



COMMONWEALTH OF AUSTRALIA

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**

WEDNESDAY, 15 AUGUST 2007

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

Wednesday, 15 August 2007

Members: Mr Anthony Smith (*Chair*), Ms Grierson (*Deputy Chair*), Senators Mark Bishop, Chapman, Hogg, Humphries, Moore, 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, Chapman and Hogg and Mr Barresi, Ms Grierson and Miss Jackie Kelly

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.

WITNESSES

GUMLEY, Dr Stephen, Chief Executive Officer, Defence Materiel Organisation 1
KINNAIRD, Mr Malcolm, AO, Board Member, Defence Procurement Advisory Board..... 1
MORTIMER, Mr David Allen, AO, Chairman of Board, Defence Procurement Advisory Board..... 1

Committee met at 11.36 am**GUMLEY, Dr Stephen, Chief Executive Officer, Defence Materiel Organisation****KINNAIRD, Mr Malcolm, AO, Board Member, Defence Procurement Advisory Board****MORTIMER, Mr David Allen, AO, Chairman of Board, Defence Procurement Advisory Board**

CHAIR (Mr Barresi)—Welcome to this public hearing of the committee's inquiry into financial reporting and equipment acquisition by the Department of Defence and the Defence Materiel Organisation. The Defence Procurement Advisory Board was established in March 2004 to advise and support the CEO of the DMO in improving the DMO. One of the board's primary roles is to monitor the implementation of Defence Procurement Review 2003 recommendations. The reforms that have come about as a result of the review are core to this inquiry and, as such, it is appropriate that we discuss the role that the Defence Procurement Advisory Board plays in overseeing the implementation of these reforms. I advise witnesses that this will be the last of the public hearings of the committee.

I also 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. Would anyone like to make an opening statement?

Mr Mortimer—In the period that we have had a role as a defence advisory board, we have been very impressed with the work that Steve Gumley and his team have conducted—the way they have approached the tasks that have been before them with a great deal of rigour. From the perspective of an advisory board that does not play any role in the management of the organisation—as I am sure I do not need to tell you—standing back I think it would be fair to say that some significant progress has been made. We have been impressed with the calibre of the senior management team. In the Defence organisation that we are exposed to we have been impressed with the recruiting process that has been pursued to strengthen that management team over the last 18 months or so. It resulted in, I think, the first female band 3 executive within Defence, which is also great to see.

From the board's perspective, we have been very impressed with the level of activity we have seen. We also recognise that, like any big organisation, it takes a while for change to filter down to the lower echelons of the organisation. We are of course very much aware of that and we are watching that very carefully with Steve to see how deep the progress of cultural change is going with the new organisation. That is still a work in progress.

Mr Kinnaird—As a member of the committee that produced the report that was adopted by the government, I am delighted that we have been able to attract the quality of people that we have attracted to the executive. They have embraced the policies that we felt were essential to start a cultural change and they are implementing our recommendations with persistence, effectiveness and, at times, courage. It is a long task because there is a large body of people who believe that their sole responsibility is to meet process. We were much more concerned with

accountability and outcomes. Much of what we recommended was done so in an effort to try to shift the organisation so that it was more outcomes focused.

CHAIR—Would you like to make a comment, Dr Gumley.

Dr Gumley—Not at this time, Chairman.

CHAIR—You mentioned that your focus has been on outcomes more than anything else. Can you go through what kind of progress there has been in that regard? It is three years down the track now. You said in your opening comments, Mr Mortimer, that there has been some progress. Can you outline where that has been? Obviously there will be areas where there has not been progress and we will get to that later.

Mr Mortimer—There are 10 major recommendations of the Kinnaird reforms. I am very confident that they have all virtually been completed. They are not marked by our board as having been completed because we still have the task of measuring the effectiveness of some of the outcomes that Malcolm referred to. That is going to take a little bit more time. In other words, the database is not large enough for us to be able to say satisfactorily that they are all green lights. If we look at the schedule of tasks that we had before us, I think there is only one minor recommendation—which is recommendation 9, the Defence financial systems—that still has some way to go. All of the others, without exception, have been completed or are signalled to have virtually been completed with some outstanding testing to be done on the effectiveness of the changes that have been introduced.

Ms GRIERSON—I am pleased to hear you say that you feel that so many of the recommendations are on track. We were told that it was about 85 per cent complete—according to the Defence portfolio statements. How do you know that? How do you gauge it? What processes have you been through or what involvement have you had to know that those have been achieved?

Mr Mortimer—The process that the board has adopted is that we have virtually had monthly meetings at which all of the recommendations were gone through line by line with the executive team to all of the board. We discussed the progress at that time; we received reports. We then might have changed the status of the recommendation to red or to green or whatever the case may be. The mathematical 85 per cent I can assure you does not come from the board. An attempted assessment has been done by the management team and it is of that order, but we think that—

Ms GRIERSON—So your perceptions are based on data given to you by DMO or Defence or whatever.

