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Report 448

Review of the 2013-14 Defence Materiel Organisation Major Projects Report

Joint Committee of Public Accounts and Audit

May 2015
Canberra

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Foreword

This report constitutes the second Defence Materiel Organisation (DMO) Major Projects Report (MPR) reviewed by the Joint Committee of Public Accounts and Audit (JCPAA) in the 44th Parliament and the seventh to be reviewed by the JCPAA overall. This year's report covers 30 projects with a combined approved budget of \$59.4 billion.

The DMO MPR constitutes the ANAO's review and analysis of the progress of selected major Defence acquisition projects managed by DMO, and aims to consider cost, schedule, and capability performance and to function as a longitudinal analysis of procurement projects over time.

The JCPAA assesses the overall content, accessibility and transparency of the information provided in the MPR, and also reviews and endorses the guidelines that constitute the MPR.

The Committee is committed to ensuring the information presented in the Major Projects Report helps to maximise transparency and accountability in the Defence acquisition process for major projects that have been managed by DMO and will continue to be managed by the Department of Defence in the future.

Specific areas of focus in the Committee's review of this year's report include some specific projects listed in the 'Projects of Concern' as well as broader issues regarding and governance and business processes.

Defence Major Projects are inherently complex and meeting cost, schedule and capability targets must be considered in this context, particularly for developmental projects.

DMO has previously summarised the range of issues affecting the completion of Major Projects. These include managing induced schedule delays as a result of budgetary constraints; employing and maintaining an appropriately skilled workforce where the skills required are in high demand by other industries; acquiring new equipment presenting multiple integration challenges; contractor overestimation of the technical maturity of proposed equipment solutions; contractor underestimation of the level of effort and complexity required to deliver new equipment; unavailability of in-service equipment (due to operational

requirements) limiting the ability of projects to install, and test new or upgraded equipment in accordance with the original planned project schedule; complying with increasingly demanding certification and regulatory requirements; and ensuring access to intellectual property to enable continued further enhancement and improvement of systems.

The Committee acknowledges these various challenges.

DMO has played a strong and positive role in the development of the MPR since its inception in the mid-to-late 2000s. With DMO's abolition and the Department of Defence re-absorbing the DMO's functions, the Committee expects the Department to continue working on the MPR with the same intensity shown by DMO over the past eight years. The Committee looks forward to working with the new reformed Department of Defence to produce the same high-quality MPR in the future so as to ensure that the improvement gains made in terms of project acquisition management over the past eight years are maintained.


The Committee, in conjunction with Defence and ANAO, is now focussed on establishing a mechanism through which sustainment reporting can be better scrutinised. Objections in the past by DMO/Defence have centred on security issues – i.e. that more detailed reporting of sustainment in the public arena would compromise national security. The Committee is in complete agreement with Defence about the need to protect classified information.

Having had a series of options presented to the Committee by ANAO, initial discussions with Defence have already occurred and at this stage it appears likely that sustainment reporting be developed through an evolutionary process until both the Committee and Defence are comfortable with a final structure, not unlike the development of the MPR itself.

On behalf of the Committee, I would like to express my appreciation for the work done by the DMO and the Australian National Audit Office in producing the Major Projects Report this year.

I also thank the witnesses from the DMO and the ANAO for their participation in the Committee's review.

Dr Andrew Southcott MP
Chair



Membership of the Committee

Chair Dr Andrew Southcott MP

Deputy Chair Mr Pat Conroy MP

Members Mr Anthony Albanese MP

Ms Gai Brodtmann MP

Mr Andrew Giles MP

Dr Peter Hendy MP

Mr Craig Laundry MP

Mrs Jane Prentice MP

Mr Angus Taylor MP

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Senator Chris Ketter

Senator Bridget McKenzie

Senator Dean Smith

Committee Secretariat

Secretary Ms Susan Cardell
Research Officer Dr Andrew Gaczol
Administrative Officers Ms Tamara Palmer
 Ms Yvonne Lee



List of recommendations

4 Future developments

Recommendation 1

The Committee recommends that the reformed Department of Defence continues to provide the same priority and appropriate resources to the Major Projects Report in the future as DMO have done in the past so that the achievements of the past eight years are not lost. The same level of effort should also apply to the future development of sustainment reporting.

Introduction

Background

- 1.1 The 2013-14 Major Projects Report (MPR) is a consolidated review of 30 selected major defence acquisition projects ('Major Projects') being managed by Defence Materiel Organisation (DMO). Projects in the MPR include, for example:
- Air Warfare Destroyers;
 - Joint Strike Fighters;
 - MRH90 helicopters;
 - Collins Class Submarines; and
 - Bushmaster Vehicles.
- 1.2 The MPR reviews overall issues, risks, challenges and complexities affecting Major Projects and also reviews the status of each of the 30 selected Major Projects, in terms of cost, schedule and forecast capability. The MPR is a joint publication of the DMO and Australian National Audit Office (ANAO) and is prepared in accordance with Guidelines approved by the Joint Committee of Public Accounts and Audit (JCPAA).
- 1.3 The aim of the MPR is to improve accountability and transparency for the benefit of the Parliament and other stakeholders.
- 1.4 In 2003, the Senate Foreign Affairs, Defence and Trade Reference Committee recommended that the Department of Defence produce an annual report on the progress of major defence acquisition projects, detailing cost, time and technical performance data for each project.¹

1 Senate Foreign Affairs, Defence and Trade References Committee, *Report into Materiel Acquisition and Management in Defence*, March 2003, pp.xv-xvi.

- 1.5 In December 2006, the JCPAA recommended that the ANAO receive additional funding to produce such a report. In August 2008, the Committee published *Report 411: Progress on Equipment Acquisition and Financial Reporting in Defence*, which provided a broad outline of the key features deemed critical for inclusion in the report. Thereafter, the ANAO and DMO have jointly published the MPR, which is usually released in December each year and covers the previous financial year.
- 1.6 Since the first iteration, the MPR continues to evolve. During 2011-12, a stakeholder survey found that “73 per cent of users agreed that the MPR was useful for understanding the DMO’s project performance, while around 44 per cent used it as a comparison tool and to produce further reports.”²
- 1.7 The 2013-14 MPR is the seventh produced by the DMO and ANAO. The JCPAA has reviewed six of the past seven MPRs and produced reports on five (2007-08; 2009-10 to 2012-13).
- 1.8 The MPR comprises a series of Project Data Summary Sheets (PDSSs) for each of the 30 selected projects and analysis by ANAO and DMO. Project data (except forecasts of capability) is subject to an assurance audit by the Auditor-General.
- 1.9 In February 2012, the JCPAA identified the future MPRs as a priority assurance reviews.³ This allows ANAO to utilise information gathering powers available under the *Auditor-General Act 1997*.⁴

Role of the Committee

- 1.10 The MPR is automatically referred to the JCPAA in accordance with its statutory obligation to examine all reports of the Auditor-General that are tabled in each House of Parliament.⁵
- 1.11 The JCPAA assesses the content, accessibility and transparency of the information provided on Major Projects. The Committee concentrates its review on overall transparency, performance and governance, rather than specific details of individual projects.
- 1.12 More generally, the JCPAA has a duty under s.8(d) of its Act to report to Parliament on any matters in the “accounts, statements or reports” of the

2 JCPAA, *Report 436*, p.32. Based on a sample of 86 respondents.

3 *Major Projects Report 2011-12*, p.17; JCPAA, *Report 429*, p.33; *Auditor-General Act 1997* (Cth) s.19A(5).

