

## Performance Audit Report No. 52 (2014-15)

# ADF's Medium and Heavy Vehicle Fleet Replacement (Land 121 Phase 3B)

- 2.1 Chapter 2 focuses on the Joint Committee of Public Accounts and Audit (JCPAA) review of Australian National Audit Office (ANAO) Audit Report No. 52 (2014-15) *Australian Defence Force's Medium and Heavy Vehicle Fleet Replacement (Land 121 Phase 3B)*. The chapter comprises:
- inquiry context and background
  - ANAO report overview
  - Committee review
  - Committee comment

## Inquiry context and background

- 2.2 Project Overlander Land 121 is a multi-phased project to provide the Australian Defence Force (ADF) with new field vehicles and trailers to enhance ground mobility. Phase 3B<sup>1</sup> of the project is to acquire medium and heavy trucks, modules and trailers, at a budgeted cost of \$3.386 billion. The vehicles are a core element of ADF capability, and essential for the conduct of operations. They will be used for the movement of Army troops, assets and supplies in combat theatres,

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<sup>1</sup> Phase 3B forms the medium and heavy field vehicle, module and trailer component of Project Overlander LAND 121. Other current phases of Land 121 include Phase 3A light/lightweight vehicles; and Phase 4 Protected Mobility Vehicle. The ANAO report generally refers to Project Overlander LAND 121 Phase 3B as the medium and heavy vehicle fleet acquisition.

humanitarian operations, natural disaster relief, general peacetime operations and training.<sup>2</sup>

- 2.3 Land 121 Phase 3 received government first-pass approval in June 2004. At the time, the Department of Defence (Defence) considered that the medium and heavy vehicle acquisition was a relatively low risk military off-the-shelf (MOTS) procurement. Defence originally released a Request for Tender (RFT) for the medium and heavy vehicle segment in December 2005, but decided to retender in December 2008, due to concerns over the selected vehicles. Key milestones for the acquisition included:
- in August 2007, Defence received government second-pass approval to enter negotiations with Stewart and Stevenson as the supplier for the Phase 3B vehicles and modules, and with Haulmark Trailers for the Phase 3B trailers;
  - in August 2008, Defence withdrew from negotiations with Stewart and Stevenson, citing technical and probity issues, and a tender resubmission process was initiated;
  - in April 2011, Defence endorsed Rheinmetall MAN Military Vehicles–Australia (RMMV-A) as the preferred supplier for the vehicles and modules, and Haulmark Trailers was confirmed as the preferred supplier for the provision of trailers; and
  - in July 2013, Land 121 Phase 3B received a revised government second-pass approval and Defence entered into contracts with RMMV-A and Haulmark Trailers.<sup>3</sup>
- 2.4 Defence is acquiring 2,536 medium and heavy trucks, and 2,999 modules, from RMMV-A; and 1,582 trailers from Haulmark Trailers. The total number of vehicles being acquired under Phase 3B is, however, 2707 following a decision to also acquire 122 Mercedes-Benz G-Wagon vehicles and 49 Thales Bushmaster vehicles. The capability will comprise a variety of vehicles including semi-trailers, recovery trucks, hook lift trucks and flatbeds in both protected and unprotected configurations.<sup>4</sup>

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2 ANAO Audit Report No.52 (2014-15), p. 11.

3 ANAO Audit Report No.52 (2014-15), pp. 11-12.

4 ANAO Audit Report No.52 (2014-15), p. 12.

## ANAO report overview

### Audit objective and scope

- 2.5 The ANAO's audit objective was to assess the effectiveness of Defence's management of the acquisition of medium and heavy vehicles, associated modules and trailers for the ADF. The audit focused on the acquisition of the medium and heavy vehicle fleet from first-pass approval in 2004 through to early 2015.<sup>5</sup>
- 2.6 The high-level criteria developed by ANAO to assist in evaluating Defence's performance were:
- requirements definition, acquisition strategies and plans, and capability development processes met Defence policy and procedures;
  - procurement processes complied with the *Financial Management and Accountability Act 1997* (FMA Act) and Regulations, and other relevant Commonwealth and Defence procurement requirements; and
  - the acquisition has progressed to the expectations of the Commonwealth in terms of cost, schedule and delivery of required capability.<sup>6</sup>