Mr Mortimer—That is correct.

Ms GRIERSON—Are you quite confident that you are getting full access to the information you need?

Mr Mortimer—Yes, I think we have had tremendous cooperation from not only the leaders of the defence department on the service side and the executive side but also their whole team.

There has been nothing that we have asked for that we have met resistance with. There have been issues that have needed quite extensive discussions, as I am sure you would appreciate, where there are differences of opinion—but, from what we have seen at the level we have been dealing with, it has been very constructively debated. Indeed, we have seen pretty sensible outcomes. The big debate is over budgets, which is one that is still probably in that 15 per cent category.

Ms GRIERSON—It plagues the industry all over the world, doesn't it.

Mr Mortimer—Well, it is really the method of how you allocate the funds. I doubt whether that will ever be totally resolved, but that was the subject of some progress at our last meeting, and again with debate between some of the directors on the board who have public sector experience—Ken Henry and Ian Watt, with Steve and Nick Warner—there has been a constructive move towards perhaps even coming up with a solution in that area.

Ms GRIERSON—There are lots of questions on other issues and I will let my colleagues have a go very soon. How does your board interact with the Audit Office? Do you have briefings on their reports or do you look at their findings? I am asking that because I am very keen to know your views on the process that we are going to see in reviewing the top 30 projects. Have you had much interaction with the Audit Office or do you take briefs on their reports?

Mr Mortimer—We are receiving a report at each board meeting, which is virtually monthly, as I said, from the audit committee of DMO. We have had three meetings, if I recall correctly—Malcolm, correct me if I am wrong—with the Auditor-General and his team. We are very aware of the issues that DMO has been grappling with, and indeed Defence has been grappling with, and we have attempted to give some balance to the debate so that some of the private sector experiences are taken into consideration by both the executive and the Australian National Audit Office.

Ms GRIERSON—The 30 projects review has absolute bipartisan support in terms of the process that needs to be implemented. What do you think will be the factors that influence its success? What would you like to see in that process? Do you have any views to share with us on how you would like to see that operate and at what level? Do you have any advice at all on that?

Mr Kinnaird—The Audit Office appears to have a culture of point-scoring and their brownie points will come from finding as many problems as they can. Even the problems that we point out to them and are being fixed, there will always be problems that they have found out. I can only say, as someone whose whole life has been in the private sector, I am at times appalled by the effect of an audit in its usefulness in actually creating a constructive approach to problems that are being dealt with.

Ms GRIERSON—How can that change?

Mr Mortimer—I actually think it is in the process of changing, frankly. I think there is a good rapport from what I have seen between Dr Gumley and Ian McPhee.

Mr Kinnaird—I agree that is there.

Mr Mortimer—They all have clear briefs, and the Australian National Audit Office has an obligation to parliament that they have to follow. We have talked about this at length. To some extent, the DMO is a little bit guilty of not being able, through its own communication devices, to effectively communicate the positives that are being achieved within that regime. I think we are all aware of that and are trying to do something about it. The sorts of things that I think are important in terms of a performance review are exactly that. A performance review looks at the project and says: ‘This is where it is right. This is the direction it is going. There are a few weaknesses here, whatever they are. There are a few strengths there. But on balance we are going in the right direction.’ Or, if there is a systemic failure, that obviously has to be highlighted. I see it as being something that comes back to the DMO, to Steve and his team, so they can look at the recommendations that come from a performance audit and say, ‘We have got this wrong. That is a good suggestion. That is a bad suggestion.’ And there should be an active interchange between Dr Gumley’s executive team and the audit team to address those identified issues in a positive interchange between both parties. In my experience in the private sector, that is what is happening.

CHAIR—We heard some of that in the way the UK Audit Office operates with their defence department. It was very clearly pointed out to us their concentration on performance rather than on the paper trail type auditing that takes place. It has been raised with the Audit Office as well. One of the issues which is the strength of the UK office is that they have their people embedded within the defence procurement department as part of it.

Mr Kinnaird—I think it needs to be remembered that a lot of what they have been looking at are projects that were commenced many years before our report was handed over and this transformation started. And there are so-called pre-Kinnaird and post-Kinnaird projects, legacy projects.

Mr Mortimer—Coming back to your question, Deputy Chair, I think Malcolm’s point is a valid one: when you do a performance audit of the top 30 projects, if some of those are pre-Kinnaird then it would be helpful for the Auditor-General to draw your attention to the fact that it is pre-Kinnaird and for the Auditor-General to comment on whether those issues have been addressed or whether they are still being addressed.

Ms GRIERSON—Dr Gumley, you have views on how that process could be workable.

