

Friday, 2 July 2010

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(10.00 am)

MR BRUCE MANN

MR TREVOR WOOLLEY

MR TOM MCKANE

THE CHAIRMAN: Good morning everyone. We have three witnesses appearing today in a joint session and they are: Trevor Woolley, who is both the former Director General of Resource and Plans and subsequently Finance Director in the MoD until 2009; Bruce Mann, formerly Director General of Financial Management of the MoD; and Tom McKane, who succeeded Mr Woolley as the Director General Resource and Plans at the MoD and held that post until 2006.

The session will focus on the force structure and planning assumptions relevant to operations in Iraq, the MoD's delivery of military capability to support operations in Iraq, and the provision of funding to the MoD for operations in Iraq.

Now we shall not be asking Mr McKane about his responsibilities in the Cabinet Office, where he worked for Sir David Manning before he assumed his post as DG Resource and Plans at the MoD; the relevant issues on that were covered during Sir David's appearance in the first round of public sessions.

1 I should also state for the record that I worked  
2 closely with Mr Mann as a member of the Butler Committee  
3 on the review of intelligence on weapons of mass  
4 destruction, at which he was the secretary.

5 Now, we are publishing this morning two declassified  
6 documents which will go up on our website.

7 As I say on every occasion, we recognise that  
8 witnesses are giving evidence based on their  
9 recollection of events. We are, of course, checking  
10 what we hear against the papers to which we have access,  
11 and which we are still receiving, and I remind every  
12 witness on each occasion they will later be asked to  
13 sign a transcript of the evidence to the effect that the  
14 evidence given is truthful, fair and accurate.

15 Before Sir Martin starts the questions, there is  
16 a lot of technical language involved in this morning's  
17 session. I would just like to ask, for my own better  
18 understanding, when the term "force structure" is used,  
19 what is its meaning. Mr Woolley?

20 TREVOR WOOLLEY: Well, my understanding of the term "force  
21 structure" is that it is the various force elements that  
22 make up a deployed operational force.

23 THE CHAIRMAN: Meaning much the same as "package" then?

24 TREVOR WOOLLEY: I think, depending on the particular  
25 context, I think it would be much the same as "package".

1 I think you would also talk about the overall force  
2 structure of the armed forces, which would obviously be  
3 different from a particular package, but you could,  
4 I think, talk about the force structure in the context  
5 of a particular set of deployed force elements.

6 THE CHAIRMAN: Thank you. So it really has both meanings?

7 TREVOR WOOLLEY: Yes.

8 THE CHAIRMAN: The larger meaning, but also the more  
9 specific?

10 TREVOR WOOLLEY: Yes.

11 THE CHAIRMAN: Thank you very much. I'll turn to  
12 Sir Martin Gilbert.

13 SIR MARTIN GILBERT: Perhaps I can start with a piece of  
14 terminology really to help public understanding of  
15 today's session. Could you briefly explain what the  
16 defence planning assumptions are and how the MoD uses  
17 them?

18 TREVOR WOOLLEY: The defence planning assumptions are  
19 designed to inform the overall force structure of our  
20 armed forces. They start from an identification of the  
21 military tasks that the armed forces might be required  
22 to undertake and these are revised from time to time.  
23 They make assumptions about the scale of effort required  
24 for each of those military tasks, what force elements we  
25 might be expected to require in order to meet those

1 military tasks. They make assumptions about the  
2 endurance of these military tasks and, in particular,  
3 when it comes to expeditionary operations, it makes  
4 distinctions between the endurance of war-fighting  
5 operations and the endurance expected of peacekeeping  
6 operations, certainly those were the distinctions during  
7 the period we are talking about.

8 It also makes assumptions about the concurrency of  
9 operations, how many operations at different scales we  
10 should be prepared -- be prepared to undertake in  
11 different circumstances.

12 These, together, form the defence planning  
13 assumptions and they are used to both calculate, if you  
14 like, what our requirement is for different force  
15 elements and also to determine the level of readiness  
16 required of those various force elements.

17 SIR MARTIN GILBERT: Thank you very much. That leads me to  
18 the considerable debate that there has been with regard  
19 to the deployment to Iraq as to whether the armed forces  
20 had been operating beyond their planning assumptions and  
21 perhaps if I could quote from the SDR new chapter in the  
22 spring of 2002:

23 "We have routinely deployed our armed forces on more  
24 operations concurrently than we envisaged in the SDR."

25 In 2002, what were the defence planning assumptions

1 and how far were they exceeded by the deployed forces?

2 TREVOR WOOLLEY: The defence -- the key defence planning  
3 assumptions in 2002 were that we should be ready to  
4 undertake either a single large-scale operation -- that  
5 is to say an operation which in land forces terms was of  
6 approximately divisional strength -- or concurrent,  
7 medium-scale -- two concurrent, medium-scale operations,  
8 one of which would be war-fighting and one of which  
9 would be peacekeeping. The war-fighting operation to  
10 last for six months and the peacekeeping operation to be  
11 enduring. Those were the key assumptions.

12 Before the Iraq war, I believe we were operating  
13 within those assumptions. The Iraq war itself was  
14 consistent with the large-scale assumption. What  
15 subsequently led to our operating outside our planning  
16 assumption was that the level of deployment -- the  
17 large-scale level of deployment endured for longer than  
18 the six months that was planned for a war-fighting  
19 operation.

20 SIR MARTIN GILBERT: If I could move on then from that to  
21 the funding aspect, we were told both by the former  
22 Permanent Secretary, and also the former  
23 Defence Secretary, that within the MoD there was a view  
24 that the SDR, strategic defence review, of 1998 had not  
25 been funded to the levels necessary to deliver the force

1 structure envisaged. Did the UK have the force  
2 structure envisaged by the SDR in 2002?

3 TREVOR WOOLLEY: Well, I would need to recall the precise  
4 details of when the changes in the SDR envisaged came to  
5 be implemented but, in general terms, I believe that the  
6 force structure in 2002 was consistent with the outcome  
7 of the SDR. That is not to say that there were not  
8 budgetary pressures and, indeed, there were budgetary  
9 pressures. But I cannot recall there being any element  
10 of the force structure that the SDR had planned in that  
11 timescale that was not in place in that timescale.

12 SIR MARTIN GILBERT: In his evidence to us, in his public  
13 evidence, Sir Jock Stirrup highlighted, among other  
14 things, what he called expeditionary campaign  
15 infrastructure and also strategic tactical mobility as  
16 two examples where he felt the SDR had not been fully  
17 realised.

18 Were there other capabilities and force structures  
19 that had not been fully developed?

20 TREVOR WOOLLEY: I think what is quite difficult is to, if  
21 you like, drill down one level lower than the reasonably  
22 high-level outcome of the strategic defence review.  
23 I mean, the strategic defence review of 1998 did specify  
24 force elements, the requirement for different force  
25 elements; that is to say different numbers of aircraft

1 squadrons and numbers of major warships and so on.

2 Below that level, you could come to particular types  
3 of equipment, which weren't actually specified in the  
4 SDR, certainly in the published SDR document, and so  
5 I think you could have a debate as to whether the level  
6 of intelligence and reconnaissance and target  
7 acquisition equipments that we had available in 2002 was  
8 consistent with the intention of the SDR, but I don't  
9 think one could say that it actually contradicted the  
10 outcome of the SDR.

11 I don't know, whether, Tom, you have anything to add  
12 on that point?

13 TOM MCKANE: No, I think that's right and, if you go back to  
14 the SDR, certainly one of the conclusions at the time  
15 was that we needed to put more investment into what were  
16 called "key enablers", by which was meant things like  
17 military transport aircraft and, as Mr Woolley has  
18 referred to, intelligence surveillance target  
19 acquisition, equipment and so on.

20 But those were -- those were things that were going  
21 to be brought in over a period of a number of years and  
22 whether they were all coming in to the timetable that  
23 was expected around 1998 is something that one would  
24 have to go back into the detail to check.

25 SIR MARTIN GILBERT: Can you explain what changes the new

1 chapter introduced to the force structure and planning  
2 assumptions and, in particular, was there time for these  
3 changes to be put into effect before operations began in  
4 Iraq?

5 TREVOR WOOLLEY: The main change in the -- the main change  
6 introduced by the new chapter was a greater recognition  
7 that we were likely to be involved -- we could be  
8 involved in more than two concurrent operations and,  
9 therefore, there was a greater recognition that we had  
10 to be prepared to do more concurrent operations at  
11 a smaller level of effort and that this would reduce  
12 marginally the requirement for the -- for many of the  
13 front line fighting elements, but increase the  
14 requirement for the enablers; that is to say the  
15 logistic enablers and the movement enablers, the  
16 strategic lift and so on.

17 So, for example, as I recall, the new chapter  
18 reduced the air and maritime effort that would be  
19 assumed for medium-scale peacekeeping operations and, by  
20 reducing the level required from medium to small for  
21 medium-scale peacekeeping operations, when that went  
22 into the overall calculus, the requirement for warships  
23 and fast jets reduced.

24 By the same token, the consequence of the new  
25 chapter was to increase the requirement for the

1           enablers.

2   SIR MARTIN GILBERT:   Was the MoD satisfied that the defence  
3           budget was amply sufficient to cover these requirements?

4   TREVOR WOOLLEY:   Well, what we did in the 2002 spending  
5           review was to make a specific bid related to the outcome  
6           of the new chapter. We actually submitted it after our  
7           main bid to match the timetable for the new chapter  
8           work.

9           Whether -- I mean, the Ministry of Defence, I think,  
10          never feels it has enough resources for what it is  
11          required to do. So I certainly wouldn't say that we  
12          felt we had sufficient resources to implement the  
13          implications of the new chapter in full and, clearly, we  
14          had to make judgments about the allocation of resources,  
15          as we always had to.

16   SIR MARTIN GILBERT:   Sir Kevin Tebbitt told us in his  
17          evidence that the core budget, as a whole, was just too  
18          small during this period.

19          Can you define for us what the core defence budget  
20          is and perhaps give us some sense of the gap between  
21          what the MoD felt it needed to deliver the SDR and what  
22          was provided for in the defence budget?

23   TREVOR WOOLLEY:   Well, I think Sir Kevin was probably  
24          referring to the defence budget minus the net additional  
25          cost of military operations, which, as you know, is

1 funded separately from the Reserve. So it is, if you  
2 like, the main defence budget.

3 I think one of the difficulties is that there are  
4 a lot of judgments to be made about the level of --  
5 about the detailed defence programme within the overall  
6 strategy of the SDR. So, for example, the SDR didn't  
7 specify a timescale for modernising servicemen's  
8 accommodation and the rate at which we spent resources  
9 on modernising servicemen's accommodation could have  
10 a very considerable impact on our expenditure. But  
11 whether it was more or it was less, it could still be  
12 argued to be consistent with the SDR.

13 Similarly, levels of activity, levels of training,  
14 while a certain level of training is clearly necessary  
15 in order to ensure that particular force elements meet  
16 their readiness requirements, there is an element of  
17 judgment as to what that minimum level of training is,  
18 and that, too, could have a big effect on the --  
19 a considerable impact on the expenditure of the defence  
20 budget.

21 So I think that it is quite difficult to say that  
22 one level of defence budget was consistent with the  
23 outcome of the SDR and a different level was  
24 inconsistent. There was clearly quite a range involved.

25 I think what happened was that the -- what caused

1 the budgetary pressures we faced by 2002 was a number of  
2 factors. One was that the SDR assumed a very  
3 challenging efficiency programme within the  
4 Ministry of Defence. It was 3 per cent year-on-year  
5 against a baseline that encompassed, as I recall, a very  
6 high percentage of the defence budget. So the  
7 assumption was that we would make those efficiencies and  
8 that would release funds to fund the capabilities.

9 While we did make many efficiencies in that period,  
10 not all of them were capable of translation into actual  
11 budgetary reductions and, therefore, enabling recycling  
12 of resources into our priority areas.

13 So that was one difficulty. The other difficulty  
14 was that although the defence budget did grow in real  
15 terms -- that is to say as measured by the GDP deflator,  
16 which is the conventional way of calculating real growth  
17 in departmental budgets -- the costs that the  
18 Ministry of Defence were incurring grew at a pace that  
19 was greater than the GDP deflator.

20 So, for example, the pay of the armed forces and of  
21 civil servants during this period was generally -- in  
22 fact, I think consistently -- above the GDP deflator.  
23 We were hit by and have been continuously, by the  
24 increase in fuel prices. We were hit by changes in  
25 exchange rates, that added to our costs. Exchange rates

1 obviously go up and down, but the perception was that  
2 they were always working against us.

3 Although it is a more difficult area to make the  
4 calculation, the general view is, I think, that costs in  
5 the equipment programme increased, inflation in the  
6 equipment programme increased faster.

7 So the combination of all this meant that the  
8 purchasing power of the defence budget did not increase  
9 and probably decreased over this period. Therefore,  
10 even had the SDR been fully funded -- and as I say,  
11 there is an issue as to what we precisely mean by "fully  
12 funded" -- in 1998, unquestionably the purchasing power  
13 of the defence budget was a little bit less in four  
14 years' time.

15 SIR MARTIN GILBERT: What effect did the completion of the  
16 spending review in July 2002 have on the MoD's ability  
17 to deliver the force structures envisaged by the SDR in  
18 the new chapter? Was that a factor?