### Audit conclusion

#### Delayed capability

- 2.7 ANAO's assessment of Defence's initial tender process to acquire a replacement medium and heavy vehicle fleet was that this was flawed, resulting in a failed tender and a second approach to market, which contributed to long delays in the acquisition of a modern medium and heavy vehicle capability.<sup>7</sup>
- 2.8 ANAO reported that Defence conducted a more effective tender resubmission process from 2008, but the process was protracted and Defence did not enter into contracts to supply the replacement fleet until July 2013. The aborted initial tender process and the time taken to finalise the tender resubmission process have delayed the scheduled achievement of Final Operational Capability by seven years to 2023. In the intervening period, Defence will continue to rely on an aged fleet of medium and heavy vehicles that is increasingly costly to operate, maintain and repair.<sup>8</sup>

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5 ANAO Audit Report No.52 (2014-15), p. 13.

6 ANAO Audit Report No.52 (2014-15), p. 13.

7 ANAO Audit Report No.52 (2014-15), p. 14.

8 ANAO Audit Report No.52 (2014-15), p. 14.

## Initial tender

- 2.9 Defence originally considered that the medium and heavy vehicle acquisition was a relatively low risk military off-the-shelf procurement. ANAO assessed that the difficulties subsequently experienced by Defence in acquiring a new medium and heavy vehicle fleet can mostly be attributed to shortcomings in its initial tender process between 2005 and 2007. Defence did not conduct any preliminary test and evaluation of vehicles before recommending a single supplier to the then Government. In selecting a preferred supplier, the ANAO assessed that Defence also did not have sufficient regard to all relevant costs and benefits identified in its tender evaluation process, so as to adhere to the Government's core principle of value for money. Defence's 2007 Source Evaluation Report initially ranked a proposal from Stewart and Stevenson last of five tenders on the basis of value-for-money, but elevated the proposal to the position of preferred tender because it was the most affordable – notwithstanding Defence's assessment of significant vehicle deficiencies against its specific requirements, and the identification of many acquisition risks in the course of the tender process.<sup>9</sup>
- 2.10 Further, ANAO reported that Defence did not advise Ministers of the significant capability and technical risks it had identified, before recommending a single supplier. Defence confirmed the previously identified shortcomings through test and evaluation after the acquisition entered an Offer Definition and Refinement Process, and the preferred supplier's vehicles were tested. Defence subsequently cancelled contract negotiations with the preferred supplier.<sup>10</sup>

## Tender re-submission

- 2.11 In December 2008, Defence again approached the market and implemented a more robust tender process, drawing on key lessons learned from the initial tender process. Defence conducted preliminary test and evaluation of vehicles supplied by five companies, before shortlisting three suppliers and asking them to submit tenders. In April 2011, Defence selected RMMV-A as its preferred vehicle supplier on the basis of value-for-money. However, the protracted Offer Definition and Refinement Process with RMMV-A required escalation to senior leaders and, as a consequence, Defence was not in a position to approach the then Government for second-pass approval until July 2013.<sup>11</sup>

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9 ANAO Audit Report No.52 (2014-15), pp. 14-15.

