



Treasury Minutes on the Thirty-seventh to Thirty-ninth Reports from the Committee of Public Accounts 2003-2004

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**Presented to Parliament by the Financial Secretary
to the Treasury by Command of Her Majesty
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TREASURY MINUTES DATED 10 NOVEMBER 2004 ON
THE THIRTY-SEVENTH TO THIRTY-NINTH REPORTS
FROM THE COMMITTEE OF PUBLIC ACCOUNTS,
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Thirty-seventh Report

Department of Trade and Industry

Risk management: the nuclear liabilities of British Energy plc

PAC conclusion (i): Despite retaining, under international treaty obligations, the large residual liabilities associated with nuclear power, the Department treated British Energy after privatisation as just another company. But the Government's formal residual liability implied that British Energy was in a different situation from any other company and the Department needed to behave as a prudent business would in managing the residual risk. The Department failed, however, to put in place any proper risk management arrangements to protect the taxpayer from these risks as set out in our predecessors' Report.

PAC conclusion (ii): The Department assumed that privatisation obliged it to distance itself from British Energy's potential problems, but that constraint was to a large extent self imposed. At privatisation the Department had prepared a risk analysis, which could have formed the basis of continuing risk management, but it failed to update this analysis, and omitted British Energy from its work underpinning the 1998 White Paper on energy for power generation.

1. The Department does not accept the Committee's conclusions. On the residual liabilities, as the National Audit Office noted in its report on the sale of British Energy (BE), the establishment of the Nuclear Generation Decommissioning Fund (to be subsumed into the Nuclear Liabilities Fund (NLF)) provided protection to the Taxpayer, and was based on extensive modelling to ensure BE was set up as a robust company well placed to meet its liabilities. The Department believes its actions in respect of BE were at all times appropriate given that the structure of privatisation was a traditional one which left the Department with few tools with which it could mitigate any risk. The Department retained no rights of information or control over the Company's decision-making. In the light of that, the Department's monitoring was appropriate given BE's financial position during the period in question: when BE was successful, monitoring was light touch and, as its financial position changed, monitoring was stepped up.

2. Since privatisation, BE has been a public limited company operating in a competitive market. The Government was (and remains) committed to fair and competitive electricity markets and believed that it would not have been appropriate to bias policy to favour a single electricity company. The basket of changes that would lead to the significant fall in wholesale electricity prices was outlined in the 1998 White Paper. Therefore, it was clear from an early stage that Government would be driving towards greater competition and that BE would be a relative loser under new arrangements. However, BE also recognised this (indeed, it had recognised in its 1996 privatisation prospectus that wholesale electricity prices were more likely to fall than to rise). BE was completing its own modelling and analysis of changes. Given this was a privatised company, it was not for the Department to second-guess this work or BE's conclusions that it would be able to meet challenges. The modelling which was carried out by the Department focused on the three major price setting generators not price takers such as BE.

PAC conclusion (iii): The Department placed too much emphasis on British Energy's dividend payments, particularly the £432 million special dividend, as an indicator of its financial position. Dividend payments are not necessarily a good indicator of a company's financial health and departments should not

rely on them. In the private sector financial institutions will make arrangements to prevent companies leaking value through paying dividends and other fees to investors where underlying performance is poor. The Department should make arrangements in the restructured British Energy to avoid the risk that the Company might be weakened by excessive distributions to its shareholders.

3. The Department accepts the Committee's recommendation regarding the arrangements in the restructured BE, and notes that the liabilities agreements agreed between the Government and BE as part of the restructuring anticipate the Committee's recommendation. The agreements prevent BE from making cash distributions (i.e. dividend payments, share re-purchases or other capital reductions in cash), capital distributions (i.e. non-cash dividends or distributions) or acquisitions of another undertaking or participating interest in another undertaking unless:

- available cash and collateral exceeds a 'target amount' of not less than £490 million (plus the amount of the distribution or consideration for the acquisition);
- committed bank facilities are available for such an amount; or
- the BE Group has an investment grade credit rating.

In addition if BE had attained an investment grade credit rating, it could not make a cash or capital distribution if it had reason to believe that the distribution would be likely to result in the loss of that rating.

4. Cash distributions and capital distributions also impact upon the NLF's 65 per cent cash sweep (a right to 65 per cent of BE's annual free cash flow) and therefore there are also restrictions on BE making such distributions if agreed parameters relating to the cash sweep would be exceeded.

PAC conclusion (iv): The Department did not have access to definitive information and in the critical two years to early 2002, it was left to British Energy to bring matters to its attention. In future where departments are exposed to potential liabilities, they should equip themselves with rights of access to company information similar to those obtained by financial institutions in a comparable position.

PAC conclusion (v): The Department failed to establish a credible overview of British Energy's deteriorating financial position, and did little more than gather information. Its inaction was compounded by split responsibilities for monitoring British Energy and the design of the New Electricity Trading Arrangements. In designing and coordinating energy policy it failed to consider the taxpayer's potential exposure. The Department should establish effective oversight of British Energy's financial position, drawing on information from outside and within British Energy and resolving any inconsistencies in information at the time they arise.

5. The Department accepts the Committee's recommendations for future oversight of BE's financial position, and also notes that the liabilities agreements anticipate the Committee's recommendations. Amongst other things, the agreements set out the financial and other information that the Department and the NLF will receive from BE in order to allow us to monitor our exposure to the company's liabilities, including an entitlement to any financial information we might reasonably require to monitor the financial health of the business. Arising from these requirements BE has agreed to provide the Department with, amongst other things, periodic reports on its business performance and strategic and business plans and for there to be regular meetings and communication with senior executives and the Board on a range of topics.

