



HM TREASURY

TREASURY MINUTES

Government responses on the First and the Second
Reports from the Committee of Public Accounts
Session 2010-11



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Treasury Minutes on the First and the Second Reports from the Committee of Public Accounts Session 2010-11

1st Report Support to incapacity benefits claimants through Pathways to Work
Department for Work and Pensions

2nd Report Delivering multi-role tanker aircraft capability
Ministry of Defence

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First Report

Department for Work and Pensions (DWP)

Support to Incapacity Benefit Claimants through Pathways to Work

Report Summary from the Committee

During 2008-09, the Department for Work and Pensions (the Department) paid £12.6 billion in incapacity benefits to 2.6 million people who were unable to work because of disability or ill health. The Pathways to Work programme was launched nationally between 2005 and 2008 to help reduce the number of incapacity benefit claimants through targeted support and an earlier medical assessment. It is delivered by contractors in 60% of districts, with Jobcentre Plus providing the service in the remainder. By March 2010, the programme had cost an estimated £760 million. The numbers on incapacity benefits reduced by 125,000 between 2005 and 2009. Pathways contribution to this reduction has been much more limited than planned.

The Department's intention of reaching a group of people who had never before been required to participate in employment support was admirable, but the Committee found that the programme has had limited impact and was not well implemented. Early medical assessments appear to have had some success in moving people off incapacity benefits, although the Department does not monitor whether all these people move into work or onto other benefits. In other areas money has not been spent effectively. Private providers have seriously underperformed against their contracts and their success rates worse than Jobcentre Plus even though private contractors work in easier areas with fewer incapacity claimants and higher demand for labour.

The Committee was concerned that Pathways was introduced without effective piloting and rigorous evaluation of its likely impact. The early evaluation, which suggested 25% of participants would find work, was flawed as it included people who made an inquiry about the benefit, but then did not go on to actually claim the benefit and, in the pilot areas, participate in Pathways. This gave an over-optimistic impression of what the programme could achieve, which then contributed to a lack of realism in the bids submitted by providers and the targets set in their contracts.

Contractors have universally failed by considerable margins to meet their contractual targets for helping claimants who are required to go through Pathways. They have performed worse than Jobcentre Plus areas, although recent improvements have narrowed the difference. Despite being paid £100 million in 2008-09, providers claim not to have made a profit from their contracts. The Department agreed to pay £24 million in service fees early in view of contractor cash flow problems, although we consider the need for this was questionable given the large size of some of the organisations involved.

The Department had an objective to build a healthy market, but has failed to develop an adequate understanding of the supply chain. It has not monitored how well prime contractors are sharing rewards and risks with the more than 80 specialist sub-contractors involved, and we have concerns that effective small private and voluntary organisations working in local communities are being asked to take an unfair share of the risk by prime contractors.

The Department should consider the evidence of the Committees enquiries thoroughly before embarking on its new Work Programme. It should ensure good value for money by making good use of Jobcentre Plus resources and maintaining a sustainable balance between public, private and voluntary providers to allow proper competition and a good basis for comparing performance.

On the basis of a Report by the Comptroller and Auditor General, the Committee took evidence from the Department and two major providers on why Pathways has failed to get significant additional numbers of incapacity benefits claimants into work, and how the lessons from Pathways can be applied to the new Work Programme.

Government responses to the Committee's conclusions and recommendations

PAC CONCLUSION AND RECOMMENDATION 1

The number of incapacity benefits claimants has remained in excess of 2.5 million for over a decade, and nearly 1.5 million claimants have been in receipt of these benefits for more than five years.

This has been an intractable problem for the Department and it deserves credit for trying to tackle it. Nevertheless, its work has, at best, reduced the number of claimants by just 125,000 between 2005 and 2009. Our recommendations suggest how we believe the Department should prioritise its work to ensure resources are used effectively to tackle this problem and help claimants back into work.

1.1 The Government agrees with the Committee's conclusion.

1.2 The Pathways programme failed to deliver the impact intended. Pathways represented a significant change of approach to try to tackle an intractable problem. It was recognised internationally as a sound system of support for this customer group. However, the overall evaluation of Pathways now suggests that the programme did not have the scale of impact originally hoped for.

1.3 The Government is committed to reducing the numbers on Incapacity Benefits by helping people on benefit return to work. A high proportion of Incapacity Benefit claimants have been on benefit for many years with little support to help them back to work. From early 2011, these customers will be reviewed and go through the Work Capability Assessment (WCA) to determine the type of support most appropriate to help them back to work, whether that be the Work Programme, or support delivered through Jobcentre Plus.

