



Supplementary Document
Corporate Governance Report 2005-06

Produced by
Ministry of Defence

Ministry of Defence (MoD) Corporate Governance Report 2005-06

Introduction

1. This report provides an overview of the corporate governance arrangements in the MoD, in accordance with Treasury guidance on corporate governance set out in *Corporate governance in central government departments: Code of Good Practice*, published in July 2005. Material on elements of our governance arrangements is also provided in the *Ministry of Defence Annual Report and Accounts 2005-06*, and in the *Departmental Framework Document* available on www.mod.uk

2. The MoD supports the development of the Code of Good Practice, and the spirit of its guidance. It raises no fundamental issues of principle for Defence, which has long operated in accordance with the principles set out. However, the role and structure of Defence, and in particular certain constitutional aspects of our governance arrangements for the Armed Forces and our fully integrated civilian-military organisation, mean that there are and will continue to be some areas where our governance arrangements differ from the specific guidance in the Code.

Parliamentary Accountability

3. The Secretary of State for Defence is the Cabinet Minister charged with making and executing Defence policy, and with providing the means by which it is executed through the Armed Forces, and is accountable to Parliament for the resources to do so. As Chairman of the Defence Council, he is responsible for the exercise of the prerogative powers of the Crown in respect of the Armed Forces, and in particular their command and administration as set out in the Letters Patent and in Statute, for which he is accountable to the Crown and to Parliament. He is supported in this by three subordinate Ministers to whom he assigns responsibility for specific aspects of the Armed Forces and the Ministry of Defence's business.

4. Although ultimately accountable for all elements of Defence, on a day-to-day basis the Secretary of State oversees:

- Policy;
- Operations;
- Personnel;
- Finance and efficiency;
- Oversight of major acquisition decisions and Defence industrial issues;
- Media and communications;

5. He has delegated the following responsibilities to his subordinate Ministers:

- **the Minister of State for the Armed Forces** is responsible for Defence policy and planning; operations; the Armed Forces (Regular and Reserves); Defence Logistics Organisation, including ABRO, DARA, and logistics transformation; regional issues and the devolved Administrations;
- **the Parliamentary Under Secretary of State and Minister for Defence Procurement** is responsible for acquisition, Defence science and technology, Defence exports, and Defence issues in the House of Lords;
- **the Parliamentary Under Secretary of State and Minister for Veterans** is responsible for Veterans' Affairs; Defence Estates; Service personnel issues; civilian personnel policy and casework; MoD Police; Health and Safety; Hydrographic Office and Meteorological Office; Non-Departmental Public Bodies; Low flying; Visits by Peers and MPs; Armed Forces Parliamentary Scheme.

These delegations change from time to time as the Secretary of State directs.

The Defence Council

6. The Defence Council oversees the Armed Forces and the Ministry of Defence. Its membership is determined by Letters Patent. It is chaired by the Secretary of State and comprises all other Defence Ministers, the CDS and VCDS, the three Single Service Chiefs of Staff, the PUS and 2nd PUS, the Chief of Defence Procurement, the Chief of Defence Logistics and the Chief Scientific Adviser. It provides the formal legal basis for the management and direction of the Armed Forces through prerogative and statutory powers. It meets at the Secretary of State's discretion, but generally about twice a year. It is supported by separate Boards chaired by the Secretary of State for Defence for each of the Armed Services (the Admiralty Board, the Army Board and the Air Force Board), which are charged by the Letters Patent with the administration and command of the Royal Navy, the Army and the Royal Air Force. Ministers chair a number of other top-level committees and boards on specific issues as required.

7. Beneath Ministers and the Defence Council lies the top management of the MoD. The Secretary of State has two principal advisers: the Chief of the Defence Staff (CDS) and the Permanent Under Secretary (PUS). They share responsibility for much of the Department's business, reflecting the input that both military and civilian personnel make to political, financial, administrative and operational matters. The CDS is the professional head of the Armed Forces and the principal military adviser to the Secretary of State and the Government. The PUS has primary responsibility for policy, finance and administration in the Department. He is the MoD's Principal Accounting Officer and is personally accountable to Parliament for the expenditure of all public money voted for Defence purposes. PUS and CDS each have a deputy: the Vice Chief of the Defence Staff and the Second Permanent Under Secretary of State, who jointly oversee the MoD Head Office.

