



Extract from the report to the
Public Accounts Committee on
the financial management of
the Danish Defence

June
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I. Introduction and conclusion

1. This report is about the financial management of the Danish Defence (the Defence) including organisational framework, management tools and management processes in relation to planning and prioritization of tasks, allocation of resources and follow-up. The report also follows up on the previous report on the Defence's acquisition and implementation of the IT system DeMars (report no. 3/2005), from which it appears that Rigsrevisionen intends to perform a closer assessment of whether DeMars, when fully implemented, has led to the required strengthening of the financial management of the Defence.

2. Rigsrevisionen has taken the initiative to this study, because the financial management of the Defence has for many years been characterised by significant deficiencies and challenges in relation to management of activities, resources and costs. As a consequence hereof, the audit opinions issued by Rigsrevisionen on the financial statements and financial management of Defence Command Denmark have in recent years been qualified. Overall the financial statement for 2009 of Defence Command Denmark was, however, considered correct by Rigsrevisionen. Rigsrevisionen is expecting this favourable trend to continue. It is Rigsrevisionen's assessment that appropriations have generally been managed in a correct and reliable manner. Although not in 2008 when considerable overspending compared to the government allocation put a halt to the activities of the Defence.

3. In June 2006, Defence Command Denmark implemented an action plan in order to address these significant deficiencies and challenges and thereby contribute to enhancing the business procedures, management and accounting principles of the Defence. Much improvement has been achieved by Defence Command Denmark since the action plan was launched. Rigsrevisionen has also established that considerable improvements have been achieved in many of the areas encompassed in the action plan. Over the past years, Defence Command Denmark has become more skilled at identifying weaknesses and deficiencies relating to the accounting processes and subsequently rectifying errors or deficiencies before the accounts are closed. However, a number of important issues addressed in the action plan remain unresolved like, for instance, the fact that the accounting principles applied should be adapted to the government accounting policy of the Ministry of Finance, and that business procedures, internal controls and data should be of a quality that underpins effective accounting processes in the Defence. Defence Command Denmark will continue to work on these issues in two projects: "Applied accounting principles" and "Accounting processes in the Defence".

Defence Command Denmark has also made efforts to adjust existing and develop new management tools and management processes in order to improve its financial management. Defence Command Denmark has stated that it has taken various initiatives to strengthen budget control. Defence Command Denmark highlights a new budget model, a halt to over budgeting by underlying authorities, strengthening of the financial management in the Acquisitions and Logistics Organization, development of new principles for budget control and improvement of the financial reporting to the management of the Defence. Defence Command Denmark is of the opinion that extensive measures and changes are still required and that enhancing the financial management will be an ongoing process stretching over several years.

The Danish Defence comprises Defence Command Denmark and all underlying authorities.

The organisational framework of the Defence includes the business model, which illustrates the connection between economy, resources, activities and results. The business model provides the basis for the financial management of the Defence.

The management tools available to the Defence include the Annual Programme and the Period Plan. The Annual Programme is used for short-term management of announcements of tasks and budgets to underlying authorities. The Period Plan is used for planning of tasks and consumption of resources in the medium and long term.

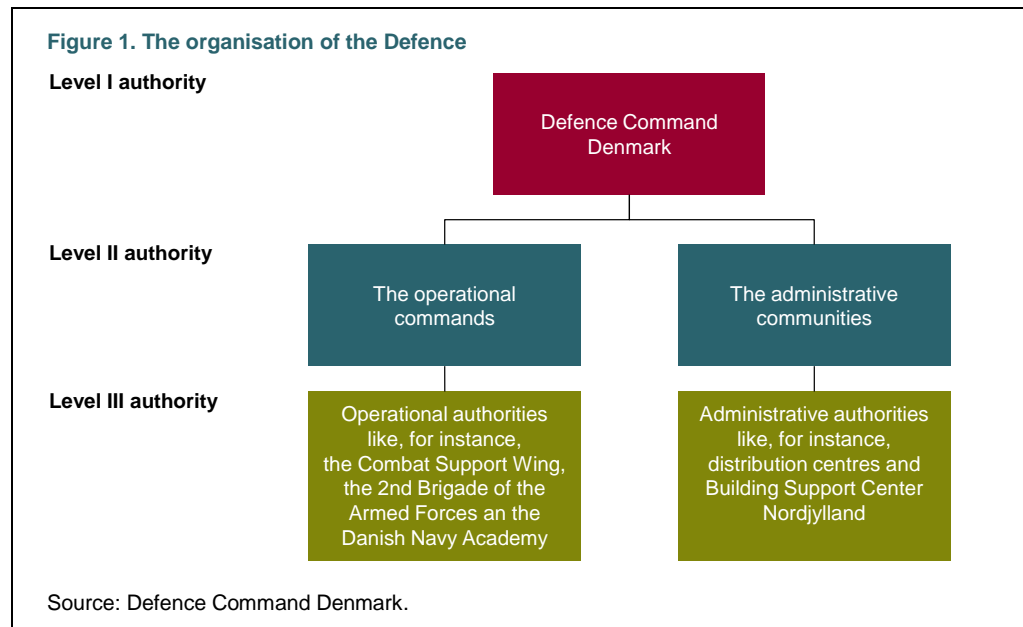
The operational tasks of the Defence are outlined in the Defence Act and includes six overall tasks: tasks no. 1-5 concern deployment to perform various tasks, whereas task no. 6 concerns sustaining the deployment capabilities of forces that are not deployed. Task no. 6 ensures that the Defence has access to deployable forces from the army, navy and air force at all times.