6. The Department does not accept that it failed to consider the taxpayer's potential exposure. This was a key consideration: the structure of the privatisation of BE represented a significant transfer of risk from the public to the private sector, the Department recognise that there was some risk that BE's liabilities might return to the taxpayer, but that risk was contingent and residual.

7. The Department does not accept that its responsibility for the New Electricity Trading Arrangements impacted negatively on its handling of BE. According to BE's own modelling, electricity prices would fall, but the company nonetheless embraced the new arrangements and believed it could mitigate a fall of the level forecast and operate effectively in the new market.

PAC conclusion (vi): British Energy executives may receive bonuses as a result of improvements in the company's finances accruing from restructuring funded by the taxpayer, including the Government's £410 million credit facility. The Department should require that financial improvements brought about through its support for restructuring are excluded when considering directors' remuneration and bonuses. One way such an exclusion could be achieved might be through a memorandum of understanding regarding the terms of directors' contracts overseen by the appointment of a partnership director on the remuneration committee.

8. The Department does not accept the Committee's recommendation. The Committee should note that, following the decision on 22 September 2004 by the European Commission to approve the Government's restructuring aid to BE, the company cannot make any further drawings on the credit facility and all outstanding amounts under the credit facility have been repaid with interest so it cannot be used to pay bonuses. For the future, Government is contributing to the cost of discharging of BE's historic nuclear liabilities and underwriting the NLF. It is not contributing to the company's operating costs. The restructuring agreements with BE put arrangements in place that protect taxpayers' financial exposure to the nuclear liabilities, but also enable BE to operate as a commercial venture with control over its non-liability related operating and financial decisions. Furthermore, it would be impractical to isolate the financial improvements brought about through the Department's support for restructuring from those financial improvements which are not.

PAC conclusion (vii): British Energy's management did not respond effectively to the changes in the electricity market and the Department did not challenge the company's strategic direction. British Energy's failure to invest in domestic electricity supply significantly contributed to the company's eventual difficulties. Where departments may have to bear residual liabilities from private companies, they should undertake strategic benchmarking of the company against its major competitors and seek explanations for significant variations as a matter of course. In future where departments face significant risks reverting back to them, they should consider whether a Public Private Partnership, with its closer relationships between departments and the private sector and scope for joint risk management, would provide a more appropriate arrangement than privatisation.

9. The Department accepts the Committee's conclusion. The Shareholder Executive was established in September 2003 to advise, and in the case of DTI manage, government departments on their interests in commercial businesses. One of its key objectives is to agree with management an appropriate strategy and corporate governance regime for each of these businesses. In the event that this leads to the conclusion that it would be appropriate to open up a business to private sector participation, the Shareholder Executive would as a matter of course consider the full range of options including a Public Private Partnership.

Thirty-eighth Report

Office of the Deputy Prime Minister (ODPM)

An early progress report on the New Deal for Communities Programme

PAC conclusion (i): The Office of the Deputy Prime Minister should work with other Departments to streamline area based initiatives aimed at deprived communities. In some areas the New Deal for Communities scheme is only one of more than fifty different initiatives with separate funding streams to address aspects of deprivation. Initiatives need to be better co-ordinated to reduce potential duplication for example by pooling them where possible to reduce the overheads of managing separate schemes.

1. The Office accepts the recommendation. Government departments have already agreed that there should be a co-ordinated approach to regeneration funding, and as a result “The Safer and Stronger Communities Fund” was announced in Spending Review 2004 that brings funding streams together from both ODPM and the Home Office in the way suggested by the Committee.

2. In addition, the development of Local Area Agreements (LAAs), which will be piloted next year, provide a further opportunity to better co-ordinate and simplify multiple funding streams in deprived areas. There are 21 LAA pilots in Greenwich; Hammersmith and Fulham; Dorset; Devon; Kent; Brighton and Hove; Suffolk; Peterborough; Derby; Derbyshire; Telford and Wrekin; Coventry; Wolverhampton; Wigan; Knowsley; Stockton-on-Tees; Gateshead; Barnsley; Sheffield; Doncaster; and Bradford.

3. Negotiations with the pilot areas will take place over the winter, and if the pilots are successful this will be followed by a rollout across England. As part of the negotiation, each area will be able to propose the funding streams that they wish to see included within the agreement.

4. Agreements will be struck between the Government, the council and its major delivery partners working in an area – working through the Local Strategic Partnership (LSP). LAAs will be structured around three blocks: Children and Young People; Safer and Stronger Communities; and Healthier Communities and Older People. They will deliver national outcomes in a way that reflects the local priorities identified in Community Strategies. This will give Local Authorities and their partners the freedom and flexibility to find local solutions to local problems, and to prioritise spending to achieve the outcomes identified in the LAA.

5. LAAs will offer local authorities and their partners: much more flexibility about the use of funding streams and associated reductions in bureaucracy and transactional costs; strengthening of partnership working and of the role of the LSP; and a greater focus and agreement between agencies on the delivery of a number of key outcomes for the area over the life of the LAA.

6. The LAAs will ensure that there is a single point of contact for each area with the regional relationship team in the Government Office (GO) and a simplified auditing and monitoring process.