4 *Major Projects Report 2011-12*, p.17; JCPAA, *Report 429*, p.33.

5 *Public Accounts and Audit Committee Act 1951* (Cth) s.8(1)(c).

Commonwealth or Auditor-General “or any circumstances connected with them, that the Committee thinks should be drawn to the attention of the Parliament.”⁶

- 1.13 As well as reviewing the MPR, the Committee annually reviews and endorses the MPR Guidelines. The MPR Guidelines include:
- criteria for project selection and removal (or ‘entry’ and ‘exit’);
 - a list of projects proposed for inclusion or removal from the MPR;
 - the roles and responsibilities of the DMO in the production and review of the MPR;
 - guidelines for the preparation of the PDSSs;
 - a PDSS template; and
 - an indicative audit program.
- 1.14 The Guidelines endorsed by the JCPAA and used to prepare the 2013-14 MPR can be found in Part 4 of the MPR on page 545.

Conduct of the review

- 1.15 The Committee received two submissions to the inquiry, which are listed at Appendix A.
- 1.16 The JCPAA has reviewed the MPR by way of a public hearing in Canberra with representatives of ANAO and DMO, which was held on 27 February 2015. Witnesses who appeared at the hearing are listed at Appendix B.

6 *Public Accounts and Audit Committee Act 1951* (Cth) s.8(1)(d).

Major Projects Report 2013-14

Introduction

- 2.1 This chapter provides an overview of the 2013-14 Major Projects Report (MPR) and a summary of the Australian National Audit Office (ANAO)'s findings in regard to cost performance; schedule performance; capability performance; and governance and business processes.
- 2.2 This overview is not intended to be exhaustive, particularly as the entire document is over 500 pages long. Rather, it seeks to highlight a few key aspects of the document and some of the pertinent issues raised through the ANAO and DMO analysis.
- 2.3 The MPR is structured into three parts:
- Part 1: ANAO review and analysis, which includes:
 - ⇒ Review, scope and approach of the MPR;
 - ⇒ Analysis of Projects' Performance including cost, schedule and capability performance analysis; and
 - ⇒ Developments in Acquisition Governance.
 - Part 2: The DMO Major Projects Report itself. This includes:
 - ⇒ Consolidated information on the status of Major Projects, such as project, budget and schedule performances, reflected by the Project Data Summary Sheets (PDSSs).
 - ⇒ Discussion of Major Projects' progress or challenges.
 - Part 3: Auditor-General's independent review report; DMO Chief Executive Officer's statement and 30 PDSSs.
 - Part 4: MPR 2013-14 MPR Guidelines. The guidelines as endorsed by the JCPAA.

- 2.4 Whereas other audit reports may contain recommendations, ANAO does not include recommendations in the MPR.

MPR fundamentals

The Project Data Summary Sheets

- 2.1 The collection of PDSSs for each of the 30 selected projects form the largest portion of the MPR. The PDSS are presented in a form compliant with Guidelines endorsed by the JCPAA.¹ In their current form, the PDSSs are structured as follows:

- Project Header – including name; capability and acquisition type; approval dates; total approved and in-year budgets; stage; complexity; and image;
- Section 1 – Project Summary: including description; current status, including a financial assurance and contingency statement; context, including background, unique features and major risks and issues; and other current sub-projects;
- Section 2 – Financial Performance: including the project’s budget and expenditure, as well as variations to the budget; in-year variances between budgeted and actual expenditure; and major contracts in place (in addition to quantities delivered as at 30 June 2014);
- Section 3 – Schedule Performance: provides information on the design development; test and evaluation process; and forecasts and achievements against key project milestones including Initial Materiel Release (IMR), Final Materiel Release (FMR), Initial Operational Capability (IOC) and Final Operational Capability (FOC);
- Section 4 – Project Cost and Schedule Status: represents the project’s cost and schedule status in a graphical format as at 30 June 2014;
- Section 5 – Materiel Capability Delivery Performance: provides a summary of the DMO’s assessment of its progress on delivering key capabilities;
- Section 6 – Major Risks and Issues: outlines the major risks and issues of the project;
- Section 7 – Project Maturity: provides a summary of the project maturity as defined by the DMO and a comparison against the benchmark score;

¹ ANAO, Audit Report No. 14 (2014-15), *Major Projects Report 2013-14*, p. 9, hereafter referred to as ‘*Major Projects Report 2013-14*’.

- Section 8—Lessons Learned: outlines the key lessons that have been learned at the project level (further information on lessons learned by the DMO are included in the DMO's Appendix 3); and
 - Section 9—Project Line Management: details current project management responsibilities within the DMO.²
- 2.2 In terms of presentation, the PDSSs were largely unchanged from both the 2011-12 MPR and 2012-13 MPR.
- 2.3 In 2013-14, the results of the ANAO's priority assurance review of the 30 PDSSs was that nothing had come to the attention of the ANAO that caused them to believe that the information and data in the PDSSs, within the scope of its review, had not been prepared, in all material respects, in accordance with the Guidelines.³

Project maturity framework

- 2.5 Project maturity assessments have been a feature within the MPR since its inception in 2007-08. While the DMO has raised some doubts about the effectiveness of the current framework, the DMO has agreed to retain maturity scores following the JCPAA's recommendation in Report 442 – the inquiry into the 2012-13 MPR. The Committee viewed the retention of maturity scores as important in relation to providing a measure of capability delivered for each project, until a measure equal to or better than current arrangements is available.⁴
- 2.6 Maturity scores are a composite indicator, constructed through the assessment and summation of seven different attributes which cumulatively form a project 'maturity score'. The attributes are: Schedule, Cost, Requirement, Technical Understanding, Technical Difficulty, Commercial, and Operations and Support, which are assessed on a scale of one to ten. While the ANAO has previously raised inconsistency in the application of project maturity scores as an issue, during 2013-14, the ANAO noted that project offices were more consistently assigning maturity scores than in previous years.⁵
- 2.7 The existing project maturity score model does not always effectively reflect a project's progress during the often protracted build phase, particularly for developmental projects. During this phase it can be expected that maximum expenditure will occur, and risks realised, some of which will only emerge as test and evaluation activities are pursued

2 *Major Projects Report 2013-14*, p. 10.

3 *Major Projects Report 2013-14*, p. 40.