8. The Head Office is responsible for leading the Defence contribution to the development of the Government's foreign and security policy and wider objectives, and for translating those objectives into departmental policy and the Defence capability needed to deliver it. The Head Office has four main roles:

- advising government on Defence;
- making policy and setting departmental strategy;
- planning and resource allocation; and
- management of Defence.

The Chiefs of Staff Committee

9. The Chiefs of Staff Committee is chaired by the Chief of Defence Staff and is the main forum through which he obtains the collective military advice of the Chiefs of Staff on operational issues. The individual Service Chiefs also advise the Chief of Defence Staff, the Secretary of State and, as required, the Prime Minister on the operational employment of their Service.

The Defence Management Board

10. The Defence Management Board (DMB) acts as the executive arm of the Defence Council and is responsible for directing a number of key processes, in particular the bi-annual re-costing of the Defence programme and the Departmental planning process. The DMB is chaired by the PUS and comprises the other Service and official members of the Defence Council, the Department's Finance Director, and at least two non-executive members appointed by the PUS. It advises PUS on implementation of his responsibilities to Ministers for the full range of Defence business, other than the conduct of operations, and as Departmental Accounting

Officer. It is responsible for the delivery of the Defence Aim, set by the Secretary of State for Defence and reflected in the Department's Public Service Agreement with the centre of Government:

To deliver security for the people of the United Kingdom and the Overseas Territories by defending them, including against terrorism; and to act as a force for good by strengthening international peace and stability.

11. The DMB delivers the Defence Aim, making the most cost-effective use of the resources that the Government provides, through pursuing three high-level Departmental objectives set out in our Public Service Agreement (PSA):

- Achieve success in the military tasks we undertake, at home and abroad;
- Be ready to respond to tasks that might arise;
- Build for the future.

It monitors Departmental performance against our PSA and other performance targets, using the Defence Balanced Scorecard, and formally reviews performance and associated top-level risks at least quarterly.

12. In delivering the Defence Aim, the DMB's core tasks are:

- Role of Defence - helping to define and articulate our strategic direction, and provide a clear vision and set of values for Defence;
- Targets and Objectives - establishing the key priorities and Defence capabilities necessary to deliver the strategy;
- Resource Allocation - ensuring that Defence priorities and tasks are appropriately resourced;
- Performance Management - managing corporate performance and resources in-year to deliver the required results.

13. The DMB places emphasis on investment in key management issues such as providing:

- better and earlier guidance to the Department on key strategic issues;
- closer alignment of strategic objectives and resource allocation;
- greater rigour in addressing the resource challenge, and greater clarity about how it is to be addressed; and
- sharper focus on performance, through rigorous definition of performance standards and targets against a small number of key strategic objectives.

14. The DMB generally meets once or twice a month. Twice a year the DMB has an 'away day' at which it reviews the way it is working, considers strategic issues in greater depth and in a less formal context than its regular meetings, and provides top-down direction for any follow on work.

15. The DMB is supported by a dedicated secretariat located within the Finance Director's organisation. The secretariat's role is to:

- manage the future programme of business for the DMB;
- provide advice on the preparation of papers, presentations and other material commissioned for the Board;
- arrange meetings and awaydays, prepare agendas and circulate papers for in-and out-of-committee consideration;
- brief PUS as chairman on the handling of Board business;
- support other Board members as required;
- record and circulate the decisions taken by the Board and track progress on them to conclusion.

16. The minutes of the meeting are the responsibility of the Secretariat, acting under the Chairman's authority. They are the formal record of the proceedings, reflecting the key points of discussion and collective decisions of the Board. The Chairman's summary records decisions taken, and in so doing takes account, where appropriate, of those occasions where there have been differences of opinion.

