

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### Inquiry into Australia's sovereign naval shipbuilding capability

#### Written Questions on Notice received from Senator Gallacher 7 September 2020

##### Question on Notice 1 (Procurement Policy)

Finance is a member of the Defence Investment Committee. What role did the Committee have and what advice did it provide with respect to the recently released 2020 Defence Force Structure Plan?

- a. Were any changes or amendments made to any procurement policies or procedures that were previously in place?
- b. What do you understand to be the current priorities of the Defence Investment Committee with respect to Australian industry?
- c. On 14 August 2020 Mr Jagers said that Finance's role is at the start of the investment process and that "*Finance provides a cost and-risk statement, and that's included in defence capability submissions which go forward for government consideration. The cost-and-risk statement provides some independent advice on the veracity of the cost estimates, the risks and affordability* – ". Please provide a copy of the cost and risk statements for the Future Submarines and Future Frigates projects and an explanation as to the consideration that was given by Finance to the factors of Australian Industry Content and sovereign defence industry capability.

##### Response

The Defence Investment Committee considered the Force Structure Plan at various stages through its development. Advice provided by the Defence Investment Committee is reflected in submissions provided for Cabinet consideration. It is a longstanding practice not to disclose information about the operation and business of Cabinet, as to do so would potentially reveal its deliberations which are confidential.

In its consideration of capability investments, the Defence Investment Committee ensures that proposals are consistent with Government policies, including in relation to Australian Industry Content and in delivering on agreed Sovereign Industrial Capability Priorities.

As with other Commonwealth entities, the Department of Defence (Defence) is subject to the Commonwealth Procurement Framework. This includes the Department of Finance (Finance) guidance on *Consideration of Broader Economic Benefits in Procurement*, published on the Finance website, which assists officials when considering the assessment of economic benefit. This was most recently updated in August 2020 to provide further guidance, including specific examples relevant to Defence procurement. This update did not reflect policy change per se.

Finance is not aware of any specific changes to Defence procurement policies and procedures that were agreed as part of the Force Structure Plan internally to Defence. Further questions in relation to its procurement practices should be directed to Defence.

In relation to the cost and risk statement, please refer to the response provided by Finance to Question on Notice 3 from the Senate Economic References Committee Inquiry into Australia's sovereign naval shipbuilding capability hearing of Friday 14 August 2020.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 2 (Procurement Policy)**

In making defence acquisition decisions, what factors are considered by Finance when providing advice in relation to the consideration of project risk?

- a. Does that advice give consideration to technical risks associated with potential tenderers and does this lead to potential tenderers being marked down in this process?
- b. If so, does this advantage overseas suppliers, as the risk is taken on by another nation?
- c. How do Australian suppliers fare in this process?
- d. Given the investment in higher education institutions (science and technology areas) and our strong defence high technology sector, why is the acquisition of advanced Defence technology from Australian-owned suppliers not more prevalent?

#### **Response**

The Defence First Principles Review recommended establishing a new single, end-to-end capability development function, including a streamlined Defence Investment Approval Process. This streamlined approval process is supported by the Smart Buyer decision-making framework, which is a risk-profiling tool that considers key project risks to develop tailored acquisition and sustainment strategies for defence capabilities. Finance considers the risks as assessed by Defence through the Smart Buyer framework, including but not limited to: requirements, cost, schedule, scope, integration, technical and strategic risks.

Finance is not involved in the tender evaluation processes undertaken by Defence. Further questions in relation to Defence tender evaluation processes should be directed to Defence.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 3 (Procurement Policy)**

How do the Commonwealth Procurement Rules and the guidance materials deal with the issue of project risk?

- a. Does this have a negative effect on Australian suppliers?
- b. To what extent is the responsiveness of local industry/suppliers both during the delivery of a project and support thereafter taken into account in the CPRs and Finance guidance materials?

#### **Response**

The Commonwealth Procurement Rules require entities to establish processes to identify, analyse, allocate and treat risk when conducting a procurement.

The effort directed to risk assessment and management should be commensurate with the scale, scope and risk of the procurement. Relevant entities should consider risks and their potential impact when making decisions relating to value for money assessments, approvals of proposals to spend relevant money and the terms of the contract.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### Inquiry into Australia's sovereign naval shipbuilding capability

#### Written Questions on Notice received from Senator Gallacher 7 September 2020

##### Question on Notice 4 (Procurement Policy)

How does Finance define sovereign capability and how is its value captured and promoted in current procurement processes?