4 JCPAA, Report 442: *Review of the 2012-13 Defence Materiel Organisation Major Projects Report*, pp. 91 – 92.

5 *Major Projects Report 2013-14*, p. 33.

through to acceptance into operational service. While the DMO guidance underpinning maturity scores was due for review in September 2012, this review has not yet been finalised. The ANAO will continue to review the framework and attribution of maturity scores in subsequent MPRs.⁶

Major Projects reviewed in 2013-14

- 2.8 The 30 Major Projects in this year's report and their approved budgets appear in Table 1 below. Project entry into the MPR is based on selection criteria found in section 1.7 of the MPR Guidelines.⁷
- 2.4 The total approved budget for the Major Projects included in the 2013-14 MPR is approximately \$59.4 billion, covering nearly 63 per cent of the budget within the Approved Major Capital Investment Program of 94.7 billion.⁸

Table 1: MPR projects and approved budgets at 30 June 2014

Project Number (Defence Capability Plan)	Project Name (on DMO advice)	DMO Abbreviation (on DMO advice)	Approved Budget \$m
AIR 6000 Phase 2A/2B	New Air Combat Capability	Joint Strike Fighter	13 455.5
SEA 4000 Phase 3	Air Warfare Destroyer Build	AWD Ships	7 847.9
AIR 5077 Phase 3	Airborne Early Warning and Control Aircraft	Wedgetail	3 873.1
AIR 9000 Phase 2/4/6	Multi-Role Helicopter	MRH90 Helicopters	3 785.1
LAND 121 Phase 3B	Medium Heavy Capability, Field Vehicles, Modules and Trailers	Overlander Medium/Heavy	3 469.0
AIR 9000 Phase 8	Future Naval Aviation Combat System Helicopter	MH-60R Seahawk	3 196.9
JP 2048 Phase 4A/4B	Amphibious Ships (LHD)	LHD Ships	3 089.4
AIR 5349 Phase 3	EA-18G Growler Airborne Electronic Attack Capability	Growler	3 036.6
AIR 87 Phase 2	Armed Reconnaissance Helicopter	ARH Tiger Helicopters	2 033.0
AIR 5376 Phase 2	F/A-18 Hornet Upgrade	Hornet Upgrade	1 881.3
AIR 5402	Air to Air Refuelling Capability	Air to Air Refuel	1 821.4
SEA 1390 Phase 2.1	Guided Missile Frigate Upgrade Implementation	FFG Upgrade	1 452.6

6 *Major Projects Report 2013-14*, p. 35.

7 See Part 4 of the *Major Projects Report 2013-14*, pp.547-548.

8 *Major Projects Report 2013-14*, p. 6.

AIR 8000 Phase 2	Battlefield Airlift – Caribou Replacement	Battlefield Airlifter	1 289.5
LAND 116 Phase 3	Bushmaster Protected Mobility Vehicle	Bushmaster Vehicles	1 250.4
LAND 121 Phase 3A	Field Vehicles and Trailers	Overlander Light	1 020.5
JP 2008 Phase 4	Next Generation SATCOM Capability	Next Gen Satellite	869.3
SEA 1448 Phase 2B	ANZAC Anti-Ship Missile Defence	ANZAC ASMD 2B	678.4
AIR 9000 Phase 5C	Additional Medium Lift Helicopters	Additional Chinook	617.2
JP 2043 Phase 3A	High Frequency Modernisation	HF Modernisation	580.1
JP 2072 Phase 2A	Battlespace Communications System	Battle Comm. Sys. (Land)	460.1
SEA 1439 Phase 4A	Collins Replacement Combat System	Collins RCS	450.1
SEA 1429 Phase 2	Replacement Heavyweight Torpedo	Hw Torpedo	426.6
JP 2008 Phase 5A	Indian Ocean Region UHF SATCOM	UHF SATCOM	419.1
SEA 1439 Phase 3	Collins Class Submarine Reliability and Sustainability	Collins R&S	411.7
SEA 1390 Phase 4B	SM-1 Missile Replacement	SM-2 Missile	407.3
SEA 1448 Phase 2A	ANZAC Anti-Ship Missile Defence	ANZAC ASMD 2A	386.9
LAND 17 Phase 1A	Artillery Replacement	155mm Howitzer	336.1
AIR 5418 Phase 1	Follow On Stand Off Weapon	Stand Off Weapon	317.4
LAND 75 Phase 3.4	Battlefield Command Support System	Battle Comm. Sys.	314.8
JP 2048 Phase 3	Amphibious Watercraft Replacement	LHD Landing Craft	239.9
Total			59 417.2

Source: ANAO, Audit Report No. 14 (2014-15), Major Projects Report 2013-14, p. 7.

Schedule slippage from original planned Final Operational Capability (FOC)

2.9 In the 2013–14 MPR, the total schedule slippage for the 30 Major Projects as at 30 June 2014 is 1,115 months (2012–13: 957 months) when compared to the initial schedule first approved by government. This represents a 36 per cent (2012–13: 36 per cent) increase on the originally approved schedule. See Table below.⁹

Table 2: Schedule slippage

Project	In-year (months)	Total (months)	Project	In-year (months)	Total (months)
Joint Strike Fighter	0	0	Next Gen Satellite	0	0
AWD Ships	0	22	ANZAC ASMD 2B	0	57
Wedgetail	0	78	Additional Chinook	0	0
MRH90 Helicopters	60	60	HF Modernisation	0	147
Overlander Medium/Heavy	0	0	Battle Comm. Sys. (Land)	0	4
MH-60R Seahawk	0	0	Collins RCS	1	109
LHD Ships	0	0	Hw Torpedo	58	58
Growler	0	0	UHF SATCOM	0	0
ARH Tiger Helicopters	0	79	Collins R&S	0	99
Hornet Upgrade	16	39	SM-2 Missile	11	26
Air to Air Refuel	12	57	ANZAC ASMD 2A	0	72
FFG Upgrade	12	132	155mm Howitzer	7	7
Battlefield Airlifter	0	0	Stand Off Weapon	4	37
Bushmaster Vehicles	0	0	Battle Comm. Sys.	15	23
Overlander Light	9	9	LHD Landing Craft	0	0
Total				205	1 115

Source: ANAO, Audit Report No. 14 (2014-15), Major Projects Report 2013-14, p. 19.

2.10 Disaggregation according to a project's Second Pass Approval shows that 80 per cent (2012-13: 87 per cent) of the total schedule slippage across the Major Projects covered in the 2013-14 MPR is made up of projects approved prior to the DMO's demerger from the Department of Defence, in July 2005. ANAO stated that:

This is a positive indicator of the benefits that the DMO, as a specialist acquisition and sustainment organisation, is able to bring to complex Defence procurement. It also demonstrates the impact on schedule performance during the transition to higher levels of Military-Off-The-Shelf (MOTS) acquisitions following the Defence Procurement Review 2003 (Kinnaird Review).¹⁰

In-year schedule performance

- 2.11 In 2013–14, there was a total schedule slippage of 205 months in the forecast achievement of FOC for the 30 Major Projects. There has been negative slippage for three projects:
- Joint Strike Fighter – currently expects to achieve FOC in October 2023, two months ahead of the original schedule;
 - Overlander Medium/Heavy – currently expects to achieve FOC in January 2023, 11 months ahead of the original schedule; and
 - LHD Landing Craft – currently expects to achieve FOC in September 2015, five months ahead of the original schedule.¹¹
- 2.12 In-year schedule slippage involved the following 11 projects (the explanation provided, drawn from the 2013–14 PDSSs, may also include the reasons for prior slippage):
- MRH90 Helicopters – delays resulting from deed negotiations with the contractor and ongoing technical deficiencies;
 - Hornet Upgrade – achieved Supplemental Type Certification and Service Release in November 2012, however additional testing was necessary in 2014 with time allowed for finalisation of data analysis prior to Capability Manager sign off;
 - Air to Air Refuel – delays resulting from issues around the Aerial Refuelling Boom System and flight testing and maintenance requirements on test aircraft;
 - FFG Upgrade – schedule extended to allow for passive sonar (PANORAMA) capability to be included in the project;
 - Overlander Light – delays resulting from complexity in finalising the design and manufacture of the Command Post Mobile;
 - Collins RCS – slippage resulting from changes to the Full Cycle Docking schedule affecting the installation schedule based on submarine availability;
 - Hw Torpedo – slippage resulting from changes to the Full Cycle Docking schedule affecting the installation schedule based on submarine availability;
 - SM-2 Missile – delays in receipt of missile spares and arrangement of in-service support requirements;
 - 155mm Howitzer – delays resulting from the time taken to approve the transfer of the Course Correcting Fuze capability to project LAND 17 Phase 1C.1;

11 *Major Projects Report 2013-14*, p. 67.

