

Defence Procurement Reforms

Background

- 2.1 In August 2003 Mr Malcom Kinnaird, AO, reported to the Secretary of the Department of the Prime Minister and Cabinet that significant reform was necessary to the processes by which defence capabilities were assessed, acquired and maintained.¹ His recommendations were contained in *The Defence Procurement Review 2003* (the Kinnaird Review).
- 2.2 The review stated that 'continuing delays in the delivery of major defence equipment mean that the ADF has failed to receive the capabilities it expects, according to the schedule required by Government.' Kinnaird stated:
- ...that fundamental reform was necessary but there was no single remedy. As the body responsible for the management of major projects, the Defence Materiel Organisation (DMO) needs to become more business like and outcome driven. But reform must extend beyond the DMO. It is clear that change is needed at each stage of the cycle of acquisition and whole of life management of the equipment that comprises the core of defence capability.²
- 2.3 Kinnaird made a number of recommendations about reforming the processes by which defence capabilities were assessed, acquired and maintained. The most significant of these were as follows:

1 Department of Prime Minister and Cabinet, *Defence Procurement Review 2003*, 15 August 2003, p. iii

2 Department of Prime Minister and Cabinet, *Defence Procurement Review 2003*, 15 August 2003, p. iii

- Defining and Assessing Capability. A single point of contact is needed to provide better integration of the capability definition and assessment process. A three star officer should be appointed to this role on a full time basis with a fixed tenure.
- A Strengthened Two Pass System. The process of capability definition and assessment was being applied in a less than disciplined manner resulting in poor advice to Government. This process should be mandated to ensure greater analytical rigour to ensure cost, schedule and technology advice to Government is accurate.
- Establish an Advisory Board. To ensure reforms are actioned and to provide advice and support to the head of the DMO an Advisory Board should be appointed which should report independently to the National Security Committee of Cabinet.
- Separate Identity for the DMO. In order to complete the transformation of the DMO into a more business-like organisation it was recommended the DMO become an executive agency in its own right.³

Defence Response

- 2.4 Defence acted quickly to implement the Kinnaird recommendations through a series of initiatives across the department. The reforms address the total capability cycle, from strategic intent, through to sustainment and then disposal of the asset. During the public hearing Defence described the intent of their reforms as being to make the department 'more business like, accountable and outcome driven'.⁴

Capability Development Group

- 2.5 A new Capability Development Group (CDG) was formed on 1 July 2004, to act as the single point of contact proposed by Kinnaird, to provide better integration of the capability definition and assessment process. This process, referred to as the 'two pass' process by Kinnaird, is the process through which Government is prepared for its role in capability selection with accurate advice regarding emerging technologies, the cost of capabilities and realistic delivery schedules.
- 2.6 The CDG was formed by amalgamating previously dispersed Defence Capability elements and is headed by Lieutenant General David Hurley.

3 Department of Prime Minister and Cabinet, *Defence Procurement Review 2003*, 15 August 2003, pp. iv-ix.

4 Dr Stephen Gumley, Chief Executive Officer, Defence Materiel Organisation, *Transcript*, p. 2.

During the public hearing Defence reported on the progress made by the CDG when it stated:

In accordance with what we were required to achieve, we have completed the first version of the defence capability strategy. We have developed and agreed with the central agencies and confirmed in the cabinet handbook the two-pass process. We have introduced new cost estimation processes. We have moved through to the integration of simulation and test and evaluation in the pre second-class process. We are now developing materiel acquisition agreements with the Defence Materiel Organisation for each project. We have established a rapid prototype and development entity with industry to help us in the development process. We are on track in regard to the recommendations in the Kinnaird review.⁵

2.7 The CDG works closely with a wide range of stake holders, both internal and external to Defence, and is required to develop a close partnership with the DMO to ensure effective implementation of the Kinnaird recommendations and efficient and timely delivery of capability to Defence. When asked to report on the developing relationship between the CDG and DMO, Defence described tools and mechanisms to formalise the relationship between the two organisations. In addition management processes have been introduced to reduce any friction that emerged due to potential conflict over limited resources.

