

House of Commons  
Committee of Public Accounts

**MINISTRY OF DEFENCE:  
PROGRESS IN  
REDUCING STOCKS**

Thirteenth Report of Session 2002–03

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*Report, together with  
Proceedings of the Committee, Minutes of  
Evidence and an Appendix*

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## **Committee of Public Accounts**

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### **Contacts**

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### **Footnotes**

In the footnotes of this Report, references to oral evidence are indicated by ‘Q’ or ‘Qq’ followed by the question number; references to the written evidence are indicated by the page number as in ‘Ev .....’.

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# THIRTEENTH REPORT

**The Committee of Public Accounts has agreed to the following Report:**

## **MINISTRY OF DEFENCE: PROGRESS IN REDUCING STOCKS**

### INTRODUCTION AND LIST OF CONCLUSIONS AND RECOMMENDATIONS

1. Keeping the right level of stock has always been a challenge for the Ministry of Defence (the Department) and its predecessors, and is a subject to which the Committee of Public Accounts has regularly returned since the nineteenth century. There is a history both of shortages of some stock and of holding too much stock of the wrong type. Following major fires in the Department's warehouses at Donnington in 1983 and 1988, for example, more than half of the destroyed stock did not need to be replaced.

2. In 1998 the Department estimated that it held stocks valued at £19 billion, of which £11 billion was non-munitions and £8 billion munitions. The Strategic Defence Review concluded that there was scope for significant reductions in stocks in the post-Cold War environment, and that savings in logistics should be used to fund the required enhancements to military capability to support joint expeditionary forces. The Review set a 20% (£2.2 billion) stock reduction target for non-munitions stocks. This target was incorporated in one of the Department's Public Service Agreements, and was to be achieved by April 2001. The Department reported to Parliament that it achieved the target by a considerable margin,<sup>1</sup> but there was insufficient information for the National Audit Office to be able to validate performance against the target.

3. The Committee took evidence on the Comptroller and Auditor General's Report<sup>2</sup> from the Permanent Under-Secretary of the Ministry of Defence and the Deputy Chief of Defence Logistics. Our Report examines three main issues:

- how effectively the Department has addressed its long-standing inventory management problems;
- the scope for the Department to make better use of the private sector to manage stocks; and
- wider lessons for the Department's other key targets.

4. Our main conclusions are as follows:

- **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 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

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<sup>1</sup> *Ministry of Defence Performance Report 2000-01* (Cm 5290), para 85

<sup>2</sup> C&AG's Report, *Ministry of Defence: Progress in Reducing Stocks* (HC 898, Session 2001-02)

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.

- **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.

5. Our detailed conclusions and recommendations are as follows:

*Tackling the inventory management problem*

- (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.
- (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.
- (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.
- (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.
- (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.

*Making better use of industry*

- (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.

- (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.
- (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.
- (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.
- (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.

#### *Identifying and applying lessons*

- (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%. The target was not well defined. Simply reducing the price of stock could have contributed 50% of the achievement. In future stock reduction exercises the Department should ensure that stock volumes are properly targeted.

#### TACKLING THE INVENTORY MANAGEMENT PROBLEM

6. While the Department has begun to tackle inventory management, stock holdings could be further reduced by greater incentives to reduce stocks, improving scrutiny arrangements and management information; developing its ability to forecast demand for stocks; and benchmarking logistics activities with other organisations.

7. Integrated Project Teams do not yet bear the full costs of owning stocks, since they do not pay for storage and distribution.<sup>3</sup> Nor do they always benefit directly from stock reductions, although the introduction of a charge on the cost of capital does provide an incentive for them to look closely at how much stock they hold.<sup>4</sup> The Defence Logistics

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<sup>3</sup> Qq 47-52

<sup>4</sup> Q 54

Organisation, not the front line user, remains the budget holder for stocks. While the Department aspires to make the front line the budget holder, it will require considerable effort and training before the front line will be in a position to take budgetary responsibility for stocks.<sup>5</sup>

8. Slow-moving stock currently costs £870 million a year. It is therefore important for the Department to have a target regime in place to tackle stock holdings, but also for the new annual targets for further reductions of between 5 and 10% to allow differentiation between Integrated Project Teams and the Services.<sup>6</sup> Central audit teams, such as the Lean Support Continuous Improvement Team, only undertake limited review of stock holdings. The Department has established teams to scrutinise stock holding but coverage and the frequency of their reviews is limited.<sup>7</sup>

