

Standing Committee on Foreign Affairs, Defence and Trade
Inquiry into Defence Procurement
Preliminary Report

Defence welcomes the invitation from the Committee to comment on its Preliminary Report from the Inquiry into Defence Procurement, released on 15 December 2011. In particular we note the Committee's desire to receive views on whether it is on the right track in its observations, and its identification of several key issues for further investigation.

Defence is committed to working closely with the Committee to assist its understanding of Defence procurement procedures and in identifying areas for improvement where warranted. In commenting on the Preliminary Report we have sought to address broadly some of the major themes identified by the Committee and to also clarify issues of fact. Defence looks forward to discussing in more detail these and other issues with the Committee as the Inquiry progresses.

Inquiry Observations

Defence supports many of the observations made by the Committee. In particular, the following themes are consistent with previous internal and external recommendations for improvement, and for which Defence has taken steps to address:

- more rigorous early analysis of capability proposals,
- improvement to the capability development process,
- increase the rate of project approvals,
- improve the clarity of defined roles, functions and responsibilities within the Defence organisation, and
- building resources to ensure competence and consistency.

Early Analysis. DMO supports CDG in the early analysis of major projects. In addition to the initiatives within CDG, over recent years DMO has been developing its skills and processes in cost and schedule estimation. This is an ongoing task, which is subject to constant refinement. Further, to inject greater rigour through independent review, DMO has instituted Gate Reviews of projects during their approval cycle that examine DMO aspects of a project.

CDG and DSTO also contribute to the early analysis of projects through work done in the Joint Decision Support Centre. DSTO contributes early analysis through the Technical Risk Indicator at entry of a project into the Defence Capability Plan (DCP). DSTO also supports the services military experimentation programs to identify capability gaps, and provides support to the Force Structure Review through technology advice particularly on emerging technologies, and through military experimentation.

Improvement to the Capability Development Process. Defence is committed to continuous improvement in the capability development process and has recently undertaken a comprehensive Defence wide review of the DCP and supporting processes. The review identified a number of initiatives to improve the capability development process in the short-term. These initiatives have been combined with others underway in CDG to form the Capability Development Improvement Program (CDIP). The implementation of these initiatives will highlight further improvements

and refinements to the capability development process, which will be reviewed on an ongoing basis for consideration for implementation.

In brief, the CDIP currently consists of the following initiatives:

- Rigorous Portfolio Management. Defence is putting in place robust orchestration, schedule reporting and performance monitoring for the management of the approval process for DCP projects.
- Simplify the Capability Development Document Set. Defence will simplify the capability development document set, incorporating flexibility so documents can be made fit-for-purpose for particular projects.
- Enhance Project Initiation Boards. Senior level (Group Head and Service Chief) membership of Project Initiation Boards (as appropriate to the project) to ensure projects are well founded, their risks understood and project staff are provided with clear guidance.
- Improve Committee Effectiveness. Defence will optimise committee activities to reduce the workload on key decision makers and staff.
- Create Integrated Program Teams. Unapproved DCP projects will be grouped into programs and Integrated Program Teams formed to gain scale in workforce and resource efficiency.
- Gain Costing Policy Agreement with Central Agencies. Seek Central Agencies' agreement to tailor the detail required for cost estimates to optimise limited staff resources.
- Increase Early Industry Input into DCP Projects. Early industry input into the development of unapproved DCP projects is being increased by the greater use of the Defence-industry Rapid Prototyping, Development and Evaluation (RPDE) program.
- Increased Capacity and Expertise in CDG through Industry Support. Industry Support Partnerships are being established between CDG and industry to provide additional expertise and capacity within CDG to meet the DCP approval schedule.
- Process and Information Alignment between CDG, DMO and CIOG. CDG, DMO and CIOG will more closely integrate their processes, reporting regimes and information technology.
- Continue to Professionalise the Capability Development Workforce. The continued professionalisation of the ADF and APS capability development workforce will be enhanced by adjusting training and education programs.

Additionally, on 6 May 2011, the Government announced a number of reforms to improve project management accountability. These reforms have now either been implemented or are underway as announced by the Government on 28 November 2011 and include:

- a rigorous cost-benefit analysis of all future projects seeking second pass approval that are not off-the-shelf (implemented);
- the establishment of Project Directives (implemented). Project Directives have been issued for all projects approved since March 2010);
- development of a more disciplined process for changing the scope of a project (the Project Directives process has been implemented and the baseline review of the scope for projects approved prior to 1 March 2010 is underway);
- Establishing a two pass approval system for Minor Projects valued between \$8 million and \$20 million (implemented);

- the establishment of an Independent Project Performance Office (IPPO) (implemented);
- the establishment of an Early Indicators and Warnings system for major projects (implemented);
- expansion of the full diagnostic reviews (Gate Reviews) system to include all major projects (underway noting that all major projects will have undergone a Gate Review by the end of 2012); and
- introduction of Quarterly Accountability Reports (underway).