- a. What work has the department undertaken to reflect the value of sovereign capability in the procurement process?
- b. With reference to Finance's "*Consideration of broader domestic economic benefits in procurement*" document and in particular Example four which relates to the case of Commonwealth officials procuring a capability valued in excess of \$4 million in support of the Australian Defence Force. The example lists nine economic benefit considerations including:
  - i. competitive pricing (listed first) and
  - ii. promoting the development of industry capabilities, including in supporting Sovereign Industrial Capability Priorities and critical industrial capabilities (listed last).

Is it correct to say that in this example competitive pricing and supporting Sovereign Industrial Capability Priorities have equal value as economic benefits? If not, what guidance is provided by Finance as to the relative weightings to be attributed to each of the nine listed economic considerations in a Defence procurement? Is this the sum total of Finance's efforts this year to enhance sovereign Defence Industry capability through Commonwealth procurement? If not, please detail any other policy/rule/guidance changes which have been introduced by Finance to further that objective?

## **Response**

The updated “Consideration of broader domestic economic benefits in procurement” guidance, released by the Department of Finance in August 2020, provided greater clarity for officials when considering economic benefits that deliver sustainable improvements to the Australian economy, for example, developing Australia’s industry capabilities.

There are various ways that a potential supplier can provide an economic benefit to the Australian economy. The guidance provides examples of how a potential supplier may demonstrate economic benefit, depending on the scale, scope and nature of the procurement. These examples are not exhaustive and are not intended to be listed in any specific order of preference.

The Government does not support uniform mandatory weightings for any evaluation criteria, as doing so could result in sub-optimal value for money outcomes. A prescriptive approach to contracting is not viable for the thousands of contracts entered into by Commonwealth agencies each year.

The Finance guidance has been developed for procuring officials in all relevant Commonwealth entities.

Further questions in relation to the Department of Defence’s (Defence) procurement practices, including measures to support Defence Industry capability, should be directed to Defence.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### Inquiry into Australia's sovereign naval shipbuilding capability

#### Written Questions on Notice received from Senator Gallacher 7 September 2020

##### Question on Notice 5 (Procurement Policy)

On page 6 of the above document there is a Checklist which includes some key steps for officials considering the economic benefit of a procurement. This Checklist states "*Weightings may not be used in a manner that discriminates against suppliers on the basis of their size, location or ownership*".

Does this apply in the case of Defence procurement? If not, why doesn't the checklist acknowledge that fact?

##### Response

The updated Consideration of broader domestic economic benefits in procurement guidance, released by the Department of Finance in August 2020 has been developed for procuring officials in all relevant Commonwealth entities.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

**Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 6 (Procurement Policy)**

The Government has committed (Minister Price's speech to AiGroup Defence Council, 25/6/19) to placing significant additional emphasis and funding on enhancing Australia's trade/technical and technological skills base. How will this change practices and procedures at the department?

#### **Response**

The National Naval Shipbuilding Office within the Department of Defence (Defence) has oversight of the establishment of the Naval Shipbuilding Enterprise, including the policies that underpin it. Any questions in relation to the development of the Shipbuilding Enterprise skills base should be directed to Defence.



# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 7 (Procurement Policy)**

Can you confirm that there are no legal impediments which prevent Australia from mandating minimum Australian Industry Content (AIC) levels in our naval shipbuilding program? (Taken on Notice).

#### **Response**

The non-discriminatory provisions of the Commonwealth Procurement Rules (the Rules) and Australia's Free Trade Agreements prevent any level of Australian Industry Content being prescribed.

The Department of Defence's Australian Industry Capability Program seeks to develop strategically relevant capabilities in Australian industry. This is a proper consideration around economic benefit as part of value for money outcomes.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

**Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 8 (Procurement Policy)**

Has there been any additional work undertaken by the department to provide appropriate guidelines to procurement officials to ensure the optimised involvement of Australian industry to meet AIC outcomes?

#### **Response**

The Department of Finance released updated guidance in August 2020 in relation to the consideration of broader domestic economic benefits in procurement. The guidance provides information to assist entities to comply with the requirement to consider the economic benefit to the Australian economy when assessing value for money in procurements.