Dr Gumley—I want to make this top 30 thing work as well. I went to see the British Auditor-General, Sir John Bourn, and had an hour-long conversation with him in London about what some of the critical success factors might be in how the British system works. I was looking for points of difference, if you like, in the way we do things and the way the British do things. He has been in the job nearly 20 years, I understand, and he used to be in Defence himself before he became the British Auditor-General. He said the biggest change they made was that over a decade ago they had the Audit Office and Defence pre-agree all facts before anything was committed to writing, either draft reports or otherwise. You might get different interpretations, but facts are facts and they were all pre-agreed before things were committed to, and he said that stopped about 80 per cent of the relationship problems between his Audit Office and the British MOD.

Ms GRIERSON—Mr Mortimer, you think that, as well as tracking 30 projects, they should be measured against the reform process in some way, continuously.

Mr Mortimer—I think it would be very useful. That is the purpose of this, so I think that should be looked at.

Ms GRIERSON—I suppose there are indicators that will be important to every project, but there is an umbrella format you would also like to see progress in. Each project may not have as much weight on some of the things we have been trying to embed, like outcomes, accountability and processes that are properly followed.

CHAIR—There has been a lot of mention of the culture of the organisation and the need for cultural change. We have heard various evidence on this. You also mentioned it in part in your opening statement. Mr Kinnaird, do you want to elaborate on that in terms of what cultural change you have seen take place over the last two or three years, since your report, and how much further is needed?

Mr Kinnaird—There is no doubt that the culture of the management group within DMO is now quite an improvement on what it was when we first started to look into the matter. I am satisfied, because I have had the chance not only to sit in the board meetings but to retain friendships and relationships within the DMO and Defence and I have taken the opportunity to talk to them from time to time. I am convinced that there is a gradual shift going on from the top down. It is gradual. There are people, as there are in every bureaucracy, who have been there a long time and whose position is ingrained. They do not want to shift, and maybe you have to have a generational change before some of the issues are addressed. As I said earlier, I think the retreat to process in bureaucracies is endemic, anyhow, in our national culture. Bureaucracies really just want to be told what process they have to follow. They do not think enough about what that process is supposed to achieve.

Mr Mortimer—My experience is centred around the Defence Procurement Advisory Board and I have looked at how the change has been led. So I have watched very carefully how Stephen Gumley has introduced that change and then how it has gone to the executive leadership team. As we have seen, we have had quite constant interchange with them on a regular basis. I have seen a freshness that could well take place in any private sector organisation. We have asked the question: let's see how we go deeper into the organisation to get feedback. We hear from the executive that there are problems at lower levels along the lines that Malcolm commented on. It just takes a long time.

Ms GRIERSON—Have you ever tested that information? If you not been completely satisfied, have you ever tested it in any other way?

Mr Mortimer—The answer is that we have not actually tested it as such, but we asked the question of Steve about 18 months ago as to how far we are penetrating in the organisation and what would be the best way to test it. That is one of the reasons why we are still operating as a board. One of the ways to do that may well be a survey of some kind. Another observation I have is that it is difficult for this organisation on a couple of fronts. Firstly, there is an obligation to the parliament to see that proper process is followed. You all are accountable to the public and you want, quite rightly, to hold the executive accountable to you in appropriate ways. So there is

that process that is a little bit more rigorous than you would see in the private sector. Secondly, there is another issue that I notice—that is, the inability of organisations within the government sector to be as flexible with their people. I think you have got, not a resistance to change, but a certain amount of static there which you as an organisation have got to deal with. It takes a lot longer than perhaps it would in a private sector situation. So we still have to test at lower levels.

Ms GRIERSON—Yes, I think that is important. It seems too cosy.

CHAIR—You have lost two of your senior officers, Stephen. There has been a lot of talk about that. What impact is that having on your organisation at the moment? How is the recruitment going? You have got those competitive forces working against your getting people into the Public Service.

Dr Gumley—As we know, there are certain skills that are in short demand in Canberra—there is not enough supply in Canberra—like good finance people. We have got to replace our CFO, who is moving over to the Department of Finance and Administration. There is competition. We are going out to an executive search agency and we are opening up very much to the private sector to see if there is a good private sector CFO who might join us. As DMO becomes more and more business focused, that might be quite advantageous.

Mr Kinnaird—It is my observation that the team have embarked on a project management training program that has been very successful in terms of the number of people who have been taken through project management disciplines and understanding and now have a qualification that they did not have before. The tragedy is that they are being trained in an organisation that is not able to pay competitive salaries with the top private sector so inevitably there is going to be leakage out as they train, just as there used to be in the large public bureaucracies—and I fancy that that might accelerate. I do not think that there are many private organisations that are investing so heavily in project management training and development.

Mr Mortimer—I absolutely agree with that. I think you should be very pleased with the work that DMO have done in that regard.

Mr Kinnaird—Absolutely.

