



**Australian Government**  
**Department of Defence**  
Strategy, Coordination and Governance

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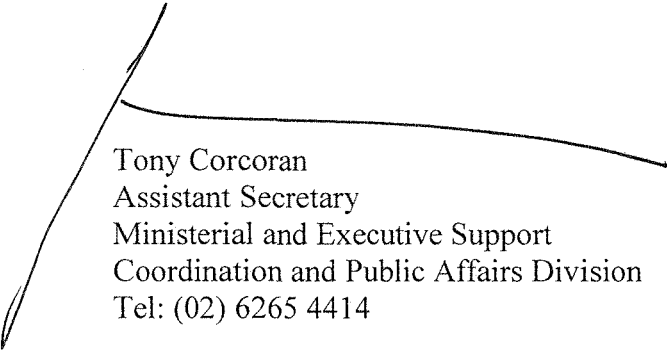
Dr Kris Veenstra  
Inquiry Secretary  
Joint Committee on Public Accounts and Audit  
Parliament House  
CANBERRA ACT 2600

Dear Dr Veenstra *kris*

Please find attached responses to questions submitted to Defence by the Joint Committee on Public Accounts and Audit regarding the Inquiry into Financial Management and Equipment Acquisition in Defence and the Defence Materiel Organisation.

If you have any questions or concerns, please do not hesitate to contact Mr Alex Tewes, Director Statutory Reporting and Accountability, on (02) 6265 6277.

Yours sincerely

  
Tony Corcoran  
Assistant Secretary  
Ministerial and Executive Support  
Coordination and Public Affairs Division  
Tel: (02) 6265 4414

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**Question 1**

**Updates on Remediation**

- a) With regard to remediation plan S2, on 29 March 2007, Mr Phillip Prior tendered an Exposure Draft regarding Proposed Amendments to AASB 102 – Inventories Held for Distribution by Not-for-Profit Entities. Can you confirm this amendment has now been approved by the AASB?
- b) Are you able provide a further update to Submission 4.5 (dated 12 September 2007) regarding GSI pricing (with particular regard to the use of surrogate or estimates where history prices cannot be verified)?

**RESPONSE**

- a) AASB 2007-5 Amendments to Australian Accounting Standard – Inventories Held for Distribution by Not-for-Profit Entities [AASB 102] was released by the Australian Accounting Standards Board (AASB) in May 2007 with an application date for reporting periods beginning on or after 1 July 2007. The amendment required not-for profit entities to measure inventories held for distribution at cost, adjusted where applicable for any loss of service potential.

Defence adopted this amendment early from 1 July 2006 as permitted by the then Department of Finance and Administration (refer Finance Brief 30 – Amendment to Inventory Standard).

- b) In order to address pricing uncertainty, Defence is confident that the processes it has in place to gain assurance around General Stores Inventory (GSI) quantities are mature and effective. Defence has developed a comprehensive plan to substantiate and, where necessary, remediate pricing where historical prices are unable to be verified. The execution of this plan will require extensive internal and external resources. Concurrently, Defence is working with the AASB to obtain relief from the requirement to demonstrate verifiable prices for legacy GSI. In the meantime, Defence has commenced work, in consultation with the ANAO, to execute the GSI legacy pricing plan outlined below.

At the top level, Defence has segmented GSI based on the likelihood that documentation exists to support the GSI price records in the Defence logistics system. This has resulted in pre-2000 and post-2000 segments.

The pre-2000 segment has been further divided into:

- i. Items that are Potentially Surplus or Obsolete. These items have had no issues since 2000 (116,000 stockcodes valued at \$178 million) and are being reviewed. It is anticipated the majority of these items will be fully adjusted for the loss in service potential and subject to disposal action. These items will not require any pricing substantiation.
- ii. Items which were last receipted pre-2000 but have had issues post-2000 (194,000 stockcodes valued at \$562 million). Defence has engaged the Australian Valuation Office (AVO) to substantiate the prices on the Defence logistics system. Where the AVO is unable to substantiate the price, it will provide an estimate of the current replacement cost of the stock item. Defence will then consider the need to index to the date of purchase using the relevant

Australian Bureau of Statistics index to obtain an appropriate surrogate purchase price. The current replacement cost is considered to be the most appropriate and reliable estimate of cost for GSI that cannot be substantiated with existing documentation.

For the post-2000 segment (166,000 stock codes valued at \$1.5 billion), Defence has adopted an Acceptance Testing approach based on advice from expert statisticians. A sample of purchase records has been selected from materiel procurement sites across Defence. Purchasing documentation is to be collected for each record and compared with the electronic record on the Defence logistics system. This process will identify those areas where procurement practices are sound and any areas that require remediation. Appropriate adjustments can then be made to the financial record.

The overall outcome of this work is expected to provide Defence management with sufficient assurance that the GSI balance is not materially misstated.

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**Question 2**

**Completion of Remediation Plans**

With regard to remediation plans S9, S10, S11, S12, S13, can you direct me to a document where it is stated that these remediation plans are now complete?

**RESPONSE**

The last time Defence reported specifically on each of the remediation plans was in the 2006-07 Portfolio Additional Estimates Statements (pages 111-127) and the 2005-06 Defence Annual Report (pages 65-67).

Since then, an update on financial remediation activity has been provided in the 2007-08 Portfolio Budget Statements (page 204) and 2007-08 Portfolio Additional Estimates Statements (pages 102-103).

The financial remediation plans were established during 2004-05 as a result of the Australian National Audit Office (ANAO) and Defence management not being able to form an opinion on the 2003-04 Defence financial statements. Since then, Defence has made significant improvements in financial management, with the last remaining area of ANAO qualification being pricing and system issues relating to General Stores Inventory.

