

Submission 53 - Department of Finance

The Department of Finance made submission 14 to the inquiry into the Future of Australia's naval shipbuilding industry in the 44th Parliament.

This document is intended as a supplementary submission to the original submission 14.

All submissions received in the 44th Parliament can be accessed via the following link:

http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Naval_shipbuilding/Submissions



Australian Government

Department of Finance

Rosemary Huxtable PSM
Secretary

Our Ref: SEC0014088

Ms Ann Palmer
Acting Committee Secretary
Senate Economics References Committee
PO Box 6100
Parliament House
CANBERRA ACT 2601

Dear Ms Palmer

I refer to your letter of 18 October 2016, in which you sought written submissions to the Inquiry into the future of Australia's naval shipbuilding industry. In this regard, I draw your attention to a submission provided to the Economics References Committee (the Committee) by the Department of Finance (Finance) dated 8 August 2014, a copy of which is attached. This letter provides an update to, or in some places reaffirms, the information provided at that time.

The specific elements of relevance to the Inquiry's terms of reference, which are addressed below are: the Commonwealth's procurement framework, Finance's role in assessing and providing independent advice to Government on defence policy and capability, and the separation of ASC Pty Ltd (ASC).

Commonwealth Procurement Rules

The advice provided in our previous submission in respect of the Commonwealth Procurement Rules (CPRs) remains current. As previously advised, officials must comply with the rules in Division 1 of the CPRs for all procurements. The additional rules in Division 2 apply where the value of the procurement is at or above the relevant threshold.

Paragraph 2.6 of the CPRs removes the need to comply with the CPRs where an Accountable Authority determines it to be necessary for the maintenance or restoration of international peace and security, to protect human health or for the protection of essential security interests.

The Defence Procurement Policy Manual, a publicly available document that can be sourced at http://www.defence.gov.au/casg/Multimedia/DPPM_March_2016_Entire-9-5247.pdf, includes a list of goods and services that Defence has determined as Defence Exempt Procurements.

Assessing Defence Capability Proposals

The Department of Defence (Defence) develops capability proposals, sponsored by the Minister for Defence and/or the Minister for Defence Industry, for the consideration of the National Security Committee (NSC) of Cabinet. Finance participates in monthly Defence Investment Committee meetings to support the development of these proposals and a stronger partnership with Defence. This approach is consistent with Defence's First Principles Review, which included recommendations and findings to support the establishment of a single end-to-end capability development function.

The NSC process may involve multiple approaches to Government for individual projects to facilitate Government consideration as required to ensure appropriate Governance is exercised. Typically, for medium to higher risk projects, the first engagement with Government is used to seek consideration of the broad options and acquisition approach to fulfil a capability requirement, followed by further engagements, as required, which seek agreement to procure goods and services to deliver a specific capability outcome.

The Government has made a number of decisions on naval shipbuilding capability projects in 2016, including:

- first pass approval for SEA 1000 (Future Submarines), with Direction des Constructions Navales Services of France selected as Australia's preferred international design partner;
- first pass approval for SEA 5000 (Future Frigates), with three ship designs shortlisted for further refinement prior to second pass;
- first pass approval for SEA 1180 (Offshore Patrol Vessels), with three ship designs shortlisted for further refinement prior to second pass; and
- combined first and second pass approval for replacement of Pacific Patrol Boats, with Austal Ships Pty Ltd selected as the preferred tenderer.

These capabilities will be built in Australia under a Naval Shipbuilding Plan that is to be released in early 2017. The plan is to be based on a continuous build program to establish a sustainable long-term pathway for industry.

Finance's Role in Advising on Defence Capability Issues

As noted in our previous submission to the Committee, Finance has developed specific expertise in providing advice to Government on Defence capability matters.

Expertise at the Senior Executive Service Level, supported by the Defence Capability Branch and other Finance branches as required, is dedicated to providing analysis and briefing material on Defence's capability proposals. The focus of our analysis includes advising the Minister for Finance and Finance senior executives on: cost and risk issues; cost contingency, cost models and supporting documentation; and other policy matters raised in submissions to Government.

Finance is also supporting Defence's development of the Naval Shipbuilding Plan. In this role, Finance provides analysis of the costs, risks and implications of the proposed arrangements, taking into account the RAND Corporation's report 'Australia's Naval Shipbuilding Enterprise: Preparing for the 21st Century'. This report identifies principles that aim to support the development of an economically sustainable domestic naval shipbuilding industry.

Finance also attends, at the Deputy Secretary-level, the Defence Investment Committee, which is responsible for bringing the future force and supporting enablers into being, and the Defence-chaired Interdepartmental Committee on Naval Shipbuilding.