19 TREVOR WOOLLEY: Well, what happens is that the  
20 Ministry of Defence conducts an annual planning round,  
21 and what happens in this annual planning round in  
22 essence is that we recast the defence programme that  
23 emerged from the previous planning round, we compare it  
24 with the defence budget that is available, we reconsider  
25 our priorities, "Has our priority changed since the last

1 planning round?" and we make adjustments to the defence  
2 programme to match it to the budget.

3 Now, clearly, the outcome of spending review 2002  
4 altered one of those variables; that is to say the level  
5 of the budget. That was factored into the planning  
6 round that followed the defence -- the spending review.

7 There was the particular issue, which no doubt we  
8 will come on to, about what was actually available to  
9 the Ministry of Defence as a result of that spending  
10 review. But there was a planning round that followed  
11 that spending review, and no doubt adjustments were made  
12 to our plans. I wasn't myself -- I think it was just  
13 about the only planning round during this period that  
14 I wasn't involved in, but I wasn't actually involved  
15 myself in that planning round.

16 I don't know whether Mr McKane has any recollections  
17 of particular changes that were made in the planning  
18 round that followed that spending review.

19 TOM MCKANE: I don't remember the details of the changes.  
20 I mean, in every Ministry of Defence planning round  
21 there are literally hundreds of changes made to the  
22 programme and there would have been many changes made in  
23 the 2002/2003 planning round.

24 The intention that we had was to implement the --  
25 what had been agreed with the Treasury in the 2002

1 spending round because, in that spending review, not  
2 only was there a new budget settlement, but there were  
3 expectations of how the defence programme would be  
4 adjusted, as Mr Woolley has said, that reflected the new  
5 chapter of the SDR with the emphasis, amongst other  
6 things, on what was called "network enabled capability"  
7 at the time.

8 SIR MARTIN GILBERT: My last question really relates to the  
9 impact of the warning time with regard to the Iraq  
10 operation and to what extent did the time factor impact  
11 on both the money available and also on the planning  
12 preparations?

13 TOM McKANE: Okay. Well, it would have had an impact on  
14 the -- the point at which detailed preparations were  
15 able to be made with industry as a number of other  
16 witnesses have commented. But it didn't have a -- it  
17 didn't have a bearing on what was being done in the core  
18 defence programme, if that's what you are getting at.

19 SIR MARTIN GILBERT: Thank you.

20 THE CHAIRMAN: Could we talk now about the contingency  
21 planning that started in the course of 2002? What's the  
22 role of the Resource and Planning staff. When you start  
23 contingency planning for operations?

24 TREVOR WOOLLEY: Well, I think the role of the Resource and  
25 Planning staff was to establish and gather, as best it

1       could, estimates of what the costs of the operation  
2       would be, in particular the likely costs of the urgent  
3       operational requirements that would be required, and to  
4       put in place mechanisms for capturing the actual costs  
5       that were incurred or that would be incurred in order  
6       that they could be accounted for separately under the  
7       longstanding arrangements that the net additional costs  
8       of military operations were funded from the  
9       Treasury Reserve. That was the main role of the  
10      Resource and Planning staff.

11             Again, Mr McKane was there in the run-up to the Iraq  
12      war. I don't know whether you want to add to that?

13      TOM MCKANE: No.

14      THE CHAIRMAN: I think this may be for Mr McKane but, when  
15      was it first known within the MoD and the Resource and  
16      Planning staff that there was going to be contingency  
17      planning for an Iraq operation? In the course of 2002,  
18      when did this go on to the slate, as it were?

19      TOM MCKANE: When I came back to the Ministry of Defence  
20      from the Cabinet Office in September 2002, the subject  
21      was already on the agenda of the resources and planning  
22      staff and they had -- they had begun to think about what  
23      the costs might be, though I think it is true to say  
24      that, at that stage, these were calculations that people  
25      were beginning to make based on a range of possible --

1 a range of assumptions about the type of operation that  
2 might ensue. In the course of the autumn, the picture  
3 and -- the autumn and then leading through into the  
4 early part of 2003 -- clearly that picture began to get  
5 clearer and, as it became clear, it was possible to  
6 start to make more detailed and accurate assessments of  
7 what the costs might be, and I was involved in a number  
8 of meetings throughout that period with, on the one  
9 hand, the staff in the operations area in the  
10 Ministry of Defence and, on the other hand, with the  
11 Treasury team, who were naturally keen to understand  
12 what these costs might be.

13 In the course of those discussions we came to the  
14 point where, in October, I think it was, we began to get  
15 authority to spend money on urgent operations -- urgent  
16 operational requirements.

17 THE CHAIRMAN: Mr Woolley, were you involved at a slightly  
18 earlier point in 2002 in this process or was it after  
19 you left?

20 TREVOR WOOLLEY: I don't recall personally being involved in  
21 it prior to my move away from the Resources and Plans  
22 area in August 2002. I think we were very focused on  
23 the spending review 2002, which was settled in July, and  
24 that was our main focus at the time.

25 THE CHAIRMAN: It would be helpful to know just how much of

1 your time personally, but also your staff -- how much  
2 Iraq was a preoccupation as 2002 wore on. We are  
3 probably talking the second half of 2002, I think.

4 TOM MCKANE: It is difficult to put a percentage on it.

5 There were one or two of the staff, both military and  
6 civilian, who were engaged full-time on the question --  
7 questions around the cost of operations. That was their  
8 function, because they -- even before Iraq, there were  
9 operations in place, there was continuing claims on the  
10 Reserve as a result of the Balkans operations.

11 So at the desk level there would have been one or  
12 two people full-time and, as for myself, I would say  
13 that in the autumn of 2002 it was beginning to consume  
14 up to 10 to 20 per cent of my time, something like that.

15 THE CHAIRMAN: Right. Mr Mann, do you get drawn into this?

16 BRUCE MANN: Yes, I was just reflecting on your question.

17 We got drawn into the fine detail of how the numbers are  
18 calculated because, of course, the way in which the MoD  
19 was accounting at that time was changing as part of  
20 the move to resource accounting and budgeting and there  
21 were, at the time of -- myself and my staff were  
22 essentially engaged on two things: first, detailed  
23 interpretation of how we should count in the light of  
24 the changing rules that were going through, providing  
25 guidance to financial staff out in budgetary areas as to

1       how accounting should be done, and then, secondly,  
2       gathering -- helping to gather the evidence, where  
3       appropriate, but also then the opposite side of that,  
4       which is sharing our data, explaining that data, in some  
5       cases, and the accounting rules we had adopted with the  
6       Treasury.

7   THE CHAIRMAN: Thank you. Various options come into  
8       consideration at the level of ministerial  
9       decision-taking that were, I think, three, or sometimes  
10      you can count it as four, alternative packages. How is  
11      that estimated in the contingency planning process and  
12      how did it change in the second half of 2002 into 2003?  
13      Because there were not only changes like taking the  
14      southern rather than the northern route, but there would  
15      have been much greater refinement, I guess, as the  
16      military planning process goes forward.

17   TOM McKANE: I can recall in these discussions that we were  
18      having both internally and with the Treasury,  
19      calculations that had been made about the -- the likely  
20      costs of different types of package. So we didn't  
21      know -- and we are not and didn't need to be privy to  
22      the discussions that were taking place between the  
23      operations part of the Ministry of Defence and other  
24      parts of Whitehall. But we did know, broadly speaking,  
25      what the options were and what types of force they might

1       involve and it would be -- it would have been the job of  
2       the desk officers, who were working full-time on this,  
3       to understand the costs and the additional costs of  
4       the -- of deploying the types of force that would be  
5       used under each of these options and the possible urgent  
6       operational requirements that would be associated with  
7       different packages. We presented these calculations to  
8       the Treasury.

9       THE CHAIRMAN: Is operational security anything of a drag on  
10       how much information you can get when in the financial  
11       system, for planning purposes, or is there pretty much  
12       internal transparency between the military planners and  
13       yourselves?

14       TOM MCKANE: I don't believe that it was a problem.  
15       Certainly the military desk officer, who I remember  
16       being engaged most closely, who was a lieutenant  
17       colonel, was involved in some detail with the operations  
18       staff in order to understand what the possible options  
19       were.

20       Now, I'm not -- I'm sure that there were plenty of  
21       details that we were not privy to, but I believe that we  
22       had sufficient information to understand what the costs  
23       were likely to be in round terms.

24       THE CHAIRMAN: So when Lord Boyce, the CDS at the time said  
25       that he was prevented -- constrained from talking among

1 others to the head of defence logistics, that was  
2 a military planning constraint, but it didn't touch on  
3 the financial planning forecasting --

4 TOM MCKANE: Well.

5 THE CHAIRMAN: It was a narrow planning circle, wasn't it?

6 TOM MCKANE: It was a narrow planning circle and there were  
7 constraints on whom one could talk to. I can't remember  
8 in detail at what point we would have started talking to  
9 the Logistics Organisation, but we would have been able  
10 to use some rules of thumb, drawing on the experience of  
11 the first Gulf War in -- at the beginning of the 1990s  
12 and, indeed, the experience in the Balkans campaigns, to  
13 know the types of running -- extra running costs that  
14 would be associated with a different size of force.

15 THE CHAIRMAN: So from your standpoint -- and I'm thinking  
16 here about the accuracy and quality of the financial  
17 information that could be given to the ministers as part  
18 of the background to the decisions they needed to make  
19 on the packages, you were satisfied in the second half  
20 of 2002 that this was accurate enough for that purpose?

21 TOM MCKANE: Yes.

22 THE CHAIRMAN: Okay. Last point from me then: you mentioned  
23 about preparing -- and I think it was Mr Mann's side --  
24 you prepare financial instructions against the  
25 contingency of operation. When do these go live, as it

1           were?

2   BRUCE MANN:  I would say we operated on something rather  
3           more broader than just a set of financial instructions.  
4           I mean, yes, there were financial instructions and those  
5           changed literally as the planning developed and we went  
6           through the autumn and into early 2003, but actually  
7           a great deal is done by more informal contact between  
8           the central finance staff and those out in, let's say,  
9           the Logistics Organisation.

10           So if I just go back to something that Mr McKane  
11           said, my staff were perfectly able to have the  
12           conversation, absent financial instructions, as it were,  
13           that -- to say on -- if we assume that a particular  
14           force package is going and that it is going to get  
15           involved in war-fighting, what is likely to be your  
16           consumption of ammunition, guided weapons missiles and  
17           bombs and so on, on some very broad costing assumptions,  
18           bearing in mind the historical evidence that we have.

19           My staff have no difficulty in doing that, and so  
20           I absolutely have to endorse what Mr McKane said.  We  
21           wouldn't, as it were, set out a need to do that in some  
22           kind of financial instruction.  That would just be an  
23           automatic part of the process.

24           You will have seen, possibly, in some of the  
25           material, every now and then I issued pieces of paper

1       that said, "This is how you should do the accounting",  
2       recognising that, on 1 April the following year, the  
3       accounting rules were all going to change, but that was  
4       more -- yes, it was financial instructions to a degree  
5       but it was also a matter of setting out clear  
6       interpretations of the accounting rules so that  
7       everybody was operating on a consistent basis.

8   THE CHAIRMAN:  The general inference from that is that it  
9       would be an error for us to simply examine the  
10      formalities of the process because there is a great deal  
11      of exchange going on at the informal level, a great deal  
12      of legacy from experience and the rest of it.

13  BRUCE MANN:  One of the things I clearly remember is that  
14      the very early costings to -- that we provided to the  
15      Treasury tended to be backwards looking.

16  THE CHAIRMAN:  Yes.

17  BRUCE MANN:  In the past, these kinds of force packages in  
18      these kinds of operations have costed this much.  As we  
19      got firmer and firmer detail about the broad scope of  
20      the operation that might be undertaken in Iraq, so it  
21      was possible to look forwards as opposed to backwards  
22      and do some much more accurate --

23  THE CHAIRMAN:  Does -- and this is my very last word on  
24      this -- the cost trend tend to go upwards as you get  
25      nearer to the event and you know more about it?

1 TOM McKANE: My recollection of the estimates that we were  
2 making throughout that period -- and we were trying to  
3 estimate not only the costs of the initial phase of the  
4 operation, but also beginning to look at what might  
5 be -- what costs might arise thereafter -- was that our  
6 costs didn't rise substantially. They did vary and  
7 actually they went up and down over time, as we -- as we  
8 were able to draw on the data of what we were actually  
9 spending as we got into that autumn and winter.

10 THE CHAIRMAN: Thank you very much. I'll turn to  
11 Sir Roderic now. Roderic?

12 SIR RODERIC LYNE: I would like to look at the assumptions  
13 and the reality in the period after the military  
14 campaign, after the war-fighting phase.

15 Mr Woolley, to a degree, I think you may have  
16 already indicated the answer to this question, but in  
17 the documents that we have published today is included  
18 an extract from a minute jointly signed by the Foreign  
19 Secretary and the Defence Secretary to the  
20 Prime Minister of 19 March 2003. That's literally the  
21 eve of the invasion of Iraq, and they stated here:

22 "It will be necessary to draw down our current  
23 commitment to nearer a third by no later than autumn in  
24 order to avoid long-term damage to the armed forces."