The operational commands on level II are: the Air Operational Command, the Army Operational Command, the Admiral Danish Fleet, the Greenland Command and the Faroe Islands Command.

The administrative communities on level II comprise the Defence Personnel Service, the Defence Acquisition and Logistics Organization, the Defence Construction Service, the Defence Informatics Service, the Defence Health Service, the Accounts Secretariat and the Defence Media Centre.

4. Following the Danish Defence Agreement 2005-2009, the Defence implemented a comprehensive reorganisation in order to ensure focus on and strengthen its operational activities. The overall structure of the Defence was changed and a level of administrative communities was established to streamline and improve the effectiveness of the staff and support functions. Changes made included centralising the administration of personnel, materiel and buildings through the establishment of the following administrative communities: the Defence Personnel Service, the Defence Acquisition and Logistics Organization, the Defence Construction Service, the Accounts Secretariat, and the Defence Informatics Service. The new organisation will be consolidated in the course of the new defence agreement period 2010-2014, during which period the Defence will also continue its efforts to develop and adapt the structure and tasks of the Defence to meet the requirements and challenges that it is currently facing. Breaking down the elements of task no. 6, which concerns deployable capabilities, is also a priority. The purpose of this exercise is to allocate costs in order to determine the cost of the individual tasks and activities that follows from task no. 6.

The organisation of the Defence appears from figure 1.



Level 1 is Defence Command Denmark. Level II includes the operational command forces and the administrative communities. Level III includes the operational authorities like, for instance, the Combat Support Wing, the Second Brigade of the Armed Forces and the Danish Navy Academy, and the administrative communities include distribution centres and Building Support Centre Nordjylland.

5. Rigsrevisionen has since 2003 in several reports to the Public Accounts Committee examined other parts of the Defence that are of significance to its financial management. In 2008, Rigsrevisionen examined Defence Command Denmark's major defence acquisitions (report no. 6/2009), and before that Rigsrevisionen looked into the issues relating to, for instance, the EH-101 helicopters, the unmanned aerial vehicle "Tårnfalken" (the Kestrel) and the Ocean Eye radar system. For the past five years, the results of Rigsrevisionen's annual audit of the financial statement of the Defence have confirmed the favourable development in the Defence's management of appropriations and financial reporting, which was manifested in an overall correct financial statement for 2009. Rigsrevisionen is therefore of the opinion that going forward, the Defence should make it a priority to strengthen and develop the remaining elements of its financial management, including management of activities, resources and costs. The conclusions of this report are thus consistent with the studies and annual audits of the Defence performed in recent years, including also the report on the Defence's acquisition and implementation of the IT system DeMars (report no. 3/2005).

6. The objective of the study is to examine and assess the financial management of the Defence, including the management tools and processes that the Defence uses for the planning and prioritization of tasks, allocation of resources and follow-up activities. The report will also provide an assessment of whether DeMars has led to the required strengthening of the financial management of the Defence. Finally, also the role played by the department in respect to the financial management of the Defence, its supervision and follow-up on the performance contract of the Defence, will be examined and assessed.