PAC conclusion (ii): The wider impact on social cohesion of targeted and piloted approaches to neighbourhood renewal should be reviewed. The New Deal for Communities is being piloted in 39 of some two to three thousand communities suffering multiple deprivation. Initiatives which favour particular neighbourhoods may cause resentment in neighbouring

communities which do not benefit from the improvements arising from targeted funding. Where neighbourhood based initiatives are introduced it is important that problems in the selected neighbourhood, such as crime and disorder for example, are addressed and not displaced to adjacent communities. Evaluations of neighbourhood based programmes should take account of their impact on adjacent communities.

7. The Office accepts the recommendation. The national evaluation of the New Deal for Communities (NDC) Programme is already designed to address some of the considerations raised by the Committee. For example, as part of the 2001-2005 phase of the evaluation, patterns of crime in neighbouring areas are being examined. In addition, some 120 NDC sponsored projects will be broadly assessed in terms of the degree to which they affect projects in the wider local area. The existing evaluation will also examine the extent to which NDC benefits the wider local area, for example through the mainstreaming of good practice in service delivery.

8. In the next phase of the national evaluation, which is due to start in 2005, the Department expects to place greater emphasis on the examination of the potential benefits or side effects on local areas, as more outcome data becomes available.

9. The overall evaluation of the National Strategy for Neighbourhood Renewal will examine the impact of how a range of renewal initiatives, including NDCs, are organised and implemented at the district and sub-district level.

10. The NDC programme selection process was based on the 1998 – the then current – Index of Local Deprivation which provided information on the degree, intensity and extent of deprivation in different areas. In addition to using this information, the Office aimed to have a regional spread, so that the lessons of regeneration could be learnt from experiences across the whole country.

11. The Office notes the Committee's concerns that the NDC programme, as an initiative that favours particular neighbourhoods, may cause resentment in neighbouring communities which do not benefit from the improvements arising from targeted funding. One of the overall aims of the programme is to encourage the dissemination of best practice across local areas and encourage the mainstreaming of services wherever possible.

12. Furthermore, the main focus now of Government intervention in deprived areas is the National Strategy for Neighbourhood Renewal, where the lead in determining local priorities is given to LSPs set up at authority wide level, who produce a Local Neighbourhood Renewal Strategy (LNRS) which focuses on deprived areas and achieving floor targets. ("Floor target" is a generic term to describe targets that set a minimum standard for disadvantaged groups or areas, or a narrowing of the gap between them and the rest of the country). LSPs are allowed to merge their LNRS and their Community Strategy into a single plan, and this is becoming increasingly common. Amongst other things this strategy is expected to take account of the need to promote community cohesion. Both NDC money and Neighbourhood Renewal Fund grants can be used to contribute to the achievement of the LNRS and Community Strategy targets determined by the LSP.

PAC conclusion (iii): For successful community engagement in the programme, community representatives on the New Deal for Communities boards need the authority to represent their communities. Existing governance arrangements allow individual community representatives to nominate themselves. The Office of the Deputy Prime Minister should review and strengthen the governance arrangements for New Deal for Communities boards and require community representatives to be nominated by a number of local residents.

13. The Office accepts the recommendation of the Committee, and has already issued a Code of Conduct for NDC Partnership Boards.

14. Over the past year ODPM officials have been developing comprehensive Governance guidelines, and these were issued in October 2004. The guidance specifically addresses the concerns noted by the Committee about how community representatives are nominated for board membership. The document aims to provide guidelines to all NDCs on the effective operation of Partnership Boards, whether they are incorporated or not, drawing on the experience of existing NDC and Neighbourhood Management Partnerships that can usefully be shared. ODPM recognises that the Board must be 'fit for purpose' and the guidelines aim to provide tools to assess how the Board is performing and suggests ways to tackle particular issues. In summary the guidelines cover roles and responsibilities, competencies and qualities, Board composition, diversity, election and succession planning, support, behaviour, running meetings and reviewing Board effectiveness.

PAC conclusion (iv): The Office of the Deputy Prime Minister needs to clarify the role of local authorities in New Deal for Communities partnerships. Mistrust between some local authorities and New Deal for Communities boards has prevented progress through the partnership approach. Clearer guidance on the role of the local authority as accountable body, for example setting out the extent of its responsibilities for New Deal for Communities project evaluations and financial control, would help to clarify matters and reduce tensions.

15. The Office accepts this recommendation, and the ODPM has produced two documents (the most recent in May 2004) aimed at clarifying the role and responsibilities of both the NDC partnership and the accountable body. This guidance is available to all NDCs and Accountable Bodies via the OPDM web-site.

16. In particular, the guidance covers Ministers expectations that Accountable Bodies should not try to micro-manage the NDC Partnership, but adopt a risk management approach – that is to say that their scrutiny is proportionate to the financial risk. The guidance also emphasises the important role that the Accountable Body can play in supporting NDCs, developing links with other bodies and initiatives, and tackling barriers to delivery.

17. ODPM is currently commissioning a series of training sessions targeted specifically at NDCs and relations with Local Authorities who act as Accountable Bodies. The training will aim to tackle the barriers to effective working relations by encouraging links and providing support for Accountable Bodies.

18. The training will highlight examples of best practice and will be delivered in conjunction with a group of NDCs and a training facilitator. The training will be rolled out to GOs, NDCs and Accountable Bodies by January 2005.