25 Were they making that statement because of the

1       assumptions that you referred to earlier about how long  
2       a force of this size, a large-scale force, should be  
3       deployed?

4   TREVOR WOOLLEY: Well, I can only speculate. I will ask  
5       Mr McKane, who was in the Director General Resource and  
6       Plans job at the time, but that would be my  
7       interpretation of it, precisely that, that we -- our  
8       planning assumptions assumed a certain duration for  
9       a large scale deployment, and that, as soon as we  
10      exceeded that planning assumption, then there would be  
11      pressures on the overall structure. But I don't know  
12      whether you can add anything to that.

13   TOM MCKANE: What I can add is that we obviously, as we were  
14      going through the period that we have just been  
15      covering, were trying to get as good a sense as we could  
16      of what assumptions were being made by those who were in  
17      overall charge of planning the operation, and I can  
18      remember that it became -- it became apparent during  
19      that period that it was expected that there would be  
20      a substantial force retained in place for a period after  
21      the fighting had been concluded for a period of, say,  
22      some six months or so. This is what I remember; which  
23      would have obliged the UK to maintain something like  
24      a divisional-strength force throughout that period,  
25      drawing down to a lower force level thereafter. That in

1           itself would have constituted a breach, if you like, in  
2           the planning assumptions, and so that kind of  
3           information, I expect, also contributed to this  
4           paragraph.

5   SIR RODERIC LYNE:   So you have said you were trying to get  
6           a clear understanding from those who you say were in  
7           overall charge of the operation.  Does that mean the  
8           Prime Minister?  Is that why this is addressed to the  
9           Prime Minister?

10   TOM MCKANE:  No, what I meant was those in the coalition,  
11           across the coalition.  So the United States.

12   SIR RODERIC LYNE:  The United States?  What this minute is  
13           doing, in this part of the minute, is reminding the  
14           Prime Minister of the SDR rule book.  It is warning him  
15           that this is the assumption.

16   TOM MCKANE:  I think it is also -- you know, it is warning  
17           the Prime Minister that, in the event that a larger  
18           force has to be retained for a longer period than would  
19           have been allowed for under the planning assumptions, it  
20           would have repercussions for what we would have  
21           available should another contingency arise and I think  
22           that would have been a perfectly normal thing to advise  
23           the Prime Minister.

24   SIR RODERIC LYNE:  We will come back in due course to what  
25           actually ensued in terms of what is called here

1 "long-term damage to the armed forces".

2 Now, this minute was only sent, as I said, on the  
3 eve of the conflict, on 19 March. Why would this have  
4 been injected so late into the top echelon of our  
5 planning of this operation?

6 TOM MCKANE: I don't know the answer to that question, but  
7 I would speculate that the timing was related to the  
8 degree of understanding that -- the point at which  
9 people began to understand more fully what the  
10 expectation was of the -- what expectations there were  
11 of the length of time and the size of force that would  
12 be required to stay in Iraq.

13 SIR RODERIC LYNE: Did it reflect a dawning realisation, as  
14 the troops went into battle, of the pressure that this  
15 commitment was going to place on the armed forces  
16 overall?

17 TOM MCKANE: I really don't -- I don't think I can answer  
18 that question. I don't know what precisely lay behind  
19 the --

20 SIR RODERIC LYNE: What lay behind the words on the page.

21 In this -- I mean, you have said that there was an  
22 understanding that we might have to leave a division for  
23 six months there. How much thought, and how was it  
24 planned out, was given to the length and level of our  
25 commitment following the campaign phase? Was this

1 something that we could, as it were, peer into and make  
2 assessments about?

3 TOM McKANE: Well, I don't want to appear difficult about  
4 this, but the Resources and Plans staff at the time  
5 would not have been the team who were responsible for  
6 considering in detail the extent --

7 SIR RODERIC LYNE: No, but they had to, as it were, do the  
8 maths based on information given to them by other  
9 people.

10 THE CHAIRMAN: They were fully sighted, were they?

11 TOM McKANE: Yes.

12 SIR RODERIC LYNE: What was the information that they were  
13 being given? What were the assumptions that they were  
14 being told to work under about the post-conflict phase?  
15 Quick in and out? Medium length of time and then we can  
16 withdraw the bulk of our forces and move down to  
17 stabilisation, peacekeeping, whatever?

18 TOM McKANE: What I understood at the time was that we were  
19 likely to be there for some time. I can recollect in  
20 that period there being an assumption that this might  
21 last for a period of two to three years.

22 SIR RODERIC LYNE: Right. So that was the sort --

23 TOM McKANE: But drawing down by the end of it to a small --  
24 in our jargon -- small-scale contribution, which would  
25 have been at, in army terms, battle group strength.

1 SIR RODERIC LYNE: "By the end of it" meaning at the end of  
2 two to three years or at the end of six months?

3 TOM MCKANE: No, by the end of the two to three years.

4 SIR RODERIC LYNE: So the sort of pessimistic scenario or  
5 the realistic scenario was sort of two to three years?

6 TOM MCKANE: That's the one that I was aware of.

7 SIR RODERIC LYNE: Yes. Thank you.

8 What was seen as being -- coming a bit closer to  
9 this question of the long-term damage -- the impact on  
10 our armed forces if we weren't able to draw down our  
11 forces in the way that it was hoped?

12 TREVOR WOOLLEY: Yes. Well, I think -- one significant  
13 consequence was -- would be that the tour intervals for  
14 some of our armed forces, though that part of the armed  
15 forces that was most directly involved, would be less --  
16 in other words the operational tours would be more  
17 frequent than our planning assumptions mandated. So  
18 typically for the army, for example, the objective was  
19 to have a two-year gap between each six-month  
20 operational deployment.

21 The consequence of operating outside and above the  
22 planning assumptions was that it was not possible to  
23 achieve that tour interval and so, in particular parts  
24 of the army, soldiers found themselves deploying on  
25 operations more frequently than that planning

1 assumption.

2 So that was one and possibly the most apparent  
3 consequence of operating beyond the planning  
4 assumptions, and obviously there was a concern as well  
5 that that might have an impact on our ability to retain  
6 armed forces personnel and that that, in turn, could  
7 have a consequence on our ability to man the force  
8 structure. So those were the sorts of concerns there  
9 would have been.

10 Also, of course, as Mr McKane has said, the concern  
11 would be that we would not have the capability to  
12 undertake other operations if we continued to be  
13 committed at a very significant level to the Iraq  
14 operation for a long period.

15 SIR RODERIC LYNE: Something that has been described,  
16 I think, elsewhere, as the "engine having to run on hot  
17 for a long period" and also with negative impact on  
18 training as well as on rest, recuperation and indeed  
19 family life.

20 TREVOR WOOLLEY: Absolutely.

21 TOM McKANE: I think the training point is certainly right.

22 There was a real concern that the extent of the  
23 commitment would have meant that other forms of  
24 collective training, which would have been normally  
25 undertaken to prepare for other operations, weren't

1           being done to the extent that they would otherwise have  
2           been.

3   SIR RODERIC LYNE:   Did you have an input from the resources  
4           end to the decision-making over the size and scope of  
5           the UK's post-conflict role?

6   TREVOR WOOLLEY:   No.

7   SIR RODERIC LYNE:   You just received the instructions and  
8           did the maths, as I said earlier?

9   TREVOR WOOLLEY:   (Witness nods).

10   SIR RODERIC LYNE:   Once we got to the point where we knew  
11           what our post-conflict role was going to be, including  
12           in MND South East and so on, and we had taken  
13           responsibility as a joint occupying power for Iraq as  
14           a whole but with specific responsibility for the  
15           southeastern box, did that change the assumption that  
16           was being made about how long we were going to have to  
17           keep substantial forces deployed in Iraq? I'm really  
18           rolling this through now towards the autumn of 2003. At  
19           what point did we start to have to change our  
20           assumptions?

21   TOM McKANE:   I don't believe that we had changed our  
22           assumptions at that point, though, I think it is true to  
23           say that, by that stage, the subject wasn't occupying so  
24           much senior time inside the resources and plans  
25           community. There were well-established processes in

1 place by then. The reporting mechanisms for reporting  
2 costs to the Treasury and to Treasury ministers and our  
3 own ministers were in place. But, as I say, I don't  
4 believe that, at that point, we had formally made any  
5 change to assumptions about the length of time.

6 SIR RODERIC LYNE: Do you recall when it did become obvious  
7 and was, as it were, relayed to you as a changed  
8 assumption that we were going to need to stay beyond the  
9 two-to-three-year period?

10 TOM McKANE: I don't, no.

11 SIR RODERIC LYNE: As it became clear that we were there for  
12 longer, what was the overall effect of this on the  
13 financial planning and the force structure planning for  
14 our forces as a whole?

15 TREVOR WOOLLEY: Yes. I mean, the impact was perhaps rather  
16 less than one might expect. Clearly, in planning  
17 rounds, in planning the core defence programme, we were  
18 very mindful of the demands of the Iraq operation and,  
19 therefore, to the extent that we were looking for  
20 savings measures, as we frequently were, we would be  
21 very careful to ensure that those were savings that  
22 would not impact on our operations in Iraq, and I'm sure  
23 we did that and, quite clearly, the Defence Board, with  
24 the Chiefs of Staff sitting on it, would be very  
25 watchful to ensure that any savings that were proposed

1           wouldn't have that impact.

2           But, because the net additional costs of military  
3           operations was separate from the defence budget, because  
4           we were confident that urgent operational requirements  
5           that were needed in Iraq would be funded from the  
6           Reserve through the arrangements we had with the  
7           Treasury, my concern, as finance director, was much more  
8           about ensuring that we properly captured the net  
9           additional costs of military operations and that we had  
10          a process that worked, as we did with the Treasury, for  
11          the approval of urgent operational requirements.

12          My priority was there, rather than having to worry  
13          too much about what changes to plans in the core defence  
14          programme we needed to make in order to -- in order to  
15          accommodate the Iraq operation.

16          It was more a case, as I say, of ensuring that  
17          nothing we did in adjusting the core defence programme  
18          would have a negative impact on Iraq than in having to  
19          redirect the defence -- the core defence programme to  
20          accommodate the Iraq operation.

21   SIR RODERIC LYNE:   In effect, you reached a point where Iraq  
22          had become a constant part of your landscape.

23   TREVOR WOOLLEY:    Yes.

24   SIR RODERIC LYNE:   You were then having to plan the rest of  
25          the core programme around it so that it didn't intrude

1 on it and you could keep the two things in parallel?

2 TREVOR WOOLLEY: Yes, I think that's true, broadly.

3 SIR RODERIC LYNE: Thank you.

4 THE CHAIRMAN: Usha, on to UORs.

5 BARONESS USHA PRASHAR: Yes, indeed. I want to talk about  
6 pre-invasion UORs. The purchase of UORs was a key part  
7 of thinking throughout the planning. At what stage did  
8 you begin to have discussions with the Treasury  
9 officials about the potential cost of the package, and  
10 were there any problems with the funding of pre-invasion  
11 UORs?

12 TOM McKANE: I was the person who was responsible for that  
13 at the time. We were involved in discussions with the  
14 Treasury about this almost from the moment I took up my  
15 appointment in September 2002.

16 As I said, earlier, those discussions involved  
17 estimates of what might be required by way of urgent  
18 operational requirements as well as the other costs --  
19 the other extra costs which might arise.

20 BARONESS USHA PRASHAR: Were there any problems with the  
21 funding of pre-invasion UORs? Because Gordon Brown told  
22 us that he discussed this with the Defence Secretary in  
23 September 2002.

24 TOM McKANE: There were discussions at ministerial level and  
25 those were both, I think, preceded by and followed by

1 much more detailed discussions between officials --  
2 between officials at the Ministry of Defence and the  
3 Treasury, and the -- those led to an estimate of what --  
4 of what types of things we might need and there were  
5 certain categories of urgent operational requirements  
6 which it was agreed we should begin to procure because  
7 of the timescales that would be involved in having them  
8 delivered, it meant that we would need to start, and  
9 that agreement was reached in the October of 2002.

10 As you will know from the papers, the agreement that  
11 was reached was to provide money from the Reserve in  
12 tranches to pay for UORs and so we first were -- there  
13 was agreement in the first instance to 150 million. It  
14 was followed, not all that long afterwards, by an  
15 additional 150 million and then 200 million on top of  
16 that.

17 At the same time, we were beginning to discuss the  
18 need to spend money on logistics, sustainability issues,  
19 which, in the first instance, were to be contained  
20 within the estimates and the caps that were being placed  
21 on each tranche for commitment to urgent operational  
22 requirements and, as the preparations for the operation  
23 proceeded, and the -- the scale of the financial  
24 commitment began to ramp up, those arrangements  
25 developed to the point where, by the early part of 2003,

1       there were -- there were -- there was a ú500 million pot  
2       for urgent operational requirements, but there was also  
3       by then money available for all the other costs of the  
4       preparations for the -- for the operation, which --  
5       which Mr Mann has referred to before.

6   BARONESS USHA PRASHAR:   So you would say you were satisfied  
7       with the relationship with the Treasury and way they  
8       responded to the requests, both from timing and the way  
9       they responded to the requests made?