9. Stock data for prices and volumes are still not fully complete and accurate<sup>8</sup> and the Department is still some way off knowing which stocks it has and which stocks it needs. This is compounded by a lack of information on the reliability of major items requiring repair, which makes it difficult to plan for future stock use.<sup>9</sup>

10. In recent years the National Audit Office has qualified the Department's resource accounts. The main areas of qualification for the 2001–2002 accounts were uncertainties over the accounting for the Department's assets in industry and stock transaction costs. Systems were not in place to capture data on the consumption of stock by contractors and existing inventory systems were not designed to provide stock accounting data for accruals based financial accounts.<sup>10</sup>

11. There are still very large amounts of obsolete and slow moving stock in the inventory. **Figure 1** shows the Royal Air Force's stock holding, including £1 billion stock classified as obsolete and £4.4 billion stock with no forecast demand.<sup>11</sup> It also shows that the Royal Air Force holds £1 billion of stock that it would take at least 60 years to consume, and a further £1.9 billion of other very slow moving stock.

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<sup>5</sup> Qq 131–133

<sup>6</sup> Q 27

<sup>7</sup> Qq 111–114

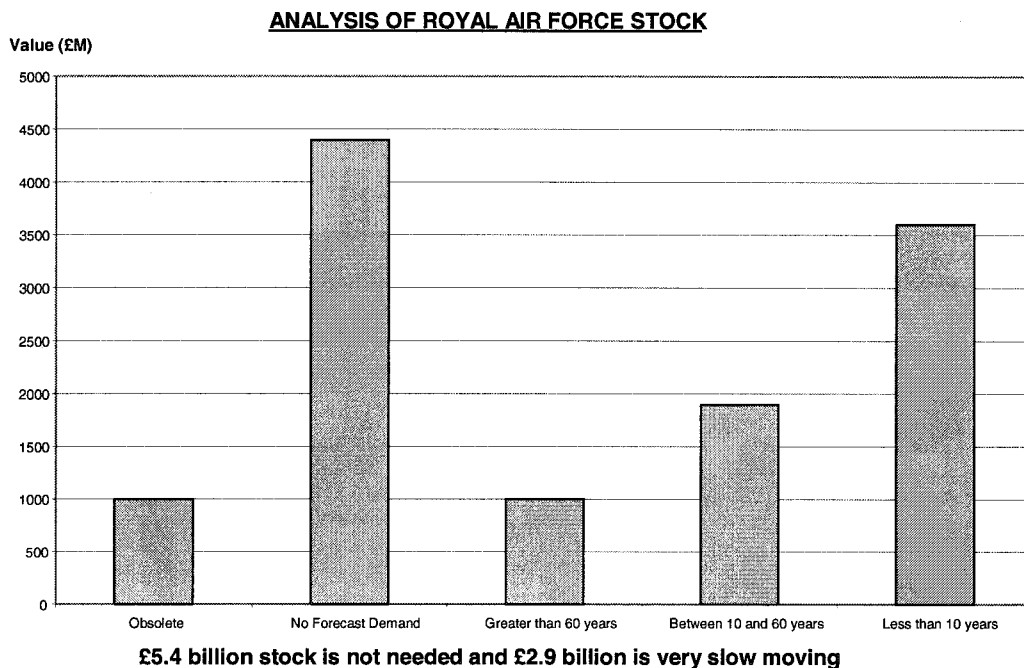
<sup>8</sup> Q 84

<sup>9</sup> C&AG's Report, paras 2.33–2.34

<sup>10</sup> C&AG's Report, *Ministry of Defence: Departmental Resource Accounts 2001–02* (HC 47, Session 2002–03), para 8

