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**Defence Resource Accountability: An Output-Based Approach**

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## ABSTRACT

Since the release of the 1962 Glassco Report, there has been an ever-increasing call for enhanced Parliamentary oversight of government expenditures. Defence has not been exempt from this criticism, with the Auditor General citing DND on several occasions for the poor quality and quantity of information provided to Parliament. The 2004 Speech from the Throne and the 2004 Budget, with their commitments to improve accountability in government, provide DND with a unique opportunity to change its approach to resource accountability. In order to enhance the understanding within Parliament, and ultimately with Canadians, of the Canadian Forces resource requirements and improve resource allocation decisions, this paper recommends that DND adopt an output-based approach to the reporting of financial requirements and expenditures.

The paper begins with a look at four alternatives that are available for reporting financial information. The focus then shifts to the specifics of DND's reporting structure and how it has evolved since unification. The analysis then examines the guidance provided by Treasury Board for resource management and reporting and the Auditor General's assessment that DND has achieved a below-average standard in Departmental Performance Reports. The paper then examines the results achieved by both New Zealand and Australia in adopting an output approach to defence departmental reporting. Building upon the structure developed by Australia, combined with the new DND Maritime Command Output Model, the author estimates that an output-based resource accountability structure could be implemented for fiscal year 2006-07.

*The most fundamental duty of Parliament is to hold governments to account for the expenditure of public funds. Annually, the federal government introduces a budget involving the expenditure of nearly \$200 billion. Despite continual cuts, the defence portion of the budget, at about \$12 billion, remains the largest discretionary item of government expenditures. Given these massive expenditure levels, it is surprising to some, probably shocking to many more, that Parliament simply rubber stamps them with barely a cursory examination.<sup>1</sup>*

## **Introduction**

The extract cited above, part of a report released during a period where there is significant interest both within and outside government in making changes to both national security and the parliamentary process, is certainly not the first call to increase Parliamentary oversight generally of government expenditures or, more specifically, those of defence. As early as the 1962 Glassco Report, concerns were being expressed about the overall financial management and reporting structures for defence, this at a time when defence represented approximately 25 per cent of federal government expenditures.<sup>2</sup>

In 1979, a Royal Commission on Financial Management and Accountability completed a three-year comprehensive review of the financial administration within government. In the introduction to its final report, the Commission noted the need for greater Parliamentary oversight into both the setting of program goals and objectives as well as the need to ensure that government resources, acquired primarily from the taxpayers of Canada, were used wisely. One of the topics examined by this Commission

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<sup>1</sup> Douglas L. Bland and Roy Rempel, *A Vigilant Parliament: Building Competence for Effective Parliamentary Oversight of National Defence and the Canadian Armed Forces*, IRPP – Policy Matters, Vol. 5, no. 1 (February 2004): 25.

<sup>2</sup> Royal Commission on Government Organization, “Report 20 – Department of National Defence,” in *Canada’s National Defence- Volume 2 Defence Organization*, ed. Douglas L. Bland (Kingston: Queen’s School of Policy Studies, 1998), 61.

was the Estimates process. Estimates are the means used by the Federal Government, and its various Departments and Agencies, to obtain approval from Parliament to undertake expenditures in support of their respective mandates and programs.<sup>3</sup>

As recently as October 2000, as part of a follow-up to recommendations made in a 1998 Auditor General of Canada examination of equipment and modernization in the Canadian Forces, the Auditor General was raising concerns about both the quality and quantity of information the Department of National Defence was providing to Parliament. The Auditor General had recommended that the Department provide Parliament with information that detailed a clear and understandable linkage between military capabilities, the resources required for each capability, and the performance achieved with the resources assigned. Despite an endorsement by the Public Accounts Committee of the House of Commons of the Auditor General's 1998 recommendations, the Auditor General's assessment in 2000 was that "the government rejected the recommendations to tell Parliament more about the capability of the Canadian Forces."<sup>4</sup>

In addition to the potential benefits in resource allocation decision-making for both the Government and the Department, parliamentary oversight is considered a key component for democratic control of the armed forces.<sup>5</sup> If Canada is to serve as a potential model of federalism for emerging democracies, as highlighted by Prime

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<sup>3</sup> Royal Commission on Financial Management and Accountability, *Final Report* (Ottawa: Minister of Supply and Services Canada, 1979), 7-11.

<sup>4</sup> Auditor General of Canada, *Follow-up of Recommendations in Previous Reports – October 2000, Chapter 16*, 16-25; available from <http://www.oag-bvg.gc.ca/domino/reports.nsf/html/0016ce.html>; Internet; accessed 24 February 2004.

<sup>5</sup> Dr. Wim F. van Eekelen, *Democratic Control of Armed Forces: The National and International Dimension*, Occasional Paper – No. 2 (Geneva: Geneva Centre for the Democratic Control of Armed Forces, 2002), 12.

Minister Martin in his reply to the 2004 Speech from the Throne, it is important that Parliament gain an improved understanding of how the defence budget is being expended.<sup>6</sup>

In order to address this common theme, existing for at least 40 years, that the Department of National Defence must improve the resource information that it provides to Parliament, an examination is needed to determine the most appropriate approach that should be adopted to manage and report on financial resources. To achieve an enhanced understanding of Canadian Forces resources and, by extension, to improve resource allocation decisions, this analysis recommends that the Department of National Defence adopt an output-based approach to the external reporting of financial requirements and expenditures. This new approach should also be used for internal resource decision-making.

The analysis will begin with a look at the general range of alternatives that are available for reporting financial information. This initial section will focus on the management accounting information that could be used by the Government and Parliament to make and approve resource allocation decisions, rather than on the Department's Audited Financial Statements where the Public Sector Accounting Board prescribes the standards to be followed. The focus will then shift to the specifics of the Department of National Defence's financial reporting structure and how it has evolved over the past couple of decades. In order to provide a comparison between the Department of National Defence and the rest of the Federal Government, the analysis will then examine the recent guidance promulgated by the Treasury Board for resource

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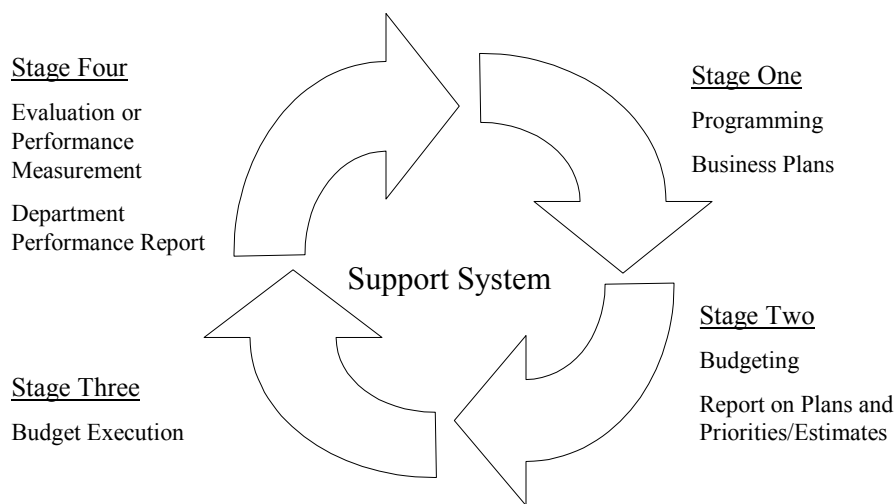
<sup>6</sup> Canada, *Address by the Prime Minister in Reply to the Speech from the Throne – February 3, 2004*; available from <http://pm.gc.ca/eng/sft-ddt.asp?id=2>; Internet; accessed 23 February 2004.

management and reporting as well as a 2003 Auditor General’s review of Departmental Performance Reports. The paper will then look at two countries that have adopted an output approach to departmental reporting, Australia and New Zealand, and the models they use for reporting planned defence expenditures. Finally, the analysis will propose to build upon the Maritime Command Output Model, recently developed to identify resource requirements and manage resource allocations for Canada’s Navy, as the basis for a new DND financial management and reporting framework.