Mr Mortimer—It is very obvious and I am sure that it will be very rewarding in due course. I agree with Malcolm's comments—it is quite difficult. Someone from the private sector rang me only a couple of weeks ago about someone who they thought would be an interesting candidate for the position of Chief Information Officer, which is currently available in the defence department. That particular person—I do not know the person—was told by the headhunter not to bother applying because his compensation ambitions were well out of the range of what would attached to this particular position. You are going to have those sorts of things. That has got positives—it means that you can grow your people from within, which is usually best because you do not make as many mistakes. The other thing that stands out in my mind is that the job opportunities within DMO are quite exciting—the challenges they have are quite demanding.

Ms GRIERSON—It is certainly a good training ground.

Mr Mortimer—It is a fabulous training ground.

Mr Kinnaird—As a lifelong engineer, I think a career in this business would be one of the most exciting opportunities an engineer could have.

Senator MARK BISHOP—We have had some discussion on the utility or otherwise of uniform reporting guidelines for major capital acquisition projects. I am aware that Dr Gumley's organisation is in negotiations with the ANAO for reporting on the top 30 projects. We were advised last time that those negotiations have commenced, they are underway and they will take some time. In due course there will be resolution and a recommendation will go up to government for consideration by cabinet for decision in next year's budget. We are well aware of that. One of the problems that interested observers like us face is getting, analysing and evaluating the hard data that is provided by Defence and DMO in a range of forums and a range of documents—PBSs, annual reports and the like. Language is a problem as well. Often when we want to analyse a project to determine whether it has been successful in terms of both the government's own purpose and the capability acquisition in due course from the particular project, we—or me in particular—are unable to find any one set of documents that are the same, year in year out, have the same headings, the same reporting and the same commentary. Coles Myer or Woolworths have a particular way that individual sections report on profit returns right across the organisation. In your mind, from those two perspectives—firstly, from a public policy perspective and, secondly, from proper and informed oversight of the executive by the parliament—is there any value in having uniform reporting guidelines in the same form that are relatively comprehensible and published in the same way year in year out for people like us to make hard analysis as opposed to engaging in a lot of sometimes useless conjecture?

Mr Mortimer—Uniform information from the defence department is an absolute prerequisite. One of the problems is exactly as you have pointed out: a lot of people who are accountable to the public and to you as parliamentarians have got a variety of different information bases and quite understandably you draw conclusions based on what you have been told. Often, what you were told on Monday can be different from what you hear on Tuesday. I would support that concept, 100 per cent. It would be absolutely invaluable. Whether the Department of Defence should be the same as, for example, cultural affairs, I would suggest not.

Senator MARK BISHOP—No. All I would be interested in is this: you could take the 30, for example, major projects—whether they are tanks, planes, communications systems or whatever—and just analyse the damn things and see whether they are on schedule or behind time or delivering the capability; whether the amendments were necessary and were properly processed; and whether the additional costing is justified and has it been appropriated or delayed or varied? My own take is that we do not get that information. You say that, from a public policy perspective, it would be of value. Would it also be of value for those disciplines to be part and parcel of DMO and Defence, and to know that they have to do it and that people like me or the chair or the deputy chair are going to be asking publicly some pertinent questions with hard information? Would that be of value?

Mr Mortimer—I think good information is absolutely essential for good decisions and good evaluation. I would see no problems with that—and I doubt you would, Steve, as chief executive. The more discipline you approach in that sense, the better.

Dr Gumley—For example, in our annual report for this year, which has not been published yet, we have a lot more information than we had in previous years. There is also a lot more qualitative discussion. It is one thing to see a set of numbers; it is another thing to see something that says what the numbers actually mean.

Mr Kinnaird—Everything I have seen would lead me to believe that the reporting you will get from the DMO will be consistent in its framework because we hope to continually improve. It will change in the sense that it will better explain what is going on. It will be more comprehensive. Whether that framework would suit the ANAO or other groups I do not know. I doubt that it would. We as a board are well satisfied with the framework of the information that we receive.

Mr Mortimer—One of the issues that all of us face is that there are different cost estimates at different stages of a particular project. From a performance evaluation or indeed a management viewpoint we need to understand what sets of databases you are working from.

Senator MARK BISHOP—Some projects that Dr Gumley administers, from an examination of the ANAO reports and the performance reviews, can only be categorised as extraordinarily successful. Indeed, they are excellent projects from beginning to end. Yet other projects—and I think it is fair to say that a lot of them these days are legacy projects—are at the opposite end of the spectrum. My interest is not in looking at Dr Gumley or ADF for mistakes, but having a sustained set of informed data whereby I can, in the privacy of my own office, do the analysis and come to the conclusions. Yes, the PBSs and the ARs have changed in recent years and they have improved but there is not one set of data that comes out every six or 12 months whereby you can sit down for two hours and follow it.

