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JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

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

WEDNESDAY, 19 AUGUST 2009

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

Wednesday, 19 August 2009

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

Members in attendance: Senators Barnett, Mark Bishop, Bushby, Feeney and Neumann and Mr Adams, Mr Bevis, Mrs Bronwyn Bishop, Mr Bradbury, Mr Georgiou and Ms Grierson

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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WEARN, Mr Steve, Chief Finance Officer, Defence Materiel Organisation..... 1

Committee met at 11.37 am

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

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WEARN, Mr Steve, Chief Finance Officer, Defence Materiel Organisation

CHAIR (Ms Grierson)—I declare open this public hearing. This is a follow-up public hearing on progress that has been made since the committee tabled its report 411, *Progress on equipment acquisition and financial reporting in Defence*. That was tabled in August 2008. In report 411, the committee outlined a number of concerns it had with the implementation of the reforms recommended by the Kinnaird review, Defence's capacity to measure the success of those reforms and the establishment of the annual major projects report. Since tabling its report, the committee has closely monitored the development of the major projects report. However, this hearing provides the first opportunity for the committee to also examine the progress that has been made on the other findings outlined in report 411.

Before beginning, 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.

I welcome representatives from the Department of Defence and the Defence Materiel Organisation. Do you have anything to say about the capacity in which you represent your organisation?

Mr Hindmarsh—I am the Chief Audit Executive of DMO.

CHAIR—There are mostly faces we have all seen before, with just a couple of new faces. That is a good sign. Do you wish to make any brief opening statements before we proceed to questions?

Dr Gumley—No.

CHAIR—Thank you. We will go to questions. The consistent application of the Kinnaird review reforms was looked at by our committee, and we were concerned with how we measure the impact and the effectiveness of your implementation of those reforms. Would you like to comment on that, please, whoever is most appropriate to do so?

Vice Adm. Tripovich—In my predecessor's testimony at the last hearing, he reassured the committee that we have in fact gone a long way towards implementing those. I think the committee were satisfied but said that they would like a report in about 12 months. Speaking from a capability development point of view, since then a number of things have happened. We have had the process of the white paper. It has involved a number of internally and externally generated examinations of how capability development proceeds, including the recently released report from the ANAO on the effectiveness and efficiency of the planning and approval of Defence major capability projects which I assume the committee is familiar with.

In summary, Defence agreed with all four recommendations, principally because they were right and they also mirrored the information that the department had gathered during the white paper process. I was pleased to be able to say in the department's response that, because of that, the remaining issues that the ANAO had highlighted are well embedded in the strategic reform program to ensure that those things are finalised. Whilst there were issues of detail raised by the ANAO, the ANAO found that we were applying the strengthened process that came out of Kinnaird. My assessment is that they were pleased with how it was going and noted that there was more work to be done. That reflects the department's view. In summary I am reaffirming what General Hurley said to you in his testimony a year ago: we are confident that the process has been implemented and we are continuing to evolve and improve it. The important thing is that it is a constantly evolving process as we learn lessons, and, when opportunities to improve the process do come up, we have to fold those in to the process, and that is what we are doing.

CHAIR—Are there any follow-up questions on the Kinnaird reforms and how their effectiveness is being measured?

Mr GEORGIU—I refer you to ANAO report 48, which, mirroring part of your comments, said:

Defence put in place a sound administrative framework following the 2003 Kinnaird Review but has not applied sufficient discipline through its governance arrangements to give assurance that the key elements of the framework are consistently applied ...

Could you comment on that.

Vice Adm. Tripovich—The areas that ANAO were talking about, and Defence also identified, go to the issues of Defence's ICT systems that would allow us to easily recover all of the documentation from way back in history. ANAO looked at 20 projects as a sample. Some of

them were legacy projects that started in the pre-Kinnaird days, and a few of them were purely Kinnaird—that is, started after 2003—and have gone through the whole cycle. We did have trouble satisfying the auditor that we could provide original signed copies of a number of the documents that are described in our process. In our response to the Auditor's section 19 draft, we said to him that some of those are beyond Defence's control. For example, we were unable to provide to the Auditor copies of cabinet decisions and cabinet papers that related to the previous government because they were now locked away. I understand that the Auditor was unable to get them from any other source either.

In our response—and I think the Auditor accepts this in the findings—we were able to generate sufficient other versions of documents and, if you like, a trail of their provenance to demonstrate to him that we did raise the necessary documents for government consideration so that the government did consider the project on the day that we said. The government did come to the decisions that we were saying the government did make, but we were unable to provide the precise final document. That goes to the issue of Defence's ICT systems and its document management system. The department acknowledged that. Improving Defence's document record management and retrieval system is certainly an issue that was raised in the various companion reviews of the white paper and it is certainly a feature of the Strategic Reform Program.

Mr GEORGIU—You distinguish between the pre and post periods. Is post-Kinnaird working better?

Vice Adm. Tripovich—Absolutely.

Mr GEORGIU—Can you develop that?

Vice Adm. Tripovich—Sure. One of the things that you identified last time was the ability to measure effectiveness. The ANAO were looking at whether we were applying it effectively and efficiently, and we looked at how we could measure that. A lot of it is subjective. We have data about how long it takes to get from entering into the Defence capability plan through to approval, for example. We know that there are about 17 projects which are purely post Kinnaird. They range from 'never been thought of before' to second pass. We know that the average is about 22 months from first to second pass. It is too early to say whether that number is coming down or going up, because it varies from project to project. Sometimes, you can do first to second pass very quickly and other times it is many, many years—like the air warfare destroyer and the joint strike fighter, for example.