Defence Industry Policy, the Defence Industrial Capability Plan and the Australian Industry Capability policy are administered by the Department of Defence.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 9 (Procurement Policy)**

What is the policy framework that applies to the decision-making process in selecting Australian contractors?

- a. How does this policy framework interact with the decision-making processes of the Primes?
- b. What policies and procedures exist to ensure that AIC is maximised?
- c. Are these policies and procedures audited and publicly reported?
- d. How is the performance of these policies measured?

#### **Response**

Officials from non-corporate Commonwealth entities and prescribed corporate Commonwealth entities must comply with the Commonwealth Procurement Rules when performing duties related to procurement.

In relation to Defence, the supply chain decision making processes of the Primes are a matter for the Primes, and subject to any contractual arrangements put in place by the Department of Defence.

Questions in relation to guidelines for the implementation of the Australian Industry Capability policy in Defence contracts should be directed to the Department of Defence.

Commonwealth procurements can be audited by the Australian National Audit Office as part of their audit program to ensure compliance with the Commonwealth Procurement Rules.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 10 (Future Frigates)**

Finance's submission highlights its role in assessing and agreeing costs associated with the Naval Shipbuilding Enterprise as well as in supporting Defence with respect to advice to Government on the Defence Integrated Investment Program.

What is Finance's current understanding or estimate of how much work on the Future Frigate acquisition will go to Australian industry?

#### **Response**

The Government is committed to maximising Australian Industry Content (AIC) across the Naval Shipbuilding Enterprise. Finance understands that BAE expects AIC for the Future Frigate build will be between 65-70 per cent. Finance does not have visibility over Defence's shipbuilding contracts and cannot advise what proportion of the Future Frigate acquisition will go to Australian industry, as this is a matter for Defence.

## Department of Finance

### Response to Question on Notice

#### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 11 (Future Frigates)**

Finance's submission highlights its role in assessing and agreeing costs associated with the Naval Shipbuilding Enterprise as well as in supporting Defence with respect to advice to Government on the Defence Integrated Investment Program.

What is Finance's understanding of why the costs for the Future Frigate program have blown out by 30 percent in two years, from \$35 billion in 2018 to \$45.6 billion in the recently released 2020 Defence Force Structure Plan?

#### **Response**

The Future Frigate Program was estimated to cost more than \$35 billion (2016-17 Pre-ERC out-turned price and exchange) in acquisition (capital investment) in the 2017 Naval Shipbuilding Plan (para 2.42, page 33). The actual acquisition cost estimate was not publicly released, consistent with standard practice, to protect the commercial position of the Commonwealth in negotiations. The out-turned total acquisition cost estimate in 2018 was \$44.3 billion (Budget 2018-19 out-turned price and exchange). This cost factored in a deliberate and continuous construction schedule as part of the Government's continuous naval shipbuilding program.

The further variance between this figure and the 2020 Force Structure Plan (FSP) acquisition cost estimate of \$45.6 billion (Pre-ERC 2020-21 out-turned price and exchange) reflects updated inflation and foreign exchange rate assumptions.

Please refer to the response provided by Defence to Question on Notice 17 from the Senate Economic References Committee Inquiry into Australia's sovereign naval shipbuilding capability hearing of Monday 7 September 2020.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 12 (Future Frigates)**

Finance's submission highlights its role in assessing and agreeing costs associated with the Naval Shipbuilding Enterprise as well as in supporting Defence with respect to advice to Government on the Defence Integrated Investment Program.

Does Finance have any concerns with the management and implementation of this acquisition given its costs have increased by \$10 billion?

#### **Response**

As outlined in the answer to Question 11, the \$45.6 billion Future Frigate Program cost estimate in the 2020 Force Structure Plan reflects the implementation of a stable Australian shipbuilding industry with a deliberate and continuous construction schedule. Changes in price and exchange rate assumptions have also contributed to cost estimate movements.

Noting the complexity and risks of shipbuilding projects, shipbuilding related capability programs are being managed by Defence through a phased approach as a mitigation strategy, with major shipbuilding capability programs presented to Government for consideration at different stages of the program.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 13 (Future Frigates)**

Finance's submission highlights its role in assessing and agreeing costs associated with the Naval Shipbuilding Enterprise as well as in supporting Defence with respect to advice to Government on the Defence Integrated Investment Program.

When did Finance first become aware of this \$10 billion increase in costs associated with this project?