<sup>11</sup> C&AG's Report, para 2.18

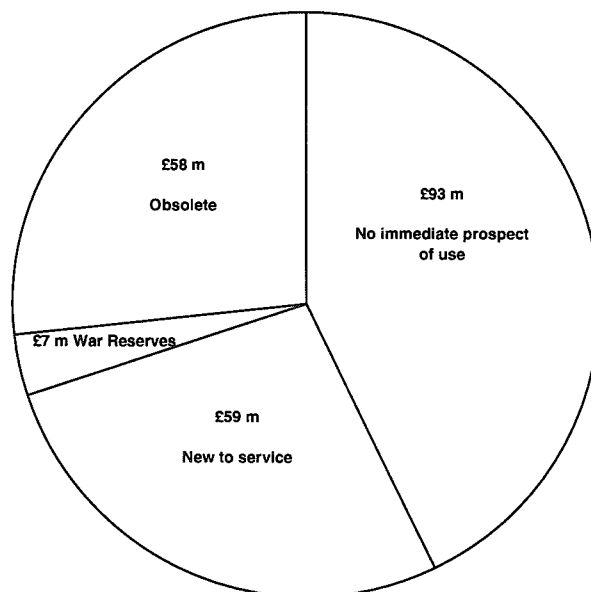
Figure 1



12. The Department holds £217 million Army stocks which are either obsolete or have no forecast demand. **Figure 2** shows that more than two thirds of this stock requires close attention. Of particular concern is the £93 million of stock that is not classified as obsolete, but has no immediate prospect of use. While the Department told us that it had reduced its holdings of stock with no forecast demand, it was not able to quantify changes in individual holdings of stock. Nor was it able to provide comparable data for the Royal Navy.

Figure 2

**ANALYSIS OF ARMY STOCK WITH NO FORECAST DEMAND**



**More than two thirds of this stock requires attention**

13. Many private sector firms have transferred their logistics activities in recent years to lean just-in-time operations.<sup>12</sup> Other countries have been testing innovative methods of managing their inventories and working with industrial partners to do so.<sup>13</sup>

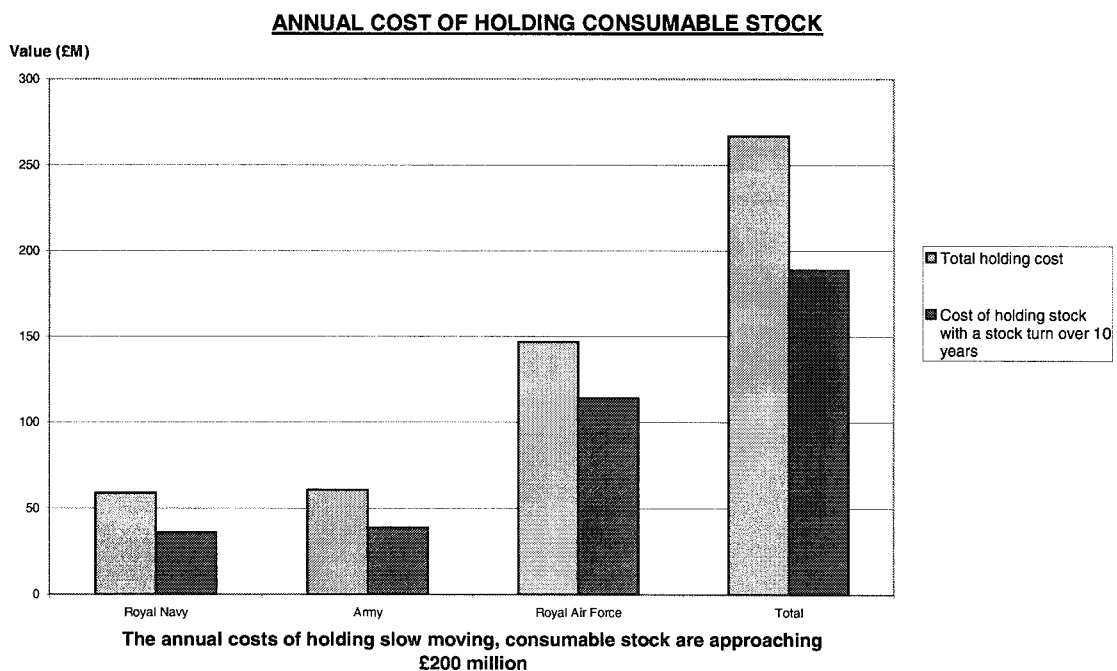
14. There are, of course, specific risks associated with military logistics, given the implications for national security if the logistics system were to fail to deliver and the hazardous nature of some military stocks. But differences between military and commercial logistics cannot be assumed to justify whatever stockholdings the Department may have accumulated. There has been little work to analyse the benefit and costs of holding on to large numbers of individual high value items. Without such analysis the Department cannot be sure that its approach to stock management is right.

15. The Department still owns nearly 2 million square metres of depot space and getting stock levels right would have implications for the amount of storage space it requires.<sup>14</sup> Reductions in stock holdings should produce subsequent reductions in storage requirements.