As I said, there are not enough projects yet. But a measure is how easily—in inverted commas—the government is able to make the decisions that it needs to make at first and second pass. That reflects the fact that the information that we are getting at first pass and the detailed information that we are getting at second pass meets Malcolm Kinnaird's original intent. Malcolm Kinnaird was a member and I used to sit next to him at the table of the now defunct Defence Procurement Advisory Board. I said to him when I took over my job that a lot of people say 'Kinnaird said'. I told him that I have read the Kinnaird report and I am trying to find out what Kinnaird really meant. I had to present to the Defence Procurement Advisory Board some reports about what we were doing on first and second pass. Malcolm, as a member of the DPAB, and the DPAB were well pleased that we were meeting the intent.

In summary, it is difficult to get precise metrics and it is too early to say whether it is becoming shorter or longer. It will be several years before we know. But there are several intangible but important measurements that we can make. The government is able to make decisions based on what we have provided to them and our proposals have been successful. In all cases, our recommended proposal has been agreed to by government. Therefore, the information has been adequate for them to be able to make those decisions.

The ANAO took a number of references. One was the *Defence Capability Development Manual 2006*, which is an internally generated document that has been publicly released and that explains how the two-pass process works. As it says in the front, it is a constantly evolving process. As we learn more, the book will be updated. We are in the process of drafting a 2009 version that will pick up the last three years worth of experience. The ANAO, being auditors, measured us against the 2006 book. They accepted my explanation of the changes that we have made, but noted in the report that those things had to be reflected in the new book. That is why, I believe, that the ANAO found that while we had done all that there was more work to be done.

The ANAO pointed out two main things. One was that we need to make sure that when we make decisions we capture those and they are able to be recovered from. We need to record those decisions on our IT system so that we can capture them. The second was that our instructions, manuals and internal procedures are well documented and up to date. Those are two of the activities out of the Strategic Reform Program reflected in your report and reflected in the ANAO and reflected in Defence's internal work.

Senator MARK BISHOP—I have a question for you, Dr Gumley. The qualification contained in the ANAO report at the top of page 103 says that there is uncertainty in relation to the reported information on prime contract expenditure at base data price presented in the project data summary sheets. The Auditor-General says, 'Consequently, I have not been able to obtain all the information necessary to be satisfied about the accuracy of the prime contract expenditure.' The Auditor-General goes on to refer to systems limitations. My question is: what are the systems limitations that resulted in an inability to provide the information? Secondly, is that related in any way to your correspondence to the chair requesting a change in the data to be provided in the major projects reports as they go forward?

CHAIR—Dr Gumley, please update on the meeting that we had regarding that as well.

Dr Gumley—Chair, have you updated your committee on that?

CHAIR—I have, but I am not sure that Senator Bishop was here at the beginning of the meeting.

Dr Gumley—I will answer the piece about what the qualification is, or at least the part about Defence systems. About 10 years ago, Defence moved from its previous accounting system, DefMIS, to ROMAN and not all of the information came across in 1999. That means that we are unable to go backwards to projects pre 1999 and find the amount of data that we need, particularly on historical costs and so on. Although we can probably do it using manpower and go to a huge amount of effort, the system does not support it easily. Given that there are only a few projects in that category now—the FFG upgrade and a couple of others—I do not think that it is going to cause too much of a diminution in the quality of the work for parliament as you

consider our reports. Those projects are coming to an end. Mr Hindmarsh will brief you on the meeting that we had the other day.

Mr Hindmarsh—The prime issue was raised with respect to table 2.7, which is what that qualification refers to. It is a table which refers to the base date dollar for the prime contract, not the total project cost. Within some of the more complex projects you will find that there are multiple contracts with multiple start base dates. So when you start to calculate what the overall dollar value is back to base date you get dollars that cannot be summed to give an accurate picture. There are several shortcomings with the table. One is the several base dates. The second is that it does not give the overall project cost. So the reason for writing to the JCPAA and looking to then change the way we do it is to give a more complete picture of what the expenditure is. It is not a suggestion that we do not know how much we have spent relative to the overall cost; it is a matter of our systems not tracking the base date dollars against individual contracts within each project—we track at the project level.

CHAIR—Mr Hindmarsh, just to put it on the record, we agreed that what we will see in the future will be cost identification as to whether it was project cost by contractors, cost that was incurred by DMO or cost that was incurred by Defence that contributed to the total cost of the project.

Dr Gumley—What we intend, subject to the committee's acceptance of this, is that in any major project we will give the cost data for the biggest five contracts within that.

Mr Hindmarsh—Correct.

Dr Gumley—You could argue that it could be three or seven, but we suggested the biggest five contracts. They are normally 95 per cent of the spend or whatever the figure might be. That indicates that we understand what our costs, but we would not be going down to every tiny little contract.

Senator MARK BISHOP—So it is the biggest five per project from inception. Is that right?

Dr Gumley—Yes.

Mr Hindmarsh—Yes.

CHAIR—Plus the additional information about the costs incurred by DMO and Defence, because we have never been able to track those before.

Dr Gumley—Yes, our own costs will be reported. In a number of these projects, DMO acts as the systems integrator, so we are taking the prime role in some of the contracts. In others, a major company has the prime role. But if we are taking the prime role then clearly we have to work with what our now our subcontractors. Therefore, you need to know our costs.

Senator MARK BISHOP—Are you costs transaction costs or other costs?

