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Official Committee Hansard

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

**Reference: Financial reporting and equipment acquisition at the Department of
Defence and Defence Materiel Organisation**

THURSDAY, 29 MARCH 2007

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

Thursday, 29 March 2007

Members: Mr Barresi (*Chair*), Ms Grierson (*Deputy Chair*), Senators Mark Bishop, Hogg, Humphries, Murray, and Watson and Mrs Bronwyn Bishop, Mr Broadbent, Dr Emerson, Dr Jensen, Miss Jackie Kelly, Ms King, Mr Laming and Mr Tanner

Members in attendance: Senators Mark Bishop and Hogg and Mr Barresi, Mrs Bronwyn Bishop, Ms Grierson, Dr Jensen, Miss Jackie Kelly and Mr Tanner

Terms of reference for the inquiry:

To inquire into and report on:

Progress in implementing systematic reforms in the areas of financial reporting and equipment acquisition at the Department of Defence and the Defence Materiel Organisation (DMO), as identified in ANAO financial and performance audits, the Defence Procurement Review 2003 (the Kinnaird Review) and the Senate Foreign Affairs, Defence and Trade References Committee's 2003 Report on the Inquiry into Materiel Acquisition and Management in Defence, including the following:

- Progress in implementing Defence's financial remediation plans, relative to international best practice in these areas, and recommend any further measures that can be adopted;
- Progress in implementing the Kinnaird Reforms, relative to international best practice in these areas, and recommend any further measures that can be adopted;
- Review Australia's relative achievements in procurement and financial reform relative to international best practice in these areas of defence administration; and
- Assess progress in Defence's adoption of international business accounting standards relative to international best practice in this area of defence administration.

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Committee met at 10.10 am

CHAIR (Mr Barresi)—I welcome everybody here this morning to this public hearing of the Joint Committee of Public Accounts and Audit inquiry into financial reporting and equipment acquisition of the Department of Defence and Defence Materiel Organisation. The purpose of this hearing is to discuss issues related to financial management of the Department of Defence and DMO, including the implementation of Defence's remediation plans on financial reform across the department.

I advise witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. The evidence given today will be recorded by *Hansard* and will attract parliamentary privilege.

[10.11 am]

JENKIN, Mr Mark, Acting First Assistant Secretary, Department of Defence

LEWINCAMP, Mr Frank, Chief Operating Officer, Defence Materiel Organisation, Department of Defence

PRIOR, Mr Phillip, Chief Finance Officer, Department of Defence

YOUNGBERRY, Mr Timothy James, Chief Finance Officer, Defence Materiel Organisation, Department of Defence

CHAIR—Welcome. Do you wish to make a brief opening statement before we proceed to questions?

Mr Prior—No.

Mr TANNER—There are obviously a number of aspects to the issues that we are dealing with, but I am interested in getting some explanation from you today about the one that has attracted the greatest attention. That is of course the set of issues around big acquisitions and the situation where, time after time, we are ending up with major cost blow-outs caused by project modifications, contract modifications, delays and those kinds of things. You all know the story.

Could whoever is the most appropriate person explain, with a middling degree of detail, the decision-making process all the way up to the political level when a new major acquisition is being signed off. In particular, how are the risks associated with that acquisition assessed, who is responsible for making those risk assessments and in what way are they considered at both the departmental or DMO level—and particularly at the higher level? For example, does PM&C get involved in any way? Does Finance or Treasury get involved in any way? If so, to what degree and in what form are they involved, and what level of risk assessment then occurs at the upper political level prior to a decision by government that we will buy helicopters, or whatever the case might be?

Mr Lewincamp—The most appropriate person to answer this question would have been the CEO, Steve Gumley, or David Hurley, the Chief of the Capability Development Group. The witnesses here are more able to answer direct questions on financial management, but I am prepared to give a broad outline of that, recognising that other more expert witnesses might have done it more fully than I will. There is an internal process within the defence organisation and then a process of government consideration. So inside the defence organisation under the new model, under the Kinnaird arrangements, there are two processes of going through the defence committees. It is either the Defence Capability Committee, which is a two-star level committee, or the Defence Capability Investment Committee, which considers the proposal on at least two occasions, and often more, to look at all of the types of issues that you mentioned. They look at the risks associated with the project, the cost, the capability to be acquired, the timing required and how it fits into the rest of the force structure. The full range of those considerations is subject to in-depth analysis in that process.

The Capability Development Group, under Lieutenant General David Hurley, has staff who manage that process and who engage the expertise they need to make the judgements on all aspects of the project going forward. That is, it goes through the senior committee on two occasions and goes twice to the National Security Committee of cabinet for government consideration. I should add that in the internal defence processes, those capability committees have representatives from the department of finance and they often have observers from the Department of the Prime Minister and Cabinet. I am not exactly sure about the membership of PM&C at these committees, but they certainly attend some of the meetings. When it goes into the National Security Committee of cabinet, you have representation from all of the departments there and they subject the proposals to full scrutiny. By the time it gets to that stage, the proposal should have a very detailed analysis of all of the factors associated with the project, including the risk and how that risk is going to be managed and mitigated.

Mr TANNER—Are the capability committees sitting in judgement on both the strategic questions and the financial questions?

Mr Lewincamp—Yes, the full range of questions associated with that acquisition. In order for the project to win its place within the capability plan, it has to be accepted as being in accordance with our strategic requirements and our strategic needs. So it includes those judgements of the strategic posture and the strategic needs all the way through to the financial questions of affordability.

Mr TANNER—Is DMO represented on those capability committees?

Mr Lewincamp—Yes, it is.

Mr TANNER—It has got two separate capability committees that it is going to?

Mr Lewincamp—It depends on the level of the project.

Mr TANNER—Assume we are talking about big projects worth billions of dollars.

Mr Lewincamp—That goes to the Defence Capability and Investment Committee, which is chaired by the Secretary of Defence.

Mr TANNER—Does it mean you have got two separate capability committees; one that is for lower level purchases?

Mr Lewincamp—One is subordinate to the other, yes.

Mr TANNER—Whereas the big ones would go straight to the heavyweight committee.

Mr Lewincamp—Yes.

Mr TANNER—That committee makes a recommendation.

Mr Lewincamp—It makes a recommendation to government at each of first and second pass approval, and if you have got really big projects like the air warfare destroyer, they will go to government on at least half a dozen occasions; it is not just one or two passes.

Mr TANNER—I accept that you are not the best person to answer this, but you have obviously got a reasonable amount of knowledge: within the process of government it is the National Security Committee of cabinet that would form a view.

Mr Lewincamp—Yes.

Mr TANNER—They say yes or no on the recommendation and presumably it then goes to cabinet.

Mr Lewincamp—I am not entirely sure of the process after the National Security Committee of cabinet, but, given the membership of that cabinet subcommittee, I am pretty sure it then gets through cabinet fairly straightforwardly.

Mr TANNER—Presumably, the cabinet subcommittee is not the decision making body; the ultimate decision making body is the cabinet.

Mr Lewincamp—I am not aware of that process.

CHAIR—Who are the members of the Defence Capability Investment Committee?

Mr Lewincamp—From memory: the secretary; the Chief of the Defence Force; the Vice Chief of the Defence Force; the chiefs of the three services; the Chief Executive Officer of the DMO; the Chief Finance Officer; and the Chief of the Capability Development Executive, Lieutenant General David Hurley—and probably I have left off one or two, but you can see that they are all the senior members—

Ms GRIERSON—And you said the department of finance would be in that as well.

Mr Lewincamp—Yes, they attend.

Ms GRIERSON—Is it a committee of the Department of Defence?

Mr Prior—We are referring to an internal committee of Defence, the Defence Capability and Investment Committee. That does not have Finance membership. The Secretaries Committee on National Security—which is departmental heads—which reviews all of this material as well, does have Finance on it.

Ms GRIERSON—And they come under the defence department.

Mr Lewincamp—Finance does attend the Defence Capability and Investment Committee.

Mr Prior—Yes.

Mr TANNER—I want to clarify that. Does that mean that in between the Defence Capability and Investment Committee and the National Security Committee of Cabinet this proposal would go to a departmental heads' response?

Mr Lewincamp—Yes. The Secretaries Committee on National Security normally takes all of these matters before they go to the National Security Committee of cabinet.

Mr TANNER—At what point in this process, to your knowledge, would a detailed financial and risk management analysis be presented to whichever level of the decision-making process is involved? At what point would that be presented and by whom?

Mr Lewincamp—It would be presented at the Defence Capability and Investment Committee by the head of the Capability Development Group executive, General Hurley. The degree of detail and the granularity of that proposal depend upon the stage in the development of the project. At the early stage, when you are talking about the broad concept to fill a particular capability gap, it might be quite generic information, but by the time you get to the second pass approval it should be very detailed information and a detailed risk assessment.

Mr TANNER—So, once you are getting close to the point where you are making a choice—do we want to buy these things: yes or no—then you would have a financial risk analysis presentation.

Mr Lewincamp—Financial risk, technical risk, schedule risk—all of those factors are included in the documentation.

Mr TANNER—It is David Hurley who is the formal presenter of that.

Mr Lewincamp—Yes.

Mr TANNER—Who in Defence or Finance would undertake the work? Who is responsible for creating that analysis?

Mr Lewincamp—Different elements of Defence have the responsibility, but it is coordinated by General Hurley. For example, if you are talking about technical or technological risk the Chief Defence Scientist would be responsible for that analysis. For the financial risk I am not sure.

Mr Prior—It is a combination of my executive, the CFO executive and David Hurley's people as well. They are the experts in a costing sense, but my folk and I also sign off on those proposals in a financial sense; so we work hand-in-hand.

Mr TANNER—Is there any Department of Finance involvement in any of this at this point?

Mr Prior—There certainly is, because ultimately we go to the Secretaries Committee on National Security, so departmental officials from Finance are involved on the way through, at a working level as well.

Mr TANNER—Does that mean that the material that is presented to the Defence Capability and Investment Committee would in effect have Finance buy-in or would they be more observers? How actively would they be participating in that process?

Mr Lewincamp—We are not quite sure about the Finance membership of the Defence Capability and Investment Committee. I know that they are members of, and attended, the subordinate Defence Capability Committee that is one level down. I think that they do attend the DCIC, but we will need to verify that and get the information back to you. Their attendance of that committee is for their advice and their input. I do not think that they would see themselves as having signed up to the outcomes necessarily; they would reserve their position for the Secretaries Committee on National Security.

Mr TANNER—My initial impression after attending a number of these hearings and reading the material is that, contrary to some popular perceptions, the real issue that we are dealing with here is a quality or depth of risk management issue. In some respects we are setting a very high bar for ourselves as a nation in what we are seeking to achieve—and that in itself is a source of difficulties, but presumably difficulties that we hope we encounter with our eyes open. My own assessment of where all this is ultimately heading is the question of the quality and depth and rigour of risk assessment.

Even though it is true to say that setting the bar very high means that you inevitably will undershoot from time to time or you will not quite end up with timescale cost delivery being as you projected initially, I think the evidence from the past 10 years, or whatever time frame you take, suggests that there has to be something inadequate with our risk assessment. I am inviting you to comment on whether, in your view, there are ways that we could strengthen, deepen and add greater rigour to the process of risk assessment for these major projects. I mean financial risk assessment; technology risk is a separate category.

Mr Lewincamp—I agree with one part of your statement—that is, that risk assessment is central to our whole business. DMO are in the business of managing risk, both in the acquisition and in the sustainment area, and we are very centrally focused on that. We agree that there are ways in which we can enhance that risk assessment capability, including by skilling our staff, by giving them greater experience, training and exposure. We have implemented measures to engage trained project managers earlier in the project stages so that we can start to work on these issues right at the early planning and preliminary stages rather than later in the process. This is what used to happen several years ago. There are a number of things that we can do.

I disagree with your characterisation about the scale of the problem that we face. In your opening comments about cost blow-outs and all the rest of it, a lot of that is a misrepresentation by the media. If you look at the analysis that has been done on schedule and on costs, you will see that a significant proportion of cost increases are related to price and exchange and a small percentage is due to real cost increases. Part of it is also due to changes in scope, where, if you change what you want to buy, clearly you have to pay a little bit more. The percentage of cost increases due to a cost blow-out is very small. Dr Gumley and others have given evidence at previous hearings of this committee along those lines, and we can go into more detail later if you wish.

Mr TANNER—People might argue that some of the things you have identified do in themselves constitute cost blow-outs; so there is a question about what is the definition of a cost blow-out. One thing which would immediately trouble me is having a decision making process where the issues of strategic capability requirement and the issues of risk—particularly financial risk—are being assessed in effect by the same people at the same time. In your view, is there an argument for separating those out and having internal decision making processes where you have a different structure that says, ‘We are here specifically to scrutinise the question,’ not, ‘Do we need this capability?’ Is it a case of not taking into account Australia’s strategic interests but simply saying, ‘Can we achieve this within the financial parameters that are suggested? What are the risks and how do we manage them? How do we play off against risks where appropriate?’ This seems to me to be a potentially more sensible way to deal with things; to keep those two processes—strategic assessment and financial assessment—separate within the bureaucratic process. By the sound of it, that is not the case. Do you have any comment on that?

Mr Lewincamp—I would not characterise it in that way. I think that they are separate. The project would not be getting the consideration it would in front of the Defence Capability Investment Committee unless it had passed the prior hurdle of being in accordance with our strategic requirements, our capability requirements and fitting in with the overall program of development of ADF capability. So there is a prior process before they even get to the point of giving serious consideration in detail to the type and costs of the capability.

CHAIR—I note that the defence department is implementing a new financial management framework with a five-year time frame. Just for my information, how far into the five years are you at the moment?

Mr Prior—We are well into the implementation of that particular project and we are at a point where the project is now active, in place and working. This is our first year for the application of that project. We now monitor our financial controls on a monthly basis and so on. The five-year time frame is really about stating an end state for when we think it is totally embedded and totally mature. But it is actually working as we speak.