10   TOM McKANE:   Overall, I would.   Inevitably in these kind of  
11       circumstances there is an anxiety and a concern on the  
12       part of the Ministry of Defence to get on with things  
13       and the -- and it did take a month or so after my first  
14       engagement in this for the agreements to be reached to  
15       start to commit money to these urgent operational  
16       requirements.

17       But thereafter, the process operated smoothly.  
18       There were some, I think, who were probably frustrated  
19       at the fact that there were -- that we were given  
20       tranches of money, but it was -- and I can remember that  
21       we would get quite quickly to the point where we had  
22       exhausted the first tranche and were then involved in  
23       the preparation of ministerial correspondence to secure  
24       the release of the next tranche, but I think that's --  
25       that was understandable in the circumstances.

1 BARONESS USHA PRASHAR: Just on my understanding, if you  
2 wanted access to the next tranche of money, you had to  
3 start the negotiations again?

4 TOM McKANE: We had to secure Treasury ministers' agreement  
5 to begin to commit to a new tranche of expenditure.

6 BARONESS USHA PRASHAR: That's what you say was causing  
7 frustration?

8 TOM McKANE: It would cause some frustration, because people  
9 would be anxious that we were going to get to the point  
10 where we had exhausted the first tranche before we had  
11 agreement to move into the next one, but I don't  
12 remember it being a major obstacle to the preparations.

13 BARONESS USHA PRASHAR: Now, the NAO report in 2004 reported  
14 that 34 per cent of all UORs for the invasion were to  
15 fill the already identified capability gap, which the  
16 MoD hadn't been able to fund through its equipment  
17 programme.

18 Were you surprised at the volume of UORs that the  
19 MoD had to procure for this operation?

20 TOM McKANE: I don't remember being surprised particularly  
21 about that. What we were focused on was the fact that,  
22 if there was going to be an operation, we needed to make  
23 sure that the -- that all the equipment that was going  
24 to be needed had been put in place, as far as we  
25 could -- as far as we could do that, and so the focus

1 was on what it was that was needed, rather than on  
2 questions about whether it ought to have been there  
3 through the -- and provided through the core budget.

4 BARONESS USHA PRASHAR: But the fact that there was so much  
5 reliance on UORs -- you know, 34 per cent is quite  
6 a large number -- did that mean that the equipment  
7 programme was not ready to deliver the capabilities that  
8 were envisaged for the expeditionary --

9 TOM McKANE: It meant that the equipment programme didn't --  
10 hadn't produced those particular items which were being  
11 procured through urgent operational requirements. That  
12 doesn't necessarily mean that there was anything wrong  
13 with the process that was being followed and I honestly  
14 can't say whether 34 per cent is, you know, a high  
15 percentage or a low percentage in the overall scheme of  
16 things.

17 BARONESS USHA PRASHAR: But did it not restrict your ability  
18 to move with speed?

19 TOM McKANE: Well, I think, you know, you need to ask the --  
20 those who were responsible for running the operation  
21 rather than me that question, and I believe that there  
22 were again -- as I have said, there was frustration that  
23 not as much was available immediately. But the process  
24 itself for procuring these requirements, you know,  
25 worked pretty well, I think.

1 BARONESS USHA PRASHAR: So from your point of view, you were  
2 more concerned with actually getting the job done rather  
3 than at which point it was coming from?

4 TOM McKANE: Absolutely.

5 TREVOR WOOLLEY: I think if I might add on this point, one  
6 of the problems with the equipment programme is that it  
7 is a bit of a supertanker. In the short-term, and even  
8 in the medium-term, there is a very high level of  
9 contractual commitment.

10 As I think the Chief of Defence Staff said in his  
11 evidence, there is a problem of agility in the equipment  
12 programme. It is quite difficult to change direction in  
13 response to new priorities because so much is committed  
14 and that which is not committed is often what is your  
15 highest priority, because it is the new programmes that  
16 are just coming onstream and, when you are under  
17 resource pressure and have to make savings in the  
18 short-term, you tend to go to what is not contractually  
19 committed, because if you try to cancel contracts, you  
20 incur charges which negate the savings you are looking  
21 for.

22 So I think in response to your implication that it  
23 is slightly puzzling that we had to acquire through UORs  
24 quite a high proportion of what might have been expected  
25 to come from the equipment programme, part of the

1 explanation, I think, is in the lack of agility to  
2 change the equipment programme in the short-term, for  
3 the reasons I have outlined.

4 BARONESS USHA PRASHAR: It is agility and inflexibility?

5 TREVOR WOOLLEY: Exactly.

6 BARONESS USHA PRASHAR: Okay.

7 THE CHAIRMAN: Thank you. Lawrence, over to you.

8 SIR LAWRENCE FREEDMAN: We are going to discuss the impact  
9 of resource accounting and budgeting. Now, there are  
10 a number of issues here for stocks, UORs and overall  
11 defence spending, and we will come on to these in turn.  
12 But it would be helpful, perhaps, if you could just  
13 briefly describe the underlying principle behind the  
14 move to resource accounting and budgeting and in broad  
15 terms its relevance for the Ministry of Defence?

16 TREVOR WOOLLEY: Okay. Well, this was a major government  
17 initiative launched in the late 1990s. Up until that  
18 time or up until -- for some time afterwards, government  
19 departments were set budgets in cash, cashflow, the  
20 actual money out of the door on a particular day was  
21 what was brought to account.

22 This, of course, was not the way accounts are  
23 produced in the private sector. It is not the way  
24 commercial accounts are produced. I think a major  
25 driver for the introduction of resource accounting and

1 budgeting was in a sense reputational, that the  
2 government felt that it could not be regarded as  
3 professional in its management of its finances if it was  
4 operating on what was a rather -- a rather crude method  
5 of accounting, rather than the more sophisticated  
6 accounting methods used in the commercial world.

7 I think government also felt that it was difficult  
8 to defend the situation in which, for example, it didn't  
9 know the value of assets it held, as it didn't before  
10 the introduction of resource accounting and budgeting.

11 So the drive was, in the first instance, to  
12 introduce resource accounting so that we would produce  
13 accounts on a comparable basis to commercial  
14 organisations. Of course, it couldn't be truly  
15 comparable because the essence of a commercial  
16 organisation is that one is interested in whether it is  
17 making a profit or a loss, whereas with a government  
18 department, what you are interested in is whether it is  
19 controlling its expenditure, however defined, within the  
20 limit that Parliament, and indeed the Treasury, has set  
21 for that government department.

22 So the main driver, was, I think, to -- both  
23 reputational and a sense that we needed to be more  
24 professional in this regard.

25 The biggest impact was in relation to the holding of

1 assets and the biggest impact in government was,  
2 therefore, on the Ministry of Defence because the  
3 Ministry of Defence held a greater value, volume and  
4 variety of assets than any other government department.

5 So the first phase of the introduction of resource  
6 accounting, which was in the late 1990s and extending  
7 into the last decade, for the Ministry of Defence  
8 focused on, first of all, creating an asset register,  
9 actually registering the assets we owned. It then  
10 focused on valuing all those assets, so that we could  
11 create a balance sheet. That was the first objective.

12 The next impact was to reflect the cost of those  
13 assets on our operating accounts, which effectively  
14 meant that we had to depreciate those assets in order to  
15 present the costs of depreciation in our operating  
16 statement accounts, and this was a very major and  
17 complicated exercise. In particular, it was complex  
18 because we had, of course, on our balance sheet, a lot  
19 of fighting equipment. That's what we are about. There  
20 is no comparator in the commercial world to holding  
21 stocks of weapons, tanks, ships and so -- warships and  
22 so forth.

23 So we had to calculate and present in our accounts  
24 the depreciation costs of these assets, which meant  
25 valuing them, lifing them -- what was the life we were

1 expecting of them -- and so forth.

2 There were also complications involved when we  
3 changed the lives of equipments or revalued equipments  
4 or revalued assets.

5 The next phase was the introduction of resource  
6 budgeting, whereby this new regime applied, not simply  
7 to how we presented accounts to Parliament, but also to  
8 the way we were controlled: what the definition of, in  
9 the jargon, the departmental expenditure limit was.

10 There are a number of dimensions to this. First of  
11 all, there was a distinction between capital expenditure  
12 and operating expenditure, which became known in the  
13 jargon as resource expenditure; and the limit as RDEL,  
14 resource departmental expenditure limit, and there was  
15 the capital budget which had its own separate  
16 departmental expenditure.

17 Then there was the need to budget and account  
18 against the budget for the RDEL element and, in the  
19 first phase, a distinction was made between those  
20 elements of resource expenditure that were related to  
21 cash expenditure and those elements of resource  
22 expenditure that were related to the holding of assets  
23 and were not related to cash expenditure.

24 This led to the distinction between the so-called  
25 near cash resource spend and non-cash resource spend.

1 Near cash resource spend was different from  
2 old-fashioned cash, because you accounted for near cash  
3 resource spend at the point you got beneficial use from  
4 that spend, rather than from the point you actually  
5 signed the cheque or had the cheque cashed.

6 So, for example, if a service was delivered in March  
7 but, for whatever reason, the cheque for that service  
8 was paid in April, under the old cash system you would  
9 account for the expenditure relating to that service  
10 in April; under the new resource system, even though you  
11 didn't pay for it until April, you got the benefit of it  
12 in March and, therefore, you accounted for it in March.

13 That was the difference between the so-called near  
14 cash and cash.

15 From 2000 until 2002, the non-cash resource spend  
16 was outside the departmental expenditure limit. It was  
17 known -- again, more jargon, I am afraid -- as annually  
18 managed expenditure. The Treasury planned, announced  
19 and set the rules for the spending review 2002 on the  
20 basis that there would be a change from what was called  
21 phase 1 RAB to phase 2 RAB, in which the non-cash  
22 resource spend would come within the departmental  
23 expenditure limit for government departments. It would  
24 be moved out of that AME category, where it was not  
25 subject to control, not subject to a budgetary limit,

1           into the DEL category, where it was subject to  
2           a budgetary limit.

3   SIR LAWRENCE FREEDMAN:  What sort of things would be covered  
4           under AME?

5   TREVOR WOOLLEY:  Well, in the context of this, the main  
6           elements were depreciation of assets, the write-off of  
7           assets, the write-off of stock and there was also, in  
8           those days, a capital charge on our assets, so the value  
9           of the assets on our balance sheet attracted a capital  
10          charge of, I believe, at that time, 6 per cent and  
11          subsequently reduced to 3.5 per cent, which appeared in  
12          our accounts.

13   SIR LAWRENCE FREEDMAN:  Thank you very much for that, and  
14          congratulations.  It is not an easy thing to make clear  
15          and I think you did a very good job.

16                 If we then take it from there -- and from what you  
17          said at the end -- is it fair to say that the incentive  
18          that this created was to get down your levels of stocks?

19   TREVOR WOOLLEY:  Yes.  There was an incentive to reduce  
20          stock levels, because -- and again, just -- I'm sorry to  
21          make this complicated, but we -- some stocks --

22   SIR LAWRENCE FREEDMAN:  I don't think you made it  
23          complicated --

24   TREVOR WOOLLEY:  It is kind of you to say so.

25   SIR LAWRENCE FREEDMAN:  -- I think it is complicated.

1     TREVOR WOOLLEY:  It is complicated.  There were capital  
2         stocks and they were subject to depreciation like other  
3         assets, and then there were consumable stocks, which  
4         were not depreciated but which still attracted a cost or  
5         capital charge because they are on the balance sheet,  
6         and so there was, in that sense, an incentive to reduce  
7         our stocks and that was -- you know, that was part of  
8         the purpose of the system; it was to encourage you to  
9         dispose of assets that you didn't actually need.

10    SIR LAWRENCE FREEDMAN:  If we go back to the previous  
11         discussion and the balance between existing stocks and  
12         UORs -- and this was something, I think, that was  
13         commented on by the Defence Select Committee in its 2004  
14         report -- was there a risk here that stocks could be  
15         reduced too far?

16    TREVOR WOOLLEY:  Well, there was a risk, but I'm not sure  
17         that I'm aware of any evidence that this risk actually  
18         manifested itself.  Yes, we put pressure on the  
19         Logistics Organisation to reduce their stock holdings  
20         during this period and there was an enormous amount of  
21         scope, I might say, for doing so, because there were an  
22         awful lot of spare parts that we were holding for  
23         equipments that were no longer in service, for example,  
24         and there had previously been little incentive for  
25         people to go through their warehouses and dispose of

1 this.

2 I'm not aware of any example -- and I'm sure it  
3 would have been persuaded if there had been such  
4 examples -- of people saying, "Well, we did have this  
5 item that they are now asking for in Iraq two years ago  
6 but we disposed of it because we were told we had to get  
7 our stock levels down".

8 SIR LAWRENCE FREEDMAN: But in general, would you say -- and  
9 the others may join in -- that there was -- the planning  
10 guidance for stocks was respected through these sorts of  
11 adjustments?

12 TREVOR WOOLLEY: Yes. I mean, we never suggested that,  
13 because of RAB, we should get rid of things that we  
14 thought we would need in the future. We were conscious  
15 that we had in our warehouses a lot of stocks, spares,  
16 that we couldn't possibly need in the future because  
17 they related to equipments that had gone out of service  
18 and our focus was on reducing them.