2.8 The principal tool used to formalise the relationship between the two procurement agencies is the Materiel Acquisition Agreement. Defence stated:

In general terms, it is a 'contract' between DMO and my organisation [CDG], essentially defining what we are trying to deliver in a project, the aim of the project; the path we are going to take to get to a decision by government; and the services and support I need from DMO to help me bring that to fruition. So that could be anything from cost estimation support to going out and discussing with industry what is available out there, helping us to put the package together....About 65 per cent or so are completed now. The aim is to have all projects with an acquisition agreement by 1 July this year.⁶

5 LTGEN David Hurley, Chief Capability Development Group, Department of Defence, *Transcript*, p. 2.

6 LTGEN David Hurley, Chief Capability Development Group, Department of Defence, *Transcript*, pp 7-8. .

Defence Materiel Organisation

- 2.9 In addition to the creation of the CDG, significant reforms continued at the DMO. The DMO is staffed by 4,400 APS personnel and approximately 1,700 ADF members. The DMO was responsible for the management of 248 major capital equipment projects as at 30 June 2004 with a total budget of \$52 billion. From 1 July 2005 the DMO will be established as a prescribed agency under the *Financial Management and Accountability Act 1997*.
- 2.10 In February 2004, Dr Steven Gumley was appointed as Chief Executive Officer of the DMO. Dr Gumley has initiated a program of reform that will professionalise the organisation's workforce, improve contract management, standardise business practice and improve its relationship with business.⁷
- 2.11 During the public hearing Dr Gumley described six themes being used in the DMO to change the culture of the organisation: professionalising, reprioritising, standardising, benchmarking, improving industry relationships and leading reform in Defence. He described progress against each of these reform themes:

We keep running those six themes, and we have built them out into 25 or 26 different programs. For example, on 'professionalising', we think it is good that engineers in the DMO become chartered professional engineers, where they have an obligation for continuing professional development. About 180 of our engineers are embarking on a program at the moment. On 'standardising', when I first got to DMO, I found that there were 240 different major projects being done approximately 243 different ways. Of course, that is not efficient in anyone's language. So we are now standardising how we deliver the projects... We are also benchmarking ourselves against the equivalent defence procurement organisations in the United States, Britain, France and Canada. I think our results are not too bad. I think we are batting quite well, compared to our equivalents overseas.⁸

General Reforms

- 2.12 The committee then explored a number of additional issues relating to Defence procurement reform. Defence described the ability of the CDG and DMO to combine to make rapid acquisitions to meet urgent

7 Department of Defence, *2003-04 Defence Annual Report*, November 2004, p. 19.

8 Dr Stephen Gumley, Chief Executive Officer, Defence Materiel Organisation, *Transcript*, p. 4.

operational requirements, citing as an example the impending deployment to the Al Muthanna province of Iraq. Defence also reported on initiatives to maintain the security of intellectual property when contracting with large corporations for defence equipment. Defence cited the case of the Eurocopter MRH-90 helicopters as an example of a contract being negotiated to include whole-of-life sustainment and intellectual property clauses.

- 2.13 One of the last of the major Kinnaird recommendations was the proposed development of a Defence Procurement Advisory Board. The purpose of this board is to provide advice to the CEO of DMO regarding best practice in a range of public and private enterprises. Defence reported excellent progress against this recommendation:

One of the real advantages we have at the moment is the DMO advisory board, which is working particularly well. It must be a very rare body that has four leading private sector people, three departmental secretaries and a Chief of the Defence Force all on the same board. There is a wonderful yin and yang between the private and public sectors in that. I think we are steering that middle road very nicely at the moment. The board is very useful to me.⁹

- 2.14 A common point of friction in projects has been unmatched expectations between Defence and industry in relation to procurement projects. Defence was asked to report on progress improving DMO's relationship with industry. Defence stated:

I think we are getting more realistic in our approach with industry on contracting. The data showed that about half the problems for the schedule delays were actually caused by industry, and half by Defence... The chief executives of most of the major defence companies and the division heads from DMO worked collaboratively for six months to come up with the new contracting templates... That agreed position has now ended up in the DMO contracting templates, AUSDEFCON. They were released on the web on 25 February this year. I guess the message is that we are all just going to get on with it now.¹⁰

- 2.15 Defence continued on the theme of improving industry relationships:

On 'improving industry relationships', the real issue is something I call 'level loading'. One of the hardest things for the defence industry to handle is peaks and troughs. One of the most

9 Dr Stephen Gumley, Chief Executive Officer, Defence Materiel Organisation, *Transcript*, p. 5.

10 Dr Stephen Gumley, Chief Executive Officer, Defence Materiel Organisation, *Transcript*, p. 3.

important things we can do for the defence industry in this country is to reach longer-term contracts with them so that they can afford to invest higher, or further, in their people and their infrastructure. That will lead to a much more robust industry in the future. In other words, giving more certainty is very important to ensuring that we have long-term capability.¹¹

- 2.16 Defence was asked to report on policies, initiatives and some outcomes in relation to maximising the opportunities for Small and Medium sized Enterprises (SMEs). Defence stated:

We in Defence feel that it is important to get a balance of work between the SMEs and the primes. We would not want the primes doing all the work. On the other hand, the SMEs have to have the project management experience to do the big projects. So it becomes a balance. We are very concerned to see Australian SMEs in particular do very well in the defence market.¹²