CHAIR—We have heard a number of witnesses talk about the cultural problems within the defence department and the DMO. It is expected that this financial management plan will help to alleviate some of those cultural problems as well, and I think that is in your submission. To what extent, and at what level, within your organisation have you made inroads in that regard?

Mr Prior—From my perspective I think the answer is yes, I do see those changes and those shifts. Indeed, only yesterday I was presenting at a senior leadership forum on financial management. That is a forum for our one-, two- and three-star members and it is well attended. We hold those particular forums regularly. I must say that the level of interest and concern from the organisation at that level is still high and continues to be appropriately set. I can see that cultural shift coming through. I think the organisation is responding to these issues, so I think that cultural shift is occurring.

CHAIR—You also mentioned that the framework will contain up to 5,000 internal controls and 1,000 of those are to be considered key. Each control will be documented and assigned a control owner—one person per control. As of June last year—so it is almost 12 months ago—

you had 161 key risks and 346 key controls documented. I assume that you have now completed that process.

Mr Prior—We were going through a number of phases. We now have in excess of 1,000 key controls that we monitor, as I said before. I do not have those particular statistics in front of me but I could make those available if the committee wanted. We went through a kind of risk based approach to identify the key controls in the first instance. We have done that and we are now monitoring those. We know where they are and we know who owns them. I get a regular report—

CHAIR—So you have identified the entire 5,000.

Mr Prior—No, we have not identified 5,000 key controls. We have identified the key controls. There are many other controls below that. I do not have the exact number in my head at the moment, but it is well in excess of 1,000 control points that we are aware of and that we monitor.

CHAIR—The plans were for the remainder to have been documented by 30 June 2006.

Mr Prior—We have documented all of the control points that we think are appropriate for our organisation, and we are comfortable about where we are at the moment. The 5,000 was set as an estimate of where we would end up in terms of total controls across the organisation. That number may be less at this time. But we have documented and monitored the key controls. When we talk about controls—if I may make the point—they may be, for instance, that someone checks a particular form. That form might be checked in 100 locations around the country. The 5,000 refers to the 100 times one. But the key control will be the one, if that makes sense. We are monitoring that one key control. But if you multiply that by 100, and you do that for all the various controls geographically, then you will get to a much larger number.

CHAIR—Can we have some updated statistics provided to us.

Mr Prior—Certainly.

CHAIR—How many of these key controls relate to inventory management and financial management information systems?

Mr Prior—I have that detail in my office. I do not have that detail with me today but I can certainly provide that to you. The key controls are allocated across the various components of our organisation.

CHAIR—Are you confident that it is certainly covering those key areas of financial management?

Mr Prior—Indeed, in terms of both systems and manual processes.

Ms GRIERSON—I want to go back to some of the issues that Mr Tanner raised. You obviously have to do the projected budget and the liabilities as well. When we deviate significantly from the capability plan, like we did with the Super Hornets—and there have been

billion-dollar projects which represent deviations—how do you cost that, how do you project that and how do you make those changes?

Mr Prior—Did you want to answer that—

Senator HOGG—It is good to see you fighting over it!

Mr Prior—It is not fighting; it is just that, because there are both DMO components and Defence components with all of these things, we are just making sure that we are able to answer the question adequately. As I said, the most appropriate expert in this matter would be David Hurley. He and his team can talk in detail about these things. But, with any project, as there are variations those variations are reviewed, assessed and understood—

Senator MARK BISHOP—The Super Hornets are not part of the DCP.

Ms GRIERSON—No, they are a deviation.

Mr Prior—That is right.

Senator MARK BISHOP—Or they are a complete separation from it.

Mr Lewincamp—Their funding is separate from the Defence Capability Plan; I think that is the key point.

Mr Prior—That is right.

Ms GRIERSON—Are you saying that the funding is coming not from the existing Defence Capability Plan budget but from consolidated revenue; that it is part of the three per cent increase to defence spending every year?

Mr Lewincamp—Yes, government supplementation.

Ms GRIERSON—So you are suggesting to me—

CHAIR—Can I interrupt for a moment to remind members of the committee that the witnesses were selected specifically for their expertise and their ability to answer questions on the remediation plans and financial reform. If your questions could be couched in terms of what their areas of expertise are, that would certainly help.

Mr Lewincamp—I might add that Dr Gumley and General Hurley would be more than happy to return for a further session if the committee would like to hear more detailed evidence on these matters.

Ms GRIERSON—I think that is probably important, because if there are going to be changes then they are assuming all the time that there will be additional moneys for the defence budget—

Mrs BRONWYN BISHOP—That is why we have governance.

Ms GRIERSON—And therefore—

Mr Lewincamp—It is not always the case. If a change to the capability plan arises for operational reasons, for a new requirement or for a new deployment requiring some additional capability, Defence either needs to find the money by offset within its own resources—it can do that either within the Defence Capability Plan or through its more general budget allocations—or, alternatively, needs government to supplement it for the acquisition. So there are broadly three alternatives to be considered.

Ms GRIERSON—If we get to a point where the deviations are significant enough that savings have to be found, who advises on finding savings or on changes to the Defence Capability Plan to match those savings?

Mr Lewincamp—At the point that the government considers the proposal, it will also consider the funding source, and at that point cabinet will make a decision either to supplement or to request that Defence finds the money within its current allocations.

Ms GRIERSON—If it is your job to find those savings—that is, if it has to come from the defence budget—what do you do then?

Mr Prior—As has been explained, we have a committee structure that considers all these issues for each of these variations in a proper, thorough and considered way. To the extent that government makes decisions or has priorities or requirements, those are factored into the forward estimates. It is not as if I simply make a decision on my own. We provide advice to government about what the resource availabilities are; we provide advice to government about what the options might be and then, ultimately, as Mr Lewincamp said, they make a decision with regard to one of those three different approaches in response to that requirement.

Ms GRIERSON—If a decision were made to abandon the Sea Sprites—you have got them in your budget costings, in your projections et cetera—what would happen then? How do you manage that? How do you measure loss and how do you show that in your accounts?

Mr Prior—Coming back to the financial statement point of view—because that is what my expertise is—if there were a capability, an asset, that did not have future service potential, we would see an adjustment to our financial statements.

Mrs BRONWYN BISHOP—I just want to follow up on that line of questioning. The bottom line is that if the government decide that defence needs a certain capability—because we are in an environment where we are deploying, where there is danger or where there are other factors to take into account—and a decision is made, then they will come to you and ask you if there are any savings available. You will then go through and give advice to government as to what is available. Government will then make the decision that if we need the acquisition you will get additional funding. It is not rocket science to work it out. It is the minister's and the government's decision, not yours. You are the people who are supplying information. The question that I wanted to ask earlier was: do you think Defence is now comfortable using accrual accounting methods or has it still got a way to go?

Mr Prior—I think that accrual accounting has its complexities, as we appreciate, but the fact that we are making great strides to remediate our financial reporting would indicate that it is starting to bed down. Do I think that there is still room for improvement? I would have to say yes. I think that is true of any organisation. Do I think that the organisation utilises accrual accounting? I would say that it does. The defence department has a balance sheet which has financial information regarding its asset base, its specialist military equipment and its inventory levels et cetera, and they are part of what we are discussing right now. Accrual accounting has shone a light onto those elements that a purely cash approach could not have done. That is not to say that accrual or cash is better or worse than one or the other. It is an integrated information set that I think helps to shed light on the very things that we are talking about.

To directly answer your question, it has been a tough journey, but I think that it has been a tough journey for all organisations. I receive a full set of accrual financial statements every month. I review those financial statements and I analyse them as a full set of accrual accounts. But there is always room for improvement. We acknowledge, for instance, that we still have work to do on our inventory accounting.

Mrs BRONWYN BISHOP—Is that still a bugbear? Defence is not an organisation that can indulge itself with just-in-time ordering.

Mr Prior—That is correct.

Mrs BRONWYN BISHOP—To have a defence force that can deploy and carry out its missions, it is necessary for us to hold inventory.

Mr Prior—That is correct.

Mrs BRONWYN BISHOP—It has always been a bugbear for defence to both find inventory in a timely way and get it to where it needs to be. Has accrual accounting assisted in that process? Are we better able to identify inventory now?

Mr Prior—I see the world in terms of physical quantities and pricing. Accrual accounting is really a reflection of a physical activity in financial terms—in documents, if you like. Your reference to the need to be able to find and deploy the inventory is a business issue that is always subject to business improvement and so on. Accrual accounting has had to struggle with getting a system around applying financial information against those physical activities. We have made significant strides in that regard and I think we still have further to go.

It is worth noting—and we have made this document available to the committee—that the Australian Accounting Standards Board has only in the last two days released a proposed amendment to the inventory standard because they recognise that there are some unique difficulties with organisations like ours in accounting for inventory. Has accrual accounting helped? I think the fact that we have a balance sheet of items—the inventory that we are holding in any year—that provides visibility is good. I think it has assisted in that regard. But I might say that from my understanding—and I do not in a sense operate the inventory—we have always been very good as an organisation in responding to the business side of it. Can we deploy with inventory in a timely fashion? My understanding is that we do that well.

CHAIR—Is this the paper that you referred to?

Mr Prior—Yes, they just provided it.

CHAIR—We have not had a chance to go through it.

Mr Prior—No, I know that, but it might be of interest to the committee.

Mrs BRONWYN BISHOP—My question is in respect of how you are going to handle future changes. As an example, let us take the F111s. We are going to buy the Super Hornets—which are a good purchase—and we have the classic Hornets as well. We will also have the Hornets that we cannibalise and utilise. How do we treat the financial accounting mechanism, in terms of how ultimately the interface between the Super Hornets and the classic Hornets is going to work? We say we are going to phase out the F111s, and at the moment that is due to be 2010, but it might turn out to be 2013 or 2014—whatever it is. In the meantime, we hold an inventory and we have got a value. How do you handle that sort of scenario in terms of financial accounting?

Mr Prior—Do you mean in terms of the phasing out of one platform and another platform coming in?

Mrs BRONWYN BISHOP—Particularly as it may vary.

Mr Prior—I might ask Mr Jenkin to offer some comments. As with any asset held in the financial statements of any organisation, there is an assessment of its future life and there is a depreciation charge against that asset over the estimated future life.

Mrs BRONWYN BISHOP—But its estimated life might be different from the phase-out date.

Mr Prior—That is right. We would make adjustments in our financial statements if that estimated life were to be reassessed and to change, so there is an accounting approach to respond to those sorts of changes in an underlying business. Similarly, with the inventory that we might hold, or the repairable items or the spares with regard to those platforms, to the extent that eventually a platform is deemed to not have future service potential, at that point there is an adjustment made in the financial statements to reflect that.

Mrs BRONWYN BISHOP—So the answer is you simply reflect any policy change which results in a financial change, on a year by year basis?

Mr Prior—Indeed.

Mrs BRONWYN BISHOP—As the information comes to you.

Mr Prior—That is correct.

Mr Jenkin—I will just add to that. We recently had the Defence Capability Committee endorse a revised plan of withdrawal dates and useful life for our key defence assets. There is a formal process by which the capability managers take account of government decisions, and so

we adjust in accounting terms. That is an annual process, as required by the accounting standards, to review the useful life of assets. We keep track of it that way. We are obliged to record our specialist military equipment at cost, and that is subject to testing for impairment. Where the service potential of an asset is reduced from the cost base, we would then take a reduction in the financial statements. As an example, last year the Sea Sprites were subject to some impairment reduction.

Mrs BRONWYN BISHOP—If they were to be dumped they would have to be written off, and if they were to be replaced there would have to be a new acquisition item. It would not be a replacement cost; it would simply be a new acquisition.

Mr Prior—Correct.

Mrs BRONWYN BISHOP—Can we then go to the question of risk. In defence, managing a department and managing the question of risk is a lot different from managing the risk of, say, a special minister of state, who might be buying things like bits of paper and pencils. The sorts of major acquisitions we are going to be buying are always going to have a very large in-built risk factor—they have to, to be at the cutting edge. So there are always going to be unknowns. That is going to require an interaction between you, as the accounting side of the operation, and the risk that gets built into a contract in terms of price. For instance, if we are going to have a fixed price contract, it is then reasonable for the contractor to build in what might be seen as a larger profit margin to take into account the risk that the provider is going to have to wear—and indeed the risk of making a loss if something goes wrong. So the capability side is going to have to liaise with you to put a price on that risk as far as you are accounting for it. Is that how you work?

Mr Lewincamp—Yes.

Mrs BRONWYN BISHOP—Do you think that there is a better way of doing it or is that a good way to proceed?

Mr Prior—The processes that are undertaken in these project evaluations and developments are as sound as they could be at this time, in my view. I think there are proper processes in place to consider all the various issues we have heard discussed this morning. They are in place and they are done as well as can be expected. I take your point. Some of these projects are at the upper end of the risk spectrum by their very nature. I am not an expert in these matters but from a financial point of view it is interesting to note, as an aside, that the GFS, the general government financial system of accounting—which is based on the United Nations and IMF accounting processes—currently writes off specialist military equipment in the year in which it is purchased, because of various risk issues, I expect. That is being reviewed at an international level. It is interesting that there are others who see that this particular asset type has a degree of risk, which is quite unusual in a normal commercial sense. All of these processes that we refer to are partly about understanding and monitoring those risks.

Mrs BRONWYN BISHOP—We often see very critical audits coming from the Auditor-General with regard to behaviour, because on a project audit they are looking at the ways in which certain things are done. Do you find when you are dealing with the Audit Office that they

have an appreciation of the sorts of risk factors that are in-built into defence, or are they looking at you more like the Department of Health and Ageing buying widgets?