**Approaches to financial reporting**

Academic literature in the area of public sector financial management focuses primarily on the issues of budgeting and performance measurement. Figure 1 provides a comparison between a generic financial management process and the specific financial cycle used by the Federal Government.

**Figure 1 – Financial Management Process**



Sources: Charles A. Bowsher, "Government Financial Management at the Crossroads," 12 and Major-General D.L. Dempster, "Generalship and Defence Management," 452.

Following the development of a proposed program in stage one, budgeting involves the formal request for resources to execute the program and the allocation of these resources once the appropriate authority has approved them. After executing an approved budget in stage three of the cycle, an evaluation of the program is conducted in order to determine and report on where the assigned resources were used and the results achieved. This last step in the process is performance measurement.<sup>7</sup> By examining the reports generated in both the second and fourth stages of the financial management cycle, it is possible to extract four potential approaches to financial reporting. These broad approaches to financial management reporting have been identified as: inputs, process, outputs, and outcomes.<sup>8</sup> Let us briefly look at each of these approaches in turn.

Inputs are the resources that are made available to undertake a particular government program. These resources can be in the form of cash, or expenditure authority, as well as other assets that one would normally find reported on a set of financial statements. In the case of defence, this would include the major equipment platforms used by the Army, Navy, and Air Force. While not currently assigned a value on the annual financial statements, personnel would also be an important defence input.<sup>9</sup> When reporting on an input basis, the focus is on individual expenditure items such as the amount of travel, the number of personnel, and additions to the capital inventory. This

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<sup>7</sup> Charles A. Bowsher, "Government Financial Management at the Crossroads: The Choice is Between Reactive and Proactive Financial Management," *Public Budgeting & Finance* 5, no. 2 (Summer 1985): 11-12.

<sup>8</sup> Lawrence L. Martin, "Outcome budgeting: A New Entrepreneurial Approach to Budgeting," *Journal of Public Budgeting, Accounting and Financial Management* 9, no.1 (1997): 111.

<sup>9</sup> Keith Hartley, *Defence Economics: Its contributions and New Developments*, Institute for Defence Research Management Paper 2003-1 (Kingston: Department of Politics and Economics, Royal Military College, 2003), 3.



has been the traditional method of accounting for defence expenditures, both in Canada and elsewhere.<sup>10</sup> At the Federal Government level in Canada, this input-based reporting has been achieved through the annual tabling of the Public Accounts of Canada.<sup>11</sup> Expenditures are summarized by Standard Object, with each Standard Object comprising a collection of related Resource Codes such as personnel, services, or capital equipment. While offering the opportunity for Parliamentarians to highlight perceived excessive expenditures, it is not possible from these reports to determine the results achieved. It is noted that a large portion of the defence debate, including within government defence policy, is focused on the distribution of inputs between personnel and capital.<sup>12</sup>

The second option available for financial reporting is to focus on the individual processes that take place in delivering defence. Two potentially different views are offered for this process-based approach. The first would be a model that divides the processes, and associated resources, into three groups: manage, operate, and support. The “manage” group is comprised of those processes that provide the overall strategic direction and command and control of the organization. The “operate” group is the category that includes all of the processes that conduct the business of defence. “Support”, the final grouping, would include processes such as training, finance, and material management. This model is one that is used to structure frameworks for

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<sup>10</sup> Verne B. Lewis, “Toward a Theory of Budgeting,” *Public Budgeting & Finance* 1, no. 3 (Autumn 1981): 80.

<sup>11</sup> Royal Commission on Financial Management & Accountability, 106.

<sup>12</sup> John M. Treddenick, “Distributing the Defence Budget: Choosing Between Capital and Manpower,” in *Issues in Defence Management*, ed. Douglas L. Bland (Kingston: School of Policy Studies, Queen’s University, 1998), 57-58.

corporate performance measurement systems.<sup>13</sup> The second process view would be to report based on organizational structure. Where individual processes have been centralized, such as medical services within the Canadian Forces, the results reported would be the same as the model described above. However, where support processes have been decentralized across several operational organizations, such as the process of material management, the financial results would be reported differently. Using an organizational model would allow Parliament to understand who within defence had consumed the resources.<sup>14</sup> As will be discussed later in this analysis, the process-based approach is one that the Department of National Defence has used in the past to report results and is consistent with the structure of the Department's Financial and Managerial Accounting System.

Outputs are the goods and/or services that are produced by a program or organization. These goods or services are not used internally by the organization that is reporting, but rather are provided to either another organization or the general public.<sup>15</sup> Adopting an output-based approach to reporting would focus on the amount of financial resources consumed in producing each of the defence capabilities that have contributed to providing an output such as the number of sea days and flying hours conducting fisheries

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<sup>13</sup> Umit Bititci, Allan Carrie, and Trevor Turner, "Integrated Performance Measurement Systems: Structure and Dynamics," in *Business Performance Measurement*, ed. Andy D. Neely (Cambridge: Cambridge University Press, 2002), 179-182.

<sup>14</sup> John M. Treddenick, "The Defence Budget," in *Canada's International Security Policy*, ed. David B. Dewitt and David Leyton-Brown (Scarborough: Prentice-Hall Canada Inc., 1995), 437.

<sup>15</sup> United States, Executive Office of the President of the United States Office of Management and Budget, *Performance Measurement Challenges and Strategies* (June 18, 2003); available from [http://www.whitehouse.gov/omb/part/challenges\\_strategies.pdf](http://www.whitehouse.gov/omb/part/challenges_strategies.pdf); Internet; accessed 4 March 2004.

patrols in support of the Department of Fisheries.<sup>16</sup> This approach would be a natural extension of the framework commonly used for defence planning, which focuses on building capabilities that, due to uncertainty, may be used immediately after acquisition or not used until decades into the future.<sup>17</sup> These capabilities would be drawn from the Department's strategic plan, to be developed following completion of the current policy reviews.

The final alternative that is available for financial reporting would be to focus on outcomes. An outcome is the result achieved from conducting a program or activity.<sup>18</sup> Linking resources through activities and outputs to outcomes has been identified as a key component of the Department of National Defence's strategy to achieve the 2020 defence vision.<sup>19</sup> With a single assigned outcome to defend Canada and contribute to both North American defence and international security, an outcome-approach would need to quantify the threats to Canada and assess whether Canada's international military deployments had reduced the number the conflicts.<sup>20</sup> While the preferred approach for results-based management, it is difficult to quantify expected outcomes when the nature of the threat to Canada or international stability is constantly changing. An outcome approach might have been easier to adopt during the Cold War when the threat was better

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<sup>16</sup> Tredennick, "The Defence Budget," 437.

<sup>17</sup> Paul K. Davis, "Uncertainty-Sensitive Planning," in *New Challenges & New Tools for Defence Decision Making*, ed. Rand (Santa Monica, CA: Rand, 2003), 141.

<sup>18</sup> United States, *Performance Measurement Challenges*. . .

<sup>19</sup> Department of National Defence, *Shaping the Future of the Canadian Forces: A Strategy for 2020* (Ottawa: DND Canada, 1999), 7.

<sup>20</sup> *Ibid*, 2.

defined than is the case today.<sup>21</sup> The other main difficulty in quantifying a defence outcome is that the primary focus of an outcome is on program effectiveness. The majority of performance measures for effectiveness are qualitative and not of a financial nature.<sup>22</sup>

This concludes the brief examination of the broad alternatives available for designing a reporting framework for financial resources. In the author's opinion, it is assessed that management of inputs, while important, does not appear to provide sufficient information to assess the results achieved. An outcome approach, while desirable, would be difficult to quantify when the nature of the outcomes is uncertain. This leaves the process-based and output-based approaches as options for further study. Let us now look at the reporting methods used by the Department of National Defence over the last couple of decades.

