



House of Commons
Defence Committee

**Defence Procurement
2006: Government
Response to the
Committee's First Report
of Session 2006–07**

Fifth Special Report of Session 2006–07

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The Defence Committee

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The current staff of the Committee are Philippa Helme (Clerk), Eliot Wilson (Second Clerk), Ian Rogers (Audit Adviser), Stephen Jones (Committee Specialist), Adrian Jenner (Inquiry Manager), Richard Dawson (Committee Assistant), Sheryl Dinsdale (Secretary) and Stewart McIlvenna (Senior Office Clerk).

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Report

The Defence Committee published its First Report of Session 2006–07 on Defence Procurement 2006 on 8 December 2006, as House of Commons Paper HC 56. The Government's response to this report was received on 8 February 2007. This is appended below.

Appendix: Government response

Introduction

1. This document is the Government's response to the Defence Select Committee's report *Defence Procurement 2006* (First Report of Session 2006–07), published on 8 December 2006. The Committee's conclusions and recommendations are set out in bold.

Response to Conclusions and Recommendations

We congratulate the DPA on achieving its Key Targets and the MoD's Public Service Agreement Target for Acquisition in 2005–06. (Paragraph 8)

2. We are grateful for the Committee's recognition of the hard work undertaken across the Department, which resulted in the achievement of both the Key Targets and the MoD's Public Sector Agreement Target for Acquisition in 2005–06.

We are pleased to see that the MoD is getting a better grip on programme time schedules. Off-the-shelf procurement, where available, can reduce the risk of programme time slippage. We look to the MoD to ensure that project teams are made aware of the lessons from the off-the-shelf procurement of the Javelin medium range anti-tank guided weapon, as this appears to be a good example of the benefits which can be delivered from this procurement route. (Paragraph 13)

3. The MoD extracts lessons from projects in various ways including learning workshops, lessons learned/ Post Project Evaluation (PPE) reports and Gateway™ reviews. These lessons are passed to the Learning From Experience (LFE) team for broader publication through the LFE website. Lessons learned from the Javelin project have been captured and the IPT held an LFE day on 10 February 2005 to highlight the key lessons learned; these lessons have been published on the LFE website on the Defence Intranet, which is available to the entire acquisition community.

4. The Learning from Experience Process is a cornerstone of the development of the MoD Acquisition Operating Framework (AOF)—a work-stream flowing from the Defence Industrial Strategy (DIS). The newly revised process will ensure that not only will Projects continue to benefit from their own and shared LFE, but that Process Owners and AOF Content Sponsors update their content in response to appropriate lessons learned. This will ensure that the organisation continues to learn from good practice.

While cost growth on defence equipment projects in 2005–06 was below the target, we have concerns that the main reason for this was reduction in the quantity of equipment ordered. Trade-offs between cost, time and performance are part of the Smart Acquisition process, but we expect our Armed Forces to receive equipment in the numbers required and with the capability to do the task required of it. Meeting Key Targets should not be given priority over meeting the requirements of our Armed Forces. (Paragraph 17)

5. As the Committee acknowledge one of the key principles of Smart Acquisition is the trading of performance, cost and time. In its review of Major Projects in 2005 the

Committee of Public Accounts said “the Department needs to be willing to sacrifice specific elements of capability on particular programmes to meet time and cost constraints if it is to deliver timely and cost effective capability from the defence budget as a whole”. Such trade offs are not made lightly and the implications are carefully considered. We do not believe any of the decisions taken to meet the MoD’s Public Sector Agreement Target or DPA Key Targets were detrimental to meeting the key requirements of the Armed Forces. Our primary concern on which we focus is the capability delivered rather than the platform and equipment numbers. Some £3.3 billion of equipment was delivered in FY 2005/06, the majority of which is new or updated capability for the Front Line Commands.

We are concerned to hear that, in the current financial year, potential cost increases on the Astute submarine and Type 45 Destroyer programmes are putting pressure on the DPA’s Key Target covering cost growth, and that the Key Target covering asset deliveries is at risk. We look to the MoD to monitor performance closely against these two targets, and to seek to limit potential further cost growth on the Astute and Type 45 programmes. We will also be looking closely at the Major Projects Report 2006 to ensure that the cost increases on these two programmes are not symptomatic of wider problems within the MoD’s procurement process. (Paragraph 18)

6. We recognise that there is a degree of risk associated with the achievement of Key Target 4 on Asset Deliveries, and are closely monitoring the position; some important deliveries are due to take place close to the year-end point. The DPA Executive Board is doing all that it can to help the Integrated Project Team Leaders and on balance we expect this target will be achieved.