Dr Gumley—The process has different customers. You talked earlier about nomenclature and jargon. For example, just in how you price a project you can have real prices, historical prices and outturn prices. If you look at something like the air warfare destroyer they can be billions of dollars apart depending on which definition you use. So it does lead to a lot of confusion in comparing two numbers. But that is a whole-of-government issue; you have to use different price definitions for different purposes.

Senator MARK BISHOP—It is an easy shot for me to say to you or the CDF in due course, ‘Hell’s bells! You told us the AWDs were going to cost \$6 billion; why are you paying \$9 billion?’ But if there is a uniform set of reporting dollars—on any of those three sets of figures—then there is a ready answer that even people like me can comprehend.

Dr Gumley—Quite often people say, ‘You said it was going to be A, it looks like it is going to be B and now you are telling the me it is C.’ In fact all three answers are correct. That is the definitional issue that you have.

Mr Kinnaird—I would think you could go back over all the projects that have been looked at and explain from your history and background, particularly on the legacy ones, why these things have happened. You could say, fairly simply, why this project was five times more expensive than the first budget. I am probably going to upset somebody but it is probably because some minister thought he had better say something about the project and he rings someone up and asks what it is going to cost. Somebody down the line says \$750 million and he does not have the

faintest idea what it is going to cost. He does not know what it is. In history, that sort of thing was common, I have to tell you. I think we are well out of the way of doing that now. It is at the core of most of what is wrong with those. The other thing is that military officers were in a position then to effect changes in the original specifications without recourse to appropriate disciplines. So you got things coming out that were not what was originally planned. It is pretty fundamental stuff. I think our principles have got rid of all that, thank God.

Mr Mortimer—We have a much better set of disciplines now than previously. It is very hard.

Dr Gumley—Senator Bishop, if you want constant data, which is what you are saying, it would be very helpful if the committee was able to give us guidance as to which set of data you would prefer. My own view is that the best way to talk about the quality of the project is to have everything in real dollars—constant dollars. That eliminates the effects of inflation and foreign exchange, and it stops this non-farm deflator instrument being used for outturned prices, which you need to do to get appropriations but it is a piece of mathematics that is used for appropriation purposes but is not terribly helpful when we are trying to work out whether a project has had a real cost increase or not.

CHAIR—It is all very well to say let the committee give you some guidance on that, but surely as an organisation, DMO can have its own policy position that if anyone asks for information on a given project, whether it be someone within government, someone from the opposition, a journo or anybody else, there is a consistency of information that you give and the terminology that is used. You do not need us to decree that. Surely as an organisation you could do that internally.

Dr Gumley—I have attempted over the last two years to use real pricing wherever possible and that is what I have asked my people to use wherever possible. But there are other bodies with legitimate needs for different types of pricing. If you are chasing appropriation, you have to use outturning, so there are legitimate reasons why you have to use other ones. In all of the work I have done with media and when I do my business plan reviews, I talk to industry and so on, I try and use real prices throughout.

Senator MARK BISHOP—I do not have a particular problem with real prices. I am interested in a constant set of information under consistent headings for internal comparison purposes, so if you have real prices and real times and the like, you just go across and down and see where it has gone right or wrong.

CHAIR—It is almost like a consistent progress report.

Senator MARK BISHOP—Yes.

Senator HOGG—A progressive matrix. That is all we are after.

Senator MARK BISHOP—We might stop wasting a lot of your time at estimates that way.

CHAIR—Mark, just hold on for a moment.

Miss JACKIE KELLY—You mentioned what you are doing in training and you seem really ecstatic, that Defence is doing a lot of training now and was doing more than what is happening in private enterprise. When we visited Qantas, they did not really need to do a lot of training of their staff because they had all been there for 20 or 30 years. These people had done procurement projects again and again for Qantas. In that last decade, I think, there was one contract in that time that had gone south like a number of the ones that we see coming out of Defence. So are you still having a high churn rate within Defence? I think that is inevitable. However exciting it is for an engineer, the opportunities come eventually; the wife wants a Mercedes.

The reason we got really interested in this was that we started out with SDSS and then went to Air 87 and so forth, and we kept being told that they were all pre-Kinnaird and were going to be fixed up. When you get this training, is there some sort of corporate knowledge that is being built-in there? You see that on the Air 87 project they made payments on unsigned invoices and they made payments without links to milestones and you see that these are the things that went wrong on this contract. It seems to me that all of these things are with the SPO and wrapped up in security.

Mr Mortimer—No lessons have been learned.

Miss JACKIE KELLY—There are no lessons learned that are publicly available, not just for the 30 major projects that Defence and DMO are dealing with but right down on to the bases. Just recently there is another contract going terribly wrong. It is probably in Public Works. It is about an extension of a tarmac for explosives that was supposed to cost so much. It gets rolling, again below the radar, and ends up blowing out in costs again. Fair enough if the people you are training are getting a bit of corporate knowledge, but there is no way of making sure this corporate knowledge stays there, let alone filters out into all of your minor projects which are less than \$20 million but still add up to considerably more than \$60 billion.