### **National Defence Reporting**

Prior to the Glassco Report being tabled in 1962 and the creation of a single Canadian Armed Forces (CAF) program through unification in 1968, each of the three services developed their own individual financial reports that were submitted to Parliament as part of the departmental Estimates. The information exclusively reflected inputs to the three services by standard object of expenditure. The Glassco Report specifically recommended, "that departmental Estimates be prepared on the basis of

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<sup>21</sup> Douglas L. Bland, "Issues in Defence Management: An Introduction," in *Issues in Defence Management*, ed. Douglas L. Bland (Kingston: School of Policy Studies, Queen's University, 1997), 1-2.

<sup>22</sup> Ken Ogata and Rich Goodkey, "Redefining Government Performance," in *Business Performance Measurement*, ed. Andy D. Neely (Cambridge: Cambridge University Press, 2002), 263.

programmes of activity rather than by standard objects of expenditure.”<sup>23</sup> In response, Treasury Board introduced a government wide planning, programming and budgeting system (PPBS). The primary intent of PPBS was to introduce a structure for formal longer-term resource planning, broadening the focus beyond single-year resource demands to a planning horizon of five years.<sup>24</sup> However, this was the first attempt to try and link resource demands (inputs) to service levels (outputs). The challenge for defence was that, given the need to take a longer-term view for capital equipment acquisitions, the Department already had a planning system in place. As is the case for most change initiatives, it is often harder to modify an existing system than starting from scratch with a brand-new approach.

The decision was made in 1965 to try and adopt a system of reporting financial resources by Capability Activity.<sup>25</sup> A total of 10 operational and 20 support activities were identified to cover the entire range of the CAF Program.<sup>26</sup> The operational activities reflected the major Formation Commands that had been created through integration, such as Air Transport Command and Maritime Command. While some of the support activities could easily be tracked to a single Functional Chief, such as materiel supply services or recruiting, over 900 different units and organizations were carrying out most of the support activities, such as administration or training. The decision was made to focus on the major organizational elements of the CAF.

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<sup>23</sup> Royal Commission on Government Organization, 62.

<sup>24</sup> J.C. Arnell and J.F. Anderson, “Program Management in the Department of National Defence,” *Canadian Defence Quarterly* 1, no. 2 (Autumn 1971): 29.

<sup>25</sup> *Ibid*, 30.

<sup>26</sup> Additional details on the activities can be found in the Arnell and Anderson article.

Accordingly, the first departmental Estimates after unification reflect Maritime, Land, and Air Defence/Transport operations, plus the newly integrated personnel and materiel support structures.<sup>27</sup> What was lost with this new format was an ability to assess the total resources expended in support of a Capability Activity, as the full cost of the Maritime activities, for example, was now divided between personnel, materiel, and Maritime operations.

This new CAF reporting structure did not last long. In 1972, the Department and the Canadian Armed Forces programs were amalgamated, as was the case with the creation of NDHQ, into a single Defence Services Program (DSP).<sup>28</sup> Unlike most government departments, where the program structure is specified in legislation approved by Parliament, the DSP is not mentioned in the National Defence Act. However, based upon over 30 years of tradition, it has become the accepted financial reporting program. The Management Review Group, whose report in 1972 recommended the creation of a single legal entity for the Department of National Defence and the Canadian Armed Forces, observed on the poor quality of financial management. The Report highlighted “the Department’s inability to allocate with precision the cost of the five operating activities ... costs cannot be related at present in any but an arbitrary way to the activities specified in the Department.”<sup>29</sup> This theme would return in future years.

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<sup>27</sup> *Ibid*, 31.

<sup>28</sup> Douglas Bland, *The Administration of Defence Policy in Canada - 1947 to 1985* (Kingston: Ronald P. Frye & Company, 1987), 88.

<sup>29</sup> Management Review Group, “Management of Defence in Canada,” in *Canada’s National Defence- Volume 2 Defence Organization*, ed. Douglas L. Bland (Kingston: Queen’s School of Policy Studies, 1998), 222.

From 1972 until 1994, the DSP reporting structure to Parliament remained fairly constant with eight major activity categories or Capability Components. Four of the categories were linked to operations: Maritime Forces, Land Forces in Canada, Air Forces in Canada, and Canadian Forces Europe. The remaining four categories were support in nature: Communications Services, Personnel Support, Materiel Support, and Policy Direction and Management Services. For fiscal year 1994-95, with the repatriation of permanent forces in Europe almost complete, the Canadian Forces Europe Capability Component was replaced with Joint Operations while the Land Forces and Air Forces groupings no longer focused exclusively on activities in Canada.<sup>30</sup>

To determine the amounts to be reported in each Capability Component, it was not possible to extract the information directly from the Department's financial information system (FIS). Instead, using a combination of organizational structure, activity rates, and standard costs, a percentage weighting by Capability Component was developed for each resource code for personnel and operations and maintenance expenditures. For capital equipment projects, expenditures were assigned to each the Capability Component(s) based on an estimate of future usage for each piece of new equipment or infrastructure. These relationships were maintained centrally in the DSP Information System (DSPIS), primarily by the Chief of Financial Services organization. While not 100 percent accurate and used exclusively for reporting to Parliament, it was the most reliable data available without changing the Department's entire financial management system.<sup>31</sup>

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<sup>30</sup> Department of National Defence, *1994-95 Estimates – Part III Expenditure Plan* (Ottawa: Minister of Supply and Services Canada, 1994), 16-18.

<sup>31</sup> From 1992 until 1995, the author was responsible for maintaining the DSPIS PO&M model.

In 1994, faced with a need to reduce expenditures due to a shrinking defence budget as well as the start of a push towards devolution of financial authorities, the alignment of activities to Capability Components was updated. While some activities and organizations did shift, the net effect on the attribution of personnel, operations and maintenance expenditures by Capability Component was marginal. Other than changing Communications Services to read Communications and Information Management, the financial tables between fiscal years 1994-95 and 1995-96 look very similar. The most significant change that started with the fiscal year 1995-96 Estimates was that capital expenditures were assigned exclusively by project sponsor rather than by allocating the costs by beneficiary. This meant that the cost of Maritime Helicopters, for instance, would now appear solely under Air Forces rather than being split between Air Forces and Maritime Forces.<sup>32</sup> While this change more firmly entrenched an organizational view to reporting, more consistent with how resources were being managed internally, this change increased the difficulty for external audiences to understand the costs of major capabilities such as a Naval Task Group.

In fiscal year 1997-98, while title changes were made in the Part III Estimates to two of the eight DSP Capability Components, the basic structure and allocation procedures remained constant. Materiel Support was changed to Materiel, Infrastructure, and Environment Support, while Policy Direction and Management Services became Department/Forces Executive.<sup>33</sup>

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<sup>32</sup> Department of National Defence, *1995-96 Estimates – Part III Expenditure Plan* (Ottawa: Minister of Supply and Services Canada, 1995), 218-220.

<sup>33</sup> Department of National Defence, *1997-98 Estimates – Part III Expenditure Plan* (Ottawa: Public Works and Government Services Canada, 1997), 4-3.



