

## Defence Portfolio

# INQUIRY QUESTION

(Question No. 1)

Mr Julian Hill MP asked the Department of Defence the following question, upon notice, on 19 May 2023:

CHAIR: The final Tender Evaluation Plan said clearly that value for money was going to be a matter for government; it was not an assessment that officials were going to undertake—which seems peculiar. I have never heard before, in my almost seven years on the audit committee looking at numerous procurement audits, that all of a sudden officials would write a Tender Evaluation Plan that just wished away value for money and said, 'We won't worry about that; government will decide that in some mysterious cabinet process'. Can you point to any other Tender Evaluation Plan where the department just said, 'We won't worry about that; government will worry about money'? Or was this unique?

Mr Yannopoulos: I would have to take it on notice to be absolute, but I am not aware of another circumstance.

The Department of Defence has provided the following answer to the question:

No, this situation appears to have been unique.

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# INQUIRY QUESTION

(Question No. 2)

Mr Julian Hill MP asked the Department of Defence the following question, upon notice, on 19 May 2023:

Rear Adm. Malcolm: I do believe there was sufficient commentary in the Auditor-General's report. I think it is important to note here that we certainly acknowledge and welcome the Auditor-General's report. We have had that now for a couple of weeks. Whilst we have worked closely with the ANAO over the last year—so it's a very extensive report—we only received the final report in the last couple of weeks. It is over 100 pages long. It's very comprehensive. It's very detailed. There are many matters that we should consider carefully and deeply. I want to make the point that none of the officials that are here today were involved in that decision-making and tender selection process. We're very keen to understand what the committee would like further. It's unlikely we can talk about what was going through people's minds at that time, or specifically regarding your questions about why or why not the TEP was changed. I note that we are very keen to help the committee understand that. We wish to understand that. We wish to learn and improve our processes. That's something that we take very seriously, as officials.

CHAIR: Could you take on notice the specific questions, to the extent that you can, about the costs; we don't need to deal with that here. We will obviously come back to this. Given the seriousness of the report, we want to have an initial hearing. Can you explain why the French FREMM project was removed from pass 1 and who made that decision?

Rear Adm. Malcolm: I will need to take that on notice.

The Department of Defence has provided the following answer to the question:

French FREMM: Rationale for including the BAE Type 26 rather than the French FREMM was provided in the Sponsor's paper to the Defence Capability and Investment Committee. The Minutes of this meeting recorded the final outcome and not the discussion leading to the outcome. None of the senior personnel currently serving in the Department were present at that meeting.

Costs: The submission included comparisons of affordability over the forward estimates and through the acquisition phase compared to the IIP provision. For each option the total whole of life costs provided included capital costs, comparison to the IIP capital provision and the future sustainment provision.

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# INQUIRY QUESTION

(Question No. 3)

Mr Julian Hill MP asked the Department of Defence the following question, upon notice, on  
19 May 2023:

CHAIR: BAE's design, which ultimately won, was evaluated as better than the other two proposals. Did that proposal meet the 23 high-level capability requirements?

Rear Adm. Malcolm: I'll take that on notice. I say that based on what I am able to share out of the cabinet submission. I don't want to overstep the mark there.

CHAIR: Ms Lutz was nodding in response to my question. Did you have something to add?

Ms Lutz: You will see in the table that is in the ANAO report as to whether it meets the requirements or not. One of those criteria was the tender admission system. It states that BAE Systems meets requirements.

CHAIR: All 23 high-level capability requirements?

Ms Lutz: If it met the requirements of the tender admission system, that was the high-level capability requirements.

CHAIR: Could you take that on notice so that I can get a specific response about all 23 requirements.

Ms Lutz: Okay.

The Department of Defence has provided the following answer to the question:

The Hansard has incorrectly recorded Ms Lutz as saying 'tender admission system' rather than 'tendered mission system'.