#### **Response**

As outlined in the answer to Question 11, the Future Frigate Program cost estimate in the 2020 Force Structure Plan reflects the implementation of a stable Australian shipbuilding industry with a deliberate and continuous construction schedule. Further, changes in price and exchange rate assumptions have also contributed to cost estimate movements.

Cost estimates for Defence projects change due to the out-turning of costs and price basis updates, which occur three times a year. The out-turned value is a projected measure of expenditure at a future point in time in the dollars (or nominal value) estimated to apply in that year. This will depend on assumptions about inflation and foreign exchange year-on-year, over the length of a project. As a result of price basis updates, cost estimates of Defence projects may increase or decrease depending on expected underlying economic factors.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 14 (Future Frigates)**

Finance's submission highlights its role in assessing and agreeing costs associated with the Naval Shipbuilding Enterprise as well as in supporting Defence with respect to advice to Government on the Defence Integrated Investment Program.

What role has Finance had in assessing and agreeing revised cost estimates for the Future Frigates – and on what date(s) has this occurred – since:

- a. the finalisation of the 2016 Defence White Paper and Integrated Investment Program?
- b. 29 June 2018?
- c. 14 December 2018?

#### **Response**

Finance does not provide cost agreements for Defence Integrated Investment Program capital projects. Finance provides a statement relating to the veracity of the cost estimates and risk solely for inclusion in Cabinet submissions relating to Defence Integrated Investment Program projects to inform Government consideration.

In relation to the Future Frigate Program, Finance provided a cost and risk statement at First Pass consideration in April 2016 and at Second Pass for the design and productionisation stage in June 2018. This advice cannot be separated from the Cabinet Submission. It is a longstanding practice not to disclose information about the operation and business of the Cabinet, as to do so would potentially reveal its deliberations which are confidential.



## Is Department of Finance

### Response to Question on Notice

#### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 15 (Future Frigates)**

Finance's submission highlights its role in assessing and agreeing costs associated with the Naval Shipbuilding Enterprise as well as in supporting Defence with respect to advice to Government on the Defence Integrated Investment Program.

On what date did Finance first become aware that the out-turned costs for the Future Frigate program would exceed \$35 billion?

#### **Response**

Subsequent to the release of the 2016 Defence White Paper and 2017 Naval Shipbuilding Plan, cost estimates for the Future Frigate Program have changed because of the out-turning of costs and price basis updates, which occur three times a year, the first change following the 2016 Defence White Paper, being an update based on parameters released in the lead up to Budget 2016-17. As a result of price basis updates, cost estimates of Defence projects may increase or decrease depending on economic factors, such as inflation or movements in foreign exchange rates.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 16 (Future Frigates)**

Finance's submission highlights its role in assessing and agreeing costs associated with the Naval Shipbuilding Enterprise as well as in supporting Defence with respect to advice to Government on the Defence Integrated Investment Program.

What role did Finance have in assessing and agreeing the revised cost estimate of \$45.6 billion– and on what date(s) did this occur?

#### **Response**

Finance does not provide cost agreement for Defence Integrated Investment Program capital projects prior to Government consideration. However, Finance provides a statement relating to the veracity of the cost estimates and risks for inclusion in Cabinet submissions relating to Defence Integrated Investment Program projects.

Finance provided a cost and risk statement for the Future Frigate Program at First Pass and Second Pass for the design and productionisation stage of the Future Frigate Program. This advice cannot be separated from the Cabinet Submission. It is a longstanding practice not to disclose information about the operation and business of the Cabinet, as to do so would potentially reveal its deliberations which are confidential.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 17 (Future Frigates)**

Finance's submission highlights its role in assessing and agreeing costs associated with the Naval Shipbuilding Enterprise as well as in supporting Defence with respect to advice to Government on the Defence Integrated Investment Program.

Did Finance conduct any analysis of these increased costs with other comparable frigate acquisition programs elsewhere in the world? If so, when and what were the findings of this analysis?

#### **Response**

The Government commissioned the RAND Corporation to conduct a detailed review of the Australian naval ship building industry. The RAND report, released in 2015, compared the costs of acquiring vessels domestically with the costs of acquiring comparator(s) from shipbuilders overseas.