The report answers the following questions:

- Has the Defence organised the financial management in a satisfactory manner?
- Has DeMars strengthened the financial management of the Defence to the extent expected when it was acquired?
- Is the department handling the supervision of the financial management of the Defence in a satisfactory manner?

MAIN CONCLUSION

The role of the Defence has undergone considerable change in the recent years as a reflection of the development in national security policy. The structure, organization and capacity of the Defence are adapted to this development continuously, as the requirements to planning and prioritization of tasks and resources are becoming more stringent. The changed requirements to the Defence have led to modifications in the conditions and framework within which the Defence operates, and have therefore also had a bearing on how the Defence could and should organise its financial management.

Managing the tasks of the Defence is complicated and challenging and calls for excellent financial management. Generally, the Defence's management of appropriations has been correct and reliable, and Rigsrevisionen established that overall the financial statement for 2009 submitted by Defence Command Denmark was correct. However, the required financial management system is not in place. This affects management of the Defence's activities, resources and costs, and the capability of the Defence to plan and prioritize tasks and activities, and allocate resources in a timely, valid and reliable manner.

The acquisition and running costs of DeMars in the implementation phase were, in the Document , estimated at approximately DKK 700 million, internal consumption of resources was estimated at approximately 170 million and costs to run existing systems during the implementation phase were estimated at approximately DKK 130 million. Annual running and maintenance costs amount to approximately DKK 130 million.

The main conclusion is based on the following findings:

The financial management of the Defence

The financial management in the Defence is based on a business model. The model is not used in its entirety and has therefore not had the expected effect on financial management in the Defence. This in combination with missing implementation of the management tools and inadequate correlation between management tools and management processes have left financial management in the Defence inadequate, fragmented and incoherent. As a consequence, Defence Command Denmark has not had full control of the financial management of the Defence.

Defence Command Denmark has not yet implemented the principles of activity-based costing and is therefore not to the extent required able to allocate costs to specific end products and support products. The reason is that the cost rates used in connection with internal settlements are not reliable and therefore do not provide a basis for true and fair cost allocation. The Defence is therefore unable to determine the cost of tasks and activities.

The Defence's organisation of the financial management is not satisfactory.

The Defence's organisation of the financial management

- The organisation of Defence Command Denmark lacks knowledge of the business model, and the consistency between Defence Command Denmark's requirements to the financial management and the practice of the authorities on Level II and III authorities, is inadequate.
- Defence Command Denmark has not clearly defined the framework set for the financial management of the Defence, nor has Defence Command Denmark updated the key management guidelines that are meant to underpin the financial management of the Defence.

The management tools and internal organisation of Defence Command Denmark

- Defence Command Denmark is not ensuring that the Annual Programme (specification of tasks and budgets for a particular year) is available before the beginning of the year it concerns which affects planning and prioritization of tasks and resources.
- The Period Plan, which should provide the basis for Defence Command Denmark's overall management of economy, resources and activities, has not yet been implemented and is thus not serving its purpose as an effective management tool in relation to the overall financial management of the Defence.
- The financial management of the Defence lacks coherence because Defence Command Denmark is not ensuring adequate correlation between the individual management tools.
- The internal organisation of Defence Command Denmark has not underpinned the correlation between the various management tools available to the Defence. The level of communication, cooperation and coordination in respect to financial management in Defence Command Denmark is inadequate.

Overall budget control

- Generally, the budgetary control performed by the Defence ensures that costs are kept within the budgets.

Activity-based costing

- The cost allocation frameworks are incorrect and announced so late in the year they concern that they fail to provide the basis for appropriate financial management.
- The rates used in connection with internal settlements are not reliable and are not providing the Defence with a correct picture of the costs relating to the individual authorities.
- More than a decade after the project concerning activity-based costing was launched, Defence Command Denmark is still not fully capable of allocating costs and is therefore unable to determine the cost of specific tasks and activities.
- Defence Command Denmark is still having huge difficulties breaking down task no. 6 and is therefore still not able to determine the cost of sustaining a specific level of alertness.

Rigsrevisionen recommends that:

- the Defence should continuously focus on improving the user-friendliness and simplifying the management processes and business procedures relating to the financial management;
- the Defence should consider implementing a simpler and more manageable model for activity-based costing, including internal settlements;
- Defence Command Denmark should describe management processes and business procedures in a manner that would make them more useful for the staff that is responsible for managing the respective business areas;
- Defence Command Denmark should implement and disseminate the management tools in the Defence;
- Defence Command Denmark should ensure that new initiatives are not implemented before current initiatives have been fully implemented and are working as intended and with the appropriate effect.
- Defence Command Denmark should strengthen its overall coordination to ensure the coherence of its financial management.