Mr Mortimer—That is one for you, Steve.

Dr Gumley—Thank you. Miss Kelly is correct, there is more work to be done in capturing organisational knowledge. I agree. We still are perhaps over-stovepiped and that keeps the knowledge in. In a 'sustain it' world, a lot of it came from the three services which was Support Command and they got all put together into DMO in about 2000-01, and those cultures take a while to work through. Some of the organisational changes that were made recently, though, started to fix that, for example, Kim Gillis coming in as General Manager, Systems. I have used that title deliberately as he is going to handle five, shortly six, domain divisions. Each of those divisions is big in dollar-plus businesses. His job is primarily standardisation in how we do things right across air, sea, land, electronics, helicopters and the new one we are looking at is explosive ordnance and ammunition. So, organisationally, we are moving to exactly what you said.

Miss JACKIE KELLY—And in the statement of requirement it has, right at the beginning, people with training that can reference other projects to give that statement of requirement.

Dr Gumley—One of the most important changes that the Kinnaird reforms made was to create what I call the air gap between the capability manager who writes the specification and

the delivery organisation. If you do not have that air gap which forces a discipline of people writing down a specification, you get spaghetti, you get scope change, you get creep, you get no-one knowing what they are really doing. That discipline has been absolutely crucial.

Mr Kinnaird—That was probably at the heart of our recommendations—that was quite lacking in forward thinking, planning, testing. We thought that, if a third of the money that was spent fixing up problems was shifted up the front and actually got the definitions clear at the beginning—and had an unchangeable, well-tested, ‘Everybody’s happy; this is it’—we would probably find out that the total cost of what was done was less. I am sure that, in the ones that are being done, that is happening. If we had five or six hours I could tell you about some of the things we looked at when we went to look at all this. It was unbelievable. Nobody felt accountable for what was going on.

Mr Mortimer—There is a recent example of this, Richard.

Miss JACKIE KELLY—But that is because no-one was ever held accountable. When you went back to ask what was wrong with the contract, you could not even find anybody who had made the payment or should have thought about this or should have checked with that.

Mr Kinnaird—That is right, because there was not a culture there that actually held anybody accountable. Even at the very top—I am sorry—there was a sense that, ‘Well, they got the processes right but made a few errors here and there.’ That is a lot different from—

Senator HOGG—Yes, but part of the problem there was the argument of ‘before my time’ and the movement that took place in staff.

Mr Kinnaird—Yes, people rotating around.

Senator HOGG—So they had naturally moved on, and no-one was held accountable and responsible.

Mr Kinnaird—That is exactly right.

Dr Gumley—The chairman made a comment earlier that we will not truly get cultural change—perhaps I am paraphrasing you, David; correct me if I am wrong here—unless we can sort out some of the Public Service staffing issues. There is a problem with evasion of accountability, where people can move at level freely within the Public Service—change departments, change groups—and you lose the corporate knowledge. There is no ability, it seems, to direct people to stay in a position to get something finished. To my mind it is a very difficult problem. So what you have to do is try and set up systems to capture the knowledge that take that into account.

Mr Mortimer—The cultural thing cannot be underestimated either. A great example, which Steve will be much more specific about than me, is the ships we just approved—or you just approved—recently. My recollection, Steve, is that, the day after approval, the Navy designers came up with a significant number of changes. That has to be moved into the front-end process. I think, Steve, to your credit, you sent them packing.

Dr Gumley—We did.

Miss JACKIE KELLY—That came about because they had purchased the C17s, and then the fireys realised, ‘Hang on a minute; we need huge fire engines to be able to cope with that type of aircraft on the deck.’ So you have all these unforeseen add-ons that knock on, which were not put into the original scoping. The Audit Office is only going to pick up where the process was not followed. It is not going to get to systemic errors. It is not going to fix that.

Mr Mortimer—The good thing about audit officers identifying these errors is that it does put pressure on the management team to make sure that they are not repeated. I think that is something that they are very well aware of.

Miss JACKIE KELLY—But it seems that there is this sort of friction between the Audit Office and Defence because, ‘Oh, you’re nitpicking.’ Their job is to nitpick. Their job is to say, ‘That invoice shouldn’t have been paid,’ not to say, ‘Hang on a minute; when you wrote the contract you should have better allocated your milestones or the method of payments.’ It is not really the Audit Office’s role.

CHAIR—We did hear that that is a changing role of audit offices overseas as well, in that they are more and more getting into that sort of performance management role as well.