Based on this, Finance undertook analysis of the bids tendered in response to Defence's Request for Tender for the Future Frigate program. This analysis formed part of briefing for the Cabinet Submission, and cannot be separated from the Cabinet Submission. It is a longstanding practice not to disclose information about the operation and business of the Cabinet, as to do so would potentially reveal its deliberations which are confidential.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 18 (Future Submarines)**

Given Finance's aforementioned role in cost assessments and with respect to Defence's Integrated Investment Program:

What is Finance's current understanding or estimate of how much work on the Future Submarine acquisition will go to Australian industry?

#### **Response**

Finance understands that Naval Group is committed to a level of Australian industry capability of at least 60 per cent of the contract value spent in Australia. Finance does not have visibility over Defence's shipbuilding contracts and cannot advise what proportion of the Future Submarine acquisition will go to Australian industry, as this is a matter for Defence.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 19 (Future Submarines)**

Given Finance's aforementioned role in cost assessments and with respect to Defence's Integrated Investment Program:

Is Finance aware of any change to the cost estimate for the Future Submarine acquisition since the \$89.7 billion estimate provided in the 2020 Defence Force Structure Plan?

#### **Response**

The \$89.7 billion acquisition estimate (2019-20 MYEFO out-turned price and exchange) for the Future Submarine Program provided in the 2020 Defence Force Structure Plan has been updated to \$88.5 billion (2020-21 Pre-ERC out-turned price and exchange), to reflect the most recent price basis update. Out-turning and price basis updates occur three times a year. As a result, cost estimates of Defence projects may increase or decrease depending on underlying economic factors, driven by changes in inflation and foreign exchange rates.

Please refer also to the response provided by Defence to Question on Notice 21 from the Senate Economic References Committee Inquiry into Australia's sovereign naval shipbuilding capability hearing of Monday 7 September 2020.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 20 (Future Submarines)**

Given Finance's aforementioned role in cost assessments and with respect to Defence's Integrated Investment Program:

Does Finance have any concerns that the costs of this acquisition have risen from \$50 billion out-turned in 2015 to nearly \$90 billion out-turned today?

#### **Response**

The 2016 public Defence Integrated Investment Program, delivered as part of the 2016 Defence White Paper, included a funding provision for the Future Submarine Program of greater than \$50 billion (out-turned) (Page 77). Defence officials at the 21 October 2015 Senate Estimates hearing explained that details of the Future Submarine Program, including refined costs, remained subject to the outcomes of the then ongoing Competitive Evaluation Process. The classified funding provision which was not made public due to commercial sensitivities, was \$78.9 billion (out-turned).

Cost estimates are updated over the life of a project to reflect movements in inflation and foreign exchange rates. Other than these movements there has been no real cost increase in the Future Submarine Program. The projected total acquisition cost for the Future Submarine Program in out-turned dollars is \$88.5 billion (2020-21 Pre-ERC out-turned price and exchange).

The constant value refers to the size of the financial commitment at a set point in time in 'base date' dollars, while the out-turned value is a projected measure of expenditure at a future point in time in the dollars (or nominal value) estimated to apply in that year.

Please refer also to the response provided by Defence to Question on Notice 3 from the Joint Committee of Public Accounts and Audit inquiry into the Defence Major Projects Report and the Future Submarine Project – Transition to Design hearing of Wednesday 20 May 2020.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 21 (Future Submarines)**

Given Finance's aforementioned role in cost assessments and with respect to Defence's Integrated Investment Program:

What does Finance understand to be the reasons that the cost of this acquisition has increased by 80 percent – or nearly \$40 billion on an out-turned basis – since 2015?

#### **Response**

As outlined in the answer to Question 20, Finance notes the Government announcement in 2015 of new naval investment, delivered as part of the 2016 Defence White Paper, included a funding provision for the Future Submarine Program of greater than \$50 billion (out-turned). The classified funding provision which was not made public due to commercial sensitivities, was \$78.9 billion (out-turned).

Out-turned budget provisions are updated over the life of a project to reflect movements in inflation and foreign exchange rates. Other than these movements there has been no real cost increase in the Future Submarine Program. In the case of the Future Submarine Program, the provision has been out-turned into the 2050s.

The constant value refers to the size of the financial commitment at a set point in time in 'base date' dollars, while the out-turned value is a projected measure of expenditure at a future point in time in the dollars (or nominal value) estimated to apply in that year.

