

OPENING REMARKS
SSCFADT INQUIRY INTO PROCUREMENT PROCEDURES
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Introduction

Good morning.

Chair, I thank you for the opportunity to provide some remarks in the absence of the Defence Secretary, and before the Defence Science and Technology Organisation (DSTO) provide their statement.

These comments reflect a joint Defence / DMO statement and seek to address the range of issues raised by the Committee, the concerns broached by the various submissions to the Committee, as well as provide you with a perspective on the context and complexity of defence major capital procurement procedures and the initiatives currently in place or being developed to ensure high quality outcomes for Government and the ADO into the future.

Key Messages

Defence projects are complex because of their scale, the levels of advanced, often developmental, technology employed, the demanding environments they must operate in and the levels of assurance required. Procurement varies from developmental / leading edge systems with significant capability, cost, and schedule risks through to less complex off the shelf buys.

All of these projects involve some level of risk. Risk can't be avoided but it must be measured, mitigated and managed.

We acknowledge that Defence has had challenges in achieving the rate of project approvals presented to Government in the White Paper 2009. While the rate of approvals has been lower than expected, there has been no reduction in the rigour of the approval process. Through a range of internal initiatives and reform implementation, the rate of approvals is now picking up, at the same time as we increase contestability and accountability expectations.

Defence also acknowledges that there are challenges regarding delays in procurement activities post-project approval and is addressing these on a case-by-case basis and at an organisational level.

Defence is committed to enhancing the rigour and accountability throughout the capability lifecycle. To examine each project's capability, cost, schedule and risk, Defence has established a comprehensive series of internal quality assurance processes through its committees, working groups, stakeholder groups and gate reviews.

Shortfalls in capability and capacity of personnel in CDG, DMO and in industry to perform at the necessary standards are being progressively addressed through a range of professionalisation and collaborative specialist skilling programs that are being developed and implemented.

CDG is enhancing early engagement with industry through the Capability Development Advisory Forum and associated Environment Working Groups to ensure both Defence and Industry have better understanding of project feasibility, options and risks earlier in the process.

Improvements in the capability development and acquisition lifecycles are being realised through the ongoing implementation of recommendations from the 2003 Kinnaird and 2008 Mortimer reviews. Additional reform initiatives resulting from the Pappas, Black and Rizzo reviews will further enhance these processes over the medium to long term.

Pace of Project Approvals

The unprecedented volume of capability projects associated with White Paper 2009 has exceeded Defence's ability to progress projects through the 2 Pass Government process at the rate initially expected.

In 2009-10, 28 major Defence capability projects were approved.

In 2010-11, 28 capability projects were approved. That is about the historic average and, while less than planned at the time of the Defence white paper, 2010-11 needs to be seen in a context of the election, the extended caretaker period and the complete change of Defence's ministers following the election.

So far in 2011/12, 9 projects have been approved in the first three months and we are seeking to achieve well above the historical average over the course of the FY.

There are three broad issues that have contributed to our inability to meet the pace of project approvals called for in the White Paper 2009:

- First, we need to identify problems in the development and acquisition of major capabilities earlier. As the minister recently announced, we are instigating a series of tiered measures focused on improving project management, minimising risk at project start and identifying problems early. These include the early indicators and warning system we are implementing, the expansion of the existing Gate review processes and the introduction of a quarterly accountability report to ministers, the secretary and the CDF.
- Second, Defence has expressed difficulty in attracting and retaining an appropriate number of skilled staff to progress our projects. Partly for this reason, we have made significant efforts to increase resources and improve skilling in the Capability Development Group, which is also exempt from the additional reductions to the forecast APS workforce.
- Third, major Defence projects are technically complex, and some have taken more time than was originally anticipated in order to mitigate technical risks ahead of government consideration. As the Minister has said, he will not accept a reduction in rigour to achieve a faster approval rate.

Higher levels of scrutiny are also being applied to projects to ensure costs are well understood and risks are appropriately identified and managed so as to ensure that Defence, the Government and the Australian tax payer obtains maximum value for money.