1.4 Alongside the WCA and reassessment of customers claiming Incapacity Benefit, the Department will be drawing on the lessons from Pathways as the Work Programme is developed. This will include considering strengthening the requirement for customers to undertake work-related activity, where their WCA result indicates this would be appropriate.

PAC CONCLUSION AND RECOMMENDATION 2

The performance by the mainly private sector providers has been universally poor in relation to their main target group, those people who are required to go on the Pathways programme.

The targets agreed with providers were over-optimistic, considerably exceeding the best performing Jobcentre Plus districts in the early pilot areas, and underestimated the difficulty of supporting this client group. Providers started from a low knowledge base with little direct experience of working with incapacity benefits claimants. Providers have also had less opportunity to work with people early in their claim, partly because handover of claimants from Jobcentre Plus has taken longer than was anticipated at the procurement stage. The Department should be more ready to challenge bids from providers where there are grounds to suspect performance projections are over-optimistic. The Department should seek to maintain a balance between public, private and voluntary providers to ensure adequate opportunity to compare performance and value for money.

2.1 The Government partially agrees with the Committee's conclusion. It is not evident why agreeing lower performance targets would have led to better performance, but it would have led to higher costs.

2.2 For the future, the Department is reviewing the role that performance targets should play in the procurement of the Work Programme. The Department believes that the key is to give providers greater incentives to deliver high levels of performance by paying largely for achieving job outcomes, which are then sustained, and by ensuring there is continuing competition in each location. To ensure high performance, the contracts will contain a number of new features:

- Providers will be paid attachment fees rather than service fees. These fees will be paid per customer starting on the programme and will be reduced progressively to zero by the fourth year of the contract. By contrast, service fees based on a proportion of the overall contract size allowed Pathways providers to receive a large proportion of their income without achieving job outcomes.
- For the two main JSA customer groups and for those new ESA customers referred to the programme on a mandatory basis, there will be a performance floor of minimum job outcome performance below which a performance review would be triggered. This could lead to contractual action against a provider up to and including contract termination.
- For JSA 18-24 and JSA 25+ customers we will expect providers, over time, to improve performance to deliver more job outcomes for a given level of expenditure. As a result, the job outcome fee for these customers will reduce over time, but those who perform very well will receive an additional incentive payment.
- At the start of the contract, referrals will be made randomly and in equal shares to each provider. We will encourage ongoing competition between providers in each contract package area by shifting market share to those who perform best.

2.3 The Department is strengthening through the Work Programme contracts, the requirement on prime contractors to put together supply chains that deal credibly with all aspects of disadvantage for the customer groups concerned. The ability to work with a range of organisations, including those that are smaller, community based or part of the voluntary sector will be an important criterion in assessing bids. In the past few months, during the run up to the Work Programme, the Department has taken steps to encourage potential prime contractors to come together with a range of potential delivery partners and sub-contractors. The Department will continue this work once the Work Programme procurement has been launched.

PAC CONCLUSION AND RECOMMENDATION 3

Effective implementation of the programme was hampered by a flawed process of piloting and evaluation, which gave too positive a view of how well Pathways could be expected to perform.

The Department should make sure it properly evaluates its pilots so that it has precise evidence of the likely employment impact for claimants before it launches future programmes.

3.1 The Government partially agrees with the Committee's conclusion. While Pathways was extensively evaluated and was rolled out in a number of controlled phases it is clear, with hindsight, that despite the care taken in developing the evaluation strategy, it did not account for all eventualities. The Department will take this experience into account in developing its evaluation strategy for the Work Programme.

PAC CONCLUSION AND RECOMMENDATION 4

In 2008-09, £94 million (38% of Pathways expenditure) was spent on employment support that did not deliver additional jobs.

The Department should fundamentally review the nature and funding of its employment support for claimants of incapacity benefits. It should provide clear guidance to those involved in delivering the Work Programme on the type of support that is most likely to deliver additional jobs, drawing on robust evidence.

4.1 The Government partially agrees with the Committee's conclusion.

4.2 The Department will pay Work Programme providers largely on the basis of the outcomes that they deliver, rather than on the activity they undertake. The Department will encourage the sharing of

good practice and will continue to publish, on its website, evidence on what support is most effective to ensure that providers are well equipped to support the Department's customers. However, the Department does not propose to specify requirements for providers. The Department believes that allowing providers to design support, without government intervention, will result in a broader and more innovative range of services, giving providers the opportunity to deliver personalised and individual services designed to support more customers back into work.