17. Beneath the DMB there is a wide range of boards and committees within the Head Office, responsible for day-to-day oversight of specific elements of the Department's business on behalf of the Board. These are:

- the Defence Audit Committee, responsible for ensuring corporate governance requirements are met, advising on the adequacy of internal controls and effective risk management;
- the Investment Approvals Board, responsible for the approval of major investment projects and oversight of the approvals process through which approval is sought;
- the Defence Estates Committee, responsible for development and implementation of policy for the Defence estate;
- the Efficiency Delivery Board, responsible for the Department's Efficiency Programme and ensuring its effective governance;
- the Defence Environment and Safety Board, responsible for policy on and oversight of environmental matters and health and safety; and
- the Policy and Programmes Steering Group, responsible for advice to the DMB on major balance of investment issues, the capability implications of significant changes in resources or policy, and production of coherent capability and policy options for consideration in the planning process.

We keep these arrangements under review. We are in particular looking at any potential implications arising from the implementation of the Defence Industrial Strategy.

18. The Code of Good Practice recommends that Management Boards engage in succession planning and talent development. The DMB's ability to do this for its own members is heavily constrained. In particular, the five Chiefs of Staff (CDS, VCDS and the Chiefs of the Naval, General and Air Staffs) are members of the Defence Council and DMB in respect of their military appointments. The DMB has no role in the selection and appointment of its military members, who are appointed to their posts on the basis of their specialist military skills and experience, in accordance with procedures governed by Queen's Regulations. The DMB does maintain responsibility for and oversight of skills planning and talent development for the Defence civil service as a whole but most civilian DMB members are Permanent Secretary appointments overseen by the Cabinet Office and Cabinet Secretary.

Independent non-executive DMB members

19. The DMB also has at least two external non-executive members appointed by the PUS, who bring independent scrutiny, wider perspective and greater objectivity to DMB discussions. Non-executives are independent in character and judgement, and are required to certify before taking up appointment that they have no relevant potential conflicts of interest. Non-executives are appointed in accordance with Cabinet Office best practice guidance for making external appointments. They are provided with written terms of reference including the specification of their roles, line of accountability and terms of appointment, which includes how their performance will be appraised. They are also provided with induction material to ensure they obtain the necessary background to perform their roles effectively. The PUS holds personal meetings with the non-executives singly or collectively as he sees fit.

Internal controls

20. The DMB places great importance on corporate governance and the management of risk. The Defence Audit Committee (DAC), chaired by an independent member of the DMB, is at the heart of the assurance process. It uses a risk-based approach to review the condition of the Department's internal control systems and advise the Permanent Under Secretary on his annual Statement on Internal Control in the Departmental Resource Accounts. The terms of reference for the DAC can be found at www.mod.uk. DAC meetings are attended by the Director of Defence Internal Audit and senior National Audit Office representatives. Since 2004-05 we have published an annual report on the work of the audit committee on the Department's website alongside the Annual Report and Accounts.

21. The system of internal control covers a number of dimensions (e.g. efficient organisation and budgetary structures, sound business processes, robust internal audit) but is, in particular based on an ongoing process designed to identify and prioritise the risks to achievement of Departmental policies, aims and objectives, to evaluate the likelihood of these risks being realised - and the impact this would have - and to manage them efficiently, effectively and economically. The Department has a clear Corporate Governance policy (Joint Service Publication 525), which we periodically review and update as necessary. This sets out managers' responsibility to anticipate risks, exploit opportunities and implement control and mitigation activities as a means of optimising performance and delivering continuous improvement. It also facilitates the Department's ability to:

- protect its people;
- harness its resources to manage more effectively the risk to the achievement of objectives;
- avoid disasters or catastrophes by managing those physical and other risks that have the potential to damage its assets, people or members of the public, or effect the environment; and,
- assess and manage risks associated with working with other nations and public and private organisations.

22. As Departmental Accounting Officer, the PUS is personally accountable for the economic, efficient and effective use of Defence resources. He is also responsible for the prudent administration of the Department and the regularity and propriety of Defence expenditure. In recognition of these responsibilities the PUS is supported by the Director of Defence Internal Audit (DIA) who is responsible for evaluating the adequacy and effectiveness of the Department's risk management, control and governance processes, and providing the Permanent Under Secretary with an annual opinion. Following discussion with senior management and stakeholders, DIA produces an annual audit programme for approval by the DAC.