10 ANAO Audit Report No.52 (2014-15), p. 15.

11 ANAO Audit Report No.52 (2014-15), p. 15.

## Capability

- 2.12 ANAO reported that Defence has not applied a rigorous approach to capability definition throughout the acquisition of the medium and heavy vehicle fleet. Defence did not complete or update its mandated Capability Definition Documents for the initial and revised government second-pass approvals in 2007 and 2013, or when negotiating and entering into contractual arrangements. Defence also developed a variety of non-standard documents to compensate for the absence of updated Capability Definition Documents; an approach which unnecessarily added to procurement risk. In addition, Defence applied different methodologies over time to determine the acquisition's Basis of Provisioning,<sup>12</sup> a process intended to measure the number of each vehicle type required by Army to meet its capability objectives. Further, Defence's Basis of Provisioning for the medium and heavy vehicle fleet has been amended on many occasions during the acquisition process to reflect the number of vehicles Defence could afford, rather than the number of vehicles it required to deliver the defined capability – a pragmatic approach which did not align with the key purpose of the Basis of Provisioning process. In the light of this experience, ANAO advised that Defence should review its 1999 Instruction to provide contemporary guidance on the Basis of Provisioning for the acquisition of specialist military equipment for the ADF.<sup>13</sup>
- 2.13 Defence advised that, as at March 2015, total expenditure on the medium and heavy vehicle fleet acquisition was \$112 million, with most expenditure to be incurred from mid-2016 when truck production commences. Defence further advised that there was sufficient budget remaining for the project to complete against its agreed scope, and the project had not applied any contingency funding to date. Under applicable budgeting arrangements, Defence is able to use approved funding later in the project, if it is not spent at the time initially anticipated due to project delays.<sup>14</sup>

## Systems integration

- 2.14 Defence remains confident that it will meet the acquisition's current critical milestones, the first being the commencement of Introduction Into Service Training in September 2016. Key issues that have affected the
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12 The Basis of Provisioning is a process for determining and recording the quantity of an asset that Army is required to hold in order to support preparedness and mobilisation objectives. Defence, Defence Instruction (Army) 64-1 Basis of Provisioning, December 1999, p. AL1 cited in ANAO Audit Report No.52 (2014-15), p. 19.

13 ANAO Audit Report No.52 (2014-15), pp. 15-16.

14 ANAO Audit Report No.52 (2014-15), p. 16.

project since contract signature include: delays experienced by RMMV-A in engaging sub-contractors to develop modules; and a range of systems integration issues. The ANAO has previously observed that cost and schedule risks tend to rise when acquisition programs approach the complex stage of systems integration, and Defence will need to maintain a focus on managing the remaining integration issues. Defence has worked with RMMV-A to manage the vehicle production schedule and production of the initial test vehicles commenced in April 2015.<sup>15</sup>

### Budgeted expenditure and value-for-money

- 2.15 The overall project delay of seven years has obliged Defence to continue to operate its in-service fleet of vehicles, delivered between 1982 and 2003. The current fleet is becoming increasingly unreliable and costly to maintain, and Defence has sought to achieve savings by disposing of uneconomical vehicles. While Defence currently expects to deliver the project within budget, the audit illustrates the impact of protracted procurement and approval processes on both Defence and industry suppliers.<sup>16</sup>
- 2.16 Against a background of other major Land Systems acquisitions approaching key milestones, this audit underlines the benefits of early test and evaluation of prospective vehicles, which strengthen Defence's ability to identify and mitigate risks, and provide informed advice for decision-making on a preferred supplier. Further, having commenced a tender process, Defence needs to keep in view the Government's core rule of achieving value-for-money, which continues to require consideration of relevant financial and non-financial costs and benefits of each proposal.<sup>17</sup>

### Audit recommendations

Table 2.1 ANAO recommendations, Audit Report No.52 (2014-15)

1	<p>To provide greater certainty in the development of relevant assessments and advice, the ANAO recommends that Defence develop contemporary guidance on the Basis of Provisioning for the acquisition of specialist military equipment for the Australian Defence Force.</p> <p><b>Defence response:</b> <i>Agreed.</i></p>
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15 ANAO Audit Report No.52 (2014-15), pp. 16-17.

16 ANAO Audit Report No.52 (2014-15), p. 17.

17 ANAO Audit Report No.52 (2014-15), p. 17.

## Committee review of evidence

- 2.17 The Committee's key sources of evidence for this inquiry were the ANAO's audit report, evidence given by representatives from the ANAO and Defence at the Committee's public hearing on 3 March 2016, and agency submissions (see details of public hearings and submissions at Appendixes A and B). The Committee also investigated relevant public sector frameworks.
- 2.18 The Committee focused on the following matters:
- implementation of ANAO recommendations
  - initial tender: poor test and evaluation
  - initial tender: flawed value-for-money assessment
  - initial tender: advice to Ministers
  - ultimate extra cost of failed process
  - accountability: who was responsible and what happened to them?
  - new risk assessment procedures through First Principles Review