Dr Gumley—Transaction costs, mostly. But there are a number of projects for which we hire engineers on our own staff to do the work. The committee might find it useful to know what that is costing.

CHAIR—So they are almost your project management costs in some cases.

Dr Gumley—Yes.

CHAIR—You are the prime project manager.

Dr Gumley—Sometimes it is project management costs; sometimes it is project management costs and engineering costs. There are a range of other costs that we would offer.

Senator MARK BISHOP—Thank you, Mr Hindmarsh and Dr Gumley.

Mrs BRONWYN BISHOP—What role is the DMO playing in identifying the \$20 billion cost savings?

Dr Gumley—We have a large part of that to achieve. Ms McKinnie is the best person to answer that. She is in charge of it for us. She can take us through our \$5.6 billion.

Ms McKinnie—Yes. We are responsible for managing the smart sustainment stream of the \$20 billion savings program.

Mrs BRONWYN BISHOP—What is that?

Ms McKinnie—Smart sustainment covers reducing maintenance costs, reducing the cost of inventory and also reducing the costs associated with non equipment procurement related to explosive ordnance, clothing and fuel.

Mrs BRONWYN BISHOP—I hope that does not mean that we are stopping the ordering of bullets.

Ms McKinnie—What we will be looking at is whether we have got the amount of stock inventory in EO right, whether the approaches we are taking to the maintenance of some of our missile systems are the best approaches that we could have and whether we could do it more cost effectively. We will be looking at other issues—for example, can we improve the way we contract for the supply of EO? So there are a range of activities that we are looking at in order to find the savings.

Mrs BRONWYN BISHOP—Repeat the amount of savings you have to achieve.

Ms McKinnie—It is \$5.5 billion.

Mrs BRONWYN BISHOP—Does that have a time frame? Do you have to plan so much a year?

Ms McKinnie—The \$5.5 billion is over the decade. We are going through the process at the moment of identifying reform activities against which we may then be able to save money, so that we can then, over the 10-year period, save that amount of money. The amount of money that we need to save starts fairly low in this year and next year but creeps up over the decade, which allows us time to get the various implementation plans in place and other strategies to find ways of removing cost from maintenance.

Mrs BRONWYN BISHOP—So how much are you going to save this year and how much next year?

Ms McKinnie—I do not recall the dollar figure that we have for this year.

Mrs BRONWYN BISHOP—Do you think you could get that for me and let me have that figure and tell me what they are progressively over the decade?

Ms McKinnie—Yes.

CHAIR—Before you leave that point, can I ask a related question on the savings.

Mrs BRONWYN BISHOP—Can I just finish my line of questioning, then you can have a go?

CHAIR—If my question is related to that question, that should be fair, Mrs Bishop. As part of procurement of the projects there has been suggestion that industry should also be contributing to saving costs. I just wanted a comment on whether industry can contribute to cost savings as well.

Dr Gumley—Absolutely, yes. Industry has got its part to play. Ninety-three per cent of all the money spent by DMO goes to the private sector. It would be impossible to get \$5.6 billion out of the seven per cent we spend ourselves, so clearly industry is going to be a big part of helping us do the savings. If industry can work out with us cleverer ways of maintaining submarines or aircraft or whatever, that is going to be part of the \$5.5 or \$5.6 billion we have got to achieve.

CHAIR—So those discussions are already occurring?

Dr Gumley—Yes. We have had the chief executives of industry with us for meetings. We are all in this together. We all have to achieve it together. Another meeting is coming up in the next couple of weeks. Industry has been very open and cooperative about how we go about getting these savings. In my view it is all achievable because, when you look over a decade, every company in the country should be looking for continuous improvement and we are on a continuous improvement regime with industry.

CHAIR—Mrs Bishop, please proceed.

Mrs BRONWYN BISHOP—Can we go back to my line of questioning to follow up on the earlier questions. How will the reforms you are putting in place to achieve this \$5.5 billion sit with the Kinnaird reforms?

Ms McKinnie—Because the reforms are in sustainment and Kinnaird did not really recommend a lot of reforms in the sustainment area, there is not a lot of overlap between Kinnaird and the reforms that we are doing. The approach we are taking to the reforms for sustainment is to look at each one of the fleets that we manage and to look at what would be the best way of making savings in how we maintain that particular fleet. So, in some cases, we will be looking to recompute the support arrangements that we might have in place. In other cases we may be looking to use lean techniques or other techniques in order to drive out costs. In other areas we may look at the maintenance intervals that we have been using against which we do routine maintenance, for example.

Mrs BRONWYN BISHOP—That is an important point—the maintenance intervals. What sorts of items would you choose for that?

Ms McKinnie—Our vehicle maintenance is an example. The original maintenance policies were based on a certain kilometre and year time frame against which we would then do preventative maintenance. With some analysis of our reliability and availability, we are saying that we probably can in fact maintain them at a different interval in terms of kilometres and time.

Mrs BRONWYN BISHOP—Are you talking about trucks? What else are you talking about?

Ms McKinnie—In that case it would be our B vehicles, our commercial type vehicles. At this point in time we have not settled the exact nature of the work that we are going to be doing to every fleet. We in DMO have prepared an initial set of potential reforms that we might go to. We are now discussing those reforms with each of the services to ensure that anything that we might be proposing is acceptable to the service chiefs as capability managers.

Mrs BRONWYN BISHOP—What about suppliers' warranties? How will that affect that?

Ms McKinnie—Where we have suppliers' warranties they would generally be in the first few years after initial acquisition and for a lot of the fleets that we are looking to reform most of the warranties would have already expired.

