

## Financial management and performance

4.1 The Defence Annual Report together with the Portfolio Budget Statements (PBS) and the Portfolio Additional Estimates Statements (PAES) provide the key source of accountability and performance information to Parliament. Through these documents, Defence's overriding objective, in 2002-2003, was explained through one outcome statement which is achieved through six output statements. This approach is consistent with the 1999-2000 public sector wide adoption of an accrual-based outcomes and outputs framework which assists in the assessment of performance and particularly effectiveness.<sup>1</sup>

4.2 The Defence outcome, as indicated in the 2002-2003 PBS, is:

*The defence of Australia and its national interests.*<sup>2</sup>

4.3 An outcome statement is defined as:

The impact sought or expected by government in a given policy arena. The focus is on change and consequences: what effect can government have on the community, economy and/or national interest? Outcome statements also perform a specific legal function by describing the purpose of appropriated funds.<sup>3</sup>

4.4 Defence stated, in relation to its Outcome Statement:

The outcome reflects the general requirements for the defence of Australia in a complex modern strategic environment. In doing so,

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1 Australian National Audit Office, *Audit Report No. 18 2001-02, Performance Information in Portfolio Budget Statements, 2001-02*, November 2001, p. 12.

2 Defence Portfolio, *Portfolio Budget Statements 2002-2003*, p. 3.

3 Australian National Audit Office, *Performance Information in Portfolio Budget Statements, Better Practice Guide*, May 2002, p. 7.

it reflects the reality that activities inimical to Australia's security and national interests may not necessary involve the use of armed forces.<sup>4</sup>

- 4.5 In 2002-03 Defence had six outputs which lead to the delivery of its single outcome. Outputs are defined as the 'actual deliverables—goods and services—agencies produce to generate the desired outcomes specified by government.'<sup>5</sup>
- 4.6 For 2003-04 Defence restructured its outcome and output framework with the introduction of seven outcome statements and 30 output statements. Defence commented that the 'increase in outcomes is a combination of elevating to outcome status the current set of six capability-focused outputs funded through departmental appropriations, and the adoption of a new outcome that relates to the management of administered appropriations.'<sup>6</sup> The new outcomes are:
- 1. Command of Operations in Defence of Australia and its Interests.
  - 2. Navy Capability for the Defence of Australia and its Interests.
  - 3. Army Capability for the Defence of Australia and its Interests.
  - 4. Air Force Capability for the Defence of Australia and its Interests.
  - 5. Strategic Policy for the Defence of Australia and its Interests.
  - 6. Intelligence for the Defence of Australia and its Interests.
  - 7. Superannuation and Housing Support Services for Current and Retired Defence Personnel.<sup>7</sup>
- 4.7 Agency performance is assessed through determining how effectively the outputs help achieve the outcomes. In particular, quantifiable targets should be included in the PBS so as to provide a basis for performance assessment. The ANAO suggests that 'targets express quantifiable performance levels or changes of level to be attained at a future date, as opposed to the minimum level of performance.'<sup>8</sup>
- 4.8 Defence has included performance targets for the majority of outputs listed in the 2003-04 PBS.

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4 Defence Portfolio, *Portfolio Budget Statements 2002-2003*, p. 3.

5 Australian National Audit Office, *Performance Information in Portfolio Budget Statements, Better Practice Guide*, May 2002, p. 12.

6 Defence Portfolio, *Portfolio Budget Statements 2003-04*, p. 3.

7 Defence Portfolio, *Portfolio Budget Statements 2003-04*, p. 3.

8 Australian National Audit Office, *Audit Report No. 18 2001-02, Performance Information in Portfolio Budget Statements, 2001-02*, November 2001, p. 51.

## Adequacy of performance and Budgetary information

- 4.9 The APS moved to the accrual outcomes and outputs framework in 1999-2000. Previously Defence has been criticised for having too broad an outcome statement and too few outputs, and because of this it is difficult to adequately assess performance. The ANAO scrutinised the outcome and outputs framework used in ten different agencies. In particular, the appropriateness of outcome statements was assessed. In relation to Defence, the ANAO stated that the current outcome statement 'does not provide a basis against which effectiveness indicators can be tested in the short-term.'<sup>9</sup>
- 4.10 The ANAO suggested that some agencies were including intermediate outcomes and/or further explanatory text that, together with the outcome statement, largely provided a useful base for the development of linked outputs and strategies.'<sup>10</sup> The Australian Strategic Policy Institute (ASPI) supports this view, and in its 2002-03 Defence Budget Brief, suggested that Defence should have more than just one broad outcome statement. The Department of Foreign Affairs and Trade, for example, has four.
- 4.11 ASPI also suggested that Defence's outputs could be improved. In the 1999-2000 PBS, Defence provided information on 22 outputs. This has subsequently been reduced to 6 outputs in 2002-03. While there are sub-outputs under each of the 6 outputs, the ASPI commented that the 'budget papers do not provide resource or performance data on these sub-outputs, and this information is not available publicly elsewhere.'<sup>11</sup>
- 4.12 In relation to the PBS, ASPI stated:
- The aggregation of outputs under the current six headings obscures much of importance. The Outputs are simply too big to be useful. Defence maintains a structure of thirty plus sub-outputs that underlie the current six outputs. These sub-outputs constitute the basic building blocks of capability. This should be the level at which the PBS reports financial and performance information. This was done in 1999-2000 and 2000-01 to an extent; there seems no reason not to go back to providing that level of detail.<sup>12</sup>