At the end of fiscal year 1997-98, when tabling the first Performance Report to Parliament, the Department identified three Business Lines drawn directly from the 1994 White Paper: Defending Canada, Defending North America, and Contributing to International Security. The introduction of performance reporting and the concept of business lines was part of DND's response to Treasury Board guidance for improved reporting to Parliament, which will be discussed further in the next section of this analysis. The fiscal year 1997-98 report advised Parliament that it would take at least two years to establish the necessary linkages between financial information and business lines.<sup>34</sup>

Fiscal year 1999-2000 brought about a change in the Part III Estimates. Instead of being a stand-alone financial document, Treasury Board directed that the information be incorporated as part of an annual report on plans and priorities. The focus was to be based on the services each department provided to Canadians in order to allow for an easier comparison of planned resource expenditures against the departmental results to be reported at the end of each fiscal year in the annual performance report. Internal changes would also incur to DND resource planning, with the elimination of the annual Defence Planning Guidance and the strengthening of the business planning process.<sup>35</sup>

While one might expect that this might have marked the beginning of an output-based approach to financial reporting, which it was for some federal departments, DND initially continued to keep the same eight categories of Capability Components as their

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<sup>34</sup> Department of National Defence, *Performance Report for the Period ending 31 March 1997*, (Ottawa: DND Canada, 1998), 5.

<sup>35</sup> Major-General D.L. Dempster, "Generalship and Defence Management," in *Generalship and the Art of the Admiral – Perspectives on Canadian Senior Military Leadership*, ed. Bernd Horn and Stephen J. Harris (St. Catharines, ON: Vanwell Publishing Ltd., 2001), 452.

Service Lines.<sup>36</sup> However, it would be unfair to leave the impression that the Department was not moving forward. In fact, DND had embarked on implementing new planning elements as part of the Treasury Board requirement for each department to have a Planning, Reporting and Accountability Structure (PRAS). The first iteration of the PRAS moved DND to a single Business Line based on the Defence Mission and seven Service Lines. These service lines were not the same as those being used to report to Parliament, but were instead designed to provide a linkage between resources and outputs. The seven PRAS 1999 Service Lines were:

- ◁ Corporate Policy, Strategy and Management;
- ◁ Operational Forces;
- ◁ Reserve Force;
- ◁ Command, Control, Communications and Intelligence;
- ◁ Human Resources Management and Training;
- ◁ Supporting Infrastructure; and
- ◁ Logistics and Technical Support.<sup>37</sup>

It was not until the release of PRAS 2001 that DND would achieve a common planning and financial reporting framework. Instead of collating financial information by major organizational grouping, expenditures would now be tied to five Capability Programs or Business Lines that were intended to provide a direct linkage between the Department's mission and the key results that the Department had to achieve. The five Capability Programs are described in Table 1. PRAS 2001 recognized that this format

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<sup>36</sup> Department of National Defence, *1999-2000 Report on Plans and Priorities, Part III Estimates*, (Ottawa: Public Works and Government Services Canada, 1999), 20.

<sup>37</sup> Dempster, "Generalship and Defence Management," 450-451.

would initially be used primarily for financial reporting and is not consistent with how resources are allocated internally. The PRAS 2001 document also indicates that DND does not report by Level One Advisor "... due to the large number of Level One organizations, the difficulty in explaining their interrelated functions, and the requirements of the prescribed reporting format ..."<sup>38</sup>

**Table 1 – Fiscal Year 2002-03 DND Capability Programs**<sup>39</sup>

<b><u>Capability Program</u></b>	<b><u>Definition</u></b>
Command and Control	Collect, analyze and communicate information, plan and coordinate operations, and provide the capabilities necessary to direct forces to achieve assigned missions.
Conduct Operations	Provide the ability to employ the range of military capabilities required to achieve its assigned missions, when and where directed.
Sustain Forces	Repair and ma 2301 sMC / Tc -0.00169 Tw 126.71.01912 309.35608 4 apabp

Instead, the expenditures for each cost center were allocated to the appropriate Capability Program based on an assessment of its primary military function.<sup>40</sup> For centrally managed financial accounts, however, such as Military Pay, alternate data sources were still being used to attribute resource expenditures to each of the Capability Programs.<sup>41</sup>

For fiscal year 2002-03, DND finally was able to report on financial expenditures by Capability Program. The 2002-03 Report on Plans and Priorities (RPP) included a “crosswalk” table that was designed to compare expenditures by Service Line to expenditures by Capability Program. Six of the eight previous Service Lines showed expenditures in all five Capability Program categories, while the remaining two Service Lines were split across four of the five Capability Programs.<sup>42</sup> While it was still possible in 2002-03 for Parliament to have a rough understanding of how much was being spent on Maritime or Land Forces, this crosswalk table does not appear in the fiscal year 2003-04 RPP. The decision by DND to adopt process-based Capability Programs has made it even more difficult for Parliament to understand the linkage between resources and deployable military forces.

While DND has continued to provide input-based reporting by Standard Object and Resource Code over the past 30 years as part of the annual Public Accounts, this information has been increasingly supplemented with financial details by organization and more recently by major defence process. Over the last ten years, however, the Department has struggled to find a common structure that can divide the DSP by Service

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<sup>40</sup> DND’s cost center structure matches very closely with DND’s organizational structure.

<sup>41</sup> *Ibid*, 3-4.

<sup>42</sup> Department of National Defence, *2002-2003 Report on Plans and Priorities, Part III Estimates*, (Ottawa: Public Works and Government Services Canada, 2002), 37.

Line or Business Line. Progress had certainly been achieved with the adoption in fiscal year 2002-03 of a common framework for planning and reporting, but this framework can still not be used for internal resource allocation or improved decision making. The Department, however, has been unable to implement a financial management accounting system that can meet these new financial reporting requirements without significant reattribution using data from other departmental information systems. In addition, with the exception of the Conduct Operations Capability Program, it has become more difficult in the last couple of years for Parliament to understand the linkage between expenditures and tangible defence outputs. The question becomes whether the current process-based Capability Program structure meets Treasury Board guidelines. The next section will look at recent Treasury Board direction as well as assessments by both Treasury Board and the Office of the Auditor General on progress achieved in improved reporting to Parliament.

### **Central Agency Requirements**

As previously mentioned, a 1979 Royal Commission examined Federal Government financial management, including the Estimates process, and found significant deficiencies in how departments were accounting to Parliament for their resource requirements and expenditures. One of the Commission's recommendations was to modify the Estimates to ensure that "each program, activity, and sub-activity displaying resource requirements in the Estimates have a specified stated purpose and, in so far as possible, a measurable result."<sup>43</sup> While the Royal Commission's report resulted

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<sup>43</sup> Royal Commission on Financial Management & Accountability, 97.

in Parliament receiving more detailed information from Treasury Board on the expenditure plans of individual departments, the report did not result in any major changes in the structure of departmental reports.

It was a 1992 Report of the Auditor General of Canada that seems to have launched the initial movement to improve financial reporting to Parliament. In Chapter 6, which focused on departmental reporting, the Auditor General identified four key questions that departments should answer in their reports to Parliament:

- ◁ What are the department's mission and lines of business?
- ◁ How does the department carry out its lines of business to achieve its mission?
- ◁ What are the department's strategic objectives for realizing its mission, and plans for managing the significant public resources under its control?
- ◁ How did the department do in meeting its objectives, and how much did it cost?<sup>44</sup>

Based on interviews with Parliamentarians and officials in individual line departments and central agencies, as well as an examination of the Estimates submitted by departments, the Auditor General determined that departmental Estimates did not answer these four questions. While some of the gap was due to a reluctance of departments to provide detailed information, the major shortfall was due to the need for departments to adhere to a rigid centralized format that was not suitable in all cases. The Auditor General recommended that Treasury Board permit departments to present the necessary information in whatever format would allow Parliamentarians to gain the greatest

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<sup>44</sup> Auditor General of Canada, *Information for Parliament – Departmental Reporting, 1992*, Chapter 6, 6.39; available from <http://www.oag-bvg.gc.ca/domino/reports.nsf/html/92menu-e.html>; Internet; accessed 24 February 2004.

understanding of individual departmental programs and activities.<sup>45</sup> Of note, DND was specifically cited by the Auditor General as one of the departments that did not use the same structure for resource management and financial reporting and that the Department should consider reporting by defence capability.<sup>46</sup>

While not all of the Auditor General's recommendations would be implemented, the need to tackle the ever-increasing government deficit prompted the Treasury Board to look for improved insight into how departments operated and where potential resource savings might exist. In 1994, the first phase of the Improved Reporting to Parliament Project was launched. On a trial basis, sixteen departments provided Parliament with two reports a year; a revised Part III Estimates as part of a new Report on Plans and Priorities in the spring and a Departmental Performance Report in the fall. The first of these new reports were presented in 1996 – National Defence was not one of the trial departments. While not perfect, Parliament was satisfied that the new reports were an improvement and passed a motion on 24 April 1997 directing all 78 departments and agencies to adopt the new format.<sup>47</sup> Meanwhile, in December 1996, Treasury Board formally approved introduction of the Planning, Reporting and Accountability Structure (PRAS) as the method each department would use in the future to request and manage resources and report on performance. The PRAS was intended to define an organization's core

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<sup>45</sup> *Ibid*, 6.46 – 6.72.

