



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Reference: Auditor-General's reports Nos 32 (2008-09) to 1 (2009-10)

WEDNESDAY, 28 OCTOBER 2009

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**JOINT STATUTORY
COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT**

Wednesday, 28 October 2009

Members: Ms Grierson (*Chair*), Mr Georgiou (*Deputy Chair*), Senators Barnett, Mark Bishop, Bushby, Feeney and Lundy and Mr Adams, Mr Bevis, Mrs Bronwyn Bishop, Mr Bradbury, Mr Briggs, Ms King, Mr Neumann and Mr Robert

Members in attendance: Senators Mark Bishop and Lundy and Mr Adams, Mrs Bronwyn Bishop, Mr Georgiou, Ms Grierson, Mr Neumann and Mr Robert

Terms of reference for the inquiry:

To inquire into and report on:

Auditor-General's reports Nos 32 (2008-9) to 1 (2009-10)

WITNESSES

DARE, Mr Greg, Director, Performance Audit Services Group, Australian National Audit Office 1

GUMLEY, Dr Steve, Chief Executive Officer, Defence Materiel Organisation..... 1

**HOLBERT, Ms Frances Elizabeth, Executive Director, Performance Audit Services Group,
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KING, Mr Warren, General Manager, Programs, Defence Materiel Organisation..... 1

**SMITH, Mr James (Jim), Chief, Projects and Requirements Division, Defence Science and
Technology Organisation..... 1**

**TRIPOVICH, Vice Admiral Matt, Chief, Capability Development Group, Department of
Defence 1**

**WHITE, Mr Peter, Group Executive Director, Performance Audit Services Group, Australian
National Audit Office..... 1**

Committee met at 11.51 am

DARE, Mr Greg, Director, Performance Audit Services Group, Australian National Audit Office

HOLBERT, Ms Frances Elizabeth, Executive Director, Performance Audit Services Group, Australian National Audit Office

WHITE, Mr Peter, Group Executive Director, Performance Audit Services Group, Australian National Audit Office

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SMITH, Mr James (Jim), Chief, Projects and Requirements Division, Defence Science and Technology Organisation

TRIPOVICH, Vice Admiral Matt, Chief, Capability Development Group, Department of Defence

CHAIR (Ms Grierson)—I open today's public hearing of the Joint Committee of Public Accounts and Audit, which is examining the Auditor-General's report *No 48 (2008-09): Planning and approval of Defence major capital equipment projects*. I welcome the representatives from the Department of Defence, DMO, DSTO and the Australian National Audit Office. I draw the attention of witnesses to the written guidance on the conduct of hearings that is available at the table. Do any of the witnesses present wish to make a brief opening statement before we proceed to questions?

Mr White—The Audit Office does not wish to make a statement.

Vice Adm. Tripovich—Defence does not have any opening statement.

CHAIR—We have an opening statement from the ANAO and I ask a member to accept that as part of the evidence today in the transcript. We will move to questions.

This report raises questions about advice to government and the Kinnaird system and its application. The report also highlights some areas about advice that we would have concerns about. Senator Bishop, I know that you wish to start off with some of those questions.

Senator MARK BISHOP—Thank you, Chair. Could I ask the witnesses to turn to page 28 of our brief, which is a summary—

CHAIR—I do not think they have that. It is the ANAO brief to us—

Senator MARK BISHOP—of the key audit findings.

CHAIR—If you could read that out, it might help.

Senator MARK BISHOP—Okay. I want to discuss two findings. The first one states:

In a number of cases, the description of technical risk did not provide sufficient guidance for decision-makers or provide confidence that an adequate assessment of risk had been conducted.

In respect of that finding by the Audit Office, could the Audit Office explain to us the significance of that and how big an issue it is. Secondly, could I ask the responsible officer from Defence to respond to ANAO's findings so that we have both sides of the argument. My next question relates to the second audit finding, which states:

In relation to cost estimates, the ANAO observed that the majority of submissions expressed cost estimates in terms of net personnel and operating costs, rather than the transparent, understandable whole-of-life cost information envisaged by the 2003 Defence Procurement Review and required by the Cabinet Handbook.

Could the ANAO explain to the committee why they regard that alternative method of providing costings as significant and why it is important and, again, could the responsible officer for Defence explain why they have chosen not to go down that path so that the committee has an understanding of the difference between the two parties? When you read that document there are parts that clearly show a difference between Defence and DOFA on the provision of accessibility by DOFA to technical information at a sufficiently early stage of the process so that it can make an informed decision as to the veracity of the information. Defence's response has been that DOFA has an officer who observes information and the questions that they ask are responded to. But there clearly is a difference between the position of Finance and that of Defence and its line of responsibilities. Could Defence explain to us why the information that is provided is sufficient and why DOFA is being overly careful or not overly careful? Finally, could ANAO comment on that so that we have an informed discussion that the committee can consider in due course. If that is okay with you, Madam Chair.

CHAIR—Certainly. That would be very helpful; thank you.

Ms Holbert—That involves flicking through the report a fair bit. Our viewpoint on technical risk is that the improvement in the advice on technical risk to government has been a continuum for a fair while. The reports that have come out during the time that we were doing this audit report once again emphasised the need to get this better in terms of the Mortimer report and the white paper.