23. There are a number of departmental high level processes which define standards and requirements for key activities (such as personnel and financial management) which take place across the various business units, to ensure that they operate consistently and effectively across Defence. These enabling processes do not deliver specific outputs, but condition how that delivery is carried out. The Business Management System was introduced in April 2005 to enable better management of a range of these. In the first instance it identified six pan-Departmental enabling processes, for: logistics; civilian workforce; Service personnel; communications; financial management; and commodity procurement. A further three Head Office enabling functions were also defined, for planning and resourcing, the strategic context, and the peace-conflict cycle. A senior Process Owner was appointed for each process, accountable to the DMB for ensuring that their process

is efficient and effective, coherent with other processes and functions, and is implemented consistently across all Top Level Budget organisations. This brought greater clarity, coherence and accountability to the way the Department is managed by defining the interconnection between these processes, the roles and responsibilities of the senior military and civilian process owners responsible for them, and their relationship with Top Level Budget Holders and Senior Responsible Owners responsible for specific outputs

Management Structure

24. Most Defence activity takes place outside the Head Office and is managed through Top Level Budget (TLB) holders and Trading Funds not included in the TLB structure. PUS grants each TLB holder extensive delegated powers over personnel, infrastructure and budget. From 1 April 2006, the Royal Navy has a single TLB. The Army and the Royal Air Force have separate TLBs for their Operational and Personnel commands. The Army has a third TLB for Northern Ireland. The other TLBs are Defence rather than single Service organisations. These are:

- Chief of Joint Operations, who is responsible for the planning and execution of joint (tri-Service) operations, and for the management of Permanent Joint Operating Bases in Cyprus, Gibraltar, the Falkland Islands and Diego Garcia;
- The Defence Procurement Agency, which procures equipment for all three Services;
- The Defence Logistics Organisation, which provides logistics support to the armed forces;
- Defence Estates, which delivers estate maintenance, works and services, and manages service housing;
- The Science, Innovation and Technology TLB, headed by the Chief Scientific Adviser, who is responsible for delivering expert advice and developing scientific and technological solutions to satisfy Defence needs and problems; and,
- The Central TLB, including the MoD Head Office and providing corporate services to other TLBs.

25. Each TLB holder has a 'contract' with the Head Office, known as a Service Delivery Agreement, which specifies the outputs he is required to deliver, the resources he is given to deliver these outputs, and the authority delegated to TLB holders by the PUS. Within the TLB structure are a number of specialist agencies spanning a wide range of Defence support activity including logistics, training and corporate services such as bill paying and policing. The Defence Procurement Agency and Defence Estates are both Top Level Budgets and Agencies. The Secretary of State owns and is ultimately accountable for the performance of Defence Agencies and Trading Funds.

26. TLB Holders are required to account annually for their management of their organisations to the PUS in the context of the Department's Statement on Internal Control. They are advised on this by a TLB Audit Committee, generally chaired by a non-executive member of the TLB management board, performing the same function for the TLB Holder as the DAC provides for the PUS. TLB Audit Committee meetings are attended by representatives of both DIA and the National Audit Office.

Non-Departmental Public Bodies

27. The Department sponsors six executive and twelve advisory Non-Departmental Public Bodies (NDPBs), a Public Corporation and an Independent Monitoring Board. Discussion is ongoing regarding the classification of a several

other bodies with links to the department. A brief description of the Executive NDPBs is below. Details of their funding from the Defence Budget and total gross expenditure can be found in the Departmental Resource Accounts. More detailed information on these and the other bodies sponsored by the department can be found at the MOD website at www.mod.uk.

Executive NDPBs

28. The Department's Executive NDPBs are the six museums with charitable status, which retain close links with the Armed Forces (the Fleet Air Arm Museum, the Royal Naval Museum, the Royal Navy Submarine Museum, the Royal Marines Museum, the National Army Museum and the RAF Museum). The Financial Memorandum setting out the arrangement between the Department and these bodies on the conditions governing payment and expenditure of the Grants in Aid made by the MoD is being revised. In addition, following a review of the Executive NDPBs by the MoD's internal audit team, we are drawing up a Memorandum of Understanding clarifying the relationship between the Department, the sponsor branches and the museums, and reflecting their independent status under charity law.