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9 Australian National Audit Office, *Audit Report No. 18 2001-02, Performance Information in Portfolio Budget Statements, 2001-02*, November 2001, p. 35.

10 Australian National Audit Office, *Audit Report No. 18 2001-02, Performance Information in Portfolio Budget Statements, 2001-02*, November 2001, p. 36.

11 Australian Strategic Policy Institute (ASPI), *The Cost of Defence, ASPI Defence Budget Brief 2002-03*, May 2002, p. 6.

12 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2002-03*, May 2002, p. 89.

4.13 Defence has clearly responded to these criticisms by introducing a more detailed outcomes and outputs structure in the 2003-04 PBS. ASPI stated:

A key purpose of the outcomes and outputs framework is to provide a basis for setting targets and measuring performance. This year's PBS [2003-04] has increased the level of disclosure of output performance targets to an unprecedented level. Nevertheless, we think there a couple of avenues for further improvement in this area...<sup>13</sup>

4.14 In 2002 ASPI criticised Defence for only having one outcome statement. This year, while there are now seven outcome statements, ASPI suggests that Defence could develop 'a set of more meaningful outcomes.'<sup>14</sup> The new set of outcomes statements are a slightly reworded form of the previous output statements. ASPI suggest the following outcomes as possible examples:

- having armed forces ready for operations to meet Australia's needs;
- maintenance of a favourable strategic environment; and
- the successful conduct of military operations as directed by Government.<sup>15</sup>

4.15 In relation to performance targets listed in the PBS, ASPI notes that there are target flying hours for ADF aircraft but no similar targets for 'sea days' for Navy vessels or 'track miles' for Army armoured vehicles. ASPI indicated that the current target for Navy of 'Unit Ready Days' relates more to availability rather than activity.<sup>16</sup> ASPI suggests that it is important to focus on 'activity' because it the level of activity which influences financial outcomes. ASPI stated:

Firstly, activity performance targets relate directly to the accrual framework which itself focuses on activities rather than cash. Many of the expenses that appear in the Statement of Financial Performance will rise and fall with activity levels. Consequently, visibility of activity levels is 'the other half of the equation' in understanding the financial statements. As discussed in Section 3, this is particularly important when assessing the additional cost of deployments.<sup>17</sup>

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13 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 7.

14 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 101.

15 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 101.

16 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 102.

17 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 102.

- 4.16 A further advantage of reporting against activity rates is that it can reveal management performance. For example, Navy only achieved 73% of its flying target for Seahawk flying hours. ASPI indicated that in this case, the target was not met because of problems with 'personnel shortages including insufficient instructors.'<sup>18</sup> ASPI also points out that if the number planned versus achieved sea days was reported on then this would indicate the additional demands faced by RAN personnel and their families when operational demands mean that targets will be often be exceeded.<sup>19</sup> It should be noted that detailed performance targets relating to preparedness are not published for security reasons.
- 4.17 The PBS provides financial information for each outcome and output. ASPI, however, indicate that there is no clear mapping of the outputs to the 'Groups' which actually spend Defence money. The Defence organisational chart on page 18 of the 2003-04 PBS shows the 'Groups' which make up the Defence structure. There are about 14 or 15 'Groups' divided into the Output Executives Group, the Owner support executives Group, and the Enabling Executives Group. ASPI stated:
- These Groups and their executives are responsible for spending Defence's money and doing its business. Consequently, it is within the group structure that financial accountability occurs. But there is no clear mapping of the Groups to the outputs. Nor does the PBS provide data on how Defence's resources are divided between the Groups. This is a significant inhibition to our understanding of Defence's resource management and accountability.<sup>20</sup>
- 4.18 In June 2002 Defence refused to provide the Senate Foreign Affairs, Defence and Trade Committee with Group Budget information claiming that this Budget information is not used for performance measurement and reporting purposes.<sup>21</sup>
- 4.19 During the hearing Defence indicated that it had recently introduced a new Budget and Output Reporting Information System (BORIS) which helps to provide detailed Budget information down to weapon systems level and is claimed to provide a 'finance transformation improvement.'<sup>22</sup> Defence stated:

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18 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 103.