Overall we reached a point where we recommended that Defence refine its methodology for assessing and describing technical risk for future acquisitions and ensure that submissions should not proceed without a clear statement of technical risk consistent with the agreed methodologies set out in the handbook. Defence agreed to the recommendation, noted that they put a technical risk statement in their submissions and advised they would refine their methodology. What we were looking at was that, as a result of the recommendations of the Kinnaird review, the *Cabinet Handbook* specifies a requirement for using standardised technology readiness levels to describe technical risk to get a consistent language to speak to government about it. The DPR actually said:

Standardised Technology Readiness Levels should be used to assess the technology maturity of equipment, including sub-systems, at various stages of development. Proposals lacking technology risk ratings would not proceed for government consideration.

When we looked at the 23 cabinet submissions attached to the 20 projects that were in our sample, we found that the assessment and description of technical risk in the samples was inconsistent. In a few cases it was vague and in many cases it did not adhere to the *Cabinet Handbook* requirement that TRLs should be used. We observed a variety of approaches. We state in our report:

... all of the first pass submissions in the sample mentioned technical risk, one did so in the body of the submission rather than in an initial business case, and the discussion was so imprecise it may have been of limited use decision makers. For example, it stated that—for one element—risk was ‘relatively low’, and that there was ‘some risk’ in respect of integration issues. Another submission, for a high profile, expensive acquisition, stated that risks in respect of integration issues ‘will need to be assessed and addressed in the acquisition phase’. Another submission presented a ‘preliminary’ risk assessment.

... Although some submissions in the sample characterised technical risk in imprecise terms such as low medium or medium high, two used Technical Readiness Levels ...

that the Kinnaird review and the *Cabinet Handbook* had required. But one of those rated the TRL for two elements as occurring between four and eight on a nine-point scale. So we considered that that was perhaps not terribly specific.

CHAIR—That is at page 107-08 of the report.

Ms Holbert—Yes, 107-108 of the report.

CHAIR—Those are loose terms. Is the technical risk ever quantified? I understand that you do that in terms of complexity and you give it a rating. But is there an understanding of what ‘medium’ or ‘medium-high’ et cetera might actually mean to a government trying to balance its budget?

Senator MARK BISHOP—Ms Holbert, I asked very particular questions. I am reasonably familiar with the background of this. You have now referred us to particular paragraphs and read out what is in the report. That is fine; the committee secretariat would, in due course, have found what is in the report—we can all read and write. What I am looking for is a specific answer to the question in everyman’s language, not in the jargon here.

Ms Holbert—Okay. I am slightly constrained because we are talking about the content of cabinet submissions, which is why I was using approved words. To put it in everyday language, how I started off is how we see it: this is a continuum on which Defence are seeking to improve over time the information provided to government about acquisitions. As recent reports such as Mortimer and the white paper have shown, there is still a way to go. We were a bit surprised to find in the cabinet submissions that on some of the projects there was a bit further to go yet in terms of getting some precision into the risk assessment, such that government would be in a position to make an informed decision.

Senator MARK BISHOP—Not enough progress on the reform side to date?

Ms Holbert—It is still a work in progress.

CHAIR—Does that answer your questions on cost estimates as well?

Senator MARK BISHOP—That was an answer in terms of risk.

CHAIR—Technical risk, yes.

Senator MARK BISHOP—The costing issue is a different one.

Ms Holbert—Yes. On the costing issue, there were only one or two occasions where the whole-of-life costings were done as envisaged in Kinnaird, from our reading of Kinnaird. Unlike us, Defence and DMO have an ongoing relationship with Mr Kinnaird and an ongoing relationship with government. So their understanding evolves over time, but we were looking to assess it against what was in the Kinnaird report and what was in the *Cabinet Handbook* about what was required. But it does strike us that in some of them there was an estimation of what the annual costs were. That is not a whole-of-life cycle costing. In some others there were the net personal and operating costs—a couple of issues come in there; how robust is our understanding of the current operating costs with the platform we have, that we are going to replace it with, to allow us to know how robust the net personnel and operating cost figures is; also, does that encompass everything we need to know in terms of government, what the whole cost of that acquisition for the life of its use will be?

Senator MARK BISHOP—Is that deficiency significant to your organisation in doing its work and is the whole-of-cost information being provided to government via alternate means? Do they have a full picture on which they can make a decision?

Ms Holbert—I would not know about alternate means because we were analysing the cabinet submissions which went first and second pass and we were not convinced by additional information. But I do not think we sought it as well. We were looking at the cabinet submissions that went first and second pass. The Kinnaird review said that there needed to be this quality of information going forward to government at those decision points. Certainly the department's response to the Mortimer review talks about how it is going to work better on that and the white paper, once again, makes the point about the importance of whole-of-lifecycle costing.

CHAIR—Senator Bishop, are you happy now for DMO and Defence to respond to those two areas which have been identified? I note that the ANAO points out that the Defence white paper reinforced the whole-of-life cost estimates issues as well.

Vice Adm. Tripovich—Before we talk about the DSTO thing, the objective of the audit, which we thoroughly encouraged to occur, was about seeing whether we were effectively implementing the strengthened two-parts process which Kinnaird came up with. And as the ANAO observed, it is a process of continuing improvement. It is important that I put that scenario at the start before Mr Smith explains why originally TRLs were seen to be the way to go, and that is in fact what is in the *Cabinet Handbook*, and how the continuous improvement has led us to a better way of expressing technical risk to the government.