One of the 10 evaluation criteria that all three tenders were assessed against was titled 'tendered mission system'. This criterion assessed the level of compliance of each design with the 23 high level capability requirements. The BAE offer was assessed as 'Meets Requirements, Medium Risk' following completion of the offer definition phase.

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# INQUIRY QUESTION

(Question No. 4)

Mr Julian Hill MP asked the Department of Defence the following question, upon notice, on 19 May 2023:

CHAIR: I am responding to your interjection. That's a fact. The former government did that. We are talking about why the advice appeared to be deficient. In January 2023, the Surface Ships Advisory Committee advised that when the previous government selected the Type 26 as the reference design it was yet to be fully designed, built and tested. It was assessed as 'extreme risk' in BAE's own tender response. They are pretty strong words: 'extreme risk'. How was that supported as compliant with the tender requirements?

Rear Adm. Malcolm: I am not sure that I can talk directly to how it was seen to be compliant, Chair. I make the comment that, in putting up our advice to government a number of things were laid out, including cost and risk and other factors. It included capability, efficiency, effectiveness, economic value—all those things. That was certainly done, including things like the 10 per cent efficiency dividend that was laid out for—

CHAIR: Hang on. A '10 per cent efficiency dividend'; is that what we are calling it now?

Rear Adm. Malcolm: Whatever the 10 per cent was. I would note that we're still trying to understand that.

CHAIR: We're still trying to understand how Defence put advice up to government that they could buy something for 10 per cent less.

Rear Adm. Malcolm: What I am telling you, Chair, is that the officials at this table need to better understand what occurred in that respect.

CHAIR: I don't envy your position. I understand that.

Rear Adm. Malcolm: I am committed to assisting the committee on that basis. That submission was put. The comments around extreme risk—all of that was laid out for government. Government took a decision with all that information. It's important to note that was all provided for assessment. CHAIR: That's fine. Could you take on notice and explain to us how the extreme risk side of things was compliant with the tender requirements. You are telling us that government was informed of the extreme risk in the second-pass advice?

Rear Adm. Malcolm: Yes, Chair.

The Department of Defence has provided the following answer to the question:

For each evaluation criteria a compliance assessment and risk assessment was completed. Compliance was assessed on whether the tender response met, exceeded, was marginal or did not meet the specified requirement. Risk related to the assessment of the successful implementation of the tendered solution. Hence the compliance is the critical element and the risk indicates areas that would need to be managed and mitigated to enable success. Defence assessed overall risk as high for all of the tender responses.

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# INQUIRY QUESTION

(Question No. 5)

Mr Julian Hill MP asked the Department of Defence the following question, upon notice, on

19 May 2023:

CHAIR: How were the 'minimum change to the reference ship' tender evaluation criteria assessed for the Type 26 versus the Australian requirements?

Rear Adm. Malcolm: I would need to take that on notice, Chair.

The Department of Defence has provided the following answer to the question:

Compliance to meet the Australian requirements, referred to as minimum change, was determined by the assessment against the high-level capability requirements. All tendered ships required modification to incorporate the Australian requirements.

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# INQUIRY QUESTION

(Question No. 6)

Senator the Honourable Linda Reynolds asked the Department of Defence the following question, upon notice, on 19 May 2023:

Senator REYNOLDS: We could schedule in time, if it works in with your time frame, to give you an opportunity to do what you need to do through that process. Para 40 says: The February 2022 Independent Assurance Review (IAR) was not assured that there was a clear path to realising the policy objective... This was about personnel and skills. Who did the independent assurance review? Does anyone know, offhand?

Rear Adm. Malcolm: We'd need to take that on notice unless it's in the report.

The Department of Defence has provided the following answer to the question:

An Independent Assurance Review of SEA 5000 Phase 1 – Hunter Class Frigate commenced in late 2021 and was conducted by Dr Ralph Neumann (Lead Reviewer) and Mr Ian Sharp (Reviewer).