Mr Lewincamp—Perhaps I could just go back to your earlier question and then answer the subsequent one. For the reasons that you outline, we certainly do have a variety of contracting mechanisms with our service providers to cover the different types of risk. We cannot treat all categories of assets or specialist military equipment as one type because sometimes it is a proven, off-the-shelf type capability and the risk factors are very low. That is when you might have a fixed price contract or a pretty firm arrangement with the contractor. At the other extreme, you might be dealing with leading-edge technology, very complex systems integration or an international supplier or we might be on a production line in another country. You have enormous risk in all of that. Therefore, it is very difficult to have very precise contracting arrangements at the start. There needs to be a great deal of flexibility in the way that Defence and DMO approach these issues.

You might have seen an article by Henry Ergas some two months or so ago in, I think, the *Australian Financial Review* which gave a very lucid explanation of this process and the risk factors that we have to manage. We are conscious of that because we do that in order to give the Australian Defence Force the best capability that it can possibly have. We have to have the optimum level of risk. We cannot reduce the risk to zero by doubling the project cost, doubling the schedule and getting proven technology, because then we would not be delivering to the Defence Force the leading-edge technology that it wants in order to maintain a capability edge. We are conscious of that and it is a key part of the consideration of how we approach the program as a whole and the individual projects.

In relation to the Audit Office, frankly it varies—as you would expect in any relationship where you have somebody coming in after the event and reviewing the process. That is always easier, and it is easier for us to look back over our own activity in hindsight and say, ‘If I was doing that over again I might have done it a little bit differently.’ It is also difficult for somebody coming in two, three or four years after the event to get a real appreciation of the interplay of factors at the time that people were making the decisions: the pressures that they were under, the various factors. We find that the understanding, appreciation and empathy, if you like, of the Audit Office tends to vary. Sometimes it is good; sometimes we think that it leaves something to be desired.

Mrs BRONWYN BISHOP—I was thinking particularly of the audit on the acquisition of the Tiger. In one of our hearings, there was a great deal of dissertation and discussion about the delivery date and the fact that the delivery date had been brought forward knowing that there were defects that had to be fixed. There was great criticism that Defence had accepted the aircraft with known defects and, in auditing terms, had said that that was the delivery date. In fact, it was not. The delivery date was a totally different date. But, in order that people could get better training and the like, a strategic decision had been made to bring that forward—taking the defects with it—knowing that at that date the defects still had to be fixed. But, if you picked up the audit report and read it, you would not pick any of that up. That is why I asked the question.

Perhaps this should be considered when the interplay is there between the Audit Office—for whom I have the highest regard—and your department during the discussions on the first audit draft that comes to you for your comments. If, for those things, you were to include in the report

a statement saying, 'A strategic decision was taken which has affected an outcome,' it would then make sense. Because, if you read it as it is, you see none of that.

Mr Lewincamp—We are engaged in discussions with the Audit Office precisely to do that. In the audit reports, we would like to see a better contextual setting for the audit—an understanding of the strategic environment and the need for the capability—rather than just the far more detailed reporting. That is a work in progress. Over the next couple of years, I hope you will see more of that contextual setting in the reports.

Mrs BRONWYN BISHOP—I will be looking for it.

CHAIR—While we are on the topic of the day, which is financial reporting management remediation plans, back in May you were going to go through progress on your remediation plans—all 16 of them. What is the progress against those plans as of now, and have there been any audit findings on those as well?

Mr Prior—To assist the committee we have handed out our portfolio additional estimates statements, and I refer you to page 111. We would like to go through the 16 plans because we think we have made some very good progress and we would like to demonstrate that and talk about our major outcomes. From page 112 onwards are the various plans that we have had in place for some years now. It starts with 'G1: Financial Reporting Framework'. On the left-hand side it describes what that plan was, while on the right-hand side it shows the major outcomes for 2005-06 and what we are planning to do in 2006-07. I will refer my comments more to the right-hand column to give you an update of how that is working.

The first one is the financial reporting framework. As I have said before, we have now got that embedded in the organisation. We monitor our controls, we have identified our key financial risks and we report on those monthly. I review and monitor those as they are done by people in my organisation. The internal audit group then come in behind us and do their audit spot checks and so on to ensure that those control assessments that we make are valid. From my point of view, I think that that control framework is now in place and working. It will continue to refine. In our discussions with other large organisations—I do not wish to mention their names, but we have contact with other very large organisations that have similar frameworks—they said it took them a number of years to continually refine and mature this particular approach. We expect that to happen as well. So, over the next few years, we will continue to see improvements.

But it is a framework that is providing me with good visibility of when the controls are strong or weak. One of my objectives is that, as my team sees that a particular control might start to falter or become weak, we have a responsibility to the organisation to go to work and remedy that control—to fix that control—as and when we identify that it has got some weakness. That happens in any organisation from time to time. We are pretty comfortable that that is now well in place and working pretty well.

The auditors have not finished their audit for this financial year. They may have some observations and some comments to make about how we can improve on that. At our regular Defence Audit Committee meetings we do review this particular framework and how it is operating. The feedback we are getting from the auditors at this stage—and I will not speak for

them; they have their own independent view—is that they are happy and comfortable with how this is progressing and where we are up to.

Indeed, I must say that we now have inquiries from other agencies. They want to pretty well pick up what we have done and implement it into their organisations—and we are very happy for them to do that. We have bundled it in such a way that if a department says, ‘We have heard about this control framework. How do you do it?’ we say, ‘Here it is,’ and we go and have discussions. Last year we had a—

Miss JACKIE KELLY—Do you make similar inquiries yourself internationally? Any member of the public can download the British accounting system off the web and have a fairly comprehensive idea of their accounts.

Mr Prior—We are not aware that the British have implemented a deeply embedded control framework like we have. Our control framework is really more modelled on the large international corporates, who are, as you know, under intense scrutiny from organisations like ASIC, so financial controls are very important to their organisations. We are modelling more that way.

Miss JACKIE KELLY—Under the British system I can see how much an operation in Afghanistan cost over and above the ordinary cost of maintaining those personnel. I cannot do that here. You have just got general costs.

Mr Prior—The PAES document is an update of additional budget impacts from the original PBS. The PBS and the PAES need to be read concurrently. This is an add-on to that. We do budget for operating costs and we do report in our annual report on operating costs and so on. That is visible, and our system does track that for all of our operations. There is a section in our annual report regarding those—I just cannot flick to it at the moment—but the PAES is not a document that—

Miss JACKIE KELLY—It is on page 22.

Mr Prior—Yes, but it shows the addition. That is what the documents were designed to do.

Miss JACKIE KELLY—We will come back to that one. Looking at page 22 versus the British system, even allowing for the pound, we seem to be expensive.

Mr Prior—I am sorry, I missed your point.

Miss JACKIE KELLY—We will come back to that one. Let us just keep going through the financial remediation.

Mr Prior—Let us just remediate G1. Included in G1, of course, is a major investment in financial management training, and we have been doing that now for some years. According to the latest statistics that I have, I think we have trained something like 10,000 people in financial management in this current year—the year to date. Last year, 2005-06, 14,610 people were put through financial management training programs. This year from February to date there have been 10,331 people. We will continue that training effort because it is an ongoing responsibility

to ensure that people understand what their financial responsibilities are and how to undertake those activities.

CHAIR—Is it helping your recruitment process as well? Is all this financial training making it easier to recruit people into the jobs?

Mr Prior—I wish I could say yes. Unfortunately, in Australia there is a lack of skilled people in this area. We particularly find it here in Canberra. I talk to my CFO colleagues on a regular basis, and they have similar issues: we cannot find enough people to do the work. Interestingly, those that come and get to know that we have these investments in this training area do see it as a particular advantage of working in Defence—because they get this sort of attention.

Senator HOGG—I will follow on there. Does that mean that your problem is retention?

Mr Prior—Do you mean in the finance base?

Senator HOGG—Yes. If you are training all these people and there is a shortage there out in the marketplace, you then have a pool that becomes very attractive to the marketplace. I am wondering about your problem in terms of retention.

Mr Prior—It is an interesting point. As we develop our controls framework and our compliance certificate framework et cetera, and other agencies hear about how we have done—and they like what they see—guess what happens to our people? They become very marketable to other people.

CHAIR—You train them and they take them.

Mr Prior—It is a problem but it is not a bad problem. My hope is that the people stay within the APS, and if we have contributed to the upskilling of the APS broadly then that is not a bad thing. Recruitment in itself is quite difficult. We put ads in the paper and it is hard finding folk, but that is a common problem around the country. On G1, we would like to think that we have got this going.

CHAIR—I thought you had already moved to G3.

Mr Prior—I am still on G1.

CHAIR—I thought G3 was about training.

Mr Prior—It will lead to G3; it is important in the framework that we train people. On G2, 'Improving the ANAO Annual Audit Process', I think that we have a very healthy relationship with the ANAO, a strong professional relationship. We submit our financial statement plan for the year to the auditors early in the financial year, and we discuss it and work through it together. We have a very mature process of sharing information at the highest strategic level for our financial statements. This particular plan is well past the remediation point: it is now embedded and it works.

The ANAO may have their view, but, again, from my regular discussions with the audit committee, they seem very comfortable that we work together well and that they can now start to develop their plans for audit in conjunction with our processes. Indeed, I recall that at the last audit committee—and my colleague will correct me if I have this slightly incorrect—the auditors commented that their audit work was more progressed this year than it has ever been. That is testimony to the fact that we are working together and we are getting on top of things. Again, I like to think that this is no longer a remediation plan but that it is a business-as-usual situation moving forward.

Mr Jenkin—Just to add to that, we had prepared our financial statements plan for 2006-07 within a month of finalising the previous accounts, which for us was a significant achievement. Likewise, the ANAO were then able to prepare their audit strategy within a month; so before the end of the last calendar year. We had agreed on plans and strategies to work together, which was a significant achievement in Defence's case.

Mr Prior—As we viewed the G3 plan to be so important—that is, to train our people—we set it apart from the G1 overall package. I have previously referred to G3, and I think we have done extremely well in this area. The numbers that I cited before speak for themselves.

We do not rest on our laurels, though. The financial training folk work in my executive and they develop new training programs continually. We try to look ahead and plan the future needs of our people across the organisation. When some of the base training starts to embed and become absorbed, we then try to develop more plans that take us to a further level.

Ms GRIERSON—What is the percentage of the budget spend on training, and how has that changed?

Mr Prior—I do not have that number in front of me, but I can get that.

Ms GRIERSON—I would be interested, because I would like to see it compared to what it used to be. I imagine that the costs will taper off a bit because, as you just said, you are going to have a cumulative effect in terms of the benefit of that training.

Mr Prior—That is an interesting point. I am not sure that it will taper off in one regard. We have the figure here of 14,000 a year, so let us assume that that becomes a steady state. That could also be higher, depending on the needs of the organisation. For instance, a new compliance certificate reporting regime was recently introduced across agencies, and that brings with it a need to train people.

Ms GRIERSON—By whom?

Mr Prior—That was a government decision led by the department of finance. So in response to that new requirement of reporting on our compliance—

Ms GRIERSON—New training.

Mr Prior—we will need some more training. So it is an ongoing thing. That is why I do not see training as a remediation activity; it is now embedded.

Ms GRIERSON—So you would like to see it as a continuous cultural development initiative?

Mr Prior—I do not think there is any way that anyone can avoid that—

Ms GRIERSON—We would be interested in the figures over the past few years.

Mr Prior—We will make those available to you.

CHAIR—Mr Prior, it is probably going to be a bit difficult to go through all 16 individually. We might pick certain ones.

Miss JACKIE KELLY—Are we going to look at G3, though?

Senator MARK BISHOP—Could I suggest that we look at G3, S1, S2 and S4. The rest have all been fixed. They are the four that are outstanding, aren't they?

Mr Prior—Thank you, Senator. That was what I was hoping to do today; to acknowledge that we have fixed things.

Senator MARK BISHOP—Yes, I know. We have had this discussion repeatedly elsewhere—

Ms GRIERSON—I would like to ask some questions on S5, the military leave records.

CHAIR—We will go through those and if there is any other documentation you want to provide on updates to them then you can submit them to us. We will go through the ones that Senator Bishop has just recommended.

Mr Prior—S1 was our next port of call. It is about stores records accuracy. It is about stock quantities; that is the story here. We have a two-year rolling stocktaking process in place and it has been in place for some years. It is now at a mature state. I see regular reports now about our stocktaking effort—and my colleagues Mr Youngberry and Mr Lewincamp may wish to comment on this. I see what I expect to see—that is, information flowing about the results of stocktakes, which are done on a regular basis. So information is flowing through. We are getting closer and closer to the point where we think we have a stocktaking process which is now business as usual. Does that stocktaking process identify stock movements and adjustments? Yes, it does, as it should do. We have a stocktaking process which, as I understand it—and I am not a day-to-day expert in these matters and there are others you may wish to talk to who could give you that information—is down at the bin level. It is down at a very low level. We have well in excess of 150 million individual items and we are counting down at the bin level across 1,100-odd warehouses. You will get adjustments; you know, someone might put a bolt in the wrong bin.

Senator MARK BISHOP—Mr Prior, I will cut to the chase: what is your current estimate of the extent to which there are material deficiencies in stores inventories across the country? That is really the key question.

Mr Prior—If we had this discussion in three weeks I would have a paper that I could potentially show you. It would have given me time to write this up. That is the exact point we are at with the auditors at this moment. We are just finalising our management view on that exact question.

Senator MARK BISHOP—Right.

Mr Prior—Where do we think we are up to? Do we think we have got to the point where we are happy that material quantity is under control?

Senator MARK BISHOP—Because when you are at that point and ANAO sign off on it, that flows through to your accounts.

Mr Prior—Absolutely.

Senator MARK BISHOP—That is the last hurdle to getting rid of qualified accounts.

Mr Prior—There is pricing, and I want to come to that as well.

Senator MARK BISHOP—Yes.

CHAIR—At the appropriate time, can you provide us with that paper?