- Stand Off Weapon – delivery delays due to issues with the reliability of the fuze; and
- Battle Comm Sys. – delays in receipt of final equipment.¹²

Entry and exit of projects

New Projects

2.13 Table 3 shows the four new projects that have been included in the 2013-14 MPR.

Table 3: New MPR projects

Project Number (Defence Capability Plan)	Project Name	DMO Abbreviation	Approved Budget \$m
LAND 121 Phase 3B	Medium Heavy Capability, Field Vehicles, Modules and Trailers	Overlander Medium/Heavy	3 469.0
AIR 5349 Phase 3	EA-18G Growler Airborne Electronic Attack Capability	Growler	3 036.6
AIR 8000 Phase 2	Battlefield Airlift – Caribou Replacement	Battlefield Airlifter	1 289.5
JP 2048 Phase 3	Amphibious Watercraft Replacement	LHD Landing Craft	239.9

Source: Expurgated version of Table 1 in the ANAO, Audit Report No. 14 (2014-15), Major Projects Report 2013-14, p. 7

Exited projects

2.14 Table 4 shows those projects that have exited from the MPR's latest iteration.

Table 4: Exited MPR projects

Project Number	Project	Government approved budget \$m	Expenditure to Date \$m	Remaining Budget \$m	FMR Achieved	FOC Achieved/ Forecast
AIR 5376 Phase 3.2	F/A 18 Hornet Upgrade Structural Refurbishment (Hornet Refurbishment)	951.3	319.1	632.2	N/A	N/A
AIR 8000 Phase 3	C-17 Heavy Airlift	1696.9	1367.8	329.1	Dec 11	Dec 11
AIR 5349 Phase 1/2	Bridging Air Combat Capability	3594.8	2881.6	713.2	Dec 12	Dec 12
SEA 1444 Phase 1	Armidale Class Patrol Boat	537.2	488.5	48.7	Nov 07	Oct 12
LAND 19 Phase 7A	Counter-Rocket Artillery and Mortar	260.3	176.0	78.4	Jan 13	Jan 13

Source: ANAO, Audit Report No. 14 (2014-15), Major Projects Report 2013-14, p. 118.

Projects of Concern at 30 June 2014

- 2.15 First established in 2008, the Projects of Concern (PoC) process was implemented to address project issues of concern to the DMO and government, relating to cost, schedule and capability. ANAO stated that the process has continued to play an important, although limited role, across the portfolio of MPR projects.¹³
- 2.16 PoC are those projects identified as having very significant technical, cost and/or schedule difficulties. The primary objective of the PoC regime is to assist with the implementation of an agreed remediation plan. Projects listed as PoC receive a higher level of oversight and management and undertake increased reporting to government. Since 2008, 22 projects, with a total value of \$30.4 billion, have been managed as PoC. There are six active PoC with a total value of \$14.6 billion as at 30 June 2014. In 2013-14, the Electronic Support Measures Upgrade Project for the AP-3C Orion Aircraft was removed, and the Air Warfare Destroyer was added as a PoC.¹⁴

Table 4: Projects of Concern

Project Name	Project Number	Date added
Collins Class Submarine Sustainment	CN10	November 2008
Air to Air Refuelling	AIR 5402	October 2010
Multi-Role Helicopter MRH90	AIR 9000 Phase 2/4/6	November 2011
Mulwala Redevelopment Project	JP 2086 Phase 1	December 2012
Direct Fire Support Weapons	LAND 40 Phase 2	December 2012
Air Warfare Destroyer Build	SEA 4000 Phase 3	June 2014

Source: ANAO, Audit Report No. 14 (2014-15), Major Projects Report 2013-14, p. 109.

Project expenditure

- 2.17 DMO reported that most projects have expended close to their given budget with minor variations attributed primarily to exchange rates or rounding issues. For example one project, HF Modernisation, had a significant overachievement of 10.3 percent. This was as a result of being able to bring forward an IT Refresh milestone. Five projects had significant underspends:

13 Major Projects Report 2013-14, p. 23.

14 Major Projects Report 2013-14, pp. 108-09.

- FFG Upgrade: the underspend is due to systems costing less than originally budgeted for, delay in invoicing due to technical difficulties and spares being paid for from sustainment budget.
- Next Gen Satellite: the underspend is due to a delay in billing by the USA and realisation of cost savings in production under the Wideband Global Satellite Program. The DMO process underspend relates to activities that have been moved to 2014-15.
- Hw Torpedo: the underspend is primarily due to the postponement of Pre-Full Cycle Docking work on *HMAS Collins*.
- SM-2 Missile: the underspend is primarily attributed to delayed contracted scope with Australian and Foreign Industry and subsequent savings as well as deferred Foreign Military Sales (FMS) payments. Establishment of In-Service arrangements has not proceeded as quickly as planned.
- Battle Comm. Sys: the underspend is primarily due to a number of supplies and quotes that are: no longer required; have been transferred to sustainment; or have taken longer than anticipated to approve.¹⁵

2.18 The Committee notes, however, these underspent projects were due to various aspects of the projects being delayed or moved to 'sustainment' rather than notable savings being achieved.

ANAO's review

2.19 Previous reviews have highlighted issues which impact on the Defence Materiel Organisation's (DMO's) administration of major Defence equipment acquisition projects (Major Projects), and their related frameworks. These issues were reconsidered by the ANAO, where appropriate, in order to assess the DMO's progress in addressing them during 2013-14. Key frameworks considered further include:

- the financial framework as it applies to the management of project budgets and expenditure, in an out-turned budget environment;
- the project maturity framework and systems in place to support the provision of maturity data in the PDSS;
- the enterprise risk management framework as it applies to major risk and issue data and its maturity; and
- the capability assessment framework, as it relates to the DMO's evaluation of the probability of delivering required capabilities.¹⁶

15 *Major Projects Report 2013-14*, p. 126.

- 2.20 The ANAO's review of the individual project PDSSs were conducted in accordance with the Australian Standard on Assurance Engagements (ASAE) 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* issued by the Australian Auditing and Assurance Standards Board.¹⁷
- 2.21 The ANAO assesses that the MPR is well positioned to examine systemic issues and provide longitudinal analysis for the 30 projects reviewed, and may also reflect on, or have implications for, general project management practices in the DMO, or more broadly within other areas of the Australian Defence organisation.¹⁸
- 2.22 The ANAO's review of the information presented in the individual PDSSs included:
- examination of each PDSS and the documents and information relevant to them;
 - a review of relevant processes and procedures used by the DMO in the preparation of the PDSSs;
 - an assessment of the systems and controls that support project financial management, risk management, and project status reporting, within the Australian Defence organisation;
 - interviews with persons responsible for the preparation of the PDSSs and those responsible for the management of the 30 projects;
 - taking account of industry contractor comments provided to the ANAO and the DMO on draft PDSS information;
 - assessing the assurance by the DMO managers attesting to the accuracy and completeness of the PDSSs;
 - examination of the representations by the Chief Finance Officer (CFO) DMO supporting the project financial assurance and contingency statements, and the independent third-party review of the project financial assurance statements;
 - examination of confirmations, provided by the Secretary of the Department of Defence and Chief of the Defence Force, from the Capability Managers, relating to each project's progress toward Initial Materiel Release (IMR) and Final Materiel Release (FMR), and Initial Operational Capability (IOC) and Final Operational Capability (FOC); and

16 *Major Projects Report 2013-14*, p. 25.