19 I'm not aware -- I mean -- or let me put it more  
20 positively: I don't believe that anybody in our  
21 Logistics Organisation would have felt under pressure to  
22 dispose of items that were relevant to the force  
23 structure that was then in place and which needed to be  
24 supported.

25 SIR LAWRENCE FREEDMAN: Would it be fair to say that this

1 encouraged the move to what has been called "just in  
2 time" procurements and logistics?

3 TREVOR WOOLLEY: Yes, and I mean, I think that this, as  
4 a principle, was a perfectly legitimate and proper  
5 approach to logistics support.

6 SIR LAWRENCE FREEDMAN: But there is clearly always a risk  
7 with "just in time" that it might turn out to be just  
8 a little late, and that might be more so when, as we  
9 know with Operation Telic, the planning time was not as  
10 long as the commanders would have wished.

11 So was it the case that this pressure for "just in  
12 time" with logistics added to the pressure on the whole  
13 UOR system and did create a risk of some delays?

14 TREVOR WOOLLEY: I can't answer that in detail. I think you  
15 are taking evidence in the future from those more  
16 directly engaged in the logistics process and I think  
17 they would be better equipped to answer that question.

18 I accept that there must have been some risk. All  
19 I can say was I'm not aware of that risk manifesting  
20 itself, but I don't know -- I mean, Bruce --

21 BRUCE MANN: Mr Woolley said that the introduction of  
22 resource accounting and budgeting was a very, very long  
23 process. It was. I was engaged in it myself within the  
24 Logistics Organisation in 1997 and 1998 and it even  
25 started, I think, in 1994. When exactly these issues

1       were being debated. We, I think, need to factor into  
2       this two cross-checks, if I can put it like that.

3               First the desk officers who were responsible for  
4       supporting particular pieces of equipment -- they were  
5       the experts in doing all the calculations -- had the  
6       defence planning assumptions. Those had first been  
7       created in the mid-1990s.

8   THE CHAIRMAN: Can you slow down a bit?

9   BRUCE MANN: Sorry. They had the defence planning  
10       assumptions which had been created in the mid-1990s and  
11       they could do their own cross-checks against the  
12       assumptions on endurance, concurrency and so on.

13               Secondly, in the -- at the turn of the decade, we  
14       were introducing inside the Ministry of Defence  
15       performance measurement arrangements about our force  
16       elements -- to use the jargon -- and how ready they  
17       were, which included a measure on sustainability that  
18       was beginning to be introduced. Again, that was  
19       producing reports from the Logistics Organisation on  
20       a whole range of quality issues, but one of those  
21       components was logistics sustainability.

22               So I wouldn't want you to rest on the assumption  
23       that there was only one force in play here and it was  
24       resource accounting; there were other checks and  
25       balances inside the system.

1 SIR LAWRENCE FREEDMAN: But I mean, just to take one  
2 example, desert clothing, which has been cited as an  
3 example of something which may have seemed a bit  
4 superfluous at one point, and then, all of a sudden, it  
5 becomes extremely important again and there were clearly  
6 problems in getting that to troops.

7 BRUCE MANN: No, I really wouldn't take that one: (a)  
8 because we had already fought one war in the desert;  
9 and, secondly, because we had a major exercise in the  
10 desert. Not very long before.

11 SIR LAWRENCE FREEDMAN: So we have to look somewhere else  
12 for the reason why?

13 BRUCE MANN: Yes. In the particular context of desert  
14 clothing, yes, I think you would. The incentives inside  
15 the system and the planning assumptions from the  
16 mid-1990s -- and I was personally engaged in writing  
17 them -- had that particular region as being one of the  
18 higher probability regions within which the armed forces  
19 might have to deploy.

20 SIR LAWRENCE FREEDMAN: So we need to explore further why  
21 that was a problem. Just finally -- I think we probably  
22 then will need to take a break -- in MoD's "First  
23 Reflections" report on Telic, it was stated:

24 "This is the first major operation to be costed  
25 under full resource accounting and budgeting principle,

1       which created some additional challenges for finance  
2       staff."

3               I'm just interested to know what those challenges  
4       were.

5   TREVOR WOOLLEY:  Well, I mean, the -- there were challenges  
6       in particular about measuring stock consumption in  
7       theatre.  One of the changes for -- that resulted from  
8       resource accounting and budgeting was that, whereas  
9       under the previous cash regime you accounted for  
10      consumable stock, like bullets, when you purchased them,  
11      under resource accounting and budgeting you accounted  
12      for them when you consumed them, ie when you fired them.

13              Therefore, in order properly to capture the costs of  
14      the operation, we needed to capture what stock had been  
15      consumed on the operation.

16              Now, unsurprisingly, this was not the top priority  
17      for those who were deployed on the operation and it was,  
18      therefore, quite difficult to get accurate data on this.  
19      And -- I mean, as the operation endured, we put in more  
20      and more processes to make this better, but certainly,  
21      to start with, that was a particular difficulty.

22              I don't know, Bruce, whether any others --

23   BRUCE MANN:  Yes, I think this broke down into two parts, if  
24      I can just pick up what Mr Woolley said.  It would be  
25      immediate consumption and how you came to it.  That was

1       certainly a challenge. In fact, we invited a curious  
2       group of people, who are the army's management  
3       accountants -- they wear uniform, but they are  
4       accountants -- to go and check what we had done --  
5       sorry, what the commanders in the fields had done in  
6       terms of logging and costing and so on, which we did on  
7       behalf of the National Audit Office because they wanted  
8       to audit that part of our accounts, possibly the whole  
9       of our accounts, and we were actually, in the end,  
10      reassured that the processes had worked actually quite  
11      well and probably surprisingly well, given that, as  
12      Mr Woolley has said, the commander's focus would have  
13      been on other things. That's one half of the equation.

14             The second half of the equation -- which turned out  
15      all right in the end. The second half of the equation  
16      was much more complex, which was more judgmental. So if  
17      I take a Tornado aircraft, flown very hard in Iraq, much  
18      harder than it would have been flying around British or  
19      German aerospace and, therefore, would have brought  
20      forward its major servicing, engine servicing and so on,  
21      costs, making some kind of judgment downstream well  
22      after the fighting phase, as to how much of that  
23      faster -- the servicing that was required sooner could  
24      be attributed to Iraq and how much was normal wear and  
25      tear, was very much more judgmental, affected a very

1 wide range of assets from Land Rovers all the way to  
2 some esoteric equipment, that was much, much, much more  
3 complex, but of course, we had to try to do it because  
4 inside there is a net additional cost of a military  
5 operation, which we have got to try to pull out for the  
6 Treasury.

7 I would say, although we worried about that first  
8 half that I described, the consumption half, at the  
9 time -- and you may have seen notes from me try to  
10 gather that -- actually, we came out okay in the end.

11 The second half proved much more, to use the  
12 language -- much more of a challenge for finance staff  
13 once we got into the post-conflict phase.

14 SIR LAWRENCE FREEDMAN: I think we will come back to that  
15 a bit after the break.

16 THE CHAIRMAN: Yes. Let's break for ten minutes.

17 (11.30 am)

18 (Short break)

19 (11.40 am)

20 THE CHAIRMAN: We need to go further into the resource  
21 accounting and budgeting woods, so, Lawrence, would you  
22 like to resume?

23 SIR LAWRENCE FREEDMAN: You mentioned a couple of issues  
24 before the break. Can I ask you now about another one,  
25 which is UORs? Before the invasion, had you reached an

1 agreement on how the costs of UORs would be treated  
2 under resource accounting and budgeting?

3 TOM McKANE: We had a series of what were, in the end,  
4 slightly inconclusive discussions about the treatment of  
5 UORs. I can remember at the time arguing that if UORs  
6 were to be treated under the new resource accounting and  
7 budgeting rules, that would mean potentially that  
8 either, when they were written off at the end of the  
9 operation, there would be a cost which would arise in  
10 the accounts or, if they were brought into the -- into  
11 the core -- and taken on to the MoD's core programme,  
12 there would be some continuing costs of depreciation and  
13 capital charges that would have to be taken into  
14 account, and I sought to get the agreement of the  
15 Treasury that there should be some relief on both those  
16 counts.

17 The -- and the negotiations, as far as I can  
18 remember, were never concluded before the -- before the  
19 campaign came into --

20 BRUCE MANN: We had -- as Mr McKane has said, we had to have  
21 several conversations in some cases on the esoteric  
22 detail, working through some worked examples. I do  
23 recall -- I would need to refresh my memory -- but  
24 I issued a note just before the campaign started which  
25 said -- a reminder of the rules of costing. That

1 included resolution of one of the issues to which  
2 Mr McKane has referred, which is, to the degree that  
3 equipment was written off in theatre, how it should be  
4 charged to the operation and so on.

5 It included an important principle, which we had  
6 secured with the Treasury, which was that we wouldn't  
7 look at this issue through an accounting optic because  
8 that would just encourage people in playing games,  
9 playing financial games, but we would make a judgment  
10 on, in the longer term, what we should do with equipment  
11 bought through UORs on operational utility and value for  
12 money grounds and the accounting would follow, if you  
13 see what I mean. That, to me, was an important point of  
14 principle which I thought worth recording at the time.

15 SIR LAWRENCE FREEDMAN: So in practice, therefore, how did  
16 the acquisition of the UORs affect the core defence  
17 budget in terms of what you were deciding to keep? Was  
18 it -- in practice, has it been managed in the sensible  
19 not too accounting way you suggested?

20 TREVOR WOOLLEY: Yes, I think it has, because we had  
21 particular -- we had particular concerns about  
22 depreciation costs of UORs at this time because we were  
23 expecting to move to a regime in which the non-cash  
24 costs were integral to the budget and, therefore, if you  
25 like, there was an opportunity cost for every non-cash

1 cost you incurred.

2 When, after the events of the autumn of 2003, we  
3 effectively reverted to a budgetary control regime which  
4 was the status quo ante-- that is to say one in which  
5 non-cash costs were separated out again -- under that  
6 regime the depreciation costs of UORs no longer became  
7 an issue for us.

8 What became an issue for us was whether we decided  
9 to retain UORs in service after the completion of the  
10 operation because, under those circumstances, we would  
11 incur in the main defence programme the running costs --  
12 the cash running costs of those UORs and what we have  
13 had to do in each case is make a judgment after the  
14 conclusion of a campaign for which a UOR was  
15 specifically acquired, whether we wished to take that  
16 UOR into the inventory and accept the costs or not.

17 Now, generally, for most UORs, the running costs are  
18 sufficiently marginal, when taken against the main  
19 defence budget, and the utility of the UOR is such that  
20 it might well be of relevance to other operations that  
21 we have chosen to do so, but not in all cases, and we  
22 make a judgment on each occasion.

23 SIR LAWRENCE FREEDMAN: I think the procedures for funding  
24 UORs were altered under the comprehensive spending  
25 review settlement in 2007. Is that correct?

1     TREVOR WOOLLEY:  Yes.

2     SIR LAWRENCE FREEDMAN:  If so, what were those sorts of  
3       changes?

4     TREVOR WOOLLEY:  Well, the change in 2007 was intended to  
5       give a little bit greater certainty to the Treasury of  
6       what the UOR bill was likely to be and it was  
7       effectively an attempt to incentivise us to forecast in  
8       advance what the UOR spend in a particular year -- in  
9       the forthcoming year would be.

10       So the arrangement was that we would agree with the  
11       Treasury what the likely UOR bill in the forthcoming  
12       year would be.  If, in the eventuality, that amount were  
13       to be exceeded, the Treasury would still pay for the  
14       UORs when the cost was incurred, but -- and I'm dragging  
15       back my memory here -- I think the arrangement was that  
16       50 per cent of the cost above that forecast would be  
17       claimed back by the Treasury from the  
18       Ministry of Defence budget three years later.  I think  
19       that was the arrangement.

20       That was the position that was agreed in 2007 and  
21       which had begun to be implemented in 2008, during my  
22       last period as finance director.  It may be that things  
23       have moved on a little bit since I ceased to be finance  
24       director on that, I don't know.

25     SIR LAWRENCE FREEDMAN:  But presumably that would have more

1 impact on Afghan operations.

2 TREVOR WOOLLEY: Absolutely. That was purely an  
3 Afghanistan-related issue.

4 SIR LAWRENCE FREEDMAN: Because, by that time, Iraq was  
5 making fewer demands on you?

6 TREVOR WOOLLEY: Yes.

7 SIR LAWRENCE FREEDMAN: Okay. You have mentioned already  
8 the issue that arose in September 2003. You have also  
9 given us a definitive explanation of the differences  
10 between cash, near cash and non-cash, which are not  
11 terms that are readily used by non-accountants. But  
12 I think this is a very -- obviously this particular  
13 issue has come to take up a certain amount of time of  
14 the Inquiry and I think we do really want to try to  
15 establish now what actually happened and the  
16 implications of what happened.

17 Sir Kevin Tebbitt told us that the differences that  
18 developed between the Ministry of Defence and the  
19 Treasury during the course of 2003 led in September to  
20 the Chancellor, Mr Brown, instituting a complete  
21 guillotine on the settlement, referring to the 2002  
22 spending review settlement.