4.3 The Department will ensure that providers under the Work Programme are set job outcome performance floors for Jobseeker's Allowance customers and Employment and Support Allowance customers in the Work Related Activity Group, which will trigger a performance review if providers fall below these levels. This review could lead to contractual action against a provider up to and including contract termination.

PAC CONCLUSION AND RECOMMENDATION 5

There is a lack of robust information on what happens to those claimants who fail to participate in Pathways.

The Department does not hold proper information on the number of incapacity benefits claimants who have failed to take part in mandatory elements of Pathways and had their benefit reduced as a result. In developing the new Work Programme, the Department should build on its experience of measuring sanction rates for Jobseeker's Allowance claimants and create a robust equivalent system for claimants of incapacity benefits.

5.1 The Government agrees with the Committee's conclusion. While the Department publishes statistics on sanctions applied to Jobseeker's Allowance customers, it does not currently publish such information on Employment and Support Allowance (ESA) customers. ESA is a relatively new benefit and the Department is working to develop data on ESA sanctions. The Department will publish relevant statistics once this development is complete.

PAC CONCLUSION AND RECOMMENDATION 6

Better information is needed to help set incentives for providers based on better analysis of the claimant group.

Providers favour a differential pricing system that would reflect the varying levels of support needed to help people with different problems. The Department should collect data so that it understands the costs and benefits of the different types of support for incapacity benefits claimants. It should use this knowledge in designing and testing the contracting model it develops to deliver the Work Programme from Summer 2011.

6.1 The Government agrees with the Committee's conclusion.

6.2 A differential payment system is needed to help ensure, as far as possible, that everyone gets the support that they need to get back to work. The Department is actively developing differential funding as part of the Work Programme. As part of the evaluation, the Department will investigate how the payment system influences the support delivered by providers.

6.3 The Department agrees that it needs to strengthen its understanding of what support works for various groups. The Department is currently developing the evaluation strategy for the Work Programme, which will look at both the effectiveness of its delivery and the experiences of customers on the programme.

PAC CONCLUSION AND RECOMMENDATION 7

The controls in place are insufficient to manage the risk of providers submitting inaccurate contract payment claims.

The Department should strengthen its controls to provide greater confidence that it will detect claims that are not valid, drawing on a range of techniques including systematic checks against benefit records, and contact with individuals and their employers. Contracts should be clear that, where errors are found, the rest of a provider claim will be investigated and deductions applied.

7.1 The Government partially agrees with the Committee's conclusion. The Department has already taken steps to improve the controls in place to ensure that payments made to contracted employment provision providers are valid.

7.2 The Department will monitor payments via a series of pre-payment checks, which will be conducted in all cases, supported by post-payment checks conducted on a sample basis. These checks will combine checks of benefit systems with checks of HM Revenue and Customs (HMRC) records as well as contacting employers and customers directly. Using a statistically valid sample for the post-payment sample check will also allow the Department to extrapolate the error rate found in the sample across all payments to the provider in that period and recover on that basis.

7.3 The Department is looking to introduce these changes to coincide with the introduction of the Work Programme. Work is already underway to ensure that appropriate changes are made to standard contract terms and conditions to facilitate this change.

PAC CONCLUSION AND RECOMMENDATION 8

The Department lacks the information it needs to understand the supply chain for employment support, which conflicts with its objective of ensuring a healthy market exists.

The work underway to guard against unfair treatment of subcontractors and other delivery partners through the new 'Merlin' standard is welcome. The Department should assess its effectiveness in ensuring risks and benefits are distributed fairly throughout the supply chain and should report back to this Committee by the end of 2010.

8.1 The Government partially agrees with the Committee's conclusion.

8.2 The Department has developed the Merlin standard, which has been developed to make DWP's Code of Conduct more robust and ensure positive supply chain behaviour. It has also made changes to tendering arrangements to ensure that details of proposed supply chains are fully set out in tenders and backed up by letters of agreement, signed by each sub-contractor. This will enable the Department to have a better understanding of the supply chains involved in delivery of provision.

8.3 The Department will report to the Committee on the Merlin standard in summer 2011, when more information will be available about the supply chains mobilised to deliver the Work Programme.

PAC CONCLUSION AND RECOMMENDATION 9

As the Employment and Support Allowance is extended to all existing claimants, there is a risk that some of those who are re-assessed and found fit to work will not receive the employment support they need.