Mr Kinnaird—The board, despite its lack of line control or line influence, technically, does see itself as accountable for the progressive implementation of the principles behind this report. I am comfortable that that continues and that we are well informed. Hopefully, we are doing a good job. I know it is a good job. If you were in the private sector, you would have an auditor but they would play a very different role to the one that this auditor plays. You would have a board which was much more connected and influential throughout the depth of the business than we can be—or as far as we want to be. But, having said that—

Miss JACKIE KELLY—Wouldn’t you want to be? Surely, when Defence comes up with a statement of requirement, if all of the providers of anything remotely connected to that could have a look at that statement of requirement before going out to tender, they could sit there and say: ‘Look, that’s not commercial off-the-shelf. This is in existence already. If you went for this type of thing, that is out there in industry and is a more realistic grab than what Defence is saying.’ The board does not do that as a rule.

Mr Kinnaird—In practical terms, I do not think you could ask any of us to actually take that role and do it effectively. We are there to overview, to comment on what we see, to ask questions and to open up new lines of comment or criticism. But to turn this into a private organisation you would want to get rid of all the public framework that sits around it, because there are so many layers of discipline and interaction between the government processes and what happens at the DMO that it is just not possible.

Mr Mortimer—I am sure you do not need me to tell you, but, again, in the private sector interchange between auditors and managers there is what we call a management letter, which draws out the sorts of things that you talk about—the process corrections which are always going to be there. To the extent that we have an audit office, we would expect them to constructively identify those things if we have missed them and to have a very real discussion

with management and a written trail which would support the decisions that have been taken on the actions that have been taken or not taken so that the transaction is closed. At the higher level, for performance audits you are looking at a different animal altogether. We are certainly seeing in the private sector that sort of interchange, but it does not appear in the audit reports. It is dealt with; it comes to a committee before the board; they are tabled and they are available; and corrective action is usually taken.

The sorts of things I think you are getting at are actually the cultural issues where one has to go back to the design of the project beforehand. I agree with everything you are saying, but I sense huge delays, if you are not careful, in getting things done. There is always going to be a little bit of a compromise.

Mr Kinnaird—One of the fundamental recommendations we made was to put a structure together at the front that went a lot further in getting that design correct, balanced and checked than ever before. It was not there before. It just was not there.

Senator HOGG—I understand that the tenure of the advisory board is until the end of March next year and then there will be an evaluation of the need for the board to continue. Is that correct and, if so, who will do the evaluation and when will it be done so that there is continuity for the board? Obviously, you just cannot come to the end of March and then, all of a sudden, say, ‘We are going to conduct a review,’ and so the board no longer exists for a period of time and then has to be re-established?

Mr Mortimer—I imagine that that will be done by the minister, in consultation with the department heads. It is certainly nothing to do with us. We will have no role to play in that. We obviously get feedback internally. We report to the ministers each month, or after each meeting, giving them an update on progress, but it is purely up to them to make a decision. I imagine that would also be influenced by the election. There may be changes in the ministry and all those sorts of things.

Senator HOGG—That is what I was concerned about. That is why I raised it today. It is not a criticism of you; it is just looking at the process issue. It would seem to me that if the board is working well—and it seems to be working well—it would be desirable to confirm whether there is an ongoing role and function for the board as soon as it can possibly be achieved.

CHAIR—Take the worst case scenario: if, in early 2008, your board no longer exists, where does that leave your work program? Are there going to be things on your work program that just will not get done?

Mr Mortimer—There will be things that will not have been fully tested, so we will not know the effectiveness of some of the recommendations which have been implemented. It comes back to what I said earlier on about how deep down the changes are in the organisation and how effective the changes have been in getting the certainty that Senator Mark Bishop was asking about earlier on. Those sorts of things will be unmeasured.

Mr Kinnaird—To some extent, it is a constant improvement program that we have the chance to influence.

Mr Mortimer—I think the board has also been helpful in other areas, apart from the Kinnaird review issues—for example, in personnel and staffing—not in terms of the organisation. We have been there, as is our term of reference, to give advice to Steve Gumley on how he discharges his responsibilities. So there is a whole range of other things which we do and which may or may not be needed in future. Frankly, someone has to make an evaluation as to whether, ultimately, it is producing some value to you as parliamentarians.

Mr Kinnaird—I think the opportunity for three department heads, the head of the Defence Force and some others to get together once a month and look at all this is pretty significant. Certainly, the members of the board take it as a very significant and serious business.

CHAIR—You have the private sector working with the public sector on this issue, which is good.

Mr Mortimer—I think, Steve, there have been a number of policy issues that have been resolved by that mixture of people talking together.

Dr Gumley—The yin and yang of private and public sector together has worked extremely well, and having the agency heads from Finance and Treasury has also been very important, because much of the bureaucratic clutter you get is actually being sorted out at the top level and everyone just gets on with it. So I think that, as an efficiency mechanism, it has been quite good.