Dr Gumley—Mrs Bishop, perhaps I could give a couple of examples if that is helpful. We have been doing a lot of statistical work on the maintenance of our jeeps and like vehicles. There appears to be some evidence accruing that we might be overmaintaining them, doing too much maintenance compared with when you look at the optimum time to do maintenance and the cost of breakdown versus the cost of repair. So they are putting a lot of analysis into it. We think we can reduce the amount of maintenance you actually have to do on the jeeps. The second one is that we are looking at the usage upkeep cycle on the submarines. It originally started at six years and we are looking very hard at the engineering now to take that to eight years. Clearly, if you can do a major docking on a submarine at eight years instead of six years you would have to do less dockings and therefore you save money. They are examples. It always has to be backed up with some very detailed engineering analysis.

Mrs BRONWYN BISHOP—I am very pleased you raised the submarines. I am concerned that we only have six submarines and we only have two boats in the water. In light of what you have just said, does that mean that, if you in fact had not four but five boats out of the water, it would actually save money because you would do less maintenance?

Dr Gumley—I would not quite put it that way. You could have all the boats on the beach and do no maintenance on them and save all the money but then you have no operational boat, so—

Mrs BRONWYN BISHOP—That is what I am getting at.

Dr Gumley—Yes, I know that is what you are getting at. The issue with the submarine is that we had a couple of unplanned breakdowns and that has affected the upkeep cycle.

Mrs BRONWYN BISHOP—But the reason we do not have boats in the water is a crewing issue, is it not?

Dr Gumley—No, it is a combination of crewing issues and maintenance issues.

Mrs BRONWYN BISHOP—Could we have specific evidence about how many boats are there due to crewing issues and how many boats are there due to maintenance?

Dr Gumley—There is a feedback loop there. You need boats to be able to train crew. They actually do get linked up together. Do we need more operational submarines? The answer is yes. We are working on it very hard and we expect to have four—

Mrs BRONWYN BISHOP—How many are not in the water because of crewing issues?

Dr Gumley—Only one, and that will come back in the water again. We expect to be up to four operational boats by about March next year.

Mrs BRONWYN BISHOP—The \$5.5 billion that you are saving is being done by lessening of maintenance and so on. How do you balance that up with the reliability of kit when it needs to be deployed? Are we doing risk management? Are we saying, ‘We can take a bit of a risk and put the soldiers, sailors and airmen at risk but we are balancing it up’?

Dr Gumley—Of course we are doing risk management. Nothing we are going to do is going to affect the safety of our troops.

Mrs BRONWYN BISHOP—But if you are doing less maintenance, are we placing people at greater risk?

Dr Gumley—If an analysis said that we are going to be putting our people at risk, we will not do less maintenance. We will do the appropriate amount of maintenance such that our troops are not put at risk.

Mrs BRONWYN BISHOP—So the savings plan over the 10 years may slip?

Dr Gumley—No, I did not say that.

CHAIR—No, you did not say that. Senator Bishop, you have a question?

Senator MARK BISHOP—Last week Dr McCarthy, the new deputy secretary, briefed the Defence Subcommittee on Defence's plans for implementing the SRP. You are a bit under one-third of total savings from the figures you have indicated. Is DMO working as a stand-alone agency, are you coordinating with Dr McCarthy and are you reporting to her? What is the nature of the relationship, your time lines and your responsibility and reporting mechanisms?

Ms McKinnie—We are reporting to Dr McCarthy as part of the broader reform program. In order to achieve the savings plans we have to work very closely with the capability managers because, if we are changing any maintenance regimes or whatever, we need to ensure that that fits within their operational concepts and their operational requirements. We will be reporting to government as part of the overall SRP. A range of reporting regimes have been set up. By the end of this year we need to report to government on how we are going to make the savings and the level of savings that we are targeting against each of the reform streams. I recall the intention is that we will be reporting to government at least six monthly on how we are going against the saving targets.

Senator MARK BISHOP—Do I take it from that that you expect a sign off by the National Security Committee re your plans for the SRP by the end of this year? Is that a fair response?

Vice Adm. Tripovich—As I understand it—and I was not at Dr McCarthy's briefing to you—there is a proposal going to government about the frequency and the contents of the reports. I do not think that has been finalised yet. That is the intention of the concept—routine biannual reports to NSC on progress. As you know, there is the government's Defence Strategic Reform Advisory Board, which will be part of that overview insight, consisting of secretaries from a number of the key agencies. It culminates in biannual reports. When I spoke to Dr McCarthy the other day she said it was just to be finalised and still to be agreed. I think that is the philosophy. So it is a report to the NSC.

Senator MARK BISHOP—Is DMO giving any consideration to a public reporting mechanism or committee of the parliament reporting mechanism in addition to the detailed reporting you have to give to the NSC and its various subcommittees? Will that be part of your recommendation that goes forward for consideration of NSC in due course?

Dr Gumley—Dr McCarthy has responsibility for the governance of the program. I imagine that she will put on the public record the data that is required by the various parliamentary committees.

Senator MARK BISHOP—So I should ask that question of her; is that what you are saying?

Vice Adm. Tripovich—When it is finally agreed with the minister and the government, I guarantee that with the SRP there will be a lot of interest. Ministers are the champions of transparency, so you can imagine it will be as transparent as it can.

Senator MARK BISHOP—I will pursue it elsewhere, I understand.