Early evidence shows that the new medical assessment, introduced with Employment and Support Allowance, will deliver a significant reduction in the number of incapacity benefits claimants. The Department should evaluate the accuracy of the new medical assessment robustly to evaluate that it is fit for purpose.

9.1 The Government partially agrees with the Committee's conclusion.

9.2 The Department agrees that those who are found fit for work should receive the support they need to move into work. The Department keeps the Work Capability Assessment (WCA) under continuous review and has a statutory duty to independently review the WCA annually for the first five years of its operation. The first independent review, led by Professor Malcolm Harrington, reported November 2010 and the Government has accepted these recommendations.

9.3 Professor Harrington found that the WCA is the right process, but that it is not working as fairly or effectively as it should. As a result, the Government has committed to take forward the recommendations as quickly as possible. Improvements to the process include:

- empowering Jobcentre Plus Decision Makers to make the right decision;
- making the process more compassionate and easier to understand;
- improving transparency of the Atos assessment by piloting the audio recording of Atos assessments; and
- accounting for the particular difficulties in assessing mental health conditions by ensuring Atos employ mental health champions.

9.4 This work builds on an internal review of the WCA, which the Department published in March 2010. The review identified the following areas for improvement:

- simplifying the language;
- making greater provision for people awaiting or in between courses of chemotherapy;
- making the higher support rate of Employment and Support Allowance available to more people with certain communication and mental health problems; and
- taking greater account of how someone has adapted to their condition or disability.

PAC CONCLUSION AND RECOMMENDATION 10

Many existing incapacity benefit claimants will be found fit to work when they undergo the new medical assessment, and many will move on to the more work-focused benefit, Jobseeker's Allowance.

The Department has no information on claimants who are refused incapacity benefits. It should monitor them to know how many move onto Jobseeker's Allowance. The Department has also not yet fully evaluated its capacity to support large numbers of people who transfer in this way. It should undertake such an assessment and put in place the additional support required before the medical assessment is rolled out.

10.1 The Government disagrees with the Committee's conclusion. The Department has information on claimants who have been refused incapacity benefits.

10.2 The Department has commissioned a survey on customers who made a claim for ESA. This survey includes people who were found fit for work, or whose claim ended before they received a decision. A report of the findings from the first survey, including information on the activities of people no longer claiming ESA, was published in the Department's research report series in November 2010. A report of findings from the second survey, which re-interviews the same people approximately six months after their first survey, will provide more information on the subsequent activities of this group. This will be published in early 2011.

10.3 Additionally, the Department is commissioning qualitative research to look in depth at the experience and support needs of a number of people whose ESA claims are closed before a decision has been received, or who are found fit for work. Fieldwork is expected to take place in early 2011, with publication of the findings, in the Department's research report series, in spring 2011.

10.4 The Department has used feedback and lessons learnt from the implementation of ESA to help plan for its contact with customers being reassessed. The reassessment trials currently underway in the Burnley and Aberdeen areas will also allow the Department to ensure that support processes are robust before the nationwide reassessment begins in spring 2011.

10.5 The Department is aware that the reassessment is likely to change how existing incapacity benefits customers interact with the Department, and anticipates that the number of people visiting Jobcentre Plus may increase. The business case for the reassessment has established the level of staffing required for Jobcentre Plus to deal with the impact of all aspects of the incapacity benefits reassessment. The business processes, for the reassessment, will predominantly be based on customer contact via the telephone. Allowances have been made to deal with the footfall expected in Jobcentre Plus offices.

Second Report

Ministry of Defence (MoD)

Delivering Multi-Role Tanker Aircraft Capability

Report Summary from the Committee

In March 2008, the Ministry of Defence (the Department) signed a private finance initiative (PFI) contract with AirTanker Ltd, for the Future Strategic Tanker Aircraft (FSTA) to provide air-to-air refuelling and passenger transport services. FSTA is based around 14 modified Airbus A330s and will replace the 24 Tristars and VC10s that form the RAF's current fleet.

Under the contract, AirTanker owns the aircraft and will provide them to the Department when required. AirTanker will also provide the associated aircraft support, maintenance and infrastructure, making the scope of the deal broader than any other defence PFI contract to date. The value of the contract, worth £10.5 billion over 27 years, also makes it the largest signed.