Mrs BRONWYN BISHOP—Malcolm, one of the things that has always been of concern to me—as you know, from years ago—is the nature of the contract and the contracting process that we engage in. We usually swing from benchmarking to fixed price and everything in between. One of things I asked the Auditor-General, when we were having our private briefing with him, was whether he could use his expertise to make some suggestions about the more effective way of contracting for Defence. We all remember that the submarines contract was a pipeline to the Mint for the Swedish government, via their contracting party. And the same thing happened with the over-the-horizon radar network. He, to my knowledge, has not come back to this committee, but I wonder whether there had been any contact with you, Dr Gumley? Has the Auditor-General talked to you at all about those issues, because I still think he must have some expertise that could be helpful in looking at that question?

Dr Gumley—I would be pleased to receive some advice.

Mrs BRONWYN BISHOP—We might give him a bit of a prod and see if you can. Malcolm, do you have a view about that?

Mr Kinnaird—I would just make the observation that all the contracts are influenced by inputs from a number of different departments, including the legal department. Quite frankly—I am making a personal observation—I am just appalled at the number of words they have to use. They seem to want to mitigate risk, but you get such a morass of words and so on that some of these contracts are extremely hard to follow or implement.

Mrs BRONWYN BISHOP—Are they doing any outsourcing of the legal work on those contracts or are they all in house?

Mr Kinnaird—Are they doing that?

Dr Gumley—Absolutely.

Mrs BRONWYN BISHOP—Are they improving?

Dr Gumley—We are using many of the big firms to write contracts. It becomes quite a difficult issue. If you write a short contract, the contractor drives a hole right through it and you start paying lots of money. So the lawyer tightens it up, then they find another loophole. If you are not careful, it ends up like the tax act. Therefore, every so often you have to start again. We are going through that process at the moment.

Mr Mortimer—On your comment about the Auditor-General, I personally would be reluctant to have the Auditor-General designing my benchmarks, whether it is the national Auditor-General or, indeed, any from the private sector, because I do not think it is their skill set. I might add: my suspicion is that they would be reluctant to play an advisory role.

Mrs BRONWYN BISHOP—I did not want him to be an active adviser. What I wanted him to do was look at, through his project audits, where the glitches or the problems occur, and give some general advice as to how the contracting process could be improved, simply looking at the empirical evidence of what has transpired before. I was not suggesting he be a drafter of the contracts or looking over anyone's shoulder.

Mr Mortimer—One shudders at the thought!

Mrs BRONWYN BISHOP—I very much follow the line of thought of the difference between the private sector auditor and the public sector auditor, and I have certainly been on the record here to maintain that difference.

Mr Kinnaird—Our report recommended that some consideration be given to a range of different contracts, which Steve is doing—alliance contracts and the like. Once again, it is new ground for the DMO and they have to work their way through a lot of this to find the advantages.

Mr Mortimer—And it is very difficult, too, because of the nature of the industry. There is often a single-source supplier, so it is quite a challenging task for Steve and his team to extract proper value from the contract and retain their integrity.

Mrs BRONWYN BISHOP—I think there has been a significant improvement—I really do. Having been a minister who fought madly against ever buying that dreadful helicopter—it has never flown—and being unable to do so because it was too far down the track, I think we have improved markedly from those days. I know you come in for a hell of a lot of criticism, and I know some of the contractors come in for criticism, but sometimes when I look at the recitals in the reports I think there is not quite an understanding of the way in which you can take early delivery and still get things fixed up because you get a benefit in training or whatever it is. There is a different way of looking at some of these auditing processes. I do not think I will ask any more today. I will just say I think there has been a big improvement.

CHAIR—Mrs Bishop, that is probably a very good way to end the meeting. Thank you very much. Senator Bishop, do you have another question?

Senator MARK BISHOP—I would like some guidance. I have some questions I want to ask Dr Gumley on the Tigers. I do not know if this is—

CHAIR—No, this is about the Defence Procurement Advisory Board.

Senator MARK BISHOP—Only about that?

CHAIR—Yes, it is. And this is the last of our public hearings. You may submit the questions in writing.

Senator MARK BISHOP—Can I put it on the record?

CHAIR—Stephen, are you willing to accept a few more questions in writing and get back to us?

Dr Gumley—Yes, Chair.

Senator MARK BISHOP—I will say them now. Could we have a status report on the negotiations concerning the through-life support costs of Australian Aerospace? I raised that at estimates and you said you were just starting. Secondly, provide us with an update on the anticipated delivery of the simulators for the Tigers, and could you advise us why the liquidated damages for the simulators are only \$10 million when the price for the simulators, I think, is \$150 million?

Dr Gumley—I will take those questions on notice.

CHAIR—Mr Kinnaird, Mr Mortimer and Dr Gumley, thank you for coming in again. This is our last public hearing. We will attempt to have our report out before the end of this term, but the way things look it is probably highly unlikely, so that will have to be something that will be determined by the next committee, I dare say. Then again, we might be surprised. There might be one out before the end of the year. Thank you very much for your time today.

Resolved (on motion by **Ms Grierson**):

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

Committee adjourned at 12.35 pm