#### MAKING BETTER USE OF INDUSTRY

16. Industry premiums for direct supply may well be cheaper than the cost of holding stock. Consumable items are on the whole easier to supply directly and quickly than repairable items and in many cases can be bought from a wide industrial supply base. **Figure 3** shows annual costs of nearly £200 million for consumable stocks with a stock turn of over 10 years. The Department told us that there were very high savings to be made on consumable items, and that McKinsey's estimated savings perhaps amounting to as much as 14% of the overall consumable costs, or £1.6 billion.<sup>15</sup>

**Figure 3**



<sup>12</sup> C&AG's Report, para 2.29

<sup>13</sup> *ibid*, para 2.38

<sup>14</sup> Q 43

<sup>15</sup> Q 136

17. Legacy systems present a challenge to efficient inventory management. Some equipment, such as the Canberra aircraft, is in service for over forty years and it becomes impossible to source spares from the original manufacturers. Other equipment may not be so old, but may still require large volumes of spares to be held.<sup>16</sup> Recent experience suggests that outsourcing the holding of some of these stocks to industry could help the Department. Matra BAe Dynamics (now MBDA) and Unipart have successfully taken control of the inventory of the Rapier air defence system in recent years, managing the repair process, as well as 18,000 consumable items formerly overseen by the Department.<sup>17</sup> The Department has also had some success in pooling the inventory for the Airborne Warning And Control System aircraft with its collaborative partners.<sup>18</sup> These examples show that industry can provide a viable solution to some of the Department's stock holding challenges.

18. For new equipments the Department is adopting a longer term perspective, identifying the operating, maintenance and disposal costs, as well as initial procurement costs. Incremental acquisition is being used on the Department's new procurement projects such as the Royal Navy's Type 45 destroyer.<sup>19</sup> In addition, the principle of Whole Life Costing is increasingly being used in acquisition projects by the Defence Procurement Agency including in many cases the provision of Contractor Logistics Support. In Private Finance Initiative contracts such as Skynet 5, full support, including all stocks, are to be provided by the industrial contractor.<sup>20</sup> All of these are ways in which the onus is being placed on industrial suppliers to take on responsibility for the management of equipment maintenance and repair and the provision of spares.

19. There is much scope for more efficiency in some high value asset categories such as aero-engines where the Department found that turnaround times were typically four times longer than those of industry.<sup>21</sup> By improving its asset tracking information, the Helicopter Engines Integrated Project Team was able to reduce the number of engines it held, identify efficiencies in the repair loop and improve service to its front line customers.<sup>22</sup> A one-day reduction in repair times for tanks and other major land vehicles could permit stock reductions of £3 million. A project on marine diesel engines reduced the repair loop from 200 to 50 days with a consequent reduction in stocks of £4.6 million.<sup>23</sup>

20. The Government Procurement Card has been successfully introduced at some sites. The Non-Project Procurement Office is trying to transfer stockholding risks to industry where possible and reduce stock turn to two months where it does decide to retain stock. In its first year of operations it reduced its customer base from 150 to just six companies, making savings of some £40 million on new contracts valued at £350 million. It has already identified savings of £120m over the life of various projects.<sup>24</sup>

#### IDENTIFYING AND APPLYING LESSONS

21. The Department's stock reduction exercise was a major undertaking for the Department, involving stock worth billions of pounds. There are lessons to be learnt, both for the Department and for other government bodies, in terms of performance validation and the specific task of managing stock inventories.

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<sup>16</sup> Q 7

<sup>17</sup> C&AG's Report, para 2.32

<sup>18</sup> Q 63

<sup>19</sup> C&AG's Report, *Ministry of Defence: Major Projects Report 2002* (HC 91, Session 2002–03), paras 3.9–3.12

<sup>20</sup> *ibid*, paras 3.14–3.17

<sup>21</sup> C&AG's Report, para 2.34

<sup>22</sup> C&AG's Report, *Ministry of Defence: Major Repair and Overhaul of Land Equipment* (HC 757, Session 2001–02), para 1.18

<sup>23</sup> C&AG's Report, para 2.34

<sup>24</sup> *ibid*, para 2.31

22. It was not clear what volume of stock was disposed of during the exercise. The Department was not able to give a precise figure for the percentage of stock disposed of by volume, but estimated it to be around 50%. The impact on depot rationalisation was also unclear, although the Department estimated that it had reduced its required storage capacity by 18% as a result of the stock reduction exercise.<sup>25</sup>