Mr Smith—Three issues were raised. One was the adequacy of the advice and what it is based on. The second was the fact that TRLs are not appearing in cabinet submissions. The third is that there are a variety of approaches. If I consider first the TRL question: technical readiness levels allow one to assess the maturity of the technologies being used in the sub-systems that make up the equipment you are buying. They, of themselves, do not tell the whole story about what risks derive from the technologies you are using and indeed about how the various systems integrate to form the whole package. If I give you a very simple example, we all have TVs, VCRs and cassette tapes. If you pick up a random VCR, a tape and a random remote controller, they will not necessarily all work together, even though they are all TRL 9. They are all fully developed and fit for purpose; it is just that they have not been properly integrated to form that system.

Simply and only looking at TRLs is good to give you a start-up feel for where the technology is but it does not tell you about the technical risk you are going to have to manage in delivering the system and it does not tell you about what steps you are going to have to take to integrate the various components each with the other or, indeed, with other systems which you already operate.

What we do in providing advice which informs the cab sub is produce a document called a 'technical risk assessment' for pretty much every project. That starts with an assessment of a technology readiness level of all the key subsystems in that equipment and from there goes to look at how those systems are integrated together, the suitability of the technology for the purpose for which it is intended and the risks which may arise due to the need to develop technology by a particular time so that you can acquire the system effectively. All of that information is assembled into a document which has a standard and defined format where all the risks terms are fully defined and that document informs the preparation of the cabinet submission. The simple answer is we do not use TRLs as a stand-alone indicator of risk because they do not actually tell you anything about risk; they tell you about the maturity of the technologies you start from.

In terms of the adequacy of the advice, because the Audit Office seems to have booked entirely at the cab subs, they are not seeing the defence documentation which lies behind those cabinet submissions and DSTO, on its open website, has two relevant reports which describe our process. The first of these is called 'Technical risk assessment in Australian Defence projects.' That was written in 2004 as we implemented the Kinnaird reforms.

Subsequently we made an assessment of how things were going in terms of keeping a continuous eye on our product improvement and we issued a practitioner's guide to technical risk, which is also available through our website, which provides some additional guidance, particularly to our staff, for making sure we are improving the process and delivering properly.

Concerning the third aspect, the variety of approach, we have introduced this process after the Kinnaird reforms and we have learnt how to implement it better as we have gone on. This was one of the reasons why we produced our second practitioner's guide. It is also one of the reasons why we feel quite strongly that mandating the use of TRLs in the *Cabinet Handbook* is not helpful advice. As indicated in the Defence response to the report, at the moment we are going through a further review of that methodology with a view to refining it and we would expect to

provide some recommendations as to what measures should be used to better describe risk so that the *Cabinet Handbook* can be updated.

Senator MARK BISHOP—Okay, I understood that response. The second issue is the whole-of-life information in terms of costs.

Vice Adm. Tripovich—I have the lead in pulling together the cabinet submissions and the contents thereof. The audit team observed in the various documents related to the 20 projects—which are listed on page 84—that they are somewhat historic in their nature in that they went through first and second pass somewhere between 2004 and 2007 and we have moved since in this continuous improvement.

The net personnel and operating cost is our expression, in dollar terms, for how much government would have to pay for the extra people and money needed to go from the current level of capability to whatever the new project delivers. It is a net figure, which is important because it is the new money that goes on top of the current funding stream Defence has for the current capability. When you multiply our net personnel and operating cost per year by the life-of-type and add it to the capital acquisition cost and the other elements of contingency and the like, you end up with the total cost, from start to the end of its life, that you would have had to spend to deliver that capability in 30 years or whatever the life-of-type is.

CHAIR—Is there a loading for technical risks? Do you increase that?

Vice Adm. Tripovich—Certainly we do that in developing our costs and provisions—and it is important to recognise that there is a slight difference. In coming up with our options and costing our options, we go to industry—we have huge databases and we have international sources—to develop what is likely to be the cost of a particular technology in a particular platform when, we envisage, we are going to buy it. There is a lot of science and a little art required to predict how much you might have to pay for something that is, often, a long time away. As you know, we have started work on the Future Submarine project. The submarine will come into service in 2026 and the first one will last for 30 years. Trying to assess what that will cost over its life has its challenges, as you can imagine.

In doing that, there is a difference between what you think the cost will be and what you need to provide for financially—what your provision should be. That provision includes a premium for things like the technical risk inherent, the known events that might occur as you continue in the project—the known unknowns, if you like—assessments of the rate at which the cost of materials may grow over time and the like. Technical risk is certainly a part of that. That gets built into the contingency that you should sensibly provide for this project to cover events, likely or unlikely. So, technical risk is built into it. A highly developmental project, for example, would warrant much higher contingency than something that I can go and buy, literally, off the shelf down the road, because that is a known price.

Senator MARK BISHOP—If the information you provide is acquisition cost, operating cost and personnel cost, and it has an in-built contingency cost depending on the risk of the project, how is that different from what is called here ‘understandable whole-of-life cost information’?

Vice Adm. Tripovich—Our interpretation is that the ANAO's point was about consistent presentation to the government so that the government could see consistent information and understand what it is getting. We have taken that on board, so we will use a standard process now. We have engaged with DOFD, PM&C and Treasury to see what their view is on the information they require to advise their ministers. We now have an agreed format for the cost sheet that goes to those agencies so they are able to fully understand both the net personnel and operating costs and the whole-of-life cost—if you add acquisition, contingency and all the other elements and then the operating costs when it is in service. To my mind it is developing an agreed, consistent form of expression.

CHAIR—Would I be right in thinking that might become much more important when government has to make a choice between two or three options or between two platforms?