Rate of Project Approvals. Paragraphs 4.31 to 4.36 provide comment about the lower than anticipated rate of DCP project approvals since the release of the Defence White Paper in mid 2009. Defence has acknowledged, as noted earlier in this brief and in testimony to the Committee, that it faced challenges in delivering the high number of project approvals for Government consideration (50-60 approvals per year in the early years) that flowed from the DCP 2009-19. Previous to the 2009 White Paper, Defence had delivered on average 26 major projects for approval each year in the period 2004-05 to 2008-09. In 2010-11, Defence made progress in lifting the sustained rate of submission for Government consideration, with a target of an average of 40 approvals each year.

On 13 December 2011, the Minister for Defence and the Minister for Defence Materiel announced that the Government had made a record number of approvals for Defence capability projects in 2011, with 46 first pass, second pass and other approvals for major projects at a total value of more than \$6 billion.

Roles and Responsibilities. Within the detail of both the Kinnaird and Mortimer reviews are suggestions regarding responsibilities for specific tasks during the capability life cycle. While each stage has a clearly identified lead, there has been instances where the detailed inputs from some stakeholders has not been clearly understood resulting in overlaps and tension between organisations. Work on the Capability Manager roles and responsibilities as part of the implementation of Mortimer is a specific example of where Defence has progressed in this area.

Building Resources. Kinnaird, Mortimer and Rizzo all identified areas within DMO requiring further development to support acquisition and sustainment. DMO has been running programs to upskill and professionalise its workforce for many years. These programs include engineering, project management and procurement training and professional certification. DMO is committed to continuing these programs.

There are several additional observations made by the Committee that Defence would like to address:

- the assertion that DMO has replaced skilled professionals with unskilled generalists,
- the suggestion that DMO does not use systems engineering methodologies,
- the Committee's comments on early engagement of industry,
- the suggestion that Defence should give preferential treatment of Australian industry in procurement selection decisions,
- the suggestion that DMO has expanded its responsibilities beyond the original intention,
- the potential for DSTO's advice on technical risk not to be heard, and

- the potential for DSTO's advice not to be understood by CDG desk officers (now titled CDG project managers).

Skilled Professionals. DMO has a large number of skilled staff in many fields including engineering, logistics, project management, procurement, finance and legal. DMO has also been undertaking a certification program against national industry standards, which remains an important plank of its professionalisation agenda. Where there is no competency based professional association, as is the case with logistics, the DMO has developed competency based logbooks and frameworks as the basis of professional assessment. The details of these programs are in Table 1 (it should be noted that these numbers are a mixture of both military and civilian staff).

DMO Job Family	Estimated Target Group	Currently In-Progress	Total Certified/Achieved	Total in Program	% of Target in Program
Engineers	665	257	186	443	67%
Technical Officers	600	57	34	91	15%
Project Mgt	527	180	369	549	104%
Accountants	106	61	43	104	98%
Lawyers	18	3	16	19	106%
Logistics	1473	136	75	377	31%
Procurement and Contracting	160	8	22	30	19%

Table 1 – DMO Certification numbers – as at August 2011

Notes: Project Management - all in PM discipline

Engineers – includes EL1 and above plus 50% of APS 6 includes Grads

Lawyers - all practicing lawyers in DMO Legal

Procurement and Contracting – APS 6 and above

Systems Engineering. Systems engineering is, and has been, a key foundation to the project and engineering management methodology in DMO. The objective of engineering in DMO is to ensure that ADF materiel systems are effectively and efficiently specified, designed, developed, manufactured and maintained using systems engineering practices. In addition, systems engineering methodologies support project management in many aspects from estimation to scheduling and program management. It would be incorrect to suggest that systems engineering principles are not used in DMO to complement project management.

Early Industry Engagement. Defence supports industry engagement as an integral tool in Defence procurement. The concern is more about the form that such engagement may take. Early industry engagement in a DCP project's development takes place under the auspices of the Rapid Prototyping, Development and Evaluation program (RPDE), environmental working groups and other mechanisms as noted earlier in this response. To date, around 30 per cent of unapproved DCP projects have been reviewed by RPDE, and this number is being increased to all unapproved DCP projects.