## Implementation of ANAO recommendations

- 2.19 At the public hearing, Defence provided an update on implementing the ANAO recommendation:

Defence Instruction (Army) Administration 64-1 forms the basis of provisioning guidance and is the extant policy on [Basis of Provisioning], with the extant document released on 10 December 1999. A significant rewrite has been undertaken as a result of the audit, to bring it up to contemporary demands. This contemporary approach has been effectively used recently on a trial basis in the approval of Land 121 Phase 4. The draft rewrite of the DIA admin 64-1 has been completed and is now out for consultation and discussion with subject matter experts, both internal and external to Army, for review. Army expects to have the review comments finalised by 1 April 2016, with the updated policy released no later than 1 July 2016.<sup>18</sup>

- 2.20 Defence also provided an example of where it had put its improved processes into practice:

The audit report, quite appropriately, told us to revise that process... Under the Hawkei provision, for example, we have a

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18 Major General Fergus McLachlan, Head, Modernisation and Strategic Planning, Army, Department of Defence, *Committee Hansard*, 3 March 2016, p. 1.

provision inside the Defence Capability Plan, as it was then – it would now be the Integrated Investment Program – that reflects what we have to achieve our acquisition under. We do the best we can in partnership with our acquisition agency as they go into a contract negotiation with the supplier to get the price down to the extent that is possible. We make cost/capability trade-offs through that process... We made sensible trade-offs about the number of those that we would need and we came up with a number for the vehicles that was short of our optimum but was better than we had at the start of the process. The simple reality is that it is a process that we have to responsibly take within the provision that we have been allocated by government.<sup>19</sup>

2.21 Finally, Defence also explained what procedure have been put in place to meet the LAND 121 acquisition's current critical milestones:

As far as schedule is concerned, we are now on schedule and on budget. There were some initial delays with Rheinmetall MAN Military Vehicles in providing a level of technical support required, and Rheinmetall has markedly improved its performance in this area. The issue was raised to board level. There is a weekly videoconference between Victoria Barracks, Melbourne, and Germany at a senior level to ensure that we remain on track.

The first vehicles have arrived in Australia. They arrived last month and the first 12 vehicles will be delivered by April 2016. As far as trailers are concerned, we are slightly ahead in trailers of where we need to be and the modules are on track.<sup>20</sup>

## Initial tender: poor test and evaluation

2.22 Defence was asked to explain the failure of process where they did not conduct any preliminary test and evaluation (T&E) of vehicles before recommending a single supplier to the then Government. Defence responded:

The initial issue with this as a test and evaluation was that the initial acquisition predated the formal establishment of the Australian Defence Test and Evaluation Office. There were some elements of policy and process that we had not fully resolved in terms of how we would plan for and conduct preview T&E [test

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19 Major General Fergus McLachlan, Defence, *Committee Hansard*, 3 March 2016, p. 7.

20 Major General David Coghlan, Head, Land Systems Division, Department of Defence *Committee Hansard*, 3 March 2016, p. 3.



and evaluation]. In the initial acquisition, based on the assessment that this was an off-the-shelf acquisition with elements of commercial off-the-shelf and elements of military off-the-shelf, the decisions that were taken at that time suggested that we did not need to conduct detailed preview test and evaluation.<sup>21</sup>

2.23 Importantly, Defence itself acknowledged the ANAO's criticisms:

I fully accept the criticisms of the audit office here that, with hindsight, we should have done a much better job in the way we conducted this test and evaluation and the risks we took. At the time, the people who were there obviously made an assessment and made that decision. With hindsight we accept the recommendations of the audit office, but we also have implemented, through the recommendations of the *First Principles Report*, a significant change to the T&E regime and the risk assessments that we do when there is an environment where there is a modification or there is a requirement to take a commercial off-the-shelf piece of equipment. I think at that point in time we were probably in an environment where we were just taking COTS vehicles at face value without actually understanding the true risk, and we have learnt from that. We are looking at a number of different acquisitions at the moment, and we are doing things very differently these days.<sup>22</sup>