7. The Astute project faces significant financial challenges and work is progressing with BAE SYSTEMS and other stakeholders to drive out costs across the current programme for boats 1 to 3. Scoping studies for the subsequent programme, boat 4 onwards, have indicated the potential for design simplification and efforts are focused on achieving the means to deliver the associated savings.

8. Bearing down on Type 45 cost pressures is being approached through ongoing negotiations with BAE SYSTEMS for hulls 4–6. The project is making progress and January saw the launch of the second ship in the class, HMS Dauntless.

Work to merge the Defence Procurement Agency and the Defence Logistics Organisation is underway and, on current plans, the new organisation will begin operating on 2 April 2007. The MoD is managing the merger as a project with four phases and target dates for the completion of each of these phases. Given the importance and scale of the merger, we recommend that the MoD provide us with quarterly progress reports. (Paragraph 24)

9. Enclosed separately is a summary of Phase 2 of the programme which ran to the end of December 2006.¹ We will provide a similar summary when Phase 3 concludes at the end of March 2007.

A key objective of the new Defence Equipment & Support organisation is to improve the management of acquisition on a through-life basis. We are pleased to learn that

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there will be new targets to measure the performance in this area and a target covering how quickly the new organisation responds to the needs of our Armed Forces. Given some of the substantial cost increases and time slippage experienced by some equipment programmes in the past, we expect the MoD to continue to monitor its performance at procuring equipment to time, cost and quality, and for the performance data to be published on an annual basis as it is now. Otherwise, there is a risk that poor procurement performance could be buried in long-term project management data. (Paragraph 26)

10. We will continue to monitor performance of procuring equipment to time, cost and performance within the new Defence Equipment & Support organisation. In FY 2007/08 acquisition performance will be reported externally against the extant Departmental Public Service Agreement. The current Comprehensive Spending Review negotiation will determine the Departmental performance targets post 2007–08. The Major Projects Report will also continue and we are currently examining how this might evolve to reflect more appropriately the management of projects and capability on a through-life basis.

The success of the Defence Equipment & Support organisation will depend on whether the new organisation has the staff with the required skills to improve Through Life Capability Management and provide more agility in responding to the needs of the Armed Forces. Much work is being undertaken to identify the current skills gaps and to address these through training or external recruitment, and we welcome this. It is essential that the MoD commit the investment required to address the skills gaps identified. (Paragraph 31)

11. DE&S has established a specific project to improve skills in the new organisation, focussing first on the commercial, financial and project management skills critical to business success. Additional funding has been put into the budget next year and in subsequent years to deliver improved levels of professional qualifications, to cross-train staff into these functions and recruit new skills where necessary.

We recognise that collocating the Defence Logistics Organisation with the Defence Procurement Agency is a sensible step, given that the aim of the merger of these two organisations is to improve Through Life Capability Management. The merger will result in a substantial number of job losses and the collocation will have a major impact, particularly on those who work for the Defence Logistics Organisation and their families. We expect the MoD to continue to consult with the Trades Unions during this period of change and to provide appropriate support to those affected. (Paragraph 34)

12. The statement “the merger will result in a substantial number of job losses” is not correct. The Enabling Acquisition Change review, and thus the merger, was not driven by the need to identify savings. Current planned Departmental efficiency programmes, including personnel reductions in the DPA and DLO, will continue. The Trades Unions have been consulted on these, and on both the DACP and collocation.

We would expect the merger of the Defence Procurement Agency and the Defence Logistics Organisation to deliver substantial efficiency gains. We look to the MoD to

identify what efficiency gains are likely to be delivered, and to monitor whether these gains are achieved. (Paragraph 35)

13. There may be further efficiencies that can be identified in due course for the DE&S TLB, but it is too early to confirm this. Any such reductions would be subject to Trades Union consultations in accordance with normal practice. Any future efficiency measures will be monitored and delivered as a contribution to departmental savings.