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# INQUIRY QUESTION

(Question No. 7)

Mr Julian Hill MP asked the Department of Defence the following question, upon notice, on 19 May 2023:

CHAIR: Is it normal procedure to reduce a percentage of the production cost without the tenderer's agreement? One of the things that also stunned me in the paperwork that went to government was that it appears that a price was put in and the Department of Defence, for reasons that it's not been able to explain, knocked 10 per cent off the price in sending the bill up to government.

Rear Adm. Malcolm: Again, we don't have an understanding of why that occurred. I would note that it is not normal practice. We will take on notice to answer that question.

The Department of Defence has provided the following answer:

No. The 10 per cent reduction was applied across all three tenderers to the cost estimate for construction only.



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# INQUIRY QUESTION

(Additional Questions 1 - 27)

The Committee asked the Department of Defence the following additional questions, upon notice, on 30 May 2023:

1. How has the Department addressed the two recommendations made by the Auditor-General regarding record keeping and advice to government?
2. The report states that entities have a duty under the PGPA Act to promote the proper use and management of public resources in accordance with the Act, including by complying with the CPRs. Does the Department agree with the report's suggestion that further training and oversight is required of Defence officials advising on major capital acquisition projects?
3. Has Defence considered or planned training for Defence officials involved in major projects to address the ANAO's findings?
4. Will the Department consider the other suggestion that more active engagement is needed with Finance to ensure procurement is compliant with the Commonwealth's procurement framework?
5. How will the Department improve its advisory process to provide complete and timely advice to Government?
6. What steps will be taken to address the unilateral application of a 10% reduction to tendered build costs by Defence without negotiation with tenderers?
7. Will there be any changes to the governance structure or oversight mechanisms within the Department to ensure these issues are not repeated in future projects?
8. What steps will the Department take to ensure that key records, including the rationale for the procurement approach, are retained in future processes?
9. What lessons have been learnt from this project to ensure that an effective tender process is conducted for ship design for future projects?
10. Was value for money a key consideration in the tender process? a. Did Defence engage with the Department of Finance on the appropriateness of this process?
11. Defence why did you exclude the whole-of-life cost estimates for the tenderers from the advice provided to government?
12. Why did Defence choose to not compare the maturity of design across the tenderers in the advice provided to government?
13. Was Finance consulted throughout the procurement process?
14. Defence, please advise why the contract management plan was created so long [3.6 years] after the contract was signed?
15. What are the potential financial pressures faced by Defence on the Hunter Frigate project?

16. Can you provide an update on the current cost estimates for the Hunter Class Frigate project and any significant cost overruns that have been experienced?
17. How does the Department plan to address the 18-month delay and additional costs in the Hunter Class Frigate project?
18. How does Defence plan to mitigate the risks and issues identified in the Independent Assurance Reviews, particularly regarding insufficient resources and expertise in the project team?
19. What is the impact of the reported unaffordability of the Hunter Class Frigate project on the broader Defence budget and allocation of resources?
20. What are the implications for Australia's naval capabilities?
21. How does the Department plan to address the significant underspend of: a. \$134.7 million against the management services scope? b. \$328.1 million against the design and productionisation scope?
22. How will these underspends be allocated or reinvested in the project?
23. What provisions are in the Department's contract with BAE to hold them accountable for underspend and delays?
24. What are the lessons learnt from this underspend that will inform future decision-making and management?
25. How will Defence ensure the Hunter Class Frigate project complies with the Australian Industry Capability targets to effectively transfer relevant defence personnel and skills to Australia?
26. What actions will be taken in response to the Defence Strategic Review's findings on the Hunter Class Frigate project?
27. How will the Hunter Class Frigate project be aligned with the Defence Strategic Review?