23 Gordon Brown described the outcome somewhat  
24 differently, saying that the Ministry of Defence  
25 actually ended up with a higher budget than was

1 originally proposed in the spending review. Perhaps to  
2 get through this story we could just start by -- perhaps  
3 you could explain how the issue arose in the first  
4 place.

5 TREVOR WOOLLEY: I'll, if I may, give a little general  
6 background because I think it did emerge out of spending  
7 review 2002, which I was at the centre of. The actual  
8 dispute emerged when I was temporarily out of the  
9 Ministry of Defence headquarters and Mr McKane was doing  
10 my job. So I'll pass to have him in a moment, if I may.

11 The background was the fact that it had been  
12 advertised that spending review 2002 would be conducted  
13 on a RAB stage 2 basis. That is to say that the  
14 non-cash element of resource expenditure would be  
15 brought in from outside the budgetary structure into the  
16 budgetary structure and, therefore, that there would be  
17 both an opportunity and a cost, depending on how high  
18 your non-cash costs were within the budget.

19 As far as we were concerned, the spending review  
20 process instructions were quite clear on this, that  
21 there would be a single resource budget. It is,  
22 I think, significant that the papers which went to the  
23 Ministerial Committee, which examined the  
24 Ministry of Defence's spending review bid, for want of  
25 a better word, in May 2002, expressed all the financial

1 numbers on that full stage 2 resource accounting basis.

2 The settlement letter that the Chief Secretary sent  
3 to the Secretary of State in July 2002 presented all the  
4 figures on a full stage 2 RAB basis. As something of an  
5 aficionado of Treasury settlement letters, having been  
6 involved in four successive spending reviews, I can say  
7 that they tend to be rather punctilious in instructing  
8 departments as to what they may or may not spend  
9 different elements of departmental budget they have been  
10 granted in the settlement on.

11 This settlement letter made no reference to there  
12 being a separate limit on the non-cash element of the  
13 overall resource budget.

14 There was a reference in annex E on the settlement  
15 letter which said:

16 "In order to allow a reconciliation back to previous  
17 plans, and for use in presentation, the table below  
18 gives an estimate of the cash spending associated with  
19 these plans."

20 Now, that was designed in order to make a comparison  
21 of what one might expect the spending power of the  
22 budget to be following the settlement compared with the  
23 spending power of the budget previous to the settlement,  
24 given that the currency had changed.

25 So we made the assumption that there was no separate

1 limit within our budget for non-cash, that we were to  
2 regard all resource budget as available for whatever  
3 resource purpose it was required and, in the planning  
4 round which followed the settlement, we planned on  
5 a full resource basis without making the distinction  
6 between non-cash and near cash spend.

7 SIR LAWRENCE FREEDMAN: Just in practice, that meant that  
8 you could, by drawing down your stocks, and so on,  
9 you -- bearing down hard on your assets, you would be  
10 able to move into other forms of cash expenditure?

11 TREVOR WOOLLEY: That is true. That is true. But --  
12 I mean, I think what I ought to say is that -- and,  
13 again, I will defer to Mr McKane in a moment. But what  
14 I ought to say is that these non-cash numbers remained  
15 extremely volatile over this period and, for example, if  
16 I take the four years of Ministry of Defence accounts  
17 from 2001/2002 to 2004/2005, the depreciation and  
18 amortisation that we -- that appeared in our accounts  
19 varied from 6.1 billion, 7 billion, 5.7 billion,  
20 6.1 billion.

21 So there were quite substantial variations year on  
22 year and this was not the consequence primarily of  
23 actions we took to change the way we did our business;  
24 rather, they reflected, for example, revaluations. We  
25 did periodic revaluations of our assets, and the

1 consequence of a revaluation on the depreciation that  
2 resulted could be quite significant.

3 It depended on the amount of write-offs of assets or  
4 stocks that took place during that year. It depended  
5 on, for example, changes in the in-service dates of  
6 equipments, if you were planning the in-service date of  
7 a new and expensive equipment in a year's time, you  
8 would need to make in your forward plans provision for  
9 the depreciation of that equipment when it entered  
10 service, but if the equipment in service date slipped by  
11 a year, you would no longer incur the depreciation  
12 charge related to that new equipment.

13 So my general point is that there were a large  
14 number of variations that -- or a large number of  
15 external factors, not, if you like, directly within the  
16 control of the planning community, that led to these  
17 figures being quite volatile.

18 SIR LAWRENCE FREEDMAN: One of the figures you gave was  
19 7 billion. Which year was that?

20 TREVOR WOOLLEY: That, I think, was in 2002/2003.

21 SIR LAWRENCE FREEDMAN: In terms of volatility, that is the  
22 one that stands out in the numbers you have given us.

23 TREVOR WOOLLEY: Indeed.

24 BRUCE MANN: If I may add to that, another good example,  
25 which I think demonstrates the various factors in play

1 here was -- I refreshed my memory on this last night --  
2 a note which you may have seen from the then finance  
3 director to the Defence Secretary, enticingly entitled  
4 "The Biggest Increase in the Defence Budget Ever", just  
5 before -- as it happens, just before we got into the  
6 conflict phase in Iraq.

7 That had a £12.5 billion increase in the defence  
8 budget, going through supplementary estimates in the  
9 jargon, of which £1.8 billion was cash, some of it was  
10 for Iraq and other things. But if I read some of the  
11 other numbers, £6.6 billion was for asset revaluation on  
12 the basis of a five-year revaluation required by  
13 accounting rules. £2.9 billion was write-off, and  
14 £1.8 billion were changes in provisions made for future  
15 eventualities. So the numbers there are colossal and  
16 two things are going on inside there.

17 First, even under normal accounting in steady state  
18 operations, there are routine revaluations and so on and  
19 those have to be reflected in the books and in  
20 a department with an asset base the size of the  
21 Ministry of Defence, those can have a very material  
22 effect.

23 Secondly, at that time, the Ministry of Defence had  
24 accounts which were heavily qualified by the Controller  
25 and Auditor General as being not -- in many areas, not

1 materially accurate. That's not something that affected  
2 cash. We had been doing cash accounting and auditing  
3 for 300 years. So we could do that. The areas where we  
4 were not good enough, in the view of the auditors, were  
5 on the asset base and, hence, in the non-cash.

6 So inside the numbers I have just described to you  
7 are corrections because our accounts -- the quality of  
8 our accounts was still being improved and routine  
9 revaluations. As I say, it gives you an idea -- and  
10 I go back to Mr Woolley's word "volatility" -- it gives  
11 you a sense, I hope, of the volatility inside the  
12 numbers at that time.

13 SIR LAWRENCE FREEDMAN: We obviously need to move the story  
14 forward a bit, but did the Treasury see it coming then  
15 in terms of the biggest defence budget increase ever?

16 BRUCE MANN: Yes. We had been having a debate for many,  
17 many years, to my certain knowledge, with the Treasury  
18 to try to understand this volatility and, actually, you  
19 may have seen paperwork in the run-up to spending review  
20 2002 with a long stream of questions from the Treasury  
21 which we tried to answer on exactly this subject. We  
22 provided some worked examples. "What happens if ... how  
23 many Tornados do you lose each year because they crash?  
24 What's the impact on impairments, faster write-downs and  
25 so on?"

1           So there had been a long, long process which tried  
2           to capture this. Inside the spending review 2002, the  
3           paperwork underneath it all, was something called the  
4           forecast balance sheet assessment which is trying to  
5           understand the way in which a balance sheet might evolve  
6           and how changes in the balance sheet might affect the  
7           budgeting numbers. That had been a routine process for  
8           a very substantial period.

9   SIR LAWRENCE FREEDMAN: When did you first get a sense that  
10          the Treasury were getting alarmed at the cash  
11          implications of the way that the Ministry of Defence was  
12          handling this?

13   TREVOR WOOLLEY: I think Mr McKane should take over at this  
14          point.

15   TOM MCKANE: Well, I think the first thing to say about this  
16          is that, as Mr Woolley has said, when we were conducting  
17          the planning round in the autumn and winter of  
18          2002/2003, we were doing so on the basis of the  
19          instructions in the -- in the spending review 2002  
20          settlement letter. So we were -- we were conducting the  
21          planning round on the basis of full resource accounting  
22          and budgeting stage 2 resource accounting and budgeting.

23          The -- the focus was therefore on whether the --  
24          whether, at the end of that planning round, we were able  
25          to say that we had a programme which balanced with

1 the -- both the capital budget, on the one hand, and the  
2 resource budget -- the resource budget, by that stage,  
3 not differentiating between the cash and the non-cash  
4 elements.

5 The first indication that there was some concern  
6 came in the -- in the spring of 2003, when the estimates  
7 were presented to the Treasury for -- for subsequent  
8 presentation to Parliament, and the -- the Treasury were  
9 concerned that the cash -- and by this I don't mean near  
10 cash, but net cash -- the cash consequences of the plans  
11 showed a rise of -- in the region of £800 million,  
12 compared to the expectations that they had had.

13 That led to a series of meetings, both at official  
14 level and at ministerial level, between the  
15 Defence Secretary and the Chief Secretary and, at one  
16 stage in that process, the Treasury offered, I think it  
17 was, £200 million on account, as it were, to settle the  
18 issue.

19 We did not settle on that basis. We were concerned  
20 to ensure that the principle of operating within the new  
21 framework was upheld, as far as we were concerned. We  
22 were operating to the rules that had been set out.

23 Following the meeting between the Defence Secretary  
24 and the Chief Secretary, which was, I think, from  
25 memory, around about April or May of 2003, there were

1 continuing discussions in which they asked officials in  
2 both departments to conduct in order to find an  
3 agreement, and those discussions didn't ever get to an  
4 agreement through a period of four or five months, and  
5 then, in the -- in the September of 2003, the Treasury,  
6 by this stage, were focused on the near cash  
7 consequences, as opposed to the net cash consequences,  
8 and the near cash consequences which had appeared, to  
9 begin with, to be around the £400 million or  
10 £500 million mark, it became clear that they were  
11 substantially greater than that and were around  
12 £1.1 billion, at which point the Chancellor wrote the  
13 letter, which you will have, to the Prime Minister,  
14 saying that this was not acceptable to him and that he  
15 would re-impose a near cash regime.

16 There was then a further period of negotiations  
17 between the Treasury, Number 10 and the department, at  
18 the end of which, as well as reintroducing the -- or  
19 introducing the near cash -- or resource accounting and  
20 budgeting stage-1-type controls, there was an agreement  
21 that the -- that the Treasury would make £400 million  
22 available over and above the sum which they believed we  
23 should have been spending in that year, and so, from one  
24 perspective you could say that the defence budget  
25 benefited to the tune of £400 million in that year but,

1 from our point of view, it was a cut in what we had been  
2 expecting to spend as a result of the planning round  
3 following the 2002 settlement.

4 SIR LAWRENCE FREEDMAN: We will come on in a second to the  
5 impact of that. Just to make sure I understand the  
6 politics of this, in terms of the previous evidence we  
7 have heard, one explanation of what's going on is that  
8 the Ministry of Defence had felt underfunded and under  
9 pressure for a number of years, the strategic defence  
10 review had not been fully funded. These new accounting  
11 rules were coming in, which, as it happened, affected,  
12 as we have heard, Ministry of Defence more than anybody  
13 else and that what you were doing was taking as full  
14 advantage of the opportunities provided by these new  
15 rules to deal with some of the gaps that had developed  
16 over time.

17 The Treasury had not quite anticipated this and  
18 became alarmed at the extent to which the  
19 Ministry of Defence was taking, in a sense, advantage of  
20 rules to go beyond that which they might have expected  
21 in normal times. Is that a fair assessment of the  
22 politics of it?

23 TOM MCKANE: Well, Mr Woolley will be able to comment on  
24 what the expectations were in the period leading up to  
25 the conclusion of the 2002 spending review. From my

1 point of view, coming in in that autumn, we were simply  
2 operating to the regime which had been -- which had been  
3 put in place. It is certainly true that it did, as it  
4 transpired, enable us to create additional cash spending  
5 power, but that was, from the point of view of those who  
6 were running the planning system at that stage,  
7 a consequence of operating to the new regime, and we  
8 weren't, during that period, focusing on the old control  
9 and, therefore, seeing to what extent the new controls  
10 differed from the old.

11 SIR LAWRENCE FREEDMAN: The Treasury argument in part was  
12 that -- it claimed there was a loss of control, that the  
13 individual spending agencies within the  
14 Ministry of Defence were -- in a sense, lost a degree of  
15 financial discipline, which is why these numbers had  
16 arisen.

17 TOM MCKANE: I think we were operating to the new controls,  
18 and within the new controls we were living within the  
19 limits that had been set. So it certainly, from our  
20 point of view, didn't -- didn't -- there was no question  
21 of us losing control.

22 TREVOR WOOLLEY: I think it was a decision not to control,  
23 rather than a loss of control, and it was a decision not  
24 to control on the basis that we understood that we were  
25 not being controlled on that basis.

1           Once the rules reverted to the stage 1 RAB, then we  
2           placed those controls on our subsidiary budgets and we  
3           did indeed control to them, such that, notwithstanding  
4           the difficulties we faced during the course of the  
5           financial year 2003/2004, we ended up controlling  
6           defence expenditure as measured by the reintroduced  
7           controls to the budget for that year.