Mr Prior—We could do it as a position paper. We have provided this committee before with our position papers on a whole range of topics to do with our accounts. We are finalising that position paper. If you would not mind, I would prefer to hold off my opinion on that until I have finalised my own personal due diligence in that regard.

Senator MARK BISHOP—That is fine, because you are going to do the work. I will just put you on notice, and you might be able to advise your colleagues, that I will come back to it in estimates—whether we do that in May or June—and get a status report on the level of material deficiency, if any, on stores inventory right across the country.

Mr Prior—Indeed.

Ms GRIERSON—And you have no idea yet of the level of accuracy?

Mr Prior—I do have an idea—

Ms GRIERSON—But you do not want to put a figure on it.

Mr Prior—With all these things, we are talking about a significant amount of inventory across so many locations. We have been monitoring the statistics of the stocktaking effort during the year—during the past two years. We are on the verge of forming a view as to whether we think we now, materially, have that under control. My view, in short, is that we are pretty close.

Senator MARK BISHOP—If you come to a view that you are on top of it, does that then need to be ticked off by ANAO—

Mr Prior—Absolutely.

Senator MARK BISHOP—or is your conclusion sufficient?

Mr Prior—Absolutely, because our conclusion is management's view. The auditors then have to independently form their view. That is why I go back to the arrangements with the ANAO. We are in a position where we now present to the auditors and say, 'Here is our view, and here is the basis for our view. Here is the basis for the work that underpins our view.' Then they do their audit.

Miss JACKIE KELLY—The SDSS was one of the key ANAO reports that I suppose kicked off this thing: the way that it was funded originally, then was put to government at a certain cost and then had blow-out after blow-out. I think they subsequently had SDSS fix-it Nos 1, 2 and 3. I notice now that your improved logistics information system has gone through second pass approval. Is that further money into SDSS?

Ms GRIERSON—Before you answer, can I add that, according to the last dot point on page 115, you have this year to get SDSS right because in 2008 you are going to a new system.

Mr Lewincamp—There are several different elements to this. Perhaps we can come back to the future of SDSS—which is the military integrated logistic information system, JP2077, that you want to talk about—and the additional funding. We might do that after Mr Prior has finished. But a key part of getting the financial framework right was to get controls reliance in SDSS. I have reported previously—I think to this committee, but also in estimates—that we put in a new controls framework in SDSS. That has been tested and independently quality assured. We now believe, at the management level, that we have controls reliance in SDSS and we are just about to put that position to the National Audit Office for them to review. So we have done a significant amount of work in sorting out that system.

Miss JACKIE KELLY—So the contract for JP2077 is post-Kinnaird and is not going to have any of the problems that SDSS had.

Mr Lewincamp—Can we come back to that after Mr Prior finishes?

Miss JACKIE KELLY—Okay.

Ms GRIERSON—And can you also explain how this military integrated logistics information system, which is going to replace SDSS in 2008, is going to operate.

Mr Lewincamp—Can I deal with all of that after Mr Prior?

CHAIR—Yes. Let us just work through this and take those other questions later.

Mr Prior—Have I covered S1 to your satisfaction?

Senator MARK BISHOP—Yes. You have told us that you think you have done the work, you are reviewing it, you are writing a position paper and I can ask you further questions as necessary. You should then be able to answer questions on the level of material discrepancy in inventory, if any.

Mr Prior—Correct, and if there are any surprises we will certainly let you know about them.

Senator MARK BISHOP—Yes, that is right.

Mr Prior—Because life is like that.

Senator MARK BISHOP—Life is like that. Pour it out, because we will find out anyway.

Mr Prior—That is right.

Ms GRIERSON—I am still not clear on this. You and the Audit Office agreed on the accuracy of inventory, stores and controls in SDSS, which you put in place, and then you are going to move to a whole new material logistics financial framework.

Mr Lewincamp—Perhaps I can deal with that now.

Ms GRIERSON—That is S1 and S2, so I would really like to know.

Mr Lewincamp—There were two different elements of our approach to SDSS. One was to fix the immediate problems with the system so that it could contribute towards the proper financial management of defence. Those immediate problems were things like fixing the Julian date problem—you may remember we had a date processing thing. That has been done. We put in place better compliance systems and assurance programs around the use of SDSS. We put in a place a new IT controls framework and a whole range of different measures to improve the way that SDSS was supporting the current business. But at the same time our future business is much more demanding. SDSS is a reasonably clunky system. We needed to upgrade the software and in particular we needed to get a better definition of the division between what SDSS does in financial terms and what ROMAN does in financial terms. We reached an agreement between the two projects about where the financial functionality would be split between the two systems, and that is part of a new software upgrade in SDSS.

The new system will be called MILIS rather than SDSS. The first phase of that will include a new software system—a new software core—that has better financial functionality and a much better interface with ROMAN. Other elements of the upgrade are things to improve in-transit visibility. We have had separate audit reports, as you know, about the inability to actually track an asset or a piece of inventory right from the start of the system through to the end. There are a couple of different elements for improving that and improving deployment capability, because SDSS is now operating around the world. The system is deployed in Iraq, Afghanistan and East Timor and it is working well.

But we need to improve its ability to work in an interrupted communications environment, and part of the upgrade is to do that: to enhance the deployability in a comms interrupted environment. So there will be a whole range of different measures that we will need to do to

continue to improve the logistics information system as developments occur in computing technology, accrual accounting requirements and financial requirements. That is what the future upgrade is all about.

Ms GRIERSON—Where does this MILIS system come from?

Mr Lewincamp—It is project JP2077. It is a major project, and it has been through all of the required approval processes.

Ms GRIERSON—So it is just a renaming of—

Mr Lewincamp—Yes.

Mr Prior—It is an upgrade.

Senator MARK BISHOP—It will take another seven years, though, in two phases, won't it?

Mr Lewincamp—If you count subphases it is more than that but, yes, it will take some time because the final phase of the current project has not yet been through the internal Defence process. We are still determining what that will mean. But we have finished one phase of this new upgrade and two more have been approved by government. One is under contract, the second is under contract negotiation, and they will be finished in two to three years time.

Senator MARK BISHOP—Has the work until 2014 involving the \$450 million spend that the minister announced in the middle of last year all been ticked off by the appropriate committees now?

Mr Lewincamp—I am not entirely sure what announcement you are referring to.

Senator MARK BISHOP—The minister put out a press release around July of last year on the improvement of the SDSS system—the morphing into the MILIS system that Ms Grierson was talking about. My recollection is that it was going to be two phases and involved a spend of up to \$450 million, to be finalised in 2014. I am hearing you now say that there is a further phase after that.

Mr Lewincamp—I will go through the phases in detail: we have two phases for 2B and, as we always do, we have split them into 2B.1 and 2B.2. One of them has government approval of the order of \$130 million. The second phase is of the order of \$90 million, so it is slightly more than \$200 million for those two. Phase 2C—in-transit visibility—which is now being completed, is about \$25 million. Then we have got phase 2D, which is the one that has not yet been fully costed and fully scoped and has not yet been through the internal process. So the government approval to this stage—one occurred in about July last year and one, I think, occurred in December last year—is just over \$200 million.

Miss JACKIE KELLY—That is on a contract that initially went out with Defence thinking that less than \$15 million would fix it?

Mr Lewincamp—No, this is entirely different. I think you are referring to the original upgrade program in 2003, and then there was the subsequent Get Well Program. Yes, it is true that the upgrade program—it might even have been 2001, and I think it was completed in 2003—had a cost blow-out from some \$15 million to \$50 million.

Senator MARK BISHOP—Miss Kelly is right; the original SDSS upgrade project back in 2000 was going to cost \$15.8 million.

Mr Lewincamp—That is right. We are in agreement on that.

Miss JACKIE KELLY—It is amazing that, back then, Defence scoped the project and said it was going to cost this much and then, after a proper look at it, they said it was \$225 million. How do you get it so wrong?

Mr Lewincamp—No, the upgrade at that time was a quick fix, immediate fixes; it was not for the future development of the integrated logistics system. We know that, with a system like this—

Miss JACKIE KELLY—Was it simply that, when you had the spotlight on you, you had to go through all the clear approval processes?

Mr Lewincamp—No, there was quite a conscious decision at that time that further work would be needed, but we wanted to do some quick fixes first. Now we are going through the phases of the system. This is an enormously complex system with tens of thousands of users. We know that in five or six years time we will be going through this again for the next upgrade.

CHAIR—One was a patch-up, and the other one was a full upgrade to the system?

Mr Lewincamp—Yes.

CHAIR—Mr Prior, do you want to continue.

Mr Prior—I think we are on to S2, which is general stores inventory pricing and accounting. This is probably the most difficult of the areas to deal with. In our view, there are three components to this. There is one which we think will now be remedied if the new exposure draft by the Accounting Standards Board does actually get up.

Previously, the accounting standards required us to price our inventory at lower cost or replacement cost. When you have 150 million-odd items, to do that exercise every year is just not possible. In the exposure draft that the standards board has put forward we were very much involved in helping them understand what the issues were, and, from our point of view, they have been very open-minded in understanding the issues. That exposure draft now refers to the requirement to value that inventory only at cost, and there are some particular provisions regarding that inventory if it is impaired or loses its service potential. So, assuming that that standard gets up, the exposure draft will be out—I am not sure when. Do you know, Mr Jenkin?

Mr Jenkin—There will be a comment period until 11 May, I believe, with the expectation that the board will then approve the final version of the standard at their main meeting, for

application from 2007-08, but with the ability to early adopt for this financial year, should we choose to do so.

Mr Prior—So, given that that all happens, that problem we had with pricing will go away, and we can revert to recording our inventory just at cost. Moving forward, that means that that is now something that we can get on and do.

The second part of the pricing problem is what we call the legacy problem. As you would appreciate—and I think we have highlighted this in previous attendances—we have stock that we hold just in case. Some of that stock sits there for many years—unlike Coles or Woolworths that hold stock to turn over as fast as they possibly can. The records associated with some of that inventory that goes back many years are not readily available. Does that mean that Defence has some legacy of record-keeping issues? The answer is clearly yes. But that is what we have got.

Ms GRIERSON—Can you put a value on that sort of stock?

Mr Prior—We do have the statistics, but they are not in front of us. Part of the process of remediating this is to stratify all of our inventory into different groups—for instance, that which has not moved since 1990 or whenever, that which has not moved in 10 years and so on. So those records issues then impact from an audit point of view, with the auditors being able to validate the price of inventory. We are working with the ANAO to try to find a way to use a surrogate pricing approach. Having lost a record—

Ms GRIERSON—You need to make it up.

Mr Prior—You need to find some way not so much to make it up but of then using methods to come to a price which might be quite sensible in the circumstances. For instance, we may have some stock that has not moved for a long time and that we do not have the record for. If there is a similar item which we have purchased in the last little while, you might argue: ‘This is kind of like that. Can we use the price from this new item as an approximation of the price of that old item?’

Mrs BRONWYN BISHOP—They might turn out to be genuine antiques.

Mr Prior—Indeed, they might be.

Senator HOGG—That is right. They could have a really unexpected value.

Miss JACKIE KELLY—The point of accrual accounting is that when you purchase an item you have already got a write-down built into that. So if you buy F111s, you say, ‘Yes, they are going to last for 30 years.’ You just price that into it and then you have replacement costs and you know that at this time—

Mrs BRONWYN BISHOP—Accrual accounting is a new feature. When I first came to parliament it was all cash accounting.

Ms GRIERSON—You have to apportion that cost over time.

Mr Prior—Indeed. So that is one approach. The other approach is to try to ascertain—Mr Jenkin is more fully across this—different indexation approaches. You referred to the British approach. If you read the notes to their accounts, you see that they use a lot of indexing to keep their prices under control without having to refer to individual invoices all the time. But Mr Jenkin might be able to shed some more light on this.

Mr Jenkin—I will expand on the size of this issue. We have segmented our general stores inventory to get a feel for turnover and for how old some of our stock is. As an example, we have found that currently in our SDSS system there are general stores valued at close to \$100 million that have not had any receipts or issues against them since 1993. With items like those, what assumptions can we make about whether they even have a value at the moment?

We are segmenting the database for what movements and turnover there have been. Where you have current prices, we are doing that analysis and then looking at ways of approaching it to either come up with a verifiable value or to decide whether it may need to be written off in a financial sense if it has no economic value to us.

Miss JACKIE KELLY—When we toured the site, comments were made—by those who may or may not know—that a lot of the stock at the Holsworthy and Moorebank sites is held for equipment that is no longer in use. It is just kept there. If you actually crunched it down, you would need one-fifth of the space to keep what we currently have in use. So if something is 15 years old you have to—

Mr Jenkin—In an accounting sense we are looking at that for immediate write-off, because, clearly, if the equipment it is supporting is no longer there then it potentially has a miniscule residual value.

Ms GRIERSON—If it is an anchor and there is a chance that once every 20 years you might need a new anchor, it still has to have a cost, doesn't it?

Mr Prior—It is an interesting question. It has a cost but, under the new international accounting standards, there is a notion of impairment—that is, we need to assess whether this stock, this inventory, has any future service potential. Some of it is a judgement call. And you are quite right; some of it might be held just in case. From a financial sense there is a question of whether there is a value there or not. So that is the judgement—

Ms GRIERSON—Or is it almost a liability?

Mr Prior—Indeed, so it goes to all those issues and we are working our way through them. The good news is that we have visibility of these things—we know where they are and we understand them.

Miss JACKIE KELLY—Surely there have to be savings on 15 years of storage cost by saying, 'The required time for that is about a month, because that is the kind of turnaround time to get the ship in and to get the parts fitted.'

Mrs BRONWYN BISHOP—Yes, but the problem is that it might be something from an M113, which are in excess of 30 years old, and we still need the parts that are 30 years old to maintain some of that kit, because they are not made anymore.

