

**DEFENCE AUDIT COMMITTEE**

**ANNUAL REPORT 2007-2008**

(A paper by the Chair of the Defence Audit Committee)

**Introduction**

1. Under its terms of reference the Defence Audit Committee is required to report annually to the Accounting Officer in advising him on the Statement on Internal Control he is required to sign as part of the Departmental Resource Accounts. Additionally, the *Corporate Governance Code of Good Practice* mandates central Government departments to report annually on the work of the Audit Committee. This report sets out the Committee's main activities over the year.

2. In reviewing the Department's control and assurance arrangements for 2007-2008, the Committee met six times during the year, in December 2007 and January, March, April, May and June 2008. Copies of the minutes of its meetings were sent to Defence Board members, Top Level Budget Command Secretaries and the non-executive Chairs of their audit committees. A number of papers were also considered out-of-committee.

**Review of Internal Control Systems 2007-2008**

3. The Committee reviewed a number of items in the course of the year in order to assure itself of the adequacy of the Department's internal control arrangements, taking account of its advice to the Accounting Officer in the context of the 2006/07 SIC. These included:

- **Departmental risk and assurance arrangements**, including:
  - reporting to and management of risk by the Defence Board;
  - the Departmental assurance matrix;
  - Top Level Budget Holders' Risk Management processes, including a review by the Director of Internal Audit of the integrity and effectiveness of risk management processes in place across the Department;
  - the Director of Economic and Statistical Advice's review of Investment Appraisal and Project Evaluation performance across the Department; and

- information assurance, including Sir Edmund Burton's review;
- **Internal and external audit of the Department**, including:
  - Reporting on the Defence Internal Audit Programme; and
  - the National Audit Office audit strategy for 2007-2008;
- **Internal reviews of Corporate Governance practice**, in particular the Annual Report setting out the Department's corporate governance arrangements in relation to the Treasury's Code of good practice;
- **Annual stewardship and process owner reports** from:
  - the 2nd Permanent Under Secretary, as the Chair of the Defence Environment and Safety Board (including Scientific risks);
  - the Chief of Defence Materiel for the logistics process;
  - the Finance Director for Departmental financial and planning systems;
  - the Deputy Chief of the Defence Staff (Personnel) for Service personnel processes;
  - the Surgeon General for clinical governance processes;
  - the Personnel Director for civilian personnel processes;
  - the Defence Commercial Director for commercial processes;
  - the Director General of Defence Acquisition Policy for acquisition processes;
  - the Director General Media and Communication for the Strategic communications processes;
  - the Director General Security and Safety as the Departmental Security Officer, for security and business continuity;
  - the Director General Information for information management including DII(F) and information risk management and assurance (in line with Cabinet Office guidance);
  - Directors of Operational Capability and of Internal Audit on their programmes and findings over the previous year (including the Defence Fraud Analysis Unit);
  - the Director of Internal Management Consultancy; and
  - from the Director of Performance and Analysis setting out the main conclusions from the review of Top Level Budget Holders' Annual Assurance Reports.
- **The programme for production of the Departmental Resource Accounts for 2007-2008, the Statement on Internal Control for 2007-08 and the Accounts themselves**, in particular the losses statement, to consider whether they contained anything indicative of any systemic control failures.

## **The Statement on Internal Control Process**

4. The Department continued its previous practice to collect information for the Departmental Statement on Internal Control from Top Level Budget organisations. Under this Top Level Budget Holders were asked to provide a brief report, approved by their Audit Committee, to the Accounting Officer, that assured him as appropriate that their management systems were working adequately, and which drew to his attention to any concerns about the operation of governance arrangements, particularly any failures of control that their Audit Committee judged to be significant at Top Level Budget level. They were also asked to report on how their Audit Committee addressed specific areas of governance and stewardship to assure itself of the adequacy of the Top Level Budgets' internal control arrangements, and the conclusions it reached. They were also encouraged to share best practice. This again ensured a more detailed and transparent central scrutiny of the risk management and assurance arrangement in place across the Department by the Director of Performance and Analysis in cooperation with Defence Internal Audit, including the cross-checking of issues identified in the annual process and stewardship reports against Top Level Budgets' information. This enabled the Committee to take an independent view of the adequacy of risk management and assurance arrangements across the Department and offer substantive advice to the Accounting Officer on the Department's Statement on Internal Control. The process was fully reviewed in summer 2007 and found to be basically sound; accordingly only minor adjustments were made in its third year of operation, and it is planned to continue with the current process in 2008-09.

## **Internal Control Issues**

5. 2007-08 was the first full year of live operation of the Joint Personnel Administration system (JPA) following the third and final phase of rollout to the Army in April 2007. Over the year it became clear that the shortfalls identified in 2006-07 in JPA's support to Departmental financial and manpower accounting processes were more deep-seated than we had thought and were of sufficient materiality as to have a continuing impact on the Department's ability to exercise full financial control. Significant progress was made during the year and there is a continuing programme of further work. Owing to the technical nature of some of the issues and the range and scope of the rectification and improvement work required, it is likely that resolving them will take a further 12-18 months.

6. Following the theft in January 2008 of an MoD laptop containing unencrypted recruiting records, Sir Edmund Burton conducted an independent review into the circumstances that led to the data loss. Sir Edmund found that the Department's policies and procedures were fit for purpose but that the treatment of information, knowledge and data as key operational and business assets was inadequate in practice. He also concluded that at least some of the Department's information systems were likely for a time to have been in contravention of the Data Protection Act. In combination these factors, and in particular the inadequacies in the handling of personal data, represented a significant failure of internal control. The Department has accepted all Sir Edmund's recommendations and has published an action plan to take them forward. In addition the Defence Board has added Information Security to its strategic risks, and the Permanent Under Secretary has appointed a senior dedicated Data Protection Officer to ensure MoD practices and procedures are at the highest possible standard.

7. Other than these issues, the Committee is content that the information it reviewed during the year provided sufficient assurance that effective corporate governance arrangements were in place for all other significant risks facing the Department, and that where areas of weakness had been identified, corrective action was in hand. On this basis, the Committee endorsed the draft Statement on Internal Control for the Accounting Officer's signature.

### **Other Business**

8. The Committee conducted the annual review of its operations as called for in its Terms of Reference, which included:

- its composition and Terms of Reference; and
- the forward business programme up to and including the review of the Department's Statement on Internal Control.

### **The Audit Committee Handbook**

9. In March 2007, the Treasury published a revised Audit Committee Handbook. This sets out the requirement for departmental level audit committees to be established in accordance with the five principles of the Handbook or to set out in the context of the Committee's annual report any areas where internal procedures differ, and why. Overall, the Committee operates within the context of the principles and no significant differences in internal procedures have been identified which require to be reported.