Vice Adm. Tripovich—I think your question was: will there be separate and parallel reporting about DMO activities? I think the answer to that is really what Ms McKinnie said—no, it is a coherent program. All the streams are reported together. It is important they are managed,

measured, monitored and reported together because it is a complete Strategic Reform Program and not a Defence and DMO activity. As Ms McKinnie said, with hindsight previous programs to try to save money have ended up being stovepiped activities where one side saved a lot of money and the capability managers suffered greatly as a result. It is a key principle of the SRP to make sure that that is not the case. That is why it needs to be managed very closely together.

There will be times when we get deeper and deeper into the SRP a particular target might not be able to be met to the degree that we anticipated at the start because of second and third order effects. It will then be for Defence to work out what other savings we will find to still make the \$20 billion target that we have to get to. That is why it is very important that it stays together.

Mrs BRONWYN BISHOP—Have there been fewer projects for people to bid on since the directive was announced?

Dr Gumley—I am not aware of any change of activity.

Mrs BRONWYN BISHOP—Would it be possible to do an analysis over five years to see what the volume was, did it average out and whether it has dropped in the last year? I do hear anecdotally that there is less work around.

Dr Gumley—The amount of business that is being done this year in real terms is going to be about the same as last year in terms of the sustainment budget. In terms of acquisitions the amount of business is going up. For the defence industry in Australia as a whole there is as much business in the year that we have just started compared to the year that we have just finished.

Senator BARNETT—I have two questions relating to some media reports, firstly, about the payroll system upgrade which rose in cost from \$50 million to \$500 million. I would like your responses to the veracity of that in terms of government waste. Secondly, regarding the communications network upgrade, in the 2004 capability plan there were estimates of \$280 million to \$400 million for that and now there are estimates in the latest plan of \$500 million. There were questions asked about reliability and concerns expressed in that regard plus the delay in rollout from 2012 to 2017 in terms of that network.

Vice Adm. Tripovich—I will address your questions with a broad answer. I do not have before me the 2004 figures and the public DCP 2009 figures but I will take it that what you have said is right. In broad terms there have been annual updates to the Defence Capability Plan. The Defence Capability Plan needs to change as our plans change. The value of a project can change for a number of reasons. As we move from initial entry into the DCP, to being in contract and then making the last payment the cost of a project will always change. In fact, it is a feature of the Kinnaird process. Kinnaird said: ‘You should have as good a number as you can when you enter the DCP and then on the way to first pass. Then on the way to second pass you should continually get more information so that when you go to government at various times you have the right information.’ So in iterations of the DCP the provision set aside for a project should change. The provision will increase if we understand there are more risks than initially thought with a project. The provision in the DCP should change if the scope of the project changes. In relation to the comms and the payroll the scope of the total chief information officer’s plans for ICT and systems related to pay, inventory management, software and the like changed considerably during the process of the white paper as we examined what we need to do to do our

work better. The scope of projects changed considerably, some up and some down, in the public DCP 2009 versus the public DCP 2004 you have referred to and indeed the last public DCP.

Senator BARNETT—Could you take it on notice? It is a tenfold increase in the payroll system upgrade from \$50 million to \$500 million.

CHAIR—We are not here to look at the payroll system.

Vice Adm. Tripovich—I am happy to take the question on notice. The answer to your question is that it is not apples and apples. The scope of the projects changed considerably.

Senator BARNETT—If you can take those two questions on notice, I am happy for you to do that both for the communications network and the payroll.

Vice Adm. Tripovich—To make sure that I answer the right question, it is what did the numbers change from and to and the reasons why.

Senator BARNETT—Thank you.

CHAIR—In our report we expressed concerns about the lack of resources available to the Capability Development Group. That was echoed in the Mortimer report was well. We also note that the last audit report, No. 48, also referred to that and made reference to inadequate resourcing in the CDG. Has that been addressed in any way, and how?

Vice Adm. Tripovich—Absolutely. In parallel with the ANAO audit, the internal companion reviews, the Defence budget audit and all the other reviews happening in the white paper—and the development of the new Defence Capability Plan and the increased number of projects that is in public DCP that you will see—we did an analysis very mindful of your findings and our own findings that we needed to make sure we were properly resourced both in the numbers of people and their skills. My internal companion review of that, my analysis of the DCP and the ANAO audit all, because they were happening at the same time, came to the same conclusion. As a result, I am funded this year to increase my staff by 62. There is a total of 312, military and civilian, increasing to 374. It then increases slightly to match the workload. There is a surge at the front half of the DCP, if you like, and then it gradually settles down to a net increase from last year's number of about 30-odd. So, if you like, it surges up to about 70 for about three or four years and then it comes down.

CHAIR—That is significant.

Vice Adm. Tripovich—Yes, it is.

CHAIR—What can we expect from all that additional resourcing?

Vice Adm. Tripovich—The second part of this—it is not just shipping in people—is providing their training. The ANAO audit noted that we should do—and we had found the same thing and were telling them, which is why it made it into both of our reports—a contemporary training needs analysis to determine the skills that are required and the sort of training needed. That initial work has been done and we are now embarking upon getting the courses and training

lined up for those people. That is not to say, however, that we did not train people before. The ANAO audit recognised that we had these training courses but that there needed to be a constant process of examining our requirements and updating the courses. That actively is a part of the Strategic Reform Program.

Mr BEVIS—What backgrounds and attributes do you look for in what is a very highly specialised area?

Vice Adm. Tripovich—I will not get them all, but there are a number of broad skills. Clearly we need a percentage of people who are military—who have field experience—because they bring with their own experience, obviously.