The new Defence Equipment & Support organisation will be huge, in terms of both manpower and expenditure. Its roles of procuring equipment and managing equipment through-life are key to ensuring the effectiveness of our Armed Forces. We are concerned that, as the organisation will not have agency status, its activities may lose transparency. We recommend that the new organisation publish an annual report so as to allow proper public accountability, and parliamentary scrutiny in particular. (Paragraph 38)

14. The activities and performance of DE&S will be fully reported on as part of the MOD Annual Report and Accounts. In addition, the annual Major Projects Report to Parliament will continue to cover major aspects of DE&S business.

We are surprised to learn that the prices for boats 2 and 3 have still to be agreed and, as a consequence, the financial liability to the MoD is unknown. We look to the MoD to ensure that the negotiations on the prices for these boats are resolved as soon as possible. Lessons must again be learned from this programme, as letting contracts without pinning down prices, and negotiating prices when equipment is at an advanced stage of manufacture, cannot be considered ‘Smart Acquisition’. (Paragraph 47)

The delay in agreeing prices on Astute boats 2 and 3 is delaying the placing of a contract for boat 4. This, in turn, has an impact on the submarine skills base in the UK. We are examining this issue as part of our inquiry into the Future of the Strategic Nuclear Deterrent: the manufacturing and skills base and plan to report at the end of the year. (Paragraph 48)

15. The Astute contract was placed in March 1997 for the design and manufacture of three submarines. This is one of the so-called legacy projects which were placed before ‘Smart Acquisition’ was introduced. Following the difficulties reported by BAES (Submarine Solutions) in 2002, an amended contract was placed in December 2003, which separated out the design, development, build and acceptance of the First of Class from Boats 2 and 3. As a result, Boat 1 was priced as part of the agreement and, at the insistence of BAES (Submarine Solutions), Boats 2 and 3 are proceeding on ascertained costs pending completion of price negotiations.

16. Significant work has been done over the last 14 months to agree prices for Astute Boats 2 & 3 with BAES (Submarine Solutions). A common price position was reached between MoD and BAES (Submarine Solutions) in December 2006 and awaits MoD approval, and BAES Corporate endorsement. The time taken to agree prices for Boats 2 and 3 was to allow the Boat 1–3 design and the Boat 1 build to reach a sufficient level of maturity to deliver robust prices, whilst still delivering price agreement prior to commencing Astute Boat 4 pre-production processes at BAES (Submarine Solutions) at Barrow-in-Furness. This addresses a key lesson learnt that the timing of pricing and placing a contract for

whole boat construction needs to be undertaken at an appropriate time, balancing maturity of design and the opportunity for incentivisation.

17. The MoD intends to agree robust prices for future Astute-class orders (Boat 4+ onwards) at an earlier stage than was possible on Astute boats 2 & 3, building on the tighter commercial terms proposed for, and the joint MoD/industry cost estimating processes put in place, on Boats 2 & 3.

18. The criticality of a regular drumbeat in sustaining the required capability and skills has been recognised. The 22-month construction drumbeat has been introduced across the Astute Class, better aligning resource availability with the programme requirements. The approval to build the next Astute boat, Boat 4, is being sought on this basis.

The price for the two future aircraft carriers had yet to be agreed. The MoD has sensibly commissioned an independent financial review to advise on what the carriers ‘should’ cost, and it is to be hoped that this will lead to agreement on a challenging contractual price which industry will seek to beat. We look to the MoD to ensure that negotiations on price are moved forward as quickly as possible so that the main investment decision on the future carriers can be taken. (Paragraph 54)

19. Detailed negotiations between MoD and the Alliance companies are in progress and are benefiting from the mature status of the design for construction.

Discussions on the Future Carrier programme will be crucial to the future of the UK shipbuilding industry. The programme is a key element of the Maritime Industrial Strategy. We will examine the Maritime Industrial Strategy as part of our inquiry looking at the progress of the Defence Industrial Strategy. (Paragraph 56)

20. Lord Drayson provided an update on the Maritime Industrial Strategy to the Committee on 19 December as part of his Defence Industrial Strategy Update.