23. Despite the evidence provided by the Department that it had indeed disposed of a large amount of stock, the National Audit Office was unable to validate whether or not the stock reduction target had been achieved. Three main factors stood in the way of the validation. The original baseline was not reliable, as it could have been over or understated by 20%—the same as the stock reduction target itself. The basis of measurement was not consistent between the Services, particularly in terms of including new stock and counting disposals. And the reporting of achievement was not accurate, due to the difficulty of comparing like with like over the three-year period.<sup>26</sup>

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<sup>25</sup> Q 30

<sup>26</sup> C&AG's Report, paras 1.11–1.17

MINUTES OF PROCEEDINGS OF  
THE COMMITTEE OF PUBLIC ACCOUNTS

SESSION 2002–03

MONDAY 2 DECEMBER 2002

Members present:

Mr Edward Leigh, in the Chair

Mr Geraint Davies	Mr Brian Jenkins
Angela Eagle	Mr David Rendel
Mr George Howarth	Mr Alan Williams

Sir John Bourn KCB, Comptroller and Auditor General, was further examined.

The Committee deliberated.

Mr Brian Glicksman, Treasury Officer of Accounts, was further examined.

The Comptroller and Auditor General's Report on Ministry of Defence: Progress in reducing stocks (HC 898, Session 2001–02) was considered.

Sir Kevin Tebbit KCB CMG, Permanent Under-Secretary of State, and Mr John Oughton, Deputy Chief of Defence Logistics, Ministry of Defence, were further examined; and Mr David Clarke, Director, National Audit Office, was further examined (HC 144-i).

The witnesses withdrew.

The Committee further deliberated.

\* \* \* \* \*

[Adjourned until Wednesday 4 December at Four o'clock.

\* \* \* \* \*

MONDAY 24 MARCH 2003

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon	Mr David Rendel
Mr Ian Davidson	Mr Gerry Steinberg
Mr George Howarth	Jon Trickett
Mr Brian Jenkins	Mr Alan Williams
Mr George Osborne	

Sir John Bourn KCB, Comptroller and Auditor General, was further examined.

The Committee deliberated.

Mr Brian Glicksman, Treasury Officer of Accounts, was further examined.

\* \* \* \* \*

Draft Report (Ministry of Defence: Progress in reducing stocks), proposed by the Chairman, brought up and read.

*Ordered*, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 3 read and agreed to.

Paragraph 4 postponed.

Paragraphs 5 to 23 read and agreed to.

Postponed paragraph 4 read and agreed to.

*Resolved*, That the Report, as amended, be the Thirteenth Report of the Committee to the House.

*Ordered*, That the Chairman do make the Report to the House.

*Ordered*, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

\* \* \* \* \*

[Adjourned until Wednesday 26 March at half past Three o'clock.]

REPORTS BY THE COMMITTEE OF PUBLIC ACCOUNTS  
SESSION 2002–03

		Publication Date
1	Collecting the Television Licence Fee (HC 118) . . . . .	18/12/02
	Government Reply (Cm 5770) . . . . .	06/03/03
2	Dealing with pollution from ships (HC 119) . . . . .	09/01/03
	Government Reply (Cm 5770) . . . . .	06/03/03
3	Tobacco Smuggling (HC 143) . . . . .	10/01/03
	Government Reply (Cm 5770) . . . . .	06/03/03
4	Private Finance Initiative: redevelopment of MOD Main Building (HC 298) . . . . .	30/01/03
5	The 2001 outbreak of Foot and Mouth Disease (HC 487) . . . . .	14/03/03
6	Ministry of Defence: Exercise Saif Sareea II (HC 502) . . . . .	12/03/03
7	Excess Votes 2001–02 (HC 503) . . . . .	19/03/03
8	Excess Votes (Northern Ireland) 2001–02 (HC 504) . . . . .	19/03/03
9	The Office for National Statistics: outsourcing the 2001 Census (HC 543) . .	26/03/03
10	Individual Learning Accounts (HC 544) . . . . .	04/04/03
11	NHS Emergency Planning (HC 545) . . . . .	16/04/03
12	Tackling Pensioner Poverty: encouraging take-up of entitlements (HC 565) .	09/04/03
13	Ministry of Defence: progress in reducing stocks (HC 566) . . . . .	11/04/03