



Treasury Minute on the Thirteenth Report from the Committee of Public Accounts 2002-2003

13th Report: Ministry of Defence: Progress in Reducing Stocks

**Presented to Parliament by the Economic Secretary
to the Treasury by Command of Her Majesty
June 2003**

TREASURY MINUTE DATED 25 JUNE 2003 ON
THE THIRTEENTH REPORT FROM THE
COMMITTEE OF PUBLIC ACCOUNTS, SESSION 2002-2003

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Thirteenth Report

Ministry of Defence

Progress in Reducing Stocks

The Committee's main conclusions

The Department still needs to take radical action to tackle its long-standing inventory management problems. Some 19 years after the first fire at Donnington, the C&AG's report shows that the Department's inventory still contains large amounts of obsolete and very slow moving stock. Yet other reports from the National Audit Office have revealed shortages of key items on exercises and deployed operations and instances where the stock issued has been of poor quality. The Department needs to get a grip on its inventory, ensuring that it holds what it genuinely needs and gets rid of what it does not.

The Department has made significant progress in reducing stocks but accepts that more remains to be done. We are continuing to take action on the four key recommendations set out in paragraph 16 of the Comptroller & Auditor General's (C&AG) report by:

- Revisiting our stock-reduction targets, especially on slow-moving targets and on consumables;
- Establishing targets with clearly defined baselines;
- Ensuring that its stock holdings reflect current military plans and requirements, and that obsolete stocks are disposed of as soon as is practicable;
- Becoming a centre of best practice and to disseminate it through the Department.

To support this work, the Department is undertaking:

- A review of the end-to-end logistic processes across Defence to simplify inventory processes and to eliminate waste;
- The redesign of the inventory procurement processes and organisation, including the development of a co-ordinated purchasing function;
- A programme of inventory process and information system improvement across the Department to achieve better visibility and management of stock.

Also in train is a detailed analysis of the logistic support and logistic sustainability requirements throughout all phases of Defence activity (covering both peace and combat operations). All of this work is being undertaken with the over-arching military imperative – to ensure that the Armed Forces have adequate supplies of equipment and materiel available for any contingency operation they may be asked to undertake – uppermost in mind.

The Department should make better use of industry in the future. It needs to be smarter in the management of its stock and work more closely with industrial suppliers. Better information on its stock holdings will allow the Department to identify which parts of its inventory can be managed by industry, for example through ‘just in time’ direct delivery to military units and contractorisation of storage functions. At a local level, the Department needs to exploit the arrangements being put in place by the Non-Project Procurement Office and extend its use of the Government Procurement Card.

The Department continues to work closely with its commercial partners to identify ways of improving logistic support, and is developing a more structured arrangement for managing its relationship with its key suppliers. The potential for “just in time” delivery is being exploited wherever possible although, given the nature of military operations, this must be addressed carefully as the impact of any delay could be far more significant than in the commercial world. The Department, through its Defence Logistics Organisation, is also looking to build on the early success achieved by its Non-Project Procurement Office (NPPO) which is expected to generate savings of £86 million on contracts valued at £500 million. The use of the Government Procurement Card across defence is also expanding.

In future target-setting the Department needs to ensure that there is a clear baseline against which to assess progress and a consistent methodology for measuring achievement. Neither of these requirements was in place for the stock reduction target: their absence prevented the National Audit Office from verifying that the target had been met. The Department should apply these lessons to its Public Service Agreement targets. The Treasury should also disseminate wider lessons on validation to other departments.

The Department accepts the Committee’s conclusion. The Department did consider undertaking further work to establish a clearer baseline for the stock reduction targets at an early stage in the post-Strategic Defence Review (SDR) work, but concluded that the potential benefits were outweighed by the delay in implementing the Review. However, clear guidelines and targets have been set from the outset for subsequent stock reduction work, and the creation of a unified Defence Logistic Organisation to assume what were previously single-Service roles and responsibilities should help further to ensure consistency. The Treasury has worked closely with the National Audit Office (NAO) on validation of the data systems underpinning Public Service Agreement (PSA) targets and will work with departments to disseminate good practice.

Tackling the inventory management problem

PAC conclusion (i): The Department cannot hope to get a grip on its inventory management while its Stock data are unreliable and it cannot fully account for departmental assets held by industry. These weaknesses have led the C&AG to qualify his opinion on the Department’s resource accounts, and they need to be addressed as a matter of priority.