PFI works best where activities and demand are predictable. This is clearly not the case for FSTA. For instance, it is simply astonishing that the Department did not decide until 2006 that FSTA should be able to fly into high threat environments such as Afghanistan. Yet the Department is inhibited from changing the specification because of the implications to the cost of the PFI. Just two years after the deal was signed, the forthcoming Strategic Defence and Security Review is likely to change the demand for the services AirTanker has been contracted to deliver. As the Committee's previous work shows, dealing with changes on PFI deals is expensive and the Review may question whether this PFI deal is sensible or affordable. The fact that no other country has chosen to procure air-to-air refuelling and passenger transport using PFI type arrangements is further indication that PFI is not a suitable procurement route for such important military capabilities.

There are significant shortcomings in the Department's procurement of FSTA and the Committee does not believe the procurement was value for money. The shortcomings include:

- assuming that PFI would be the right solution from the outset without a sound evaluation of alternative options;
- running only a limited competition;
- never developing a realistic fallback if the PFI solution proved unworkable;
- failing to have a clear understanding of the full costs of running its current aircraft fleets and failing to secure visibility of sub-contractor cost data, meaning the Department was unable either to compare costs with the price being offered by AirTanker or determine whether the PFI option was good value for money;
- not fixing the requirements until late into the process so that the negotiations themselves took over nine years to complete, more than double the expected four years. This delay in turn led to a considerable cost increase against initial estimates.
- not having the right skills and experience in place and failing to provide firm leadership until the later stages of the procurement to effectively manage the procurement, and
- not making timely decisions on fitting the necessary protection equipment to enable the aircraft to fly into high threat environments like Afghanistan, a task that the Tristar may have to continue doing until 2016.

In order to obtain best value going forward, the Department must retain contract expertise and ensure that staff make decisions regarding FSTA in the full knowledge of the financial implications. Without this action, the risk is that extra demands will be placed on AirTanker which result in additional, and unnecessary, payments being made by the Department.

On the basis of a Report by the Comptroller and Auditor General, the Committee took evidence from witnesses from the Ministry of Defence on: why PFI was used to procure FSTA, shortcomings in the procurement process, availability of cost data, how the deal was managed and risks in the transition from the current fleets.

Government responses to the Committee's conclusions and recommendations

PAC CONCLUSION AND RECOMMENDATION 1

The use of PFI to deliver a vital military capability like FSTA was inappropriate. In 2004, even the project team recommended abandoning the PFI solution in favour of a conventional procurement. Military needs are not like hospitals or schools where activity is predictable and more suited to PFI.

The Department, working with HM Treasury, should set out clearly when PFI is appropriate for defence and the characteristics of a successful defence PFI deal.

1.1 The Government does not agree with the Committee's conclusion on Future Strategic Tanker Aircraft (FSTA) or on the applicability of PFI to Defence, but agrees with the Committee's recommendation.

1.2 The Government agrees that PFI is not necessarily suitable to deliver military capability in every case. However, the Department has signed off 54 PFI projects and of these has a current portfolio of 45 operational projects, the majority of which are operating successfully. Although less widely adopted than in the United Kingdom, several countries (such as The Netherlands, the United States and Australia) have used Public Private Partnership (PPP) as a procurement route for defence infrastructure, such as headquarters and accommodation.

1.3 Operational and security related issues tend to narrow the potential for PFI in relation to defence equipment projects, though these issues are not insurmountable in every case. Whilst it is true that PFI might not be appropriate for tanks, attack aircraft and warships, which need to be deployed flexibly and are operated and maintained (at least in part) by service personnel, PFI could be appropriate in areas such as training - for example: helicopter simulators, support tasks -for example: the strategic sealift / roll-on roll-off ferries, and ancillary services -for example: dockyard tenders. Overseas, France and Greece have delivered defence equipment PPPs for training helicopters and simulators.

1.4 The Treasury's *Value for Money Assessment Guidance* sets out a quantitative and qualitative approach to assessing the potential for value for money of PFI procurement. In addition, the Department has its own guidance¹ setting out the criteria for selecting PFI as a procurement route in defence. A key requirement of a business case is to consider alternatives as part of the options appraisal. Where PFI is being considered, the project team will evaluate whether a PFI procurement strategy is expected to deliver a value for money in accordance with the Treasury's and the Department's guidance. The Department will work with the Treasury to review this guidance to ensure that together they set out clearly when PFI is appropriate for use in Defence.

1.5 In addition, the Department, as part of its assurance role to the internal Investment Approvals Board (IAB), uses twelve critical success factors or characteristics to assess the maturity of PFI projects at various points in their acquisition cycle. These are set out in the Department's guidance on conducting assurance on PFI projects.