Mr Prior—We are conscious that we are financial experts. We are not operational experts. There is an interplay between the operational experts and the financial experts to ultimately make these calls. I was reminded the other day that we have Land Rovers, and I am not sure if anyone makes parts for Land Rovers anymore.

Mrs BRONWYN BISHOP—That is correct and, furthermore, they are extended Land Rovers, so they are a little bit more specific.

Mr Prior—I am not an expert in these operational matters, but they are the sorts of things that the operational people have to deal with. What we do is analyse and understand what the valuation impacts might be, and that is what we are now working very hard on.

Ms GRIERSON—So, Mr Prior, you are answering all of these questions, but the accountable officer is the CFO to the DMO.

Mr Prior—Yes. Mr Youngberry is sitting here. Mr Youngberry joined the department only six months ago. Because, ultimately, the financial statements inventory is reflected in the defence financial statements, I take a keen interest into this matter, regardless of Mr Youngberry's position. Ultimately, I have to sign off on the value of these items anyway.

Ms GRIERSON—Before Mr Youngberry says anything, this suggests that there has to be great coordination and cooperation.

Mr Prior—And there is.

Ms GRIERSON—Is that in place?

Mr Youngberry—I can give you a bit of context of my role in all of this. Mr Prior has mentioned the operational experts who need to make judgements around whether inventory is still required for use. That expertise resides within DMO. My organisation provides the conduit through which the finance executive comes in to DMO. We help coordinate the activities across all of DMO. I have some of my people closely involved in the accounting work that goes with it. But, as Mr Prior said, inventory sits on the defence balance sheet and he has a close and vested interest. We work very closely to make sure we address these issues.

Ms GRIERSON—Okay. Thank you.

Mr Prior—There is a third element to the pricing story. The first one is the AASB standard, and if that comes into play, fantastic. On the second one, legacy invoices, there is still a lot of work to do and the ANAO have to come to an agreement with us. Again, we will put a position to them as to our view about what we do. There is a third legacy issue. I am not sure if the committee understands it this way, but it is what I call the \$1 item problem. SDSS, as I understand it—and it was well before my time—was originally established as a logistics

management system. It was designed to manage the quantity of inventory—we need particular items here and there and we need to know where they are. That is what it was designed for.

As Mr Lewincamp referred to previously, some of our upgrades in remediation are about getting a more financial component into SDSS so that it can respond to the system being not just a logistics quantity system but also one that has to take account of all the value elements. It is my understanding that, in the past, there were items entered into the system, in the former regime of a quantity management system, when the price was not so relevant. So there are incorrect prices in the system. We are working to try to find them all and then to put them in our legacy pricing category. So there is a third element in that, over time, we need to update some of the items that were entered for a quantity purpose—

Ms GRIERSON—Someone just had to put a price next to it. They were more concerned with knowing how many there were and where they were located than with what the value was.

Mr Prior—That is as I understand it.

Ms GRIERSON—It was just a matter of putting anything in the box.

Mrs BRONWYN BISHOP—The location problem was a very real driver.

Mr Prior—Absolutely.

Mrs BRONWYN BISHOP—It was a huge problem with 150 million—

Ms GRIERSON—No-one is disputing that.

Mr Jenkin—In fact, as I understand it, the business process 10 or 15 years ago, whenever it was, was to put zero or one as the value.

Mr Prior—That was an instruction.

Mr Jenkin—We have been able to do the analysis by line item, basically, to see the zero priced and \$1 or 1c priced items. Obviously, that is the area we are focusing on.

Ms GRIERSON—Could you generalise and say they were very small items, or is that not necessarily so?

Mr Jenkin—You could not generalise necessarily, but, having said that, given the age of a lot of those, we can now focus on whether those items are still there in quantity and then determine again their materiality in the total value of inventory.

Ms GRIERSON—Will you make the end-of-year target for transferring over in 2008 to a new system?

Mr Prior—Transferring to a new system? Yes, as far as I am aware.

Mr Lewincamp—That is neutral with respect to this problem.

Ms GRIERSON—So you will transfer anyway, no matter what the situation is.

Mr Lewincamp—We will transfer the information from the current system into the new system. But my understanding is that there is not much; there are a proportion of items like those with this residual value problem. It is a small problem.

Mr Prior—That is right. It is a small problem but one that I just want to mention because it is a three-part process.

CHAIR—You are still working on it.

Proceedings suspended from 11.37 am to 11.45 am

CHAIR—We will finalise these two remediation plans and then we will go back to some general questions that members have.

Mr Prior—As you may have noted in the auditors report for 2005-06, explosive ordnance now has had its qualification lifted, so from our point of view the auditors are—and we are—satisfied that we have that under control and managed in a financial reporting sense. That is where that is at.

Senator MARK BISHOP—Wait a minute. I am not aware of that. Is that right?

Mr Prior—Yes.

Senator MARK BISHOP—Where does it say that here?

Mr Prior—It does not say that there.

Senator MARK BISHOP—No. If you go over, for example, to S6, the civilian leave records column, it states:

The audit qualification for civilian leave was removed ...

It does not say that in respect of S4, and the last discussion I had a couple of months ago on ordnance was that you had not resolved the identification, tracking, pricing and location issues.

Mr Jenkin—The audit qualification around EO pricing was lifted in 2005-06, and I think that that is addressed in point (a) of 'Major outcomes: achieved in 2005-06'. So, from that perspective, the audit qualification matter was lifted.

Senator MARK BISHOP—I am sorry, Mr Jenkin. I was not aware of that. Do you now have a full inventory of all ordnance which identifies geographic location and placement?

Ms GRIERSON—Can you validate that it is real and that it is there?

Mr Prior—Which question do you want me to answer?

CHAIR—Answer Senator Bishop's question.

Senator MARK BISHOP—My question is: with the audit qualification having been removed, do you now have a system that accurately identifies all ordnance in inventory by geographic location?

Mr Jenkin—As the financial accountants, our understanding is that the balances are materially correct and that they are verifiable in terms of location; stocktaking is done.

Miss JACKIE KELLY—But if there is a shipment of explosives, say, on a Hercules out of the RAAF base, does SDSS—

Mr Jenkin—The system for recording munitions explosive ordnance is COMSARM, which is separate from SDSS.

Ms GRIERSON—But, DMO, you are accountable for it. Can you say in an unqualified way that all explosive ordnance has been verified in terms of where it is and that now you are working through its values?

Mr Youngberry—As the accountants, we are satisfied that the information we provide to Defence for their financial statements is materially correct. It is managed out of the COMSARM system, which is run by one of the divisions within DMO. We have processes around how that system is managed. There will be stocktaking procedures in place for it.

Miss JACKIE KELLY—And that covers it in transit?

Mr Youngberry—I would have to check on that.

Senator MARK BISHOP—Can your system accurately identify how many rocket launchers you have in the locations where they are supposed to be?

Mr Youngberry—I do not know the detailed workings of the system, so I will have to take that on notice and come back to you.

CHAIR—It is a fairly basic question.

Mr Youngberry—I am talking here as the accountant.

Miss JACKIE KELLY—Further to that, if a rocket launcher is in transit and signed out of one base, what is the guarantee that it will be signed in at the destination base, and who double-checks that? If it is already signed out of the area that it is supposed to be in, and somebody decides to divert it, where is the double-check to make sure that it is signed into the area it is headed to, either in transit around Australia or on ships?

Mr Prior—I have an understanding of the COMSARM system in a high-level management sense, and my understanding is that there are reconciliation processes for things that are sent and received.

Miss JACKIE KELLY—And received, but if it is not received then—

Mr Prior—Then my understanding is that there would be a reconciliation gap.

CHAIR—Is there an accepted time frame for that reconciliation to take place? If something is signed out of Holsworthy and is in transit to Richmond—one would expect it to be something like a 1½-hour drive—do we wait 12 months to do that reconciliation?

Mr Lewincamp—Chair, we agree that these are entirely reasonable questions, but we do not have the expertise to answer—

Senator MARK BISHOP—No, you do not.

Miss JACKIE KELLY—That is for explosives, but the same goes for SDSS as well in terms of other items.

Ms GRIERSON—Points (c) and (d) say that you have achieved:

Formulation and implementation of a compliance framework to ensure user access is managed effectively ...

I assume that means that no-one can pilfer it or move it without it showing up somehow.

Mr Prior—I would not like to suggest that no-one can do anything. I am not trying to divert from the question, but I do know that Coles Myer and Bunnings and everyone has things stolen. We would not want any of this stolen; our objective in the organisation is to have none of this stolen, to have none of this go missing at any time. The compliance frameworks, as I understand them, are built on the basis that we take this as the highest, most serious control mechanism that we should apply. But, from a financial point of view, have we had the auditors review all of those systems and processes? Yes, we have. There was a major effort last year at Orchard Hills by the auditors. My people were involved to make sure that—

Ms GRIERSON—Point (d) states:

Periodic reviews implemented to ensure access management is effective ...

Can you give us the result of the last periodic review?

Mr Prior—I do not have that information, but that is the sort of information that the head of Electronic and Weapon Systems Division would have access to and would monitor.

Ms GRIERSON—I think that should be requested.

CHAIR—There are a few questions that we have been asking you to put on notice. There is the one from the deputy chair, and also Senator Bishop has a few that he wants to read out. Do not answer them; just take them on notice and we will have some responses.

Senator MARK BISHOP—I would like you to take the following questions on notice. Firstly, what is the system that is used by Defence or DMO for identifying inventory records of all ordnance? Secondly, is the system operating to 100 per cent efficiency; if not, why not? Thirdly, can and does the system identify the geographic location of all ordnance used by the ADF both inside and outside Australia? Fourthly, does the system identify locations in particular of ordnance such as guns and rocket launchers? Fifthly, has there been any recent advice to senior levels of Defence about rocket launchers, weapons and missiles that have gone missing without reason or without cause?

Mr Lewincamp—I want to clarify the last question: do you mean recent advice or ordnance that has recently gone missing?

Senator MARK BISHOP—I meant both, and subsequent to the earlier press this year—that was in January or February.

Mr Lewincamp—That is why I asked the question, because a lot of that was many years ago.

Senator MARK BISHOP—Yes, it was. I am talking about post-February.

Miss JACKIE KELLY—Also, you mentioned pilfering. I think that pilfering in Coles Myer is about five per cent; they just say, ‘That was pilfered.’ Do you have a record of that amount for Defence, or do your records show that there was no pilfering?

Mr Prior—I reconfirm that for EO—explosive ordnance—this is taken very seriously. Pilfering is not something that we at any time accept any level of. Zero tolerance is the position regarding EO. There is no strategic position, whereas with other items of stock you may risk manage some of those in the same way that Coles Myer might risk manage.

Miss JACKIE KELLY—Do they show as pilfering?

Mr Prior—We do have adjustments to inventory. I do not think that we show them as pilfering. It might come through as ‘in a bin there were supposed to be 93, and there are only 92’, but it will not show as a pilfering account, as far as I am aware.

Miss JACKIE KELLY—Is that a fair and accurate assessment? Are those accounts real?

Mr Prior—Yes.

Miss JACKIE KELLY—Defence never loses any equipment.

CHAIR—That is not what he said.

Mr Prior—No, what I was trying to point out was that our records indicate both positive and negative adjustments to our general stores inventory levels. We do track the pluses and minuses and we can drill down and see where they occur.

Miss JACKIE KELLY—There has to be some tracking of unaccounted loses when there is an implication that someone took something they were not authorised to take. Then, over time, you can get an idea of whether that is going up or down or what is happening with it—

Mr Prior—We do. We track that.

Miss JACKIE KELLY—and whether we have an issue at one warehouse or not.

Mr Prior—We do that.

CHAIR—I was going to make that point: are you able to track by location to see whether or not there is greater prevalence in one location, or with one section, than another?

Mr Prior—That tracking is done by the logistics group. That is what their responsibility is.

Miss JACKIE KELLY—But it does not show up in any of the accounts.

Mr Prior—It does show in the accounts. When we see in our accounts a write-off—a write-down—that will reflect the fact that those adjustments are taking place in a physical sense. So there is a financial representation of that loss. It is in our accounts.

Mr Lewincamp—There is a prior step, of course. When you first have an anomaly or some inconsistency, you then have a process of review, checking and investigation. If at the end of that point you cannot reconcile it, you then come to the financial treatment.

Miss JACKIE KELLY—What part of the \$235 million worth of asset write-offs in this report are unaccountable, missing items?

Mr Jenkin—The write-off figures are made up of a number of things. In gross terms, within what we call general stores inventory, in 2005-06 we had write-offs in the order of \$227 million. Of that, stocktaking adjustments, physical adjustments—which are really what we are talking about—were about \$50 million. To give you an idea of the other sorts of write-off adjustments that we make, some of them are pricing corrections based on the fact that we are reviewing the pricing amounts that we have. Some of it is reclassification, where we move assets from inventory to repairable items or another classification of asset. The residual is basically the amounts that we are disposing of or providing for as obsolete.

Miss JACKIE KELLY—So \$50 million is the figure—

Mr Jenkin—That \$50 million is the write-off figure, but then you need to take into account the write-ons. As Mr Prior alluded, because we do our stocktaking at a very detailed micro level, quite often they might not find something in that bin but they will find it in this bin. The write-ons were \$57 million of stocktaking adjustments. The net stocktaking adjustment was \$7 million out of \$1.8 billion in general stores inventory.

Miss JACKIE KELLY—Basically no-one takes anything, anywhere, across all of defence. In fact, they all put it back.

Mr Prior—I do not think that is a fair characterisation. What we are saying is that the accounts try to faithfully reflect when there are anomalies in the inventory. The anomalies are both pluses and minuses. We have tracked this back over the last eight years and there is, if you like, a sort of normalised level of what these ons and offs would be. As you said, as you would expect with any other large organisation with inventory, these pluses and minuses will occur. I cannot look you in the eye and say that there were no items taken.