1. The Department accepts that reliable data is crucial to the effective management of stock. A great deal of work has been done first to account for assets held by industry on the Department’s behalf, and secondly, to improve the quality of stock data generally through the work of its Cleansing Project Team (the efforts of which have been recognised by nomination for a prestigious e-Government award).

PAC conclusion (ii): For effective inventory management, the final consumers of stock ought to know the costs of the demands they are making on the logistics system, and hold the relevant budgets. They could then weigh the cost of holding stock against the risk of breakdown in the supply chain. Integrated Project Teams, whose decisions play a major role in stock levels, do not currently bear the full costs of holding stock. The Department should as a first step ensure that Integrated Project Teams are charged the full costs of holding stock and explore how to make front line units the responsible budget holders.

2. The Department accepts that full visibility and understanding of the costs of stock (and logistic support generally) is essential if it is to make informed decisions that balance cost and risk. The Department's Defence Logistics Organisation has addressed this through the development of a series of formal agreements with its major customers that establish clear linkages between resources and the level of support provided. Although this arrangement does not give front-line units the formal budgetary responsibility for stock holdings, it provides the basis of a clear and auditable division of responsibility between the front-line and the Defence Logistics Organisation without the administrative burden that would accompany a hard-charging regime.

3. Integrated Project Teams (IPTs) currently bear the vast majority of the costs associated with holding stock. The exception to this are the storage and distribution costs incurred by the Defence Storage and Distribution Agency (DSDA) which are managed centrally in order to provide effective leadership and management. However, such costs represent only a small element (generally less than 3 per cent) of the overall cost of ownership and the Department considers that the heightened financial discipline that has accompanied the introduction of Resource Accounting and Budgeting, coupled with continued use of clear targets for stock reduction, provides sufficient direction and incentive to its IPTs.

PAC conclusion (iii): Better management information will also be needed to enable the Department to modernise its management of stocks. The Department should draw up a firm plan with clear milestones for the introduction of information systems consistent with modern supply chain management, with details of the numbers, location, price, condition and forecast demand for stock items.

4. The Department accepts that the provision of high-quality, timely and reliable management information is essential to its drive further to improve stock management. Current information systems are largely those that have been inherited from the previous single-Service approach to the provision of logistic support. The Department is developing a programme to modernise and join together its systems and processes. This work forms part of the wider Defence Logistics Organisation Change Programme and is being managed against specific milestones and project plans. In the shorter term, the need to improve visibility of in-transit stock during Operation TELIC was met by the introduction of simple commercial off the shelf asset tracking system.

PAC conclusion (iv): While there are differences between military and commercial logistics, many of the processes are similar. The Department should devise a coherent programme for benchmarking its activities against others and for applying the results.

5. The Department seeks to identify and apply examples of best practice, both from industry and from the public sector, both at home and abroad. However, despite the similarity in process with the private sector, the nature of defence logistics (particularly the need to hold sometimes significant amounts of stock against contingency requirements) require that parallels are exploited with care and pragmatism. The Department's Lean Support Continuous Improvement Team has also been working to develop business models that will allow supplies to be ordered in the most economic quantities; this is being done in line with private sector practice. However, by its nature Defence may require different levels of stock holdings than a private sector company operating to "just in time" principles.

PAC conclusion (v): Given the presence of high-value, slow moving stock and the costs of holding such stock, current stock reduction targets may not be sufficiently challenging. The Department should strengthen its targets and make more use of its scrutiny teams to review stock holdings. It should increase their frequency and extend their coverage, bearing down on slow moving stocks. It should set targets for rationalising depot storage space as a consequence of driving down its stock holdings.

6. The Department does not agree that its current stock reduction targets are not sufficiently challenging. It has set robust overall stock reduction targets of £1.8 billion; these include a target of £100 million (and an even more demanding "stretch" target of £120 million) for consumable items alone. In addition, the Department's Lean Support Continuous Improvement Team (LSCIT) has identified stock savings in excess of £186 million. Slow moving stock however is often held against contingency requirements where insufficient lead time is likely to be available to allow direct supply from industry. More efficient use of existing storage space has also been addressed by the Defence Storage and Distribution Agency.