19 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 103.

20 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 7.

21 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 104.

22 Mr Lloyd Bennett, Secretary and Chief Finance Officer, Department of Defence, *Transcript*, p. 44.

It is something which has been developed in the last six months. ...What we have done is provide the total cost of defence capability, excluding the capital use charge, and then split that across each of the capabilities...In the third line, you see the sub-outputs. This work was tabled for the first time, but not in this sort of visible format, in the PAES document, where we have provided a fully audited cost of sub-output and capability.<sup>23</sup>

## Conclusions

- 4.20 The Defence 2003-04 Portfolio Budget Statement (PBS) is a significant improvement over the presentation used in 2002-03. Specifically, there are now seven outcome statements and 30 output statements. For the majority of the output statements there are performance targets. However, there are a range of improvements that could enhance the level of transparency and accountability to the Parliament. A range of measures have been proposed by the Australian Strategic Policy Institute (ASPI) which could be implemented in time for the next set of Budgetary documentation. ASPI's key proposals, in its Defence Budget Brief 2003-04, pages 99 to 105, are reproduced in full at Appendix B.
- 4.21 In particular, the Committee has examined and supports ASPI's proposals that:
- Defence include more performance information on 'activity' for Army and Navy rather than just availability; and
  - that 'Group' financial and personnel data be provided in the PBS in addition to the current outcome output data.

### Recommendation 4

- 4.22 **The Committee recommends that the Department of Defence should respond to the measures proposed by the Australian Strategic Policy Institute (ASPI) to improve Defence budgetary transparency discussed on pages 99 to 105 of the ASPI Defence Budget Brief 2003-04.**

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23 Mr Lloyd Bennett, Secretary and Chief Finance Officer, Department of Defence, *Transcript*, pp. 37-38.

## Adequacy of Defence spending

4.23 The Defence 2000 White Paper stated that the ‘Government estimates that defence spending will need to grow by an average of about three percent per annum in real terms over the decade and has directed Defence to plan within that budget.’<sup>24</sup> The White Paper stated:

Over the last decade defence funding remained relatively constant in real terms. The proposed level of growth constitutes a substantial increase in defence spending. By the end of the decade, defence spending in cash terms will stand at approximately \$16 billion per year in today’s dollars, compared with \$12.2 billion this year [2000]. In all, defence spending over the decade is expected to increase by a total of \$23.5 billion in real terms, compared to total defence spending had the defence budget been held flat in real terms over the decade.<sup>25</sup>

4.24 The growth in 2002-03 is estimated at 2.6 per cent. Table 4.3 shows the past and projected growth rates. ASPI indicates that the ‘difference between the nominal and real growth rates is that the former is corrected for the changes to the buying power of the currency due to inflation.’<sup>26</sup> In calculating the real growth rate, ASPI indicated that the ‘nominal dollar values of the individual years have been converted to a single base year using the deflator used by the Department of Finance to maintain Defence buying power in real terms.’<sup>27</sup>

**Table 4.3 Total Defence Funding – Real and nominal growth rates**

	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
\$m	12 445	12 648	14 501	14 609	15 806	15 942	16 174	17 139
\$m adjusted	12 445	12 648	14 501	14 857	15 557	15 942	16 174	17 139
nominal growth		1.6%	14.7%	2.5%	4.7%	2.55	1.5%	6.0%
real growth		-2.7%	12.4	-0.6%	2.6%	0.5%	-0.5%	3.9%

Source Australian Strategic Policy Institute, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 15.

24 Department of Defence, *Defence 2000, Our Future Defence Force*, 2000, p. xvii.

25 Department of Defence, *Defence 2000, Our Future Defence Force*, 2000, p. 117.

26 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 15.

27 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 15.

- 4.25 In respect to the commitment to increase Defence spending at about three percent over the next decade, ASPI states that there 'is no reason to expect the 3% real growth delivered by the White Paper in 2001-02 to be visible given the very significant additional funds allocated to Defence in the early years of this decade in supplementation for deployments over and above the White Paper increases and the budget measures enacted to boost domestic security.'<sup>28</sup>
- 4.26 It should be noted that in Table 4.3 that the significant growth in 2001-02 is due to the initial White Paper funding, commencement of the war on terrorism and exchange rate fluctuations. ASPI commented that these 'factors tend to exaggerate the actual growth from the previous year and serve to reduce the growth to 2002-03 that would have otherwise been the case.'<sup>29</sup>
- 4.27 In 2003-04 Defence spending as a percentage of GDP will be about 2 per cent. Defence spending as a percentage of GDP and Commonwealth Payment for past and future years is shown in Table 4.4.