DMO's approach to industry engagement has been classified by some observers as conservative and cautious. Government procurements must be characterised by fairness, transparency and probity. The Commonwealth Procurement Guidelines require that we "deal with suppliers and potential suppliers even-handedly". The

usual approach to this requirement is to remain open to the broad market as much as possible.

As noted above, CDG and DMO are currently exploring additional mechanisms that might enable industry to provide project-specific comment and input throughout the capability development lifecycle, and the intention is to issue detailed guidance for use both internally and within industry about the available mechanisms. An important part of this guidance will be how these mechanisms can be used in a way that sees fairness and probity maintained in both a real and perceived sense.

Australian Industry. It is Defence's position that industry must become more resilient and self-reliant if it is to prosper and grow in the future. It can no longer expect the Government to use offsets or local content quotas to help protect Australian defence industry from overseas competition. Previous experience has shown that this approach is not in the best interests of Government, industry or Defence – and the Government is committed to an open and competitive defence marketplace. Moreover, the Commonwealth Procurement Guidelines state that:

“The Australian Government procurement policy framework is non-discriminatory. All potential suppliers should have the same opportunities to compete for government business and must, subject to these CPGs, be treated equitably based on their legal, commercial, technical and financial abilities. Procurement methods must not discriminate against potential suppliers due to their degree of foreign affiliation or ownership, location or size. The property or services on offer must be considered on the basis of their suitability for their intended purpose and not on the basis of their origin.”

Accordingly, any consideration of preferential treatment to Australian industry is a matter for Government policy, not Defence process.

On 29 June 2011 the Government announced reforms to strengthen the Australian Defence industry. These reforms have now either been implemented or are underway as announced by the Government on 28 November 2011 and include:

- reducing the threshold for mandatory Australian Industry Capability Plans (AICPs) from \$50 million to \$20 million (implemented) Initial guidance has been released and compliant AIC plans are being developed for DCP projects.
- removing the ability of a company to arbitrarily reduce the level and type of work included in an ACIP; (underway with initial guidance released);
- introducing a new clause to be included in the Conditions of Tender allowing a company to be excluded from a tender if they have previously failed to meet their AICP obligations (underway). New tenders for DCP projects incorporate the new clause);
- including the AICP performance in the company scorecard (implemented); making project teams more accountable for AICP performance by including them in the DMO Project Manager's Charter (implemented). All new DMO Project and Product Manager Charters include the performance requirement. Existing Charters for relevant projects and products are being progressively updated under the DMO's Charter Review cycle; and
- making AICPs public (underway).

DMO Role. The DMO was formed in 2000 from the amalgamation of the Defence Acquisition Organisation and Support Command Australia whose roles were to:

“realise the Government’s priorities for the development of Australian defence capabilities through...timely acquisition and delivery of major capital equipment and systems that meet endorsed operational requirements, achieve value for money and are supportable”; and “deliver at minimum cost the materiel support required by the ADF to train and fight”.

DMO’s role today is to *“equip and sustain the Australian Defence Force”* which seems consistent with its predecessors. It is therefore unclear where the impression of a “growing role of DMO” has originated.

The Preliminary Report stated that *“one of the issues before the committee in relation to sustainment is whether responsibilities that now fall under the DMO’s purview should remain so or whether those responsible for sustainment within the DMO should be accountable to the relevant Service (thereby remaining respons[ive] to the Service needs) as well as the CEO DMO.”*

DMO is accountable to the relevant Capability Manager (usually the relevant Service Chief) through service agreements such as the Material Sustainment Agreement (MSA).

As Mortimer noted, the Services’ *“demand for sustainment services are detailed in MSAs that define the products and services to be provided and the price and schedule for delivery of those products and services. These agreements are developed between DMO and the respective Capability Managers.”*

In addition, Capability Managers negotiate MSAs to establish a level of support that will allow them to meet their obligations to the CDF/Secretary for the required capabilities and preparedness levels laid down in their preparedness directives and organisational performance agreements. Each MSA is renegotiated between the DMO and the respective Capability Manager on an annual basis, within a 10-year context.

Technical Risk Advice. Defence can confirm that the advice provided by the Chief Defence Scientist (CDS) on technical risk is highly respected and is not diluted or lost in the decision-making. CDS’ technical risk certification is included verbatim in the ministerial or cabinet submission. The Technical Risk Assessment (TRA) process is well-embedded in the capability development process and is quoted in the project documents for First and Second Pass. Further, the technical risks identified by DSTO are considered in Integrated Project Team meetings to develop risk treatments.