Making better use of industry

PAC conclusion (vi): The National Audit Office's 1998 report on stores management concluded that the Department's cost of holding stock could well exceed the premiums charged by industry for direct supply. Consumable items, many of which are readily available from multiple suppliers in industry, account for £2.7 billion of the £12 billion slow moving stock held by the Department. The Department should look to industry to manage most of its consumable stocks and should set targets for reducing consumable stocks held in its depots and getting industry to manage such stocks.

7. The Department accepts the Committee's conclusion. MOD is seeking to move to a different support model, where the Defence Logistics Organisation (DLO) becomes an 'intelligent decider' responsible for effectively managing performance across a range of service delivery arrangements. This requires the DLO to leverage industrial capacity and shape the arrangements with industry to deliver improved availability, capability and sustainability, together with better value for money through life. The Department is also developing the role of its Non Project Procurement Office (NPPO) which seeks to achieve economies of scale by bundling together requirements for consumables and non-proprietary items. The NPPO has secured conspicuous early success, generating forecast estimated savings of £86 million on contracts valued at over £500 million.

PAC conclusion (vii): The Department holds many items of stock which were produced for old equipment and which in some cases may no longer be manufactured. There are examples of industry managing such stocks and delivering savings, but there is a need for further impetus to contract industry to manage more of these stocks. The Department should identify those old equipments for which inventory management by industry could lead to savings.

8. The Department accepts the Committee's conclusion. Although the Department strives continuously to improve the management of stock generally, including through the greater involvement of industry, it is considered that improving the though-life management of new systems and platforms offers the best rate of return.

PAC conclusion (viii): For new equipments, the Defence Procurement Agency and the Defence Logistics Organisation need to adopt and implement modern procurement processes. For example, transferring inventory management, and repair and maintenance responsibilities to industry, should ensure that the Department is not left with large amounts of obsolete or slow moving stock. The Department should review whether such arrangements can be applied more widely.

9. The Department accepts the Committee's conclusion. The Defence Procurement Agency and Defence Logistics Organisation already work closely together, and work is in hand to develop further the principles of the Smart Acquisition initiative and focus on developing a Whole Life approach. In this context, all projects must be supported by Through Life Management Plans which are required to contain Cost of Ownership (COO) data.

PAC conclusion (ix): There are examples where the Department and industry have worked to achieve significant reductions in repair times of major equipments, and the Department should look to extend these arrangements. Turnaround times for some Royal Air Force engines are four times longer than for industry. More effective management of equipment repair would enable the overall number of high-value assets, such as aero engines, to be driven down, thus reducing stock holdings. The Department should ensure that information systems can track where individual items are within the repair cycle and measure how long repairs take.

10. The Department accepts the Committee's conclusion. Although much progress has been made in reducing the time that weapon systems and equipment spend in the "repair loop", more remains to be done, both to achieve reduction in stock holdings and, more importantly, to improve availability at the front line. The introduction of better asset tracking and visibility systems has a part to play, and the Department is also exploring with industry the potential offered by innovative partnering arrangements further to streamline the equipment support process.

PAC conclusion (x): The Department should consider increasing the number of local bases using the Government Procurement Card and using direct delivery arrangements from industry suppliers to bases. There would be consequent savings as less stock would go through the Department's own depots.

11. The Department accepts the Committee's conclusion. Use of the Government Procurement Card (GPC) across defence is expanding. However, use of the GPC has to be controlled to ensure that holders still take advantage of the economies of scale offered by defence-wide contracts such as those set up by the Department's Non-Project Procurement Office (NPPO).

Identifying and applying lessons

PAC conclusion (xi): The Department reported the achievement of its target in this stock reduction exercise, but the National Audit Office was unable to validate performance. The baseline figure was not established robustly and could have been over or understated by around 20 per cent. The target was not well defined. Simply reducing the price of stock could have contributed 50 per cent of the achievement. In future stock reduction exercises the Department should ensure that stock volumes are properly targeted.

12. The Department recognises that the Committee's conclusion is based on paragraph 1.7 of the Comptroller and Auditor General's report. However, as was explained by the Accounting Officer in his evidence, and acknowledged by the C&AG, although the NAO was not able fully to validate the Department's claim that its £2.8 billion stock reduction exceeded its £2.2 billion Public Service Agreement, it does not invalidate the achievement. Improvements have been made to the way in which targets are set, and progress against them is measured, and the Department has continued the process set in train by the SDR by setting demanding annual targets for stock reduction. These have all been met or exceeded, and the total value of stock reductions achieved since 1998 now stands at £6.5 billion.



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