It must also be remembered that there was always a level of over-programming built in to the Defence Capability Plan – i.e. more projects were identified for approval than could be progressed to allow flexibility should some projects fail to achieve all requirements for approval in the time provisionally allotted.

Way Ahead

A CDG internal review of processes and time lines has already been completed. It aims to install greater discipline to the project approval process.

In addition Defence is reviewing its current and future budget estimating processes and forecasts to ensure we have better estimates of funds required to progress projects in the Defence Capability Plan.

Capability Development Group is also conducting a review of the Defence Capability Plan to ensure it better takes account of factors such as slippage, contingency funding, indexation and overprogramming. As part of this review MINDEF has directed a reduction in the level of over programming within the Defence Capability Plan (DCP).

As part of the strategic reform program, a Business Process Review of our major capability development process will be undertaken. This covers the force development process from idea to delivery.

ANAO has commenced a performance audit of the 2 Pass process. Results of this will further inform areas that can be improved upon.

Procurement Process Post Project Approval

The DMO is responsible for the acquisition and sustainment of the materiel elements of operating capability for the ADF. As a Prescribed Agency, the DMO utilises a purchaser – provider model, underpinned by agency service agreements, to deliver commercial, engineering and project management services in an accountable, outcome focussed and business-like manner to Defence Capability Managers.

Since the DMO was established in 2000, there has been a commitment to the process of continual improvement. In that time, it also has to be said, procurement in Defence has been the subject of significant external scrutiny and review. This has included the Kinnaird, Mortimer and Rizzo Reviews, the Defence Budget Audit, two White Papers and more than 25 ANAO acquisition or sustainment performance audits.

More recently we have also had the Major Project Report as a collaborative effort between the Audit Office and the DMO.

These reviews in conjunction with internal business initiatives have been major contributors to enhancements in procurement processes, and stronger links through the entire capability development lifecycle. Across Defence and the DMO we are now starting to see clear evidence of improvement as a result.

Based on internal analysis of past performance, we believe that the DMO is becoming more effective in delivering projects. The DMO has continued, on average, to deliver approved projects within the available funding.

As has been noted publicly and in committees in this place in the past, the real challenge has been in delivering projects to schedule. In this area too, we have seen a steady improvement but we can and must continue to do better.

Since 2000, we have seen the average level of schedule slippage decrease from over 50% to around 30%, and there remains room for further improvement, albeit at a slower pace.

It is also worth noting that DMO's performance in relation to schedule is comparable to the acquisition organisations within the UK Ministry of Defence and the US Department of Defence.

Much of this success is linked to identifying and addressing problems and risks earlier in the project life cycle. Even with the best project managers – and we believe we have some very good ones – it is decisions taken and delays suffered in the start-up phases of projects that are the most difficult to recover as the project matures.

At this point it is worth re-stating a point that's been made before about our approach to project risks – whether they are to capability, cost or schedule. In the technologically demanding and expensive defence procurement marketplace we have to manage risk rather than avoid it.

In simple terms, to avoid schedule risk by lengthening project delivery timeframes would deny the capability to the warfighter in the timeframe that they need it. To avoid cost risks by always opting for a fielded capability solution rather than investing in the development of a new technological solution could similarly deny the ADF a capability edge.

In seeking to achieve the best capability outcomes for the warfighter, the best commercial outcome for the Government and industry and the best value for money result for the taxpayer, we cannot avoid risk and even with management strategies in place, we are unlikely to be able to retire all schedule risk from every project.

Defence notes that one of the common themes contained in submissions and witness statements to this committee relates to the inconsistent application of policy and procedures throughout the capability life cycle.

Whilst there may have been areas of inconsistency in the past, a number of steps have been taken to improve this aspect including:

- Under the Strategic Reform Program (particularly the Mortimer and Capability Development Reform Streams), the approval process has been reviewed and strengthened.
- The revised Defence Capability Development Handbook articulates more rigorous governance and process requirements. The internal Defence capability committees'

Business Rules and Standard Operating Procedures have also been revised and promulgated.

- Defence continues to strictly observe the rules stipulated in the Government's 'Approval Mechanisms for Defence Capital Investment Projects'.