The Department of Defence has provided the following answer to the Committee's questions:

1. A management action plan has been developed in response to the ANAO report, and an internal review has been established to identify lessons learnt and updates to processes, where required.
2. Defence agrees that training is always beneficial to reinforce the requirements of the CPRs.
3. No.
4. Yes
5. Defence will provide advice to Government and Ministers in accordance with the Cabinet processes and any other direction given by the Government of the day.
6. The reduction has not occurred in other tender evaluations. For the Hunter project, Defence has not entered into a contract for ship construction and will not do so until the cost has been negotiated and agreed with BAE Systems and the Government has approved the procurement.
7. Defence considers that current governance arrangements for major capital acquisitions are appropriate.
8. The ANAO did not find any shortcomings with Defence's record keeping within the Hunter Class Frigate project post contract signature. Defence recognises that the ANAO recommendation relates to historic record keeping. In 2021, the Department released a new

Defence Data Strategy 2021-2023. This strategy underpins Records Management within the Department and is being followed by the project.

9. An internal review is underway to determine lessons learnt and process improvements.
10. Yes.  
Yes.
11. Whole-of-life costs were not excluded. Given that all of the ships under consideration included modifications to accommodate Australia's unique requirements, a rough order of magnitude sustainment estimate was sought but was unsuitable for evaluation given the level of uncertainty as the design changes for each of the options had not been commenced. The sustainment provision was used as a fair substitute in offering a whole-of-life cost estimate.
12. The design maturity was considered and a comparative assessment included in the submission.
13. Yes.
14. The contract management plan was created in December 2018 and underwent multiple updates until it was approved in August 2022. The Capability Acquisition and Sustainment Group has long standing and well documented business processes for the management of Defence contracts. While it is considered good practice to have a Contract Management Plan tailored to specific contracts, the absence of a specific SEA 5000 Contract Management Plan did not prevent the SEA 5000 project office from exercising appropriate governance practices during the first few years of the contract.
15. Similar to many aspects of Defence operations and in other parts of society, cost increases are being experienced for labour, materials, transport, shipping and storage.
16. No. The Government will be provided with an updated cost estimate once the formal offer from BAE systems has been received for the first batch of ships, negotiations have been conducted, and the formal submission put to the Government. The current and only approved phase of the project, Design and Productionisation, will be delivered within the approved budget.
17. Government in June 2021 and the cut steel date adjusted from December 2022 to June 2024. The project is on track to commence production against the new agreed date of no later than June 2024.
18. The issue of expertise in the project team has been addressed in the combat systems area by the CSI Collaboration Agreement between Defence, BAE Systems, Lockheed Martin Australia and Saab Australia. The resource issue is being addressed by having a high probabilistic schedule based on a realistic resource availability given global pressures.
19. The Government's response to the Independent Analysis Team's report will determine the resource allocation for Australia's surface combatant capabilities. The Defence Integrated Investment Program will be rebuilt in order to deliver the highest priority capabilities detailed in the Government's response to the Defence Strategic Review.
20. The Government's response to the Independent Analysis Team's report will determine the implications for Australia's surface combatant capabilities.

21. The reported underspend was at a point in time. The Design and Productionisation stage of the project is currently forecast to be delivered within the approved budget.  
  
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22. The reported underspends were at a point in time. The Design and Productionisation stage of the project is currently forecast to be delivered within the approved budget.
23. Profit is at risk in the current design and productionisation contract for milestones missed from July 2022 onwards.
24. In a 'cost plus fixed fee' contract, underspends and overspends are inevitable. Such contracts are typically used when there is uncertainty in the schedule and/or a risk profile for which an alternative contract type such as target cost incentive model is inappropriate. Defence considers that the current commercial arrangement (cost plus fixed fee) is appropriate for the Design and Productionisation stage of the project.
25. BAE is meeting their AIC target that was put in place when the Head Contract was executed in February 2019. This is monitored at the monthly business review and quarterly progress meetings. The transfer of skills will be monitored to ensure the required design and construction skills are in place in accordance with the Sovereign Capability and Option Deed.
26. and 27. The Defence Strategic Review recommended the conduct of an independent analysis of Navy's surface combatant fleet capability. The Government accepted this recommendation and an Independent Analysis Team has been established. The Hunter class frigate project will be considered as part of the Independent Analysis Team's review.