Vice Adm. Tripovich—Absolutely, because it may be cheap to buy something but very expensive to own it, if you see what I mean. You can buy a cheap car, but it is very expensive to service every year. By the time you dispose of the car, you might have spent more than you would have had you bought a more expensive car that was cheaper to run. It is very important.

CHAIR—You are saying that refinements and improvements as a response to this information in the audit report are happening at the moment?

Vice Adm. Tripovich—Absolutely.

CHAIR—ANAO, how do you feel when you hear Mr Smith say that TRLs, which are mandatory in terms of the *Cabinet Handbook*, are insufficient? You obviously have to go on what is mandatory when you review these in an audit. What is your response to that?

Ms Holbert—The context is that we operate in two different worlds. DSTO are meant to be the experts on this area and certainly we would not purport to have greater expertise than DSTO in determining the correct way to talk about risk, but, equally, the *Cabinet Handbook* did have the requirement it had and the DPR did say what it had said, so we were looking for what was happening with that. Certainly what is being explained to us—the work that is being done at the moment—sounds very positive in further addressing the desire of government for improvement in this area. We have no particular attachment to TRLs. It is simply that they were what was required at the time.

Vice Adm. Tripovich—In summary, if we can tie off the TRL one, and go back to the principle of 'Are we applying what Kinnaird envisaged effectively?', we have grown to learn, as has the government, that a TRL is in itself not sufficient. The more comprehensive technical risk assessment that now forms part of the cabinet submission that Mr Smith described is a more effective way than just a TRL to explain the important technical risks and the issues that arise from that for government. As you correctly identified, there are projects which have significant technical risks involved. If the government decides that that is the capability it wants to do and that is the option it seeks then it understands through the provision that it has to set aside how it will deal with it. Sometimes risk can be mitigated by scientific endeavour or by setting aside money or by other means to deal with it not reaching technical maturity to make sure you have it covered. The important thing is that, when the government makes its decision, Defence and government fully understand what we are getting ourselves into, that we have full transparency

of all of the issues and that they are known and in the cabinet submission. Government has an assurance that we have them covered, if you see what I mean, by ‘How are we going to deal with these technical risks?’ It is impossible to retire every technical risk before second pass. It is just impossible. As Mr Smith said, using a television, a VCR and a controller as an example, there is still an inherent technical risk when you buy those off the shelf and bring them to your house.

Mr GEORGIU—Does that mean you were ahead of the game but the *Cabinet Handbook* did not reflect your leaps?

Vice Adm. Tripovich—Certainly that is the case. The ANAO audit happened at the same time as Defence’s review process—the companion reviews that we have all heard about—leading up to the white paper and the Strategic Reform Program. The evolution has been ongoing since 2005. The ANAO came in for a snapshot in the middle of that, and we were very open with them about the things that we had already found in our capability of element companion review and in the S&T companion review that we were going to feed eventually into the Strategic Reform Program. That is why when the ANAO audit came out Defence was easily able to say that we agree with the recommendation. They were consistent with what we had found in our own internal review. It was a very good external analysis of what we had already found, which is always very helpful. When we had our initial meeting with Mr White and his team, I was very enthusiastic about it happening because it was going to happen while we were doing the review. It would have been terrible if it had had happened after the SRP, for example.

As Mr Smith indicated, it is very likely that one of the recommendations that will come out will be to the Cabinet secretariat to consider changing the drafter’s guide, which is at the back of the *Cabinet Handbook* and which is where the TRL bit is, to explain why a technical risk assessment is a much better way to express it together.

CHAIR—Just before we go on to other areas, I note that we have present in the public galley a representative of the foreign affairs department of the National Assembly of Laos. Welcome. I see you are visiting our parliament and I hope your visit is successful. We welcome you with David Monk from the Clerk’s office to this public hearing today.

Senator MARK BISHOP—The third issue is the difference between Defence and DOFD.

Vice Adm. Tripovich—I am more than happy to address that. When the section 19 report came out, we were asked to comment on the initial finding of how DOFD was engaged. At pages 63 to 65 of the ANAO report, it comments on what DOFD had told them and our response, which is at paragraph 2.50 on page 64. I do not want to repeat the paragraphs, 2.52 and 2.51, but we feel that clearly and demonstrably. We have an enormous amount of evidence of committee meetings, diary engagements and the transmission of documents to DOFD to show that, as described there, that DOFD was fully engaged at at least a one star level, the SES band 1 level, very, very early in the process. That does not mean you cannot be improved. As a result of the audit, in our response—in our management action plan—we said that we would work very closely with Finance, PM&C and Treasury to make sure that we got an agreement that the form and timing of engagement met their requirements.

CHAIR—On page 67 of the report, you agreed with the recommendation that ‘with Finance a suitable approach to allow Finance’s early and ongoing involvement in the evaluation of

capability development proposal costings' would be developed. You say that you are working towards that. Can you give us an update on how you are working towards formalising the process of engagement so that it always happens in terms of the Department of Finance and Deregulation?

Vice Adm. Tripovich—This issue had been identified during our own internal review process. It was reflected in the ANAO's finding and, as I said, we had difficulty with DOFD's view of their level of engagement and that was reflected in our response, which has been captured in paragraphs 2.50 and 2.51. Nevertheless, we realised that if there was a different view we needed to sort it out. So, immediately after the report came out, we engaged at the band 2 level between my organisation, PM&C and Finance to come up with an agreement that our level of engagement was acceptable. And I can confirm for you that there is an agreed pattern now.