**Table 4.4 Defence spending as a percentage of GDP and Commonwealth Payments**

<b>Year</b>	<b>Total Departmental Funding % of GDP</b>	<b>Underlying Cash Balance Impact % of GDP</b>	<b>Total Departmental Funding % of Commonwealth Cash Payments</b>	<b>Underlying Cash Balance Impact % of Commonwealth Cash Payments</b>
2000-01	1.89%	1.86%	8.17%	8.04%
2001-02	2.03%	1.85%	8.87%	8.05%
2002-03	1.93% (1.97%)	1.79%	8.59% (8.74%)	7.96%
2003-04	1.99% (1.96%)	1.89%	8.94% (8.80%)	8.51%
2004-05	1.90%	1.82%	8.58%	8.22%
2005-06	1.83%	1.80%	8.35%	8.24%
2006-07	1.83%	1.82%	8.55%	8.48%

Source Australian Strategic Policy Institute, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, pp. 16-17.

- 4.28 Table 4.4 provides an 'underlying cash balance impact' as a % of GDP and Commonwealth Payments. ASPI comments that the 'underlying cash

28 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 15.

29 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 15.



balance impact' 'accords with government financial statistics conventions used by the Australian Bureau of Statistics and may provide a better measure for international comparison.'<sup>30</sup> ASPI indicates that the figures in brackets 'are the result after taking account of the repayment in 2003-04 for expenses incurred in 2002-03.'<sup>31</sup>

4.29 In view of the terrorist events of 9-11 and 10-12, Australia's commitment to the war on terrorism, and the debate about the relevance of Australia's military strategy of 'home defence', there is a need to consider the adequacy of Australia's commitment to Defence spending. The White Paper suggested that through the decade Defence spending will remain at close to 1.9% of GDP which is 'justified within our overall national priorities and will ensure that we can achieve the strategic objectives we have identified.'<sup>32</sup> However, using the underlying cash balance impact shown in Table 4.4 Defence spending through to 2007 will be closer to 1.8 % of GDP and not 1.9%.

4.30 The Defence spending level of 1.9% of GDP is considered, by some groups, to be inadequate for Australia's security needs. As part of the inquiry into maritime strategy, the Centre for International Strategic Analysis (CISA) commented:

A steady commitment of 2.5% of GDP across the past decade and into the decade ahead would have put the ADF in a better position to meet Governments' expectations. A large increase in defence expenditure is now required. However, given the lead times for the acquisition and introduction to service of defence systems and personnel the results of this will appear too late to be effective in the current crises. Australia's national security, and the ability to protect our national interests are in jeopardy.<sup>33</sup>

4.31 Similarly, the Navy League of Australia commented that it 'is deeply concerned that the increased demands placed on the Defence Force since Defence 2000 was published and the possibility of continued and growing involvement with international coalitions of forces has already shown that actual and forecasted funding for Defence is inadequate.'<sup>34</sup>

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30 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 16.

31 ASPI, *The Cost of Defence, ASPI Defence Budget Brief 2003-04*, May 2003, p. 16.

32 Department of Defence, *Defence 2000, Our Future Defence Force*, 2000, p. 118.

33 Centre for International Strategic Analysis, Submission 6 to the inquiry into Maritime Strategy.

34 Navy League of Australia, Submission 11 to the inquiry into Maritime Strategy.

## Conclusions

- 4.32 In recent times, the overall funding of Defence has never been so critical. Australia, like many western democracies, is confronting and responding to the war on terrorism through initiatives to enhance homeland security and through contributing Australian forces globally to coalitions against terror. There is an increased operational tempo which places significant demands on personnel and equipment. At the same time, Defence is facing 'block obsolescence' in a range of key defence platforms over the next decade. It is in this context that the Parliament and the Australian people should engage and revisit the debate about what is an adequate level of defence spending. This debate would need to examine overarching strategy, capability and force development.
- 4.33 Defence funding in 2002-2003 was about \$14.5 billion and in 2003-2004 it is estimated to be about \$15.8 billion. The latter is estimated to be about 2 per cent of GDP. The usage of GDP share is only a broad indicator and there is no correlation between increases in GDP and changes in Australia's security. Outlays to Defence would depend as much on movements in GDP itself. The Committee has previously commented on this issue.<sup>35</sup>
- 4.34 The Committee is conducting an inquiry into Australia's maritime strategy and a report will be tabled later in 2003. As part of that report, the Committee will comment more on the adequacy of defence spending.

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35 Joint Standing Committee on Foreign Affairs, Defence and Trade, *Funding Australia's Defence*, CanPrint, April 1998, p. 16.