Way Ahead

Recommendations of the Kinnaird, Mortimer and Pappas reviews continue to be implemented, resulting in increased rigour and reduced slippage rates.

Mortimer reform initiatives will clarify responsibilities and result in improved through life support strategies for new capabilities, and implementation and maturation of an Early Indicators and Warnings system will improve Defence and Government's ability to react to failing projects.

Other on-going reforms to Defence procurement are listed in the Defence paper submitted to the Inquiry, including reforms to early procurement stages, project management, existing capability management, introduction of an Early Indications and Warnings system and management of projects of concern.

Our acquisitions since the White Paper show we are continuing to build Force 2030 and that we can react and adapt to meet emergent capability gaps.

Rigour and Accountability in the Capability Lifecycle

The Kinnaird and Mortimer reviews focused on capability acquisition accountability and transparency. Many reforms associated with these reviews have been implemented and more are being implemented, resulting in robust and effective governance of capability development and acquisition.

These reviews, as well as the Black Review of accountability in Defence, address the division of responsibility between capability managers and other parts of the Defence organisation that deliver inputs to capability.

CDG manages the development of the governance, management and technical documentation for future Defence capabilities for consideration by Government.

It works collaboratively with the individual Services, other Defence Groups including CIOG, HQJOC and the DMO to ensure that identified needs can be best met through the proposed acquisitions.

The development of capability proposals for government consideration is guided by and tested at a number of gates starting at Project Initiation and continues until the project is approved by government for acquisition. Prior to Project Approval (ie Second Pass approval), the primary review mechanisms are:

- Project Initiation Board (PIB);
- Capability Development Stakeholder Group (CDSG);
- Options Review Committee (ORC);
- Capability Gate Review Board (CGRB);

- DMO Gate Reviews;
- Defence Capability Committee (DCC); and
- Defence Capability Investment Committee (DCIC).

Following Second Pass approval, the project is monitored through the:

- Capability Manager Steering Group (CMSG);
- Project Management Stakeholder Group (PMSG); and
- DMO Gate Reviews.

In many cases there are also Three-Star level Steering Groups – generally for the largest, most complex projects, such as JSF, Air Warfare Destroyer – and as required projects will return to the Defence Capability Investment Committee to resolve major issues.

These committees combine to provide assurance for Government that the capability to be acquired meets strategic guidance, will provide a timely and cost effective capability at an acceptable level of risk and that the project has been developed in accordance with the agreed guidance and plans, and to a depth and level that is commensurate with the outcome desired and identified risks.

There has also been increased focus on both organisational and personal accountability.

Initiatives have included:

- Formal customer-supplier arrangements between Defence and DMO;

- Greater emphasis on accountability for delivery of capability residing with the capability manager; and
- Clearer descriptions of roles and responsibilities for individuals (including Charters for Project and Product Directors in DMO).
- Joint Project Directives from CDF and Secretary to relevant Group Heads in the capability development process.

The Capability Development Group's (CDG) Capability Investment and Resources (CIR) Division is charged with performing independent review of capability proposals.

In light of the announcement of *Improving Personal and Institutional Accountability in Defence* on 9 August, this division will be moved directly under the new Associate Secretary (Capability) and given the responsibility of establishing even stronger contestability. Moreover, scrutiny is also undertaken by Defence and external stakeholders throughout the capability development process as documented in the Defence Capability Development Handbook.

There has been an increased focus on reporting to Government on capability development and acquisition, through development of an Early Indicators and Warnings system, Projects of Concern and DCP Highlight Reporting, as well as progress toward Quarterly Accountability Reporting. Such improvements to reporting will also serve to better synchronise the relationships between capability managers, CDG and DMO as capabilities are acquired and introduced into service.

Staff Skills and Abilities

Over the next decade, Defence will continue its major procurement program to deliver the capability requirements for Force 2030. Running concurrently will be the Government's Strategic Reform Program which will improve the way we do business, and reduce our costs so that those resources can be reinvested into Force 2030.

Like many other organisations, Defence and DMO face the challenge of attracting and retaining qualified and skilled staff to progress this large number of projects throughout the capability life cycle.