Mr BEVIS—Are they required to leave their military post to take up a position?

Vice Adm. Tripovich—Just to make it clear, this year I will have 207 public servants and 148 military—so, roughly 150 military. They are military positions—Navy, Army and Air Force. People are posted in and out. Like my position, like my deputy's position, which was my last job, and like the captain's position I was in in 1998, they are specific military positions.

There are a range of people. We analyse the projects coming up. If I am bringing in a new patrol boat project, then I will clearly be looking for people with patrol boat experience. We work with the services to forecast the requirement for when a project is going to start and the posting cycle aims to match the right person for the right job. That is a constant engagement with the services. I am very pleased to say that the service chiefs, recognising this is actually a big demand for additional military people in headquarters, have recognised that. I have said to them, 'I don't mind the rank. I need the right person. I need the skills, not the rank.' I think that is really important.

So you have the military people for all right reasons you would imagine. Then you have a raft of public servants. You have people who are very good at finance. I need people who are very good at doing cost estimating. I need people who are very good at the front end of project management, if you like. I need very good policy developers and policy interpreters, because a key thing in the capability development process, highlighted in the white paper, is making sure that we seek to acquire things that strategic guidance says we need. In a strategic division they write strategy and I need people to interpret that to turn it into what it is we need to meet the strategic guidance. So I need people who can write and understand policy. They are a mix of military and civilian people. Once again, it is by position. We identify the job, we understand what is coming up and we start to seek people with those skills from the services and in the Public Service train and/or advertise for people who have those skills.

Mr BEVIS—Do you have an expectation of length of time in the posting?

Vice Adm. Tripovich—The various audit reports and, for example, the Mortimer review and Kinnaird talked about the importance of people staying a long time. We did a lot of analysis during the Companion review and gave that to the ANAO audit. Interestingly, broadly speaking, military and Public Service people stay about the same time, around two years. Interestingly, the Chief of Navy can tell me to stay in my job. I cannot choose to apply for another job anywhere else, unless I resign. In the Public Service you do not have that certainty. We are probably glad

that public servants stay as long as military people, if you see what I mean. But it is around two years. That said, Mortimer recognised that we should work on how we can reuse those skills and, in a very broad sense, and asked: should capability of element and acquisition experience become one of those things that become, if you like, a subspecialisation? Using me as an example, I first came first came to Capability Development in 1998 as a captain—a colonel equivalent—I came back as a rear admiral and then I was fortunate enough to take over my boss's job here. By the time I finish my job, I will have five years straight, preceded by two years in 1998, so I will have seven years experience.

In a military sense, it would be deleterious to a military person's career to keep them here and not on the field; we want them to keep going back. It is about getting the right balance, without stopping their advancement in a military career. I personally have a view that I would never stand in the way of someone's advancement in a military career by demanding that they stay. I have a principle that, if they got hit by a bus tomorrow, we would replace them. That said, I work very hard with the chiefs of the service. They understand it is not to their benefit if they keep cycling people through. I think two years is what we have achieved. If we do get longer it should not impact on the military officer's career.

In the Public Service you deal with it in a different way. We work very hard to make Capability Development a place that people want to stay in. We have had good retention in my group. I cannot mandate that public servants stay where they are. You make it attractive so they come back and you reuse their skills. Indeed, if you take the strategy line, I would want people to go off to Strategy Group and come back. I would want people who are good at cost estimating to go to Dr Gumley's organisation and then come back. He would want people who have done project management in my world to eventually transition, perhaps as a military person, out of the service into the Public Service and join his organisation. They still work for the same company and that is important. It is when you lose it from Defence that it truly becomes a loss of the capability.

CHAIR—Can I just go back to our Capability Development Groups. In our report we expressed concerns about the ability of that group to have access to full information and therefore to report as fully as we would have liked to government regarding capability. One of our recommendations—and I think Mortimer reinforced this, too—was that there should be regular meetings between the CEO of DMO, the chief of Defence's Capability Development Group and capability managers with a view to finding the correct structures and exploring options to make it the most effective it could be in giving the best information to government on capability. Could you tell us how that is progressing?

Vice Adm. Tripovich—I think the engagement that Steve and I have—and we describe ourselves as the other diarchy in Defence, joined at the hip, for very good reasons, I am told.

Dr Gumley—It is on the record now!

Vice Adm. Tripovich—And the service chiefs are all within one or two floors of my office. We meet very frequently to discuss the big issues. The defence committee, of which all of the three stars are members, meet weekly. I personally am in the service chief's office once or twice a week. My staff are doing the capability development work for them—that is, Navy, Army and

Air Force people are doing the capability development for the chiefs of Navy, Army and Air Force.

The defence committee's internal committee processes, which develop proposals, consider them and then agree the options, the business case, the risks, the money, the colour, the speed and all those sorts of things, of which I chair a number, fully engage at the SES Band 1 or one-star, SES Band 2 or two-star and then finally at the three-star level—all of the groups and all of the services. It is a daily engagement. There is no stovepiping and there is nothing done in isolation. As I was saying to my staff, we are not developing these services for me; we are developing them for the Navy, Army, and Air Force, and they are fully engaged.

CHAIR—Dr Gumley, what impact has that had on the quality of the information reported to government?