<sup>46</sup> *Ibid*, 6.101.

<sup>47</sup> Treasury Board of Canada Secretariat, *Improved Reporting to Parliament Project*, Phase 1; available from [http://www.tbs-sct.gc.ca/rma/eppi-ibdrp/irp-arp/irp-arp\\_e.asp](http://www.tbs-sct.gc.ca/rma/eppi-ibdrp/irp-arp/irp-arp_e.asp); Internet; accessed 23 February 2004.

business or business lines and identify the resource allocations and key performance measures for each business line.<sup>48</sup>

With a new resource management and reporting structure, the basics of a new framework should have been in place. However, in 2000 the Auditor General assessed that the pace of change in improved reporting to Parliament was too slow.<sup>49</sup> The Government responded with a new management framework entitled Results for Canadians.<sup>50</sup> The intended focus of this new approach was a shift away from reporting on the processes used to achieve results towards more emphasis on the results actually achieved and the impact each government program had on the lives of Canadians. Performance reports to Parliament were to be delivered in a format that made sense to Canadians. In addition, where more than one Department was involved in providing a service, such as protection of Canada's maritime approaches, the results-based format was supposed to be consistent across each of the departments involved in the service so that an assessment could be made by Parliament on the total cost of the program and the value of the service to Canadians.<sup>51</sup> In order to provide this information, departments had to shift their management and reporting focus away from process towards outputs and, where possible, towards outcomes. Managing processes to ensure that they were

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<sup>48</sup> Treasury Board of Canada Secretariat, *Planning Reporting and Accountability Structure (PRAS) Policy Review – Report of the Task Team – July 2002*, 3; available from [http://www.tbs-sct.gc.ca/rma/dpr/taskteam\\_e.asp](http://www.tbs-sct.gc.ca/rma/dpr/taskteam_e.asp); Internet; accessed 23 February 2004.

<sup>49</sup> Auditor General of Canada, *Rating Departmental Performance Reports – 2003, Chapter 1*, 1.2; available from <http://www.oag-bvg.gc.ca/domino/reports.nsf/html/0301ce.html>; Internet; accessed 24 February 2004.

<sup>50</sup> Treasury Board of Canada Secretariat, *Results for Canadians: A Management Framework for the Government of Canada*; available from [http://www.tbs-sct.gc.ca/res\\_c2\\_0\\_0\\_10.02\\_427.13235\\_511\\_73:198.65918\\_1.02\\_231.3879](http://www.tbs-sct.gc.ca/res_c2_0_0_10.02_427.13235_511_73:198.65918_1.02_231.3879)



efficient, effective, and necessary would still be important, however, process-based reporting was no longer considered sufficient to meet the needs of Parliament or Canadians.

In order to support departments in implementing the requirements of Results for Canadians, Treasury Board requested an external review of the PRAS policy by the firm Pricewaterhouse Coopers in 2001. Pricewaterhouse determined that at least 50 per cent of the PRAS reports had major shortfalls and that many departments saw no value in adopting the PRAS process for internal management. As a result, Treasury Board established a PRAS Review Task Team in 2002 to analyze the deficiencies within the existing PRAS framework, determine their causes, and draft new guidelines. Amongst the team's major findings were that:

- ◁ almost 80 per cent of departments were not using the PRAS to support decision-making;
- ◁ the existing PRAS framework was not consistent with the requirements of Results for Canadians; and
- ◁ departments were having great difficulty linking resources to results instead of organizational structures or processes.<sup>52</sup>

The team recommended that Treasury Board adopt an Integrated Management and Accountability Framework that would “align how a department ... governs itself, supports government-wide outcomes, and accounts for results achieved and resources used both internally and to Parliament.”<sup>53</sup> The linkage would be achieved through the definition, by each department, of their individual strategic outcomes and business model.

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<sup>52</sup> Treasury Board of Canada Secretariat, *Planning Reporting and Accountability Structure (PRAS) Policy Review*, 4-6.

<sup>53</sup> *Ibid*, 8.

This business model would form the basis of internal resource and activity management as well as the framework for external reporting.

To help sustain the momentum for change, the Auditor General decided to rate nine of the fall 2002 departmental performance reports against a model of good reporting criteria. This Auditor General model is based on both public and private sector best practices. While the Auditor General acknowledged an improvement in the overview of planned departmental strategic outcomes, the performance reports continued to fall short of requirements in the areas of clarity, credibility, and focus on results.

**Figure 2 - Auditor General Evaluation - 2002 Departmental Performance Reports**

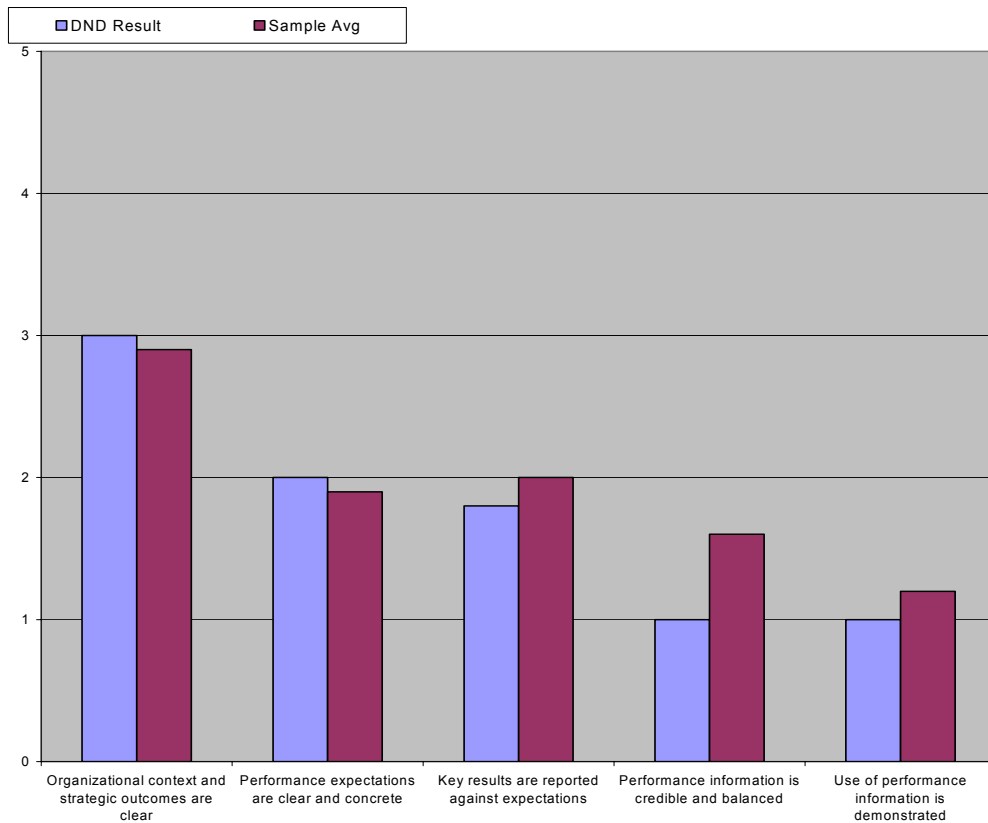


Figure 2, developed by the author, provides a comparison of the average results achieved by the sample departments in each of the five assessment criteria with the