We have no doubt that the Minister for Defence Procurement, the Chief of Defence Procurement and MoD officials have made considerable efforts to ensure that the United States are fully aware of the information required by the UK on the Joint Strike Fighter to allow the aircraft to be operated independently. However, it is still uncertain whether the United States is prepared to provide the required information. If the UK does not obtain the assurances it needs from the United States, then it should not sign the Memorandum of Understanding covering production, sustainment and follow-on development. Such an impasse on a procurement programme of such strategic importance to the UK would be a serious blow to UK/US defence equipment co-operation, which has hitherto been of such positive benefit to both our nations. If the required assurances are not obtained by the end of the year, we recommend that the MoD switch the majority of its effort and funding on the programme into developing a fallback ‘Plan B’, so that an alternative aircraft is available in case the UK has to withdraw from the Joint Strike Fighter programme. We must not get into a situation where there are no aircraft to operate from the two new aircraft carriers when they enter service. (Paragraph 64)

21. The details of the assurances obtained from the United States in connection with information access to JSF data are detailed in a classified bilateral supplement to the

Production, Sustainment and Follow On Development (PSFD) MoU which was signed by the Minister for Defence Procurement on 12 December 2006 and entered into effect on 31 December 2006. The assurances we have received fully meet the requirements set out by the UK to deliver operational sovereignty.

We are concerned to hear that possible changes to the early production of the Joint Strike Fighter aircraft programme could lead to an increase in the price for each aircraft. We look to the MoD to monitor this situation very closely and keep us informed of developments. (Paragraph 65)

22. JSF continues to be the most cost-effective solution for our Carrier Strike requirement. We have not yet made a main investment decision and continue to monitor aircraft costs as the early production orders for US aircraft are placed. We intend working closely with the US and other partners to ensure that best value solutions are delivered by Lockheed Martin (including partners Northrop Grumman and BAES, as part of “Team JSF”), Pratt and Whitney and GE/RR in accordance with the PSFD MoU. The Committee will be kept informed of any major developments.

There has been a long list of defence equipment projects that have experienced severe problems in terms of cost overruns and time slippage, including Eurofighter Typhoon, Astute submarines and Nimrod MRA4 aircraft. The procurement of eight Chinook Mk 3 helicopters is a case which illustrates the impact that poorly managed procurement can have on operations. Our Armed Forces in Afghanistan and Iraq desperately need heavy lift helicopters, yet eight such helicopters are sitting in hangars in the UK and no-one can tell us when they will be operational. We look to the MoD and Boeing to resolve this problem as quickly as possible. The reputations of both parties have already suffered from this sorry episode. (Paragraph 73)

23. The MoD has previously acknowledged that the initial procurement of the eight Chinook Mk3 aircraft was deeply flawed. The lessons learnt from this experience and the implementation of SMART acquisition principles help ensure that past mistakes are not repeated.

24. We are currently in a period of intensive analysis and negotiations to develop a robust way forward. This process has been time consuming but essential to avoid the mistakes of the original procurement, as well as ensuring that all project risks have been comprehensively explored and effectively mitigated.

The Defence Procurement Agency is to be congratulated for its performance, to date, in procuring Urgent Operational Requirements for UK Forces deployed on operations. We consider that there are some important lessons which can be learned from the procurement of Urgent Operational Requirements and applied to mainstream equipment procurement, and we expect the MoD to ensure that this is done. (Paragraph 77)

25. The UOR process is designed to acquire and deliver rapidly to the front line theatre-specific, battle-winning capability that is required urgently by our Armed Forces on operations. Both the National Audit Office and the Public Accounts Committee have acknowledged the success of this process and paid tribute to the agility, flexibility and ingenuity it demonstrates. Some clear behavioural lessons have already emerged from the

UOR process: more self-discipline in accepting what is available on the market rather than going bespoke; incremental acquisition; and even closer involvement of the front line in drawing up the requirement and identifying solutions.

26. We are working on applying lessons from the UOR process to our wider procurement as part of the MoD's follow-up to the Enabling Acquisition Change report; this is being taken forward under the direction of the MoD's Defence Commercial Director which is due to complete in June this year. The results of this work will inform the wider work of the Defence Acquisition Change Programme.