17 *Major Projects Report 2013-14*, p. 26.

18 *Major Projects Report 2013-14*, p. 26.

- examination of the 'Statement by the Chief Executive Officer (CEO) DMO', including significant events occurring post 30 June, and management representations by the CEO DMO.¹⁹

Governance and business processes

Financial framework

- 2.23 A number of project offices added additional disclosures to their PDSSs, and in particular, AWD Ships, LHD Ships and ANZAC ASMD Phase 2B recognised that available funding for price indexation was a key concern. Prior to 1 July 2010 projects were periodically supplemented for price whereas the allocation for price indexation is now provided for on an out-turned basis at Second Pass Approval. This change in supplementation policy has meant that price indexation has emerged as a risk for some projects, which would generally emerge later in a project's life cycle.²⁰
- 2.24 The ANAO stated that the emergence of indexation risk has, to some extent, changed the nature and use of the contingency budget from dealing only with project risk management to including broader price management. This requires project office finance staff to have a greater understanding of the factors that influence indices and their likely movement over the life of the project.²¹
- 2.25 In conjunction with the financial assurance statement, introduced in the 2011-12 MPR, the contingency statements were introduced for the first time in this, the 2013-14 MPR. Together, they provide greater transparency of projects' financial status, following the move to out-turned budgeting in 2010, and highlight the use of contingency funding to mitigate projects risks.²²
- 2.26 In 2013-14, while all projects continued to operate within their total approved budget, the AWD Ships, LHD Ships and ANZAC ASMD 2B project offices continued to recognise that available funding may be insufficient as contracted indices escalation may be greater than the approved project budget. In relation to the AWD Ships project, the 2013-14 Statement by the CEO DMO, noted concerns in relation to the adequacy of the total project budget, which will be dependent on the results of the AWD Reform Program.²³

19 *Major Projects Report 2013-14*, pp. 26-27.

20 *Major Projects Report 2013-14*, pp. 28-29.

21 *Major Projects Report 2013-14*, p. 29.

22 *Major Projects Report 2013-14*, p. 29.

23 *Major Projects Report 2013-14*, p. 30.

- 2.27 During 2013–14, the DMO continued to support the project financial assurance statements with an independent third-party review, considering factors including: remaining budget, Projects of Concern listing, complexity, diversity across divisions and past history.
- 2.28 Projects selected for third-party review in support of the financial assurance statement assurance process included:
- detailed review – Overlander Medium/Heavy, MH-60R Seahawk, Growler and Additional Chinook; and
 - standard review – Joint Strike Fighter, AWD Ships, MRH90 Helicopters, LHD Ships, Battlefield Airlifter and Next Gen Satellite.
- 2.29 Observations from the review included that both the AWD Ships and LHD Ships projects have significant contractual exposure to indexation factors and that both project offices have recognised and costed a risk in relation to this matter. The ANAO stated it would continue to assess the outcomes of the financial assurance statements in future MPRs.²⁴

Committee comments

- 2.30 The MPR is now in its seventh iteration and has progressively developed into a high-value document to help assess Defence procurement funding. The MPR and its accompanying processes have reached a level of maturity which the Committee is generally satisfied with. The Committee will continue to scrutinise the MPR and recommend changes to the MPR Guidelines when and where necessary. Looking forward, the Committee is broadening its focus to further examine other aspects of Defence funding, namely sustainment expenditure.
- 2.31 The issue of sustainment funding, and its lack of transparency, has been one which has occupied the Committee for some time and the JCPAA is currently in the process of seeking greater clarity from Defence/DMO on where and how these funds are being expended. This will be covered in greater detail in Chapter 4.
- 2.32 The projects identified as PoCs are of concern to the Committee and have already caught the JCPAA's attention through separate ANAO reporting such as the MRH90 which was reviewed by the Committee in Report 447.²⁵ Issues pertaining to the Collins-class submarines and the Air

²⁴ *Major Projects Report 2013-14*, pp. 30-1.

²⁵ JCPAA Report 447, EPBC Act, Cyber Security, Mail Screening, ABR and Helicopter Program: Review of Auditor-General Reports Nos 32-54 (2013-14), <http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Public_Accounts_and_Audit/Review_of_Auditor-Generals_Reports_32-54_2013-14/Report> accessed 23 April 2015.

Warfare Destroyer have also received attention from the Committee and these will be examined in greater detail in the following chapter.

The Committee's Review

- 3.1 The MPR is an exceptionally detailed publication and in the 2012-13 review the Committee concentrated on overall performance and governance rather than scrutinise individual projects. This year, the Committee's review focussed more on specific governance concerns raised in the document and on specific projects.

Recurring governance concerns

- 3.2 ANAO's analysis has identified four areas of project management which continue to be of concern. The Committee sought further detail on how DMO was responding to these concerns.

Price indexation and budget allocations

- 3.3 With regard to the continued concerns of project offices in relation to price indexation and budget allocations, and inconsistency in the recording and application of contingency funds, DMO responded:

I think in this report we have highlighted that we are now exposing more and putting more information in regard to the application of contingency, and that, I think, has met the requirement of the committee. In terms of price indexation, I think that issue comes back to the old issue about out-turning. There will always be projects looking ahead and making a judgement call on where indexation might go or where inflation might go, and it is part of their remit, if you like, to look at those risks. Those risks will always be there, but at this point in time we do not

foresee any projects not meeting their current budget. It will still remain an issue, but I think it is still manageable at this stage.¹

3.4 ANAO commented:

I think the CFO is correct. I think we were always thinking that eventually we would see projects focusing on the forward estimates that are made, in terms of change of indices over time, and this report and the committee's requirement for reporting in that space is highlighting that. It is a case now of seeing it being managed through.²

Project maturity scores

3.5 With regard to the inconsistency in the application of the Project Maturity Framework reducing its level of reliability as a maturity assessment, the MPR shows a number of projects, some of them quite large – like Air Warfare Destroyers, Wedgetail, the MRH90 helicopters and the FFG upgrade – where the project maturity score has either stalled or actually regressed over the past 12 months.³ In contrast, the Next Generation Satellite project shows a large increase in the maturity score in the same time period from system testing to project completion in one year.⁴

3.6 DMO advised that they are tending not to use the project maturity score as a project management tool and are moving towards a system known as the Materiel Implementation Risk Assessment (MIRA) which gives a broader narrative of the projects status, and is tending to manage projects through mechanisms other than the project maturity score. DMO explained:

MIRA is used as part of the original cabinet approval. When we initially established the project maturity scores, the intention was to provide decision-makers with an understanding of comparative risk across all of the projects. Over time – because it was a score – it became a number that people really did not understand the context of, so we then went about establishing a materiel implementation risk assessment that looked at the same issues but provided a narrative of our understanding of what the risks were, and how we intended to mitigate those risks. Within the PDSS there is the current set of risks that are reported. Those risks are

1 Mr Steven Wearn, Chief Finance Officer, Defence Materiel Organisation, *Committee Hansard*, 27 February 2015, p. 10.

2 Mr Michael White, Executive Director, Assurance Audit Service Group, Australian National Audit Office, *Committee Hansard*, 27 February 2015, p. 10.