To summarise how it now appears for the 2009-19 DCP, for example, we have a costing sheet that has been developed to determine the provision that should go into the DCP when a project enters a Defence capability plan. They are all released to Finance and PM&C before the DCP is presented to government. For 2009-19 all of the cost sheets have been agreed to Finance. That is a formal process. As those cost sheets are updated, as the capability development process continues, there is a routine process where those sheets are made available to Finance and PM&C. They see the changes as they occur.

Mr GEORGIU—You have lost me. Have Defence and Finance agreed that you are giving them what they want and when they want it?

Vice Adm. Tripovich—Absolutely. At the band 2 level.

CHAIR—Is it formalised in a way that ANAO can find it next time?

Vice Adm. Tripovich—They will be able to.

Senator MARK BISHOP—What is the band 2 level?

Vice Adm. Tripovich—It is a rear admiral in the military; it is an SES band 2 in the Public Service.

Mr GEORGIU—You have squared it away. They are happy. You are happy.

Vice Adm. Tripovich—I can guarantee it.

CHAIR—But is it evidenced in any way so that in the next audit inquiry we will find it?

Vice Adm. Tripovich—If the ANAO were to come and ask, we would be able to provide the evidence that agreement has been reached on the new process.

Senator MARK BISHOP—We might ask Finance to confirm that.

CHAIR—They are not here to tell us.

Vice Adm. Tripovich—I am more than happy to put that in writing. And there is PM&C. The three-cornered triangle, if you like, is PM&C, Finance and Defence.

Senator MARK BISHOP—We should ask PM&C and Finance to confirm the comments here.

CHAIR—Yes, I think that is a good idea because there were also four cases where Finance did not agree on the costings, according to the audit report. Why did Defence not then go ahead and alter their proposal before government consideration? If you did not agree with Finance, that is fine, but do we have any evidence to show why you went straight ahead with your decision without any agreement? Did you consider that advice from Finance?

Vice Adm. Tripovich—Absolutely. We always try to get agreement before it is lodged. In fact, it is one of the requirements—

Mr GEORGIU—You are not always successful.

Vice Adm. Tripovich—No, we are not always successful. And that is important in striving for agreement to costs, understanding an agreement to costs, before the submission is lodged to SCNS and then to NSC. There will be times when there is not agreement. If the minister says, ‘I accept that there is not agreement but I want to lodge and take this to my cabinet colleagues,’ that is a decision for the minister. I do not have the details of those four projects but I can assume that it was lodged because the minister agreed he would take it forward. We cannot lodge without the minister’s agreement.

CHAIR—ANAO, do you want to comment on that?

Ms Holbert—Certainly it is a matter for the minister. We were simply looking at the requirements set out in the *Cabinet Handbook*, but the Auditor-General was certainly alive to the fact that there might be circumstances in which there is disagreement and that there is disagreement for good reason and that needs to be considered at the highest level in terms of the National Security Committee of Cabinet. Because there was the requirement in the handbook, we went looking for the agreement and noted that, in the four cases in which it occurred, it is in only one of those cases that government decided to defer consideration of the proposal because of the disagreement of costs.

CHAIR—Dr Gumley, is the two-pass approval system all that we hoped it would be? Is it being applied in the best way to deliver the best outcomes?

Mr GEORGIU—Just say yes!

CHAIR—Don’t you dare!

Mr GEORGIU—There is very careful probing in this committee.

Dr Gumley—The Mortimer review reached a conclusion that the two-pass process is mostly working pretty well but there are occasions when you need to have either more passes to government or, on occasions, fewer. I will give you two examples. You need more passes when it

is a major project of public significance which may have several steps in it. An example might be the Joint Strike Fighter, where I think we will go to government four or five times before we are through. For the Air Warfare Destroyer—Warren, how many times was that?

Mr King—We did seven visits to NSC, and I think at the end of that the Prime Minister commented how well informed government was in coming to its conclusion. That was a public statement. I think in that case you very much need that additional review, but we also find there are other occasions where so much review is probably not necessary.

Dr Gumley—That is an example where with your very, very large projects that are a matter of intense public interest it is worth going more often. There are also the occasional ones where you should be able to combine first and second pass in the interests of efficiency. An example there might be a follow-on buy of the same asset. For example, at the moment we have 12 C130J Hercules aircraft. If government were to choose to buy some more, and there is only one type of Hercules out there, why would you need two passes when you can get it at a known price from the US government? That might be an example—not that it has happened yet—where on a follow-on buy of the same asset you would only bother the NSC once. So, overall, Mortimer led to some flexibility in the process based on the risk that the government of the day is facing.

CHAIR—What does ANAO require to find flexibility more acceptable? They are very reasonable propositions put forward, but under a performance audit they may be a deviation from the standard practice as mandated and therefore trigger a response from the Audit Office. What could make sure that does not happen?

Ms Holbert—In the course of the audit, the admiral did communicate to us that he was in the process of developing a new defence capability development manual and that would look to give guidance to CDG staff such that they would understand what to do in the flexible design to fit the particular project environment. Our only concern was that the guidance to staff made clear to them what elements are mandatory and what elements are not mandatory—in certain circumstances it may be that none are mandatory—that the process for particular projects is authorised at a sufficiently senior level and signed off and that, when things are done at the direction of government, the advice from government is recorded, clear and available.