2.24 Defence outlined its risk management approach to this area at the time:

The dilemma between first and second pass in the early stages of LAND 121 Phase 3B certainly illustrated very clearly the risk of: no matter how mature we think a design might be, the risk was in relying on what ended up being a paper based down-selection based on advice from the suppliers or the tenderers that were involved at the time and involving only the tendered documents of would-be suppliers to make those assessments. It results in a situation where Defence engineers have misunderstood or not fully understood the technical and performance risks in those tenders without the accompanying opportunity to do the preview test and evaluation. In effect, that is where we are now going... [T]he assessment at the time, based on the data that we had, in accordance with the procurement rules, was that the risks were tolerable and that the understanding of the detail and data that

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21 Air Vice Marshal Mel Hupfeld, Acting Chief, Capability Development Group, Department of Defence, *Committee Hansard*, 3 March 2016, p. 2.

22 Mr Kim Gilles, Deputy Secretary, Capability Acquisition and Sustainment Group, Department of Defence, *Committee Hansard*, 3 March 2016, p. 4.

was provided by the tenderers was of sufficient quality and technical coherency that we would be able to proceed without doing any test and evaluation. And, indeed, as I said, our test and evaluation policy and process then was not as robust as it is now.<sup>23</sup>

- 2.25 Defence further explained what measures they were putting in place to address the mistakes made:

We are now putting policy governance and process in place to address how we would do preview test and evaluation in the future to learn lessons from what has occurred under Land 121 Phase 3B. The key point is that it is still a risk based approach to take to look at what is necessary given that there are significant costs involved in doing any sort of test and evaluation, including preview test and evaluation. That was omitted in the first part of the acquisition phase for Land 121 Phase 3B.<sup>24</sup>

### Initial tender: flawed value-for-money assessment

- 2.26 There was also interest in further understanding why, in the initial tender, Defence had elevated the most affordable tender above all other tenders despite it initially being ranked last of five on a value-for-money basis and since Defence had already assessed the proposal as having significant vehicle deficiencies against its specific requirements and many acquisition risks.<sup>25</sup>

- 2.27 Importantly, the ANAO noted that Commonwealth procurement guidelines at the time:

...had an expectation that in assessing value for money in a procurement context there would be a comparative analysis of all relevant costs and benefits throughout the procurement cycle. The point we were making in the audit ... was that it seemed inconsistent with that general principle in the procurement guidelines of the day ... that somehow in this process – which had competitive elements; it was not a sole source; I think there were five tenderers in the process – for some reason the least competitive on an important set of dimensions was elevated to the key position.<sup>26</sup>

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23 Air Vice Marshal Hupfeld, Defence, *Committee Hansard*, 3 March 2016, pp. 3-4.

24 Air Vice Marshal Hupfeld, Defence, *Committee Hansard*, 3 March 2016, p. 2.

25 ANAO Audit Report No.52 (2014-15), pp. 14-15.

26 Dr Tom Ioannou, Group Executive Director, Performance Audit Services Group, Australian National Audit Office, *Committee Hansard*, 3 March 2016, p. 4.

## Initial tender: advice to Ministers

- 2.28 Defence acknowledged that the then Defence Minister had not been advised of the significant capability and technical risks it had identified, before recommending a single supplier.<sup>27</sup> When asked why the Minister hadn't been informed, Defence responded:

The preferred tenderer was advised to Government in August 2007 as part of Second Pass approval where the technical risk was assessed as medium. This did not involve the selection of a particular vehicle. The preferred approach was to proceed to an Offer Definition and Refinement Period (ODRP) with a single preferred tenderer. Government was advised that prior to contract signature Defence would define, refine and confirm the tendered offers based on the key issues, activities and deliverables identified during evaluation.

A comparative ODRP to mitigate risk leading to final source selection occurred in the second quarter of 2008.

Introductory negotiations during the ODRP, along with a vehicle demonstration and compliance test, identified an increased level of technical risk and gave rise to significant concerns with the preferred tenderer's capacity to deliver against its tendered offer.