PAC conclusion (v): Increased business activity and employment opportunities are needed to increase wealth in deprived communities. New Deal for Communities partnerships should take more active steps to bring businesses into deprived areas. They could for example identify what skills shortages exist in local businesses and target training in the community to meet these needs. They could also identify what barriers there are to businesses moving into their areas, for example, reliable transport or building infrastructure and work with the relevant agencies to overcome these.

19. OPDM accepts this recommendation. The National Evaluation on NDCs has reported that NDCs work well with a number of agencies, especially Job Centre Plus, to deliver a range of labour market supply initiatives.

20. ODPM will be asking NDCs and GOs to make greater use of the specialist expertise available to strengthen NDC performance on business, wealth creation, and employment to build on this good start and challenge agencies to translate this in to positive economic outcomes.

21. ODPM, working with the Department for Work and Pensions and GO colleagues, has set up a programme of events for NDCs and other bodies working in this area, for spring 2005. The aim is to

- maximise the opportunities of NDCs working with Job Centre Plus and other bodies, and
- share good practice, in particular on initiatives to tackle supply side problems and initiatives to complement labour market trends in the wider district.

22. There are general initiatives to promote business engagement and employment opportunities, including improved targeting of Regional Development Agencies on enterprise creation and employment rates in deprived areas. Business Brokers contribute to promoting links with the private sector. The Sheffield Broker won an award at the recent NDC Achievement Awards in Birmingham for promoting enterprise and business partnership in Burngreave NDC.

PAC conclusion (vi): Evaluation of the New Deal for Communities programme should focus on identifying the additional benefits from the specific approach adopted. Many improvements in local services are likely to emerge from the injection over ten years of £2 billion of additional funds in 39 targeted neighbourhoods. But the Office of the Deputy Prime Minister needs to identify and evaluate the specific benefits that arise as a direct result of the community partnership approach of the New Deal for Communities programme compared to other approaches to neighbourhood renewal.

23. The Office accepts the recommendation. The national evaluation of NDC is already designed to address this in two main ways. First, as a result of work carried out in all 39 from 2002 onwards it has been possible to create a 'community involvement' index across all the 39 areas. The evaluation will thus be able to identify the degree to which change at the NDC level is associated with greater or lesser community involvement by individual NDC partnerships.

24. Second, all changes in NDC areas will be benchmarked against changes in other similarly deprived neighbourhoods, many of which are subject to other area-based initiatives. Over time, this will help us understand the added impact of the community partnership approach used by NDCs, compared with other area-based initiatives.

25. The precise measurement of the added value of community engagement is complex, so the evaluation of this element will continue to be largely based on the views of NDC board members, staff, local residents and other stakeholders.

PAC conclusion (vii): To ensure that the Office of the Deputy Prime Minister can determine the relative success of different approaches to neighbourhood renewal from their various regeneration schemes, the Department needs to track consistent data for all their regeneration initiatives. The Office of the Deputy Prime Minister has developed a set of indicators to help track the progress in bringing the New Deal for Communities neighbourhoods up to a level that is on a par with national averages in five key theme areas: crime, education, health and housing and the physical environment. The Department also needs sufficient data from their other regeneration initiatives to ensure that they can compare them and identify what works best to improve neighbourhood renewal.

26. The Office accepts the recommendation in principle. The collection of consistent small area data of deprivation related indicators is being taken forward through the Neighbourhood Statistics initiative. This will better enable the relative success of the impact of regeneration initiatives to be measured, wherever they are based in the country.

27. The set of outcome indicators for monitoring of the impact the NDC Programme is based on both survey and administrative data. The Office does not believe it will always be methodologically appropriate or cost-effective to collect similar survey-based measures for all neighbourhoods subject to regeneration initiatives. For some schemes, for example, it may be more appropriate to only collect detailed information in a smaller number of case study areas.

28. The Neighbourhood Statistics initiative is developing the collection of small area data on deprivation related measures on a new consistent small area geography (super output areas). This will better enable the relative success of the impact of regeneration initiatives to be measured, wherever they are based in the country. The use of 'comparator' areas in the NDC national evaluation can also be used as a benchmark against which to identify good practice. For example, administrative data on the receipt of social security benefits can be used to monitor the impact of regeneration initiatives on rates of worklessness in deprived areas.

29. It is better that small area data on deprivation issues is produced and published via the Government's Neighbourhood Statistics initiative for the whole of England. As data is produced this will enable progress in NDC – and other regeneration initiatives – to be tracked and comparisons made to better understand what works best to improve neighbourhood renewal.

30. ODPM already has in place a performance management system to ensure a systematic assessment of NDCs, which can be used as a tool for self-improvement. The model of assessment is based upon 7 categories:

- Results on the 5 themes of NDC (health, housing and the environment, crime, worklessness, and education)
- Robustness of the partnership
- A coherent programme and its management
- Resources, financial management and administration
- Diversity, race and fair access
- Working with other organisations and key agencies
- Learning, improvement and forward planning.

31. The NDC, in liaison with the GO, can devise an improvement plan based on the performance management assessment concentrating on those areas most in need of attention.

32. The Office has also been considering ways to obtain more detailed project information from NDCs in order to assist in answering Ministerial and Parliamentary questions, provide comprehensive project data to the NDC evaluation team, and assist in the Value for Money evaluation.

33. As a result of these considerations the Department has commissioned the development of a central database, System K, which will upload local partnership expenditure and project monitoring information on a quarterly basis.

34. The regular updates of the database will allow ODPM and GOs to check that NDCs continue to monitor their programmes adequately in terms of expenditure and milestones. Quarterly reports will be produced for Ministers and the ODPM website which will demonstrate progress against performance indicators. This project will go live in November 2004.