Miss JACKIE KELLY—It would just be against human nature.

Mr Prior—I cannot—

Miss JACKIE KELLY—I would suggest it would be the norm, as in any other organisation.

CHAIR—Have any personnel been sanctioned because of allegations or—

Mr Jenkin—We are probably not aware of any individual cases, but where you have loses above certain thresholds there are formal investigations made. Potentially, ADF or APS staff could be sanctioned for that.

CHAIR—How many of these formal investigations have gone to the conclusion of saying, ‘Yes, there has been pilfering taking place’?

Ms GRIERSON—For example, those missiles that were taken.

Mr Lewincamp—I will have to take that on notice. You occasionally see in the press clippings somebody taken to court on this very basis with criminal charges.

Mr Jenkin—I was also going to add that a lot of our inventory is, of course, managed by contractors, and we hold the contractors to account in a financial sense for loss based on stocktake.

Ms GRIERSON—So have you changed your supply chains?

CHAIR—I would like to know that information. I do not want the situations where the errors are taking place due to incompetence. I want the situations where there has been a deliberate breach of the law.

Ms GRIERSON—Could you also include the situations where a supplier has been changed because of concerns—if that has occurred.

Senator HOGG—I want to clarify something in my own mind. As the accountants in this role, you can only rely on the information that is passed to you to make your adjustments either up or down. How do you satisfy yourself that the process to get the adjustments is based on the correct information in the first place? I presume you are not responsible for collecting the information, but you are responsible for reflecting it in a financial way. Can you tell us that?

Mr Prior—We do rely on the information provided. We have a number of what we call due diligence processes. We require the custodians of particular business aspects—like inventory—to sign off on various assertions about what they have done in terms of managing the quantities. We are also very much close to monitoring some of the stocktaking processes and so on—the systems that are in place. We take an active interest in all of those areas, but it is not a managerial interest, if I can make that distinction. We do not simply sit back and say, ‘Oh, we’ve got this; it must be right.’ We apply a risk based approach from our own position to ask, ‘What areas do we think we need to delve into deeper to satisfy ourselves whether the information that comes through is reliable or not?’ Certainly, last year, in the explosive ordnance environment, we had a lot of our people deeply involved in ensuring that the assertions being made by the managerial custodians were in fact assertions that we thought were valid. Also last year, in the area of provision for land decontamination, for instance, we spent a lot of time with the group responsible for that to ensure that we understood that they had done it properly. We do take an active role, but, again, it is not a managerial responsibility role; it is to help us to come to a view.

I would point out the word ‘materiality’ in a financial reporting sense because it is very important in this. To refer back to your question, if a nut has been stolen, lost or broken, will the accounts need to reflect that half a cent of value? I would not chase it. It is not material to the financial representations. But if it were an entire platform that was missing it would be material and of course the accounts would have to reflect that. So there is a sense of materiality in this that we accountants are taking into account.

Mr Jenkin—Further to that, in gaining assurances around the financial information, we do also use external providers to give us an additional level of assurance over some of those processes, particularly with some of the more difficult areas of accounting that we have been weak on in the last year or two.

Ms GRIERSON—For example?

Mr Jenkin—With the provision for decontamination, as Mr Prior said—

Ms GRIERSON—So you outsourced some work to someone?

Mr Jenkin—We had a combined team: our people with some external accounting assistance to make sure that the processes that we used were in compliance with the accounting standards as required. Likewise, with the pricing of EO—explosive ordnance—last year, we combined with some external advisers to make sure that the processes were compliant, and the auditors ultimately agreed with that position.

Mr Prior—A very good example is the work we did last year on the employee entitlements. Employee entitlements is a very complex area that had been qualified for a number of years. I had a number of our people deeply embedded in that space to give me some comfort as to the quality of the information. In that case, we even had to refer to external statisticians to help us to understand what that information was telling us. As you can appreciate, with the volume of people and transactions in a year, you cannot test every single one of them, so we used statistical means to get some understanding of the robustness of the information.

Ms GRIERSON—So you have had a considerable budget to bring about these remediations.

Mr Prior—I do not have that information in front of me, but we have reported before, each time we have counted, how much we have spent on this remediation. The \$80 million-odd number comes to mind, so there has been a very big—

Ms GRIERSON—In part (b) of S4, what are UNIX risks?

Mr Youngberry—UNIX is a computer operating system.

Ms GRIERSON—Used for what?

Mr Youngberry—I would have to go back and check what they mean when they say that, but presumably it is something to do with how the system functions at the operating system level.

Mr Prior—UNIX is an operating system rather like Windows is an operating system, if you like. It is that sort of level, without being a techo.

Ms GRIERSON—I see. I am still intrigued.

Senator MARK BISHOP—I have just one final question to Mr Lewincamp. With those other questions, Mr Lewincamp, could you advise us what is the current state of information with respect to ordnance on hand?

Mr Lewincamp—I am not quite sure I understand the question. Can you paraphrase that in slightly different terms?

Senator MARK BISHOP—Can and does the system accurately identify all levels of ordnance within the system?

Mr Lewincamp—Quantity levels?

Senator MARK BISHOP—Yes.

CHAIR—Are there any other questions you want to put on notice? We will move to S5 then. Miss Kelly would also like to touch on S10(1).

Mr Prior—Can I just, for the record, go back to the discussion about systems regarding EO. Just to be very clear, my recollection is that COMSARM is our primary system where EO is contained. When EO is issued out to units for range practice et cetera, it does transfer to other subsystems. I just want to be clear about that. That is my understanding.

Mr Jenkin—That is correct, particularly in the case of Army. Once it is issued out of COMSARM, which is a classified system, to those user units, they then maintain the information in SDSS, as an example.

Ms GRIERSON—So they do not interface; it has to be re-entered.

Mr Jenkin—It is not an electronic interface, as I understand it.

CHAIR—Perhaps you can clarify to us—not necessarily now—at what point it is your responsibility, and then when someone else, whoever else that is, takes over, and then when you come back into the process again?

Ms GRIERSON—Will the new system interface with it? COMSARM is going to stay there, isn't it?

Mr Prior—Yes, it is.

Ms GRIERSON—Will the new system in 2008 interface with it and be compatible?

Mr Lewincamp—I am not sure what is intended. I will need to take that on notice.

CHAIR—This sounds like a structural responsibility issue here.

Ms GRIERSON—COMSARM is a secure system.

Mr Prior—Correct.

Mr Lewincamp—There is a problem with them operating as two different levels of security classification, so we need to be really careful about any electronic connectivity between them.

CHAIR—All right, shall we keep going?

Mr Prior—Are we up to S5?

Ms GRIERSON—Yes.

CHAIR—It might be better for continuity to go into straight into S10, because there is a bit of similarity with S4.

Miss JACKIE KELLY—In the dim dark past when I was in the military, there were always large discrepancies in stock. But when there was an extremely large one, things were investigated. On one occasion there was actually an ad in the local gazette just out of Amberley where they were selling military stock and helping themselves out of the warehouse to fill the purchases. That became apparent by stock discrepancy. I find it unusual that you have in S10 your stock holding controls, but there is not any financial line item where you can follow that. Do you know what I mean? I would think that as accountants you would make allowance for ordinary human behaviour statistically. It definitely happened once when I was in the RAAF, but it could obviously happen again. These are the people who are in control of the warehouse.

Mr Prior—We do have in our system provision for 'ons' and 'offs' and different categorisation as to what the ons and offs are about. I do not have visibility of a stolen items account. At the warehouse level they may well have; I do not know.

Miss JACKIE KELLY—But you should have visibility of discrepancies by location—or do you just get discrepancies across the Defence Force?

Mr Prior—We can drill down to that level through the system.

Mr Lewincamp—We could certainly track discrepancies. What we are struggling with is the cause of the discrepancy, because in most cases the cause will not be criminal behaviour by some of the staff. There will be a whole range of other reasons why there are discrepancies.

Ms GRIERSON—In previous evidence we heard that data entry accuracy was very low and that one of the contributing factors was that you could not print out any meaningful reports. So even the data enterer could not print out a report of what had just been done or whether each month was improving or not improving. Point (b) there suggests you have done some improvements to the report function of SDSS.

Mr Prior—Can I give you an example. In the financial sense there is a report that I can refer to which tells me for 2005-06 what are pricing errors, what are reclassifications, what are disposal adjustments, what are write-off adjustments and what are quantity adjustments et cetera.

Ms GRIERSON—So there must be improved functionality?

Mr Prior—Yes, and then I can drill down below that to start to get data by location and then, as you say, whether a particular location was showing a regular problem with a particular adjustment. What I am suggesting is that the financial folk then start to interface with the logistics folk and we have discussions about what is happening there and why there are these sorts of volumes coming through. Does that help?

Ms GRIERSON—Yes, that does help.

Mr Lewincamp—S10 had three components. One was to tighten the controls framework, so we put restrictions on what people could do with the system. The second was to increase the range of diagnostic reports coming out of SDSS, and the third was to improve user education awareness and training.

CHAIR—Miss Kelly, do you have any more questions on S10? Let us see if there is a logical flow, otherwise we will go to S5.

Ms GRIERSON—I think S5 is very straightforward. You are very satisfied with the outcomes at S5. We now have accurate leave records.

Mr Prior—And the auditor signed off on that last year.

CHAIR—Can we go to S7, then, please: executive remuneration.

Senator MARK BISHOP—Go to page 121, paragraphs (a) and (c): what was achieved in 2005-06. I think you have 240 SES officers in Defence and DMO and I do not know how many military officer equivalents. Why did you do self-confirmation?

Mr Lewincamp—That 240 includes military equivalents.

Senator MARK BISHOP—Okay, so 240 in total SES. Why did you do self-confirmation there?

Mr Prior—We developed a strategy of confirming this balance to our satisfaction and that strategy included this particular activity. The purpose was really to establish once and for all, with no doubt, a baseline to say that everyone agrees. An employee liability is rather like any other liability, in a sense—we owe a creditor money. In my past life, when I was a registered company auditor, it was not uncommon for us to get third-party confirmation from the creditor to say, ‘Is this the amount that is owed to you by the company that is being audited?’

Senator MARK BISHOP—It is like when I advise you that I have 12 weeks of annual leave; three lots of four not taken. I started in 1998, so I have a notional amount. That is what you did.

Mr Prior—That is what we did. So then we make sure our records are confirmed with you, under the creditor relationship. That is what we do so that once and for all, with no doubt, we know where we are and we have a baseline. That helped management to come to the view that we did have the executive remuneration note accurately stated within tolerances of materiality.

Ms GRIERSON—Did you apply the same methodology for non-SES personnel?

Mr Prior—No, because the executive remuneration note does not apply to non-SES. This only applies to the SES.

Ms GRIERSON—Is this for ordinary entitlements? I want to know if people were allowed to input into their own records and validate them in any way.

Mr Prior—We do have that process ongoing within our system, in any event. People are entitled to do that at any stage.

Ms Grierson—So they can challenge and appeal against what you decide, if there is no base record?

Mr Prior—Indeed, that is available.

CHAIR—With regard to administrative issues, you were saying that you did not have accurate personnel records and that you had to do a self-confirmation.

Mr Prior—No, I am suggesting that—

CHAIR—Is it not illegal not to have accurate personnel records?

Mr Prior—In my time as the CFO of this organisation I did not form the view that we did not have accurate leave records. I formed the view that we did have accurate leave records.

Senator MARK BISHOP—But the ANAO did not have this view?

Mr Prior—No. This year—the time that I have been here—the ANAO agreed with me.

Senator MARK BISHOP—We are not talking about your recent time, Mr Prior; we are talking about when there was a problem.

Mr Prior—I am trying to make the point that I was not there to make the call.

Senator MARK BISHOP—Okay.

Mr Prior—You could have a debate about what constitutes a record and whether the records are adequate et cetera. Importantly, we have all agreed that this is now under control, and we are now able to say that we have got adequate records.

CHAIR—Was there much discrepancy between what you thought was already there on your record and what they confirmed as being their understanding?

Mr Prior—Do you mean the ANAO?

CHAIR—No, I mean the individuals.

Mr Prior—I do not have the detail in front of me. My understanding was that the discrepancy was not substantial, not significant—if there was one at all. I just do not have that in front of me.

Ms GRIERSON—But you are assuring us that there was an appeal process for everybody and that you could challenge that your entitlements were not as the record showed.

Mr Prior—That, in fact, is in place as we speak—this is not a one-off.

Ms GRIERSON—It should be.

Mr Prior—For the SES the particular process said, ‘This does not prevent you from challenging it.’ Those were not the exact words, but they were words to that effect.

Ms GRIERSON—It does not matter what your rank or position is?

Mr Prior—No.

Mr Jenkin—For executives it was a positive affirmation of the balances and the transactions. Broadly, most of our civilian staff have access to PMKeyS Self-Service, and they can see on a daily basis what the balance is and all the transactions that have been recorded against them.

Ms GRIERSON—What about military personnel? Do they have access to something like that, or do they use paper documents?

Mr Jenkin—They predominantly use paper documents at this point in time, but there are transition plans.

Mr Prior—One of the exercises that I undertook last year to satisfy myself was to review all of our departures. The exercise that I undertook was to review the departures over the last two

years. What I was looking for were all transactions or adjustments to people's entitlement in the 30 days leading up to their actual departure date. My logic was that if there was someone who was about to leave, one of the things that they would naturally do is say, 'I wonder if my records are right?' and they would go and have a look. There were adjustments that people would come up with, but the level of adjustment was—and I have not got this precisely—less than one per cent.

Ms GRIERSON—That is reassuring.

Mr Prior—We had about 10,000 people—not the exact number—over that two-year period leave the organisation. With such an adjustment rate, I said, 'Firstly, people clearly have access to query their balance, and if it needs adjusting it is adjusted—that's good. Secondly, it indicated that the records weren't entirely that wrong.'