Separation of ASC Pty Ltd

On 11 October 2016, the Government announced its decision to separate ASC Pty Ltd (ASC) into three Government-owned companies, independently focussed on shipbuilding, submarine sustainment and infrastructure. This decision followed a strategic review of ASC that sought to identify its optimal corporate, capital and governance arrangements to support implementation of the Government's naval shipbuilding plans.

Finance is working with Defence and ASC to implement the ASC separation and restructure. The immediate focus is to establish an infrastructure entity to support the development of shipbuilding infrastructure required for the future capability projects.

The changes to the structure of ASC are being made to provide an appropriate structure, including to support the necessary infrastructure development, protection of critical assets and, in turn, a sustainable continuous shipbuilding industry.

Thank you for the opportunity to provide information to the Committee. I trust this information further assists with the Inquiry into the Future of Australia's naval shipbuilding industry.

Yours sincerely

Rosemary Huxtable
Secretary

3 March 2017



Australian Government
Department of Finance

Jane Halton PSM
Secretary

Our Ref: SEC 0010552

Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Dr Dermody

I refer to your letter of 14 July 2014, in which you sought written submissions to the Inquiry into the future of Australia's naval shipbuilding industry and my response of 17 July 2014 in which I indicated that the Department of Finance would consider the scope of the Senate Economics References Committee inquiry and provide a response in the future.

Following your letter the Department received a request for Mr John Sheridan, to attend a Committee hearing of 21 July 2014. As you would be aware, Mr Sheridan and Mr John Edge, Acting Deputy Secretary attended at that time and provided evidence. Responses to questions on notice taken at that hearing form part of this Submission.

In regard to matters raised in the Committee's terms of reference, this Submission provides further information and context in the areas of Commonwealth procurement, the processes associated with Defence procurement that relate to the Department of Finance and the role of the Department in advising government on defence matters.

Commonwealth Procurement

As noted in the evidence of Mr Sheridan, the Department of Finance is responsible for the whole of government procurement framework including the Commonwealth Procurement Rules (CPRs). The CPRs were most recently updated in 2014 and set out the basis on which procurements are conducted by the Commonwealth. Relevant international obligations have been incorporated into the CPRs.

Officials must comply with the rules in Division 1 of the CPRs for all procurements regardless of value, and apply the additional rules in Division 2 where the value of the procurement is above \$80,000 (general goods and services) and \$7.5 million (construction services).

Paragraph 2.6 of the CPRs provides an overarching exemption removing the need to apply the CPRs where an Accountable Authority has determined it necessary for the maintenance or restoration of international peace, to protect human health or for the protection of essential security interests. In practice, this allows an entity to undertake an alternative form of procurement, such as a limited tender, should they choose, including for procurements above the relevant procurement thresholds.

The Defence Procurement Policy Manual, a publicly available document which can be sourced at <http://www.defence.gov.au/dmo/Multimedia/DPPM-9-5247.pdf>, includes the list of the goods and services that Defence have categorised as Exempt Procurements under paragraph 2.6 of the CPRs. 'Ships, Small Craft, Pontoons and Floating Docks' is one such category.

Assessing Defence Capability Proposals

Department of Defence capability proposals are developed by Defence and brought forward to the National Security Committee (NSC) of Cabinet by the Minister for Defence in keeping with the requirements of the Kinnaird Two-Pass process.

- The Kinnaird Process entails seeking initial direction from the NSC on the direction of fulfilling a capability requirement, followed by a second pass which provides specific direction to Defence on fulfilling that capability.
- It is usual for individual phases of a defence capability project to be subject to the two pass process because the projects are complex and of a prolonged nature.

In regard to the specific case of the supply ships that are being considered in this inquiry, First Pass consideration of the capability was considered by the NSC on 4 April 2014, with an announcement made on 6 June 2014 by the Minister for Defence of the government's decision to conduct a restricted competition between Navantia of Spain and Daewoo Shipbuilding and Marine Engineering for the replacement of the two replenishment ships, *HMAS Success* and *HMAS Sirius*, which are coming to the end of their useful lives. Finance provided advice on the Submission and to the Minister for Finance in the usual way.

Finance Role in Advising on Defence Capability Issues

The Department of Finance has developed specific expertise in providing advice to government on defence capability matters. In addition to the Department's role in advising on whole of government procurement matters, and in advising the Finance Minister on the cost and quality of new policy proposals put forward by agencies, Finance has developed a specialised defence capability assessment role.

Expertise at the Senior Executive Service Band 1 level is dedicated to this role with support provided by the Defence, Capability and Intelligence Branch. The work undertaken by Finance in this regard includes advising the Finance Minister on: priority cost and risk issues; cost contingency, cost models and supporting documentation; and other policy matters raised in Submissions.

To conclude, I have attached responses to questions on notice taken by Finance officials at the hearing of 21 July 2014 (Attachment A refers).

I trust this information further assists the Inquiry into the Future of Australia's Naval Ship Building Industry.

Yours sincerely

Jane Halton
Secretary

7 August 2014