Dr Gumley—We have a governance mechanism of three-star steering groups, which are used on the big projects, where the capability manager, the head of capability and myself, and on some of them the Chief Defence Scientist as well, act as a three-star steering group to make sure that all the needs and wants of each of the different parts of defence are reflected in the information to government. For example, we use this process for the Joint Strike Fighter; we use it for the Air Warfare Destroyer—but there we have some industry people as well on the governance board; we are using it on the new submarine; and we also use it on many of the projects of concern. By getting the feedback and the input from the operator, those who define the capability and those who have to deliver it, I think we are giving a higher quality of information to government.

CHAIR—Good. We have had evidence in our inquiry from the Defence Procurement Advisory Board. Now we know there is an intention to establish the Strategic Reform Advisory Board. What will the interface and division of responsibilities be between those two bodies?

Vice Adm. Tripovich—To my knowledge, the DPAB is going to be disbanded. The Defence Strategic Reform Advisory Board will fulfil the role of overseeing the whole program.

CHAIR—We also were concerned about how we measure and what the metrics of cultural change are. A lot of what you have said today demonstrates some cultural change, but we were concerned that there are never any metrics—yet quality assurance is an important part of what you do. Therefore, we are wondering whether there is any progress in how we measure and how we will know if that culture is improving in both organisations.

Ms McKinnie—In the DMO we are looking at using a cultural survey technique. We are currently looking at a number of instruments that we might be able to use. That would then provide us with an ability to benchmark our overall progress year on year. If we want it to, it would also allow us to benchmark how we are going against the companies or other outfits that are part of that benchmarking regime.

Vice Adm. Tripovich—There is a very similar approach being taken in our world. As I said before, a lot of it is intangible and it is hard to measure. Surveys are really drawing together opinions and views. Other things you can measure over a long period of time—for example, how long it takes to get from first to second pass, the number of projects that get through in a year

and any projects or proposals that have been rejected by government. You can have a large degree of satisfaction and a small number of hard numbers, but you have to take those together. It is the same sorts of things that Ms McKinnie talked about.

CHAIR—One of the other things we talked about in our report was the delivery of capability versus operational capability and acceptance by defence. Dr Gumley, could you explain to us how that is being progressed?

Dr Gumley—I am having a little bit of a problem understanding the question.

CHAIR—It is about the delivery of equipment versus the delivery of capability and whether both are achieved.

Mr King—We, and Defence, in the Strategic Reform Program have changed the influence a little bit in the relationship between the capability manager, Admiral Tripovich's organisation and DMO. We have now articulated clearly that the capability manager, in the submission to government and commitment to CDF, takes responsibility for introducing the whole of the capability into service. The element parts of that now are clearly DMO for the materiel aspects, but there are other organisations, as you would imagine—the facilities groups and CIO groups and so on. So there is now a more cohesive picture going to government for approval about how the whole of the capability is introduced.

One of the unintended consequences of the Kinnaird process was to put a little bit too much focus on materiel aspects and not all aspects. I think, unintentionally, some of the capability issues got taken out of focus. So that tuning has put the emphasis right back on the whole of the capability being introduced into service.

CHAIR—Of course, what we are wanting to see in the major projects report is a distinction between equipment received and capability signed off. So how that could be shown in the reports in future?

Dr Gumley—The major projects report will talk about the cost of delivering the materiel. Overlaying that will have to be some mechanism for understanding when the entire asset gets into service. So if you deliver helicopters and you do not have the pilots or the hangars than you do not really have a capability. As Mr King said, we probably got a little bit too enthusiastic with the materiel aspects a few years ago and now we recognise the other enablers are just as important.

Another critical change has come out of the Pappas review, and I think this is going to be fundamental to the way Defence does its business in the future: from 1 July next year, the service chiefs will get their budgets pretty much more under their control in the sustainment areas. So they are going to be very much driving the demand patterns and therefore the enablers that are needed for each of the capabilities. That is going to change things quite a bit, in my view.

Vice Adm. Tripovich—Chair, if I could just add to that.

CHAIR—Yes, certainly.

Vice Adm. Tripovich—In the government's response to the Mortimer review, just to give you some text if you wanted to read it, recommendation 3.1 talks about capability managers signing the materiel acquisition agreements, along with Dr Gumley and me; 3.2 is about capability managers overseeing and coordinating all the elements of the capability; 3.3 talks about the framework through which the capability managers can provide their inputs; and 3.4 is about them reporting regularly to government. That is on pages 26 and 27 of the government response. On pages 12 to 13, as part of the 20-step plan Defence has for implementing procurement reform, step 18 is strengthening the role of the capability manager, and there are two or three paragraphs to explain how it is intended to do that.

Dr Gumley—So where your committee was going last year is very similar to where Mr Mortimer went with his review.

CHAIR—Yes.

Mr King—The interesting thing here is that I think it is actually an indicator of the improvement of the materiel acquisition aspects that now these matters, like complete operational introduction, are coming to the surface. In the past, we had such problems with delivering some of the capability that the matter of how the whole thing got into service was almost under the radar. In an indirect way, actually seeing an improvement means that we can now focus on that totality rather than just the materiel aspects.

CHAIR—I think that is what we have been aiming for for a long time, so that is pleasing. I just want to confirm from our discussions the other day, DMO, that we did agree that changes to section 4 of the statements, the major projects report, would include the clear identification of risk, whether it was an anticipated, upfront risk or an emerging risk, and that would remain in section 4?

Dr Gumley—That is correct. That is what we intend to do.

CHAIR—Good. That is fine. Also, I note that the Wedgetail project seems to be a little better back on track; how will that be shown in the statements?

Dr Gumley—I will leave Mr King to answer that, because that is a double-barrelled question!

CHAIR—These flick passes!