PAC CONCLUSION AND RECOMMENDATION 2

The prevailing support for PFI at the time is not a justification for the Department's decision in 1997 to commit to a £10.5 billion project to deliver a vital military capability without knowing whether it was the best value option. HM Treasury should also have challenged the Department's selection of PFI as the preferred option without conducting a robust evaluation of alternatives.

HM Treasury should publish the basis upon which it reviews the value for money offered by the contracts the Department proposes to enter into, and the robustness of the option appraisals underpinning the initial choice of procurement route.

¹ *Introduction to PFI in Defence* (November 2009)

2.1 The Government partially agrees with the Committee's conclusion and notes the recommendation. Both value for money and the options appraisals guidance has been published.

2.2 The statement that 'in 1997 the Department committed to a £10.5 billion PFI' is incorrect. Commitment only takes place after Main Gate approval and Treasury approval, which occurred in 2007. However, the Department accepts that in 1997, when it elected to pursue a PFI strategy, more could have been done to look at alternative methods of procurement to ensure that a PFI approach represented value for money.

2.3 The Treasury instituted a revised process for assessing the value for money of PFI projects in 2004. This process is defined within the *Value for Money Assessment Guidance*.¹ This sets out the basis on which the Treasury assesses the value for money of PFI projects. Departments are required to follow this when preparing their business cases. The Treasury has also published the requirements for conducting robust options appraisals. These requirements are listed in the *Green Book*², which sets out the core principles on which all public sector economic assessment is based. Both sets of guidance are published on the Treasury's website.

PAC CONCLUSION AND RECOMMENDATION 3

The final decision to commit to FSTA in 2007 was made using a Public Sector Comparator which was not a realistic or affordable alternative to the PFI and the outcome was highly dependent on which discount rate was used. Nor did the Department develop a robust fallback plan which could have provided a more realistic alternative way of delivering the capability.

At the outset of all future major investments the Department should identify:

- ***a realistic alternative against which to assess the value for money of its preferred solution, and***
- ***the latest point at which it would be credible to adopt the fallback option so that a realistic comparison of the relative value of alternative ways of delivering a capability can be made.***

3.1 The Government partially agrees with the Committee's conclusion and agrees with the Committee's recommendation.

3.2 The Public Sector Comparator (PSC) was realistic as a VFM comparator and showed that the PFI deal offered good value for money, using either discount factor, at the level of confidence against which the Department would expect to deliver. But it is accepted that it was not an affordable alternative to the PFI procurement. Indeed the PSC is a cost comparator for delivering an equivalent service, and therefore must not be constrained by affordability considerations. It is not intended to be a fallback. The Department has identified, as one of the key lessons learned, the importance of developing a viable fallback option at an early stage and updating it regularly.

3.3 In accordance with the Treasury guidelines, Departmental guidance mandates the development and maintenance of a PFI reference model from the inception of the project. The PFI reference model should be constructed on the basis of a 'Should Cost Model' which represents the Department's interpretation of what a potential PFI for the stated requirement may cost. The model provides the Department with a realistic affordability calculation and provides a comparison tool for bid evaluation purposes.

3.4 The implementation of fallback options is addressed in any investment decision approved by the Department's Investment Approvals Board.

¹ http://www.hm-treasury.gov.uk/ppp_vfm_index.htm

² http://www.hm-treasury.gov.uk/data_greenbook_guidance.htm

PAC CONCLUSION AND RECOMMENDATION 4

It took over nine years, more than twice as long as expected, to place the FSTA contract. The Department incurred extra costs over this period and the last aircraft will not be delivered until 19 years after the procurement began. FSTA was undermined by a series of procurement mistakes. We have criticised the Department before for such failings but FSTA demonstrates that action is still needed to prevent their repetition.

On future projects, we expect the Department to demonstrate it has truly learned and successfully applied the lessons from its repeated procurement failings.

4.1 The Government agrees with the Committee's conclusion and recommendation, and accepts that it took longer than it should have to place the contract.

4.2 In relation to PFI projects, project teams will be required to demonstrate, as part of the assurance process, that they have reviewed all of the relevant PFI lessons (contained within the Department's Private Finance Unit guidance documents) and applied these to their project.

