in this area will be less than that total, hence the broader view is that the Equipment Plan is affordable in 2017/18 without needing to draw on other parts of the budget.

¹ Respectively, SCAPE and ERNIC stand for Superannuation Contribution Adjusted for Past Experience (SCAPE) and Earnings Related National Insurance Contributions (ERNIC)
Finally, let me reassure you that the UK remains committed to meeting both the NATO target to spend at least 2% of GDP on defence and to spend 20% of our defence budget on equipment and associated support. NATO's most recent figures, published in March, show that we are estimated to spend 22% in 2017. The UK is currently one of only 12 NATO countries to meet this metric and one of only a small number of countries to meet both the 2% and 20% targets.

Yours sincerely,

STEPHEN LOVEGROVE