3 *Major Projects Report 2013-14*, p. 203; p. 214; p. 228; and p. 328.

4 *Major Projects Report 2013-14*, p. 327.

the risks that we are managing each year, and they have been reported in the PDSS for each project. The MIRA is what we start out with when we initially get the project approved and then, over time, the project risks are managed by the project.⁵

- 3.7 ANAO advised that project maturity scores are a composite indicator and are very complex to manage, both through guidance and through the on-the-job work. ANAO acknowledged that there are great difficulties in that type of reporting but that the maturity scores demonstrate a fair presentation of the results over the last 12 months.⁶ The Next Generation Satellite project's score is a good example of this. DMO explained that although the score had experienced a large shift, this reflected the project's status:

...the project [was] actually meeting its objectives. It is to be expected that if a project begins the financial year, say, at a point where we are ahead of testing, and during the financial year the testing is complete, it was successful and we are able to accept the equipment and then introduce it into service—in a year, then the maturity score can move quite quickly to be fully mature.⁷

Inconsistency in the recording and reporting of major risks

- 3.8 In terms of the inconsistency in the recording and reporting of major risks and issues by project offices, and in the terminology and reporting within the mandated Predict! and Excel risk management systems, DMO responded:

I think here—and I think we say it in the report—we have done a lot of work to standardise our risk management systems. We have done a lot of work to standardise our risk management manuals and our risk management guidance. We are trying to get a consolidated approach to risk management across the organisation. I think that will improve now that we have standardised our tools and our risk management methodology and our risk management terminology. I would hope that you would see improvement in that in future reports.⁸

5 Ms Shireane McKinnie, General Manager, Joint Systems and Air, Defence Materiel Organisation, *Committee Hansard*, 27 February 2015, p. 3.

6 Mr Michael White, Executive Director, Assurance Audit Service Group, Australian National Audit Office, *Committee Hansard*, 27 February 2015, p. 3

7 Ms Shireane McKinnie, General Manager, Joint Systems and Air, Defence Materiel Organisation, *Committee Hansard*, 27 February 2015, p. 3.

8 Mr Harry Dunstall, Deputy Chief Executive Officer, Defence Materiel Organisation, *Committee Hansard*, 27 February 2015, p. 10.

Inconsistency in the application of the Capability Assessment Framework

3.9 Finally, with regard to inconsistency in the application of the Capability Assessment Framework DMO responded:

We have struggled to provide, at an unclassified level, capability assessments. Each project has a set of requirements which are defined by the ADF at the outset, and when we do the capability assessment we do look back at how those requirements were set. Each set of requirements does differ and, because of the very wide nature of the projects that we are managing, it is difficult to come up with one methodology.⁹

I think that it is difficult to get a true quantitative approach to this. Inherently, there needs to be some subjectivity to it simply because you might have 100 requirements and you meet 99, but the one requirement that is not met might have a fundamental impact on the delivery of the total capability. So I think, inherently in this, it is going to have to be a qualitative assessment based on judgement.¹⁰

Specific Projects

Collins submarines

3.10 The Collins-class submarine sustainment has been on the list of projects of concern since November 2008. In December 2012, the Coles Report into the Collins-class was published. Key recommendations to deliver long-term improvements for the sustainment and availability of Collins Class submarines include:

- accepting that sustainment of the Collins Class had fallen far short of what was required due to systemic failures attributable to logistic support arrangements not being put in place initially;
- setting realistic performance targets that will progressively improve performance over the next three years;
- clearly defining roles, responsibilities and authority in submarine sustainment; and

⁹ Ms Shireane McKinnie, General Manager, Joint Systems and Air, Defence Materiel Organisation, *Committee Hansard*, 27 February 2015, p. 10

¹⁰ Mr Harry Dunstall, Deputy Chief Executive Officer, Defence Materiel Organisation, *Committee Hansard*, 27 February 2015, p. 10.

- moving quickly to bed-down the new In Service Support Contract between DMO Organisation and ASC to deliver more efficient and effective sustainment.¹¹

3.11 DMO reported on the Collins-class status and what criteria would determine when the project could be expected to be removed from the Projects of Concern list:

I think the implementation of all the Coles reforms really will be the point at which we would be recommending to the minister for removal from the projects-of-concern list. Under each of the projects of concern, the way that process works is that we agree a remediation plan with the relevant contractor, and really it is when the matters that have been agreed in the remediation plan have been given effect to, to our satisfaction, that we would then make the recommendation to remove from projects of concern. So, the remediation plan for Collins is really implementation of the Coles reforms.¹²

MRH90

3.12 In May 2013, the then Minister for Defence and the then Minister for Defence Materiel announced that the MRH90 Helicopters project would be considered for removal from the Projects of Concern list by the end of 2013, following the signing of a Deed of Variation (termed Deed 2) to the original contract, to address commercial, technical and schedule issues. As at June 2014, MRH90 Helicopters is still listed as a Project of Concern as remediation actions are yet to be completed.¹³

3.13 DMO reported on the MHR90 status and what criteria would determine when the project could be expected to be removed from the Projects of Concern list:

The major criterion for that project being removed from the projects of concern is, No. 1, that we establish a commercial settlement with the company on outstanding issues that we had. That has been achieved. The other criterion is to achieve Navy IOC, which has not yet been achieved. There were some delays with that when we had a rotor brake issue on one of the aircraft

11 'Coles Review: The Study Into the Business of Sustaining Australia's Strategic Collins Class Submarine Capability', <<http://www.defence.gov.au/dmo/aboutdmo/currentreviews/colesreview/#sthash.VQS0kG2R.dpuf>> accessed 10 April 2014.

12 Mr Harry Dunstall, Deputy Chief Executive Officer, Defence Materiel Organisation, *Committee Hansard*, 27 February 2015, p. 5.

13 *Major Projects Report 2013-14*, p 89.

while it was on-board *HMAS Stuart* and it took quite some time to bring the ship home to take the helicopter off to diagnose the problem. We have now diagnosed that problem and we understand what the root causes are. Also, we have had issues where the cargo hook on the aircraft does not meet Navy's requirements. We are working on a new design with the company in order to address that issue. It is in use at the moment, but with operational limitations. As part of our final testing, there have also been some issues identified with the electronic warfare self-protection suite. We are going through looking at how we might resolve those issues as well.¹⁴

- 3.14 The Initial Operational Capability (IOC) for the Army variant of the MRH90 has been achieved but the Navy IOC – originally scheduled for July 2010 – had still not been achieved by September 2014.¹⁵ Subsequent information from DMO confirmed that on 25 February 2015, the Chief of Navy declared that the MRH90 had achieved its initial operational capability. The current forecast for achievement of the MRH90s final operational capability is the third quarter of 2019 – some five years behind the original schedule.¹⁶

Air Warfare Destroyers

- 3.15 In June 2014, the Air-Warfare Destroyer (AWD) project was added to the Project of Concern list. As a result, the project was reviewed through a separate government process.
- 3.16 The review, led by former US Secretary of the Navy Professor Don Winter, has provided the government with an independent assessment of the program's costs, schedule and quality of performance as well as identified a range of solutions.
- 3.17 The review – known as the 'White-Winter Report' – identified several causes for the cost and schedule issues, including problems with:
- the initial program plan;
 - inadequate government oversight;
 - the Alliance structure's capacity to manage the project and deal effectively with issues if and when they arose; and

14 Ms Shireane McKinnie, General Manager, Joint Systems and Air, Defence Materiel Organisation, *Committee Hansard*, 27 February 2015, pp. 5-6.