Auditor General's assessment of DND's 2002 performance report. The levels or ratings are: 1 – Basic; 2 – Fair; 3 – Good; 4- Very Good; and 5 – Excellent.<sup>54</sup>

DND was only able to achieve a rating of good for clarity of strategic outcomes, with the remaining criteria assessed as fair or basic. DND did not achieve the highest rating amongst the nine departments in any of the five criteria and would have been ranked fifth of nine, tied with the RCMP, if the Auditor General had provided an aggregate score. Transport Canada and the National Parole Board had the highest aggregate ratings, although even for these two departments the average score fell between fair and good.<sup>55</sup> In order to achieve an improved result in any future Auditor General review, DND will need to adopt a greater focus on outputs and outcomes and provide clearer information that better demonstrates to Parliament and Canadians how assigned resources are linked to results.

In response to the Auditor General's 2003 report, Treasury Board released a new Management Accountability Framework in November 2003. The primary focus of this new framework was to help focus strategic leaders on ten elements of sound modern management and recognize that each of the program elements, such as people, risk management and resource stewardship, are interdependent.<sup>56</sup> A leader cannot simply focus exclusively on one or two areas. In addition, changes in one element will impact on the others. The new framework calls for performance indicators that assess the alignment of the department's management framework to strategic outcomes, linkage

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<sup>54</sup> Auditor General of Canada, *Rating Departmental Performance Reports – 2003, Chapter 1*, Exhibit 1.1.

<sup>55</sup> Ibid, 1.21–1.56.

<sup>56</sup> Treasury Board of Canada Secretariat, *TBS Management Accountability Framework*; available from [http://www.tbs-sct.gc.ca/maf-crg/maf-crg\\_e.asp](http://www.tbs-sct.gc.ca/maf-crg/maf-crg_e.asp); Internet; accessed 23 February 2004.

between strategic resource allocations and performance, and departmental reporting based on measurable outcomes.<sup>57</sup> As discussed earlier, it would be very difficult for DND to achieve a performance reporting framework based on outcomes. However, a move to reporting by outputs would provide a framework from which outcomes could be assessed on an annual basis, when results achieved are matched against the strategic events that influenced where the Canadian Forces capabilities were employed in a given fiscal year.

On 24 March 2004, following Budget 2004 that focused on improving accountability in government, Treasury Board announced further reforms to the management processes with the Public Sector. Proposed initiatives include a strengthening of the November 2003 TBS Management Framework, development of a government wide expenditure management information system, and improve the information provided to Parliament when seeking expenditure approval. As part of these initiatives, departments have been requested to submit a revised program activity architecture that, when adopted, will replace the current approved PRAS.<sup>58</sup>

For the past 25 years there has been a push for change in how departments report to Parliament. Over the last ten years, based on the work of the Auditor General, Treasury Board has made significant progress in developing an improved framework for reporting, based on strategic outcomes, to provide Results for Canadians. As noted, change has been slow in coming in many departments. Treasury Board has responded to

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<sup>57</sup> Janet Wong, "Management Excellence: Are we finished yet," *FMI Journal* 15, no. 1 (Autumn 2003): 14-15.

<sup>58</sup> Treasury Board of Canada Secretariat, *Strengthening Public Sector Management- An Overview of the Government Action Plan and Key Initiatives*; available from [http://www.tbs-sct.gc.ca/spsm-rgsp/spsm-rgsp\\_e.asp](http://www.tbs-sct.gc.ca/spsm-rgsp/spsm-rgsp_e.asp); Internet; accessed 1 April 2004.

these observations by making modifications to the management framework, where necessary, based on lessons learned from the initial implementation phases.

As shown in Figure 2, DND's progress appears to have been below average when compared against a sample of other departments. As identified earlier, part of this result can be attributed to the difficulty for defence to work with strategic outcomes in an uncertain strategic environment. However, in the author's opinion, DND has also been slow to adopt Treasury Board direction and, when adopted, tried to minimize the level of change. DND has not moved its internal financial management and external reporting away from a combination of processes and organizational structure. In addition, the internal DND financial management system used for resource allocation and decision-making has become increasingly disconnected from the structure used for external reporting. The recently announced Treasury Board initiatives provide DND with an ideal opportunity to modify its resource management and reporting structure, including its Financial and Managerial Accounting System, and shift toward an output-based framework that can be linked to strategic outcomes. However, is an output-based framework achievable for defence? The next section will, therefore, look at two countries that have adopted this approach to resource allocation and reporting for their defence departments.

### **Output-Based Models**

The first Western country to embark on an output-based approach was New Zealand, a nation that experienced major economic and political turmoil in 1984 following the election of a new Labour government. Removal of foreign investment

restrictions and trade barriers, the introduction of a consumption tax (the equivalent of Canada's GST), and the privatization of government-owned organizations were just some of the actions taken by the government to reduce New Zealand's national debt. Core government services that could not be privatized were also directed to change. The traditional system of a single rules set and processes across all departments and highly centralized public service career management, common in a British parliamentary system, were largely abandoned. A series of legislation provided each department increased flexibility, matched with enhanced accountability. The Public Finance Act, passed in 1989, revolutionized public sector financial management, introducing concepts such as accrual accounting and budgeting.<sup>59</sup>

To implement the required reforms and move away from the traditional focus on resource inputs, the New Zealand Defence Force (NZDF) also had to tackle the challenge of measuring a potential capability rather than the actual levels of service to the public that other government departments deliver. In addition, since most offshore NZDF missions were conducted as part of a coalition, it was not fair to evaluate NZDF performance against strategic outcomes. Accordingly, a model was built that would measure and resource the NZDF based on a combination of potential capacity to employ military force and actual military capability delivered during the fiscal year. The New Zealand Parliament, based on an agreed level of quantity and quality, would resource each defence output separately. Quality would be linked to a readiness level, with an enhanced readiness posture requiring additional resources. When a potential capability

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<sup>59</sup> Cathy Downes, "Reforming Defence Management: Lessons from the New Zealand Defence Force Expenditure," in *Issues in Defence Management*, ed. Douglas L. Bland (Kingston: Queen's University School of Policy Studies, 1998), 14-20.

was to be deployed by the New Zealand government, all additional costs, including depreciation on equipment used, were to be fully financed by the government rather than from within the existing NZDF resource envelope.

With the additional oversight available to Parliament on each defence output, the NZDF no longer faces the same difficulty as the Canadian Forces in being reimbursed for government policy decisions. In addition to improving financial management and reporting, it has been assessed that the NZDF produces approximately the same level and standard of military force as before the reforms started at two-thirds of the cost.<sup>60</sup> The NZDF has adopted a model with the following sixteen defence outputs:

- < Military Policy Development, Coordination & Advice;
- < Naval Combat Forces;
- < Naval Support Forces;
- < Mine Countermeasures, Diving and Diving Support Forces;
- < Naval Control of Shipping Forces;
- < Hydrographic & Oceanographic Data Collection & Processing;
- < Land Combat Forces;
- < Land Combat Support Forces;
- < Land Combat Service Support Forces;
- < Specialised Forces;
- < Maritime Patrol Forces;
- < Fixed Wing Transport Forces;
- < Rotary Wing Transport Forces;
- < Miscellaneous Support Activities; and
- < Operationally Deployed Forces.<sup>61</sup>

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<sup>60</sup> *Ibid*, 22-23.