4.3 The Department has already identified and started to implement some of these lessons. For example, current work on Project Termination includes the requirement for fallback plans to be maintained and updated as the project proceeds including key decision points at which it can be assessed whether projects are no longer viable. Likewise, the Permanent Secretary, or Deputy Chief of Defence Staff (Capability) appoint Senior Responsible Officers (SROs) for all of the Department's Capability Programmes (all equipment capability projects, regardless of size, sit within broader programmes).

4.4 The Department is continuing to improve the way in which it understands, sets and reviews requirements from the outset, especially to improve on agility and flexibility in relation to contractual arrangements. The Department accepts the importance of identifying clear funding responsibilities, and through its programme and project management aims to achieve this beyond equipment alone. It is important to consider all the factors (including personnel, training, infrastructure, future exports and potential international collaboration) which will affect the long-term affordability of the capability.

4.5 The issues set out above are all fundamental to acquisition, but also raise broader issues around the way in which the Department plans and resources. The Department will examine these further as part of the ongoing review by the Defence Reform Unit, including the implications for the Department's operating models.

PAC CONCLUSION AND RECOMMENDATION 5

The Department did not understand the costs of the deal it was negotiating as it did not obtain access to detailed industry cost data. This meant it could not gauge the whether the deal was value for money. In particular, it could not determine whether profit margins were appropriate or the premium it was paying to transfer risk to industry.

We were not persuaded by the Department's generalised assurances that it had got a grip on this problem on current procurements. The Department should agree with its commercial partners a framework against which to assess what constitutes appropriate access to cost and other data in differing procurement circumstances and ensure it enforces its access rights rigorously.

5.1 The Government partially agrees with the conclusion and agrees with the Committee's recommendation.

5.2 For the Future Strategic Tanker Aircraft project the Department had access to the prime contractor cost data including the financing costs. It is accepted that the Department did not have access to the detail of the subcontractor costs, but it is not accepted that this undermined the VFM assessment. Furthermore, the situation with FSTA was not unusual. When price is set by competition, the right of the purchaser to underlying cost information is limited - "open book" accounting rules apply only to single tender situations and changes after contract award.

5.3 At the outset of a project, policy requires the establishment of a team with the requisite skills to specify the cost data required to support pricing. It includes, where justified, the involvement of specialist Cost Assurance and Analysis Service staff, which also assist in the construction of a robust 'should cost' estimate against which the value for money of bids is assessed.

5.4 In the management of costs during project delivery, including the cost of contract change, extant policy also governs access to data, including cost data. This applies to all new high value projects with the Department's industry partners using non-competitive procurement strategies and to amendments to competitively placed contracts. This contributes to the continual demonstration and improvement of VFM.

5.5 'A Partnering Handbook for Acquisition Teams', published by the Department in August 2008, along with associated Commercial Policy Statements, sets out the requirement for "open book" transparency in partnering and similar arrangements. This requires project teams to put in place with industry partners a joint disclosure agreement governing the approach to continuing access to cost, schedule and performance information throughout the contract term. Where appropriate, these principles flow into the supply network.

PAC CONCLUSION AND RECOMMENDATION 6

The Department can only make sensible decisions with robust financial and performance data. In this case, the Department did not have data on the performance of its current aircraft fleets, the cost breakdown of the deal or the potential costs of alternatives so it could not either compare costs or know whether the PFI option was value for money. We believe FSTA is illustrative of a wider problem for the Department which if it is not addressed will fundamentally affect its ability to deliver value for money.

The Department should set out clearly its financial and performance data needs, how it will develop the underpinning management information systems, how long this will take and how it will change the culture of the organisation to place a premium on generating and using such information.

6.1 The Government partially agrees with the Committee's conclusion and recommendation.

6.2 The VFM assessment was based upon an industry competition, a public sector comparator, and cost modelling. The absence of some aspects of the information referred to did not undermine the ability to assess VFM.

6.3 The Department has striven to strengthen the collection of information on total "Through Life Costs" of individual capabilities and alternative options in support of the development of proper Investment Appraisals and Combined Efficiency and Investment Appraisals in support of major acquisition decisions. The Department will conclude a pilot study in spring 2011, in which such information has been regularly collected, before deciding on the wider utility and rollout of such information requirements.

6.4 With respect to PFI, the Department's Private Finance Unit is conducting an exercise in parallel to identify the key data sets required to enable effective cost comparisons on PFI projects. This exercise will report in 2011.

PAC CONCLUSION AND RECOMMENDATION 7

The progress of the procurement improved only when the Department applied enough of its scarce staff with PFI and commercial skills to FSTA.