As noted in the submission from the Department of Finance and Deregulation:

“Finance staff rely heavily on the technical risk assessment provided by the Defence Science and Technology Organisation”

This has led to greater visibility of risk treatment and risk management in project documentation and in the submission to the minister or cabinet. There have been many instances in cabinet submissions where the CDS has raised technical risks and the risk treatment is then described. There have been instances where DSTO’s technical risk advice has had significant influence on a project. For example, advice on areas of high technical risk for the Seahawk Capability Assurance Program was influential in the decision to bring forward AIR 9000 Phase 8 (replacement for the current Seahawk helicopter) for Government consideration. Furthermore, DSTO is frequently asked by the project office to contribute to risk treatments, particularly in

the testing and evaluation of equipment, and where this is the case these activities are included in the Science and Technology Plan for the project.

CDG Staff Officer (Project Manager) Skilling. The Scientific Adviser in CDG (SA-CDG) position was established to assist CDG staff officers to understand and make effective use of advice from DSTO. This position has been key in ensuring DSTO’s role in capability development is understood by CDG. To assist this, SA-CDG contributes to the Capability Development Skilling Program on this topic and also assists in clarifying issues between CDG and DSTO on a day-to-day basis.

CDG and DSTO staffs engage regularly through IPTs and other meetings. CDG staff officers regularly engage with DSTO staff in DSTO’s laboratories to better understand the technologies involved in their projects.

Cost Overruns and Schedule Delays

The Preliminary Report raised several issues relating to Defence’s performance in the procurement of major capital assets, including cost overruns and schedule delays.

Defence is of the view that there is not a major issue with cost overruns. The information provided by Defence to the Committee demonstrated through analysis of projects closed between 1997 and 2008 that DMO tends to deliver under budget (spending on average 98% of approved budget). This analysis has since been extended to include all projects closed between 1997 and 2011 and confirms the spend of 98% of approved budget. Moreover, in both the 2009-10 and 2010-11 Major Projects Reports, the ANAO noted that *“while projects’ budgeted cost requires careful management by the DMO, this dimension of project performance has not been a major issue.”*

The perception of cost overruns seems to stem from a misunderstanding of the impact of price and exchange variation on approved project budgets. Defence projects budgets are subject to *“routine budget supplementation to deal with both price changes (via price indexation) and foreign exchange movement (via a whole-of-government ‘no win/no loss policy)’”*¹.

Defence also provided evidence to the Committee of significant improvements in the schedule performance of major projects. The schedule performance of 150 open and closed projects with commencement dates from 1992 to 2011 has been assessed. The information indicates a steady improvement of schedule performance from the year 2000. Defence contends that reforms over the past 10 years have had a significant impact on project performance. Current DMO performance is comparable with similar Defence acquisition agencies [see Table 2 which measures the delay between forecast Initial Operating Capability (IOC) (at time of Main Gate (UK) or Milestone C (US) approval) and actual or current IOC].

	UK	US	AUS
Top projects/programs			
UK Top 14 projects	25.4%	29.3%	20.4%
US Top 39 programs			
AUS Top 21 projects			
Additional analysis	28%	NA	16.5%

UK	87 projects/			
US	Not Available			
AUS	Additional 6 projects in the 2010-11 MPR			

Table 2: Results of schedule delay analysis using IOC

On 29 June 2011 the Government announced a number of reforms to strengthen the Projects of Concern process. These reforms have now either been implemented or are underway as announced by the Government on 28 November 2011 and include: :

- the introduction of incentives for companies to fix projects that are on the Projects of Concern list (implemented);,
- establishing a more formal process for adding projects to the list (implemented);,
- establishing a more formal process for removing projects from the list (underway); and
- increased Ministerial involvement and oversight of projects (implemented). In addition to regular reviews of Projects of Concern, the Minister for Defence Materiel chairs bi-annual summits between Defence, industry and Government stakeholders).

This is not to suggest that no further improvement to major project performance is possible or should be expected, but to highlight that significant performance improvement should be a basis to inform further debate.