<sup>61</sup> New Zealand, *Report of the New Zealand Defence Force for the Year Ended 30 June 2003*, 124; available from <http://www.nzdf.mil.nz/public-documents/annual-reports.html>; Internet; accessed 4 February 2004.

For most outputs, the military capability has been divided in two categories: performing predictable or routine tasks and maintaining the ability to respond to unknown future events. Parliament votes a specific resource level for each output that the NZDF must use to pay for its military and civilian personnel, fund operations and maintenance, and set aside for future capital equipment or infrastructure acquisitions. The NZDF is free to decide the split between the three broad expenditure categories, with a different ratio for each output. The NZDF maintains its own bank account and receives interest on its investments; however, it must also pay a capital charge on its assets and fund the GST component of defence expenditures.<sup>62 63</sup>

In order to match defence expenditures against agreed outputs, the NZDF has developed a two-stage cost allocation process. In the first stage, overhead and support unit costs are attributed to the appropriate force element (ship, aircraft squadron, or army battalion) using an allocation method that reflects the expected level of a force element's activity based on a five-year average activity rate (sea days and flying hours are two examples of activity rates). Each force element is then assigned in the second stage of the allocation process to one or more outputs. The expenditure allocation framework is reviewed on an annual basis in order to ensure the same model is used to both allocate resources at the start of the fiscal year and to track performance throughout.<sup>64</sup> The

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<sup>62</sup> Ibid, 45.

<sup>63</sup> In Canada, GST is funded centrally and individual departments can not maintain separate bank accounts or receive interest on funds carried-forward to future fiscal years.

<sup>64</sup> New Zealand, *New Zealand Defence Force – Departmental Forecast Report 2003/04*, 60; available from <http://www.nzdf.mil.nz/public-documents/forecasts.html>; Internet; accessed 4 February 2004.



quality of each force element is measured against standards for readiness, combat viability, deployability, and sustainability.<sup>65</sup>

Exporting the NZDF output framework directly to DND would be difficult. First, the total NZDF annual expenditure of \$1.4B Cdn for fiscal year 2002-03 represents approximately ten percent of the \$12.3B DND budget for the same time period.<sup>66</sup> While the basic force elements are similar, the magnitude of the difference in number and size of units is significant. Second, all New Zealand government departments have implemented a comprehensive employee time tracking system that facilitates the attribution of support and overhead costs. With the exception of a few organizations such as JAG and the Fleet Maintenance Facilities, DND does not have such a system or the culture within government to implement such a system.<sup>67</sup> Fortunately, a second nation, Australia - with a defence budget and force structure comparable with Canada, has followed the example of New Zealand and adopted an output-based framework for defence.

In 1997, Australia started to transform their public sector financial management structure when all government departments were directed to develop an accrual-based outcome and output framework. The initial model for defence had one outcome: “Prevention or defeat of armed aggression against Australia and its interests”, and four deliverables.<sup>68</sup> The deliverable of combat capability had nineteen outputs, while the

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<sup>65</sup> New Zealand, *Report of the New Zealand Defence Force*, 45.

<sup>66</sup> Department of National Defence, *2002-2003 Report on Plans and Priorities* . . . , 38.

<sup>67</sup> Treasury Board of Canada Secretariat, *Improved Reporting to Parliament Project*, Annex B.

<sup>68</sup> Australia, Department of Defence, *Defence Annual Report 1997-98*, 6; available from <http://www.defence.gov.au/budget/97-98/dar/dar98p1.pdf>; Internet; accessed 4 February 2004.

remaining three capabilities of international activities, national support tasks, and strategic policy had one output each. It was not until fiscal year 2000-01, however, that the Australian Defence financial management system had been modified sufficiently to provide Parliament with an estimated cost per output. During the intervening period, the number of outputs was reduced to five: Defence Operations, Navy Capabilities, Army Capabilities, Air Force Capabilities, and Policy Advice.<sup>69</sup> A separate defence output for intelligence was added in fiscal year 2002-03 and the increased experience with accrual budgeting and activity based management permitted a refinement of costs to create standard prices for each major activity.<sup>70</sup>

In early 2003, the Australian Parliament approved the funding of defence based on outputs. Table 2 summarizes the structure. Funding is received and expenditures are reported to Parliament against 29 outputs consolidated into the six output groupings that Defence had been using in previous years. The ADF has renamed these output groupings as outcomes; however, they do not meet the definition of outcomes previously discussed in this paper.<sup>71</sup> At the end of each fiscal year, the ADF will have to explain any significant variances between the estimated cost by output grouping and the actual expenditures. As fiscal year 2003-04 had not been completed when this paper was being prepared, it is too early to evaluate the results of this new output structure. However, Parliament had sufficient confidence in the information provided by the Australian

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<sup>69</sup> Australia, Department of Defence, *Defence Annual Report 2000-01*, 37; available from <http://www.defence.gov.au/budget/00-01/dar/01.pdf>; Internet; accessed 4 February 2004.

<sup>70</sup> Australia, Department of Defence, *Defence Annual Report 2002-03*, 12; available from <http://www.defence.gov.au/budget/02-03/dar/index.htm>; Internet; accessed 4 February 2004.

<sup>71</sup> Australia, Department of Defence, *Portfolio Budget Statements 2003-04*, 39; available from <http://www.defence.gov.au/budget/03-04/index.htm>; Internet; accessed 4 February 2004.

**Table 2 – Australian Defence Outputs<sup>72</sup>**

<b><u>Output Groupings</u></b>	<b><u>Outputs</u></b>
Command of Operations in Defence of Australia and its Interests	<ul style="list-style-type: none"> <li>◊ Command of Operations</li> <li>◊ Defence Force Military Operations and Exercises</li> <li>◊ Contribution to National Support Tasks</li> </ul>
Navy Capability for the Defence of Australia and its Interests	<ul style="list-style-type: none"> <li>◊ Major Surface Combatants</li> <li>◊ Naval Aviation Operations</li> <li>◊ Patrol Boat Operations</li> <li>◊ Submarine Operations</li> <li>◊ Afloat Support</li> <li>◊ Mine Warfare</li> <li>◊ Amphibious Lift</li> <li>◊ Hydrographic and Oceanographic Operations</li> </ul>
Army Capability for the Defence of Australia and its Interests	<ul style="list-style-type: none"> <li>◊ Special Forces Operations</li> <li>◊ Mechanised Operations</li> <li>◊ Light Infantry Operations</li> <li>◊ Army Aviation Operations</li> <li>◊ Ground Based Air Defence</li> <li>◊ Combat Support Operations</li> <li>◊ Regional Surveillance</li> <li>◊ Operational Logistic Support to Land Forces</li> <li>◊ Motorised Infantry Operations</li> <li>◊ Protective Operations</li> </ul>
Air Force Capability for the Defence of Australia and its Interests	<ul style="list-style-type: none"> <li>◊ Air Combat</li> <li>◊ Combat Support to Air Operations</li> <li>◊ Strategic Surveillance</li> <li>◊ Maritime Patrol Aircraft</li> <li>◊ Airlift</li> </ul>
Strategic Policy for the Defence of Australia and its Interests	<ul style="list-style-type: none"> <li>◊ Strategic and International Policy, Activities and Engagement</li> <li>◊ Military Strategy and Strategic Operations</li> </ul>
Intelligence for the Defence of Australia and its Interests	<ul style="list-style-type: none"> <li>◊ Intelligence</li> </ul>

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<sup>72</sup> *Ibid*, 39.