Due to increased levels of technical, cost and schedule risk identified, Government was advised in June 2008 that Defence could exercise its discretion under the conditions of tender and invite all initial tenderers back into the evaluation process, and initiate a tender resubmission process.<sup>28</sup>

## Ultimate extra cost of failed process

- 2.29 Questions at the public hearing investigated whether revisions to the acquisition over time may have resulted in less protected and more unprotected vehicles being purchased, but for higher overall cost. Defence was asked to provide more definitive numbers of protected and unprotected vehicles and the reason for the significant increase in cost.<sup>29</sup> In response, Defence provided the following tables<sup>30</sup> that give exact number of vehicles:

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27 ANAO Audit Report No.52 (2014-15), pp. 64-65.

28 Department of Defence, *Submission 4.1*, p. 7.

29 Acting Chair, Mr Pat Conroy MP, *Committee Hansard*, 3 March 2016, p. 7.

30 Tables are included in Department of Defence, *Submission 4.1*, p. 10.

<b>Basis of Provisioning at 2007 2nd Pass</b>		
<b>Total BOP<sup>31</sup></b>	<b>Protected</b>	<b>Unprotected</b>
2471	1433	1038

<b>Basis of Provisioning at 2013 - 2nd Pass</b>		
<b>Total BOP<sup>32</sup></b>	<b>Protected</b>	<b>Unprotected</b>
2707	1172	1535

2.30 Defence also provided the following comparison of the Second Pass approval costs for the original proposal of 2007, and the second in 2013:

The total cost of the Medium-Heavy Capability element of LAND 121 Phase 3 at the 2007 Second Pass approval was \$2,572.5 million (2012-13 Portfolio Budget Statement Outturned).

The total cost of LAND 121 Phase 3B (Medium-Heavy Capability) at the 2013 Second Pass approval was \$3,298.2 million (2013-14 Portfolio Budget Statement Outturned).

The difference between the 2007 and 2013 figures is \$725.7 million. This included \$712.2 million of LAND 121 supplementation approved by Government as part of the second pass approval to deliver the required capability. Key factors included an increase in vehicle numbers under a revised basis of provisioning; changes to operational requirements (including updated requirements for digitisation); and changes to legislative requirements (including environmental and work health and safety).

A further \$13.5 million was received to provide for exchange rate variation between June 2012 and Second Pass approval in 2013.<sup>33</sup>

2.31 In addition, Defence was asked what the overall total cost of the delay in providing the new vehicles has been. Defence responded:

The cost of the LAND 121 Phase 3B acquisition delay is approximately \$25 million (excluding GST).<sup>34</sup>

31 Basis of Provisioning

32 Basis of Provisioning

33 Department of Defence, *Submission 4.1*, p. 11.

34 Department of Defence, *Submission 4.1*, p. 1

## Accountability: who was responsible and what lessons have been learned?

- 2.32 The Committee has, in the past, asked questions about whether there are ramifications for the senior executives of organisations involved in making poor procurement and management decisions.
- 2.33 The Committee again asked Defence whether there were ramifications for the individuals involved when mistakes have been acknowledged, noting that the Committee did not seek any information that would identify the individuals. The committee merely sought information as to whether there were any disciplinary or other consequences for the individuals that made the poor procurement and management decisions. However, at the time of finalising this report Defence had not responded to this question. The Committee looks forward to receiving a response and remains interested in this matter.
- 2.34 Defence were also asked how corporate knowledge is maintained regarding T&E – i.e. how will the lessons learnt from projects such as LAND 121 Phase 3B be kept and transferred to new staff. Defence responded:

Corporate knowledge is maintained through the standardisation of Test and Evaluation (T&E) documents such as the Test Concept Document (TCD) at First Pass, the Early Test Plan at Second Pass and the Test & Evaluation Master Plan (TEMP) post Second Pass. These documents are endorsed and approved by senior stakeholders at a One Star/SES Band 1 level and ensure continuity of the test planning phase. Trial Reports are also approved by the senior T&E manager in an agreed policy and quality accredited format, which are formal Defence records.