Please refer to the response provided by Defence to Question on Notice 3 from the Joint Committee of Public Accounts and Audit inquiry into the Defence Major Projects Report and the Future Submarine Project – Transition to Design hearing of Wednesday 20 May 2020.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 22 (Future Submarines)**

Given Finance's aforementioned role in cost assessments and with respect to Defence's Integrated Investment Program:

On what date did Finance first become aware that the out-turned costs for the Future Submarine program would exceed \$50 billion?

#### **Response**

Subsequent to the release of the 2016 Defence White Paper and 2017 Naval Shipbuilding Plan, cost estimates for the Future Submarine Program have changed because of the out-turning of costs and price basis updates which occur three times a year, the first change following the 2016 Defence White Paper, being an update based on parameters released in the lead up to Budget 2016-17. As a result of price basis updates, cost estimates of Defence projects may increase or decrease depending on economic factors, such as inflation or movements in foreign exchange rates.



# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 23 (Future Submarines)**

Given Finance's aforementioned role in cost assessments and with respect to Defence's Integrated Investment Program:

What role has Finance had in assessing and agreeing revised cost estimates for the Future Submarines – and on what date(s) has this occurred – since:

- a. the 2015 out-turned estimate of \$50 billion?
- b. the finalisation of the 2016 Defence White Paper and Integrated Investment Program?
- c. 26 April 2016?
- d. 30 September 2016?
- e. 25 January 2018?
- f. 11 February 2019?
- g. 5 March 2019?

#### **Response**

Finance provided a cost and risk statement as part of Cabinet Submissions for early design work, Future Submarine Program implementation update and the Future Submarine design contract. The cost and risk statements provide independent advice on the veracity of the cost estimates, risks, affordability and value for money associated with Defence Integrated Investment Program projects. This advice cannot be separated from the Cabinet Submissions. It is a longstanding practice not to disclose information about the operation and business of the Cabinet, as to do so would potentially reveal its deliberations which are confidential.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 24 (Future Submarines)**

What role did Finance have in assessing and agreeing the revised cost estimate of \$89.7 billion for the Future Submarines – and on what date(s) did this occur?

#### **Response**

Finance does not provide cost agreement for Defence Integrated Investment Program capital projects prior to Government consideration. However, Finance provides a statement relating to the veracity of the cost estimates and risks for inclusion in Cabinet Submissions related to Defence Integrated Investment Program projects. This advice cannot be separated from the Cabinet Submissions. It is a longstanding practice not to disclose information about the operation and business of the Cabinet, as to do so would potentially reveal its deliberations which are confidential.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 25 (Future Submarines)**

Given Finance's aforementioned role in cost assessments and with respect to Defence's Integrated Investment Program:

Does Finance have any concerns with the management and implementation of this acquisition given the massive increase in costs?

#### **Response**

Finance notes there has been no real cost increase in the Future Submarine Program. The movements in cost estimates have resulted from price basis updates, to reflect changes in inflation or movements in foreign exchange rates.

As outlined in the 2016 Defence White Paper and the 2020 Force Structure Plan, the Government's shipbuilding plans are based on long-term continuous builds of major warships and minor naval vessels. To reflect this, and the complexity and risks of shipbuilding projects, shipbuilding related capability programs are being managed by Defence through a phased approach as a mitigation strategy, with major shipbuilding capability programs presented for Government consideration at different stages of the program.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

#### **Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 26 (Future Submarines)**

Given Finance's aforementioned role in cost assessments and with respect to Defence's Integrated Investment Program:

Defence officials have previously said that the sustainment costs for the Future Submarines will be \$145 billion.

- a. Has this \$145 billion cost estimate been agreed with Finance and, if so, when?
  - i. If not, when did Finance and Defence last agree a cost estimate for the sustainment of the Future Submarines and what was the estimate?
- b. What role did Finance have in assessing and agreeing this cost estimate?
- c. Has there been any change to this cost estimate since 2015? If so, please identify on each occasion there has been a change to this estimate and by how much the estimate changed.

#### **Response**

Finance does not provide cost agreement for Defence Integrated Investment Program Capital projects. However, Finance provides a statement relating to the veracity of the cost estimates and risks for inclusion in Cabinet Submissions related to Defence Integrated Investment Program projects.

Noting Government's decision to take a phased approach to consideration of shipbuilding projects at different stages of the project, Finance provided a cost and risk statement for Future Submarine Program Cabinet Submissions related to early design work, implementation update, and design contract.

The estimated sustainment costs for the Future Submarine Program are based on Defence parametric estimates, noting that will be refined as the Future Submarine Program progresses through the design and construction phase.