The availability of sufficient commercial experts and a more general awareness of commercial issues in the wider defence community underpin successful acquisition. The Department should develop a more comprehensive training and development programme to ensure there are sufficient skilled individuals to support all of its complex projects. The Department should also ensure that all staff involved with FSTA are fully aware of the financial implications of any decisions they make.

7.1 The Government agrees with the Committee's conclusion and recommendation.

7.2 As part of the Department's Director General for Defence Commercial's five year strategic plan, the Commercial Capability (CC) team is leading on his strategy for:

- a refreshed and strengthened learning and development programme;
- a commercial strategic workforce plan;
- new commercial skills and capability framework;
- matching commercial need with resource; and
- continuous improvement of the business graduate and mid level management entry schemes.

7.3 A recurring lesson from PFI project Learning From Experience exercises is that a suitably skilled, resourced and stable project team is one of the key factors in achieving a successful PFI project outcome. The Department has carried out an assessment of corporate PFI related risks. This identified that the lack of skilled resources in acquisition teams is one of the key strategic risks affecting the Department's PFI programme.

7.4 As part of a refreshed and strengthened learning and development programme, the Department, in conjunction with the Commercial Capability team, intends to carry out a review of PFI skills and training needs through a Training Needs Analysis to identify required functional competences, existing training, training gaps and new training requirements relevant to PFI core acquisition teams.

7.5 The Future Strategic Tanker Aircraft Project Team is fully committed to ensuring that all staff are fully aware of the financial implications of any decisions made. A succession plan has been developed to ensure that experienced staff (military and civilian) are maintained on the project until after *Introduction To Service* has been achieved and an ongoing training programme has been developed which allows for staff to be continuously refreshed on the financial and commercial aspects of the programme. In addition the Project Team, as part of its original transition plan, has produced a user's guide to the contract to describe its provisions to non specialists who will be involved in the project.

PAC CONCLUSION AND RECOMMENDATION 8

For much of its procurement the FSTA project lacked leadership. In the early years the project averaged a team leader a year and a Senior Responsible Owner (SRO) was not appointed until 2007.

The Department accepted this failure but stated that all major projects do now have someone with an overview of the various elements of the project and influence over them. This is not the same as strong leadership. The Department should take action to ensure its managerial and budgetary structures enable SROs to act as empowered leaders able to drive the delivery of defence equipment capability.

8.1 The Government agrees with the Committee's conclusion and recommendation.

8.2 The Permanent Secretary approved a revision to the Department policy, in July 2010, that guides the role of the SRO. The guidance follows the best practice guidance published by the Cabinet Office Efficiency and Reform Group, including a single list of generic and Departmental specific responsibilities; and closer alignment in respect to SROs' levels of empowerment, authority and accountability needs to be examined as part of the work of the Defence Reform Unit. For major military capability, business change programmes and projects, the appointment is made by the PUS and the SRO is accountable to the Defence Board.

8.3 The SRO is personally accountable for delivering the programme and for the realisation of expected benefits that meets its objectives and delivers the projected benefits. The SRO is

responsible for overseeing all aspects of programme delivery to ensure that it is successfully implemented, that the potential of the change or capability is fully exploited and that the through-life benefits are delivered. These issues will be examined further as part of the Defence Reform Unit's review to determine how the SROs' empowerment, accountability and responsibility can be strengthened.

PAC CONCLUSION AND RECOMMENDATION 9

In 2006 the Department recognised the need for additional protection to enable FSTA to fly into high threat environments such as Afghanistan but failed to include this in the contract negotiations. Four years later it has still not decided whether to fit the necessary equipment. The Department urgently needs to find a robust long term solution to this issue. Otherwise, the aircraft will enter service without being able to replace the Tristar in its current role of flying personnel in and out of Afghanistan and the Department will incur extra costs finding alternative ways of providing the capability.

The Department should report back to us within six months of the completion of the Strategic Defence and Security Review explaining what solution it has chosen and why, and what the operational consequences are.

9.1 The Government partially agrees with the conclusion and agrees with the Committee's recommendation. FSTA will be fitted with a Defensive Aids Suite.

9.2 In the light of the evolving threats faced on current operations the Department is looking at the possibility of providing additional protection. Aircraft modification may not be the most cost effective solution

9.3 The Department will provide the Committee with a written response within six months of the completion of the Strategic Defence and Security Review. Due to the sensitive nature of this issue, the response will be subject to the usual security classification restrictions.



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