We think it vital that the actual user of equipment is involved in defining the requirement for both equipment procured through the normal procurement process and equipment procured through the Urgent Operational Requirements process. MoD should have arrangements in place to ensure that the actual user of equipment is consulted and involved in defining the requirement for new equipment. (Paragraph 78)

27. It is a central tenet of the acquisition process that users at all levels are involved in the requirement capture as well as being represented within the Integrated Project Teams. It is accepted that in some cases the arrangements have not worked as well as they should. The Committee's point is well made and is accepted. The recent re-definition and re-emphasis of the Service user within the MoD customer role, together with the appointment of the new three 3* Chiefs of Materiel to champion their individual Services within the DE&S, should greatly improve the involvement of the actual end user from the outset of every project.

During our visits to UK Armed Forces in Afghanistan and Iraq before the Summer recess, we were told that additional equipment was required urgently, such as more helicopters. We welcome the Prime Minister's commitment that whatever package of equipment commanders on the ground want will be provided. There will always be a need for requests from the front line to be evaluated by the chain of command, and ultimately approved by Ministers, but this must be done quickly. We note the high satisfaction with the Urgent Operational Requirements process, and look to the Ministry of Defence and the Defence Procurement Agency to rise to the challenge presented by the Prime Minister's commitment, ensuring that requests from the field are processed as quickly as possible. We also look to the Treasury to speed up the approval of the funding for such equipment procurement and to recognise that the MoD will require additional funding to support the equipment once in-service. Service commanders must not be inhibited from asking for equipment required in the field by fears that this will impact on their future budgets. (Paragraph 83)

28. The Urgent Operational Requirement (UOR) process fast tracks capability to forces on the Front Line. Time is the key driver. All those concerned with the delivery of UORs fully appreciate the importance of such Requirements and give them special attention. UOR business is the highest priority of the Equipment Capability area, taking precedence over other procurement activity. UOR timeframes reflect the operational urgency of the requirement, generally equating in a 'flash-to-bang' time of approximately six months from identification of a capability gap to filling of that gap. More complex equipment that requires additional development or integration may unavoidably take longer to come into service.

29. While equipment is used on an operation, the support costs are funded by the Treasury, and there is no need for commanders on the ground to be inhibited by issues relating to the long-term support of equipment procured under the UOR process: this is dealt with as part of the MoD's normal planning process.

It is disappointing that modifications are required to the General Service Respirator which will result in a ten month delay in getting the respirator into service. We look to the MoD to ensure that the necessary investment is made, and the required retrialling undertaken, to ensure that the General Service Respirator is fit for purpose when it enters service. (Paragraph 89)

30. Every effort is being made to minimise the delay to introducing the General Service Respirator into service. The latest user trials in late-2006 were successful in demonstrating that the majority of previous issues had been resolved. However, the recurrence of a problem for a minority of users was significant enough to undermine confidence in the new respirator. The MoD continues to be committed to the delivery of a product that is fit-for-purpose in all climatic conditions and operational environments. The investment in further rectification and validation trials to demonstrate full compliance will delay the in-service date until October 2007.

Given that UK Armed Forces personnel, and police and ambulance personnel, are likely to be working together in the future, we look to the Home Office and the Department of Health to consider the benefits of procuring the same General Service Respirator as is being procured for UK Armed Forces. (Paragraph 90)

31. Joint working with the Home Office and Department of Health on Chemical, Biological, Radiological and Nuclear (CBRN) research and acquisition programmes has been initiated. We have shared requirements, research and other information and the MoD is actively involved with the Home Office delivery team in exploring the level of interest in the General Service Respirator from the police and ambulance services.

The Maritime Composite Training System has the potential to provide flexible and efficient training for Royal Navy personnel. We look to the MoD to claw back some of the slippage that this project has experienced and to ensure that the lessons learned from the use of Earned Value Management techniques on this project are promulgated to other project teams in the Defence Procurement Agency. (Paragraph 101)

32. Both MoD and BAE Insyte are highly focused on maintaining the current programme and wherever possible seeking ways to recover the slippage. It is an ongoing activity, through the formal reviews of the programme schedule, to examine any elements that can be completed sooner which will contribute to recovery of the programme.

33. With regard to the promulgation of lessons learned from the use of Earned Value Management (EVM); the DPA has mandated the use of EVM on projects valued at £20 million or above and the implementation of this policy will be supported by a dedicated team that will ensure the spread of best practice across the department. The lessons from the Maritime Composite Training System (MCTS) and other programmes will form a key part of the 'hands-on' support that will be provided.