Several skilling and professionalisation strategies have been implemented to enhance the skills base of Defence and DMO workforces.

Identified skill shortages are being addressed via education and training, targeted recruitment and employment schemes, and 'above-the-line' contractor support when necessary.

As part of our commitment to improve our performance, Defence and DMO have introduced a professional industry standard certification framework for procurement and contracting staff. This includes a Continuing Professional Development (CPD) program.

A structured CDG Desk Officer Skilling Program (DOSP) has been implemented to address core Capability Development (CD) skilling. The DOSP provides an annual induction course and then a flexible progressive skilling program to address project and individual needs.

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Skills shortages in Cost Estimation are also being addressed through the delivery of structured overview and detailed level training courses for CDG desk officers.

The DOSP is improving the skill base of the workforce. Early indicators are the increasing quality and acceptability of submissions and supporting business cases. Realisation of the full benefits of the initiatives will be protracted due to the extended procurement lifecycle (two to five years).

Overall, CDG managers currently deem 90% (104/117) of the Desk Officers to be sufficiently skilled to perform their assigned duties without additional support.

The DMO has, over recent years, maintained a strong focus on professionalization and up-skilling of both its staff and that of industry and is working toward an integrated professional framework (vocational, university and professional accreditation) and has introduced professional industry standard certification framework for procurement and contracting staff.

DMO has also completed work with Government Skills Australia and other Government agencies on the redevelopment of Australian vocational procurement and contracting competencies and qualifications.

DMO attracts and retains engineers and technical staff via the Materiel TAFE Employment Scheme, Materiel Graduate Scheme, Materiel Undergraduate Scheme and the Engineering Undergraduate Scholarships at ADFA.

To attract and recruit high quality engineers and technical staff, Memoranda of Agreement have been established with Engineers Australia and the Australian Maritime College.

DMO is continuing to support the Australian Procurement and Construction Council initiative to develop Strategic Procurement courses at Australian Technology Network universities and with the University of Canberra.

Way Ahead

CDG will continue to enhance the skills of its workforce through the ongoing development of the DOSP, including implementation of structured coaching, deployment of additional e-learning modules and the continuous improvement and evaluation of skilling outcomes. Realisation of the full benefits will take time due to the project procurement lifecycle (of up to five years).

Defence is taking steps to meet the Minister's direction on 9 August to improve skilling and retention. The Services have been asked to fill desk officer positions in CDG with postings of three years, as well as to place greater numbers of personnel on professional development courses such as the Capability and Technology Management College (CTMC).

DMO will undertake professionalisation initiatives including membership and certification with the Chartered Institute of Purchasing & Supply, Australasia (CIPSA) or the Australian Association of Procurement and Contract Management (AAPCM), development of further training courses in areas of concern, establish a Procurement Professionalisation Configuration

Control Board and enable DMO Procurement courses to be available across the Commonwealth and State/Territory public sectors as well as (where possible) to industry.

DMO is committed to the continued development of maritime engineers through the sponsorship of selected individuals to attend the submarine design course at the University of London. Work is also underway to develop a course equivalent to this international standard, to be delivered locally.

DMO is planning a recruitment register to specifically attract experienced Engineers and Technical Officers who have retired, and are interested in contributing to the DMO workforce under flexible working arrangements or in a non-ongoing capacity.

Industry Aspects

I would like to make a few comments in relation to industry's role in delivering defence capability.

In this financial year, DMO will direct over \$10 billion or more than 90 per cent of its budget to industry for acquisition and sustainment. Of this it is estimated that more than \$5 billion will be spent in Australia. The long term forecast for in-country expenditure indicates that more than half of future funding will be directed to local industry.

Industry engagement remains an important aspect of delivery and support of future capability.

Industry engagement forums have recently been re-energised and enhanced by the establishment of the Defence Industry Innovation Board and re-energising of the Environmental Working

Groups (of which there are five) which report to the Capability Development Advisory Forum.

Post second-Pass, the CEO Roundtable established with key Defence Industry leaders in 2009 has also been a successful engagement mechanism.