Mr GEORGIU—Can I pursue that. It seems to me that Audit does have a point—you have a mandatory requirement that is not being complied with because for some reason you think you are doing better. There is a point just of compliance with something which is as straightforward as a cabinet directive. Can Defence address that, please.

Vice Adm. Tripovich—The *Cabinet Handbook* does allow for what is called combined first and second pass where things are simple and clean, as in the example Dr Gumley gave. Where we have put a combined first and second pass forward it has been with the agreement of the other agencies. It has been consistent with the way the agencies and government agree it should be done. We have to be practical and pragmatic in the number of times we go back to government. What the ANAO audit correctly identified was that we have to record our decisions for doing certain things. The *Defence Capability Development Manual* is the guide to my desk officers and a lot of other people in Defence about how to go through the process.

Mr GEORGIU—Sorry, can I ask that again: were they compliant with the *Cabinet Handbook*?

Ms Holbert—On a couple of the issues as we described there were some noncompliances, but it is not that we do not accept Defence's arguments for why what they are doing might be better or is an evolved approach. We are simply suggesting that there needs to be agreement in government on what is required and what is not required.

Vice Adm. Tripovich—When we lodge a submission, the minister has agreed to the strategy of the project. In our proposal to the minister, if we have proposed to do a combined first and second pass, it is with his agreement and we would not do that unless the other agencies were in agreement that it is appropriate. So where is that decision captured? I guess it is captured in our advice to the minister and his agreement that a deviation from the *Cabinet Handbook* is the strategy for this particular project. I feel we do capture it and it is done with authority at the ministerial level.

Ms Holbert—I would have to say, Chair—I am sorry, Admiral—that we did not have a problem with the combined approvals. I would say that some of the things we were talking about in the noncompliances in the cabinet submission fell into two categories: lower level issues and others which were a bit higher. The ones which were higher were the ones we pointed out, which were about the submissions communicating effectively to government about technical risk and ensuring that the communication to government about whole-of-lifecycle costing was of a high standard as well. We noted some of the others as noncompliances but we do not see them as a huge issue.

Mr ROBERT—Admiral, on page 16 of the report in paragraph 12 it says that:

Defence further advised that deviations from the process ... in the DCDM are the result of ... evolution, rather than departures ... and that the DCDM was developed by Defence to provide generic guidance.

So it is generic guidance?

Vice Adm. Tripovich—Yes, that is correct. In the front of the DCDM it says that this outlines a process. It is available to be tabled. Indeed it will evolve over time. It recognises that and says that at the start. We have had a 2006 manual and there is a 2009 manual under development now to pick up all the things which have come out of the Mortimer review, the Strategic Reform Program and the lessons we have learned to bring it up to date. But it will always be the case that it will paint, if you like, the generic model, but it must always be tailored for the particular project. Otherwise we will be bound by process.

Mr ROBERT—We are happy with that. Mr White, on page 33 of your one-page summary of the audit you describe the DCDM as being 'authoritative guidance'.

Mr White—Which page?

Mr ROBERT—Page 33 of the briefing for us. It is your one-page summary of audit which ANAO provided. You actually said that the DCDM was 'authoritative guidance'.

Ms Holbert—Yes, that is a quote from the DCDM.

Mr ROBERT—Are we all happy that it is generic guidance?

Vice Adm. Tripovich—I will defend the ANAO. The book does say that—

CHAIR—Oh my goodness! It is too cosy.

Vice Adm. Tripovich—but the book also says that it should and will evolve over time and it should change; it should change and be tailored. Indeed, I think the report says that I told them that it is authoritative guidance. The context of that is that I say to my desk officers, ‘This is the guidance you are to follow. If you have to change it, you do not make that decision yourself.’

Mr ROBERT—We all agree we can clear the language up in the 2009 manual. You have made the point that it evolves—great—and you just said, Admiral, that people who do depart from it should seek guidance and approval.

Vice Adm. Tripovich—Yes.

Mr ROBERT—On that, I go again to ANAO’s comment in the document which Defence does not have which says:

Nevertheless there was no evidence that tailored approaches had been clearly authorised.

That is a statement from ANAO. You have just said that your process is that the deviations on the evolution process are authorised. How do you go about that authorisation process?

Vice Adm. Tripovich—We have a number of internal committee processes. As the capability development process unfolds at internal committees desk officers present their plan—‘Here’s what I’m thinking; here are the options,’ and we give them guidance at those committees, which are minuted. ANAO observed that we did not capture in that or in any other form every single decision to deviate. We had quite a robust discussion about the level of recording that should be necessary. I have taken that on board and it is obviously important that, if at any time government wants to look back and ask, ‘Why were certain things done?’, we need to be able to provide the evidence.

Mr ROBERT—Let us dig in a bit, Admiral. In these 20 projects, how many times have authorised tailored approaches been used?

Vice Adm. Tripovich—I would say, depending on the degree of tailoring you want to go down to, that most projects would have had a degree of tailoring that was appropriate to the project.

Mr ROBERT—So most projects would have deviated from the manual, as the manual certainly allows?

Vice Adm. Tripovich—Yes, they would have been tailored to suit the requirement. Using the word ‘deviated’ makes it sounds as if I am breaking the rules, and that is not the case.

Mr ROBERT—Heaven forbid!

Mr GEORGIU—They diverged.

Vice Adm. Tripovich—That is right, yes.

Mr ROBERT—That would make sense from your point of view. Of those, how many were authorised in minutes and clearly documented?

Vice Adm. Tripovich—ANAO did the assessment. I have not measured it.