Defence Department that they were willing to endorse an additional \$2.1B in funding over five years to support implementation of a new White Paper.<sup>73</sup>

The New Zealand and Australian examples demonstrate that it is possible for a defence organization to adopt an output-based framework for resource management and reporting. New Zealand now has almost ten years of experience with this approach and has been able to develop a process to assess the performance of both actual services delivered and potential capabilities available for government use. The Australian Defence experience shows that it takes several years to refine the output structure and to develop the necessary financial management system. Moreover, if Parliament is provided with sufficient details, then they are more willing to consider approval of increased management flexibilities, such as accrual budgeting, and possibly provide additional resources. Accordingly, the final section of this analysis will look at a potential implementation approach for DND.

### **Output Model for DND**

In building a new financial management model for DND it is important that the department not “start from scratch” or try and build something that is uniquely Canadian. In the author’s opinion, it is assessed that with minor modifications, the output-groupings that have emerged from Australia would be valid for DND. One major difference is the need to account for the significant joint force generation activities that occur within the NDHQ Groups such as the Deputy Chief of Defence Staff, Assistant Deputy Minister (Human Resources - Military), and Assistant Deputy Minister (Information

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<sup>73</sup> Australia, Department of Defence, *Defence Annual Report 2002-03*, 12.

Management). Rather than adding an extra output grouping, the author suggests that a Joint Capability output grouping could incorporate Intelligence, as Intelligence does not appear to have the same stand-alone significance in DND as it does in Australia. Establishing a dedicated output for Joint Capability would also ensure that benefits gained through integration are not lost.

Another major difference would be in the intermediate outputs used to capture the cost of activities that would then flow through to the ultimate output groups. While most of Australia's defence activities can readily be linked to one of the 29 intermediate operational outputs due to their retention of three separate services, in DND it would be much more difficult to attribute overhead and support costs to an output such as submarine operations or airlift. Instead, by adopting the major functional areas as intermediate outputs, it would be easier to match activities with customers. The principal customers would be the Navy, Army, Air Force, and Joint Capabilities as well as Operations and Strategic Policy, thereby matching the output groupings. For most organizations, their activities would fall within one or two intermediate outputs. This is the approach recently adopted by the Navy in developing the Maritime Command Output Model.

In 2002, the Navy faced significant resource pressures to generate and sustain the maritime forces required to support post 11 September 2001 demands, both in the defence of Canada through enhanced maritime surveillance as well as in international naval deployments as part of the multi-national coalition against terrorism.<sup>74</sup> The Chief of Maritime Staff authorized the establishment of a Maritime Command Activity-Based

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<sup>74</sup> From 2001 until 2003, the author was the Maritime Staff Comptroller/Support Services.

Costing (ABC) Working Group to develop a pan-naval strategic ABC model.<sup>75</sup> The first stage in building the ABC cost flow model was to define a common set of outputs that could be used for both resource planning and costing. In order to ensure that resource allocation decisions as well as performance measurement and reporting were linked, this step was assessed as being the most important. The Business Planners and Comptrollers from each of the major Maritime Command formations, with oversight from their respective Chiefs of Staff, worked for almost a year to reach agreement.<sup>76</sup> The three Ultimate Outputs and eleven Intermediate Outputs that form the Maritime Command Output Model were:

◁ Ultimate Output Groups:

- Combat-Capable Multi-Purpose Maritime Forces – Current,
- Combat-Capable Multi-Purpose Maritime Forces – Future, and
- Support to Others; and

◁ Intermediate Outputs:

- Governance,
- Personnel,
- Equipment,
- Realty Assets,
- Doctrine,
- Training,
- Operational Capacity,
- Supply,
- Engineering and Maintenance,
- Protection, and

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<sup>75</sup> Adam M. Ali, “Strategic Cost Management: Take it from the Top,” *FMI Journal* 15, no. 2 (Winter 2004): 29.

<sup>76</sup> *Ibid*, 30-31.

- Vehicles and Miscellaneous Equipment.<sup>77</sup>

The Navy was able to use this new output structure to prioritize activities and additional resource requirements in support of its 2004-05 Capability Plan submission. In addition, by using Microsoft Access to develop a datamart to store the naval activity and output structure and associated allocations, combined with

seeking, could be in place in time to plan for fiscal year 2006-07.<sup>79</sup> As Treasury Board has requested that departments submit a revised program activity architecture, it is important for DND to move quickly to build upon the momentum generated by the Navy's initiative.

## **Conclusion**

DND has a unique opportunity to revolutionize the method it uses to report both planned and actual resource usage to Parliament and to Canadians. After years of criticism from the Auditor General that DND has not been able to provide the details necessary to explain the actual capabilities that can be acquired and sustained from a given level of resources, the potential now exists to adopt a much different focus than in the past. While reporting based on the major resource inputs of personnel, capital equipment, and finance will still be required to support Public Accounts, DND needs to finalize the development of linkages between financial resources and outputs.

The introduction of flexibility in the Part III Estimates as part of a new Report on Plans and Priorities in the late 1990s, combined with the new PRAS management framework, were important initial steps towards improving the financial reporting structure, recognizing for the first time that each department has unique requirements. DND, however, has struggled to find a common structure that can be used for planning, reporting, and internal management. Whether by adopting the seven Service Lines in the 1999 DND PRAS or the five Capability Programs in the 2001 DND PRAS, these changes

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<sup>79</sup> To use an output-based structure for fiscal year 2006-07, it must be developed by 1 June 2005 in order to be included in Level 1 Business Planning guidance. As the Navy was able to develop a new structure in less than a year, the author believes a dedicated team could expand this new structure DND wide in a comparable time period.



have simply resulted in providing a different process-based view for internal and external audiences.

Internal resource management would initially continue to occur using the organizational process structure, which is the process most compatible with the structure of DND's Financial and Managerial Accounting System. Rather than devoting the effort to adopt a common process-based view, DND should transition to an output-based approach for financial resource planning, management, and reporting. In time, DND's Financial and Managerial Accounting system will need to be modified accordingly.

There is no doubt that adopting an output-based structure would be consistent with the guidelines emanating from Treasury Board. The Improved Reporting to Parliament Project and the recently announced Management Accountability Framework are two major initiatives that call for the adoption of a resource management system that is aligned with the strategic outputs of the department. The May 2003 Auditor General report, which assessed the quality of departmental performance reports, calls for the reporting of performance in a clear and concrete fashion based on outputs so that Canadians have a better understanding of the results achieved from their tax dollars.

DND is fortunate that it does not need to be the first defence department to move to an output-based approach. New Zealand has over ten years experience using this method for financial management and reporting. In addition, New Zealand was able to overcome the challenge of reconciling between resources needed to develop and maintain potential capabilities and the actual cost of deployed force elements and predictable outputs such as strategic policy advice. While the much smaller size of the New Zealand Defence Force could be used as an argument that the model could not be implemented in

Canada, recent achievements in Australia demonstrate that larger military forces can also manage and report financial resources by output. The six output groups and 29 individual outputs, an ADF model that has emerged gradually through almost seven years of mutual development between the Australian Defence Force and their Parliamentarians, provides a solid foundation that DND can build upon. The Australian example has also shown that providing better information to Parliament can assist in achieving the goal of increased resources.

With a single unified force and integrated functional support areas, it would not be practicable for DND to construct an output model based exclusively on the main types of operational units. Instead, while the major output groupings in DND should be similar to those adopted by Australia – replacing Intelligence with Joint Capability, the intermediate outputs in DND should be structured around the 11 major functions that have recently been used in the Maritime Command Output Model. This initiative by the Navy shows that, while a fully integrated departmental information system is preferable, it is possible to construct a strategic model that can be used for capability planning, resource prioritization, and performance reporting. By adopting a top-down strategic focus and building upon the momentum achieved within the Navy, DND could have an output-based model in place using the existing information systems for fiscal year 2006-07.

The government announced on 24 March 2004 that increased accountability and transparency is a priority. DND needs to take advantage of this unique opportunity if the Department wants to move its financial reporting structure to a higher level.

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