PAC conclusion (viii): Regional Government Offices should satisfy themselves that NDC funds are not being used to replace existing resources provided to local statutory agencies. A small proportion of service delivery agencies (5% of those responding to the National Audit Office survey), acknowledge that some New Deal for Communities money is being used to substitute for local authority spending. The Government Offices need to monitor spending on projects to uphold the Office of the Deputy Prime Minister's requirement that this money should not be used to finance projects that should be supported by existing public or private sector grants.

35. ODPM accepts this recommendation. Regional GOs work closely with LSPs to ensure planned delivery of local projects, including evaluating performance and value for money and monitoring spend. GOs will continue to scrutinise local plans to eliminate any misdirection of funds.

PAC conclusion (ix): New Deal for Communities partnerships should plan how momentum is to be maintained after the programme has ended. Although the programme has several years to run, New Deal Communities partnerships need to consider at an early stage how successful projects and initiatives are to continue in the longer term once additional programme funding has ended. This will require partnerships to work closely with service delivery agencies such as their Local Authorities, Police Authorities, Primary Care Trusts and others to agree long-term strategies and funding. Government Offices should also seek assurance that partnerships are planning for the end of the programme and, if necessary, act as brokers between the partnerships and service agencies to help secure realistic funding for the future.

36. ODPM accepts this recommendation. Planning work is already in progress to ensure that successful initiatives from the NDC programme continue past the end of the 10-year central funding. ODPM already has in place Whitehall facing teams, who liaise with other Government Departments on neighbourhood renewal issues, and so can provide support to NDC Partnerships in dealing with mainstream providers of services.

37. ODPM is also currently working to develop events at which NDC Partnerships and mainstream agencies will be invited, to help all parties engage more effectively and develop positive working relationships. NDC is an innovative programme in community regeneration. The key message to Local Authorities and other key partners is that they should give NDCs some priority.

38. NDCs are encouraged to engage with service deliverers to secure long term changes to services and ODPM is encouraging the Accountable Bodies to ensure this is happening. LSPs, as the partnership bringing together the public, private, voluntary and community sectors in the local area, can use their strategic role to support the NDC and make co-ordinated approaches to service deliverers. ODPM has asked NDCs to share delivery plans with their LSP to ensure service deliverers are aware of priorities for the NDC area. In addition, guidance is currently being prepared to ask LSPs to engage with NDCs where they currently do not, or the links are weak.

39. ODPM supports any efforts by NDCs to attract other sources of funding to mainstream the regeneration of their neighbourhood. When ODPM funding ceases, NDC residents will be at liberty to apply to register as Registered Social Landlords under the same conditions as other non-statutory bodies or, to petition to become parish councils (outside London), or to become Community Interest Companies. All the options available to NDCs at the end of the 10 year funding are currently being reviewed by ODPM officials with the aim of ensuring that the support mechanisms are in place by the end of the 10 year programme to enable NDCs to be sustainable.

Thirty-ninth Report

Ministry of Defence: Operation TELIC – United Kingdom military operations in Iraq

PAC conclusion (i): The operation benefited considerably from the experience gained and lessons learned on Exercise Saif Sareea II which took place in Oman in 2001. Operation TELIC demonstrated how valuable large-scale exercises such as Saif Sareea II can be. As the planning for Saif Sareea II demonstrated, exercises are often threatened with cancellation or are reduced in scope in the face of financial pressures elsewhere in the Defence budget. The priority given to exercises should be decided in the knowledge of the full costs and benefits, as a key element in maintaining military capability. The Department should analyse these factors when it considers its exercise programme each year.

1. The Department welcomes the Committee's comments on Exercise SAIF SAREEA II and accepts the Committee's recommendations, which are fully in line with our existing practices.

2. We are committed to ensuring that our armed forces are prepared to fulfil a multitude of tasks, wherever and whenever required. Training is tailored to ensure that we are prepared to undertake these roles and is sufficiently demanding to derive the maximum benefit from it. However, the diversity of these training requirements and competing demands of operational commitments mean that the Department cannot exercise for all eventualities every year. Furthermore, good quality exercises place a significant demand on resources. Therefore the Department must assess each one to ensure they deliver the most appropriate training, at the right time and for the best value for money.

3. The Department plan training exercises five years in advance. This is conducted both individually by each Service and jointly to provide a single coherent and definitive document, the Defence Exercise Programme. It is reviewed and prioritised on an annual basis. Major exercise opportunities, such as Exercise SAIF SAREEA II, can then be forecast in sufficient time to allow the Department to properly test the requirement and benefits of such training against the resource implications, other training priorities and operational commitments. The recommendations of the Committee's report will be fed into this process of review to further reinforce good practice in this area.

PAC conclusion (ii): The Department deployed a large, highly capable force to the Gulf in around 10 weeks, less than half the time that it had taken to send a broadly similar sized force for the 1990–91 Gulf War. But the speed of deployment exposed areas where risks had been taken on how quickly gaps in capability, ... could be made good. The management information that the Department uses to report its readiness to deploy forces should identify these gaps and how they could rapidly be made good if required.