8   SIR LAWRENCE FREEDMAN: So essentially, you were passing  
9           down the new system and expecting the individual budget  
10          holders to act accordingly?

11   TREVOR WOOLLEY: Yes. I mean, we were effectively  
12          reintroducing the system that had obtained up until very  
13          recently. So it wasn't, in that regard, too difficult.

14   SIR LAWRENCE FREEDMAN: We have declassified the  
15          Capgemini -- the independent report. I mean, one  
16          question that does arise from that -- and Mr McKane has  
17          already touched on it -- is the surge, if you like, of  
18          the extra cash requirement from £800 million to  
19          £1.1 billion, which it points out.

20          Does that suggest that you weren't wholly sure  
21          yourselves which way all of this was working out within  
22          the Ministry of Defence?

23   TREVOR WOOLLEY: I think what -- it comes back to my point  
24          about the volatility of the non-cash numbers and the  
25          fact that they could change a lot from year to year.

1       The big increase that came in cash was the consequence  
2       actually, of the requirement for non-cash going down.  
3       Therefore, of budgets being set with a rather larger  
4       element of near cash within their resource budgets than  
5       non-cash, and that in turn generating additional  
6       requirements for net cash.

7       SIR LAWRENCE FREEDMAN: We need to move on. Can I just,  
8       therefore, ask just two points following on from these  
9       events. The first is: were there any areas where the  
10      reductions in capability that resulted from the cuts  
11      that you did have to make as a result of the guillotine,  
12      and then plus a little bit or plus quite a few hundred  
13      million that you got, but not as much as you thought you  
14      were going to have -- were there any impacts on force  
15      generation for Iraq?

16     TREVOR WOOLLEY: I'm not aware of any impact.

17     SIR LAWRENCE FREEDMAN: So you were able to contain the  
18      effect by putting the pressure on other areas of defence  
19      commitments?

20     TREVOR WOOLLEY: Indeed. I mean, what we did -- we  
21      approached the problem in two stages. We had a set of  
22      sort of emergency budgetary measures that we imposed in  
23      2003/2004 and for a further two years, which was  
24      effectively just looking at any areas of uncommitted  
25      expenditure and bearing down very hard on it, but not

1 effectively -- it not sort of looking at the structure  
2 of the armed forces, keeping the structure of the armed  
3 forces.

4 Then we also introduced a medium-term exercise -- it  
5 was called the medium-term work strands -- to adjust the  
6 overall force structure of the armed forces to the  
7 budget that was then available in the medium- to  
8 long-term and the consequences of that exercise were  
9 published in a White Paper in July 2004 and did include  
10 a number of changes to the force structure, but they  
11 were changes that were not judged to impact on our  
12 ability to undertake operations in Iraq.

13 SIR LAWRENCE FREEDMAN: If you had had to accept the full  
14 guillotine, would you have been able to avoid an impact  
15 on Iraq?

16 TREVOR WOOLLEY: Well, I think we would have striven  
17 extremely hard to do so because of the importance of it.  
18 I mean, what -- I mean, there were clearly some more  
19 indirect -- arguably more indirect impacts.

20 For example, we had to cut back on estate  
21 maintenance; that would have had an impact on the living  
22 accommodation of servicemen, which might have had an  
23 impact on the morale of servicemen, and so there is that  
24 sort of indirect consequence because, ultimately,  
25 everything in defence is about being able to produce

1           capability for operations.  But I think the effect was  
2           very indirect.

3   SIR LAWRENCE FREEDMAN:  Lastly on this area, this was  
4           clearly quite a heated debate between the Exchequer and  
5           the Ministry of Defence.  Did it affect working  
6           relationships elsewhere -- for example, on UORs -- or  
7           was it kept quite separate?

8   TREVOR WOOLLEY:  I think we managed to insulate it.  
9           Certainly I don't think there was any evidence  
10          whatsoever -- and I'll defer to Mr McKane -- that the  
11          Treasury became more difficult about UORs as  
12          a consequence.

13   TOM MCKANE:  No, at my level we agreed with the Treasury  
14          officials that, you know, this was an issue that had to  
15          be settled on its own and it did not infect the question  
16          of the extra -- the negotiation of extra costs for the  
17          operation in Iraq.

18   SIR LAWRENCE FREEDMAN:  We now turn to the net additional  
19          cost of military operations, which you have already  
20          referred to, but, again, just to set the scene for this,  
21          it might just be helpful to have a statement of what  
22          this comprises.

23   TREVOR WOOLLEY:  The basic principle was very simple, that  
24          costs incurred -- or rather expenditure incurred by the  
25          department that would not have been incurred were it not

1 for the operation were accounted for separately and  
2 reimbursed by the Treasury, and there were really two  
3 main components.

4 The first were the urgent operational requirements,  
5 which were a mixture of equipment and logistics support,  
6 and then there were the running costs, the extra running  
7 costs of the operation, and this would include such  
8 items as additional allowances for servicemen serving  
9 abroad, the cost of chartering ships and aircraft to  
10 transport people and cargoes to the theatre, the  
11 consumption of stock during the course of the operation  
12 and so on.

13 SIR LAWRENCE FREEDMAN: Thank you. Now, when Gordon Brown  
14 appeared before us, he made clear that the Treasury had  
15 provided £8 billion of additional money to the  
16 Ministry of Defence, defending costs of operation for  
17 Iraq, and that included the UOR proportion of about  
18 £2 billion. These figures are on the public record. So  
19 we don't need to go into them further.

20 Does the additional money from the Reserve for the  
21 net additional costs of operations in fact cover both  
22 the direct and indirect costs in full?

23 TREVOR WOOLLEY: Well, we certainly strove very hard to  
24 ensure that we properly recorded the net additional  
25 costs so that they were fully covered from the Reserve.

1 It is worth saying that we had to identify actual  
2 additional expenditure that was incurred so we weren't  
3 talking about the costs, for example, of people who  
4 might be redeployed from other duties to work on -- to  
5 do work in support of the operation. So we had to  
6 demonstrate -- which was absolutely right and proper --  
7 that we did incur extra expenditure.

8 Now, as Mr Mann indicated earlier, in some cases  
9 that might be difficult, if we were trying to judge  
10 whether an additional cost of servicing an aircraft in  
11 the UK was a consequence of its having been used in  
12 a particular way in Iraq.

13 So I mean, I don't think we could say that we always  
14 managed to capture 100 per cent of the extra costs, but  
15 certainly, when I conducted my quarterly reviews -- each  
16 year I would have four reviews with each of the finance  
17 directors of the top level budgets to go through their  
18 forecast expenditure for the year, one of the things we  
19 did focus on was, were we properly capturing the  
20 additional costs of military operations, and I think we  
21 were pretty successful in doing it.

22 SIR LAWRENCE FREEDMAN: One area where there has been  
23 concern as to whether the full financial cost has been  
24 captured is the long-term healthcare bills for those who  
25 have been injured, physically or mentally. Have you

1 commissioned any estimates of what this might be?

2 TREVOR WOOLLEY: I don't think that generally that would  
3 fall to the defence budget. The pensions and disability  
4 payments relating to servicemen prematurely leaving the  
5 service are covered by the armed forces pension scheme,  
6 which, although it is part of the defence budget, is not  
7 subject to an expenditure limit, or they might be -- or  
8 other medical costs of servicemen who have left the  
9 service would be covered by the NHS.

10 So where we are talking about medical costs incurred  
11 in Iraq, additional medical costs incurred in Iraq, so,  
12 for example, the additional medical supplies used in  
13 Iraq, that would have been captured by the net  
14 additional costs of military operations.

15 SIR LAWRENCE FREEDMAN: I mean, in terms of getting  
16 an overall sense of the cost of the operation, these  
17 other aspects are quite important.

18 TREVOR WOOLLEY: Yes. I mean, you are right to say that, in  
19 terms of what the overall cost to the nation is, we  
20 perhaps haven't covered that.

21 SIR LAWRENCE FREEDMAN: It has been an issue for some time  
22 as to whether or not a figure can be found to -- some  
23 sense of what it has cost in that aspect.

24 But also, I mean, you have got welfare and aftercare  
25 support for people who are still in service as well.

1 I know the MoD has introduced a number of measures to  
2 improve this. Are these measures which come from the  
3 core budget or do they have to come -- or do some of  
4 them come from the Reserve as well?

5 TREVOR WOOLLEY: I think where it is possible to identify  
6 individuals who have been recruited especially for this  
7 task, then that would be a proper charge to -- the  
8 additional costs of military operations. Where these  
9 services are provided by people who are already on the  
10 payroll then that would not be an additional cost.

11 SIR LAWRENCE FREEDMAN: But again, have you been able to  
12 give any sort of assessments of the impact?

13 TREVOR WOOLLEY: I'm not myself aware that we have made such  
14 an assessment.

15 SIR LAWRENCE FREEDMAN: Okay, my final question -- it is  
16 a big question but it may have a small answer -- which  
17 was whether financial considerations ever constrained  
18 military operations and strategy in Iraq  
19 between March 2003 and July 2009?

20 TREVOR WOOLLEY: In my -- I'll ask Mr McKane for his view.  
21 In my experience, the answer is, no, they did not.

22 TOM MCKANE: No. I agree with that.

23 THE CHAIRMAN: We have got about four sets of questions to  
24 get through. So we will need to move at some speed  
25 through the rest. I think we have had the core already

1       this morning, and very valuable it has been, but with  
2       that, let's get quickly on. Usha?

3   BARONESS USHA PRASHAR: Thank you. I want to ask a couple  
4       of questions on the forecasting of the costs of  
5       operations, because two reports, the Defence Select  
6       Committee report and the NAO, have sort of acknowledged  
7       some of the challenges of that.

8                Could you briefly describe what the complexities are  
9       in both forecasting and recording the cost of  
10       operations?

11   TREVOR WOOLLEY: I think recording the costs of operations  
12       is relatively straightforward. We cascade down the  
13       department, down the financial chain in the department  
14       to our top level budgets and below, instructions for how  
15       additional costs are to be recorded, that people should  
16       look for evidence of where additional cost has been  
17       incurred and to record it separately and, as -- in my  
18       answer to Sir Lawrence Freedman, I think I'm reasonably  
19       confident that we did that pretty well.

20               Forecasting is obviously more difficult. What we  
21       tended to do was to look at what the expected force  
22       level in theatre was and to focus the forecast round the  
23       numbers of people who were going to be out there, in as  
24       much as the people related -- the number of servicemen  
25       deployed was likely to be the driver for the cost and,

1           therefore, we would focus on the numbers of servicemen  
2           expected to be deployed.

3           But, of course, the reality was sometimes that the  
4           force levels were different from those at the time of  
5           forecast and, therefore, the costs would be different  
6           and, of course, there were some costs that were either  
7           greater or less than one might have expected with that  
8           level of force level anyway. So there was more  
9           difficulty there.

10   BARONESS USHA PRASHAR: But if you look at your outturn cost  
11           of operations -- this list has come out lower than  
12           estimated by the MoD -- is it an indicator that MoD will  
13           often -- will not overestimate the cost of operations?  
14           If you look at the figures in your annual report ...

15   TREVOR WOOLLEY: Yes. I mean, I think -- we -- in seeking  
16           Parliamentary supply for the cost of operations, as we  
17           had to, we were clearly keen that the amounts we would  
18           put into the estimates, into the Parliamentary  
19           estimates, would be sufficient, because we did not want  
20           to be in a position where we had spent more money than  
21           Parliament had authorised.

22           So I think it is probably true to say that we did  
23           tend to put in our Parliamentary estimates a small  
24           element of contingency in to ensure that we did not  
25           exceed the supply and that is why the outturn would tend

1 to be less than the Parliamentary estimate.

2 BARONESS USHA PRASHAR: Have you taken any steps to try to  
3 improve the way the forecasts are made or records are  
4 kept? Are you satisfied with the way it has happened in  
5 the past?

6 TREVOR WOOLLEY: I don't think this has been an area that  
7 either we or the Treasury have felt has been a major  
8 concern. I think, as experience over the years has  
9 built up, so the process has got better.

10 BARONESS USHA PRASHAR: It has got better? But against the  
11 background of a period of high operational intensity for  
12 the MoD, how did you intend to retain its skill base of  
13 forecasting the costs of operations in the future?

14 TREVOR WOOLLEY: That is an interesting question and  
15 I think -- and obviously I have moved on from being  
16 finance director -- it may be that my successor has some  
17 plans in hand. I think, to be honest, we are being so  
18 focused on supporting current operations that we  
19 probably haven't given a lot of attention to answering  
20 the question you have asked for the future, but that may  
21 be -- unless, as I say, my successor has something in  
22 hand, maybe that's something we should be looking at.

23 BARONESS USHA PRASHAR: Thank you.

24 THE CHAIRMAN: Thank you. Roderic?

25 SIR RODERIC LYNE: A quick non-cash, non-esoteric question.

1           In military parlance, what does recuperation from  
2           a military operation mean?

3   TREVOR WOOLLEY:   Perhaps Mr McKane could have a go at that  
4           one?

5   TOM MCKANE:   What it means is the means by which we, in the  
6           Ministry of Defence, ensure that the armed forces'  
7           capabilities are restored to the point that they were at  
8           before the operation started.