15 *Committee Hansard*, 27 February 2015, pp. 10-11.

16 Department of Defence, *Submission 2*, Question on Notice 3.

■ the performance and capabilities of ASC and major subcontractors.¹⁷

3.18 A joint Department of Finance and DMO remediation strategy is currently underway. Interim arrangements have been put in place and a steering group has been established to give effect to the recommendations in the Winter-White Report. DMO is currently in the process of negotiating the final arrangements to reset the AWD program and this program is expected to identify the triggers for removal from the PoC.¹⁸

3.19 Although the review has not been published in its entirety, DMO explained that:

In effect the recommendations are fourfold. There is:

- the injection of shipbuilding expertise into ASC, and that is happening
- the comprehensive cost and schedule review to be undertaken using external advice, and that is underway
- consideration of the reallocation of blocks between block builders to make better use of the capacity and capabilities, and that has happened – three blocks have been reallocated from ASC across to Williamstown
- is a structural separation within ASC between ASC AWD Shipbuilder Pty Ltd and the submarine business, and that is underway at the moment.¹⁹

3.20 Finally, the MPR notes that the procurement of the electronic warfare radar, electronic attack sub-system been deferred as current technology does not meet the contract and the RAN requirements.²⁰ DMO advised that:

The AWD Alliance is contractually required to deliver the Air Warfare Destroyers with a Radar Electronic Attack (R-EA) capability.

At the time of the R-EA selection process in 2009-10, only 'first generation' systems were available while more powerful 'second generation' systems were expected to be available in 2017-18.

17 Minister for Finance and Minister for Defence – Joint Media Release – 'Putting the Air Warfare Destroyer program back on track', 4 June 2014, <<http://www.minister.defence.gov.au/2014/06/04/minister-for-finance-and-minister-for-defence-joint-media-release-putting-the-air-warfare-destroyer-program-back-on-track/>> accessed 13 April 2015.

18 Mr Harry Dunstall, Deputy Chief Executive Officer, Defence Materiel Organisation, *Committee Hansard*, 27 February 2015, p. 6.

19 Mr Col Thorne, General Manager, Land and Maritime, Defence Materiel Organisation, *Committee Hansard*, 27 February 2015, p. 8.

20 *Major Projects Report 2013-14*, p 192.

Rather than install a system that would require an expensive upgrade early in the ships' life, the Alliance sought to defer procurement of the R-EA until the second generation technology was available. Funding was set aside, and provisions were made to the Air Warfare Destroyer platform design, for the accommodation of the newer R-EA systems.²¹

Committee comments

- 3.21 Projects of high costs and complexity that are not achieving designated milestones remain the key areas of interest for the the Committee and, indeed, DMO and the ANAO.
- 3.22 The review of these projects through the MPR, alongside the separate but complementary ANAO reporting, has now established a practical system of review for Defence acquisition projects. The Committee is generally satisfied with the MPR process and expects to continue to scrutinise these and further projects through this mechanism.
- 3.23 One area not fully encompassed in the MPR is reporting on sustainment after the acquisition phase of the project has been completed. Previous efforts by the Committee to examine further the funds expended through this phase of the equipment's life-cycle have been hampered by the need to not compromise classified information. The Committee is in complete agreement with DMO and the Defence about the need to protect classified information and is now seeking to establish a sustainment reporting process that complements the MPR without compromising national security. Defence sustainment reporting is discussed further in Chapter 4.

21 Department of Defence, *Submission 2*, Question on Notice 2.

Future developments

Introduction

- 4.1 The MPR process has reached a level of maturity which the Committee is generally satisfied with. Although the MPR will continue to be scrutinised as a document, and changes recommended when and where necessary to its content and the development process, the Committee is now seeking to develop further avenues of expenditure reporting to complement the MPR, namely the reporting of funds expended during the sustainment phase of the project's life-cycle.
- 4.2 This chapter will outline initiatives the Committee is pursuing to develop a process for sustainment reporting which allows transparency and yet maintains national security.
- 4.3 This chapter will also provide comment on the continued MPR process, given that DMO will now be folded back into the Department of Defence.

Sustainment spending and reporting

- 4.4 Once a project has been deemed complete, it moves to the sustainment phase of its life-cycle. Sustainment relates to the provision of ongoing parts, supplies, services and (sometimes) upgrades to Defence systems and assets. While sustainment activities are outside the scope of the MPR, which is focused on acquisition projects, the amount of expenditure on sustainment is too large for the JCPAA to ignore.¹

1 The *Defence Annual Report 2013-14* Table W6.17 provides a list of the top 30 sustainment products by expenditure as forecast in the Portfolio Budget Statements 2013-14. There, the 'Actual Expenditure for 2013-14' of 'Total Sustainment Product Funds Available' is listed as slightly over \$5 billion. <<http://www.defence.gov.au/annualreports/13-14/part->

- 4.5 The Committee has sought, in conjunction with DMO/Defence and ANAO, to establish a mechanism through which sustainment reporting can be scrutinised. Objections by DMO/Defence have centred on security issues – i.e. that more detailed reporting of sustainment in the public arena would compromise national security. The Committee is in complete agreement with DMO and the Defence about the need to protect classified information, but still has sought a process through which sustainment acquisition could be reviewed.
- 4.6 In September 2014, the Committee resolved to request a sustainment options paper from ANAO to explore the best procedure for exploring sustainment funding while still protecting classified information and maintaining national security. This paper was provided to the Committee which then resolved to make it a public document in February 2015.²
- 4.7 The ANAO developed the following four options for further sustainment reporting for the Committee's consideration:
- **Option 1:** Provision of an annual *in-camera* briefing. Defence, through the Vice Chief of the Defence Force, has offered to provide an annual in camera briefing to the JCPAA, to expand on the unclassified sustainment reporting included in publicly available reports, for example, the Portfolio Budget Statements and Defence Annual Report;
 - **Option 2:** Continued expansion of sustainment reporting for the Top 30 sustainment products in the Defence Annual Report. Following recent Parliamentary and JCPAA interest, Defence has agreed to improve consistency and seek opportunities to improve the current analysis regarding performance targets and achievements within publicly available reporting. The new sustainment Key Performance Indicators being developed for Defence for Materiel Sustainment Agreements also offer opportunities for increased reporting and in addition, the information could be made more structured and comprehensive, subject to any security considerations;
 - **Option 3:** Expansion of the MPR to include further sustainment reporting. Ongoing developments to the MPR have provided for the inclusion of a range of diverse projects. This includes unique arrangements, for example, the Collins Reliability and Sustainability project, which consists of two new capabilities and 20 engineering enhancements, and two projects that are transitioning to sustainment (Collins Replacement Combat System and ARH Tiger Helicopters). Consideration of the criteria for the 2015–16 MPR Guidelines could

two/chapter-six/program-1-02.asp> accessed 30 April 2015.