CHAIR—I take it that we have finished on the remediation plans. Thank you very much; it was very thorough going through all those. We have not finished our inquiry, though.

Mr Prior—I want to close by saying that going forward we will not report on many of these remediation plans. My intention is to fold these activities now into the ordinary course of business, so, to the extent that leave has now been settled with the auditors, there is not much point in continually reporting it—it is done.

Senator MARK BISHOP—It is done. I would assume that in the document that we will get in May or June, you will only be giving status reports on those remediation plans that are not resolved.

Mr Prior—Indeed, and when you cut to the chase that is essentially inventory.

Senator MARK BISHOP—It is.

Mr Prior—If you are happy with that, that is the way that I will proceed.

CHAIR—We will go to general questions.

Dr JENSEN—These questions relate to procurement. One of the issues you mentioned was cost blow-outs of projects—that it can be an issue of currency fluctuations. Would it not be a good idea to represent the cost of projects both in Australian dollars and in the currency of the nation that we are procuring the product from so that we can see whether or not we are talking about constant price in their currency? We would be able to more easily pick out whether it is a currency fluctuation issue or whether it is an actual cost blow-out with the procurement.

Mr Youngberry—Some of the things that we are looking at including in our PBS that we will table in May are: to separate project approvals out into what the base approval was at the approval date; price and exchange adjustments that have occurred to that; and any other adjustments that have occurred to project budgets. This will give you a sense of what is a foreign exchange increase, or what is a general price increase, versus what might be a real cost increase or decrease. So we are going through the process at the moment to identify those elements by project. And we will have that—

Dr JENSEN—The other questions concern risk with project blow-outs. Do you put in thresholds? For example, GAO has reported that the average unit procurement price on the JSF is about \$US112 million, which is about \$A142 million. The project budget is \$15.5 billion for 100 of them. If we have just a small currency fluctuation variation, we are going to have a problem with getting those platforms within budget. Whereabouts do you have a threshold at which you start saying, ‘Hey, we have got a problem here. We may not actually be able to do this with the budget that we have got’?

Mr Youngberry—I do not think we have formal thresholds as such. As part of each budget update that we do with the department of finance, we do go through and analyse the foreign exchange commitments that we might have. In the case of the Joint Strike Fighter, it has not yet gone through second pass approval, so it is a bit of a hypothetical situation.

Dr JENSEN—I was not asking for details on that project; I was just giving you a for instance.

Mr Youngberry—At least a couple of times a year, we go through and look at what our foreign exchange commitments are and what the impact is on project approvals.

Dr JENSEN—I am not just talking here about exchange rate issues; I am talking about the project itself. I guess that, with a project of that size, somewhere or other you would expect that there would be a threshold where you would be saying, ‘There is grave risk here that we will not be able to get this capability within the budget that has been assigned.’

Mr Lewincamp—That is certainly true, and that is a factor that Defence takes into consideration through the capability development process run by General Hurley. And the government will take it into consideration when any advice is given to it.

Dr JENSEN—But there are no sorts of formal thresholds?

Mr Lewincamp—I am not sure how you would go about pre-setting thresholds. It would be a very complicated task, I would have thought.

CHAIR—So the implication would be that, if there were, you would just simply wear it—you just adjust your records to reflect that change in price?

Mr Lewincamp—As Mr Youngberry said, we are talking in this case about a project that has not yet got government approval, so any changes that are occurring in the unit cost at this stage are still able to be factored into the advice that government will consider. If there is a change after government approval and before contract signature, that raises an interesting set of issues. If we have a contract, then we have a contracted price. So there are three different scenarios, if you like, all handled slightly differently.

Senator MARK BISHOP—I want to ask some questions about PMKeys. Is this the right place?

Mr Lewincamp—It depends what the nature of the questions is, but probably not.

Mr Prior—If they are systems development questions, we will struggle a bit.

Senator MARK BISHOP—ANAO identified a whole range functionality problems. The system did not deliver what it was designed to do. My question is: where are we at with those functionality problems? Is the system up and running as was planned?

Mr Prior—I really cannot respond. I do not know.

Mr Lewincamp—The system is running; it is operational. I am not able to comment on how much it is falling short of what our expectations are, if at all. But there is an upgrade project that is being managed by the Chief Information Officer Group. They are currently looking at the future development path of PMKeyS.

Senator MARK BISHOP—Is the upgrade really a completion of the original specification or do you plan enhancements as well?

Mr Lewincamp—No, this will be quite different. It is a bit like moving from SDSS to MILIS. This will be quite a different system. We are looking at integrating the enterprise system. We are looking very closely at the relationship between the financial system, ROMAN, and the personnel system, PMKeyS, in particular.

Senator MARK BISHOP—So it would be incorrect to describe it as an update. You are planning a new system that integrates the two existing systems.

Mr Lewincamp—I would not be comfortable going any further beyond the answers that I have given. If we can take some questions on notice we will do that.

Senator MARK BISHOP—All right. While you are taking questions on notice, on 8 February 2007 Mr Matthews gave evidence that was very critical of a whole range of matters in respect of defence. Could we have a formal written response, in due course, to the allegations he raised?

Mr Prior—Based on his evidence—is that what you are referring to?

Senator MARK BISHOP—Yes. His evidence was critical and raised a number of allegations as to process, improper practice and mala fides. I would like your people to go through it line by line and respond.

Mr Lewincamp—Through you, Chair, I might ask that we refine that a little bit. There was an awful lot in Mr Matthews's submission and his evidence that does not bare any objective scrutiny. For us to go through and rebut it line by line is a considerable amount of work. Can we refine this to some key elements or key statements that he made?

Senator MARK BISHOP—That is fair enough, yes. I am talking more of his written submission, where he made assertions. We did have a lengthy discussion that went all over the shop.

Mr Prior—For the record, can I say that there are assertions that would indicate that Mr Matthews may not be in line with some contemporary accounting and so on. I will make that clear.

Senator MARK BISHOP—Yes, I presume that that is the case. I am just giving you the opportunity to rebut that material for the record.

Mr Prior—Yes, we will do that.

Senator MARK BISHOP—I have some questions but I do not know if this is the right place, so you might tell me, Mr Lewincamp. DMO is developing revised tendering and contracting templates. One of the new initiatives is the Procurement Improvement Program. Industry has a range of concerns, and I have a range of questions relating to that. Are you the appropriate person to raise that with?

Mr Lewincamp—I could probably deal with it.

Senator MARK BISHOP—Can you inform us generally on where the DMO is at with the Procurement Improvement Program?

Mr Lewincamp—The Procurement Improvement Program has been underway now for almost two years, a bit over 18 months. We reached the point towards the end of last year where a range of exposure drafts were provided to industry—I think it was the end of October. Industry replied to us in February of this year, raising a number of concerns. Separately, in internal consultations within the DMO, other areas of the DMO and people who are practitioners in this procurement raised a number of concerns with the exposure draft. The CEO, Dr Gumley, decided to pause the exposure drafts at that point and go back and look at ASDEFCON, to review some of the work done by other people on improvements to those templates, processes and exposure drafts, and to re-engage industry and internal people in wider consultation about how we go forward. We have just appointed a new person to head that. The position is a sort of content project manager inside the organisation with a deal of experience in contracting and procurement. We expect that that process will take some months.

Senator MARK BISHOP—So really you have stopped and you are doing a review of where you are at to date. You have appointed a new project manager and he or she will recommence the work some months forward.

Mr Lewincamp—We will review all of the work to date. We have a functioning ASDEFCON suite of templates and contract arrangements and they are still working. We are now looking at the best way to improve those to upgrade our procurement activities and we will do that. We will think again about how we take that forward.

Senator MARK BISHOP—Was former DMO legal counsel Ms Gillian Marks involved in the initial approach to devise that new procurement template, the one that is on hold?

Mr Lewincamp—Gillian Marks is the general counsel of the DMO, not the former. She still is the general counsel.

Senator MARK BISHOP—I thought she was on leave; that is why.

Mr Lewincamp—She is on leave, but she is still the general counsel. It was one of the tasks that she had when she was contracted to join DMO, I believe in October 2004. She was running

the General Counsel Division, which included our procurement and contracting activity, our financial investigation services and a range of legal services, assisting the CEO in legal advice on major project and procurement activities and running the Procurement Improvement Program. That was her range of responsibilities.

Senator MARK BISHOP—In particular, did she have oversight of the Procurement Improvement Program?

Mr Lewincamp—Yes.

Senator MARK BISHOP—She was the senior officer involved.

Mr Lewincamp—Yes.

Senator MARK BISHOP—And, as you say, she is on leave. You are doing an internal status review on where you are at on the PIP. There is going to be a new project manager and he is going to take it forward in due course. Does that mean Ms Marks will be off the PIP going into the future, or will this project manager still be reporting to her as general counsel?

Mr Lewincamp—No, the project manager is reporting to a project management steering group. I am on that group, amongst other senior officers in the DMO. We are unaware of Ms Marks's return to work date and so we have put in place arrangements for the interim period.

Senator MARK BISHOP—So she is no longer involved in the PIP.

Mr Lewincamp—Not at this stage.

Senator MARK BISHOP—All right then. When Ms Marks was the senior officer in the PIP, was the project that she supervised, or had responsibility for, outsourced to an external law firm?

Mr Lewincamp—There were a number of external service providers who did work on the Procurement Improvement Program, yes.

Senator MARK BISHOP—And one of those external service providers was a law firm?

Mr Lewincamp—More than one.

Senator MARK BISHOP—Which law firms were they?

Mr Lewincamp—I do not have all the detail, but Freehills was the firm that did the original work and provided a good deal of material to us. Then an American company was employed also.

Senator MARK BISHOP—What was the name of the American company?

Mr Lewincamp—I do not have that in front of me. I just want to get their name correct. It is something like Pillsbury Shaw Pittman. I am sorry, I do not have name right in front of me.

Senator MARK BISHOP—And that is a major legal firm in Washington, in the United States?

Mr Lewincamp—Yes, and some staff moved from that firm to another firm, Alston & Bird, and so the work transferred to that other firm.

Senator MARK BISHOP—Is Alston & Bird a United States law firm as well?

Mr Lewincamp—I believe it is. The people we were dealing with were in the United States.

Senator MARK BISHOP—So the net of that is that, before Ms Marks went on leave, she was the senior officer in terms of the PIP, that work was done both in Australia and in the United States and some of the work in the United States was devolved from Pillsbury Winthrop Shaw Pittman to a secondary firm, Alston & Bird.

Mr Lewincamp—Yes.

Senator MARK BISHOP—Can you provide us with detailed advice as to the payments made to each of the firms involved in the PIP that was under the supervision of Ms Marks. I would like the proper names of the legal firms, the amounts of any funds paid and a general description of the services that were provided in exchange for that consideration—no commercial secrets or anything like that.

Mr Lewincamp—I can certainly take that on notice.

Senator MARK BISHOP—Give me an assessment of that and the total amount paid for the PIP—under Ms Marks's tutelage—to the cut-off date when you started your review.

Mr Lewincamp—The total price spent to date on that program is just under \$5 million.

Senator MARK BISHOP—Are you the senior man, Mr Lewincamp, on the steering committee that is reviewing the work to date?

Mr Lewincamp—Do you mean the new project management steering group? No. The senior man is Dr Gumley, the CEO.

Senator MARK BISHOP—So Dr Gumley is taking a personal interest—if I can put it that way—in the work to date?

Mr Lewincamp—He has a very strong personal interest in this.

Senator MARK BISHOP—Yes, I understand that—because some \$5 million has been spent, and generally we are not satisfied with the quality of the work that has been done, are we?

Mr Lewincamp—There were concerns expressed about some elements of the exposure drafts. In particular, I am going back to some of the earlier conversations we had about the balance of risk assignment between the DMO and industry providers—that was one particular issue. A second issue was whether the exposure drafts had strayed too much into US law and US

legal processes and methodologies, rather than something that is more typical for us here. So there were a range of different issues that industry had, and we have taken those on board. We will look at that again.

Senator MARK BISHOP—Five million dollars is really a small fortune—I would like to have \$5 million. How did it get to the stage where that much was spent from 2004 through to the end of 2006—a bit over two years?

Mr Lewincamp—It is just over 18 months.

Senator MARK BISHOP—Some \$5 million was spent on this procurement template, the PIP. Generally, there is considerable dissatisfaction with industry, as you say, on the risk allocation, forms of contracting—

Mr Lewincamp—I did not use the words ‘considerable dissatisfaction’; I used the words—

Senator MARK BISHOP—But there is significant dissatisfaction.

Mr Lewincamp—They may be your words. I said ‘some concerns’.

Senator MARK BISHOP—Are the words ‘some concerns’ and ‘significant dissatisfaction’ synonyms? Five million dollars has been spent. The senior officer has gone on leave—we do not know when she is going to return. Dr Gumley has established a steering committee; he is a very busy man and he is taking a personal interest in work to date. I think that that is more than ‘some concerns’.

Mr Lewincamp—I would characterise the establishment of the project management steering group, and Dr Gumley’s and my participation in it, as a desire to bring this to a successful conclusion as quickly as we can—as you rightly say, given the amount of funds invested in this.

Senator MARK BISHOP—I am sure that you want a successful conclusion. My concern is that it has had to be kicked upstairs to your level and to Dr Gumley’s level after 18 months and \$5 million. There are hundreds of committees in DMO.

Mr Lewincamp—No, not quite.

Senator MARK BISHOP—There are a stack of committees

CHAIR—There are a few less than are here in parliament.

Senator MARK BISHOP—There is a stack of committees in DMO. Dr Gumley is not involved in 95 per cent of them; he has now chosen to be involved in this one and your general counsel has gone off on a form of leave for an undetermined time. She is also forwarding legal letters to a whole range of former colleagues of hers in DMO, isn’t she?

Mr Lewincamp—Not that I am aware of.

Senator MARK BISHOP—You are not aware of that? You have not been formally advised?