9           So, for example, reference has already been made to  
10          the consumption of stocks, the usage of missiles, the  
11          usage of bullets, whatever. We would expect to be able  
12          to recover the levels, the holdings, of those sorts of  
13          things once the operation had concluded.

14          That's the -- those are the main elements.

15   SIR RODERIC LYNE:   In the case of Operation Telic, when did  
16          the process of recuperation begin and, within the bounds  
17          of what you can say in a public session, when should it  
18          have been complete?

19   TOM MCKANE:   Well, discussions about recuperation began  
20          quite early on in the operation and some recuperation  
21          activity would have taken place as the operation was  
22          unfolding. But it has not been concluded as yet.

23   SIR RODERIC LYNE:   In 2010? The costs of recuperation, do  
24          they come from the core defence budget or are they part  
25          of the net additional costs of military operations?

1 TOM McKANE: They are part of the net additional costs.

2 SIR RODERIC LYNE: So as it is not completed, you are still  
3 having to work out what the net additional costs were of  
4 things that happened quite a while ago?

5 TOM McKANE: We have identified what we believe those costs  
6 are and we have agreement in principle that they would  
7 be made good.

8 SIR RODERIC LYNE: Roughly how far had the recuperation  
9 process gone at the point when the decision was taken to  
10 deploy forces into Afghanistan?

11 TOM McKANE: I think that's a difficult question to answer.  
12 As I have said, there would have been some recuperation  
13 going on during the previous period, in the sense that  
14 equipment would be -- levels of stocks and so on would  
15 be being replenished as the operation proceeded. But  
16 plainly, it would not be possible to have completely  
17 recuperated from the Iraq operation while it was  
18 still -- while it was still underway.

19 SIR RODERIC LYNE: Just to situate this, my understanding is  
20 that the decision to put a significant uplift into  
21 Afghanistan was taken in 2005 and the actual deployment  
22 was effective from the middle of 2006, if I have got  
23 that right.

24 Now, Sir Kevin Tebbitt told us that he had concerns  
25 about taking on the additional military in Afghanistan

1 at a time when our forces were still so heavily engaged,  
2 committed, in Iraq. Ahead of that decision, do you  
3 recall what advice the MoD's Resource and Plans staff  
4 were providing to ministers about its impact?

5 TREVOR WOOLLEY: I don't think we were providing advice  
6 about the impact -- the impact in the terms you are  
7 suggesting. I mean, what we had and what we were -- I,  
8 as finance director, was responsible for, was running  
9 the department's performance management system, and  
10 reporting to the board on a quarterly basis on the  
11 performance of the department and the armed forces as  
12 a whole and a key element of that was measuring the  
13 readiness of our individual force elements and the  
14 readiness of all our force elements, a battalion,  
15 a squadron of aircraft, whatever, are regularly reported  
16 on the readiness against the readiness target that is  
17 set for them in our departmental plan, which, itself, is  
18 the outcome of the previous planning round, and the  
19 components of readiness include manning, training,  
20 equipment, logistics, deployability, those sorts of  
21 things.

22 So the department did have a system whereby it was  
23 able to see at the high level and then drill down as  
24 necessary, what the overall state of readiness of our  
25 armed forces was in relation to the readiness targets

1 placed upon them.

2 So that process enabled the Defence Board and  
3 ministers to have a sense of the readiness and  
4 capability of the armed forces for taking on new  
5 operations.

6 SIR RODERIC LYNE: When in the second half of 2006 through  
7 2007/2008 one had two concurrent enduring operations  
8 running in Afghanistan and in Iraq -- going back to the  
9 conversation we had at the beginning of the day -- how  
10 far beyond the SDR planning assumptions was that taking  
11 us over this period of two/two and a half years?

12 TREVOR WOOLLEY: It was taking us quite considerably beyond  
13 the planning assumptions, because the planning  
14 assumption was that a -- one of the two medium-scale  
15 operations would not endure for more than six months and  
16 we had two that were enduring and, therefore, that  
17 placed demands on the force structure that were over and  
18 above those that we had planned the force structure to  
19 be able to have.

20 That's not to say that, therefore, the force  
21 structure was inadequate for doing this, but what it  
22 meant was that compromises had to be made in other  
23 elements of our planning assumptions in order to  
24 accommodate it, most notably, as I referred to earlier,  
25 in terms of the tour intervals for units.

1 SIR RODERIC LYNE: Did priority decisions have to be taken  
2 between Iraq and Afghanistan over resources?

3 TREVOR WOOLLEY: Clearly, the operational staffs had to make  
4 judgments about the priority between Iraq and  
5 Afghanistan for individual elements of the force  
6 structure. They weren't, as it were, financial  
7 decisions; they were decisions about, given what was  
8 available, what should be -- what is our relative  
9 priority between having those available forces in Iraq  
10 or Afghanistan?

11 SIR RODERIC LYNE: But from a resource perspective, you were  
12 able to ensure that both theatres were adequately  
13 resourced, were you, or were you stretched?

14 TREVOR WOOLLEY: Well, because the resource implication  
15 was -- manifested itself in terms of an additional cost  
16 of military operations, the stretch came on the reserve  
17 rather than on the defence budget.

18 SIR RODERIC LYNE: Was there any sense that one or other  
19 operation had the higher priority?

20 TREVOR WOOLLEY: I don't think I am in a position to comment  
21 on what those who were making the decisions on  
22 priorities might have -- might have -- might say in  
23 answer to that question.

24 SIR RODERIC LYNE: Some of the operational commanders have  
25 told us that, in the later stages, it was their

1 impression on the ground in Iraq that a greater priority  
2 at that point -- 2007, let us say, 2007/2008 -- was  
3 being given to Afghanistan. This wasn't feeding back  
4 down into the area of resources that you were  
5 overseeing?

6 TREVOR WOOLLEY: From our parochial point of view, I think  
7 it probably is fair to say that we had become, in this  
8 area, more focused on Afghanistan, but that is simply in  
9 terms of the parochial business we in the resources and  
10 finance area had to do, and we were more focused on it  
11 because it was setting up a new operation, there were  
12 requirements for new and different types of UORs and so  
13 on, whereas Iraq was something that had been going on  
14 for some while, where the processes were  
15 well-established.

16 So I think, in terms of the way we were doing our  
17 work, we probably were more focused on Afghanistan. But  
18 I think that is answering a slightly different question  
19 to the one that you are really getting at.

20 SIR RODERIC LYNE: From what you said earlier, would it be  
21 correct to infer that the Afghan deployment did have  
22 a negative effect on the pace of recuperation from Iraq?

23 TREVOR WOOLLEY: Well, I mean, it is certainly the case  
24 that, if you interpret completion of recuperation as  
25 enabling our force elements to recover the overall

1       readiness that was consistent with our strategy, then it  
2       did delay that recuperation because, if you are actually  
3       on operations, you can't be ready to undertake  
4       contingent operations.

5       SIR RODERIC LYNE: Were you warning the Defence Board in  
6       this period -- this is my final question -- that there  
7       was this negative impact on readiness?

8       TREVOR WOOLLEY: Well, it was evident to the Defence Board  
9       from the figures that were presented to them -- and they  
10      were incidentally figures -- readiness targets were in  
11      our -- our public service agreements with the Treasury  
12      that appeared out of the spending. Readiness targets  
13      were there, so they were something that were measured  
14      and they were something that were clearly visible to the  
15      board and, indeed, they were reported in our annual  
16      reports and in the quarterly reports, and the House of  
17      Commons Defence Committee was -- had visibility of this.

18      So there was a high level of visibility of the fact  
19      that our readiness levels were considerably below our --  
20      the targets for our defence strategy, that slightly  
21      stemmed from our defence strategy. But there was a very  
22      obvious answer as to why that was. It was because we  
23      were on operations.

24      SIR RODERIC LYNE: It was clear that that was the case.

25      Thank you very much.

1 BARONESS USHA PRASHAR: Thank you. I want to talk a bit  
2 about funding of the security sector reform generally.  
3 I mean, as you know, a campaign like Iraq covers a broad  
4 range of activities and not all of it shall fall on the  
5 armed forces to deliver. But were you satisfied that  
6 the government had a clear approach to funding the UK's  
7 overall strategy in Iraq?

8 TOM McKANE: I'll answer that if I may.

9 I think -- the first thing to say is that the focus  
10 of the Resources and Plans part of the  
11 Ministry of Defence was on the -- on defence's part in  
12 this operation. That said, the issues that did arise  
13 were to do with what were known as quick-impact  
14 projects, and there were discussions that took place  
15 between the Ministry of Defence and the Permanent Joint  
16 Headquarters and the Treasury about the extent to which  
17 the Reserve should pay for quick-impact projects and,  
18 also, there was a general discussion that would go on  
19 about the extent to which the Department for  
20 International Development's budget should help with  
21 these projects.

22 I don't think it is any secret that the commanders  
23 on the ground were extremely concerned that they didn't  
24 have as much money available as they felt that they  
25 should have for quick-impact projects. Having said

1           that, there was money made available to the defence  
2           budget from the Reserve, both in 2003/2004 and certainly  
3           in 2004/2005, relatively modest sums by comparison with  
4           the overall cost of the operation to defence.

5   BARONESS USHA PRASHAR: But the reform of the -- the  
6           reconstitution of the Iraqi army and the reform of the  
7           police force, you know, was a kind of a long-term -- it  
8           was not so much of a quick impact. But how was that  
9           activity funded?

10   TOM McKANE: That activity was -- partly, the training of  
11           the new armed forces was being done by the -- by the  
12           troops on the ground. So in a sense, the cost of the  
13           operation embraced the cost of training the Iraqi army  
14           that was being undertaken by the British contribution.

15   BARONESS USHA PRASHAR: So that would be the core budget?  
16           It came from the core budget?

17   TOM McKANE: No, not the core budget. Well, to the extent  
18           that the personnel costs were part of the core budget,  
19           but all of the additional costs involved in having them  
20           in Iraq undertaking this activity were being -- were  
21           coming from the Reserve.

22   BARONESS USHA PRASHAR: Thank you.

23   THE CHAIRMAN: I think we have come almost to the end.

24           Sir Martin, the last question.

25   SIR MARTIN GILBERT: My question is essentially, to what

1 extent during the course of the Iraq campaign was the  
2 MoD able to fund those aspects which had emerged during  
3 the various lessons learned exercises which were being  
4 done? For example, Saif Sareea had a lessons learned  
5 component and in the question, say, of the desertisation  
6 of the Challenger 2 tank, there had been a lessons  
7 learned which, I believe, reported in December 2003 that  
8 modifications should be put in place.

9 So the question is really: were you able to fund the  
10 various lessons learned, the proposals, during the  
11 course of the campaign, to benefit the campaign?

12 TOM McKANE: I think in general the -- some of the urgent  
13 operational requirements which were funded from the  
14 Reserve were requirements that had arisen as a result of  
15 lessons learned, whether through a formal lessons  
16 learned process or simply as the result of the  
17 experience of the troops on the ground, feeding back  
18 into the raising of new requirements. So I think the  
19 answer to your question is, broadly speaking, yes.

20 SIR MARTIN GILBERT: Through the UOR?

21 TOM McKANE: Yes.

22 SIR MARTIN GILBERT: Thank you.

23 TOM McKANE: Not simply through the UORs, I would say,  
24 because I think the lessons learned applies to a whole  
25 range of ways in which the operation was being

1 conducted.

2 THE CHAIRMAN: Just to ask -- standing back from the Iraq  
3 experience and looking at the Resource Plans area of the  
4 Ministry of Defence, any significant lessons to be  
5 drawn, any significant alterations, improvements,  
6 required, or did it actually work in this very complex  
7 and long drawn-out operation satisfactorily?

8 TREVOR WOOLLEY: I think it generally worked out very  
9 satisfactorily. I mean, the key issue was the  
10 relationship with the Treasury in terms of the funding  
11 of the net additional costs of military operations and,  
12 although, during this period, we had many discussions  
13 with the Treasury on a very wide range of issues, on the  
14 net additional costs of military operations, although  
15 there were discussions with the Treasury, they were not  
16 issues between us.

17 The principle that these costs came from the Reserve  
18 was fully accepted by the Treasury and the mechanisms we  
19 had in place for capturing the costs, for claiming the  
20 costs from the reserve and for approving UORs worked,  
21 I think, on the whole extremely smoothly.

22 THE CHAIRMAN: Thank you. Is that what you would both say  
23 as well?

24 TOM McKANE: Nothing to add.

25 THE CHAIRMAN: Okay, I think that brings us to the end. Are

1           there any more general reflections which you would wish  
2           to offer, or is that it?

3   TREVOR WOOLLEY:   Not from me, thank you very much.

4   BRUCE MANN:   No thank you.

5   THE CHAIRMAN:   In that case, thank you very much to our  
6           witnesses, it has been an extremely valuable session.  
7           We are grateful.  We will resume the hearings again on  
8           Monday afternoon at 2 o'clock.  We will be hearing from  
9           Sally Keeble, who was a junior minister for  
10          international development between May 2002  
11          and June 2003.

12                 With that, I'll declare this session closed.  Thank  
13           you.

14   (12.56 pm)

15   (The Inquiry adjourned until Monday 5 July 2010 at 2.00 pm)