Knowledge transfer can be a challenge particularly relating to staff turn-over. Military posting cycles allow for a three year period and, in the main, members are able to conduct a handover to ensure corporate knowledge is maintained, with postings promulgated 3-6 months in advance. Australian Public Service employees tend to stay longer and provide consistency in regard to corporate knowledge.

Knowledge transfer in Defence is encouraged through a number of initiatives such as mentoring, networking, and transition to retirement programs. In addition, some areas of Defence plan a staggered rotation of staff, and some flexibility exists to extend military staff for an additional year to assist with this planning. The individual T&E competencies for Defence are now being reviewed through a formal Skills Census that commenced 7 March

2016 and is due to be completed by 27 May 2016. The results will be used to improve T&E training and management, as recommended by the ANAO audit Test and Evaluation of Major Defence Equipment Acquisitions, Report No 9, 2015-16, and to update the current policy in the Defence Capability Development Manual.<sup>35</sup>

## New risk assessment procedures through *First Principles Review*

2.35 The *First Principles Review*, announced in April 2015, is a fundamental re-structure of Defence, particularly with regard to equipment procurement and sustainment given the abolition of the Defence Materiel Organisation and the re-absorption of its functions into the Department proper.

2.36 Defence explained the relationship between the *First Principles Review* and the improvement of procurement and T&E policies:

The *First Principles Review* is certainly one of the strong elements that would look at addressing some of these concerns. It certainly drives to accountabilities within the department and details those accountabilities at every phase of the capability life cycle. The Department of Defence is committed to that and we are obliged to return to government based on their commissioning of the report. We have to report back and demonstrate that we are implementing under the *First Principles Review*...

Inevitably, the business that we are in is about trying to balance affordability against the capability needs that we have and making the appropriate trade-offs to provide government with the best options to deliver the capability that is required to meet the strategic requirements that are given for the Department of Defence. Those trade-offs entail assessment of risk. What we have been discussing this morning is being able to better understand, articulate and then make appropriate recommendations to government for approvals based on those risks to get the best possible outcomes that we can so that we get efficiency in both the acquisition and then ongoing sustainment. The *First Principles Review* goes to the heart of those issues. We are right in the middle of planning those elements. We will shortly start to implement, once we gain approvals through the appropriate senior leadership of the department up to government.<sup>36</sup>

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35 Department of Defence, *Submission 4.1*, pp. 4-5.

36 Air Vice Marshal Hupfeld, Defence, *Committee Hansard*, 3 March 2016, pp. 5-6.

2.37 Defence explained how its new smart buyer model was consistent with what the *First Principles Review* was trying to achieve. When asked about 'undue processes' in the long LAND 121 acquisition process in comparison with the much shorter acquisition of similar vehicles conducted by New Zealand,<sup>37</sup> Defence responded:

I think you have just synthesised what the new capability development life cycle is, the smart buyer model, the *First Principles* and what Defence is implementing currently, which is that, for these types of processes, there are smarter acquisition processes... In essence, the change that has happened – and it is currently happening as we speak – the move towards the new capability development life cycle, which is a risk based assessment, against what is the best acquisition strategy for less complex, complex and significantly complex acquisitions, and the smart buyer model which is: how would a very efficient and effective organisation best utilise its resources to buy equipment for the Defence Force? That is the undertaking that I have on behalf of the secretary in CDF.<sup>38</sup>

## Committee comment

2.38 The results of the LAND 121 Phase 3B acquisition process emphasise the need for better risk management practices for Defence acquisition projects.

2.39 The failed first tender process resulted in an estimated seven-year delay to delivering the vehicles and a need to sustain the existing fleet far beyond initial specifications. The total cost to taxpayers has been quantified by Defence at \$25 million. However, Defence only provided an annual cost,<sup>39</sup> and therefore the total cost of sustaining the existing fleet remains unknown. The Committee is disappointed that a comprehensive answer

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37 Relating specifically to LAND 121 Phase 3, the *Asia Pacific Defence Reporter* made an unfavourable comparison between Australia and New Zealand which had also ordered Rheinmetall MAN Military Vehicles Australia (RMMV-A) trucks. They said:

