

Prime Minister

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To note.

Wm  
21/8

PRIME MINISTER

An excellent result -  
I am delighted with  
the choice, execution &  
implementation of the  
scrutiny.

SCRUTINY PROGRAMME 1980: INSPECTION AND AUDIT IN THE  
MINISTRY OF DEFENCE

Please could  
this be known  
to those  
concerned  
with it.


1. This minute advises you of the outcome of the scrutiny of Inspection and Audit in the Ministry of Defence, in which you asked me to take a particular interest on your behalf. I enclose a summary of the scrutiny's main findings and recommendations should you need it.

#### The Scrutiny's Findings and Recommendations

2. The report concentrates on three of the organisations responsible for some form of management audit: staff inspection, internal audit and central management services. The picture painted by the scrutiny is not all black and I know the top management of MOD attaches considerable importance to the correct deployment and use of resources in this area.

3. The scrutiny report cast doubt on the effectiveness of the existing arrangements, particularly in the following areas:

- Despite a plethora of different types of inspections (but reporting to different people) the Permanent Secretary has no single source of advice on what 'audit' is revealing about the management health of the Ministry.
- Staff inspection is less effective than imposed "cuts" as a means of controlling manpower numbers; its effect on grades is uneven and does not prevent "grade drift"; and rates of implementation have been poor.

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- On internal audit, effectiveness is hindered by too much audit of low risk areas and insufficient co-ordination and direction of effort where it is most needed; insufficient training of auditors; too much detailed guidance; and a lack of capacity to look at functions across the board.
  - Whilst central management services appear to perform an effective role, there is scope for improvement to provide a better return on effort.

4. The team concluded that an improved system of much more selective but higher quality "audit", backed up by better management information and the placing of greater responsibility for resource management on line managers through 'staff budgets', should be achievable by employing fewer staff of better quality. To effect this a number of detailed changes to methods of working and organisation were proposed, leading to a possible 30% saving in posts.

5. To promote co-ordination and the development of a more unified approach to the audit of all resources it was recommended that the internal audit, central management services and central manpower audit functions should be brought together, though remaining as distinctive functions, under a Director General of Management Audit (DGMA); and that a small nucleus of team leaders at Principal or equivalent level should be attached to the DGMA with specific responsibility to mount selective management audits of the use of all resources in particular areas or of systems of control, functions and grading standards across the board. The report recommended against a more "radical option" of replacing the three separate audit functions with a unified and centrally directed management audit approach (see also para. 10 below).



Ministers' Decisions


6. Ministers have decided to implement the scrutiny's main recommendations.

7. A Director General of Management Audit and a professionally qualified accountant as his deputy have been appointed. The DGMA's responsibilities and those of the Deputy Secretaries in the main management areas of the Department (including their relationship with the DGMA) will be promulgated. The DGMA will bring forward within 6 months worked-up proposals for reform in line with the scrutiny recommendations. He will report to a Management Audit Board, chaired by Sir Frank Cooper, which will also oversee implementation.

8. The new policy and the detailed changes to the way in which the 'audit' function is carried out will be introduced progressively, with the aim of achieving full implementation by April 1984. It is proposed that there should be a comprehensive review of progress in summer 1983 (but see para. 12 below). Changes in audit philosophy and method will be worked out with the Treasury, the Exchequer and Audit Department and the Head of the Government Accountancy Service (who have expressed some disagreement with the detailed recommendations of the scrutiny). Some changes in the guidance given to auditors across the Civil Service may result from these consultations.

9. There will be an initial target reduction of 10% of April 1981 staff levels (which are already 5% below the levels existing at the time of the scrutiny report) for achievement during 1981/82, saving £0.9m a year. The scope for further staff reductions will be examined in the course of further work to get the new organisation going and will take into account the scrutiny report's conclusion that a 30% reduction of staffing levels should be achievable.

10. Further moves to abandon altogether the three separate internal audit, management services and staff inspection functions in favour of a unified and centrally directed management audit approach




are not ruled out for the longer term; and in the short term the Ministry of Defence will be looking to see whether the three functions can be integrated in selected areas. Defence Ministers agreed with the report's rejection of this more radical option (at least for the present) because of the size and complexity of MOD, which argue against over-centralisation, and the need to maintain credible audit arrangements while the new organisation moves progressively towards the more selective and co-ordinated approach to audit recommended in the report.

Comment

11. I very much agree that a better quality investment in audit will produce a better result and that the continuance of the existing arrangements can hardly be tolerated. The Ministry of Defence picked a particularly good subject for scrutiny here. I am glad therefore that Ministers have decided to implement the scrutiny's main recommendations.

12. I am generally well content with the action proposed and do not quarrel with the initial target staff reduction of 10%. I have offered to Defence Ministers, and they have generally accepted, a number of suggestions to strengthen and expedite action, including the following:

- the DGMA's annual report to the Defence Council should contain a section appraising the use made of inspection and audit staff, whose complement should be considered in the light of this with a view to reducing numbers by the 30% recommended;
- the review of progress with the implementation of the new policy and of audit achievements should be made every 6 months, rather than deferred until summer 1983;
- in considering the improvements to the provision of management information and the scope for introducing staff budgets the DGMA might have regard to work carried out for Mr Heseltine in this area;

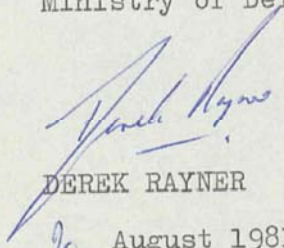
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- great emphasis should be placed on improving the quality and training of auditors and inspectors;
  - the DGMA should have the right of direct access to the Permanent Under Secretary of State, and the Management Audit Board's duties should be clearly specified by means of an instruction from the Secretary of State; and
  - consideration should be given to achieving full implementation before April 1984.

13. I am glad that the "radical option" is not closed off from further consideration. I have suggested to Ministers that all this should be made explicit at the time of the announcement of their decisions and picked up in the regular progress reviews. I would regard unification and the 'management audit' approach as the most effective way of ensuring maximum co-ordinated audit activity, avoiding artificial distinctions in functions and achieving value for money in administration.

#### Conclusion

14. I invite you to take note of the scrutiny's findings and recommendations and the intended action.

15. I am copying this minute to Mr Goodhart, who has Ministerial responsibility for over-seeing the scrutiny programme in the Ministry of Defence.

  
DEREK RAYNER

2c August 1981