Mr Lewincamp—I am not aware of any legal letters from Ms Marks to any of her former colleagues.

Senator MARK BISHOP—Are you aware of any legal letters from solicitors acting on her behalf?

Mr Lewincamp—I am not aware of any such letters.

Senator MARK BISHOP—Thank you, Mr Lewincamp.

Miss JACKIE KELLY—I would like to go back to procurement again. This is going right back to before we looked at the remediation plans. When you do the costings on your Defence Capability Plan and then a little hairball like the Super Hornet is thrown in, how do you take that into account? Let us use the Super Hornets as an example. The F111 have a dual aircrew. The decision was made to go to the Joint Strike Fighter, so a lot of your other aircrew say, ‘You don’t get any pilots. You are not getting me.’ They have all left the squadron or left the services. Suddenly, with the Super Hornet, you have to get these personnel back and train them up—and you have a problem. There is a cost attached to that. Is that built in to anything anywhere?

Mr Prior—We have a process of including net personnel and operating costs when there is a change in platform. I think that answers your question.

Miss JACKIE KELLY—Can you show me an example in the PAES?

Mr Prior—It is within the costings as we go forward. If a platform is to replace another platform then the costs of the existing platform are compared to the costs of the new platform. So, to the extent that the forward estimates require any addition or deletion, those adjustments are made.

Miss JACKIE KELLY—Again, I refer you to the British examples. They are just a little bit more transparent. Is there any move to build that in? Or have I missed it in these documents?

Mr Prior—I am just trying to find the budget document reference that you are talking about. I did not come prepared for a discussion of that. I am not suggesting that we do not have that information.

Miss JACKIE KELLY—Take that one on notice.

Mr Prior—Can I refer you, for instance, to page 78. This is about existing capabilities, and you will see that there is a budget estimate, a revised estimate and a variation. It is that sort of approach that we take to displaying this.

Miss JACKIE KELLY—If I show you the British system, you will see that they break it down even more than that. Let me find it.

CHAIR—Is this to be read with another document?

Mr Prior—I always suggest that this document is an addition to the original PBS and to get a comprehensive story it is better if you can read the PBS and this—

CHAIR—Will a response to Miss Kelly's question be in the other document?

Mr Prior—In part. I am not sure about the question; it might be about whether the British disclosure system is better or worse than ours.

CHAIR—There were two questions. The first was a specific question about whether or not you costed the changes that have taken place. The second was: why are they not in this document when the British document does provide those types of changes?

Mr Prior—Yes. For instance, on page 105, there is also a table of explanations of significant variations across defence—across various items as well.

Miss JACKIE KELLY—In the British equivalent, this goes down to manning in terms of training strengths, training requirements, variation of training strengths et cetera. It really starts to break apart the costs of submarines and patrol boats. It would be interesting if I could find it and do a comparison to see if they drill down a bit further.

Mr Prior—You mentioned submarines, for instance. On page 78 of our PAES document, the capability for submarine operations is articulated and any change in the forward estimates for submarine operations is contained in that line. On pages 78 and 79, there is an expose of our outcome and output structure—the outputs that we have produced and so on.

Miss JACKIE KELLY—You do for submarines, but not for the F111s or the FA18s.

Mr Prior—That will be within some air capability, so it is not down at the individual platform level.

Miss JACKIE KELLY—It is for the Navy. You have got submarines and patrol boats.

Mr Prior—I am not an expert on these matters, but apparently that is the way Navy configures its operations in terms of platform grouping. In Air Force capability for defence of Australia's interests, there is a capability for air combat operations, command support for air operations et cetera. My understanding is that you would find the F111s and Hornets within air combat operations.

CHAIR—It is not contained in this document.

Mr Prior—That is on page 79.

CHAIR—I understand that one, the general one, but to go down to the platform level, where would we get that information?

Mr Prior—Our PAES document does not contain platform-level information.

Ms GRIERSON—For example, where is the capability for patrol boat operations?

CHAIR—Is that in the annual reports? I notice, Jackie, that the document that you are looking at, the British one, is their annual report, whereas the one we are looking at is the portfolio additional estimates statements.

Miss JACKIE KELLY—But even in your annual report you do not break it down. When you have a major project such as the Joint Strike Fighter coming on, government and opposition politicians would like to monitor costings and what has been put to us as through-life costings, how those decisions come out and how the value is arrived at to come to government with a bid in that Defence Capability Plan. So how much it is going to cost?

Ms GRIERSON—Can I give you an example, Jackie? In terms of the patrol boats, that is going to vary because they have been having significant operational problems, and patrol boats that were going to be decommissioned have been brought back on stream until the problem is solved. How will that play out in accounts?

Miss JACKIE KELLY—And the Sea Sprites, as well. I am sure that if we had seen the Sea Sprites when we canned the ships, somebody would have said, ‘Hey, take them too,’ and it might have been cancelled 12 months or 24 months earlier. It is just a matter of oversight—just as this document is a parliamentary oversight—and being a bit more robust; that is all.

Mr Youngberry—Yes, I am not sure that I can answer the fine detail. Within the DMO section of the budget statements, we do report what the gross plan is for each of the top 30 major projects in any given year, which gives visibility in terms of how much we expect to spend in any given year, or in the budget year.

Mr Prior—So, for instance, the portfolio budget statements, on page 283—not the PAES but the PBS—contain a listing of the approved project expenditure, cumulative expenditure to date—

CHAIR—We do not have that.

Mr Prior—Sorry. It is in the PBS. It is a table of the top 30 projects and the expenditure against them, and so on.

Ms GRIERSON—What page?

Mr Prior—That is in the portfolio budget statements. In a sense, for a whole year, the portfolio budget statements are then updated for any significant changes in the portfolio additional estimates statements.

Mr Youngberry—If you refer to page 176 in the portfolio additional estimates statements, we go through the top 30 projects.

CHAIR—Will we be able to get a copy of that?

Mr Prior—Indeed, we can make them available for you.

CHAIR—Thank you.

Miss JACKIE KELLY—If Defence had to be more transparent to the parliament, I think we would reduce a lot of the issues that led to this inquiry. I think things like the SDSS overspend—although I do not imagine you would have got that down to a line item—but certainly the frigates and the Tiger helicopters would have been picked up.

Mr Prior—The reporting on the top 30 projects—bear in mind there are some 240 projects—is an attempt to try and give clarity and transparency to the major ones. We update this schedule in each budget document.

Mr Lewincamp—In addition, as you are aware, this committee has recommended to government that DMO do a report on the top 30 projects, which is then subject to independent assessment by the Australian National Audit Office. The Prime Minister, I think, has written back to the chair, agreeing to that happening, and we are in discussions with the National Audit Office at the moment about the methodology for doing that. We met yesterday with the Deputy Auditor-General and we have an agreed way ahead. We will now work with the Audit Office on what the report will look like in terms of what it contains. They are all starting to work on the processes and the staff they need to recruit in order to be able to do the assessment.

Ms GRIERSON—Have you made a budget allocation to prepare for that process, because we recommended that an extra \$1 million be given to ANAO to start the process this year. That was not agreed to by the PM. You are already in those sorts of discussions. Have you made a budget allocation for those sorts of processes?

Mr Lewincamp—No. We will do this out of our normal operating expenses. We currently expend a lot of effort in dealing with both internal and external audit, and this will just be another overhead, if you like, on that.

Miss JACKIE KELLY—What I would like is another line item on fighter capability. It says \$6 billion for the Super Hornet, but once you add in the through-life costs, your retraining costs of bringing those aircrew back on line to then get rid of them again, I cannot see that from this.

Mr Prior—It is always a difficulty. I am not trying to step away from your suggestions. It is always a difficulty to know how much information to provide and where you deliver it. These budget documents are government-owned budget documents. The construct of these is done at a whole-of-government level to try to provide what the government sees as the appropriate amount of information.

Miss JACKIE KELLY—Even a final sum-up line to say that the original contract price was for \$6 billion and we are at this stage would be helpful. Our general knowledge is going to tell us that we have not seen a helicopter yet; we have six and we are supposed to have 22, and it is all spent.

CHAIR—Just on that, Mr Prior, you are saying that these are government documents and you are pointing it to government, but, just picking up on Jackie's question, you still determine to what extent you are reporting here, or are there specific guidelines that you are following, set down by the Department of Finance and Administration?

Mr Prior—There are specific guidelines by the department of finance. These documents contain generally more information than the guidelines, but ultimately these documents are signed off by the minister.

Miss JACKIE KELLY—I put to you that the British procurement is much more transparent to parliament.

CHAIR—You make your point strongly, Jackie.

Ms GRIERSON—I have a few short questions. Firstly, are you on track to deliver the 2006-07 financial statements on time this year?

Mr Prior—From Defence's point of view, last year we delivered the 2005-06 financial statements within the time frame of the guidelines. We have set a target of delivering those signed financial statements within the time line again this year, so that is what our target is. We are working towards that.

Ms GRIERSON—It was suggested by Defence that there would be a bit of a trial run, a dress rehearsal, in February to see how the accounts were shaping up. Did that occur?

Mr Jenkin—Correct. We did what we would call a February hard close, where we produced a full set of financial statements and accompanying notes and schedules. We are just in the process of finalising all the work papers to support that, and we intend to provide that to the auditors in the next week or so. As you said, we have seen it more as a trial run for our own processes.

Mr Youngberry—For DMO, we produce our own separate financial statements now, and I think this goes partly to Ms Kelly's comments on transparency. Since prescription, DMO does have some additional reporting obligations on it, including financial statements in its own right. We signed off the 2005-06 accounts on 9 October. We are aiming to complete them by the beginning of September this year—so taking basically a month off the time frame from the previous year—and have them all cleared by that date.

Ms GRIERSON—On the matter that Senator Bishop raised, industry confidence is very important in terms of DMO operations. Have you changed or reviewed your controls regarding accountability because of that?

Mr Lewincamp—In relation to the Procurement Improvement Program?

Ms GRIERSON—Yes. Is this new steering committee in response to that? Is it a new control, a new accountability control? Is it a new check?

Mr Lewincamp—No. The intention was to give it a degree of oversight and senior direction and impetus, if you like, to finalising the program.

Ms GRIERSON—At previous hearings, Dr Gumley has told us that 72 per cent of projects are on schedule and 28 per cent are behind schedule. What is the proportion in terms of value?

Mr Lewincamp—Do you mean in terms of cost?

Ms GRIERSON—Yes.

Mr Lewincamp—According to the figures that I have, since July 2003 there has only been a three per cent real cost increase in project costs.

Ms GRIERSON—No, I mean the ratio. What is the breakdown? It is all very well to say that 72 per cent are on schedule when that might be a really small amount of the actual cost in value.

Mr Lewincamp—I would have to take that on notice. Do you mean: what value is the 72 per cent?

Ms GRIERSON—Yes. What value is that 72 per cent and that 28 per cent? Are we talking about minor items or are we talking about the really big ones?

Mr Lewincamp—Can I take that on notice? Clearly, some of the ones that are delayed are things like AEWC, so there will be some high value in the delay.

Ms GRIERSON—But are you happy to provide a figure for that?

Mr Lewincamp—Yes.

Ms GRIERSON—Thank you very much.

Senator MARK BISHOP—I want to finish off a couple of questions, Mr Lewincamp, on the previous discussion that you and I were having. Ms Marks was recruited as general counsel for the DMO. Was her former employer Freehills?

Mr Lewincamp—I do not know.

Senator MARK BISHOP—Can you take that on notice and find out whether her former employer was Freehills. It was—I know that—but I would like to get it confirmed. Media reports suggest that it was. I would like you to confirm that for us. Secondly, in terms of the \$5 million that has been spent on the PIP, can you advise whether Defence is aware that Ms Marks had any financial or legal or other interest in any of the firms that were contracted to do the work both in the United States and in Australia? Thirdly, can you advise the committee—also on notice—if Defence is aware that Ms Marks retained any obligations that involved consideration from her former employer after she left her former employer and came to work for DMO. Finally, in that context, does Defence have any rules or guidelines that permit, authorise or do not permit—that is, prohibit—employees at a senior level from retaining any interest in former firms that involves consideration?

Ms GRIERSON—Adding to that, is there a declaration of interest requirement for senior staff in terms of your professional codes of conduct?

Mr Lewincamp—I can answer the last one now: yes, there is. All senior executives in the Defence organisation are required to file a declaration of financial and personal interests. That is retained by the Secretary of Defence and accessed as needed.

CHAIR—Thank you very much. It has taken three hours. I now know what it is like to be a senator going through estimates.

Senator MARK BISHOP—No, you do not.

CHAIR—I am not sure that I would like the experience. I do thank you for your time, for coming in here and answering all the questions that have been put. There are a number of questions that have been asked of you on notice. We look forward to those answers so that we can incorporate them as part of the evidence. There may be other questions that we may have subsequent to today. If there are, we will inform you and seek those answers as well.

Ms GRIERSON—I think it is important to put on the record that we started this inquiry because of some of the accountability and financial problems, and the progress does appear to be quite considerable.

CHAIR—Certainly, as a newcomer, I am quite impressed with what I have heard and with the progress that has taken place, considering that some of the evidence goes back a number of years and what has happened since then. I thank you.

Ms GRIERSON—It is good to see.

CHAIR—I also appreciate your forbearance in answering some of the questions, which were outside your area of responsibility—but that is the nature of it all.

Ms GRIERSON—You indulged us very nicely.

CHAIR—Thank you very much.

Resolved (on motion by Ms Grierson):

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

CHAIR—I thank you on behalf of the committee. The public hearing component is concluded. Is it the wish of the committee that the documents entitled portfolio additional estimates statements 2006-07 and ‘Proposed amendments to AASB 102–inventories held for distribution by not-for-profit entities’ be presented and accepted as exhibits to the committee’s inquiry? There being no objection, it is so ordered.

Committee adjourned at 1.00 pm