To facilitate industry's ongoing role in delivering defence capability, the Government released its

Defence Industry Policy Statement in 2010. The Government expects that Australian defence industry will become more resilient and self-reliant. For its part, the Government and Defence

will provide programs and facilitate opportunities for competitive companies to enhance their capacity for innovation, skilling and productivity, and prosper through integration in the global

supply chains of the multinational primes and their major subcontractors.

Importantly, the Government has ruled out returning to an offsets or protectionist approach to

work being done in Australia. Decisions on defence procurements will continue to be made with value for money as the core commercial consideration.

The Industry Policy Statement takes a strategic view of the various Defence support programs

available to industry to ensure they work in a complementary way across the total capability development, acquisition and sustainment cycle.

It provides a number of assistance programs to improve productivity, innovation and competitiveness. To facilitate this, the government is investing almost \$450 million in these programs over a ten year period.

Way Ahead

Through the establishment of the Defence Industry Innovation Board and re-energising of the Environmental Working Groups under the Capability Development Advisory Forum, significant improvements to the front end phases of the capability lifecycle are expected to be realised over the coming years.

The implementation of initiatives contained in the Defence Industry Policy Statement will help ensure industry capability and capacity to meet the future high demands of delivering Force 2030.

Summary

Defence is defining and acquiring highly complex and often developmental weapon systems and supporting systems, requiring application of Australia's most complex project management discipline.

Force 2030 – comprising some 150 projects valued at over \$150 billion - is a very ambitious program to deliver and it was planned to be so. Defence has had challenges achieving the rate of project approvals originally envisioned but the rate of approvals is now picking up.

At the same time as delivering these long term requirements, Defence is also progressing a number of short notice acquisitions to meet urgent operational capability gaps. The Largs Bay acquisition and additional C-17 are good examples of the flexibility to meet urgent demands.

CDG has been allocated additional resources to address the high workload and has expanded its skilling program to ensure its people have the right skills to do the job. CDG is also investigating an industry partnership arrangement where Defence skills are boosted by industry.

DMO has become increasingly outcome focussed. An analysis of pre-Kinnaird major projects (1992-2005) against all post-Kinnaird major projects currently underway has been undertaken.

The analysis demonstrated that:

- In relation to cost, projects after Second Pass approval continue, on average, to be delivered under budget.
- There has been a significant improvement in the schedule performance of post-Kinnaird projects
- There is an increase in the number of projects where project managers expect to deliver the required capability (an increase from 77 percent to 86 percent).

Defence and DMO are enhancing engagement with industry through the Defence Industry Innovation Board, the Capability Development Advisory Forum and associated Environment Working Groups to ensure better understanding of project feasibility, options and risks early in the process.

CDG and DMO are working together to ensure a greater level of scrutiny and analysis of procurement risk and estimates during the capability development process.

DMO will be enhancing its use of performance metrics to improve project and business management with the objective of clearly identifying risks and to provide triggers for earlier intervention.

To improve schedule management, intensive training and development of specialist schedulers is also being conducted.

DMO will continue to ensure that the management of the Projects of Concern and reporting of projects in the Major Projects Report remains a priority.

DMO is committed to strengthening its engineering, logistics and contracting templates, policy, practices and management systems to greater support complex and technically challenging projects and in-service equipment management.

Recommendations of the Kinnaird, Mortimer and Pappas reviews continue to be implemented, resulting in increased rigour and reduced slippage rates.

Other on-going reforms to Defence procurement are listed in the Defence paper submitted to the Inquiry, including reforms to early procurement stages, project management, existing capability

management, introduction of an early indications and warnings system and management of projects of concern.

In all of this, it's important to recognise that the 'Force 2030' envisioned in the White Paper is not some far off concept. Force 2030 is being delivered today – every new piece of equipment that is acquired, every facility that is built and every recruit that graduates from basic training is part of it. The new Chinook helicopters, the Landing Helicopter Docks, Wedgetail Early Warning and Control aircraft and the Cyber Security Operations are as much a part of Force 2030 as the future submarines or replacements for the ADF's future frigates which will be delivered well into the future.