Ms Holbert—Very few.

Mr ROBERT—Any—one?

Ms Holbert—It is a matter of what level you are talking about.

Mr ROBERT—You said that there was no evidence that tailored approaches had been clearly authorised. You did not say there were ‘some’ or ‘a limited number’; you said there was ‘no’ evidence.

Ms Holbert—That means that, on each occasion where we found a tailored approach that did not fit with the guidance that was in the manual and then asked for the documentation of where the evidence had been taken and recorded, it could not be provided.

Mr ROBERT—So Defence could not provide you with a single bit of documented evidence where a tailored approach had been authorised?

Ms Holbert—Not in that sense.

Mr ROBERT—Great. Clearly there is—

Mr GEORGIU—How many instances were there? Can we not be coy?

Ms Holbert—I might have to defer to my team. I am not really being coy, Mr Georgiou. It is a failure in my memory.

Mr GEORGIU—That is a bit unusual. Can I say that Defence is not Robinson Crusoe in not documenting every—

Ms Holbert—No, absolutely not.

Mr GEORGIU—That is the first time I have defended Defence in my life!

Vice Adm. Tripovich—Thank you, Senator.

Ms Holbert—As an example, we did a performance audit in FaHCSIA on their grants programs a couple of years ago, and they had considerable difficulty providing us with the documentation of thousands and thousands of dollars worth of grants. Records are something that we in the Public Service struggle with. But, as the National Archives say in the guidelines that they put out, you need to have the documentation so that people know that the records are genuine, that they are accurate, that they can be trusted, that they are complete, that they have not been altered, that they are secure, that they can be found when they are needed and that they relate to the relevant documents. For us, that was the heart of the CDG records management issue.

Mr ROBERT—Admiral, notwithstanding that the minute takers were a little errant, are you happy in your professional judgment that, where approaches have been tailored and moved away, the decisions have been properly made?

Vice Adm. Tripovich—Yes, I am confident.

Mr ROBERT—Thank you.

CHAIR—Can I just draw your attention to pages 81, 83 and 87 of the report. The ANAO's examination found that many key capability documents:

were unsigned, were labelled 'draft', and/or had unaccepted tracked changes

The audit also noted that there were 'extended delays in gaining access to the requested documents' for this examination because of 'shortcomings in CDG's records management'. The ANAO recommended that CDG 'develop, promulgate and implement a sound records management policy'. Could you please update us on any progress in implementing that recommendation?

Vice Adm. Tripovich—We agreed that we did have great trouble locating official documentation related to the project. There was a whole raft of reasons, not the least of which was that it is very difficult to find documents on Defence's ICT system. Another was that a great number of documents were locked away after the change of government and are not available. We asked ANAO to talk to PM&C, or whoever is the keeper of the stuff that is locked away, to get release because we do not have access to it any more.

CHAIR—Is that normal practice?

Vice Adm. Tripovich—Yes, that is normal practice. It is official, I think. Nevertheless, where we were able, we tried to provide, as near as we could, the final. For example, we still had on file a number of documents which reflected the ministerial submissions that went across seeking for something to be lodged. We attempted to show ANAO that they could reasonably read in that these were the proposals that went to government. But we are bound by certain things.

To answer your question, Chair: since the audit came out, we have, within CDG, promulgated formal policies on our document and management system, a formalised document-naming convention to make it easier to recall things from the system and a process for signing off documents and keeping signed copies. Training has commenced across the 250 people that work

in my organisation. I will have a change of some staff over Christmas and it will be firmly part of our annual training continuum thereafter. By about mid-2010, I will have done a compliance audit, an internal check, to see if people had been doing what they were told to do. As I said, the training has started to roll out. It is very difficult to try to recover documents that you cannot find now.

Senator MARK BISHOP—Admiral, sorry to interrupt you—I do not mean to be rude; I have to run to another place. In respect of the earlier discussion you had with Mr Robert, I accept your explanation and I accept the integrity with which you said it: your officers depart from the tailored program, it is raised in your meetings in the internal process, it is authorised and it is done. I accept all that. I do not regard it as a matter of errant minute takers, and I would ask you and the committee chair to consider in due course whether there should be some formal process documented whereby departure is noted and authorised so we do not have ANAO coming to talk to us—

Vice Adm. Tripovich—I agree.

Senator MARK BISHOP—Thank you for your help this morning. It is much appreciated.

Vice Adm. Tripovich—In short, we have written and implemented a policy and got the training going, and I am confident that what we set in place should address the shortcomings in the future.

CHAIR—You said that would have to be done in your response to the ANAO report under the Strategic Reform Program. Is that how it is happening? I gather that is a 10-year process.

Vice Adm. Tripovich—Certainly the Strategic Reform Program is a 10-year program, but I also said that we would have the management action plan for the audit completed by December 2009, and we have.

Mr GEORGIU—I have a question to ANAO. What standard of assurance is the *Defence Materiel Organisation major projects report*?

Mr White—That is limited assurance.

Mr GEORGIU—Limited assurance, not reasonable assurance? I am now across the fact that there are two levels of assurance—one is limited and one is reasonable.

Mr White—It is a limited assurance. I do not have it with me. I will double-check.

Mr GEORGIU—Not a problem. I always thought there was only one.

Mr White—There are different levels of assurance.