4. The Department accepts that, on occasion, Urgent Operations Requirements (UOR) delivery timescales will be tight. However, we cannot hold forces and supplies for every potential contingency. Inevitably, there will be scenario specific requirements that have to be met by UORs. Gone are the days of the Cold War when all eventualities (and the locations) could be planned in advance. For today's scenarios we need agility which UORs inevitably play a part. While the speed at which the deployment had to be mounted meant that not all shortfalls were made good by this method, it is equally the case that those shortfalls which occurred were not critical to the process of the mission. The judgement as to whether our forces

were ready for combat operations, quite rightly, rested with the operational commanders. They were required to declare that they had 'full operational capability' before political authority to begin the operation was given. Troops would not have been allowed to cross the line without the necessary equipment for the task.

5. Some of the gaps which occurred, were unavoidable, given the pace and scale of the required deployment, the restricted warning time and the late change to the military plan. However, the Department also agrees that there is also room to improve stockpile planning. The ongoing revision of Defence Planning Assumptions, will inform the forthcoming Logistics Sustainability and Deployability Audit 2005. This audit will also take account of relevant lessons identified from Op. TELIC. Other work aimed at improving risk mitigation against realistic scenarios and warning times will also enhance the logistic requirement setting and stockpile planning process.

PAC conclusion (iii): A particular risk was the extent to which urgent purchases were expected to make up any shortfalls in stock and equipment levels. The Department is now reviewing stock levels. In its review the Department should set a timetable for examining ways of engaging industry earlier in the pre-operational period to increase the likelihood that urgently purchased equipment and modifications are delivered to the frontline in good time. Such ways could include involving contractors in the early stages of planning an operation, early funding of some 'at risk' areas and provision in supply contracts for surges in production.

6. The Department accepts the need to ensure that the right balance is struck between having expensive stocks on the shelves and relying on procurement during the readiness period. The ongoing review of stock and equipment levels will reassess the adequacy of stock levels against plans, but the requirement for urgent purchases and modifications cannot be wholly removed. To do so would be prohibitively costly.

7. Affordability has to be factored into the equation, in relation to the size of the Defence budget and other priorities and judgements made on the likelihood of action being required.

8. The Department notes the Committee's concern regarding timely engagement with industry. Early engagement with industry is an intrinsic part of the planning process, although for Op. TELIC political and security concerns prevented this. Also, UOR requirements are strongly influenced by operational plans, which are often very fluid. Industry is unlikely to set costly arrangements in-hand ahead of the Department being able to place firm orders.

9. For items which are expected to be required, but which have a long lead time, the Department, in conjunction with Treasury, considers procurement "at risk". Identification of 'at risk' areas and the need for early funding is included in the ongoing risk articulation work. Recognising the increasing global nature of the defence industrial base, the Department is working with key allies and their respective industries in establishing processes to assist prioritisation of supplies for urgent defence equipment requirements.

10. The UOR process is used to fine-tune military capability to ensure UK forces are as well equipped as possible for the tasks they are asked to carry out. It must be borne in mind that the capability we do have is highly potent, and with relatively minor enhancement provides strong basis on which to build successful operations.

PAC conclusion (iv): The Department needs to ensure security of supply. The supply of ammunition for Underslung Grenade Launchers was potentially at risk when the Swiss Government withdrew its export licence. Although this incident had no impact on operational capability on this occasion, it serves to illustrate the potential vulnerability of United Kingdom supplies. The Department should identify any other cases where sourcing from overseas could put supplies at risk and seek alternative sources.

11. The Department accepts the need to ensure security of supply wherever possible.

12. This is fully in line with the Government's Defence Industrial Policy (published in October 2002) which made clear the utility of protecting the armed forces security of supply. The Department also recognises that an increasing mutual reliance on security of supply is inevitable for all nations.

13. In terms of ammunition, security of supply is taken into account when competing all requirements and forms an integral part of the vetting process before tenders are progressed. The majority of ammunition contracts, including key ammunition natures, are currently let to UK suppliers. However, there is a growing tendency, in global markets, for UK suppliers to outsource component supply to non-UK countries.

14. The Swiss case serves to highlight the importance of maintaining a munitions stockpile to ensure that UK troops are sustainable against the most demanding scenarios and timelines in Defence Planning Assumptions. In terms of wider equipment supply, the Defence Logistics Organisation is improving procurement processes using Supplier Based Optimisation as part of a formal procurement reform programme. The Department continues to review the ability of industry to meet different requirements in relatively short timescales and adapt stock levels accordingly.

PAC conclusion (v): Equipment shortages at the front line exposed troops to increased risk. As a result of a combination of shortages of initial stockholdings and serious weaknesses in logistic systems, troops at the frontline did not receive sufficient supplies of a range of important equipment. Troops should not be exposed to anticipated attack without the detection and protective equipment required for their defence.

15. The Department takes very seriously the issue of ensuring that our troops are properly equipped for the tasks that they are asked to perform.

16. The Department accepts that in the early phase of Op. TELIC there were some shortages experienced at the front line despite stocks of desert clothing, boots, combat body armour and Nuclear, Biological and Chemical suits being in place to meet anticipated operational requirements. However, the commanders on the ground did not regard these difficulties as imposing any limitation on operations. This was clear in that they were able to declare full operational capability in advance of the commencement of operations.

17. This issue must also be seen in the context of existing stock levels that are dictated by Defence Planning Assumptions. These assumptions predicated operations at medium scale of effort and allowed for the build-up of theatre stocks over a period of months.