Finance continues to review the whole-of-life costs and affordability of the Future Submarine Program as the design and technical specifications mature through the current design phase and yet to commence construction phases.

## Department of Finance

### Response to Question on Notice

#### SENATE ECONOMICS REFERENCES COMMITTEE

#### Inquiry into Australia's sovereign naval shipbuilding capability

#### Written Questions on Notice received from Senator Gallacher 7 September 2020

#### Question on Notice 27 (ASC Pty Ltd)

Per your submission, Finance provides oversight of ASC Pty Ltd as your Minister is the Shareholder Minister for this Government Business Enterprise.

- a. ASC Pty Ltd has reported attrition rates in the order of 9 to 10 percent among its engineer workforce that sustains the Collins class submarines. Is Finance concerned that this attrition rate is negatively impacting ASC and what, if anything, is Finance doing to address this issue with ASC?
- b. Has any consideration been given to the sale or privatisation of ASC Pty Ltd or any of its constituent parts?

#### Response

a. Workforce and staff turnover is under constant monitoring by ASC. While ASC has previously reported attrition in the order of 9 to 10 per cent in previous years, most recently on 3 March 2020, as part of the 2019-20 Additional Estimates, Mr Stuart Whiley, the Managing Director and chief Executive Officer of ASC stated (emphasis added): *“Overall attrition is just over nine per cent. I don't have percentages, but I can give you some figures on engineers: in calendar year 2018 we lost 24 engineers; in calendar year 2019 we lost 16 engineers; since last Senate estimates, in October, we've lost four engineers; and so far this year we've lost one. The general recent trend is that the attrition of engineers is actually dropping. I'm not aware of any significant change in operations staff.”* Finance notes that ASC Pty Ltd has maintained above international benchmark performance in Collins submarine sustainment and availability of the platform. This performance has been sustained for several years notwithstanding attrition and Finance remains committed to supporting ASC in the delivery of its objectives in submarine sustainment.

b. No.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### *Inquiry into Australia's sovereign naval shipbuilding capability*

Written Questions on Notice received from Senator Gallacher 7 September 2020

#### **Question on Notice 28 (ASC Pty Ltd)**

ASC Pty Ltd will be responsible for managing the life of type extension of the Collins class submarines, which is meant to begin with the full cycle docking starting in 2026.

- a. Have any contracts been signed with ASC for the performance of the life of type extension work from 2026?
- b. Has any consideration been given to bolstering ASC's capacity to perform the life of type extension on Collins – such as additional recruitment or contracting of expertise?
- c. Has a decision been made about where life of type extension work will occur – will it be in South Australia or Western Australia?
  - i. If not, when does Finance expect a decision will be made?
  - ii. Is Finance concerned that the delay in making this decision is impacting ASC's workforce and the organisation's ability to effectively plan for this work?
- d. On 28 February 2019, ASC produced an 'interim report' arising from the 'Collins Class Full Cycle Docking Location Study'. Has any subsequent modelling or analysis been conducted by ASC or the Government with respect to the future location of full cycle docking work?

#### **Response**

The Government's approach to the transition from the Collins Class fleet to the Attack Class is currently under consideration. The location of Collins Class full cycle docking is a component of this, and is yet to be considered.

To support the Government's consideration of this issue, a Steering Group comprising officials from the Department of Finance, the Department of Defence (Defence) and ASC Pty Ltd) has continued to work on options for the location of full cycle docking.

There are currently no contracts in place for the life of type extension work expected to commence in 2026. ASC continues to work collaboratively with Defence in relation to planning the life of type extension of the Collins Class submarine including in relation to development of the required capabilities.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

**Written Questions on Notice received from Senator Gallacher 7 September 2020**

#### **Question on Notice 29 (ASC Shipbuilding)**

What IP or other skills/capability transfer will occur through the separation and transfer of ASC Shipbuilding to BAE Systems Australia? And how will this be retained by ASC upon transfer of ASC Shipbuilding back to it?

#### **Response**

ASC Shipbuilding Pty Ltd was transferred to BAE Systems Australia in December 2018.

The Commonwealth of Australia retains a sovereign share in ASC Shipbuilding. BAE Systems is obliged to develop and ensure the retention in Australia of intellectual property, a highly skilled workforce and the associated equipment and tools to be transferred back to the Commonwealth at the end of the Hunter Class program.