2 ANAO, *Submission 1*.

further expand the scope of sustainment products included within the MPR; and

- **Option 4:** Development of a new sustainment report and limited assurance review. The experiences of the DMO and the ANAO in producing the MPR could be utilised to develop a complementary and separate sustainment focussed report. However, security concerns surrounding the public reporting of sustainment matters are elevated under this option and would need to be addressed.³

4.8 In March 2015, the Committee met with the Vice Chief of the Defence Force, VADM Griggs, and associates from the DMO to discuss ways forward on sustainment reporting to Parliament and the JCPAA. It was decided an *in-camera* briefing would be conducted in October 2015 consistent with Option 1 of the ANAO Sustainment Reporting Options Paper.

Committee Comment

4.9 The Committee appreciates the work done by ANAO, in consultation with DMO and Defence, on the Sustainment Options Paper and acknowledges and appreciates the openness with which Defence and DMO are willing to approach the question of sustainment reporting. Their position – that all information is up for discussion as long as national security is not undermined – is constructive and the Committee looks forward to working with both Defence and ANAO on developing a process which satisfies the Committee’s requirements for transparency while still maintaining security requirements.

4.10 Sustainment expenditure is currently at approximately \$5 billion⁴ per annum and predicted to increase significantly over time. The Committee considers sustainment expenditure to be an area requiring further parliamentary scrutiny on the adequacy and performance of Defence involving billions of dollars in the future.

4.11 One aspect of sustainment reporting that needs more attention is the definition of what is ‘sustainment’. Which aspects of project management for weapons, platforms and equipment are ‘acquisition’ and which are ‘sustainment’? For different projects, ‘sustainment’ may mean different

3 ANAO Sustainment Reporting Options Paper, *Submission 1*, pp. 1-2. A copy can be found at: <http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Public_Accounts_and_Audit/2013-14_DMO/Submissions> accessed 14 April 2014.

4 The *Defence Annual Report 2013-14* Table W6.17 <<http://www.defence.gov.au/annualreports/13-14/part-two/chapter-six/program-1-02.asp>> accessed 30 April 2015.

- things and while drawing a line between 'acquisition' and 'sustainment' might be clear for one project, that line might be quite blurry for another.
- 4.12 Resolution, or at least discussion of, such questions will be crucial to define what actual information is required by the Committee from Defence. Clarity of purpose and information will greatly assist all those involved in this process to produce an accurate assessment of sustainment expenditure, and how best to examine and report on that expenditure without compromising national security.
- 4.13 The final structure for sustainment reporting – i.e. whether it will remain as just Option 1 or whether the JCPAA pursues other options as well – is as yet undecided. At this stage it appears likely that sustainment reporting be an evolutionary process until both the Committee and Defence are comfortable with a final structure, not unlike the development of the MPR itself. We will continue to consult with ANAO and Defence as the process evolves.

Structural changes to Defence

- 4.14 In April 2015, the Minister for Defence, the Hon Kevin Andrews, announced a series of reforms for the Department of Defence. One of the reforms announced through the *First Principles Review: Creating One Defence* policy paper⁵ was the abolition of the DMO and the return of its functions to the broader Department of Defence through a new capability and sustainment group which will have a life-of-project orientation.⁶
- 4.15 Since the 2003 Kinnaird Review, DMO has significantly improved the Defence acquisition process. In 2008, the Mortimer Review concluded that:
- The implementation of the Kinnaird Review recommendations has resulted in wide-ranging reform and improvement in the capability development process in Defence, and the acquisition process in DMO.⁷
- 4.16 This is also acknowledged in the 2013-14 MPR:

5 *First Principles Review: Creating One Defence*, <<http://www.defence.gov.au/publications/reviews/firstprinciples/Docs/FirstPrinciplesReview.pdf>> accessed 1 May 2015.

6 Minister for Defence – Transcript – The First Principles Review announcement – 1 April 2014, <<http://www.minister.defence.gov.au/2015/04/01/minister-for-defence-transcript-the-first-principles-review-announcement-1-april-2014/>> accessed 13 April 2015.

7 <<http://www.defence.gov.au/publications/mortimerreview.pdf>> accessed 1 May 2015.

MPR projects which were initiated post the 2003 Kinnaird review continue to demonstrate improvement in schedule performance, confirming the value of the reforms implemented in the DMO since that time, and in particular following the DMO becoming a prescribed agency on 1 July 2005. It is interesting to observe that the pre-Kinnaird projects within the MPR sample continue to have a disproportionate influence on the reported schedule performance.⁸

4.17 The Auditor-General was asked about this potential reform at the public hearing of 27 February 2015. He responded:

I think we need to be careful not to dismiss the contribution DMO has made here. I know that internally, within the defence organisations, there are movements about how to get greater efficiencies from the way they combine back offices and other arrangements. DMO has provided a critical mass of skills, but it has meant that the capability managers have had to adjust their approaches as well. So there is not an easy answer and, to be fair, we have not seriously looked at the pluses and minuses. In the past, it has been integrated, and it has been separated, and the debate now is just: where is the balance? And I think that is a question we see asked all across the public sector, in terms of where the balance is... It is a never-ending journey, this one.⁹

Committee comment

4.18 The Committee, along with ANAO, DMO and the Department of Defence, have worked diligently and constructively over the past eight years to progress the MPR to where it is today.

4.19 DMO's achievements during this period were substantive and it is imperative that the progress achieved over the past eight years should not be lost as a result of the *Creating One Defence* reforms.

4.20 The reforms to the Department are designed to bolster efficiency and they must not result in a diminution in the intensity with which Defence approaches its work. The Committee looks forward to working with the new reformed Department of Defence to produce the same high-quality MPR in the future so as to ensure that the improvement gains made in terms of project acquisition management over the past eight years are maintained and improved upon. This also applies to the new sustainment

8 'CEO DMO Foreword', *Major Projects Report 2013-14*, p. 101.

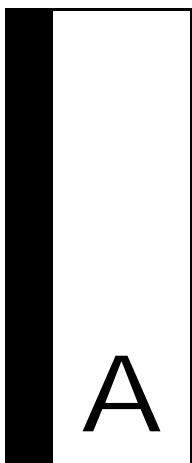
9 *Committee Hansard*, 27 February 2015, p. 14.

reporting that the Committee, ANAO and Defence are now embarking upon.

Recommendation 1

The Committee recommends that the reformed Department of Defence continues to provide the same priority and appropriate resources to the Major Projects Report in the future as DMO have done in the past so that the achievements of the past eight years are not lost. The same level of effort should also apply to the future development of sustainment reporting.

Dr Andrew Southcott MP
Chair



Appendix A - Submissions

1. Australian National Audit Office
2. Department of Defence



Appendix B – Public Hearings

Friday 27 February 2015

Defence Materiel Organisation

Mr Harry Dunstall, Deputy Chief Executive Officer

Mr Steven Wearn, Chief Finance Office

Ms Shireane McKinnie, General Manager

Mr Col Thorne, General Manager

Department of Defence

Vice Admiral Ray Griggs, Vice Chief of the Defence Force

Australian National Audit Office

Mr Ian McPhee, Auditor-General

Mr Michael White, Executive Director

Mr Tony Steele, Senior Director