18. The Department accordingly had sufficient stocks to achieve a medium scale operation. Op. TELIC very quickly became a large scale operation exceeding Defence Planning Assumptions for both stocks and deployment timelines. Having engaged in a large scale operation at significantly reduced notice, matters were

further complicated by the restrictions on early engagement with industry. This was to ensure that the diplomatic efforts were not compromised. Despite readiness and force preparation times being truncated, and limitations on engaging fully with its suppliers, the operation was mounted on a scale far exceeding the current planned levels, without any significant shortfalls. This should be seen as a significant achievement.

19. Experience of Op. TELIC has however provided valuable lessons. In light of operations in Iraq, planning assumptions have been revised which has allowed procurement action to be put in place to increase stockholdings of desert and temperate clothing, including boots and Nuclear, Biological and Chemical items. Amendments have also been made to the Department's Operational Stocks Register. Stock controls have also been introduced to ensure the serviceability of stocks of Residual Vapour Detectors and the obsolete Nerve Agent Immobilised Enzyme Alarm & Detector is now being replaced by the Manportable Chemical Agent Detector.

20. The Chiefs of Staff have now endorsed a policy that will provide a cost-effective and guaranteed means of ensuring that Service personnel and deploying civil servants are provided with Enhanced Combat Body Armour (ECBA) prior to deployment on operations. Plans are also in hand to issue all regular Service personnel (less Royal Navy, but including Royal Marines) with a personal set of Combat Body Armour (CBA) for the duration of their career. The Department is also procuring and storing sufficient quantities of ceramic plates (which are used to form ECBA) to equip personnel up to large-scale operations such as Op. TELIC. When a regular unit is placed at five days (or less) notice to deploy, it will be issued with the appropriate scale of ceramic plates. Those not issued with a personal set of CBA (Royal Navy, Reserves and any others who may be required to deploy to a theatre of operations) will be issued with ECBA prior to deployment.

PAC conclusion (vi): Deficiencies in equipment management were exposed. Equipment had not always been managed well. The Department should re-examine how it keeps track of small but important items such as body armour, including whether more items of kit should be designated as 'personal issue', for which the person issued with the kit is held accountable. The Department should also draw up, and undertake, a regular programme of testing the serviceability of Nuclear, Biological and Chemical Warfare protection equipment.

21. The Department accepts that there were some lessons to be learned.

22. The loss of visibility of 200,000 components of body armour referred to in the report was a reference only to records held at the departmental level. The Department at unit level does account for all publicly funded materiel, including body armour parts, and we do have a full audit trail of issues to units. Items within the defence inventory can be pursued individually depending on their value or sensitivity.

23. Combat body armour has now been designated as an item of personal issue to regular service personnel (less Royal Navy, but including Royal Marines). Individuals will be held accountable for the care of their body armour; if damaged or lost it will, of course, be replaced in line with existing procedures.

24. Although the stock of Residual Vapour Detectors had deteriorated on the shelf, sufficient quantities were deployed to theatre to meet requirements before the commencement of combat operations. Stock controls have now been introduced to ensure that the problem does not arise in the future. A rolling programme of inspections, underpinned by the appropriate repair capability, is also undertaken to ensure depot stocks of Chemical, Biological, Radiological and Nuclear detection equipment remains serviceable.

PAC conclusion (vii): We were particularly concerned that armoured vehicles including the Challenger 2 tank did not have viable Nuclear, Biological and Chemical defence filters fitted and that operational filters had not been delivered by June 2003. While we accept that armoured vehicle crews may have had recourse to their personal protective suits and respirators, we consider that both the wearing, and the robing and disrobing of such protective equipment whilst potentially under enemy fire ... must inevitably seriously impair their operability and therefore the effective operation of weapons and instrumentation during battle. It is essential that Challenger 2 tanks are fitted with protective filters in future.

25. The Department believes that this is a matter for Military Judgement.

26. Commanders assessed that the risk posed to the Force by these shortages was low.

27. For the NBC filter on armoured vehicles, as with other threats, we had to judge the balance of risk between waiting for all equipment to arrive and be available and delaying the start of combat operations. Although a limited number of NBC vehicle filters for some types of vehicle had arrived in 1 (UK) Division before hostilities began, these had to compete with other priorities such as in-theatre integration of forces and receiving and integrating the final two armoured Battlegroups into the Division.

28. Not all armoured vehicles have NBC filters fitted. For example older designs such as most of the FV430 series and some of Combat Vehicle Reconnaissance (Tracked) variants do not. Our principal fighting vehicles, such as Challenger 2, Warrior and AS90 do. Sufficient NBC filters were dispatched to Iraq, most in time for operations, but problems with asset tracking in theatre meant that these were unable to be located until after hostilities had ceased.

29. Troops are fully trained to operate armoured vehicles wearing personal protective NBC equipment, irrespective of whether the vehicle has collective NBC protection.

PAC conclusion (viii): Despite investing over £550 million since the first Gulf War in new computerised systems that include an asset management capability, the Department still lacks a credible consignment tracking system. The Department should consider whether it might be better to procure a system that meets essentials and can be introduced into service quickly rather than trying to develop a technically advanced bespoke system.

30. The Department accepts that the speed and size of the deployment to Iraq challenged its current consignment tracking systems, which resulted in the temporary loss of visibility of some items.