DeMars – the administrative IT system of the Defence

The Defence uses DeMars for budget control and financial reporting. DeMars is not used for activity-based costing and is not used to its full potential to generate management information, despite the fact that these were the two main reasons for the decision to acquire the system. Generally, training of the users is inadequate which makes it impossible to utilise the system to its full potential.

DeMars has only strengthened the financial management of the Defence marginally compared to the assumptions made when the system was acquired.

The Defence's application of DeMars for financial management

- The appreciation of DeMars as a system that is underpinning the financial management is not widespread among key staff in the Defence.
- The operational level II authorities use DeMars for budget control and financial reporting, but not for financial management in general.
- The level II and III authorities are generally content with the DeMars system which is considered an excellent system for budget control because it adds transparency and uniformity to the management.
- Defence Command Denmark has not integrated any essential management tools such as the Annual Programme and the Period Plan in the DeMars system.

Utilisation of possibilities and potential

- Defence Command Denmark is not using DeMars for allocation of total costs to end products and support products. Defence Command Denmark is thus not using DeMars in compliance with the original intention, and the financial management of the Defence is therefore only being marginally strengthened by the system.
- Defence Command Denmark has not implemented the DeMars system in full. Essential elements of the management information module have not yet been implemented and the project management module has not been implemented at all.
- The Defence is using other systems alongside DeMars, and as a consequence hereof there is a risk that aggregate data are incorrect and do not provide complete insight into the financial position of Defence Command Denmark.

Competencies, training and user-friendliness of the DeMars system

- The training of managers and case officers using the DeMars system is inadequate. As a consequence, the users lack the competencies that are required to utilise the possibilities and potential of DeMars to underpin the financial management of the Defence.
- Due to the complexity of the DeMars system, its user-friendliness is low. This makes it imperative that the users are sufficiently trained and capable of, for instance, updating data in the system on an ongoing basis.

Rigsrevisionen recommends that:

- Defence Command Denmark should make it a priority to actively utilise the possibilities and potential of DeMars to strengthen the financial management of the Defence;
- Defence Command Denmark should upgrade the training in the use of the DeMars system, including appreciation of the interaction between DeMars and the management tools of the Defence.

The supervision of the financial management of the Defence by the department

Since 2008 the department has had special focus on appropriation control and financial reporting in order to ensure that costs are kept within the appropriated amounts and that the financial statement of Defence Command Denmark is correct. However, certain areas are still in need of improvement, i.e.; knowledge sharing and communication in respect to the department's general obligations as a supervising authority, ongoing follow-up on reporting from Defence Command Denmark and Defence Command Denmark's performance contract. The department has not ensured that the information provided by Defence Command Denmark to the department was sufficiently focused and relevant for the financial management.

Thus the department has not handled the supervision of the financial management of the Defence in a satisfactory manner.

The framework set for the department's supervision of Defence Command Denmark

- The department has not to the extent required coordinated and integrated its supervision of Defence Command Denmark. The supervision is shared between several offices in the department and it is therefore crucial to ensure that knowledge and communication are shared across the department.
- The department's management and supervision have not been adequately structured and coherent.
- The department has over a number of years been of the opinion that the information provided by Defence Command Denmark has not been sufficiently useful and manageable. Yet, the department has not imposed clear and specific requirements on Defence Command Denmark in respect to the quality of its reporting.

Defence Command Denmark's performance contract

- The department has not ensured that the performance contracts for 2008, 2009 and 2010 were signed before the beginning of the year they concerned. Due to the belated signing of the contracts towards the end of the year, the contracts did not fulfil their purpose and did not facilitate management between the department and Defence Command Denmark. Rigsrevisionen has noted that the contract for 2011 was signed in December 2010.
- The targets set in the performance contract were not adequately followed up neither by the department nor Defence Command Denmark.

Rigsrevisionen recommends that:

- the department's supervision should focus more on Defence Command Denmark's coupling of financial and technical data and thereby contribute to ensuring that the requirements to the financial management performed by the Defence are not limited to keeping costs within the appropriated amounts, but also include establishing the connection between results achieved and resources spent.