The Thermal Sighting System being procured by the MoD will allow the Self Propelled High Velocity Missile system to be operated at night, through cloud or in poor visibility and address a significant capability gap. Changes in the threat mean that 51 of the 134 Thermal Sighting Systems being procured are no longer required. We expect the MoD to identify how these surplus systems might be best used to ensure value for money for the money spent. We also look to the MoD to find an alternative use for the surplus 51 vehicles fitted with the Self Propelled High Velocity Missile system. (Paragraph 106)

34. It has been decided that the excess Thermal Sighting Systems will be best deployed as spares. The detail of this solution is being negotiated with the supplier. Of the 51 surplus Self-Propelled vehicles, 18 have re-rolled as Troop Reconnaissance Vehicles, 3 are to be used in driver training and the remainder are being used to reduce future purchase of major assemblies and spares for the Self-Propelled High Velocity Missile fleet.

There are lessons to be learned from the successful management of smaller-size equipment projects which can usefully be applied to larger equipment projects, and we look to the MoD to ensure that such lessons are promulgated. We are pleased to hear that the MoD is working with the Australian Defence Materiel Organisation and the National Audit Office to identify better ways of defining project complexity and better ways of controlling projects. It is vital that what is learned is fully embedded in the new Defence Equipment & Support organisation, which will be formed following the merger of the Defence Procurement Agency and the Defence Logistics Organisation (Paragraph 110)

35. Learning from experience, and from other organisations, is a key process within both DLO and DPA and this will be carried forward into DE&S.

Annex: The Defence Logistics Organisation & Defence Procurement Agency: Merger Programme

Introduction

The merger programme is divided into four phases from July 2006 to March 2008. Phase 1, which ran from July to September 2006, delivered agreement on elements of the top-level design of DE&S, including its purpose, core functions and top level performance measures. Strategic roles were defined and agreed along with the top level structure with most appointments filled.

Phase 2, which ran from October to Christmas, saw work on further detailed design and implementation planning. Senior post holders were appointed and given guidance on establishing their respective business areas and were also given responsibility for developing those functional aspects of DE&S required to ensure a fit-for-purpose organisation is ready for the 1 April 2007.

Phase 3, from January to March 2007, will focus on implementing what comes out of the design work currently underway. Some of this will be deferred to 2007/08. The aim is to implement the core changes and make sure everyone understands these ahead of 30 March 2007.

Phase 4 will last from April 2007 until April 2008 and will consist of further “bedding-in” of the new organisation and evolutionary changes to deliver a truly integrated Procurement & Support Organisation.

Phase 2 achievements

- A Paper was issued on 2 October outlining Organisation Structure at Director General level and above, a top-level business model, operating concept, core functions and performance management approach.
- The incumbents of the new Chief of Materiel posts were announced on 16 January. Chiefs of Materiel (Fleet) and (Land) took up their appointments on 16 January; Chief of Materiel (Strike) will start in April.
- All current posts have been mapped into the new structure to create a fit-for-purpose solution which will evolve from April 2007 as part of Phase 4 activity, through experience and continuous improvement.
- Key processes have been identified and agreed at top level and were circulated to staff in a paper published 17 January 2007.
- Agency disestablishment is being progressed.

Detail

- An Office of Government Commerce Gateway review was concluded in November. The recommendations in the report are currently being addressed.
- The top-level organisation design was produced and communicated to staff, and configuration of Integrated Project Teams within Director General Areas was decided.
- Detailed post mapping was carried out to form a Trades Union (TU) consultation paper which was issued to TUs on 16 January.
- A paper to communicate the DE&S organisational design and operating principles to DPA and DLO staffs was released on 17 January.
- The Launch Plan, including DE&S branding and signage, is under development.
- Briefing and Breakthrough Plans for staff continue to develop.
- A targeted Communication Plan was developed to explain the Merger to Industry.
- Integration of DPA and DLO elements of infrastructure is underway
- Development of financial and commercial processes was largely concluded

- Governance of safety management within DE&S was defined. Work to define delegations will continue in Phase 3.
- Proposals for development and implementation of a technology management framework were developed.
- Development of corporate / internal communications processes has begun, but will extend into Phase 3.
- Key Learning from Experience lessons have been delivered.

Conclusion

Phase 2 was an intensely busy period but all of the essential work planned for this Phase was achieved on time.