31. Improvements have already been made including the retention of the US Radio Frequency Identification (RfiD)(TAV(-)) equipment that was purchased as an UOR and the extension of functionality of existing systems. It is recognised that further improvements are required and the Department has identified £17.5 million over the next four years to improve the existing systems. The proximity of consignment tracking equipment to the front line will continue to be governed by a number of factors such as the tactical situation and the ability to provide communications, but it is intended to extend the footprint much closer to the warfighter as new investment is made. Progress is being made as follows:

- *Total Asset Visibility (TAV)*. TAV was procured as an UOR for Op. TELIC, using radio frequency identification to track consignments through specified points within the supply chain. A maintenance contract has recently been signed for the system and TAV is delivering improved capability to operational users. Short Term Planning (STP) funding of £2.56 million (£640,000 per annum) for this project was secured in April 2004.

- *Consignment Visibility (CONVIS)*. CONVIS is addressing the major problems in the Department's consignment tracking capability. Initial improvements to the current systems, Visibility In-Transit Asset Logging (VITAL) and RN Invoicing and Delivery Systems (RIDELS), have already been deployed including an interface between the two. An incremental programme of further improvements is continuing and will include Defence wide training from April 2005.
- *Management of Materiel in Transit (MMiT)*. This will provide the management information system and common set of processes to allow logisticians to monitor and control the end-to-end supply of items from their initial point of despatch, into the supply chain and to the final point of receipt. The assessment phase will complete in 2005 with rollout in 2006. Defence Modernisation Funding of £5.87million was secured in October 2003 for the assessment and demonstration phases of the project. The whole life cost is expected to be around £20 million.

PAC conclusion (ix): United Kingdom forces played a valuable role in achieving improvements to conditions in southern Iraq immediately following hostilities but the handing over of responsibilities to civilian agencies needs to be better planned and carried out.The Department should draw up a protocol setting up agreed arrangements for full, early and continued consultation between all interested governmental, non-governmental and civilian agencies and contractors. It should also devise a scheme for the rapid deployment of civilian personnel or sponsored reserves and consider whether these arrangements should be practised in one of its exercises.

32. The Department acknowledges that there is scope to improve the United Kingdom's capacity to deal with immediate post conflict stabilisation, including integrating civilian and military policy, planning and operations. To this end, the Ministry of Defence, Foreign and Commonwealth Office (FCO), and the Department For International Development (DFID) announced in joint statement to the House on 16 September 2004 their intention to set up a Post Conflict Reconstruction Unit (PCRU) to lead this work.

33. The PCRU will have a double remit. First, on policy, to develop government strategy for post conflict stabilisation, linking military and civilian planning, and working with the wider international community for the spread of best practice, capacity building and burden-sharing. Secondly, on practical capabilities, to plan and manage the United Kingdom's contribution to post conflict stabilisation, including identifying, training and deploying civilian personnel.

34. The recommendations of the Committee's report will form an essential input into the issues that need to be considered by the PCRU.

35. The Government expect to be able to formally establish the PCRU later this year. The Head of Unit has already been appointed. Recruitment for the remaining key staff is anticipated by the end of 2004. At full capacity, the Unit is expected to comprise of a core cross-government, multi-disciplinary staff of around 40 as well as a 'surge' capacity of trained experts who can be called on at times of crisis.

36. The Department, along with the FCO and DFID anticipate being able to inform parliamentary colleagues about the initial capabilities of the PCRU in Spring 2005.

PAC conclusion (x): The repeated identification of important logistics lessons since 1991, such as the absence of an adequate consignment tracking system, suggests fundamental shortcomings in the Department's ability to learn and act upon lessons from previous experience. The Department should identify ways to prevent lessons identified in warfighting slipping down the list of priorities during peacetime, for example by specifically identifying and quantifying the risks that result if a lesson is not implemented, and assigning responsibility for implementation.

37. The Department has a comprehensive lessons learnt process and has already acted on a number of lessons from Op.TELIC and previous operations; this is acknowledged in the National Audit Office report.

38. However, the speed at which lessons identified can be implemented depends on resource levels, competing priorities and technical challenges. These practical constraints may effect implementation, but there should be no doubt as to the Departments commitment to ensuring that action is taken to continually improve performance. Several systems are in place to ensure that lessons identified are addressed.

39. The Directorate of Operational Capability (DOC) compiles Operational Lessons Reports for consideration by the Department. These then become factored into the Department's financial plans, and force development in general. However, it is important to note that endorsed DOC Lessons do not generate funding, and that simply to address the lessons of past conflicts is to prepare to fight the last war. DOC Lessons ensure that operational experience is not forgotten, but funding decisions must balance the lessons of the past with the demands of the present and analysis of future requirements.

40. Further reporting on Joint capabilities is undertaken annually by Permanent Joint Head Quarters through the Joint Operational Estimate of Capability and Readiness and the Joint Warfare Resourcing and Priorities List. In addition there is a single, specific study on the Readiness of the Joint Rapid Reaction Force in the light of Op. TELIC.

PAC conclusion (xi): Ordinary Service men and women's experiences and perceptions of equipment shortages were often communicated through the media or through unofficial mechanisms. It is important for the experiences of those at the battlefield to be given weight and for personnel to feel that their views are valued. The Department should specifically canvass the opinions of personnel and should include the views of front line service men and women in their post operational.

41. The Department agrees about the importance of having proper channels to receive and to resolve issues that are of a concern to the armed forces.

42. With regard to perceptions of equipment shortages, Service personnel had and continue to have the opportunity to communicate any problems with their personal kit via their individual chain of command. These complaints can then be channelled through the Customer Satisfaction Survey which is currently undertaken every six months.

43. Alternatively specific complaints can be made via the official defect reporting system which is already in place.



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