Correcting the Record

The Preliminary Report notes that the complexity of the Defence procurement process is a challenge to understand. To assist this understanding, Defence would like to clarify some inaccuracies in the Report as follows:

- Sub-paragraph 4.40 2. could be incorrectly interpreted to indicate that the Preliminary Operational Concept Document (POCD) is submitted to government at first pass. While information from the POCD and the other documents in the Capability Definition Document (CDD) suite (Function and Performance Specification and Test Concept Document (TCD)) is contained in the Ministerial or Cabinet Submission, the POCD is not submitted to government at first pass.
- In sub-paragraph 4.40 3.a, the TCD is correctly referred to as part of the Capability Definition Document suite, but its authorship is incorrectly attributed to DSTO. The TCD is a CDG document prepared by the Australian Defence Test and Evaluation Organisation (ADT&EO).
- Paragraph 4.34 states: *“Air Marshal Harvey acknowledged that Defence faces challenges regarding delays in procurement activities post project approval but was addressing them 'on a case-by-case basis at an organisational level'. He was of the view that:*
...when we report at the end of this financial year you will see a number well above the average over the last few years. So far this year we have had nine approvals, one first pass and seven second passes, in the three-month period, which is already a good positive trend. “

- The initial reference to challenges regarding procurement delays is correctly linked to the post project approval stage. The quoted comments on the status of project approvals, however, refer to the pre-approval stage. These two comments have been incorrectly linked.
- Paragraphs 4.59 and 4.69 refer to the DSTO Test Concept Document (TCD). This is an error and should refer to the DSTO Technical Risk Assessment (TRA).
- Paragraph 5.6 is a partial attempt to describe the DSTO risk documents, and incorrectly attributes the role of the full TRA to the Technical Risk Indicator (TRI), which is later correctly described in paragraphs 5.24-25. The TRI informs the Options Review Committee in considering the entry into the DCP for a project, while the TRA is produced at First and Second Pass.
- Paragraph 5.10:
 - second dot point should read: solicitation documentation (RFT, Letter of Request).
 - Third dot point/third sub-dot point should read: Letter of Request (LOR) which initiates a request for the establishment of a United States of America Foreign Military Sales (FMS) case.
- Paragraph 5.11, third last line should read: ‘...draft MAA with DMO and the Capability Manager...’
- Paragraph 5.32 incorrectly states that the Defence committee system was established to strengthen the two-pass process and then attributes comments from the Black Review about committees more generally in Defence to the capability development process, which Black has not specifically commented upon. The senior Defence committee system has been in operation, under various titles and functions, since the early 1970s following the formation of the Department of Defence and the disestablishment of the individual Departments of Navy, Army and Air Force.
- Paragraph 5.36 could also include RPDE in the list of organisations from which CDG gathers relevant advice in the development of capability submissions.
- Paragraph 5.38 advises that CDG CS Div Desk Officers (Project Managers) were not adequately trained and lacked appropriate supporting management structures, processes and tools and references an ANAO submission. What should be made clear in the footnote is that this information was gathered by the ANAO from CDG focus groups in mid-2008 and related to support for records management/better supporting information management systems, timely training (particularly cost estimation) and process support tools.
- Paragraph 5.45 advises that the quality of record keeping in CDG is poor and references an ANAO submission. What should be made clear in the footnote is that the advice is based on an ANAO Performance Audit conducted in 2008-09 of a sample of 20 out of 84 DCP projects that had received their first and or second pass approval in the period mid-2004 to mid-2007.

- In para 6.31 of the report the committee notes that the DMO sets itself to be the “*premier program management, logistics and engineering services organisation in Australia*”. The report omits "procurement" from the relevant sentence which should read that the DMO’s Vision is “*to be the premier program management, logistics, procurement and engineering services organisation in Australia*”. The Committee then questions “*whether the DMO's aspiration in relation to program management is appropriate*”. The intent of this question is unclear.
- The acquisition phase is appropriately described as covering “the period from government approval for a project (at second pass) to the transition of the acquired equipment into service”. Paragraph 6.4 (and repeated in paragraph 6.5) then states that this phase includes “release of tender documentation and completion of the tender evaluation”. This activity is undertaken prior to second pass (ie following first pass) to support the Department of Finance and Deregulation requirement for tender quality data to be provided in support of second pass submissions.
- Paragraph 6.7 states that the DMO General Manager Commercial was appointed in February 2007. The General Manager – Commercial was appointed in February 2010.
- Paragraph 6.9 indicates the Joint PD is issued by the Secretary and CDF following second pass. A Joint PD is issued following first pass to cover the activities leading to second pass and then a subsequent Joint PD is issued following second pass as described in the paragraph.
- Paragraph 6.11 states that “*the draft MAA is finalised and approved by government after second pass*”. The paragraph should advise that a draft first to second pass MAA is developed in the lead up to first pass approval and then signed by representatives of the CEO DMO, CCDG and the Capability Manager after Government first pass approval is gained. A draft post-second pass MAA is developed in the lead up to second pass approval and then signed by representatives of the CEO DMO, CCDG and the Capability Manager after Government second pass approval is gained. The MAA is not approved by government.