*Compare this to the situation in New Zealand, where their Department of Defence announced on May 15 the acquisition of 200 Rheinmetall-MAN vehicles for NZ \$135 million...*

*Despite ordering vehicles of identical complexity to Australia's, the NZDF will take delivery of all of their trucks by the end of 2014 – at least two years earlier than the ADF. Every New Zealand truck will be in service by the end of 2015, while the last of Australia's will still be arriving in 2020.*

Bergmann, K., "Truck contract – is this finally the end?" *Asia Pacific Defence Reporter*, 25 August 2013, <<http://www.asiapacificdefencereporter.com/articles/319/LAND-121-Phase-3B>> accessed 24 February 2016.

38 Mr Kim Gilles, Defence, *Committee Hansard*, 3 March 2016, p. 5.

39 ANAO Audit Report No.52 (2014-15), p. 97.

was not provided by Defence given that the total sustainment costs can be assumed to be in the hundreds of millions.

- 2.40 Regarding the additional cost of providing the new capability, the Committee notes that the second pass approval budget increased by \$725.7 million between 2007 and 2013 as a result of a revised Basis of Provisioning and other factors. This cost increase is in the context of acquiring 261 fewer protected vehicles, which are the most expensive class of vehicles in this project.
- 2.41 The Committee expresses strong disappointment in this flawed process and costly outcome.
- 2.42 Given the frequency with which Defence procures new equipment, it is difficult to understand how such fundamental mistakes as poor test and evaluation of the proposals, significantly flawed value-for-money assessments, and failure to inform the Minister of the significant capability and technical risks could be made. These are all public sector procurement basics, and the size and complexity of the procurement should have only served to increase attention on such fundamentals.
- 2.43 Despite these mistakes, Defence did not provide information on whether there were any ramifications for the individuals involved. This exposes Defence to criticism that there are no ramifications.
- 2.44 The Committee also notes the ANAO observations and recommendation on Defence's Basis of Provisioning for the medium and heavy vehicle fleet. This process was amended on many occasions during the acquisition process to reflect the number of vehicles Defence could afford, rather than the number of vehicles it required to deliver the defined capability – an approach which did not align with the key purpose of the Basis of Provisioning process. The Committee was therefore pleased to note Defence's progress in implementing the ANAO recommendation, in particular that they are nearing finalisation of a updated administrative instruction on this matter and have started to put improved processes into practice.
- 2.45 When asked why ANAO had made only one recommendation in its report despite the series of failures uncovered, ANAO responded:
- ... we do not recommend that which already exists or is required to be done... We believe that Defence has for a long time understood the importance of test and evaluation. We believe that the essentials for running a good process and an effective process were understood in Defence, but they were not necessarily followed in the first process. There was evidence of improvement in the second process, and we have reported that. On balance we



did not feel it was necessary to remind Defence of what it already knows.<sup>40</sup>

- 2.46 Defence presented a strong argument that the lessons of the failed first tender process have been learned and the ANAO acknowledged that many of the issues they exposed have been recognised by Defence and reforms are being implemented.<sup>41</sup> In addition, the Committee acknowledges that the reforms underway as part of the FPR process could minimise the risks of similar issues. A good example of this is the strengthening of the T&E office and its increased senior officer accountability.
- 2.47 However, given the significance of the audit findings and that the FPR reforms are still ongoing, the Committee seeks additional assurance that the lessons learned through this acquisition are being firmly embedded and broadly disseminated across Defence.

### Recommendation 1

- 2.48 **The Committee recommends that the Department of Defence provide evidence to the Committee that the lessons learnt from the failed first tender process for LAND 121 Phase 3B have been incorporated into the department's standard operating procedures for acquisitions. This evidence can take the form of:**
- revised manuals;
  - specific internal case studies and training briefings; and
  - any other relevant material.

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40 Dr Tom Ioannou, Australian National Audit Office, *Committee Hansard*, 3 March 2016, p. 6.

41 See to comment by Dr Tom Ioannou, Australian National Audit Office, *Committee Hansard*, 3 March 2016, p. 4: "This audit itself shows that when Defence conducted its second process it was more soundly based."