Mr GEORGIU—I express on the record my concern that a number of issues that ANAO thought were significant enough to raise in a performance audit were not actually—how can I put it?—flagged or intimated at by the major projects report. Also, because I did not understand the explanation, would ANAO please provide the committee with a briefing about why matters

that were significant enough to be raised in the performance audit were not evinced in the major projects report—no little alarm bells started ringing. I would like to understand that.

CHAIR—Mr White, would you respond to that and could Dr Gumley attempt to respond as well?

Mr White—I attempted to address that, but we will come back to the committee with an explanation.

Mr GEORGIU—I honestly could not understand. Would you make it in broken English?

Mr White—As we are trying to say, there is a difference between an in-depth performance audit and what we are trying to do in the major projects report. But we will come back with an explanation setting that out for you.

Mr GEORGIU—I am concerned because the committee has put a lot of effort into Defence too and I would like some sort of signal about whether there are systemic issues which you have found here.

Mr White—As I said before, that first report was a pilot. It is limited in the amount of information that we have. I still have high hopes that over the next couple of years that will be a very authoritative and informative document for parliament in terms of the trends happening on projects. We are not there yet.

Mr GEORGIU—I am genuinely not arguing. I am expressing concern and desiring an explanation.

Mr White—DMO and the Audit Office are making a considerable investment in it.

CHAIR—Ms Holbert, how much overlap was there? How many projects were in last year's major projects report and in this ANAO report?

Ms Holbert—We would have to come back to you specifically on that. We really were not thinking about it in that context because we were looking at the first and second pass.

CHAIR—I know. But the 20 are listed at appendix 3, I think.

Mr GEORGIU—Is there any reason to believe that these are idiosyncratic and are no way reflective of that? Somehow you came upon a sample where there were divergences from the *Cabinet Handbook*, for example, that only applied to these but not to the majority of projects?

Ms Holbert—There are a whole range of issues. There are timing issues—

Mr GEORGIU—Is there anything that would lead you to believe that what you have found here you would not find there, despite the fact that you did cover some of the same projects?

CHAIR—Page 132 does list the case study projects. Someone might be able to go through and see which ones of those, if any—

Mr GEORGIU—Is there any reason for ANAO to think that its findings in the report are idiosyncratic or deviant?

Ms Holbert—I think the simplest answer is that they relate to different things, in the sense that, when we are doing the major projects report, we are reporting on the current status of the project against its material acquisition agreement, its contract and where we are in managing the project.

Mr GEORGIU—Sorry; I did not explain myself properly. What I meant to say was: is there anything that would lead Audit to anticipate that somehow its findings in *Planning and approval of major Defence capital equipment projects* are not characteristic of issues across Defence as a whole?

Mr White—Not at this stage. What we try to do with the major projects report is to look at the trends and issues that come up in particular performance audits.

Mr GEORGIU—Yes, but, with that, you are also giving us a certain degree of comfort that is not reflected when you do your performance reports.

Mr White—It is a different degree of comfort. It is a lower level.

Mr GEORGIU—I think I have grasped the point.

CHAIR—Dr Gumley, if it is at a lower level, would you have some concern that the major projects report is not a useful or reliable document?

Dr Gumley—No. I think the major projects report is very useful and reliable. I think we had a discussion in this committee several years ago about what the major projects report was supposed to achieve. We were faced with either doing 30 performance audits at the higher level of approval or audit or giving a summary year by year. What we are doing is giving a longitudinal summary so that you can see for every year how things have changed: how the risks have changed and how the dollars have changed. It is a very different process indeed from what this audit was about, which was examining the two-pass process. To answer your question as to whether there is any overlap: looking quickly, the only one that is in both lists is the C17 heavy airlifter. Of course, that is one that did not actually go through the two-pass process anyway.

CHAIR—Good, that clarifies things.

Mr GEORGIU—That gives my question more point. Is there anything that would lead Audit to advise this committee that there was something idiosyncratic in these findings that did not apply across other Defence compliances?

Ms Holbert—I am sorry, I really do not understand the question.

Mr GEORGIU—Is there anything that you believe would make the conclusions you reached in the performance audit about compliance, for instance, with cabinet handbooks, not apply to a range of other Defence projects which are not covered in this?

Ms Holbert—In terms of compliance with the things we were looking for in the first- and second-pass phases, I think our sample of 20 would lead us to believe that there would be other projects that exhibited those characteristics and some of those may be in the current bundle of work.

Vice Adm. Tripovich—I would agree. We worked with the ANAO to come up with the representative list. They asked for some extras to be put in. If you picked another project from about the same era—and that is important—you would not be surprised to find some similar issues. I would like to think, though, that, if you picked one that was just about to go to cabinet this week, for example, you would not find those things. I would be very confident that ANAO would see a completely different document and a completely different process as a result.

CHAIR—We would like to think that too.

Mr ROBERT—I have a quick supplementary question, Admiral. Can you give the committee some assurance—hope, if you will—that the DCDM for 2009, your revised process manual, will set out, if you deviate, your approval process and how it is to happen?

Vice Adm. Tripovich—The approval process for the process, if you like? Yes, absolutely. We are going to pick up all the things that were in the ANAO audit and all the other things that we have found internally.

Mr ROBERT—Great.

Vice Adm. Tripovich—And it will be a constantly evolving process.

Mr ROBERT—As it should be.

CHAIR—That concludes our questions. Thank you very much for appearing today.

Resolved (on motion by **Mr Robert**):

That this committee authorises publication, including publication on the parliamentary database, of the transcript of the evidence given before it at public hearing this day.

Committee adjourned at 12.49 pm