As a result of the removal of the ANAO qualifications relating to explosive ordnance, repairable items (a component of specialist military equipment), land and buildings, infrastructure, plant and equipment, asset recognition thresholds relating to asset classes, and civilian and military leave provisions, the corresponding remediation plans have been closed and the financial management framework has been established as ongoing business.

Comprehensive management action plans continue to be developed to deal with the remaining audit findings with particular focus on the higher risk findings around the logistics management processes (including General Stores Inventory) and purchase to pay processes. The development of and achievement against these plans is being coordinated within Defence by dedicated 'tiger teams' established under the direction of the Chief Finance Officer.

Defence will continue to report progress on resolving these remaining issues through its external accountability documents.

The Financial Management and Controls Committee, which replaced the Financial Statements Project Board, monitors financial remediation and the financial controls environment within Defence.

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**Question 3**

**Defence Business Improvement Board Agenda**

Has the Defence Business Improvement Board's agenda to pursue matters related to inventory management practices as a priority (which the Chair, DBIB indicated at a private briefing before the Committee) been made public anywhere? If so, can you please direct us to that document.

**RESPONSE**

Matters relating to inventory management practices considered by the Defence Business Improvement Board (DBIB) have not been made public. However, the DBIB was supportive of the Chief Finance Officer Group-led initiative to improve inventory management practices.

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**Question 4**

**Kinnaird Review**

Page 86 of Defence's submission (No. 4) to the inquiry reports progress against Recommendation 1 of the Kinnaird Review and a list of *Desired Outcomes (to be achieved by December 2006)*. Can you please provide us with an update on the implementation of this recommendation?

**RESPONSE**

Defence provides this information annually to the Government. Defence has established a planning guidance framework which is based on the last White Paper with subsequent Strategic Updates defining the types of likely contingencies and the capacity of the ADF to apply the required military force now and into the future. Subordinate planning documents translate the Government's intent into options against the types of contingencies that may require a Defence response. This process links the strategic advice provided to Government to the delivery of capability in a structured manner.

Given the release of the *Australia's National Security – Defence Update 2007* and the relative maturity of the planning framework, the Defence Procurement Advisory Board determined that the implementation of the recommendation was completed.

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**Question 5**

**JP 2077 (MILIS)**

Can you provide us with an update on the MILIS project (Joint Project 2077)?

**RESPONSE**

***Military Integrated Logistics Information System***

**Improvements to the Logistics Information Systems—JP 2077 Phase 2B**

**ADF Deployable Logistics Systems—JP 2077 Phase 2B.2**

**Prime Contractor:** Mincom Ltd is the prime contractor for Phase 2B, and is the provider of the core software system to be known as the Military Integrated Logistics Information System (MILIS).

JP2077 is a project to modernise and integrate Defence's logistics information systems. The Program is being delivered in multiple phases, each addressing specific capability requirements, which include supply chain, inventory control and repair and maintenance functions to support the ADF's capabilities in Australia and in all areas of operations. The existing core Logistics system, the Standard Defence Supply System (SDSS), is based on a product developed by Mincom Pty Ltd in the 1990s.

Phase 2B.1 of the project is in the acquisition phase. Phase 2B.1 will provide upgraded core software and improved financial management capability. Implementation will occur in 2009.

Phase 2B.2 will provide an enhanced deployable capability as well as improved in-transit visibility. Second pass approval was attained from the Government in December 2006. The project is currently reviewing the acquisition strategy for this phase with delivery due for completion by 2012.

Other phases include:

- Phase 2C has delivered a radio frequency identification capability which allows the tracking of supplies in transit. This system was successfully deployed within Australia in December 2006 and was progressively deployed to overseas areas of operations from mid-2007.
- Phase 2D will deliver major capability enhancements through global industry engagement. First pass approval was attained in May 2007 and further consideration is scheduled for early 2009.

JP2077 is a significant business transformation activity and the associated change management is a key risk that is being actively managed.



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**Question 6**

**DNSDC Moorebank**

How many items of stock does the Moorebank facility hold?

**RESPONSE**

As at 14 March 2008, DNSDC Moorebank held 53,541,942 items of stock.

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**Question 7**

**Project AIR 87 (Tiger helicopters) Flight Simulators**

At the hearing on 1 March 2007, MAJGEN Fraser indicated that “the readiness for training has a liquidated damages bill of \$10.2 million attached to it, which the company acknowledges it will need to pay. We will execute that once we gain delivery of the Tiger flight simulator.” (p. 3)

At Additional Budget Estimates before the Senate Foreign Affairs, Defence and Trade Committee on 20 February 2008, MAJGEN Fraser indicated that “...we accepted the simulator in December last year” (p. 71). Has the \$10.2 million liquidated damages bill referred to above now been executed?

**RESPONSE**

The Tiger Armed Reconnaissance Helicopter project is two years behind schedule, primarily due to training issues. The Stop Payment provision of the contract was executed on 1 June 2007 for failure to achieve Initial Operational Capability. Australian Aerospace initiated formal dispute over the Through Life Support contract and the Acquisition contract on 9 October 2007. As part of the dispute resolution on all ARH matters, that included the issue of Liquidated Damages, DMO has negotiated the provision of two EC135 helicopters to be based in Darwin for two years so as to provide lead-in skills training to the ADF. This will have the benefit of maximising pilot training time on the Tiger transition course, and will enable operational capability to be developed faster than without this aspect of the lead-in skills training.