- 2.17 Defence was asked to expand further on the means by which SMEs can bring their products to the attention of Defence. Defence stated:

We have done something about that. The SME portal has now been set up. We set up an SME portal in the industry division of DMO, which is like a first-stop shop. When someone has a good idea or they want to introduce their company, they can come in through the portal and they will get assistance on where to go next and how to go about it. We cannot do their business for them, but we can help and guide them in directions where they might be able to do business themselves.¹³

- 2.18 The committee is aware of a number of competing demands for uniformed officers from the three services. Defence was asked about the number and quality of staff available to the DMO, and in particular those with military experience. Defence stated:

The military people are extremely important in DMO because they have the domain knowledge. If I could have more, I would. They are rationed. I find that the military add an enormous amount to the DMO. It would be a much weaker organisation if we did not have them. The only problem has been the very short posting cycle—that is, the two-year posting cycle. Under the new military staffing plan, which was signed off by the DMO advisory board, the Chief of Defence Force, the secretary and the minister, we are

11 Dr Stephen Gumley, Chief Executive Officer, Defence Materiel Organisation, *Transcript*, p. 4.

12 Dr Stephen Gumley, Chief Executive Officer, Defence Materiel Organisation, *Transcript*, p. 3.

13 Dr Stephen Gumley, Chief Executive Officer, Defence Materiel Organisation, *Transcript*, p. 14.

now moving to four-year posting cycles in the DMO for the senior positions—Major and above. We think that is going to fix the one remaining defect of having the military working in DMO. That policy started taking hold last November, and it will be fully in place for the next posting cycle decisions in September-October.¹⁴

Conclusions

- 2.19 The committee notes the significant reforms enacted by Defence to achieve the Kinnaird recommendations. These reforms have been adopted across Defence, though they are most clearly shown by the formation of Capability Development Group (CDG) and by changes to the Defence Materiel Organisation.
- 2.20 Progress against the major acquisition projects in Defence is still mixed. A number of difficult legacy projects remain from the period which caused Kinnaird to report that ‘continuing delays in the delivery of major defence equipment mean that the ADF has failed to receive the capabilities it expects, according to the schedule required by Government.’¹⁵ These include but are not limited to the guided missile frigate (FFG) upgrade, the Sea Sprite helicopter acquisition.
- 2.21 On the other hand, more recent projects are performing very well. The Airborne Early Warning and Control (AEWC) aircraft are progressing according to contract schedule and the Tiger helicopter has commenced delivery on time and on budget. The Australian Light Armoured Vehicle (ASLAV) is another very successful project which has demonstrated the ability of the DMO to support the system through its life, procure additional systems and then rapidly upgrade those systems in response to a particular threat during ongoing operations in Iraq.
- 2.22 The committee notes that projects with demanding requirements for systems integration continue to contain the most risk of cost or schedule overrun. Improved concept development in the CDG and better contracting at the DMO have the potential to deliver significant improvements against both these risk areas – timely progress given the scale and risk involved with the impending Air Warfare Destroyer project.
- 2.23 The more realistic relationship the DMO has established with industry is also a significant achievement. Shared blame for various weaknesses in the earlier relationships has been acknowledged and a path forward has

14 Dr Stephen Gumley, Chief Executive Officer, Defence Materiel Organisation, *Transcript*, p. 15.

15 Department of Prime Minister and Cabinet, *Defence Procurement Review 2003*, 15 August 2003, p. iii

been agreed. DMO contracting templates will provide consistency for industry and 'level loading' will allow industry to minimise peaks and troughs in their business cycle. SME are acknowledged for their innovation but are now expected to be sufficiently robust to be considered reliable business partners. The SME portal and concept demonstration activities will provide an opportunity for these enterprises to gain exposure, both by the DMO and by the larger prime contractors.

- 2.24 The committee also noted the DMO comment regarding the value of uniformed officers in the DMO and the results of the recently signed military staffing plan. The committee retains reservations regarding the ability of the uniform component of the ADO to concurrently meet the increasing requirements for uniformed personnel in the DMO, the DIO and reduce existing officer shortages in headquarters and units around the ADF. It is understood the various proposed reforms draw on different skill sets or groups of officers but when taken together they result in significant pressure on the officer corps of all three services. The committee is therefore concerned that individual officers may be left bearing the cost of these organisational demands through reduced career progression or posting opportunities to command or operational deployments.

Recommendation 1

- 2.25 **The committee recommends that initiatives to increase the number and tenure of military officers posted to the DMO and DIO are closely monitored to ensure that individual officers are not left bearing the cost of these organisational demands through reduced career progression or posting opportunities to command or operational deployments.**