Mr King—By better—I think we would like to say—stabilised and now adhering to the revised—

CHAIR—It is not just going to keep spinning out?

Mr King—No.

CHAIR—That is good.

Mr King—The major projects report at the moment, as I see it structured, is still very much about the totality of the project. And I do not have a direct answer for you. You are right in

saying that we now have a plan to execute AEW&C and that plan seems to be stabilising, and we will bring those aircraft back and so on.

The way the major projects report is structured at the moment, though, it is very much about what did you start out to do and what did you end up doing. What it does not really cater for—it does in the narrative. If you look at FFG-7s, for example, it deals with IOR, initial operational release, and so on. So we have texturally dealt with how that is improving and how we are getting it into service, and AW and C can do the same thing. What it will not do it, I suppose, is say at what time did you re-baseline and have you done that re-baselining. That is sort of being covered under the projects of concern area, not in the way it is reported in the major projects at present.

CHAIR—I think we are anticipating the next major project report will be tabled in parliament on 18 November. Is that on track and expected to be the final date for release?

Mr Hindmarsh—We are on track. As we said last week, we are continuing to work very cooperatively with the ANAO and we believe that that deadline will be met.

CHAIR—That is excellent.

Senator MARK BISHOP—One brief question. Dr Gumley, you recall discussions in other forums about delivery of capability to individual services when the contract had, from your organisation's perspective, been complied with. You identified a couple of problems in those previous discussions. Can you give me a status report on whether the problems are still extant, or are they proceeding to resolution?

Dr Gumley—Are you referring there to acceptance into service?

Senator MARK BISHOP—I am.

Dr Gumley—Acceptance into service is always a difficult issue. Part of it is communications with your customer to make sure that the expectations are set. Part of it is bringing your customer with you as you start delivering the equipment into service. If you just dump equipment on them, they have a problem. So we are working our way through with the capability managers how we better manage getting the equipment into service. It is work in progress, Senator Bishop, and I would hope in the next year or two to be able to report positive outcomes.

Senator MARK BISHOP—It is still a work in progress.

Dr Gumley—Yes, it is.

Senator MARK BISHOP—With each of the services or just with one?

Dr Gumley—No, they all have different technical regulatory environments that you have got to meet. That is fine, I do not have any problem with that, but it does require work. It is not something you can just leave to the end of the project and wave a magic wand and think it is

going to happen; it is something that has to be worked on and built into your project schedule from the very beginning.

Vice Admiral Tripovich—One of the things Dr Gumley has talked about is getting an understanding between Dr Gumley and the capability manager as the sponsor as early as we can. From the capability manager's point of view, what elements of the capability will he need to be able to commence the acceptance into service process, and when does he need various deliverables before we can say, 'Okay, I have got the whole lot'? And getting that upfront early and setting the expectations on both sides is very important so that, if you like, there is no last-minute, 'I need a bunch of more stuff before I can start my process.' If we know that at the start, Dr Gumley can arrange the contracts and the deliveries such that the right amount turns up on the wharf, if you like, for the chief to start the process, delivery over a period of time and the time that the chief needs it but not all at the start, and making sure he has got all he needs to make his final judgment about whether something is released into operational service or not. Getting that process is a good thing and we are working very actively with it. It is a thing between the capability managers and the DMO and me as the sponsor. That is one of the reasons why it is important the capability manager signs the acquisition agreement at the start because that sets out the requirements for all to see. There is no doubt about what the chief's requirements are, what CDMO's obligations are and what my role in it is. I think that is a very healthy thing. The Mortimer review picked it up and we did in our own internal reviews and it certainly folded into the strategic reform program in strengthening the role of the capability manager. We all welcome it and we think it is great because it removes another thorn in people's sides that has been caused by what we now reflect on as being insufficient planning at the start.

Mr King—I want to add that we have got two cases in point that highlight that at the moment. One is FFG-7, where we had a pretty difficult position 18 months ago. Not only have we addressed the materiel aspects but we and Chief of Navy and CDG have worked very closely together to put in the trials program and the staged release into operational release. The other one is the Wedgetail. I think that is actually working very effectively.

CHAIR—Dr Gumley, before we leave, you mentioned that industry do have a contribution to make to savings in the defence budget generally and procurement budget. I note that one of the defence industry leaders said that some of the costs would be saved on tendering. Do you have a comment on the tendering costs themselves?

Dr Gumley—Tendering costs have been a thorny issue for the last 30 or 40 years. I do not think it has necessarily got much better or much worse. Tendering can become pretty expensive when you are bringing a multibillion dollar complex platform into being, particularly when large parts have never been invented before. I think it goes with the territory. It does not mean we cannot do better with our processes and I am sure we are working on it, but I do not think it is anywhere near the driver that many people think it is.

CHAIR—I am sure that is not quite the answer they wanted to hear, what I am interested in that answer.

Dr Gumley—No, we are working on it. We have a procurement improvement program which is working on how we get a better suite of documents and how we make things more transparent

and easy. But it is one we have just got to just keep working on. I notice that it is no different in any of the other Western democracies when it comes to military procurement.

CHAIR—On behalf of the committee, thank you for attending and giving evidence today. I declare the public hearing closed.

Resolved (on motion by **Senator Feeney**, seconded by **Senator Bishop**):

That, pursuant to the power conferred by section 2(2) of the Parliamentary Papers Act 1908, this committee authorises publication, including on the parliamentary database, of the evidence given before it and submissions presented at public hearing this day.

Committee adjourned at 12.41 pm